

## Offshore Trusts: Types and Uses (2 of 3)

This is the second of three articles, which examines some of the most common types of Offshore Trusts and their uses.

By **Paul Harvey**, 19th April 2022

This series considers the key elements of Offshore Trusts, particularly Isle of Man Trusts. This is the second of three articles, which examines some of the most common types of Offshore Trusts and their uses. If you would like to read the other articles in the series you can find them here:

- [Offshore Trusts: An Introduction \(1 of 3\)](#)
- [Offshore Trusts: Misunderstandings, Pitfalls and Solutions \(3 of 3\)](#)

From protecting family legacies, to ensuring proper succession planning, providing for dependents or even employees, the Offshore Trust is still an extremely flexible tool at the advisers' disposal - hopefully the following article will help illustrate this point.

Article 2 of 3, Offshore Trusts: Types and Uses will explore the following:

- [\*\*Discretionary Trusts\*\*](#)
- [\*\*Interest in Possession Trusts\*\*](#)
- [\*\*Accumulation & Maintenance Trusts\*\*](#)
- [\*\*Other Forms of Offshore Trust\*\*](#)

## **Offshore Discretionary Trusts**

The Discretionary Trust is one of the most commonly used types of Trust and can provide maximum flexibility for the Settlor and Trustees in terms of how the Trust achieves the desired objectives.

For instance, a Discretionary Trust can provide the Trustees with the ability to make distributions in a way that avoids wasting or depleting the Trust Fund unnecessarily and in line with changing circumstances - this can be for many reasons, including the protection of vulnerable Beneficiaries, tax planning or even asset protection with regards to Beneficiaries personal liabilities, and more.

Additionally, whilst a class of Beneficiaries may be apparent, the Settlor may not know what the best way of dividing the fund will be and may wish to allow for future changes in circumstances and even additional beneficiaries to be considered - for example, unborn grandchildren.

Discretionary Trusts can be formed during the Settlor's lifetime, either as a living settlement or written into their Will, coming into existence upon death. If created as a living Trust, the Settlor may be liable to taxation on the chargeable transfer value. Furthermore, the Trustees may also be liable to a periodic liability on 10 year anniversaries, and on any distributions to Beneficiaries. For this reason, tax advice should be sought at the outset in respect of the circumstances of the Settlor and Trustees.

The Settlor must not retain any beneficial interest in possession or control over the assets settled into the Discretionary Trust, otherwise the Trust may be considered a sham or voidable, and the assets may still form part of the Settlor's estate.

Instead, the Trustees are empowered to administer the Trust Fund in the interests of the Beneficiaries and the Trust itself. The Trustees are also able to make distributions at their discretion, to any beneficiary at a time they deem appropriate. Whilst the Discretionary Trust provides Trustees with complete control over the arrangement, their actions must still be compliant with the Trust Deed.

The provisions of the Trust Deed can provide for restrictions that the Settlor wishes to put in place. In addition, the Settlor may elect to appoint a Protector, who is usually a

trusted professional adviser, to oversee the Trustees and ensure compliance with the Trust provisions. The Protector retains certain powers as desirable, to make sure that the Trustees achieve the objectives of the Trust in congruence with the Trust Deed. Whilst the inclusion of the Protector can provide controls, it is important to not restrict the Trustees so as to erode the effectiveness of the Discretionary Trust.

Finally, the Settlor can guide the Trustees by providing a Letter of Wishes. The Letter of Wishes provides a statement of the Settlor's intentions at that point in time, allowing the Trustees to take this into consideration when making decisions and distributions. So long as the Letter of Wishes is regularly reviewed, it can provide fantastic insight into the Settlor's mind as circumstances change – albeit, this document is persuasive and not binding; it creates no legal obligation on the part of the Trustees.

The Discretionary Trust is a very attractive solution that delivers maximum flexibility and gives the potential to remove tax liability from the Settlor's estate – although this flexibility comes at a price. Discretionary Trusts can be complex, requiring specialist knowledge to avoid pitfalls – the Settlor needs to understand that they are placing their assets under the control of their chosen Trustees, who must act bona fide in line with the Trust Deed, but not necessarily in line with their wishes – so long as they consider it is in the best interests of the Trust and Beneficiaries.

#### **Offshore Interest in Possession Trusts**

Less common, but still widely used, is the Interest in Possession Trust. This type of Trust can have a myriad of uses, all of which hinge on this instrument's ability to provide the Settlor with access to the Trust Fund during their lifetime – in fact, sometimes this type of Trust is called a Lifetime Possession Trust.

The interest in possession can either be for a fixed period of time or indefinite. It is very common for provision to be made for the remainder of the Settlor's lifetime.

In an interest in possession arrangement, the Settlor places the assets into Trust, thus transferring legal title to the Trustees (as per every Trust arrangement) – but here the settlor carves out an interest in possession, giving themselves an immediate and automatic right to the income flowing from the Trust assets.

Sometimes the Settlor of an Interest in Possession Trust is referred to as an Income Beneficiary or a Life Tenant, because of this legal right. The carveout can provide the Settlor with rights to enjoy the assets and/or all income generated from the assets during their lifetime. For example, to live in a property, pay living expenses or pay for long term care etc. from the gains of investments or other assets such as dividends from

shares in a family business.

There can be more than one Income Beneficiary or Life Tenant, who will not typically have any beneficial right to the settled assets themselves, such as a spouse. In the case of income payments, this is paid to them periodically as set out in the Trust Deed.

The income received will be less the expenses of the Trust – it is important to remember that this will include any costs of administering the assets (custodian fees, investment adviser fees, property management etc.) along with potential remuneration of Trustees, which so long as fair is allowable under Trust Law.

When making investments decisions, Trustees will have a duty to both the Income Beneficiary / Life Tenant and the Beneficiaries who are entitled to the assets, making such decisions by considering the competing needs of income and longevity, unless otherwise stated in the Trust Deed.

As per the Discretionary Trust, the Trust assets will be held by the Trustees for the benefit of the named classes of beneficiaries or named individual Beneficiaries contained within the Trust Deed. These Beneficiaries can benefit after the set period that the Income Beneficiary or Life Tenant can enjoy the interest in possession – this is normally after death.

There are tax implications for the implementation of this type of Trust, and as ever, it can be quite complex. Therefore, tax advice should be sought in all cases.

### **Offshore Accumulation and Maintenance Trusts**

Accumulation and Maintenance Trusts are somewhat of a hybrid approach between a Discretionary Trust and a Bare Trust. At its core, this type of trust places the Trust Fund under the care of the Trustees until a child or young Beneficiary reaches a specified age, up to 25 years.

For the intervening period, the Trustees will have discretion over the administration of the settled assets and how best to use them for the benefit of the Beneficiary – of course in compliance with the provisions of the Trust Deed. Broadly the Trustees may accumulate the income and gains to build the Beneficiaries capital entitlement or can apportion elements for the ongoing maintenance of the Beneficiary.

Prior to the Finance Act 2006 changes to the treatment of Accumulation and Maintenance Trusts, these Trust arrangements were set up to achieve certain IHT

planning benefits - however, in the modern day, and due to the changes in the Relevant Property Regime (RPR), this benefit has now been removed. Accumulation and Maintenance Trusts will need to consider the RPR, which can result in periodic 10 year anniversary charges, as per Discretionary Trusts discussed above.

For those Accumulation and Maintenance Trusts settled pre-2006, there was a window until the 5<sup>th</sup> of April 2008, whereby the age of majority could be increased from 18 to the maximum of 25 years. These Trusts will continue to receive the same pre-2006 IHT treatment for the lifetime of the Trust i.e. before the Beneficiary reaches the age of majority. However, it is important to note that any additional settlements post-2006 will render the trust subject to the RPR changes. Furthermore, if there is no absolute interest in the trust i.e. it is a Discretionary Accumulation and Maintenance Trust, and the age of majority was not amended before 6<sup>th</sup> April 2008, the RPR changes and periodic charges will be applicable.

Before maturity, whilst the Trustees can elect to roll up the income and growth of the Trust assets, they can also defer or even reallocate them depending on the Trust Instrument. This can only be actioned before the Beneficiary gains an interest in possession at age 18 or 25 as per the trust terms.

If done so bona fide and in line with the Trust Deed, the Trustees could invest the Trust Fund into certain specific fixed form assets before the Beneficiary's 18<sup>th</sup> birthday e.g. real estate, bonds, fixed term deposits etc. This means that the value could be released in tranches over time or produce ongoing income via maturing investments, rent etc. in turn avoiding wasteful behaviour and allowing the Beneficiary to mature beyond the age of Majority.

In summary, Settlers may feel more comfortable establishing an Accumulation and Maintenance Trust, rather than a full Discretionary Trust - this is because the Trustees will have the flexibility of administration during the Trusts lifetime, whilst the Beneficiaries' position can be fixed. However, the drawback is that the child Beneficiary will have an automatic right to the Trust Fund at the age of majority, which might be considered detrimental depending on their character and level of maturity.

#### **Other Forms of Offshore Trust**

In addition to the above, it is worth noting some other commonly used types of Trust. For brevity these have been listed below with a short description:

- **Purpose Trust** – Rather than being set up for the benefit of an individual Beneficiary, the Object of a Purpose Trust is to achieve a specified commercial or charitable objective e.g. financing transactions, acquisition or disposal of property etc. On the Isle of Man, there is a dedicated piece of legislation that caters for this Trust – Purpose Trusts Act 1996.
- **Employee Benefit Trust (EBT)** – Employee Benefit Trusts are created by employers for the benefit of past, present or future employees, dependants and relations. They can be a vehicle for conveying any number of benefits, and useful for companies of any size – especially those that have a global footprint. Common uses include operating share purchase schemes, discretionary bonuses, pensions etc.

There are of course many more Trusts available, and we would recommend speaking with your professional adviser to assist with choosing the right type of Trust for meeting your objectives.

### **Working with Dixcart**

Dixcart has been providing Trustee Services and guidance on Offshore Trusts for over 50 years; assisting clients and their advisers conduct their offshore planning.

We have in-house experts with a wealth of experience in all matters relating to Trusts; this means we are well placed to support and take responsibility for any Offshore Trust, acting as Trustee and providing specialist consultancy services where appropriate.

Due to our diverse offering, which includes an array of Isle of Man structures, we can assist From pre-establishment planning and advice to the day-to-day management of the vehicle and troubleshooting issues. We can support your goals at every stage.

### **Get in touch**

If you require further information regarding the use of Offshore Trusts, or Isle of Man structures, please feel free to get in touch with Paul Harvey at Dixcart:

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