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The Private Trust Company

The benefits, structuring issues and pitfalls

By Assad Abdullatiff

The Private Trust Company (**PTC**) may be a relatively new animal, but the last decade has witnessed a growth in its popularity because of its appeal both to clients and professional trust companies. The PTC in its simplest form is a company formed for the specific purpose of acting as trustee of a single trust, or a group of related trusts.

The secret to the success of the PTC - Overcoming the dichotomy

For years and years, the relationship between the client and the trustee could have been described as a tug-of-war, each pulling in opposite directions.

On the one hand, the modern trustee, with their office becoming more and more onerous, is likely to adopt a prudential attitude in performing their duties fully aware of the possibility of being faced with an action for breach of trust by one disgruntled beneficiary.

Indeed much water has flown under the bridge since Lord Hardwicke described trusteeship as an "act of great kindness" (*Knight v. Earl of Plymouth (1747)*). The office of the trustee can be better compared today to a minefield exposed to ever expanding and increasingly expensive litigation.

Then, the standard of care required of professional trustees as established by the eponymous rule in *Bartlett v. Barclays Bank Trustee (1980)* means that trustees are unlikely to accept to assume responsibility for risky (or exotic) assets or hold shares in underlying trading companies. Yet it is these very assets that very wealthy families wish to have held in trust!

Furthermore, whilst high net-worth individuals very often readily identify the benefits available in using the trust to pass inheritance generation to generation in a tax efficient manner, they then resist the crucial step, that of taking a back seat: the loss of control which is entailed is too great a step to take.

At the same time clients want the trustees to take rapid commercial decisions in relation to the trust's underlying assets whereas the professional trustee, fully mindful of his risks and potential liability, prefers legal advice before taking strategic decisions.

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Finally, for the ageing settlor, the traditional trust structure does not allow him to empower children and pass control and influence over family business interests and wealth to the next generation.

A PTC attempts and succeeds in converging these seemingly contradictory interests by providing a means by which a settlor (or their family) can retain a greater degree of control over their trust affairs and have a hands-on approach in the management of the affairs of the trust without compromising the validity of the trust structure, all the whilst providing enhanced protection for fiduciaries.

With a PTC, the settlor, members of their family or their advisors can be appointed to the board of directors and in this capacity they are in a position to influence the manner in which the trust is administered. The composition of the board can be changed from time to time to bring in members of succeeding generations and in this way involve them in the management of family affairs. The company itself will generally be administered by a fiduciary in the chosen offshore location and which will be represented on the board.

Benefits for Clients and Professional Trust Company – A Win-Win Situation

The PTC enables him to control the trust (through the board) without compromising the validity of the trust structure. The board also provides an opportunity to create a round-table forum in which the settlor or family members can participate, perhaps together with trusted advisors. When the trust assets comprise of operating companies, the PTC is likely to be better-placed than a professional trustee to take rapid commercial decisions concerning the management of the operating companies, being able to draw on the specialist experience of its board members.

The PTC also provides an alternative to the settlor, who may not be comfortable with a 'public' corporate trustee.

But over and above the mere issue of control or security, a PTC - unlike other techniques that address the difficulties with settlor control issues, enables family participation and empowerment of children and leads to the start of a 'family office' where all the client's financial affairs may be centralized. It provides a convenient way to pass control and influence over family business interests and wealth to the next generation over a suitable period of time and in a regulated manner by bringing in designated successor(s) as director(s) of the PTC during the lifetime of the client. By allowing a designated successor to participate in the affairs of the PTC during their lifetime, the settlor achieves the dual objective of allowing the successor to become familiar with the operations of the PTC, the underlying business and investment activities and the way in which the structure is run, while

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also allowing the settlor to evaluate the suitability of the designated successor and their aptitude to run the business.

The PTC as an 'umbrella structure' has a definite cost element where the assets within a PTC structure are substantial, as the costs of maintaining the structure are likely to be less than the costs that would otherwise apply were the family trusts to be directly administered by a professional trust company.

The advantages of the PTC for the professional trust company should also not be underestimated. The trust company is unconcerned about the underlying assets of the trust or about the settlor (or family) exercising control or interference as it is not providing trusteeship services. The trust company therefore bears no trustee liability and still gains a commercial advantage as it provides corporate administration services to the PTC. There are no problems of conflict with settlor's or family's wishes as the trust company is not acting as a trustee and does not have to take decisions.

Structuring the PTC – Ownership and Governance

We now come to the interesting subject of how to structure a PTC, and in particular, the question of who should own the shares of the PTC. While there is no legal impediment for the client to own the shares of the PTC, it is generally thought to be undesirable that the ownership should have any link with the client, particularly if the client is from a civil law jurisdiction, as the shares do not then form part of their estate. Separating the ownership of the PTC also limits the possibility that the PTC may be held to be a sham. There are various options regarding ownership, including the Discretionary Trust option or Purpose Trust option, but the preferred choice appears to be the Purpose Trust option where the sole purpose of the trust is to hold the shares of the PTC.

The board of the PTC forms the backbone of the PTC and therefore choosing the right directors is crucial. Obviously, one of the reasons for setting up a PTC is to provide a means by which a settlor (or his family) can retain a greater degree of control over their trust affairs and have a hands-on approach in the management of the affairs of the trust. Therefore the structure would ideally make provision for at least one representative of the settlor/ settlor's family on the board of the PTC. Depending on the jurisdiction in which the PTC is established, corporate directors may also be allowed. However, care should be taken not to have a majority of directors in a jurisdiction having CFC rules as this may adversely impact on taxation of PTC trustee and hence on the residence of the underlying trust(s). Also the question as to who appoints directors has to be determined at the outset. Normally under most company legislations, directors of a company may be appointed by ordinary resolution of the shareholders. However, in the case of a PTC the appointment of directors could still be reserved to the shareholder purpose trust, but the purpose trust deed could be drafted in such a way that at least one director shall be nominated by the protector of the trust – who may be the client himself.

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Practical issues and pitfalls

Obviously, professional advisors and trustees should be wary of the pitfalls of setting up a PTC, but provided appropriate care is taken none of them are insurmountable. The perceived difficulties in the set up of a PTC are the sham argument, central management and control issues and possible liability issues for the directors of the PTC.

To avoid any possibility that the structure may be held to be a sham, there must be evidence that both the settlor and the trustee intended to set up a trust, the trust must have substance and the trust should be run as if it were to be treated as a trust. Therefore the role of the board of the PTC and how it operates becomes crucial to avoid the sham argument. However, the fact that the day-to-day administration of the PTC is undertaken by a professional trust company minimizes the risk of the structure being held to be a sham.

Central management and control is another hazard for the unwary. As the residence of a trust normally depends on where the trust is administered and where the majority of the trustees are resident, care should be taken in not allowing the trustee PTC to become resident in another jurisdiction through the residence of the directors. This is because if the majority of the board of the PTC is resident in a jurisdiction having CFC rules, this may result in the PTC being controlled and managed in such a jurisdiction which would make the trust resident in that jurisdiction with adverse tax consequences. Therefore it is crucial that central management and control not only be seen to be from the jurisdiction of incorporation of the PTC but actually be there. This goes beyond the mere fact of having a majority of the directors resident there but involves the directors properly discharging their duties, understanding what they are doing, meeting to discuss and being aware of the company's business as opposed to acting as mere rubber stamps.

The issue of liability – if any – of the directors of the PTC directly to the beneficiaries of the trust is worth looking at, especially in the light of the recent case of *HR v JAPT*.

On a strict application of company law, directors (unlike trustees) have to act in the best interests of the company, as opposed to trustees who have to act in the best interest of the beneficiaries. By necessary extension, directors of the PTC should not generally be liable for the acts of the PTC in its capacity of trustee. Even in the case where directors have breached their duty, the general rule is that duties imposed on directors are owed to the company and not to the shareholders of the company: this is generally the case under most company legislations. Generally, the only way in which directors could be held to be liable is if the court is willing to lift the veil of incorporation. The circumstances when this will happen are generally well settled from cases such as *Adams v Cape Industries [1991]* and more recently *Trustor AB v*

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Smallbone [2001], namely where the company is a sham or when there is fraud. Recently in the case of *HR v JAPT*, it was sought to make the director of a trustee company personally liable to the beneficiaries. Five arguments were advanced:

1. Directors of corporate trustees owe a direct fiduciary duty to beneficiaries.
2. Directors of corporate trustees owe a direct tortious duty to beneficiaries.
3. The corporate veil of the trustee company should be lifted in such circumstances.
4. Where they have procured or assisted in a breach of trust, directors of corporate trustees could be liable as accessories.
5. Directors of corporate trustee companies owe an indirect fiduciary and/or indirect tortious duty to the beneficiaries.

The judge rejected the first three arguments. However, he found that the other two grounds were sustainable in law and must be tried on their facts to determine whether the director was personally liable in this case. Those were:

- *Accessory Liability*

  This was on the basis of constructive trusteeship, or `accessory liability`, pursuant to the line of authority most recently explained in *Royal Brunei Airlines -v- Tan [1995] 2 AC 378*, that is a person may be liable for breach of trust if he has 'dishonestly' assisted the trustee in the commission of a breach of trust. Having analysed that decision, the judge concluded that dishonesty in this sense is governed by an objective, rather than a subjective standard. In other words, if a reasonable person would have regarded the conduct of the director as dishonest that will be sufficient even if the person concerned thought otherwise.

- *Indirect Fiduciary Duty and Indirect Tort*

  The argument was that the director owed a duty of care to the trust company, that he had breached that duty and caused loss. This was described as the `dog leg` claim. The argument was based, in part, on the decision in Royal Brunei. In that case, Lord Nicholls made a comment about advisers and others who provide services to trustees and stated:-

  > 'For the most part, [they] owe the trustees a duty to exercise reasonable skill and care. The rights flowing from that duty form part of the trust property. As such, they can be enforced by the beneficiaries in a suitable case if the trustees are unable or unwilling to do this.'

Directors of PTCs should therefore be aware!

However, having said that, it is important to emphasise that the judge had only to decide, for the purpose of this application, whether or not the claims were arguable. Beyond this, he expressed no opinion as to their merits. It would be interesting to see how this argument later develops.

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PTC Jurisdiction update – Mauritius

Mauritius has recently joined the select club of jurisdictions which enable PTCs to be established.

PTC Regime in Mauritius

It is worth noting that there is no specific legislation in Mauritius relating to the PTC but the Financial Services Commission of Mauritius has advised that where a private company acts (as trustee) for a limited number of trusts for the benefit of a family or related family groups, rather than offering its services to the public in general, it will not be regarded as carrying on (trust) business in Mauritius and therefore, provided that it satisfies various safeguards, it will not be required to be licensed under the Financial Services Act 2007 as a 'Corporate Trustee'.

Salient fearures of the Mauritius PTC Regime:

- A PTC can be set up either as a Category 1 (tax-resident company) or a Category 2 (non-resident company for tax purposes) Global Business Company (GBC). As tax would rarely be an issue for the Trustee Company, it would appear that the preferred option would be to set up the PTC as a GBC2 company due to the flexibility that it provides and the low cost of maintenance.
- The PTC must be set up by a licensed Management Company
- The PTC must adhere to conditions set out by the Financial Services Commission
- The PTC does NOT need to be licensed as a Corporate / Qualified Trustee
- The PTC is required to:
  - ❖ restrict its activities to that of private trust business services;
  - ❖ at all times maintain a minimum paid up capital of US$5,000;
  - ❖ provide its private trust business services solely to connected persons;
  - ❖ not solicit trust business from, or provide trust business services to, the public;
  - ❖ appoint a duly licensed Management Company to carry out its trust administration services in relation to any express trust to which it is a trustee;
  - ❖ appoint the Management Company as Company Secretary;
  - ❖ adhere to the AML/CFT Framework.

There are now many compelling reasons for families to establish their own Private Trust Companies. PTCs allow them to involve their family members, advisors and institutions, all with the goal of providing fiduciary and other wealth management services to the family, through the family owned PTC. Additionally, the PTC provides the family with several advantages and benefits they could not otherwise attain. However, care should be taken in the way that the PTC is structured to avoid unwanted consequences.

Assad Abdullatiff is the Managing Director of Axis Fiduciary Ltd

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