Private Foundations: Alternative or Complementary to Trusts?

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On 05 June 2012, the Mauritius Parliament passed the Foundations Act aimed at allowing for the setting-up of Private Foundations in Mauritius. Mauritius is already known for being the prime gateway for the structuring of investments into India and Africa. Leveraging on its fiscal and non-fiscal advantages and innovative and forward looking Trust Law, the jurisdiction has also grown in the past years to become a leading jurisdiction for private client services in the region. The enactment of a Foundations Act is aimed at promoting Mauritius as a platform for wealth management services, succession and estate planning. This article looks at the characteristics of Private Foundations and considers whether they may replace the "Trust" in the context of private wealth management with a particular focus on the Mauritius Foundations Act.

Introduction

Mauritius, a leading international financial centre, has recently enacted a Law allowing for the setting-up of Private Foundations ("Foundations") to further diversify its product-offering to an ever-growing international client base. Foundations, which derived from foundations of the civil law, are expanding in popularity across the globe. The Foundation specially appeals to High Net Worth Individuals (HNWI) from Civil Law Jurisdictions who find it to be an ideal structure for succession planning and private wealth management. They are extremely popular in other jurisdictions who are using it to woo high net worth individuals and business families.

Background

Traditionally, "trusts" have been the preferred planning tool in the context of wealth management planning for high net worth families. A well structured trust can be very effective, allowing for a number of advanced tax and estate planning strategies. Trillions of dollars' worth of assets are held through trusts worldwide. Trusts have a very long history – indeed the trust idea originates from the medieval times and personal trust law developed in England at the time of the Crusades, during the 12th and 13th centuries. At the time, land ownership in England was based on the feudal system. When a landowner left England to fight in the Crusades, he needed someone to run his estate in his absence, often to pay and receive feudal dues. To achieve this, he would convey ownership of his lands to a "trusted" acquaintance, on the understanding that the ownership would be conveyed back on his return. However, Crusaders would often return to find the legal owners' had turned "untrustworthy" and would refuse to hand over the property.

Unfortunately for the Crusader, English common law did not recognize his claim. As far as the King's courts were concerned, the land belonged to the acquaintance, who was

under no obligation to return it. The Crusader had no legal claim. The disgruntled Crusader would then petition the king, who would refer the matter to his Lord Chancellor who was regarded as the keeper of the king's conscience. The Lord Chancellor could do what was "just" and "equitable", and had the power to decide a case according to his conscience. At this time, the principle of equity was born.

The Lord Chancellor would consider it "unconscionable" that the legal owner could go back on his word and deny the claims of the Crusader (the "true" owner). Therefore, he would find in favor of the returning Crusader. Over time, it became known that the Lord Chancellor's court (the Court of Chancery) would continually recognize the claim of a returning Crusader. The legal owner would hold the land for the benefit of the original owner, and would be compelled to convey it back to him when requested. The Crusader was the "beneficiary" and the acquaintance the "trustee". The term *use of land* was coined, and in time developed into what we now know as a *trust*.

However what began as a means to circumvent feudal rigidities but has become one of the most useful and flexible tools for practitioners and exported itself in a number of jurisdictions worldwide, including Mauritius.

Foundations on the other hand are a new-comer to the world of financial services but are being increasingly considered by practitioners in the context of Private Wealth Management and/or for charitable giving. The Private Foundation finds its origin in 1926, when Liechtenstein created the Family Foundation by the Law of Persons and Companies. Today there are a number of jurisdictions which have a law on private foundations namely Panama, Bahamas, Malta, Nevis, Anguilla, Isle of Man, Seychelles and now Mauritius. So, would the Foundations quickly replace the trust as the preferred tool in the context of private wealth management or would we still need both types of arrangements in our product armories?

Trusts v Foundations

Defining Characteristics

Although there are a number of similarities between trusts and foundations, there are also many differences. The Foundation arguably has all the advantages of a trust but very differently to a trust, it is a legal entity in its own right and can therefore own assets directly. This is perhaps the most defining characteristic of a foundation as compared to a trust. As explained above, a trust is an equitable obligation binding a person (the 'trustee') to use or apply property over which he has been given control for the benefit of persons or purposes set out in the trust document. A person, commonly known as the 'settlor', usually creates the trust by transferring assets to the trustee to be held on the terms of a trust document. A trust is thus not an entity but a relationship which gives rise to fiduciary obligations.

On the other hand, a foundation is the dedication of property to an entity to be used for the benefit of people of for a specific purpose. To create a foundation, ownership of the relevant assets is transferred to the foundation by the founder(s) (the 'founder') to achieve

a specific purpose or purposes. A foundation is thus an entity with separate personality which made a British solicitor say that "the Foundation is dressed like a corporation, yet has the soul of a trust".

Formation

There are strict legal requirements for the creation of trusts. A Trust will not be valid in the absence of any of the "three certainties", formal requirements not being complied with and if the assets to be held on trust are not transferred to (or under the control of) the trustees. Trusts generally don't have to be registered and are formalised via a trust deed or declaration of trust.

On the other hand, it is easier to create a Foundation which simply requires its constitution document (usually referred to as the 'Articles' or 'Charter') to be filed and registered. This act of registration creates, in law, an entity with specific juridical personality, enjoying aspects of corporate ability. The foundation's articles / charter will be required to contain only minimal information about the foundation and like a Company's Memorandum and Articles of association. In most cases however, it will be possible for the Council to make regulations, which will provide for more detailed matters such as beneficiaries interests.

Governance

A Trust is governed by the Trustee who is the legal owner of the assets held in trust and has to manage them "en bon père de famille" (good paterfamilias). Where the Trust is a discretionary trust, the Trustee will also have the power to appoint beneficiaries and determine their entitlement. One of the defining characteristics of Trustees is that there are personally responsible for liabilities incurred by the trust, or for making good any loss to the trust. Liability of trustees can only be excluded to some extent – case law has held that irreducible core of duties cannot be excluded.

When it comes to a Foundation, the latter is managed by the Council which carries out the objectives and purposes of the Foundation. Similar to Trustees, Council may have the power to appoint new beneficiaries and determining the extent and nature of beneficial rights and the standard of care of the Council is normally that of *good paterfamilias*. However, liability of Council can generally be excluded and members of Council would be more akin to that of Company Directors so that personal liability should be the exception as opposed to the norm.

Potential Uses of Private Foundations

Foundations have some of the attractions of a trust vehicle and can thus potentially be used for purposes that trusts are used for, namely:

- Accumulation & Preservation of Wealth
- Succession & Estate Planning
- Asset Protection
- Tax Planning

- As SPVs in off balance sheet transactions
- Corporate finance/asset financing
- Securitisation

However, compared to the trust which is a common law concept, the Foundation vehicle will appeal to clients based in civil law territories where they are less familiar with the trust concept.

Because the Foundation is an independent legal person, assets may be directly held by a Foundation unlike a trust where the assets are held by the Trustee on trust. This means that foundations may be more appropriate to hold assets which are "wasting" or subject to volatility in value. In traditional trust structures, careful drafting of the trust instrument is often necessary where the purpose of the trust is to hold a single asset such as a business, or exotic assets such as an artwork, an aeroplane or a boat. Given the trustee's duty to diversify, act prudently, and in the best (financial) interests of the beneficiaries, trustees are often nervous about holding such assets. Foundations may become the preferred vehicle for such assets. It will be possible to establish a Foundation specifically to hold such an asset and the Council will not be subject to the same duties as trustees. The Council's duty (and ultimately the Guardian's) will be to ensure the object of the Foundation (namely the holding of the asset) is achieved.

It is also a much more effective financial planning tool for those clients who want to maintain more personal control of the assets. Frequently trust deeds will be drafted with an express reservation of powers in the hands of the settlor of the Trust (or a third party of his choice), the most common power to be reserved being that of investment. However, case-law has shown the danger of settlor reserved powers, often leading to sham arguments and other problems. Most importantly, the performance by a settlor of a reserved power does not disengage the trustee from its fiduciary duties. The attraction to using a Foundation as opposed to a trust where the power to direct investments is to be reserved is that the overriding duty to monitor the performance of the investment to which a trustee is subject is not one to which the Council of a Foundation will be subject.

The Mauritius Foundations Act 2012

The combination of fiscal and non-fiscal advantages together the diverse product-base have been the key ingredients of the Mauritius success story. Although Mauritius is better known as a gateway for the structuring of investments into India and increasingly Africa, it has also grown to become a leading jurisdiction for private client services in the region. A number of HNWI already use a Mauritius "Trust" for estate, succession planning and family office services. The first Trust Act (which was an updated and improved version of the English Trustee Act 1925) was enacted in 1989. In 1992, the Offshore Trusts Act was enacted to specifically provide for many of the desirable features prevailing in other offshore jurisdictions. In 2001, a new modern and forward looking Trust Act was enacted. The Act contained most of the desirable features prevailing in other offshore jurisdictions but also brought about a number of innovative features paving the way for Mauritius to become an important jurisdiction for estate planning.

However, as explained above, whilst the ‘trust’ appeals to clients from common law jurisdictions, it is less attractive to those clients from Civil Law jurisdictions where the ‘trust’ concept is largely unknown. Also, a ‘trust’ does not have corporate personality which means that very often, an underlying SPV has to be resorted to when the intention is to hold property in some civil law jurisdictions which do not recognize a trust. In 2009, a Joint Working Group (JWG), comprising of key representatives of the public and private sector in Mauritius was set-up to make proposals on ways and means to enhance the international competitiveness of the Mauritian Global Business Sector, in particular on the introduction of new products. Amongst others, the JWG concluded that the adoption of a law on Private Foundations would be beneficial to the jurisdiction.

The authorities were quick to embrace the recommendations of the JWG and a draft Foundations Bill (the “Bill”) was prepared, circulated and commented upon. The Bill was introduced in Parliament on 29 May 2012 and passed on 05 June 2012. The following are the salient features of a Mauritius Foundation under the Act:

(a) it can be set-up intervivos (by charter) or by will;
(b) it can be set-up to benefit persons, class of persons or to carry out a purpose which may be charitable, non-charitable or both;
(c) it needs to be managed by a Foundation Council which should comprise of at least one member ordinarily resident in Mauritius;
(d) it requires a secretary in Mauritius which would need to be a licensed by the Financial Services Commission;
(e) it needs to have a registered office in Mauritius;
(f) when registered it would have separate legal personality;
(g) it needs to keep proper books of accounts and keep its records in Mauritius at its registered office;
(h) it will not be subject to being set aside by a Mauritius Court and a Mauritius Court would not recognise the validity of any claim against the property of a Foundation pursuant to the law of another jurisdiction or the order of a court of another jurisdiction;
(i) Where the founder and all the beneficiaries are non resident (or if set-up for a purpose, that purpose is being carried out of Mauritius) it will be exempt from tax in Mauritius.

Trusts or Foundations…or both?

The trust concept has been around for centuries and comes as a tried and tested product with nearly a thousand years experience of case law. On the other hand, foundations are a relative newcomer to the scene. However, the Foundation benefits from legal personality and can hold assets directly as opposed to trusts. Ultimately, both have their advantages and weaknesses and both have probably equal worth. Trusts would probably continue to be preferred by clients from common law jurisdictions but foundations would certainly be preferred by those from civil law jurisdictions. Interestingly enough, they can be used together in the context of an estate plan, where there is a need for example to have an

orphan structure; for example, it is common to use a Private Foundation to hold the shares of a Private Trust Company (PTC).

Conclusion

It is submitted the Foundations Act adds to the already diverse product offering of Mauritius as an International Financial Centre of substance and will offer one of the most versatile and dynamic foundations available from any jurisdiction and further promote Mauritius as a platform for wealth management services, succession and estate planning.

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