



## Guide to the Commercial Use of Trusts in Jersey

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## PREFACE

The lack of rigid formal requirements for the creation and operation of trusts, unlike companies, and the tremendous flexibility allowed in inserting clauses in trust instruments make the trust a very useful device for achieving many commercial purposes if there are no tax disadvantages in its use. Jersey law offers the additional attraction of permitting the establishment of non-charitable purpose trusts as an alternative to traditional beneficiary trusts.

The particular commercial/legal features and advantages of using a purpose trust are:

- that a person owns or controls property which is subject to an obligation to apply that property for a particular purpose;
- the purpose is specified by the originator of the arrangement;
- the obligation is maintained by operation of law and cannot be revoked by any person unless the terms of the trust so permit. (This is the most prominent feature of the purpose trust – the maintenance of the obligation to apply the trust assets to the specified purpose irrespective of the wishes or legal rights of the obligee or any potential recipient (or classes of recipient) of benefit from the arrangement);
- the precise terms of the purpose and its mode of execution can be specified outright in the trust instrument or may be subject to variation within parameters specified by the originator; and
- the trust assets are dedicated to the specified purpose and “ring-fenced” from insolvency risks of the trustee. Subject to any defeasance rights the trust assets will also be protected from creditor claims against the originator of the purpose trust.

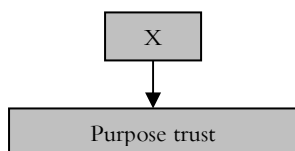
Trusts have long been used as a core element of many commercial arrangements whether in the context of pension funds, unit trusts, employee benefit structures or security trustee arrangements in capital markets issues. The following pages summarise certain less well known commercial uses to which a purpose or a hybrid purpose / beneficiary trust may be put. It is by no means an exhaustive description of possible uses which are limited only by the imagination and ingenuity of businessmen and lawyers in the commercial context.

A short summary of the legal and regulatory requirements for establishing a Jersey Law purpose trust is set out at the end of this guide together with summary information on the taxation of trusts in Jersey.

It is recognised that this Guide will not completely answer detailed questions which clients and their advisers may have. It is intended to provide a sketch of the subject matter covered. The Guide is, therefore, designed as a starting-point for a more detailed and comprehensive discussion of the issues.

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St Helier, Jersey  
July 2005

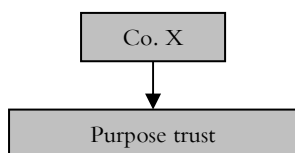
## 1. SINKING FUND TRUSTS



The purpose trust concept offers the benefit of being able to dedicate monies or other assets comprising the trust fund for pre-defined business or commercial purposes without any person being entitled to claim a direct ownership interest in the same or prevent application of the monies or assets to the specified purpose.

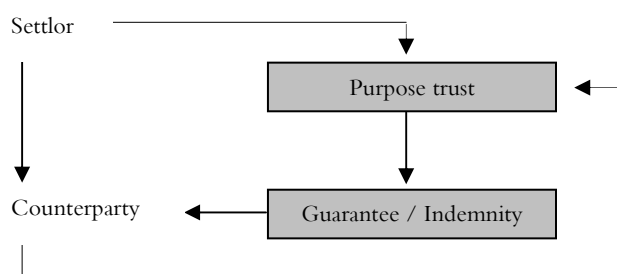
The purpose trust may be used to establish a sinking fund to enable monies to be set aside and paid regularly by X to trustees so that an adequate fund will be available over time to meet the costs of a particular project e.g. major repairs to a building, installation or de-commissioning expenses, environmental cleansing costs.

## 2. COMPANY RESERVE OR PROVISION



Where a company or its directors wish to set aside monies or assets to create a reserve fund or a provision in respect of an anticipated funding obligation of the company a purpose trust may provide an attractive and flexible framework for this. Depending upon the particular circumstances Company X may be able to declare itself trustee of the assets or monies to be held pursuant to the purpose trust so these assets or monies remain on the balance sheet of Company X but subject to a note that they can only be applied to the specified purpose. In practice there would need to be adequate segregation of the purpose trust assets so they were separately identifiable from the other assets of Company X. In the absence of vitiating factors at the date of establishment of the purpose trust the reserve fund or provision will be ring-fenced from insolvency risk of Company X or creditor claims against Company X which do not relate to the trust purpose. Such a scheme might be used for example to create a ring-fenced reserve to fund top-up contributions to directors' pension arrangements. The purpose trust could also be established using an independent trustee to take the monies or assets in question off the balance sheet of Company X.

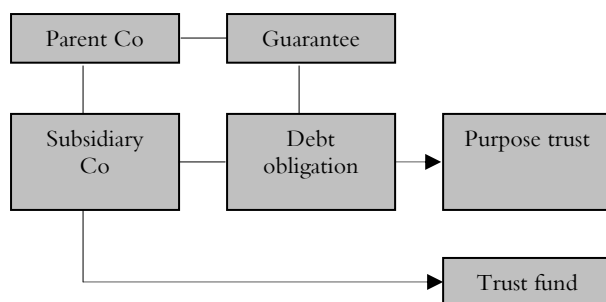
## 3. PROVISION OF SECURITY AND GUARANTEES



The purpose trust may be established as a collateral fund arrangement under which the trust will issue a guarantee or undertake an indemnity obligation in favour of a counterparty to the person who establishes the purpose trust (the “**settlor**”). The settlor may fund the purpose trust fully in respect of its exposure under the guarantee or indemnity to be issued by the trust. Alternatively the settlor may only fund the trust in respect of

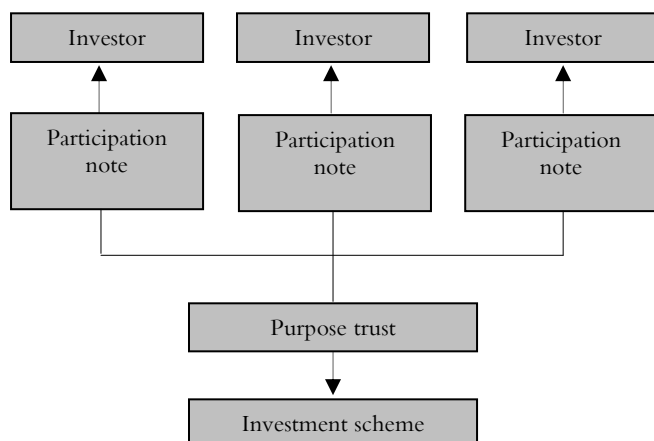
part of its exposure on the basis that the trust fund will be invested in high grade zero coupon bonds or fixed interest securities with profits and gains rolling up inside the trust fund with the intention that over time these retained profits and gains together with the trust capital will match the exposure under the guarantee/indemnity. Alternatively, the trust may only be funded with sufficient monies to purchase insurance cover in respect of its exposure if any claim is made under the guarantee / indemnity. The trust will operate as a limited recourse vehicle so that the guarantee or indemnity obligation can only be met and satisfied out of and to the extent of monies or assets in the trust fund. Until a claim is made under the guarantee or indemnity or the primary obligation which is secured by the purpose trust is otherwise discharged, the trust cannot be revoked and will be insolvency remote. At the end of the trust period any monies or assets remaining in the trust can be repaid to the settlor either under a residual beneficiary arrangement or pursuant to a resulting trust.

#### 4. DIVESTMENT OF DEBT OBLIGATIONS



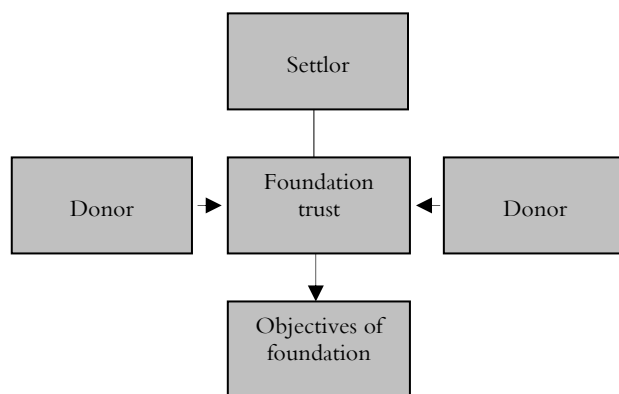
In this example a subsidiary finance company has issued some form of debt instruments supported by a guarantee from its parent company in favour of the holders of those debt instruments. The terms of the debt instruments may prevent early repayment and accordingly the finance subsidiary may wish to divest itself of the direct obligation to meet repayment of the debt instruments in order to improve the group’s credit rating and simplify accounts presentation perhaps in preparation for entry into another financing transaction or parent group acquisition. The finance subsidiary or some other group company will arrange sufficient funding to enable the purpose trust to be established with assets to cover interest and ultimate capital repayment obligations on the debt instruments which are in issue. With the agreement of the paying agent / trustee of the debt instruments the obligations of the finance subsidiary will be transferred to the trust or possibly a special purpose company wholly owned by the trust. The contingent liability of the parent company under the supporting guarantee may also be capable of being released at this point so as to remove it from the consolidated balance sheet liabilities of the group.

#### 5. PRIVATE INVESTMENT FUND



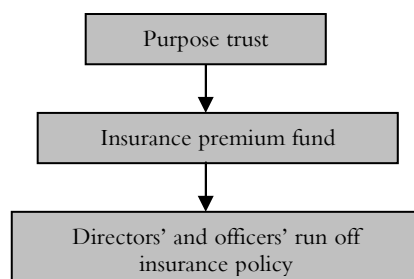
As an alternative to a traditional unit trust structure where investors or capital providers are beneficiaries of the trust and have a proprietary interest in the underlying investments or assets held, a purpose trust which issues participation notes may have taxation advantages in some circumstances. The investors or capital providers will not participate as beneficiaries under the trust but will merely have contractual rights as set out in the terms of the participation notes to participate in the profits, gains or revenues from the holding management or development of the underlying assets. Investors/capital providers can rank equally for participation in the arrangement or participation notes can be investor specific with different rights or entitlements conferred between investors/capital providers e.g. splitting income and revenue profits from capital profits and allocating them to different investors. The use of a purpose trust also side steps complications which may arise if a corporate fund vehicle were used as a result of company law requirements defining distributable profits and setting out maintenance of capital requirements and restrictions on return of capital prior to a winding up.

## 6. QUASI-CHARITABLE TRUSTS AND FOUNDATIONS



Where a settlor wishes to establish a vehicle to promote certain interests or objectives which may be business related or philanthropic in nature but which fall wholly or in part outside the definition of charitable activities it may not be possible to establish the vehicle as a charity in the settlor's jurisdiction. An alternative approach would be to set up a non-charitable purpose trust under Jersey law under which there is freedom to define the specific objectives which are to be promoted subject only to the overriding requirement that the purpose trust cannot be established for purposes which are unlawful, immoral or contrary to public policy.

## 7. DIRECTORS' RUN-OFF INSURANCE TRUSTS



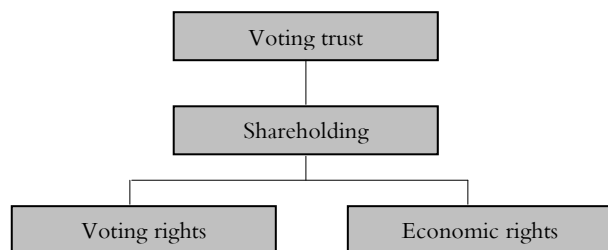
Boards of directors often fail to put in place arrangements to reserve for insurance premiums which need to be paid following the acquisition of their company in a take-over or sale or where it ceases operation in order to provide run off insurance cover for themselves in respect of risks arising from acts and omissions carried out by individual directors or the board prior to the take-over or sale or liquidation of the company. Company law generally permits the company to pay the premiums on directors' and officers' insurance

policies. Failure to reserve by the company for premiums which will need to be paid at or following take-over, sale or liquidation often means that if the directors want the protection of run-off cover they will have to purchase the same from their own resources.

However, by establishing a purpose trust the board can arrange for a contingency or reserve fund to be built up by transfers of monies from their company to the purpose trust to be used for the purchase of run-off insurance policies. The funding may be by means of one lump sum payment by the company or may be spread over a period of time by means of a series of smaller payments to the trust. If the company subsequently goes into insolvent winding up the trust fund should be available to ensure that adequate insurance cover is purchased post the winding up date to cover the ongoing risk of claims to which directors will be exposed during limitation periods which may run for several years after the winding up date. Care will need to be taken to structure the trust so that it is insolvency remote and cannot be challenged by creditors of the company.

Alternatively if a company is sold as a going concern and becomes part of a new corporate group it is normal for the group insurance arrangements of the acquiring group to cover the directors of the new subsidiary for directors' and officers' risk but only in respect of risks arising after the date of acquisition of the new subsidiary. The directors of the subsidiary will not be covered under the new parent group's insurance for risks which predate the acquisition. By using a purpose trust to build up a reserve fund in advance of the take-over or sale the board of the target company can arrange purchase of appropriate run-off cover without having to pay for the same from their own resources.

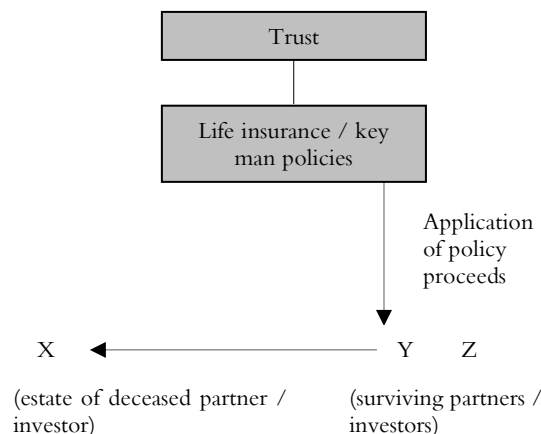
## 8. VOTING TRUSTS



Voting trusts are a fairly well known and long established example of the commercial use of trusts. In this case the voting rights and controlling influence attaching to shares in a particular company can be split off from the right to participate in the profits and capital of the company by having all or a proportion of the voting shares in the company owned by a trust which will then hold the various benefits arising from those shares for the appropriate group of beneficiaries. Accordingly income and capital distributions from the company will go to one group of beneficiaries while the voting rights are exercised separately by the trustee either in its discretion or in accordance with the wishes of some other group of beneficiaries. Care is needed in drafting such voting trusts to protect the trustee from competing claims of beneficiaries (ie those entitled to income may complain if the votes carried by the shares are exercised in such a way as to reduce the level of dividend from the company).

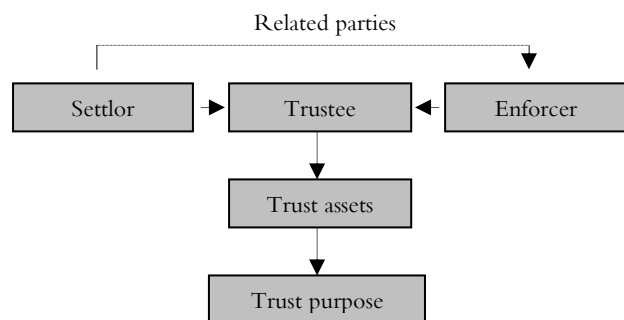
In another case a trust may be established to own a minority stake in a joint venture company in which, for example, two principal parties have equal shares. The minority stake owned by the trust can be treated as “voting only” shares carrying no right to dividend or other economic interests. The voting rights attaching to the minority stake held by the trust will be exercised only in accordance with the views of an independent third party acceptable at the outset to both parties to the joint venture. Using an arrangement of this type can prevent deadlock between the parties at a later date.

## 9. PARTNERSHIP/JOINT VENTURE BUY OUT TRUSTS



To deal with the death of a partner or joint venture investor there may be a partnership or joint venture buy-sell agreement funded by insurance held by a trustee for the parties. The insurance money will provide the funds to enable the surviving partners to buy the interest of the deceased partner, thereby avoiding sale of the partnership or joint venture assets which might jeopardise the continuity of the enterprise.

## 10. JERSEY PURPOSE TRUSTS: SUMMARY INFORMATION



### a. Basic Legal Requirements for Purpose Trusts

Trusts can be established under the Trusts (Jersey) Law 1984 as amended which are for the benefit of persons (which can include both individual natural persons and companies) or for any non-charitable purpose (which is not for the benefit only of the trustee). Hybrid or mixed trusts can also be set up in favour of beneficiaries and purposes.

Purpose trusts cannot be established for purposes which are unlawful, immoral or contrary to public policy. A valid purpose trust can endure for a maximum of one hundred years.

As a fundamental condition of the validity of a purpose trust the terms of the trust must provide for the appointment of a person to act as enforcer of the trust. The enforcer is under a duty to ensure that the trustee carries out the terms of the trust in connection with the specified purposes.

The enforcer cannot be the trustee. Subject to this rule any person whether an individual or a company can act as enforcer. If required there can be multiple enforcers. The enforcer need not be independent of the settlor of the purpose trust and will often be connected to or associated with the settlor.

The enforcer is entitled to receive trust accounts.

There is no statutory requirement that the trustee or the enforcer must be Jersey resident persons or entities although issues related to the ultimate enforceability of the purpose trust by the courts in Jersey and the desirability of some substantive connection with the jurisdiction which provides the proper law for the trust may weigh in favour of having one or more of these functions carried out from Jersey. (In this context consideration would also need to be given to the situs of the trust assets).

In addition to the trustee and the enforcer it is possible to establish purpose trusts which also provide for a protector to be appointed. A protector is a person or company who has appointed to him or it by the terms of the trust certain powers relating to the administration of the trust and/or relating to the application and disposition of the trust property. These powers are defined by the terms of the trust. Typically these provisions require the trustee to seek the prior approval of the protector before the trustee carries out some action or activity which falls within the list of matters which are subject to the effective supervision of the protector.

Again there is no statutory requirement for any protector who is appointed to be Jersey resident.

#### **b. Basic Regulatory Requirements for Purpose Trusts**

There is no register of trusts maintained in Jersey and therefore the establishment of a Jersey law purpose trust is a private matter between the trust settlor or originator and the trustee.

Where the services of a professional trustee or trust company in Jersey are engaged the trustee is required to be registered to conduct trust company business under the Financial Services (Jersey) Law 1998 and is subject to supervision by the Jersey Financial Services Commission in the exercise of its trust company business.

It is possible to incorporate special purpose Jersey companies to act as corporate trustees of specific trusts. Such private trust companies in Jersey are not themselves subject to direct regulation by the Jersey Financial Services Commission but are required to be administered by a trust company in the island which is registered under the Financial Services (Jersey) Law 1998.

## **11. TAXATION OF TRUSTS IN JERSEY**

Where a Jersey resident trustee is appointed, by virtue of the trustee being resident in the island, the trustee is strictly chargeable to Jersey income tax in respect of all income arising to them in that capacity.

However, by long standing published concessions from the Comptroller of Income Tax in Jersey exemption from that liability (so far as it relates to non-Jersey source income and Jersey bank deposit interest) is automatically available where the settlor or originator of the trust and any beneficiaries of the trust are non-residents of the island.

Where one or more beneficiaries or default beneficiaries are or may be Jersey resident partial exemptions from Jersey taxation can be negotiated with the Jersey taxation authorities upon application.

There is no capital gains tax in Jersey or any stamp duty upon the creation of a trust and the execution of any trust instrument. Jersey is outside the EU for the purpose of VAT.

For more specific advice on the Commercial Use of Trusts in Jersey, we invite you to contact the following:

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