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Trusts and succession planning

Succession planning

Succession planning encompasses a lot more than just drafting a will, as many believe. It's the means by which older generations can make their intentions known about the continuation of their legacy, ensure the care of their loved ones, preserve family wealth, protect younger generations from imprudent spending and contribute to society.

Striking a fair balance on the above is quite an adventure, especially when family biases come into play. The balancing exercise becomes more complex when dealing with "citizens of the world", whose succession is characterised by strong cross-border elements. The EU Succession Regulation was the EU's response to the increasing complexities of estates with cross-border elements, yet the interplay between applicable regimes of EU and non-EU countries remains a source of uncertainty.

Trusts: Another way

In this complex reality, trusts provide a simple and flexible solution for succession planning. Unlike a company, a trust is not a legal person. It is a pool of assets. The person who owns the assets (settlor) transfers them to another person (trustee). The trustee manages the assets for the benefit of specified persons, classes of persons or for specific purposes, for example the relief of poverty (beneficiaries). Assets transferred to the trustee are not owned by the settlor and do not form part of the settlor's estate.

Trustee: The manager of the assets

The relationship between the trustee and the beneficiaries is one of absolute faith. The trustee must always act in the best interests of the beneficiaries. Assets managed by the trustee are not their personal assets. The trustee is obliged to keep their personal assets and the assets they administer as a trustee separate.

The provision of trustee services is regulated. At least one trustee must be a Cypriot resident. For Cypriot International Trusts, at least one trustee must be a Cypriot tax resident. The settlor may appoint a protector – a trusted person who supervises the trustee's actions (the settlor may be appointed protector).

An important exemption to the licensing requirement on providing trustee services is the private trustee company. A private trustee company is typically owned by the settlor and may only be appointed as trustee to family trusts. A family trust is understood as a trust whose beneficiaries are the settlor's relatives up to fourth degree of kindred and/or their spouse. Directors of the private trustee company may include professional advisors together with (or without) family members.

Trust governance

The trust, its administration and management are regulated by the trust settlement – a document executed by the settlor and the trustee. The trust settlement typically includes the powers and discretions of the trustees, the procedure for adding property to the trust, changing beneficiaries, making distributions and appointing new trustees/protector.

Major decision-making powers of the trustee may be made subject to the consent of either the protector or the settlor, adding an extra layer of supervision. In parallel to the trust settlement, the settlor may issue one or more letters of wishes, in which they express their wishes on trust matters. The letter of wishes, although non-binding, must be considered by the trustee before taking any decision.

Why establish a Trust?

- A trust may easily be incorporated in any structure. The trust (through the trustee) may own shares, hold bank/investment accounts, own immovable property or be party to a transaction.

- A settlor may wish to benefit some persons more than others, benefit certain persons on the occurrence of particular events and/or contribute to society by adding a charity as beneficiary. A trust makes this possible, whereas it's not possible under a will, where the forced heirship rules (applicable in most countries) dictate how much of their estate a testator can distribute by will, who inherits and how much.

- Trusts offer protection from claims by creditors against the settlor's property. The Cyprus International Trusts Law provides that creditors may bring a claim against property transferred to the trust within two years from the date of transfer.

- Assets under a trust are not owned by the settlor and do not form part of the settlor's estate. This facilitates continuity of operations of assets under the trust.

- Trusts may contribute to limiting imprudent spending by younger persons who would otherwise be entitled to considerable assets at a young age.

Tax matters

Explicit guidance on the tax treatment of trusts is limited. It is therefore essential to obtain tailored tax advice before the establishment of a trust. In practice, trusts are treated as tax transparent, and the taxation of income earned by a trust usually depends on the beneficiaries' tax residency. The contribution of assets into a trust is not a taxable event for the trust, though it may have tax consequences for the settlor.

If a trust (through the trustee) holds investments and the beneficiaries of such trusts are (i) non-Cypriot tax residents and/or (ii) Cypriot tax residents non-Cyprus domiciled, any dividend income earned by the trust would in principle be exempt from tax in Cyprus. It's important to note that Cyprus does not impose inheritance tax or any wealth tax.

Overall, the increasing complexities of the modern world should not be an impediment to meaningful succession planning. Trusts can provide a simple, flexible and tax efficient solution. As J.K. Rowling put it in Harry Potter and the Sorcerer's Stone, "After all, to the well-organised mind, death is but the next great adventure." This may sound like a morbid statement; however, it is an accurate description of the need for a succession planning process.

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