

## What is a trust?

In common law legal systems, a **trust** is a relationship where property (real, personal, tangible or intangible) is held by one party for the benefit of another. A trust typically arises when property is transferred by one party to be held by another party for the benefit of a third party, although it is also possible for a legal owner to create a trust without transferring it to anyone else, simply by declaring that the property will henceforth be held for the benefit of the beneficiary. A trust is created by a **settlor** transferring some or all of his property to a **trustee**, who holds that trust property for the benefit of the **beneficiaries**.

In the case of the self-declared trust, the settlor and trustee is the same person. The trustee has legal title to the trust property, but the beneficiaries have equitable title to the trust property (separation of control and ownership). The trustee owes a fiduciary duty to the beneficiaries, who are the "beneficial" owners of the trust property. A trustee may be either a natural person, or a legal person such as a company or a public body, and there may be a single trustee or multiple co-trustees. There may be a single beneficiary or multiple beneficiaries. The settlor may himself be a beneficiary.

The trust is governed by the terms under which it was created. The terms of the trust are usually included in a trust **instrument or deed**. The terms of the trust must specify what property is to be transferred into the trust (certainty of subject-matter), and who the beneficiaries will be of that trust (certainty of objects). It may also set out the detailed powers and duties of the trustees (such as powers of investment, powers to vary the interests of the beneficiaries, and powers to appoint new trustees). The trust is governed by local law. The trustee is obliged to administer the trust in accordance with both the terms of the trust and the governing legislation.

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## Basic principles

Property of any sort may be held on trust, but growth assets are more commonly placed into trust (for tax and estate planning benefits). The uses of trusts are many and varied. Trusts may be created during a person's life (usually by a trust instrument) or after death in a will. One of the most significant aspects of trusts is the ability to partition and shield assets from the trustee, multiple beneficiaries, and their respective creditors (particularly the trustee's creditors), making it "bankruptcy remote", and leading to its use in pensions, mutual funds, and asset securitization.

## Creation

Trusts may be created by the expressed intentions of the settlor (express trusts) or they may be created by operation of law known as implied trusts. An implied trust is one created by a court of equity because of acts or situations of the parties. Typically a trust can be created in the following ways:

- A written trust instrument created by the settlor and signed by both the settlor and the trustees (often referred to as an inter vivos or "living trust");
- An oral declaration;
- The will of a decedent, usually called a testamentary trust; or
- A court order (for example in family proceedings).

In some jurisdictions certain types of assets may not be the subject of a trust without a written document.

## Trustees

A trustee may be held personally liable for certain problems which arise with the trust. For example, if a trustee does not properly invest trust monies to expand the trust fund, he or she may be liable for the difference.

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**The trustees are the legal owners of the trust's property.** The trustees administer the affairs attendant to the trust. The trust's affairs may include investing the assets of the trust, ensuring trust property is preserved and productive for the beneficiaries, accounting for and reporting periodically to the beneficiaries concerning all transactions associated with trust property, filing any required tax returns on behalf of the trust, and other duties. In some cases, the trustees must make decisions as to whether beneficiaries should receive trust assets for their benefit. The circumstance in which this discretionary authority is exercised by trustees is usually provided for under the terms of the trust instrument. The trustee's duty is to determine in the specific instance of a beneficiary request whether to provide any funds and in what manner.

By default, being a trustee is an unpaid job. In present times trustees are often lawyers, bankers or other professionals who will not work for free. Therefore, often a trust document will state specifically that trustees are entitled to reasonable payment for their work.

Trusts are often confused with legal persons, but are mere relationships, not entities. Thus, they have no legal existence independent from the trustee and his or her ownership of the subject matter of the trust. In order to sue a trust, one must sue the trustee in his or her capacity as trustee for a specific trust; equally, if the trust needs to sue someone, the lawsuit must be brought by the trustee in his or her capacity.

## **Beneficiaries**

The beneficiaries are beneficial (or equitable) owners of the trust property. Either immediately or eventually, the beneficiaries will receive income from the trust property, or they will receive the property itself. The extent of a beneficiary's interest depends on the wording of the trust document. The settlor has much discretion when creating the trust, subject to some limitations imposed by law.

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## Purposes

Common purposes for trusts include:

- **Privacy:** Trusts may be created purely for privacy. The terms of a will are public and the terms of a trust are not. In some families, this alone makes the use of trusts ideal.
- **Spendthrift Protection:** Trusts may be used to protect beneficiaries (for example, one's children) against their own inability to handle money.
- **Wills and Estate Planning:** Trusts frequently appear in wills (technically, the administration of every deceased's estate is a form of trust). The executor of the will is (usually) the trustee, and the children are the beneficiaries.
- **Charities:** In some common law jurisdictions all charities must take the form of trusts.
- **Pension Plans:** Pension plans are characteristically set up as a trust, with the employer as settlor, and the employees and their dependents as beneficiaries.
- **Remuneration Trusts:** Trusts for the benefit of directors and employees or companies or their families or dependents.
- **Corporate Structures:** Complex business arrangements, most often in the finance and insurance sectors, sometimes use trusts among various other entities (e.g., corporations) in their structure.
- **Asset Protection:** The principle of "asset protection" is for a person to divorce himself or herself personally from the assets he or she would otherwise own, with the intention that future creditors will not be able to touch that money, even though they may be able to bankrupt him or her personally. One method of asset protection is the creation of a discretionary trust, of which the settlor may be the protector and a beneficiary, but not the trustee and not the sole beneficiary. In such an arrangement the settlor may be in a position to benefit from the trust assets, without owning them, and therefore without them being available to his creditors.

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- **Tax Planning:** The tax consequences of doing anything using a trust are usually different from the tax consequences of achieving the same effect by another route. In many cases, the tax consequences of using the trust are better than the alternative, and trusts are therefore frequently used for legal tax avoidance.
- **Offshore trust:** An offshore trust is a trust which is resident in any jurisdiction other than that in which the settlor is resident. However, the term is more commonly used to describe a trust in one of the jurisdictions known as offshore financial centres. Offshore trusts are usually similar to onshore trusts in common law countries, but with legislative modifications to make them more attractive by abolishing or modifying certain common law restrictions.

A directed trust is a trust in which the trustee is directed by a number of other trust participants in implementing the trust's execution. That trustee is referred to as a **directed trustee**. Examples of other trust participants may include a distribution committee, trust protector, or investment advisor. A directed trustee's role often includes: following distribution and investment instructions, holding legal title to the trust assets, providing fiduciary and tax accounting, coordinating trust participants and offering dispute resolution among those participants. Typically, these duties and the other participants in the trust are defined and governed by the trust document itself.

High net-worth families face an ever increasing set of challenges managing their wealth across generations. Major changes in trust law, combined with modern investment strategies, new tax factors and complex family and financial advisor dynamics, have created demands that traditional trusts and trust companies are not well equipped to handle. In the face of these demands, many families are moving away from conventional trusts that rely on single or co-trustees to new **"multi-participant" trusts**, with a directed trustee central to the administration of their trust. This arrangement is also commonly referred to as "open-architecture" trust design. As families move to gain more control over certain trust functions, multi-participant trusts have emerged as a powerful tool for achieving optimal estate planning results, while limiting risks to participants.

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The participants or "agents" of this new form of trust are granted specific powers by the trust based on their skills, location in advantageous trust jurisdictions or past relationships. They are responsible, and therefore liable, only for matters that they are best equipped and prepared to manage. This approach is an advance over the traditional unitary trust model, where single or co-trustees lack either the in-depth expertise or the appetite for risk needed to effectively manage the breadth of issues that trusts face.

A popular structure for this is the private trust vehicle (such as found in Bermuda). In summary, a private trust company (PTC) is established to act as trustee of the trust. No license is required because it acts only for named trusts in the family group for example. The settlor can sit on the board of the PTC which gives him control over the assets (assuming that works for his particular tax situation). A purpose trust is also very popular for holding shares in the PTC so that the settlor is not himself the shareholder.

### **Trusts under Maltese Law**

The establishment and administration of trusts in or from Malta is regulated by the Trusts and Trustees Act, 2004 which came into force in January 2005. A trust may be created in any manner under Maltese law, orally, by unilateral declaration, by an instrument in writing including a will, by operation of the law or by a judicial decision. The tax implications of a trust would be dependent on various factors, such as, the residence of the parties to the trust, the nature and location of the trust property and the various stages in the life of a trust (settlement of property on trust, administration of trust property, distribution of trust assets, reversion of trust property and the transfer of the beneficial interest in a trust).

### **Malta Tax Treatment**

Although current legislation allows for Maltese residents to create and utilize local trusts for asset protection, for estate planning, as a commercial tool, for testamentary purposes or simply to ensure that assets are passed

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down from generation to generation, the creation and use of a local trust by Maltese residents for tax planning purposes provides no fiscal benefit. Maltese tax authorities essentially adopt a “look through” approach and see through the trust and tax (or exempt from tax, as the case may be) any transaction or party to the trust in the same manner as they would have done in the absence of such a trust.

From an international perspective, however, Maltese trusts may provide certain tax planning opportunities to non residents, whilst also offering them the protection, security and estate planning benefits that come with the creation of trusts. The settlement of foreign assets on trust by a non resident settlor for the benefit of non resident beneficiaries would not normally trigger off any Maltese tax implications. Under Maltese law, however, the general rule is that where at least one of the trustees of the trust is resident in Malta for tax purposes, then tax shall be payable in Malta on all income attributable to the trust. This would comprise the total income or gains chargeable to tax under Maltese law which accrue to or are derived by the trustee at any stage in the life of the trust as outlined above.

However, the inclusion in Malta’s tax legislation of a transparency model allows, in certain circumstances, for the tax authorities to look through the trust and tax or exempt the transaction depending on the various factors that would attribute jurisdiction to tax to Malta or otherwise.

### **Distinctive Features of a Maltese Trust Relationship**

Maltese trust law is today closer to the classical English law of trusts than to models found in traditional tax havens. Unlike the U.K., however, the law establishes a vigorous and very detailed regulatory regime, effectively complementing existing legislation on the prevention of money laundering and the funding of terrorism.

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Under Maltese law a trust involves the transfer of property to the trustee who creates a distinct patrimony or fund in relation to such property. Such fund is not subject to the personal creditors or spouse of the trustee, does not form part of the personal property of the trustee and is not inherited by the heirs of a trustee.

The trustee is bound to administer the property with due care. These are similar to the duties of any administrator except that the trustee is the owner of the property and, subject to the terms of the trust, enjoys absolute rights including the power to sell and substitute property or to distribute it to the beneficiaries.

The rights of beneficiaries in relation to the trust fund can vary from receiving income, receiving an annuity, receiving distributions of capital, use of assets, distribution of assets, being supported by loans or guarantees or any combination of these as may be permitted by the trust instrument.

### **The Regulation of Trustees in Malta**

The Trusts and trustee Act distinguishes between professional and private trustees, who are both regulated by the Malta Financial Services Authority (the “MFSA”). A professional trustee is a person who receives property upon trusts or accepts to act as a trustee or co-trustee of a trust and who:

- (i) Either receives or is entitled to remuneration for acting as a trustee, or
- (ii) Acts as a trustee on a regular and habitual basis, or
- (iii) Holds himself out to be a trustee.

A professional trustee may be either an individual, resident or operating in Malta, or a corporate trustee, either registered in Malta or operating in Malta.

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Private trustees do not need authorisation to act as trustee but are bound to follow a strict procedure laid down in the law.

Professional trustees, whether they are resident or operating in Malta, must obtain authorisation from the MFSA irrespective of the proper law of the trusts they are administering and whether or not all or part of the trust property is in Malta. Authorisation will only be granted as long as certain conditions are satisfied (e.g. if the applicant is a company, its objects must include acting as trustee and carrying on activities ancillary or incidental thereto and its actual activities must be compatible and connected with the services of a trustee).

In order for a person to be considered as fit and proper, the MFSA assesses that person's competence and soundness of judgement. Where the applicant seeking authorisation to act as a professional trustee is an individual, the MFSA must be satisfied that such individual is resident or operating in Malta and is a person of good repute, possessing experience and qualifications in financial, fiduciary, accounting or legal services and whom the MFSA considers to be fit and proper to act as trustee. Furthermore, such individual must have established adequate systems for maintaining proper records of the identity and residence of beneficiaries and of the dealings and assets of the trusts to be administered.

### **More on Taxation of Trusts**

Where at least one of the trustees of a trust is a person resident in Malta, tax is normally payable by the trustee at the rate of 35% on any income and capital gains "attributable" to the trust.

However, Malta applies the transparency principle such that certain trust income or gains are deemed as "not attributable" to the trust and are considered to be derived directly by the beneficiaries of the trust. Transparency applies where:

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(a) all the beneficiaries of the trust are either not ordinarily resident or not domiciled in Malta, and

(b) all the trust income arises outside Malta (or is certain tax-exempt income in Malta)

Where the income is not attributable to the trust as indicated above, no Maltese tax is payable by the trustee or the beneficiaries of the trust.

A trust may also elect to be treated as a company ordinarily resident and domiciled in Malta for all purposes of tax law. When a trust makes such an election, all provisions in the Income Tax Acts applicable to Maltese companies would apply equally to the trust including the tax refunds applicable to the shareholders of a Maltese company. Accordingly, the beneficiaries of the trust would be registered for tax refunds in the same way as the shareholders of a Malta company would be registered. Any distributions made by the trustee to the beneficiaries of the trust would therefore be deemed to be a distribution of a dividend for the purposes of claiming tax refunds under the Income Tax Acts.

### **Foundations in Malta**

A foundation (also a charitable foundation) is a legal categorization of not for profit organizations that will typically either donate funds and support to other organizations, or provide the source of funding for its own charitable purposes. This type of non-profit organization differs from a private foundation which is typically endowed by an individual or family.

Maltese law allows the establishment of private or purpose foundations. This is often considered preferable as they allow the founder to maintain a level of control on the direction

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of the Foundation. Malta established a clear legal framework in 2008 (in the Civil Code) to define their legal structure.

Unlike trusts, foundations have a separate legal personality and the foundation becomes the owner of the foundation estate. While trusts are not registered, the legal deeds creating a foundation must be registered but minimum information is available to the public and confidentiality is maintained.

A foundation may be treated as a company for tax purposes. This means that the Foundation is subject to the normal corporate tax rate of 35% and can benefit from Malta's full imputation system. Beneficiaries of the Foundation may be able to claim the applicable Maltese tax refunds. Foundations can also opt to be taxed in the same way as a Trust. An important aspect of the legislation is that it allows for the conversion of a Trust into a Foundation and vice versa.

### Offshore Trusts

Legally an offshore trust is similar to any arrangement in the UK or Malta as a binding arrangement whereby a person (or a number of people), known as the trustee or trustees, become the legal owner(s) of assets transferred to them by a settlor but only in as much as they are holding those assets for the benefit of another person or people (beneficiaries). The assets which are placed into a trust are called trust properties and can include anything which can be legally transferred such as:

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- Cash
- Securities
- Property
- Boats/cars
- Antiques
- Intellectual Property – copyrights / patents etc.
- Land
- Pension funds
- Companies

Although a trust can be a verbal agreement and implied by law, it is far more common for a trust to be established by way of a written document called either a Deed of Trust or Declaration of Trust (and in fact this is preferable). The person giving assets to a trust is known as the settlor and is commonly named in the Trust Deed, but, depending upon the jurisdiction where the trust was established, not necessarily so. It is therefore quite possible to give assets to a trust anonymously (not wanting to be connected as having given assets to 'your' trust). Great care must be taken in such instances since otherwise tax authorities tend to see through the trust and tax accordingly and it can be difficult to disprove such a connection with a trust.

### Beneficial Trusts

A beneficial trust is one in which the beneficiaries are specifically named in the trust document. While beneficial trusts can be of value for asset protection and inheritance tax purposes, because there is a specifically named beneficiary (or several), they are all but useless for tax planning and privacy purposes, the Tax Authorities in the country of residence of the beneficiary will soon become aware of the 'inheritance'.

### Discretionary Trusts

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If a beneficiary is named in a trust document, or if the beneficiary is clearly also the settlor, Tax Authorities tend to 'look through' such trust arrangements and regard the Beneficiaries as the owners of the trust assets and income. Thus it is quite feasible that beneficiaries can be taxed on assets or income which they never own or receive simply on the basis that they could be the owners. To get around this problem, discretionary trusts were established. These are arrangements where the actual beneficiaries of the trust are at the absolute discretion of the trustees. Since no specific beneficiaries are named in the trust document, Tax Authorities cannot tax any potential beneficiaries since there is no way of knowing when or even if, they will benefit from the trust, although tax is (in theory) payable on the receipt of the proceeds of the trust by a specific beneficiary. Beneficiaries can receive funds via an offshore account or company linked to the Trust.

### Offshore Asset Protection Trusts

An asset protection trust is little more than a specific type of discretionary trust and, as its name implies, is generally used by either private individuals or corporations to hold their assets in a form which makes them untouchable under any court order imposed against them. These are very common in the U.S.A., correctly formulated and held, asset protection trusts are showing signs of resisting attacks by creditors far better than Family Limited Partnerships which are widely promoted and frequently far more expensive.

### Trust Structure & Administration

A Trust, whether onshore or offshore, and of any type, has a number of component parts, several of which have already been mentioned. In essence these are very simple and straightforward, although the Deed itself is a complex legal document and should be drafted by

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someone with detailed understanding of the trust laws of the chosen jurisdiction. The major components of an offshore trust (of any type) are:

- The settlor (Grantor). This is the person or entity who formulates the trust and who settles his assets into the trust.
- Deed of Trust (Trust Document). This is the legal trust document itself and contains all the permutations and combinations of what the trust and its controlling trustees can and cannot do according to both the wishes of the settlor and the laws of the jurisdiction where the trust is written.
- Trust Property (Assets). The assets which the settlor places into the trust from time to time. Depending on the type of trust, settled assets do not need to be specified in the initial Deed of Trust but may be added later.
- Trustee. The named individual, individuals or company appointed by the settlor to administer his wishes according to the Deed of Trust. Frequently a professional Trust Agent within the jurisdiction of the trust, the trustee has absolute control over the trust assets.
- Beneficiary. The person or persons to whom the settlor wishes the trust assets or income thereof to be paid to according to circumstances dictated in the Deed of Trust. Depending on the type of trust, Beneficiaries do not need to be specified in the Deed of Trust, but can be made known to the trustees privately.
- Protector. A settlor can name a third-party individual to 'oversee' a trust to ensure that the trustee is administering the trust according to his wishes.
- Letter of Wishes. A settlor can write a Letter of Wishes alongside a Deed of Trust which spells out exactly what actions he wishes the trustees to take under differing sets of circumstances. This letter is totally private between settlor and trustee and whilst not

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legally binding, is an excellent guide for a trustee to follow, especially if the settlor is no longer in contact with the trustee for any extended period.

For any form of trust to work efficiently and effectively and be secure, the settlor must have absolute faith in the trustees otherwise a trustee could simply run off with the trust assets, name friends and relatives as beneficiaries or invest trust assets in a totally reckless way. There are a number of safeguards in this respect and trustees worldwide will observe both written and unwritten rules.

Firstly, in all common offshore jurisdictions, trustees have to be licensed by the government to carry out trust work, and these licenses are usually only given out to highly reputable and established organizations such as lawyers or accountants. There has not been a publicized case of misappropriation of funds by a trustee in over 20 years.

Secondly, when a trust is established, the settlor can prepare a 'Memorandum of Wishes'. This document, which may be changed at any time, expresses the settlor's wishes concerning the management and distribution of the trust. Whilst not legally binding, a memorandum of wishes is usually the major guide a trustee has, and is usually observed to the letter, unless there are over-riding considerations which prevent a trustee of doing so. In this event the trustee would return to the settlor for instructions.

Thirdly, it is also possible to appoint a protector or guardian to oversee a trust and control the powers exercised by the trustees, however there are potential problems with tax authorities here, since the appointment of a protector could be construed as a thinly veiled attempt by a settlor to influence the trustees to his advantage.

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Finally, in particular under Panama trust laws specific provision is made to allow the settlor, under the written authority of a Power of Attorney given by the trustees, to act effectively as a Trust Manager. This can have major advantages for a settlor who wishes to have tight control over a Trust and is reluctant to let any trustee have total control but, whilst legal under Panama law, this provision is regarded by most major tax authorities as making the trust a sham and thus giving them full legal rights to disregard it and over-ride its provisions and protection. Having said that, this Power of Attorney is a totally private document between the settlor and the trustees and if used wisely and carefully can be a very valuable tool in offshore asset management.

### General Summary

Offshore Trusts can be valuable vehicles for tax avoidance, (not evasion) either in a personal or a corporate role, as offshore companies can be. There are many cases where a combination of the two can be used for both tax avoidance on worldwide company income, plus a means of ensuring that all those profits are centralized and can be inherited, again free of tax, by heirs or other named people.

### Setting up a Trust

Popular locations for offshore trusts are Panama and Belize the legislation there being amongst the most comprehensive in the world. Similar arrangements exist in other offshore jurisdictions. Panama trusts in particular are totally private, the trust document does not have to be registered and there is no public inspection, there is no taxation of trust income and assets can be settled after a trust is formed and trusts established within Panama jurisdiction are governed by Panama laws, one of which is that it can over-ride that of other countries.

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**Please note for cost purposes it is sometimes preferable to have a trust established under one jurisdiction but have the trustee resident in another, as long as the trustee meets local regulatory requirements. For example it would be possible to have a Maltese based trustee of a trust established in Turks and Caicos which is a particularly cost effective option.**

### **An alternative-The Offshore Foundation**

Foundations have become popular across the globe, especially in civil law jurisdictions where the concept of 'Anglo Saxon Trusts' is less well known. Foundations can be established in many countries (but not all they are very rare in France for example). A foundation is a separate legal entity, without members or shareholders, and is generally established to reflect the wishes of the founder, who may be an individual or a corporate entity. These wishes are contained within the Foundation's Charter and Regulations. Foundations can be established for a fixed or indefinite period of time and can be used for charitable, commercial or for family purposes.

Foundations are a very important component when structuring the ownership of family and corporate assets and are particularly important where trusts are not generally recognized. They are in many respects similar to corporate entities but afford the protection and continuity derived from the use of trusts.

Please contact us if you would like further information about [trusts](#), [foundations](#), [estate & wealth management](#), or other [private client matters](#).

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### Practical uses of offshore foundations

- Private relationship: e.g. the founder's wishes are not publicly registered
- Wealth protection
- Recognised in all common and civil law jurisdictions
- Holding assets which can be passed on from one generation to the next (estate planning)
- Inheritance tax planning
- Avoidance of forced inheritance rules
- Maintenance of corporate control
- Separation of voting and economic benefits
- Employee share option schemes
- Pension funds
- Art collections
- Charitable purposes

A foundation is the solution for individuals who want to preserve their wealth against uncertainty, political, economic or family related, who want to transfer wealth to their heirs in a tax-efficient manner. It helps those who want to transfer wealth to their heirs in accordance with their wishes and not in accordance with the laws of the country where they live or want to consolidate the ownership of assets owned throughout the world in one location. It helps to minimise or eliminate estate taxes arising on the death of the founder.

### Why Establish a Foundation Offshore?

When a foundation is established in a suitable offshore jurisdiction, provided that residents of the offshore jurisdiction are excluded from receiving benefit from the foundation, then there will be no local taxes applicable to the assets and income of the foundation.

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