SATC Swiss Association of Trust Companies

Trust Glossary

This Trust Glossary is based on definitions contained in the Circular No. 30 on the Taxation of Trusts dated August 22, 2007 of the Federal Tax Conference. This (unofficial) English translation was made by the Society of Trust and Estate Practitioners, STEP. A link to the full text of Circular No. 30 is available on our website, www.satc.ch, under "Links" in German and French language.

Trust

Main features of the trust

The term describes a legal relationship which arises when the settlor transfers certain assets to one or more persons (trustees) on the basis of a trust deed with the obligation to administer and use such assets for a purpose pre-determined by the settlor for the benefit of one or more third parties (beneficiaries).

The trust is a legal relationship which originated historically in England and consequently it has developed mainly in the common-law states (Great Britain, United States, Australia, Canada, South Africa, New Zealand). In addition, institutions similar to trusts can be found in other countries such as, for example, Japan, Panama, Liechtenstein, Mexico, Colombia, Israel and Argentina.

In practice, the trust has proved to be an extremely flexible instrument. It is frequently used in connection with estate planning and for so-called asset protection for individuals. In addition, trusts in the Anglo-Saxon legal world are among the most frequently used structure for charitable institutions, and employee pension plans and also to implement employee stock option plans for companies listed on the stock exchange. In view of the variety of possible forms of the trust, listing all types of trust would be an impossible undertaking and would also be of little use for determining their treatment for tax purposes. It is preferable to fix the principles of the tax treatment of trusts independently from the type of trust concerned.

The trust can either be set up by way of a legal act between living persons or by way of a testamentary instrument.

Even if its structure is similar to a Swiss foundation, the trust does not have separate legal personality. From a formal point of view, the trustee is the holder, on a fiduciary basis, of the trust assets. However, the trust is, on the other hand, not just a mere contract. Although the trust is originally set up by the settlor, it is, after its creation, essentially a legal relationship between the trustee and the beneficiaries which is principally governed by the trust deed and secondarily by the specific rules of the applicable legal system. In organising the trust, the settlor has a comparatively extensive freedom. Once the trust is set up, however, the settlor has only a limited degree of influence over the trust, as in the case of a founder of a Swiss foundation. After the trust is created, the trustee's primary duty is to safeguard the interests of the beneficiaries and not those of the settlor.

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Another typical feature of a trust is the complex legal relationship which exists with respect to the trust assets. The trustee is the owner in civil law (common law: legal interest) of the trust assets, but he is required to administer the assets held on trust separately from his own assets and, in the event of death or bankruptcy of the trustee, the assets are not regarded as his own but are still subject to the law applicable to the trust and are held separately for the beneficiaries or the new trustee to be appointed.

Differences between the trust and the foundation

The Swiss foundation serves the purpose, similar to the trust, of endowing assets to a specified purpose (art. 80 ZGB). Once set up, the foundation acquires the status of a legal entity. On the other hand, the trust does not have legal personality. The trust has no legal capacity and therefore cannot own assets. In contrast to the trust, the foundation becomes the owner of the assets endowed for the particular purpose.

Differences between the trust and the 'fiducia'

The Swiss trust (fiducia) is based on a contractual relationship (a mandate in accordance with art. 394 et seq. OR). The trustee has to accept the mandate so that the contractual relationship can come into being. The agreement of the trustee is, on the other hand, not necessary for the creation of a trust. For this reason, the settlor can designate any person as trustee by a unilateral instrument during his lifetime or by testamentary instrument to take effect on death. Such nomination is comparable to the appointment of the executor of a will in accordance with Swiss inheritance law which gives him the position of an independent fiduciary in his own right.

The trust is not a (mere) contract. Although the trust is originally set up by the settlor, it is, after its creation, mainly a legal relationship between the trustee and the beneficiaries. After setting up the trust, the prime obligation of the trustee is to protect the interests of the beneficiaries and not those of the settlor.

The Hague Convention on the law applicable to trusts and on their recognition

The Hague Convention on the law applicable to trusts and on their recognition came into force in Switzerland on 1 July 2007. It enables the recognition of foreign trusts in civil law on the basis of internationally recognised norms and should, thus, increase legal certainty in this area.

The tax treatment of trusts is to be determined exclusively under Swiss tax law. Art. 19 of the Hague Convention provides expressly that the Convention does not prejudice the powers of States in fiscal matters. Ratification of the Hague Convention thus has no effect on the tax treatment of trusts.

Terms defined

Settlor

The settlor is that person who creates the trust by way of a legal act between living persons or upon death. Where he establishes an irrevocable trust, he relinquishes ownership definitively and, in principle, has no more rights and duties in respect of the trust assets. Alternatively, the settlor can create a revocable trust. In this case he still has control over the assets of the trust.

Beneficiary

The beneficiary is the person who benefits from the distributions of the trust. The settlor can appoint himself or any other natural or legal entity, domestic or foreign, as a beneficiary. The assets of the trust can be distributed to the beneficiary during the lifetime of the settlor or after his death.

The beneficiary can legally sue both for claims to payments from the trust assets and for the dutiful administration of the trust by the trustees. He has the economic ownership of the trust assets (common-law: equitable interest). Further, he has a right to claim the segregation of the assets of the trust in the event of bankruptcy of the trustee. The beneficiary thus has not only an actionable right with respect to benefits but also certain rights of supervision and oversight which make him a kind of supervisory authority. If the trustee mislays the trust assets, the beneficiary can demand restitution of the trust assets to the trust or to the trustee.

Trustee

Through the creation of a trust, certain assets are transferred to one or more natural or legal persons (trustees) who are required to administer them and use them for the purpose predetermined by the settlor. The trustee has full authority to dispose (ownership in civil law) of the trust assets but he is obliged to administer the trust assets in the interests of the beneficiaries in accordance with the provisions of the trust. He administers and uses the trust assets within the framework of the provisions of the trust in his own name as an independent legal holder towards all third parties but separately from his own assets.

The trustee is obliged to allow the beneficiaries (but not the settlor) and any protector, to have access to the records concerning the administration and management of the trust.

Protector

The protector is a natural or legal person who can be appointed by the settlor if he so wishes to monitor whether the trustee is fulfilling his obligations in accordance with the settlor's intent. The authority and the functions of the protector can be greater or smaller depending on the wishes of the settlor. This will be described in detail in the provisions of the trust.

Trust Deed

Formally, the trust must be created by way of a written instrument signed by the settlor and the trustee (the agreement of the trustee is not, however, necessary for the creation of the trust). In this trust document (trust deed), which is binding on the trustee, the provisions with respect to the administration and preservation of the value of the trust assets are stipulated in favour of the designated beneficiaries nominated.

Letter of Wishes

The settlor can communicate his wishes and guidance to the trustees by means of a letter of wishes. The letter of wishes is, in contrast to the trust deed, not legally binding and thus only represents an indication as to how the settlor wishes to have his trust administered. Essentially, the letter of wishes has only practical significance in the case of irrevocable and discretionary trusts.

Revocable/irrevocable trust

A difference has to be made between revocable and the irrevocable trusts. The latter are then divided into so-called discretionary and fixed interest trusts. It is essential for tax purposes to determine whether the settlor, on the creation of the trust, fully divests himself of his assets or whether he has reserved the right (legally or economically) to resort to the trust assets.

If the settlor establishes an irrevocable trust, he divests himself definitively of the trust assets, and in principle he basically has no more rights or duties in respect of those assets. Alternatively, the settlor can form a revocable trust. In general, there is no irrevocable divestment if the settlor has appointed himself as trustee or beneficiary. Furthermore, divestment is not recognised if the settlor retains any influence over the trust, in whatever form. The following factors (derived by way of example from the Federal Court's practice concerning family foundations) allow the distinction to be made between revocable and irrevocable trusts.

Can the settlor

- benefit from capital distributions from the trust assets?
- benefit from distributions of income of the trust assets?

Does the settlor have the right

- to remove the trustee and to appoint another one?
- to appoint or cause the appointment of new beneficiaries?
- to replace the protector who in turn has powers comparable to those of a trustee?
- to amend the trust deed or cause it to be amended?
- to revoke the trust?
- to require liquidation of the trust?
- to exercise a veto over the trustee's decisions with respect to the trust assets?

An affirmative reply to any one of the above questions will lead to the trust being treated as a revocable trust for tax purposes.

Revocable trust

In the case of a revocable trust, the settlor reserves the right to revoke the trust at a future date and to recover the remaining assets or have them transferred to a third party. The settlor has therefore not definitively divested himself of his assets.

For tax purposes, it is not the designation in the trust deed which is conclusive but rather the economic reality. A trust designated as «irrevocable» may also fall into the category of a revocable trust if the divestment is not absolute.

Revocable trusts become irrevocable trusts following the death of the settlor unless the right of revocation is exercisable by another person or is transferred to someone else.

Irrevocable fixed interest trust

In the case of a fixed-interest trust, the provisions relating to the beneficiaries and their respective rights are to be found in the trust deed. With this type of trust the trustee thus has no freedom of discretion in the distribution of the income and/or capital of the trust. The trustee has neither the economic ownership of the trust assets nor does he have any independent freedom of disposition over the assets. In setting up an irrevocable fixed interest trust, the settlor has definitively divested himself of his assets.

In contrast to the discretionary trust in which case the rights of the beneficiary are merely in the nature of an expectancy, the beneficiary of a fixed interest trust has a legally enforceable actionable claim to the assets. Consequently, the beneficiary of a fixed interest trust can be considered by analogy to be an usufructary.

Irrevocable discretionary trust

In general, the trust deed of a discretionary trust only includes a broad class of beneficiaries. The decision as to whether who, ultimately, is to receive distributions from the trust is left to the trustee.

The settlor may in a letter of wishes indicate to the trustee his reasons for creating the trust and can suggest to him, in a way that is not legally binding, how he would wish the trustee to exercise his powers.

If the settlor places particular importance on certain specific issues, it can be provided in the deed that certain decisions of the trustee require the prior approval of a protector.

When a discretionary trust is created, there is no enrichment of the beneficiary as it is not yet certain which persons will receive a distribution, and of how much and at what time. The rights of the beneficiary are thus merely in the nature of an expectancy.