

A New Twist on Private Trustee Companies

A private trustee company can provide savings, control, and privacy for clients who prefer not to place their assets with a trustee company owned by a financial institution. This article looks at how these entities operate in the Cook Islands.

Most offshore jurisdictions require a grantor to appoint a licensed trustee company to act as trustee of an offshore trust if the trust is to be domiciled in that jurisdiction. In some jurisdictions, however a client may form a separate offshore company (a private trustee company) for the special purpose of acting as trustee of his or her trust or trusts, instead of appointing a licensed offshore trustee company. There are many situations where it may be advisable for a client to form a private trustee company. The Cook Islands has special provisions ensuring that private trustee companies are easy to establish and operate, as well as being effective. Most importantly, in the Cook Islands there is no need to form a separate purpose trust to hold the shares of a private trustee company, as the different forms of corporate ownership of a Cook Islands offshore company make this extra entity unnecessary.

Reasons for Forming a Private Trustee Company

A licensed trustee company may be unwilling to act as a trustee of a client's trust, whether because of the litigation risk applicable to that client, or because of the nature of the asset to be held, or because of the investment activity planned by the client. The planned investment activity may involve the trustee in potential liability, or it may require on the spot decision making which is not practical with a trustee in another time zone.

Some trustee companies require complete control of the trust's investment activity without client participation. Furthermore, it is common for licensed trustee companies owned by financial institutions to require the investment of client trust funds in financial products of entities related to that financial institution, whereas clients normally want to have the right to choose the funds and products the trust will invest in, as well as the fund manager.

Often the only licensed trustee companies giving the client the security of being owned by a financial institution are exposed in jurisdictions such as the United States because of their worldwide links. The alternative of placing assets under control of an individually owned trustee company may not be comfortable for the client or his advisers, nor can this risk be negated by fidelity insurance. Some clients may not even want to disclose the affairs of their trust to the staff (often expatriate) of a licensed trustee company, particularly where the information is politically sensitive.

Finally, where a trust or a group of trusts has a substantial amount of activity, or where the trust assets themselves are substantial, a client can achieve savings by carrying out his own administration rather than have these activities carried out on a time cost basis or on a percentage fee basis by a licensed trustee company.

Problems with a Private Trustee Company

The principal issue is the consequence of the client owning the private trustee company, or having control over the activity of the private trustee company. In an asset protection environment, ideally the client should not have personal ownership or personal control of the private trustee company. In the event of a threat to the trust, the client must not be subject to court orders exposing the trust assets. Different tests must be met if there are tax or reporting issues.

To deal with these problems, a number of jurisdictions have developed special laws permitting non charitable purpose trusts.¹ A purpose trust (i.e. a trust that is created for a stated purpose rather than for stated beneficiaries) is permitted to be established with objects limited to holding the shares in the private trustee company. The client is thereby able to control the activity of the purpose trust and, indirectly, the private

trustee company. This “solution” does have some problems however. Purpose trusts are a creature of statute, and there is still some discussion about their effectiveness, particularly in dealing with the issue of ultimate beneficial ownership.² Further, there are the extra costs involved in maintaining an extra entity.

Private Trustee Companies in the Cook Islands

Establishing Nexus

The Cook Islands International Companies Act (1981-82) (ICA) contains special provisions for a client to form an international company (a private trustee company) for the purpose of acting as a trustee of an international trust, without being independently licensed in the Cook Islands as a trustee company. Before registering as a Cook Islands international trust, a trust must establish a nexus with the Cook Islands jurisdiction. Section 2 of the International Trusts Act 1984 (ITA) requires a trust to appoint either a licensed trustee company, or a Cook Islands international company, as its trustee. The international company is permitted to act as trustee for no more than three trusts, but otherwise must not carry on business as a trustee company.³

When forming a trust, therefore, the client can first incorporate his own specially structured international company. That international company is eligible for appointment as trustee of the client’s trust, making the trust eligible for registration as a Cook Islands international trust.

Structure of the Private Trustee Company

The structure of the international company will depend on the level of control the client wishes to exercise over the activity of the company, and thereby the trust. Control over an international company is normally vested in the shareholders and the directors.

Share Ownership

The share ownership alternatives in the Cook Islands include the following:

1. The international company can issue bearer shares to the client or his nominee.
2. The international company can issue “default shares” to the client or a nominated party.
3. The international company can be formed as what I call a purpose company, with no shares.
4. The shares of the international company can be held by

a licensed trustee company which exercises shareholders voting rights as nominee for the client.

Default Shares

The shares of a Cook Islands international company may provide that on the happening of any specified event (such as the commencement of litigation against the member) the membership interest of any member shall automatically vest in some other specified person or persons.⁴

Purpose Companies

A Cook Islands international company may be formed as a purpose company. After incorporation, the shares of the international company are forfeited by the company under a statutory process. The promoter of the company or his nominee is then issued with a perpetual bearer debenture the powers of which enable the bearer to effect appointment and removal of directors.⁵

Control of Management by Directors

There is a high degree of flexibility in structuring control over the international company. Control over the business of the company, and thereby the day to day business of the trust, rests with the directors of the company. The client may want himself or his personal advisors to be appointed as directors, or may request a licensed trustee company to provide the directors. The client may then want to have the directors approve his own appointment to manage the business of the international company, or may want to contract a licensed trustee company to carry out part of these functions.

Management of Private Trustee Company by Licensed Trustee Company

It is common for a licensed trustee company to provide certain management services to private trustee companies, in the same way as licensed trustee companies provide management services for offshore banks and insurers. This means that the client will be able to get the benefit of the licensed trustee company’s experience (particularly relating to keeping proper records and following procedures as a trustee to ensure there is no room for argument as to a sham) while retaining overall control. A licensed trustee company will normally be able to give a fixed quote for providing these services.

Number of Trusts

Each private trustee company may act as a trustee for up to

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three international trusts. This creates an opportunity for professional advisers to form a private trustee company which they can then have administered for groups of their clients.

Exit Strategy for Asset Protection Trusts

If a threat develops against the client, the client must be in a position where he cannot be forced to repatriate the assets of the trust. Cautious clients will not allow themselves to be in this position at any time, but the two shareholding structures described above are particularly suited to immediate transfer of any residual control without formality. In the case of the default shares, the shares can be issued subject to terms that vest the shares of the private trustee company in a licensed trustee company in the event of any threat against the client. In a similar situation with a purpose company, a cautious client can transfer the bearer debenture by simple delivery. If a change of jurisdiction is called for, then as an alternative to redomiciling the trust by a change of trustee, the private trustee company itself may be redomiciled.⁶

Establishment

The client must first form the international company in collaboration with a licensed trustee company, which appoints a resident secretary, provides the registered office for the international company, and often provides a director to attend to initial transactions. The international company can then be appointed as the trustee of the client's trust. The trust is then registered, with the licensed trustee company also being appointed as the registered office of the trust. The licensed trustee company will attend to the filing of the annual return for the international company and the annual renewal of registration of both the international company and the trust.

Taxation Consequences

No taxes are payable by either the private trustee company or the international trust of which it is appointed trustee.

Comparison with other Jurisdictions

A Cook Islands private trustee company structure has several advantages over similar structures in other offshore jurisdictions.

First, no Purpose Trust Required. In other jurisdictions the shares of a private trustee company must be held by a purpose trust to separate legal ownership by the client of the private trustee company. Although a purpose trust may be established in the Cook Islands, it is not necessary given the company structures available.

Another advantage is that no local appointments are required. In other jurisdictions a local person must be appointed as a trustee in addition to the private trustee company, or as a director of the private trustee company.⁷ These appointments add cost and give opportunity for disclosure. No such appointments are required in the Cook Islands.

Finally no audit is required in the Cook Islands. In other jurisdictions the accounts of the private trustee company must be audited annually. In the Cook Islands the need for an audit can be dispensed with by a shareholders' special resolution.⁸

An Illustration

John is a successful businessman in his late 50s. Although he has no known creditors, he is interested in offshore asset protection because he is concerned about potential risk from a new business venture. He is also not confident in the ability of his heirs to avoid litigation. He therefore wants to establish an asset protection trust in an offshore jurisdiction to serve as a nest egg for his own retirement, and to hold further assets for his heirs. John started a high risk investment portfolio five years ago. He directs the investment personally and has seen its cash value grow substantially. This portfolio is the asset he wants to settle on the asset protection trust. He intends to continue trading in high risk investments, and directing trading himself.

John has spoken to several offshore trust companies. Because of their potential exposure for calls as well as the risk of action by beneficiaries in the event of loss of capital, they are unwilling to act as trustee if John expects the trust to invest in high risk investments. Even if John changes to more conservative funds, they are not comfortable with him in effect being the manager. They offer to manage the funds for John on a percentage of funds under management basis (one percent), but he is not comfortable with giving control to a company outside the United States, run by people he has never done business with before, nor is he satisfied with the returns they offer.

John's attorney, Anna, recommends that John form his own private trustee company. Anna gives instructions to the trust company to form an offshore company with no shares. A bearer debenture is issued to Anna as the promoter of the offshore company, and she uses her powers under the debenture to appoint John as a director. The directors of the offshore company then pass resolutions authorizing the opening of trading accounts in the name of the offshore company as trustee, and approving the appointment of the offshore company as trustee of a trust to be settled by John.

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Anna then prepares an asset protection trust in the form of trust she is accustomed to using. The licensed trust company will not impose any requirements as it is not acting as trustee, although the instrument will have special asset protection provisions dealing with items such as duress, change of trustee, and appointing a standby trustee. The offshore company signs the trust as trustee, and the trust is sent to the licensed trustee company to register.

While John is in control of the offshore company, he must be careful to maintain its separate identity as a trustee to avoid any accusation that the structure is a sham. This requires John to maintain a certain level of administration, and he may wish to bring in another person in whom he has confidence to act as a director of the offshore company to promote this independent stance. The offshore company must keep separate minutes as trustee and must ensure that it enters into contracts in this capacity only. It will need to prepare its own accounts as well as separate accounts for the trust, and should prepare a formal report to the beneficiaries annually. Anna reviews these records with John annually.

In the event that John does come under threat of litigation at a later date, he can resign (or be removed by the debenture holder) as a director, and the bearer debenture can be delivered by Anna to the licensed trustee company which would also appoint its own nominee as new director. Alternatively the international company could be removed and the licensed trustee company appointed as trustee. Under Cook Islands

law, the trust would have survived through the limitation of actions period and would then be protected from litigation.

Conclusion

A private trustee company formed in the Cook Islands can form a useful and inexpensive part of a client's offshore structure, as well as provide a level of comfort for the client not prepared to surrender all control of his or her affairs to an offshore trustee. The structure is familiar to clients, easy to explain and understand, and has adequate safeguards in the event of a challenge to the trust assets.

Endnotes

- ¹ For example, Nauru, Bahamas, Bermuda, British Virgin Islands, Belize and more recently, Jersey.
- ² See "The New Trust; Obligations Without Rights" by Paul Mathews, Trends in Contemporary Trust Law.
- ³ Section 7(3) International Companies Act 1981-82 (Cook Islands).
- ⁴ Section 228B International Companies Act 1981-82 (Cook Islands).
- ⁵ Section 14(10)-(18) International Companies Act 1981-82 (Cook Islands).
- ⁶ Section 209 International Companies Act 1981-82 (Cook Islands).
- ⁷ Section 12(2) Trusts Act 1989 (Bermuda).
- ⁸ Section 117 International Companies Act 1981-82 (Cook Islands).