

# SOCIAL AND ECONOMIC BENEFITS OF TRUSTS



STEP  
Artillery House,  
11–19 Artillery Row,  
London, SW1P 1RT,  
United Kingdom

[www.steg.org](http://www.steg.org)

Telephone: +44 (0)20 3752 3700

Email: [step@step.org](mailto:step@step.org)

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STEP is the worldwide professional association for those advising families across generations. We promote best practice, professional integrity and education to our members. Our members help families plan for their futures: from drafting a will or advising family businesses, to helping international families and protecting vulnerable family members.

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# INTRODUCTION

Trusts have a longstanding tradition under English Common Law, most recently acknowledged by the UK government that stated in 2018 in its Taxation of Trusts consultation document, 'Trusts are an intrinsic part of the UK's legal system, and have been in use for centuries.'<sup>1</sup> The document also acknowledged that there are 'many circumstances throughout UK society in which trusts play a valuable role'. This is a theme prevalent in many jurisdictions, in both common and civil law, where trust-like structures can also be found.

As private legal arrangements, it can be difficult to source quantified, empirical evidence about the uses of trusts and the benefits they bring, both economically and socially.

The counter-evidence where trusts have been used for improper purposes or where trustees have abused their powers is more readily available and quantified. The story, often sensationalised, is based around those few cases that come to public attention.

The purpose of this work is therefore to draw together existing evidence and research about the ways in which trusts can be, and are, used for wider societal benefit, and how they impact every facet of society.

In part, this is about improving understanding and addressing common misconceptions, both by presenting the positive evidence base and by shining a light on how and why trusts are used.

It is for practitioners, regulators, policymakers and the public to determine how the use of trusts will evolve in future. In pulling together the available evidence, this report seeks to create a more detailed picture about trusts and how they are used, and to demonstrate the important role that they play in what may be very ordinary contexts.

# EXECUTIVE SUMMARY

Trusts have a longstanding foundation in the English common-law tradition, but they appear to remain subject to an external perception that they are available only to the super-rich or are used to hide assets or for other improper, if not outright illegal, purposes.

Most of the factual, thoughtful or philosophical articles, essays and reports about trusts open with historical anecdotes. This is not a quaint narrative artifice: it is a testament to their resilience and longevity. It shows an enduring reliance on the concept of trusts, whose origins are deeply rooted in principles of fairness and equity. Predicated on the protection of familial interests, they may seem irrelevant to the general public, but in reality, a material proportion of the population in the UK, for example, is likely to comprise beneficiaries of trusts, principally in the form of trust-based pension schemes.

The rationale behind trusts has been to serve the fundamental needs of the public. As a demand-led arrangement, the purpose and use of trusts has necessarily evolved over the years, reflecting changing asset bases, societal trends and digitalisation (which improves availability of information and widens accessibility). This evolution has not been masterminded by lawyers or accountants, but has demonstrably been demand-driven by individuals and families seeking to manage their assets both within and beyond their lifetime, and by companies seeking to use them for commercial purposes in support of their businesses, employees and clients. While a counterview might say that the wealthy minority has had undue influence on the accompanying legislative and regulatory framework, evidence suggests that this is not, in fact, the case and the use of trusts has had a much wider application.

In lockstep with this evolution, and in some cases leading it, such as with the Goode Report<sup>2</sup>, and

the passing of the *Pension Schemes Act 1993*; and the *Pensions Act 2008* in the UK, the widespread use of trusts to hold pension funds has made the benefit of using trust arrangements available to the wider public<sup>3</sup>.

Alongside this evolution, governments and regulators have constantly endeavoured to ensure the neutrality of trusts, by keeping track of tax and transparency implications and making necessary adjustments. Some of the key examples of these regulations (evolving to address the issues of the time) are national legislation such as the UK *Trustee Act 1925* (updated by the *Trustee Act 2000*) and international conventions such as the Hague Trust Convention of 1985.

Trusts are, and have long been, an integral component of the financial services landscape. This means that trusts are generally subject to the same (and in some cases more) rigorous scrutiny and regulation as companies. This level of regulation and transparency has evolved over time and is designed to ensure that trusts cannot be used for the purpose of hiding assets or concealing beneficial ownership from tax or regulatory authorities. This is clearly demonstrated by the adoption of the international automatic exchange of information agreements and the introduction of trust registers and new robust anti-money laundering and counter terrorist financing legislation. There are now almost 200 signatories to the Financial Action Taskforce's (FATF) new, tougher standards that in 2012 called for countries to better identify beneficial owners (real ultimate owners and controllers) behind companies and, separately, arrangements such as trusts. The relevant FATF guidance to trust and corporate service providers was comprehensively updated in 2019<sup>4</sup>.

There is no evidence that trusts are more likely to be used for illegal or improper purposes than

<sup>2</sup>[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/272069/2342\\_ii.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/272069/2342_ii.pdf)

<sup>3</sup>Law Commission, *Pension Funds and Social Investment*, 2017

<sup>4</sup><http://www.fatf-gafi.org/media/fatf/documents/reports/RBA-Trust-Company-Service-Providers.pdf>

any other part of the global financial system. In fact, the evidence suggests they are less likely to be misused than, for example, shell companies. The NGO Transparency International UK in its report 'Hiding in Plain Sight' expands on this by highlighting the extensive ways shell companies are misused and stresses that it is important to avoid the assumption that shell companies and trusts are the same thing. The report uses the US Treasury's Financial Crimes Enforcement Network definition of a shell company as a 'non-publicly traded corporation, limited liability company (LLCs), or trust that has no physical presence beyond a mailing address and generates little to no independent economic value.'<sup>5</sup>

By their nature, many trusts are private undertakings. This does not in itself make them inherently bad, or more susceptible to misuse. When considering the EU Fifth Anti-Money Laundering Directive<sup>6</sup>, there appears to have been an acknowledgement that when assessing the risk of money laundering and terrorist financing in legal entities such as companies and legal arrangements such as trusts, the risk assessment relates to the nature of the activity and not the structure as such. The implication being that there was no greater risk associated with trusts.

Notwithstanding this, provisions in the EU Fifth Anti-Money Laundering Directive that include the requirement to identify all beneficiaries and related parties are more onerous for trusts than for companies, as companies are only required to identify beneficial owners in excess of minimum percentage thresholds (25 or 10) whereas trusts need to identify any beneficiary regardless of their interest in the trust. Additionally, particularly in the UK, which has gold plated and gone beyond in its implementation of the various EU money laundering directives, regulation is very stringent.

Because trusts often take the form of private legal arrangements, we have found there to be little empirical, quantified evidence as to the benefits they bring. This means public perception may be skewed by sensational,

scandalous or celebrity stories that reach the mainstream news. These often involve more convoluted shell company and offshore arrangements, but trusts are tarnished by association and the sense of scandal and secrecy perpetuates the idea that these arrangements are the sole purview of the rich elite and ignore their everyday uses by the rest of society.

In fact, trusts form key parts of the very fabric of modern society, performing vital functions to serve the social and collective good. At their heart (from education to charities, from home ownership to retirement and protection of the elderly and vulnerable) they ultimately provide a means of ensuring flexibility and control over financial assets and specifying how future generations should be allowed to use them. Trusts touch every aspect of life ranging from giving young people from disadvantaged backgrounds the opportunity to obtain an education; supporting in the fight against COVID-19 (Bill & Melinda Gates Foundation); giving people the chance to enjoy a comfortable retirement through occupational pension schemes; and allowing minors whose parents have died, or people with disabilities, to be supported through the use of trusts for vulnerable beneficiaries.

This report goes on to explore the existing evidence and research about the ways in which trusts can be, and are, used for wider societal benefit.

<sup>5</sup>Transparency International UK, *Hiding in Plain Sight*, 2017

<sup>6</sup>The Commission Staff Working Document Accompanying the document 'Report from the Commission to the European Parliament and the Council' date 24 July 2019

# THE CHANGING FACE OF TRUSTS

## OVERVIEW

### What are trusts?

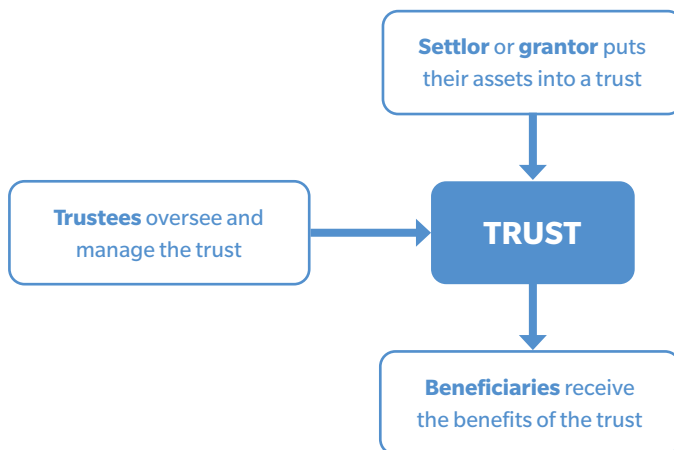


Fig 1. Basic trust structure

A trust generally involves three parties (see Figure 1); the settlor or grantor (the original owner of the asset) sets up the trusts and commits to formally gifting certain assets into the trust. The trustees assume the job of managing and overseeing the trust assets. They do this for the benefit of the current and often future beneficiaries. The trustees have a fiduciary relationship<sup>7</sup> with the beneficiaries, meaning they are obliged to put the beneficiaries' interests above their own. They are also the legal owners of the assets in the trust.

Trusts allow for flexibility and control over where, when and under what conditions someone's assets are used to provide a benefit for someone else.

## History

In one form or another, trusts have been around for centuries. In charting their history, we consider three key inflection points that shaped their evolution and acted as significant milestones.

Several claims exist that a form of trust goes back to ancient Greek and Roman times. However, trusts in the sense of the modern understanding first arose in the Middle Ages at the time of the Crusades. Crusaders would leave their families for long periods of time while on Crusade. During this time, their

wives and children (who could not hold property themselves) would be reliant on income from the crusader's estate. To ensure this was handled properly, a departing crusader would sign over his property to someone else on the understanding that upon the crusader's return, the new owner would return the property. The origins of trust law have their roots in this distinction between the concepts of legal and equitable ownership and the moral obligations of church law that arose from this period.

Moving forward, the *Statute of Uses 1536* was one of the first written documents that concerned trust law. It was drawn up because Henry VIII was concerned about his tax revenues from land. This structure was expanded on by Lord Denning in his judgment on *Hussey v Palmer (1971)*. Where he stated, 'By whatever name it is described, it is a trust imposed by law whenever justice and good conscience require it. It is a liberal process, founded upon large principles of equity, to be applied in cases where the legal owner cannot conscientiously keep the property for himself alone, but ought to allow another to have the property or the benefit of it or a share in it. The trust may arise at the outset when the property is acquired, or later on, as the circumstances may require. It is an equitable remedy by which the court can enable an aggrieved party to obtain restitution.'<sup>8</sup>

<sup>7</sup>Fiduciary relationship – relationship in which one party places special trust, confidence, and reliance in and is influenced by another who has a duty to act for the benefit of the party

<sup>8</sup>Stephens, *The Jurisprudence of Lord Denning: A Study in Legal History, in Three Volumes*, Volume 3, 2009, pp141& 222

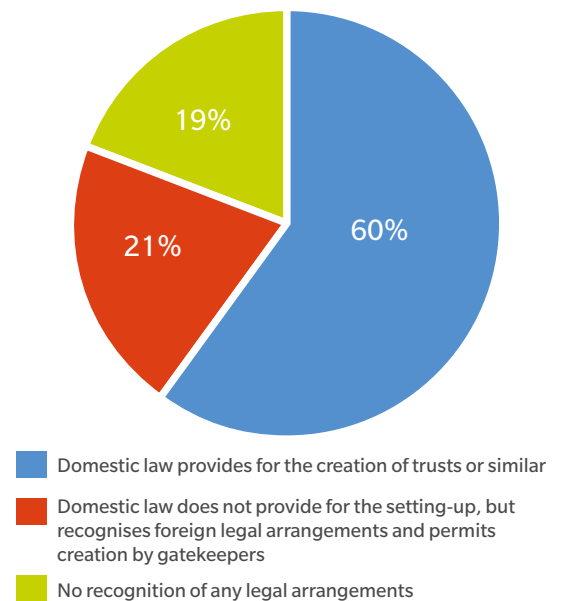
A significant turning point was the development and growth of discretionary trusts through the 20th century. Discretionary trusts give the trustees power to make decisions on areas such as what gets paid out (income or capital); to which beneficiary should payments be made; and how often payments are made.<sup>9</sup> The beneficiaries have no fixed rights, merely a right to be considered for a payment or benefit. This flexibility is particularly important where one beneficiary may need more financial help than another or where a person wants to leave property to a beneficiary who is not capable of dealing with the property themselves.

Discretionary trusts became popular in England and Wales in the 1970's after the case of *McPhail v Doulton* [1971] AC 424, where it was found that as long as any given claimant could clearly be determined to be a beneficiary, or not, a trust was valid. As under a discretionary trust, no one beneficiary could be said to have title to any trust assets prior to a distribution, this made discretionary trusts popular in tax planning.<sup>10</sup> These benefits however were restricted by the Finance Acts of 1975 and 1988, which imposed a capital transfer tax on any property settled on a discretionary trust, which was then replaced by an inheritance tax.

A more modern turning point is the Hague Trust Convention, concluded in 1985. Trusts are well known and defined in common-law countries. However, disputes can arise where a trust holds assets and the settlor, trustee or beneficiary is resident in a country that does not recognise trusts in the same form. These types of disputes became increasingly prevalent with the exponential growth of the financial system across borders. Families that held property in different jurisdictions through trusts would run into lengthy disputes about ownership upon a family member dying. The Hague Trust Convention assured cross-border acceptance and described the features a trust has to possess in order to be regarded as such. To date, it is effective in 14 countries, including the UK and its overseas territories and crown dependencies, the USA, Australia, Canada, Cyprus, Italy, Liechtenstein, Luxembourg, Malta, Monaco, Netherlands, Panama, San Marino and Switzerland.<sup>11</sup>

Figure 2 shows that in 2018, 81 per cent of the 64 jurisdictions surveyed by FATF and the Egmont Group have legal arrangements in place for setting up trusts or similar structures, or recognise these through different arrangements, like the Hague Trust Convention.

Fig 2. Percentage of jurisdictions on domestic trust creation<sup>12</sup>



These three isolated pointers help illustrate a pattern in the evolution of trusts. First, that they are rooted in a tradition of equity or fairness. Second, their inherent characteristics were designed to allow them to respond to societal changes. Third, both the judiciary and the legislature have influenced the development of trusts to enable them to be used in ways that benefit society, leading to a historical piecemeal approach to regulation.

## Changes over time

'If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer to give than this, namely the development from century to century of the trust idea.'<sup>13</sup>

Considering the inherent flexibility of trusts and their longevity over more than 700 years, there are two notable historical changes that differentiate a classical trust from a modern one and show how they have evolved following socio-demographic trends.

First, the type of assets placed in trusts has changed. Historically, trusts mostly concerned land, which has been long associated with the wealthy in society. However, when societies evolved and the agrarian economy (in which land was almost always a pre-requisite for wealth), changed to an industrial economy, sources of wealth also changed. National wealth increasingly became focused on cash, shares, bonds and other tradable securities. New self-made

<sup>9</sup><https://www.gov.uk/trusts-taxes/types-of-trust>

<sup>10</sup>McDonald & Street: *Equity & Trusts Law Concentrate*, 2009

<sup>11</sup><https://www.hcch.net/en/instruments/conventions/status-table/?cid=59>

<sup>12</sup>FATF & Egmont Group, *Concealment of Beneficial Ownership.*, 2018

<sup>13</sup>Maitland, 1911, p.72



classes of merchants and industrialists arose, who were equally keen to transmit and preserve their wealth in the same way as previous landowners.<sup>14</sup>

The second change concerns the role of the trustee. Classically (around the 17th Century), a trustee was more likely to be a name on the legal documentation with no day-to-day participation in the trust, rather than actively administering and overseeing it. In a modern trust, the trustee is required to administer the trust, for example by controlling the oversight and management of the trust assets solely in the interest of the beneficiary.<sup>15</sup> Contrary to popular belief, as described in Lewin on Trusts, trustees also bear financial liability for the mismanagement of assets; trustees have a fiduciary duty to act in the best interests of the beneficiaries.<sup>16</sup> If a trustee does not take reasonable care in making a decision that loses money for the trust, the trustee may be personally liable<sup>17</sup>.

These changes do not undermine the underlying principle that, at their heart, trusts offer a means of managing and transitioning assets between generations. The role of family trusts has become

more pronounced due to shifts in societal and familial trends. This has been particularly noticeable in relation to the role of family trusts and trusts in general in regard to charitable giving, which has seen a noticeable increase during the COVID-19 pandemic of 2020.<sup>18</sup>

Globalisation has arguably led to an increase in globally dispersed families and their assets, who use trusts to help manage their finances responsibly. It is far more common now for families to live in, and own properties in, a number of different countries. Combined with the Hague Trust Convention that standardises trusts and assures mutual recognition across borders, trusts are an effective instrument for this purpose.

Since the ending of exchange controls, an increasing number of UK citizens own homes in Italy. Prior to the Hague Trust Convention, there was legal uncertainty about the prevailing law. For example, if the owner were to draw up a UK will (i.e. in England and Wales, Scotland or Northern Ireland) and appoint solicitors as trustees to hold the property and pay the income to the owner's children, there may have been doubt

### Trust structures in civil-law countries

Several civil-law jurisdictions have many trust-like structures that are based on Roman institutions such as the *fiducia* or *fideicommissum* or the *usufruct*. For example, the Italian *fondo patrimoniale*, allows for parents to set aside funds for a child to which potential creditors of the parents do not have access.

The Netherlands and Germany know other similar trust-like structures, called *stichting* and *stiftung* respectively, which roughly translate to 'foundation' and have similar attributes. They are all legal entities and can hold property, claims and can be liable (neither of which is always the case for trusts). They are set up by a founder, and usually governed by a board for a specific purpose. They can receive donations with a tax benefit for the giver and are usually set up for charitable purposes. However, they have also been used to manage family wealth.

In the Netherlands, regulation has made a *stichting* 'see-through', as the estate is attributed to the settlor. Since September 2016, the *stichting* needs to show material and operational activity for a special purpose, and checks and balances have been put in place to identify the origin of the assets.

Stichting INGKA Foundation owns the private Dutch company INGKA Holding that is the holding company for 315 out of the 360 IKEA outlets. This structure was created in 1982 for tax efficiency reasons, but also protects the company from takeovers and provides the founding Kamprad family with long-term control. This has been covered in greater detail in the following Economist article (<https://www.economist.com/business/2006/05/11/flat-pack-accounting>). Similarly, the majority of the Danish Carlsberg Group is owned by the Carlsberg Foundation, which was created when J.C. Jacobsen, Carlsberg's founder, reallocated shares to operate the Carlsberg Laboratory and the natural history museum at Fredriksborg Palace. His will stipulated that the foundation should always own at least 51 per cent shares of the brewery.

Property in France is often held in a usufruct by the bare owners for the benefit of the usufructuary during their lifetime.

Similarly, in most civil law jurisdictions, marital property may automatically be held by one spouse for the benefit of both spouses in a matrimonial property regime

<sup>14</sup>Lau, 2011

<sup>15</sup>Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?, *The Yale Law Journal*, 2005

<sup>16</sup>Lewin on Trusts, 20th ed, 2020

<sup>17</sup>*Capital and Income in Trusts: Classification and Apportionment*, Law Commission, 2009

<sup>18</sup><https://blog.step.org/2020/05/26/the-covid-19-crisis-prompts-a-rash-of-philanthropic-giving/>

about enforcing the trustee's responsibilities and whether this was even permissible under Italian law (given that the trustee is not the legal owner). With mutual recognition enshrined in The Hague Trust Convention, it permitted trusts to be recognised in certain cases under Italian law.

Across the globe, we also see a much more diverse 'family' concept, which in turn has prompted families to set up trusts to govern the use of assets, particularly when the law governing these new 'blended families' lags what is happening in practice. For example, a parent may choose to set aside assets for their children in case they pass away. If their surviving partner remarries, the assets cannot be claimed by the new family members. They can also be used to support people treated as family members but who may not fit the norms still required under traditional laws, such as surrogate children or co-habitees.

Simultaneously, we see an ageing demographic across the globe, but mostly in Western societies. Trusts cater for this trend in two ways. First, they are used by those wishing to plan ahead for their own retirement, acknowledging the importance of private savings given the increased pressure on public pension provision. In addition, younger generations can use trusts to set aside finances as a guaranteed way of caring for their elderly family members. Individuals of advanced years or those facing the prospect of declining capacity earlier in life for any reason can also establish trusts to ensure their assets are suitably protected to provide for their own future lifestyle and care/medical needs. Trusts therefore allow people to ring-fence their assets to allow piece of mind. This use of trusts, to provide security and certainty for the family, is the mostly widely cited reason behind their establishment.

Trusts have also become visible to the mainstream public, as the populace has become more informed and financially literate, supported by the wave of digitalisation and the growing demand for information on demand, which has allowed them to see the fundamental, every day uses of trusts and how they benefit through them.

General economic developments see a rise in considering the consumer as the focus point of a business, making the 'customer experience' key to business outcomes with the phrase 'the customer is king' influencing many companies' mentalities. Knowing the customer, and getting personal with the customer, will be increasingly important for all

industries.<sup>19</sup> As trusts have become more mainstream and available to everyone, they have also adapted to this philosophy. This can be evidenced especially in the form of occupational group pension schemes advertising their services and acting in a manner to allow them to gain and maintain beneficiaries in the form of the participating companies and individuals.

## Trusts in numbers

There is significant variance in how the existence of trusts are reported worldwide. As legal arrangements, rather than legal entities, there is no holistic, globally harmonised obligation to report the value and volume of trusts. Nor has there ever been felt a need to do so. In the UK, for example, trusts were initially only required to register when they generated tax consequences. Reporting standards are changing, however, in line with a growing drive for transparency, not least with the implementation of the EU's Fifth Anti-Money Laundering Directive from January 2020, with the relevant regulation being laid in September 2020, the number of trusts required to register will substantially increase.<sup>20</sup>

The currently available data (which may be incomplete and is not necessarily comparable between jurisdictions) tells us that:

- The 2015 National Risk Assessment estimates that an estimated 1.5-2 million express trusts are administered in the UK.<sup>21</sup> This figure includes both commercial trusts (such as commercial pension schemes) and personal trusts (such as those that provide family support). However, a recent survey by STEP suggests that the figure is likely to be much higher, with the feedback showing that the estimated number of personal trusts alone stood at over 2 million.<sup>22</sup>
- The Australian Tax Office estimates that there are 850,000 trusts in Australia (with almost AUD385.7 billion in value).<sup>23</sup>
- New Zealand had 11,671 foreign trusts registered in 2016.<sup>24</sup> Overall New Zealand is estimated to have between 300,000 and 500,000 trusts and as such they are considered an important part of New Zealand society and the economy.<sup>25</sup>
- In Hong Kong, the estimated net value of what was held in Securities and Futures Commission authorised trusts was USD132 billion in March 2017.<sup>26</sup>

<sup>19</sup>PWC, *Consumer Demand for Personalisation*, 2019

<sup>20</sup>HM Treasury, *Consultation Trust Registration Service*, January 2020

<sup>21</sup>HM Treasury, *NRA of Money Laundering and Terrorist Financing*, 2017

<sup>22</sup>www.step.org/step-journal/step-journal-march-2019/step-data-maps-uk-trust-industry

<sup>23</sup>ATO, *Taxation statistics 2016-2017 - Trusts*

<sup>24</sup>New Zealand Government, *Government Inquiry into Foreign Trust Disclosure Rules*, June 2016

<sup>25</sup>www.justice.govt.nz/justice-sector-policy/key-initiatives/trust-law-reform/

<sup>26</sup>This last figure also includes SFC-authorised mutual funds. KPMG, *Hong Kong Trust Industry Spotlight*, October 2017

## USES OF TRUSTS

While there is little quantifiable evidence on the specific economic impact of trusts themselves, there are myriad examples of their association with many of the key drivers of productivity and growth, like education, homeownership or setting up a business.

### Succession planning

Succession planning is one of the most well-known uses of trusts. It is the overarching use of trusts that supports the different drivers of economic growth and it is an option that is increasingly available to all.

Passing on assets across generations is nothing new to all strata of society, and bequests have always been subject to tax. If we look at taxation rates, we see a steep decline in the so-called 'death tax'. The estate of an American is nowadays 95 per cent less likely to face tax than in the 1960s, and in the UK today less than 5 per cent of estates are taxed. Within the OECD countries, tax revenues from inheritance tax have also fallen.<sup>27</sup>

There are many reasons a person may want to specify how their assets are used after their own death. People may want their money to go to causes, people or charities that they care about when they pass away. Alternatively they may want to protect minor children or those not felt capable of managing the assets, but needing an income or somewhere to live. A will trust is the most common way of arranging this and comes into force upon someone's death. The will trust specifies what needs to happen with particular parts of the estate, it names the trustees and beneficiaries, and sets out what should happen with the trust.

For example, a settlor would be able to put provisions in place that in case of their early demise would financially support their dependents, in particular any minors, and protect any assets (such as a house) for the beneficiaries. Additionally, as there is an increasing commonality for complex and blended families, there is a need for an arrangement where the financial needs of a second spouse can be balanced against the financial needs of, or the desire to pass property to, children from a first marriage. In this case, a trust offers a way of enabling on-going administration by trustees providing for financial support for a second spouse, while ensuring that the property ultimately passes to the children of the person making the will in accordance with his or her wishes, or otherwise allowing his or her dependents with different interests to be supported.

In the US, using a trust rather than a will provides several advantages. The execution of a will is subject to at times lengthy probate<sup>28</sup> procedures, whereas a trust is not. US probate is costly. In California, attorney fees are mandated by state statute, in tiered thresholds according to the gross value of the probate estate.<sup>29</sup>

To probate a USD400,000 estate in California costs around USD22,000 and an USD800,000 estate around USD38,000. It can take between nine and 18 months, at times even longer, before a probate case is completed.<sup>30</sup> This can be a lot more expensive than using a trust (see Table 1 on page 18).

In the US, a trust can be a will substitute and can be executed by the trustees without probate procedures. Another perceived benefit is that a trust remains private, whereas a will, because of probate procedures, becomes part of the public record. This often is a factor for those who want to preserve family privacy for security or other reasons.

A less well-known but very common use of a trust structure for family purposes, is a life insurance policy written in trust. These policies can be written into trusts by insurance providers (or solicitors), meaning that upon the settlor's death, the money goes directly to the beneficiaries, without lengthy probate procedures and without tax. Another simpler form of trust arises in the sphere of death in service benefits, where some employers permit an employee to name individuals to whom the employer would pay out the death in service benefit as a tax-free amount if the employee died while working for them.

### Education

*Education is a leading determinant of economic growth, employment, and earnings. For every USD1 spent on education, as much as USD10 to USD15 can be generated in economic growth.*<sup>31</sup>

Worldwide, universities are increasingly expensive, while governments are providing decreasing levels of financial assistance. In the US, student loans are the biggest (USD1.4 trillion) share of US non-housing debt (USD3.8 trillion), which can be attributed to the increase in the cost of education.<sup>32</sup> The cost of university per student has risen by almost five times the rate of inflation since 1983.

Combined with a lack of wage growth, younger generations are increasingly struggling to pay off such debts. And there are very few indications that the cost of education is declining any time soon.

<sup>27</sup>Economist, *A hated but a fair one*, November 2017

<sup>28</sup>Probate – the granting of probate is the first step in the legal process of administering the estate of a deceased person, resolving all claims and distributing the deceased person's property under a will.

<sup>29</sup>California Probate, Article 2, Code 10810

<sup>30</sup>California Courts, *Wills, Estates and Probate*, February 2020

<sup>31</sup>UNESCO, 2012

<sup>32</sup>Maldonado, 2018

Historically, education has been for the few, not the many. As an instrument of collective ownership or of financial distribution, trusts have supported a shift in this attitude. Many scholarship plans are held in trust structures, with the grantor or settlor being a member of a wealthy family, a business or another organisation like a non-governmental organisation (NGO), who put assets into a scholarship trust with the aim of helping the disadvantaged. The beneficiary is the student receiving the scholarship, whereas the trustee usually consists of a committee that assess the scholarship applications and award the grants on merit-based principles.

One famous scholarship held in trust is the Cambridge Trust, for study at the University of Cambridge in the UK. It currently provides the largest number of scholarships for international students at Cambridge. However, there are many smaller less well-known trusts that provide similar support. For example *The Guide to Educational Grants 2020/21* notes that it 'contains over 800 sources of non-statutory financial help for people in education, offering a total of GBP47.2 million each year'.<sup>33</sup> Many of these resources will be held in trust.

Privately, families are also using trusts to manage their children's educational future. Parents can allocate money in specific education trusts, which their children can only use for educational purposes, safeguarding it against being frittered away.

In the UK, schools can have the option to work with a trust to receive extra financial support. These so-called foundation or trust schools are government-funded, and supported by a charitable foundation or trust, which appoints governors to the school's governing body. In this way, individuals, businesses or community groups can flexibly support their local schools and through them the local community. Compared to a straight donation, it gives the settlors more control over how the money is spent and, for the school, can be vital in allowing it to operate efficiently and to effectively support its students.

## Buying a home

*Access to affordable and quality housing is central to community wellbeing. Apart from meeting the basic need for shelter, it provides a foundation for family and social stability, and contributes to improved health and educational outcomes and a productive workforce. Thus, it enhances both economic performance and 'social capital'.<sup>34</sup> After correcting for income and other influencing factors, data shows that the math*

*achievement for children in owned homes is up to 7 per cent higher, and their reading achievement is up to 6 per cent higher.<sup>35</sup>*

Until 2004, most OECD countries saw a steady increase in home ownership.<sup>36</sup> This trend has since reversed, especially among young people across all OECD countries. 'In 1995-96, 65 per cent of those aged 25-34, with incomes in the middle 20 per cent for their age, owned their own home. Twenty years later, that figure was just 27 per cent.'<sup>37</sup>

Increasing levels of home ownership has long been a key policy goal in many OECD countries. These policy goals are driven by the belief that home ownership contributes to economic growth. It is linked to better educational outcomes for children, but also to higher future income prospects and stronger community engagement. It is also well known as an instrument for wealth accumulation.<sup>38</sup>

There are several ways in which trusts support a wide variety of people's home ownership aspirations. First, parents (or grandparents) can set up a trust to provide their child (or grandchild) with funds that can be used as a deposit for a home or provide a loan or other financial support so that their children/grandchildren will, in the future, be able to afford their own home. Holding such money in trust ensures that it is not spent on anything else, can be used for the child or grandchild in the most flexible way and the money or home will be protected in the event of bankruptcy, illness or other unexpected life events.

In simpler circumstances, in the UK, trusts are used where individuals jointly own a property, which enables the individuals to clearly define differing interests to reflect their economic contribution.

Trusts are also often used as a means of collective ownership. An example is Community Land Trusts (CLTs). These are a US invention and have provided a form of home ownership for many who otherwise would not be able to afford a home.

The CLT model was adopted in federal law in 1992, as part of the *Housing and Community Development Act 1992*. The CLT buys land with the intention to retain it forever and build houses on it. A household buys into a CLT and can often get down-payment assistance and low-interest mortgages from the trust. The trust members appoint board members to democratically determine the community's priorities. Houses are kept affordable, because the board members can decide

<sup>33</sup><https://www.dsc.org.uk/publication/guide-educational-grants-2020-21>

<sup>34</sup>Australian Productivity Commission (2004, p3)

<sup>35</sup>Haurin et al, *The Impact of Home Ownership on Child Outcomes*, 2002

<sup>36</sup>OECD, *The Evolution of Homeownership Rates*, 2011

<sup>37</sup>The Institute for Fiscal Studies, *The Decline of Homeownership among Young Adults*, 2018, p3

<sup>38</sup>OECD, *The Evolution of Homeownership Rates*, 2011

to limit the amount of appreciation that would go to a homeowner. At times, a trust collects a percentage of sales to support new families buying into the CLT.

In 2016, the UK government committed GBP300 million to community-led housing, building over 5,000 affordable homes.<sup>39</sup> In the UK, there are around 5 million people living in approximately 2 million affordable homes administered by 1,500 housing associations, which provides affordable housing for all and are administered in structures reflecting their origins as housing trusts.<sup>40</sup> Since 2016, CLTs have arrived in the UK, and have been positioned by some as a potential the solution to the current housing crisis.<sup>41</sup> Figures from the National CLT Network show that there are currently 290 CLTs in the UK, with half of them being established in the past three years. In 2019, there were 23 homes as part of the London CLT and it is looking to increase this to 143 by 2021.

Numerous research studies have identified that home ownership has significant societal benefits, such as boosting the educational performance of children, inducing higher participation in civic and volunteering activity, improving healthcare outcomes, and reducing crime rates and welfare dependency.<sup>42</sup>

Research also shows that home ownership has a positive impact on both physical and psychological health. Rohe and Stewart (1996) found that as homeowners glean both an economic and personal (sense of ownership and pride) interest in their properties, this provides powerful incentives for owner-occupants to maintain their properties at a higher standard.<sup>43</sup> This links in with research from Krieger and Higgins (2002) who found that there is a strong causal relationship between living in poor housing and a range of health problems, including respiratory conditions such as asthma, exposure to toxic substances, injuries and mental health.<sup>44</sup>

## Marriage and divorce

*'In the US, in 2014 only 46 per cent of children lived with two parents in their first marriage, compared to 73 per cent in 1960.'*<sup>45</sup>

Across the globe, more and more people are part of 'non-traditional' families, e.g. divorced with children, second marriages, single parents or same-sex

couples. Children are increasingly likely to experience a variety of family arrangements because of increases in divorce rates, cohabitation, remarriage and even surrogacy.<sup>46</sup> Given these trends, families can use trusts to set assets aside for the future and protect their wider and fluid family's interests.

Until recent legislative change (in certain places) on same-sex marriage, trusts were used to bridge the mismatch with legislative provisions afforded to heterosexual couples. 'Same-sex couples must create the legal rights and privileges that married couples are afforded by statute through the use of estate planning tools such as wills, trusts, family limited partnerships, and other business entities.'<sup>47</sup>

Trusts remain an attractive instrument to provide for children. They can help transfer assets and protect the surviving spouse. An advantage is that a lifetime trust may be less contestable than a will, which in the case of internal division or disagreement among surviving family members can be advantageous and ensure that the assets will be available to meet different needs of the surviving family members.<sup>48</sup>

Trusts can provide certainty during a divorce settlement. Often the house is the most valuable asset in the family, but also the hardest to divide, especially with young children in the mix. A trust can be set up that allows one of the spouses to remain living in the house until the children are of age, when the house can be sold and proceeds divided. In this example, the trust offers certainty and stability for the children by deferring the sale of the family home and the division between the divorcing spouses.

## Building a business

*'Small Medium Enterprises (SMEs) represent about 90 per cent of businesses and more than 50 per cent of employment worldwide. In emerging economies, they contribute up to 40 per cent of GDP.'*<sup>49</sup>

A common purpose of trusts worldwide – but perhaps most notably in Australia and Canada – is setting up trusts for the purpose of carrying on a family business.<sup>50</sup> In Australia, a number of businesses are set up as trusts as it allows them to take advantage of a 50 per cent capital gains concession and offers asset protection in the case of the business going bankrupt.

<sup>39</sup>Barker, 2019

<sup>40</sup>[https://www.ourproperty.co.uk/guides/housing\\_association/](https://www.ourproperty.co.uk/guides/housing_association/)

<sup>41</sup>Wainwright for The Guardian, *The radical model fighting the housing crisis: property prices based on income*, 2017

<sup>42</sup>National Association of Realtors, *Social benefits of homeownership and stable housing*, 2016

<sup>43</sup>Rohe & Stewart, *Homeownership and neighbourhood stability*, Housing Policy Debate, 1996

<sup>44</sup>Krieger & Higgins, 'Housing and health: time again for public health action', *American Journal of Public Health*, 2002

<sup>45</sup>Pew Research Center, *Parenting in America*, 2015

<sup>46</sup>Pew Research Center, *Parenting in America*, 2015

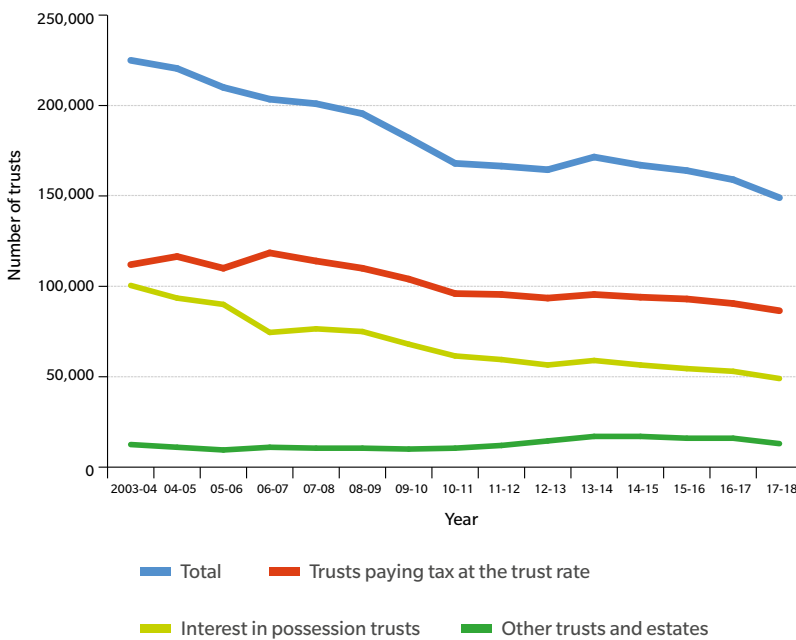
<sup>47</sup>Quinn and Baker, 2004, p.498

<sup>48</sup>Bouchard and Zadworny, 2008

<sup>49</sup>The World Bank, *SMEs Finance*

<sup>50</sup><https://www.smallbusiness.wa.gov.au/business-advice/business-structure/trust>

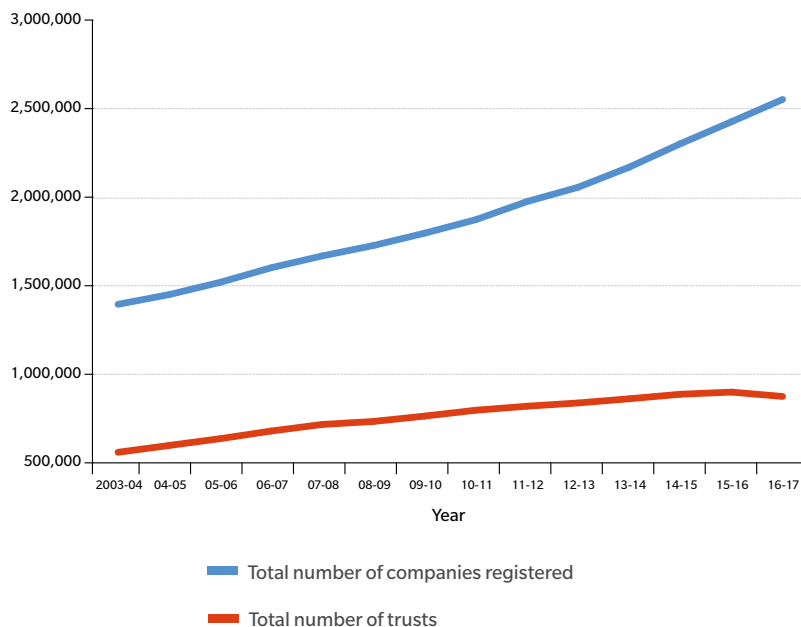
Fig 3. The number of UK trusts and estates that make a full Self-Assessment return<sup>51</sup>



Business trusts play a significant economic role in Australia where they are a common instrument used for setting up a business. Compared to the UK, where the use of trusts has declined by 29 per cent over the past 12 years<sup>52</sup> (see Figure 3), Figure 4 shows that Australia has seen a 63 per cent uptake in the amount of trusts between 2004 and 2017 and their total business income value increased by 56 per cent.<sup>53</sup> In 2017, the Australian government puts the number of trusts at a total of 874,874, with a total business income value of AUD385,667 million.<sup>54</sup>

Australia historically has had a high number of family businesses held in trusts, which have been encouraged due to the strong agricultural history of Australia and the political power landowners/farmers have wielded throughout its history. For this reason it has been in the government’s interest to protect and maintain the integrity of Australia’s farms.<sup>55</sup> Trusts have been encouraged for family businesses not just for taxation reasons but because they also help manage succession and related estate-planning issues; provide a mechanism to retain control of the intact business within the family for future generations, and provide asset protection.<sup>56</sup>

Fig 4. Australia: Total number of recorded trusts vs registered companies<sup>57</sup>



Where trusts are used as a way of creating companies, they are also used to plan for succession of family businesses. It is estimated that 70 per cent of family businesses do not make it from founder to the next generation.<sup>58</sup> A trust can facilitate the transition and focus control in the business driver or lead, yet provide for other family members. For example, a business owner can set up a revocable living trust that can establish an advisory board when the owner passes, to manage the business during transition. Or when more than one child is active in the business, but it is unclear which should have control, the owner can hold on to the voting shares until the decision is made, and a trust can be set up to provide direction in case the business owner passes before transferring voting shares.<sup>59</sup> Without these measures, a company can suffer from lack of control for a significant amount of time, which increases the risk of ultimate failure.

There is increasing evidence of investment trusts that specifically target small and medium-sized enterprises (SMEs). There is plenty of evidence to show that smaller companies outperform large over the long term in most major markets. In 2018, the European

<sup>51</sup>HMRC, *Trust Statistics*, 2019

<sup>52</sup>*The Gazette*, Number of trusts and estates in the UK drops by 6%, 2019

<sup>53</sup>Australian Taxation Office, *Taxation Statistics – Trusts*, 2019

<sup>54</sup>*Ibid.*

<sup>55</sup>Lennox & Curtis, *Rural Landownership in South East Australia since European Occupation*, Australian Geographer, 2013

<sup>56</sup>Parliamentary Joint Committee on Corporations and Financial Services, *Family Businesses in Australia – different and significant: why they shouldn’t be overlooked*, 2013

<sup>57</sup>ASIC, *Company Registration Statistics, 2004-2017* & ATO, *Taxation Statistics – Trusts*, 2019

<sup>58</sup>GHM, *The Three Levels of Family Business Succession Planning*, 2017

<sup>59</sup>*Ibid.*

benchmark MSCI Europe Small Cap returned more than 300 per cent compared with 132.2 per cent for the MSCI Europe.<sup>60</sup>

The number of employee-owned businesses in the UK is growing, and there is increasing awareness that employee ownership can lead to enhanced productivity and performance, which could be better shared with those who help generate the rewards. The UK government created the 'employee ownership trust' (EOT) structure to encourage company owners to sell a controlling stake to their employees. Providing certain conditions are met, transfers to an EOT offer capital gains tax (CGT) relief. An EOT can also be used to pay income-tax-free bonuses to employees.

## Protecting the vulnerable

Trusts are widely used to set aside funds to ensure the care of someone vulnerable. The term vulnerable goes beyond the technical definition of those incapable of caring for themselves. As per the UK *Care Act 2014*, the legal definition of vulnerable is that of a person who is physically or mentally disabled or a minor and is unable to look after themselves or their finances. A prime example of this would be someone who has developed dementia and lives by themselves, a vulnerable beneficiary trust would look after this person's needs and would shield them from any potential exploitation (physical or financial).

In the UK, these types of trusts for vulnerable people can provide tax benefits, but are bound by strict requirements on who qualifies as a vulnerable beneficiary. They need to be eligible for benefits (even if they do not receive them). This eligibility is strictly controlled by the UK government. People with mental health conditions may also be qualified as beneficiaries, but need to be a patient covered by the *Mental Health Act 1983*.<sup>61</sup>

As of August 2018, the UK Ministry of Justice's Court Funds Office has around GBP2.4 billion of funds under management and over 185,000 accounts – many of them belonging to vulnerable clients, such as young children that have been awarded damages in civil actions or persons under a medical vulnerability.

In most jurisdictions there are strict limits on gifting assets to people, regardless of the purpose, even if they are vulnerable. A trust structure has three advantages. First, the beneficiary has no direct access to the assets directly and therefore cannot haphazardly spend them. Second, as in any trust,

there is no limit on the amount of assets that can be placed into a trust for a vulnerable person. Third, no outside parties can lay claim to the assets in the trust as they do not belong to the beneficiary, but to the trust. All of these advantages enable those classed as vulnerable to be protected from any direct or indirect exploitation.

## Retirement

*'Population ageing is a global phenomenon. In 2015, there were around 901 million people aged 60 years and over worldwide, representing 12.3 per cent of the global population. By 2030, this will have increased to 1.4 billion or 16.4 per cent and by 2050, it will have increased to 2.1 billion or 21.3 per cent of the global population.'*<sup>62</sup>

The ONS in its 2018 report 'Living longer: how our population is changing and why it matters' found that on average, disposable income is GBP10,000 higher for households with a private pension than for those without, which not surprisingly had led to significant increases in people paying into a private pension.<sup>63</sup> With the total private pension wealth in the UK standing at GBP6.1 trillion in April 2016 to March 2018 (42 per cent of total wealth).<sup>64</sup>

In the UK, trusts can be used as a collective ownership vehicle for occupational pensions with commercial trusts sitting at the back of the majority of pension funds. In these trust-based pension schemes or occupational pension schemes, the trust is set up and all the members of the pension fund are its beneficiaries. Trustees are appointed and are responsible for managing the scheme and for reviewing and monitoring investments. These schemes are subject to multiple sources of law, including the terms of the trust deed and various pensions' legislation, and are regulated by The Pensions Regulator (TPR), which gives them an extra layer of scrutiny.<sup>65</sup> This ensures that the pension payments are separated from the company's assets and protected in case of bankruptcy or any other events that may affect the financial viability of the company, they additionally protect the beneficiaries' funds from any financial impropriety as unfortunately seen during the Maxwell scandal in the early 1990s. In 2018, 45.6 million people in the UK were members of occupational pension schemes,<sup>66</sup> and 76 per cent of UK employees were members of a workplace pension scheme, with this figure jumping to 90 per cent for those in the public sector.<sup>67</sup> Individuals can also privately set up trusts to put aside assets for their own retirement and can set up investment trusts to increase their retirement fund.

<sup>60</sup>*Financial Times*, Investment trusts see beauty in small companies, 2018

<sup>61</sup>HM Government, *Trusts and taxes*

<sup>62</sup>*Living Longer: how our population is changing and why it matters*, ONS, 2018

<sup>63</sup>*ibid*

<sup>64</sup>Pension wealth in Great Britain: April 2016 to March 2018, ONS, 2018

<sup>65</sup>Law Commission, *Pension Funds and Social Investment Summary*, 2017, pp6-7

<sup>66</sup>*Living Longer: how our population is changing and why it matters*, ONS, 2018

<sup>67</sup>*Employee workplace pensions in the UK: 2018 provisional and 2017 revised results*, ONS, 2018

In Hong Kong, a significant proportion of trusts take the form of pension schemes. In 2017, approximately 85 per cent of the Hong Kong working population has a form of retirement protection under the MPF (Mandatory Provident Fund) and ORSO (Occupational Retirement Schemes Ordinance) schemes. The MPFs are privately managed, fully funded contribution schemes, usually set up as trusts and have over time become the backbone of the Hong Kong retirement protection regime. They are regulated by the MPFA (Mandatory Provident Fund Schemes Authority), who registers schemes, approves trustees, regulates their affairs and activities, and formulates guidelines and rules. Before the MPF scheme was implemented, many employers were using voluntary schemes, which were also set up as trusts and regulated under ORSO.<sup>68</sup>

In Canada, investment by way of trust to provide a pension is a multi-billion-dollar industry, and only the banks control a larger pool of capital than the Canadian pension funds. There are a few different ways in which this can be done, but according to Donovan Waters, a trust academic, a trust is the best instrument for the provision of pensions for a large and constantly evolving workforce, because of its inherent flexibility.<sup>69</sup> The Canadian pension funds also invest in other countries, for example the OPTrust has almost CAD22 billion in assets under management, and has investments in the UK.

## Charitable trusts

*'According to the Charity Commission for England and Wales, there are over 168,000 registered charities with over £77bn in annual income. 38.8 per cent of these, report an annual income of less than £10,000.<sup>70</sup> The Association of Charitable Foundations estimates that the top 300 charitable trusts and foundations in the UK distribute £2.7bn in grants each year. This equates to about 15 per cent of all annual income into voluntary organisations.<sup>71</sup>*

Charitable trusts are a well-known way for people to support causes that they care about, and are one of the most well-known forms of trust structures. The National Trust is one of the biggest charitable organisations in the UK. Charitable trusts are under high scrutiny, because of the perception that they provide tax benefits to donors, and people question the money they receive. For these reasons they are well regulated across the world.

In Hong Kong, charitable trusts are one of four broad structures that can be used to establish a charity. Here

(and arguably wherever charities are set up) they have a deep impact on the social, cultural and economic fabric of Hong Kong.<sup>72</sup>

In most jurisdictions, charitable trusts are subject to different regulation than other types of trusts, as they have a clear socio-economic purpose and benefit society more generally. For example, in the UK, there is a Charities Commission that regulates and oversees charitable trusts. Only when registered can a charitable trust claim valuable tax benefits. In Hong Kong, support has been increasing for adopting a similar arrangement. Currently, charities in Hong Kong have no obligation to inform the public of how they operate.

<sup>68</sup>KPMG, *Hong Kong Trust Industry Spotlight*, 2017

<sup>69</sup>Waters, p111-112, 1999

<sup>70</sup>Charity Register Statistics, September 2018

<sup>71</sup>Foundation Giving Trends 2016

<sup>72</sup>KPMG, *Hong Kong Trust Industry Spotlight*, October 2017



# ADDRESSING COMMON MISCONCEPTIONS

## PUBLIC PERCEPTION

It could be argued that trusts entered mainstream public consciousness via various popular 19th-century novels that revolved around the fortunes of the wealthy. The lot of the Bennet sisters would have been very different had their father's estate not been 'entailed'.<sup>73</sup>

To the lay reader, then, trusts were strange, complex constructs designed to support the protagonists (who were invariably well-off).

*'What shall we do with trusts? Has of late become an absorbing theme of public discussion. Indeed, the public mind has begun to assume a state of apprehension, almost amounting to alarm, regarding the evil economic and social tendencies of these organizations.'*<sup>74</sup> This quote comes from a text on the economic and social aspects of trusts written in 1888, but it could have easily been written in a newspaper today. Trusts are still broadly perceived in negative terms by the public, no doubt shaped by the publication of the Panama Papers, the Paradise Papers, and the Lux Leaks *inter alia*.<sup>75</sup> The media coverage of a series of high-profile tax avoidance and money laundering cases, and the sense that they are shrouded in secrecy, and therefore something to be treated with suspicion.

Coverage can be skewed and reinforce the perception that trusts are the purview of the 'super-rich' and are often associated with 'loopholes', offshore assets and complex corporate structuring of affairs. This plays squarely into the public's sense of injustice, that there is something 'not quite right' about the use of trusts, and that they are for the few, not the many. This also lends itself to tabloid reporting on 'untrustworthy' attributes.

The media has, however, also reported on trusts as a force for good. Recent examples from the *Financial Times* and other publications include:

- **Philanthropy.** Time-limited (spend-out) trusts are a powerful way to target funds towards specific, live, causes (the Diana Princess of Wales Memorial Fund (raised GBP138 million), the Bill and Melinda Gates Foundation (has made over USD50 billion grant payments as at Q4 2018),<sup>76</sup> Chuck Feeney's Atlantic Philanthropies

foundation that provided more than USD8 billion in grants over the past 38 years).<sup>77</sup> The COVID-19 outbreak of 2020 also demonstrated trusts as force for good with trusts such as the Bill and Melinda Gates Foundation contributing large sums of money to combating the disease.

- **Sustainability.** The Global Sustainable Farmland Income Trust was due to float on the London Stock Exchange in February 2020, which would have made it the first publicly traded trust in the UK (there are several international examples in the US and Australia). It aimed to raise USD300 million to buy farmland around the world that specialises in crops such as fruit, vegetables and nuts.<sup>78</sup> However due to unforeseen external market pressures the IPO was delayed until further notice.
- **International money markets.** The International Monetary Fund (IMF) operates over 50 trusts or administered accounts (including Poverty Reduction and Growth: highly indebted poor countries trust). It has been suggested that an IMF-administered Venezuela Asset Recovery Trust could facilitate the recovery of stolen or misappropriated assets as part of the efforts to resolve Venezuela's sovereign debt crisis (benefiting creditors and citizens).<sup>79</sup>

There would appear to remain a fundamental disconnect in the public's mind between these two 'faces' of trusts.

The public at large is instinctively sympathetic towards the case being made by the Tax Justice Network (see box), as their platform is one for using eye catching examples while demanding a fairer, more transparent tax regime that is not weighted in favour of the privileged few but protects society at large. At the same time, to avoid giving further ammunition to these misconceptions, there is a need for regulation to evolve and address any issues that may be identified.

There are some aspects of trusts that, when sensationalised and taken out of context, help feed the main public preconceptions about trusts.

<sup>73</sup>Jane Austen, *Pride and Prejudice*, 1813

<sup>74</sup>Gunton, 1888, p.385

<sup>75</sup>*Inter alia* – This phrase is often found in legal pleadings and writings to specify one example out of many possibilities

<sup>76</sup>*Financial Times*, How time-limited trusts are focusing funds on specific causes, 2019

<sup>77</sup>*Irish Times*, <https://www.irishtimes.com/business/media-and-marketing/chuck-feeney-dissolves-atlantic-philanthropies-after-giving-away-8bn-1.4355718>, September 2020

<sup>78</sup>*Financial Times*, Farmland-focused trust launches \$300m UK float, December 2019

<sup>79</sup>*Financial Times*, Venezuela's debt resolution: recover the assets, October 2019

## Tax Justice Network

The Tax Justice Network (TJN) is an independent international network that pushes for systemic change on a wide range of issues related to tax, tax havens, and financial globalisation.

It is a vocal opponent of trusts. While acknowledging trusts are widely used for properly legitimate business purposes and to protect vulnerable individuals, TJN is firm that they pose two main 'dangers' to society: namely impenetrable secrecy and the manipulation of ownership rights (shielding assets from creditors, tax authorities, law enforcement and public scrutiny).

## The cost of trusts

Setting up a trust is complex and therefore comes with certain costs. A valid trust needs a trust deed, which needs to be approved by someone with the right qualifications like a solicitor. The Hague Trust Convention also only applies to trusts declared in writing. The cost of setting up a trust will vary according to its complexity. Table 1 lists typical costs by country. While not cheap, it is clear that trusts are not only accessible for ultra-high-net-worth individuals, and people with a moderate amount of assets can also set up a trust cost effectively.

Table 1. The costs of setting up trusts

<b>Australia</b>	AUD500-2,000 (plus yearly fees)
<b>UK</b>	GBP500-1,500
<b>USA</b>	USD700-1,000 (for individuals, by legal document assistants)  USD1,100-2,800 (for individuals by attorney)
<b>Hong Kong</b>	HKD200,000 (setting up trust deed)
<b>Canada</b>	CAD500-700

## The (increasing) transparency of trusts

The wave of transparency measures of the past few years have made trusts a lot less secretive than they used to be. Transparency registers, including on beneficial ownership, have shone a light on the

different types of trusts that exist, what they are used for and what type of assets they cover.

The FATF consolidated assessment ratings show that an increasing number of jurisdictions is adhering to FATF's recommendations. Since their latest evaluations, 47 countries have upgraded their compliance with FATF's 40 recommendations, whereas five jurisdictions got downgraded.<sup>80</sup>

In Hong Kong there is not yet a requirement to register trust documents with Hong Kong authorities. However, to increase measures against money laundering, the Hong Kong authorities have increased the licensing regime for TCSPs in March 2018. In recent years they have also set up a Fraud and Money Laundering Intelligence Taskforce (FMLIT) and an Anti-Deception Co-ordination Centre (ADCC).<sup>81</sup>

## Taxation of trusts

Around the world, governments are increasingly making use of the information generated by cross-border information exchange<sup>82</sup> to obtain information about how domestic taxpayers benefit from trusts located in other countries.

In the United States, the Inland Revenue Service's (IRS) declared intent is that there should be no income tax advantage to trusts and that there should be no onerous trust reporting requirements. Trusts have to file federal tax income returns, when the annual income is higher than USD600 or if there is a non-resident alien<sup>83</sup> as a beneficiary. If the assets in the trust are still part of the settlor's estate, the settlor has to file income from this trust on their own tax return.

In Hong Kong, non-resident trust beneficiaries get a 100 per cent tax exemption on their income from the trust. And they are not required to submit audited financial statements or annual tax returns.

<sup>80</sup>FATF, *Consolidated Assessment Ratings*, 2020

<sup>81</sup>KPMG, *FATF Mutual Evaluation Report on Hong Kong*, 2019

<sup>82</sup>E.g. the OECD's Common Reporting Standard (CRS) and the US Foreign Account Tax Compliance Act (FATCA)

<sup>83</sup>Non-resident Aliens are non-citizens who may not have passed or be exempt from Green card or presence tests.

### Tax Avoidance Taskforce – Trusts (Australia)

In the 2013-14 Budget, the Australian government announced it would provide funding over four years for a multi-agency taskforce. This taskforce was set up to take compliance action against taxpayers involved in tax avoidance or evasion using trusts.

The taskforce targets higher risk trust arrangements in privately owned and wealthy groups on the basis of a number of ‘trust risk rules’ that identify higher risk compliance issues. Most trusts do not trigger these risk rules.

The taskforce’s priorities are to:

- undertake focused compliance activity on privately owned and wealthy groups involved in tax avoidance and evasion arrangements using trust structures;
- target known tax scheme designers, promoters, individuals and businesses who participate in such arrangements;
- lead cross-agency action to pursue the most egregious cases of tax abuse using trusts; and
- undertake projects to gather intelligence on and deal with specific risks.

There is a perception that the wealthiest in the UK give away their wealth and place it in trusts to avoid paying inheritance tax. However, it is likely this does not take full account of the 2006 changes to the inheritance tax regime for trusts, which now includes charges when assets are put into or taken out of trusts in excess of the inheritance tax ‘nil rate band’, and periodically throughout the trust’s existence. Figure 6 shows a steady decline in the value and number of trusts after 2014-2015, which could be a delayed effect of the 2006 trust reforms<sup>85</sup> Some issues in this area feature in the government consultation on the taxation of trusts published on 7 November 2018.<sup>86</sup> Figure 7 shows that only 38 per cent of UK trusts fall within the inheritance tax ‘nil-rate band’.

As shown in Figure 5 in the UK trusts are taxed in several ways. If the value of the assets settled into post-2006 trusts exceeds the inheritance tax nil-rate band, then the settlor will pay an ‘entry charge’ of 20 per cent on the excess. Each ten years thereafter, a further ‘periodic charge’ of up to 6 per cent is payable by the trustees. This means that over the first 30 years, a trust will pay about 38 per cent in charges. Compared to a ‘normal’ passing on of assets, this is a near-neutral outcome when compared with inheritance tax at 40 per cent on death. However, if the trust covers more generations, the entry charge does not need to be paid again, and over time the effective inheritance tax rate drops to 18 per cent. A gift of assets into trust will be treated as a disposal and if any gain arising will be subject to tax in the hands of the settlor. Thereafter the trustees are liable to capital gains tax on gains arising when assets are sold or distributed from the trust. In addition, trustees of a discretionary trust are liable to tax at the highest rate of tax with none of the allowances available to individuals.

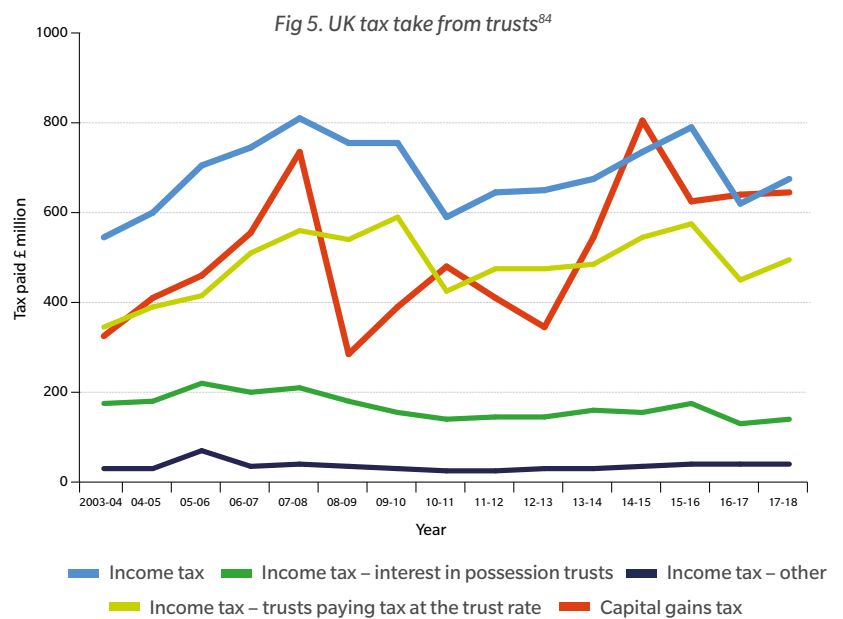
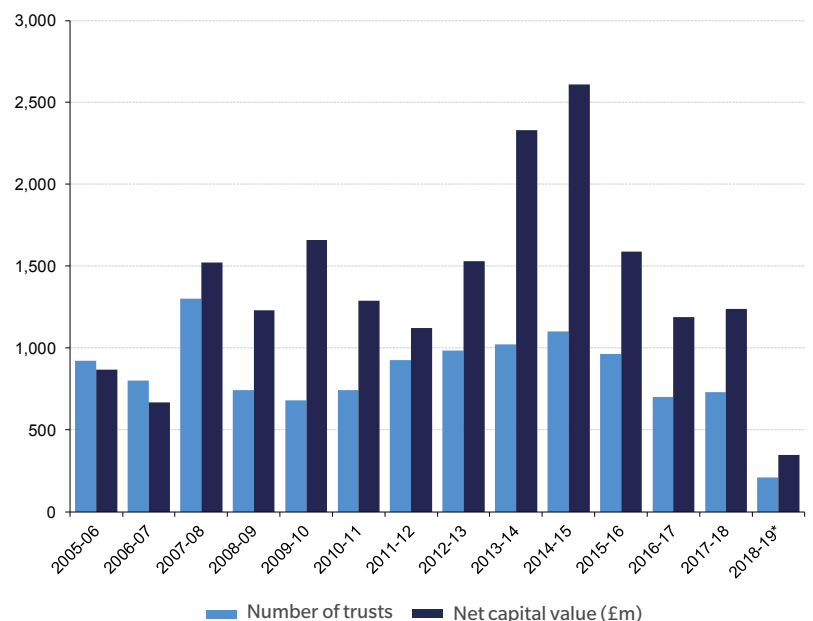


Fig 6. Net capital value of trusts that file Self Assessments between 2005 and 2018<sup>87</sup>



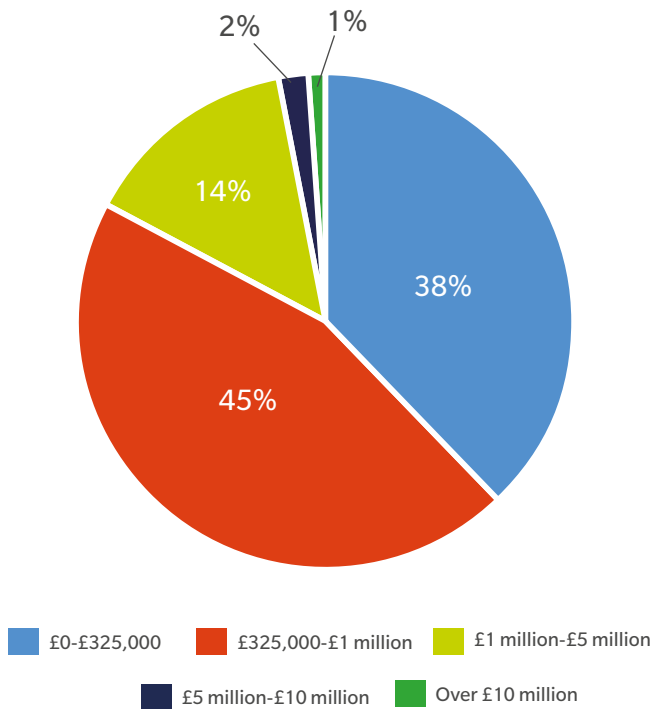
<sup>84</sup>Office of National Statistics, *Tax from trusts*, 2019

<sup>85</sup>HMRC *Inheritance Tax Statistics 2016-17*

<sup>86</sup>HMRC, *The Taxation of Trusts*, 2018

<sup>87</sup>HMRC *Inheritance Tax Statistics 2016-17*

Fig 7. The value of UK trusts<sup>88</sup>



Governments, while looking at taxing trusts, aim to work on the key principles of transparency and neutrality. With the neutrality principle being that tax generated from the use of a trust should be largely neutral when compared to the tax that would be generated by an individual or group of individuals who own the assets outright. Neutrality in this way leads to a fairer, more consistent and less discriminatory system between different taxpayers. The difficulty of practically implementing this approach is that neutrality can often be difficult to measure as each individual will have different economic circumstances.<sup>89</sup>

## FINANCIAL CRIME

Despite widespread negative reports of the relationship between trusts, tax avoidance, criminal activity and money laundering, the UK’s 2017 National Risk Assessment of Money Laundering and Terrorist Financing found that there is ‘very little evidence of UK trusts ... being abused for money laundering purposes. The risk of criminals exploiting UK trusts to launder money is therefore assessed to be low.’ This report ultimately concluded that the vast majority of UK trusts are assessed to be used for legitimate purposes (pp.58-59).<sup>90</sup>

### A taxonomy for trusts?

The OECD and FATF have both called for a taxonomy of trusts. This could be used to shape regulation for the different types and better understand what types exist. However, the inherent flexibility of a trust structure makes it difficult to a priori determine under what category it would fall.

For example, in Quebec, the Civil Code of Quebec holds categories that largely overlap (see nr 1267 and 1270 below). When a client wants to create a trust to be used solely for education for their (grand-) children, they may ask how long this trust can exist. Whether it is a social, private or personal trust, determines whether it can last perpetually or has a limited duration.

Civil Code of Quebec:

*‘1267. A personal trust is constituted gratuitously for the purpose of securing a benefit for a determinate or determinable person*

*1270. A social trust is a trust constituted for a purpose of general interest, such as a cultural, educational philanthropic, religious or scientific purpose. It does not have the making of profit or the operation of an enterprise as its main object.’*

An educational trust has a purpose, and can therefore be considered a personal trust, but its purpose is education, which could make it a social trust. Determining upfront what it should be has real legal consequences. (Lubetsky, 2013)

Internationally, a taxonomy can prove useful for tax purposes, and can be used ensure that the ones used for nefarious purposes are more strictly regulated than the ones used for the protection of vulnerable people or for charitable purposes. However, determining what is what remains a challenge inherent to the trust concept.

<sup>88</sup>STEP, *Internal Survey*, 2019

<sup>89</sup>STEP’s response to HMRC’s *The Taxation of Trusts* consultation document, 2018

<sup>90</sup>HM Treasury & Home Office, *National Risk Assessment of Money Laundering and Terrorist Financing*, 2017, p.58

# THE REGULATORY AND POLITICAL RESPONSE

The Tax Justice Network rebuts the ‘few bad apples’ defence of trusts with the analogy that you cannot abolish airport security on the basis that ‘most people are not terrorists’. This analogy can be taken further: if a particular individual is intent on doing harm then no amount of regulation can pre-empt every eventuality.

As a general rule, across the policy spectrum this is a common reality. Legislation is drafted on the basis of the known information and practical operation at the time. Authorities – tax, judicial and prudential – are closely involved in the development of new laws or regulations. For financial services in particular, the global standard setting bodies drive much of the activity. Policymakers tend to be responsive, acting to close loopholes once they have been discovered (by relevant authorities, the media, or other channels).

Regulators are typically granted quite wide- ranging supervision and enforcement powers that give them flexibility to act within an overarching framework.

## RECENT CHANGES

A recent surge in regulatory, tax and transparency measures, such as the UK’s Register of Beneficial Ownership, the OECD’s Common Reporting Standard (CRS) and the EU’s Anti-Money Laundering Directives (AMLDs), have sought to reduce the secrecy around trusts and safeguard against their misuse.

In 2011 the World Bank published its report ‘Puppet Masters’,<sup>91</sup> which gave an unprecedented look into the world of hidden assets. By analysing more than 150 cases of corruption, conducting extensive practitioner interviews and soliciting shell companies, the researchers aimed to show where the challenges

of the misuse of the corporate vehicles are, which laws and standards are effective and which are not, and how shortcomings in the system were allowing for corrupt officials to launder money.

The report made several recommendations on curbing the misuse of trusts. It recommended minimum information for corporate registries to collect and make publicly available about legal and beneficial owners. It also proposed exploring the role of trust service providers in due diligence around beneficial owners and it called for strengthening investigative capacities.

The World Bank’s report was preceded by an extensive report from FATF (2010): ‘Money Laundering Using Trust and Company Service Providers’.<sup>92</sup> It highlights three main reasons for the proliferation of money laundering. First, the lack of effective and appropriate standards or frameworks against money laundering or terrorist financing. Second, the presence of people in trust and company service provider sector who are willing to engage in illicit activities. And third, a high ratio of staff who do not have the appropriate expertise to understand the complexities of their client’s affairs. The report was part of a wider project considering how FATF standards can be made more effective.

Globally, FATF has reviewed its recommendations and last amended them in June 2019. They are a framework of measures that countries should implement to combat money laundering and terrorist financing. FATF conducts mutual evaluations on the implementation and effectiveness of its recommendations. These in-depth country reports focus on effectiveness and technical compliance.

### The Egmont Group

The Egmont Group is a united body of 164 Financial Intelligence Units (FIUs) and provides a platform for the secure exchange of expertise and financial intelligence to combat money laundering and terrorist financing (ML/TF). It lists trusts and company service providers (TCSPs) as a commonly exploited intermediary.

It holds the view that ‘while TCSPs appear to be less likely to be the masterminds of schemes designed to obscure beneficial ownership, the services provided by TCSPs are vulnerable to exploitation by criminals and other professional intermediaries involved in these schemes.’

*Concealment of beneficial ownership*, July 2018

<sup>91</sup>World Bank, *The Puppet Masters*, 2011

<sup>92</sup>FATF, *Money Laundering Using Trust and Company Service Providers*, 2010

FATF consolidated rating assessments show a clear increase in compliance with FATF recommendations over the past five years.

In the UK, politicians have, to date, held a relatively robust line on trusts and demonstrated little appetite to enact wholesale reform. Their position was neatly summarised in the 2018 consultation ‘The Taxation of Trusts: A Review’<sup>93</sup>:

*Trusts are an intrinsic part of the UK’s legal system, and have been in use for centuries. The government wishes to ensure that the many UK individuals and companies using trusts legitimately benefit from a clear and transparent regime that is easy to understand, while also taking steps to ensure that trust taxation does not produce unfair outcomes and that trust structures do not facilitate tax avoidance or evasion.*

Since 2015, the UK has implemented a series of reforms to increase the transparency of UK incorporated legal persons and arrangements, and to prevent their misuse for illicit purposes. These reforms include, but are not limited to, the introduction of the publicly accessible people with significant control (PSC) register; the abolition of bearer shares; the introduction of a register of trusts; and the introduction of Unexplained Wealth Orders (UWOs). It is too early to measure the impact of many of these reforms, but we expect these measures to go some way towards preventing the misuse of companies and trusts and assisting law enforcement agencies in their investigations where misuse does occur.

## FUTURE DIRECTION

There seem to be no signs of the push for greater registration, disclosure and publication to abate. While heavyweight institutions like the OECD, FATF and the Egmont Group note that there is minor potential for trusts to be misused (but far more likely with other financial instruments such as shell companies) it is highly unlikely that this policy direction will be reversed – rather, that additional measures will be introduced.

While in the past the UK government has defended UK trusts against what they see as disproportionate measures, the introduction of a beneficial ownership register in 2017 shows a shift in that attitude. In 2019/2020 the UK implemented the transposition of the EU Fifth Anti-Money Laundering Directive, which significantly increases transparency by the introduction of the Trust Registration Service.

The government’s initial objection was the distinction between the ‘ease’ with which (mostly European) countries with a civil-law legal tradition could implement a register, versus the complexity facing those common-law countries like the UK or US with domestic trust laws and large trust industries.

During a debate on the EU Fourth Anti-Money Laundering Directive in 2014, then-Treasury spokesperson Lord Newby said: ‘We consider registration of trusts to be a disproportionate approach and, in particular, one which undermines the common-law basis of trusts in the UK.’

The adoption in the UK of a beneficial ownership register will likely raise expectations on other common-law countries. The Australian Tax Office (ATO) commissioned an independent report in October 2017 that was released in December 2019. Author John Glover (professor of law at RMIT University) believes Australia lags behind other countries when it comes to the regulation of trusts and has proposed introducing a register similar to that in the UK to address issues posed by reliance on voluntary lodgement of trust tax returns.

Brexit and some assertions by politicians and regulators about taking a divergent path may provide an opportunity to seek a different treatment. However, it is striking that the EU’s opening negotiation position paper included a proposed commitment to support international efforts to prevent and fight against money laundering and terrorist financing, particularly through compliance with FATF standards. This is likely to continue to be the dominant direction of travel.

# CONCLUSION

Trusts are a longstanding tradition in the UK and beyond, in the majority of cases driving valuable and necessary societal and economic outcomes, and touching people's lives far more frequently and directly than is generally realised and understood.

This report has traced the origins of trusts – with their centuries-old roots in equity and fairness – as well as demonstrating their adaptation to change and ongoing societal evolution. More than this, trusts have continued – and continue – to play a key role in planning the intergenerational transfer and protection of assets, due to their inherent characteristics that offer flexibility and control to individuals for every day uses in the common-law world in the same way that similar structures, such as usufructs<sup>94</sup> and matrimonial property regimes, do in the civil-law world.

As shown in the report, trusts have in the past and recent years received a negative press, often due to misconceived preconceptions derived from a lack of clarity on the nature and history of trusts and from the actions of some who use them for unscrupulous purposes. This report's primary purpose has been to 'open the curtain' on trusts and to help give the reader a greater understanding on what they are and what they can be used for.

As can be seen, trusts can have an overarching positive influence at every stage and every day of someone's life from beginning to end, from education to buying a home, from marriage to retirement planning. They are not just for the benefit of the individual but are used for wider societal benefit, and impact every facet of society directly and indirectly, playing a pivotal role in the third sector, in the form of charitable trusts, safeguarding heritage assets, and in protecting the vulnerable. Internationally they are a common basis on which to incorporate companies, ensure the smooth succession of family businesses, support those who wouldn't be able to afford higher education, and manage estates in a timely and cost-effective manner.

While the economic benefits derived from these activities cannot be solely attributed to trusts, the flexibility and ability of trusts to specify particular uses of assets inarguably plays an important role when it comes to managing personal wealth.

As this report has shown, trusts are not for the exclusive use of the super-rich and are in the UK in the form of occupational pensions used by over three-quarters of the working population and help people plan for a comfortable future.<sup>95</sup> Thus, a simple fact that is not covered when there are public calls for tighter and stricter regulations on trusts is that this would negatively impact all aspects of society rather than a select few by potentially making it harder for people to invest in and enjoy their retirement or for families to set up structures to protect their vulnerable members.

Notwithstanding the cases in which they are used legitimately and for positive, well-intentioned personal, societal and economic benefit, trusts have been subject to intense speculation about their misuse.

As is the case in the financial services and corporate world more generally, trusts can be manipulated or used for illegitimate purposes but the few examples do not outweigh their positive impact, though it does skew the public perception. Additionally, as raised by Transparency International UK, there is more evidence of other vehicles such as companies being misused. With their report finding that out of the 766 UK corporate vehicles alleged to have been used in 52 large-scale corruption and money laundering cases covering around GBP80 billion, all of these were companies rather than trusts.<sup>96</sup>

The research in this report counters some of the common claims about trusts. We found that:

- Cost is not in itself a prohibitive factor in setting up a trust. Coupled with the rise of digitalisation and the availability of information online, trusts are no longer something only the 'elite' can afford.
- Trusts do not have de facto tax exemptions, and there are already laws that govern tax planning. Some of the most egregious examples of trusts being used to avoid tax are often conflated with shell company and offshore arrangements.<sup>97</sup>
- There is no clear evidence that trusts are inherently more subject to abuse than other aspects of the financial system, with the evidence in fact showing that the abuse is less likely compared to other vehicles.<sup>98</sup>
- Both domestically and internationally, there is an increasing focus on transparency and tackling financial crime with recent material changes to disclosure requirements.

While there is acknowledgement that trusts are generally used for legitimate purposes, they have already been subject to internationally driven efforts to mitigate the rare cases of misuse (or the potential for their misuse). Their longevity and prevalence do not (and should not) make trusts immune from future change, but given the breadth of uses identified in this report, simply prohibiting the use of trusts, or penalising their use in a way that has the effect of prohibiting their use is likely to have wide-reaching and unintended consequences on all aspects of society. There are few substitutes that are threaded through everyday life that can wholly recreate their flexibility and offer families, individuals and other groups of people the same level of comfort and certainty about how their assets may be used in future while offering an overarching direct and indirect benefit for society as a whole.

<sup>94</sup>Usufruct – the right to enjoy the use and advantages of another's property short of the destruction or waste of its substance

<sup>95</sup>Employee workplace pensions in the UK: 2018 provisional and 2017 revised results, ONS, 2018

<sup>96</sup>Transparency International UK, *Hiding in Plain Sight*, 2017

<sup>97</sup>*Corporate and Trust Structures: Legal and Illegal Dimensions*, Chaikin & Hook, 2018

<sup>98</sup>HM Treasury, *NRA of Money Laundering and Terrorist Financing*, 2017

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