The Debate of Trust vs Foundation:
Evaluating the Pros and Cons

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When it comes to managing wealth and succession planning, trusts have been the tool of choice for many generations. Now there is a new kid on the block – foundations.

Both foundations and trusts are instrumental in wealth management, family office operations, and charitable activities. They can serve the same purpose, and deciding between using a foundation or a trust requires some understanding of their respective unique structures and operational mechanisms.

The Origins

TRUSTS: The historical origin of trusts can be traced back to the medieval era, particularly to the time of the Crusades in 12th century England. During the Crusades, English knights who were leaving to fight in the holy lands would transfer the legal title of their lands to a trusted individual. This person, effectively a trustee, was tasked with managing the land and using its income to support the knight's family in his absence. Upon the knight's return, the trustee was expected to transfer the ownership back. However, issues arose when some trustees refused to return the lands, leading to legal disputes.

The English courts initially refused to adjudicate on such disputes. Eventually, the resolution of such disputes fell under the jurisdiction of the Court of Chancery. The Chancellor would make decisions based on principles of fairness and equity, ensuring that the benefits of the property were enjoyed by the rightful beneficiaries as intended by the original owner. This gave rise to the "uses" which is the precursor to the modern trust.

The formalisation of the trust concept continued to evolve over time, with significant developments such as the Statute of Uses in 1535 and the Statute of Charitable Uses in 1601, which further defined and regulated the use of trusts in England.

These statutes laid the groundwork for the legal framework of trusts that we recognise today, encompassing a wide range of applications from estate planning to the establishment of charitable organisations.

FOUNDATIONS: Foundations have their roots in ancient civilisations. The Roman "fiducia" and Islamic "waqf" were legal mechanisms allowed for the management and preservation of property for various purposes, including charitable, religious, and familial.

In medieval Europe, family dynasties and feudal lords often set up estate structures that functioned similarly to modern non-charitable foundations, ensuring the preservation and continuity of family wealth across generations. During the Renaissance, wealthy families and merchants in Europe began to formalise these structures, often designed to protect assets, manage family wealth, and ensure the smooth transfer of assets to heirs without the need for division or fragmentation. These were the precursors to the modern non-charitable foundations. The 20th century saw the proliferation of various types of non-charitable foundations, particularly in civil law countries, where the foundation structure is recognised as a legal entity separate from its founders.

Over time, civil law jurisdictions developed specific regulations and laws governing non-charitable foundations. In Europe, the "Stiftung" (in German) and "fondation" (in French) are a common form of non-charitable foundations. It is a legal entity without shareholders that can be used for a variety of non-charitable purposes, including family wealth management, corporate holdings, and private interests. In civil law systems, charitable foundations provide a high degree of privacy and asset protection, making it a popular choice for high-net-worth individuals and families. They can be established for both charitable and non-charitable purposes.

A Trust is not merely a contract!

A trust and a contract are distinct legal arrangements with different purposes and obligations. A trust involves a settlor transferring assets to a trustee, who manages them for the benefit of a beneficiary. In contrast, a contract is an agreement between parties that creates legally enforceable obligations.

Although a trust is often created through a contract (the trust document), the rights and obligations of the parties differ significantly once the trust is established. Trustees owe fiduciary duties to manage assets in the beneficiary's best interests, while parties to a contract are only obligated to fulfill their contractual responsibilities. Breaching fiduciary duties can lead to severe consequences, whereas breaching a contract typically results in monetary damages. The primary difference between trusts and contracts lies in their formation intent: trusts aim to entrust assets to a trustee for the beneficiary's benefit, while contracts create mutual obligations between parties.

The Virginia Supreme Court recently reinforced these distinctions in Boyle v. Anderson (2022), holding that a trust is not a contract, and an arbitration clause within a trust cannot be enforced against beneficiaries. The Court emphasised that beneficiaries' actions against trustees should be brought as claims for breach of fiduciary duty, not breach of contract.

According to the court, the three key differences between trusts and contracts are:

Formation: Trusts are formed through a conveyance of an equitable interest and do not require the beneficiary's knowledge or consideration. Contracts require mutual assent, acceptance, and consideration.

Duties: Trustees owe fiduciary duties to beneficiaries, which are stricter than contractual obligations. Parties to a contract act in their own interests.

Property ownership: Trusts involve divided ownership of property between the trustee (legal title) and beneficiary (equitable title). Contracts do not involve this division of property interest.

Common law jurisdictions also have foundations, but until recently, foundation structures were generally reserved for charitable purposes. Non-charitable foundations, as formal legal entities with a structure like charitable foundations but used for private, non-charitable purposes, were not typically part of the common law system. However, post the millennium and recognising the utility of foundations in wealth management and estate planning, several offshore financial centres started enacted specific legislation to allow for the creation of foundations, including non-charitable ones. In 2004, the Bahamas enacted the Foundations Act, permitting the formation of foundations in a jurisdiction traditionally known for its common law trust structures. Jersey introduced foundations into its legal system with the Foundations (Jersey) Law 2009. Labuan introduced the Labuan Foundation Act in 2010, and similarly, Guernsey passed the Foundations (Guernsey) Law in 2012. Many other countries with common law systems have since adopted foundation laws.

By incorporating foundations into their legal frameworks, these jurisdictions have expanded the estate planning and wealth management tools available within their legal systems. They have effectively created a hybrid model that caters to a global clientele with diverse legal backgrounds and needs and meet the demands of international finance and wealth management.

Common Features

Trusts and foundations share several key features that make them attractive options for managing wealth, asset protection and succession planning.

Flexibility: Both trusts and foundations offer a high degree of flexibility in their structures. They can be discretionary, allowing the trustee or council to make decisions regarding beneficiaries, timing of distributions, and other terms. Additionally, it is possible to appoint a third party, such as a protector, guardian or supervisor, to oversee the management of trust or foundation assets. Settlors (trusts) or founders (foundations) can also reserve powers for themselves or grant them to others, empowering specific individuals to direct investment decisions, distribute assets to beneficiaries, or add/remove beneficiaries.

Privacy: Both trusts and foundations maintain a high level of privacy which make them ideal for operating discreet and private arrangements. In most jurisdictions, there are no requirements to register a trust or disclose trust-related documents or information publicly. While some jurisdictions with foundation laws may require limited information regarding foundations to be made publicly available, the founder's identity, beneficiaries, and purposes normally remain confidential. Jurisdictions such as Labuan do not allow for public disclosure of non-charitable foundations.

In addition, both trusts and foundation ensure privacy by avoiding probate, which means the details of the estate do not become public record, safeguarding the privacy of the settlor/founders and beneficiaries.

Creditors' Remote: It is well recognised, once a settlor has settled assets into a trust, and certain time-period has passed, the assets cannot be clawed back by creditors. The claw back period varies from jurisdiction to jurisdiction. Similarly, almost all foundation laws have restrictions against creditors' claw-back. For example, it is quite typical that assets that have been endowed into a foundation cannot be clawed back after 2 years. Therefore, both trusts and foundations provide legal frameworks for asset protection against creditors and lawsuits.

The Differences

TRUSTS: A trust is a creature of common law. It is fiduciary arrangement where one party (trustee) holds legal title to assets for the benefit of another party (beneficiary). While it is possible to create a trust by a settlor merely transferring assets to a trustee, properly advised, and created trusts are governed by complex documents (trust document) which outline how the assets are to be managed, protected, and distributed. In most jurisdictions with developed trust laws, there are also specific legislation supplementing the provisions of the trust documents, or covering areas left uncovered by the trust documents.

FOUNDATIONS: A foundation is a creature of legislation. A foundation (like a company) has distinct legal status, and the characteristics of the foundation are dependent on the jurisdiction in which it is incorporated. Like a company, a typical foundation has a governing body (often called council) which runs the foundation and hold the assets of the foundation. A foundation has no shareholder, but (like a trust) the assets can be used by the foundation for the benefit of another party (beneficiary). Foundation is governed by the law in which it is incorporated and the foundation's constitution (or charter).

Therefore, whereas a trust is based on a common law development, and legislations are enacted to temper some of the quirkiness of historical developments and to deal with gaps in trust documents, a foundation is a creation of statutes, and common law is applied by courts in the interpretation of the statutes.

Proper Law of the Trust

A settlor has the freedom to select the trust's governing law (the proper law of the trust). This choice isn't without constraints, and careful deliberation is warranted:

Jurisdictional Connection: There should be a tangible link between the trust and the chosen jurisdiction, such as the location of assets, the trustee's residence, or another significant relationship.

Legal Infrastructure: Settlor should opt for a jurisdiction with developed trust laws. Not all countries legally recognise trusts or have modern trust laws.

Lawfulness: What the settlor wants should be legally enforceable under the trust law of choice.

Heirship: Despite the chosen law, some jurisdictions have forced heirship regulations which might affect the trust.

Tax: The tax consequences of the selected jurisdiction and their interaction with other applicable tax regimes should be assessed.

Advantages and Disadvantages of Trusts

The advantages of trusts include:

- **Well-developed legal system:** Trust has a long history, well-developed case law and years of jurisprudence. It is familiar to most practitioners. This makes trusts a reliable structure with few uncertainties. Therefore, trusts instil confidence in users and practitioners alike due to their long history of use.

- **Flexibility:** In most cases, settlors have freedom to choose the governing trust law most suited for their needs. In addition, as trust are principally governed by the trust documents, settlors and trustees have significant freedom in determining the characteristics of the trust.

- **Privacy:** Trusts are created based on a private arrangement between the settlor and the trustee, and normally documented in a trust document. In most countries, trust do not require registration, offering a flexible approach to wealth management, asset building and asset ringfencing. Hence, a trust can ensure the utmost privacy, as between the settlor and the trustee. However, in recent years, due to AML requirements, particularly involving operating bank accounts, this privacy often becomes illusory.

The disadvantages of trusts include:

- **Trustee's misfeasance:** Trust involves the settlor transferring the title to the assets to a trusted independent trustee. The settlor no longer has direct control over the trust assets. From time to time, trustees do breach their trust and abscond with trust assets. Due to this, settlors might prefer to use larger, reputable, and more

established trustees (such as bank backed trustees) or even set up their own private trust companies (PTC) to act as trustees, but these are often more expensive and are usually beyond the means of smaller trusts.

- **High cost:** Choosing a trustee is a balancing act between expertise and cost. A lay trustee may not fully understand the intricate duties of managing a trust. On the other hand, a professional trustee offers valuable experience but at a potentially high cost - usually a fee based on a percentage of the trust's assets. In discharging the trustee's fiduciary duties, the trustee will wish to be properly advised by professionals, which may entail significant additional costs.

- **Suitability:** The trustee's responsibility is to manage trust assets carefully, using reasonable skill and attention. This duty isn't limited to overseeing the assets themselves, but also extends to any businesses or investments within the trust assets. For example, if the trust owns a significant portion of a business, the trustee needs to monitor how that business is run. However, professional trustees might not be the best suited for handling complex, non-financial assets, which can make trusts less suitable for higher risks and complex investments.

- **Complexity:** As mentioned, the trust document is the cornerstone of a trust and must be carefully crafted to reflect the settlor's intentions within the trustee's accepted terms. This task can be particularly challenging for those new to trusts or not fluent in English (such as those from mainland China). Settlors may find themselves depending on the trustee's standard document without fully understanding it, which might not align with their specific needs. While setting up a trust can be simple in theory, in practice, it requires a detailed and sometimes complex trust document to accurately capture the trustee's duties and responsibilities.

- **Lack of transparency:** Once the assets have been transferred to the trustee, the settlor relinquishes direct control and, consequently, visibility into the ongoing management of the trust assets.

Advantages and Disadvantages of Foundations

The advantages of foundations include:

- **Familiarity:** Foundations operate very much like normal companies (except they do not have shareholders). So, they are easy to understand and familiar to those in the corporate world,

The Astonishing Downfall of Deborah Annells – A Case Study of a Rogue Trustee

A In the realm of trust, the foundation is built upon the concept of "trust". However, what happens when that trust is destroyed? This is exemplified by the story of Deborah Annells, a British tax consultant residing in Hong Kong, and her company Azure Tax. It serves as a cautionary tale of the catastrophic consequences that occur when a trustee betrays the trust placed in them.

Annells, a British citizen, was a well-known tax consultant in Hong Kong. She was the founder and CEO of Azure Tax and Azure Trustees, which specialised in providing tax advice and trustee services primarily to expatriates in Hong Kong.

Annells had a reputable reputation in the industry and was a member of the Hong Kong Institute of Certified Public Accountants (HKICPA) and the UK-based Chartered Institute of Taxation (CIOT). She also held prominent positions in organisations such as the Rotary Club of Hong Kong and the British Chamber of Commerce in Hong Kong, and regularly spoke at public events, chambers, and forums. However, beneath her facade of respectability, a storm was brewing.

Between 2009 and 2013, Annells embezzled over HK$30 million from her clients. Despite numerous complaints and substantial evidence of fraud and breach of trust presented to the Financial Secretary's Office and the HKICPA, both bodies failed to take prompt action. It was not until 2013 that she was finally brought to justice. In 2015, she was found guilty of perverting the course of public justice, attempted fraud, and possessing a false instrument, and was sentenced to four years in prison. In 2016, she pleaded guilty to an additional 45 counts of theft and fraud and was sentenced to nine years in prison, to be served concurrently with her original sentence.

The shocking account of Deborah Annells serves as a stark reminder of the dire consequences when a trusted trustee deceives those who have placed their faith in them. It highlights the challenges victims face in monitoring their trustee's actions and taking appropriate measures against untrustworthy trustees.

It is crucial to carefully select a reliable and reputable trustee to manage one's trust assets, but what happens when the person chosen turns out to be a "wolf in sheep's clothing"? Trust is the cornerstone of the trust industry, but ultimately, faith is what clients must rely on.

making them ideal for strategic wealth planning and legacy building, especially for those from civil law jurisdictions where the concept of legal/beneficial ownership is not generally understood.

- **Governance:** Rather than entrusting the assets to the hands of a trustee (as with a trust), the founder can directly participate in the running of the foundation by being a council member. This gives the founder more control over the assets and flexibility to choose the people governing the foundation.

- **Greater control:** The foundation itself holds both the legal and beneficial ownership of its assets, meaning that beneficiaries have no claim to the foundation's assets until such time as the assets are vested in them. A foundation structure allows the founder to retain control often not possible with standalone trust structures.

- **Ability to act on its own:** Foundations possess their own separate legal entities and can therefore act on their own. They can enter contracts with third parties independently, have their own bank accounts and sue (and be sued) in their own right. This makes managing a foundation much easier than managing a trust[1].

- **Non fiduciary relationship:** Under foundation laws, the council (the governing body) owes a fiduciary duty to the foundation itself. Except in relation to beneficiaries who's interested are already vested, the foundation is not normally deemed to owe its beneficiaries any fiduciary duty, thus reducing the duty of care owed to beneficiaries. This makes foundations more attractive as holding vehicle for holding operating and high-risk assets.

- **Ease of setting up:** Foundations are underpinned by foundation legislations. These legislations typically provide a basic framework for operating a foundation. It can be easy to set up a foundation by first adopting standard foundation terms and amending the foundation charter as needs arise.

- **Cost:** The cost of setting up a foundation is generally competitive and tend only to be

Setting up a foundation? - How to choose where to go

With a myriad of countries offering foundations, selecting the right place to set up a foundation is not always straight forward. The following is a list of critical factors to consider:

Residency Requirements: Consider if the jurisdiction requires the founder/donor to be a resident.

Public Disclosure: Assess what (if any) information about the foundation will be accessible to the public. If privacy is a concern, prioritise jurisdictions that offer private registration to protect sensitive information.

Tax Considerations: Many low-tax jurisdictions like Jersey, Labuan, and DIFC offer tax advantages for non-charitable foundations, provided the foundation meets the economic substance requirements. While these jurisdictions may be tax attractive, it is important to Investigate whether the economic substance obligations can be realistically met.

Asset Protection: Choose a jurisdiction with clear asset protection laws to ensure that once assets are donated and a certain period has passed, they are safeguarded from the founder or donor's personal liabilities.

Local Representation: Some jurisdictions mandate the involvement of a resident council member, officer, or agent in the foundation. They have an influence over how a foundation can be managed. Is this acceptable?

Costs: Some jurisdictions are more expensive than others. Costs to bear in mind includes audit fees, annual dues, and costs associated with maintaining economic substance.

Beneficiary Rights: Some jurisdictions offer beneficiaries more rights (especially information rights) than others. Consider how this aligns with the foundation's objectives.

International Reputation: Foundations from jurisdictions perceived as tax havens may face challenges when accessing global banking services due to their reputation.

Future-proofing: Choose a jurisdiction which laws permit re-domiciliation to another jurisdiction if circumstances change.

[1] It is however possible for a trust structure to be created whereby the trustee holds a company in which the settlor is also a director. This gives the settlor some transparency over the operations of the trust.

slightly more than setting up a normal company.

The disadvantages of foundations include:

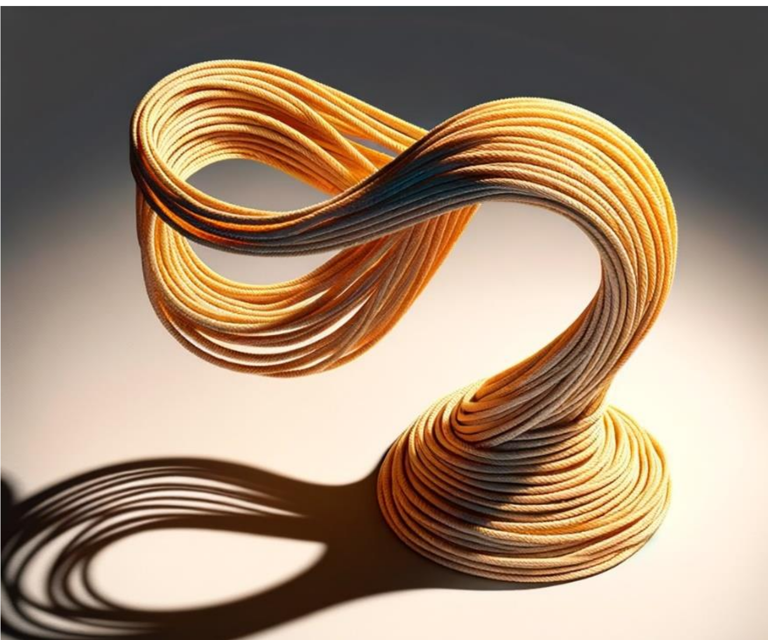
- **Lack of well-developed case laws:** In contrast to the robust body of law underpinning trusts, foundations are relatively new to common law jurisdictions. While countries try to give foundation similar protective provisions as trusts through legislation, there is limited foundation case law, thus giving rise to uncertainties whether courts would uphold those protections.

- **Privacy:** Unlike trusts, foundation must be registered, and some information must be filed with the relevant authorities. While information pertaining to beneficiaries and the foundation objectives are normally not made publicly available, nonetheless, foundation may be perceived to be less private than trusts.

- **Less flexibility:** It is relatively easy for trusts assets to be distributed and trusts collapsed after the assets are disposed of. Foundations, like companies, require to be liquidated in an orderly manner.

Conclusions – deciding between trust and foundation

The choice between trusts and foundations significantly impacts wealth management. Both entities have evolved to meet the needs of settlors/founders and wealth managers.



To choose between a trust and a foundation, one must consider factors like registration requirements, funding sources, and the purpose of these entities. Trusts excel at succession planning, protecting vulnerable beneficiaries, and asset protection, especially for passive and non-operating assets. In contrast, foundations are notable for their tax advantages, asset management capabilities against creditors, and business continuity, making them integral to family office and wealth management strategies.

Choosing between a trust and a foundation involves evaluating personal goals, tax implications, the level of control and, importantly, who the settlor/founder wishes to manage the assets to be settled/donated.

Often the choice may just boil down to who the settlor/founder can recruit to manage the trust or foundation. If the settlor/founder has a pool of trusted advisers and managers, a foundation may be a more flexible choice. On the other hand, if the settlor/founder must rely on third-party managers and professional trustees, then a trust may be a better choice for the settlor/founder can choose from a larger pool of banks and reputable trustees.

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