Hong Kong and Singapore are the two private banking hubs from which the rest of Asia is served. The purpose of this article is to discuss the use of Private Trust Company (PTC) structures by Asian families. As will be explained shortly, in Asia, PTC structures are most frequently promoted by the private banks and their affiliated trustee companies. It is also the purpose of this article to provide some comments on structuring PTCs, based on the perspective of the Hong Kong trust industry as well as to consider whether Hong Kong might itself be an attractive location from which to establish a PTC.

The Baby and the Chocolate Cake
It is not uncommon to open up the newspapers in Hong Kong and see a picture of a chubby baby sitting in a high chair and eating a large piece of chocolate cake. To be more precise, the baby is smothered in chocolate cake. The caption for this newspaper advertisement reads “You can have your cake and eat it too”. It is actually an advertisement for a PTC. The message behind this advertisement is that if you set up a PTC structure, on the one hand you can get all of the benefits of having a trust to own your family wealth, but on the other hand, you can still have control, and to Asian families, control is everything. The baby covered in chocolate cake is an accurate symbol of the key selling point of a PTC structure in Asia, from the perspective of the client/settlor. The question of how much control the settlor may have over a PTC is of course not a simple topic; and any family that decides to establish a PTC structure will want to be advised on the risks of the structure being challenged as amounting to a “sham”, and how best to avoid those risks.

The Other Side of the Coin
There is another perspective. While different banks in Asia have different risk appetites and different policies and procedures, in general terms it can be said that bank trustees are very happy to hold financial assets, but they are wary about holding shares in operating companies or large stakes in listed companies. As such, in Asia, it is not so much the case that a family decide to set up a PTC structure because they don’t want to be subject to a bank trustee deciding how to exercise discretionary powers in favour of their family members, as the case where the bank trustee promotes the PTC structure because the bank doesn’t want to accept the fiduciary risk of holding an operating business or a controlling stake in a listed company as trustee. Hence a critical goal of PTC structures in Asia is the avoidance of fiduciary risk. (Like the question of settlor control, whether the bank trustee can achieve this objective by helping their clients to set up a PTC is of course not as simple as one might hope.) It is not uncommon in practice to see one high net worth individual establish a trust with a bank trustee holding liquid financial assets, and to establish a PTC structure, sponsored by that bank trustee, holding the family’s operating company.

Drama in the Boardroom
In Chinese, there is a saying that wealth cannot survive for three generations. And a great deal of wealth in Hong Kong and in Asia is family owned wealth. Trust structures are often seen as a mechanism for preserving the family business (or the family controlled listed company). But it is important not to fall into the trap of thinking that having a trust will solve all of your family wealth succession dilemmas. A trust is a tool; it is not a solution. A well known statistic is that a family owned business has only a 30% chance of
Family Governance

The Kwok family dispute is a good example that you cannot use a trust structure to keep emotions and family dynamics under wraps. Families need to avoid the mistake of thinking that once a trust is set up, all of their estate and succession planning work is completed. It is suggested that the preservation of family wealth over the long-term is a question of developing effective family governance practices. This includes creating proper boundaries between family, ownership and management and creating separate forums (for example, a family council) for the discussion of family and ownership concerns, separately from business management issues. It is important to work on issues of communication and joint decision making. As mentioned, trust structures should be looked at as tools, the purpose of which is to ensure that the agreed upon family governance arrangements are actually carried out in practice. In the writer’s experience, a PTC structure in particular, where family members or their chosen representatives, sit on the board of the PTC is a very useful structure to formalise a “family council” or an “owner’s forum”. A PTC can be said to impose a certain discipline to ensure that family meetings are held. If there is an outside party serving as secretary and administrator to the PTC, this third party can also act as meeting facilitator and can ensure that directors’ meetings are held in a professional and businesslike manner. It is these kinds of practices, which a PTC can help support, that will go much further towards helping to preserve the family wealth, than the simple establishment of a trust as an ownership structure.

Lessons from Estate Duty

Hong Kong has some experience of its own with PTCs from the days when we had estate duty. A popular, albeit complex, structure for the avoidance of estate duty was the so-called “private unit trust” structure. The trustee of the private unit trust was invariably a PTC. Under the estate duty rules, estate duty could be imposed on any Hong Kong situs assets that were beneficially owned by a company from which benefits accrued to the deceased. The unit trust structure was designed to avoid these “controlled company rules”.

The unit trust structure involved having a bank trustee acting as trustee of an irrevocable discretionary trust (the family trust). The trustee of this family trust would in turn own 99% of the issued units in a private unit trust. It would often also own the shares in an offshore company that acted as trustee of the unit trust (the PTC). This PTC was invariably incorporated in one of the popular offshore finance centres. The PTC trustee of the unit trust would then own, as trustee, Hong Kong situs assets. In practice, the directors of the PTC comprised of the settlor and his/her family members. Rarely would these directors have experience in running a trustee company. The trustee licensing procedures applicable for the PTC would depend on the jurisdiction of incorporation of the PTC.

The Proof of the Pudding

Unlike the more modern approach to PTC structures, with these unit trust structures, the bank trustee of the family trust would not have entered into an administrative services agreement with the PTC, and the bank trustee would try to take a hands off approach from the administration of the unit trust. In practice, if the settlor of one of these structures died, it was not easy for the Estate Duty Office (EDO) to connect the deceased with the trust assets, but it was very interesting in those cases when the EDO did make the connection. When they did, one of the first things the EDO would do is ask the directors of the PTC to prove that the assets were property of the unit trust and not beneficially owned by the PTC in its own right. And sometimes unfortunately the directors of the PTC were not able to produce the necessary trust accounts and trustee records to prove that the assets were in fact trust assets, in which case the EDO could then invoke the controlled company rules. The problem in this scenario was that the family member directors of the PTC had been provided with a sophisticated trust structure that they did not always understand and that they did not have the necessary professional support to properly administer. The lesson from this experience is that often it is not so much the way a PTC structure is established, as the way in which it is administered, that makes all the difference. After all, the proof of the pudding (or should I say chocolate cake) is in the eating.

The Modern PTC Structure

How does the modern PTC structure work today? A private bank based out of Hong Kong might suggest that a family based in Hong Kong or elsewhere in Asia should establish a PTC structure, usually to hold the family’s business or listed company shares. Most typically, the PTC would be incorporated in a traditional offshore centre that is popular for PTCs (e.g., Bermuda, Cayman or Jersey), and the sponsor of the PTC would typically be the affiliated trustee company of that private bank, again located in an offshore centre. That affiliated trustee company would own the shares in the PTC as trustee of a non-charitable purpose trust and would enter into an administrative services agreement with the PTC. Depending on the structure of the private bank in question, the Hong Kong office might provide services ranging from liaison and relationship management through to providing secretarial or administrative support for the PTC. Could more of this structure actually be done from Hong Kong?

A Hong Kong PTC

It is a simple process to incorporate a Hong Kong private company limited by shares. A Hong Kong company can do anything that a natural person can do, including acting as a trustee. There is no requirement to obtain a licence for a Hong Kong company to act as a trustee. A Hong Kong company can now have one shareholder and one director. Corporate directors are currently possible but this is being reviewed. The register of directors and shareholders is public record information and can be searched. It is not possible to issue bearer shares. It is possible, however, to incorporate guarantee companies and hybrid companies. While there is no need to be licensed to act as a trustee in Hong Kong, Hong Kong is a well regulated, transparent jurisdiction. Any person (e.g., a lawyer, accountant, bank trustee or independent service provider) involved in the formation or administration of a Hong Kong PTC will be subject to all of
the anti-money laundering provisions of the Organised and Serious Crimes Ordinance (Cap 455).

The Family Trust

The Hong Kong Trustee Ordinance (Cap 29) is based on the UK, 1925 legislation. One option would be to have the Hong Kong incorporated PTC act as trustee of one or more trusts (the family trust) that are governed by Hong Kong law. A Hong Kong law trust can have a maximum fixed period of up to 80 years specified. Unfortunately, Hong Kong trust law does not allow for income to be accumulated for the full duration of the perpetuity period. In practice, however, it would not be that common to see the family trust being governed by Hong Kong law. Most likely, the proper law for the family trust would be that of a well known offshore trust centre, which is expressly permitted under the Recognition of Trusts Ordinance (Cap 76). One thing to note though is that Hong Kong does not have any “anti-forced heirship provisions” and the Recognition of Trusts Ordinance incorporates the provisions of Article 15 of the Hague Trusts Convention.

Who would own the PTC?

The Hong Kong Trustee Ordinance does not expressly permit the creation of non-charitable purpose trusts. One could however use a Hong Kong professional trustee company to own the shares in the PTC as trustee of a Hong Kong law charitable trust. Could you have a Hong Kong professional trustee own the shares in a Hong Kong PTC as trustee of a non-charitable purpose trust established under e.g. Jersey proper law? Why not? The only issue here is as to whether the choice of Jersey proper law, in this example, would contain anything “the application of which would be manifestly incompatible with public policy” (Article 18 of the Hague Trusts Convention). The other alternative of course is to have a Hong Kong company limited by guarantee to act as the trustee.

Death and Taxes?

While we no longer have an estate duty, what about other taxes? In Hong Kong the tax base is very narrow. There is no tax on capital gains and no tax on dividends or interest. There is no general income tax. Beneficiaries of a Hong Kong administered trust are not liable to any taxation on distributions they receive from the trust, whether income or capital. What there is however is a tax on the profits from a trade profession or business carried on in Hong Kong, to the extent those profits have a Hong Kong source. That is to say, the Hong Kong tax system is a territorial one. Accordingly, if the Hong Kong PTC were directly engaged in a trade profession or business (i.e. it is acting as a trading trustee) in Hong Kong, then there would be a tax liability to the extent the profits have a Hong Kong source. However, as is more usually the case, if the PTC as trustee of the family trust is just holding the shares in an investment holding company, and as trustee, receives dividends from that investment holding company, then there would be no exposure of the trust, or its beneficiaries, to Hong Kong profits tax. On the other hand, if the PTC is charging a fee for acting as a trustee, this fee would be liable to profits tax at 15% (assuming the PTC is regarded as being “in Hong Kong”), and any person who is a director of the PTC and who charges a directors fee will be liable to Hong Kong salaries tax on that fee (the top rate is 17%), even if they never spend a single day in Hong Kong. In summary, Hong Kong is not a “no tax jurisdiction”, but with a little care, a Hong Kong company can be used as a PTC without exposing the family trust (or its beneficiaries) to any taxation in Hong Kong.

Conclusion

As Hong Kong is one of Asia’s leading financial centres, well regulated and with excellent professional and banking support and a thriving and experienced trust industry, a Hong Kong PTC is well worth considering.

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Family Legacy Asia

The goal of Family Legacy Asia is to help families in Asia preserve their family wealth. But this is not an easy task. Only one in three family controlled businesses successfully pass into the second generation and only about 12% last to the third generation. In Chinese there is a saying that wealth only lasts for three generations.

While the above statistics are well known, it would still be the exception rather than the norm to see a family in Asia with a written succession plan, a family shareholders agreement or a formal “Family Council”.

While ultra high net worth families in Asia are starting to get more exposure to the concept of “Family Governance” and the advantages of having, for example, a written “Mission Statement” or “Family Constitution” getting help to implement these new concepts is still a challenge.

Family Legacy Asia (HK) Limited

Family Legacy Asia was established to provide Asian families with an independent alternative that is focused solely on helping ultra high net worth families plan and then implement best family governance practices.

Clients

We act for families that control a business or listed company, for family offices, and for private trust companies.

Services

Our services include structuring complex trusts (e.g. “incentive trusts” and “family banks”) and family foundations; helping to administer private trust company structures; facilitating family meetings; and providing families with advice on Family Governance.

Models Frameworks and Tools

The preservation of family wealth requires families to engage in an ongoing strategic planning process. We can provide families with the models frameworks and tools they need to get organized, to facilitate communication, and to plan ahead in an objective impartial manner.

Examples Of Our Experience

Our experience includes facilitating family meetings, setting up the family council, creating the family foundation, drafting family shareholder agreements, and drafting the family employment policy.

Our Approach

We believe that ultimate responsibility for long term strategic planning for a family lies with the family itself. Our approach is to advise the family as to the proper process and the key tasks they have to undertake. We play the role of the independent project manager and facilitator.

Our perspective

We aim to bring a wide perspective that is intended to make families think beyond the trust structuring, the asset management decisions and the business management decisions.
Christian Stewart founded Family Legacy Asia to help Asian families preserve their family wealth for generations, by providing them with independent and objective advice on good family governance.

He has eighteen years experience in advising high net worth individuals and families on complex trust structuring, estate planning and succession matters, including fourteen years in Asia.

Before founding Family Legacy Asia, he was a Managing Director and the head of the Wealth Advisory Team in Asia for JPMorgan Private Bank for six years. In that capacity, he has worked with some of the leading families and Family Offices in Asia on family governance, private trust companies, and cutting edge wealth structuring techniques.

Family Legacy Asia provides advice on family governance and advice to business controlling families. It also specializes in trust planning and private trust company (“PTC”) structures.

When he first joined JPMorgan Private Bank in 2002, its Asian Wealth Advisory team primarily focused on trust structuring. Christian transformed the services and skill set of his team by helping to bring to Asia JPMorgan’s US know how and expertise on charity and philanthropy, family governance and family owned business succession, and applying this expertise for the benefit of JPMorgan’s Asian clients. In his six years with JPMorgan, he grew their Wealth Advisory team in Asia from a team of 3, to a team of 8 professional Wealth Advisors.

Prior to joining JPMorgan, Christian was a Tax Partner at PricewaterhouseCoopers in Hong Kong. In his eight years at PwC he helped found and lead its Trust and Private Client Group and helped PwC create a reputation as one of Hong Kong’s leading firms in the trust planning area.

Christian started his career as a Solicitor in private practice in South Australia. During his 4 years as a Solicitor, he helped clients with tax, trusts, wills and estate planning work.

He is qualified as a solicitor in the Australian State of South Australia, in England and Wales, and in Hong Kong.

In June 2002, he was named one of the top ten tax advisors in Hong Kong by the International Tax Review in its annual survey of leading tax advisors.