

# THE ACCOUNTANT

## KEEPING IT IN THE FAMILY

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### Succession planning is currently on everybody's lips.

As family businesses, already idiosyncratic and complex in their own right, are transferred from one generation to the next, professional advisers are increasingly looking at developing their own family business practice and ensuring that they possess those extra skills and resources needed to serve the family business client.

Statistics quoted by the Maltese Government in support of recent legislative initiatives specifically enacted to address the needs of family businesses show that there are around 38,000 small family businesses in Malta, and that only 30 per cent of businesses which completed the successful transition from the first to the second generation survived for the long term and less than 10 per cent of such businesses scraped through to the third generation <sup>1</sup>. Local advisors are most certainly aware of the current discussion on the proposed introduction of a Family Business Act – said to be the first of its kind in the European Union.

However, with much less fanfare and hype, a new instrument is now available for owners and advisors of family businesses to consider when restructuring their family business or assets either as part of their succession planning or as a means of better wealth management.

### “FAMILY TRUST”

The “family trust” is an instrument which allows the setting up of a trust where the family assets are either instantaneously or progressively settled on trust and therefore transferred to a trustee to hold such family assets for the present and future needs of family members or dependants who are related to the settlor of the trust, and who are definite and can be ascertained on the creation of the trust.

In practice, the individual wishing to create the “family trust” (that is, the settlor) sets up a company which will act as trustee of the family estate transferred to it under trust, for the benefit of the family members or family dependants.

### HISTORICAL BACKGROUND

Family trusts were first introduced as part of an omnibus bill amending various financial services legislation presented to the House of Representatives in June 2012.

Following a period of consultation (and a delay due to the 2013 general elections), the Trusts and Trustees (Amendment) Act, 2014 was eventually enacted on 25 April 2014. As a result, a new article 43B was introduced permitting the establishment of family trusts and setting out the framework necessary for the introduction of rules intended to regulate family trusts.

The new Article 43B creates a parallel regulatory framework for trustees satisfying the following conditions. A trustee company:

- i. whose object and activities are limited to acting as trustee in relation to a specific settlor or settlors and providing administrative services in respect of a specific family trust or trusts;
- ii. which does not otherwise hold itself out as a trustee to the public; and
- iii. which does not act habitually as a trustee, in any case in relation to more than five settlors at a time <sup>2</sup>;

is only obliged to register with the Malta Financial Services Authority (‘MFSA’) and a company may not act as a trustee for a family trust unless it is so registered. The family trust company, as opposed to professional trustees, need not be subjected to the rigorous authorisation process set out at law and handled by the MFSA.

### RULES

The registration process, and the registration requirements and conditions imposed by the MFSA for such registration, shall be established by rules that are as yet to be issued by the MFSA. The MFSA has, however, on 25 November 2014, issued a consultation document together with draft “Rules for Trustees of Family Offices” <sup>3</sup> (the “Rules”). The relevant consultation period closed on 23 December 2014 and it is not yet known whether any feedback has been received and how the Rules will be amended to take into account such feedback, if any.

Despite the exemption from authorisation, family trustees are not free from all forms of supervision. The Rules set out a number of conditions which must still be met, albeit less rigorous.

### ELIGIBILITY

The Rules create a public Register of Trustees for Family Offices, which registry shall be updated and maintained by the MFSA.

In order for a trustee company to be included in such a register, an applicant must necessarily be a company registered in Malta having as its object (as set out in its Memorandum and Articles of Association) acting as trustee in relation to a specific settlor or settlors and providing administrative services only in respect of a specific family trust or trusts.

### INSURANCE

The Rules also require the family trustee company to maintain insurance cover at all times, which cover shall be proportionate to the nature and size of the activities carried out by the same trustee company.

### FAMILY DEPENDANTS

The Rules also intend identifying those persons who would fall within the parameters of the term "family dependants".

According to the definition currently found in the Rules, a family trust can be set up by a settlor by progressively transferring his/her assets to the family trustee company for the benefit of family members or of those individuals who are related to the settlor by blood or by marriage, whether ascendant or descendant, in the collateral line up to the fourth degree (that is, first cousins).

## TRUSTEE COMPANY GOVERNANCE

One of the dangers of having the settlor setting up a company to act as trustee of the family estate transferred to it under trust, for the benefit of the family members, is that such a trust risks being seen as a sham where the settlor had no genuine intention to create a trust relationship and effectively retains effective control (through the trustee company he owns and manages) and, as a result, remains the beneficial owner of the assets settled on trust.

It is against this background that the Rules impose strict rules on the governance of such family trustee companies by introducing an element of 'independence' from the family in its administrative and management body.

The Rules require that the family trustee company's board of directors is composed of at least three individual directors, composed by both family members and independent and qualified individuals – referred to in the Rules as the 'qualified director'.

The 'qualified director' must be a person of good repute, possessing experience and qualifications in financial, fiduciary, accounting or legal services and approved by the MFSA as being fit and proper to carry out the duties related to the role of the trustee. The qualified director is seen as a watch dog for the trust vehicle who must ensure that the trust company is operated and managed in line with the provisions of the Trusts and Trustees Act including ensuring that the company keeps accurate accounts and records of its administration.

Apart from his professional qualifications, the 'qualified director' must also be seen as being independent from the family members. The independence criteria will be assessed by the MFSA on whether the director is related by consanguinity or affinity or has had any business relationships with the settlor or beneficiaries. Furthermore, the 'qualified director' cannot have been employed by the settlor or have been an employee or an executive officer of a company owned or controlled by the settlor for the previous three years; cannot have had a significant business relationship with the settlor, either directly or as a partner, shareholder director or senior employee of a body that has such a relationship with the settlor; or has had close family ties with the settlor or with any of the other directors or senior employees of the trustee company.

The composition of the trustee company's board ensures a balance between, on the one hand, the family retaining a (limited) degree of control over the trust and the comfort in knowing that the family estate is not in the hands of persons unrelated to the family, and, on the other hand, the independent 'qualified director' who will bring to the family trust a sense of objectivity and expertise, and minimising the possibility of conflicts of interest and undue influence by interested parties. The 'qualified director' should also have the benefit of emotional detachment from the family.

This position creates an opportunity for qualified, competent, professional and non-executive directors who may wish to make themselves available for appointment to boards of family trustee companies.

## ADDED VALUE OF THE FAMILY TRUST

The healthy balance between family involvement (brought about by family members sitting on the trustee company's board) and independence (brought about by the 'qualified director') highlights a fundamental feature of the family trust which addresses what, on the basis of experience, has been the biggest stumbling block to the more frequent use of the trust as a vehicle for succession planning and wealth management.

Too often, persons looking for wealth management or succession planning solutions desperately seek their lawyer's guidance so as to understand what a trust (very often proposed by their bank managers) entails. They are very often reluctant to go down the trust route because they cannot fathom how transferring their patrimony or prized assets – very often a source of great pride – to a third party over whom they exercise little influence and no control can be in their interest.

The family trust structure being proposed by the recently amended Trust and Trustees Act and the Rules would be preferred by owners of Maltese family businesses over the regular trust structure as the settlor/s will not be transferring their wealth to an independent third party. The settlor and his/her family may still possess some form of control over the trust through their position on the board of directors. This composition provides assurance and allows the family members to participate in the managements of the estate and not relinquish complete control of their assets.

The emergence of such an instrument under our law clearly provides the ultimate benefit as whilst the family members retain some form of control over their assets, the 'qualified director' provides the emotional objectivity of a third party and also his/her professional expertise. This provides reassurance and peace of mind to the settlor who knows the status of his assets and still have the assurance that the assets are being.

The regulatory framework for family trusts will also continue to add to Malta's offering as a jurisdiction of choice for wealth management and family offices. Foreign high net worth individuals and their families may now use, when managing their family assets, a bespoke trustee solution in which they can also actively participate, which is designed around their family's distinct needs in a stable and reputable jurisdiction, and which benefits from a simplified registration procedure.

## FOOTNOTES

<sup>1</sup> Macdonald, V. Benefits of the new Family Business Act (Times of Malta, Thursday 26 March 2015) p.7

<sup>2</sup> Article 43B, Trust and Trustees Act (Cap. 331, Laws of Malta)

<sup>3</sup> [Family Trusts Rules](#) last accessed on 6 April 2015

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**ABOUT DAVID ZAHRA**

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David Zahra is founder of David Zahra & Associates Advocates, a commercial law firm based in Valletta, Malta. He has specialised in international and



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