Setting up a family trust in Hong Kong

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As wealth management and family offices are attracting more attention, Hong Kong has become a popular place to set up trusts for families, especially those from mainland China. This article explains how a trust works and why it may benefit a family.

Typically, a family trust is a legal arrangement where a family member (the settlor of the trust) transfers assets to a third party (the trustee, which could be a company or an individual) so that the trustee becomes the owner of the trust assets. The trustee in fact holds the assets for the benefits of family members (the beneficiaries of the trust) and has the duty to manage and ensure that the trust assets are applied for the enjoyment of the beneficiaries. It is important to note that those assets, when transferred to the trustee, will no longer belong to the settlor.

Under common law and the concept of trusts, it is important to distinguish between the legal title to the trust assets held by the trustee, and the equitable interest of the trust assets (i.e., the right to enjoy the benefits of the trust assets) held by the beneficiaries.

The settlor may set up a family trust during their lifetime, or may do so in a will (also known as a "will trust"). With the latter, the trust comes into effect on the death of the settlor and the assets to be transferred to the trust are those specified in the will.

Another categorisation of a family trust is whether it is a fixed trust or a discretionary trust. A fixed trust provides benefits to specified beneficiaries in a predetermined proportion. Under a discretionary trust, the beneficiaries are usually described as a class (i.e., beneficiaries are not fixed) and the trustee can determine the amount to be distributed among the beneficiaries.

The benefits

The assets in a trust do not have to be transferred to any beneficiary in one go. The trust may set out conditions for making distributions (the assets or income generated from the assets) in order to protect vulnerable beneficiaries, who may make unwise spending decisions if they obtain assets in their own names too early. It may also set aside money for future purposes, such as education of the settlor's descendants, or expenses of family members who need long-term medical care or special care.

A discretionary trust allows flexibility in determining the beneficiaries, e.g., to include the settlor's children who are not yet born when the trust is set up, or to exclude descendants' spouses.

As a trust can exist for a very long period of time beyond the lifetime of the settlor, a family trust may be used for succession planning. The family business can be put in the trust which may then provide financial security and career opportunities to family members. As the business and the family wealth in the trust do not belong to any particular branch of the family, they may be managed through future generations and support loyalty among family members.

Assuming there is no fraud and the required conditions are met when the settlor sets up the trust, the trust assets could be protected from seizure by creditors if the settlor subsequently becomes bankrupt. This is because neither the legal title to nor the equitable interests in the trust assets belong to the settlor. The assets settled into a trust may only be available to the settlor's creditors under very restricted circumstances, such as:

(1) There are grounds to set aside the transfer of the assets to the trust or to declare the trust as void, e.g. the settlor having lacked capacity; the assets were transferred under undue influence; the main purpose of the transfer was to effect unfair preference to the settlor's creditors; the trust is a sham.

(2) The settlor is entitled to "call for" distributions from the trust, e.g. through the reservation of a power of revocation over the trust.

(3) The settlor reserves extensive powers over the trust assets such that the trust should be reduced to a bare trust for the settlor's benefit, a nominee arrangement, or a sham.

Privacy is another benefit in setting up a trust because trust arrangements are confidential. With trust assets held in the name of the trustee, it would be difficult for the public to establish a connection of the assets with the settlor or the beneficiaries. Settlors in countries where extortion or kidnapping are common may find this privacy reassuring. Nevertheless, some countries have a central register where beneficial interests in trusts must be disclosed to the authorities.

Replacing a trustee

It may be necessary to replace the trustee to ease concerns of an unhappy working relationship between the settlor and the trustee. A role known as "protector" can be created in a trust. The protector usually has powers to replace the trustee, appoint new beneficiaries and exercise other powers to preserve the trust assets.

Key takeaway

A trust is great tool for wealth planning and protecting family assets and family businesses. However, to actualise benefits of a trust, it is crucial for potential settlors to seek legal advice from qualified and experienced practitioners.

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