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The Legal Structure, Economic Function, and Statistical Treatment of Trusts

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Cover note for IMF Committee on Balance of Payments Statistics:

1. Trusts are a device of Anglo-American legal systems that involve the splitting of aspects of ownership and control. The attached paper discusses the nature of trusts as legal structures and their economic functions and, on the basis of those functions, considers possible statistical treatments.

2. In legal form, a trust is a relationship between a trustee/s (who has/have legal title to the trust property) and the beneficiary/ies (for whom the trustee is obliged to use that property to benefit). The trust deed may allocate control flexibly among the trustee, beneficiaries, creator of the trust, and a contracted manager, or there may be no discretion required beyond instructions in the trust deed. The trust can be distinguished from activities of the trustee in other capacities, and from the beneficiaries whose involvement may be as little as a potential to receive future income. With the structure, a range of economic functions can be carried out, most commonly collective investment vehicles, family businesses, and asset holding for families and individuals.

3. The main issues for statisticians are how to know when a trust can be recognized as an institutional unit and how it is to be treated. While trusts are not systematically dealt with in the existing statistical manuals, the paper argues that they should be treated like other legal arrangements that are used to perform comparable functions. For example, unit trusts perform the same function as incorporated mutual funds, some family trusts are like private corporations in that they used to run small businesses, and some are charities like incorporated foundations.

4. Trusts present particular issues for statisticians when the parties involved are in different countries. With purely domestic trusts, while treatment and classification may be problematic, any treatment that is applied consistently will avoid gaps or double counting. However, where beneficiaries are in one country but the trustee or manager is in another jurisdiction, such as an international financial center, there is a risk of omission.

5. Statistical treatment of a trust as an institutional unit for statistical purposes would reflect where decisions are implemented and records kept. As well, trust service providers are usually regulated, and so they could be a feasible data collection point for aggregate data on trusts under management, while data could not practically be collected from beneficiaries. Treatment of trusts as a unit would have the practical advantage of recognizing the fact that ownership can be uncertain (as in discretionary trusts) or unknown in the country of the beneficiaries (as management is in the hands of the trustee). The alternative is not to recognize the trust as a unit, that is, to treat it as "transparent" or “see through” the trust by treating the trust’s property as if it were owned directly by the beneficiaries. In some cases, this may be

the economic reality because the trust is passive or the beneficiaries exercise complete control over the trust assets. While the first treatment is proposed for financial intermediaries, businesses, and charities, further investigation is needed in the case of simple asset-holding trusts as both treatments have benefits.

6. The paper invites advice from the statistical community on current treatments, data availability, and the conceptual issues associated with trusts.

Issues for the Committee:

- **Have trusts been raised as an issue in committee members' countries? How are unit trusts, pension fund trusts, charitable trusts, and simple asset-holding trusts treated in statistics?**

- **Are significant values of assets trusts managed from members' countries for nonresident beneficiaries? Are significant values of assets managed for resident beneficiaries by nonresident trusts? Are data available on these activities? Which treatments would be most compatible with available data sources? Are gaps and asymmetries in the treatment of trusts contributory factors in global statistical imbalances?**

- **What statistical treatment of trusts should be adopted? Should the issues be referred for discussion in other statistical fora?**

I. Introduction

1. Trusts are legal arrangements commonly used for holding assets and running small businesses. A trust is a legal relationship in which one party (the trustee) holds the "legal title" to the trust property under an obligation to use it for the benefit of one or more others (the beneficiaries). The essential feature of a trust is the separation of the legal title to assets from right to benefit from those assets and, hence, the splitting of aspects of ownership.[1]

2. Trusts emerged in medieval England and are characteristic of legal systems inherited from the English common law.[2] Trusts were first developed to deal with situations of people unable to exercise the rights of ownership. In such cases, legal title could be transferred to another person with a promise to manage the assets and provide the income to the intended third party. For example, a knight going off to a war would want his assets managed and his family provided for during his absence; or someone providing for an infant in a will might want to have the assets managed by an adult until the child became an adult. If the person holding title used the property for their personal benefit, there was no legal remedy because the original owner was not present to sue and the law did not recognize the right of a third party, such as the intended beneficiary, to enforce the contract. In response to these problems, intended beneficiaries petitioned the king to force legal owners to do as had been promised. In the interests of fairness, the king could require the legal owner to use the property in the interests of the intended beneficiary. As this petition process evolved, the responsibility for adjudication moved from the sovereign to the Lord Chancellor, to separate equity courts, and finally to integrated courts of equity and common law. At the same time, the principles behind the imposition of these obligations moved from unfettered discretion of the sovereign to a systematic body of law of trusts that had evolved through precedent.

3. A trust creates obligations on the trustee to use the trust property in the beneficiaries' interests. As a result, both trustees and beneficiaries have elements of the ownership of the

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[1] Other than for trusts, "legal title" and "beneficial ownership" are in the same hands, so the distinction does not need to be made. The trustee holds "legal title" in the sense that the trustee exercises the legal functions such as having title is registered in that name, carrying out transfers of property, or suing and being sued. This definition may be understood in the historical context (outlined below) of trusts emerging as duties imposed on a person who already had legal title. The term "bare legal title" is sometimes used to highlight legal title that has been split from its corresponding beneficial ownership. Because of the complex legal status, the word "ownership" usually needs be qualified when talking about trusts.

[2] "The institution of the Trust is unique in that is unknown in half the world and is considered to be indispensable in the other half." (Quoted in a speech by Mr. T. P. Morgan of the Guernsey Financial Services Commission at the Egmont Group/GPML Training Seminar January 11-12, 2001, Vienna, Austria; where it was attributed to *Introduction to the Draft Hague Convention of 1984*.)

property—the trustee has the legal title but not the right to benefit; and the beneficiaries have equitable ownership, which brings the right to benefits, but control can only be exercised through the trustee. The law of equity imposes a basic set of obligations on the trustee to manage the trust property in the interests of the beneficiary/ies, keep the trust property separate from his or her own property[3], and account for the trust property. In addition, a trust deed or will may specify other and more detailed arrangements.

4. Trusts offer several benefits for the holding of assets. They include providing a convenient vehicle for pooling of assets, the potential to protect unwise beneficiaries from their own poor judgment, sometimes to minimize income and estate taxes, and to protect assets from bankruptcy proceedings or divorce property settlements. Although the trustee has legal title, if the trustee goes bankrupt, the trustee's creditors do not have access to the trust property because of its separate status.

5. Trusts are typically found in legal systems based on or influenced by the English common law, including the United States, many members of the British Commonwealth, and a number of offshore financial centers that are or were British colonies. Other legal devices have similar results, such as contractual obligations or corporate structures (for charitable foundations or private interest foundations) rather than by having a special class of ownership, as with trusts. Trusts have some advantages in that trustee's obligations are already well established by the legal system (in contrast, contract arrangements need to be specified) and there is relatively little paper work (in contrast, corporations have registration and reporting requirements).

6. For statistical standards, it is necessary to identify "institutional units" that are the actual decision-making units and hence are appropriate for data collection and useful for economic analysis. (An "institutional unit" as the term is used in a statistical sense may not exactly coincide with legal structure because some legal units may be split or combined for statistical purposes.) Once the relevant institutional units are identified, concepts of residence and institutional sector can be applied. As well, for data collection, clear concepts provide the basis for designing suitable questionnaires and reporting systems that avoid gaps and double counting. For example, errors may arise if trustees or beneficiaries do not know whether they should include trust property with their personal property or not.

7. From the point of view of economic analysis and, hence, statistical concepts, entities should be treated according to:

- their status as a unit, such as having decision-making power, accounts, and having legal status; and
- the economic functions that they carry out;

[3] For example, the separate status of assets held by a trustee as a trust property is shown in *International Accounting Standards* section 30, para. 55, which requires that trust assets not be included in the balance sheet of the trustee.

rather than their legal form. Accordingly, trusts should not be treated as a category of entities in their own right, but treated in the same way as other legal arrangements that carry out the same economic functions.

8. The nature of trusts is that they have a separate legal status from other property and have their own accounts. However, some are decision-making units, while others do not.

II. Trusts in Practice

9. An example of a trust is when a grandparent transfers specified assets to his or her lawyer to be held in trust for the benefit of grandchildren. In this case:

- the grandparent is the *settlor* or *grantor* of the trust;
- the instructions to the lawyers would be the *settlement*, *trust deed,* or *declaration of trust*. This document creates the trust and defines its conditions of operation (e.g., what the trust can invest in, who makes decisions, how benefits are allocated, and how the trust could be wound up);
- the assets are the *trust property* or *trust estate*;
- the lawyers are the *trustees* and owners of legal title to the assets. The trustee may be one or more persons (sometimes required to be more than one) or a corporation;
- the grandchildren are the *beneficiaries* of the trust (also called *cestui que trust* or *beneficial owners* or owners of the *equitable title* to the assets).
- Sometimes, a *protector* (often a settlor) is appointed with veto power over actions of the trustee.

10. The possible motivations for setting up a trust are varied, even for the simple illustration of the grandparent's gift. One motivation for a trust rather than a gift in this case would be to protect the grandchildren from squandering the assets while they were young. Another possibility could be a desire to have the assets under the control of someone with expertise in financial management or with the ability to pool the assets with others to gain the benefits of scale. A further possibility would be to provide discretion so that the benefits could be allocated according to later circumstances that could not be anticipated by the settlor, such as future school fees or birth of great-grandchildren. A further possibility may be minimization of income taxes, if the alternative of giving the assets to the grandchildren's parents could result in tax being incurred at the parents' marginal income tax rates. Similarly, holding assets in trust rather than directly giving them may help in qualifying for social security or other asset or income-tested benefits. Trusts may also minimize estate taxes, as the trust property is taken out of the estate of the settlor. Another potential motivation for the grandparent could be to keep the assets outside the reach of ex-spouses should the

grandparent or the grandchildren have unsuccessful marriages. Finally, a trust may assist in protecting the assets from bankruptcy proceedings.

11. The main economic functions undertaken through trusts are three-fold: [4]

- Operation of family businesses;
- Operation of collective investment schemes; and
- Asset holding among individuals, families, and other small groups of people.

12. In practical arrangements, the trust is often a close substitute for incorporation. For example, unit trusts use a trust to own assets for collective investment, while a mutual fund uses corporate structure instead with economically similar results. Similarly, trusts and privately held companies are often close substitutes as legal structures for operating small businesses.

13. The terms of a trust are established in the trust deed or will (for a trust *inter vivos* or testamentary trust, respectively). Some of the terms include length of operation, scope and shares of beneficiaries, powers of trustees, revocability, and confidentiality. Management of the trust property can be allocated as the settlor wishes, to the trustee, settlor, beneficiaries, or others. However, control in the hands of the settlor or beneficiaries may mean that the trust will not be regarded as a separate entity for the purposes of tax, divorce, or bankruptcy laws. The terms of the trust may vary significantly. The trust deed may define any of whether the income or assets of the trust can or must be distributed. It may limit investments to particular kinds of assets. Some trusts may only hold assets passively, while others can actively manage assets and incur liabilities. A trust may also use the assets to undertake a business in the same way that a corporation or other legal structure would. In the extreme, a trustee in a "bare trust" has no discretion and must act entirely on the instructions of the beneficiary. Another example of a trust with no discretion is for American Depository Receipts (ADRs), where foreign companies are listed on a United States stock exchange through a trustee that issues ADRs backed by its holdings of the foreign stocks. In other situations, the trustee may have wide discretion, while the beneficiaries are entirely passive recipients of income. A trustee might also delegate some of the responsibilities to another organization, for example, pension funds trustees contract decisions to investment managers.

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[4] Trusts are a common structure for operating small businesses or holding family assets. For example:
(a) in the United States in 1998, the Internal Revenue Service received returns from 4.4 million trusts and estates (cf. 5.3 million corporations and 1.8 million partnerships; Source: Internal Revenue Service website);
(b) In Australia, there were tax returns for 454,000 trusts for 1997-98 (cf. 577,000 corporations and 527,000 partnerships; Source: Australian Taxation Office website) of which about 90 percent are discretionary (*Sydney Morning Herald*, February 21, 2001).

14. Trusts have many alternative forms. A testamentary trust is created by a will and takes effect after the death of the donor, in contrast to a “living trust” or trust *"inter vivos*," which takes effect while the settlor is still alive. “Express trusts” are expressly created, in contrast to resulting and constructive trusts that arise in situations where the law imposes obligations on a legal owner, for example, to prevent unjust enrichment or prevent vandalism of an asset that is already under a contract for sale. Trusteeship is also used for the management of bankrupt corporations, with the receiver holding the assets and running the business in trust for the creditors.

15. Trusts may be discretionary or fixed. With a discretionary trust, the trustee can allocate the assets or income among the beneficiaries in any way allowed within the scope of the trust deed. With a fixed trust, the beneficiaries’ shares are in fixed proportions. A fixed trust is the usual form of trust where the beneficiaries are unrelated such as for a collective investment scheme. In contrast, a discretionary trust may be preferred in family situations or charitable purposes. It is also possible to have hybrid trusts, where some elements are discretionary (perhaps income), while others are fixed (e.g., shares of assets in the event of the winding up of the trust). Besides discretionary trusts, beneficiaries are indeterminate for charitable trusts and trusts where the interest only vests after some event (e.g., due to the death of another person or the marriage of the beneficiary).

16. The beneficiaries of a trust may have only limited knowledge about its operations. Knowledge is important in identifying statistical treatment, as a meaningful institutional unit cannot be formed if the unit is not capable of knowing about its own activities. With a discretionary trust, each beneficiary cannot quantify the value of his or her interest in the trust property. Indeed, potential beneficiaries may be defined as a class, such as the children of a particular person, rather than as individuals and may not even have been born. Furthermore, many beneficiaries even in fixed trusts may have little knowledge of the operations of the trust because they do not need to do so and lack the time, interest, or capacity.

17. Trusts offer the ability to split incomes without splitting the asset. A very common example is to give ownership of a family business or accumulated family wealth to a trust. Trusts allow income to be split among larger numbers of people, such as spouses or children, to take advantages of tax-free thresholds or lower tax rates, while the business or other assets are kept under single management. Incorporation offers similar benefits for income splitting and separation of the personal assets from business liabilities. However, compared to incorporation, trusts offer an extra option of discretionary allocation to family members. Trusts may also avoid double taxation in tax systems that tax income in both the hands of the company and the final recipient. Income tax treatments differ by country and type of trust. Two general approaches are found, namely, to treat trusts as a taxable entity in their own right, or to treat them as “transparent” or “see through” them, that is so that the income is taxable in the hands of the beneficiaries at the beneficiaries’ tax rates. Some countries have a mix of treatments, e.g., all trust earnings reported, retained earnings taxable by the trust, distributed earnings taxable in the hands of the beneficiary; bare trusts taxable in the hands of the beneficiary, other trusts taxed as entities.

18. Collective investment schemes are a means of placing large volumes of funds from many contributors under professional management. In the case of mutual funds, a corporate structure is used—that is, investors buy shares in a company that pools the funds so that they can be professionally managed. By contrast, in the case of a unit trust, a trust structure is used—that is, the funds are transferred to a trustee who pools the funds for management. From the investor's point of view, the results are almost identical and choice of legal structure does not seem to be emphasized in marketing. Despite differences in legal form, both the mutual fund and unit trust have the same underlying economic reality. In the case of unit trusts, like most trusts outside a family, the settlor is also the beneficiary. Units are used to define interests in investment vehicles as they are convenient for dealing with beneficiaries who joining or leave the trust. Real estate investment trusts are a collective investment scheme that specializes in real estate.

19. Nominee companies have the objective of holding assets on trust without managing them. They are often established by lawyers, brokers, or banks for the purpose of pooling of funds, expediting share dealings, or providing anonymity.

20. "Blind trusts" have the distinguishing feature that the beneficiaries cannot be told details of the asset holdings of the trust. This device is often used to preserve the wealth of an official while avoiding conflict of interest in official decisions.

21. Trusts are often used as a device for charitable purposes. In the case of a charitable trust, the beneficial obligation is for particular purposes, rather than to people. The purposes could be as wide as all charitable purposes or for particular ends such as research, education, or assistance to the handicapped. A similar result may be obtained with a different legal form by creating a corporation with specified charitable purposes (often called a foundation) to hold the assets.

22. The duties of trusteeship may be given to one or more natural persons, a corporation that has other purposes, a separate corporation created solely for the purpose of the trust, or a trustee company that handles many trusts. A licensed trustee company may be given a special legal status and be subject to regulation and inspection in return for being able to offer its services to the public. In addition to the usual duties of good faith imposed on trustees, public trustees may be required to show technical skills, good character, and financial capacity. In these cases, it is the trustee that is regulated, rather than the individual trusts, which are usually regulated only if they are open to the public at large, such as with collective investment schemes. "Public trustees" are government trustees with functions such as looking after property of people who die without a will, unclaimed assets, etc. without the assets becoming state property.

23. There may be complex arrangements of units surrounding the operation of a trust. For example, a "pension fund" may involve assets that are held by a trustee, with investment decisions made by one or more separate fund managers, and administrative tasks carried out by yet another organization. These institutions often have separate ownership, may even be in different jurisdictions, and should be treated separately in statistics. Similarly, a company

pension fund may be set up as a trust in which the company is both trustee and manager. Although control may remain with the company, by virtue of fiduciary obligations of the trustee, the assets and decisions need to be kept separate from the rest of the company's operations.

24. The terminology associated with trusts is often used in different ways. For example, the term "trust" is sometimes used as a generic term for asset management by a third party. "Mutual funds" can mean corporate forms in some countries, or trust forms in others. In the United States, the law on anticompetitive behavior and monopolies is often called "antitrust" legislation. At the time of its initiation, trusts were used to combine separate operations to achieve effective monopolies while maintaining the separate corporate identities of the components. Today, the terminology is misleading in that the legislation is mostly applied to corporations, which are the usual legal structures for large-scale businesses.

25. From a legal perspective, legal organization is highly flexible—legal structures can be changed easily and combined; trust and corporate forms can be used to achieve similar objectives. For even moderate accumulations of assets, legal costs of introducing and changing structures may be low in relation to other burdens that wealth may be subject to, such as taxation and divorce rulings. Similarly, legal concepts of ownership are very flexible, and it can be split or shared. Statistical concepts of ownership and institutional sector are rather simplified and rigid in comparison. Statisticians need to keep in touch with the complexity of the real world, as economic actors often use conceptually complex arrangements because complexity can be cheaper than taxes or preferable to having less security over an asset.

III. General Concepts for Institutional Units for Use in Statistics

26. The economy is made up of institutional units, which make economic transactions and which are the basis for collecting economic statistics. The classification of the institutional units by their residence and sector determines how they are included in aggregates. When an institutional unit is engaged in production, it is an "enterprise."[5]

27. The general definition of institutional unit is given by the *System of National Accounts 1993 (1993 SNA)* (para. 4.2):

[5] *1993 SNA* para. 5.1. An enterprise is made up of one or more establishments, which are "local kind of activity units," that is, they are homogeneous as to kind of activity and location and so are more suited to analyzing production behavior. However, separate establishments are not suitable for financial data, because financial decisions are made at the enterprise level.

> An economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities.

28. The *1993 SNA* identifies four main attributes of institutional units (para. 4.2):

> (a) An institutional unit is entitled to own goods or assets in its own right; it is therefore able to exchange the ownership of goods or assets in transactions with other institutional units;
>
> (b) It is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;
>
> (c) It is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts;
>
> (d) Either a complete set of accounts, including a balance sheet of assets and liabilities, exists for the unit, or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were to be required.

29. One of the main types of institutional unit is for "legal or social entities whose existence is recognized by law or society independently of the persons, or other entities, that may own or control them." (para. 4.3).

30. The concept of "economic entity" takes into account both legal status and the point at which financial decisions are made within a country. From the text, it appears that a number of considerations are taken into account:

- The definitions emphasize making economic decisions and having accounts and as strong indications of being a separate unit (from attributes (b) and (d) of the *1993 SNA* definition, respectively).

- Being a separate legal entity is an indication of separate status, but is not an absolute requirement. While some factors refer to legal status, many of the specific instances discussed in the *1993 SNA* are not legal entities, but have some lesser legal status.[6]

[6] The *1993 SNA* prefers the decision-making principle to the legal entity principle in all the cases within a single jurisdiction that it discusses, namely, households (*1993 SNA* para. 4.4); ancillary corporations (para. 4.40-4.44), quasi-corporations (paras. 4.49-4.50), unincorporated financial enterprises (para. 4.82), and unincorporated partnerships para. 4.145).

Further, institutional units are described in the *1993 SNA* as "legal *and social* entities." [emphasis added]. Many of the recognized institutional units have a degree of legal recognition that falls short of being entities that can sue or be sued in their own rights.

- For situations crossing international borders, there is a preference in statistics for delineation of institutional units that belong to a single economy. A registered company is a resident of the country in which it is registered (*1993 SNA* para. 4.16 (c), *Balance of Payments Compilation Guide* para. 706, forthcoming *External Debt Statistics: Guide for Compilers and Users,* and the forthcoming second edition of the *Coordinated Portfolio Investment Survey Guide*). This criterion is not qualified by a requirement to have a presence in the country.[7] Further, where a single company operates in more than one jurisdiction, a separate institutional unit is identified for each jurisdiction if they undertake significant production (unincorporated branch offices in a country *1993 SNA* paras. 4.16 (c) and 14.22-28).

31. The definitions of institutional units are built on a basis of economic function, not legal status. Although the terminology might suggest otherwise, the type of legal structure does not appear to be decisive, and different legal devices may be used for similar economic functions. Institutional units are classified to sectors on the basis of their economic function—households, financial and nonfinancial corporations, general government, and private nonprofit institutions serving households. The distinction between them is based on their different "economic objectives, functions and behavior" (para. 4.17) and legal status is only relevant to the extent that it may be an indication of a separate identity or residence.

32. Highlighting that the legal status of incorporation is not an essential feature of the "corporations" in the *1993 SNA*, unincorporated entities whose activities can be separated from the owning households are included in the corporations sector as "quasi-corporations" (paras 4.49-53). The intent behind the concept of a quasi-corporation is "to separate from their owners those unincorporated enterprises which are sufficiently self-contained and independent that they behave in the same way as corporations" (para. 4.51).

33. A trust is a legal relationship, that is, a set of rights and obligations. Like a corporation, it cannot do anything by itself, but its capacity through the trustee to own assets that are separate from the trustee's personal property, incur liabilities, and make contracts means that it can be used to undertake a range of economic functions. In economic analysis, the focus is on the economic functions that are carried out with those legal structures, rather than with the particular legal forms. The economic and statistical interest is the trust property and activities undertaken with it, rather than the trust obligations. The question is which

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[7] However, a possible conflict is that the *1993 SNA* states that "ancillary corporations" (i.e., that only serve their parent corporations) should be combined with the parent into a single institutional unit (paras. 4.40-4.44) without making any qualification for the case where an ancillary and its parent are in different jurisdictions.

institutional unit is to be regarded as the owner of the property and whether the set of legal relationships in a trust gives rise to something that can be recognized as an institutional unit.

34. An issue associated with institutional units is the choice of the unit for data reporting. While collection from the institutional unit directly is an option, in some cases, it may be more efficient to collect data from an aggregation of units, or a service provider, or counterparty. For example, it may be efficient to collect consolidated data for all trusts under one service provider in order to reduce collection costs or avoid confidentiality concerns.

IV. Existing Guidance on Trusts in Statistical Manuals

35. The international statistical standards mention trusts not at all, in a limited way, and without consistent rationales. The *1993 SNA* provides general principles on institutional units without mentioning trusts.[8] The fifth edition of the *Balance of Payments Manual* (*BPM5*) does not offer a general treatment, but specifically adopts (paras 58, 65) the same concept of institutional units as the *1993 SNA.* There is also a specific mention that recognizes investment trusts as institutional units (para. 388).

36. The *Monetary and Financial Statistics Manual* (*MFSM*) adopts the general principles of the *1993 SNA* (para. 62) but also mentions a variety of specific treatments for trusts. Trusts undertaking financial intermediation are regarded as being institutional units in their own right in the cases of investment pooling and securitization vehicles (para. 100), pension funds (para. 102), and collateralized security issuance (para. 105). The operations or holdings of a trust in a country outside its country of constitution could be a quasi-corporation in limited but not fully specified cases (para. 105); these terms differ from those of the *1993 SNA* on the somewhat analogous topic of the recognition of branches. A reporting unit based on aggregations of personal trusts administered by depository corporations, but allocated to the household sector is also suggested (para. 104). However, in other cases not mentioned specifically, it suggests that the trust assets should be assigned to the beneficiaries (para. 103), the settlor, or trustee according to control or benefit (paras. 103 and 104). It also recognizes that it may be impractical to assess trusts individually on the criteria of control or

[8] In the chapter on income accounts, there is a relevant indirect reference. The *1993 SNA* states that by reason of insurance technical reserves being held “in trust” for the benefit of policyholders or beneficiaries, they “are, therefore, considered to be assets of the policyholders or beneficiaries and liabilities of the insurance enterprises” (para. 7.123). While the reference is in passing and “in trust” is used in a broad sense to apply to all insurance (whether or not a trust is used), this passage illustrates recognition of an intermediary, rather than “seeing through” (that is, the beneficiaries' asset is a claim on the insurance company rather than direct ownership of the insurance companies' assets).

benefit.[9] Accordingly, a convention may need to be used that they are all part of the household sector (para. 104).[10] [11]

V. Treatment of Trusts as Institutional units

37. The lack of specific discussion of trusts and their unique characteristics of splitting aspects of ownership and control mean that there is a need for more explicit guidance for statistical compilers.

38. Some trusts seem to be separate institutional units because they have an identity separate from the trustee and beneficiary. Trusts may have an identity quite separate from their beneficiaries–the beneficiaries often do not have individual control over the decisions of the trust, may have little involvement, and may be incapable or even unborn. Indeed, the shares of individual beneficiaries in discretionary trusts are indeterminate, so the trust is more separated from its owners than is a corporation. In such cases, it makes no sense to split the trust between each of the beneficiaries and have those parts combined with the beneficiaries' other property to be an institutional unit. Trusts always have an existence separate from the trustee, in that the trustee is required to separate the assets from personal property. Trustees' fiduciary duties require them to have accounts for trust property that are separate from their own. However, separate trusts under a single trustee may sometimes be combined and managed together, so the effective decision-making unit would be the group of trusts. In some cases, a trustee is a company created solely to be a trustee of a particular trust, so that the trustee has little or no activity or assets other than the trust.

39. However, some trusts seem to have less of the characteristics of separate economic units. With a bare trust, the beneficiaries make all the decisions, so the trustee is solely an implementer of decisions, not a decision-maker. Securities held through nominee accounts are an example of where the trustee's involvement is solely administrative, so that while accounts may be separate for the property in trust, decision-making is not separate from the beneficiaries. For example, although ADRs appear to be a separate instrument, their rules of operation mean that their supply is managed passively, and they are in economic effect the same for the ADR owner as owning the original shares, and so the ADR issuer has been "seen through." A "sham trust" involves the settlor/s, trustee/s, and beneficiary/ies all being

[9] Apart from difficulty of investigation, such an assessment could be inconclusive because the special nature of trusts means that benefit and control can be in different hands, and so the criteria may contradict each other.

[10] That convention would be inappropriate for international financial centers as many beneficiaries and some controllers may be nonresidents, rather than domestic households.

[11] While the *MFSM* discussion of trusts seems to lack a coherent rationale, the conclusion of this paper to treat trusts like legal arrangements with equivalent economic functions tends to lead to similar results in many cases (even to the extent of leaving uncertainty about the treatment of simple asset-holding trusts.)

identical and so does not amount to any actual change in ownership of the asset. Sham trusts" are not allowed in some jurisdictions, but if allowed, the trust would be a separate legal device with a limited economic identity.

40. It is desirable to separate the trust property from the trustee in statistics. Although the trustee may exercise control over the trust property, the trustee deals with trust property in different ways and with different objectives to those of the trustee's personal property. (Even if under the trustee's control, it is "off-balance sheet.")

41. Trusts do not have a separate economic function from other legal structures that would justify having them as a separate class of institutional units. Rather, trust structures are used as ways of undertaking different economic functions (namely, financial intermediation, production, and asset-holding) that are also undertaken by other types of legal structures such as companies and partnerships.

42. Some of the economic functions carried out by trusts and the corresponding institutional sectors to which trusts could be allocated are as follows:

- Nonfinancial corporations, for trusts that produce goods and services. Trusts are used as a structure to operate small businesses and businesses in bankruptcy. In these cases, trusts perform a similar function to the corporation of separating the business from personal assets, while allowing more flexibility in arrangements for control and income allocation. (The alternative of not recognizing the trust as a unit would require the identification and allocation of the activities to some other controlling or benefiting unit and is impractical in these cases.)

- Collective investment vehicles, other financial intermediaries, and financial auxiliaries. When trusts are used as a collective investment vehicle, such as pension funds or unit trusts, recognition of an institutional unit seems to reflect the reality and avoids inconsistency with economically similar activities that use different legal structures. Like the corporate equivalent, the trust structure allows for the pooling of assets, administered separately from all the individual owners' interests and involves the creation of a new financial asset for the unit holders. For instance, unit trusts and corporate mutual funds are essentially similar.

- General government and nonprofit institutions serving households. Trusts are used for both these purposes and there is no problem in including them in the respective sectors. For example, charities are frequently run through trusts, while a foundation (which is a company with a charitable purpose) has the same objective. Governments may have trust accounts to separate funds that have designated purpose. There may sometimes be separate units in some cases (e.g., for assets being held by a public trustee). It may be preferred to combine a trust fund with another unit or separate it, according to whether it had separate operation and administration or combined with other purposes).

- Financial arrangements without financial intermediation. Some cases such as nominee holdings and issue of ADRs are made through trust structures, but fall short of being financial intermediation, which is defined as constituting issuance of a new financial asset (*MFSM* para. 82). The borderline between creation of a new financial asset and repackaging an existing one may be made unclear by financial innovation.

- Private asset-holding entities. A particularly common use of trusts is as a vehicle to simply hold financial assets for a small number of beneficiaries, who are often related. This is a more difficult case because the statistical treatment of corporations that hold assets without undertaking production is also unclear.[12] The degree of separation of the activities from ultimate owners or beneficiaries can be greater for trusts than equivalent companies because the beneficiaries of discretionary trusts, unvested interests, and charitable trusts all have indeterminate interests in the trust property. As well, the owners of corporations have straightforward voting control, while the legal control of a trust is not necessarily associated with a beneficial interest. Accordingly, it could sometimes be more difficult to "see through" than to recognize the trust as a unit.

VI. Specific Issues

43. If a trust or group of trusts gives rise to a separate institutional unit, then the unit needs to be classified according to a number of statistical dimensions.

A. Residence

44. Residence is defined as the "center of economic interest" of an institutional unit. In many cases, all the parties and property of the trust will be in the same jurisdiction, so that there is no doubt. However, individual beneficiaries, trustees, trust property, trust activities, and trust legal processes could be in different jurisdictions.

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[12] Shelf corporations and international business corporations can perform this function. "Corporations" in the sense used in the *1993 SNA* are only for production (i.e., financial intermediation and production of other goods and services, see para. 4.23, or as a holding company for corporations engaged in production, see para. 4.100). Simple asset holding is not financial intermediation or production. Accordingly, there is no sector corresponding to this economic function. The possible treatments would be to treat them as financial auxiliaries in the financial corporations sectors, identify a new sector or subsector to cover them, or treated them as part of the unit that owns the corporation (usually one or more households, sometimes another corporation) which is the treatment for artificial companies in *1993 SNA* para. 4.42. Treating the assets as owned in the country/ies of the shareholders seems to ignore the reality that the assets are organized and are subject to the legal system of the country of the incorporation or registration (which is also recognized in *1993 SNA* para. 4.16 (c)). These difficulties become evident when the shareholders are residents of a different country to the company or the shareholders are in different countries to each other.

- If the trust is not treated as a separate unit from its beneficiaries, allocation to residents of different countries may be impractical. These difficulties are greatest when the beneficiaries live in a different country from the management of the trust, when the beneficiaries live in different countries from each other, and when beneficiaries' shares are not determined.

- If the trust is a separate unit from its beneficiaries, by analogy with corporations, the residence should follow from the place of legal registration or submission of tax returns, if required.

- If trusts are not registered, the location of the trust's operation is probably best identified from the trustee, because the trustee exercises the legal personality of the trust (e.g., formal title, suing and being sued on behalf of the trust). It is conceivable that these could be split between countries as well, so that the jurisdiction from which most of the management functions (such as accounts and records) are undertaken could be used to determine the residence. If a trustee participates in making decisions with other trustees, but another trustee or trust service provider handles the day-to-day administration, the residence of the latter seems to be the most appropriate center of economic interest.

- A trust can have assets in several jurisdictions. For trusts, like corporations, a single legal entity should be split up (i.e., a branch recognized in another country) only if there were production, land, or buildings in the other country (*1993 SNA* para. 14.22).

- Some trust deeds specify that the law of a particular jurisdiction applies. However, without any other connection to that country a dispute procedure should probably not determine the residence of the trust for statistical purposes.

B. Classification of the Interests of Beneficiaries of the Trust

45. If the trust were not recognized as a separate entity, then the beneficiaries or a settlor in control of the trust would need to be regarded as owning the assets of the trust directly. On the other hand, if the trust is a separate unit from its beneficial owners, then the trust owns the trust property for statistical purposes and the beneficiaries have a financial claim on the trust. (An example of beneficiaries having a claim on the trust is mentioned in *1993 SNA* para. 7.123.) Beneficiaries' interests are not specified separately in classifications of financial assets and liabilities. If the trust is treated as a quasi-corporation, the financial asset and resulting income are similar to "shares and other equity." because the beneficiaries can be regarded as owning the quasi-corporation or unincorporated entity. The beneficiaries' interest has the defining characteristic of having the residual interest in the value of the assets after other claims have been met, like a shareholder's interest in a corporation and in contrast to debt claims. The text of both the *1993 SNA* and *MFSM* refers to equity in both corporations and quasi-corporations.

46. Although the total value of claims can be measured for a discretionary or charitable trust, the financial claim of individual potential beneficiaries is indeterminate. Further, some trust interests only become vested upon the fulfillment of a condition such as a beneficiary's marriage. Accordingly, there are cases where the total liability and the class of potential beneficiaries can be identified from the trust's point of view, but the individual beneficiaries' shares are not yet determined. This is a practical problem to the extent that the potential beneficiaries live in more than one jurisdiction or in more than one economic sector.

47. Whether distributed or retained, income from trusts that are separate units should be treated in the same way as corporate income. Income from pension fund trusts should be treated in the same way as other pension funds, while other trust income should be shown as "withdrawals from the income of quasi-corporations" if distributed.

C. Direct or Other Categories of Investment

48. If a trust has international elements, the classification of the relationship needs to be determined as direct or other categories of investment according to the *BPM5* functional classification. Direct investment involves a "lasting interest" and "implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the company" (*BPM5* para. 359). This concept is defined in practice as the investor owning "10 percent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise)" (*BPM5* para. 362). Other kinds of equity or tradable debt instruments are "portfolio investment", while other instruments are classed as "financial derivatives," "other investment" and "reserve assets."

49. For investment by the trust in other units, ownership through trusts generally raises no additional issues compared with other vehicles for ownership of assets.

50. Beneficiaries' interests in the trust are analogous in some ways to equity in a corporation. For a corporation, some shares have voting power, and some are nonvoting. Similarly, beneficiaries in some trusts do not have a right to instruct the trustee, which means that those beneficiaries do not have a voice, cannot have a direct investment interest in the trust and, therefore, have a portfolio investment interest like that of owners of nonvoting shares in a corporation. Some trusts could be regarded as separate units, but beneficiaries might have a voice in management, so there is a potential for the beneficiary being recognized as having a direct investment ownership in the trust.

51. If a trustee was determined to be a resident of a different country to some of the trust property, a direct investment issue could arise. While trustees in their function as trustees differ from shareholders in not receiving the benefits of the trust property, they may exercise a voice in decisionmaking, which is the essence of the concept of direct investment. Accordingly, a trustee could be in a position to have a direct investment interest if that interest (through the trust and any other interests) exceeded 10 percent of voting power.

D. Trust Service Providers

52. Trust service providers or trustee companies have the function of offering their services as a trustee to the public at large. Such trust service providers will earn income from fees for the establishment and maintenance of many trusts under their trusteeship. The trust service provider is an independent institutional unit from the trusts. Any service charges taken out of the trust income or charged to the beneficiaries directly are a payment for a service. Trustee services are a productive activity carried out by the trustee in its own right (and the trust itself is the purchaser of the service).

53. In these cases, the trust service provider may provide a convenient point to collect aggregated data that would not be readily available from other sources and which avoids concerns about the trustee's duty of confidentiality of individual trusts.

E. Data Reporting Issues

54. While economic function, rather than legal structure, is important for statistical concepts, in practice, it may often be the case that only data classified by legal structure are available, e.g., taxation data. Sometimes, it may be relatively straightforward for their data to be disaggregated according to functions such as producers of goods and services, charities, etc., if information on their activity is also available. However, this disaggregation may not be possible if data are reported through counterparts (such as banks). As well, counterparts may not always be able to separate trusts from trustees.

55. Consequently, data availability may make it necessary in practice to adopt a simplifying convention about the classification of trusts, such as that they are part of the household sector. Similarly, countries may not separate quasi-corporations from households in practice because the distinction is not made in some data sources, especially administrative byproducts.

VI. Conclusions

- Trusts are used to perform a wide range of economic functions and the paper concludes that trusts should be treated in the same way as other legal structures used to perform similar functions.

- Accordingly, trusts used to undertake financial intermediation or production should be treated as institutional units for statistical purposes.

- Trusts are often used simply to hold assets without any financial intermediation or production. Sometimes corporations undertake the same functions. The alternatives are to treat the trust or corporation as a separate entity, "see through" it by allocating the assets on the basis of benefit or control, or a mix (e.g., a separate entity only if the beneficiaries are nonresident or beneficiaries' interests are discretionary). "Seeing through" the trust will reflect the reality for trusts that serve administrative or tax purposes without changing the underlying economic reality. Alternatively, treating trusts as entities may recognize the separate legal status and avoid the uncertainty potentially associated with investigations of control or benefit. When such functions are undertaken by a corporation, the statistical treatment is also unclear and so there is no guidance that can be applied to trusts. More research is needed on this issue.

- The trustee has the legal responsibility for the trust, so is a suitable point for data collection. Licensing of professional trust managers makes data collection from them potentially feasible, more practically for aggregates for all trusts under management by a single trust manager. Further work is needed to explore the practicality of data collection and the implications for counterpart data.