

Discretionary vs. Fixed Trusts — Legal Distinctions

Executive Summary

Trusts are fundamental instruments in wealth protection, estate planning, and international structuring. Two of the most common classifications are Discretionary Trusts and Fixed Trusts — each with distinct legal implications regarding beneficiary rights, trustee powers, and tax exposure.

Choosing between the two is not a mere administrative detail — it directly affects asset control, creditor protection, taxation, and compliance with reporting regimes like CRS, FATCA, and CFC rules.

1. Definition: Discretionary Trust

A discretionary trust is one in which the trustee has full discretion to determine:

- If, when, and how much a beneficiary receives
- The selection of beneficiaries from a defined class
- The distribution of income and/or capital

Key Legal Feature: Beneficiaries hold no vested interest. Their entitlement arises only upon actual distribution.

Use Cases

- Asset protection from creditors, divorcing spouses, or future claims
- Estate planning where flexibility is needed (e.g., minors, vulnerable dependents)
- International structuring where CFC or tax attribution rules require uncertainty of benefit

2. Definition: Fixed Trust

A fixed trust (also called a bare trust or deterministic trust) is one where:

- Beneficiaries have a legal entitlement to a defined portion of income or capital
- Trustees have no discretion regarding distributions

Key Legal Feature: Beneficiaries have a vested, enforceable interest in the trust assets.

Use Cases

- Tax-planning for known beneficiaries (e.g., family members)
- Trusts used in investment structures or nominee arrangements
- Where local law requires fixed interest for compliance (e.g., for some pension or charitable structures)

3. Key Legal Differences

Feature	Discretionary Trust	Fixed Trust
Beneficiary Rights	No vested interest	Vested, enforceable interest
Trustee Powers	Full discretion over distributions	Must follow predetermined allocations
Asset Protection	High – beneficiaries cannot claim control	Lower – assets may be considered owned
Disclosure under CRS/FATCA	Only potential beneficiaries disclosed (sometimes)	Beneficiaries must be reported
Tax Attribution (CFC rules)	Less likely if no beneficiary has control	Attribution likely due to fixed interest
Court Enforcement	Trustee discretion hard to challenge	Beneficiaries can sue for specific entitlements

4. Implications in Offshore Planning

- Discretionary Trusts are favored in asset protection and international tax structuring where beneficiary uncertainty prevents attribution of income or assets under Controlled Foreign Corporation (CFC) regimes.
- Fixed Trusts are more transparent and sometimes necessary in regulated structures, but they offer reduced protection due to clear beneficiary claims.

5. Hybrid Structures

Modern trust planning may include hybrid mechanisms, such as:

- Fixed interest to one class, discretionary remainder to another
- Letter of Wishes accompanying a discretionary trust to guide the trustee without binding them
- Power of Appointment reserved for the settlor or protector to later vary trust characteristics

These allow a balance between control, compliance, and flexibility, particularly in cross-border or long-term family office contexts.

6. Jurisdictional Considerations

Some jurisdictions (e.g., Cook Islands, Nevis, Belize) explicitly favor discretionary trusts in their trust laws for creditor protection. Others (e.g., UK, Ireland) impose look-through taxation if fixed interests exist.

It is essential to align the trust form with:

- The residency and tax status of the settlor and beneficiaries
- The asset location
- The reporting requirements under CRS or FATCA
- The governing law and enforcement risks

Conclusion

Choosing between a discretionary and a fixed trust is a foundational legal decision — not just a tax preference. It defines who owns what, who controls distribution, and how courts or tax authorities will treat the assets.

Proper structuring must be aligned with asset protection goals, family succession plans, and cross-border regulatory realities.