



## Cayman Islands trusts

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This memorandum has been prepared for the assistance of clients considering creating a trust in the Cayman Islands. It is intended to provide a summary of the main legal requirements and general principles applicable to the establishment and administration of trusts. It is not intended to be comprehensive in its scope and it is recommended that a client seek legal advice on any proposed transaction prior to taking steps to implement it.

A series of briefings on other aspects of Cayman law have been prepared by Ogier and are available on request.

### **Introduction to the Cayman Islands**

The Cayman Islands are a United Kingdom Overseas Territory. Although a Governor is appointed by the UK, there is a large measure of internal self-government. The UK retains responsibility for internal security, defence and external affairs, and appoints certain public officers, including judges. The Cayman Islands have a well-developed and experienced court system which has been tested with large trust and commercial cases. The Government's policy is to allow litigants to appoint the counsel of their choice and at any given time a number of eminent Queen's Counsel from London will be appearing before the Grand Court of Cayman. The final court of appeal is the Privy Council in London.

Legal and accountancy firms in the Cayman Islands recruit professionals from top firms in all of the major financial centres, so providing a high level of trust expertise. Many of the trust companies located in the Cayman Islands are subsidiaries of major Canadian, British and Swiss banks.

Cayman has excellent communications, information technology, automation and computerisation facilities, meaning that an onshore party will not suffer any delay as a result of dealing with an offshore service provider.

### **Introduction to the trust concept**

A trust is a legally binding arrangement whereby a person (known as a settlor) transfers assets to another person (known as a trustee) who is entrusted with legal title to the trust assets, not for his own benefit, but for the benefit of other persons (known as beneficiaries, who may include the settlor) or for a specified purpose.

The instructions from the settlor to the trustee as to the disposition of trust assets will normally be contained in a document called the trust instrument. This is for the benefit of all parties as it will ensure that the settlor, the trustee and the beneficiaries know precisely what their respective rights and duties are. The trust instrument will usually provide that the trustee has the power to manage the trust assets in accordance with the terms of the trust instrument and the strict duties imposed on the trustee under statute.

In addition to the trust instrument it is also usual for a settlor to indicate to the trustee his wishes as to the management and disposition of the trust fund in the future in a less formal manner. His expression is often contained in a letter of wishes which, although not legally binding, will generally be considered by the trustee to be of persuasive effect when performing his duties and, for example, determining to make a distribution out of the trust fund.

## **The trust system in the Cayman Islands**

The local legislation relating to trusts is largely the result of a close partnership between the government and the private sector. This has enabled the Cayman Islands to keep ahead of its competitors with modern, cutting-edge legislation. As noted above, Cayman law is derived from English common law. However, there are particular developments of the laws relating to trusts in the Cayman Islands which should be noted.

Although the trust as developed in England gave settlors great flexibility in deciding how trust property might be applied and enjoyed, certain limits were established, including:

- a trust, with minor exceptions, could only be established for the benefit of persons and not for the promotion or advancement of impersonal objectives
- beneficiaries were entitled to be informed about the state of the trust property and the way in which the trust was administered by the trustee and, if necessary, to commence court proceedings to protect their interests
- the duration or life of the trust was limited
- trust property might in some circumstances be seized by the settlor's creditors, even if he were not a beneficiary, notwithstanding that he was solvent when the trust was created and that the trust had been created many years earlier
- the extent to which the settlor might interfere in the administration of the trust once it was created was curtailed

These restrictions have largely ceased to apply to Cayman trusts as a result of changes in the law adopted by the Cayman legislature:

- trusts may now be established for the promotion or advancement of impersonal objectives [see the section 'Special Trusts' below]
- beneficiaries rights to information and to take court proceedings may be excluded [see the section 'Special Trusts' below]
- in some instances, no limit applies to the duration of a trust; where a limit still applies, a trust period of up to 150 years is now permitted
- a solvent settlor may create a trust that cannot be attacked by his creditors after six years have expired, even though he is a beneficiary [see 'Asset Protection' below]
- a trust which takes effect during the settlor's lifetime will not be treated as a will or invalid testamentary disposition
- a settlor can reserve extensive powers or interests to himself or a protector or third party without jeopardising the integrity of the trust as an enforceable lifetime trust

Legislation has strengthened Cayman trusts in other ways as well:

- the choice of Cayman law as the governing law is conclusive and any questions arising in connection with the trust will be determined according to Cayman law and the application of foreign law is excluded
- it prohibits the enforcement of a foreign judgment regarding a Cayman Trust on the basis that it contravenes forced heirship laws because the trust concept is not recognised in that jurisdiction

Cayman has led the way amongst the offshore countries with its innovative legislation which makes it the most favourable destination for trusts. It is not a party to the Hague Convention which provides that parties to the Convention will recognise trusts which are more closely connected to states other than those chosen for the institution of the trust, the applicable law, the place of administration and the habitual residence of the trustees.

## **The components of a trust**

### **The settlor**

Once a trust is created the settlor will have divested himself of legal ownership of the trust assets. The settlor may be a beneficiary and, in certain circumstances, he may also act as a co-trustee. The settlor may, also, retain a degree of control over the trust, such as the power to approve distributions, the power to appoint and remove trustees and the power to revoke the trust.

However, it is essential to the validity of a trust that the settlor actually disposes of himself of the trust assets and he may not, for example, simultaneously be a sole trustee and a sole beneficiary.

## The trustee

Legal title to the trust assets is vested in the trustee under the obligations imposed by the trust and he is responsible for the administration of the trust. There is no need for the trustee to be a Cayman resident, although that will usually be more convenient where the trust is to operate in accordance with Cayman law.

The Trustee's duties include but are not limited to:

1. the duty to administer the trust impartially in the interest of all the beneficiaries, with diligence and in good faith
2. the duty to keep trust accounts and accurate records of all distributions made and decisions taken in administering the trust
3. the duty to be actively administer the trust and to take his own decisions, not simply to await the instructions of others
4. the duty to invest the trust fund with care, skill and caution in such investments as may be authorised

## The beneficiaries

The beneficiaries are the persons entitled to benefit from the assets held on trust. As stated above, the settlor may himself be one of the beneficiaries. In order for a trust to be valid there must generally be sufficient certainty as to the identity of the beneficiaries. An express power for the addition of further persons to the class of beneficiaries may, however, be included in the trust instrument. The beneficiaries may enjoy equal or unequal benefits, as the trust instrument prescribes or, in the case of a discretionary trust, as the trustee may determine.

It is also possible to include in the trust instrument a power to exclude beneficiaries from future benefit.

Within certain limits, the settlor may describe purposes for which the trust assets or their income is to be applied rather than individuals [see the section 'Special Trusts' below].

## The trust fund

The assets constituting the trust fund may be of any type of movable or immovable property (except in the case of Special trusts which cannot hold land in the Cayman Islands directly). At any time after settlement on trust of the initial assets further assets may be added. Indeed, a common

arrangement is to establish a trust with a nominal initial amount and subsequently to add more substantial assets.

## The protector

A settlor may include a 'protector' in the structure of the trust. The function of a protector is usually to provide some indirect control over the trustee, particularly where the settlor has accepted advice that he should not attempt to exercise control himself. So a trustee may be required to obtain the protector's consent before taking particular steps, or to act in some respects at the direction of the protector; the protector may be given power to remove and replace the trustee. The choice of a protector is as difficult a matter as the choice of a trustee; normally the settlor will choose one or more individuals who enjoy his confidence, but that does not wholly overcome the problem of continuity after the death of those originally chosen.

## Forms of trusts

Various types of trust have been developed over time and the most appropriate structure for the settlement will depend on the settlor's particular circumstances and objectives. Some of the more common types of trust are described below.

### Fixed interest in possession trust

Under the fixed interest trust the principal beneficiary will normally be granted a vested interest in the income of the trust fund throughout his lifetime and the discretion of the trustee regarding the disposition of the trust fund will be limited. For example, the trust instrument may specify that the trustee is required to distribute all of the income of the trust fund to a particular individual during that person's lifetime and subsequently to distribute the capital of the trust fund in fixed proportions to named beneficiaries (such as the settlor's children).

### Accumulation and maintenance trust

An accumulation and maintenance trust is one where no beneficiary has a fixed entitlement to the benefits accruing to the trust for a certain period, during which time income is accumulated and becomes an accretion to capital. The persons who are ultimately entitled to the trust capital may thus benefit from the accumulation of capital. The trust instrument may give the trustee a discretionary power to make distributions amongst the beneficiaries up to a specific age for their education, maintenance and benefit and to provide thereafter for a designated share of the trust fund to be distributed to each child on attaining a specified age. An accumulation and maintenance trust may be particularly appropriate where the settlor wishes to benefit a group of children, for example, his grandchildren.

### Discretionary trust

The discretionary trust provides maximum flexibility and is often the most efficient structure for both settlor and beneficiaries. Under the terms of a discretionary trust the trustee is given wide discretionary powers as to when, how much and to which beneficiaries he should distribute the income and capital of the trust. Such a form of trust is useful where at the time of creation of the trust the future needs of beneficiaries cannot be accurately determined. The beneficiaries are not regarded as having any direct legal rights over any particular portion of the trust fund but only a right to be considered to benefit when the trustee exercises his discretion.

## Revocable trusts

Although for tax and other reasons it is generally desirable for a trust to be constituted as an irrevocable settlement, in certain circumstances the settlor may require the additional comfort of knowing that he has retained the power to revoke the trust and enforce the return of the trust fund. Careful consideration requires to be given to the possible consequences of a revocable trust because under the jurisdiction of the settlor's domicile, residence or nationality, revocation may negate some of the expected benefits of creating the trust.

## Charitable purpose trusts

Generally, in order for a trust to be valid there must be identifiable beneficiaries. In brief, the onerous duties imposed upon trustees are owed to the beneficiaries and without ascertainable beneficiaries who may enforce these duties against the trustees a trust will not be upheld. A long held exception to this general rule has permitted trusts to be established in favour of charitable purposes. It is the Attorney General who is tasked with the role of enforcing the trustee's duties and obligations. The Cayman Special Trusts (Alternative Regime) Trusts law permits the creation and enforcement of non-charitable purpose trusts, i.e., trusts in which property is held by trustees on trust to carry out specific purposes which do not qualify as charitable purposes.

## 'STAR' Trusts

The Special Trusts (Alternative Regime) Act 1997 (**Special Trusts Act**) (now Part VIII of the Trusts Act (Revised)) allows a trust to be created:

1. that may be indefinite in duration
2. that confers no right on any beneficiary to bring court proceedings against the trustee or to have information about the trust property and its administration by the trustee
3. that may be directed to the promotion or advancement of impersonal objectives

Such trusts may be established for 'purposes' as an alternative to, or jointly with provision for 'persons'. The reference to 'purposes' embraces applications of trust property and income which are not directed to particular individuals or companies in the capacity of beneficiaries. It thus involved a radical change in the law. The following examples are possible.

1. A settlor may authorise or direct the trustee of a STAR trust to apply trust property or income in the pursuit of objectives, for example in the development of his business, without any expectation that they will prove profitable.
2. A settlor who is motivated by benevolence may create a STAR trust for objectives that are charitable in the popular sense or public-spirited without the danger that the trust will be held invalid if the objectives are not exclusively charitable in the strict sense.
3. A settlor may, by a STAR trust created by his will, direct his executor to expend a large part of his estate in the erection of a monument to his memory.
4. A disaster fund raised for the relief of victims of a disaster may be organised as a STAR trust and so avoid the difficulty, where such a fund is organised as a charitable trust, that victims may only be benefited if they are poor.
5. Those concerned with campaigns to secure particular changes in the law or the election of a candidate to a public office may organise their funding under a STAR trust.
6. In a commercial context, a STAR trust may offer the possibility that the beneficial ownership of the shares in a company is not vested in any of the parties to a transaction.

The Special Trusts Act provides that no beneficiary under a STAR trust has any right to take court proceedings to enforce the accountability of the trustee or any right to be involved in, or informed about, the conduct of the trust and that all rights of that description are to be the exclusive concern of an 'enforcer', a person or persons chosen for the purpose by the settlor. The settlor may nominate a beneficiary or beneficiaries as enforcer; where he has chosen to appoint a protector, he may combine the roles of enforcer and protector in one person.

The rule that a trust must confer enforceable rights on the beneficiaries has been abolished in regard to trusts set up under the regime introduced by the Special Trusts Act.

The trustees of a STAR trust must include the holder of an unrestricted trust company license in the Cayman Islands.

## **Practical applications of Cayman trusts**

In essence a trust is a legal device, first developed under English law, under which legal ownership of assets is vested in a trustee whilst the enjoyment of the trust fund is preserved for the benefit of the beneficiaries on terms determined by the settlor.

The range of uses to which a trust may be employed is still being developed but flexibility and confidentiality are the principal advantages which a trust has over other legal forms designed to hold, preserve and transmit wealth. The trust concept has proved to be enormously adaptable and is widely used in financial planning.

Some typical applications are the following:

## Preservation of wealth

Trusts may be used to preserve the continuity of ownership of particular assets, such as a business, within a family. By vesting legal ownership of the assets in the trustee, the relevant individuals may be able to continue to benefit from the assets, whilst avoiding fragmentation of ownership amongst a large number of second and third generation beneficiaries. The use of a trust avoids, on the death of a beneficiary, the risk of a share of assets becoming owned outside the family, and thus enables settled assets to be preserved intact for the benefit of future generations.

## Forced heirship

Where a settlor disposes of assets during his lifetime by settling them on trust, the trust assets will not form any part of the settlor's estate upon his death. This may enable a settlor to avoid forced heirship rules which may be mandatory under the laws of his domicile, residence or nationality and which would otherwise dictate the persons to whom and proportions in which a settlor's estate will devolve.

The choice of Cayman law as the governing law is conclusive and any questions arising in connection with the trust will be determined according to Cayman law and the application of foreign law is excluded. Furthermore, legislation prohibits the enforcement of a foreign judgment regarding a Cayman trust on the basis that it contravenes forced heirship laws because the trust concept is not recognised in that jurisdiction.

## Succession planning

The effect of a trust is to divest the settlor of ownership of the settled assets. Accordingly, upon the death of a settlor there will be no need to obtain a grant of probate or similar formalities in order to deal with the trust fund. A trust, therefore, provides an efficient vehicle for the transfer of beneficial ownership interests on the death of a settlor.

In addition, a trust can be used to hold shares in a company owning immovable property situated outside Cayman rather than directly in the real property itself, with the effect of transforming characterisation of an interest from immovable to movable, which can present attractive opportunities for tax and financial planning. A trust may also be used to protect financially unsophisticated beneficiaries and to make financial provisions for the improvident.

## Asset protection

Historically trusts have been established for the principal purpose of protecting assets from risk. In a modern context, trusts may be employed to hold assets in a secure and stable political environment. Trusts play a major role in financial planning for individuals, families and companies



and are apt to serve as a shield to protect assets against the potential future liabilities of a settlor, such as punitive taxation. The use of a trust in conjunction with an underlying company can be used to convert an onshore asset into an offshore one and to interpose an additional layer of confidentiality in a chain of ownership. The use of the trust and company combination may also enable trust assets to be held in a jurisdiction which does not recognise the trust concept. Such an arrangement may be attractive to a lender for the purpose of obtaining security against assets. Trusts can also safeguard assets against strategic risks, such as confiscation or expropriation by the State in the country of the Settlor's domicile, residence or nationality. As a further protection, a modern trust instrument can provide for the proper law of settlement to be moved to another jurisdiction in the event of political or strategic emergency in the country of the trustee's residence.

## Commercial trusts

The variety of means to which a trust may be put in the commercial context has only been partly realised. Cayman trusts have been used for the following commercial purposes:

1. pooled investment funds such as a unit trust or mutual fund for the collective investment of capital
2. debenture trusts where a trustee will hold security for a company's debenture holders pursuant to the terms of a debenture trust deed
3. in off-balance sheet transactions, the share capital of an 'orphan' special purpose vehicle will typically be held by a trustee under the terms of a STAR or charitable trust
4. asset securitisation schemes have been structured to provide for mortgages and receivables to be held pursuant to the terms of a trust
5. employee share option and executive incentive schemes (as well as regular pension schemes) will benefit from being established in a politically stable, fiscally neutral jurisdiction

## Taxation

There are no corporation, capital gains, income, profits or withholdings taxes in the Cayman Islands. Moreover, the government, in exchange for registration, will give an undertaking that no taxes will be imposed in the Cayman Islands on the trust for fifty years, and such an undertaking will usually be renewed at the end of such period. Otherwise trusts do not require registration.

## Creation of a trust

It is preferable for a trust to be created by the execution of a formal written instrument so that all parties will know exactly what their respective rights and duties are. The Trusts Act does, however, permit a trust to come into existence by oral declaration or by conduct.

Trusts created in writing may be either a Settlement of Trust signed by both the settlor and the trustee, or by a Declaration of Trust signed by the trustee alone. Following execution of the trust instrument a trust will come into existence upon settlement of the initial property, which may be supplemented later. Ogier is able to assist with preparation of all of the appropriate documentation.

## Services offered by Ogier

In connection with the formation of trusts our Trust and Estate Planning team is able to provide the following services:

- advise and liaison with professional advisers in other jurisdictions in order to recommend the most practical and efficient structure to achieve the settlor's objectives
- preparation of the trust instrument, letters of wishes and formation of underlying companies to hold the trust assets
- preparation and review of documentation relating to commercial transactions underlying the trust
- assistance to the settlor in the choice of a trustee for a Cayman trust and the preparation and review of all documentation to provide for the proper administration and operation of the trust and underlying companies

### About Ogier

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

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