

# Carey Olsen Aviation Bulletin 2023/2024: Aircraft repossession – using a Cayman Islands trust to hold the aircraft

**Briefing Summary:** Cayman Islands charitable and STAR trusts offer flexible “work-out” ownership structures in which repossessed aircraft can be held during the “work-out” period. We have assisted clients to reach positive outcomes with the sale of aircraft held in such structures and in this updated briefing we highlight some considerations to take into account when terminating the structure following the sale.

**Service Area:** Banking and Finance, Aviation Finance

**Sector:** Aviation and Maritime

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## Using a charitable trust during the work-out period

The charitable trust is likely to be familiar to many in the aviation finance sector as it is the type of trust that is typically seen in Cayman Islands “orphan” structures for aircraft finance and securitisation transactions. The trust is not an entity with separate legal personality rather it is a legal relationship that arises when a natural or legal person provides assets to a trustee to hold on trust for the benefit of a beneficiary or for a specified purpose. Title to the assets of the trust is held by the trustee who may deal with the assets subject to the terms of trust (as negotiated by the parties) and in accordance with the fiduciary duties owed by the trustee. As a matter of Cayman law, a trust is considered a charitable trust if the terms of the trust are drafted to provide that the proposed beneficiaries or purposes of the trust are exclusively charitable in nature. The type of charitable trust commonly seen in aircraft finance transactions is not required to register with any government body and the only formality required to establish the trust is the execution and delivery of the trust deed by the trustee.

In the typical orphan structure for an aircraft finance transaction, the property held on trust is usually all of the issued shares in a special purpose company (an “SPV”) that itself owns the aircraft. The trustee holds title to those shares on trust for a charitable beneficiary which has only an indirect interest in those shares on the basis that those shares form part of the general trust property (the “orphan” label derives from this trust arrangement). The trustee must have regard to its duties as a mortgagee-in-possession when dealing with the trust property – under Cayman Islands law, such duties would include the duty to obtain market value for the asset(s).

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To set up a work-out trust an identical structure can be used whereby title to the repossessed aircraft is transferred to an SPV that is incorporated for the purposes of the transaction. Alternatively, if a creditor has security over the shares of the company that owns the aircraft (as would usually be the case where the creditor has provided secured financing to a special purpose company), then it may be possible to transfer title to those shares to the trustee. The work-out trust is only required to remain in existence for as long as is necessary to sell the aircraft. At that time there can be flexibility as to whether the purchaser acquires title to the aircraft from the SPV or title to the shares from the trustee. The latter option may mitigate taxes, filings, and other costs.

## Using a STAR<sup>1</sup> trust during the work-out period

A STAR trust is a special type of trust which can have beneficiaries or purposes (charitable and non-charitable) or both. In the context of a work-out situation the purpose of the STAR trust could be as simple as holding the shares of the aircraft-owning SPV pending sale of the aircraft or the shares of that SPV with no requirement for any beneficiary (charitable or otherwise). Despite their apparent suitability, STAR trusts have not been used widely for "orphan" asset finance transactions which is likely due to their introduction at a time when the more familiar charitable trust model had been in use for over 30 years. As with a charitable trust, the STAR trust does not have legal personality, title to the assets of the trust is held by the trustee and the trustee is party to any relevant transaction documents in its capacity as trustee of the trust.

Like a charitable trust, there is no requirement to register a STAR trust with any government body and the only formalities required to establish a STAR trust are that the trust deed contains a declaration that Part VIII of the Trusts Act (2021 Revision) applies to it, the trustees include a Cayman Islands trust corporation and that the trust has an 'enforcer' (as discussed below).

A key distinction between a STAR trust and a charitable trust is that an 'enforcer' is required to be appointed in respect of a STAR trust. The enforcer is the only person that has standing to enforce the trust and is basically in office to ensure that the trustee observes the terms of the trust. Where a STAR trust is established to participate in a financing or work-out transaction the enforcer is usually an independent professional services company which results in additional costs compared to the charitable trust alternative.

With the exception of the need to appoint an enforcer a STAR trust structure to hold shares in an aircraft-owning SPV during a work-out period would be substantially similar to a charitable trust structure. The STAR trust would remain in existence for as long as is necessary to sell the aircraft and the terms of the trust would ordinarily provide the same flexibility to transfer to the purchaser title to the aircraft or title to the shares of the SPV.

## Terminating the work-out structure

As described above, irrespective of which type of trust is used, title to the aircraft will in almost all cases be held by a legal entity and the shares (or other equitable interests) in that entity will be held by the trustee subject to the trust. The trustee must have regard to its duties as a mortgage in-possession and these duties will apply to how it treats the shares and the voting and other rights. In cases in which the aircraft is sold by the SPV, the shares will remain in the trust. The question then arises as to how to deal with those shares.

The options available to the trustee are likely to include:

- winding-up the SPV (voluntary liquidation): winding up will involve realising and distributing any remaining assets, settling liabilities, and dissolving the SPV. If the SPV was incorporated solely for the purposes of the work-out then we would expect the parties to have planned for its winding up (and the associated costs) when the structure was set up. If the shares in the SPV were transferred to the trustee pursuant to the creditor's security arrangements then there may be limited appetite for incurring the costs of winding-up unless the SPV has other assets that can be realised by the process.
- transfer of the shares back to the original shareholder: in the case of the shares of an SPV that were transferred to the trustee pursuant to the creditor's security arrangements then it may be possible for the trustee to transfer the shares back to the original shareholder.

## No tax liability in the Cayman Islands

There is currently no form of income, revenue, withholding, corporate, sales, title transfer or capital gains tax that would be imposed under the laws of the Cayman Islands in respect of any rent, sale proceeds or other payments received by an aircraft-owning SPV held within either form of work-out trust described above or by the trustee of the related trust acting in such capacity. During the work-out period such trust structures are therefore tax neutral and from a Cayman Islands perspective the gross amount of any sale proceeds or other payments received should be available to meet sums owed to the creditor.

## Rapid set up

In a bankruptcy or insolvency scenario time may be of the essence and being able to quickly set up a work-out structure may mean it is possible to pre-empt a bankruptcy filing in another jurisdiction that would otherwise prevent or delay enforcement.

If a Cayman Islands service provider is to be engaged to act as trustee (or enforcer (if applicable)) then a charitable or STAR trust can generally be set up rapidly as the service provider should be familiar with the form of documentation required and have experience of both types of trust.

If it is necessary to incorporate a Cayman Islands company as the aircraft owning SPV for the structure then that company can usually be incorporated on the same or next business day.

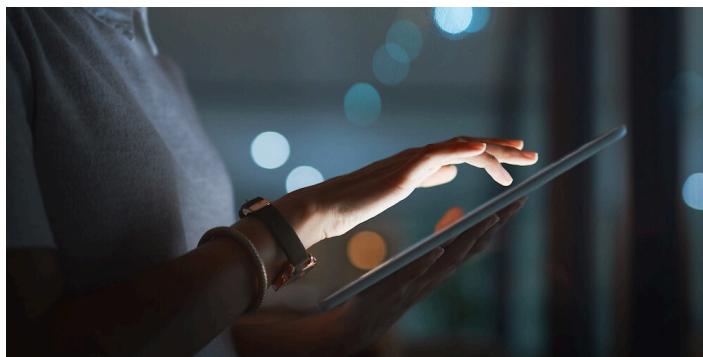
1 STAR stands for "Special Trusts – Alternative Regime" as contained in Part VIII of the Trusts Act (as revised).

This article is part of the Carey Olsen Aviation Bulletin 2023/2024 series.

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