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Reforming a Cayman Islands STAR trust: A lesson in obsolescence

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As trusts and beneficiaries age, and families become increasingly mobile and dispersed, wealth succession and asset protection structures may need to be reviewed and restructured to ensure that they remain fit for purpose. However, from time to time, the issues faced by trustees and beneficiaries become more complex or concerning than could ever have been anticipated and court intervention may be required in order to ensure that the best interest of all parties are protected.

Such was the case in *CIBC Bank & Trust Company (Cayman) Limited v T & S* [1], in which – for the first time in the jurisdiction - the Grand Court of the Cayman Islands (the **Court**) was asked to reform two Cayman Islands STAR Trusts on the basis that their purposes had become obsolete. The written reasons recently released by the Court provide an informative insight to how the statutory regime in operation in the Cayman Islands can offer innovative and helpful tools to solve problems affecting modern trust structures.

Establishment of the trusts

The trustee in the matter before the Court in this instance (the **Trustee**) was the trustee of two Cayman Islands STAR trusts referred to in the judgment (by virtue of confidentiality and anonymization orders) as the AR Trust and the Ta Trust (collectively, the **Trusts**). The Trusts had been established by Dr T (the **Settlor**) in 2010 for the benefit of himself, his second wife (**Madame S**) and their only son (**T**). The purposes of both Trusts were the same: to hold the trust income and principal for the benefit of the Settlor, Madame S, and T as well as T's issue in accordance with the terms of the trust. The Settlor had chosen to establish special purpose trusts in the Cayman Islands because of the jurisdiction's "*political and economic stability, adherence to the rule of law, and the fact that Cayman is a tax neutral jurisdiction*", and had wished the Trusts to benefit T and his descendants to the maximum extent possible, regardless of their place of residence or domicile.

At the time the Trusts were established (and at the time of the hearing of the Trustee's application to the Court), T and Madam S were living in the United Kingdom (the **UK**) and had residences throughout Europe and T's country of birth. At no time had it been anticipated by the Settlor that T, the primary beneficiary of the Trusts, would relocate to the United States (the **US**); the family had no connection at all to that jurisdiction. However, in mid-2018, T decided to relocate to the US largely for business reasons to pursue his interests in the technology sector. He applied for a visa under the US Immigration Investor Program, which was expected to be approved imminently.

In preparation for his move to the US, T sought the advice of US tax and immigration attorneys. On T's behalf, the attorneys informed the Trustee that, despite the fact that T and his family had no previous connection with the region, T's relocation to the United States and his new residency status would trigger very serious adverse tax consequences, exposing the trust assets to income, estate, gift and generation-skipping transfer tax laws operating in the US. Because of the way in which the trust deeds had been drafted, those laws would apply to (and significantly diminish) the assets in the Trusts unless steps were taken beforehand to mitigate those consequences.

[1] *Unreported, 16 July 2021, written reasons of the Hon. Chief Justice.*

The STAR and the cy-près provisions in the trusts act

Ordinarily, a trustee faced with similar issues might deploy a mitigation strategy involving variations to the trusts pursuant to section 72 of the Trusts Act. However, section 72 does not apply to STAR Trusts. Instead, the Trustee and T agreed that it would be necessary to protect the interests of the beneficiaries of the Trusts by making an application to the Court to reform the Trusts cy-près pursuant to section 104 of the Trusts Act (the **Application**). The Application was filed, on an urgent basis, and was the first of its kind to date.

By way of explanation, section 104(1) provides that, if the execution of a STAR trust in accordance with its terms becomes, in whole or in part (a) impossible, impracticable; (b) unlawful or contrary to public policy; or (c) obsolete due to a change in circumstances, the trustee shall apply to the Court to reform the trust cy-près. A centuries-old doctrine, cy-près has allowed the courts to save a charitable trust from failing when a charitable objective has become impossible or impracticable to fulfill by altering its objectives to be performed as closely as may have been originally expected by the settlor. As the Court noted, at English common law, a cy-près application can only be made in respect of property subject to charitable trusts. However, in the Cayman Islands, STAR trusts are intended to be innovative in ways which would not be recognizable at common law, and the application of the cy-près doctrine to special trusts (even those without charitable purposes) by way of statutory provision reflects this intention.

Obsolescence and the "spirit of the gift"

The Trustee and T agreed that section 104(1)(c) applied to the Trusts: the execution of the Trusts in accordance with the terms of the governing trust deeds had become obsolete in that, because of T's changed circumstances in deciding to relocate to the US, the general intent of the Trusts could no longer be achieved.

As the term "obsolete" is not defined in the Trusts Act and there was no relevant Cayman Islands case law on the point, the Court conducted a wide-ranging analysis of the term in order to determine if the general intent of the Trusts had become obsolete due to T's proposed relocation. In doing so, the Court noted (among other things) that:

- the meaning of "obsolete" in reliance on the New Oxford Dictionary, provided definitions including "*fallen into disuse*" or "*out of date*";
- section 62(1)(a)(ii) of the Charities Act 2011 (UK), to which the Cayman legislators had regard while drafting section 104 of the Trusts Act, stated that in applying the cy-près doctrine, regard may be had to circumstances "*where the original purposes, in whole or in part, cannot be carried out, or [cannot be carried out] according to the directions given and to the spirit of the gift*";
- the English Court of Appeal in *Varsani and Others v Jesani and Others* [2] had noted that the phrase "the spirit of the gift" meant "*the basic intention underlying the gift or the substance of the gift rather than the form of the words used to express it or conditions imposed to effect it*"; and
- the concept of "the spirit of the gift" is reflected in section 104(1)(c) of the Trusts Act, where the latter speaks of the execution of the special trust being "*obsolete in that, by reason of changed circumstances, it fails to achieve the general intent of the special trust*."

Having conducted this analysis, the Court accepted that obsolescence in this context meant that the basic intention underlying the gift into trust, or the substance or spirit of the gift, could no longer be carried out.

Change in circumstances

The Application was supported by evidence from the Trustee that the "general intent" of the Trusts was to benefit the objects of the "Purposes" as defined in the Trust Deeds (that is, the beneficiaries of the Trusts) in a tax- efficient way in a politically stable environment so that as many of the Trusts' assets as possible may be used for the Purposes. The Trustee had formed the view that this general intent had been achieved while the Trusts were located in the Cayman Islands and T was located outside the US, but could no longer be achieved on T's relocation to the US unless the Trust Deeds were significantly reformed.

The Court found that the Trustee was no longer administering the Trusts in circumstances (as were in existence at the time of settlement of the Trusts) where none of the beneficiaries had a connection with the US or an intention to relocate there. T's proposed relocation to the US had by necessity led to a complete and extensive restructuring plan to be drawn up by his US advisors to deal with the relocation, which he had provided to the Trustee. With this information in front of it, the Trustee was no longer in a position to ignore the potential and very significant US tax liabilities that would accrue on his relocation: US tax provisions had to be taken into account by the Trustee in any exercise of its discretion. Perhaps most importantly, the Trustee had determined that if it was to exercise its discretion without proper regard to the US tax position of the beneficiary, in light of the information provided to the Trustee by the tax advisors, such an exercise would be liable to be set aside, or could expose the Trustee to breach of trust claim, for failure to exercise its discretion having taken into account all relevant considerations.

The Court noted that the proposed reforms to the Trusts were far-reaching and transformative, but that they nonetheless remained within the basic intention underlying the spirit of the Settlor's gifts to the beneficiaries and would be approved. As a result, the Court decided that it was appropriate to grant the order for reform of the Trusts cy-près.

Lessons for trustees

The written reasons released by the Court will be a very helpful guide for trustees of STAR Trusts who are faced with a situation in which the purposes of the STAR Trust can no longer be achieved – a situation that may become increasingly

[2] [1999] Ch 219

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common in the current global climate. Section 104 of the Trusts Act clearly offers a route to reform a STAR Trust so that the spirit of a settlor's gift can still be recognised and adhered to despite changes in circumstances and without any detriment to the beneficiaries of the Trust. Section 104(1)(c), and the ruling of the Court in this judgment, show a practical and flexible approach to the protection and preservation of a settlor's wealth and wishes well beyond the settlor's lifetime.

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