Types and uses of Cayman Islands law trusts

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Introduction

A trust is a legal arrangement which distinguishes between the legal and beneficial ownership of property. Legal ownership is transferred to a trustee who manages and administers the property for the benefit of the beneficiaries, or for the furtherance of certain purposes. It is an arrangement intended for the safekeeping, management and eventual disposal of property.

The Cayman Islands is one of the leading jurisdictions for the establishment and management of trusts. It has a sophisticated professional trust sector, modern trusts legislation and an effective judicial system. There is a specialist Financial Services Division of the Grand Court which handles trust matters, and ultimate appeals to the Privy Council in the United Kingdom.

There are generally no gift, estate, income or capital taxes in the Cayman Islands for individuals or companies. Cayman therefore offers fiscal neutrality for trusts established in the jurisdiction.

Trusts terminology

The settlor (or grantor) of the trust is the owner of the assets to be placed or 'settled' on trust. The settlor creates the trust and may also benefit under its terms. The assets settled on trust comprise the trust fund.

The trustees are the individuals or companies to which the legal ownership of the property is transferred and who are empowered to hold, administer and distribute such assets in accordance with the terms of the trust. Cayman law trusts are generally administered by professional corporate trustees regulated by the Cayman Islands Monetary Authority ("CIMA"), but are also often administered by trustees in other jurisdictions.

A trust is normally documented by a trust instrument or trust deed which sets out the terms on which the settlor and the trustees have agreed that the latter will hold and administer the trust fund. The trust instrument will generally identify the beneficiaries of the trust, that is, those persons intended to benefit from the trust fund, and/or the purposes the trust was established to further.

Cayman trusts law

The principles of English common law and equity, both with respect to trusts and generally, apply in the Cayman Islands subject to variation by local statute. The principal trusts legislation is the Trusts Act (as revised) of the Cayman Islands,[1] which is supported by a body of case law from the Cayman courts.[2]

Common types of Cayman trusts

The following are the most common types of Cayman trusts used.

Discretionary and fixed interest trusts

Whilst some settlors wish to confer fixed interests on beneficiaries, that is, they wish to specify the precise circumstances in which beneficiaries are to be given the income and/or capital of the trust fund, most settlors prefer to give trustees sufficient flexibility to take account of changes in the circumstances of the beneficiaries.

A discretionary trust gives the trustees wide powers to administer the assets and to distribute them at their discretion. The trustees will usually be guided by a letter of wishes from the settlor setting out his or her wishes regarding the manner in which the trust fund is to be administered and distributed. Such letters of wishes can be updated from time to time.

STAR Trusts

Cayman provides for a different form of trust called a "STAR Trust" after the legislation passed to establish this alternative trust regime. The STAR Trust mechanism is an exceptionally flexible one, allowing for:

- charitable and non-charitable purpose trusts
- mixed trusts for purposes and persons
- perpetual trusts which are non-charitable
- trusts which restrict the rights of the beneficiaries to enforce the trust or obtain information about it from the trustee
- trusts which cannot subsequently be varied through the courts (for example, following the death of the settlor)

These are results often difficult or impossible to achieve under the traditional form of trust.

1 Other important trusts legislation in Cayman includes (non-exhaustively) the Perpetuities Act (as revised), the Fraudulent Dispositions Act (as revised), the Powers of Attorney Act (as revised) and the Settled Land Act (as revised).
2 Case law from other trust jurisdictions is persuasive and routinely cited in the Cayman courts.

The persons with standing to enforce a STAR Trust are those who have been appointed as enforcers by the settlor when the trust was established (beneficiaries may or may not be enforcers), pursuant to the trust deed or an order of the court. STAR Trusts must have at least one enforcer, and at least one of the trustees must be a licensed trust company or registered as a private trust company in Cayman.

STAR Trusts are often used, in addition to the uses noted below with respect to purpose trusts, to hold operating companies in such a way as to limit trustee involvement in the business, or to establish a trust which will prevent the beneficiaries consuming the trust fund assets in speculative legal claims.

Non-charitable purpose trusts

It is possible for trusts governed by Cayman law to be established partly or wholly for non-charitable purposes using the STAR Trust regime.

In a private wealth context such trusts may be used to collect and protect family heirlooms or antiques, or to hold certain assets such as the shares in a family trading company or private trust company or to pursue philanthropic purposes that may not fall within the traditional heads of charity.

Typical features of Cayman trusts

Whilst it is not possible to cover the features of all trusts in this guidance note, the points below are worth noting:

Revocability of trusts

A Cayman trust may be revocable or irrevocable. If a trust is revocable, the settlor may terminate the trust and regain ownership of the trust fund held on trust on the date revocation takes effect.

An irrevocable trust cannot be revoked, and it may be advantageous in certain cases (often for tax reasons) to use this form of trust rather than one that can be revoked.

The use of protectors

The settlor of a discretionary trust may wish to ensure certain controls are placed around core powers of the trustees, whether dispositive or administrative. This can be achieved by requiring the trustees to obtain the consent of a third party before exercising such powers.

Such a third party is often known as a protector of the trust. The rights and obligations of a protector vary from trust to trust and should be expressed in the terms of the trust instrument. Usually the protector is a close friend, relative or professional adviser of the settlor.

Common powers which are made subject to protector consent include the trustees' power to appoint new trustees, the addition and removal of beneficiaries and the distribution of capital from the trust fund.

Reserved powers

It is possible for a settlor to reserve certain powers for him/herself (or to confer such powers on others) under the terms of a trust instrument, and Cayman has enacted legislation confirming that the reservation of such powers will not, ipso facto, invalidate the trust. Powers to add and remove trustees, make alterations to the class of beneficiaries, change the proper law and/or forum of administration of the trust and withhold consent from specified actions of the trustees are all expressly recognised as capable of being reserved. It is also possible to reserve powers to direct the trustees in relation to the investment of the trust fund and distributions of income generated by the trust fund.

Private trust companies

Private trust companies or "PTCs" can be established in Cayman which act as the trustee for one or more family trusts. PTCs which only conduct 'connected trust business'[3] and which register with CIMA are exempted from the licensing requirements generally applicable to trust companies under the regulatory laws in Cayman. It is also possible for a PTC to obtain a 'restricted', rather than a 'full', trust licence from CIMA where this may be desirable.

One of the key perceived advantages of private trust companies is the scope that they give for settlors and other family members or close advisers to be involved in and to control the decision-making of the trustee entity, and to keep the affairs of the trust confidential in circumstances where there are acute sensitivities.

STAR Trusts are often used to 'orphan' PTCs so that the shares in the PTC do not form part of the settlor's estate.

3 As defined in the Private Trust Companies Regulations (as revised).

Perpetuities

Ordinary non-charitable trusts governed by Cayman law may now exist for periods of up to 150 years, and trusts established for charitable or non-charitable purposes, or otherwise under the STAR legislation, may exist in perpetuity.

Practical uses of trusts

Trusts are generally used by individuals and companies for a variety of personal and business reasons, particularly in the context of estate and succession planning and in the sphere of investment activities.

The following examples outline some of the practical ways in which trusts are used:

Asset management and protection

Settlors capable of handling their own investments may be concerned about the ability of heirs to do so after their death. A trust can be established reserving investment powers to the settlor during his lifetime. On the death of the settlor, either a person nominated by the settlor or the trustees may assume responsibility for the investment of the trust fund.

Settling assets on trust can also serve important asset protection functions, so long as the trust is not established with the intention of defrauding creditors and the settlor does not reserve to himself unrestricted powers to revoke the trust or otherwise recover the trust assets. Transferring assets to a trustee on the terms of a discretionary trust can serve to ensure that the assets are not available to the creditors of the settlor or the beneficiaries of the trust, and that the assets are protected in the event of family breakdown among members of the beneficial class.

Avoidance of probate formalities

Assets owned by an individual usually pass on death in accordance with the terms of a will. If the assets are held in a wide variety of countries it may be necessary to obtain a grant of probate with respect to the will in each country where assets are located. This can be onerous, expensive and time-consuming. In addition, there may be estate duties and taxes payable before the estate can be settled and the assets distributed to the heirs of the deceased.

However, if such assets are settled on trust, they can be held for the benefit of succeeding generations in accordance with the terms of the trust instrument: the death of the individual should have no detrimental consequences for the continued operation of the trust.

Forced heirship

Assets held in a trust can be distributed in any manner that the settlor desires. An individual from a country with rigid legal or religious inheritance laws may, during his or her lifetime, wish to implement a scheme of distribution of assets among his heirs that differs from that prescribed by his domiciliary law. By establishing a trust outside that country in Cayman, and depending on the location of the assets that will constitute the trust fund, the desired distribution plan can often be implemented.

Philanthropy

Trusts are often established as a vehicle for philanthropic giving, either with respect to existing charitable institutions or charitable purposes more generally. Charitable trusts can last indefinitely.

Privacy, confidentiality and anonymity

Trusts are generally created by a private document to which the settlor, the trustees and any protector are the only parties. The trust instrument does not have to be filed with any public body in the Cayman Islands,[4] and information relating to the trust is not accessible by the general public.

There are, however, certain limitations in this regard: in particular, beneficiaries of a trust may be entitled to financial and other information relating to the trust.[5] Furthermore, as part of the global initiative to improve tax compliance, Cayman is party to a handful of international agreements providing both for the automatic exchange and exchange upon request to the relevant authorities of other contracting states of certain information held in Cayman by professional trustees and other institutions relating to the trusts they administer or for which they maintain financial accounts.[6]

4 Unless there is a desire for the trust to be registered under the 'exempted trust' regime. See footnote 5 below.

5 This can be restricted using a STAR Trust. See below.

6 Following the enactment of the US Foreign Account Tax Compliance Act ("FATCA") and the development of the OECD Standard for Automatic Exchange of Financial Account Information – Common Reporting Standard ("CRS"), the Cayman Islands has passed regulations implementing the international agreements to which it is a signatory which make provision for, among other things, the automatic exchange of certain information held by Cayman-based professional trustees and other financial institutions to tax authorities in the 'home' jurisdictions of the individuals connected to the trusts in question (eg settlors, protectors and beneficiaries). Cayman is also party to a series of OECD sponsored Tax Information Exchange Agreements with various countries which provide a legal framework within which the relevant authorities of those countries may make formal requests to the Cayman authorities to obtain and exchange information held in Cayman, including information held by professional trustees, relating to specific criminal or civil tax matters under investigation in the requesting country.

Prevention of division of assets

An individual who has built up a sizeable private company may have some children who are interested in the running of the business and some who are not. The individual may wish to benefit the children equally but would not like any of them to be able to dispose of their interest in the family company to non-family members. Such arrangements can be achieved through the use of a trust, and the STAR[7] regime holds particular advantages in this regard.

Family assets may also take the form of works of art or real estate which, by their nature, cannot be divided but from which a number of individuals benefit. Such property can be held in trust for the beneficiaries without disturbing the underlying property.

Control of spending

Many individuals may be unfit to manage their own affairs due to age, infirmity or profligacy. A trust structure can allow trustees to help in the management and preservation of wealth by controlling the manner in which trust funds are spent.

Commercial uses

There are also a range of uses to which trusts are put in the commercial sphere, including trusts established:

- for conferring benefits and incentives on employees (eg employee benefit trusts and employee share option schemes);
- as a vehicle for the administration of pension funds;
- as a platform for investment funds allowing investors to spread risk by acquiring limited stakes in a large portfolio of investments (eg a unit trust)[8];
- to hold security over a borrower's assets for the benefit of lenders under syndicated loans; and
- as an 'orphaning' mechanism to hold assets 'off balance sheet', and in the creation of 'bankruptcy remote' structures.

Conclusion

A trust is a flexible arrangement which can be structured to meet the objectives of a settlor. Tax advice should be obtained by the settlor and in some cases the beneficiaries before a trust is established and it is in response to such tax advice that we, as Cayman legal advisers, can tailor the terms of a trust to suit the needs of a settlor and those he or she intends to benefit.

7 "STAR" is an acronym for the Special Trusts (Alternative Regime) Act, 1997, which is now contained in Part VIII of the Trusts Act (as revised) of the Cayman Islands.
8 There is even an 'exempted trust' regime in the Cayman Islands, often used in relation to Unit Trusts, which enables a tax exemption certificate ("TEC") to be obtained by the trustees of the exempted trust. The TEC is an undertaking given by the Governor in Cabinet to the trustees of an exempted trust that no law which may be enacted in Cayman imposing any estate duty or inheritance tax will apply to any property comprised in or any income arising under an exempted trust. This undertaking can be valid for a period of up to 50 years from the date of establishment of the exempted trust.

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