

GUIDE TO TRUSTS IN THE CAYMAN ISLANDS

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PREFACE

This Guide is a summary of the law and procedures relating to the establishment and operation of trusts in the Cayman Islands.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to any member of the team, using the [contact information](#) provided at the end of this Guide.

Appleby

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1. CAYMAN ISLANDS – JURISDICTION OF CHOICE

The Cayman Islands is a jurisdiction recognised worldwide as an international financial centre of the highest calibre. Leading financial institutions, Fortune 500 companies and private and public businesses from across the globe have chosen Cayman as their jurisdiction of choice for many reasons, including the following:

Reputation: due to its well established legal system, stability and strong financial services industry, the Cayman Islands have a reputation as a high quality offshore centre.

Flexibility: the Cayman Islands have the advantage of progressive “leading edge” legislation, developed in consultation and collaboration with industry stakeholders.

Central time location: the Cayman Islands’ central time location (GMT-5) is ideal for organisations operating their businesses from Asia, Europe and the Americas.

Tax neutrality: Cayman has no capital gains, income, profits, corporation or withholding taxes. If a trust is an “exempted trust” the Cayman Islands Government will issue an undertaking that even if the law were to change it will remain tax-free for a period of up to 50 years. Expert advice from the jurisdiction in which an interested party is tax resident should always be sought before entering into any international arrangements or transactions.

Speed: once all necessary information, including “know your client” documentation, is gathered and verified, a Cayman Islands trust can be established in a matter of days. There is no requirement for registration, and for most types of trusts there is no requirement to have a Cayman Islands trustee.

Availability of world-class professional services: Cayman has a wealth of trust companies, trustees, lawyers, accountants and other service providers who specialise in providing trust and trust related services.

Trustworthy and reliable legal system: Cayman Islands law, which is derived from English common law and supplemented by local legislation, ensures that business in the Cayman Islands is conducted in the context of a sophisticated, respected and reliable legal system. The Cayman Islands court system is well developed, user-friendly and staffed by a respected and independent judiciary with appeals ultimately going to the Privy Council in London. Trust cases are dealt with by a dedicated Financial Services Division of the Grand Court.

Compliance culture: the Cayman Islands has long been committed to implementing best international practices and is compliant with the anti-money laundering and anti-terrorist financing requirements of the Organisation of Economic Cooperation and Development (**OECD**) and Financial Action Task Force. Cayman is on the OECD “white list” and has entered into a multitude of tax information exchange agreements.

Stable and business-oriented government: the Cayman Islands are a British Overseas Territory and have a history of stable government, committed to promoting the financial services industry.

Sensible and proportionate regulation by the Cayman Islands Monetary Authority (the Authority): the Authority’s mission is to regulate and supervise the financial services industry in order to maintain a first class financial system. The Authority’s focus is on safeguarding the interests of investors in, and customers of, regulated institutions from undue loss. The Authority has regard to international standards and the need for operational freedom by financial services providers, with the focus on maintaining a dynamic and competitive industry.

Exchange controls: there are no exchange control regulations in the Cayman Islands. As such, money and securities in any currency may be freely transferred to and from the jurisdiction.

Legal Opinions: Cayman Islands legal opinions are routinely relied upon in international and overseas transactions.

With this extensive portfolio of advantages, it is unsurprising that the Cayman Islands has established itself as a premier jurisdiction for the establishment of trusts.

2. LEGAL FRAMEWORK AND THE NATURE OF TRUSTS

2.1 Legislation and Case Law

The primary legislation in the Cayman Islands is the Trusts Law which is enhanced by the Fraudulent Dispositions Law and the Perpetuities Law. However, Cayman Islands trusts law is not fully prescribed by statute. Trusts established in the Cayman Islands and subject to Cayman Islands law are strongly influenced by English common law. This comprises judicial decisions of the English courts in trust cases which often go back hundreds of years but which are nevertheless still relevant.

The other source of Cayman Islands trust law is the decisions of the Cayman Islands courts. Given the status of the Cayman Islands as a premier offshore financial centre, it is unsurprising that there is a deep pool of Cayman Islands case law from which to draw knowledge and certainty on matters of interpretation.

2.2 Nature of a Trust

A trust has no separate legal personality and is not a legal person. A trust creates a fiduciary relationship with respect to property, imposing on the trustee an obligation to deal with the trust property for the benefit of specified persons or, in certain cases, for specified objects.

A trust can be established by a unilateral declaration of trust made by the trustee. Alternatively, a trust can be established by means of deed of settlement to which both the trustee and the settlor are parties.

A majority of trusts are irrevocable, which means that, subject to the comments below, the settlor loses control over the trust assets completely. Alternatively, a trust can be declared revocable, usually by the settlor, or it can be partially revocable in certain circumstances. Adverse tax consequences may flow from the creation of a revocable trust and onshore tax advice should be taken in this regard.

Trusts are principally established "*inter-vivos*" which means that they are created and assets contributed to the trust within the lifetime of the settlor. Alternatively, a testamentary trust is possible in which the relevant assets are deemed to be held on trust on the death of the settlor, under the terms of the will or succession arrangements.

3. REASONS FOR ESTABLISHING A TRUST

There are a number of valid and compelling business and personal reasons to establish a trust, including:

Estate planning: estate planning is a primary reason for establishing a trust, whether onshore or offshore. Within this context, the exclusion of assets of an estate subject to probate is usually the prime consideration. Other factors include (a) ensuring that particular assets (e.g. the family business) are kept within the family and (b) avoiding forced heirship rules in civil law jurisdictions.

Professional portfolio management: whilst it is not necessary to establish a trust in order to take advantage of the professional portfolio management capabilities which most trust companies usually have, this is often a factor taken into account in conjunction with other reasons for establishing a trust.

Tax mitigation: tax evasion is a serious offence in most jurisdictions and is not a valid reason to set up an offshore trust. In fact, due in part to past abuses, many jurisdictions have now imposed substantial rules and regulations which limit the tax advantages of establishing an offshore trust. Nevertheless, even if establishing a trust for other reasons, it is always an important consideration to ensure that there are no tax disadvantages onshore to establishing a trust. It is essential when establishing a trust structure that settlors and trustees obtain appropriate tax advice from all relevant jurisdictions.

Asset protection: as an offshore jurisdiction, the Cayman Islands discourages fraudulent dispositions of any kind. In 1989, the Cayman Islands were the first jurisdiction to legislate in this area with the enactment of the Fraudulent Dispositions Law. The intention of this law is to make any disposition of property into, for example a trust, voidable by a creditor prejudiced by such disposition where the disposition is made with intent to defraud present or contingent creditors. The burden of proof to establish the fraudulent intention is upon the creditor. An action by a creditor to attack what would otherwise be a fraudulent disposition cannot be brought more than six years after the relevant disposition. This is in contrast with other offshore jurisdictions which have much shorter limitation periods of one or two years.

Another important aspect of the Fraudulent Dispositions Law affects the trustees rather than the settlor of a trust or its beneficiaries. This provision provides that a trustee that has not acted in bad faith, notwithstanding that a fraudulent disposition is set aside, will have first claim on the trust assets for its costs in defending the fraudulent disposition action as well as its other proper fees and costs. Moreover, any distributions made by the trustee in good faith to beneficiaries before the trust is set aside will not be recoverable.

4. TYPES OF TRUSTS

4.1 Discretionary Trusts

The discretionary trust is probably the most common trust vehicle used in the Cayman Islands. In effect, the trustee is given an absolute discretion as to how to manage and invest the trust estate and how much and to which beneficiaries distributions should be made. In many countries (particularly, we have found, in Latin America) there is an understandable reluctance to give a third party complete control over one's lifetime earnings and assets. Under the Trusts Law there are a number of limitations (or degrees of limitations) which can be imposed on these discretionary powers.

English judicial decisions going back hundreds of years have established that the common law duty of a trustee is to preserve the capital for the benefit of the beneficiaries. In the absence of careful documentation, therefore, a trustee will be restricted to a balance of conservative investments. Equities, for example, have been determined to be too high risk for a trust investment and one can only guess what the attitude would be to derivatives and options.

4.2 Strict Settlements

A strict settlement is the opposite of a discretionary trust. The trust document will strictly define exactly what the trustee can and cannot do, when it will be done, for whose benefit and what will happen if circumstances change and the strict instructions cannot for some reason be followed. This highlights probably the less flexible nature of this type of trust because the unforeseeable will usually happen thereby

paralysing the trust. The trustee will then have to apply to the courts for directions as to what it should do in those circumstances.

4.3 **Trusts with Protectors**

One halfway house between a discretionary and strict settlement is to make provision within the trust document for a protector or other similar individual to be given quasi-trustee powers. The trust document will then limit the discretionary powers of the trustee by requiring the trustee to consult with, obtain the consent of or otherwise follow the instructions of the protector (or similar individual). These limitations can be in relation to the investment powers of the trustee and can also extend to the distribution of assets to the beneficiaries. A common feature is to give the protector the power to remove the trustee and appoint a new trustee. However, adverse tax consequences can result for the trust if a protector (or similar individual) is resident in a jurisdiction which would attempt to tax the trust because of the powers retained by the protector.

4.4 **Trusts with Reserved Powers**

An alternative to the appointment of a protector is to retain (or reserve) certain powers in the hands of the settlor of the trust. Again, such powers reserved by the settlor can include the power to appoint or remove the trustees, power to consult or direct investment management functions and power to control distributions to the beneficiaries. However, adverse tax consequences can flow both to the settlor and to the trust depending upon the tax jurisdiction to which the settlor is subject.

4.5 **Exempted Trusts**

An exempted trust is entitled, upon request and payment of a fee, to a tax exemption undertaking from the Cayman Islands government. This undertaking guarantees that the trust will pay no Cayman Islands taxes for a fixed period (usually 50 years). It should be remembered that no Cayman trusts pay any Cayman taxes of any nature whether exempted or otherwise now (and no such taxes are foreseeable).

4.6 **Private Trust Companies**

One way for a settlor to retain some control over the affairs of a trust is to establish and licence a private trust company in the Cayman Islands to act as the trustee. Depending on the type of Private Trust Company required (there are two types: Registered and Restricted Licence) it may be necessary to appoint directors with substantial trust and fiduciary experience.

4.7 **STAR Trusts**

Special Trusts (Alternative Regime) trusts (**STAR Trusts**) are non-charitable purpose trusts that may be created for any objects, whether persons, purposes or both, provided they are lawful and not contrary to public policy. STAR Trusts are governed by a separate part of the Trusts Law, which provides a secure legal framework for such entities, making them more desirable than a standard purpose trust for many commercial purposes. For example, the beneficiary principle (which provides that there must be an ascertainable beneficiary with a proprietary interest in the trust property capable of enforcing the trust) has been solved by the requirement for an Enforcer who is subject to fiduciary duties. The requirement of certainty whereby the terms of the trust must be sufficiently clear and capable of being executed is facilitated in the legislation by giving the court power to resolve uncertainty. The rule against perpetuities does not apply to a STAR trust so there is no risk of a resulting trust in favour of the settlor at the end of the permitted period. For a full discussion of STAR Trusts, and their usefulness in many commercial arrangements (particularly structure finance transactions) please see Appleby's "Guide to STAR Trusts" available on our website at www.applebyglobal.com.

4.8 Charitable Trusts and Foundations

The Cayman Islands do not recognise as a separate legal entity charitable foundations which are common in some European jurisdictions. However, it is possible to achieve the same effect by the use of charitable trusts, STAR Trusts or a Cayman company limited by guarantee with charitable objects. The perpetuity period becomes important here. One of the exceptions to the rule against perpetuities is that a charitable trust can have an unlimited duration. Cayman Islands law adopts the English common law definition of charitable objects and it is important to ensure that a charitable trust complies with the English definitions or the charitable purpose could be held to be void.

A particular use of charitable trusts has developed in the Cayman Islands as part of structured finance transactions. In such transactions, particular assets are settled into a charitable trust so that the assets will no longer be owned by the settlor and will be deemed to be "off-balance sheet". These structures are particularly useful for the repackaging of securities and other self-financing transactions. Charitable trusts are discussed in more detail below.

5. CONTROL

5.1 Investment Parameters

It is important to establish investment parameters within the trust document. This can either be done within the trust deed itself or by incorporating into the trust documents investment guidelines which can be subject to change by, for example, the settlor or a protector, depending upon changes in circumstances. Such guidelines should establish a base currency for the trust and contain a description of the general investment parameters such as the percentage mix between sovereign and corporate issuers and geographical concentrations (e.g. OECD or emerging markets).

5.2 Letter of Wishes

A common practice has developed of the settlor issuing a non-binding letter, known as a "Letter of Wishes", addressed to the trustee to supplement the provisions of the trust documents. The intention is to give the trustee a degree of guidance on investment guidelines and distributions to beneficiaries without derogating from the discretion of the trustee. It is important to bear in mind that a letter of wishes is not binding on the trustee but merely serves as a guide. From the point of view of the trustee, therefore, the trustee cannot escape liability just because the trustee has followed the wishes of the settlor. As compared to incorporating the investment guidelines within the trust document as previously mentioned, high risk guidelines in the letter of wishes will not protect a trustee from attack by future beneficiaries. Similarly, whilst the general practice is that trustees will usually seek to follow the wishes expressed in the letter where possible, circumstances may change which may mean that the trustees cannot and should not follow the settlor's wishes. It must always be remembered that the beneficiaries can enforce their rights against the trustee by requiring the trustee to act either in accordance with its common law duties or otherwise in accordance with the trust documents.

6. FORCED HEIRSHIP

A number of jurisdictions do not recognise the concept of a trust. Furthermore many of these same jurisdictions specify how the assets of a deceased person must be distributed to his heirs with a fixed percentage of the estate, for example, going to the spouse and fixed percentages for the children. A trust created by a settlor who is domiciled in one of these jurisdictions may be subject to attack both by the heirs in that jurisdiction and/or perhaps by a regulatory or tax authority in that jurisdiction. In response to this, Cayman trusts legislation provides that no trust governed by Cayman Islands law is void or can be set aside because the laws of any foreign jurisdiction prohibit or do not recognise the concept of a trust, or the

trust avoids or defeats forced heirs rights conferred by foreign law. The express selection of the laws of the Cayman Islands to govern the trust will be valid and effective, even the capacity of the settlor to create the trust will be governed by Cayman law.

Consideration must also be given to the location of the trust assets. Obviously a jurisdiction with forced heirship laws will not hesitate to attack any assets of the trust which it finds within its jurisdiction, so that the trust assets can be applied in accordance with the local forced heirship rules.

7. FIDUCIARY AND OTHER DUTIES OF TRUSTEES

A trustee has a fiduciary obligation towards the beneficiaries (not the settlor) of the trust, an obligation which demands honesty, integrity, loyalty and high standards of care and good faith. The trustee is required to act within the terms of the trust instrument and must always act in the interests of the beneficiaries.

The precise obligations of a trustee will vary according to the provisions of the trust instrument. Unless expressly extended in the trust, a trustee's investment powers are restricted to those powers granted pursuant to the Trusts Law. The general duties of trustees are to:

- act in good faith and in accordance with the terms of the trust deed;
- manage the trust fund bona fide in the best interests of the beneficiaries;
- exercise the level of care and skill in administering the trust as might reasonably be expected of trustees with their level of experience;
- take reasonable steps to preserve and protect the assets in the trust fund;
- disclose any conflict in relation to the trust. A trustee must not generally profit from the trust (unless authorised by the trust instrument);
- keep accurate records and accounts;
- satisfy itself as to the legitimacy of the source of the funds in trust.

A trustee is under a personal duty to acquaint itself with the powers and duties which will be assumed by accepting the office. A trustee who fails to comply with its duties could be liable to the beneficiaries to account for loss occasioned by any breach of trust. Where there is more than one trustee all decisions should be unanimous unless otherwise specified by the trust instrument.

8. CHARITABLE TRUSTS

Duties

The duties of charity trustees are the same in principle as those of non-charitable trustees. The primary duty is to execute the trust in accordance with its terms. For example, it is a breach of duty for charity trustees to divert a charitable fund given for one object to another not contemplated by the settlor.

If it is established that the stated objects of a charitable gift fail, the property may be applied *cy-près* for a charitable purpose similar to the original object, otherwise the whole gift fails.

The Crown is the protector of all property subject to charitable trusts, such trusts being essentially matters of public concern. The Attorney General, who represents the Crown for all forensic purposes, is the proper person to take proceedings on behalf of and to protect charities. The Attorney General represents the beneficial interest (i.e. the objects) of the charity.

The Attorney General is not under a duty to enforce for his strict legal rights when the result of enforcing them would be oppressive to individuals. However, if he insists the court will enforce them.

Generally, the court does not interfere with the execution of a charitable trust unless it appears that its interference will benefit the charity. However, the court always has a general controlling power over all charitable institutions and can always enforce the performance of trusts and redress breaches of trust.

9. **ACCOUNTS**

Charity trustees have a general duty to keep proper books of account with respect to the affairs of the charity. Trustees of private trusts are also required to keep such accounts as are appropriate to the trust and the trust property.

10. **ANTI-MONEY LAUNDERING OBLIGATIONS**

The Cayman Islands legal system incorporates sophisticated anti-money laundering laws and regulations in accordance with modern international best practice. Appleby has always required certain information from our clients in all cases. Beyond that, we are required to obtain and keep on file extensive documentation of the identity of each client for whom certain specified types of business are conducted. In certain cases, it may be possible to rely on an exemption or on client identification carried out by another regulated service provider, and we will do so where appropriate. However, it will often be necessary to ask clients or prospective clients for documentary evidence of their identity, and often also that of related parties, as well as certain references.

We ask for the co-operation and understanding of our clients in this process, which is an important element of the drive by leading offshore financial centres such as the Cayman Islands to ensure that they are not used as a vehicle for unlawful purposes.

For more specific advice on trusts in the Cayman Islands, we invite you to contact:

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For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found [here](#).