

Cayman Islands

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With a sound base of English trust law principle incorporated into its common law, benefiting from many hundred years of English law precedent, the Cayman Islands has established itself as a leading jurisdiction for the establishment of Trust structures for high net worth individuals. By pioneering specific legislation that enables dynastic planning Chinese High Net Worth individuals can create Trust and corporate structures that both accumulate wealth and provide for its distribution to successive generations.

China with its highly successful planning and infrastructure development is projected to become the world's leading economy by 2020 and establish a growth rate three times that of most Western economies. This extraordinary success will create significant wealth and opportunities for Chinese companies and individuals. As Chinese entrepreneurs expand their investment horizons to take advantage of opportunities on a global basis, it becomes more important to undertake careful consideration and planning as to the manner in which those global investment opportunities should be structured to minimise income, corporation and inheritance tax risks, and to ensure that the structure created will withstand not only attack from creditors and expropriatory Governments during the lifetime of the Chinese entrepreneur but will confer similar and continued benefits for successive generations.

The Cayman Islands is a well established and highly effective jurisdiction for this form of structuring. It is currently an Overseas Territory of the United Kingdom, and therefore benefits from an English Common Law structure that respects rights of ownership under an English style court system having ultimate appeal to the Privy Council in London, comprised of Justices of the Supreme Court, the highest court in the United Kingdom. The Cayman Islands is currently the only financial centre with no income, corporation, capital gains, payroll, value added, sales or inheritance taxes and no exchange controls. Notwithstanding the absence of taxation, guarantees are available from the Cayman Islands Government for periods of 20 and 50 years for Company and Trust structures.

Furthermore, permanent residence is available for high net worth individuals and there are a variety of structures including Private Trust Companies which can be established for the management and protection of private wealth and worldwide investments.

So too regulation is of the "light touch" variety, it being understood that Cayman Islands corporations undertaking business activity in onshore jurisdictions must comply, in any event, with the laws and regulations of those onshore jurisdictions; duplicative regulation and unnecessary expense is thereby avoided.

Company or Trust?

The answer is both. In terms of specific structures for wealth structuring, the Company remains an inherently more satisfactory vehicle than the Trust for undertaking commercial transactions and accumulating wealth. Specifically, it has the benefit of limited liability for its shareholders and importantly, the liability of the Company as between itself and its creditors is regulated by statutory priority which provides the essential certainty for all forms of financing transactions. Furthermore, there is uniform treatment amongst the Common Law jurisdictions of the world with regard to the residence and domicile of a Company which may be treated as firmly sited in the Cayman Islands. But if nothing more is done by the entrepreneur than own the shares in a Cayman Islands Company, those shares are available to his creditors in the event of difficult financial circumstances arising. The core point here is that ownership of the shares of the Company, and it doesn't make any difference whether these are registered or bearer shares, remains in the estate of the entrepreneur and is vulnerable to attack either when the entrepreneur is alive or after his death by any creditor, whether this is a third party lender, a spouse, heir, or expropriatory Government. Furthermore, in the inevitable event of the death of the entrepreneur, the issued share capital will fall to be dealt with under the laws of his jurisdiction of residence or domicile and will fall into account

for domestic, estate or inheritance tax purposes. For that reason, the better suggestion is that the issued share capital of any such Company or group of Companies is owned by a Common Law Trust domiciled in a jurisdiction like the Cayman Islands. The Trust, with its ability to give effect to testamentary disposition to successive generations, is the ideal vehicle to dispose of wealth when accumulated.

Specific legislation

Having been involved in the drafting of the specialist trust Laws in the Cayman Islands in the early 1990's, I can say, given their subsequent widespread adoption, that they set at the time, and continue to set, the benchmark for flexible and effective Trust structuring. Specifically, the issues that were resolved arose under three separate areas, each of which prior to the amending legislation in the Cayman Islands, had historically caused great difficulty and uncertainty with respect to the creation of Trusts and wherever established. The first area concerned the question of the law that should govern the Trust, the capacity of the Settlor to establish the Trust and the disposition of assets to the Trust. Very often the Settlor would come from a jurisdiction which did not recognise the concept of trust and so Cayman Island law provided that where the document selected Cayman Island law as its governing law, then questions of capacity of the Settlor to create the Trust and the essential question of the law governing the disposition of assets to the Trust would be Cayman Islands law.

Thus the Cayman Islands was the first offshore jurisdiction to introduce legislation that dealt with the conflicts of law issues as between the jurisdiction of residence and domicile of the Settlor and Beneficiaries on the one hand, and on the other hand the laws of the Cayman Islands. Specifically, the following points of difficulty could arise:

- The laws of the jurisdiction of the domicile of the Settlor might have nothing similar to the Trust concept;
- The laws of the jurisdiction of the domicile of the Settlor, might impose forced heirship, that it to say a distribution regime that applies automatically in the event of the death of the Settlor;
- The laws of the jurisdiction of the domicile of the Settlor might impose a community of property regime.

Accordingly, the Trusts (Foreign Element) Law 1987 (now incorporated into the Trusts Law) clarified and changed Cayman Islands law in the following key areas:

- The express selection in a trust of Cayman Islands law as the governing law of the Trust is valid and conclusive;
- All questions relating to the Trust including dispositions of property to the Trust are to be determined only by reference to the laws of the Cayman Islands, in particular, (a) the capacity of the settler; and (b) any aspect to the validity of the Trust and any disposition thereto.

This amending law addressed head on the issues of non recognition of trusts by civil law jurisdictions and stated that no Trust governed by the laws of the Cayman Islands or any disposition to such a Trust should be invalid or defective or the capacity of the Settlor questioned because of the laws of that foreign jurisdiction.

The second law which provided specific benefits to protect the Cayman Islands Trust was the Fraudulent Dispositions Law 1989 (again now incorporated in the Trusts Law). This law reversed an earlier English statute which provided that:

- Future creditors could attack a Trust even though their claim arose after the date of disposition of assets to the Trust;
- Dissatisfied spouses and heirs could attack the Trust; and
- Expropriating Governments could attack the Trust.

This law reversed these possibilities so that the Trust can only be attacked as a matter of Cayman Islands law by a creditor whose claim arose prior to the disposition of assets to the Trust. The law thereby also provided greater

certainty to Trustees who, provided they acted in good faith, were protected throughout against future third party claimants.

The third specific piece of legislation (again now incorporated in the Trusts Law) dealt specifically with the question of the extent to which the Settlor of the Trust could continue to be involved with the management and control the Trust Assets during his lifetime. This had previously been a source of difficulty under the prior law as over much control by the Settlor could result in a trust being set aside as a sham arrangement under the principles established in the Jersey case *Rahman*. The new legislation enabled the reservation of the following specific powers to the Settlor of the Trust:

- Any power to revoke, vary or amend the Trust instrument or any trusts or powers arising thereunder in whole or in part;
- A general or special power to appoint either income or capital of the Trust Assets;
- Any limited beneficial interest in the Trust Assets;
- A power to act as a director or officer of any company wholly or partly owned by the Trust;
- A power to give binding directions to the Trustee in connection with the purchase, holding or sale of the Trust Assets;
- A power to appoint, add or remove any Trustee, Protector or Beneficiary;
- A power to change the governing law and the forum for administration of the Trust; or
- A power to restrict the exercise of any powers or discretions of the Trustee by requiring that they shall only be exercisable with the consent of the Settlor or any other person specified in the Trust instrument.

Including any one or more of these powers in a Trust is thus specifically authorised and provides that the Settlor may retain considerable control over the management of the underlying assets, notwithstanding that they are held by the Trustee on the terms of the Trust. Nevertheless, very careful consideration must be given to the provisions of the Trust document, particularly since a number of the conflicts which may arise can only arise after the death of the Settlor. Careful and logical thinking must be applied to the specific terms of the Trust document. In this respect, the issues that will arise in China are no different from the issues that have arisen in other jurisdictions. What is certain is that where the structure is ill thought out without the benefit of experienced professional advice, it may be appropriate neither for the needs of the Settlor nor his family. Experience has shown that the following concerns can arise:

- The Trust document may be a standard form hastily prepared without the benefit of professional advice and does not deal with the complexities of generational planning;
- The Trustee may find itself in very real difficulty relying on the indemnity and exculpation clauses because the Settlor was not properly advised;
- Whilst we have seen that the specific legislation mentioned above may enable the Settlor to retain control over the management of the underlying Trust Assets, particularly by serving as the CEO of subsidiaries owned by the Trust, proper information flows must be established so the Trustee is aware of what is occurring with the Trust Assets. The foregoing is essential because on the death of the Settlor, the commercial situation may deteriorate rapidly. It may be too late at that stage for the Trustee to become involved in complex underlying industrial or commercial investments or arrangements.

The role of the Protector

What must be avoided in the event of the passing of the Settlor is the Trustee having to step in with no prior involvement or understanding of the operation of the underlying Trust Assets. Careful planning by the Settlor and his professional advisers is essential. Not only in dealing with the foregoing issues but specifically also:

- To ensure that the Trust document in all respects reflects the intention of the Settlor because the question of intention is central to the integrity of the Trust document and to its withstanding subsequent challenges;
- Secondly, to utilise independent counsel who will minimise the risk of the argument arising that the Trustee was responsible to the Settlor and the Beneficiaries of the Trust as to conflicts of law, estate planning issues,

tax or dispositive issues. The Trustee will be more comfortable that the Settlor is independently advised because there is greater certainty that the Trustee can then rely on the trust provisions and particularly, the provisions for indemnity and exculpation.

- Whilst the issue of management and control by the Settlor of the underlying commercial or investment assets held by the subsidiary is resolved, thought must also be given to the transitional arrangements that must be included as a matter of good succession planning. The involvement by the Settlor in day to day operations can leave the Trustee effectively isolated and incapable of demonstrating effective control on the passing of the Settlor. For this reason, it is important to establish either or both of a Protector or a Committee of Protectors or one or more Advisory Committees including both professionals and, ideally, representatives of the next generation, so that not only may transitional arrangements be effected but the role of the Trustee is not unnecessarily increased. Whilst the Trustee is of crucial importance in providing long-term security and stability to the structure the Trustee will unquestionably require assistance in dealing with high risk commercial or operating Trust Assets and investments and the well thought out structure must contemplate that assistance.

Multiple Jurisdictions: A great idea or not?

Lastly, most importantly, careful consideration must be given to the jurisdictions in which the Trust and underlying subsidiaries are located. Historically, there was some attraction to the idea that the use of multiple jurisdictions would be a benefit. Perceived benefits may have been:

- The spreading of political risk;
- The additional buffer of confidentiality between jurisdictions;
- Possibly the creation of more layers for a creditor or unhappy heir or spouse, or expropriatory government to have to attack when seeking to set aside the structure.

But against this, we must now consider:

- How many jurisdictions does it make sense to worry about in terms of political risk, precisely what evaluation of political risk is being undertaken and who has the responsibility for the ongoing evaluation;
- The administrative costs and burdens will be increased and the number of service providers must increase with multiple jurisdictions;
- The risk of multiple law suits in multiple jurisdictions is increased;
- To obtain the benefits of the legislation (above mentioned) that is of specific application to Cayman Islands trusts, both the Trust and the underlying subsidiaries should be located in the Cayman Islands. If not, the Cayman Islands legislation carefully considered in the initial structuring may become irrelevant.

Given the foregoing circumstances, the better view is that multiple jurisdictions should be avoided and emphasis placed on the certainty and political stability of the legal regime of the Cayman Islands and on proper corporate formalities being applied to the underlying companies owning the assets so that the corporate identity is at all times maintained.

Given that most sophisticated offshore jurisdictions, including the Cayman Islands, now have legislation that permits the mobility of Trusts and Companies, it is simpler to select one jurisdiction and to take the maximum advantage of its legislation than to involve conflict of law issues that result from spreading the structure over multiple jurisdictions.

Conclusion

With the foregoing points in mind and in conclusion, the following may summarise the advice to the Settlor with

regard to the establishment of a Trust in the Cayman Islands to benefit successive generations and which seeks to avoid forced heirship, or community of property claims, the claims of prospective creditors, or expropriatory Governments:

- It is in the best long term interests of the Settlor intending to establish a Trust to benefit successive generations that he develop with his professional advisors a careful and well thought out plan appropriate to his circumstances and the underlying commercial or investment assets;
- It is the primary task of his professional advisors to assist him with this. If at the outset he has no such advisors, it is most important that his Bank or Trust Company ensures that such advisors are retained otherwise the Bank or Trustee is at risk if the structure does not work;
- Suitable powers can be reserved to the Settlor and to any Protector or Advisory Committees under the Trust to ensure that the Settlor and or the Protector, or any such Committees, have appropriate authority to manage and control the Trust Assets;
- The structure must have the ability to continue smoothly after the Settlor's death, thus the Settlor must be willing to establish a formalised structure with appropriate reporting and information flows to the Trustee;
- The structure should be conservative in its aims and acceptable to the Settlor's family and heirs as a whole;
- A Trustee should be used which is to the extent possible, removed from the jurisdiction of the Courts likely to be hostile to the Trust. In this respect, it may be worthwhile to establish a Private Trust Company solely for the purpose to act as Trustee for that particular private trust or group of trusts;
- Whilst underlying companies can assist in shielding the ownership of Trust Assets, those companies must be run in accordance with proper principles of corporate governance to avoid abrogation of "sham" transactions.

With due emphasis on the foregoing, it is possible to create in the Cayman Islands a dynastic trust for the benefit of future generations, substantially protected from the claims of future creditors and which, with appropriate onshore advice, minimises taxation and estate or inheritance taxes.

Author Biography



Anthony Travers

A Scholar of Cambridge University with a First Class Degree in Law, Anthony spent 30 years with Maples and Calder advising many of the world's leading financial institutions on offshore transactions and serving as the Senior Partner and Managing Partner of that firm until his retirement in 2006. In 2012 Anthony joined Thorp Alberga (renamed Travers Thorp Alberga) as Senior Partner.

An expert in all forms of offshore financial structuring, he was the architect of the legislation governing key financial services in the Cayman Islands including the Exempted Limited Partnership Law 1991 and the Mutual Funds Law 1993 which formed the foundation for private equity and investment funds in the Cayman Islands and, in the area of private client, the Fraudulent Dispositions Law 1989. Having advised government on and prepared the Stock Exchange Law 1996, he has served as Chairman of the Cayman Islands Stock Exchange from inception and has advised the Cayman Islands Government on legislative initiatives as a member of the Financial Services Council. Anthony has served as President of the Cayman Islands Law Society and as the Chairman of Cayman Finance, the representative body of the Cayman Islands Financial Services industry.

Anthony has spoken and written extensively on offshore issues over the years. A synopsis of his writings is available at www.anthonytrovers.com and his career may be reviewed on Wikipedia. He was awarded the Order of the British Empire for service to the Cayman Islands Financial Services industry in August 1998.

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