

# Private and commercial trust structures

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The decision to establish a trust should not be taken lightly, and certainly not without due consideration of all of the relevant factors and consultation with professional advisers. The formation of a trust may involve a whole new set of business structures, laws and taxes. The process is made even more difficult as consideration is given to the myriad of “offshore” jurisdictions and service providers that offer trust services. Clearly not all jurisdictions are the same, as each offers certain unique features that can be baffling to the uninitiated, but creates opportunities if time is taken to consider the relative merits of each.

**T**he process of transferring ownership of significant assets to a trustee in a remote jurisdiction offshore can be unsettling, unless the settlor appreciates the legal and equitable principles governing the trust relationship.

Every trust structure is unique, and it is not possible to deal with the many issues in the detail they deserve. Professional advice concerning the best way to arrange your own personal affairs, is advised.

In this article, we will provide an introductory discussion of trust law concepts followed by a review of commonly used trust structures. We will finish with a discussion of the unique strengths of three out of our eight jurisdictions – Bermuda, British Virgin Islands (“BVI”) and the Cayman Islands (“Cayman”).

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## I. Reasons for establishing a trust offshore

In our experience, the four most frequent reasons for establishing a trust are as follows:

### A. Estate planning

Estate planning is one of the primary reasons for establishing a trust, whether onshore or offshore. The exclusion of assets from an estate which is subject to probate is usually the prime consideration. Other factors relating to estate planning include: (a) ensuring the family business is kept within the family, and (b) avoiding forced heirship rules present in most civil law jurisdictions.

## B. Forced heirship

A number of jurisdictions specify how the assets of a deceased person must be distributed to his/her heirs. Correctly structured, a trust may provide the mechanism to control the distribution of assets upon death, by simply ensuring that the assets do not form part of the deceased's estate. Bermuda, BVI and Cayman are well placed as offshore jurisdictions because of their very attractive legislation regarding forced heirship considerations.

## C. Tax minimisation

International trust structures are especially effective as a part of a tax minimisation strategy due to the international nature of today's high net worth families. It is not uncommon to find that family members are spread throughout the world, many having homes in several tax jurisdictions. The use of a tax neutral or low tax jurisdictions as a hub for the family assets or investments of a multinational family constitutes sensible tax planning and has very powerful advantages if done properly.

In Bermuda, BVI and Cayman, there are no taxes on profits, income or dividends, nor is there any capital gains tax on trusts. Bermuda is not subject to the provisions of the EU Savings Tax Directive, and accordingly has no obligation to collect taxes or disclose information to EU member states. However, there is a nominal stamp duty fee payable on certain trust documents where the trust fund holds non-Bermuda property.

Beneficiaries of a trust who are not resident in the BVI are exempt from all BVI taxes, when distributions are made to them. However, the BVI does not offer the same benefits to a resident beneficiary.

The only personal taxes in Cayman are stamp duty on real estate transfers and other specified transactions.

## D. Confidentiality

Ordinarily, offshore jurisdictions will have strong confidentiality laws or enable nominee arrangements to be entered into. In certain cases, usually involving drug-related or terrorist funds tracing, or where there is a criminal investigation into tax evasion, there may be exchange of information with onshore authorities.

## II. Why establish a trust in Bermuda, BVI or Cayman?

Bermuda, BVI and Cayman all enjoy a long history of providing sophisticated financial and professional services both to international businesses and to high net worth clients. Each enjoys:

1. **Tax neutrality** – a beneficial tax environment.
2. **Reputation** – a strong economy and a reputation as one of the pre-eminent offshore jurisdictions, with world-class advisory and financial services infrastructure.
3. **Strong governance** – a stable and business-friendly government conducive to modern commercial transactions. Each has a trustworthy legal system, a tradition of transparency and an anti-

money laundering culture that complies with the highest international standards.

4. **Appeal to Privy Council** – final appeal to the Privy Council in England.
5. **Asset preservation** – legislation designed to preserve the trust assets for the beneficiaries, including from claims of creditors, forced heirship and certain decisions of foreign courts.
6. **Flexibility** – progressive leading edge legislation passed to remove many of the traditional limitations of the trust vehicle.
7. **Exchange Controls** – no exchange control regulations, as such money and securities in any currency may be freely transferred to and from the jurisdictions.

## A. Perpetuity period

In Bermuda and BVI, it is usual for a trust to provide for a perpetuity period of 100 years; but there is no perpetuity period for purpose trusts and pension trusts in Bermuda. The Cayman Islands perpetuity period is now fixed at 150 years save that a Cayman STAR trust may be perpetual.

## B. Regulatory authorities

The Regulatory Authorities in Bermuda, BVI and Cayman maintain first-class regulatory systems. They seek to regulate and supervise the financial services industry in a manner that will preserve the islands' international business reputation while still allowing a measure of flexibility.

The Regulatory Authorities and the offshore professions constantly vet and monitor the international business that comes to their islands. Wealthy families and Fortune 500 Companies seem to appreciate this.

## III. Discretionary trusts

A discretionary trust is the type of trust most commonly used in Bermuda, BVI and Cayman to protect family assets. The principal feature of a discretionary trust is that the beneficiaries do not have any legal enforceable right to any part of the trust property. In reality, the trustees of the trust have an unfettered discretion as to the administration of the trust property, and as to whether or not a beneficiary receives a benefit under the trust. The beneficiaries of the trust do, however, have the right to enforce their rights against the trustee by requiring the trustee to act in accordance with its fiduciary obligations and the terms of the trust documents.

The trustees of the trust are usually directed by the settlor's (or grantor's) Letter of Wishes which assists the trustees as to how such trust property should be administered. The intention of the Letter of Wishes is to provide the trustees with guidance as to investments and distributions to beneficiaries without derogating from the discretion of the trustees. The trustees will usually seek to follow the wishes of the settlor as set out in the Letter of Wishes, however the contents of the letter are not legally binding on the trustees.

There are two main advantages of establishing a discretionary trust:

1. It is flexible as it allows the trustees in the exercise of their duties and discretion to take into account

factors that may not have been evident when the trust was initially created. The flexibility also allows the trustees to control and protect the trust property from being dissipated or from claims from creditors.

2. As the beneficiaries have no legal enforceable interest or entitlement to any part of the trust fund this may have beneficial tax consequences in the country of domicile, residence or citizenship of the beneficiary.

#### IV. Private Trust Companies (“PTCs”)

PTCs are commonly used by wealthy families as a replacement for institutional trust companies, or as part of their global planning. It is usual for a PTC to be formed to act as the trustee of one or more private family trusts or connected trusts. These might be separate trusts for family members that each own shares of a single/common operating company, trusts holding non-income producing assets such as yachts, airplanes or real estate, or charitable trusts used by the family in their philanthropic activities.

There are advantages to using a PTC, namely:

- **Cost** – when created in the appropriate jurisdiction, a PTC is not subject to an expensive licensing process. Accordingly, in some cases the fees related to the formation and ongoing administration of the structure will be less than those charged by an institutional trustee;
- **Familiarity** – many settlors from civil law jurisdictions are unfamiliar with trust concepts. The combination of a trust and a PTC is similar in effect to a corporate or foundation structure;
- **Efficiency** – the absence of licensing makes it easier, quicker and less expensive to make changes to directors, officers or other structure elements;
- **Comfort** – many clients are hesitant to transfer legal ownership of significant assets to an institutional trust company in an offshore jurisdiction. The client may be more comfortable having the assets owned and administered by a PTC that they have created, and perhaps control (depending upon the tax and other factors affecting the settlor and beneficiaries);
- **Control** – the structure of a PTC enables family members or trusted advisers to be involved in the decision making process by becoming directors or consultants to the PTC;
- **Privacy** – many families may be concerned about the disclosure of information regarding the family, their assets and their activities. A PTC makes it easier to control access to, and disclosure of, confidential information. This is especially true where the board of directors of the PTC consists of the family and their trusted advisers;
- **Consolidation** – many institutional trustees are unwilling to hold certain types of assets. The PTC does not have similar constraints, and all of the assets can be administered by a single trustee;
- **Integration** – the PTC integrates easily with a Family Office, an operating company or even a private philanthropic trust. It is possible to share a common name, board of directors and administrative facilities.

The PTC can also be used to act as the trustee of commercial trusts. A financial institution will form a wholly-owned PTC to act as trustee of “in-house” collective investment trusts, such as unit trusts or mutual funds. The PTC might also be used to own special purpose vehicles that are used in financing or other structures.

#### V. Bermuda and the private trust company

Bermuda has been at the forefront of the development of the purpose trust and, in particular, its use is to hold shares in a PTC. This possibility was first introduced in Bermuda by the Trusts (Special Provisions) Act 1989 and refined by the 1998 Amendment Act. Over the past several years, the use of a Bermuda PTC in combination with a purpose trust has been increasingly attractive to many clients, including clients from civil law countries.

Bermuda legislation is designed to make the formation of a Bermuda PTC quick, easy and relatively inexpensive compared to many other jurisdictions. A Bermuda PTC is a company with trustee powers which does not require licensing under Bermuda’s trust legislation. The Trusts (Regulation of Trust Business) Act 2001, only requires that it fulfils the following criteria:

1. It is not carrying on business as a trustee, in essence, it cannot offer its services to the general public;
2. By the terms of its memorandum of association, it is empowered to act as trustee of only a limited number of identifiable trusts;
3. The PTC must also certify to the Bermuda Monetary Authority in writing that it qualifies for the exemption from licensing by virtue of the above restrictions, and provide some description of the trust which it administers; and
4. There are no minimum share capital requirements for a PTC.

The Bermuda PTC, combined with a Bermuda Purpose Trust, is seen as an ideal legal solution for those wishing to establish a family office structure, or for those who do not wish to use institutional trust companies.

#### VI. Purpose trusts

Bermuda, BVI and Cayman permit the establishment of non-charitable purpose trusts as an alternative to traditional discretionary trusts in the commercial context. Five particular advantages of using a purpose trust are:

1. The purpose is specified by the originator of the arrangement;
2. The trustee owns or controls property which is subject to an obligation to apply that property for a particular purpose;
3. The obligation is maintained by operation of law and cannot be revoked by any person unless the terms of the trust so permit. This is the most prominent feature of the purpose trust – the maintenance of the obligation to apply the trust assets to the specified purpose irrespective of the wishes or legal rights of any potential recipient (or classes of recipient) of benefit from the arrangement;

4. The precise terms of the purpose and its mode of execution can be specified outright in the trust instrument or may be subject to variation within parameters specified by the originator; and
5. The trust assets are dedicated to the specified purpose and “ring-fenced” from insolvency risks of the trustee. Subject to certain rights of others, the trust assets will also be protected from creditor claims against the originator of the purpose trust.

Different jurisdictions have adopted various legislative enhancements to make their purpose trusts unique. BVI and Cayman have their own bespoke purpose trusts, the VISTA Trust and the STAR Trust which are discussed in more detail below.

## VII. British Virgin Islands and the VISTA trust

A unique feature of BVI as a trust jurisdiction is its VISTA trust, derived from the title of the legislation permitting its establishment —the Virgin Islands Special Trusts Act 2003 (the “Act”). The Act establishes a trust system whereby the owner of a family business is able to establish a trust to hold the shares of his company under which the shares can be retained indefinitely. The trustee’s primary responsibility is to retain the shares of the company as part of the trust fund. Essentially:

1. The Act only applies where there is an express provision in the trust instrument directing that it applies;
2. The Act allows BVI trusts to exclude the “prudent man of business” rule which requires trustees to monitor the affairs of underlying companies. The trustee cannot intervene in the management of the company except in order to resolve specific problems in the operation of the company;
3. The trustee has a statutory duty to retain the shares of the company which can be retained for as long as the directors deem fit. The trustee’s fiduciary obligations and duty of care regarding the assets of the trust or their conduct in the affairs of the company are restricted to an “intervention call” on behalf of a beneficiary of the trust, parent or guardian of a minor beneficiary or such other “interested person” as outlined in the Act;
4. The trustee of a VISTA trust must be a company which is licensed to carry on trust business in BVI under the Banks and Trust Companies Act, 1990. The Act precludes a director of the underlying company from being a trustee.
5. The Act allows the settlor to specify how the trustee must exercise its voting powers in relation to the appointment, removal and remuneration of directors, via special “Office of Director” rules, detailed in the trust instrument. This effectively enables the settlor to control who becomes a director of the company.

VISTA is seen as an ideal solution for settlors who would wish to create a trust of their company shares, but for the constraints imposed by the “prudent man of business” rule. VISTA will be an invaluable tool for a settlor who does not wish to have trust assets diver-

sified, but wishes to retain the company indefinitely. Other possible opportunities for the use of VISTA include, personal succession planning and matrimonial settlements in addition to trusts for commercial purposes such as holding voting shares of mutual funds, special purpose vehicles and other structured finance vehicles.

## VIII. The Cayman Islands and the STAR trust

In 1997, Cayman introduced a novel approach to the purpose trust commonly known as a “STAR Trust”. A unique feature of a STAR trust is that it may be created for any objects, whether persons, purposes or a mixture of both, provided they are lawful and not contrary to public policy.

The STAR Trust must have at least one trustee that is a trust corporation licensed in Cayman. The main characteristics of the STAR Trust are:

1. STAR allows the establishment of a trust with mixed purposes — a STAR trust for both persons and purposes is permitted; the purposes may be charitable or non-charitable or a mixture of both;
2. STAR allows the possibility of an unlimited trust period because the perpetuity period (150 years in Cayman) does not apply to STAR trusts;
3. Under STAR, the settlor of the trust may be given the power to make investment decisions;
4. Under STAR, the trust must have one or more enforcers, who may or may not be beneficiaries. In the event that the beneficiaries are not appointed as enforcers, the beneficiaries will have no rights of enforcement.

At present there is no requirement to register a STAR Trust with any regulatory authority in Cayman.

STAR Trusts are used as a solution for personal estate planning situations, in a variety of commercial situations and as vehicles used to own the shares of a PTC, amongst many other possible uses.

## IX. Consolidation of jurisdictions

Continuous amendments to existing legislation, combined with the enactment of pioneering new legislation in Bermuda, BVI and Cayman provide the modern day trustee with innovative solutions to the practical issues faced by them in these three sophisticated offshore island jurisdictions. This approach will enable Bermuda, BVI and Cayman to remain at the forefront of international trust practice as these islands continue to attract highly specialist trust practitioners and their clients to their island shores.

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