KEY POINTS

What is the issue?

As the needs of private clients become increasingly complex, those advising such clients can benefit from another 'tool in the toolbox' to solve certain structuring issues where a traditional trust or company may not be suitable.

What does it mean for me?

The Cayman Islands foundation company is proving to be an innovative and flexible vehicle with myriad uses.

What can I take away?

With separate legal personality, no requirement for shareholders/members and an ability to appoint beneficiaries, foundation companies are an attractive alternative to traditional trusts and companies.

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Laying the foundations

MONIQUE BHULLAR AND JAMES GLOVER REVIEW THE BENEFITS OF FOUNDATION COMPANIES IN THE CAYMAN ISLANDS, FIVE YEARS ON FROM THEIR INTRODUCTION

Introduced by the *Foundation Companies Law 2017* (the Law), a foundation company (FC) is a type of company governed by the laws of the Cayman Islands. The same body of law applies to an FC as to any other Cayman Islands company, unless modified or excluded by the Law. The constitution is set out in a memorandum and articles of association, which may be supplemented by a set of by-laws (similar to a letter of wishes for a trust). The FC is managed by a board of directors, although other persons, including the founder, may be granted various degrees of control over the affairs of the FC.

Although an FC takes the legal form of a traditional company, key differences include the following:

- the constitution may provide that the objects of an FC may not be altered;
- the objects of an FC may include providing financial or other benefits to beneficiaries;
- there is no requirement that an FC should have members or shareholders; and
- an FC must appoint a secretary that is a Cayman Islands licensed service provider.

UNIQUE FEATURES

The benefits of a trust

The key difference between an FC and a trust is that an FC, being a company, is a legal entity. Accordingly, it may own assets, enter into transactions and contracts, and sue or be sued in its own name.

Issues of legal certainty that may arise in relation to a trust do not arise with an FC. An FC is a body corporate with a certificate of incorporation to evidence its existence. In contrast, a traditional trust structure can be less attractive to clients in civil-law countries, where there can be unfamiliarity with the separation of legal and beneficial interests and uncertainty regarding tax treatment.

The Cayman Islands' asset protection legislation, traditionally associated with transfers into a trust, applies equally to the transfer of property to an FC. By virtue of the *Fraudulent Dispositions Law*, an individual with no existing claims against them and no reasonably foreseeable claims in the pipeline may transfer assets to an FC safe in the knowledge that those assets will be ring-fenced against the claims of future creditors.

Other offshore foundations

FCs benefit from long-established jurisprudence that relates to companies. Accordingly, the FC structure is tried and tested and its legal treatment is certain. A number of offshore jurisdictions have established common-law or offshore foundations by way of entirely new legislation. The challenge with this approach, however, is that offshore foundations are relatively new legislative constructs that do not have the benefit of an established body of jurisprudence. This can result in uncertainty in determining how a court may interpret, apply or treat these entities.

Confidentiality and avoiding disputes

FCs provide a high degree of confidentiality for individuals and families. The only publicly available information regarding an FC is the date of its incorporation, the company number, whether it is active or dissolved, the company's registered office address and the names of its current directors. Although the memorandum and articles of association are filed with the registrar, these documents are not available to the public. The by-laws are not filed with the registrar.

Unless the FC's constitution provides otherwise, a beneficiary has no powers or rights relating to the FC, its management or its assets, and no rights to receive reports, accounts or any other information about the FC. Generally, a beneficiary of a trust (save certain types of trust, such as a STAR trust)[1] has well-established rights to receive information about the trust and its assets, and potentially to bring a claim against the trustee.

Flexibility and protection from foreign inheritance laws

With respect to FCs as a succession-planning tool, the founder's plans for their family (which may cover multiple generations) may be set out in detail in the FC's articles of association or in the by-laws. The founder's plans may include details of management and governance, distributions or beneficiary information. The founder may reserve or grant powers, including rights to appoint or remove beneficiaries, directors and officers, manage and distribute assets or alter the constitution documents.

An FC can also assist to preserve and prevent fragmentation of family wealth from the application of foreign heirship and inheritance regimes. The Cayman Islands impose very few restrictions on an individual's freedom to dispose of their property, both during their lifetime and on death. This extends to transferring property to an FC. Cayman Islands law will actively protect any such transfer by means of statutory rules known as the 'firewall'. When determining the validity of a transfer of assets to an FC, these rules exclude the application of all foreign-heirship laws. Any foreign judgment that is inconsistent with these principles will not be recognised nor enforced by the Cayman Islands courts.

> 'A growing trend is the use of FCs by a younger generation of ultra-high-net-worth individuals or entrepreneurs in the technology sector'

FCS IN PRACTICE

FCs for succession planning

As a result of these unique features, the Cayman Islands have seen an increase in the use of FCs by high-net-worth individuals (HNWIs) for business and family succession-planning purposes.

Although the majority of this business continues to come from onshore jurisdictions, including countries in the Middle East and Asia, a growing trend is the use of FCs by a younger generation of ultra-high-net-worth individuals (UHNWIs) or entrepreneurs, often in the technology sector. There has been significant growth in both the relocation of UHNWIs and/or their businesses to the Cayman Islands, and the innovation and technology sectors in the Cayman Islands, including companies established in the Special Economic Zone.

This has resulted in a number of UHNWIs who have utilised the flexible FC regime for corporate structuring purposes now utilising FCs for their own personal succession planning as well. FCs are particularly useful for holding higher-risk, less-diversified assets, given that the directors of the FC owe duties to the FC itself rather than to its beneficiaries. This bodes well with many clients in the technology sector who hold primarily non-traditional, virtual assets.

FCs as 'orphan' vehicles

FCs are increasingly being used as private trust companies in place of the traditional structure of an ordinary company whose shares are held by a purpose trust, with a licensed trust company acting as trustee. By using an FC, the structure is consolidated into a single vehicle, as the FC is structured as an 'orphan' company without members (eliminating the need for a purpose trust).

FCs structured without members are also commonly used for philanthropic and not-for-profit ventures. Using an FC provides the founders of a philanthropic or not-for-profit organisation with a great deal of corporate governance flexibility, including the ability to allocate powers, duties and control among a range of stakeholders. The objects of an FC can include charitable and non-charitable purposes, which provides flexibility for founders to establish a hybrid vehicle, often eliminating the need for two separate vehicles.

FCs in fintech and cryptocurrency structures

The number of FCs registered in the Cayman Islands during the past 24 months has almost doubled and a significant part of this growth can be attributed to FCs used in fintech and cryptocurrency structures.

The flexibility and adaptability of FCs make them particularly well suited for decentralised autonomous organisations (DAOs). DAOs operate in a different way to many traditional legal vehicles and structures. In particular, an objective of a DAO is to achieve a bottom-up, democratic form of governance, whereby decisions are made by a defined community. As DAOs and their many users become more mainstream, there is a growing need for many DAOs to take a legal form.

Although traditional corporate vehicles and structures require a shareholder or owner (which sits uneasy with the concept of community), an FC does not require an owner: it can be structured as an 'orphan' vehicle. Further, an FC's constitution can be very bespoke and flexible; meaning the constitutional documents of an FC (most commonly its by-laws) can ensure the FCs rules and decision-making processes mirror those of a DAO. This may include, for example, providing that the founder (if any) has a nominal role and restricting the powers of the directors to reflect the fact that DAOs seek to be governed from the bottom up and have a democratic governance model.

This complementary relationship, since their introduction five years ago, between FCs and decentralised projects, is likely to see the number of FCs continue to rise, as the use of foundations for such projects becomes more widespread.

#CAYMANISLANDS
#COMPANIES
#FOUNDATIONS

1 STAR trusts are derived from the *Cayman Islands Special Trusts (Alternative Regime) Law, 1997*.

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