

## Cayman Foundations: New Wealth Management Tool

A new corporate entity has been introduced to the Cayman Islands in the form of the Foundation Company (“**Cayman Foundation**”), under the Foundation Companies Law 2017 which is now in force.

Cayman Foundations will no doubt be put to various uses, including in the structured finance industry. They are likely, however, to prove to be a popular means of managing family assets in a tax-efficient manner. This note focuses on the use of the Cayman Foundation as a wealth management vehicle.

A Cayman Foundation is a separate legal entity that holds assets in its own name. In principle, it can operate as an investment vehicle, the fruits of which may be drawn down by beneficiaries designated by the founder or founders, and whose identity may be changed from time to time. It may therefore prove to be a useful vehicle for holding and managing family assets.

One key advantage over a company or trust is that the beneficiaries (including the founder if a named beneficiary) do not have any proprietary or other interest in the assets of the Cayman Foundation. This means that any change of entitlements does not lead to a disposition of assets from the founder to a beneficiary or from one beneficiary to another.

That notwithstanding, founders and/or beneficiaries may be treated as ultimate beneficial owners of the assets, for anti-money laundering purposes or for taxation by revenue authorities in different jurisdictions. Local legal and taxation advice will therefore be important when considering whether or not a Cayman Foundation is appropriate in any given case.

### **What is a foundation?**

Foundations are familiar to certain civil jurisdictions, such as Liechtenstein, Germany and Austria. They may be used for any legal purpose, which does not have to be a charitable one. In practice, most civil law foundations are instruments of estate planning of the founder, for the benefit of the founder’s family. A foundation may therefore serve as a functional equivalent to a trust or a will. Some jurisdictions prevent foundations from carrying out commercial activity.

Their success derives in large part from the control that can be reserved to founders, without the founders retaining any proprietary interest in the assets once placed into the foundation.

Civil law foundations typically have the following characteristics:

- a foundation has separate legal personality, has no members, and operates by reference to its constitutional documents under the stewardship of a board or council;
- neither the founder or any beneficiary (unlike in the trust context) has any proprietary interest in the assets of the foundation, which are owned by the foundation absolutely once transferred to the foundation;
- a founder can effectively bind the board or council of the foundation to do his wishes, by way of simple contract. It is possible therefore for the founder to direct how the foundation's capital and income are to be applied, and who is to be a beneficiary, and to change those instructions from time to time;
- a founder can in principle be sole beneficiary during his lifetime, entitled to draw on both the capital and income of the foundation, with provision for other beneficiaries after the founder's death.

Common law practitioners often puzzle over the concept: foundations are not really companies or trusts, but they have certain characteristics of each. Indeed, a trust under which the settlor is the sole beneficiary entitled to capital and income is not a trust at all; but this is possible in a foundation.

In recognition of the popularity of foundations, some offshore common law jurisdictions have established foundations by statute – Jersey, Guernsey and now the Cayman Islands.

## **What is a Cayman Foundation?**

A Cayman Foundation is in fact defined as a species of company, and the Companies Law applies in modified form as well as the Foundation Companies Law 2017. Unlike foundations in some jurisdictions, a Cayman Foundation *can* carry out commercial activity, such as investment activity (so long as it is activity outside the Cayman Islands).

In substance, though, a Cayman Foundation is not too dissimilar from civil law foundations or its common law cousins.

A Cayman Foundation is a company with separate legal personality; but it needs no members, and does not have to have any shares in issue. Through careful drafting of the constitution, the founder can exercise very significant control over how the capital and income of the Cayman Foundation are to be used and who may draw on them. The founder can also have the power to alter the Cayman Foundation's constitutional documents, as well as what are known as the 'bylaws' of the foundation.

Amongst other things, it is envisaged that the bylaws will provide greater specificity than the constitution about (i) how the foundation should operate, (ii) who are to be beneficiaries and (iii) the scope of the entitlements of the beneficiaries.

### ***Establishment***

Cayman Foundations are simple to establish. A Cayman Foundation requires a secretary, who must be a qualified person who maintains the books and records of the foundation; and the registered office will be at the secretary's business address in the Cayman Islands. Amongst other things, the secretary is the gatekeeper for contributions to the foundation, for anti-money laundering requirements.

In addition, a Cayman Foundation needs a supervisor and at least one director. The supervisor and director can be the same person.

In reality, therefore, a founder may need only two service providers – a secretary and a supervisor/director.

There is no need to have members of the Cayman Foundation or shares. There is in fact little benefit to having members, since one feature of Cayman Foundations is that payment of dividends or distributions of profits or assets to members is prohibited. Rather, the manner in which assets and income are to be applied or drawn is a matter for the constitution or bylaws.

### *Constitution*

As with ordinary companies, the constitution of the Cayman Foundation comprises a memorandum and articles of association.

The constitution can give rights, powers, or duties to *any* person. These might relate to amendment of the bylaws or the constitution. Powers given by the constitution may be exercised for any purpose; they need not be exercised in the interests of the Cayman Foundation itself.

It is possible, therefore, for the documents to be drafted in a way that means that the founder or any other person may have:

- the right to alter the constitution of the Cayman Foundation or its bylaws;
- the right to appoint or remove any of the service providers to the Cayman Foundation, including the supervisors; and
- the power to designate or alter beneficiaries and their entitlements.

### *Bylaws*

Bylaws are not part of the constitution of the Cayman Foundation, but it is contemplated that they will be the blueprint for how the Cayman Foundation is operated and managed, and who may draw on its assets and income.

Although bylaws must not be inconsistent with the constitution, they may relate to all aspects of the management and operation of the Cayman Foundation, from the duties, powers, and remuneration of directors; the benefitting of beneficiaries; the investment, management and protection of the Cayman Foundation's assets; and the appointment of advisers and other service providers.

In the context of family planning, it will be the bylaws that provide that, for example, the founder has an absolute right to draw on the capital and income of the foundation during his lifetime, but other specified persons (or classes of persons) will be entitled to draw on capital and/or income after his death. It should be noted that, as with trusts, foreign heirship rights will not be recognised in relation to foundation assets.

### *Information rights and enforcement rights*

Only “interested persons” have information rights and enforcement rights against the foundation company. Interested persons are (i) members (or those entitled to be members), (ii) supervisors (or those entitled to be supervisors) or (iii) any person so named in the constitution. Beneficiaries are not interested persons.

### *Insolvency and winding up*

Dispositions may not be made by the Cayman Foundation if to do so would mean that the Cayman Foundation is unable to pay its debts as they fall due in the ordinary course of business.

Cayman Foundations are capable of being restructured by way of scheme of arrangement.

In terms of winding up, the constitution must expressly set out how the assets are to be distributed, in the case of any surplus after payment of creditors. Unlike with other companies, after payment of creditors, there is not necessarily any distribution to members of the Cayman Foundation.

### **Contentious issues**

In terms of dispute resolution, the constitution of a Cayman Foundation may provide that disputes be resolved by arbitration or any other lawful method. This means that disputes can be resolved in procedures that are confidential, such as arbitration, without the need to resort to public hearings in Court.

Since Cayman Foundations are a newly established type of corporate entity, areas that are likely to give rise to dispute cannot be identified with confidence. One area of uncertainty, though, relates to the duties owed by directors of Cayman Foundations.

Under the statute, directors may commit an offence and incur civil liability if they knowingly and wilfully authorise a disposition of assets when the Cayman Foundation is insolvent. There are also other specifically defined offences and liabilities that directors may incur, for example in relation to the need to maintain registers, and provision of information to the secretary relevant to anti-money laundering.

More generally, though, it is unclear from the statute how the common law duties of directors of companies are to apply in practice in the case of Cayman Foundations, given that:

- a founder can retain significant control over the operation, management and assets of a Cayman Foundation without necessarily being a director, officer, member, supervisor, or beneficiary;
- no member (if there are any members at all) will have an economic interest, in his character as member, in a solvent Cayman Foundation; and
- beneficiaries have no powers or rights relating to the Cayman Foundation, its management or its assets and are not interested persons.

## Conclusion

The introduction of foundation companies is a welcome addition to Cayman Islands law. With careful drafting of the constitution, Cayman Foundations are likely to be adaptable to many different uses, including as a wealth management tool.



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