

# THE CYPRUS INTERNATIONAL TRUSTS

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### The Trust

The concept of the trust as we know it in our days dates back to the Crusaders in the 12<sup>th</sup> Century and is based on the Anglo-Saxon legal system. It was devised to allow continuity of family property and succession in troubled times when the “master of the house” was off to war.

### Basic Structure

Although the various types of trust vary in complexity, the common feature or basic structure is as follows:

1. The **Settlor** is the person who creates the trust; he is the owner of the initial property placed under trust; he has the assets and places the same into the trust.
2. The **Trustee/s** is the person/s (individual or company) who agree/s to hold the trust assets (the '**trust assets**') in its/their name for the benefit of the **Beneficiary/ies** under the terms of the trust.
3. The Trustee has the legal title to the trust assets whereas the **Beneficiary** has beneficial or equitable title to the trust assets. Save in cases of bare trusts the Beneficiary is usually unable to have a say in the management of the trust property or the termination of the trust.
4. The **Protector** (is not compulsory but if appointed, it) is the person that has the power to restrict key powers of the trustee, such as the power to add beneficiaries to the trust.
5. The **Enforcer** (could be the Protector) is the person or persons whose duty is to enforce an international trust for a non-charitable purpose in accordance with the CIT law.

A trust may be created by the owner of property upon his death, by a testamentary disposition of the property into the trust accompanied by a letter or wishes but it is more appropriate and common that the trust is created during the lifetime of the owner of the property by a **trust instrument/deed**. A trust created through a testamentary disposition would not avoid inheritance laws or taxes where applicable, whereas a disposition of the trust property during the Settlor's lifetime avoids such problems.

### Uses of Cyprus International Trusts

Asset protection by means of a Cyprus international trust (CIT) is a very effective legal way of placing assets of high net worth individuals beyond the reach of future potential creditors or other claimants. Except for using it for asset protection the CIT is used in many other situations, such as tax planning, estate planning, for wealth management, investment, for charitable purposes and other. The confidentiality it offers is a major consideration which is also taken into account by prospective Settlers. The law imposes a duty of confidentiality on the trustee, the protector, enforcer or any other person concerned as regards the identity of the settlor or of any beneficiary, the accounts and the assets of the trust etc. Such information can only be revealed by a court order in any civil or criminal proceedings if the court is convinced that such information is material to the outcome of proceedings relevant to the trust property or the parties to the trust.

### Requirements for a valid trust

For a valid trust to be created the following criteria must be met:

- (a) The Settlor must be of full age and **capacity** (sound mind);
- (b) **Three certainties** must exist:
- (i) **Certainty of intention:** evidence of express intention of the settlor to create the trust. This is usually evidenced by the trust instrument. The test in determining whether the intention exists is whether based on the words used and from the behaviour of the parties, there is a distinct and clear intention that the property is to be held on trust for the benefit of a third party.<sup>1</sup> Care must be taken with word choices since precatory words – that is words of mere hope and desire (e.g. “in the hope that”, “I would like that” etc.)- are not enough to create a trust<sup>2</sup>
  - (ii) **Certainty of subject-matter:** this means that the trust assets must be readily identifiable otherwise the trust is void for uncertainty, i.e. can be money, shares or other movable property, immovable property and so on. In the case of intangible assets such as a trust of a specific number of shares, the trust will not be void for uncertainty merely because it refers to a number of shares in a company and does not refer to specific shares; shares of the same class are indistinguishable from each other and therefore it is not necessary for the particular shares to be identified or segregated.<sup>3</sup>
  - (iii) **Certainty of objects:** the identity of the beneficiaries of the trust must be ascertained or ascertainable at the time of setting up the trust.<sup>4</sup> The beneficiaries may be a specified class of beneficiaries that is an ascertainable group of people.<sup>5</sup> It is therefore not necessary for each and every potential beneficiary to be identified by the trustee.
- (c) **No formalities** or reporting requirement are required under Cyprus Law. However, registration of trust related information in the Cyprus Registry of Trusts is a legal requirement for all supervised entities administering trusts and/or providing trust services. The Registry is confidential and can only be accessed by the competent regulatory authorities. The information filed with the Registry are the following: the name of the trust, the name and address of every trustee, the date of establishment of the trust, the date of any change in the law governing the trust and the date of

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<sup>1</sup> (a) **Re Kayford** [1975] 1 All E.R. – Megarry J held that “it is well settled that a trust can be created without using the word “trust” or “confidence” or the like; the question is whether in substance a sufficient intention to create a trust has been manifested”.

(b) **Twincetra Ltd v Yardley** [2002] 2 A.C. 164 Lord Millett said (§ 71) “A settlor must, of course, possess the necessary intention to create a trust, but his subjective intentions are irrelevant. If he enters into arrangements which have the effect of creating a trust, it is not necessary that he should appreciate that they do so; it is sufficient that he intends to enter into them.”

<sup>2</sup> **Re Adams and the Kensington Vestry** (1884) 27 Ch. D. 394 – The testator’s estate was devised by will to the absolute use of his widow “*in full confidence that she will do what is right as to the disposal thereof between my children*”. These were mere words of aspiration and did not impose a legal obligation.

<sup>3</sup> (a) **Hunter v Moss** [1993] 1 W.L.R. it was held that the test should be whether, immediately after the declaration of trust, the court could, if asked, make an order for the execution of the trust, which it could only do if the subject-matter of the trust is identified with sufficient certainty.

(b) **Lehman Brothers International (Europe) (in Administration), Re** [2010] EWHC 2914 (ch) - mentions Hunter v Moss.

<sup>4</sup> **Double Happiness Trust, Re (also known as Grant Thornton Stonehage Ltd v Ward)** [2003] W.T.L.R. 367- it was held that for a trust to be valid, there had to be certainty as to the subject matter, the beneficiaries and the beneficial interests. While the subject matter of the settlement could be ascertained, there was some difficulty in respect of certainty as far as the beneficiaries were concerned. Accordingly the settlement had to be declared void for lack of certainty.

<sup>5</sup> **Re Baden’s Deed Trust** (also known as McPhail v Doulton) [1971] A.C. The test to be applied in ascertaining the validity of a trust is whether or not it can be said with certainty that a given individual is or is not a member of the designated class.

termination of the trust. No information is filed relating to the beneficiaries and/or the UBOs.

### New legislation

The CIT has undergone major reform and the new law introduced in early 2012 (Law 20(I)/2012, which amends the 1992 law) is said to have transformed the Cyprus trust regime into ***the most modern and favourable trust regime in Europe***. The new legislation aimed to make CITs more workable, accessible and effective as it is founded on much greater certainty, clarity and stability.

### What constitutes a Cyprus International Trust

The **CIT** is a trust:

- (a) whereby the Settlor is not a tax resident<sup>6</sup> of Cyprus during the year preceding the year in which the trust was formed. There is no longer any prohibition on settlors relocating to Cyprus after the establishment of the CIT;
- (b) beneficiaries may also relocate to Cyprus after a year following the trust creation.
- (c) the trust property can include all kinds of assets situated anywhere in the world and it can comprise of real estate property located in Cyprus;
- (d) at least one of the trustees must be a resident of Cyprus;

### Some of the CIT benefits:

#### **A. Tax benefits**

- a. Income, gains and profits from non-Cyprus sources are exempt from income tax, capital gains tax, special defence contribution or any other taxes in Cyprus.
- b. Worldwide income, profit and gains are taxable in Cyprus only where the beneficiary is a Cyprus tax resident; beneficiaries who are non-residents of Cyprus are taxed only on Cyprus sourced income in accordance with the Cyprus income tax laws. In the case of local trusts, the Cypriot resident settlor or any beneficiary will be treated as transparent vehicles for income tax purposes.
- c. Dividends, interest or royalties received by a CIT from a Cyprus international business company are not taxable and not subject to any withholding tax.
- d. Trust capital received in Cyprus by a foreigner resident or retired in Cyprus from trusts not resident in Cyprus is not taxable on the trustee.
- e. There is no estate duty or inheritance tax in Cyprus.
- f. The CIT may be used to distribute untaxed income in Cyprus to the beneficiaries, that is to say, family members.
- g. Pre-migration: persons who have the intention to migrate to a high tax jurisdiction may obtain tax advantages in their new country by protecting assets in a CIT in Cyprus.

#### **B. Asset Protection**

- a. The CIT may be used to protect assets from risks arising in tort, contract or otherwise in relation to transactions entered into by the Settlor. Types of claims

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<sup>6</sup> 'resident' of Cyprus has the meaning assigned to that term by the Income Tax Law. It means an individual who resides in Cyprus for more than 183 days in any calendar year or a company which is managed and controlled from Cyprus.

may include negligence, breach of contract, claims of spouses or former spouses, expropriation, breach of statutory duty and so on.

- b. A CIT or a transfer of trust assets may only be set aside by the settlor's creditors to the extent that it is proven to the satisfaction of the court that it (the CIT) was made with the intent to defraud creditors. The burden of proof is on the creditors who must prove that the CIT was made with intent to defraud them and that they were creditors at the time of the making of the CIT. An action must be brought within a period of **two years** from the date when the transfer or disposal of assets was made by the settlor to the CIT and only with regard to those assets and not any assets transferred earlier.

### C. Confidentiality and reporting

- a. Registration of the CIT is necessary but confidentiality of the beneficiary and/or UBO is safeguarded.
- b. There are no reporting requirements in Cyprus for the CITs other than registration of its existence. The trust may hold shares of a Cyprus company with Cypriot nominee shareholders who will hold the shares of the company for the real owner, i.e. the trust.

### D. Complicated family structures/managing family wealth/estate planning

- a. The CIT is ideal for high net-worth individuals with somehow complicated family structures, like for instance, divorced spouses and children from different weddings.
- b. Because of the economic crisis managing family wealth by means of a CIT has gained great importance because of the way families wish to distribute property.

E. **No exchange control** regulations are applicable to the CIT.

F. The CIT duration can be **indefinite**.

G. The **Cyprus law** is the proper law of the CIT.

- a. If the chosen law of the CIT is the law of Cyprus, then Cyprus is under an obligation to protect that trust. All questions relating to CITs are to be determined in accordance with the laws of Cyprus without reference to the law of any other jurisdiction. This protects against the application of foreign laws such as forced heirship laws. It further provides for greater control, protection and security over the CIT.
- b. The new legislation specifies that the CIT or the disposition of trust assets will not be void or voidable or capable of being set aside or be subject to any implied terms and in no circumstances will the capability of the settlor, the trustee, the protector or the beneficiary be subjected to any obligations or be questioned. When the CIT contains a choice of law clause in favour of Cyprus law, the provisions of the CIT law will be applicable irrespective of any other conflict of law provisions in force in Cyprus. This is a fundamental rule which must be abided by as a matter of public order.

H. The trust instrument is subject to stamp duty only in the amount of EUR430. Local trusts are subject to stamp duty in the amount of EUR18. Registration of a trust in the Cyprus Trusts Registry is also subject to a one-off fee of EUR30.

### Regulation of Trustees

The trust assets are separate and do not form part of the trustee's own estate (as they do not form part of the settlor's own estate either). The trustee has the power and the obligation to manage, apply or dispose of the trust assets prudently and to comply strictly with all the terms of the trust and his duties under the law. Even if the trust assets are not his own, the trustee can treat the trust assets as if they were his own. In doing so, he must adhere to strict duties on how to manage the trust. Being a trustee comes with burdensome responsibilities since trustees can be held personally liable to the beneficiaries. It is therefore common practice for trustees to ensure that the appropriate exemption clauses are inserted in the trust document in order to restrict their potential liability. If properly drafted, an exemption clause can protect the trustee from any potential liability except of course liability resulting from fraud or intentional wrongdoing.<sup>7</sup>

When the trustee acts in a way which does not comply with the trust, in other words when he breaches the trust and as a result the trust suffers a loss, then the trustee is personally liable to cover the trust for the loss. Where there is a breach of trust by the trustee, the beneficiaries may bring an action in court against him forcing him to administer the trust assets according to the trust terms. They may choose to file a claim against the trustee personally or a claim against the trust assets. Tracing of the trust assets ends where the trust assets are traced to a bona fide purchaser without notice of the trust, that is to say someone who has bought a trust asset without knowing that the asset was part of the trust. The beneficiaries may also bring a criminal action against the trustee.

The Law Regulating Companies Providing Administrative Services (196(I)/2012), as amended, brings Cyprus in compliance with the European Union Directive 2005/60/EC (the third anti money laundering directive). This relatively new law contains provisions regulating trustees among other professionals such as directors and secretaries of companies, nominees as well as provisions regulating the provision of corporate services by introducing licensing procedures and strict regulations. The aim is to provide greater control, certainty and security to clients in so far as the protection of the interests of the beneficiaries are concerned. The relevant licencing authorities are the Cyprus Securities and Exchange Commission, the Cyprus Bar Association and the Institute of Certified Public Accountants of Cyprus. Each regulatory authority maintains a registry of members and the licences will be issued on such terms and conditions as such authorities will consider appropriate. These authorities will also have the power to issue directives that it may consider necessary for the enforcement of the law, where it may be required but it remains to be seen whether other measures, such as amendments to the Companies' Law itself will be necessitated.

### Trustees' investment powers

The new law on CIT provides trustees with a much broader scope of investment power. Subject to the provisions of the memorandum of the trust, the law allows the trustee to invest at any time all or part of the capital in any investment forum as he would be able to do

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<sup>7</sup> 1. **Armitage v Nurse** [1998] Ch. – A clause providing that a trustee was exempted from liability for loss or damage to the funds or its income “unless such loss or damage shall be caused by his own actual fraud” could validly exclude liability for gross negligence; furthermore, a clause purporting to exclude liability for everything except actual fraud was not repugnant or contrary to public policy.

2. **Spread Trustee Co Ltd v Hutcheson and others** [2011] UKPC – adopts the approach in *Armitage v Nurse*.

if he were the absolute beneficiary of the trust assets irrespective of where the investment is located and whether the capital is already invested or not. This gives the trustee the power to invest the trust assets as if they were his own, eliminating any reservations in making investment decisions. It is clear now that investing in movable or immovable property in Cyprus is not prohibited.

The new law brings the trustee's investment powers in line with those of a trustee in England and Wales and other trust jurisdictions that have followed the English Trustee Act, like Malta.

### Settlor reserving powers to himself

When relinquishing control to the trustees while setting up a trust, the settlor may reserve for himself powers specifically drafted into the trust instrument. A new section (**s.4A**) was introduced in the CIT law this year clarifying that *'notwithstanding the provisions of any other law or regulation, the reservation or grant to a settlor of a trust of any right or interest in the trust assets or any of the powers mentioned in subsection (2), whether reserved for the settlor or conferred on him in the capacity as protector or enforcer of the trust or otherwise, shall not in any way affect the validity of the trust nor delay the execution of the trust'*.

The powers referred to are the following:-

- (a) To revoke, vary or amend the terms of a trust;
- (b) To advance, appoint, pay or otherwise apply income or capital of the trust assets or to give directions therefor;
- (c) To act as, or to give binding directions as to the appointment or removal of a director or officer of any company wholly or partly owned by the trust;
- (d) To give binding directions to the trustee in connection with the purchase, retention, sale, management, lending, pledging or charging of the trust assets;
- (e) To appoint or remove any trustee, enforcer, protector or beneficiary;
- (f) To appoint or remove any investment manager or investment adviser;
- (g) To change the proper law of the trust or the forum of administration of the trust;
- (h) To restrict the exercise of any power or discretions of a trustee by requiring that they shall only be exercisable with the consent of the settlor;

In exercising these powers, the settlor will not be deemed to be acting in breach of the trust. Where a power as above has been reserved by the settlor or conferred on him in his capacity as protector or enforcer, no intention to defraud may be imputed to the settlor.

Similar provisions to those contained in section 4A are to be found in the laws of other trust jurisdictions, such as the BVI, Guernsey, Jersey, Cayman Islands, Nevis and Bahamas.

Although the power to remove and appoint trustees is included in s.4A(2) the lawyer who will be responsible for the drafting of the trust instrument should have regard to Article 2 of the Hague Trusts Convention which provides that *'the reservation by the settlor of **certain rights and powers is not necessarily inconsistent with the existence of a trust'***. Further, international case law<sup>8</sup> indicates that, if a settlor is to choose a power which he should not

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<sup>8</sup> USA case, **In Re Stephen J. Lawrence** 279 F.3d 1294 (11<sup>th</sup> Cir. 2002) – the judge ruled that the settlor retained de facto control over the trust though his power to appoint trustees;

Australian case, **In the marriage of Ashton** (1986) 11 FamLR 457, 461 – the husband who had retained the power to appoint and remove trustees replaced himself as trustee with a corporate trustee. He received trust income although he

reserve for himself that would be the power to remove and appoint trustees. Mention must also be made to the well-known Jersey case of **Rahman v. Chase Bank**<sup>9</sup> where the Jersey Court held that, although the trust deed purported to give the trustees discretion over the trust property, the settlor had given directions to the trustees which they had slavishly followed. The trustees were therefore found to be no more than the settlor's nominees and the assets were in effect available to the settlor's heirs.

### 'Sham' trusts

What appears on the face of it to be a trust may be set aside as a sham<sup>10</sup> if the truth of the matter is that the settlor retains full beneficial entitlement and there is no intention that the apparent beneficiaries are to obtain any benefit.<sup>11</sup> There are conflicting views as to whether the intention must be that of both the trustee and the settlor or whether something less than full intention on the part of the trustee will suffice. In the case of a unilateral declaration of trust only the settlor's intention is relevant.

If a trust is found to be a sham then any transfer of property to the trustees is cancelled and no property title is considered to have been passed and the transaction is liable to be set aside. The persons acting as trustees are considered to be bare trustees or nominees holding the trust assets on a resulting trust for the settlor who is considered as the only beneficial owner.

### Amendments to the CIT

The CIT law allows amendments to the terms of the trust with the approval of the court. Further, and without prejudice to the powers of the court, the terms of the trust may be amended or varied in any manner as may be provided in the trust instrument.

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was not a beneficiary. He was deemed to be 'in full control of the assets of the trust' as he applied the assets and income from them as he wished and for his own benefit;

USA (Iowa) case, **In the marriage of Goodwin** Appeal No. 172 of 1989 – the court recognized the reality of the situation 'that no person other than the husband had any real interest in the property or income of the trust except at the will of the husband' and 'the husband had the sole power of appointment of the trustee, which was a creature under his control, and he was a beneficiary to whom the trustee could make payment exclusively of other beneficiaries as the husband saw fit' an order was granted by the court in favour of the wife;

English case, **In Browne vs Browne** (1989) 1 FamLR 291,

<sup>9</sup> **Abel Rahman v Chase Bank (CI) Trust co Ltd** [1991] JLR 103

<sup>10</sup> 'Sham' has been said to mean 'acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create', **Snook v London and West Riding Investments Ltd** (1967), 2 QB 786, (1967) 1 All ER 518, CA, per Diplock LJ.

<sup>11</sup> **Middland Bank plc v Wyatt** [1995] 3 FCR 11.