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Offshore Legal Insight

STAR Trusts and Foundation Companies - Developing uses in the Digital Asset space

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Introduction

The Cayman Islands has a deserved reputation for boasting a variety of alternative and original structures. Whilst as a common law jurisdiction the concept of a trust is one that is recognised, upheld and commonly utilised, the Cayman Islands nonetheless has some alternative structures to rival the traditional trust arrangement. In this article we will consider “STAR Trusts” and “Foundation Companies” which are two such examples.

Foundation Companies

We will first consider the Foundation Company which was introduced by its own legislation – the Foundation Companies Act, 2017 and is a structure which has grown in popularity since 2017, particularly for use in the digital asset space (e.g. as a decentralized autonomous organization (“DAO”), service provider to DAO, treasury for fungible tokens, NFTs, and network for building digital asset ecosystems). As the name implies, a Foundation Company is a company and it therefore bears some similarities with more conventional types of company that are available in the Cayman Islands. A Foundation Company is registered with the Registrar of Companies, it has separate legal personality, it is incorporated with a memorandum and articles of association and it has a Board of Directors who are responsible for the day to day conduct of its affairs.

However, this is where the similarities with more conventional companies end as whilst Foundation Companies have some characteristics of a conventional company, practically they operate in a manner that is more akin to a trust. They therefore provide the functionality and flexibility of a trust but without any of the complexities associated with trust administration. Further,

as they are a company with separate legal personality, this aids their recognition in civil law jurisdictions whose principles of 'ownership' mean that common law trusts often are not recognized.

Ownership

Whilst Foundation Companies can (but don't necessarily in practice) have shareholders, the shareholders in their capacity as shareholders are **not** entitled to receive dividends or other distributions. This can be contrasted with conventional companies whose shareholders participate in the profits simply by virtue of being a shareholder. Instead, Foundation Companies have a class of interested parties known as the "beneficiaries" and it is these beneficiaries who (depending on the applicable terms) are entitled to participate in any profits generated by the Foundation Company.

Further, whereas shareholders in more conventional companies have some ability to control the affairs of a company (e.g. by appointing or removing Directors or by passing (or refusing to pass) shareholder resolutions) and they have the right to access certain company records, the beneficiaries of a Foundation Company have no such rights. Beneficiaries' rights, if any (including in relation to their right to distributions) must be expressly provided for in the Foundation Company's constitution. Therefore, those who choose to establish a Foundation Company have considerable flexibility in determining what the rights of the beneficiaries will be and when they will arise and therefore careful thought needs to be given to drafting the constitutional documents to ensure that proper effect is given to the founder's intentions.

Corporate Governance

Whilst the ownership structure of Foundation Companies described above undoubtedly has its benefits, the lack of shareholder oversight removes one of the important checks and balances from the corporate governance of a Foundation Company. It is for this reason that Foundation Companies are required to have a "Supervisor" whose role is to oversee, and hold to account, the Board of Directors. A Supervisor's role can be greater, to the extent provided for in the constitutional documents and it is common for the constitution to provide for a number of 'reserved matters' in favour of the Supervisor, which can range from the right to appoint and remove the Supervisor, Directors and/or beneficiaries to the right to alter the constitution of the Foundation Company.

A Foundation Company is also required to have a Secretary who is either licensed or permitted by the Companies Management Act (2021 Revision) to provide “company management services”. The Secretary must also provide the Foundation Company’s registered office in the Cayman Islands.

Foundation Companies can also implement a set of by-laws which can extend, modify or supplement the constitutional documents. By-laws can assist with the administration of the Foundation Company but since they don’t form part of the constitution, they are a document that remains entirely private.

[Use in practice](#)

As will be apparent from the above, those who choose to use a Foundation Company as their corporate vehicle have considerable flexibility in how the Foundation Company will be established, governed and what the rights of each person associated with it will be. It will therefore come as no surprise that the uses of Foundation Companies are just as varied.

Foundation Companies have proven to be popular with Family Offices and they have also been successfully deployed for philanthropic purposes and with estate planning more generally given the relevance of “beneficiaries” to the structure and the fact that such beneficiaries’ involvement in the Foundation Company beyond their financial entitlement is restricted. Foundation Companies have also been used to establish charitable / non-profit foundations whilst they have also been successfully deployed for purely commercial projects, particularly in the digital assets space (e.g. as DAOs, treasury for fungible tokens, NFTs, and network for building digital asset ecosystems).

STAR Trust

STAR Trusts (meaning “Special Trusts – Alternative Regime”) are created pursuant to Part VIII of the Trusts Act (2021 Revision). STAR Trusts are typically discretionary trusts but crucially they can exist for either charitable or non-charitable purposes, provided that the purposes are “lawful and not contrary to public policy”. The ability to mix charitable and non-charitable purposes is a feature that is unique to the STAR Trust structure and underlines its inherent flexibility.

Further, unlike other trusts, the lifespan of a STAR Trust is not limited by the rule against perpetuities and so the usual position which limits their lifespan to not more than 150 years, does not apply – i.e. a STAR Trust can be of an unlimited duration.

Beneficiaries

The settlor of a STAR Trust has considerable flexibility when defining who, or what general purpose, will benefit from the STAR Trust and on what basis. Any beneficiary's participation in the STAR Trust is strictly limited to the financial benefits that the terms of the trust grant to them. Indeed, similar to Foundation Companies, a beneficiary of a STAR Trust has no right to enforce the terms of the STAR Trust, whether by way of actions against the Trustee or by having access to information about the activities and current financial position of the STAR Trust.

Corporate Governance

As with Foundation Companies and because the beneficiaries of the STAR Trust have no rights of enforcement, the checks and balances on the administration of the STAR Trust are provided in a different way. The two key positions to be held in relation to a STAR Trust are (1) the Trustee; and (2) the Enforcer.

The Trustee performs the usual role of a trustee in an ordinary trust by holding the legal title to the assets of the STAR Trust on behalf of the beneficiaries. Unless a court order to the contrary is obtained, it is a requirement of a STAR Trust that the Trustee must be (or must include if there is more than one) a trust corporation, which is an entity that is licensed to conduct "trust business" within the Cayman Islands.

A STAR Trust is also required to have an "Enforcer", who is the only person who has the capacity and power to enforce the terms of the STAR Trust and to hold the Trustees to account. The Enforcer can, but need not, also be a beneficiary. If they are also a beneficiary, they can only enforce the terms of the STAR Trust in their capacity as Enforcer on behalf of all beneficiaries and not in their capacity as an individual beneficiary.

Use in practice

As with Foundation Companies, the inherent flexibility of the STAR Trust structure means that it has been applied in many different ways since their inception in 1997. For example, they have been used (i) in ensuring an orderly succession of interests in family run businesses (with the limited rights of beneficiaries to enforce the terms of the Trust again being particularly useful), (ii) for philanthropic purposes, (iii) in substitution for an 'ordinary trust' in order to obtain the benefit of the unlimited duration of a STAR Trust and to restrict or limit the level of information to which beneficiaries would otherwise have an entitlement to access under an ordinary trust, (iv) in finance and investment transactions to facilitate "off balance sheet" or bankruptcy remoteness in holding

assets, (v) in as a holding vehicle for valuable chattels such as artwork, jewelry and vehicles and as an alternative to a charitable trust (especially where the objects of the Trust might be a combination of charitable and non-charitable).

However, one limitation on this structure is that no land in the Cayman Islands (or any interest therein) can be held by a STAR Trust. It would, however, be permissible for a STAR Trust to have an interest in another entity which owns land in the Cayman Islands (or an interest therein) but only for the purposes of carrying on its business.

Conclusion

As will be apparent from the above, the two structures we have considered offer great flexibility for many different types of application. Whilst there is a considerable degree of overlap between the two, the purpose of the venture and/or the preference of those behind the project will dictate the use of one over the other.

This publication is not intended to be a substitute for specific legal advice or a legal opinion. For specific advice on STAR Trusts and/or Foundation Companies, please contact your usual Loeb Smith attorney or:

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