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Conyers Dill & Pearman

## Cayman Islands Trusts

## Foreword

This memorandum has been prepared for the assistance of those who are considering the formation of trusts in the Cayman Islands (“Cayman”). It is not intended to be exhaustive nor a substitute for proper legal advice but provides a basic guide to the trust concept and an outline of trust law and trust administration in Cayman for clients of Conyers Dill & Pearman.

Clients are advised that they should consider the implications in their home jurisdiction of establishing a Cayman trust and should consult with their own legal, financial and other professional advisers as appropriate.

We also recommend that our clients seek legal advice in Cayman on their specific proposals before taking steps to implement them.

This memorandum has been prepared on the basis of the law and practice as at the date referred to below.

**Conyers Dill & Pearman**

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## 1. INTRODUCTION - PLANNING USES FOR CAYMAN TRUSTS

Cayman trusts are employed to achieve a variety of estate, personal, financial, tax or other business planning objectives. These objectives often include one or more of the following:

- provision for spouses and dependents
- protection of assets from future personal liability
- minimization of estate/inheritance tax, income tax, and capital gains tax
- preservation of family wealth and continuity of family businesses
- efficient and timely distribution of assets upon death
- protection against exchange controls
- creating or making provision for charities
- establishing pensions or employee stock option plans
- ownership of particular assets or of investments generally
- lender protection in corporate financing transactions

## 2. THE TRUST CONCEPT

The trust is a legal concept originally developed by English courts of equity although it is now governed, to a certain extent, by legislation. Cayman trust law is based on English trust law but has been enhanced in certain areas by Cayman legislation. English common law is of highly persuasive authority in Cayman.

### 2.1 Description of trust

A trust is the legal relationship created whereby a person (the “settlor”) gives property (the “trust fund”) to a trustee or trustees to hold the legal title to the trust fund for the benefit of certain persons (the “beneficiaries”) or for a specified purpose. Some trust arrangements also include a “protector”.

## 2.2 The Settlor

The settlor may be a sole beneficiary, or one of many beneficiaries of a trust and, in certain circumstances, can also act as a co-trustee. However, in order to avoid the trust being considered a sham, the settlor cannot be both the sole beneficiary and the sole trustee of a trust. A company may act as settlor if it has the corporate capacity to make a gift of its assets or otherwise to dispose of them for the purpose of establishing a trust.

## 2.3 The Trustee

The trustee is the person (or persons) who holds the legal title to the trust fund and who is obligated to administer the trust for the benefit of the beneficiaries. The trustee can be a company if it has the corporate capacity to act as a trustee.

The trustee stands in a fiduciary position vis-a-vis the beneficiaries and is required to honour certain stringent duties imposed by law (outlined in paragraph 4 below).

## 2.4 The Beneficiaries

The beneficiaries can be individuals, companies and other legal entities. Trusts can also be established to further charitable or non-charitable purposes.

In order for a private trust to be valid, the identity of the beneficiaries must be capable of being established with sufficient certainty. Thus in the case of a trust for groups or classes of persons, the trustee must be able to determine whether any given person is or is not a member of that group or class.

## 2.5 The Trust Fund

The property constituting the trust fund can be any type of real or personal property (e.g. cash, securities, real estate, personal effects or other tangible or intangible property). The property must be capable of being ascertained in order to be subject to a trust.

## 2.6 The Protector

The protector is usually a person who is a friend or advisor of the settlor. The inclusion of a protector is not necessary for the creation of a Cayman trust but can balance the wide discretionary and fiduciary powers often given to the trustee under the trust. Typically, the protector (which may be an individual or committee of individuals or a company) is appointed to ensure the wishes of the settlor are carried out by the trustees. The role of the protector is considered in more detail in paragraph 7 below.

## 3. TYPICAL FORMS OF TRUST

### 3.1 Discretionary Trust

The discretionary form of trust often provides the most flexible and efficient structure for the settlor and the beneficiaries.

After establishing the trust, the settlor will normally have divested himself of any ownership interest in the assets held in the trust (unless he retains certain powers).

Under the terms of a discretionary trust, the trustee is generally given wide discretionary powers over the trust fund and decides (according to the beneficiaries' best interests as a whole) when and to which beneficiary he should distribute capital and or income of the trust, and in what proportions. For this reason, the beneficiaries are regarded as not having a specific interest in the trust but only a right to be considered when the trustee exercises his discretions.

### 3.2 Fixed Interest Trust

Under a fixed interest trust, primary beneficiaries will normally be granted a right to receive the income and capital of the trust fund and the trustees will have little, if any, discretion over the nature and extent of distributions from the trust fund.

The fixed interest form of trust is used for estate planning purposes or to ensure that certain property passes on stipulated terms and at stipulated times for the benefit of relevant family members in an orderly manner. It is often specially drafted to suit the particular planning goals contemplated by the settlor (e.g. the settlor of a fixed interest trust can provide that the beneficiaries will not be able to sell off or otherwise dispose of their inheritance in a hasty manner). Many modern pension trusts take the form of fixed interest trusts where the trustee holds a fixed share for the member (beneficiary) of the pension scheme.

### 3.3 Charitable Trusts

A charitable trust may be established under Cayman law to create a charitable fund or to make provision for existing charitable institutions or purposes.

A trust under Cayman law is charitable if:

- (a) all its purposes fall exclusively within one or more of the categories of charitable purposes recognized by law listed below:
  - (i) the relief of poverty;
  - (ii) the advancement of education;
  - (iii) the advancement of religion; or
  - (iv) other purposes beneficial to the community at large; and
- (b) there is an element of public benefit.

A charitable trust may continue indefinitely.

### 3.4 Settlers' Reserved Powers

Cayman enacted "reserved powers" legislation in 1998, which was consolidated into the Trusts Law in 2001. It sets out which powers may be reserved to the settlor of a trust without invalidating the trust. The powers permitted to be reserved include the following:

- (a) any power to revoke, vary or amend the trust instrument or any trusts or powers arising thereunder in whole or in part;
- (b) a general or special power to appoint either income or capital of the trust property;
- (c) any limited beneficial interest in the trust property;
- (d) a power to act as a director or officer of any company wholly or partly owned by the trust;
- (e) a power to give binding directions to the trustee in connection with the purchase, holding or sale of trust property;
- (f) a power to appoint, add or remove any trustee, protector or beneficiary;
- (g) a power to change the governing law and forum for the administration of the trust; and
- (h) a power to restrict the exercise of any powers or discretions of the trustee by requiring that they shall only be exercisable with the consent of the settlor or any other person specified in the trust instrument.

Whilst the legislation gives welcome clarity to the question of what rights can be reserved by the settlor of a trust, great care is still required in structuring the arrangements to ensure that an agency relationship is not created, rather than a trust.

### 3.5 Special Trusts – Alternative Regime ("STAR") Trusts

Cayman enacted the Special Trusts Alternative Regime law in 1997 which was consolidated into Part VIII of the Trusts Law and provides for a different form of trust commonly referred to as a "STAR trust".

The objects of a STAR trust may be persons or purposes or both. The persons may be of any number, and the purposes may be of any kind, be it charitable or non-charitable, provided that they are lawful and not contrary to public policy.

The only persons with standing to enforce a STAR trust are those persons who are appointed “enforcers” under the trust deed or by order of the court. Enforcers are deemed to have a fiduciary duty to act responsibly with a view to the proper execution of the trust, subject to evidence of contrary intention.

Trustees of a STAR trust are required to be (or include) a trust corporation licensed in Cayman or registered as a private trust company.

STAR trusts are commonly used in securitization transactions. In a typical securitization transaction, a company is incorporated with a view to owning certain income producing assets (a “special purpose vehicle” or “SPV”). Shares in the SPV are then issued to the trustee of a STAR trust, on trust, for the purpose of holding those shares. The SPV then issues securities such as notes to raise funds to purchase the asset pool from the originator. The asset pool is then “ring fenced” by the grant of a security interest over the asset pool in favour of the indenture trustee. The income flow from the asset pool is used to pay the transaction fees and costs and interest to the note holders.

### **3.6 Exempted Trusts**

Cayman law provides for a special type of trust known as an “exempted” trust. Exempted trusts must be registered in Cayman with the Registrar of Trusts. The beneficiaries of an exempted trust cannot include any person resident or domiciled in Cayman, other than a charitable object.

The Governor in Cabinet may give an undertaking to the trustees of an exempted trust that no law which may be enacted in Cayman imposing any estate duty or inheritance tax will apply to any property comprised in or any income arising under

an exempted trust. This undertaking is normally valid for a period not exceeding 50 years from the date of creating the exempted trust.

## **4. TRUSTEES' DUTIES AND TRUST ADMINISTRATION**

### **4.1 Who May Act As Trustee?**

Individuals, as well as companies licensed as trust companies under the Banks and Trust Companies Law (as amended), may act as trustees of a Cayman trust. Under Cayman law it is possible to have a sole trustee (although this is not recommended practice except in the case of a corporate trustee).

Whereas an individual is liable for the whole of their assets in the event of claim against the trustee, a trust company is liable to the extent of its capital.

Before accepting such an onerous responsibility, the trustee is under a personal duty to acquaint himself with the powers and liabilities which will be assumed by accepting the office. The trustee should satisfy himself as to the legitimacy of the source of the funds in trust and take specific legal advice periodically whenever prudent.

### **4.2 Trustees' Duties**

Trustees are required by law to fulfil certain fiduciary duties. Save to the extent to which these duties may be modified by the Trusts Law as it applies to certain types of trusts (such as STAR trusts) the most important duties include the following:

- (a) to act honestly and in good faith for the best interests of the beneficiaries in accordance with the terms of the trust;
- (b) to bring and keep under their control trust property which must be kept separate from their private property and from any other property of which they are trustees;

- (c) to obey the terms of the trust deed unless all the beneficiaries are adult and consent to trustee actions contrary to the terms of the trust or if the court sanctions a variation of the trusts' terms;
- (d) to act impartially between the beneficiaries. This duty amounts to a fair balancing of the interests of beneficiaries, particularly where certain beneficiaries are entitled to current income and others to future interests in capital;
- (e) to preserve the trust property and to sell wasting assets unless a contrary intention is expressed in the trust deed;
- (f) to exercise reasonable care, skill and caution in the administration of the trust and the investment of the trust assets. The Trusts Law contains a list of authorised investments which are usually extended under the trust deed. Unpaid trustees are bound only to use such due diligence and care in the management of the trust as a man of ordinary prudence, diligence and vigilance would use in the management of the affairs of a person for whom he felt morally obliged to provide. A higher standard of diligence and knowledge is expected from professional trustees who receive remuneration for the services (unless the trust deed provides otherwise);
- (g) not to delegate duties or powers either to a third party or to a co-trustee except when appropriately authorised by the trust deed;
- (h) to act unanimously unless otherwise expressly authorised under the trust deed. Accordingly, investments and all trust property should be in joint names or held to the order of all trustees;
- (i) to act gratuitously, unless remuneration is authorised by the trust deed;
- (j) disclose any conflict in relation to the trust and not to profit from the trust property nor to purchase trust property for personal enjoyment. A trustee must account to the beneficiaries for any profit or other benefit received by virtue of his position as trustee. The purchase by a trustee of trust property is voidable by a beneficiary, unless authorised by the trust deed, irrespective of the fairness of the price paid; and
- (k) to keep accounts and at all reasonable times and on request to furnish any beneficiary with accounts.

### 4.3 Administration of the Trust

Trustees are required to keep proper records and accounts of all trust assets and trust business. As a matter of proper administrative practice, all substantive trustee decisions or business decisions taken at the trustee level should be approved and recorded in trustee minutes.

The trustees should hold at least one or two formal trustee meetings each year in order to review and consider the accounts, trust business and financial position of the trust as a whole.

Trustees are required by law to ensure that they are properly informed as to the value of the trust assets and the nature of the business activities of any corporate entities held by them. Successor trustees are also impressed with a duty to review the history of the trust's business and examine the accounts and other trust records in order to satisfy themselves that no prior breach of trust has occurred.

Where the trust assets are being re-invested on a regular basis, the trustees will often recommend that a professional investment advisor be employed to make recommendations to the trustees so that the trustees have professional advice upon which to base their investment decisions or to assist the management of the assets.

### 4.4 Failure to Act

A trustee's failure to act bona fide or to act properly can expose the trustee to a breach of trust claim brought by the beneficiaries. These claims can be made if the beneficiaries feel that any act or omission by the trustee has wrongly prejudiced their interests. A trustee against whom such a claim is successfully made will be liable to the beneficiary to account for any loss occasioned by the misfeasance.

#### 4.5 Liability to Third Parties

As a trust is a legal arrangement, and not a legal entity; all contracts made in connection with the trust will be made in the trustee's name and not in the name of the trust. This means that if the trustee enters into a contract with a third party relating to trust business, that third party will be able to make a claim against the trustee personally under the contract (subject, of course, to the terms of the contract itself).

Exclusion and indemnity clauses are typically found in trust instruments, protecting to some extent the trustee for certain acts or omissions. Usually the trustee will have a right of reimbursement from the trust fund in respect of most liabilities incurred in respect of the trust, but this is limited clearly to the level of the assets in the trust fund. The trustee can therefore be susceptible to any shortfall.

#### 5. JURISDICTION OF THE CAYMAN COURTS

Subject to any express term to the contrary in the trust deed, all questions arising in regard to a trust which is governed by the laws of Cayman are to be determined according to the laws of Cayman, without reference to the laws of any other jurisdictions with which the trust or disposition may be connected. This includes all questions as to the capacity of any settlor, any aspect of the validity of the trust or disposition or its interpretation or effect, the administration of the trust (including questions as to the powers, obligations, liabilities and rights of trustees and their appointment and removal) and the existence and extent of powers of variation or revocation of the trust and powers of appointment.

No trust governed by the laws of Cayman and no disposition of property to be held upon the trusts thereof is void, voidable, liable to be set aside or defective in any fashion, nor is the capacity of any settlor to be questioned, nor is the trustee, any beneficiary or any other person to be subjected to any liability or deprived of any right, by reason that -

- (a) the laws of any foreign jurisdiction prohibit or do not recognise the concept of a trust; or
- (b) the trust or disposition avoids or defeats rights, claims or interests conferred by foreign law upon any person by reason of a personal relationship to the settlor or by way of heirship rights, or contravenes any rule of foreign law or any foreign judicial or administrative order or action intended to recognise, protect, enforce or give effect to any such rights, claims or interests.

The rules set out above:

- (i) do not validate any disposition of property which is neither owned by the settlor nor the subject of a power in that behalf vested in the settlor, nor do they affect the recognition of foreign laws in determining whether the settlor is the owner of such property or the holder of such a power;
- (ii) take effect subject to any express contrary term of the trust or disposition;
- (iii) do not, as regards the capacity of a corporation, affect the recognition of the laws of its place of incorporation;
- (iv) do not affect the recognition of foreign laws prescribing generally (without reference to the existence or terms of the trust) the formalities for the disposition of property;
- (v) do not validate any trust or disposition of immovable property situate in a jurisdiction other than Cayman which is invalid according to the laws of such jurisdiction; and
- (vi) do not validate any testamentary trust or disposition which is invalid according to the laws of the testator's domicile.

## 6. GENERAL LEGAL CONSIDERATIONS

### 6.1 Cayman Legislation

The principal legislation governing trusts in Cayman is the Trusts Law, the Fraudulent Dispositions Law and the Perpetuities law.

The Trusts Law, among other things, grants certain powers to trustees of Cayman trusts including the power to apply income for maintenance and education and to advance capital to a beneficiary who is entitled to a presumptive share. These powers will apply unless excluded or restricted or varied by express terms in the relevant trust deed. The Trusts Law also grants the Court jurisdiction to vary a trust in certain circumstances.

The Fraudulent Dispositions Law provides that a disposition of property made with intent to defraud and at an undervalue shall be voidable at the instance of the creditor prejudiced thereby. The creditor has six years from the date of the relevant disposition to commence an action.

## **6.2 Rule against Perpetuities**

With the exception of STAR trusts, the English common law rules against the vesting of trust property in perpetuity and against the remoteness of vesting apply in Cayman to trusts created before 1 August 1995. For trusts created on or after that date, the common law rules on perpetuity have been abolished and replaced with the provisions of the Perpetuities Law.

The Perpetuities Law modernises and simplifies the application of the rule against perpetuities so as to ensure the validity of certain trusts which would otherwise have been invalid under common law rules. This law provides that a fixed period not to exceed 150 years may be chosen as the duration of a trust. It further introduces the “wait and see” principle, so that a gift in trust will not fail for remoteness of vesting until it is established that the gift will not vest within the perpetuity period. The Perpetuities law provides that a change in the governing law of a trust from Cayman law to the law of a foreign jurisdiction is not invalidated by reason of the foreign jurisdiction having a different rule against perpetuities.

Pursuant to the Perpetuities Law STAR trusts are not subject to the rule against perpetuities, which makes it possible for STAR trusts to continue indefinitely.

### 6.3 Effect of Foreign Laws on Cayman Trusts

In 1987 Cayman enacted the Trusts (Foreign Element) Law which has been consolidated into Part VII of the Trusts Law. It provides that in determining the governing law of a trust, priority is given to the terms of the trust. It goes on to provide that a term of the trust expressly selecting the laws of Cayman to govern the trust is valid, effective and conclusive regardless of any other circumstances. The legislation is designed to strengthen the position of Cayman trustees in resisting litigation. It sets out what matters are to be determined by the governing law and excludes the application of any foreign law (i.e. laws of civil jurisdictions that may not recognize the trust concept, that provide for community of property and forced heirship) that may have some connection with the trust.

## 7. PROTECTORS

There is no definition of a "protector" in the statutes or case law in England or Cayman. However, the practice of designating certain persons to be protectors in offshore trust deeds is quite common, especially where the settlor is from a country which does not recognise the concept of a trust (e.g. such as most South American countries).

The protector is usually a person who is a close friend or other confidant of the settlor. Typically, the protector (which may be one individual, a committee of individuals or a company) is appointed to ensure that the wishes of the settlor of the trust are carried out by the trustees in the proper fashion.

The protector will normally be given an express power to receive financial information and to review the investment management of the trust. Also, he will be able to advise the trustees on what financial needs the beneficiaries may have. The protector often holds certain powers, such as: (i) power to remove and appoint trustees; (ii) power to agree trustee fees and (iii) power to vote or consent to the addition or removal of beneficiaries.

Whether the protector is deemed as having fiduciary obligations may well depend upon the type of powers that he holds under the trust. Most trust deeds attempt to limit the fiduciary nature of the responsibilities of the protector since he or she is usually not a professional trustee, but rather a close friend or advisor of the settlor.

A protector is not a trustee and every effort should be used to ensure he does not appear to be one. If the protector is conferred too many powers under the terms of the trust deed, he could be considered to be a de facto trustee and subject to all of the stringent fiduciary duties of trustees. Accordingly, careful drafting of the trust deed is important to ensure that the protector is independent of the trustee (as a general rule).

## **8. LICENSING REQUIREMENTS OF CAYMAN TRUSTEES**

A trust company carrying on business from Cayman must be licensed pursuant to the Banks and Trust Companies Law. Licences are required to satisfy certain prescribed net worth requirements and to be owned and managed by fit and proper persons. Unrestricted, restricted and nominee licences are available. A trust company with an unrestricted licence is required to maintain a net worth of not less than CI\$400,000 while the net worth requirement for a restricted licence is CI\$20,000. A nominee licence is only available to a wholly owned subsidiary of another licence.

Through the licensing application process, Cayman seeks to protect its status as a reputable financial centre. As such, the process involves a thorough and rigorous examination procedure for new licensees and close supervision of the business of existing licensees. Cayman licence fees (available on request) are payable on application and annually. Applications for licences must be made to the Cayman Islands Monetary Authority ("CIMA") in the prescribed form. In particular, extensive personal questionnaires together with financial and character references and police clearance certificates are required in respect of each proposed director and officer of the trust company. CIMA routinely conducts its own background checks in respect of each director and officer. Applicants are also required to provide a business plan,

financial projects and evidence of trust experience of a least one of the directors who will be actively involved in the business.

## 9. PRIVATE TRUST COMPANIES

Under the Private Trust Companies Regulations, 2008 (the “Regulations”), a Cayman Islands private trust company (a “PTC”) which only conducts connected trust business and is registered with the Cayman Islands Monetary Authority (“CIMA”) is exempted from the licensing requirements of the Banks and Trust Companies Law.

The test for determining whether a PTC carries on connected trust business for the purposes of the Regulations looks solely at the relationship between the settlors/contributors of the underlying trust assets: each settlor/contributor must be a connected person to each other. The scope of “connected person” is broadly defined; it includes relationships by blood and marriage between individuals as well as companies within the same group and certain shareholder and company relationships. There is no requirement for the beneficiaries to be connected persons. The majority of PTCs, which typically are set up by and for individual families, should satisfy the connected persons’ test without difficulty.

Other requirements under the Regulations include: that the PTC must be incorporated in the Cayman Islands and have its registered office provided by the holder of an unrestricted trust licence; that the company keep at its registered office copies of the relevant trust deeds and trust documents; and that the company must use the words “Private Trust Company” or the letters “PTC” in its name.

There is no requirement for a PTC to obtain approval either prior to incorporation or at any subsequent stage from CIMA or from any other body. AML/CFT checks will now be carried out by the licensed trustee providing the registered office. There is no requirement under the Regulations to disclose to any person details of the settlor/contributor or of the beneficiaries of the trusts.

A PTC must pay an initial registration fee and annual registration fee thereafter (available on request) when it files its annual declaration with CIMA declaring: the names of the company and of its directors; the name of the holder of the trust licence providing the registered office of the company; that the company is only carrying on connected trust business; and that the company is in compliance with the Regulations.

It will still be possible for a PTC to obtain a restricted trust licence if it so desires.

The cost of incorporating and operating a PTC may be lower than the fees of a professional trust corporation. Use of such a company ensures greater flexibility and confidentiality and allows the settlor and his family or friends, if he so wishes, to play an active role by serving on the board of directors or by owning the shares of the PTC. The shares of the PTC may be held directly or in a purpose trust, charitable trust or other private trust.

The PTC also has a role to play in reducing the potential liability of professional trustees. Due to the increasing risk of being sued both by beneficiaries and third parties, professional trustees are increasingly reluctant to take ownership of assets or participate in ventures where substantial risks may be present, such as owning commercial real estate in high tax jurisdictions, venture capital investments or companies which own ships or aircraft. The professional trustee's preference is normally for a diversified portfolio of low risk investment. In such circumstances the incorporation of a PTC may be advisable. The professional trustee is then able to provide management and administration services to the PTC rather than acting as trustee.

## 10. CONFIDENTIALITY

There are no public registration requirements or other disclosure requirements concerning the establishment of trusts in Cayman except, as mentioned above, in the case of exempted trusts (see section 3.6 above). Trust records kept by a trustee should not be disclosed unless required by law. Certain rules relating to the disclosure of evidence and information are found under various treaties and anti-money laundering legislation.

## 11. TAXATION AND STAMP DUTY

Nominal stamp duty is payable on every settlement and deed which are in writing under the Stamp Duty Law. *Ad valorem* rates apply to conveyances or transfers of immovable property situate in Cayman.

There is no income, capital gains, wealth, withholding, gift or inheritance tax in Cayman. In addition, an exempted trust (see section 3.6 above) is entitled to apply for, and will likely receive, an undertaking that no law which may be enacted in Cayman imposing any estate duty or inheritance tax will apply to any property comprised in or any income arising under an exempted trust.

Application and annual licensing fees are also payable by a company engaged in trustee or banking services, or if a company is engaged in local trade or business.

*This publication is not a substitute for legal advice nor is it a legal opinion. It deals in broad terms only and is intended merely to provide a brief overview and give general information.*

### **About Conyers Dill & Pearman**

Conyers Dill & Pearman advises on the laws of the Cayman Islands, British Virgin Islands, Bermuda, Mauritius and Cyprus. Conyers' lawyers specialise in company and commercial law, commercial litigation and private client matters.

The combination of Conyers' structure, culture and expertise enables the highest quality, responsive, timely and thorough legal advice. Conyers' strategic global presence in major international business centres allows a seamless 24 hour service.

Conyers' sophisticated client base includes FTSE 100 and Fortune 500 companies. Working with leading local and international firms, Conyers advises on highly complex multi-jurisdictional projects.

Affiliated companies (Codan) provide a range of trust, corporate secretarial, accounting and management services.

Founded in 1928, Conyers has 600 staff, including more than 150 lawyers.

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