

THE CYPRUS INTERNATIONAL TRUST AND THE PANAMANIAN FOUNDATION

1. Introduction

In recent years, Cyprus has played a paramount role in structures which predominantly involve the use of a trust and a foundation, mostly, but not exclusively, with respect to Very High and Ultra High Net Worth Individuals. The term Very High Net Worth Individuals (hereinafter both collectively referred to as 'VUNWIs') refers to those individuals with assets between \$5 and \$50 million, whereas Ultra High Net Worth Individuals are exclusively those individuals with assets above \$50 million. These types of structure though, should not be considered as the blanket solution for each and every situation in order to mitigate the tax liability of VUNWIs. The trend, which involves making use of Cyprus as a jurisdiction, has demonstrated that the pattern followed by VUNWIs with a view to their group of trading companies, commercial and business activities is predominantly the use of a Cyprus Holding Company, which is a private limited liability company by shares, incorporated and governed under the Cyprus Companies Law, Chapter 113. Conversely, for their personal wealth management as well as inheritance planning, VUNWIs and especially VUNWIs tend to use a Cyprus International Trust and a Panamanian Foundation.

2. The International Trusts Law:

The conditions necessary for a trust to fall within the ambit of the IT Law and thus be considered as an international trust are the following:

- i. the settlor, being an individual or legal person, is not a resident of Cyprus in the calendar year which precedes the year in which the trust was created;

- ii. at least one of the trustees for the time being is, during the whole duration of the trust, a permanent resident in Cyprus; and
- iii. none of the beneficiaries, being individuals or legal persons, other than a charitable institution, is a resident of Cyprus in the calendar year which precedes the year in which the trust was created.

The criterion that at least one of the trustees for the duration of the trust, be a permanent resident in Cyprus, ensures that the Cyprus Courts have effective jurisdiction over the trust. It is noteworthy to mention that the IT Law allows a Cyprus corporate entity or a partnership to act as trustee, and the provision contained in Section 2 of the IT Law clearly states that a company or partnership can be the settlor or beneficiary of an international trust.

3. Panamanian Foundations

3.1. Background information

The Panamanian Law No 25 of 12 June 1995, which governs Private Foundations, defines how foundations are established and how they operate. The provisions in this law are regulated through Executive Decree No 417 of 8 August 1995, which created the Private Foundation Section of the Public Registry and regulated the registration of the constitution, modifications, and revocation of such foundations.

Liechtenstein law was where the inspiration was taken from and the European foundation model was adapted in order to create a more flexible and modern instrument known as the 'Panamanian private foundation'. The Private Foundation has evident advantages for international asset planning and is qualified to conduct non-habitual 'commercial transactions'. The Panamanian Foundation includes certain interesting aspects that are predominantly found in Anglo-Saxon Law, for example, the institution of a protector or supervisory body.

3.2. Structure, establishment and use of Panamanian Foundations

A Panamanian foundation may serve private purposes (hereinafter referred to as a 'Foundation') and is created when either one or more natural persons or legal entities hereinafter referred to as 'Founder(s)' formalize a document, such document being known as the Foundation's charter (hereinafter referred to as a 'Foundation Charter'), which is registered at the Public Registry of Panama, whereby the parties undertake to make a donation, being not less than the equivalent of USD\$10,000 (hereinafter referred to as the 'Foundation's Assets'). This amount may thereafter be increased through further donations. The Foundation's Assets are managed by the council of the Foundation (hereinafter referred to as the 'Foundation Council') which is supervised by the protector(s) who act for the benefit of the beneficiaries of the Foundation. A protector is not required to be appointed and is in fact not always appointed. Whether or not a protector shall be instituted, depends solely on the founder, at the time that the Foundation is being set up.

The Panamanian private Foundation is predominantly used for the following purposes:

- to own family businesses and thus avoid inheritance taxes;
- to avoid political or economic instability;
- to act as a substitute for marriage or pre-nuptial agreements;
- to act as a substitute for a will, thus avoiding complicated inheritance procedures;
- for the avoidance of forced heirship rules;
- to act as a vehicle for owning real estate or valuable art work;
- to own shares, interests, and stocks of private companies while maintaining confidentiality of ownership;
- to act as a vehicle for investing in time deposit accounts, stocks, bonds, or other securities;
- for any asset protection purposes.
- to guarantee payment of money or individual asset distribution to members of one or more families for their subsistence, education, clothing and other living expenses, or as a mechanism by which their children/grandchildren may partake in their parents/grandparents' earnings. In Europe, private foundations for the aforementioned purposes are known as "Family Foundations"

In order to put things in a clearer perspective, a clear distinction needs to be drawn between what is contained in the Foundation's Charter and what is contained in the Foundation's regulations (hereinafter referred to as the 'Foundation's Regulations').

The information which is contained in a Foundation's Charter is information such as the name of the Foundation, its initial capital of USD\$10,000 or more, the identities of the Council members, the foundation's domicile or country of registration, the name and domicile of its resident agent, the purpose for its creation, the manner of appointing its beneficiaries, its duration and the destination and distribution of its corpus if the Panamanian Foundation is dissolved.

Moreover, other provisions may be contained in the Foundation's Charter which the client feels are appropriate or necessary. The Foundation's Regulations constitute a private and confidential document that complements the Foundation Charter. It does not require registration with any Registry or authority. As such it will not be available for inspection through the Registry or any other means.

The information contained in the Regulations are the powers of the Foundation Council, the composition of the Foundation's Assets, the form of administration, the beneficiaries of the Foundation (at this stage, the actual names of the beneficiaries and not of the nominee beneficiaries may be stated), the benefits corresponding to each beneficiary, the rules on the distribution of benefits, the rules on the rendering of accounts, the class of the beneficiaries and how they may be varied, substituted, removed, or added, the rules relating to remunerations, the appointment of the protector and his powers (here also the name of the protector is stated), and how the Foundation Assets may be liquidated. Any other areas requiring to be regulated may also be provided for in the Regulations.

Particularly Panamanian law regarding Foundations, does not contain restrictions or limitations other than those outlined the Foundation Charter, with respect to the contents of either document. The Regulations may also contain any other stipulations regarding the operation of the Foundation that has not been included in the Foundation Charter. Thus, either document can be structured according to the needs of the Founder.

3.3. Assets of a Panamanian Foundation

Contributions made to as well as income received by a Foundation are not subject to attack or the object of any precautionary action or measure, unless they relate to obligations which have been incurred, or for damages which have been sustained, following the attainment of the Foundation's aims and objectives.

The Foundation's assets may not be used to address the obligations of the founders, of the beneficiaries or of any other person regardless of whether such person(s) are connected to the Foundation.

3.4. Limitation period against the Foundation's creditors

There is a 3-year limitation period, in accordance with the law whereby a creditor may attack the assets of a Foundation.

3.5. Corporate status

Due to the fact that Panama grants corporate existence to a Foundation, a Foundation may thus acquire and own property (not restricted to immovable property), incur obligations, and be a party in judicial proceedings.

3.6. Commercial objectives

A private interest Foundation must seek to fulfil non-profitable purposes; however, it may carry out activities of a commercial nature provided that the outcome of such activities is in line with the purposes of the Foundation. Accordingly, it may not engage directly in business but it may carry out its business in a non-habitual manner; thus, a Foundation may derive earnings from the sale of real property, hold cash deposits, lend money as well as invest (without limitation) in shares of private companies, public companies, bonds, but the Foundation may not trade.

3.7. Revocability and dissolution of Foundations

In the following circumstances, the Founder may revoke the creation of a Foundation or the transfer, namely if:

- the Foundation Charter is revocable;
- the Foundation has been created to enter into effect after the Founder's death;

- the Foundation Charter has not been registered at the Public Registry;
- Under the relevant provisions of the Civil Code of the Republic of Panama, there is just cause for the revocation of donations.

Regarding the dissolution of Foundation specific reasons are established by law.

3. 8. Taxation

The acts of creation, modification and liquidation of a Foundation shall, just as acts of transfer, transmittal or encumbrance of a Foundation's assets and the income arising therefrom or any other act in connection therewith, shall be exempt from all taxes, contributions, rates, liens or imposts of any kind or description, provided that said assets consist of:

- Assets located abroad;
- Money deposited by natural or juridical persons whose income does not arise from a source in Panama or is not taxable in Panama for any reason;
- Shares or securities of any kind, issued by companies whose income does not arise from a source in Panama, or where their income is not taxable for any reason even though such shares or securities are deposited in the Republic of Panama.

The transfer of immovable property, titles, certificates of deposit, securities, monies, or shares made in pursuit of the objectives or purposes of a Foundation or due to the extinction of a Foundation, in favour of the founder's relatives within the first degree of consanguinity or to the founder's spouse, shall also be free from any taxes. However, all Foundations are subject to the payment of registration fees and annual franchise tax with such annual franchise tax being approximately USD\$300.

3. 9. Re-domiciliation of Foundations

Foundations constituted in accordance with a foreign law may submit to the provisions of the Panamanian Law No 25 of 12 June 1995.

When a foreign foundation elects to become subject to the provisions of Panamanian Law No 25 of 12 June 1995, it shall submit a Certificate of

Continuation issued by the governing body according to their internal organization which shall contain:

- the name of the foundation and the date of its constitution;
- the data relating to its recording or deposit at the registry of its country of origin;
- the express declaration of its wish to continue its legal existence as a Panamanian Foundation;
- the new foundation charter or a transcription of the original charter; and minutes of the foreign foundation granting power to transfer/redomicile to the Republic of Panama

As mentioned in the introductory section of this article, VUNWIs prefer the use of an international trust either solely or coupled with a Panamanian Foundation, not so much for commercial uses but for private wealth management purposes. Moreover, the confidentiality factor that is apparent in both structures is especially appealing and accordingly the fact that both types of structure offer a strong protection against the disclosure of the details and the identity of the settlor(s), founder(s), and beneficiaries, as such data are not disclosed without being accompanied by an appropriate request as described hereinabove.

4. The structure preferred by VUNWIs: a proposal and its practical approach

4.1. Step one: the Cyprus angle

When setting up a Cyprus International Trust, the contributor of the assets must determine whether he/she would like to appear as settlor or not in the instrument creating the Cyprus International Trust. If the contributor wishes to remain confidential, then this can be achieved by having as settlor a corporate entity, which will endow the assets to the Cyprus International Trust (whereby the actual founder has already at a previous stage endowed the assets to this very entity now endowing the assets).

It should be noted that in such instances the corporate settlor should not be a Cyprus resident in the year preceding the year of creation of the international trust; thus, it is recommended that such settlor be an offshore corporate body in the case of a legal entity. The offshore corporate entity may have as its registered shareholder a nominee individual or entity (preferably also located offshore), which would hold the shares on trust in such non-Cypriot corporate entity for the benefit of the actual contributor. Thereafter, the choice of who shall be acting as trustee of the Cyprus International Trust should be resolved. The trustee may also be a corporate entity; however, it should be noted that at least one of the trustees must be a Cyprus resident, as per the requirements of the IT Law.

Accordingly, where more than one trustee shall be appointed, it is important to mention that the majority of trustees should be Cypriot residents in order to maintain the tax residency of the International Trust within Cyprus. Although it is not necessary that the Cyprus International Trust appoints a protector and/or a supervisor of the performance of a trust, this may be done, the additional governance and oversight on the administration of the international trust and its assets. It should be noted that the concept of a supervisor of the performance of a trust has only been introduced into the Cyprus International Trust concept via the IT Law; this concept did not previously exist in the 1992 Law. The appointment of a protector and/or a supervisor of the performance of a trust adds an additional layer of protection and is usually an entity controlled by an individual or individual who is most familiar with the settlor's long-term financial and personal goals. Practise has shown that the protector is usually the balance of power between the instrument creating the international trust, the settlor, the trustee(s), and the beneficiaries. However, where the settlor vests any of the powers that may be attributed to him via Section 4A of the IT Law, then it is unlikely that such balance of powers can be said to have been maintained.

If management and/or executive powers vis a vis the international trust are vested elsewhere (other than the Cyprus resident trustee), diligence should be applied in order to avoid shifting substantial powers from the Cyprus resident trustee(s) of the International Trust to the protector, trustee(s), settlor, and supervisor of the performance of a trust, thus shifting the management of the international trust to another jurisdiction.

It is preferable and recommended that neither the trustee(s) and/or the protector and/or supervisor of the performance of a trust should be a family member nor related to the family by blood or marriage. Both positions should be independent of each other acting in the long-term interests of the beneficiaries.

The wording and contents of the instrument creating any trust are crucial, since it is that very document that all parties will at look at to determine their obligations, duties [regarding the trustee(s), protector(s), and supervisor(s) of the performance of a trust], and rights (regarding the beneficiaries). Many clients seek to make the instrument as wide as possible in order to capture any eventuality; this is however not the recommended approach. The best angle to tackle this task is to address it from a worst-case scenario basis (ie what mechanisms will be triggered if a nominee turns rogue or hostile) and also ways in which new beneficiaries may be barred even if they per se would qualify under the wording of the trust instrument (due to its wide wording), but the actual settlor did not intend them to qualify or be admitted. One must keep in mind when drafting the trust instrument that once the trust instrument is created and signed, it is a mechanism that should be able to function automatically, without any additions and/or editions. Following the exercise of the rights under Section 4A of the IT Law the settlor may regulate the situation if the above issues ever arises, provided that such settlor wishes to have the applicable powers vest with him.

The Panamanian Foundation: the beneficiary of the international trust?

Most VUNWIs are very clear about who they would like to be identified as beneficiaries of a Cyprus International Trust from the outset; however, following discussions with them and when addressing the practical side, the clarity they initially possessed on who was to be named as beneficiary of the trust, becomes somewhat obscured. What is noticeable is that there is an intention to include specific beneficiaries and also to potentially add new ones thereafter who they consider may qualify in future. Another reason is that they may want start with certain beneficiaries and then wish to add additional beneficiaries, who were actually considered by the settlor as qualifying beneficiaries from the outset, but the settlor at the time of the setting up of the trust did not wish to disclose the beneficiaries who are to be added at a later stage. This may be avoided by not naming them as beneficiaries at the time that the trust instrument is drafted and executed, but including a mechanism in the same trust instrument which would make such individuals (who shall form the new beneficiaries) able to satisfy the criteria to be added as beneficiaries thereafter. Accordingly, the way that VUNWIs initially developed to by-pass the possibility that the existing beneficiaries would become aware of the addition of further beneficiaries, was to appoint a corporate entity as a beneficiary (to represent each physical beneficiary and to have as registered shareholder of such corporate entities either physical or legal

nominees). The problem with this mechanism though is that in the event of the death of a beneficiary, the legal entities will be in deadlock, since the nominees will no longer be able to obtain instructions in order to be able to act.

Furthermore, the same also applies in situations where there are no nominee(s) acting as registered shareholder(s) for the beneficiary but the physical beneficiary himself is the registered shareholder. If this beneficiary then dies, the applicable death certificate needs to be obtained as well as any applicable tax clearance certificates which may be required in order for that entity to collect payments and/or effect trading/corporate actions. After much deliberation and research on the matter, a winning combination was reached which was effectively the following; namely the use of a Panamanian Foundation as the beneficiary of the Cyprus International Trust. Granted, that even though the reserved rights of the settlor give him flexibility regarding appointment and termination of a beneficiary under the new IT Law, the issue of confidentiality and other benefits that the Panamanian Foundation offers in being placed as the beneficiary of an international trust, is one which should be taken into serious consideration, as is explained in the following section.

4.2. Step two: the breakthrough

We are now turning to expand on why a Panamanian Foundation is a good choice to be named as beneficiary under a Cyprus International Trust.

This is mainly done to meet the wishes of the settlor on the one hand and to avoid the situations which have already been described under Step 1 above, on the other. The Panamanian Foundation's principal aim is asset protection and it is most notably established for the purpose of dealing with the succession into private assets. It offers high confidentiality and flexibility to the 'real' founder who can retain powers as he wishes while at the same time the his name as well as the names of his successors (ie the beneficiaries) remain absolutely confidential. Since the founder of the Panamanian Foundation may be any person or entity which forms such Foundation in the Panamanian Public Registry and usually a nominee founder's name may appear, the privacy of the Cyprus International Trust as Founder is maintained. Neither names nor passport numbers are registered in the Panamanian public registry when the Foundation is incorporated. The Foundation Council fulfills the same role as the directors of a corporation. The protector of the Panamanian Foundation is the ultimate

controller of the Panamanian Foundation. Once incorporated, the council appoints the protector. This is done via the Foundation's Regulations which are contained in a private, non-publicly registered document, as already outlined above, and thus the identity of the protector remains absolutely confidential. From this point onwards, the protector has full control over the Panamanian Foundation and of its assets. The beneficiaries of a Panamanian Foundation (which at this time may be the actual individual beneficiaries) are appointed and set out in a separate document, the Regulations, so that the identity of the beneficiaries remains again absolutely confidential. What is noteworthy to point out is that the Foundation's Regulations may be changed or modified at any time, but only by the protector or as otherwise designated therein.

5. Conclusion

The IT Law that amended the 1992 Law was a long awaited and overdue change. The amendments have reinforced the robustness of Cyprus as a competitive jurisdiction in the field of trusts and have once again placed Cyprus as lead in the race of favourable jurisdictions in international tax planning, personal wealth management, and inheritance planning. Making a Panamanian Foundation beneficiary of a Cyprus International Trust offers many advantages, inter alia the possibility to keep the identity of the beneficiaries of both trust and foundation confidential as well as a great flexibility to amend the circle of beneficiaries. Coupling the Panamanian Foundation with the Cyprus International Trust bestows upon it a European Union element and truly turns it, as the title of this article suggests, into an 'unrivalled structure'.

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