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Drafting a Trust to be Governed by Cook Islands Law

Over the last 15 years the Cook Islands has become the foremost jurisdiction for establishing offshore trusts. Cook Islands trust law is particularly well developed in the protection of trustees and trust assets from foreign court orders. In addition, it deals with a number of current issues in trust law giving the Cook Islands considerable advantage over other offshore jurisdictions in general offshore trust work.

To ensure that their clients get the full benefit and advantage of Cook Islands law it is important that attorneys are aware of the many unique provisions of Cook Islands law in the International Trusts Act 1984 (ITA). Some provisions which the client may want, may apply only if adopted by the trust document. Other provisions which the client may not want, may need to be excluded from the trust document. This article provides a guide to attorneys drafting a trust which is to adopt Cook Islands law, either wholly or partly, as its governing law.

The reference to the law of equity throughout this article as “the common law” is because, unlike the English system, there are not separate courts for equity and common law. In the Cook Islands the common law of trusts has been substantially modified by the ITA and its amendments. The ITA was specifically drafted following consultation with United States lawyers, to provide certainty to trust grantors against the effects of bankruptcy and fraudulent conveyance law. It applies only to trusts registered under the ITA (international trusts), and makes numerous modifications to Cook Islands trust law applicable to international trusts. All section references below are to the International Trusts Act 1984 (as amended).

1. Qualification as an International Trust

The application of the ITA is restricted to an international trust registered under the ITA and which has as a trustee:

- (a) A Cook Islands trustee company;

- (b) A Cook Islands international company; or
- (c) A Cook Islands foreign company.

Adopting Cook Islands law, without both appointing a Cook Islands trustee and registering as an international trust, is therefore of limited advantage.

2. Date of Creation of a Trust

The common law treats a trust as being settled once the grantor has taken all steps necessary to transfer the property to the trustee. The practice of dating a trust instrument does not of itself establish the date of creation of that trust. However, one must identify this date accurately for:

- (a) Registration as an international trust.
- (b) Reporting the existence of the trust under rules in the grantor’s home jurisdiction.
- (c) Calculation of time limits for limitation of actions.
- (d) Calculating the exact date from which Cook Islands law applies to an international trust.

Section 7. provides that unless otherwise provided for in the trust instrument, the date of execution by the grantor is the date of creation of the trust. This provision will apply unless excluded by the trust instrument.

The recommendation is that one should rely on the provision unless it is unlikely that presentation for registration of the trust will occur within 45 days of the date of creation. The

attestation clause for the grantor should include the date of execution by the grantor, and if the trust instrument itself is to be dated, that date should be the date the grantor executed the instrument.

3. Place of Execution

Under the common law, the grantor normally executes the trust instrument and effects the transfer of property in the same jurisdiction to attract the creation of the trust under the law of that jurisdiction. The law of that jurisdiction becomes the governing law of that trust. This is clearly an impractical rule with offshore trusts.

Section 7. provides that where the trust instrument and its counterparts are executed by different parties on different dates and in different places, within or outside of the Cook Islands, the trust is deemed valid as if all the parties had executed the trust instrument simultaneously within the Cook Islands. This provision will apply unless excluded by the trust instrument.

4. Perpetuity Period

The rules as to perpetuities and remoteness of vesting are well known and apply in English common law jurisdictions, as well as in the United States. Section 6. abolishes both rules as well as the rule against perpetual trusts. The abolition applies irrespective of the trust instrument. To accommodate this, the ITA authorises the trust instrument to provide for the vesting or non-vesting of trust property within or outside of time periods or events.

Therefore, if the grantor wants to limit the life of the trust, the trust instrument must include this limitation. It is not sufficient to describe this limit by reference to a "perpetuity rule". In the event that neither a limitation period nor any power to determine is contained in the trust instrument, one must interpret the trust as if it were a perpetual trust. If a dynasty trust is intended however, there are other provisions attorneys must consider. (See paragraph 17).

5. Powers to Extend or Reduce the Vesting Period

Trustees have no power under the common law to extend or reduce the vesting period. A trust instrument may provide for these powers, but the powers cannot extend the trust beyond the perpetuity period applying in the jurisdiction of creation of that trust. These powers are particularly important for a trust migrating from a perpetuity jurisdiction to a non perpetuity jurisdiction, or vice versa. For example, in

the event that a perpetual trust is to migrate from the Cook Islands jurisdiction, it may need a perpetuity period in order to comply with the perpetuity law of the new host jurisdiction. Another example is when a trust with a limited perpetuity period is migrating to the Cook Islands the trustees may want to adopt a longer, perhaps indefinite, vesting period.

Section 6.(5) gives the trustees a power to extend the duration of a trust for a period of time, or until the occurrence of an event in time, or in perpetuity, with the consent of the "interested parties". Section 6.(6) is more restricted in its application and applies only when an international trust migrates from the Cook Islands to another jurisdiction. It empowers the trustees to reduce the duration of a trust and adopt a shorter period in which the property shall vest. Both powers apply unless excluded by the trust instrument.

6. Rule in *Saunders v Vautier*

The common law rule in *Saunders v Vautier* is that where all beneficiaries under a trust are of full age and capacity, then notwithstanding the trust providing for the assets to be retained in trust, or that income is to be accumulated, the beneficiaries can apply to a court to terminate the trust and require the distribution of the trust income and assets to them. In special circumstances this may also apply to the objects of a discretionary trust.

Section 10 negates this rule where the trust contains an express provision to accumulate income, or to refrain from making any distribution of capital or income until a specified date or event. If the grantor does want to restrict payment of income or capital to final beneficiaries beyond their common age of majority, the trust must contain an express provision to this effect in the trust instrument.

7. Recording of Title

The common law does not acknowledge a trust as an entity, rather as a relationship described by reference to the trustees. Property is held by the trustees, not the trust. Section 13.(1) modifies this rule, permitting the trustees to adopt a name for a trust. This power applies unless excluded by the trust instrument. Further, Section 13.(2) allows a trust instrument to provide for the trust property to be held under that name, rather than in the names of the trustees. This provision will apply if included in the trust instrument.

8. Spendthrift Beneficiary

Unlike United States common law, the common law in the

Cook Islands does not allow a trust to protect the vested interest of a beneficiary from creditors of that beneficiary, and allows creditors access to both income and capital vested in that beneficiary (subject to limited exceptions). Section 13F allows a trust instrument to provide for a vested interest in income or capital to be protected from creditors. This provision will apply if included in the trust instrument.

9. Governing Law

The common law provides a variety of tests to determine whose law shall be the governing law of a trust. It is now common for grantor trusts qualifying as domestic trusts for US tax purposes to have more than one governing law applying to different aspects of the trust. However, there is no clear support from common law for a trust to have more than one governing law.

Section 13.G(1) directs a court to accept the governing law specified in the trust instrument to the exclusion of other factors. Section 13.G(3) permits a trust instrument to provide for simultaneous application of different governing law. These provisions are permissive, are important to all trusts, and must be included in the trust instrument.

10. Migration of Trusts

The common law does not provide for migration or redomiciliation of trusts, requiring instead that the trust be re-settled in the new jurisdiction. It is the considered opinion of many prominent English lawyers that the common escape clause in many offshore trusts causes the trust to become invalid. A number of provisions in the ITA deal with this and consequential issues.

Section 13.G(4) permits a trust instrument to provide for changing its governing law. Section 13.G(11) permits a trust instrument to empower the trustees to amend the trust to adopt various principles of Cook Islands law on registration as an international trust (this change is often the objective of the redomiciliation). These provisions apply unless excluded by the trust instrument.

Section 6.(6) gives the trustees power to reduce the duration of a trust and adopt a shorter period in which the property shall vest, in the event of the trust emigrating from the Cook Islands. This provision applies unless excluded by the trust instrument and if a trust is to be a perpetual trust, careful consideration of the provision is necessary.

11. Community Property

Where community property is transferred to a trust, the character of that property as community property would normally be lost. Section 13J provides that where community property is transferred to a trust, except where the provisions of the trust deed may provide to the contrary, it retains its characteristic as community property notwithstanding that it has been transferred to the trust. This provision applies unless excluded by the trust instrument.

12. Third Parties and Trading Trusts

At common law, a third party contracts with the trustees, and not with the trust itself. The trustee relies for his protection on common law rights of indemnity against the trust property, which are effective provided, amongst other matters, the transaction is not ultra vires, and that he is not otherwise in breach of his duties.

The rights of a third party contracting with a trust can therefore be uncertain, and this tends to restrict the use of trusts in commercial situations. For example, a lender might find itself with a useless remedy against a bankrupt trustee and no remedy against the trust company assets. Section 19J gives a third party rights directly against the trust property, rather than against the trustees. This provision applies unless excluded by the trust instrument.

13. Majority Trustee Decisions

At common law, trustee's decisions must be unanimous. Section 19D is a permissive provision that allows a trust instrument to provide for trustees to make majority decisions.

14. Holding of Title to Property

Under common law all trustees must hold title to each item of trust property. This is not always practical where trustees reside in different countries. Section 19H allows a trust instrument to provide for trustees to delegate the holding of title between themselves.

15. Secrecy

At common law, the trustees are under obligations to divulge certain types of information concerning the trust to beneficiaries. However, section 23 makes it an offence to divulge any information concerning a trust to any person. Subsection (4) permits a trustee to divulge information in certain limited circumstances, unless the trust instrument

provides otherwise.

The trust instrument should therefore set out clearly any restrictions on information which any class of beneficiaries might otherwise be eligible to receive, as well as make provision for the trustees to provide basic information to a restricted group of persons to enable the trust to be administered properly. Subsection (4) should be examined and if the powers are not accepted, this provision must be negated in the trust instrument.

16. Charitable and Purpose Trusts

Charitable trusts must fall within certain narrow objects to be valid under the common law. Section 12 extends the definition of charitable trusts to trusts which benefit certain objects. If a trust is to be charitable, its objects must include those set out in Section 12.

The common law does not recognise purpose trusts outside of charitable trusts and other very limited exceptions. Section 12.(2) makes provision for purpose trusts and provides that they shall be enforceable on the terms as set out in the trust instrument. In establishing a purpose trust provision must be made for the enforcement of the trust in the trust instrument.

17. Dynasty Trusts

Although Section 6. abolishes the rule against perpetuities and allows dynasty or perpetual trusts to be established, consideration of the following areas is necessary for establishment of a dynasty trust:

- (a) Power of the trustees to reduce the vesting period (Section 6.(6)).
- (b) Power of the trustees to amend the trust instrument on changing the governing law (Section 13.G).
- (c) Provisions permitting beneficiaries to consent to a variation to the trust (Section 21).
- (d) The rule in *Saunders v. Vautier* (see paragraph 6).

18. Reduction of Administration Costs and Increasing the Performance of Trusts

The common law imposes severe duties on trustees, expecting them to be extremely conservative in their investment and administration of trust affairs. The consequence is that trustees often target simple preservation of capital rather than growth. However, many grantors are self made people who have generated the settled funds in their own lifetimes,

and who want the trustees to respond to their recommendations at least for investment of the trust funds.

The ITA contains several provisions which allow the grantor to restrict the duties and liabilities of trustees, with the objective of making the trustees more responsive to the grantor's wishes.

19. Trustees Duties to Beneficiaries

Under the common law, the standard and nature of the trustees' duties to the beneficiaries are numerous and extremely onerous. The courts strictly interpret attempts by the grantor in drafting the trust instrument to relax these duties to minimise operating costs and bureaucracy. Section 19A is a permissive provision and specifically authorises the trust instrument to limit the duties and obligations which might ordinarily apply to the trustees.

20. Delegation

Under common law, trustees are given restricted powers to delegate and are generally exposed to any breach by the delegatee. For example, delegation of control over trust funds to a funds manager can expose the trustees to liability for any losses made by that fund manager. The alternative of having the trustees carry out all their functions personally can be impractical.

Section 19B permits the trust instrument to authorise trustees to delegate management of the trust property to skilled persons, and to allow the trustees to be indemnified from liability for acts of any such persons. This is particularly important where the grantor wishes to nominate the fund manager.

21. Custodian Trustees

The common law requires all trustees to act together and does not encourage delegation of duties between trustees. This is often impractical when a trust has trustees living in different countries, particularly if the chosen investment activity requires quick decisions.

Section 19F provides for trustees to divide their functions so that the trustee in an offshore jurisdiction can hold title to assets (the Custodian Trustee), while the trustee in the home jurisdiction carries out all active management (the Managing Trustee). The power to appoint a custodian trustee and the powers of a custodian trustee as provided in the section apply unless excluded in the trust instrument.

22. Advisor to Trustees

The common law allows the trustees to take advice from persons designated by the trust instrument, but nevertheless makes trustees personally responsible for all decisions after taking that advice.

Section 19G permits a trust instrument to provide for the appointment of a trust advisor, whose function is to advise the trustees. The trust instrument can exempt the trustees from liability for following this advice.

23. Trust Investments

At common law, trustees were permitted to invest in a narrow range of investments. Attempts to enlarge this class were interpreted restrictively by the Courts. Section 19C permits the trust deed to state either generally (the equivalent powers of an individual) or in specific terms, what type of property the trustees may invest in, and directs the court to give a “fair, large and liberal interpretation” to these powers.

24. Consent of Beneficiaries

There are many situations which arise during administration of a trust when the trustees must consider the rights of various classes of beneficiaries. The consent of beneficiaries may also be required, either because the trust instrument requires it, or because the trustees require this to protect them from liability before acting in a certain manner. The process of obtaining such consent is complex, requiring separate legal representation for each class of beneficiaries, potential beneficiaries, minor beneficiaries and even unborn beneficiaries.

Section 21 permits the trust instrument to provide for the consent of beneficiaries to be obtained from a “designated person” to avoid the costs and to expedite the above process. The trust instrument will need to deal with the appointment and removal of the designated person.

25. Protector

At common law, a protector may be treated as a fiduciary, and therefore have duties to the beneficiaries, along with risk. It may be difficult to persuade an independent protector to accept this risk, and the appointment of a protector may then incur further cost. Section 20 permits a trust instrument to appoint a protector and

MATTERS WHICH APPLY UNLESS EXCLUDED BY THE TRUST INSTRUMENT

S. 6 (6)	Trustees’ Power to Extend Duration of Trust
S. 6 (7)	Trustees’ Power to Reduce Duration of Trust
S. 7	Date of Creation
S. 7	Place of Execution
S. 10	Modification of <i>Saunders v. Vautier</i>
S. 13 (1)	Power to Adopt a Name
S. 13 (J)	Community Property
S. 19 (A)	Trustees’ Duties
S. 19 (J)	Third Party Rights
S. 19 (F)	Custodian Trustee

MATTERS WHICH APPLY IF INCLUDED IN THE TRUST INSTRUMENT

S. 12	Charitable Trusts and Purpose Trusts
S. 13 (2)	Power to Hold Property Under Name
S. 13F	Spendthrift Beneficiary
S. 13G (1)	Governing Law
S. 13G (3)	Multiple Governing Law
S. 13G (4)	Change Governing Law
S. 13G (11)	Trustees Power to Amend Trust on Change of Governing Law
S. 19B	Delegation Power
S. 19C	Trust Investments
S. 19D	Trustee Majority Decisions
S. 19E	Trustees’ Liability
S. 19G	Advisor to Trustee
S. 19H	Delegation as to Title to Property
S. 20	Protector
S. 21	Consent of Beneficiaries

MATTERS WHICH APPLY IRRESPECTIVE OF THE TRUST INSTRUMENT

S. 6	Perpetuities & Vesting Period
S. 23	Secrecy

to provide for the protector not to be a fiduciary.

26. Interpretation of Exclusion of Liability of Trustees Clauses

In addition to imposing severe duties on trustees, the courts interpret strictly any clause in a trust instrument which purports to reduce trustees' liabilities. The consequence is again that trustees are extremely cautious in their approach to the administration of the trust, often causing them to prefer investment in low return high security investments, as well as running up high costs in ordinary administration.

Section 19E permits the trust instrument to reduce the trus-

tees liability where the grantor wishes to do this, and directs that such provisions shall be given a fair, large and liberal interpretation.

Summary

As long as attention is paid to the above provisions, there is no reason that a US attorney cannot use his standard estate planning trust document as the basis for a client's asset protection trust. Awareness of the unique provisions of Cook Islands trust law allows an attorney to more effectively achieve his client's objectives through a Cook Islands international trust. ■