aviation and packaging. Consumer durables, health care, sewing machine, television and radio, and beverage industries are other growth areas. In the financial sector, banking, hire purchase, insurance, housing finance and investor information are growing. In addition, the government recently identified other priority sectors for foreign investment: infrastructure (specifically, power, highways and ports), food processing, leather and leather goods, ready-made garments, chemicals and metallurgy;

- incorporating new guidelines in the government's foreign investment policy that form the basis on which the government will evaluate FDI proposals. The Industry Ministry stated in 1997 that it has no objection, in principle, to permit FDI or the establishment of 100% foreign-owned subsidiaries in non-priority industries, provided these create employment opportunities, or are in some way beneficial to the agricultural sector, contribute to foreign exchange earnings, produce world-class products, bring in distinctive brand names and new technologies, or enhance exports. Applications to set up ventures in the consumer sector would, however, be considered on a case-by-case basis. FDI would be especially welcomed in infrastructure, high-technology areas and in sectors promoting value-added items and export, provided the interests of domestic companies are not compromised. It is hoped that these guidelines will overcome the earlier system of ad hoc clearances and impart greater transparency to existing clearance procedures;
- new policy has been evolved for those multi-national companies (MNCs) which seek to set up 100% subsidiaries in addition to operating joint ventures with Indian partners. The aim of this policy is to protect the interests of shareholders of such joint ventures when their MNC partners apply to establish a wholly-owned subsidiary in the same product range as that of the joint venture. Some concerns were expressed in early 1996 by minority investors regarding the affiliates of some MNCs. It was felt that overseas parent companies would accord preference to their wholly-owned subsidiaries. Whilst retaining their affiliates and their manufacturing outfits, these parent companies would make their wholly-owned subsidiaries the marketing vehicle, thereby diminishing the prospects and advantages that could derive to the joint venture.

The government made public guidelines for approval of wholly foreign-owned subsidiaries in February 1997. According to the guidelines, the government may consider and approve proposals for 100% foreign-owned companies in the following cases:

- where only 'holding' operations are involved;
- where proprietary technology is sought to be protected, or sophisticated technology is proposed to be brought in;
- where at least 50% of production is for export purposes;
- where proposals are for consultancy services;
- where proposals are for power plants, ports, industrial townships or industrial parks.

The government has announced that investors could be granted temporary approval to set up 100% subsidiaries on the condition that they divest 26% of their holding to Indian investors or the Indian public within three to five years of the approval.

The government has clarified that wholly-owned subsidiaries will not be allowed to be paid royalties, a policy generally followed in the past but never publicly articulated. The government has, however, yet to decide the question of whether other payments, such as technology or know-how fees, or research and development fees, will be allowed instead.

CONCLUSION

According to the Indian Government's *Economic Survey Report* for 1997–98 the reform and liberalisation process has created a much improved economic situation in the country. Although the pace of future reforms and the precise form that they will take is uncertain, one thing is clear: economic reform will continue. In this context, the economic decision-making role of state governments is expected to grow and investors will have to deal more with state authorities than central authorities. The government seems to be taking deliberate and measured steps to develop a growth-focused environment, the aim being to try to accommodate diverse interests without deviating from its primary goal of poverty alleviation, social justice and social development, and to maintain India's status as a secure and attractive destination for foreign investment.

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The Cayman Islands

Sham trusts

by Naomi Lawton

The *Trusts (Amendment) (Immediate Effect and Reserved Powers) Law* 1998 (the 'Amendment') came into effect in the Cayman Islands in May 1998 and was designed to address the issue generally referred to as 'invalid testamentary dispositions' or 'sham trusts'.

The general rule (inherited from English law principles) is that where the owner of property transfers legal title to property to another, with instructions to deal with the property entirely as the owner directs and on the death of the owner to deliver the property as a gift to a third party, the person taking possession is merely an agent for the owner and not a trustee. The agency terminates on the owner's death. No interest in the property passes to the third party before the owner dies. Nor will any interest pass to the third party on the death of the owner because the disposition is regarded as testamentary and, if it was not executed in accordance with the Wills Law, is invalid.

The difficult issue has always been the extent to which a settlor may reserve powers (or grant them to a third party) without there being a risk that a court will deem the arrangement an agency (and therefore testamentary) rather than a trust. In the Cayman Islands, as in many other jurisdictions, the area has been unclear until recently.

The case of the US, however, has been somewhat different. There, the development of the concept of the reservation of powers in a trust can be traced back to the 1930s and the issue has been the subject of a significant number of cases in many states. In the *Restatement of Trusts* as adopted by the American Law Institute (ALI) in 1935, it was stated in s. 57 that:

'Where the settlor transfers property in trust and reserves not only a beneficial life estate and a power to revoke and modify the trust but also such power to control the trustee as to the details of the administration of the trust that the trustee is the agent of the settlor, the disposition so far as it is intended to take effect after his death is testamentary and is invalid unless the requirements of the statutes relating to the validity of wills are complied with.'

However, over the next 20 or so years, the law developed significantly, to the extent that, in the ALI's *Second Restatement of Trusts* adopted in 1957, s. 57 was modified to read:

'Where an interest in the trust property is created in a beneficiary other than the settlor, the disposition is not testamentary and invalid for failure to comply with the requirements of the Statute of Wills merely because the settlor reserves a beneficial life interest or because he reserves in addition a power to revoke the trust in whole or in part, and a power to modify the trust, and a power to control the trustee as to the administration of the trust.'

Despite there having been some anomalous decisions since then, resulting in some states clarifying the position by statute (see, e.g. *Florida Statutes,* s. 689.075, amendment passed in 1969), the trend of modern authorities in the US has been to uphold an inter vivos trust no matter how extensive may be the powers over the administration of the trust reserved by the settlor.

By contrast, no similar development took place under English law, possibly because of the early introduction of restrictive trust taxation provisions. There were, and still are, very few English cases that are directly on point, and many of the cases cited as authority in relation to sham trusts are cases involving devices to circumvent restrictions contained in the Rent Acts or the Hire Purchase Acts, and most of those are relatively recent. The more recent decisions in England and in some of the offshore territories have given very little guidance as to how extensive may be the powers reserved by the settlor. In the Cayman Islands it was felt that the position required statutory clarification.

The effect of the Amendment is to create a presumption in construing any trust instrument (which is not expressed to be a will, testament or codicil) that such trust instrument has immediate effect. Although rebuttable, the presumption is intended to clarify trust instruments in which the settlor retains significant control over the trust assets and the powers of the trustee. The Amendment also enumerates a number of specific powers, the reservation or grant of any or all of which it is expressly provided will not invalidate the trust or affect the presumption of lifetime effect. These include:

- power to revoke, vary or amend the trust instrument;
- power of appointment of income or capital;
- any limited beneficial interest in the trust property;
- power to act as a director or officer of any company wholly or partly owned by the trust;
- power to give the trustee binding directions in relation to the investment of the trust property;
- power to appoint, add or remove any trustee, protector or beneficiary;
- power to change the governing law and forum for administration;
- power to restrict the trustee's powers by requiring the consent of a third party before the exercise of the power.

It has been suggested that the reserved powers specified in the Amendment are powers which a settlor could have reserved prior to the Amendment. That is possibly true. However, it was not known how many of the powers could be reserved *in aggregate* without running the risk of a Cayman court declaring that too many powers had been reserved, thus constituting the arrangement an agency rather than a trust. The idea of the Amendment was simply to draw a line so that trust practitioners would know that the reservation of one or more of the listed powers is safe but to go beyond that brings one back into the grey area. Nevertheless, care is still required to ensure that the arrangement is not, in fact, operated as an agency or a sham to the extent that in practice the settlor exercises more powers than he or she has reserved.

In relation to the position of the trustee, the Amendment provides that a trustee who complies with a valid exercise of any of the reserved powers will not be in breach of trust. This is clearly a very significant provision in practice. However, care must be taken in drafting the trust instrument if the trustee is to enjoy the full protection of this statutory provision.

In particular, the drafting must make clear that the trustee is required rather than merely permitted to observe the directions of the relevant party. A common example is the settlor who, having retained the power to direct the investments of the trust fund, embarks upon a risky investment policy. If the trustee is to be fully protected the relevant provisions of the trust deed must not permit the trustee to act to avoid the losses and ensure alternative investment.

The Amendment applies to all trusts created after the date of the Amendment (11 May 1998) and to any other trust to which it is expressly extended by deed executed by the trustees.

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