The Offshore Taxation Review

THE ISLE OF MAN LIMITED LIABILITY COMPANY OR "LLC": PART II

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Differences between LLCs in the United States and LLCs Established elsewhere (not the Isle of Man)

As has been explained in the first part of this article, it is a fundamental feature of the limited liability company as created and organised within the USA. that although it is created and organised as a company in each of the respective States having LLC-type legislation, the tax status of the company compels it to be treated as a partnership for US Federal tax purposes.

As has also been explained in the first part, the recognition that the limited liability company is capable of being taxed as a partnership for federal income tax purposes dates from a ruling by the US Internal Revenue Service in 1988.

Subsequently, in April 1995, the Service published its criteria for a favourable ruling on limited liability companies whether established within or outside the United States. This answered many of the difficulties which until then had been identified with limited liability companies and provided the basis for establishing greater opportunities in permitting limited liability companies to be classified as partnerships. The Service then contemplated an expansion of the limited liability company concept by proposing that an entity can elect to be taxed as a partnership or a corporation simply by filing a form with the Service but that limited liability companies established outside the United States could present special problems.[2] As a result, the criteria originally applicable to limited liability companies established within the United States and requiring to be classified as partnerships

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2 This has now, as of 1st January 1997, been legislated for in Regulations; see below at 42 et seq.

will no longer apply equally to limited liability companies established outside the United States and seeking similar classification.

In the case of jurisdictions other than the US, the distinction between the general law and tax law status of the limited liability company did not depend on a difference in recognition of the tax and general law status of a particular form of association. Each of the jurisdictions seeking to permit the creation of the limited liability company within their system of law brought into law provisions which were calculated to enable the US to treat the foreign association as a partnership for US tax purposes whilst continuing to recognise it as a corporation or company for non-tax purposes. This was done by ensuring that the enactment enabling the creation of the limited liability company compelled it to adopt characteristics within its founding provisions which made the particular association or body one to which the US Federal tax system would accord partnership status rather than corporate status. These characteristics are the third, fourth and sixth of those identified in the US Supreme Court decision in *Morrissey v US* (1935). The necessity of ensuring that these requirements were within the legislative provisions permitting the creation of non-US limited liability companies ensured that although the particular body or association had limited liability for its members, nevertheless it would be recognised for US Federal tax purposes as a partnership. But for all purposes other than tax purposes, the body or association would be accorded separate personality, so that limited liability status could be attached to it.

Features of Isle of Man LLCs

In the case of the Isle of Man the Committee which encouraged the ultimate establishment within Isle of Man jurisdiction of the 1996 Act was concerned to bring as much clarity into their local law as was possible and in particular to endow the LLC established under Isle of Man law with defined characteristics which could be simply ascertained without having to trawl through numbers of legislative provisions in order to deduce the characteristics of the LLC from a prolonged consideration of those provisions. To this end the 1996 Act, enacted into Isle of Man law, is unusual in that it commences with a section which is described in the margin as "Description of the features of limited liability companies". Section 1 of the 1996 Act sets forth the principal features of the LLC in subsection (1) of the section. Subsection (2) of section 1, however, provides that:

> "This section is for the purposes of explanation only and does not affect the operation of the following provisions of this Act."

Subsection (1) provides as follows:

"A limited liability company formed under this Act is a body of persons the principal features of which are that:

(a) the company has legal personality and capacity for the exercise of its purposes and powers (section 2); and

(b) the company will in any event be dissolved within thirty years of being formed (section 7); and

(c) the liability of its members is limited to the extent of their contribution to its capital (section 13); and

(d) restrictions are imposed on the transfer of members' interests in the company (section 16); and

(e) the management of the company is vested in the members in proportion to their contributions to the capital of the company or as otherwise permitted by this Act (section 17); and

(f) the company must be wound up and dissolved on the happening of certain events such as the death or resignation of a member (section 27); and

(g) the profits of the company will be treated as the income of the members for the purposes of income tax (section 46)"

Status of the Isle of Man LLC

(I) As seen in the Isle of Man

Before discussing the provisions containing the details as to the features of the Isle of Man LLC, more needs to be said about the status of the Isle of Man LLC - at any rate from the point of view of Isle of Man law. As the name of the company implies, it appears to take effect as a company. Indeed, section 3(1) of the Act provides that the words "limited liability company" or its abbreviations "LLC" or "L.L.C." shall be included at the end of the name of every such company; whilst subsection (2) of the section provides that the omission of these words in the use of the name of the company is to render any person who participates in the omission or who knowingly acquiesces in it, liable for any indebtedness, damage or liability occasioned by the omission. But there are some puzzling features about the legislation. The stated intent in the preliminary discussion paper and later

explanatory Memorandum which introduced the Bill which became the 1996 Act into Tynwald was to cause the LLC to be classified as a company under Isle of Man law. The language of the 1996 Act, bearing in mind that it adopts the features of the earlier Wyoming Limited Liability Company Act, appears aimed at causing the LLC to be classed as an association (or body) where all the participants have limited liability, rather than a company the members of which have limited liability as is the case with a conventional limited company which is constituted under the ordinary Companies Acts (in the Isle of Man the Companies Acts 1931 to 1993). The following four points may be noted:

1. The 1996 Act provides that it is "An Act to provide for the establishment of limited liability companies; for the taxation of such companies; and for other purposes." This is the preamble to the 1996 Act which is similar in scope to preambles in other Acts of Tynwald or Acts of Parliament. But it is noteworthy that the 1996 Act, in establishing the LLC, does not appear to contemplate that the LLC will be treated as being a company within the Isle of Man Companies Acts. It has been suggested by a member of the Committee which was responsible for advising the Isle of Man Government on the creation of the LLC as an entity recognised under Isle of Man law, that the 1996 Act would create a kind of company which was different to the company which could be incorporated under Isle of Man company law as represented by the Isle of Man Companies Acts. There are some provisions in section 52(1) to (3) of the Act which include amendments to sections 79, 290(1) and Part XI of the Companies Consolidation Act 1931 which appear to contemplate that part of the Companies Acts may be supplemented by provisions which might appear to equate an LLC with other companies - see in particular subsection (3) which in relation to Part XI provides that it is to apply "to all companies (including limited liability companies)" and contains a definition that the expression "limited liability company" means "a company which accords to a limited liability company organised under the Limited Liability Companies Act 1996".

2. In subsection (1) of section 1 of the 1996 Act it is stated that:

   "A limited liability company formed under this Act is a body of persons....."

   The phrase "body of persons" is not defined anywhere in Isle of Man legislation. There are a number of compendious phrases which could perhaps have been better used instead of the phrase "body of persons". One of these is the word "person" which would have made it clear that, as appears to be intended by the 1996 Act, the LLC shall have the status

of a legal person separate from its members. Another phrase which could equally as well have been used is the word "association" which is defined in section 120 of the Isle of Man Income Tax Act 1970 as meaning "any company corporate or unincorporate, fraternity, fellowship, associate or association of persons". In that same Act the word "person" is partially defined in that it is stated that the word "includes any association of persons corporate or unincorporate", which is part of a more comprehensive definition of that term in the Isle of Man Interpretation Act 1976. A third could have been the phrase "corporation aggregate". But the Isle of Man Interpretation Act does not contain a definition of the phrase "body of persons". By way of contrast, it should be noted that the term is the subject of an exhaustive definition in the UK Income and Corporation Taxes Act 1988 section 832(1) replacing earlier legislation containing a similar exhaustive definition.[3] In that legislation it is stated that the term "body of persons" means:

"any body politic, corporate or collegiate, and any company, fraternity, fellowship and society of persons whether corporate or not corporate".

There is a similar definition of the phrase "body of persons" in Jersey law: this definition appearing in Article 3(a) of the Income Tax (Jersey) Law 1961 - not that Jersey law is in any way relevant to this subject. But the point that is being made is that the use of the phrase "body of persons" is confusing because the term implies that the particular body may be corporate or unincorporate. If it was intended to make it clear that the LLC under Isle of Man law had corporate or incorporated status, then what would have been simpler than to describe it as "a body corporate" or "corporation aggregate"? The impression is gained that perhaps it is

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3 The reader should understand that although Isle of Man law and English law are separate systems of law, in practice the Isle of Man has drawn upon English common law usages and customs when its own law has been silent. This is not a paper which is intended to explain the constitutional or legal overlap between the United Kingdom (or English) and Isle of Man legal systems. The reader should however assume that unless Isle of Man statute law or judicial decisions express otherwise, the Isle of Man law on a particular topic will be similar to that in operation in England. This will however be less likely where the law being drawn upon is of a statutory nature Isle of Man statute law is separate and distinct - one being enacted by Tynwald and the other by Parliament - they both require the Royal Assent to become effective. Such persuasive effect as comparable under English or United Kingdom statute law may have in an Isle of Man context is rendered of even less persuasive effect where the legislation in question is tax legislation, since the tax systems of the United Kingdom and Isle of Man jurisdictions are completely separate and neither has any derivative origin in relation to the other.

intended that under Isle of Man law the LLC will be treated as having a separate juristic personality but not perhaps amounting to a true incorporated company. That there can be juristic personality without the person in question being an incorporated company is an acceptable feature of modern law - see, for example, the status of a firm under Scots law (which defines it as a person separate from the partners comprised within the firm - see section 4(2) Partnership Act 1890). Other examples of juristic persons lacking in corporate status are the Establishment (Anstalt) and the Foundation (Stiftung) in Liechtenstein.

3. In subsection (1) of section 2 of the 1996 Act it is provided that "a limited liability company is a legal entity which is distinct from its members, manager and registered agent". So it is clear that the intent is that the LLC shall have a personality which is separate from that of its participants or officers or agent. But there is an absence in the 1996 Act of a number of phrases which would normally connote an intention that this separate legal entity was to be endowed with corporate status. For instance:

(i) The 1996 Act describes the LLC as something which "is organised under this Act". It is not stated that the LLC "is incorporated under this Act"

(ii) Section 2(3) provides that nothing in the 1996 Act is to be interpreted as precluding any one of certain kinds of person "from forming a limited liability company". Again, there is an absence of a reference to someone "incorporating a limited liability company"

(iii) In section 7(1) and later provisions of the 1996 Act the constitution of the LLC is described as "the Articles of Organisation" and not as "the Memorandum of Association" or "the Articles of Association" or a similar cognate expression which would be associated with an incorporated company.

(iv) Section 7(1) of the 1996 Act also contains matters which must be specified in the Articles of Organisation. These are the name of the LLC, the period of its duration, the names and addresses of its members, and the name and address of its registered agent and the matters referred to in Schedule 2 of the 1996 Act. Schedule 2 lists a number of additional matters which must be set forth in the Articles of Organisation and which matters are the sort of matters that would be found in Articles of Association. Section 7(2) of the 1996 Act then provides that "It is not necessary to set out in the

Articles of Association any of the powers specified in this Act" and Schedule 1, which is expressed to refer to powers of the LLC, contains a number of provisions which are clearly identified with objects of a conventional company. What is surprising is that the Act does not specify or even recommend a form of Articles of Organisation, in contrast to conventional Companies Acts which often contain Tables - such as Table A - specifying the form which a Memorandum of Association or Articles of Association may take. In contrast, partnership legislation never contains anything comparable to Table A or suchlike, the drafting of partnership Articles being left to the intentions of the prospective partners or their advisers.

(v) Section 24 of the 1996 Act provides specifically that a member of any LLC "is not a proper party to proceedings by or against" the LLC "except where the object is to enforce a member's right against or liability to" the LLC. A provision of this nature sits strangely in a context of an enactment dealing with the creation of a company. It is, however, consistent with provisions where the entity concerned is intended to be a person which is not a company but is nevertheless treated as a separate juristic person. One may contrast the provision with a somewhat similar provision in section 4(2) of the Partnership Act 1890 which enables partners in a Scottish partnership to obtain relief from the partnership firm in proceedings to enforce their rights or liabilities.

There are other examples in the 1996 Act where words and phrases have been used which are consistent with an intent for the LLC to have juristic personality while not necessarily being accorded corporate status. To name but one, section 52(3) of the 1996 Act states that in relation to Part XI the expression "limited liability **company**" means "a company which accords to a limited liability company **organised** [emphasis not in legislation] under the Limited Liability Companies Act 1996". Note here the use of the word "organised" in contrast to the word "incorporated".

On the other side of the line, there are two examples of words used which would indicate that the LLC might have been contemplated to have been analogous to a company incorporated under the Companies Acts rather than be in the nature of an entity lacking incorporated status. Both are to be found among the prescribed forms which are prescribed for the purposes of the 1996 Act, the prescribing being effected by the Limited Liability Companies (Forms) Regulations 1996 which were one of the sets of regulations made by the Treasury and which came into force on 17th October 1996 as referred to above. In one - Form No. L7, which is stated

to be "Statement of Amendment(s) to the Articles of Organisation under section 7(5) of the Act", there is a reference to there being listed in the form "the following amendment(s) to the **Articles of Association** of the company....." (emphasis not in the legislation). The reference to the Articles of **Association** is clearly an error but is an error which must derive from an intention on the part of the form's draftsman that he was dealing with a form relating to a species of incorporated company. The other - to be found in Form L20/2 - is stated to be "Particulars of a Series of **Debentures** containing, or giving by reference to any other Instrument, any Charge to the benefit of which **Debenture** Holders of the said series are entitled pari passu" and is expressed to be "under para.2(5) of Schedule 3 to the Act". Again, the emphasis is not in the text of the regulations and is put in to show a reference to the use of a word which is normally associated with an incorporated company which is incorporated under the Companies Act rather than to any other form of body. The words "Debenture" and "Debentures" and "Debenture Holders" appear in sub-paragraphs (4) to (6) of paragraph 2 of Schedule 3 to the 1996 Act. Again, the use of these words suggests a belief on the part of their draftsman that an incorporated company was being referred to rather than some other body. But the words used are in the context of forms or in a Schedule to the 1996 Act and do not appear in provisions contained in the 1996 Act itself. The doubts about the status of the Isle of Man LLC are not dispelled by the references to these words.

It should be noted that the term "debenture" has a common law meaning, being defined as "a document which creates a debt or acknowledges it" by Chitty J in *Levy v Abercorris Slate & Slab Co* (1888) 37 ChD 260 at 264 and in *Edmonds v Blaina Furnesses Co* (1887) 36 ChD 215 at 219. That particular judge is also on juridicial record as stating that it must be issued from a company to a person who has a charge and it must be secured on the company. The term "company" was of course being used in the sense of an incorporated company by reference to that term as defined in then known Companies Acts, the particular one then being the Companies Act 1879. But it has been held that unincorporated associations can issue debentures if there is power so to do in the rules - see *Wylie v Carlyon* (1922) 1 Ch 51. So the fact that the LLC is not a company incorporated under the Companies Acts does not mean that it cannot in law issue debentures. But unless the contrary appears, the term must refer to an instrument which is within the common law meaning.

There is also a strange provision, originating in section 52 of the 1996 Act and relating to amendments which that section provides are to be made to certain provisions in the Companies Acts and in the Companies Act 1931 in particular, and which appear to have assumed that the LLC was envisaged to be capable of being equated with a company incorporated under that Act or under the Isle of Man Companies Acts in general. There are two provisions in particular:

(A) Section 290 of the Companies Act 1931 is concerned with the perpetuation of an ability on the part of certain bodies which were capable of being incorporated under the Companies Act 1931 but which had not been so incorporated, to be registered as ordinary companies under that Act. These provisions are probably now regarded as semi-academic. But subsection (2) of section 52 provides that a limited liability company organised under the 1996 Act shall not register in pursuance of the section. This provision appears to assume that the LLC is a species of body which, but for the provision, could have applied to be registered and therefore converted from LLC status to conventional company status.

It should be noted here that the provisions presently to be found in section 16 of the Companies Act 1931 enabling a company to re-register are only of application to a company which is either formed and registered under the Companies Act 1931 or previous legislation. The LLC is not a species of company qualifying for any such re-registration.

(B) Subsection (3) of section 52 contains amendments to Part XI of the Companies Act 1931 which enable foreign companies with a place of business in the Isle of Man to be registered as oversea companies. Not all foreign companies are capable of being thus registered. To be eligible for registration the entity in question must be a species of the class of "all companies incorporated outside the Isle of Man", and the expression "companies" is not defined in the Companies Act 1931 or elsewhere. However, there are some interesting statements in subsection (3) which embody amendments to Part XI. The following are the amendments:

(a) In section 312 of the Companies Act 1931 - the introductory section requiring that all companies incorporated outside the Isle of Man and with a place of business in the Isle of Man must be registered as oversea companies - it is provided that after the words "shall apply to all companies" there is to be inserted the phrase "(including limited liability companies)";

(b) In sections 313(1)(b) and 315(2), after the phrase "directors and secretaries", there is to be inserted on each occasion that the phrase appears "(if any)";

(c) In section 321 a new definition appears. After the word "director" this new definition reads as follows:

"Limited Liability Company" means a company which corresponds to a limited liability company organised under the Limited Liability Companies Act 1996;"

The reference in section 312 to "limited liability companies" as being included within the categories of companies requiring to register as oversea companies, coupled with the definition of the expression "limited liability company" indicates that the draftsman envisaged that the LLC was a species of company - i.e. a company as that term is defined in the Companies Act 1931. In this connection the Companies Act 1931 defines the expression "company" as meaning a company formed and registered under that Act or under previous Isle of Man legislation. It is therefore a reasonable inference that the draftsman envisaged that LLCs which were organised under non-Isle of Man originating legislation would be similar to LLCs organised under Isle of Man legislation and that both were to be regarded as a species of company similar to a company incorporated under Isle of Man law even though the law was not the Companies Acts but a separate Act. As will appear from a review of the contents of this paper as a whole, whatever may be the status of the Isle of Man LLC, it is not a status which involves incorporated status. Thus the draftsman envisaged that LLCs created under systems of law other than that in operation in the Isle of Man were to be regarded as species of companies as that term was commonly understood under Isle of Man law, whereas, in fact, such bodies - no matter where they are established under systems of law as at present known - are definitely not incorporated companies. But it remains the case that the draftsman of the Isle of Man LLC appears to have envisaged that the LLC organised under Isle of Man law would somehow have incorporated status and that LLCs established elsewhere than in the Isle of Man also must be regarded as having incorporated status.

4. There are supplementary provisions about the taxation of LLCs which are also somewhat perplexing when compared with the description of the taxation position as summarised in section 1(1) of the Act. Paragraph (g) of section 1(1) of the 1996 Act, which introduces the references in the 1996 Act to the taxation of LLCs, refers at the end of the provision to section 46 of the 1996 Act, but a review of a number of provisions in the 1996 Act indicates that section 46 is not the only provision which affects the taxation of LLCs. The subject of taxation of the LLC under Isle of Man law is considered in a later section of this paper in more detail: but it is fair to say that whereas section 1(1)(g) states that the 1996 Act provides (in section 46) for the income of the LLC to be the income of its members for the purposes of Isle of Man income tax, a reference to section 46 itself puts this reference into a slightly different context. The section consists of the insertion of a

new provision in the Isle of Man Income Tax Act 1970 which provides that:

(a) the LLC is to be treated in all respects as if it is a partnership; and

(b) each member of the LLC is to be treated as a partner.

This declaration of treatment of the LLC is not really necessary if all that is being sought is to impute the income of the company to its members. Because the provision goes further and seeks to treat the company as a partnership and its participants as partners, this stated treatment is a further justification for inferring that the intent behind the 1996 Act is to classify the LLC as a body of persons having unincorporated status rather than as that species of person which has corporate status - i.e. as being equated with an incorporated company or corporation.

To sum up, it appears to be the case that although the LLC is described as "a limited liability company" and in section 1(1) of the 1996 Act as "a body of persons the principal features of which are that" (inter alia)....."the company has legal personality", nevertheless the LLC will be regarded as lacking in full corporate (i.e. as a body corporate) status. Thus it will not be regarded as comparable to an incorporated company being one incorporated under the Companies Acts. The point must be regarded as of no great juridical significance under Isle of Man law. At the very worst the use of the term "company" to embrace both the LLC created under the 1996 Act and the incorporated company incorporated under the Companies Acts does little more than cause confusion when the term is used in a context which might cause it to be inferred that a particular basis of legal treatment might be different according to whether the "company" was the LLC or the incorporated company. No particular Isle of Man provisions come immediately to mind in which the distinction is of significance: for example, there is no separate tax for companies or corporations to that for other persons. The distinction becomes of much greater importance when it is sought to evaluate the LLC in the context of legal systems outside the Isle of Man where the distinction between the status of the LLC as being an unincorporated company rather than an incorporated company - i.e. as being either a body corporate or some form of association or body lacking the incorporated status - becomes of much greater legal and practical moment. The point is further developed in later sections of this article.

(II) As might be seen in the United Kingdom (and the Republic of Ireland)

It would appear that for purposes other than tax, the LLC will be regarded outside the Isle of Man as being equated with an incorporated company even though the LLC is not formed under the current legislative system of company statute law prevailing in the Isle of Man. There is really nothing dramatic about this. A number of Caribbean jurisdictions provide for the creation of international business companies which are formed by reference to legislation which is separate and distinct from the conventional company law prevailing in the respective jurisdictions. Even in the USA the LLC owes its origins to legislation which is separate and different from existing company statute law.

Two jurisdictions where the tax status of the LLC may prove to be obscure are the United Kingdom and the Republic of Ireland for purposes of corporation tax and capital gains tax. In each jurisdiction the primary direct tax is income tax. That tax is payable equally by any person and it is immaterial whether the "person" is an individual or natural person or an artificial person (such as a company or corporation) or a body of persons. Although capital gains tax is equally payable by persons irrespective of their nature, there are some classes of potential capital gains tax liability where the status of the person to which liability may be attributed matters - e.g. where the person is a "close company". And to be within the charge to corporation tax the assessable person must be within the term "company" as defined under the corporation tax legislation.

The status of the LLC will determine whether for United Kingdom or Republic of Ireland tax purposes:

(a) it is subject to corporation tax liability on its profits;

(b) irrespective of whether it is within the charge to corporation tax, it is within the meaning of the phrase "company" in the Income Tax Acts or Corporation Tax Acts for purposes of United Kingdom tax (and the Corporation Tax Act 1976 and comparable legislation in the Republic of Ireland); and

(c) whether the LLC can be a species of "close company" for the purposes of corporation tax, income tax, capital gains tax or inheritance tax.

Section 832 of the UK Income and Corporation Taxes Act 1988 which is concerned with definitions of words and phrases throughout the UK Tax Acts provides in subsection (1) that (inter alia):

> " 'company' means .... any body corporate or unincorporated association but does not include a partnership....."

The definition then refers to two further exclusions not material to this paper (to do with local authorities). A similar definition - not referring to local authorities - is to be found in section 288(1) of the UK Taxation of Chargeable Gains Act 1992 concerned with capital gains tax and which similar definition is also concerned with the meaning to be attributed to the word 'company'. Other definitions of the word 'company' in other parts of the UK Tax Acts make it plain that the word includes a body corporate; but otherwise the meaning to be attributed to the word gives rise to only a partial definition and it is possible for the word 'company' to be extended to "an unincorporated association".

A similar definition of "company" appears in the Irish Corporation Tax Act 1976, so the position for Irish capital gains tax purposes is less similar being based on provisions contained in the Irish Finance Act 1975 as amended.

What then is the LLC, when evaluated against the definition of "company" in section 832(1)? It is apparent from the 1996 Act section 1(1) - the descriptive introduction to that Act - that under Isle of Man law the LLC is to be regarded as "a body of persons". It is apparent from section 2 of the same Act that it is "a legal entity which is distinct from its members, manager and registered agent". But the fact that it is a legal person, just as much as an individual, does not mean that it is then automatically to be regarded as a body corporate - i.e. as a corporation - at any rate under English law (and presumably a similar result follows under the law of Ireland) So it seems clear from the original authorities on the nature of corporations that an essential element in their legal conception is that their identities are continuous, that is to say the original member or members and their successors are one (see Grant, *Law of Corporations* at p.20). Accordingly, once a liability or obligation has become binding on a corporation it binds the successors even though they are not expressly named, and even without the words "for the time being". There is ancient judicial authority for this - see *Bentley v Bishop of Ely* (1726) Fortes Rep 298 at 299. It is further the case that under English law a corporation has within its ordinary establishment the right to exist in perpetuity and in consequence it cannot exist for a limited period unless, being a corporation established by Royal Charter, that Charter creates it for a limited period - see, for example, the original East India Company, the first Charter for which granted corporate status by the Charter for a period of fifteen years and subject to prior possible annulment if not found to be advantageous to the country and subject to that limitation with a provision for renewal - see *Mills History of British India* (4th Edition) at pages 24-25. To take a more recent example, the BBC was originally incorporated by Charter for a period of ten years from 1st January 1927. It is therefore evident from the foregoing that a body

which is endowed with separate personality for only a limited period cannot be accorded the status of corporation and therefore cannot be a body corporate.

In practice, the question of whether a particular body has corporate status - or incorporated status for that matter - is established by the source of its creation which if not by Royal Charter will be by Act of Parliament. Thus, the modern limited company created under English law derives its incorporated status from an Act of Parliament - namely the Companies Act 1985 replacing earlier Companies Acts originating in Acts first passed in the nineteenth century. That Act specifically provides for a company to be incorporated by registration and for it to have the right of perpetual succession following incorporation and for it in fact to have express incorporated status, such status being conferred by the relevant provisions of the Act. Other statutes apply to the incorporation of Building Societies (Building Societies Act 1962 sections 1 to 3), Industrial and Provident Societies (Industrial and Provident Societies Act 1965 sections 1 to 3), and Employers Associations (Trade Union and Labour Relations Act 1974 section 3).

Against this can be stated the fact that the LLC though created by registration is not thereby endowed with incorporated status : the 1996 Act provides for its "organisation" and for it to be "organised" with "Articles of Organisation". So it is clear that - at any rate under English law - the LLC is not a corporation nor a body corporate. Since the Isle of Man statutory company law still derives from the Companies Consolidation Act 1931, which contains provisions similar to those in the English Companies Acts as regards the status of their incorporated companies, it appears necessarily to follow that a company which is established under Isle of Man law will only be regarded as an incorporated company if established under the Companies Acts and will not have incorporated status if established under the 1996 Act.

But for the purposes of United Kingdom and Irish corporate taxation, the fact that the LLC is not a body corporate will not prevent it from being subject to corporation tax in relation to its profits chargeable to the tax in either jurisdiction, whether those profits give rise to income tax-type liability or to capital gains tax-type liability. Both tax liabilities can be avoided if the LLC does not have an agency or branch in the particular jurisdiction. But for liability to arise at all, the Isle of Man LLC must first fit within the definition of the word "company": and as it is not a body corporate it must fit within the definition of the phrase "unincorporated association".

What is an "unincorporated association"? In the ordinary meanings of the two terms, the word "unincorporated" means something which does not have corporate status. The term "association" is a reference to a group of persons. So an Isle of Man LLC appears to be capable of being classed as an association which is not

incorporated and ought therefore to be within the term "unincorporated association". But there is authority in the United Kingdom consisting of a definition provided by a member of the appellate judiciary - namely Lawton LJ - which indicates that the phrase "unincorporated association" has a meaning for United Kingdom corporation tax purposes which might take the Isle of Man LLC outside its scope. In his speech to the Court of Appeal in *Conservative and Unionist Central Office v Burrell* [1982] 2 All ER 1 at 4, Lawton LJ described an "unincorporated association" as being:

> "two or more persons bound together for one or more common purposes, **not being business purposes"** (emphasis supplied and not forming part of the judgement) "by mutual undertakings, each having mutual duties and obligations, in an organisation which has rules which identify in whom control of it and its funds rests and on what terms and which can be joined or left at will."

Although what "not for business purposes" means is not elaborated upon, it would appear that this means that the purpose of the association is not with a view of gain. It would appear that if the "association" is not incorporated and is established to carry on business with a view of gain, then it is strongly arguable that the "association" is a partnership. The Partnership Act 1909 (Isle of Man) and the Partnership Act 1890 (Great Britain) define a partnership as "the relation which subsists between persons carrying on a business in common with a view of profit". Although neither Act says so, it has been held in the United Kingdom that "carrying on business with a view of profit" means that the partners are entitled individually to a share of the profits, (see *Blackpool Marton Rotary Club v Martin* [1988] STC 823 per Hoffmann J at 830/831). In contrast, although sharing in the profits in a partnership must, as a corollary, involve sharing in the liabilities, Jean Warburton in *Unincorporated Associations* at page 76 states that "The status of members" of an unincorporated association "imports no liability beyond that of the annual subscription". It seems to be this factor that distinguishes a partnership from an unincorporated association. This factor also appears to distinguish an unincorporated association from the LLC .

It is, however, possible for the "association" to be established otherwise than for the purpose of carrying on business having for its object the acquisition of gain. Indeed, it is possible to create an association to provide for the management of assets with powers of selling the assets and re-investing the proceeds, meantime accumulating or distributing income. Although it is possible for these powers to be related to the carrying on of a business, it would be the case that the business was carried on through the agency of its members. It has been held by the Court of Appeal in the well known case of *Smith v Anderson* (1880) 15 ChD 217, where assets consisting of shares in a number of companies had been vested in trustees

upon trust to apply the income of the shares to pay interest and to apply the surplus in redeeming subscription certificates with the ultimate duty after redemption of all subscription certificates to realise the assets then held and to divide the proceeds of realisation among the holders of what were described in the arrangements as "deferred coupons", that the arrangements did not amount to either a company, a partnership or even an association - which, if there had been any of these designations attributed to the arrangements, would have rendered the arrangement illegal as carrying on a business having for its object the acquiring of gain for more than twenty members, contrary to what was then section 4 of the Companies Act 1862 (a provision repeated in later Companies Acts).

The Court of Appeal held that the certificate holders did not form an association, company or partnership within section 4; that the arrangements did not have as their object the authorising of the carrying on of a business but had as their object the provision of management of a trust fund with subsidiary powers of selling and reinvesting assets and sale proceeds and that any business which might (on an extreme view) be carried on was carried on only by the trustees, who did not carry it on as agents or directors of the subscribers, so that the latter could be regarded as company participants, partners or associates. What this case basically decided was that investment activities could not be carried on in a partnership and did not constitute the carrying on of business having as its object the acquisition of gain. It follows from this that if the LLC is carrying on non-trading activities or investment activities or management activities or like passive activities, then although it may not be a partnership it will not be regarded as within the definition of an unincorporated association in the light of the construction put upon that expression by Lawton LJ in the *Burrell* case mentioned above. Equally, however, the LLC will not be regarded as constituting a trust or as being a trustee for its members. Rather it will be regarded as an entity which is the beneficial owner of its property and which does not hold that property on any trust, actual or constructive, in favour of any other party whether the party be a member or otherwise. This will be the case even if the property vested in the LLC is put into it by way of gift. The House of Lords case of *Bowman v Secular Society* [1917] AC 817 is final authority for this proposition, even though that particular case applied to a conventional limited company and not to a person such as one of which the LLC is a species.

So what precisely is the status of the LLC under English or Irish tax law? There exist in the enabling legislation - the 1996 Act - indicia of corporate, partnership, and unincorporated association status. Unincorporated associations generally do not have separate personalities and consequently cannot be the owners of property or be the subject of legal rights and duties. On the other hand LLCs, though they have separate legal personality, appear to be bodies of persons, and therefore to be persons, even though not incorporated. Partnerships in England and Wales and

the Isle of Man do not have separate legal personality, though they do in Scotland. But in all of these jurisdictions - and in Ireland as well - the entity described as "a body of persons" is a "person". This appears to be confirmed by the recent decision of the High Court in *Padmore v CIR*, a decision involving a Jersey law-governed partnership with governing law similar to that in England and Wales and in which it was held that such a partnership, being a body of persons, was a "person" for tax purposes in both the United Kingdom and Jersey. Perhaps, therefore, the LLC, being expressly taxed as a partnership, is intended to take effect as a partnership with legal personality, like its Scottish counterpart. It could not therefore be a "company" for United Kingdom and Irish tax purposes, since both jurisdictions exclude a partnership from the definition of the word "company" referred to above.

This has an extremely interesting consequence in a capital gains tax context. If the Isle of Man LLC is not within the term "company", then could it be a "close company" for the purposes of United Kingdom (or Irish) tax legislation? The term "close company" is a species of "company" as that term is defined in a corporation tax context and has effect not only in the context of corporation tax and capital gains tax in the United Kingdom but also inheritance tax in that territory. If the LLC cannot be a close company then, if it was resident in the United Kingdom for tax purposes, it could not be a close company. This is sufficient to take it out of section 13 of the Taxation of Chargeable Gains Act 1992 (attribution of UK capital gains to participators). A similar result follows in an Irish capital gains tax context.

To sum up therefore, it appears to be the case that for purposes other than tax the LLC will be accorded a status equivalent to that of an incorporated company even though it is not in fact incorporated. For tax purposes it is not a body corporate nor probably an unincorporated association: it will therefore not be within the term "company" as used in either the United Kingdom or Irish income tax or corporation tax or capital gains tax legislation, so as therefore not to be subject to corporation tax in either jurisdiction or to be within other tax legislation where the assessable entity is either a company, as that term is understood for corporation tax purposes, or is within some cognate expression deriving its meaning from that term - e.g. a "close company". This does not take it out of tax legislation - it merely takes the entity out of those bases of assessment which are attributed to any species of "company" for corporation tax purposes.

The foregoing is the product of considerable, detailed and analytical research. It does not follow that United Kingdom tax or other authorities will be so careful. An instance of this is to be found in relation to the attitude of the Revenue in regard to the concept of the Jersey limited liability partnership. This is a concept which derives its validity from the Limited Liability Partnerships (Jersey) Law

1996, the draft of which was the subject of second reading on 3rd September 1996 by the Finance and Economics Committee of the States of Jersey. That legislation is expressed to make provision for the establishment of limited liability partnerships - i.e. partnerships registered in Jersey and the form whereof contemplates that each and every one of the partners shall have limited liability. This is different from the concept of the limited partnership as understood in the laws of the United Kingdom or the Isle of Man and under which, in relation to limited partnerships as such, at least one of the partners has to have unlimited liability. The essence of a limited liability partnership as registered in Jersey is that it will be a partnership in which no partner has unlimited liability. Clause 2(4) of the draft Law provided that:

> "A limited liability partnership is a legal person (other than a body corporate) distinct from the partners of whom it is for the time being composed."

Accordingly, a contract binding the partnership would be made only with the partnership and not with the partners individually or collectively and any change in the persons comprised in the partnership as a result of the admission, retirement or death of a partner, or by a partner which was not an individual ceasing to exist, would not affect the existence, rights or liabilities of the partnership. The partnership was to continue until either it was dissolved or it ceased to have two or more partners, when in such circumstances it was to cease to be a legal person (draft Article 25(4)). Thus, the draft legislation made it plain that the limited liability partnership, though a person separate from the members comprising the partnership within the personality (so to speak), was not to be and was not intended to be a body corporate. Yet the Inland Revenue, speaking through one Stephen Hollis, apparently an inspector or officer connected with Inland Revenue Business Profits Division is reported (according to *Accountancy Age*) to express the view that they would treat a limited liability partnership as being a company for corporation tax purposes and not as a partnership. There was no legal validity for this statement bearing in mind the definition of a company in section 832(1) of the Income and Corporation Taxes Act 1988 and bearing in mind the details of the discussion already set forth in this paper as to the nature of a company for United Kingdom tax purposes. Indeed, another person - apparently another spokesman from the Inland Revenue - is on record as saying that the views of Mr Hollis amounted to no more than a statement that the Inland Revenue "may" tax such a body as a company rather than "will" tax such a body as a company. The apparent willingness of the Revenue to make a statement without any apparent justification for its veracity as a matter of law, is an indication of the fact that the Revenue may, without the benefit of statutory force to support their viewpoint, accord to a body of persons the status of a company even though the body is not a body corporate and, by reference to the views of Lawton LJ in the *Burrell* case

mentioned above, is not an unincorporated association, by attributing to the body the status of an unincorporated association as that phrase is used in section 832(1) so as to deem it a company for United Kingdom tax purposes. Bearing in mind that a partnership is expressly excluded from being a company by section 832(1) and that a Scottish firm though defined as a species of partnership by section 4(2) of the Partnership Act 1890 is nonetheless just as much a person as, and no more than, a limited liability partnership, the Revenue statement increases rather than reduces the level of uncertainty in this particular area.

So, when the LLC becomes first exposed to possible UK taxation liability, the authorities could treat it as subject to corporation tax as being a company. It would then take tax litigation, probably involving an appeal to Special Commissioners and probably higher appellate judicial ruling, for the true nature of the LLC to be determined - is it a company as we know these things or is it a partnership or is it some other association? And if the latter, is it an unincorporated association as within the Lawton definition or is that definition to be regarded as limited by its context so that the phrase bears its ordinary meaning - that of an association of persons not incorporated? And if so, does that bring it back within the corporation tax ambit or will it be treated as a partnership? The possibilities are extraordinary and certainly not free from doubt. It may be that a Court would seek to "massage" the Lawton definition in order to widen the meaning of the phrase considered in the *Burrell* case.

(III) As seen in the United States of America

As was explained in an earlier section of this article, the United States Internal Revenue Service has in the past treated LLCs which are organised under the laws of the individual States making up the United States of America as partnerships. It was therefore reasonable to draw the inference that the LLC would be treated similarly - that is to say, for tax purposes it would have been treated as a partnership and not as a corporation and accordingly its profits would have been attributed to the members as if they were partners. Ignoring tax matters, the LLC would not be classed as a trust because it had certain of the attributes which were associated with corporations and partnerships when they were within the terms of the *Morrissey* decision referred to above. In particular, it had associates and was demonstrably established to conduct the management and exploitation of assets and to attribute those assets and surpluses arising from their exploitation to its members. It therefore appeared likely that the LLC would be regarded as a limited liability company but not one established under legislation which empowered the establishment of corporations. Again ignoring tax considerations, it would not be classed as a partnership for non-tax purposes since under United States laws partnerships were not usually endowed with separate personality.

However, the position as regards the status for US Federal tax purposes of the foreign LLC - i.e. one established otherwise than under the laws of a State within the United States of America - has been coloured by regulations issued by the Internal Revenue Service on 17th December 1996, the drafts of which were issued on 9th May 1996, having first been introduced to the public as a possibility in April 1995. These regulations, which acquired the force of law on and from 1st January 1997, claimed to simplify (but in fact made much more complicated as a result of various changes) the rules for classifying business organisations by reference to an elective regime in place of what the draftsmen of the rules described as rules which "have become increasingly formalistic". Under the previous regulations an unincorporated entity was classified as a corporation if it had three or more of the four corporate characteristics originally identified in the *Morrissey* decision of the Supreme Court in 1935 and further identified in the subsequent *Larsen* decision of 1976 - and referred to earlier in this article. The new arrangements involved a different procedure. In summary the procedure is now as follows:

1. The first step involves determining whether there is an entity which is separate for federal tax purposes.

2. An organisation so recognised is then either in a trust or a business entity. The trust element is then eliminated, usually by establishing whether the entity has associates (i.e members) and/or an objective to carry on business for profit.

3. If the organisation is a business entity it is then either a corporation or a partnership. To establish whether the particular entity is one or the other one then establishes:

   (a) whether the organisation was in existence prior to 1st January 1997;

   (b) if so whether the entity was the subject of classification either under the previous rules or following examination by the Internal Revenue Service

4. If the entity was not in existence at 1st January 1997 then:

   (a) if it had two or more members it can be classified as a corporation or partnership. If it had only one owner it could either be either classified as a corporation or disregarded; if disregarded its activities would be attributed to the owner for tax purposes.

(b) certain business entities are automatically classified as corporations including:

(i) those denominated as corporations under applicable State or federal law;

(ii) joint stock companies;

(iii) insurance companies;

(iv) certain banking organisations;

(v) State-owned organisations; and

(vi) certain organisations formed under the laws of a foreign jurisdiction or a US possession or territory. These are fully listed in the new regulations - see section 301. 7701 - 2(b)(8)(i). Note here that one of the foreign jurisdictions is the UK and that the particular organisation referred to is the public limited company. Note also that although there are 81 jurisdictions that are expressly referred to, the Isle of Man is not one of them, though sub-paragraph (iv) of section 7701 - 2(b)(8) provides that:

> "any reference to a limited company (whether public or private) ... includes, as the case may be, companies limited by shares and companies limited by guarantee."

Thus the internal revenue service appear to acknowledge that a company limited by guarantee is a limited company for the purposes of the new regime."

5. If a business entity is not classified as a corporation by reference to the foregoing, such entities can choose their classification under the new regulations. If the entity has two or more members it can be classified as either a partnership or as a corporation. A single member entity can elect to be taxed as a corporation or to be disregarded as an entity separate from its owner - e.g. treating the business as if conducted by the member as a sole proprietor. The election procedure is regarded as operative if the relevant entity files Form 8832 with the proper Internal Revenue Service centre or if a copy of that form is included with the entity's tax return for the year the election is effective. There are provisions for entities which have made an election for one form to perhaps change it to another.

An entity which is organised within the United States will have to file an election if it wishes to be classed as a corporation. Under the new regulations an entity eligible to make the election as being either a corporation or a partnership and which has two or more members but which does not file an election, will be classified automatically as a partnership or, if of a single member nature, will be treated as not being separate from its owner.

In the case of an entity which is organised outside the United States - and of which the Isle of Man LLC is an example - the regulations provide that in the absence of an election the entity will be:

(a) classed as a partnership if it has two or more members and at least one member does not have limited liability;

(b) classed as a corporation if all the members of the entity have limited liability - as is the case with the Isle of Man LLC ; or

(c) disregarded as an entity separate from its owner if it has a single owner which does not have limited liability. A member is regarded as having limited liability if the member has no personal liability for the debts or claims against the entity.

It follows from the foregoing that the Isle of Man LLC is potentially classed as a corporation unless it has the ability to elect for partnership status and for that election to have validity in a US Federal tax context. This therefore means that in practice there will have to be a taxable connection with the United States for an election to need to be made. Thus, at least one of the members of the entity would need to be a US citizen, resident or corporation. Alternatively, the relevant entity will need to have a trade or business connection with the business conducted in the United States.

The foregoing comments prospectively apply to all entities from 1st January 1997 regardless of the date of their establishment. But unless it elects otherwise an eligible entity in existence prior to 1st January 1997 will be classed in the same way that it claimed previously provided it had a reasonable basis for that classification, the Federal tax consequences were recognised and neither the entity nor any member had been notified by the Internal Revenue Service that the classification of the entity was under examination before 9th May 1996. Only those parts of the new regulations that appear to be of relevance to the status of the Isle of Man LLC have been referred to herein. But it is plain that from a US Federal tax viewpoint, an Isle of Man LLC will not automatically be classed by the US Internal Revenue Service as a partnership despite the hopes of its promoters

within the Isle of Man that the clear statements as to the tax treatment of such bodies under the tax laws of the Isle of Man would facilitate its automatic classification within the US as a partnership without the need for election and subsequent recognition as compared with the tax rules which were identified as applicable to such bodies by reference to the earlier judicial decisions.

Unfortunately, the text of the new regulations was not known at the time that the first part of this article was published, otherwise the new regulations and their relevant details would have been referred to in such first part. The fact of not referring to them does not undermine the points made in the first part of this article those these are now largely of historical interest only.

(IV) As seen from elsewhere

Apart from the Isle of Man, the United Kingdom and Ireland and the United States of America, it is likely that because the LLC is declared to have a juristic personality separate from that of its members, it will be treated as a company in other jurisdictions. In consequence, it will fall to be treated and taxed in those other jurisdictions as if, because it is such a person, it is in the nature of a company. The point is one of importance because, having regard to the emphasis in the Isle of Man on treating the LLC for tax purposes as a partnership, when other jurisdictions may wish to treat it as a company, this may lead to a position of potential prejudice for its users in relation to other taxation systems. Suppose that the LLC is subjected to income tax (or corporation tax) on its prospectively taxable profits. The basis of this liability will be that the LLC, because it is called a company, will be taxed as a company. The taxing authority will levy taxes on the profits of the LLC and will disregard the fact that for Isle of Man tax purposes the LLC is not liable to tax in that jurisdiction on those same profits. Thus this creates a position of potential double taxation, for tax will then be imposed on the profits of the LLC and the Isle of Man will tax the same profits to Isle of Man income tax and neither system will, as a matter of law, be obliged to give credit for one tax against the other. This cannot have been intended to be the case by the draftsman of the LLC legislation. But it is a result that inevitably arises from the insistence of the legislators that the LLC be immunised from Isle of Man tax on its profits.

It is of course the case that the LLC was conceived of as a medium for attracting United States-related business and with a view to it being adopted as a primary medium for the utilisation of the LLC concept as available for use by bodies which might be created or organised under systems of law other than ones within the United States. It is doubtful whether anyone gave any thought to any other use to which the LLC might be put in an international - i.e. non-Isle of Man - context.

Thus, as was pointed out under (II) above, the present basis upon which the Isle of Man LLC is evaluated for tax purposes means that it is excluded from being within the scope of the Isle of Man-United Kingdom double taxation convention. It is considered that there would be a similar exclusion - in the absence of specific wording to the contrary - if the Isle of Man ever became party to any other double taxation convention, this view being based on the fact that double taxation conventions tend to follow a uniform pattern of wording which, in the context of other tax systems, would require the Isle of Man entity to be subject to tax. As matters stand at the moment, the Isle of Man LLC would not be eligible for inclusion within any double taxation convention.

But this failure to evaluate the Isle of Man LLC in an international context has other unfortunate consequences in the international dimension. There are a few jurisdictions - the Netherlands in particular - which exclude a company from local taxation in regard to profits attributable to a branch located within the jurisdiction if the profits of the body to which the branch belongs are subjected to tax in another jurisdiction. Thus, for example, the Netherlands branch of a United Kingdom company, being subjected to United Kingdom tax on the profits of its Netherlands branch, would not then be subject also to Netherlands tax on those same profits. In the case of the Isle of Man LLC, however, which would attribute tax liability to the members of the LLC rather than to the LLC itself, the profits of the Netherlands branch of an Isle of Man LLC would not escape Netherlands tax because the profits originating from the branch activities would not be subject to tax in the LLC but would be taxed to its members unless the LLC was an International LLC, in which case both LLC and members would be exempted from Isle of Man tax whilst nevertheless subject to full Netherlands tax on the Netherlands branch profits.

Such a state of affairs therefore effectively precludes would-be users of an Isle of Man LLC from using it in relation to Netherlands-related activities. A similar shortcoming would arise in relation to other jurisdictions having features similar to the Netherlands in relation to the profits of branches located in similar jurisdictions.

Statutory Provisions Governing the Isle of Man LLC

In essence, the concept of the LLC is comparatively simple. Certainly the legal provisions governing its creation, existence and activities are far simpler than those affecting the conventional incorporated company formed in the Isle of Man. There is only one Act - the 1996 Act. It contains 47 sections applicable to LLCs backed up by four Schedules, two Appointed Day Orders and some supplementary regulations, only some of which have so far been published. There is a total of

42 pages of statutory provisions (ignoring the Orders and Regulations). When this is set against five statutes and several hundreds of pages of the present collection of Companies Acts, it presents a much more simple code of operation.

The principal characteristics of the LLC have already been explained. It now seems appropriate to set forth some of the more detailed provisions as they affect everyday operations.

The LLC consists of its name, a registered office, objects, a registered agent, its members (with perhaps a manager) and a constitution consisting of articles of organisation and an operating agreement. Taking each of these in turn:

Name of LLC

The provisions governing LLC names are broadly set forth in section 3(3) to (10) of the 1996 Act and are similar to those for a conventional company. The Chief Registrar (meaning the Registrar of Companies) must approve any change of name (section 3(3),(4)). No LLC can have a name which is either misleading or offensive, likely to be harmful to the public, undesirable in the opinion of the Financial Supervision Commission or similar to the name of another company in the British Isles (section 3(3),(5)). The Chief Registrar can require the company to change its name if he forms the view that it infringes any of these criteria (section 3(5)). A direction to change the name must be complied with during a period of six weeks thereafter (section 3(6)). Appeals to the High Court against such a direction can be lodged within three weeks (section 3(8)). Fines to a maximum of £5,000 are leviable on summary conviction for not changing the name after being requested so to do by the Chief Registrar (section 3(10)).

Registered Office

The LLC must maintain a registered office in the Isle of Man (section 4(1)). If it defaults for more than a month there is a maximum penalty of £5,000 on summary conviction and the company is deemed defunct and liable to be treated as dissolved until the default is remedied (section 4(2)). Changes in registered office must be registered with the Registry within a month of the change: maximum penalty for non-compliance is a fine as referred to above (ibid).

Objects

Any LLC may undertake any lawful activity, trade or business other than banking business within the meaning of the Banking Act 1975, insurance business within the meaning of the Insurance Act 1986, investment business within the meaning of the Investment Business Act 1991 or "such other business as may be prescribed" (section 2(2)(d)). This is presumably intended to be covered by regulations as and when made. Note here that the definition of banking business is narrower than in the United Kingdom, that the definition of insurance business is similar to that in the UK and that investment business is similarly somewhat more restricted than in the UK. Presumably offending activities may in due course be prescribed. A licensee or authorised (as regards its business) person can form any LLC which can invest in shares or debentures of a company carrying on a licensable or authorisable business if not prohibited by specific legislation or constitution of the would-be creator (section 2(3)).

Registered Agent

Every LLC is to have a registered agent in the Isle of Man whose status as such must be registered with the Chief Registrar and who must hold the prescribed qualifications (section 5(1)). These qualifications are prescribed by Treasury Regulations being the Limited Liability Companies (Registered Agents' Qualifications) Regulations 1996 which came into force on 17th October 1996. The qualifications prescribed are either an advocate, a legal practitioner registered under the Legal Practitioners Registration Act 1986, someone qualified to be appointed as the auditor of a company under the Companies Act 1982, a chartered management accountant, chartered secretary or banker. English solicitors, if not registered under the Legal Practitioners Registration Act 1986, are not qualified to be registered agents. The 1996 Act levies fines similar to those already mentioned if this provision is infringed and the company is to be deemed to be defunct and liable to dissolution until it has a proper registered agent. Neither apply unless any default continues in excess of a period of one month (section 5(2)).

Members

Every LLC must have two or more members (section 6(1)). The LLC is required to be managed by its members (section 13(1)) and does not have directors as a necessary adjunct of creation. The members may nevertheless appoint an outside party not being one of themselves to be the manager of the company (section 17(3)). A manager will have whatever powers are reposed in him by the operating

agreement and expressly conferred by the members (section 17(5)) and holds this office for whatever period the members determine (section 17(3)(b)) unless the operating agreement provides otherwise. If, however, the articles of organisation do not provide for management to vest in a manager (ibid), then a manager cannot be validly appointed.

There are further provisions about the position and functions of company members - these are dealt with below.

Articles of Organisation

These must comply with the requirements of the 1996 Act and must be signed by the person forming the company and the first members named in the articles (section 6(1)). The articles must specify the name of the LLC, its period of duration (30 years maximum or such shorter period as specified), the names and addresses of its members and the registered agent, and other incidental matters specified in Schedule 2 of the 1996 Act (section 7(1)). The objects or powers of the LLC need not be set forth in the articles (section 7(2)).

The articles need to be amended if there is a change in the name of the LLC, the amounts or character of capital contributions, membership, duration of the company or other essential particulars (section 7(3)). Changes must be lodged with the Registrar within one month of any alteration (section 7(3)).

It is noteworthy that the articles of organisation resemble, but are not described as, the contents of the Memorandum of Association of a company formed under the Companies Acts. Such a Memorandum normally contains the name of the company, the country in which its registered office is situated, its objects, the fact that it has limited liability, its capitalisation, a few incidental matters (sometimes but rarely) and a declaration of the desire on the part of its initial members to be formed into a company together with their names and addresses and share numbers taken by each. It might have been more appropriate for the document to be called a Memorandum of Organisation rather than Articles of Organisation because the document appears to be indicative of those parts of the constitution of the LLC that are intended to be on public display. The operating agreement, though part of the constitution of the LLC, does not have to be registered with the Chief Registrar and is not available for public inspection, unlike other registered documents which have to be made available by the Chief Registrar for public inspection (section 48). Unlike a company incorporated under the Companies Acts, no register or other document can be inspected by the public, even if maintained at the registered office of the LLC.

Registration of the LLC

To register any LLC, the articles must be lodged with the Chief Registrar (section 6(1)) accompanied by consents in the prescribed form signed by the proposed registered agent and a statement in the prescribed form of the situs of the intended registered office (ibid). The person forming the LLC need not be one of its members (section 6(2)). Changes in the situs of the registered office must be filed with the Chief Registrar within one month of the change (section 9(1)) with the maximum penalty fine and rendering of defunct status upon the company if there is default (section 9(2)).

Fees and duties are now prescribed in respect of certain matters affecting LLCs, the prescribing being under the Limited Liability Companies and Limited Partnerships (Fees and Duties) Order 1996 which came into force on 17th October 1996, being another of the sets of Treasury Regulations referred to earlier in this article as required to come into operation to render the LLC legislation workable. The Government fee to register any LLC is £115 (paragraph 2 and paragraph 1 of the Schedule to the last-mentioned Regulations). Incidentally, filing fees are prescribed in amounts of £42 and £107 in respect of Annual Returns filed within or out of time, £65 for delivering any other document for filing out of time (there is no charge for filing any such "other document" within the time for filing prescribed under the 1996 Act), and £40 for filing a notice of dissolution (in or out of time).

If the Registrar is satisfied that the requirements of the Act in respect of registration and matters incidental to it have been complied with, he retains and registers the documents (section 8(1)) when he must then certify in writing that the LLC is organised and registered under the 1996 Act (section 8(2)). This certification is conclusive evidence that the requirements of the 1996 Act in regard to registration and creation have been complied with and that the LLC has been organised and registered under the 1996 Act (section 8(3)) The LLC can only transact business or incur indebtedness if it is incidental to its organisation and registration or in obtaining subscription for, or payment of, contributions until the certificate of organisation has in fact been issued (section 8(4)).

Points Concerning Drafting of Registration Documents

As has already been pointed out, the primary documents which need to be filed in connection with the registration of the LLC are the Articles of Organisation - apart, that is, from forms which are prescribed by the Forms Regulations and which contain brief details of the specific items of information. The Articles of Organisation need to be prepared in tandem with a form of Operating Agreement:

but only the Articles of Organisation need to be filed in connection with the registration.

There are provisions which have to be in the Articles of Organisation. These are set forth in Schedule 2 of the 1996 Act. It is envisaged that most of the everyday details governing the operation of the LLC will be set forth in the Operating Agreement. Although paragraph 6 of Schedule 2 provides that provisions can be set forth in the Articles of Organisation which are required or permitted to be in the Operating Agreement, this suggests that a separate Operating Agreement might not be required. However, if any provision for internal regulation is to be contained in the Articles of Organisation without there being a separate Operating Agreement, then whenever a slight administrative alteration has to be made, the amended Articles of Organisation reflecting this alteration must be registered in accordance with the 1996 Act. In consequence it is better, in the interests of saving time and avoiding unnecessary formalities, to set forth all administrative provisions in a separate and more detailed Operating Agreement. Additionally, whereas the Articles of Organisation are available for public inspection, the Operating Agreement is not so available.

The 1996 Act, apart from specifying in the course of its sections matters which must be in the Articles of Organisation and which might perhaps be in them or in the Operating Agreement, is silent on the form which either the Articles of Organisation or the Operating Agreement might take. This is in marked contrast to the provisions of the Companies Acts which specify a standard form of Table A containing most of the common form provisions which are relevant to the internal regulations of a statutorily incorporated company. However, this silence on the existence of a common form precedent is similar to the silence that exists in regard to a precedent form of partnership agreement or limited partnership agreement, both of which are absent from the partnership and limited partnership enactments. Bearing in mind the comparative novelty of the LLC legislation coupled with the fact that it is intended to create a different set of principles of company law for companies within its scope in comparison to those applicable under the ordinary Companies Acts, it is felt that it would have been better for there to be a precedent form of Articles of Organisation and Operating Agreement set forth in a Schedule to the 1996 Act. At the present time precedent forms of Articles of Organisation and of Operating Agreements are not readily available and would-be users of the LLC concept must draft their own.

The LLC Following Registration

An LLC is comparatively free of restrictions in regard to its method of operation and transacting of business. There are some points that need to be borne in mind however:

1. In each year the LLC must complete an Annual Return in the prescribed form which must be submitted to the Registrar within 28 days of the anniversary of the registration of the LLC (section 10(1)). The Return must show its name, registered office address and the names and addresses of the registered agent, members and any manager (section 10(2)). The penalties and rendered defunct status already referred to will apply if these procedures are infringed (section 10(3)). The fees payable on delivery of the Annual Return are as mentioned above.

2. Every LLC must keep accounting records (section 19(1)) that are sufficient to show and explain the company's transactions (section 19(2)) and its financial position (section 19(3)). Particular matters which have to be recorded within the accounting records are specified in section 19(4). The accounting records must be kept at the registered office or such other place as the members decree and must be open to inspection by the members of the company (section 19(5)). The accounting records can be kept outside the Isle of Man (section 19(6)); but in such cases accounts and returns must be sent to, and kept at, a place in the Isle of Man and be open for inspection as aforesaid (ibid) and be so sent at six-monthly intervals (section 19(7)). Records of this kind must be retained for six years from the date on which they are made (section 19(8)). If these provisions are not complied with, offenders can be imprisoned as an alternative to being fined (section 19(9),(12)).

3. There are specific provisions in section 20 and Schedule 3 of the 1996 Act dealing with registration of mortgages or charges. In general, details of these must be lodged with the Registrar within one month of their creation. As before, non-compliance results in maximum penalties and defunct status.

4. Instruments and documents in regard to the acquisition, merger or disposition of property of the LLC are provided to be valid and binding upon the LLC if executed by:

   (a) any member, if management is retained by the members; or

   (b) its manager, if management has been conferred on a manager (section 21).

The 1996 Act is silent upon the question of what other formalities are required to be observed if the LLC contracts with another party or is or becomes a party to a deed or other formal document which is not related to a property transaction of the nature specified in section 21. The assumption is that ordinary laws of contract will apply; but this is made more difficult given the unusual status of the LLC. It would seem that matters relating to the making of contracts or entry into deeds or other formal documents will be regulated by provisions in the Operating Agreement; but the 1996 Act does not contemplate that the Operating Agreement will be a public document available for public inspection. Accordingly, it would appear that the Articles of Organisation should contain a special provision which has the effect of not requiring outside persons dealing with the LLC to look beyond the special provision in the Articles dealing with the ability of a member or the manager to bind the LLC. Such a provision might simply read:

"All acts of a member of the limited liability company or of its manager if and for so long as a manager of the limited liability company has been appointed and is recorded as being such manager on the public records of the limited liability company, shall be valid and effectual and shall be binding on the limited liability company as between it and any other person whether a member of the limited liability company or not even if there is some defect in the appointment of the manager and even if the act constitutes an infringement of any provision in the operating agreement regulating what act or acts can validly be undertaken by a member or manager of the limited liability company."

This provision is similar to that set forth as respects directors of a conventional company incorporated under the Companies Acts.

It is provided in section 22 of the 1996 Act that persons who act on behalf of the company without authority are jointly and severally fully liable for the debts and liabilities of the company. The inclusion within the Articles of Organisation of a clause similar to that suggested above would appear to overcome the risk of an unwitting outside party relying on the act of a member or manager of the LLC which is in some way an infringement of the regulations governing the internal management of the LLC.

5. It is provided that where notice is required to be given to a member or manager of the LLC, a waiver in writing signed by the person or persons entitled to the notice, whether given before or after the time stated in it, is equivalent to the giving of notice (section 23).

6. There are specific provisions in sections 24 and 25 of the 1996 Act dealing with requirements for proceedings proposed to be served on any LLC; for inspectors to be appointed to investigate the affairs of any LLC and to report to the Court (section 26); and regulating the procedures and formalities to be observed if any LLC comes to be wound up or dissolved (sections 27 to 36). Apart from not being hugely detailed, these are not dissimilar to those affecting conventional incorporated companies.

Members of the LLC and their Capital Contributions and Rights

It is a specific requirement under section 17(1) of the 1996 Act that the LLC must be managed by its members. It is provided that their rights to manage are to be in proportion to their capital contributions as adjusted from time to time to reflect any additional contributions or withdrawals on the part of the members (section 17(2)). A manager can be appointed if the Operating Agreement does not provide against such appointment and provided such person is elected by the members; such a person will have duties or rights as specified in the Operating Agreement and confirmed by the members (section 17(3),(4) supra).

The capital of the LLC is provided by its members in the form of contributions which may be in cash, property, services or by means of a promissory note or other obligation (section 12). The liability of each member is limited to the difference between the contributions provided and the contributions agreed to be provided but not actually paid or transferred (section 13(1)).

Once having been made, a capital contribution cannot be returned or reduced in favour of a contributing member unless:

(a) the liabilities of the company are paid or provided or are secured by property belonging to the LLC;

(b) the consent of all the members has been provided; and

(c) the articles of organisation permit withdrawal or reduction of capital.

Even then, the return can only be in the form of cash unless there is a statement in the articles of organisation to the contrary or all members consent (section 14(4)). Apart from this, a member can only demand the return of his contribution either on dissolution of the LLC or after he has first given notice to two other members of his desire to seek a return of any contribution wholly or in part (section 14(2)). Six months' notice of such a demand must be given unless the Operating Agreement provides otherwise (section 14(3)). Unless and until the

LLC is dissolved and its affairs wound up, no member has a right to demand the return of any amount in excess of capital paid or contributed (section 14(2)).

In the unlikely but possible event that the member seeking the return of his contribution rightfully demands its return but is unsuccessful in obtaining it, he may have the LLC dissolved and its affairs wound up. He also has this right if the other liabilities of the LLC have not been paid or if the property of the LLC is insufficient for the liabilities to be paid and the member would otherwise be entitled to the return of his contribution (section 15(5)).

So far, what has been discussed is the right of a member to seek the return of some or all of his capital contribution. There are also provisions in section 15 which enable any LLC from time to time to divide and allocate its business profits and losses amongst its members in accordance with the Operating Agreement (section 15(1)). However, no distribution is to be made if after such distribution the LLC assets do not exceed its liabilities - apart, that is, from liabilities to members on account of their contributions (section 15(2)). Profits and losses are to be allocated on the basis of the value of members' contributions to the extent that they have been received by the LLC and have not been returned, this being in the absence of any provision to the contrary in the Operating Agreement (section 15(3),(5)). Distributions are to be allocated in the manner provided by the Operating Agreement and may be distributions of cash or other assets (section 15(4)). These provisions do not affect the limit on members' liability already referred to under section 13.

Finally, some words should be stated about the transferability of members' interests and the governing provisions which are in section 16 of the 1996 Act. The interest of each member in any LLC constitutes part of his personal estate and its transferability or assignability is as provided in the Operating Agreement. If, however, all the members of any LLC do not approve of any proposed transfer or assignment and are unanimous in that behalf, then the transferee of the member's interest has no right either to become a member of the LLC or to participate in its management (section 16(2)). Such a transferee is then entitled to receive the share of profits or other compensation by way of income and the return of contributions to which the transferor member would otherwise have been entitled (section 16(3)).

From time to time in the foregoing paragraphs references have been made to the possibility that the LLC may be deemed defunct. Section 11(1) of the 1996 Act provides that if this happens the Registrar can strike its name off the register in the same way as in regard to a conventional incorporated company where the company is not in operation. Before striking off the Registrar must write to the particular LLC (ibid); and after dissolution as a result of being first rendered defunct, the

LLC can apply to the Registrar within two years for restoration on terms similar to those applicable to a conventional incorporated company (section 11(3)).
There are provisions in the 1996 Act regulating the position of property of the LLC which is discovered after dissolution has taken place. If any such property is discovered, it vests in the registered agent at the time of dissolution or, if there is no registered agent, the members of the company at that time as trustees as aforesaid (section 34(1)). There is provision (in section 34(2)) for someone else to be appointed as trustee in place of the members. Unlike the position with a conventional company, this property can never be forfeited to the Crown. Under the provisions of section 34(3) the property must be held and applied first for the creditors, and finally for the members, of the dissolved LLC.

There are also provisions (in section 35) for the High Court to declare a dissolution void.

From the foregoing it should be apparent that the scheme of operation of the LLC is relatively simple. In practice, it is envisaged that it would be ideal for use by the proprietors or managers of small businesses who may perhaps be less enthusiastic about embracing all the legal requirements applicable to conventional incorporated companies and who may wish to utilise them as if they were partnerships but without being deprived of limited liability as would normally be the case if they were general partners in a limited partnership.