
The Offshore Taxation Review

THE ISLE OF MAN LIMITED LIABILITY COMPANY OR LLC: FURTHER POSTSCRIPT - THE POSSIBILITIES FOR ACTIVITIES IN GREAT BRITAIN

Patrick Taylor¹

At the conclusion of the third of the articles already written concerning the LLC, the case was made, in a postscript, for promoting the adoption of the LLC concept into Great Britain or the United Kingdom. At the time the Postscript was written, the stated reason was to “provide small businesses with a much simpler format than is the case at present”. When the third part of the article was published the Editors kindly volunteered to comment that the Postscript incorporated “a case for the adoption of the LLC concept within Great Britain for this purpose”.² On seeing and noting this comment, the writer formed the view that there would be something to be said for expounding in more detail the virtues of utilising a non-United Kingdom established LLC as a possible entity for activities or business in or from Great Britain.

There is, however, an important aspect to any proposal involving the utilisation of an overseas-established entity or body, whether it be a company, body of trustees or other body of persons, for utilisation for the benefit of individuals ordinarily resident within a part of the United Kingdom for the tax purposes of the Kingdom. Section 739 Income and Corporation Taxes Act 1988 creates a liability for such individuals to be subjected to income tax on income which becomes payable to any overseas-established enterprise, whether a company or trust or other body, where the income becomes payable by virtue or in consequence of a transfer of assets with or without any

¹ Patrick Taylor LLB, ATII, PO Box 2, Port Mary Street, Isle of Man IM99 7PB.
Tel: (01624) 834903 Fax:(1624) 834921.

² See Offshore Taxation Review, Volume 7, Issue 2, at page vi.

associated operations, such liability arising where the transferor is either the UK resident in question or his or her spouse. The liability will arise to the transferor or to his or her spouse either if the individual in question has power to enjoy the income of the overseas company or body or if the individual in question receives or is entitled to receive a capital sum the payment whereof is connected in any way with such transfer. Additionally, section 740 enables the Inland Revenue to impose income tax liability on any such individual in regard to such income if any benefit, whether of a capital or income nature, is derived by any such individual from any such income, assuming that the individual is not a transferor so as to be within section 739.

However, section 741 Income and Corporation Taxes Act 1988 provides a defence to the creation of this liability if the individual in question shows in writing to the satisfaction of the Board of Inland Revenue, or on appeal to the Special Commissioners, that tax avoidance was not the purpose or one of the purposes of the transfer or any associated operation or that the transfer **and** associated operations were bona fide commercial transactions not designed to avoid United Kingdom taxation.

It therefore has to be the case that a UK resident seeking to utilise a foreign-established LLC for the purposes of creating or drawing income as a result of any activity or business venture, will have to satisfy the Inland Revenue or the Special Commissioners under section 741 if he or she is to avoid liability under sections 739 or 740. This being the case, it appears to be desirable to highlight some of the many advantages which can result from carrying on any activity or business through the LLC, assuming for this purpose that the entity in question is one created or constituted (by virtue of registration) by reference to the law of some territory other than a part of Great Britain. Although there are many possible points that could be taken, the following, which are non-tax related, may be of potential relevance:

Publicity and Administration

An obvious advantage is that the level of publicity surrounding the force of LLCs and the level of regulatory control over them, is considerably less than for conventional companies. For example, LLCs do not have to endure the stringent accounting procedures which are applicable to conventional companies. For instance, although there are provisions requiring accounting records to be kept in accordance with section 19 of the 1996 Act, there is no provision at all in the Isle of Man - either for ordinary companies or LLCs - for the filing of those accounts and there is not, therefore, the degree of public scrutiny of the financial position of the LLC as there is for conventional companies - see, for example, section 384 Companies Act 1985 as applicable in Great Britain. For litigation purposes this has an important effect when coupled with the absence of any provision in the 1996 Act that replicates section 726(1) Companies Act 1985 for Great Britain - the corresponding provision in the Isle of Man is section 336 Companies Consolidation Act 1931 - which enables a Court to make a security for costs Order when the plaintiff in a civil action is an impecunious

limited company. One of the ways in which such an Order is obtained is by exhibiting the company's accounts to an affidavit which a defendant can easily obtain by means of a search of the Register of Companies in England or Scotland. In the case of the LLC, one cannot obtain this sort of information with such relative ease; and even if one tried to obtain it, if defending a claim against an impecunious LLC, it would seem that no security for costs is then available.

Not only is there less public knowledge in respect of the financial position of the LLC, there is also much less formality about the preparation of accounts. In the case of the conventional company, it is necessary (with certain stipulated exceptions) for the accounts to be audited by a qualified auditor. There is no such limitation upon the preparation of formal accounts for the LLC. This therefore means that the accounts can be prepared by someone who is not an accountant, as is the case for example with partnership accounts or accounts of a sole trader.

There is also much less information available on a public basis about operating structures and administration. Articles of Organisation of the LLC must be filed with the Chief Registrar, but the Operating Agreement does not need to be similarly filed. It is possible, therefore, to confine within the Operating Agreement the mechanism for running the LLC, rather than putting it in the Articles of Organisation. This therefore enables the Operating Agreement to be protected from public scrutiny.

Only those matters set out in Schedule 2 of the 1996 Act are required to be set forth in the Articles of Organisation, and they are:

- (a) details of cash and property other than cash contributed by the members;
- (b) additional contributions agreed to be made by the members;
- (c) details of the right to admit additional members;
- (d) details concerning the right for remaining members to carry on business when events occur that terminate membership of the LLC;
- (e) a statement that the members can appoint a manager to manage the LLC; and
- (f) any other provision **if the members elect to have same set forth in the Articles**

Detailed provisions regarding Minute Books, meetings, Annual General Meetings and Resolutions for companies, which in the case of conventional companies are set forth in sections 366 et seq of the Companies Act 1985 in relation to the United Kingdom - there are similar provisions in the Isle of Man Companies Acts - are also not replicated in the 1996 Act. Accordingly, the administration of the LLC is considerably easier than that for a conventional company. This is especially important in that one gets the

benefit of separate legal personality and limited liability for all members without the burden of many of the administrative and regulatory rigours that accompany these privileges in an ordinary company.

Members, Managing Members and Directors

There is a considerable distinction between the way in which members, managing members and directors are controlled between one another and in respect of their relationships with the LLC.

Loans to LLC members - even to managing members - are not proscribed or restricted as is the case with loans to the directors of a conventional company, which are potentially illegal - see sections 330 to 344 Companies Act 1985 in relation to Great Britain. There are no corresponding provisions in relation to Isle of Man-incorporated companies. Further, Part X of the Companies Act 1985 contains detailed provisions under the title "Enforcement of fair dealings by Directors". In sections 311 et seq of that Part, there are various restrictions on directors taking financial advantage. For example, directors must disclose interests in contracts with the company (section 317) - the equivalent Isle of Man legislation is in sections 148 and 148A Companies Consolidation Act 1931; directors' service contracts are to be open to inspection (section 318) - there are no corresponding Isle of Man company statute provisions; and there are restrictions on substantial property transactions involving directors or persons connected with a director (section 320) - no corresponding Isle of Man company statute provisions. Sections 323 et seq contain restrictions on share dealings by directors and their families (no corresponding Isle of Man company statute provisions), and restrictions on directors' loans appear in sections 330 et seq - no corresponding Isle of Man company statute provisions. All these references to sections are to sections in the United Kingdom Companies Act 1985.

None of these provisions apply as regards members or managing members of the LLC.

There are various provisions creating offences, and dealing with punishment of the offenders, in the Companies Acts (and related statutes) as well as the 1996 Act. The primary difference between the two relates to disqualification. It is the case that there are provisions in the 1996 Act (Schedule 4, paragraph 4(5)) for disqualification of members, managers or registered agents for a period not exceeding five years from holding office as a registered agent or manager without the leave of the Court. But these are provisions in Isle of Man law and are not operative in the United Kingdom, whereas the provisions contained in the Company Directors Disqualification Act 1986 relating to disqualification of persons as directors or managers of conventional companies, are enforceable within the UK. There are similar provisions relating to Isle of Man companies in sections 26 and 27 of the Companies Act 1992. There is therefore a positive disadvantage for the regulatory system in not being able to secure a disqualification if the LLC is carrying on a business activity within the UK rather than the Isle of Man.

There are provisions for disqualifying directors in the Company Directors Disqualification Act 1986, but there are no corresponding provisions for disqualifying members: we are of course referring here to England and Wales only. The maximum period for disqualification in the UK (if that is relevant) is fifteen years, with a minimum of two years. This is considerably more Draconian than for the LLC. Further, the Disqualification Act 1986 is much more detailed in its provisions than is the 1996 Act in regard to disqualification matters.

Another possible benefit of the LLC is the level of control which the members can exert on the transfer of members' interests. Reference can be made to section 16 of the 1996 Act in this regard. It is possible to a degree for members to protect their position under that section and there is much less need for remedies arising out of unfair prejudice, such as having to resort to petitions under section 459 Companies Act 1985. It is also much easier for the members to reduce the capital of the LLC, whereas the Courts exert rigorous control of the reduction of the share capital of a conventional limited company, both in Great Britain and the Isle of Man.

Insolvency Matters

The rules in relation to the insolvency of LLCs are those arising under the laws relating to bankruptcy rather than those relating to the insolvency of companies - see section 31 of the 1996 Act. Furthermore, the members - in the case where the LLC is to be wound up other than by the High Court act as the professional liquidator until they unanimously agree in writing to appoint someone as liquidator. The provisions of Part X of the Isle of Man Companies Consolidation Act 1931, which normally apply to liquidations of companies, will only apply if the LLC is the subject of an order for winding up by the Isle of Man High Court and not even then if the LLC has less than eight members, for in such a case it is not within the definition of an "unregistered company" as defined in section 306(3) Companies Consolidation Act 1931. It is true that the High Court retains a very wide power to "do or secure the doing of all such things as appear necessary or expedient for such winding up or dissolution" (see section 32(1) of the 1996 Act); nevertheless, even by reference to a winding up, the LLC is the more flexible vehicle in contrast to a conventional company. Again, publicity may be the overriding advantage in this distinction. For example, there is no requirement in the 1996 Act for advertisements in relation to windings up by reasons of insolvency.

Miscellaneous items relating to Taxation

The remarks following are supplementary to those made in earlier parts of this Postscript article and relate specifically to United Kingdom taxation.

There has already been a discussion as to whether the LLC is within the definition of

a “company” for the purposes of UK corporation tax or capital gains tax, and it would appear that by reference to existing law there are strong grounds for having the view that the LLC is not within that definition. Equally, it does not appear to be a partnership, though for Isle of Man tax purposes it appears to be subject to taxation as a partnership (section 46(1) of the 1996 Act). Arising from provisions contained in the Finance Act 1993, it now appears to be the case that a person which is not within the definition of a “company” cannot be liable to UK taxation unless, being a company, the entity in question carries on a trade or business in the UK through a branch or agency. It further appears to be the case that if the entity is not a company and not a partnership, it may not be subject to taxation, even on the footing that it is carrying on a trade in the United Kingdom. These possibilities appear to be equally capable of application even if the LLC is managed from within the UK, because since it is not within the definition of a “company”, it appears not to be capable of being resident in the UK for tax purposes by reference to the location of its place of management and control if that place should happen to be in a part of the United Kingdom.

All in all, there appear to be some extremely interesting taxation possibilities.

Conclusion to Further Postscript

It would appear from the foregoing comments that there must be a realistic basis for claiming that the LLC has commercial possibilities within the United Kingdom.

No doubt the Inland Revenue will be reading this and the previous pages of this further Postscript. One can only wonder as to the nature of their reaction if they have one. Perhaps there may even be a letter to the Editor which would be suitable for publication, thus advancing the discussion.