

BUSINESS FORMS IN THE ISLE OF MAN SECTION 2

INTRODUCTION

The Isle of Man is an island of 221 square miles located in the north Irish Sea, equidistant between the northeast of Ireland, the southwest of Scotland, and the northwest of England. It has been a separate self-governing jurisdiction for over a thousand years, and is not and has never been a part of the United Kingdom.

Every country and jurisdiction has its distinct forms of business. The Isle of Man is no exception. The Isle of Man has been legally and politically distinct for over a thousand years, and in modern times has become one of the leading centres of the world for offshore financial services. Companies and other forms of business organisation established under the law of the Isle of Man have been widely used internationally. As will be seen, it is no accident that business organisations established in the Isle of Man have become so widely used. It is arguable that the Isle of Man has the most sophisticated law relating to forms of business organisation of any centre for 'offshore' work, and is among the leading jurisdictions of the world in this respect.

The Isle of Man is a 'Common Law' jurisdiction. The basis of Manx law is Manx customary law, itself derived from a combination of Gaelic Brehon law, Norse Udall law, and both being very heavily influenced by English Common Law over the centuries. Equity, as it developed in the English courts, has been applied identically in the Isle of Man since the seventeenth century. With a few notable exceptions, notably in Land law and Constitutional law, the Isle of Man closely follows English legal precedents and legislation.

Part of the success of the Isle of Man in this area is its professional services industry. The Isle of Man legal profession is a fused profession practising law to the highest standards. The Judiciary of the Isle of Man enjoys the highest international reputation and its judgements carry great weight internationally. The accountancy profession is well established, with all the major international firms represented from the Chartered, Certified and other branches of the profession. The Institute of Chartered Secretaries and Administrators is also represented, as is the banking profession through a thriving centre of the Chartered Institute of Bankers.

The Financial Services Industry is well regulated. Nearly all aspects of the financial services industry are regulated by Government Agencies. The Financial Supervision Commission is the regulator for banking business, investment business, trust and corporate service providers whilst the Insurance & Pensions Authority regulates pensions and insurance business. The Isle of Man has adopted all internationally agreed measures and plays an active part in combating money-laundering and other criminal activities.

The Financial Supervision Commission is also responsible for the Companies Registry and all functions relating to the regulations of companies, limited liability companies, partnerships and industrial and building societies. It

also has *inter alia* powers to prescribe fees and duties and to initiate inspections into the affairs of companies.

To enhance further the Isle of Man's reputation as a well-regulated centre for offshore business, legislation in respect of the regulation of corporate and trust service providers came fully into force in 2005.

The regulation of fiduciaries was introduced in two stages with the licensing of corporate services preceding the licensing of trust services. Both classes of fiduciary activity are now subject to regulation under the Corporate Service Providers Act 2000 as amended by the Fiduciary Services Act 2005 ("the amended Act") (see Appendix B). Therefore the Corporate Service Providers Act 2000 and the Fiduciary Services Acts 2005 together form the statutory basis for the regulation of fiduciaries and are collectively known as the Fiduciary Services Acts 2000 and 2005 ("the Acts").

The Acts will, however, be replaced when the Financial Services Bill completes its progress through Tynwald (the Island's parliament) and comes into operation. The Financial Services Bill consolidates all the financial services regulatory legislation relating to banking, investment business and fiduciaries, into a single piece of legislation. Therefore, in future (anticipated in the second half of 2008) corporate services and trust services will be separate classes of financial services licences issued under the new Act. The following principles relating to the licensing of corporate and trust service providers will in other respects remain substantially as described.

Under section 2 of the amended Act it is an offence for, **any person, in or from the Island, to act or hold himself or itself out to be a fiduciary without the relevant licence unless he/it falls within an exemption** from the requirement to hold a licence. The requirement to hold a fiduciary licence also applies to an Isle of Man incorporated company that conducts fiduciary business outside the Island.

The General Strategy for Licensing and Regulating Fiduciaries

The General Licensing Policy as published on the FSC's website at www.fsc.gov.im applies to applicants for fiduciary licences, which are required to meet the "fit and proper" criteria, and, on an on-going basis, to licenceholders which must continue to be "fit and proper".

Regulated activities and Categories of fiduciary licences

A fiduciary licence is designated by the class of activity to which it refers, which may be either CSP or TSP. The classes are further sub-divided into categories as follows:

1. Category 1 CSP licence
2. Category 2 CSP licence
3. Trust Corporation licence

4. Category 1 TSP licence
5. Category 2 TSP licence

A summary of the regulated activities and licence categories as defined in the Acts can be found under Licence Categories on the FSC's website at www.fsc.gov.im.

A business may hold either a CSP or a TSP licence or both. However a Trust Corporation licence is restricted to companies (bodies corporate) and Category 2 licences are restricted to individuals.

The Commission's licensing policy for Fiduciaries

The Commission's General Licensing Policy provides guidance for fiduciary licenceholders. A licenceholder and its key staff are required to be fit and proper persons. The Commission's licensing policy is to apply a test of fitness and propriety based on the key elements of integrity, competence and solvency.

Corporate and Trust Service Providers are required to conduct their business in accordance with Regulatory Codes, which will be replaced by a Rule Book issued under the new Act when that comes into operation (probably in the second half of 2008). The practical effect has been to bring standards up to the highest level of professionalism, as already practised by the majority of this sector.

This brochure describes the various forms of business organisation available under the law, and their uses. These include Partnerships, LLC's and Trusts. A word is required here on terminology. In this brochure the word 'Company' is given the meaning found in English Company law, and equates to the American word 'Corporation'. The word 'Company' as used in America means an unincorporated association. There is no direct equivalent in Manx law. However, the American usage has been used in the Manx legislation providing for LLC's (Limited Liability Companies), and for the avoidance of confusion, these entities will always be described as 'LLC's in this brochure.

PARTNERSHIPS

Legislation

The law relating to partnerships is contained in the Partnership Act 1909. This provides for two types of Partnership:

- a. General Partnership.
- b. Limited Partnership.

Definition of Partnership

“Partnership is the relationship which subsists between persons carrying on a business in common with a view to profit”.

A company incorporated under the Companies Acts or any other Act of Tynwald is not a partnership within the terms of the Partnership Act

Any association of more than twenty persons formed for the purpose of carrying on any business in common with a view to gain or profit must be registered under the Companies Acts and may not be a partnership under the Partnership Act 1909, but this is modified by excluding from this prohibition:

- a. Firms of advocates (Manx lawyers), all of whose partners are advocates.
- b. Firms of accountants, all of whose partners belong to recognised bodies.
- c. Firms of stockbrokers in a Stock Exchange, all of whose partners are members of that Stock Exchange.
- d. Any other firms specified by the Isle of Man Treasury by regulation.

Regulated Collective Investment Schemes have been excluded from this prohibition, as have partnerships for the ownership, management or charter of ships and aircraft.

In determining whether a partnership does or does not exist, the following rules are applied

- a. Joint tenancy, tenancy in common, joint property, common property, or part ownership does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof.
- b. The sharing of gross returns does not itself create a partnership, whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived.
- c. The receipt by a person of a share of the profits of a business in prima facie evidence that he is a partner in the business, but the receipt of such a share, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business; and in particular:
 - (i) The receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him a partner in the business or liable as such.
 - (ii) A contract for the remuneration of a servant or agent of a person engaged in a business by a share of the profits of the business does not of itself make the servant or agent a partner in the business or liable as such.

- (iii) A person being the widow or child of a deceased partner, and receiving by way of annuity a portion of the profits made in the business in which the deceased person was a partner, is not by reason only of such receipt a partner in the business or liable as such.
- (iv) The advance of money by way of a loan to a person engaged, or about to engage in any business on a contract with that person that the lender shall receive a rate of interest varying with the profits, or shall receive a share of the profits arising from carrying on the business, does not itself make the lender a partner with the person or persons carrying on the business or liable as such; provided that the contract is in writing, and signed by or on behalf of all the parties thereto.
- (v) A person receiving, by way of annuity or otherwise, a portion of the profits of a business in consideration of the sale by him of the goodwill of the business is not by reason only of such receipt a partner in the business or liable as such.

GENERAL PARTNERSHIP

Partnership Property

A partnership is not a legal person in its own right, as is a company. As such therefore, assets of a partnership are owned in the joint names of all partners, or, where this is inconvenient, the assets will be owned in the name of a trustee who will hold the assets in trust for the partners.

Assets acquired for the partnership must be held and applied exclusively for the partnership and in accordance with the partnership agreement.

The assets of a partnership are owned jointly by the partners. Thus, a judgement for debt against an individual partner cannot be enforced against partnership property, although the interests of an individual partner in that property can be charged.

The interests of the partners in the partnership assets, and the rights and duties of the partners are governed by the partnership agreement, if there is one, which may be express or implied. In the absence of any agreement to the contrary the following rules apply in relation to the partnership property:

- a. All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards all losses.
- b. The partnership (or "firm", as it is sometimes styled) must indemnify every partner in respect of all payments and liabilities made and incurred by him on behalf of the firm.
- c. Any individual partner who makes capital available to a partnership in excess of the capital required from him or her is entitled to have the excess treated as a loan, with interest payable to him at 5 per cent.

Interest is not payable on the capital that is required from partners under the partnership agreement.

If a partner assigns his partnership interests, the assignee is not entitled to exercise the rights of a partner, other than to receive such profits or, on termination of the partnership, to receive such capital distributed by the partnerships as is distributable to the assignor.

Relations of Partners to Persons dealing with the Partnership

Every partner is an agent of the partnership for the purpose of the business of the partnership, and an act or instrument relating to the business and executed in the name of the partnership by a partner is binding on the partnership.

An admission or representation made by an partner concerning the partnership affairs and in the ordinary course of business is evidence against the partnership.

Where notice is given to an active partner, such notice also operates as notice to the partnership (except where that partner is party to fraud against the partnership).

Where notice is given by a partnership that a restriction has been placed on the power of one or more partners to bind the partnership, persons having received such notice cannot bind the partnership to acts done in contravention of such restriction.

Where an action of a partner in the course of business of the partnership gives rise to loss or injury to another person, not being a partner, the partnership is liable to the same extent as the partner concerned. If a partner misappropriates the assets of a third party which are in the custody of the partnership, the partnership is liable to make good the loss. In respect of the liability of a partnership in this context, each partner is jointly and severally liable, i.e. each partner has full individual liability as well as liability jointly with his partners for the liabilities of the partnership.

If a partner, being a trustee, improperly uses the property of the trust in the partnership, the liability of such partner for breach of trust is confined to himself. The other partners are not liable. But any other partner who has received notice of the breach of trust may become individually liable. Trust property in the possession of the partnership can be reserved for the trust.

Every partner in a partnership is liable jointly with the other partners for all debts incurred while he is a partner. After his retirement or death, he or his estate continues to be liable.

Where a partner pledges the credit of the partnership for a purpose apparently not connected with the business of the partnership, the partnership is not bound by that partner's action.

Any person who, not being a partner in a partnership, holds himself out as a partner in that partnership shall be liable, as if he were a partner in that partnership, in respect of any liabilities incurred thereby. But where the name of a partnership contains the name of an individual, the continued use of that individual's name after his death does not make his estate liable.

A person admitted to an existing partnership as a new partner does not become liable to the creditors of the partnership prior to his admission.

A continuing guarantee given by a partnership to a third party, in the absence of an agreement to the contrary, automatically terminates on a change in the constitution of the partnership. An incoming partner cannot be bound by the commitments entered into by the previous partners.

Relations of Partners to One Another

The rights and duties of the partners in the partnership are determined in a partnership agreement. In the absence of such an agreement, whether express or implied, there are certain rules that are applied in relation to the partnership property. Other rules are:

- a. Every partner may take part in the management of the partnership business.
- b. No partner may be paid a salary or remuneration.
- c. All partners must agree before any new partner is introduced.
- d. Day to day business decisions may be made by a majority of partners, but any fundamental change to the nature of the partnership business requires unanimous agreement of the partners.
- e. The records of the partnership are to be kept at the principal place of business, and every partner may have access to them and copy them.

The rights and duties of partners may be varied by the consent of all the partners, and such consent may be express or implied.

A partner can be expelled only by the unanimous agreement of all other partners. A simple majority is insufficient, unless such arrangement has been expressly agreed by all the partners.

Where no fixed term has been agreed upon for the duration of the partnership, any partner may, by giving proper notice, terminate the partnership. If the partnership agreement is in writing, the notice must also be in writing.

Where a partnership entered into for a fixed term continues after the expiration date, and without any new express agreement, the previous arrangements will continue.

Accounting Information - Conflicts of Interest

Partners must render true accounts and full information on everything affecting the partnership to any other partner or his legal representative.

Every partner must account to the partnership for any benefit or profits made by him from any transaction concerning the partnership, its assets or connections.

If a partner without the consent of the other partners, carries on another competing business of the same character, he must account to any pay over to the partnership all profits made from such other business.

Taxation of Partnerships

For the purpose of Manx income tax a partnership is not a taxable entity and so is not assessable in its own right in respect of the partnership's annual profits or gains. However, each partner is liable to pay income tax on their share of partnership profits. A non-resident partner is only liable to Manx income tax on income derived from Manx sources.

Further information may be found on the Income Tax Division's website, www.gov.im/treasury/incometax/, in particular Practice Note 145/07.

Dissolution and Winding Up

Upon the dissolution of a partnership, the authority of each partner to bind the firm, and the other rights and obligations of the partners, continues, but only so far as is necessary to wind up the affairs of the partnership and to distribute the assets.

The partnership ceases from the date of dissolution. However, where a third party deals with a partnership after a change in its constitution (i.e. the dissolution of the old partnership and the creation of a new partnership) he is entitled to treat all apparent members of the old partnership as continuing to be members of the new partnership until he has had notice of the change.

Voluntary Dissolution

A partnership is dissolved:

- a. on the expiration of the fixed term for the partnership, if there be such a fixed term;
- b. if the partnership is entered into for a specific "adventure", upon the conclusion of that "adventure";
- c. by a partner giving notice to his fellow partners of his intention to dissolve the partnership;
- d. on the death of a partner;
- e. on the bankruptcy of a partner;
- f. at the option of the partners, if a partner gives a charge to a third party on his share of the partnership property in relation to his private debts;
- g. if it becomes illegal for the business of the partnership to be carried on.

Involuntary Dissolution

On application by a partner, the court may decree a dissolution of the partnership where:

- a. a partner is of unsound mind;
- b. a partner is, for any other reason, incapable of performing his part of the partnership contract;
- c. the conduct of a partner (other than the applicant partner) has been prejudicial to the business of the partnership;
- d. a partner (other than the applicant partner) persistently is in breach of the partnership agreement or otherwise makes the partnership impracticable;
- e. the business of the partnership can only be run at a loss;
- f. the court is, in the circumstances, of the opinion that it is just and equitable for the partnership to be dissolved.

Dissolution - General

After the dissolution, the authority of a partner continues but only in so far as it is necessary to wind up the affairs of the partnership and to complete unfinished transactions. A bankrupt partner has no authority.

On the dissolution of a partnership, every partner is entitled to have the partnership property firstly to be used to pay off the liabilities of the partnership, and thereafter to be distributed to the partners in accordance with the rights of the partners. In this context, a partner may, after the dissolution of the partnership, apply to the court to wind-up the business and affairs of the partnership.

Where one partner has paid a premium to another partner on entering the partnership for a fixed term, and the partnership is prematurely dissolved otherwise than by the death of a partner, the court may order the repayment of all or part of the premium.

Where a partnership contract is rescinded on the grounds of the fraud or misrepresentation of one of the partners, the injured partner has certain rights as against the partnership property and the partner guilty of such fraud or misrepresentation.

Where a partnership has been dissolved as the result of the retiral or death of a partner, and the remaining partners have carried on business in a new partnership without settling accounts with the retired partner, or his estate, the outgoing partner, or his estate, is entitled to share in any post-dissolution profits, or to interest, on the amount of capital attributable to him and used in the partnership.

On the dissolution of a partnership, any partner may give public notice and may require the other partners to concur for such purposes.

The Partnership Act 1909 imposes no specific duties on the partners after the dissolution of the partnership, but there is an implied obligation to wind-up the

affairs of the partnership in accordance with the procedures and the rights of partners set out in the Act.

In a dissolution of a partnership, the following rules, subject to any agreement, apply :

- a. Losses shall be paid first out of profits, second out of capital, lastly by the partners individually in the proportion in which they were entitled to share profits.
- b. Assets shall be applied:
 - (i) in paying the debts and liabilities of the partnership;
 - (ii) in paying to each partner rateably what is due to him for advances, as opposed to capital;
 - (iii) in paying to each partner rateably what is due to him in respect of capital;
 - (iv) in paying the ultimate residue among the partners in the proportions in which profits were divisible.

LIMITED PARTNERSHIPS

General

The following provisions apply additionally to limited partnerships which are also governed by the Partnership Act 1909.

A limited partnership may not have more than twenty members, unless it falls within the exempted categories as previously noted.

It must consist of one or more “General Partners” with unlimited liability, and one or more “Limited Partners”. A limited partner shall, at the time of entering the partnership, contribute a defined amount of capital or property, and his liability for the debts of the partnership is limited to that amount. A limited partner may not draw out or receive back, directly or indirectly, his contribution during the continuance of the partnership. A corporation may be a limited partner.

A limited partnership must be registered, and in default thereof, every limited partner shall be deemed a general partner with unlimited liability.

Notwithstanding the registration requirements, a limited partnership does not constitute a legal person in Manx law.

Limited partners may not take part in management, unless, following an Statutory Order made by the Manx Government, they are permitted to do so.

The Financial Supervision Commission is also the registrar of limited partnerships, and is required to keep appropriate records.

The following information must be supplied to the Companies Registry when registering a Limited Partnership:

- a. The name of the partnership.
- b. The general nature of the business.
- c. The principal place of business.
- d. The full name of each of the partners.
- e. The term, if any, for which the partnership is entered into, and the date of commencement.
- f. A statement that the partnership is limited, and the description of every limited partner as such.
- g. In respect of prescribed classes of limited partnership only, the sum contributed by each limited partner, and whether paid in cash or how otherwise.

Upon registration, the Financial Supervision Commission shall issue a certificate of registration.

During the continuance of a limited partnership, any change made in the particulars provided on establishment must be notified to the Financial Supervision Commission within a month.

A certificate of registration or a copy of or extract from any statement registered shall, if certified a true copy by the Financial Supervision Commission, be received in evidence in all legal proceedings.

Any person may inspect the statement filed by the Financial Supervision Commission for a small fee. Any person may require a certificate of registration or a copy of or extract from any registered statement certified by the Financial Supervision Commission for a prescribed fee.

Public Notices

The following notices must be advertised in two newspapers published in the Isle of Man:

- a. Notice of any change whereby a general partner becomes a limited partner.
- b. Notice of any assignment by a limited partner of his share in the limited partnership to any other person.

Modification of General Law of Partnership

The following modifications apply:

- a. A limited partner shall not be dissolved by the death or bankruptcy of a limited partner, and the lunacy of a limited partner shall not be grounds for a court dissolution, unless this is the only means of realising the lunatic's share of the assets.
- b. After a dissolution, the affairs of a limited partnership will be wound up by the general partners.
- c. Applications to the court to wind up a limited partnership shall be by petition under the Companies Acts.

- d. Subject to any agreement expressed or implied between the partners:
- (i) Any difference arising as to ordinary partnership business may be decided by a majority of general partners
 - (ii) A limited partner may assign his share in the partnership to a third party, and the assignee shall then become the limited partner in place of the assignor.
 - (iii) The other partners may not dissolve the partnership by virtue of a limited partner charging his share of the partnership for his separate debt.
 - (iv) A person may be introduced as a partner without the consent of the existing limited partners.
 - (v) A limited partner shall not be entitled to dissolve the partnership by notice.

TRUSTS

Definition of a Trust

Isle of Man Trust law has its origins in **English Trust law**, which developed in the Middle Ages. There is no complete definition of a trust in statute law, since trust law is derived from the rules of 'Equity' as evolved in English law, and not from any Statute or Code. In English law, the system of Equity evolved as a parallel system to that of 'Common Law'. It is therefore not correct to describe a trust as a 'Common Law' entity, since Common Law specifically does not recognise a trust. It is from this contradiction of the two systems of Equity and Common Law that the duality of ownership that is one of the essential characteristics of the trust is derived.

In general, a trust is a fiduciary relationship whereby one person (the 'Trustee') receives an asset from another person (the 'Settlor') to hold for the use or benefit of a third person (the Beneficiary'). The legal ownership is vested in the trustee, but the beneficiary has an 'equitable' interest. There are many forms of trust, and many definitions. Indeed, no single definition of the trust has yet been written which is comprehensive and precise. It should not be confused with the concepts of bailment, agency, or debt and is not contractual in character.

For the purpose of this outline, however we may note that a trust may be:

- a. Express or Non-express
- b. Private or Public
- c. Bare

An express trust is one created by the express and intentional declaration of a settlor. This declaration is normally a written 'deed' (or 'indenture', as is the terminology in the USA), but may, in certain circumstances, be manifest by the behaviour of the parties concerned. A non-express trust is one that is created without any express intention to do so by a settlor. Such a trust is often termed an 'implied' trust. It may be:

- a. A presumed resulting trust
- b. An automatic resulting trust
- c. A constructive trust.

The difference between a private and public trust exists purely in relation to its purposes. For example, a charitable trust for a public charitable purpose is a public trust. Such trusts in the Isle of Man must be registered, must file annual audited accounts, and are subject to supervision by Her Majesty's Attorney-General in the Isle of Man. A public trust is always an express trust.

A non-discretionary trust is where a trustee has no discretion as to which of a class of beneficiaries shall receive benefits, nor the amounts or timing of such benefits. In a discretionary trust the trustee has such discretion to a greater or lesser extent as the trust deed may determine.

A 'bare' trust is where a trustee holds property on trust for a single beneficiary absolutely. He has no power or discretion to do anything other than hold the property, and deliver it when requested to the beneficiary. A 'nominee' relationship is often a bare trust.

As business entities, the normal forms are either the unit trust (sometimes known as a mutual fund), or the trading trust.

The situs of administration of a trust will normally be that of the trustee. As such, if the situs of administration is in the Isle of Man, the Manx courts will have jurisdiction, irrespective of the proper law of the trust.

Legislation

As noted, the law of trusts is derived from the rules of equity. Since a trust is a form of human relationship, trust law, at its heart, is concerned with recognition of that relationship, enforcing its provisions and providing remedies where there has been a breach of the relationship. Legislation has not been used to 'create' trust law, but to guide it and to check it when it threatened to evolve undesirable practices, or to clarify uncertainties.

The legislation that is applicable to trusts is as follows:-

- (i) Trustee Act 1961
- (ii) Variations of Trust Act 1961
- (iii) Perpetuities and Accumulations Act 1968
- (iv) Powers of Attorney Act 1971
- (v) Powers of Attorney Act 1983
- (vi) Trusts Act 1995
- (vii) Purpose Trusts Act 1996
- (viii) Trustee Act 2001

Other legislation which is relevant to trusts is as follows:

- (i) Settled Land Act 1891
- (ii) Settled Land Act 1983.

- (iii) Public Charities Act 1922.
- (iv) Charities Act 1962
- (v) Charities Act 1986.
- (vi) Wills Act 1985

The Trust Law of the Isle of Man is, with only a few minor exceptions, identical to that of England. The Isle of Man is a signatory to the Hague Convention on the Recognition of Trusts.

Elements of a trust.

As noted, a trust is not 'formed' as such, but comes into being as a result of the express or implied wish or actions of the settlor. In any trust, there are certain essential component elements.

There must be:-

- a. A settlor, sometimes also described as a 'Grantor' or a 'Trustor'. The settlor is also referred to as a 'creator' or in the case of a trust set up upon death, a 'testator'. In any event, the settlor is the individual whose assets he has caused to be placed, given, granted or 'settled', into the trust or 'settlement'. It is possible for a person to be both settlor and trustee. In that case, a person would, by a declaration, declare that, henceforth, he declares certain assets of his to be held on trust for a named beneficiary.
- b. A trustee, being the recipient of the assets given by the settlor.
- c. A beneficiary, or 'Cestui Que Trust' (see the section on purpose trusts).
- d. Trust property. Since the trust derives its existence from arrangements relating to property, it is impossible to establish any trust without trust property. The nature of the property is irrelevant.

It will be seen that the settlor and the trustee can be the same person. The settlor can be a beneficiary (indeed he can be the sole beneficiary). But the trustee cannot be the sole beneficiary, though he can be one beneficiary where there are also other persons being beneficiaries.

It is not necessary, except in situations relating to land, for the terms of the trust to be in writing. A trust can exist without a written documents, although where there is the slightest complexity or room for doubt, a trust deed is obviously essential.

Establishing a Trust Inter Vivos

An Inter-Vivos trust is, as its name suggests, a trust established between living persons. The settlor, while alive settles the property on the trustee.

Establishing a Trust by Will

A trust can be set up on the decease of a settlor. The testator, as he is called in such a case, directs in his will that the trust property be taken from his estate and given to the trustee to establish the trust.

Because a trust is not dependent upon a document in writing, or the existence of a contract, or upon any public registration procedure, the existence and validity of a trust is judged by reference to the criteria broadly described above.

The transfer of the trust property to trustees has the nature of a gift except in the case of a private company limited by shares or by guarantee. Since the conveyance of the property to the trustee is an essential part of the creation of a trust, a trust cannot come into existence until the trust property has been so conveyed, or, at least, the process of conveyance has been irrevocably commenced.

Once the trust is in existence, additional properties can be added to the trust property by additional settlements.

The maximum period for which a trust can exist is eighty years. The Trustee Act 2001 extends the maximum period (perpetuity period) for which a trust can exist to 150 years, except in respect of the will of a person dying, or any other instrument made, before 1 January 2001, which can only exist for 80 years.

There is no statutory rule against accumulations in the Isle of Man, there being no equivalent legislation to the Accumulations Act 1800 of England.

Trustees

A minor may not be a trustee as he is devoid of legal capacity. A trustee may not be appointed against his will.

A company may be a trustee, if so empowered by its constitution. The expression 'trust corporation' has specific meaning in Manx law. It means the Public Trustee under the English Public Trustee Act 1906, or a corporation appointed by the Court in any particular case to be trustee, or an Approved Trust Corporation which has been approved by the Court under the Judicature Amendment Act 1935. The principal benefit of such approval is that it enables the company to apply for probate and to act as Executor of Wills.

To be approved, the company has to meet certain minimum capitalisation rules. There are, however, many companies in the Isle of Man, some of which are substantial, which provide trustee services, but which because they do not handle executorships and have no need of the status, have not sought 'Approved Trust Corporation' status.

In addition, a trustee carrying on banking or investment business must be licensed by the Financial Supervision Commission.

In trusts holding land, there may not be more than four trustees. In other trusts there is no such restriction, although where statutory power to appoint additional trustees is used, the maximum number is four. There may be only one trustee, but, for a trust holding land, if this is not a trust corporation, there must be two trustees.

A trustee under a private express trust may be appointed by:

- a. The settlor
- b. A person given an express power to appoint in the trust deed.
- c. The Court
- d. Under the provisions of the Trustee Act 1961, sec.35, which provides for the appointment of trustees where a trustee dies, or absents himself, or otherwise vacates his office.

Normally the initial trustee is appointed as part of the act of creating the trust. The trustee will be a party to, and execute the trust deed. Once appointed, the trustee cannot be removed by the settlor, unless the trust deed specifically so provides.

Where the deed gives power to a third party to appoint a trustee, he is called the 'appointor'.

A trustee can remove his responsibility only in limited circumstances. The trust deed must provide for the trustee's retirement and replacement.

[The Court has an inherent right to approve the retirement of a trustee just as it has the right to appoint a trustee.](#)

A retiring trustee continues to be liable for breaches of trust committed during his trusteeship.

The Trustee Act 1961 provides for the retirement of a trustee, without being replaced, provided there remain sufficient trustees to act. It also provides for the appointment of trustees in place of retiring trustees.

Where a trustee dies, any remaining trustees continue without him. If he is the sole trustee, the deceased's legal representative will be responsible either as trustee, or for appointing new trustees, subject to the provisions of the trust deed.

Duties of a Trustee

The duties of a trustee have evolved as the law of trusts has itself evolved and are now determined by the trust deed itself, the Trustee Act 1961, the Trustee Act 2001 and other legislation. The Trustee Act 2001 imposes a statutory "duty of care" in certain circumstances. It requires a trustee to exercise:

such care and skill as is reasonable in the circumstances, having regard in particular :

- (a) *to any special knowledge or experience that he has or holds himself out as having; and*
- (b) *if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.*

It is both an objective test referring to what is reasonable in the circumstances, and is a subjective test, referring to the particular knowledge and experience of the trustee and the capacity in which he acts.

The statutory duty of care applies in relation to the investment of the trust assets by the trustee; the acquisition of land; the authorisation of an agent, nominee or custodian of trust property; and in respect of certain powers under the Trustee Act 1961 in relation to compounding of liabilities, insurance, reversionary interests, valuations and audit.

It may, however, still be true to say that the duties of a trustee are primarily determined by the trust deed itself as the Trustee Act 2001 permits the exclusion of the duty of care. However, whether it is possible to exclude the duty of care in respect of an existing trust deed, will depend on the existing powers to vary contained in the deed itself:

The duty of care does not apply if or in so far as it appears from the trust instrument that the duty is not meant to apply.

Within that framework, the trustee has an absolute duty to the beneficiaries of the trust, not only to them as a class, but also to act fairly and impartially as between them. It is an office of absolute faith, requiring a trustee to be entirely disinterested in his actions.

The trustee must with all diligence take possession of the trust assets and administer them strictly in conformity with the trust deed, statute and his fiduciary duty.

It is a principle of equity that a trustee is prohibited from deriving any direct or indirect personal profit or benefit from his office. Prior to the Trustee Act 2001 coming into operation, it was therefore necessary for the trust deed to provide for a trustee's remuneration if he was to receive any remuneration or benefit whatsoever. However, the Trustee Act 2001 provides that if there is provision in the trust deed entitling him to receive payment out of trust funds, a trustee who is a trust corporation or acting in a professional capacity (provided he is not the sole trustee), is entitled to receive payment for his services and if no provision is made in the trust deed, he is entitled to receive reasonable remuneration out of the trust funds for his services and also to be reimbursed in respect of any expenses incurred by him when acting on behalf of the trust.

Powers and Discretions of Trustees

The source of a trustee's powers and discretions may be the trust deed, a statute such as the Trustee Act 1961, the Trustee Act 2001 or a Court Order.

The Trustee Act 1961 provides, subject to certain conditions:

1. Power of sale, or postponement of sale
2. Power to give receipts
3. Power to compound liabilities
4. Power to raise money by sale, mortgage, etc.
5. Power to insure
6. Power to apply insurance monies
7. Power to deposit documents etc. in safe custody
8. Power to have assets valued and audited
9. Power to assign or convey property
10. Power to delegate, while abroad
11. Power to apply income for maintenance during a minority

In relation to investments, the Trustee Act 2001 provides, subject to any restriction or exclusion imposed by the trust deed or any statutory provisions:

- (i) A general power of investment which allows a trustee to make any kind of investment that the trustee could make if he were absolutely entitled to the assets of the trust. However, before exercising the power of investment or when reviewing the investments of the trust, the trustee must obtain and consider proper advice about the way in which the power should be exercised. The exception is that a trustee need not obtain such advice if he reasonably concludes that in all the circumstances it is unnecessary or inappropriate to do so.
- (ii) A power to acquire freehold or leasehold land in the Island or the United Kingdom whether as an investment, for occupation by a beneficiary, or for any other reason.
- (iii) Subject to certain restrictions, a power to authorise any person to exercise any or all of their delegable functions, which are defined as functions relating to the distribution of assets, whether any payments of fees due should be paid out of income or capital, powers to appoint trustees, or any power conferred by any other statutory provision or the trust deed. In the case of a charitable trust, delegate functions are, carrying out a decision that the trustees have taken; any function relating to the investment of assets subject to the trust, any function relating to the raising of funds for the trust otherwise than by means of profit of a trade which is an integral part of carrying out the trust's charitable purpose; any function prescribed by an Order made by the Council of Ministers.
- (iv) Subject to certain restriction, a power to appoint a person to act as nominee for the trustees, or as a custodian, in relation to specific assets of the trust. If trustees retain or invest in securities payable to bearer, they must appoint a person to act as a custodian of the securities.

A discretion is derived from a power. Some powers give limited discretion to a trustee (e.g. where a fixed trust for the proceeds of a sale is coupled with a power of sale, the power must eventually be exercised. The discretion of the trustee relates to the timing of the sale). But some discretions are much more general. Such discretions are derived from powers given in the trust deed itself, while others are derived from statutory provisions.

Protector

It is common practice for protectors to be appointed to supervise and guide trustees, and sometimes to appoint and remove trustees. Sometimes such protectors have negative powers, and trustees may require their consent to certain actions. Care needs to be taken to ensure that a protector does not have such powers as would make him a constructive trustee in his own right, or as a trustee de son tort. In addition, recent litigation has established that a protector has a fiduciary duty, like a trustee, to the beneficiaries, and not to the settlor.

Beneficiaries

The rights of a beneficiary will depend upon:

- a. The intention of the settlor of the trust
- b. The type of interest/property conveyed to the trustee
- c. The type of trust

The rights of a beneficiary may be defined in many ways. In a unit trust, the rights are determined by units, representing proportionate interest in the settled property.

An interest in a fixed trust is assignable. A creditor of a beneficiary can enforce a valid claim against such an interest of the beneficiary in a fixed trust.

A beneficiary has the right to information from the trustee on the administration of the trust.

It is not necessary for a settlor to obtain the consent of a prospective beneficiary, to establish a valid trust. However, a beneficiary can disclaim and renounce an interest.

A beneficiary has the right to seek injunctions and Court orders to compel a trustee to discharge his obligations, or otherwise to direct a trustee, or even to remove trustees and appoint new trustees.

Where a trustee has been in breach of trust, the Court will order the trustee to make restitution. The rule is that the trustee in breach of trust must restore to the trust what has been lost by the trust as a result of the breach.

A beneficiary who is absolutely entitled to the whole beneficial interest in a trust may terminate the trust at will, notwithstanding the opposition of the trustee, and the terms of the settlement.

Accounts and Investment Management

The trustee must keep clear and accurate accounts and have these accounts available for inspection. He must be ready to give a beneficiary a full and proper explanation of the dealings of the trust.

Taxation

Trustees are taxpayers and are obliged to file tax returns when they are resident in the Isle of Man.

However, where the beneficiaries of a Manx trust are resident outside the Isle of Man and the trust's income arises outside the Isle of Man or is from local approved sources e.g. bank interest from local banks, the Assessor of Income Tax will 'look through' the trust and will not seek to tax the income in the Isle of Man.

Further information may be found on the Income Tax Division's website, www.gov.im/treasury/incometax/, in particular Practice Note 141/07.

Liability of Third Parties and Beneficiaries

Starting with the principle that a trustee cannot obtain any greater interest or rights in settled property than that which was enjoyed by the settlor, it can be seen that where property with a defective title is settled on the trust, the title continues to be defective.

Property can be traced to all third parties, except a bona fide purchaser of legal estate.

Variation and Termination

Unless specifically provided for in the trust deed, the deed as executed is binding and cannot be changed

Where all the parties concerned are in agreement - settlor, trustees and all the beneficiaries - it is difficult to see how an alteration could be challenged. But note that where there are minors, or as yet unborn beneficiaries, this option is not possible.

The courts have an inherent jurisdiction to approve alterations of the terms of a trust.

The exercise of this jurisdiction is very limited and usually relates only to the management of the trust. There are also certain statutory powers given to the courts relating to the variation of trusts.

The court will pay a great deal of attention, when considering a proposed variation, as to whether the variation will remain consistent with the original intentions of the settlor.

Once a trust has been validly constituted, the settlor no longer has any interest, and cannot revoke the settlement. However, a settlor could arrange for a specific power of revocation to be included in the trust deed, thereby making the trust revocable.

Alternatively, he could include himself as a beneficiary.

A trust may terminate for a number of reasons:

- a. It may fail at the outset, due to failure to meet the basic requirements of law, such as the rule against perpetuities, or because the trustee has never taken full control of the settled property.
- b. The exhaustion of the trust property will terminate the trust.
- c. The trust may terminate, having reached the end of its life.
- d. The trust may terminate as a result of premature action.

Trusts may prematurely terminate as a result of:

- a. Revocations
- b. The combining of the equitable interest of a sole beneficiary with the legal interest of the trustee. A trust cannot exist where the trustee and a sole beneficiary is the same person.
- c. Where the beneficiaries are entitled to demand that the trust properties be paid to them at once, and do so demand.

The trustees continue to be bound by their fiduciary duty after a trust has terminated and during the winding up process. This will end only after all the property has been distributed and the beneficiaries have discharged the trustee from his duties.

Foreign Trusts

Trusts validly established in a foreign jurisdiction are recognised. However, where a foreign trust has a local situs of administration, or other substantial connection with the Isle of Man, the courts have jurisdiction in enforcing and supervising the trust.

Forced Heirship

Some jurisdictions have what are called 'forced heirship' provisions, whereby the assets of a deceased person must be divided as prescribed by law. This can create a conflict where the assets concerned have been settled on a trust.

The Trusts Act 1995 resolves this conflict by stating that foreign 'forced heirship' provisions shall have no effect in regard to a trust in the Isle of Man.

Purpose Trusts

Trusts established for a purpose have always existed as charitable trusts, where the enforcement function of the beneficiary has been discharged by the H.M. Attorney General. The Purpose Trusts Act 1996 enables non-charitable purpose trusts to be established. They must have at least one 'designated' trustee in the Isle of Man, who is qualified and there must be an independent enforcer.

Trading Trusts

Trusts may be established in which specific powers are given to the trustees to carry on trading activities. Trustees of such trusts have immense exposure to litigation for breach of trust, should they incur any losses; nonetheless, it is occasionally appropriate for this type of trust to be established. The purpose, usually, is to carrying on a trading activity where the taxable events are attributed directly to the beneficiaries, thereby omitting a level of corporate taxation.

Unit Trusts

A unit trust is a trust in which the interests of beneficiaries are defined by reference to 'units' held by them. Such an investment vehicle can be open-ended, since the number of 'units' is infinitely variable, and units can be 'created' and 'redeemed' at will.

Unit trusts make excellent holding vehicles because of this flexibility. Extended families often use private unit trusts, since they provide for participation by family members separated from management, with an independent trustee to hold the assets.

A unit trust will generally be a collective investment scheme within the meaning of the Financial Supervision Act 1988. Any unit trust which has more than fifty named beneficiaries (participants) and which does not contain a prohibition in its trust deed against promoting itself to the general public is required to be licensed and supervised by the Financial Supervision Commission.

Public unit trusts usually have a custodian in addition to the trustee, who actually holds the title to the assets, thereby providing an additional layer of protection for the unit holders.

Regulation of Trust Service Providers

The Financial Supervision Commission has introduced legislation for the regulation of persons who provide trust service by way of business – The Fiduciary Services Acts 2000 and 2005.

LLCS - (US STYLE LIMITED LIABILITY COMPANIES)

Origins in the USA of the LLC

One of the newest forms of business organisation is the Limited Liability Company, as originally conceived in Wyoming, USA, and which has in the last twenty years spread throughout the USA and beyond. The phrase Limited Liability Company uses the word 'Company' in an American sense, and can be misleading. We therefore shall always refer to them as LLCs. The name can be translated into English as an *Association with Limited Liability*. The concept was developed entirely for tax reasons, to provide a vehicle which, while having corporate personality and limited liability, would be categorised as a Partnership for US federal tax purposes. Since the introduction of the LLC, however, US tax categorisation rules have become much more flexible, but the LLC has developed a strong place of its own as a simplified form of business vehicle.

Legislation

The Isle of Man in its legislation adopted the Wyoming legislation as its model and legislated the Limited Liability Companies Act 1996. Under the current US categorisation criteria, the Isle of Man LLC could for US tax purposes, be a constructive Trust, depending on the drafting of the articles of organisation. If it is not a trust, it will be a default corporation, but could elect to be treated as a Partnership. In the original legislation, there was a time limitation on the duration of the LLC of thirty years. This was removed in 1999. There is now no time limitation on the duration of the LLC.

Characteristics

An Isle of Man LLC is formed by the registration with the Financial Supervision Commission of the articles of organisation, and subsequent issuing by the Financial Supervision Commission of a certificate of registration.

The documents which govern the LLC are the *articles of organisation* and the *operating agreement*.

- a. The articles deal with a few major points, such as the name of the LLC, the identity of the members, the capital introduced by each member, the principles governing the admission of new members, and the ability of surviving members to continue the business in the event of a member dropping out as a result of death, resignation, or otherwise.
- b. The articles of organisation is a public document.
- c. The operating agreement is a private document entered into by the members, and deals with the internal governance of the LLC. Although a few matters must be dealt with as required by the Limited Liability

Companies Act 1996, the operating agreement is largely drafted to suit the members.

- d. There are no directors of an LLC. As in a partnership, the members manage the LLC directly.
- e. The members may appoint one or more managers, but such a manager has only those powers specifically delegated to him by the members, and has no assumed powers or duties as is the case with the director of a company. His powers are only those which are specifically given to him.
- f. The LLC will be wound up automatically if a member ceases to be such, whether by dint of death, resignation or disqualification. If the number of members falls below two the winding up is obligatory. However, if two or more members remain, they may resolve to carry on, in which case the outgoing member will be paid out, and the LLC will continue.
- g. The LLC does not have a share capital as such. The members declare in the articles of organisation their capital contributions, and their voting and profit sharing rights are deemed to be proportionate in the absence of provisions to the contrary in the operating agreement. Thus it is possible to issue a certificate stating that a particular member has a percentage 'share' in the business, but there are no definitive 'shares' as there would be for a US-style corporation, or a company limited by shares.
- h. The members have their liability limited to the amount of their capital contribution as declared in the articles of organisation.
- i. Membership is not transferable or assignable. The equitable interest of a member can be transferred on the basis of a member resigning and a new member joining in replacement, and the interest of an existing member is, of course, subject to a charging order, but a third party holding such a charged interest has no power to participate in the management of the LLC, and no power to require a distribution of capital or profit, or to require the LLC to be wound up.
- j. There is no provision for an annual meeting or, indeed, any formal meeting of members. There is no provision for the auditing or filing of accounts, although the Act does require the members to keep proper accounts.
- k. Charges on the assets of the LLC must be registered, as is the case with a company.
- l. An annual return is submitted each year, setting out the details of the members and any manager.
- m. Under Isle of Man tax law, the LLC is taxed as a partnership, and thus is a wholly transparent entity. If, however, it is carrying on a trading activity

in the Isle of Man, it may have to register for Value Added Tax. This, however, creates yet another set of opportunities, in the context of trading in Europe.

Constitutional documents

The LLC is formed by two or more persons registering with the Financial Supervision Commission of the articles of organisation of the LLC, and, simultaneously, entering into an operating agreement.

The articles of organisation need not be long. They are obliged to deal with following matters:

- i. The name of the LLC (which must receive prior approval from the Financial Supervision Commission, and must end with 'Limited Liability Company', 'L.L.C.' or 'LLC')
- ii. The names and addresses of the members.
- iii. The name and address of the Isle of Man registered agent, who must be a professionally qualified Manx resident individual.
- iv. The total amount of cash, and description and agreed value of property other than cash, contributed by the members of the LLC.
- v. The total additional contributions, if any, agreed to be made by the members and when they are to be made.
- vi. The right of the members, if any, to admit additional members.
- vii. The right of the remaining members to continue the business on the cessation of membership of a member which would otherwise terminate the LLC.
- viii. The right of a member to receive out of the property of the LLC repayment of all or a part of his capital contribution.
- ix. If the members are permitted to appoint a manager.

At the same time as the articles are signed, the parties enter into the operating agreement. These provide for the internal governance of the LLC and the rights of the members amongst themselves.

After the articles have been registered, the Financial Supervision Commission will issue a certificate of organisation (e.g. registration), and the LLC is in business.

Taxation

For Isle of Man Income Tax purposes, an Isle of Man LLC is treated as a partnership. (See the related text on taxation of partnerships for more details.)

Uses of an Isle of Man LLC - by US persons

As noted, the LLC may have any characterisation available under the Internal Revenue Code. This means that it could be a trust, a corporation or a

partnership. If the LLC is a trust or a partnership, it cannot, by definition, be a corporation, and cannot therefore be a Controlled Foreign Corporation (CFC), a Foreign Personal Holding Corporation (FPHC), or a Passive Foreign Investment Corporation (PFIC).

This is significant because, where a US person participates in a foreign company, there are some severe tax drawbacks. If the company is a Controlled Foreign Corporation, or another similar tax entity, the reporting requirements are considerable and onerous. Furthermore, for a CFC, on the death of the US shareholder, certain punitive rules apply in relation to basis step-up in respect of capital gains tax.

As a holding entity

The LLC, by electing for partnership status, however, can provide an inexpensive offshore holding vehicle with complete avoidance of these onerous provisions, including considerably reduced reporting requirements, and complete avoidance of the penal basis step-up provisions. It would be transparent for US tax purposes.

As an Asset Protection vehicle

By appropriate drafting of the articles of organisation and the operating agreement, the LLC can be used as an effective asset protection vehicle.

As a vehicle for Joint Ventures with Non-Resident Aliens

It is by no means uncommon for US persons to enter into foreign joint ventures with non-resident aliens of the USA. However, because of the penalties for a US person using foreign companies, a US person entering into such a joint venture will wish to have the company acting as the joint venture vehicle in the USA.

The non-resident alien joint venture partner may not be happy about participating through a US entity, as that may expose him to US taxation.

By using an Isle of Man LLC, with the LLC electing to be as a partnership for US tax purposes, the taxable profits attributable to the US partner will be taxed in his hands, and he suffers no penalties. The taxable profits attributable to the non US partner will not be liable to US taxation.

Uses of an Isle of Man LLC - generally

As a tax transparent investment vehicle

There is no limitation to the number of members of an LLC. The form lends itself readily as a vehicle for the issue of debt instruments in the raising of investment funds.

As a simple form of business entity

In many cases, conventional companies are too complex and costly to administer. The requirement for the separation of ownership (shareholders) from management (directors), the need for annual general meetings, etc. are inappropriate for a small holding company, or a small trading business.