

CM SKYE

CM Notes

A SIMPLE INTRODUCTION TO ISLE OF MAN PRIVATE FOUNDATIONS (EXCLUDING REGISTERED CHARITIES)

What is a Foundation?

Every legal system needs a form of legal entity which can be used for charitable or private asset conservation purposes. The essential characteristics is that it is capable of owning and managing property, that it has management and continuity., and that it can be established for specific purposes. It should also provide privacy and confidentiality.

Traditionally an entity that was established for charitable or private asset conservation purposes was often called a 'Foundation' as a generic name.

In the English legal tradition, two legal forms have always been traditionally used:

- i. The Trust. This name does not describe an actual legal 'entity', but a relationship, whereby a person, the 'Trustee', holds and manages assets in accordance with the provisions and objects set out in a Trust Deed, for other persons, the 'Beneficiaries', or for a Purpose. Where the Trust is for a Purpose, it will either be registered as a Charity, and thus subject to supervision by a Government Authority, or if it is in a jurisdiction which permits non-charitable Purpose Trusts, it will be supervised by an Enforcer. Although they are widely used, Trusts for this purpose are far from ideal. They are complex and usually misunderstood. The liabilities of Trustees are significant, and the current climate of business is highly litigious.
- ii. The Company Limited by Guarantee, and its sibling, the Company Limited by Guarantee and Having Shares It is this latter entity with which this brochure is concerned.

In the Roman legal tradition, the trust is scarcely known. Although the trust concept was widely used in Europe in the Middle Ages, it never developed the sophistication of its English cousin. It was swept away by the Napoleonic reforms at the end of the eighteenth century. In recent years, however, the trust concept is making a limited come-back in Roman law countries, particularly in those providing 'offshore' financial services such as Liechtenstein and Panama.

Civil Law provides for such charitable or asset-conservation objectives to be attained through the use of Associations or corporate Foundations.

Article 3 on Entities Juridique published in the Official Journal of the EU dated 31st August 1993, No C236/1, classifies Guarantee and Hybrid companies as Foundations in the context of European law.

Thus, irrespective of the legal tradition or the mechanism, for our purposes, a Foundation is a corporate entity whereby assets can be held and used for defined charitable or quasi-charitable, or for private asset conservation purposes, and with effective management and continuity.

Why use a Manx Private Foundation?

The Isle of Man has inherited its basic company legal concepts and statutes from England. In consequence the two jurisdictions have very similar company law.

The private Foundation established in the Isle of Man has substantial advantages over a trust:

- it can be dynastic. It is not subject to the rules against perpetuities and accumulations. It can last for ever;
- it can be structured to have a purpose as its beneficiary. As such, it is a great deal more flexible and simple to operate than a so-called 'Purpose' Trust;
- it can trade without problems. The responsibilities of the Directors are governed by Company Law, and not by Trust law, so that the onerous responsibilities of trustees in relation to trading subsidiaries are avoided;
- it can be controlled by the founder. It cannot be a sham trust, since it is not a trust. This means that it is possible to give the Founder (and his descendants) effective control without imperilling the structure's effectiveness and legal status;
- it will be recognised in civil law countries. There is no problem in relation to the recognition of trusts by civil law jurisdictions.

The private Foundation in the Isle of Man has substantial advantages over a Civil Law Foundation as is found in Liechtenstein or Panama.

- It can be established without the need for any PATRIMOINE or CAPITAL. Funds can be introduced at any time as may be appropriate, and can be received as a contribution to the company by the Founder Member, or as a donation to the company from anyone. There is no tax or duty on such capital receipts or donations.
- It is tax free. In the Isle of Man, the Foundation may be entirely exempted from all direct taxation, including income, capital, gift and estate taxes. There is an annual duty payable to Government in the Isle of Man of £470. per annum (US\$845).
- It can be established without any objects, and is thus infinitely flexible in its activities.
- It can be designed to meet any requirements of the Founder relating to the future dynastic control of the Foundation by his descendants.
- It is confidential. Although the identity of the Directors is on the Public Record, the identity of the controlling Members and the Founder Member is entirely confidential. Although accounts must be audited for the benefit of the Members, they are not filed on any public register, and are entirely confidential.
- It is inexpensive to establish and run.

Corporate Nature of the Manx Private Foundation

A Manx Private (or Family) Foundation will always be structured as a Company Limited by Guarantee and Having Shares (a 'Hybrid' Company).

This form of Company was provided in the first English Companies Act in 1862. In the Isle of Man, Company Law followed the development of English Company Law. The current Companies Act is based, with many subsequent amendments, on the United Kingdom Companies Act of 1925. Thus such Foundations have a history of use of over 135 years.

The Manx Companies Acts permit several different type of companies, in addition to the familiar Company Limited by Shares.

The Company Limited by Guarantee is a Company whose members are elected into membership without being necessarily required to contribute to the capital either on election or thereafter, but who can be required to contribute to capital should the company subsequently go into liquidation while insolvent. This 'Guarantee' can be any amount in any currency, but is usually expressed as a nominal amount (e.g. £10.)

A variant of this is the Company Limited by Guarantee AND having Shares (which we shall refer to as 'Hybrid' Company). This company has both normal Shareholder Members, and also members who, as in a Guarantee Company, hold no shares.

It is very important to note that non-shareholding members of a Hybrid Company own their rights in common, and enjoy the economic rights in common. They are mutual members. It is this mutuality that prevents a member having any defined interest and therefore can escape taxation. If defined rights are required for a class of members, they will receive their rights through redeemable shares.

Structured as a Private Foundation

Members

The constitution is designed so that there are at least two, and possibly three or more classes of members:

- the Shareholders, who are the 'Controlling Members'. The Controlling Members are usually professional trust administrators, in whom are vested all the voting and administrative powers. **They have no right to benefit from the Foundation in any way whatever.** The sole function of the Controlling Members is supervisory. They elect the Directors. Such Members are usually the Trustees of a Purpose Trust set up for this specific purpose. (CM Skye will provide these);
- the second Class will be Beneficiary Members. They have no shares, and no voting rights (other than where their rights under the constitution of the Foundation are to be changed). However, they can receive distributions by the Foundation, at the discretion of the Directors. If there are no Beneficiary Members, the Directors have the power to select appropriate beneficiaries for election as beneficiary Members in the future. The ability of the Directors to exercise their choice can be restricted as the clients may choose;

- an optional third class of non-shareholding member could be the 'Founder Members'. This arises where the Foundation is set up by a Founder to hold family or Private assets, and where it is wished that the descendants of the Founder are to have defined rights in perpetuity. These rights could include the right to liquidate the Foundation, or the exclusive right to nominate directors, or other rights, depending on the requirements of the clients, and the law in their country of residence. They can also be Beneficiary Members. 'Founder Members'; can have special voting rights to appoint Founder Directors (see below);
- where it is wished for a person to have a fixed interest (as opposed to having rights at the discretion of the Directors), this is done by creating one or more special classes of participating Shareholders. Such shareholders would have fixed rights to participate in distributions, and the shares would be redeemable thereby enabling them to receive their 'share' of the capital assets at the appropriate time.

Directors

The actual management of the Foundation is carried on by the Directors.

Normally, there is one class of Directors, appointed by the Controlling Members. However, there can be a class of Founder Directors, with a special status.

The Directors are always elected by the Controlling Members.

Protector

It is often desirable to make provision for the appointment of a Protector, who would be either an officer of the company or a special class of non-participating member (depending on the powers he is to have), with the power to supervise the Foundation and power to veto the election of members and the disposal of assets. The Protector should be an independent third party, with a relationship with the potential Beneficiary Members, so that he can both protect their interests, and also advise the directors when so requested.

The consent of the Protector may be required for any changes to the constitution, the election of Beneficiary Members, and for other matters.

Funding the Foundation

The Foundation can receive assets as a gift. Normally, the Founder will transfer the assets to the Foundation as a donation, or as an initial subscription payable upon election as a Founder Member. (Although Members of a Foundation are usually elected into membership without any requirement to subscribe capital, the assets being transferred into the Foundation could be injected as the capital subscription of a new Founder Member). There is no prescribed minimum or maximum amount- a Member can be elected without the payment of any capital subscription whatever.

In Brief

The Founder transfers the assets or rights to be owned by the Foundation into the Foundation. Beneficial ownership of the assets vests in the Foundation, and the Board of the Foundation now exercises control over the assets or rights.

The Foundation may have two or more types of Members, which include:

- controlling members, **who have ultimate control, but have absolutely no right to benefit**, but who appoint the Directors. They are shareholders;
- Beneficiary Members, who have the right to benefit, but no management rights. They hold no shares.

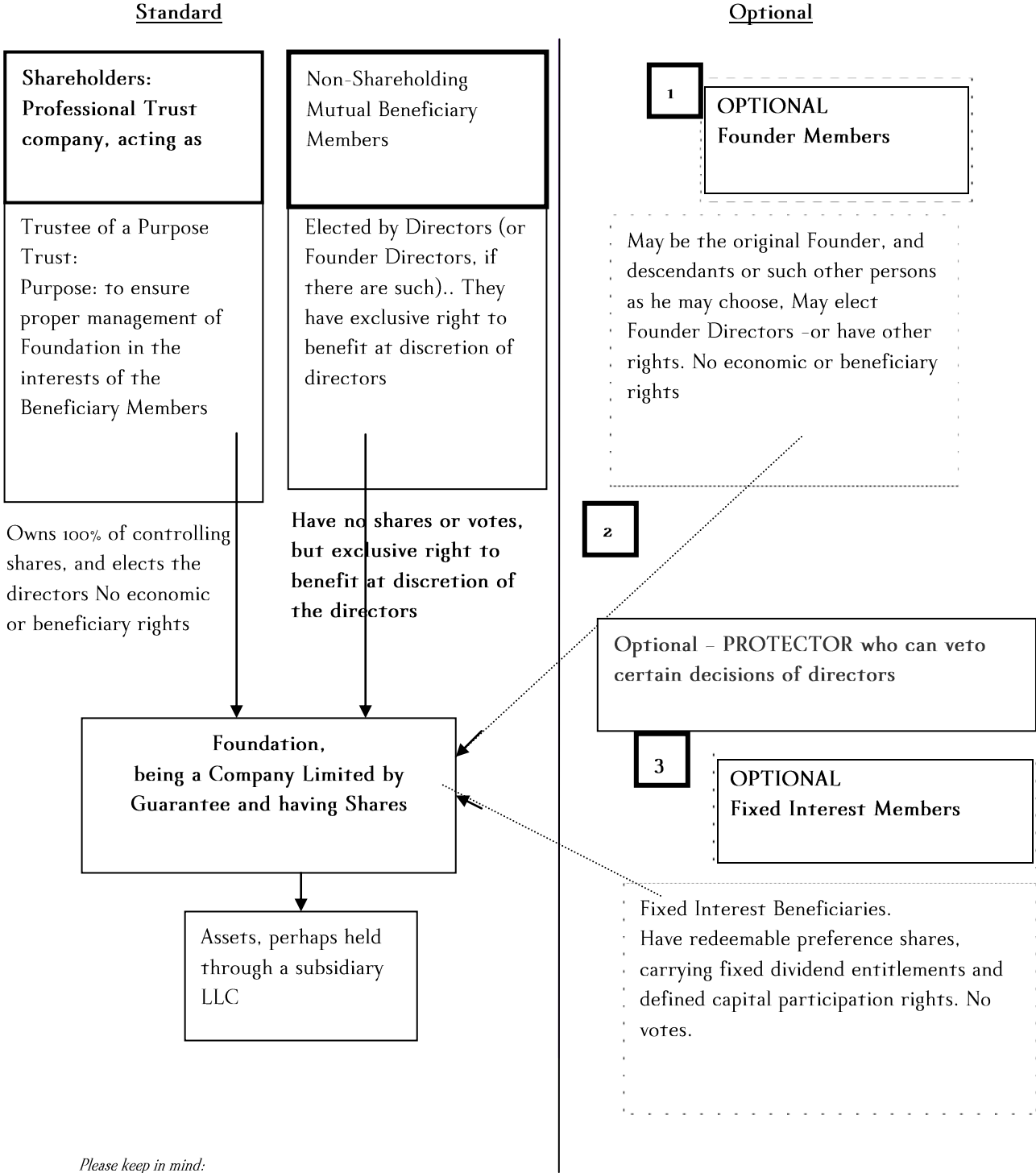
Exchange Control

Beneficiary Membership does not give rise to any property interest or any negotiable or transferable security, and thus is not subject to Exchange Control regulations on those grounds. Where no transfer takes place, there is no Exchange Control reporting requirement.

Controlled Foreign Company/Corporation/Entity

Properly set up, because Beneficiary Membership is a 'mutual' membership, it does not give rise to any property interest or vote and thus cannot lead to the Foundation being a Controlled Foreign Company or Corporation or Entity. (For US tax purposes, however, a Foundation will normally be characterised as a Trust, and should be reported as such. This is unique to the USA.)

Illustration of simple Foundation structure



Please keep in mind:

The contents of this material are not intended to provide anything other than general information as to the issues addressed. This material is confidential and may contain proprietary information, and its contents may not be disclosed, copied or otherwise made available to any person without prior consent.

This material is distributed with the understanding that it is not rendering accounting, legal or tax advice.

Additional information is available upon request from CM Skye at Commerce House, 1 Bowring Road, Ramsey, Isle of Man, IM8 2LQ. Email: office@cm-worldwide.com