

Hybrid and Guarantee Companies - British Virgin Islands

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Introduction

Guarantee Companies that are not authorized to issue shares, are often used to incorporate clubs, such as sporting clubs, or associations where the benefits of limited liability are desired. An easy mechanism is required for members to join (no shares transfer required). Pure guarantee companies have very few commercial uses and applications.

Guarantee Companies that are authorized to issue shares, the so-called "hybrid" companies, must have at least one guarantee member and may have one or more shareholders. The liabilities of guarantee members and shareholders of a hybrid company are the same as they would be in a pure guarantee company and a company limited by shares, respectively. Hybrid companies are highly flexible entities and are often used where it is desired to split ownership, control and economic rights (with two categories of members). Hybrids are considered tax minimization vehicles and can be used for timeshares.

Hybrid Companies

The term "Hybrid Company" describes a company that is both limited by guarantee and has a share capital. Thus a Hybrid Company has two classes of members - Shareholders and Guarantee Members. The term "Shareholder" is familiar and well understood. The term "Guarantee Member" is less common, although clubs or societies may be structured as companies limited by guarantee and thus having Guarantee Members.

A Guarantee Member is elected into membership of the company by the directors on condition that the member undertakes to contribute to the debts of the company up to a certain specified maximum amount - often US\$500 or less. Thus a Guarantee Member holds a contingent liability - an obligation - in contrast with a shareholder who holds an asset - the shares. Guarantee Members may also make contributions of capital to the company through Membership Fees. This, as well as loans to the company, are the two main ways of getting capital from the Guarantee Members into the company.

The rights and obligations of each class of membership may be set out in the Articles of Association of the company. Alternatively they may be set out by the directors in board meetings if there is a desire to keep the terms and conditions of membership confidential. The rights and obligations that attach to each class of membership can be drafted to suit virtually any requirement.

Hybrid companies are often used as quasi trusts, particularly by persons resident in civil law countries that do not recognize trusts. As with trusts, hybrid structures may be useful for asset protection, tax planning (including estate tax planning), confidentiality and the avoidance of forced heirship rules.

When used as a quasi trust, the hybrid company is typically structured with the Shares each carrying one vote but having no rights to dividends and no participation in the capital or income of the company in any way. The Guarantee Members have no voting rights but participate fully in the income and capital of the company. (They may be given as many or as few rights as is necessary to comply with the relevant regulations in the client's home jurisdiction.) In this way control of the Company legally rests with the Shareholders, but all benefits flow to the Guarantee Members. The shares are then issued to professional managers, who have legal ownership of the Company and its assets but are unable to receive financial benefit from holding the shares. All of the financial benefits flow to the Guarantee Members. This has the effect of creating an entity much like a trust but within a corporate framework, with the Shareholders taking the role of Trustees and the Guarantee Members that of Beneficiaries.

Further, the interests of the Guarantee Members may be structured to have the right of survivorship. In this case, upon the death of a Guarantee member the remaining Guarantee Members retain all of the rights and benefits of Guarantee Membership among them. By eliminating a Guarantee Member's interest on death, succession problems are eliminated, probate requirements removed and therefore this may eliminate any inheritance tax/estate duty implications.

The income tax statutes of many 'onshore' countries, and in particular any related anti-avoidance provisions, often seek to tax undistributed profits of companies in low tax jurisdictions as if they had been distributed to the shareholders. This goal is approached in different ways but there is often a focus on the percentage of *shares* held. Alternatively, the legislation may focus on the *control* of the company, even if control is achieved otherwise than through the ownership of shares. However, in the organization of a typical Hybrid Company as set out above the Guarantee Members do not own shares nor have control. Rather, professional managers act as shareholders and have legal control of the Company. This may make the typical anti-avoidance legislation ineffective in taxing profits accumulated within a hybrid structure. Additionally, such a structure may not bring about any reporting requirement for the Guarantee Members so unwanted attention from onshore revenue authorities may be avoided.

In some estate tax situations, a variant of the above structure that does not require the use of professional managers might also be considered. In this case the Guarantee Members would be the older generation, who would retain control of the company and perhaps receive payment of some or essentially all of the profits of the business while they were alive. The younger generation would be the Shareholders. The interest of each Guarantee Member would be eliminated on death. Therefore, after the death of the last remaining Guarantee Member, the Shareholders would be the only remaining members of the company and would own it completely. But as with many income tax statutes, estate tax legislation often identifies the owners of a company as the Shareholders of that company. To the extent this is true, notwithstanding the powers exercised by the Guarantee Members during their lifetime, the Shareholders of the company have always been the legal owners for estate tax purposes. As a result, the elimination of the interest of the final Guarantee member on death and the ascendancy of the Shareholders may not constitute a taxable event, as it may be considered that there is no change of ownership for estate tax purposes.

A Hybrid Company may also provide a means of overcoming difficulties caused by Exchange Controls. Although a Guarantee Member would normally be issued with a membership certificate, this is not a share, a stock or a security. Since most Exchange Control regulations refer to securities, the holding of a Guarantee Membership may not require Exchange Control approval.

Guarantee Companies

A guarantee company is a company which is limited only by guarantee and therefore has no shareholders, only Guarantee Members. The comments made above about the Guarantee Members of a hybrid company apply equally to this type of structure so the guarantee company can be used for similar purposes. However, the Hybrid Company may have an advantage in that it may be beneficial to be able to point to the fact that control rests with a third party (i.e. the shareholders).

In a guarantee company the Guarantee Members, rather than shareholders, would hold the voting rights and therefore the control. Thus the members may not so easily be able to sidestep the anti-avoidance legislation and Exchange Control regulations of some of the onshore countries.

Main Objects/Purpose of the Company

The company limited by shares is the most common type of BVI company which is unlike the guarantee and hybrid companies.

There is a company type which is limited by guarantee but is not authorized to issue shares. The most common purpose of this type of company to be used by non-profit organizations.

There is also a company type limited by guarantee which is authorized to issue shares. This type of company, called "hybrid" type of company, offers a better flexibility with regards to the structuring of transactions.

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The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve Management Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.