

The potential uses of Cayman LLCs

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Introduction

On 18 December 2015, the Limited Liability Companies Bill, 2015 (the **Bill**) was published in the Cayman Islands. The Bill is expected to be enacted in early 2016, although commencement of the law is expected to be delayed until a later date in 2016.

Once the Bill becomes law, a new class of Cayman Islands entity, the limited liability company (LLC), will be available for use. The LLC is loosely based on the Delaware limited liability company with various amendments, resulting in a hybrid between an exempted company and an exempted limited partnership.

This article examines briefly some of the potential uses, the need for clear conceptual understanding of the underpinnings of the law and the importance of careful drafting.

Differences between a Cayman LLC and a Delaware LLC

Although the Cayman LLC is loosely based on the Delaware LLC, it is important to bear in mind when drafting an "LLC agreement" (this is the name given to the constituent document for a Cayman LLC) that there are important differences between the legal traditions of the Cayman Islands and Delaware. We mention but one - the concept of "good faith".

As presently drafted, section 26(4) of the Bill provides:

(4) Subject to any express provisions of an LLC agreement to the contrary, a manager shall not owe any duty (fiduciary or otherwise) to the limited liability company or any member or other person in respect of the limited liability company other than a duty to act in good faith in respect of the rights, authorities or obligations which are exercised or performed or to which such manager is subject in connection with the management of the limited liability

company provided that such duty of good faith may be expanded or restricted by the express provisions of the LLC agreement.

This provision is obviously intended to maximise flexibility in the drafting of an LLC agreement - in the same way as the Delaware counterpart does. But what does “good faith” in this context mean?

Section 18-1101(d) of the Delaware Code similarly allows an LLC agreement to provide for the limitation or elimination liabilities for breach of contract and breach of duties (including fiduciary duties) on the part of a manager and others, but with this important proviso: “that a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing”.

In construing the meaning of “good faith” in section 26(4), any guidance offered by section 18-1101(d) of the Delaware Code would need to be approached with the utmost care for the following reasons:

- The Delaware concept of “good faith and fair dealing” is an implied contractual duty that has no equivalent in English common law applicable in the Cayman Islands. English law does not recognise a general implied duty of good faith in contracts.
- In the nearest English/Cayman equivalent to an LLC - a partnership, good faith describes a broad-based fiduciary duty.

Comparison of these concepts risks comparing apples and oranges.

The lesson is this: the preparation of an LLC agreement for a Cayman LLC should be a nuanced exercise in which reliance upon any Delaware precedent is approached with the utmost care.

Possible uses of Cayman LLCs

With this caveat in mind, let us consider some potential uses of Cayman LLCs. Commentators have already identified some potential uses, so the following list is not intended to be exhaustive.

Incorporated JV

Increasingly, the Cayman Islands have been a popular jurisdiction for incorporated joint ventures i.e. ventures where the JV participants carry on the JV business through a corporate vehicle.

Subject to an important proviso, an LLC may be preferred in future. The proviso is this: under section 9(1) of the Bill, an LLC must not carry on business with the public in the Cayman Islands,

except in furtherance of the business or affairs of the LLC carried on outside the Islands; an LLC is, however, able to effect and conclude contracts in the Islands and to exercise in the Islands all of its powers necessary for, or ancillary to, the carrying on of its business or affairs outside the Islands.

An LLC would have the same advantages as a company; it will be a body corporate (with legal personality separate from that of its members from time to time) with the usual attributes of a body corporate, namely: perpetual succession; the capacity to sue and to be sued, and to defend legal proceedings in its name; and the power to acquire, hold and dispose of property (see section 9(3)). But, an LLC could offer additional advantages not available to (say) a Cayman exempted company. Without being exhaustive, they could include the following (depending on the drafting of the LLC agreement):

- partnership-like treatment of profits and losses allowing, for instance, for ease of distributions without having to satisfy the onerous capital-maintenance rules applicable to companies (see, generally, Part 6);
- pass-through treatment of profits and losses for tax purposes, although (as appears below, under the heading “Other considerations”) this may be subject to very careful drafting (see, generally, Part 6);
- by contrast with a Cayman company, the ability to stipulate in the LLC agreement that a person appointed to a board or committee by a particular member may act in the best interests of that member rather than the LLC (see section 26(6)(b)); and
- by contrast with a Cayman company, the increased flexibility to specify the extent of duties of board members (see, generally, Part 7).

For a Cayman exempted company that currently acts as a JV company, consideration should be given to converting it to an LLC (see section 56).

Securitisation SPV

At present, a Cayman special purpose vehicle (**SPV**) often takes the form of a Cayman exempted company in which all of the shares are held by a Cayman STAR trust. This structure achieves the following objectives:

- Limited liability
- “Orphan” status, with the shares being held by a purpose trust so that the underlying asset pool being securitised is off balance sheet and not consolidated with the originator
- Bankruptcy remoteness, including limiting the objects and powers of the SPV to allow it to only enter into the specific transactions related to the securitisation.

Going forward, all of the above could be achieved with a Cayman LLC, but its increased flexibility could make it more suitable as an SPV than an exempted company. For instance, the fact that the STAR trust would hold a membership interest rather than shares arguably makes it better suited to achieving “orphan” status.

Holding company

A Delaware LLC is frequently the vehicle of choice to act as the holding entity of a corporate group.

The Cayman Islands have key advantages that contribute to its entrenched status as a leading international financial centre, such as tax neutrality, legal respectability (grounded in the application of common law, with the Privy Council at its apex) and a pro-investment culture. Undoubtedly, there will be circumstances where these advantages make the case for a Cayman LLC to be preferred to a Delaware LLC.

Investment feeder fund

Some commentators have observed that a key driver for a Cayman LLC is the ability to provide greater symmetry with onshore vehicles. Take, for example, the common master-feeder structure with a US feeder and a Cayman feeder. If the US feeder were structured as an LLC, the ability to have an LLC for the Cayman feeder that was a close mirror of the US feeder would offer the potential for greater ease of administration, with consequent cost savings.

This potential for greater alignment may, however, not be realised to the extent that some commentators think. Our preliminary feedback from US counsel is that many will continue to use a limited partnership (rather than a Delaware or other US LLC) for the US feeder.

Other Considerations

On 1 July 2015, the UK Supreme Court handed down the landmark decision of *Anson v HMRC* [2015] UKSC 144 in which it unanimously held that a UK member of a Delaware LLC was entitled to relief under the UK/US double taxation treaty (the **Treaty**) for US tax paid on the profits derived from the LLC. The ruling reversed the decisions of the Upper Tribunal and the Court of Appeal and upheld the original First Tier Tribunal decision.

The key issue was whether, for the purpose of the relevant provision of the Treaty, the UK tax and the US tax in relation to the LLC’s profits were assessed in respect of “same profits or income”. The Supreme Court held that they were despite the fact that the US treats an LLC like a partnership (i.e. fiscally transparent) whereas the UK treats an LLC as a company.

The following lessons stem from this decision and the HMRC’s response to it (essentially, the HMRC takes the view that the decision is limited to its facts):

- First, whether a Cayman LLC will be tax transparent or tax opaque will be a matter for the relevant onshore jurisdiction, albeit based on findings of fact as to the nature of the entity in the light of Cayman law.
- Second, there may be a degree of flexibility under the onshore jurisdiction's tax laws to treat a Cayman LLC tax as transparent or tax opaque depending on the drafting of the LLC agreement. (In *Anson*, the Supreme Court placed emphasis on the automatic profit-allocation language in the LLC agreement to conclude that the LLC in that case was tax transparent.) Such flexibility is useful; it allows the desired outcome to be achieved through careful drafting, although it may come at the cost of increased uncertainty. For instance:
 - tax opaqueness may be preferred where the taxpayer seeks access to UK's grouping provisions or wishes distributions to be made by means of tax-exempt "dividends"; and
 - tax transparency may be preferred where the taxpayer seeks access to tax credits under a relevant double-tax treaty.

As far as the US is concerned, there is a high degree of flexibility anyway under the US's "check-the-box" rules.

- Third, drafting is key, especially as regards tax treatment for UK purposes.

The Cayman LLC will be a helpful addition to the offering of Cayman products available for structuring international transactions. It will not however replace the exempted company or the exempted limited partnership. Instead, it will provide a useful alternative to users of Cayman products. Additionally, potential users should be aware that whilst there will be similarities between a Cayman LLC and a Delaware LLC, there will also be material differences and careful consideration of these differences will be required.

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Meet the Author



Angus Davison

Partner

Cayman Islands

E: angus.davison@ogier.com

T: [+1 345 815 1788](tel:+13458151788)

Key Contacts



Joanne Huckle

Partner

Cayman Islands

E: joanne.huckle@ogier.com

T: [+1 345 815 1895](tel:+13458151895)



Nicholas Plowman 鄺國強

Partner 鄺國強

Hong Kong

E: nicholas.plowman@ogier.com

T: [+852 3656 6014](tel:+85236566014)



Nick Rogers

Partner

Cayman Islands

E: nick.rogers@ogier.com

T: [+1 345 815 1844](tel:+13458151844)



Justin Savage

Partner

Cayman Islands

E: justin.savage@ogier.com

T: +1 345 815 1816



Kate Hodson 律師 . 律師

Partner and Head of ESG (Legal) 律師

Hong Kong

E: kate.hodson@ogier.com

T: +852 3656 6049

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