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Using a Bahamian Company (an IBC) Limited by Guarantee Without a Share Capital (a "CLG") As a Trust Substitute

NOTES FOR ADDRESS

Introduction

The focus today is on a legal creature that has actually been around for quite some time under our law – well more than 50 years, in fact; a legal creature that is superbly adaptable to a wide variety of succession/estate-planning/wealth management applications. It's a structure that gives all of the practical advantages of a trust – or a will - but without actually creating a trust or a will. In this sense it may really be one of those rare instances where you actually get to have your cake and eat it too.

But before delving into the heart of my topic today, some background-observations about trusts and the offshore trust industry are in order.

Firstly, the search for trust-alternatives has become more appealing in recent times due to the emergence of tax-driven disclosure/reporting regimes in certain onshore jurisdictions; regimes that are focused on offshore trusts but less so on stand-alone companies.

Secondly, the rising level of trustee accountability under traditional trust structures has also spurred the search for alternative structures that can achieve the same estate or succession planning/wealth holding benefits of a trust but without having to contend with all the exposure-burdens, idiosyncrasies and inherent complexities of trusts.

Thirdly, having regard to the increasing dominance of Latin American, Middle Eastern and to a lesser extent, Eastern European, markets in the Bahamian financial services industry, the trust is really a bit of a dinosaur now. The countries that make up these new dominant markets are nearly all civil law jurisdictions where the trust concept is alien to the jurisprudence and the subject of endless bewilderment for the end-users (the clients). There's a basic problem of familiarity here. Most clients in these markets simply don't understand the trust. *(It should perhaps be recalled that when the offshore trust industry started in The Bahamas in the late 1930's early 40's with the emergence of The Bahamas*

General Trust Company for well-heeled clients-cum-tax emigres like Sir Harry Oakes, and as it grew even robustly in the post-War period (40s through the 60s), it was predominantly for clients from common law countries – the U.K. Canada and the U.S. Only later (in the 70's) did the centre of gravity begin to tilt more towards continental Europe with the arrival of the Swiss and French banks. In the last two decades or so, however, there has been a much more radical geographical re-alignment of the industry: all of North America (U.S and Canada), the UK, and virtually all of continental Europe are now not only no longer the dominant markets, they are essentially off-limits because of the tax-based aggression of the G-8 and their satellites such as the OECD. Latin America - largely tax-neutral and civil law-oriented - has become the major point of focus for the industry.

While the trust concept may be alien to the new markets of the financial services industry of The Bahamas, companies, by contrast, are universally recognizable legal constructs - as familiar to persons in civil law jurisdictions as in their common law counterparts.

Moreover, the concept of a company as a distinctive legal entity is much more readily grasped by just about everybody, whether they be in civil law countries or in common law territories. This is to be contrasted with trusts which are not entities at all under our law but rather a complex of intersecting relationships triangulated between a settlor, a trustee and the beneficiaries, with lots and lots of moving parts and with a superstructure, built up piecemeal over the centuries largely by case-law, of complex rights and obligations in relation to the holding, management, investment and disposition of the trust property. Really complicated stuff, not readily comprehensible to the multitudes!

Another thing : curious though it may sound, the trust is becoming increasingly less important to the modern trust structure in any event. Nowadays the main theatre of action in most trust structures is not the trust itself but what we colloquially refer to as "is the underlying company".

Note: typical trust structure:

- A trust company at the top, which in turn has
- a nominee-company that will own the issued shares in
- another company that hold the trust assets ("the underlying company")

The reality today is that in many trusts (perhaps even the majority) the only real activity that takes place at the trust level is the receipt and then distribution to beneficiaries of the dividends and capital distributions that are periodically upstreamed from the underlying company to the trustees as shareholders of the latter.

So, given all this, has the time perhaps come to move away from the alien, unwieldy, risk-prone, and increasingly irrelevant trust structure towards a single corporate entity,

one that encapsulates, even clones to some extent, the best of the trust concept but without actually creating a trust? Why not create a more compact, more streamlined, more manageable structure that can do the best of what the trust structure can do but without all the hassles. Why not indeed?

Enter the company-limited-by-guarantee-without-a-share-capital (a "CLG")

What is a CLG?

It's :

- a company (either an IBC or regular company)
- with no share capital (although a hybrid – viz. company limited both by guarantee and shares – is also possible)
- thus a company with no shareholders, only members
- with limited liability, liability being "limited by guarantee"….." viz. the members agree that in the event of the company's winding-up, they will "guarantee" payment of the company's liabilities by contributing a specified sum but no more. (Historically, this cap has always been so low as to make the guarantee essentially illusory : one dollar ($1.00) or even the lowest coin of the realm, one cent ($0.01)).

The CLG, it bears emphasis, is not some Johnny-come-lately, untried, smoke-and-mirrors invention of the offshore world. Rather, it has a most respectable pedigree in the mature onshore common law-based jurisdictions, including England, Ireland, Canada and Australia.

Indeed it should be noted that :

- Many onshore sporting bodies, charities and non-profit organizations, clubs and the like, have long been organized as CLGs, e.g PGA European Tour, Cricket Australia, OXFAM.

- CLGs have also had a variety of commercial applications in the onshore world: e.g. the parent organization for Deloitte is a private UK-based CLG. High Speed 2, the massive railway project in UK, is another example.

- Here in The Bahamas, we have had CLGs for well more than 50 years. They are available for the same sort of charitable, non-profit and commercial purposes of the kind just described but they are also available for any number of other purposes as well, including using the CLG as a structure to hold and manage private wealth for families or HNWI and to do so, moreover, with the same degree of privacy and convenience that would apply to to any other type of Bahamian company.

Important Features of a CLG

- A CLG, as previously stated, in common with most companies, possesses full legal personality (unlike a trust which, as previously noted, is not a legal person at all).
- As is true for all limited liability companies, a CLG's legal personality is separate and distinct from the members of the company (the Saloman v. Saloman principle), one consequence of which is that the company's assets belong to the company itself and not its members. Of equal importance, the debts and liabilities of the CLG are not attributable to the members of the CLG. Instead, the debts and liabilities are enforceable only against the CLG itself.
- As the CLG has no authorized capital for division into shares, the membership is not equity-based in any conventional sense. The members can honestly say that they do not own the assets of the company.
- It is, however, perfectly permissible to organize a CLG on the basis that its assets are to be used solely for the care, maintenance, welfare and benefit of its members. In this regard, S. 9 of the IBC Act provides that an IBC has power *"to protect the assets of the company for the benefit of the company, its creditors and its members and, at the discretion of the directors, any person having a direct or indirect interest in the company."*
- The duties of the directors of a CLG are owed to the company itself, not to the members of the company - unlike trusts under which the trustee's duties are always owed directly to the beneficiaries.

Modelling a CLG on the standard discretionary trust but without creating a trust

A CLG can be developed along lines that very closely simulate the discretionary trust model but without actually creating a trust.

Looking at how a CLG can be structured with that in mind:

For the purpose of this exercise, one should imagine a CLG that is organized with three (3) classes of membership (entirely optional, of course but let's say there are three distinct classes of members - but remember not shareholders!) : Class A, Class B, and Class C members.

CLASS A MEMBERS

- The Class A member would be the equivalent of the trustee under a typical trust. (Typically, this would be a nominee company owned by a licensed trust company).
- The Class A Member would be the director (perhaps even the sole director) of the CLG.
- The Class A Member would have all the voting rights of the Company.

- As such, the Class A member would generally be vested with sole authority and power:

    - to decide how the underlying assets of the CLG are to be deployed for investment purposes (but with power to delegate this investment power to another person if so authorized by the CLG's Articles of Association);

    - to decide how and when the assets are to be distributed among all or any one or more of the Class B members, or how they are to be otherwise used for any of the other authorized purposes of the CLG (which would be set out in the objects-clause of the Memorandum of Association).

It needs to be stressed that this is just one of many possible permutations. The powers of the Class A Member, relative to the other classes, can, of course, be increased or diminished in accordance with the relevant client's particular requirements, the IBC Act affording maximal structuring flexibility in this regard.

Class B Members

Turning now to the Class B members:

- They would be the equivalent of the beneficiaries under a trust. They could, for example, include the person who would ordinarily be the grantor/donor/ settlor under a typical trust, his spouse; and his issue – although any variation is possible.
- Class B members would typically have no powers or rights of any significance. Instead, they would merely have the possibility or prospect of being designated by the Class A Member as a recipient of a donation from the company. However, they would have no legally enforceable entitlement in this regard (although if such an entitlement was desired it would be an easy matter to provide for it). This non-entitlement of the Class B Members to the underlying assets of the CLG would approximate, of course, the position of beneficiaries under a standard discretionary trust.
- Structuring along these lines can go even further : rather than creating any Class B members at the outset, the Articles of Association of the CLG could instead merely authorize the Class A Member to elect one or more Class B Members from time to time from among a class consisting of (say) the client's spouse, children, etc). As soon as they receive what they are intended to have, they can be shipped out, as it were. Thus, it's possible to have a Class B membership that is not permanent at all; they come and go, thereby eliminating the concerns for "beneficiary rights" that are an intrinsic feature of trusts where the beneficial class is usually stable.

- To enhance privacy (bearing in mind that a company's constitutive documents are on public record at the Companies Registry), there could perhaps be a single class B Member – another company - with the intended "beneficiaries" being members of this second company rather than bringing them onto the record as named Class B Members. In such a case, the Articles could authorize the Class A Member *"to elect one or more Class B Members from time to time from among a class consisting of the persons who are from time to time the members of XYZ Limited"* (XYZ Limited in this example being the holding company for the intended "beneficiaries"). The beauty of such an arrangement is that the potential Class B members (the equivalent of discretionary trust beneficiaries) could honestly and truthfully state that they have no proprietary interest in the CLG. That would be completely true under Bahamian law as they would have only a hope of becoming Class B Members and thus only a hope of receiving some benefit.

- Another variation of Class B Membership could serve as a kind of "will substitute", similar to the old "mini-trust" or the "interest-in-possession" trust paradigm under which the settlor would be the only beneficiary of the trust during his lifetime but upon his death, the beneficial class would automatically enlarge to embrace his intended heirs (thereby avoiding the need for any probate). This same concept could be used in a CLG, so that upon the client's death, the intended heirs would automatically become Class B Members.

Class C Members

Finally, there would be the Class C member (s) of the CLG. Conceptually, this person (or it could perhaps be a group of persons such as a family council, or another company comprising such persons as members) would essentially have the same powers that would ordinarily be reserved to the settlor or protector under a trust.

The key idea here would be to creates checks-and-balances on the powers of the Class A member, such that the Class C member would have ultimate control, including, for example, having the following special powers (which again are similar to commonly reserved powers of settlors and protectors under trusts):

- the power to remove the Class A Member and appoint a new Class A Member (equivalent to the power to remove and appoint new trustees under a trust);
- the power to add or remove persons to or from the Class B membership (equivalent to the power to change beneficiaries under a trust ;
- the power to require certain types of decisions of the Class A member to be made only with the Class C Member's prior consent;

- the power to direct that the assets of the CLG be transferred to another company or even another trust or foundation
- the power to export ("continue") the CLG from The Bahamas to another jurisdiction (equivalent to the power to move a trust to another jurisdiction);
- the power to amend the Memorandum or Articles of Association (or, alternatively, to require the Class C member's consent before the Class A Member could amend the same) – equivalent to the power to amend under a trust ;
- the power to approve the delegation of certain powers, e.g. appointment of investment advisors to the CLG.

There could be any number of variations of what I have just outlined. For example, where the client wishes to use the CLG as the equivalent of a revocable trust, this could be achieved rather simply by providing in the CLG's constitutive documents that in the event of a winding-up, the net assets are to be distributable solely to the client (or his designated holding company), or as he might otherwise direct. Indeed the client could himself control whether or not the company goes into a voluntary winding up by making himself the Class C member and reserving the winding-up power on terms that only he (the Class C member) would be able to benefit on a winding-up.

Again, to enhance privacy, the Class C Member could be organized as another company in which the client or his nominee is the sole member.

Finally, it should be possible to structure the commercial relationship between the CLG and the relevant "service provider" – trust company, etc. - in much the same way as would be the case under a conventional trust relationship.

SUMMARY OF STEPS FOR CREATION AND OPERATION OF A CLG

The incorporation process is exactly the same as it would be for an ordinary IBC, including the following main steps:

- choice and formal reservation of legal name;
- preparation and signature of the constitutive documents by two "subscribers" (which could be the trust company's in-house nominee companies)
- submission of the CLG's Memorandum and Articles of Association to the Registry of Companies

Following incorporation, "first minutes" would be prepared, formalizing the appointment of the sole Class A Member which would automatically be the first and sole director of the Company under the Arts (unless, of course, other directors were required), and attending to the appointment of the Class C Member as well.

Resolutions (in lieu of meeting) of the Class A Member would then be prepared to:

- appoint the officers of the CLG (e,g. President, Secretary – all optional offices under the IBC Act);
- authorize and establish relevant bank and/or securities accounts for the CLG
- accept the donation of assets from the client : (NOTE: The funding process would be very similar to the funding of a trust. The relevant money or other property - the equivalent of the "Trust Fund" under a trust - would be contributed to the CLG by way of gift, and held by the CLG in an approved account. The gift (and there could be multiple gifts from various sources over the life of the CLG) could also be accompanied by the equivalent of a confidential letter of wishes from the donor expressing a preference (non-binding, of course) as to how he would wish the gift to be used or applied among the Class B Members. It would also be open to the benefactor to make the gift subject to certain restrictions.
- nominate and select the initial Class B Members (or possibly only settle the list from which they would be drawn)
- engage an Investment Manager or Advisor and/or other managers or agents of the CLG (if required);
- settle the terms of remuneration of the Class A Member/Director.

OPERATIONAL MATTERS POST-INCORPORATION

Periodic distributions (not dividends) to Class B Members would be made pursuant to the resolution of the Class A Members/Directors : NOTE : This would essentially approximate the case where trust assets are distributed under a discretionary trust except that here it would be the Class A Member that would pass the necessary resolution for the distribution to the relevant Class B Members, being guided in this regard by the equivalent of any letter of wishes that the benefactor/client might have given at the time of his gift to the company.

Changes in the Class A Members: Should need arise, the removal of a Class A Member and the installation of a new one (as well as, e.g., the appointment of additional Class A Members) could be effected by the Class C Member by resolution, if the Articles so provide.

Changes in the Class B Members : Class B Membership could also be made amenable to change from time to time in a way similar to the workings of a power to add and exclude beneficiaries under a trust.

Indemnities for Class A Members/Directors: These would be built into the Articles. The indemnities for directors (Class A members here) under the IBC Act (ref. S. 58) are not particularly robust but this weakness could be remediated by (a) securing indemnities directly from the client and/or (b) having the CLG take out insurance for its directors in accordance with S. 59 of the Act which permits insurance coverage of risks that fall outside the limited range of director-indemnification under S. 58.

Liquidation/Dissolution of the CLG : the Articles of Association might also give the Class C Member the power to put the CLG into liquidation, perhaps on terms that any surplus assets would be distributable among such one or more of the Class B Members as may be selected by the Class A Members (or perhaps the Class C Members) or, in the absence of any such selection, among the Class B Members equally.

Another possibility would be to provide that upon winding-up or dissolution, the surplus assets are to be distributed not to the Class B Members but to another company or - perhaps even a trust - having the same or similar purposes as the CLG, as determined by the Class A Members (or perhaps by the Class C Members) prior to the commencement of the winding-up or dissolution of the CLG.

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