HYBRID COMPANIES

The term "hybrid company" is used to describe a company which is limited both by shares and by guarantee so has two classes of members:- Shareholders and Guarantee Members. The former are familiar and well understood, the latter is less so although many sporting clubs or societies are structured as companies limited by guarantee and joining members become 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 - typically $2,500. As such a Guarantee Member holds a contingent liability, which is an obligation, and this contrasts with the position of the shareholder who holds an asset - the shares. The rights and obligations which attach to each class of membership can be laid down in the Articles of Association of the company or by the directors in board meetings thereby keeping the terms and conditions of membership confidential. The arrangements which can be made are infinite and flexible as the different rights and obligations which attach to each class of membership can be arranged to suit and skilful drafting can be used to create structures which are precisely tailored to the different needs of the client

Hybrid companies are often used as quasi trusts particularly by persons resident in civil law countries which do not recognise trusts. Typically the company will be structured so that the shares are issued on terms that each carries one vote but no rights to dividends or to participate in the capital or income of the company in any other way. The Guarantee Memberships would be issued on terms that they carry no rights to vote but all the rights to participate in the income and capital of the company. Thus all control rests with the shareholders but all benefits flow to the Guarantee Members. The shares can be issued to professional managers, who therefore act as quasi trustees, but unlike normal shareholders they cannot receive financial benefit from holding the shares. All financial benefits flow to the Guarantee Members who are therefore in a position not unlike the beneficiaries of a classical trust structure. Also, a Guarantee Members interest is extinguished on death so there are no succession problems, no need to obtain probate and therefore there will normally be no inheritance tax implications/estate duty.

The anti-avoidance legislation enacted by many onshore countries aims to tax the undistributed or untaxed profits of low tax paying companies as though those profits have been received by the shareholders. The different legislations achieve this in different ways but normally focus on the percentage of shares held or the control of the company if control is achieved otherwise than through the ownership of shares. Under the arrangements outlined above the Guarantee Members would not own shares nor have control - as professional managers act as shareholders - so it may be that *this type of anti-avoidance legislation is ineffective in taxing profits rolled up within a hybrid structure*. Additionally, it will normally be the case that such a structure does not bring about any reporting requirement for the Guarantee Members so, on a practical level, unwanted attention from onshore revenue authorities is avoided.

There are a number of offshore jurisdictions in which it is possible to form hybrid companies - the structures offered by both the Isle of Man and Gibraltar have been the subject of much recent interest - but the TCI hybrid offers perhaps the most flexibility and greatest advantage.

TCI Hybrid Companies

A Hybrid company (as referred to on this website) is first and foremost a company limited by guarantee. It differs from a standard Guarantee company however, in that it also has a share capital. TCI legislation makes specific provision for companies "limited by guarantee" and for companies "limited by guarantee and having a share capital".

Background

The concept of Guarantee companies having a share capital is derived from the development of company law in the UK and is familiar to practitioners in that part of the world. Guarantee companies and hybrids were originally intended to provide an alternative means of limiting the liability of the members in circumstances where a company had no capital requirements (where a Guarantee company could be used) or limited capital requirements (where a hybrid company could be used). As a term of membership members guarantee to contribute a fixed amount (e.g. US$100) to the assets of the company in the event that it has debts when it is wound up.

Application

Because Hybrid companies also have a share capital the voting control can be separated from the prospect of receiving distributions and/or participating in any liquidation. That is, the members of a hybrid company that hold shares can be exclusively entitled vote at general meetings, but can be precluded, under the articles of association from receiving distributions from the Board of Directors. The potential to receive distributions from the Board can be restricted to the client members, who would provide a Guarantee but do not take up voting shares.

The Articles of Association of TCI Hybrid Companies are drafted to separate management powers from the potential to benefit from assets contributed or accumulated by the Hybrid. When properly structured a Hybrid Company creates a relationship between the management and the contributing member/client which is similar in effect to that of a trustee and a settlor.

Notwithstanding that an individual is a member of a TCI Hybrid Company, when properly structured his/her position will be as follows:

- Not a shareholder
- Not a director or officer
- No voting rights or fixed entitlements to assets contributed
- No tangible control over dividends, loans or payments

Uses

Objectives which may be achieved by careful use of TCI Hybrid Companies include the following:

- Indefinite, legitimate deferral of capital gains tax in certain circumstances;
- Enhanced asset protection;
- Confidentiality of membership (exempted TCI Hybrid Companies benefit from the same high level of confidentiality as standard IBC's and are almost as simple and cost-effective to maintain);
- Avoidance of probate and estate costs.

By virtue of the above Guarantee Companies can clearly be useful as conduits for active investment enterprises and as shareholders in other structures, e.g. by structuring them as charitable foundations and utilizing them as shareholders of trustees to private family trusts.