What is a fund and why set up an offshore fund?

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November 2019, edited May 2020

Introduction

Many potential clients have come to us and asked to set up 'a fund' without really knowing how generally the term can be interpreted – i.e. what it really means! I wonder if you understand the term by its textbook definition, by virtue of funds you have been involved with, or as 'something your successful friend manages' and you want to emulate, or dare it be said, better them!

The often 'unknown known' with 'funds' is that in broad terms, unless you are offering investment to the public or beyond a close circle of friends and (ideally regulated) advisers, and unless a right of redemption is offered to the investors, funds do not need to be regulated and probably all they need is an investment company. So a 'fund' request in fact becomes a request for a basic company for Joint Venture or 'friends and family' investment purposes. Down go perceptions of high costs and lengthy time taken to be regulated (including fees of multiple professional advisers) and your 'fund' can be up and running in a day or two.

Textbook stuff

Investopedia defines a fund thus yet it is easy to see this does not cover the whole gambit of everyday professional usage of the term:

A fund is a pool of money that is allocated for a specific purpose. A fund can be established for any purpose whatsoever, whether it is a city government setting aside money to build a new civic centre, a college setting aside money to award a scholarship, or an insurance company setting aside money to pay its customers' claims.

On closer looking at specific legislation, in the BVI's offshore fund world (2^{nd} most popular globally after Cayman), funds are defined more precisely for practical purposes in the Securities and Business Investment Act 2010:

A "mutual fund "as defined under the SIBA, including a company or partnership which (i) collects and pools investor funds for the purpose of collective investment and (i) issues fund interests that entitle the holder to receive on demand or within a specified period after demand an amount computed by reference to the value of a proportionate interest in the whole or in a part of the net assets of the company or partnership

Why offshore?

Offshore, usually meaning 'low tax' is another misnomer. It usually conjures up sparsely populated desert islands with a few banks and law firms hoarding – and cashing in on - foreign money fair and foul. You may know that the UK is the largest 'offshore' (read: by policy, tax exempt) centre for currency dealing the world's largest industry by turnover. The US is indeed a haven for non-resident situations, e.g. Nevada and Wyoming – and due to FATCA disclosure requirements being monoliteral only, the US is still a wonderful place for the bad and ugly to hide money as the US (usually) won't automatically report account holders or Ultimate Beneficial Owner's account details to their home states ('go figure!'). We conclude that 'offshore' really means just 'beneficial situation for non-residents'.

So with 'offshore', low taxation is a given. On that basis, and given the perception witch hunt against smaller nations in the 'offshore game', one has to recommend not only well regulated jurisdictions but also ones which have not fallen foul of media blitzes (in some cases, justifiably) against 'offshore'. However the issue is more complex than it at first seems.

We therefore would direct clients away from the likes of Panama and we establish offshore funds in Delaware (US), UK, Luxembourg, Singapore as well as the classic 'offshore' hubs of Cayman and the BVI.

You may ask why it might be fair to be anywhere which is low tax and the answer is simply one of providing a fair, low tax playing field. Any solution using a higher tax jurisdiction might unfairly prejudice investor groups who would otherwise not suffer such high levels of tax e.g. from the Middle East, Hong Kong, Singapore, Russia.

Other reasons for choosing 'offshore' is that over 30 years of industry in the jurisdictions have attracted and developed stable, robust and efficient support services with former city lawyers (like the author!), accountants and financial advisors providing first class services within the popular jurisdictions such as the BVI and Barbados. Further, advisors are able to provide services within the 'offshore' jurisdictions at often half the cost due to reduced sunk costs.

Conclusion

Remember that a fund is a co-investment group which only requires regulation, other than for cosmetic posturing, if at least one right of redemption is offered or because members of the public may be offered to subscribe also…*

Offshore funds, whether regulated or not, play a vital role in investment globally which makes the heart of the world beat. They are not nefarious beasts to be feared and it is worth mentioning that these days have far lower cost barriers to entry (say $10,000-25,000). Whether they need to be regulated or not is a matter of form as well as structure and we would be delighted to be your guide in this process in due course.

*Note that in 2020 both BVI and Cayman began to require closed-ended funds to apply to and be regulated by their regulators. Recognition in the BVI for what is now a 'Private Investment Fund', for example, must be sought by July 2020.

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