

## **Choosing Your Offshore Jurisdiction—Avoiding Asset-Raising Pitfalls**

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### **Why Go Offshore?**

In today's environment, the process of establishing, launching and managing a hedge fund has higher barriers to entry than ever before...including higher costs. In the early 2000s, an initial capital raise of \$10 million could enable a new fund to get up and running with good prospects for further growth. In 2016, however, a fund starting with less than \$100 million will find it challenging to provide the resources and infrastructure required for long-term viability and to attract institutional assets. To meet this greater start-up price point, many managers are looking to access additional sources of capital outside their home marketplace. An offshore vehicle, either as a stand-alone fund or a feeder fund into an onshore master, is a way to accommodate these international investors.

The offshore fund will need to be “tax-neutral,” meaning the fund itself is not the subject of direct taxation, or significant levels of direct taxation, in its own jurisdiction, but there may be taxes applicable in the jurisdictions in which assets are held and investors may be required to pay tax on any income and capital gains where they are liable to tax in accordance with their own tax rules. Tax neutrality is offered by many international financial centres, including Bermuda. The use of offshore funds is not novel; indeed, if you are investing or trading internationally, or seeking to offer your fund to international investors, an offshore company is an essential building block for your business.

### **Not All Offshore Jurisdictions Are Alike**

In recent years, instances of fraud, money laundering and tax evasion involving some international financial centres have cast aspersions over the legitimacy of business done in such jurisdictions. Mainstream media, politicians and NGOs often do not differentiate between jurisdictions, meaning that “offshore” has become synonymous with illicit, illegal or immoral activities. This is simply inaccurate and

ill-informed. To be sure, some jurisdictions have enabled such crimes by having sub-standard laws and regulations, banking secrecy, and no international tax-treaty partnerships or cooperation agreements. But not all international financial centres are the same. The leading fund domiciles pride themselves on having efficient and effective regulatory environments, long-standing records of transparency and compliance, and expert service-providers who ensure ongoing operational management is carried out in accordance with the highest international standards.

It is therefore important, if you are considering launching an offshore vehicle, to be aware of what differentiates a “good” jurisdiction from a “bad” one. The choice of offshore domicile will also be one of the factors that investors consider important. Especially in today’s world, the reputation and sophistication of the jurisdiction where the fund is established is a strong indicator of its likely quality and longevity. An investor will feel more comfortable investing in an entity built on a solid foundation of established laws, commercially sensible oversight and recognised best practices.

### Why Bermuda?

Bermuda provides all the attributes and advantages that both managers and investors look for in a quality offshore centre.

**Convenient Location:** Bermuda is a self-governing British Overseas Territory, 650 miles east-southeast of Cape Hatteras, NC, with daily direct flights to US gateway cities, Toronto and London. The island is less than two hours from New York. Its favourable Atlantic Standard Time zone, between North America and Europe, makes it an ideal location for serving global markets, and is easily accessible by clients and investors for meetings, due diligence visits, etc.

**Globally-Respected Regulation:** Bermuda’s pragmatic, risk-based regulation has made it a business-friendly jurisdiction. Established in 1969, the Bermuda Monetary Authority (BMA) oversees all financial entities, from banks and hedge funds to captive insurers and reinsurance companies; it is a full member of the International Organisation of Securities Commissions (IOSCO), a member of the Group of International Finance Centre Supervisors, and a founding member of the International Association of Insurance Supervisors (IAIS). The BMA has signed agreements with most European Union (EU) member states on the Alternative Investment Fund Managers Directive (AIFMD), a pre-condition to allowing Bermuda-based AIFMs the ability to access EU markets. In early 2016, the EU awarded Bermuda full



equivalence with Europe's Solvency II insurance regulatory regime, and in July, gave Bermuda a favourable recommendation towards third-country passport rights under AIFMD.

**Reputation and Commitment to Compliance:** Bermuda understands and embraces the worldwide movement towards greater financial transparency and regulatory cooperation. Bermuda does not have laws that promote and protect banking secrecy. Bermuda complies with global anti-money-laundering directives and anti-terrorist financing standards. And Bermuda has had a central beneficial ownership register in place for 70 years that shares information requested by legitimate international authorities within 24 hours. Bermuda's 90-plus tax-transparency treaties with countries around the globe and 2016 adoption of the OECD's Country-by-Country reporting regime under Base Erosion & Profit Shifting (BEPS) standards underscore Bermuda's commitment to cooperation and compliance—these attributes have been differentiating hallmarks of the jurisdiction for decades.

**Tax Neutrality:** Bermuda has a unique tax system designed to support its own infrastructure. In relation to the establishment and operation of funds, it is tax-neutral in that there is no income, corporation or profits tax, withholding tax, capital-gains tax, capital-transfer tax, estate duty or inheritance tax payable by a mutual fund, an investment company, a unit trust or a partnership, or their respective shareholders, unit holders or partners, other than shareholders, unit holders and partners ordinarily resident in Bermuda. The island does have a consumption-based taxation regime that levies payroll tax, import duties, social insurance, and custom duties on goods and services. Where a fund has a physical presence in Bermuda, for example, by establishing a Bermuda-based investment manager, the employer and its employees would be subject to Bermuda payroll tax.

**Legal System and Commercial Court:** Bermuda's legal system marked its 400th anniversary in June, 2016. It is based on English Common Law, with recourse to the UK Judicial Committee of the Privy Council. In 2006, a dedicated division of the Supreme Court was established to preside over commercial cases; this has led to expeditious and well-reasoned judgements in fund disputes.

**Infrastructure:** Bermuda has secure, modern and world-class physical and technological infrastructure, including excellent telecommunications, broadband and a fully electronic Bermuda Stock Exchange. An example is that City of Hamilton businesses suffered no down-time after Hurricane Nicole, a strong Category 3 storm, hit Bermuda in October 2016.



**Access to Experienced Service Providers:** Bermuda’s sophisticated and collaborative business community contains a network of fund service professionals with extensive experience in alternative investment products, including hedge funds, fund-of-funds, private equity, venture capital, real estate, infrastructure funds, hybrid funds and insurance-linked securities (ILS) funds. Bermuda’s fund lawyers, administrators, auditors and tax advisors are well-versed in complex structures and strategies and have a long history of working together.

**History of Innovation:** Innovative legislative and regulatory developments implemented over the past three years have improved the island’s legal framework and invigorated Bermuda’s asset management industry. Legislation passed in October 2013 created two new categories of funds—known as Class A and Class B Exempted funds—which are easier, quicker and less expensive to incorporate. Since then, Bermuda fund launches have increased steadily, with BMA statistics showing incorporation numbers growing by approximately 10 percent year-on-year, with a majority of new funds being in the Class A and Class B categories. Today, the BMA has almost 800 funds on its register, and reports total assets under administration and management of almost \$200 billion.

New corporate legislation has kept the jurisdiction globally competitive amid ever-changing market demands. Recent reforms include changes to Bermuda’s partnership laws, and the passage of the Limited Liability Company (LLC) Act—which introduced a hybrid entity combining features of both corporations and partnerships. LLCs are commonly used in the US for private-equity funds and other asset-management structures, as well as trusts and private-client vehicles. Closely modelled on Delaware law, Bermuda’s LLC legislation is particularly attractive to US counsel and the new fund structure is expected to be a very popular vehicle for new funds and holding companies incorporating in Bermuda.

**Welcoming Environment:** Bermuda welcomes foreign companies and their employees, as exemplified by the Incentives for Job Makers Act and work-permit policies updated in 2015. Through the Incentives for Job Makers programme, there is a well-defined path to permanent residency for expatriate workers who meet certain seniority and other eligibility requirements.

## Conclusion

The future of offshore funds can be summed up in one word: regulation. Fund managers, investors and service providers need to embrace the trend of ever-increasing regulation, and stay ahead of the curve.



Offshore financial centres where these funds are based must stay current and compliant, if they are to remain part of the long-term economic landscape. The less sophisticated, lower-quality options are going to have short lifespans.

Bermuda intends to be one of the jurisdictions that evolves and stands the test of time. By keeping pace with the accelerating pace of global changes and committing to compliance with regulatory and financial reporting initiatives, Bermuda will be one of the offshore survivors. And for fund managers, this is important for their asset-raising objectives. International allocators looking to deploy capital will be most likely to invest in a fund established in a jurisdiction that instils a sense of comfort and confidence.

### **CONNECTING BUSINESS**

The Bermuda Business Development Agency (BDA) encourages direct investment and helps companies start up, re-locate or expand their operations in our premier jurisdiction. An independent, public-private partnership, we connect you to industry professionals, regulatory officials, and key contacts in the government to assist domicile decisions. Our goal? To make doing business in Bermuda smooth and beneficial. For more information, contact Sean Moran, Business Development Manager, [BERMUDA BUSINESS DEVELOPMENT AGENCY sean@bda.bm](mailto:sean@bda.bm). [www.bda.bm](http://www.bda.bm).

