

KEY FACTS
THE DELAWARE CORPORATION

The prestige enjoyed by Delaware as a corporate domicile is in part due to the emphasis which the state has placed in making its corporate laws, court system and infrastructure attractive to businesses. The success achieved by the state is reflected in the almost one third contribution to the income of the state government from registration and franchise taxes. Other frequently cited reasons for Delaware's popularity as a company domicile include:

- Delaware is the only state within the US to have a separate Court of Chancery whose judges are highly experienced in company law. The decisions of that court have established a body of law relevant to corporations which are frequently followed by other courts in the US.
- The Delaware General Corporation Law is used as a standard by which the corporate laws of other states are tested; it is the corporate code that is used in most US law schools to train lawyers which results in greater familiarity with Delaware corporate law among lawyers.
- Delaware does not impose a corporate income tax on corporations that are formed in Delaware, but which do not transact business in the state. Non-resident companies only pay an annual franchise tax to the state with a minimum of US\$175 payable annually.
- The large number of well-known companies with Delaware as their corporate domicile has influenced many small and medium sized companies to adopt the same strategy.

Advantages of Delaware Corporations

- No disclosure of the names of Shareholders.
- An individual can hold all corporate offices and be the sole Director.
- The annual state franchise tax is low.
- Meetings and records can be held anywhere in the world.
- Shareholders and Directors can act by written unanimous consent.
- No minimum capital is required in order to commence business.
- No residency requirements for Shareholders, Officers and Directors.
- Corporations can be established for any lawful act or activity.
- No state income taxes for corporations which do not transact business in the state.
- Special provisions can be included in the Certificate of Incorporation and By-Laws which exculpate Officers and Directors from personal liability and provide indemnification of Officers, Directors and Shareholders.

KEY FACTS
Delaware Corporate Structure

- The Certificate of Incorporation is the public document registered with the Office of the Secretary of State of Delaware on formation of a corporation.
- By-Laws are the regulations of the corporation as adopted by the Directors which describe the procedures by which the management of the company is to operate.
- The Stockholders are the owners of the company, but they do not manage the company. Typically, they hold common stock and have the right to one vote for each share they own. Only one Stockholder is required.
- The Directors manage the company and are responsible for the affairs of the company such as the issuance of shares, election of Officers and approving transactions. Only one Director is required.
- The Officers of the company are appointed by the Directors and handle the day-to-day business of the company. The Officers carry out the Board's decisions and implement the Board's policies. Officers are usually the President, Vice President, Secretary and Treasurer.

Foreign Ownership of Delaware Corporations

There are important tax and corporate governance issues relating to the ownership by non-US persons of a Delaware corporation. These are:

- No restrictions on foreign ownership or management of the corporation.
- Shareholders may be individuals or business entities of any nationality or domicile.
- With the exception of a Registered Office and Registered Agent in Delaware, no physical presence in Delaware is required.
- The By-Laws of a corporation are not a matter of public record.
- No disclosure in the public record of the names of the Shareholders of the corporation.
- The corporate records may be maintained outside the US.

As a corporation incorporated within the United States the company is required to comply with US Federal Tax and Reporting requirements. A Federal Tax Identification Number must be applied for and on an annual basis the company is required to file a tax return with the US Internal Revenue Service.

Note: Trident Trust is able to arrange for qualified professionals to prepare and file the company's tax filings.

Government Filings

A Certificate of Incorporation is filed with the office of the Secretary of State of Delaware upon the incorporation of the company which lists:

- The name of the corporation which must end with the words "Company", "Corporation", "Limited" or "Incorporated" or one of the abbreviations such as "Co.", "Corp.", "Ltd." or "Inc."
- The name and address in Delaware of the corporation's Registered Agent and Registered Office.
- The nature of the business or purposes to be conducted or promoted.
- The total number of shares of stock which the corporation shall have the authority to issue and any designations, preferences, rights, qualifications, limitations or restrictions on the shares.

On March 1st of each year, every Delaware Corporation must file an annual Franchise Tax Report and pay an annual Franchise Tax. The tax is based on the authorised share capital of the corporation and the Tax Report must include the names and addresses of the Directors and Officers. Late filing of the report and payment of the tax will incur penalties and interest which is compounded daily.

KEY FACTS
THE LIMITED LIABILITY COMPANY

The Limited Liability Company (LLC) is a modern tax transparent legal entity which combines features of partnership and corporate law. In the international context the LLC offers advisors and their clients the opportunity to cost-effectively combine access to onshore legal systems with the confidentiality and tax neutrality that is available in the traditional no tax corporate domiciles.

LLC legislation exists in industrialised countries such as the United States, France, Switzerland, Italy and Belgium, and in jurisdictions such as the Bahamas, Barbados, Cayman Islands, Cyprus, Jersey, Isle of Man and Nevis.

At present the Delaware LLC legislation is recommended more frequently by international advisors because of the prestige that Delaware corporate law, its courts and government infrastructure enjoy.

Trident Trust also offers clients LLC services in a number of other jurisdictions. Information on these services is available on request.

Instructions for Delaware LLC formation can be given to any Trident Trust office, the contact details for which appear on the last page of the Key Facts.

The LLC Concept

The Limited Liability Company has special features that distinguish it from ordinary companies. Like a corporation, an LLC has a legal existence separate and distinct from its owners. Like the Shareholders and Directors of an ordinary company, the members and managers of an LLC are not personally liable for the LLC's debts and obligations. The principal attractions of the LLC for advisors and their clients are its operation and tax treatment:

- Operationally the management of the LLC functions similarly to a partnership and is governed by a written agreement among the members of the LLC; this is different from the traditional corporate governance of companies where management is outlined in the Articles of Association (also known as Bylaws).
- A properly structured LLC will be treated by many tax regimes as a pass-through entity with tax being paid by the members and not at the LLC level.

The Delaware LLC

Each of the 50 states of the United States is constitutionally an independent legal jurisdiction with the right to enact laws in many areas of activity. Each state has enacted its own LLC statute with most states doing so after 1988 when the US Internal Revenue Service commenced issuing rulings that an LLC would qualify for partnership tax treatment. Among the states, the state of Delaware has emerged as the premiere LLC jurisdiction with approximately 25,000 LLCs being formed annually. The status of Delaware as the leading LLC domicile is linked in part to the important role played in the US by the Delaware corporate legislation and its Chancery Court in the development of American corporate jurisprudence. The influence of the Delaware corporate regime is evidenced by the fact that more than half of the companies on the Fortune 500 list and of the companies listed on the New York Stock Exchange are domiciled in Delaware. An equally important factor for Delaware's popularity as a corporate domicile is the pro-business role of the Delaware Government – specifically the office of the Secretary of State which is responsible for corporate formation.

Delaware does not impose an income tax on companies that are formed in Delaware, but which do not transact business in the state. Non-resident companies pay an annual US\$300 LLC fee to the state.

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Foreign Ownership of LLC

Important tax and corporate governance advantages to the ownership by non-US persons of a Delaware LLC:

- No restrictions on foreign ownership or management of the LLC. Members may be individuals or business entities of any nationality or domicile. Single member LLCs are permitted.
- With the exception of a Registered Office and Registered Agent in Delaware, no physical presence is required. The LLC management agreement is not a matter of public record and can be in any language. No disclosure in the public record of the names of the members or managers of the LLC.
- Non-residents of the US who are members of an LLC and who are not otherwise subject to US federal income taxation pay no tax in the US if the LLC's income is from non-US sources and the LLC carries on no business in the US.
- Foreign-owned LLCs are required to file Form 90.22.1 "FBAR" with the US Department of the Treasury to report interest in or signatory authority over a foreign financial account.
- The LLC's corporate records may be maintained outside of the US. The ownership interests in an LLC of an individual non-resident of the US are subject to the US estate tax, but can be avoided if the ownership interest is held through a foreign company.

Government Filings

- On formation the LLC files a Certificate of Formation with the office of the Secretary of State which lists:
 - The name of the LLC which name must contain the words "Limited Liability Company" or the abbreviation "L.L.C." or "LLC".
 - The name and address in Delaware of the LLC's Registered Agent and Registered Office.
- The LLC is not required to make any reports to the State of Delaware of its members, managers, Directors or income.
- If the LLC has more than one member it is required after establishment to apply for a Federal Tax Identification Number and on an annual basis to file an information return with the US Internal Revenue Service. Provided that there is no income earned from US sources that would be taxable by the US, the information return will reflect that the LLC had no taxable income for the relevant tax year. As part of our LLC management service we can apply for the LLC's Tax Identification Number and prepare and file the LLC's annual information return.
- If the LLC has only one member its existence as a separate entity can be disregarded for US federal income tax purposes. The single member LLC is not required to apply for a Federal Tax Identification Number nor file an annual information return.

Corporate Governance

A unique feature of the LLC legislation is that it allows members to define their business relationship in a written agreement which governs the operation and management of the entity. The policy of the drafters of the LLC legislation was to allow members of the LLC the maximum freedom of contract in the commercial context. As part of our LLC service we provide clients with a specimen LLC operating agreement for their use.

The members of the LLC may choose whether they wish to manage the entity or to appoint a member or a third party to be the manager. There is no requirement that members themselves be the managers of the LLC. A member acting as the manager or a third party acting as the manager is not liable for any debts or liabilities of the LLC solely by reason of that person being a member or acting as a manager.

The typical LLC agreement will address the following issues:

- Identifying the party responsible for managing the LLC.
- Rights and duties of the manager and any limitations or restrictions on such authority.

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- The economic rights of members, including the making of contributions to the LLC, the right to receive allocations of profits and losses, and the timing of and restrictions on distributions by the LLC to its members.
- Any special voting rights.
- Any classes or groups of members or managers with different rights, powers and duties.
- The issuance and transfer of interests in the LLC, the admission and withdrawal of members.
- Mandatory and non-mandatory purchase of interests in the LLC on the occurrence of specified events such as death, disability, resignation or expulsion of a member.

Where the operating agreement is silent on a management issue, the provisions of the LLC statute will apply.

Partnership Tax Treatment

Depending on the tax domicile of members it may be possible to provide through a written agreement of members for allocations of income and/or deductions of an LLC treated as a partnership among members on amounts which differ from the members' economic interests in the LLC as well as the ability to provide a tax basis to members for non-recourse debt. It also is permissible for the members to elect for an LLC to be treated as a separate corporate entity.

Uses for LLC

The LLC structure is particularly attractive as an alternative to the use of general partnerships and limited partnerships as the LLC provides all members with limited liability protection against claims of creditors. This protection benefits entrepreneurs and other start-ups.

- The pass-through tax character of the LLC means that for a single member LLC tax return preparation and reporting occurs only at the member level with resulting cost savings and administrative efficiencies for all businesses that can operate in an LLC structure.
- Venture capital, real estate and other types of joint ventures can take advantage of the ability to use the LLC operating agreement to allocate profits and losses among participants in a manner which reflects the business agreements they have reached.
- The ability to limit the life of the LLC can also be used effectively in joint ventures, start-ups and other projects with a transactional purpose that is for a specified time period.
- The LLC can be employed in the international context to achieve tax efficiencies where the income of an LLC is allocated among members from different tax regimes.
- It is not recommended to use the LLC structure to hold foreign bank and financial accounts due to the requirement to report on an annual basis with the US Department of the Treasury any interest or signatory authority over a foreign account.

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