

# Offshore fund vehicles

A transparent guide to making the right choice to maximise your fund's potential. By Philip Graham

## Introduction

One of the most common scenarios we encounter is a US-based manager who initially establishes a domestic fund to attract US taxable investors. With the performance going in the right direction, the manager begins to think about US tax-exempt investors, such as charities, pension funds and university endowments, as well as investors based outside of the US, who like the track record and want to invest.

They have probably then been made aware that they will need an offshore vehicle and now have the task of working out why, where, and how much they need to spend.

## Why do I need one of these?

US tax-exempt and non-US investors will want to avoid potential US tax exposure that could result from direct investment into your US vehicle and so they will want to come into an offshore "blocker" vehicle. To ensure you can take in their capital, you will need to add at least one offshore structure to form either the traditional "master-feeder" or the "mini-master".

## What is a master-feeder?

Here, we will create two new offshore vehicles. Your existing US fund will then contribute its assets into the offshore master fund upon the launch of the new structure. The offshore feeder vehicle will then be available to take in US non-taxable investors and the non-US investors and "feed" into the offshore master fund as well, allowing for a co-mingling of all of the invested capital in the most tax efficient manner.

## Sounds good, so what about the mini-master?

In a mini-master structure, a single offshore fund is established which is taxed as a corporation to benefit US tax-exempt investors and block UBTI for non-US investors.

Adding a single offshore vehicle saves cost and therefore has proven popular with startup and emerging managers. The offshore fund invests directly into the existing US fund, which will then act as the master fund (whilst remaining the fund into which the US taxable investors will continue to invest).

This provides an additional benefit of not requiring the ownership of the assets of the domestic fund to be transferred. This reduces the administration around the restructuring and subsequently the cost as well. While there are some tax consequences to be discussed (and some investors may not want to invest even indirectly into a US vehicle), it has proved to be appealing to those looking to keep it as simple as possible to begin with.

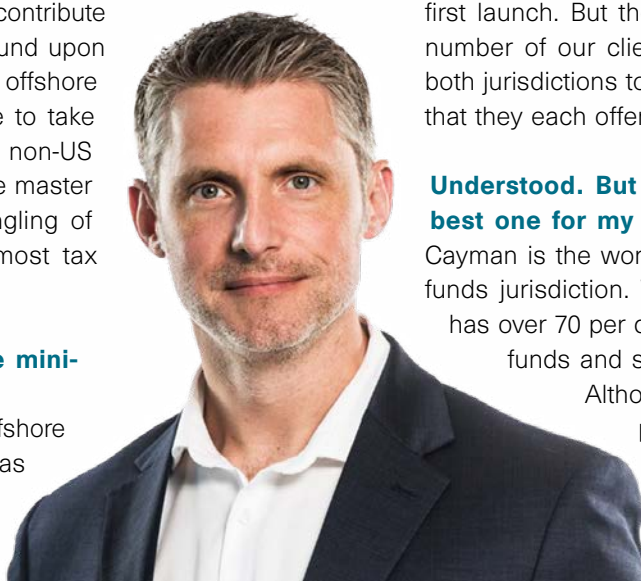
## Okay, so I need one of these structures. Where do I choose to set it up?

The British Virgin Islands and the Cayman Islands are both highly suitable and well-regarded offshore fund jurisdictions that have been used for many decades and always strive to meet the requisite international standards. We have long-standing clients who elected to use one or the other for different and highly sensible reasons at the time of their first launch. But there are differences, and a number of our clients have fund vehicles in both jurisdictions to maximise the advantages that they each offer.

## Understood. But how do I choose the best one for my fund?

Cayman is the world's most popular offshore funds jurisdiction. We estimate that Cayman has over 70 per cent of the world's offshore funds and so is the well-trodden path.

Although the BVI has around 15 per cent, managers who opt to establish their funds in the BVI sometimes encounter the additional question





from institutional investors of “Why BVI?”. Whilst there are very reasonable and logical answers, the selection of Cayman removes this additional query in the DDQ.

### **But I am also looking to minimise cost...**

In terms of corporate and regulatory costs, Cayman is a significantly more expensive jurisdiction than the BVI, both upon formation and for the annual maintenance of the vehicle(s). This is then compounded by the greater regulatory requirements in Cayman, which result in the cost differential for the jurisdictions being substantial.

For this reason, many fund managers who are operating with a relatively low level of AUM prefer to establish their offshore fund in the BVI to keep overheads down whilst they build a track record and the BVI has intentionally designed some fund products to do this very thing. The Incubator Fund and the Approved Fund in the BVI have developed quite a following since their launch in 2015 and with the ever increasing barrier to entry in the funds industry, they provide very attractive cost-saving possibilities.

### **Is it important where my potential foreign investors are likely to be based?**

Absolutely, although given the strong fund industries in both domiciles, you will generally find that investors are well aware of both jurisdictions and will not particularly object to either option given the vast similarities.

That being said, careful consideration should be given to this analysis to ensure that your fund’s particular offering is well catered for; a conversation with your chosen offshore counsel will often lead to helpful guidance in this area.

One aspect that should be noted is if you are considering marketing in the EU, you will need to seek advice on the marketing restrictions within this region. While both the Cayman Islands and BVI vehicles continue to operate under the long-standing EU national private placement regimes, managers do need to be very careful around their EU marketing strategy, as well as thinking through the position in the UK and Switzerland separately. With that in mind, we do also assist with the structuring of investments funds in Luxembourg, which is the pre-eminent European funds jurisdiction and has a wide range of structuring solutions for managers looking to attract EU investors.

### **Conclusion**

While there are many other options available to a US manager, this article should give you a solid platform to begin your thought process around taking the next step. We always recommend discussing this initially with your US counsel because they are best placed to ensure that your success story continues by surrounding yourself by the right service providers. ■

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