

BRIEFING NOTE

The Features and Ongoing Requirements of Exempted Limited Partnerships and their popularity for structuring Cayman Islands' Private Equity Funds and Venture Capital Funds

Introduction

The most common structure for a Cayman Islands domiciled private equity fund (“**PE fund**”) or a Cayman Islands domiciled venture capital fund (“**VC fund**”) is as an exempted limited partnership (“**ELP**”) formed under the Exempted Limited Partnership Act (As Revised) (“**ELP Act**”). However, there are some Fund sponsors who choose a Cayman Islands exempted company or a Cayman Islands limited liability company (LLC) instead of an ELP as the corporate structure for their PE funds or VC funds for a number of reasons, including, their own specific onshore tax or regulatory requirements or benefits, or the investors are more familiar with or prefer to invest in a Cayman Islands exempted company or LLC.

Features of Exempted Limited Partnerships

Who can be General Partner?

The ELP is required to have a general partner (“**GP**”) which is most commonly a Cayman Islands exempted company. However, a foreign company upon its registration as a foreign company in the Cayman Islands or another ELP are able to qualify as the GP of an ELP. The list of persons who may qualify as a GP of an ELP also includes a limited partnership or limited liability partnership established in a recognized jurisdiction (e.g. United States, United Kingdom, Hong Kong, BVI, Singapore, Jersey, Luxembourg) (a “**foreign limited partnership**”) provided such a foreign limited partnership is registered as a foreign limited partnership in the Cayman Islands.

The Directors and shareholders of the GP are typically persons who are affiliated with the sponsor of the PE fund or VC fund. There is no requirement for any Director or shareholder of the GP to reside in the Cayman Islands. The GP will not be carrying on a ‘relevant activity’ for economic substance purposes in solely acting as the GP of an ELP.

Who are the Limited Partners?

The limited partners of the ELP will be the investors subscribing for limited partnership interests in the ELP. There are no restrictions on the number of limited partners that may be admitted to an ELP. There is no requirement for any limited partner of the ELP to reside in the Cayman Islands.

No Corporate Personality

An ELP does not have a legal personality of its own. The ELP is a legal arrangement between its GP and its limited partners and the terms of this legal arrangement are governed principally by the terms of the limited partnership agreement ("**LPA**"). The contractual rights and equitable interests in the assets of the ELP are held on trust for the ELP by its GP (and, if there is more than one GP, by the general partners jointly).

The ELP Act states clearly that (i) relevant provisions of the Cayman Islands' Partnership Act are preserved in relation to ELPs, and (ii) the principles of common law and equity applicable to partnerships also apply to ELPs.

Tax Transparency

Not having its own legal personality, the ELP is generally regarded from an onshore tax perspective as being tax transparent (or as having "see-through", "look-through" or "flow-through" status, which signify the same thing) with the effect that the ELP itself will not be liable to any onshore taxes; and value distributed by it will "flow-through" to the investors (and may be subject to local taxes in their hands).

Limited Liability

A limited partner of the ELP will not lose its limited liability unless it takes part in the conduct of the business of the ELP in its dealings with persons who are not partners of the ELP as if it was, for the period of participating in the ELP's business, a general partner of the ELP. In such circumstances, the limited partner may be liable to a person who transacts business with the ELP with actual knowledge of the limited partner's participation in the management/operation of the ELP and who then reasonably believed the limited partner to be a general partner.

Restrictions on participation by Limited Partners in the business of the Partnership

A limited partner may not participate in the conduct of the ELP's business, and all contractual documents and papers must be executed by the GP as the contracting party acting on behalf of the ELP. As stated above, any limited partner participating in the management/operation of the ELP, as though it were a GP will, for that period of management participation be liable for the debts and obligations of the ELP, if the ELP goes insolvent, to any person transacting business with the ELP through the limited partner and who had actual knowledge of such limited partner's participation and who reasonably believed that limited partner to be a general partner.

The ELP Act sets out certain non-exhaustive "safe harbours" of activities in which a limited partner may engage without risk of being deemed to be participating in the conduct/management of the ELP's business and thereby losing its limited liability status. These include:

- i. holding an office or interest in, or having a contractual relationship with, a general partner or being a contractor for or an agent or employee of the ELP or of a general partner or acting as a director, officer or shareholder of a corporate general partner;
- ii. consulting with and advising a general partner or consenting or withholding consent to any action proposed, in the manner contemplated by the LPA, with respect to the business of the ELP;
- iii. investigating, reviewing, approving or being advised as to the accounts or business affairs of the ELP or exercising any right conferred by the ELP Act;
- iv. acting as surety or guarantor for the ELP either generally or in respect of specific obligations;
- v. approving or disapproving an amendment to the LPA;
- vi. calling, requesting, attending or participating in any meeting of the partners;
- vii. taking any action that results in the winding up or the dissolution of the ELP;
- viii. taking any action required or permitted by the LPA or by law to bring, pursue, settle or terminate any action or proceedings brought pursuant to section 33(2) of the ELP Act;
- ix. serving on any board or committee of the ELP, a general partner, the limited partners or the partners, or by appointing, electing or otherwise participating in the choice of a representative or any other person to serve on any board or committee, or by acting as a member of any board or committee either directly or by or through any representative or other person, including giving advice or consenting, or refusing to consent, to any action proposed by the GP on behalf of the ELP and exercising any powers or authorities or performing any obligations as a member of that board or committee in the manner contemplated by the LPA;

The LPA may nonetheless provide for any amount of limited partner participation in the conduct of the ELP's business.

Duties and obligations of the General Partner

The GP is responsible for conducting the management of the affairs of the ELP and is ultimately liable for all debts and obligations of the ELP to the extent that the ELP has insufficient assets. As noted above, the GP will sign all contracts on behalf of and in the name of the ELP.

The ELP Act imposes an absolute duty on the GP to act, at all times, in good faith and, subject to any express provisions of the LPA to the contrary, in the interests of the ELP. The requirement to act in the interests of the ELP often raises the issue of conflicts of interest for the GP, particularly when it acts as GP to more than one ELP. A GP which acts as the sole GP to several PE funds or VC funds (structured as ELPs) has to, for example, consider how to discharge its statutory duty to act in good faith in the interest of each fund, in relation to investment opportunities. The ELP Act states that this duty to act in the interests of the ELP can be restricted, limited or varied by the terms of the LPA between the GP and the LPs. Accordingly, the LPA can expressly empower the GP to act for the ELP and other funds (e.g. parallel funds or subsequent funds) and the LPA will typically provide for issues regarding conflicts of inter-

ests to be resolved through consultation with a Limited Partner Advisory Committee (“LPAC”) or other committees of the ELP.

The LPA will typically also grant power and authority, and impose other duties and obligations upon, the GP regarding, for example, (i) power and authority to interpret the provisions of the LPA reasonably and in good faith, (ii) the GP not to act in violation of the ELP Act and to manage the ELP in a manner that ensures that it is not in violation of any material law, regulation or guidelines applicable to the ELP or the GP.

Duties and obligations of Limited Partners

A limited partner of an ELP owes no fiduciary duty to any other partners of the ELP or to the ELP itself in exercising any of its rights or performing any of its obligations under the LPA, except to the extent that it has expressly agreed to such fiduciary obligations in the LPA. Partners may nevertheless agree to set out certain fiduciary obligations in the LPA. They might, for example, agree to impose fiduciary duties on members of an LPAC or other advisory committees of the ELP.

Dealings with partnership interests

With the consent of the GP, a limited partner may transfer or grant a security interest over its partnership interest in the ELP, subject to it complying with any provisions in the LPA dealing with the requirement for consent. In the case of a transfer of a partnership interest, the transferee is typically admitted to the ELP in accordance with the formalities prescribed in the LPA. When the requirements for admission have been met, the ELP Act provides that the incoming partner is deemed to have agreed to and be bound by the terms and conditions of the LPA as if all parties had together duly executed and delivered it. The GP may also, subject to the terms of the LPA, transfer or grant a security interest in its general partnership interest with the written consent of any other general partner.

Default by Limited Partners

The LPA typically includes provisions setting out the consequences for a partner who fails to perform any of its obligations under the LPA. The LPA may, for example, provide that if a limited partner fails to contribute to the ELP such funds as have been committed, that partner shall forfeit its partnership interest. The ELP Act expressly provides that such provisions in the LPA will not be unenforceable solely on the basis that they may be penal in nature.

Return of contributions and Clawback

The ELP Act provides that if a limited partner receives a payment representing a return of any part of that person’s contribution or is released from any outstanding obligation in respect of that person’s commitment and at the time that the payment was made or the release effected:

- i. the ELP is insolvent including where the payment or release causes the insolvency; and
- ii. the limited partner has actual knowledge of the insolvency of the ELP,

then for a period of six (6) months commencing on the date of that payment or release but not thereafter, the limited partner shall be liable to the ELP for the amount of the payment or the due performance of the released obligation in respect of that person’s commitment in each case to the extent that the repayment or performance of the released obligation is necessary to discharge a

debt or obligation of the ELP incurred during the period that the contribution or commitment represented an asset of the ELP.

Regulation

The Private Funds Act (2021 Revision) (the "PFA") requires the registration of "private funds" with the Cayman Islands Monetary Authority ("CIMA"). A "private fund" includes an ELP that "offers or issues or has issued investment interests, the purpose or effect of which is the pooling of investor funds with the aim of enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments, where:

- (a) *the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and*
- (b) *the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly, but does not include:*
 - (i) *a person licensed under the Banks and Trust Companies Act (2021 Revision) or the Insurance Act, 2010 [Law 32 of 2010];*
 - (ii) *a person registered under the Building Societies Act (2020 Revision) or the Friendly Societies Act (1998 Revision); or*
 - (iii) *any non-fund arrangements"*

The PFA applies to PE funds, VC funds, and other types of closed-ended funds which fall within the definition of "private fund" above and so ELPs need to consider (i) whether their business falls within the scope of a "private fund" as defined, and (ii) the issue of registration with CIMA.

An ELP may also be used for the purposes of operating a mutual fund and in that case, the GP of the ELP needs to consider (i) whether their business falls within the scope of a mutual fund, and (ii) the issue of registration with CIMA.

Timing

Formation and registration of an ELP and its GP can take place either on a same-day express basis with the payment of an express fee of approximately US\$488 to the Registrar of Companies or within 5-7 business days on a standard basis.

Taxation

There are no capital gains, income, profits, withholding, estate or inheritance taxes in the Cayman Islands. The ELP can apply for (and can expect to obtain) an undertaking from the Cayman Islands government that no form of taxation that may be introduced in the Cayman Islands will apply to the ELP for a period of 50 years from the undertaking being given. The GP can also apply for (and can expect to obtain) an undertaking from the Cayman Islands government that no form of taxation that may be introduced in the Cayman Islands will apply to the GP for a period of 20 years from the undertaking being given.

Ongoing obligations of an ELP

Statutory registers

The GP has the responsibility for maintaining (or causing to be maintained) the following statutory registers:

- i. **Register of limited partners.** This register must contain the name and address of each limited partner and the date on which a person became or ceased to be a limited partner. The register of limited partners can be kept anywhere in the world. If the register is kept at a place other than the registered office it must still be readily accessible, as it is required to be made available at the registered office should there be a notice or order for production under the Cayman Islands' Tax Information Authority Act. The register of limited partners can be kept in electronic form and must be updated within 21 days of any changes. The ELP Act provides that subject to any express or implied term of the LPA, the register (and the record of address at which the register is maintained if it is not maintained at the registered office) is open to inspection by all partners and by any other person with the consent of the GP. If the GP defaults in complying with the above requirements for maintaining the register of limited partners it commits an offence and is liable on summary conviction to a fine of approximately US\$12,200 for each day that the default continues and the GP is required to indemnify any person who thereby suffers any loss.
- ii. **Record of contributions and payments.** The ELP Act also provides that the GP must maintain a record of contributions and payments which must show the amount and date of the contribution or contributions of each limited partner and the amount and date of any payment representing a return of the whole or any part of the contribution of any limited partner, and this record may be kept within or outside of the Cayman Islands but must be updated within 21 days of any change and be accessible to the registered office. These records are only available for inspection by any person (including a limited partner) with the consent of the GP.
- iii. **Register of security interests in relation to limited partnership interests.** The ELP Act places an obligation on the GP to maintain or cause to be maintained at the ELP's registered office, a register of security interests that have been granted over any limited partnership interest. When a security interest is granted over the whole or any part of a limited partnership interest, the ELP Act requires that notice must be given by the grantor (i.e., the limited partner) or the grantee (e.g., the lender) to the ELP at the registered office. The GP must then enter on the register of security interests (i) the identity of the grantor and the grantee, (ii) the relevant partnership interest, and (iii) the date on which notice of the security interest was validly served. The register must be open for public inspection during regular business hours. Any security interest has priority according to the time that the written notice is validly served at the registered office.
- iv. **Changes to the Section 9 Statement.** Any changes to the Section 9 Statement of the ELP must be promptly notified to the Registrar of Exempted Limited Partnerships, by filing an amended statement signed by the GP. In general, changes must be notified within 60 days; however, a change to the GP is required to be filed within 15 days of the change and is not effective until that filing is made.

Accounts

The GP is required to keep (or cause to be kept) proper books of account. The records must be sufficient to give a true and fair view of the business and financial condition of the ELP and to explain its transactions. The accounting records are required to be retained for a minimum period of five (5) years. Subject to the terms of the LPA, each limited partner may demand and receive from the GP a true and full picture of the state of the business and financial condition of the ELP. There is no requirement for the accounts of an ELP to be audited each year under the ELP Act, although this may be required if the partnership is otherwise regulated, for example under the PFA or the Mutual Funds Act.

Annual requirements

The GP is required to make an annual return to the Registrar of Exempted Limited Partnerships in January each year regarding compliance with the ELP Act and to pay an annual return fee. The annual return will generally be signed on behalf of the GP by the ELP's registered office agent.

This Briefing Note is not intended to be a substitute for specific legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide an overview and general guidance on Cayman Islands exempted limited partnerships only. For more specific advice on the formation and usage of exempted limited partnerships as investment funds, and in corporate and financing transactions, please refer to your usual Loeb Smith contact or:

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