



August 2023

## **POLICY BRIEF | UGANDA**

### **Enhancing the legal and regulatory framework for structuring onshore domiciled private equity funds under a limited liability partnership vehicle**

#### **Introduction and context**

Uganda's Third National Development Plan (NDP III) – the third iteration of a series of national plans operationalising Uganda's Vision 2040 – states as one of its key priorities mobilising "alternative financing sources to finance private sector investment". Key to achieving the stated goal, according to the NDP III, is strengthening the legal and regulatory framework for private capital [fund domiciliation] in Uganda to enhance the supply of patient financing available to Uganda's private sector. This aspect of expanding access to enterprise finance remains fundamental to achieving Uganda's overarching goal of achieving middle-income status by 2040 by leveraging resource-led and export-oriented industrialisation.

Nevertheless, Uganda's legal and regulatory framework for the domiciliation of private equity and venture capital funds (hereafter referred to as 'fund(s)') remains unfavourable mainly due to the lack of flexible fund structuring options.

The fund structuring options available by far remain constrained in being able to allow private capital funds to: (1) attract the right calibre of investors into a fund; (2) deploy capital to target (often multiple) countries seamlessly; and (3) maximise returns to investors (tax efficiency for distributions). Under current options, while funds may have no significant obstacles to incorporating or registering, their ability to attract investment from institutional investors – after setting up a fund – is greatly hampered as current structures limit eventual returns to investors. The domiciliation of funds thus remains low in Uganda. However, the domiciliation of funds will be critical to attracting private capital providers with an investment thesis focused on Uganda and on deploying capital to Ugandan enterprises.

Thus, this policy brief outlines amendments needed to enhance the utility of Uganda's legal and regulatory framework to allow for the setting up of funds under a Limited Liability Partnership (LLP) vehicle.

# Proposed amendments

To enhance the utility of Uganda’s legal and regulatory framework for structuring private equity funds<sup>1</sup> under an LLP vehicle, the amendments proposed are as follows:

## A. Amendments to the Partnership Act (2010) to define key terms used in the structuring of LLPs, especially as they relate to the role of general and limited partners.

- [1] *Definitions:* The Partnership Act (2010) – in its “definitions” section – should be amended to include definitions of key terms, such as “contribution”, “partnership agreement”, “partnership interest”, “general partnership interest” and “limited partnership interest”. While these concepts are referenced in the body of the Partnership Act (2010), as it stands, they are not defined, thus creating legal ambiguity.

## B. Amendments to the Partnership Act (2010) to facilitate the formation and registration of an LLP as a fund.

- [2] *Permissible participants in an LLP:* An amendment to the Partnership Act (2010) should allow different entity types, such as a [person], company, a trust or a partnership, to participate in the LLP’s membership as a general<sup>2</sup> or limited partner.<sup>3</sup>
- [3] *Domicile of limited partners in an LLP:* An amendment should be made to the Partnership Act (2010) to allow for the broad participation of limited partners in an LLP, regardless of domicile inside or outside Uganda. This is important as while locally domiciled, a fund structured under a partnership vehicle may opt to fundraise from international limited partners – domiciled and registered in foreign jurisdictions – who would then become [limited] partners in the LLP.
- [4] *Domicile of general partners in an LLP:* An amendment to the Partnership Act (2010) should make provisions such that the general partner is a domiciled (resident) in Uganda: if the general partner is an individual, that such a person be resident in Uganda; if an entity, that such an entity be registered as a company under provisions in the Companies Act (2012) or as a Partnership under Section 48 of the Partnership Act (2010). Further, the Act should require that the general partner have an address in Uganda, in addition to meeting other requirements, such as certificates of good standing. While a limited partner can be foreign domiciled, the requirement for domiciliation of a general partner in Uganda is key to establishing [legal] standing of an LLP as having a domicile in Uganda.
- [5] *Registration of a local domiciled LLP:* The Partnership Act (2010) should declare that a registration certificate is considered evidence of compliance with the Act. Currently, no such finality in the registration process has been accorded to LLPs.
- [6] *Registration of a foreign domiciled LLP:* Further, an amendment should foresee a process for the registration of foreign limited partnerships, which, while not domiciled in Uganda, may want to deploy capital to Ugandan enterprises while simultaneously benefiting from assurances of contract enforcement. As a result, foreign LLPs can more easily register in Uganda to help them deploy private equity and venture capital assets. At present, unlike a company domiciled in a foreign jurisdiction, a foreign limited partnership does

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<sup>1</sup> The term **private equity funds** as used in this brief refers to leveraged buyouts, growth capital, venture capital, mezzanine and private credit funds.

<sup>2</sup> A **general partner** refers to an investment manager in a private capital (intermediated) fund.

<sup>3</sup> A **limited partner** refers to an investor in a private capital (intermediated) fund.

not benefit from automatic legal recognition as a corporate body able to enforce contracts unless the partnership business name consists of the true surnames of all partners or is otherwise registered in Uganda under provisions in the Business Names and Registration Act (1918).

- [7] *Lifetime of a registered LLP*: An amendment to the Partnership Act (2010) should allow LLPs to register for either a finite or an unlimited duration. This caters to the typical closed-ended fund (finite duration) but also addresses the increasing interest in evergreen funds (infinite duration) for private equity and venture capital deployment.

### C. Amendments to the Partnership Act (2010) to maintain the continuity of LLPs once they are established and registered.

- [8] *General partner liability*: An amendment to the Partnership Act (2010) should offer further clarity on the extent of the general partner's liability, clarifying that the general partners are indeed liable for all debts and obligations, though only in the event that the LLP's assets are inadequate. For funds, it is preferred that a general partner possesses unlimited liability. This enables a fund structured under an LLP vehicle to lend itself to passive investment, where limited partners hold a passive role (as preferred) and general partners are active and hold full powers and authority to act on behalf of the partnership [fund] without prior consultation with the limited partners.

- [9] *Limited partner liability*: The Partnership Act (2010) should be amended to include provisions limiting an investor's liability in a fund to the extent of the investor's contribution to the fund.<sup>4</sup> This is essential as it shields investors (limited partners) in a [pooled] fund from taking on monetary risk beyond and over their contributions to the fund. To achieve this:

- Firstly, an amendment can clarify that the LLP continues to exist with limited liability if a general partner temporarily ceases.
- Secondly, routine actions taken by limited partners – approving an amendment, calling a meeting, appointing a board member, etc. – should be added to the Act's list of actions that do not qualify as management or control. In their absence, a limited partner risks being qualified as a general partner and, as such, having unlimited liability beyond and over their contributions, which is not preferred.
- Thirdly, an amendment should be inserted that entrenches the limited liability of limited partners once legal proceedings are instituted against the general partner. However, courts may decide to allow proceedings against limited partners. Since limited liability is key to potential investors (limited partners), additional clarification can further protect this status.

- [10] *Limited partner exit options*: The Partnership Act (2010) should be amended to prescribe a process for transferring partnership interests. This, as limited partners in a fund may opt to transfer ownership and future obligations in a fund – including capital calls – to another limited partner (typically institutional buyers or funds of funds) in the secondary market in exchange for liquidity. Currently, the lack of any provisions for the transfer of interests would make an [early] exit of limited partners from a fund more difficult – even where a general partner has consented to the exit.<sup>5</sup>

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<sup>4</sup> **Limited liability** is where an investor's financial liability is limited only to the amount that it has invested.

<sup>5</sup> A **secondaries transaction** in this case may be either a limited partner-led or a general partner-led secondary.

#### **D. Amendments to the Partnership Act (2010) to increase disclosures by LLPs.**

[11] *Disclosures and business integrity*: The Partnership Act (2010) can require a general partner to maintain (a) records of cashflows, sales and purchases, and assets and liabilities, and (b) a register of limited liability partners. This enhances transparency, to the benefit of limited partners. Moreover, an amendment could require the Registrar to maintain records of LLP registration and open them to the public. This would facilitate public inspection of LLPs and their continued integrity. Such amendments could foresee emerging regulatory trends towards greater disclosures by private capital markets. As the private capital markets become a significant component of the global financial system, regulators are showing great interest in disclosures as a systemic risk management strategy.

#### **E. Amendments to the Partnership Act (2010) to facilitate the winding up of an LLP.**

[12] *Closure of the fund*: The Act should specify the regime of a voluntary winding up of a fund independent of that envisaged under the Companies Act 2012 or the Insolvency Act 2011: winding up should be at any time specified in the partnership agreement or upon the passing of a resolution with a two-thirds majority. It should be followed by the general partner or other person appointed as liquidator filing a note of dissolution. This is critical for closed-ended funds with a finite existence which, at the end of the fund's life, wind up the fund if no extension is required.

#### **F. Amendments to the fiscal policy to provide further incentives for local fund domiciliation beyond fund structuring vehicles.**

[13] *Independent tax regime for LLPs*: A specific taxation regime could be established for LLPs. Currently, LLPs are treated as general/ordinary partnerships under the tax codes. Enshrining these changes in tax policy would require amendments to the Income Tax Act, the Value Added Tax Act and the Capital Markets Authority Act.

[14] *Further tax incentives to encourage local domiciliation of funds*: Individuals or companies with business income arising from investments in a fund can be granted a tax deduction as an incentive. The fund itself can also be considered exempted from the payment of income tax, or pay a lower tax rate, on dividend income from investments in a company in Uganda. Currently, dividends to all resident shareholders are subject to a withholding tax at a tax rate of 15 per cent. Funds that invest in priority sectors (e.g. agroprocessing) could be considered for Value Added Tax (VAT) exemption with respect to the goods and services that the investee companies supply, provided the fund has invested funds above a certain prescribed threshold.

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