

## Guernsey substance proposals – the fund managers' perspective

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The Guernsey government has approved new regulations which impose an economic substance test for Guernsey tax-resident companies to meet the requirements of the EU Code of Conduct Group. These regulations were approved by the EU's ECOFIN council on 12 March 2019 and as a result, Guernsey was re-affirmed as a co-operative jurisdiction in terms of tax transparency and for action 5 of BEPS.

The regulations came into force on 1 January, establishing tests for tax resident companies carrying on "relevant activities", including fund management. The tests require companies that are in scope to demonstrate that they have economic substance in Guernsey, including that they are "directed and managed" in Guernsey, that certain of their "core income generating activities" are undertaken here, and that the companies have "adequate" premises, employees and expenditure in Guernsey proportionate to the level of relevant activity carried on in Guernsey.

It is important to note that the collective investment schemes themselves are out of scope, as are limited partnerships more generally, but we expect the majority of our fund manager clients to be in scope (as they are usually structured as companies and will have income in relation to their fund management activities) and so consideration will need to be given to the level of activity carried out in Guernsey, with specific consideration being given to outsourcing arrangements.

Please see [here](#) for Ogier's briefing applicable to holding, distribution and services companies and [here](#) for Ogier's briefing in respect of banks, insurance businesses and leasing vehicles.

We anticipate detailed guidance notes will be issued soon, which is likely to include some clarity on the definition of "adequacy" and will assist in interpreting the scope of delegation possible, and confirm that the definition of "employee" includes directors and employees of any third party administrator on which the fund manager may rely to enable it to perform its functions.

In summary the proposed economic substance requirements include two key tests:

### **The "Directed and Managed" test**

Fund managers must be directed and managed in Guernsey, which requires:

- meetings of the board of directors (all of whom must have the necessary knowledge and expertise to discharge their duties as a board) in Guernsey at adequate frequencies, given the level of decision making required;
- a quorum of the Board of Directors to be physically present in Guernsey at these meetings (Directors do not need to be Guernsey resident);
- minutes recording the strategic decisions of the company made at these meetings; and
- retention of all company records and minutes in Guernsey.

### **Adequacy**

Having regard to the level of fund management carried on in Guernsey, fund managers must:

- have an adequate number of employees;
- demonstrate adequate expenditure in Guernsey; and
- have adequate physical presence in Guernsey. We expect the guidance notes to clarify that "physical presence" in the context of fund management means access to premises.

### **The Core Income Generating Activities**

Fund managers must conduct Core Income Generating Activities, or CIGAs, in Guernsey, which comprise:

- taking decisions on the holding and selling of investments;
- calculating risks and reserves;
- taking decisions on currency and interest fluctuations and hedging positions, and
- preparing relevant regulatory and/or other reports for government authorities and investors.

### **Further clarification expected**

The Guidance Notes are expected to confirm that some, but not all, CIGAs must be carried on in Guernsey by a fund manager to satisfy the substance tests. Consideration will need to be given to ensuring sufficient CIGAs are carried on in Guernsey to avoid a letter-box entity characterisation. The regulations anticipate that outsourcing on-Island will be allowed but

outsourcing CIGAs off-island will not satisfy the substance requirements.

How this will work in practice is expected to be clarified in the Guidance Notes.

A detailed analysis of the business model of the role of a fund's service providers will be needed to establish whether and to what extent any restructuring or reworking of contracts may be required to ensure the fund manager is demonstrating sufficient substance in Guernsey for the purposes of the proposed regulations.

## **Sanctions**

The new law proposes sanctions for non-compliance to include progressive financial penalties ultimately leading to strike-off from the register of Guernsey companies, and reporting to any relevant tax or regulatory authorities in the EU.

## **The Ogier view**

- Fund managers should review outsourcing arrangements in respect of Guernsey tax-resident companies that fall within the scope of the new law and consider whether the third-party service provider agreements in place enable them to meet the tests set out, particularly in relation to provision of office space and appropriate access to sufficiently senior employees.
- As the legislation also includes "finance and leasing business" and "holding companies", consideration should be given to any intra-group financing and any holding company within the group structure with a view to determining whether any entities within the fund's structures in addition to the fund manager fall within scope.
- It is anticipated that many structures will be compliant with the new requirements already – consideration should still be given to whether amendments and updates are required to Policies and Procedures as a result of the new regulation.
- We anticipate further detailed guidance on the precise definition of activities to fall within the scope of the law, and the definition of adequacy in respect of employees, expenditure and premises under the tests.

If you require further information or would like to discuss how the proposals may impact your business, please get in touch with your usual Ogier contact.

Bulletin on the 2020 Guernsey Substance Amendment Regulations and the treatment of funds under the substance regime can be [found here](#).

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