

## Update on economic substance rules for Jersey fund managers

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For a more recent update on this issue read our briefing [The economic substance requirements for Jersey fund managers](#).

The Taxation (Companies - Economic Substance) (Jersey) Law 2019 (the **Law**) came into effect on 1 January 2019 and applies for accounting periods commencing on or after that date. The new economic substance requirements (the **Substance Requirements**) apply to certain Jersey tax-resident companies and have been passed in order to comply with the requirements of the EU Code of Conduct Group on Business Taxation for the purpose of demonstrating that the profits generated by Jersey companies which carry on certain specified geographically mobile activities including, in particular, for the purpose of this briefing, fund management business, are commensurate with their economic activities and substantial economic presence in Jersey.

The Substance Requirements establish new economic substance tests which require fund managers to demonstrate that (i) they are directed and managed in Jersey in relation to that activity; (ii) having regard to the level of relevant activity carried on in Jersey they have adequate employees, expenditure and physical assets in Jersey proportionate to the activities carried on in Jersey; and (iii) that all of the "core income-generating activities" (**CIGA**) they undertake are carried out in Jersey.

Jersey tax resident fund managers, whether they are regulated in Jersey or benefit from an exemption from regulation, are in scope of the Law where they have gross income in relation to their fund management activities. Fund vehicles themselves outside the scope of the Law.

Services such as fund administration, advisory services and custody services are also out of scope.

The Crown Dependencies issued a joint Key Aspects Document in November 2018 and Guidance Notes on aspects of the Substance Requirements on 26 April 2019. The Guidance Notes are intended to be a work in progress and will develop through further discussions with the OECD and the EU Code of Conduct Group.

This briefing summarises the current position relating to the Substance Requirements for fund management companies.

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

In scope companies carrying on fund management must be directed and managed in Jersey. In this regard, the Law 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 Jersey at adequate frequencies, having regard to the level of decision making required;
- a quorum of the Board of Directors to be physically present in Jersey at those meetings;
- the minutes to record the strategic decisions of the company made at those meetings (and, where the company has a sole director, strategic decisions should be evidenced by way of written resolutions of that director when physically present in Jersey); and
- the retention of all company records (including its certificate of incorporation, articles of association and financial statements) and minutes of all board meetings in Jersey (and where such records are held in electronic form, that such records are maintained and are accessible in the Island).

Whilst it is anticipated that companies with a minimal level of activity will hold at least one board meeting per annum, in the case of fund management businesses, the expectation is that board meetings should be held more frequently and at least quarterly. The Guidance Notes clarify that it is not necessary for all of the fund management company's meetings to be held in Jersey, however the expectation is that the majority of all board meetings will be held in the Island and that a quorum of directors will be physically present at such meetings. It is acknowledged that it may be necessary for certain meetings to be held outside Jersey (for example, where necessary to complete a transaction in another jurisdiction).

The Guidance Notes provide that, in order to meet the Substance Requirements, it is necessary for the board of directors to be the decision making body and not simply to approve decisions taken outside the Island. A fund management company is unlikely to meet the Substance Requirements if strategic decisions have been delegated to entities outside Jersey which make such decisions are without reference to, or real oversight by, the board.

In the unlikely event that the fund management business has corporate directors, the Key Aspects Document and the Guidance Notes provide that it is necessary to look through the corporate directors to the individuals who are officers of the corporate director who are actually performing the duties of the corporate director.

Where a management company is in liquidation, the liquidator must demonstrate that the company is directed and managed in Jersey and the board of directors should be taken to be the liquidator.

### **Adequate employees, expenditure and physical premises**

Having regard to the level of fund management carried on in Jersey, fund managers must have adequate (i.e. enough or satisfactory for a particular purpose):

- number of employees in relation to the activity who are physically present in Jersey;
- expenditure in Jersey; and
- physical assets in Jersey (for example, dedicated premises or access to meeting rooms).

The Key Aspects Documents acknowledges that what is "adequate" for these purposes, will depend on the particular company and its business. Appropriate records should be maintained by the company in order to demonstrate the adequacy of the resources utilised and expenditure incurred. The regulatory regime for fund managers in Jersey is such that most regulated companies should already be operating broadly in compliance with the adequacy tests.

The Guidance Notes adopt the definition of "employees" used by the EU in relation to SMEs and it is not limited to persons who are employed by the company, but includes persons deemed to be employees under Jersey law, owner-managers and directors. The employee count should be based on the number of full time equivalent employees during the relevant financial year. Where a company outsources or delegates some of its activities, the resources of the service provider in Jersey will be taken into consideration for the purpose of determining the number of employees. The Guidance Notes further acknowledge that automation and advances in the use of technology will create efficiencies meaning that fewer employees may be required for the performance of the company's activities.

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

Fund managers must conduct all of their CIGAs in Jersey and must be able to monitor and control any CIGAs carried out by another entity in Jersey. CIGAs in respect of fund management business include any of the following activities:

- taking decisions on the holding and selling of investments. The Guidance Notes clarify that a company which is simply implementing the decisions of another entity (e.g. by selling investments), is not performing a CIGA. Further, in order for a decision to be determined as being taken in Jersey for the purposes of CIGA, the majority of persons making the decision should be physically present in Jersey;
- calculating risks and reserves. In this context, risk includes market risk, credit risk, liquidity

risk and operational risk. A CIGA will not be being performed where calculations are limited to one area of applicable risk and not others - it will be being performed where the overall risk across the fund and the reserves required on a strategic basis;

- taking decisions on currency or interest fluctuations and hedging positions. Such decisions must be taken at a strategic level in relation to the whole fund, not just in isolated circumstances involving specific investments, for a CIGA to be being performed; and
- preparing relevant regulatory reports for government authorities and reports and returns to investors. The Guidance Notes clarify that the CIGA does not necessarily involve the administrative task of compiling the returns, even though the fund manager may be responsible for this. However, the fund manager must be able to convey the position of the funds it manages at any time.

It is not necessary for the company to carry on all the above CIGAs in order to demonstrate substance, however it must demonstrate that the CIGAs that generate its gross income are performed in Jersey and where one of those CIGAs relates to making relevant decisions, the majority of those making the decisions must be physically present in Jersey when the decision is made.

## **Outsourcing**

It is common for fund managers to outsource activities to other entities (including third parties or group companies) and the Law does not prohibit this. Examples include administrative activities outsourced to an administrator in Jersey and the execution of strategic investment decisions outsourced to investment teams of group entities located outside the Island. As long as the board of the fund manager monitors and retains the ability to control the activities of service providers in Jersey this outsourcing will be in compliance with the Substance Requirements. Furthermore, as long as the company has set the strategic decisions and investment parameters within which investment decisions may be implemented by the group entities outside the Island, it receives reports and is able to monitor and control the outsourcing, those outsourced activities will not undermine the fact that CIGA is conducted in Jersey.

## **Information to be included in company tax returns**

The Guidance Notes disclose the additional questions relating to economic substance which will be included in tax returns commencing from 2019.

A company will have to state which relevant activities it performs, enter the gross income from that activity, provide a numeric number for those board meetings in Jersey where a quorum of directors was physically present, identify the specific CIGA it performs and provide general information in relation to the relevant activities, including its accounting profits for the financial period, the number of employees in Jersey, the address of its premises and its total gross expenditure in Jersey and expenditure incurred on outsourced activities in Jersey. Further

details in respect of outsourced activities will also need to be provided.

Significantly for company directors, the company will have to declare that, on its own analysis, it has met the economic substance test in respect of its activity.

## **Sanctions**

The Law provides sanctions for non-compliance to include financial penalties, strike-off from the register of Jersey companies, and reporting to any relevant tax or regulatory authorities where the provision of such information is permitted under a bilateral agreement made between Jersey and that country or territory or the OECD and Council of Europe (2011) Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol.

## **Action Points**

- Fund managers should review outsourcing, delegation and control arrangements between the fund manager and service providers (including group service providers) to the fund manager and consider whether the arrangements in place, in particular those dealing with investment and risk decisions, meet the Substance Requirements.
- As the Law also includes "finance and leasing business", "holding company business" and "distribution and service centre business" (which may capture intra group service arrangements), consideration should be given to whether any entities within the fund manager's group that carry on intra-group financing, intra-group service arrangements or holding company activities may fall within scope of the Substance Requirements.
- Given the applicable regulatory regime in Jersey, it is anticipated that many structures will be compliant with the new requirements already – consideration, however, should still be given to whether amendments and updates are required to contracts, policies and procedures, outsourcing arrangements, offering memoranda and board resolutions and procedures as a result of the Law.
- We are already assisting many clients to scope their activities and report on their compliance with the Substance Requirements. You should get in touch with your usual Ogier contact as soon as possible should you require further information or advice on the Substance Requirements and the implications for your business.

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