

Updated economic substance requirements for Guernsey fund managers

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The Income Tax (Substance Requirements) (Implementation) Regulations, 2018 came into force on 1 January 2019, requiring all Guernsey tax-resident companies to confirm, for tax periods commencing on 1 January 2019 or later, whether they are in scope of the substance requirements and, if so, how they meet such requirements.

The substance requirements apply to Guernsey tax-resident companies that carry on certain specified geographically mobile activities, including fund management business. They have been implemented in order to comply with the requirements of the EU Code of Conduct Group for the purpose of demonstrating that the profits generated by such companies are commensurate with their economic activities and presence in Guernsey. Guernsey was put on the EU whitelist on 12 March.

The Crown Dependencies issued joint Guidance Notes on aspects of the Substance Requirements on 26 April 2019, which were updated on 22 November 2019 (the Guidance Notes).

Fund managers are in scope of the law where they have income in relation to their fund management activities. Other than self-managed funds, which will be in scope as fund managers after a change to the law expected to be effective in 2020, fund vehicles themselves are outside the scope of the Law, albeit their subsidiaries may, if they are carrying on relevant activities, be in scope.

The substance requirements establish economic substance tests which require companies to demonstrate the following:

They are "directed and managed" in Guernsey in relation to that activity

In particular:

- meetings of the board of directors (which, as a whole, must have the necessary knowledge

and expertise to discharge their duties as a board) must be held in Guernsey at adequate frequencies, having regard to the level of decision making required;

- a quorum of the Board of Directors must be physically present in Guernsey at those meetings and, where a meeting is called to consider a strategic matter, or CIGA, a majority of directors must be physically present in Guernsey;
- the minutes must record the strategic decisions of the company made at those meetings; and
- all company records and minutes of all board meetings must be retained in Guernsey, including all supporting documents relating to board meetings (or, if in electronic form, maintained and accessible in the Island).

While it is not necessary for all of the company's meetings to be held in Guernsey, it is expected that the majority of board meetings will be held in the Island and that a quorum of directors will be physically present. It is acknowledged that it may be necessary for certain meetings to be held outside Guernsey, with the revised Guidance Notes providing a welcome confirmation that isolated decisions may be taken outside Guernsey provided "it can be evidenced that the decisions taken and the CIGA undertaken in the Island are of a quality and quantity to clearly outweigh the question that the CIGA involving the decisions is undertaken outside the Island."

The board of directors must be the decision-making body and not simply 'rubber stamp' 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 Guernsey which make such decisions without reference to, or real oversight by, the board.

Adequate employees, expenditure and physical presence

Having regard to the level of relevant activity carried on in Guernsey, an in scope company must have adequate:

- employees who are physically present in Guernsey;
- expenditure in Guernsey; and
- physical presence in Guernsey (e.g. premises or access to meeting rooms).

In this context, "employees" is not limited to persons who are employed by the company, but includes persons deemed to be employees under Guernsey law, owner-managers and directors. The resources of any outsourced service provider in Guernsey will also be taken into consideration on a full time equivalent basis.

All of the "core income-generating activities" (CIGA) undertaken are carried out in Guernsey

Fund managers must conduct all of their CIGA in Guernsey and must be able to monitor and control any CIGAs outsourced to another entity in Guernsey. CIGA in respect of fund management business include any of the following:

- taking decisions on the holding and selling of investments.
 - 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 Guernsey, the majority of persons making the decision should be physically present in Guernsey;
- calculating risks (including market risk, credit risk, liquidity risk and operational risk) and reserves.
 - A CIGA will not be being performed where calculations are limited to one area of applicable risk, but requires strategic calculation of the overall risk across the fund and the reserves required;
- taking decisions on currency or interest fluctuations and hedging positions.
 - Such decisions (where relevant) must be taken at a strategic level in relation to the whole fund, not just in isolated circumstances involving specific investments; and
- preparing relevant regulatory reports for government authorities and investors.

Outsourcing

It is common for fund managers to outsource activities to other entities and the law does not prohibit this as long as the board monitors and retains the ability to control the activities of service providers and the outsourced activities are performed in Guernsey. Furthermore, as long as the company has set the strategic decisions and parameters within which investment decisions may be implemented by entities outside the Island, and it receives reports and is able to monitor and control the outsourcing, those activities will not undermine the fact that CIGA is conducted in Guernsey.

Implications and Sanctions

The Law provides sanctions for non-compliance including financial penalties, strike-off from the register of companies and reporting to relevant tax or regulatory authorities.

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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