

UPDATE

'Economic Substance' Update: Self-Managed corporate funds

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The Economic Substance Law¹ (the **Law**) provides that if a Jersey company is both tax resident and performs a 'relevant activity' in Jersey, then it must also demonstrate that it has substance in Jersey by (i) being 'directed and managed' in Jersey, (ii) having adequate people, premises and expenditure in Jersey, and (iii) conducting core income generating activities in Jersey. Previous joint guidance issued by tax authorities of Jersey, Guernsey and the Isle of Man states that collective investment vehicles (i.e. corporate funds) are outside the scope of the Law.

On 10 February 2021 the Government of Jersey adopted amending legislation² which, once ratified, will clarify the way in which the Law applies to self-managed corporate funds.

Article 3 of the Law provides that 'fund management business' is a relevant activity, and includes core income generating activities such as taking decisions on the holding and selling of investments, calculating risk and reserves, taking decisions on currency or interest fluctuations and hedging positions, and preparing reports and returns to investors and the Jersey Financial Services Commission (**JFSC**) and other regulatory/supervisory bodies. 'Fund management business' is, however, defined so that the onus falls not on the fund itself but rather on the functionary who acts as the 'conscious mind' of the fund, be that a general partner, a managing trustee or an investment manager. As a result it is the functionary, rather than the fund, who would fall within the scope of the Law and who would be required to satisfy the 'economic substance' criteria. This approach is eminently sensible in relation to funds that are structured using unincorporated vehicles (such as Jersey limited partnerships and Jersey unit trusts) and who therefore act through a key functionary, and in relation to funds who outsource the management and direction to an third party manager. In such instances the fund vehicle is essentially a holding structure and the real substance lies with the supporting service providers. The existing Law has not previously applied to corporate funds.

The recent amendment introduces a new article 5 which ensures that self-managed corporate funds are captured within the Law, with effect from their first financial period commencing on or after 1 January 2021, and will therefore be required to comply with the 'economic substance' requirements thereafter. Going forwards, and in keeping with other Jersey fund structures, these self-managed funds will need to provide supporting evidence as to how they satisfy these requirements in their annual tax return filings. The test for whether a self-managed fund is performing a relevant activity will turn on the fund management activities that it performs, and is intended to mirror the requirements applied to other entities performing fund management business.

Although self-managed funds will soon be within the scope of the Law, they will not be required to satisfy the 'directed and managed test' in recognition of Jersey's funds regulatory regime which already requires

¹ Taxation (Companies - Economic Substance) (Jersey) Law 2019

² Taxation (Companies - Economic Substance) (Amendment No. 2) (Jersey) Law 202-

substance in the Island. The Government of Jersey have clarified that a self-managed fund will not satisfy the economic substance test if it is not compliant with the relevant regulatory regime.

Revenue Jersey has clarified that it would expect the 'taking of decisions on the holding and selling of investments' to always be carried out by the self-managed fund itself and this must be demonstrated by way of frequent, detailed, and robust consideration by the board of the fund, which should be meeting regularly in person in Jersey to perform this function. Although the self-managed fund will be assessed against the same core income generating activities for fund management business as any third party fund functionary, the Government of Jersey have acknowledged that the self-managed fund is unlikely to receive a discernible income stream arising out of its fund management activities and have instead recognised that the self-managed fund will usually receive income arising from this activity as part of the overall fees paid to it by investors.

Partnerships

The Government of Jersey have confirmed their intention on or before 30 June 2021 to extend economic substance legislation to partnerships performing a 'relevant activity' in order to fulfil a political commitment given to the EU Code of Conduct Group for Business Taxation. Importantly, partnerships that are funds are expected to remain entirely out of scope.

The intention is that the new economic substance test for relevant partnerships (that are not funds) will follow the approach for companies as closely as possible. However, Revenue Jersey recognise the challenge of applying an economic substance test to partnerships as there is no international concept of tax residence for partnerships. In addition, when compared to companies, there is a much greater variety of governance and management arrangements found in partnerships which makes it challenging to construct a single test suitable for general application.

Our own view is that the new proposals should ideally offer greater flexibility in the application of substance requirements to relevant partnerships and, similarly to self-managed corporate funds, we suggest that it would not be appropriate to apply a 'directed and managed test' to them. Draft legislation is expected in the coming weeks, given the 30 June 2021 deadline agreed with the Code Group.

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