

UPDATE

Summary of Jersey Funds Updater

Update prepared by Felicia de Laat (Mourant LP Partner), Alistair Horn (Mourant LP Partner) and James Daniel (Senior Associate)

Speakers from our team shared the latest market insights and updates on the key domestic and international legal, regulatory and tax developments impacting our funds industry.

Substance for Jersey as a '2.2' jurisdiction, Felicia de Laat, Mourant LP Partner

The key concern in the Jersey fund management community as we head into Autumn is how the government of Jersey will address the concerns raised by the EU Code of Conduct Group on Business Taxation (the **Code Group**) as to whether companies carrying on fund management (and other relevant activities) in Jersey demonstrate sufficient substance in Jersey.

Where did this begin?

Throughout 2017, the Code Group investigated the tax structures of over 90 jurisdictions including Jersey and Guernsey and, by the end of 2017, ECOFIN (effectively the group of EU Finance Ministers) issued a list of 'Non-Co-operative Tax Jurisdictions' (the **Blacklist**).

Jersey and Guernsey were deemed to be co-operative jurisdictions and were not placed on the Blacklist but, as part of the Code Group's review, still found themselves listed in Annex II to the Blacklist as jurisdictions committed to addressing concerns raised by the Code Group around the economic substance of companies tax resident in their jurisdiction (known as "2.2 jurisdictions" because criterion 2.2 is the economic substance criterion in the Code Group's tax good governance criteria). The Jersey government has made a commitment to address the Code Group's concerns by the end of 2018.

The Code Group issued a scoping paper on 22 June 2018 (the **Scoping Paper**) advising how to comply with criterion 2.2. Fortunately, the Scoping Paper drew on the BEPS work done by the OECD which means that it is broadly aligned with a global standard. The government of Jersey then issued a consultation paper in July (the **Consultation**) setting out a series of proposals designed to demonstrate to the Code Group that companies carrying on what are called 'relevant activities' in Jersey have an appropriate level of local substance, in line with the Scoping Paper.

These substance proposals need to be agreed with the EU and reflected in local legislation by the end of this year so there is an extremely limited time frame to finalise this. The proposals are expected to be implemented by way of amendments to the income tax law together, with a new corporate tax return for FY2019. The Consultation has closed and draft legislation and guidance from the Comptroller is expected to be issued on or around 22 October. The government of Jersey will continue to consult with industry bodies between now and October and Mourant will be involved in that process.

What are the substance proposals?

In a nutshell, the government of Jersey is proposing that companies carrying on what are called 'relevant activities' in Jersey will need to demonstrate:

- management and control from Jersey; and

- that their "core income generating activities" (**CIGA**) for any 'relevant activities' are taking place in Jersey, supported by adequate employees, expenditure and premises in Jersey (either its own or those of a Jersey service provider).

The eight relevant activities are fund management, banking, insurance, financing and leasing, headquarters, shipping, intellectual property and holding companies.

The Consultation was deliberately high level and we understand that the legislation will also be high level with important clarifying detail being contained in the Comptroller's guidance. In particular, some important key terms will be fleshed out in the guidance, which is essential for the proposals to be workable. The guidance will therefore be key.

Section 6 is the heart of the consultation and it breaks the substance requirements down into three elements:

1. Tax resident companies carrying on 'relevant activities' must be managed and controlled from Jersey and there is a set of requirements mostly around the operation of the board of directors. For any well governed company, in principle they should be not be difficult to achieve and most will meet them already.
2. These companies must also demonstrate that they have in Jersey CIGA. For fund management, these include:
 - (a) taking decisions on holding and selling investments;
 - (b) calculating risks and reserves;
 - (c) taking decisions on currency, interest fluctuations and/or hedging positions;
 - (d) preparing relevant regulatory and/or other reports for government authorities.

For many fund managers, many of these activities are no doubt already being done in Jersey by the board, sometimes with assistance from a supporting Jersey service provider. We believe managers of closed ended funds will find it relatively easy to carry out most of these activities, although their Jersey administrators may need to provide assistance with some elements such as reserve calculations and reporting.

Some Jersey managers of open ended funds which are more regularly traded and which may require regular NAV calculations may currently rely more heavily on services provided by onshore investment managers or advisors. There are a number of funds, for example, where a Jersey corporate manager, although retaining ultimate decision-making responsibility, delegates functions back to a discretionary onshore fund manager. At this stage, we understand that the most likely outcome is that such managers can retain the flexibility to have some of the CIGA carried on outside Jersey, rather than being assessed purely on net management activity carried on in Jersey (after a transfer pricing analysis).

If the substance proposals are adopted in their present form, for fund managers of open ended funds, some functions may have to be moved, either offshore to Jersey or, if there's insufficient CIGA in Jersey to support Jersey substance, back onshore.

3. The final test for substance is that the company carrying on the relevant activity has to demonstrate that it has:
 - (a) An adequate level of (qualified) employees in Jersey **or** an adequate level of expenditure on outsourcing to Jersey service providers which is proportionate to the activities of the company;
 - (b) An adequate level of annual expenditure incurred in Jersey **or** an adequate level of expenditure on outsourcing to Jersey service providers, proportionate to the activities of the company; and
 - (c) Adequate physical offices and/or premises in Jersey **or** an adequate level of expenditure on outsourcing to Jersey service providers, for the activities of the company.

This is particularly helpful for managers who do place reliance on, and pay, local administrators to provide access to premises and support services, when needed.

Section 8 of the Consultation considered the application of the substance requirements to Jersey fund companies. The Consultation acknowledges that fund companies should have reduced substance

requirements and, if any are imposed, we consider that those should reflect the levels of substance required of fund companies under the Collective Investment Funds (Jersey) Law 1988, the Control of Borrowing (Jersey) Order 1958, the relevant JFSC Codes of Practice and JFSC policy guides.

Sanctions

The consultation put forward a series of sanctions based on an escalating series of trigger events.

Trigger 1: Failure to submit a tax return or incomplete disclosure of substance information. This would result in rejection of the tax return, "failure to file" financial penalties, detailed audits, request for additional information and notifications of non-compliance.

Trigger 2: Failure to meet substance requirements via disclosure or audit. This would result in financial penalties (aligned with those for filing inaccurate CRS returns).

Trigger 3: Persistent non-compliance and failure to enact remedial measures. Here the suggested penalty is striking off the register of Jersey companies or notification to the tax administration in the jurisdiction of incorporation of the company.

Trigger 4: Any of the above could trigger spontaneous exchange of information in relation to the company with any EU member state in which the company's immediate and ultimate parent entity is resident and/or a report to the appropriate regulatory authority regarding the lack of adherence to local legislative requirements for regulated entities.

Final thoughts

1. Funds domiciled in Jersey have been structured based on advice and requirements not just from Jersey but also from other jurisdictions. These substance proposals are being laid over existing frameworks designed to meet other purposes and requirements and, in some cases, the two sets of requirements may conflict. Those responsible for looking after fund managers will need to revisit their advice for their current structuring to identify any conflicts or issues to be worked-through.
2. The substance proposals focus on concepts of headcount and premises and this runs directly counter to the concept of the growing digital economy and flexible working – the idea you can work anywhere and at any time. Jersey wants to be part of that digital economy so we need to ensure as best we can that these proposals don't reduce our competitiveness in that sphere.
3. Finally, we believe Jersey should only implement these proposals in step with other competitor jurisdictions – not running ahead or imposing more onerous burdens than other similar jurisdictions, but keeping in step. We welcome that the government of Jersey has confirmed that it is working in lockstep with the governments of the Isle of Man and Guernsey to deliver a co-ordinated and consistent approach to the proposals.

Our own approach to these proposals has been to respond comprehensively to the government Consultation, alert local industry and discuss the proposals with some clients (selectively). So far, those clients seem relatively unfazed by the proposals, probably because of the substance model which already exists in Jersey and which has been applied to Jersey fund managers for years – experienced Jersey directors, well-staffed Jersey administrators and a strong regulatory regime.

In conclusion, despite the various uncertainties that need to be ironed out, if these proposals are accepted by the EU, Jersey will be in a position to say that it has been assessed against and 'passed' the OECD BEPS substance challenge. We will hopefully move out of Annex II, leaving others on that list and all of this should give us, as a jurisdiction, a good sustainability message. It's a journey between here and there but this is a reasonable start.

ICO Guidance Note, Alistair Horn, Mourant LP Partner and James Daniel, Senior Associate

In a positive move for Jersey's growing FinTech sector, the Jersey Financial Services Commission (the JFSC) has recently published a Guidance Note in relation to its regulation of "initial coin offerings" (ICOs) in Jersey.

The Guidance Note, which follows consultation by the JFSC with government, industry and local legal practitioners (including Mourant) sets out, amongst other things, the minimum requirements that the JFSC will expect from any ICO issuers based in Jersey (ICO Issuers) and provides much needed clarity for ICO

promoters hoping to take advantage of Jersey's status as a well-regulated and reputable international finance centre.

The Guidance Note clearly illustrates that the JFSC recognises the innovative potential of blockchain technology such as ICOs and is willing to accommodate ICO Issuers hoping to take advantage of Jersey's position as a well-regulated and sophisticated international finance centre, whilst at the same time ensuring that the risk to investors (particularly retail investors) is minimised. Please click here for our summary of the Guidance Note: <https://www.mourant.com/file-library/2018---media/2018---updates/jersey-regulator-publishes-guidance-note-on-initial-coin-offerings.pdf>

Panel Session, Moderated by Daniel Birtwistle, Managing Partner

Our experts shared their views on a variety of topics including:

- recent developments in relation to the UK CGT consultation
- proposed changes to the listing rules for TISE
- recent case law affecting the limitation of liability of trustees of unit trusts, which should cause Jersey trustees to review their standard language and, if possible, even revisit existing contracts containing limitation of liability language
- the latest on AIFMD

and gave a summary of some interesting recent structures and deal-flow.

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