

## Economic substance requirements for Jersey fund managers and self-managed funds

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The Taxation (Companies - Economic Substance) (Jersey) Law 2019, which came into force on 1 January 2019, was passed in order to comply with the requirements of the EU Code of Conduct Group on Business Taxation and applies to certain Jersey tax-resident companies.

The purpose of the economic substance requirements (the **substance requirements**) is to demonstrate that the profits generated by Jersey tax-resident 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 presence in Jersey. Jersey was put on the EU whitelist in March 2019.

The substance requirements establish economic substance tests which require fund managers to demonstrate that:

- they are directed and managed in Jersey in relation to that activity
- 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
- 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 Taxation (Companies - Economic Substance) (Jersey) Law 2019 (the **Law**) where they have gross income in relation to their fund management activities. Fund vehicles themselves are outside the scope of the Law, unless they are classified as self-managed funds - that is corporate funds which do not appoint an external manager but which are managed internally by their board of directors. Further detail on the substance requirements that apply to self-managed funds is set out below. Other services which

may be performed by a fund manager, such as fund administration, advisory services and custody services, are also out of scope.

The Crown Dependencies issued a joint Key Aspects Document in December 2018 and Guidance Notes on aspects of the substance requirements on 26 April 2019, which were updated on 22 November 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 business must be directed and managed in Jersey in relation to that activity (unless they are a self-managed fund as this is assumed). In this regard, the Law, together with the Guidance Notes, require:

- 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 Jersey at adequate frequencies, having regard to the amount of decision making required at that level
- a quorum of the Board of Directors to be physically present in Jersey at those meetings and, where a meeting is called to consider a strategic matter, or CIGA, a majority of directors making the decision must be physically present in Jersey for the decision to be considered to be made in the Island
- 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 resolution which are considered and signed by that director when physically present in Jersey)
- 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, including all supporting documents relating to board meetings (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 most likely, 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), with the Guidance Notes providing a welcome confirmation that isolated decisions may be taken outside Jersey 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 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 (whether inside or outside Jersey) which make such decisions 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 fund 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 for such purposes.

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

Having regard to the level of fund management carried on in Jersey, fund managers must have adequate - that is enough or satisfactory for a particular purpose:

- number of employees in relation to the activity who are physically present in Jersey
- expenditure in Jersey
- 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 note that the definition of "employees" is similar to that used by the EU in relation to small to medium-sized enterprises (**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.

## **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 the focus is on the taking of decisions, and a company which is simply implementing the decisions of another entity - for example by selling investments - is not performing the CIGA. Further, in order for a decision to be determined as being taken in Jersey for the purposes of this 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. The 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 is calculated 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 this CIGA to be being performed
- 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 perform the CIGAs that generate the income it has and must be able to demonstrate that the CIGAs that generate its gross income are performed in Jersey. Where one of those CIGAs relates to making relevant decisions, a quorum of directors as well as the majority of directors making the decisions must be physically present in Jersey, when the decision is made.

## **Self-managed funds**

The substance requirements in respect of self-managed funds came into force on 1 January 2021. The economic substance test for self-managed funds is applied in relation to their fund management activities and is intended to mirror the requirements placed on other fund management businesses. A separate test for self-managed funds is set out in the Law, which in summary is the following:

- all of its CIGAs must be carried out in Jersey
- it must have adequate employees, expenditure and physical assets in Jersey

Further guidance issued in respect of self-managed funds notes that, given that the fund management is carried on internally within the same entity as the fund, the overall income, if any, will not correlate with the level of fund management activity. A self-managed fund is always treated as having received income from the relevant activity of fund management.

Additionally, a specific “directed and managed test” is not required for self-managed funds because such funds are automatically directed and managed in Jersey in practice by virtue of the regulatory requirements in Jersey and the application of the CIGA to a fund managing its own investments.

The Government of Jersey has confirmed the relevant CIGA are those for a fund management business and are to be applied in the same manner as they would be applied to a separate fund manager.

The substance requirements for self-managed funds complement the regulatory requirements with regard to funds regulated or supervised by the Jersey Financial Services Commission (JFSC). If a self-managed fund cannot meet the JFSC regulatory requirements (including the JFSC requirements on outsourcing), it will not be capable of meeting the requirements of the economic substance test.

## Outsourcing

It is common for fund managers and self-managed funds 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 or fund monitors and retains the ability to control the activities of any service providers in Jersey, the outsourcing of a CIGA to that service provider will be in compliance with the substance requirements. Furthermore, as long as the company has taken the strategic decisions and set investment parameters within which investment decisions may be implemented by the group entities outside the Island, and it receives reports and is able to monitor and control the outsourcing, those outsourced activities will not undermine the fact that the CIGA is conducted in Jersey.

In the case of a self-managed fund, the Government of Jersey has confirmed that the "taking decisions on the holding and selling of investments" CIGA may not be outsourced and will always have to be undertaken by a self-managed fund itself, and the demonstration of this CIGA must involve the decision making at board level.

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

The guidance on completing the Jersey Corporate Tax return issued by the Government of Jersey on 26 April 2019 discloses the additional questions relating to economic substance which will be included in tax returns commencing from 2019 and provides assistance on completing such questions.

Significantly for company directors, the fund management company will have to declare in its tax return 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.

We assist 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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