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UPDATE

Summary of Jersey Funds Updater (16 May 2019)

Update prepared by Matt McManus (Counsel), Mathew Cook (Counsel), Joel Hernandez (Mourant LP Partner), Ben Robins (Partner), Tim Morgan (Partner) and Gabby Kellogg (Senior Associate)

Speakers from our team shared the latest market insights, as well as providing an update on the following legal, regulatory and tax developments impacting the funds industry over the last quarter including: Civil Penalties, Public Registers, UK real estate investment activity and further clarity on economic substance since the Joint Guidance Notes were published on 26 April 2019.

Headlines for Q1 2019, covered by Matt McManus, Counsel

The biggest news story since our last quarterly update is that Jersey has been placed on the 'whitelist' of co-operative tax jurisdictions by ECOFIN, following the conclusion of the EU Code Group process. This is unequivocally a great outcome for Jersey, and demonstrates once again that our jurisdiction is at the forefront of compliance with new international standards for fair taxation. The whitelisting follows significant efforts from those in government, the JFSC and Jersey Finance and in the industry itself in ensuring that the Code Group's requirements were met.

The European Investment Bank subsequently moved to clarify that there is no impediment to private equity firms in jurisdictions such as Jersey to carrying out 'business as usual' with the European Investment Fund.

While we continue to monitor developments on Brexit, the JFSC have ensured that Jersey funds can continue to market to professional investors in the UK no matter what the eventual outcome, by entering into a new memorandum of understanding with the FCA. This MoU will remain valid notwithstanding the UK becoming a 'third country' for AIFMD purposes.

Jersey AIFMs should maintain a watching brief as the EU's revised cross border distribution rules continue to develop. The AIFMD currently regulates only formal marketing of alternative investment funds; the changes would see a new concept of 'pre-marketing' introduced.

While the boundary between pre-marketing and marketing seems to have been drawn a bit more pragmatically than first anticipated, the proposals would require notification of any pre-marketing activity. In addition, the proposals effectively amount to a clampdown on reverse solicitation, in that any subscription to the AIF within 18 months of the beginning of the pre-marketing phase will be deemed to be the result of marketing (meaning that formal marketing requirements will be triggered).

The proposals are still not fully set in stone. The remaining processes of consultation and evaluation – and implementation at a local level – provide opportunities for EU and non-EU stakeholders alike to argue for a rolling back of some of the more impractical aspects of the rules.

Civil Penalties, covered by Mathew Cook, Counsel

As noted in our recent briefing revisions to the Codes of Practice will come into force in June this year, and prohibit registered persons from indemnifying, or obtaining insurance, to cover civil penalties issued to principal persons. Further, recent proposed updates to the decision making process to cover civil penalties

in relation to principal persons means the regime will soon be fully operational. Where potential breaches of a Code have taken place, a number of considerations arise:

(a) a plan to cover appropriate action should be devised. In particular, the JFSC has published a number of principles it will consider in determining the level of any penalty, as well as aggravating and mitigating features. Those matters should be addressed, including early notification, remediation, any impact on clients etc….;

(b) The question of whether or not a relevant paragraph of the Code has been breached can be a nuanced question and should be carefully considered before any final determination is reached. The JFSC process allows for an information gathering and determination stage, and that should be followed in full prior to any determination;

(c) The areas of particular concern to the JFSC can be ascertained in a number of ways, including feedback on on-site examinations, its examination programme and public statements setting out enforcement action taken. Reference can also be made to civil penalties in other jurisdictions. Ensuring you address mistakes identified in other businesses should assist in avoiding potential breaches;

(d) Whilst the interests of the registered person and its principal persons should be aligned in many respects, there is potential for some conflict. (for example, when it comes to responsibility, as well as potentially timing and manner of notification) and those conflicts will need careful management;

(e) The insurance position should be carefully addressed and policies reviewed to ensure the revised Code is not breached.

General Update on UK Real Estate Market, covered by Joel Hernandez, Mourant LP Partner

The state of the UK real estate market in the first quarter of 2019 seemed subdued with the uncertainly of Brexit, Brextension and the UK's lower GDP forecast dominating headlines and affecting investor sentiment. However, some markets proved resilient with the "Private Rented Sector", "Build to Rent" sector, student, healthcare and logistical assets receiving sizeable inflows from funds, asset managers and institutional investors in the first quarter.

Non-resident capital gains tax (NRCGT) and proposed stamp duty land tax (SDLT) surcharge (1%) on UK residential acquisitions

Following the commencement of UK's NRCGT regime on 6 April 2019, we've seen a marked increase in the establishment of Jersey property unit trusts which is welcome news. Fortunately Jersey continues to be popular jurisdiction amongst clients and the onshore tax and legal advisors for UK commercial property acquisitions.

Separately, the UK government is proposing an additional 1% SDLT surcharge on non-UK residents acquiring UK residential property. If this comes into force, it will affect non-UK resident natural persons and will also extend to non-UK corporate vehicles, contractual schemes, unit trusts and certain partnerships.

Using Jersey for UK Real Estate Investment Trusts (REITs)

A REIT, if properly structured and listed on a recognised exchange (such as TISE), benefits from an exemption on UK corporation tax on property investment income and capital gains. We explained that Jersey has a role to play in the private REIT market insofar as a UK qualifying REIT can be established as a Jersey company. There are specific structural, regulatory and taxation requirements to qualify for UK REIT status; however these can helpfully be managed with the use of a Jersey company and with the proper guidance from UK and Jersey legal and tax advisers. Mourant Ozannes worked on the first Jersey private REIT in 2013 and has advised on a number since then, including a REIT that was launched in early 2019 that acquired the London headquarters for a global investment bank (£1.2b+).

Public Registers, covered by Ben Robins, Partner

The UK's draft Registration of Overseas Entities Bill (the Bill), published on 23 July 2018, will require certain non-UK entities that own, buy, or in some instances lease UK property, to be registered on a newly-created and publicly searchable UK register maintained by the UK registrar of companies. Such "registered overseas entities" (ROEs) must also identify and provide publicly searchable details of their beneficial

owner(s)/controllers. The intention is that, subject to royal assent and secondary legislation, the register will be operational by 2021, therefore it's important that Jersey entities (particularly companies) holding UK property understand and plan ahead for the practical implications. Once registered, ROEs are required to update or confirm their ownership/control information annually, having taken reasonable steps to identify registrable beneficial owners (including sending notices to such beneficial owners). Failure of an ROE to provide annual updates is an offence, as is delivering misleading, false or deception information.

Not registering will result in:

- the ROE being unable to register as proprietor of UK land (necessary for obtaining full legal title); and
- certain dispositions made by ROE being incapable of UK land registration.

There will therefore be additional levels of registration due diligence to undertake for those proposing to enter into a UK land transaction with any ROE (and additional warranties to be sought too).

The registration requirement will be retrospective and overseas entities already owning UK land will have 18 months to register or to sell the property.

Who are Registrable Beneficial Owners?

Those:

- holding more than 25% of the shares or voting rights in the ROE (directly or indirectly);
- having right to appoint or remove majority of the board of directors of the ROE; or
- exercising, or having right to exercise, significant influence or control over the ROE (i.e. a level of control broadly equivalent to those with an interest in more than 25% of the shares or voting rights).

Where trustees of a trust, partnership members or another unincorporated entity that's not a legal person would meet the above criteria in relation to an ROE, any person who exercises significant influence or control over that trust / partnership / unincorporated entity will be a registrable beneficial owner.

Details of directors of ROE companies will not generally be required to be provided, but where it's not possible to disclose details of persons with significant control (eg there are none, or the ROE cannot identify them), the ROE must instead provide information on its "managing officers", meaning any director, manager or secretary of an overseas company – for a Jersey company ROE, that could mean Jersey directors.

The publicly searchable information relating to an ROE will include the name, date of birth, nationality and residential address of its registrable beneficial owners or managing officers, opening up a risk of exposure of those individuals to criminal activity: increased instances of cyber-crime, including identity theft (as already experienced by some on the UK's PSC register), as well as extortion, kidnap and ransom risk. The residential addresses of directors of overseas companies (other than managing officers) will not be public, but the current draft Bill fails to recognise situations where the property the ROE company owns is also the residential address of a beneficial owner/director.

Planning for 2021 implementation

Those managing/administering relevant overseas entities should:

- give themselves plenty of time to assess applicability of new legislation and level of public disclosure, by whom, required
- warn relevant client beneficial owners/directors etc. accordingly
- keep an eye on final legislation for privacy carve-outs and any helpful/unhelpful changes in scope (eg possible inclusion of trusts in the definition of an ROE.)

Possible imposition by UK Parliament of a public register of all Jersey companies

The attempt to impose public registers of company beneficial ownership on the Crown Dependencies (CDs) and Overseas Territories (OTs) continues apace, sponsored by a back-bench UK Parliamentarian group led by Margaret Hodge (Labour) and Andrew Mitchell (Conservative). Although not supported by the UK Government, the UK's Sanctions and Anti Money Laundering Act 2018 was successful in imposing public registers on the OTs. An attempt to impose them on the CDs in March 2019 through the (Brexit-related) Financial Services Implementation of Legislation Bill failed when the UK Government pulled the Bill to avoid

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defeat. Pressure to impose public registers on the CDs is unlikely to abate, notwithstanding legitimate constitutional objections from the governments of Jersey, Guernsey and Isle of Man, and is quite likely to re-appear as an amendment to the draft Registration of Overseas Entities Bill described above.

The CD's are, of course, already committed to high standards of financial services regulation and transparency and Jersey's pre-existing and secure central register of company ownership, available to UK law enforcement agencies upon demand, is verified by regulated service providers, and is a more effective means of minimising financial crime than unverified public registers. Public registers (including the UK's PSC register) render named individuals susceptible to criminal activity – see above – as well as breaching EU, UK and Jersey data protection law principles.

The means of imposing pubic registers by UK Order in Council on the CDs is also contrary to the established constitutional relationships that exist between the UK and each of the CDs. For more than 800 years, constitutional convention has held that UK Parliament does not legislate for Jersey in such domestic matters and the States of Jersey Law provides that UK Orders in Council must be approved by the States before becoming law in Jersey. The possibility of a constitutional crisis, involving Judicial Review of an Order in Council rejected by the States of Jersey, therefore arises. It would set an unhelpful precedent for Jersey to concede hundreds of years of domestic legislative autonomy in an area where UK cannot legislate directly and where Jersey already has an effective and workable domestic solution to the policy concern.

The existence of the UK PSC register, the creation of EU public registers under the 5th Anti-Money Laundering Directive and the likelihood of them being imposed on the OTs, mean that pressure on the CDs is unlikely to abate, however. Given the existence of its verified central register, Jersey's stance of committing to public registers when they become an effective global standard is in keeping with its co-operative international regulatory stance, but it must be hoped that any global standard seeks to minimise the potential data protection, information inaccuracy and security concerns posed by public registers.

Economic Substance, Interview conducted by Gabby Kellogg, Senior Associate and Partner Tim Morgan

Following the 2017 undertakings made to the EU Code Group, Jersey's economic substance law (the Substance Law has been in force since 1 January 2019. Some further amendments are being made to the Substance Law which will be debated by the States on 4 June. On the 26 April, Joint Guidance Notes (JGNs) were released covering the position in each of the Crown Dependencies.

The issue of the JGNs has assisted with clarifying a number of aspects and five months into the first year in which the law takes effect, if they haven't already companies should now have firmed up a position as to their classification – are they in scope, and if so, under which category of in scope entity? We can assist with this.

Key tests for in scope entities

This will be essential for ensuring in scope entities satisfy the relevant requirements under the Jersey substance law. The three primary elements that in scope entities should all be considering are:

1. the "directed and managed test" (local quorum and governance requirements)
2. the company must conduct some relevant "core income generating activity" (CIGA) on Island
3. the substance (people, premises and expenditure) on Island related to that activity must be "adequate" in light of that CIGA

Some of the key points to come out of the JGNs include that decisions by fund managers in relation to investments need to be made by a majority of directors in the Island, and also that if committees or other delegated entities are appointed by relevant boards, these need to be subject to board oversight or will be invalid. Quorum and meeting arrangements also need to be reviewed carefully. The "XYZ Limited" fund manager case study in the JGNs provides helpful guidance on the extent to which Jersey fund management companies can delegate elements of investment management outside Jersey.

There remain moving parts to keep an eye on, including the OECD's own evaluation of the wide range of zero or nominal tax jurisdictions (with further decisions anticipated in late June) as well as further clarifications in relation to outsourcing.

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As a result, we anticipate that market practice will continue to evolve over the next 12-18 months, which will be the period up to the first filings of tax returns under the Substance Law. In some cases, companies which might prima facie be in scope, may fall out of scope if, for example, no income actually arises in the period (e.g. a holding company where there is no dividend income) or, in some cases, where the structuring of debt securities falls outside "relevant activity" for the finance and leasing category.

We are seeing a "comply now, fine-tune later" being appropriate in a number of situations. The revised form of tax return itself is expected to be circulated soon which will also assist companies, in conjunction with their service providers, in fine-tuning their data collection activities.

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To find out more about any of the topics mentioned above, please get in touch with your usual Mourant contact, or, alternatively, contact one of the specific contacts named below:

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