

TECHNICAL

Are your offshore Directors really offshore?

"A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business."

Lord Loreburn LC in *De Beers Consolidated Mines Limited v Howe* (Surveyor of Taxes), 1906.

A recent decision made by the UK first tier tribunal has highlighted a series of crucial issues for all Board Directors who wish to ensure that they are exercising 'acts of central management and control' on an offshore rather than onshore basis from a legal and regulatory perspective. The tax tribunal's conclusions build on precedents set by a number of other cases, including the landmark 1906 House of Lords hearing quoted at the beginning of this article.

The tribunal's findings highlight the fact that Directors' failure to consistently and transparently exercise acts of central management and control outside a particular onshore tax jurisdiction can undermine a Fund or Company's offshore tax status.

The tribunal, *Laerstate BV v HM Revenue & Customs*, sat in public in London during July 2009, and considered whether a Netherlands company should in fact be treated as UK resident for tax purposes, because of the location in which a particular Board Director exercised acts of central management and control. Although the specifics of the case are related to the UK, the issues and recommendations that the case highlights are deeply relevant for every Board Director who wants to secure the legitimacy of his or

her offshore status anywhere in the world. The tribunal addressed two broad issues regarding the location and circumstances in which Directors exercise acts of central management and control, and the implications of these circumstances for a Fund or Company's tax residency status:

1. First, the tribunal addressed the type of Director actions that constitute 'central management and control' of a Fund or Company.
2. Second, it addressed the circumstances in which it must be concluded that central management and control does not rest with a particular Director.

Looking ahead, these issues are likely to prove crucial for Directors seeking to ensure that their Fund or Company's residency position is clear, robust and secure.

Acts that constitute those of 'central management and control'

Turning to the first of the two broad issues listed above, the tribunal concluded that acts of central management and control are not exclusively confined to formal Director activities such as the signing of Board Resolutions and other documents. Instead, acts of central management and control have a broader definition, the tribunal argued, covering policy, strategic and management matters. As a result, all Directors keen to safeguard their offshore status should ensure that all such activities – and not merely the signing of Board Resolutions and other documents – are conducted on an offshore basis.

01-02 : Are your offshore Directors really offshore?

03 : Mauritius as a Fund domicile

04 : UK CRC Energy Efficiency Scheme

Improvement still needed...

Augentius and the EVCA

Augentius AllStars Strike Gold



Glyn Thomas
Managing Director (Guernsey)

In this particular tribunal case, HM Revenue and Customs (HMRC) successfully argued that a particular Director had exercised central management and control on an onshore (UK), rather than an offshore, basis, citing the following supporting evidence:

- A period of 18 months had elapsed without a single board meeting taking place.
- Numerous board meetings that took place offshore did not include strategic decision-making.
- Records of recent company history indicated that important corporate decisions had been made during a time when the Director in question was onshore (in this case in the UK), rather than offshore, and at a time when no official board meetings had taken place.

In their written reasons for their decisions, published during August 2009, the tribunal judges stated the basis for their findings clearly and simply:

"There is no assumption that CMG [central management and control] must be found where the Directors meet. It is entirely a question of fact where it is found. Where a company is managed by its Directors in board meetings it will normally be where the board meetings are held. But if the management is carried out outside board meetings one needs to ask who was managing the company by making high-level decisions and where, even where this is contrary to the Company's constitution."

continued on page 2



Are your offshore Directors really offshore? **continued**

Circumstances in which central management and control does not rest with a Director

Building on the argument articulated on page 1, the tribunal judges also clarified the criteria necessary for legitimately asserting that a particular Director is genuinely exercising acts of central management and control.

The tribunal divided the potential ways that a Director of an overseas company can exercise central management and control into four categories:

1. Signing documents "mindlessly, without even thinking what the documents are".
2. Signing documents with knowledge of the nature of what they are signing (in other words, not 'mindlessly'), but without the "absolute minimum amount of information that a person would need to have in order to be able to make a decision at all on whether to agree to follow the shareholders' wishes or to decide not to sign." In the case in question, this 'absolute minimum' level of information would include, according to the tribunal judges, "such matters as whether they [the Directors] had any knowledge of, or received advice on, whether the price was sensible."
3. Signing documents with the "absolute minimum amount of information" required but without the level of information that a reasonable Director would regard as necessary for making a fully informed decision. (Though, as the tribunal put it, quoting a previous case, *Wood v Holden*: "ill-informed or ill-advised decisions taken in the management of a company remain management decisions.")
4. Signing documents with sufficient information to do so in a fully informed way.

The tribunal determined that the first two of the above categories do not represent sufficient criteria for an overseas Director to be classified as exercising acts of central management and control over a Fund or Company.

In particular, the tribunal asserted that a Director cannot legitimately exercise central management and control without the "absolute minimum amount of information" that an individual would require in order to have the ability to make a decision.

Using the above rationale, the tribunal ruled that the Director in question continued to exercise central management and control on an onshore basis, even after he had resigned from his post, on the grounds that a remaining Director, who ostensibly took over the resigning Director's central management and control responsibilities, frequently did not have the "absolute minimum amount of information" required to make the decisions at hand. In addition, the resigning Director, rather than the remaining Director, also instructed and corresponded with professional advisers to the company. In their written reasons for their decision, the judges wrote:

"We have found that [the UK-resident Director in question's] activities were concerned with policy, strategic and management matters throughout the time he was a Director of the Appellant and also after he ceased to be a Director. We find that his activities constituted the real top level management (or the realistic positive management) of the Appellant and [the remaining offshore Director's] activities were limited to signing documents when told to do so and dealing with routine matters such as the accounts. As such the place of effective management was in the UK".

Securing your Fund's offshore tax residency

In light of the tribunal case described above, (the findings of which are reinforced by various historical precedents), offshore Directors should bear the following in mind in order to ensure that they do not jeopardise the tax status of their offshore Fund or Company:

- All Board Directors should be provided with the information and time they need in order

to make all required decisions at board meetings held in an offshore location.

- Board meetings should take place offshore on a regular basis. All key strategic decisions regarding the Fund or Company should be made at these offshore board meetings – rather than at any other meetings that may take place onshore.
- Directors should avoid taking part in offshore board meetings via telephone from an onshore location; they should participate in such meetings in person as a matter of standard practice.
- Full records should be created and archived covering the content of every offshore Board meeting. These records should cover the information that was provided to Directors attending the meeting, and the content of the discussions taking place at the meeting, as well as the decisions made at the meeting.
- Offshore Board Directors and other senior representatives of the Fund or Company should conduct themselves in a manner that is consistent with the above considerations – especially when they are located onshore.

In addition, it is recommended that the majority of Directors, including the Chairman and, if relevant, the casting vote, are not resident onshore. It is also important, of course, that these offshore Directors have relevant expertise.

In today's tightening regulatory environment, there is a significant probability that HMRC and tax authorities in other jurisdictions will place corporate residency issues under greater scrutiny than ever during the months ahead. So it is crucial that every Board Director is prepared.



Mauritius as a Fund domicile



J.P. Harrop
Managing Partner

The Republic of Mauritius, an island nation approximately 900 kilometres east of Madagascar, offers a range of significant attractions as a Fund domicile. Key strengths of the country include:

- A comprehensive range of highly competitive professional services, including Fund administration, accounting and legal services.
- A network of 35 tax treaties that provide greater tax efficiency than the majority of traditional Global Business centres.
- A foreign tax credit system written into domestic tax law. Under this system, Mauritian tax liability on foreign source income has an effective rate of between 0% and 3%.

On top of these specific strengths, Mauritius also offers all of the attractions of a traditional international financial services hub, including:

- The absence of withholding tax, capital gains tax or inheritance tax.
- Zero capital duty on issued capital.
- Flexible, relevant legislation for the creation and administration of numerous types of investment businesses.
- Exchange liberalisation and free repatriation of capital and profits.

Mauritius also benefits from full legal protection of banking secrecy and global company information, plus an optimal time zone (GMT plus four hours) for working-day communications with every country from the US in the West to Japan in the East.

Mauritius is a particularly attractive Fund domicile for African and Indian Funds – two markets that are set to continue to enjoy impressive growth during the coming years. As well as the geographical proximity of Mauritius to these markets, there are a number of other key reasons for the attractiveness of the domicile for African and Indian Funds:

Benefits for African Funds

Mauritian tax treaties restrict the taxing rights

of capital gains to the country of residence of the seller of the assets. Mauritius itself does not impose tax on capital gains. Twelve African countries already have such a tax treaty with Mauritius – providing protection against the future introduction of capital gains taxes in these nations.

Mauritian tax treaties also limit the withholding tax on dividends and provide guarantees regarding the maximum effective withholding tax rate in the event of changing fiscal policy in investee countries. Again, this provides substantial comfort to investors into African Funds.

Finally, Mauritius, itself an African nation, has signed Investment Promotion and Protection Agreements (IPPAs), which provide further protection for Fund Managers and Investors, including guarantees against expropriation as well as free repatriation of investment capital and returns.

Benefits for Indian Funds

Indian Funds, meanwhile, enjoy the benefits of the Mauritius/India Double Tax Treaty, which offers short-term capital gains tax exemption to Category 1 Global Business Licence companies (GBL1) incorporated in Mauritius. The treaty also caps the dividend withholding tax at 5% for substantial shareholdings. As a testament to the attractiveness of this treaty, Mauritius is the number-one nation in terms of Foreign Direct Investment (FDI) into India.

Managers of Indian and African Funds are not the only people with an incentive to look to Mauritius: the country also has Double Taxation Agreements with other nations including China, Thailand and Singapore.

Fund Structures and legal framework

The Securities (Collective Investment Scheme and Closed-end Funds) Regulations 2008 provide the regulatory framework governing

Collective Investment Schemes (CIS) in Mauritius. There are specific rules for each of the following categories of CIS:

- Expert CIS (designed for expert investors who make an initial investment of at least US\$100,000).
- Retail CIS (for any type of investor).
- Specialised CIS (for any type of investor).
- Professional CIS (for Private Placements).

A CIS can have either a single tier structure – used by Property Funds, for example – or a two-tier structure. Private Equity Funds can use a multi-class structure, or a multi-class structure with SPV (Special Purpose Vehicle). Whatever structure is used, it is crucial that the CIS has an administrator and cash custodian based in Mauritius. A Limited Partnerships Act is expected to become law in Q2 of 2010.

Every CIS must be approved by the Financial Services Commission (FSC) in Mauritius before it launches. The FSC will consider a range of criteria during its assessment process, including:

- The structure and objectives of the Fund.
- The Investors and the market that the Fund targets.
- The kinds of investments in which the Fund will deal.
- The track record and credentials of the Promoters, Directors, Investment Manager, Custodian and Administrator.

Assuming that all documents are provided in the initial submission draft, the process of obtaining approval for a CIS can be completed within four weeks.

Augentius received final regulatory approval to administer Mauritian Domiciled Funds in February this year. A number of Fund Managers have already appointed Augentius Mauritius – and with the growth prospects in India and across Africa continuing to rise, we look forward to welcoming many more clients during the months and years ahead.



TECHNICAL

UK CRC Energy Efficiency Scheme – You have been Warned

The UK CRC Energy Efficiency Scheme, which we covered in some detail in our Summer 2009 Newsletter came into effect on 1 April 2010. Private Equity firms who have controlling stakes in portfolio companies with UK operations may be required to register with the UK Environment Agency.

The first compliance year (April 2010 – March 2011) is a 'Footprint' Year. Any Private Equity firm whose portfolio included, on 31 December 2008, a controlling stake in a company with UK operations should already have considered whether it is required to register with the UK Environment Agency. Any UK-based business that had, during 2008, a 'settled half-hourly' electricity meter (an HHM) is required to comply with the CRC in some way.

Failure to register for the scheme (where registration should have taken place) potentially gives rise to a fine of up to £45,000, and may also be 'named and shamed'. In addition, the Environment Agency may serve an enforcement notice requiring the organisation to register for the scheme. Ultimately failure to comply with an enforcement notice is a criminal offence for which a Company's Officers may be prosecuted personally.

Full details can be found at:
http://www.decc.gov.uk/en/content/cms/what_we_do/lc_uk/crc/crc.aspx

Improvement still needed...

That is the 'end of year report' from the Guidelines Monitoring Group set up to monitor the performance of the Private Equity industry against the requirements of the Walker Report. The Guidelines Monitoring Group was established in March 2008 to monitor conformity of the UK private equity industry.

Overall, the Group considers that there continues to be a high level of commitment to the Guidelines from the private equity industry. The quality of the disclosures made by the sample of portfolio companies reviewed last year was similar to the quality of disclosure found in the previous year's review. However, in both years, the quality of the disclosures varies significantly within the sample, with some firms going much further than the requirements and some falling short. Although the efforts made by the private equity industry so far are encouraging, improvement is still needed in some areas.

The Group has commissioned a guide to help portfolio companies to conform with the Guidelines. Published in March 2010, this guide includes an analysis of the detailed requirements and a summary of good practice, using examples from the reviews conducted over the last two years.

Full details can be found at:
<http://walker-gmg.co.uk/sites/10051/files/Improving-transparency-%20disclosure.pdf>

Augentius and the EVCA

Augentius is a member of the working party assisting the EVCA in putting together the 'CFO-COO Summit 2010'.

Designed and delivered by leading figures in the industry, the event will leave COOs, CFOs,

Managing Partners and Legal & Compliance officers well equipped to meet the complex challenges that lie ahead.

Through a combination of keynote presentations, interactive panel discussions and facilitated working sessions, key issues to be covered will include:

- Regulatory updates
- In-depth analysis of European tax regimes
- Update and application of the latest accountancy standards
- The role of the CFO in the management of portfolio
- Resource allocation – the balance between in-house and outsourced functions
- LP/GP relations – fair value, reporting metrics and portfolio valuation

Further information can be found at:
http://www.evca.eu/cfo-coo_summit_2010/home.html

Augentius AllStars Strike Gold

The Augentius AllStars were recently crowned champions of the London Bridge Wednesday Mens Spring League having played 10, won nine and scoring 71 goals with 32 against. The team won the league by an impressive six clear points.

The trophy will now be joining our other awards in the office and the team will be taking a well-earned break, with plans to re-form later in the year.



MORE INFO

For further information on Augentius Fund Administration please contact:

Glyn Thomas

Managing Director, Guernsey
Tel: +44 (0) 1481 734 302
Email: glyn@augentius.com

Malcolm Wilson

Manager, Luxembourg
Tel: +352 26 39 21 71
Email: malcolm.wilson@augentius.com

Walter Davis

Director, Business Development
Tel: +44 (0) 20 7397 7268
Email: walter.davis@augentius.com

Hugh Stacey

Director, Business Development
Tel: +44 (0) 20 7397 5489
Email: hugh.stacey@augentius.com

David Bailey

Managing Partner
Tel: +44 (0) 20 7397 5453
Email: david@augentius.com