What happens in a Jersey fund? Not a lot, since you ask

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A commentator on this blog has said, initially quoting me, and overall in response to comment by Dave Hartnett:

"Tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes"

Where would you say the economic substance takes place in a collective investment fund that is established in Jersey, has a Jersey board of directors, Jersey Administrator and Jersey Custodian, UK based investment advisor and global investors investing in property funds that are themselves mainly established offshore?

This is actually one of the things that drives business offshore. It is not "tax avoidance": nobody objects if commercial property held in Paris is sold at a profit and the French government levies a property or capital gains tax. And the investors have no problem paying tax on their gains according to their home jurisdiction. But it is the intermediate vehicles that do not want to be subject to additional tax. Because if they are taxed then one of the things that initially led to the investment - the principle of risk spreading - immediately looks less attractive. After all, why buy a 1/10th share in 10 properties through a fund if you will be double taxed rather than simply buy a single property direct?

I think part of the problem is that you do not regard those sort of investments as investment at all, merely speculation. And you may be right. But the flipside of your position is surely that these transactions have no "economic substance". They are little more than a form of online gambling.

And Dave Harnett might note that fund management is one of the activities most frequently outsourced from offshore, because while offshore can manage admin and custodian, a smaller (though growing) percentage of investment managers are offshore. Mind you, in my experience the real con artists are the onshore investment *managers that clog the weekend papers with their adverts aimed solely at fleecing the moderately wealthy but wholly unsophisticated. That's another story though.*

I quote at length: this is a fair question, which is why the response deserves a separate bog.

And let me be unambiguous: as the description makes clear, nothing but a little admin takes place in jersey in the situation described. The investments in this fund are not Jersey based — they will be in markets in London or elsewhere.

The economic decision making of this fund is London based — which is where the investment advisor is located. And that, after all, is the only substantial activity of an investment fund. So its real management is not in jersey at all.

In that case the Jersey directors and custodian are simply hired guns offering, selling a charade in a jurisdiction where the only product of consequence is secrecy, permitted by a legislature that has permitted this to happen, and deliberately so.

I agree, the admin may be done in jersey. So what? Since when did admin provide an indication of the epicentre of control of an enterprise?

So the question to determine is a simple one — is any activity of substance undertaken in jersey — and the answer is clearly not. In that case the claim of Jersey tax residence is clearly unreasonable — the structure is designed to abuse legislation designed to promote abuse even if the consequence is not a sham because the law has been captured to legitimise what would otherwise be a sham.

So why is the structure in Jersey? The commentator says no one minds source based taxation on investment income: this is disingenuous of him (and as he is a senior Jersey lawyer he knows that to be true). The reality is a great deal of investment income suffers little or no source based taxation these days. And he is adamant the fund must pay no tax in Jersey as indeed, it does not. The question must therefore be about the tax due on the fund in the place here the investor is resident.

Let's be clear: if the investor invested directly in, for example, the UK the tax paid at source in the UK would not change from that paid via the Jersey fund. The cost of saving through the fund would be saved: prima facie the rate of return might rise (and since most investment managers under-perform the market after costs — by definition — the use of fund manager is not a logical defence for incurring the cost). So why the Jersey structure? The only way it can possible add value is in the country of investor residence. And the only way it can add value there is by reason of the income not being declared either due to avoidance (maybe because of roll up, for example) or because of evasion. But no other explanation is possible.

So to go back to Dave Hartnett, he's right to say:

Few people put their money in Caribbean tax havens because they are looking for excellence in fund management

He could have said the same of Jersey. The reality is — as Hartnett clearly implied — that the sole use of these places is to avoid, and in many, many cases, to evade tax. There is no other use for a Jersey fund — because as the description provided made clear — there is no economic substance to that fund, at all. There is just a charade: a sham provided by secrecy providers in a secrecy jurisdiction. And let’s be clear what they are:

Secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. That regulation is designed to undermine the legislation or regulation of another jurisdiction. To facilitate its use secrecy jurisdictions also create a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so.

That’s what Hartnett is driving at. I think it pretty fair to say he and I are on the same hymn sheet.

Why don’t the profession like that? Because they’re the secrecy providers. And they need to get their acts in order, very, very fast. Because I think the balance of risk in this equation is going to shift much sooner than the profession expects — as I said to the CIOT and ARC the other evening.