ESTABLISHING FUNDS IN GIBRALTAR

Introduction

The significant global expansion in funds has exerted considerable pressure on established fund centres. Gibraltar has been proactive in attracting fund business by enacting specific legislation for the setting up of funds quickly whilst maintaining high professional and regulatory standards.

Gibraltar has a high quality infrastructure in that it has major international banks, accountancy firms and skilled financial services professionals and lawyers who are able to service the funds industry. Gibraltar offers very high standards, and being a small jurisdiction, it is able to provide such services at competitive rates.

All of the above has made Gibraltar an increasingly attractive funds location.

Although reference is made below to "Authorised Schemes" and "Recognised Schemes" (as they are able to operate in and from Gibraltar), the main focus of this paper is to provide information on the establishment of a Private Scheme and an Experienced Investor Fund in Gibraltar.

Firstly, it is useful to set out Gibraltar's status as an EU territory.

Gibraltar within the EU

Gibraltar is an overseas territory of the United Kingdom and is part of the European Union by virtue of Article 299(4) of the Treaty of Nice. It is also a part of the European Economic Area ("the EEA") by virtue of the UK Treaty of Accession. Entities established in Gibraltar can therefore take advantage of European rules on the free movement of services.

As long as a Member State has implemented legislation giving effect to relevant European Directives, an entity in that Member State will be able to provide its services or operate throughout the EU and the EEA states. Gibraltar entities enjoy passporting rights into the EU and the EEA single market in respect of investment services, insurance and banking.

Additionally, Gibraltar entities are able to provide services within the EU which are not regulated by relevant directives provided they comply with the laws of that Member State.

There is no other offshore finance centre that can claim to have these advantages.

Legislation Enabling the Establishment of Funds in Gibraltar

The Financial Services (Collective Investment Schemes) Act 2005 ("the CIS Act") regulates and sets out the basic framework for the promotion, establishment and operation of all funds (referred to in the legislation as collective investment schemes) in Gibraltar.

The Financial Services (Collective Investment Schemes) Regulations 2006 ("the CIS Regulations") deals with the detail of the regulatory regime.

The Financial Services (Experienced Investor Funds) Regulations 2005 allows and regulates Experienced Investor Funds.

The Protected Cell Companies Act 2001 allows funds to be set up so that there is a segregation of assets and liabilities in different cells in an umbrella structure with a number of sub-funds.

Gibraltar law prevents the promotion of collective schemes from within Gibraltar unless they are:

(a) Authorised Schemes;
(b) Recognised Schemes;
(c) Private Schemes;
(d) Experienced Investor Funds.

All of the above are referred to in more detail in this paper.

Authorised Schemes

Authorised schemes are either UCITS schemes (pursuant to the UCITS EU Directive relating to undertakings for collective transferable securities) or non-UCITs retail schemes. In either case, an application for authorisation has to be made to the Gibraltar Financial Services Commission ("the FSC") which is the regulator in Gibraltar. The FSC must determine an application within 6 months.

Recognised Schemes

Recognised schemes are either UCITS schemes in EEA States or foreign schemes that comply with certain conditions.

An EEA UCITS scheme is a scheme set up in another EEA State pursuant to the UCITS Directive. For the purposes of the CIS Act a collective investment scheme is constituted in an EEA State if it is constituted under the law of that State by a contract or under a trust and is managed by a body corporate under that law or it takes the form of an open-ended investment company. Such schemes can take advantage of principles of home state regulation and passporting. The entity continues to be regulated by the home State where it is domiciled.

As required by the UCITS Directive, the operator, trustee or depositary of a recognised EEA UCITS Scheme does not require to be authorised by the FSC in that capacity.

Recognised Foreign Schemes are collective investment schemes that are managed in a jurisdiction outside Gibraltar and do not satisfy the requirements for recognition as a UCITS scheme. The FSC may grant such schemes recognition if it is satisfied that the scheme, *inter alia*, is subject to an authorisation and supervisory regime in the jurisdiction in which it is constituted that, in the opinion of

the FSC, provides to participants in Gibraltar protection at least equivalent to the protection provided under the CIS Act.

Private Funds

Private funds have proved to be very popular in Gibraltar. These are permitted under section 6(3)(c) of the CIS Act provided that the scheme is promoted in accordance with, and is permitted by, the CIS Regulations. The CIS Act refers to private funds as "private schemes" and, in essence, these are collective investment schemes that are not listed on a stock exchange and are limited to no more than 50 participants.

The main advantages of a private scheme are: (i) they are very fast to set up; (ii) they do not need to apply for authorisation to the FSC to commence its investment activities and (iii) they do not require a custodian/depositary, an FSC authorised Gibraltar resident directors/trustees or an FSC authorised administrator. This allows private schemes to be set up cost-effectively and quickly.

The main disadvantages of Private Schemes are: (i) that the extra level of comfort provided to investors by an FSC authorised administrator, FSC authorised Gibraltar resident directors/trustees and custodian/depositary is not there and (ii) there are restrictions on the marketing of such schemes. Many funds start off as private schemes and, as they become more successful, they convert to Experienced Investor Funds which do require the above.

Private Schemes also enjoy significant fiscal benefits which are set out in a section below specifically dealing with the tax position in Gibraltar.

Experienced Investor Funds ("EIFs")

The restriction on the promotion of a collective investment scheme does not apply to EIFs established and promoted in accordance with the Financial Services (Experienced Investor Funds) Regulations 2005 ("the EIF Regulations") created under section 52 of the CIS Act.

The EIF Regulations are, in effect, a self-contained piece of secondary legislation dedicated to EIFs which establishes a streamlined process for authorising and establishing open-ended or closed-ended funds where the investor is an experienced investor based on a system of self-certification by the investor, the fund's Administrator and its lawyers.

The Meaning of Experienced Investor

The EIF Regulations are permissive in defining an experienced investor based on **either** his experience, minimum investment, the minimum value of the assets of a trust or company or self certification by the investor that he has a net worth of a minimum amount. This makes Gibraltar attractive, for instance, to independent asset managers who manage assets of a small or medium sized investor base of high net worth individuals.

An experienced investor is defined as:

(a) a person or partnership whose ordinary business or professional activity includes, or it is reasonable to expect that it includes, acquiring, underwriting, managing, holding or disposing of investments, whether as principal or agent, or the giving of advice concerning investments;

(b) a body corporate which has net assets in excess of €1,000,000 or which is part of a group which has net assets in excess of €1,000,000;

(c) an unincorporated association which has net assets in excess of €1,000,000;

(d) the trustee of a trust where the aggregate value of the cash and investments which form part of the trust's assets is in excess of €1,000,000;

(e) an individual whose net worth, or joint net worth with that person's spouse, is greater than €1,000,000, excluding that person's principal place of residence;

(f) a participant who invests a minimum of €100,000 in the fund.

The Vehicle

The EIF Regulations also seek to ensure that those establishing funds can use a wide range of vehicles. As well as the traditional vehicles for establishing funds such as a company or unit trust, a fund can also be established as a limited liability partnership or a protected cell company under the Protected Cell Companies Act 2001.

Gibraltar EIF companies enjoy a significant advantage in that they can have more than 50 participants without having to be incorporated as a plc. The usual restriction to remain as a private company to having no more than 50 members, does not apply (under section 40(3) of the Gibraltar Companies Act). Therefore, EIFs can conduct business with a large number of investors without having to take on the extra administrative burdens of a plc.

EIFs established as protected cell companies allow for the creation of one master fund with a number of sub-funds protected in their own cell.

In addition, funds can be established in any other form recognised under the laws of Gibraltar that is approved by the FSC either generally or in relation to a particular fund.

Self Certification & Authorisation of an EIF

Authorisation under the EIF Regulations is based on a system of self-certification by the investor, the Fund Administrator and the Fund's lawyer. The EIF Regulations provide that no person shall be accepted as a participant of an experienced investor fund unless he has provided:

(a) written confirmation that he is an experienced investor within the meaning specified in the EIF Regulations; and

(b) a written acknowledgement that he has received and accepted the investment warning required by the EIF Regulations to be contained in the offer document.

The controller, administrator, manager or trustee of the fund is not required to verify the factual accuracy of a confirmation provided by a participant or potential participant.

Within 14 days of establishment of the Fund the Fund Administrator will then provide the FSC with:

(a) written notification of the establishment of the Fund as an experienced investor fund;

(b) a copy of the offer document;

(c) an opinion from an approved Gibraltar lawyer that the fund complies with the EIF Regulations;

(d) any other document required by the FSC.

Where these conditions have been complied with, the fund is deemed to be authorised by the FSC to commence its investment activities and the fund **does not** have to wait for prior approval. This will provide investors with a tremendous amount of certainty in an area where uncertainty costs money.

Offer Document

This normally takes the form of a private placement memorandum or a prospectus.

The main requirement as to the content of the offer document is contained in the EIF Regulations. This specifies that it shall contain such information as would reasonably be required and expected by participants and their professional advisers to make an informed judgment of the merits of and risks of investing in the fund.

It must also contain a specific investment warning stating, *inter alia*, that the fund is only suitable for those who fall within the definition of an "experienced investor" as defined in the EIF Regulations.

Specific Requirements

There are certain requirements all EIFs must comply with.

(a) All EIFs must have an FSC authorised fund administrator. There are several financial services firms which provide these services. They would also be responsible for maintaining the share register and compiling and

maintaining all due diligence and anti-money laundering documentation on investors.

(b) All EIFs set up as corporate vehicles, must have two resident directors authorised by the FSC. Approved Gibraltar lawyers and the same financial services firms who provide fund administration services can provide authorised directors as well.

(c) All EIFs set up as a Unit Trust must have at least one trustee resident in Gibraltar authorised by the FSC. Authorised trustees can be provided by Gibraltar lawyers and financial services firms as above.

(d) EIFs must produce annual audited accounts prepared by a Gibraltar registered auditor. These must be deposited with the fund administrator and copies made available to the FSC.

(e) An annual return in the specified form must be filed.

Management and Control

As referred to above, there must be at least two FSC authorised resident Gibraltar directors if the fund is set up as a corporate vehicle. If the vehicle is a trust, at least one of the trustees must be an FSC authorised resident in Gibraltar.

This does not mean that there cannot be other non-resident trustees or directors. However, the majority of the management and control has to be resident in Gibraltar, which will, in any event, be necessary if the vehicle is to take advantage of the tax regime for funds.

It should be noted that nothing prevents an experienced investor fund from delegating its functions of investment management to an approved third party in another jurisdiction. A typical structure may involve a company in Gibraltar with two resident Gibraltar directors and a third director resident in another jurisdiction exercising the functions of investment manager. Indeed, the Gibraltar directors can delegate the investment management functions to entities outside Gibraltar which are not themselves directors of the company.

Protected Cell Companies

Introduction

The Protected Cell Companies Act 2001 ("PCC Act") allows funds to be set up so that there is a segregation of assets and liabilities in different cells in an umbrella structure with a number of sub-funds. Whilst a protected cell company ("PCC") remains a single legal entity, the liability of the company in respect of each cell is limited to the assets attributable to the relevant cell, not for the debts of any other cell.

Many EIFs are set up as PCCs as they can, for example, allow sub-funds to pursue different investment strategies and allow sub funds to be created for different clients.

Single Legal Entity

The PCC Act states that a protected cell company is a single legal person and that the creation by a PCC of a cell does not create, in respect of that cell, a legal person separate from the company.

Separation of assets

It is the duty of the directors of a PCC to keep the assets of each cell separately identifiable. Specifically, they must (a) keep cellular assets separate and separately identifiable from non-cellular assets and (b) keep cellular assets attributable to each cell separate and separately identifiable from cellular assets attributable to other cells.

Cell shares, cellular capital and cellular dividends

A PCC may create and issue cell shares in respect of any of its cells. The proceeds of the issue ("cell share capital") are comprised in the cellular assets attributable to the cell in respect of which the cell shares are issued. A PCC may pay a cellular dividend.

Provisions in relation to winding-up

The rights of creditors are limited to the assets of the cell of which they are creditors.

In the winding up of a PCC, the assets forming part of the estate shall only be the non-cellular assets. The winding up shall not terminate any agency, or in any way whatsoever affect the authority or power of any officer, receiver, administrator, servant or agent of the PCC in respect of the cellular assets.

Any liquidator of a PCC has a duty to keep cellular assets separate and separately identifiable from non-cellular assets. The liquidator must also keep cellular assets attributable to each cell separate and separately identifiable from those assets attributable to other cells.

Tax Position in Gibraltar

Generally

In Gibraltar there is no capital gains tax and, therefore, no tax is payable on the redemption of shares. There is no inheritance tax, no wealth tax and no tax on interest earned by Gibraltar residents. In addition, there is no taxation on dividends and interest paid by a Gibraltar Company to a non-resident recipient which includes investors in a fund. There is also no withholding tax on dividends.

Specifically in Relation to Funds

An approved fund is exempted from tax by the Commissioner of Income Tax under Rule 3(17) of the Income Tax (Allowances, Deductions and Exemptions) Rules 1992. This includes an exemption from investment and derivative premiums, interest income, income from trading securities, financial instruments and property of any class, including real property and capital gains achieved from the trading of any of these.

EU Parent Subsidiary Directive

Gibraltar funds can also benefit from the EU Parent Subsidiary Rules.

The European Commission has communicated to EU Member States that the Parent Subsidiary Directive should be applied to Gibraltar tax-resident companies. Nevertheless, at present some States are either unaware of or (incorrectly in the writer's view) do not apply this. However, some jurisdictions, including Luxembourg, have decided to do so.

This has opened up enormous opportunities for private equity and property funds looking to set up tax-efficient structures. If a Gibraltar fund wholly owns (or has a sufficient participation in) a Luxembourg company, it will not only benefit from the Parent Subsidiary Directive but also from Luxembourg's tax treaties.

A Gibraltar fund investing through its Luxembourg subsidiary in an EU property company can serve as an example. The EU property company will have to pay taxes on its trading profits and capital gains in its own State. However, dividends due to the Luxembourg company and in turn to the Gibraltar fund can be paid entirely free of withholding tax. This is possible as a direct result of the provisions of the Parent Subsidiary Directive.

Once the dividends are received by the fund these can be paid to the shareholders (as long as they are not Gibraltar residents) entirely free of tax. Therefore, in this example, the dividends paid by the EU property company have been repatriated to the investors without suffering any tax loss whatsoever.

Conclusion

As a result of the legislation implemented in Gibraltar to facilitate the establishment and operation of funds, Gibraltar is fast becoming an offshore jurisdiction catering for an extremely wide variety of collective investment schemes; from UCITS schemes, where the scheme will be able to take advantage of Gibraltar's position within the EU to passport into other EU or EEA States to lightly regulated EIFs and PCCs and private schemes.

The regulatory regime and tax benefits enjoyed by funds in Gibraltar place it in a unique position to service the funds industry, particularly regarding the efficient and cost-effective way in which private schemes and EIFs can be set up in Gibraltar.

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