

Investment Funds in the Isle of Man

January 2005

Introduction: The Isle of Man

The Isle of Man does not form part of the United Kingdom but is a member of the British Commonwealth. It is a self-governing dependency of the British Crown. Although ultimate responsibility for the government of the Island is vested in the Crown, by historical convention, the United Kingdom does not legislate for the Island except with the specific consent of the Island's Government.

The Isle of Man enjoys a special constitutional relationship with the European Union, contained in Protocol 3 to the United Kingdom's Treaty of Accession to the EU. Under this special relationship the Island is neither a member state nor an associate member of the European Union, but the Island is part of the customs territory of the EU and enjoys free movement of industrial and agricultural goods in trade between the Island and the EU.

The Isle of Man is recognised throughout the world as a leading offshore financial centre. The Isle of Man Financial Supervision Commission ("FSC"), the regulatory authority on the Island responsible for funds, is committed to applying international standards of regulation and supervision across all areas of its work in order to maintain the integrity of the Isle of Man's financial system. Its aim is to protect the public interest by providing effective regulation and supervision within the Island's financial services sector whilst at the same time supporting a competitive environment in which quality products and services are promoted for the economic benefit of the Island.

The International Monetary Fund has recently conducted an assessment of the Island's regulatory arrangements under its OFC programme and confirmed in its report that the Island complies with international standards for the regulation and supervision of financial services, and concluded that the Isle of Man has a high level of compliance with international standards in such areas as banking, insurance, securities, anti-money laundering and combating the financing of terrorism.

The Isle of Man is a recognised jurisdiction for the purposes of the Financial Action Task Force ("FATF"). FATF was established to examine measures to combat money laundering and following a review of the Island's defences against money-laundering, concluded that the Island is a co-operating jurisdiction with measures in place which are close to full adherence with FATF recommendations.

The Island is not listed on the Organisation for Economic Co-operation and Development Convention's (OECD) blacklist of tax havens.

The Island is a member of the Offshore Group of Banking Supervisors (of the Basel Committee on Banking Supervision) and of IOSCO, the main bodies responsible for the setting of international standards in the banking and securities sectors respectively.

Regulatory Framework

Funds

The promotion and regulation of collective investment schemes in the Isle of Man is governed principally by the Financial Supervision Act 1988 (the “1988 Act”), together with the regulations made under the 1988 Act. The statutory framework is based upon a wide definition of “collective investment scheme” and a general prohibition on the marketing of such schemes. Due to this wide definition, some arrangements and entities are specifically excluded, e.g. closed-ended companies.

The Island’s regulatory framework provides for a flexible regime in which to establish funds in an efficient and prompt manner.

Investment Business

Investment business operating in or from the Isle of Man is regulated by The Investment Business Act 1991 and the Investment Business Order 2004, which prescribe the activities which constitute investment business.

Categories of Investment Funds

Investment funds established in the Isle of Man fall into the following main categories:

- ~ Authorised Schemes
- ~ Recognised Schemes
- ~ International Schemes
- ~ Closed-ended Investment Companies

Notably, a distinction is made between open-ended and closed-ended investment companies, with the latter falling outside of the Island’s fund regulatory regime (see below).

The above fund types may be established as open-ended investment companies, limited partnerships or unit trusts. In addition, following the introduction of new legislation in 2004, the Isle of Man now permits the incorporation of protected cell companies (a “PCC”) whereby the assets and liabilities of the PCC may be segregated and protected within any number of individual cells of the PCC. In the context of fund structures, at present, PCCs may only be used for Experienced Investor Funds and Professional Investor Funds (see below).

(i) Authorised Schemes

Authorised Schemes are collective investment schemes established in the Isle of Man and may be promoted to the general public in the Island.

Authorised Schemes are subject to comprehensive regulation by the 1988 Act and the Financial Supervision (Authorised Collective Investment Schemes) Regulations 1988 (the “Regulations”) (together “the Rules”). The Rules are similar to the

UCITS requirements and the requirements of the UK Financial Services Authority.

At the current time, authorised securities schemes (of which Government and other public securities funds are a particular type), money market funds, umbrella funds, funds of funds and feeder funds are eligible as authorised funds.

In order to obtain authorisation, the proposed manager and trustee must apply to the FSC, using the FSC's standard form, to obtain an order declaring that the fund is an Authorised Scheme. The application form should be accompanied by as near final drafts of the scheme documents as possible.

An application for authorisation must be accompanied by an advocate's certificate confirming that the fund's constitutional documents comply with the Regulations. The application process generally takes around 6-8 weeks.

The proposed manager and trustee must be licensed as "authorised persons" by the FSC prior to authorisation of the scheme.

(ii) Recognised Schemes

Recognised Schemes are schemes established outside the Isle of Man which, once recognition has been granted by the FSC, may be promoted to the general public in the Isle of Man. Certain funds established in Guernsey, Jersey, Ireland and the United Kingdom may apply for recognition. Although applications may be made by funds originating in other jurisdictions, applicants will be subject to detailed scrutiny similar to that applied to authorised schemes and those demonstrating internationally accepted standards of regulation and supervision will be favoured.

The Isle of Man is itself a "designated territory" for the purpose of United Kingdom financial services legislation and authorised funds may apply for recognition in the UK to enable marketing of that fund within the UK. Similar reciprocal arrangements exist in Guernsey, Jersey and Ireland.

(iii) International Collective Investment Schemes

International collective investment schemes are the most popular form of fund established on the Island and defined by the 1988 Act as

"...every collective investment scheme, not being an authorised scheme or recognised scheme."

The FSC has purposely not prescribed the types of schemes which may be established as international schemes within a flexible regulatory framework, in order to encourage the establishment of innovative and new products in the Island.

Regulation of International Collective Investment Schemes

International schemes have the advantage of not being subject to any direct approval or authorisation process and control is instead exercised via the licensing of the managers of such schemes (see further below). International schemes must either be managed or administered in the Isle of Man by a licensed manager or fund administrator. Categories of international funds include:

- ~ Professional Investor Funds
- ~ Experienced Investor Funds
- ~ Exempt International Funds

At the present time, no fee is charged for launch of an international fund.

The application process generally takes around 3-4 weeks.

Professional Investor Funds (“PIF”)

PIFs are subject to the provisions of the Financial Supervision (Professional Investor Fund) (Exemption) Order 1999 (the “PIF Order”). The PIF Order was developed to attract funds whose investors are qualifying professional investors, broadly defined as sophisticated high net worth individuals and market professionals. The PIF must have a minimum initial subscription of US\$100,000.

The PIF’s offering document is exempted from compliance with standard prospectus requirements but must contain certain mandatory risk warnings and sufficient information to enable an informed investment decision to be made. There are no regulatory restrictions on investment and borrowing powers.

The day to day operation of a PIF must be carried out by an Isle of Man based manager or fund administrator licensed by the FSC (the “Approved Person”). If a manager appointed by the PIF, including those based off-island, delegates the vast majority of its duties to an Approved Person it is regarded as “exempt” and does not need to be licensed. There is no specific requirement to have a manager or trustee, although in practice a PIF will require a trustee/custodian for the safekeeping of its assets. The Approved Person is responsible for approving the PIF’s offering document and must notify the FSC within 14 days of the PIF commencing operation or being wound up.

Experienced Investor Funds (“EIF”)

EIFs are subject to the provisions of the Financial Supervision (Experienced Investor Fund) (Exemption) Order 1999 (the “EIF Order”). The EIF structure is aimed at fund structures whose investors have a high degree of investment experience. There is no minimum investment

requirement, unless agreed between the EIF and the fund administrator or manager. There is no net worth requirement.

An EIF’s offering document is exempted from compliance with standard prospectus requirements but must contain certain mandatory risk warnings and contain sufficient information to enable an informed investment decision to be made. There are no regulatory restrictions on investment and borrowing powers.

As with the PIF structure, the day to day operation of an EIF must be undertaken by either an Isle of Man based manager or fund administrator licensed by the FSC. If the manager appointed by the EIF, which may be based off island, delegates the vast majority of its duties to an Approved Person it is regarded as “exempt” and does not require to be licensed. In addition an EIF must appoint a custodian or prime broker who must be a different person to the Approved Person and either be an ‘authorised person’ or “Eligible Custodian” as defined in the 1988 Act (i.e. broadly licensed in a jurisdiction which exercises proper licensing and supervision regulation).

The Approved Person is responsible for approving the EIF’s offering document and is required to notify the FSC within 14 days of an EIF being established or wound up.

Exempt International Schemes (“EIS”)

An EIS is exempted from the provisions relating to international schemes contained in the 1988 Act provided that the scheme has less than 50 participants and its constitutional documents prohibit the making of an invitation in any part of the world to the public or any section of it to subscribe for or purchase units in the scheme. The

FSC regards EIS as private arrangements and they are therefore not subject to regulation.

There are no restrictions on investment and borrowing powers

An EIS is not required to appoint either a trustee/custodian or a manager, but any manager that is appointed to an EIS and who acts only for one EIS does not require an investment business licence (an “Excluded Scheme Manager”). Similarly, any trustee that is appointed to an EIS does not require a licence to carry on investment business. The provision of administrative services to Excluded Scheme Managers does not require to be licensed unless those services otherwise constitute investment business activities.

(iv) Closed-Ended Investment Companies

The provisions of the Isle of Man Companies Act 1931, as amended (“the Act”) govern the establishment of closed-ended investment companies. If the company wishes to make an offer to the public, it must be incorporated as an Isle of Man public limited company, although unlike UK plcs, there are no minimum capitalisation requirements. An Isle of Man plc may not issue any form of application for shares in or debentures of the company unless the form is issued with a prospectus which must comply with the prospectus requirements contained in the Act. The plc is required to file the prospectus with the Isle of Man Companies Registry on or before the day of issue. This type of vehicle is eligible for listing subject to compliance with the appropriate listing rules.

Such vehicles may be established quickly and without the need to obtain any regulatory approvals prior to launch.

The Companies (Private Placements) (Prospectus Exemptions) Regulations 2000 exempt certain schemes from the prospectus requirements, for example, where the prospectus is to be issued to no more than 50 persons for investment purposes and imminent resale.

In addition, the Companies (Amendment) Act 2003 introduced a further exemption from the prospectus requirements for plcs making an application to a recognised investment exchange for the listing or dealing of shares or debentures pursuant to an offer, provided, inter alia, that confirmation is obtained from the investment exchange that the offer conforms to the listing or other relevant requirements of the exchange (“recognised investment exchange” has the meaning given to it the UK Financial Services and Markets Act 2000).

Taxation

The Isle of Man offers an attractive tax regime and under current legislation there is no capital gains tax, inheritance tax or stamp duty in the Isle of Man. There are no exchange control restrictions operating in the Isle of Man.

A company may apply on an annual basis for exempt status from income tax in the Isle of Man. A fee of £450 is payable on an annual basis in respect of the company's exempt status (this fee is expected to increase to £475 from 1st July 2005). As a tax exempt company, the company will not be subject to Isle of Man income tax and distributions may be made by the exempt company without deduction of any Isle of Man tax. In order to gain tax exempt status, the company's income must arise from sources outside the Isle of Man other than from certain approved local sources such as bank interest. No Isle of Man resident may hold shares in the company and at least one of the directors of the company and the company secretary must be resident in the Isle of Man.

A partnership may apply for classification as an international limited partnership and thus obtain exemption for its limited partners from Isle of Man income tax. In order to obtain exemption, inter alia, the limited partnership must maintain a place of business in the Isle of Man, all limited partners must be resident outside the Isle of Man (subject to certain exceptions) and the general partner must have an Isle of Man resident director and secretary. The annual fee for exemption is currently £450 (this fee is expected to increase to £475 from 1st July 2005).

Unit trusts established in the Isle of Man have no liability to Isle of Man income tax if all their income arises from outside the Isle of Man and no Isle of Man resident has an interest in the unit trust.

Value Added Tax

Management services (including investment management) provided to Experienced Investor Funds or Professional Investors are exempt from VAT.

Fund Administrators and Managers

The profits of all Isle of Man resident managers and administrators of collective investment schemes are taxed at zero rate income tax.

Current Issues

Zero rate income tax for companies

The Isle of Man Government is committed to the introduction of a zero standard tax rate for the majority of companies by 1st January 2006, as a further evolution of its national tax strategy announced in June 2000. Once introduced, the zero rate of tax will mean that companies will no longer need to apply for exemption from tax and local residents will be able to invest in fund structures without prejudicing their tax status.

All companies will be subject to zero rate taxation on the same basis with a higher rate for defined regulated businesses.

EU Savings Tax Directive

The provisions of the EU Savings Tax Directive are expected to be brought into force in the Island on 1 July 2005, although this is conditional upon the introduction of equivalent measures in third party countries designed to ensure a level playing field for those countries

and territories affected by the Directive. The Directive seeks to achieve effective taxation of savings income throughout the EU.

Although the ultimate objective of the Directive is automatic exchange of information, the Isle of Man has announced that during a transitional period, it will apply a retention tax (i.e. a withholding tax) with respect to payments of interest or similar income, made to EU resident individuals by payment agents established in the Isle of Man. During the transitional period, affected EU residents may instead request the paying agent to exchange information rather than pay a retention tax.

Contact Us

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This document is intended to provide a general overview and should not in any way be construed as legal advice. Always seek specific advice in respect of any particular issue.

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