

# Employment Issues in the Hedge Fund Sector

A seminar presented by Dechert LLP's Employment and Tax Groups and the Dominion Group

30 April 2009

# Onshore & Offshore Employment Structures: Tax

Presented by Mark Stapleton

April 2009

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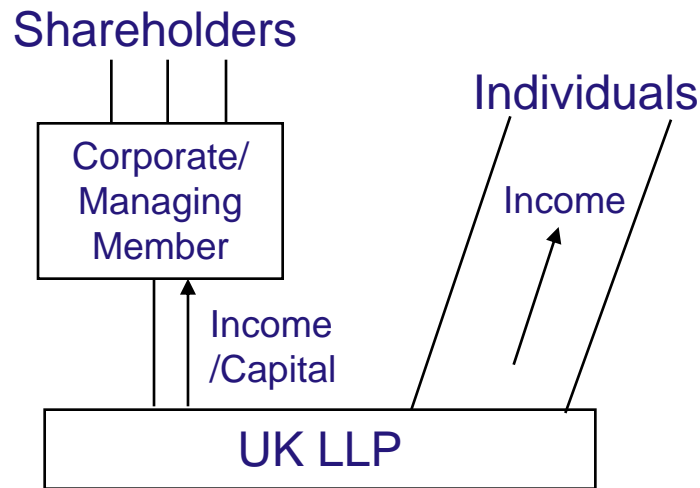
# INTRODUCTION

- The LLP – Potential Tax Savings
- Offshore Structuring and Transfer Pricing
- Jersey Structures and the need for “Substance”
- Outsourcing of HR Function, EBT & EFERB Structures

# WHAT IS AN LLP?

- Limited Liability Partnership – corporate body with limited liability
- Treated as a partnership for tax purposes
- Provides remuneration flexibility like a partnership

# BASIC LLP STRUCTURE



- 100% Capital often given to company
- Income entitlement to individuals
- Individual should contribute capital and have voting rights
- VAT grouping between LLP and Corporate member possible

# TAX SAVINGS OF AN LLP STRUCTURE

- No employees NIC (12.8%) payable on profit share payments
- Creation of a “partnership” culture
- Can assist with tax efficient reward arrangements and can obviate/remove problems with “under water” share options
- Flexibility to allocate income/capital profits
- Avoids complications with employee related share/share options  
ITEPA tax code

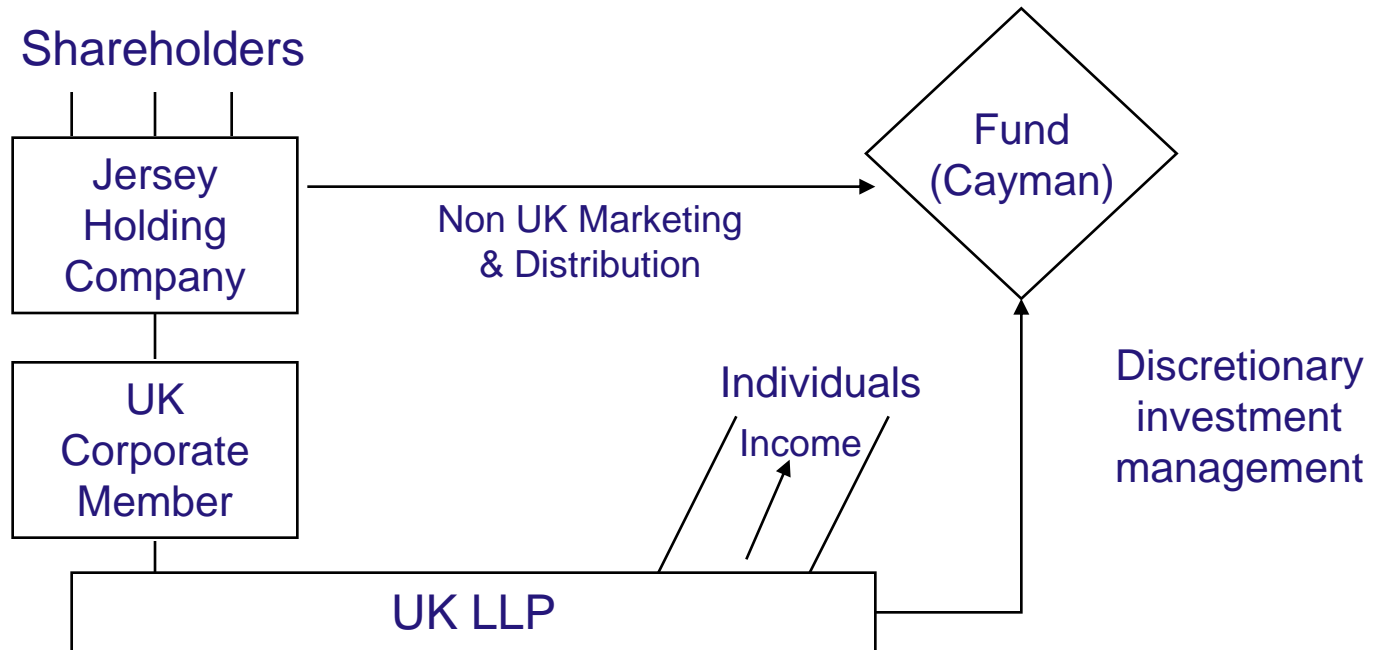
# OFFSHORE STRUCTURING

- Opportunity to avoid full taxation on investment management profits
- Creates base for employee remuneration planning and international tax planning
- Requires as much substance as possible

# UK TAX ISSUES/PITFALLS

- Avoiding UK tax for fund and investment manager
- Transfer pricing issues
- Possible EBT/Pension planning

# OFFSHORE STRUCTURE



- Jersey holding company good for non-UK domiciliaries
- Jersey company employ employs those responsible for non-UK marketing and distribution
- Shares can be given to individual members of LLP without tax charge

# HR Outsourcing

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# Dominion

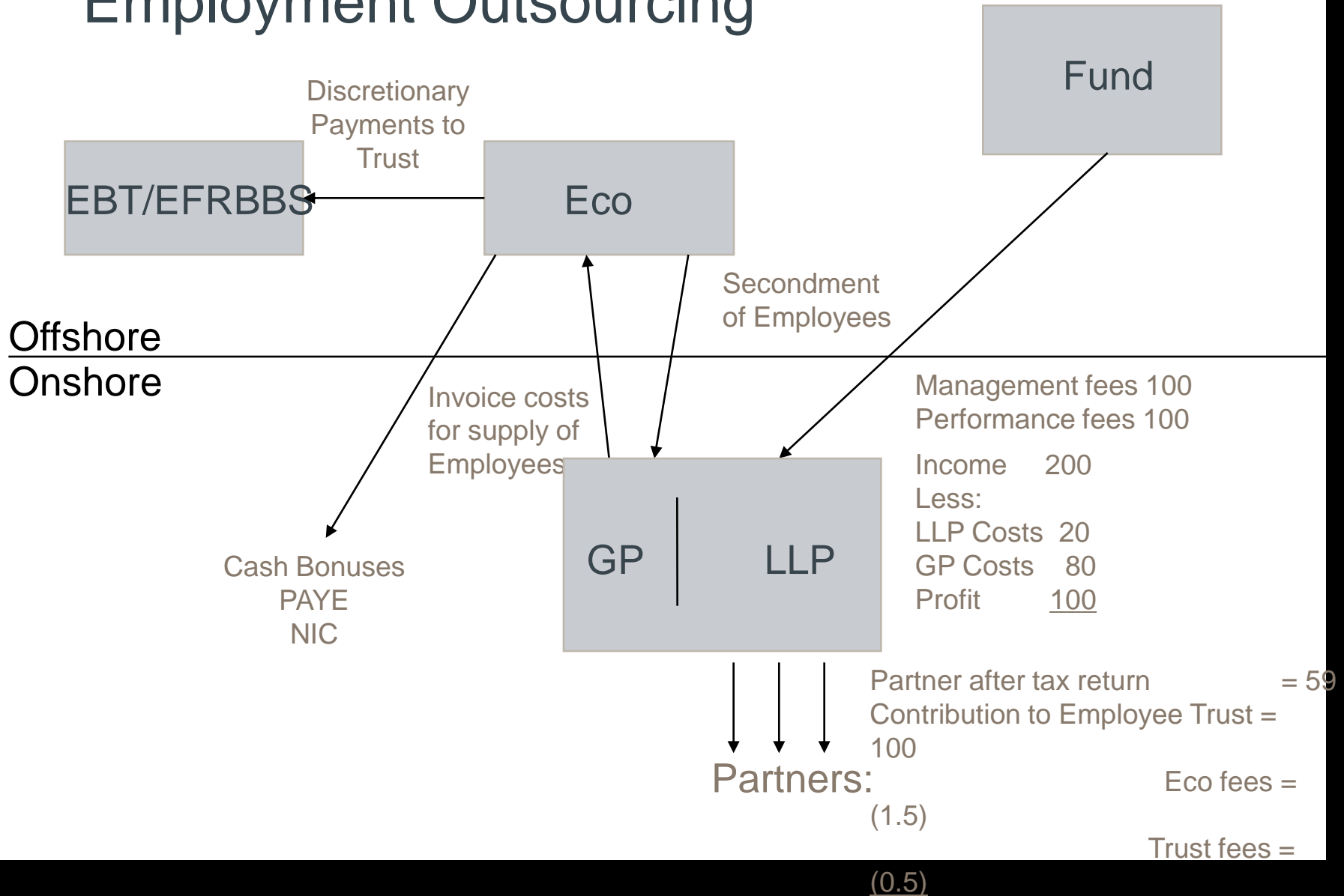
UK leaders in employment outsourcing in Financial Services sector:

- Over 100 staff based in Jersey, London and Malta.
- 90% of clients in Financial Services sector.
- Over 100 Hedge funds and clients in AIM sector.
- Over 30 clients utilise employment outsourcing services.

Employment Outsourcing:

- Clients range from 2 to over 80 staff.
- Most, but not all clients have benefit plans tailored for tax efficiency for employees based in the UK and Europe.

# Employment Outsourcing



# Service Overview

- Commercial proposition to outsource employment function.
- Assist with hiring and search selection.
- Supply employment contracts (original documentation supplied by Decherts to Dominion) along with other agreements and documentation.
- Assist in screening employees, Kroll check, interviews, etc.
- Manage ongoing employment relationship.
- Provide benchmarks for performance measurement.
- Wide range of benefit plans, with some only available to employees of offshore employment companies.

# Types of Benefit Plans

- Registered Pension Schemes – same as UK Employer.
- EBT's – loans and other cash benefits.
- EFERB's – unapproved pension plans.
- EBT/EFERB-hybrid loans and retirement benefits.
- Other forms of benefits e.g. via Trust reinvest back into hedge funds, etc on a gross basis.
- Plans generally provide for tax free roll up of capital gains and offshore income. Also plan assets are outside members estate for IHT purposes.
- Offshore benefit plans appropriate for UK and non UK domiciled plan members. [£30k non-dom fee not relevant]

## Risks & Conclusion

- Seek detailed professional advice before entering into an employment outsourcing arrangement.
- Differentiate and benchmark duties of employment vs. Partner.
- Escrow 28% corporation tax until GP tax returns accepted by HMRC.
- Generally regarded as low risk planning if entered into at the outset.
- Need good commercial fact pattern to consider arrangements for existing businesses.
- Planning advantages should be more attractive post Budget with announced tax increases.

# Contact

*Please feel free to contact either of us:*

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# Immigration Issues

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April 2009

# Immigration summary and update

- Employing non-EEA nationals under new Points Based System
- Complying with the provisions of the Immigration, Asylum and Nationality Act 2006

# Who can work in the UK?

- UK nationals
- The spouses and partners of UK nationals
- Citizens of Switzerland
- EEA nationals and their spouses/civil partners (except citizens of Bulgaria and Romania)
- People born in a Commonwealth country who have a grandparent born in the UK
- Anyone with indefinite leave to remain in the UK
- Overseas students studying at a UK institute of further education (with restrictions)
- Citizens of British Overseas Territories (with some exceptions)
- People with Highly Skilled Migrant Visas

# Non EEA nationals: routes to employment in UK

- UK Border Agency Points Based System
- Tier 1 (general) highly skilled migrant workers
- Tier 2 (general)

# Tier 1

- Replaces old Highly Skilled Migrant Worker programme
- Designed to attract people from outside the EEA who can contribute most to the UK economy
- Individuals must score a minimum of 75 points under categories: qualifications (must have minimum of a Masters degree); previous earnings; UK work experience; age (only if under 32); language skills (must be fully competent); funds
- No need for individual to have an employer to apply

## Tier 2

- Allows skilled individuals who have a job offer to fill gaps in the UK labour force
- Must score a minimum of 70 points
- Must have a job offer from a sponsored employer
- Resident market test must have been met

# Sponsorship duties

- Must have a licence – without one an employer cannot recruit non-EEA workers
- Compliance with duties to gain a licence include: having effective HR systems in place, keeping proper records, appointing individuals to defined positions of responsibility and informing the UK Border Agency if a foreign national worker fails to turn up to work, complying with provisions of Immigration, Asylum and Nationality Act 2006
- Border Agency will advise how many foreign nationals a Firm may employ – certificates are issued for each foreign national
- Spot checks by Border Agency
- Right to revoke or downgrade a licence

# Checklist

- Check all job applicants have the right to work in the UK
- Do not make assumptions about a job applicant's right to work in the UK
- Check validity of overseas national's qualifications if necessary
- Record keeping
- Ongoing checks
- Apply for sponsorship licence now if intend to recruit migrant workers in near future

# Employment Law Update

Presented by Michael McCartney

April 2009

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# Employment Law Update

## Overview

- Recent trends in Employment law
- Key principles for management
- Impact of Government Equality Initiatives
- Recent case law and its consequences

# Recent Trends in Employment Law

- Practical initiatives
  - hiring freezes
  - pay cuts
  - overtime freezes
  - short time working
  - sabbaticals
- Changing terms and conditions
  - fixed period or permanently
  - consultation (minimum period, 30 or 90 days)

# Recent Trends in Employment Law (cont'd)

- Redundancy
  - 20 redundancies within 90 days = 30 day consultation
  - 100 redundancies within 90 days = 90 day consultation
  - objective selection pools/criteria
  - consider alternative roles
  - Employment Act 2008
- Compromise Agreements
  - to avoid consultation altogether; or
  - introduced at the end of consultation

# Key Principles for Management

- Retention – motivate retained staff eg, bonus, options, line manager support
- Protection – confidentiality, waivers, restrictive covenants, proprietary information
- Cost – volunteers, enhanced payments
- Reputation – press interest, disgruntled leavers

# Government Equality Initiatives

- Timing
  - published 27 April 2009
  - MPs debate → October 2009
  - Law → Autumn 2010?
- Main elements
  - companies with over 250 employees may need to publish information on gender pay gap from 2013
  - salary secrecy clauses banned
  - positive action allows employers to discriminate between two equal candidates to promote or hire from under represented groups

# Equality & Human Rights Commission Inquiry into Sex Discrimination and Equal Pay in Financial Services Sector

- Covers:
  - gender, pay and trends in the sector
  - sex discrimination in recruitment, terms and conditions, promotion, retention and workplace culture
  - measures to prevent discrimination and pay inequality
  - differential impact of job losses
- Likely to report later this year and to make recommendations in light of its findings

# Recent Case Law

## The Good

*Kynixa v Hynes* [2008] All ER (D) 30 (Jul)

- Court held covenants binding on employees for 12 months were enforceable
- Employees who misled employer about their intention to leave as part of a team move were in breach of obligation of fidelity

## The Bad

*Kovats v TFO Management LLP & Others*, UK EAT/0357/08

- EAT confirmed that a member of an LLP can also be an employee and entitled to employment rights. The Tribunal will delve into the underlying reality of the relationship.

## The Ugly

Real cases involving alleged discrimination:

- City broker claims £5m after being forced to dress up as “Borat’s Bitch”
- Jewish employee referred to by colleagues as “Jew Boy” and “Yiddo” awarded £500,000 after being forced to dress as Hitler
- Male employer describes female employee’s record – “had cancer, been a pain, now pregnant” – awarded £1.4m
- Manager offers employee £1,000 for each weekend she agrees to sleep with him – awarded £150,000

## The Solution?

*Caspersz v Ministry of Defence* UK EAT/0599/05

- The employer successfully defended a claim of harassment by showing it had taken reasonable steps to prevent sexual comments – training and policies important

# Bonuses, Codes and Emails

Presented by Charles Wynn-Evans

April 2009

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# Topics

- FSA Draft Code on Remuneration
- Other bonus issues
- The new ACAS Code
- Email nightmares

# FSA Remuneration: not our problem or the shape of things to come?

- consultation ongoing until 18 May – rules to be published in July and come into force in November
- proposed to apply to FSA regulated banks, building societies and broker dealers above a certain size threshold (about 45 firms)
- not clear to what extent it might be extended to smaller firms
- pressure to comply with the spirit of the rules?

# FSA Remuneration Code: overview

- New FSA rule: “A firm must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote effective risk management”
- not restricted to senior executive remuneration
- permitted contract changes to ensure compliance by 31 December 2009
- otherwise amendment/termination by 6 November 2010

# FSA Remuneration Code: ten key principles

## (1)

- remuneration committee - independent/skilled/experienced – assess impact of remuneration policy on financial situation and prospects – periodic review and approval
- remuneration procedures - clear and documented, manage conflicts of interest and compliance and risk management input
- risk management and compliance remuneration - to be determined independently of other areas, based on their objectives and functions and with significantly lower ratio of salary to bonus
- bonus pools - profits - adjusted for current and future risk
- non financial performance measures - should be significant and extend to risk management and regulatory compliance

# FSA Remuneration Code: ten key principles (2)

- performance related elements - should be longer term not current year
- performance measurement - for long term awards should be risk adjusted
- fully flexible bonus policies - should be sufficient to enable reduction or elimination of bonuses in a poor financial year
- deferral - the majority of any significant bonus (when compared with salary) should be deferred with a minimum vesting period at least two thirds
- deferred element - any deferred element of remuneration should be linked to the future performance of the firm as well as the employee's division or business unit

# FSA Remuneration Code: what next?

- new rules published in the summer
- 6 November 2009 implementation
- wait and see unless pressure to comply voluntarily?
- remuneration consultants will be busy

# Other bonus issues

- challenges to exercises of discretion
- who decides
- custom and practice
- the SMP quirk
- drafting points

# Challenges to discretion: Keen -v- Commerzbank (2006)

- irrationality/perversity/breach of trust and confidence
- “the bank, not the court, is the judge of what it should pay its staff”
- overwhelming case required (to establish irrationality/perversity) “where so much must depend on the discretionary judgment of the bank in fluctuating market and labour conditions”
- explanations recommended
- beware confining discretion to performance (individual or otherwise)

# Who decides? Mouradian –v- Tradition Securities & Futures (2008)

- claimant entitled to allocate a bonus pool
- once declared, the bonus was quantified and could be recovered in an unlawful deductions claim
- checks and balances

# Custom and Practice: Small -v- Boots Co plc

- “discretionary” bonus paid for 40 years save on two occasions when performance targets not met
- the label “discretionary” did not automatically mean there was no contractual entitlement to a bonus - there may be a contractual discretion
- consistent practice of making bonus payments relevant

# The SMP quirk

- average earnings during Qualifying Period count towards calculating SMP including bonuses
- bonus payments in the Qualifying Period can increase dramatically
- 8 weeks before 15<sup>th</sup> week before expected week of childbirth
- 92% recoupment (from NICS)
- avoiding this could be discrimination itself

# Drafting

- maximum flexibility on factors
- award does not create expectation
- lose entitlement if employment terminates or notice served by a party before payment
- good leaver pro rating?
- does bonus accrue during sickness absence or garden leave?

# New ACAS Code

- 6 April 2009
- abolishes statutory minimum dismissal and grievance procedures
- so no automatic unfair dismissal or 10%-50% uplifts
- but new ACAS Code on Disciplinary and Grievance Procedures – covers performance and conduct but not redundancy/fixed term terminations
- up to 25% compensation adjustments for unreasonable breach
- transitional provisions for grievances

# ACAS Code – some key points

- uplift can still be material, particularly in discrimination cases
- fair procedures still crucial
- right to call witnesses
- mediation
- different people to conduct investigation and disciplinary stage in misconduct cases where practicable
- right to be accompanied is part of this Code – but optional for investigating meetings?
- informal resolution of grievances encouraged
- disciplinary procedures should give examples of gross misconduct
- suspension should be as brief as possible and not sanction

# Policies and procedures – steps to take

- update policies and procedures to ensure compliance with new (less rigid) rules
- consider bullying, harassment and whistleblowing cases as ACAS Code recommends
- training and consultation
- ensure policies are not contractual

# Email Nightmares

- “I want X out by Q3” - email to HR from manager who subsequently hears redundancy appeal
- “I have fired Y and offered him a severance package or a consultation process”
- “This redundancy is a joke - someone has it in for Z” emails peer of dismissed employee to a colleague in the same team
- “Let’s see how we can speed up getting this guy out”
- “I have never worked with anyone so repellent in my life. Please expedite this process”
- It’s good to talk.....

# Q&A