



Guernsey tax alert

Draft regulations on company economic substance published

On 8 November 2018, the Guernsey government published draft regulations ([The Income Tax \(Substance Requirements\) \(Implementation\) Regulations, 2018](#)) that would introduce increased substance requirements on certain Guernsey resident companies.

Two other documents have been published to facilitate interpretation of the draft regulations: a "[key aspects document](#)" issued jointly by the governments of Guernsey, the Isle of Man and Jersey, and a [flow chart](#). More comprehensive guidance notes also will be issued in due course.

The publication of the draft regulations highlights Guernsey's commitment to meet the requirements imposed by the EU Code of Conduct Group (COCG) on jurisdictions that currently appear on the EU's "grey list." Grey list countries are required to address concerns of the COCG relating to the need for businesses to demonstrate sufficient economic substance. The Crown Dependencies of Guernsey, Jersey and the Isle of Man have been working together to develop proposals that aim to meet the commitment. Jersey released [draft legislation](#) on 23 October 2018 that would introduce increased substance requirements on certain Jersey resident companies (see the [Jersey tax alert](#) dated 25 October 2018 on the draft legislation).

In his 6 November 2018 budget speech, Guernsey's President of the Policy and Resources Committee said that he is confident that these proposals "*will dispel the concerns of the EU's Code of Conduct Group for Business Taxation*" raised during a review of tax cooperation of third countries. He also pointed out that the new requirements will "*put beyond any doubt that we are an economy*

that relies on real economic activity and where businesses have a substantial presence within our jurisdiction."

If passed during the States Assembly meeting on 12 December 2018, the regulations would apply as from 1 January 2019 and impact Guernsey resident companies with accounting periods commencing on or after that date that undertake "relevant activities."

The content of the draft regulations is broadly as expected and is in line with the information provided in the 2019 budget proposals. This alert summarizes some of the key points relating to:

- The scope of the economic substance tests and their application to companies undertaking relevant activities ("in-scope" companies);
- The requirements imposed on in-scope companies to demonstrate that they are "directed and managed" in Guernsey, have Guernsey core income-generating activities (CIGA) and meet the necessary "adequate" tests; and
- Next steps in terms of ensuring compliance with the economic substance tests and administrative matters, including potential sanctions and penalties.

Relevant activities

The regulations confirm that the eight relevant activities detailed in budget proposals on the introduction of substance requirements for companies tax resident in Guernsey are within the scope of the proposed rules. These are:

- 1) Banking;
- 2) Financing and leasing;
- 3) Intellectual property holding;
- 4) Fund management;
- 5) Shipping;
- 6) Headquarter activities;
- 7) Insurance; and
- 8) Pure equity holding company activities.

The draft regulations also add a ninth category, "distribution and service center business."

As anticipated, the draft regulations include definitions of each relevant activity. In the case of banking, insurance and fund management, these reflect the appropriate Guernsey regulatory regime to which they are subject. A pure equity holding company is defined as a company that has "*as its primary function the acquisition and holding of shares or equitable interests in other companies,*" that carries on no commercial activity and that is a holding company under the Companies (Guernsey) Law 2008.

The new category of distribution and service center business is defined as:

"... the business the sole or main activity of which is:

- a) *to purchase raw materials and finished products from other members of the same group which are nonresident and to re-sell them for a small percentage of profits; or*
- b) *the provision of services to other members of the same group which are nonresident;*

but does not include any business or activity falling within the definition of banking, insurance, fund management, financing and leasing, shipping or headquartering."

This new category would mean that, in addition to distribution businesses, companies whose main or sole activity is to provide services to (non-Guernsey) group companies would have to comply with the substance requirements.

There are two instances where the substance requirements may not apply in relation to certain activities:

- 1) The definition of "finance and leasing business" involves "... *providing credit facilities of any kind for consideration.*" As a result, credit facilities that are not provided for consideration (such as interest-free loans) may alone not be expected to give rise to a relevant activity; and
- 2) Where a company carrying on relevant activities has no income from its business or activity in that period.

Substance requirements

As with the classification of relevant activities, the substance requirements are in line with those set out in the Guernsey 2019 budget proposals, with companies that carry out relevant activities being required to demonstrate that they: (i) are directed and managed in Guernsey; (ii) carry on CIGA in Guernsey; and (iii) have adequate staff, expenditure and physical premises in Guernsey proportionate to the level of the relevant activity carried on in Guernsey.

The regulations provide specific substance requirements for pure equity holding companies, recognizing that what is expected is likely to be less than for the other categories of company. A pure equity holding company would have to comply with all applicable company law requirements and ensure that it has an adequate level of personnel and physical presence in Guernsey to hold and manage the shares of equitable interests.

This definition differs from the legislation in Jersey that does not prescribe specific reduced requirements for holding companies, although it is not unreasonable to conclude that what may be considered to be sufficient in terms of both a company's direction and management, and adequate staff, expenditure and physical assets is likely to be different for an entity that only holds equity investments compared to an entity that carries out any one of the other relevant activities.

Outsourcing

The regulations make clear that outsourcing CIGA to another Guernsey entity should be sufficient to allow a company to meet the substance requirements, provided the company outsourcing the work is able to demonstrate adequate supervision of the outsourced activity.

There is no specific prohibition on outsourcing certain activities to non-Guernsey entities, but this would need careful consideration, depending on the company's situation and the typical practice within that industry. Parts of the key aspects document provide further guidance on this point.

Penalties and sanctions for noncompliance

The regulations provide further detail on the penalties that would be applied for failure to comply with the economic substance measures.

For the first year of noncompliance, the financial penalty would be up to a maximum of GBP 10,000. The next penalty would apply to a default in the third year (owing to the time that would have elapsed by the time the second year had passed) and would be up to a maximum of GBP 50,000. The penalty for noncompliance in the fourth year would be up to GBP 100,000. Where the company is registered in Guernsey, the Director of Income Tax also would be able to give notice to the Registrar of Companies to have the company struck from the Register of Companies.

Spontaneous exchanges of information would take place for each year of noncompliance with the competent authorities of the EU member state where the immediate parent company, ultimate parent company and/or beneficial owner is resident.

In addition to the above, the regulations provide for financial penalties of up to GBP 5,000 for instances where a person fails to deliver information as requested, and/or provides inaccurate information.

As expected, the regulations confirm that where a company meets the definition of a "high risk IP company," the economic substance tests would be presumed not to be met, unless sufficient information is provided to satisfy the Comptroller that the tests are met. Even in such cases, spontaneous exchange of information in relation to the high risk IP company would apply.

Next steps

Potentially affected companies should address the application of the regulations and, where appropriate, plan and take any necessary steps from both a practical and a procedural perspective to ensure compliance with the regulations when they enter into effect on 1 January 2019 (or as soon as is feasible thereafter.)

Company groups should consider the following actions:

- Classifying their structures on a company-by-company basis to flag companies that undertake a relevant activity and, therefore, fall within the scope of the new requirements;
- Considering current and future compliance for entities that undertake relevant activities with respect to:
 - The "directed and managed" requirements;
 - The adequate staff, expenditure and physical assets tests; and
 - Demonstrating the existence of Guernsey CIGA;
- Considering the means by which compliance with the economic substance tests will be documented and evidenced;
- Reviewing outsourcing arrangements to ensure that these do not contravene the economic substance tests, in particular, the requirement to evidence CIGA carried on within Guernsey; and
- Considering the increased tax return disclosure requirements arising from the regulations that are likely to be effective as from the 2019 year of charge, for which the tax return would need to be filed by 30 November 2020.

Contacts

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