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Jersey tax alert
Draft legislation on company economic substance presented

On 23 October 2018, Jersey's Minister for External Relations presented draft legislation (**Draft Taxation (Companies – Economic Substance) (Jersey) Law 201-**) that would introduce increased substance requirements on certain Jersey resident companies.

If approved, the measures would apply as from 1 January 2019 and affect Jersey resident companies with accounting periods commencing on or after that date that undertake "relevant activities."

The publication of the draft law highlights Jersey'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 government of Jersey published a **consultation document** on this issue in August 2018, and the draft legislation is the outcome of that consultation. (The same concerns were raised in respect of Guernsey and the Isle of Man, and the Crown Dependencies have been working together to develop proposals that aim to meet the commitment. Separate alerts will follow for Guernsey and Isle of Man.)

The draft law still must proceed through the parliamentary process, and the tight timetable for the implementation of the law means that regulatory guidance is still to follow, but the preamble to the law confirms that "elements" of this are expected to be made public in advance of the States Assembly debate on the law on 4 December 2018.

The contents of the draft law broadly are in line with expectations. 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 Jersey, have Jersey 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 draft law confirms that the eight relevant activities detailed in the consultation would fall within the scope of the proposed rules. These are: banking, financing and leasing, intellectual property holding, fund management, shipping, headquarter activities, insurance and holding company activities. However, the draft law adds a ninth category, "distribution and service center business."

A certain amount of detail is provided in the definition of each category of relevant activity, which largely reflects the position as anticipated following publication of the consultation. The definition of a holding company confirms that it should have *"as its primary function the acquisition and holding of shares or equitable interests in other companies."*

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

> *"… the business of either or both of the following:*
>
> *(a) purchasing from foreign connected persons –*
>
> *i. component parts or materials for goods; or*
>
> *ii. goods ready for sale; and*
>
> *reselling such component parts, materials or goods;*
>
> *(b) providing services to foreign connected persons in connection with the business,*
>
> *but does not include any activity included in any other relevant activity except holding company business …."*

It is interesting to note that the definition of "finance and leasing business" states that this involves *"… providing credit facilities of any kind for consideration."* Accordingly, 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.

Substance requirements

As with the classification of relevant activities, the substance requirements are in line with those set out in the consultation, with companies that carry out relevant activities being required to demonstrate that they (i) are directed and managed in Jersey; (ii) have Jersey-based CIGA; and (iii) have adequate staff, expenditure and physical assets in Jersey.

While the draft law does not prescribe specific reduced requirements for holding companies, 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. We would hope the upcoming guidance will provide further detail. CIGA for a holding company are defined as "*all activities related to that business*."

A welcome provision in the draft law is the confirmation that companies that undertake relevant activities but receive no gross income for such activities would not be required to meet the economic substance tests.

Outsourcing

The draft law makes clear that outsourcing CIGA to another Jersey entity should be sufficient to allow a company to meet the substance requirements, provided the company outsourcing the work is able to appropriately monitor and control the outsourcing arrangements.

There would not be a specific prohibition on outsourcing certain activities to non-Jersey entities, as long as CIGA are carried out in Jersey. Such activities would need to be carefully considered.

Penalties and sanctions for noncompliance

The draft law includes details on the penalties that would be applied for failure to comply with the economic substance measures, with the maximum financial penalties being higher than originally anticipated.

For the first year of noncompliance, the financial penalty would be up to a maximum of GBP 10,000. For subsequent years of noncompliance after an initial penalty notice has been issued, sanctions may include a financial penalty of up to a maximum of GBP 100,000 and the ability for the Comptroller to make a report to the Minister that could result in the company being struck off the Jersey Companies Register.

Spontaneous exchanges of information with relevant jurisdictions also would take place in cases of noncompliance.

In addition to the above, the draft law provides for financial penalties of up to GBP 3,000 for instances where a person fails to deliver information as requested, and/or provides inaccurate information.

Next steps

Potentially affected companies should begin to assess the application of the law, and where appropriate, plan and take steps from practical and procedural perspectives to ensure compliance with the economic substance requirements when the law goes into effect on 1 January 2019 (or as soon as is feasible thereafter.)

Companies/groups should consider the following actions:

- Classifying their structures on a company-by-company basis to flag those that undertake a relevant activity and, therefore, fall within the scope of the new requirements;

- Considering current and future compliance for those 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 Jersey 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 demonstrate CIGA carried on within Jersey; and
- Considering the increased tax return disclosure requirements that would be effective as from the 2019 year of assessment (to be filed by 31 December 2020).

Contacts

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