

# Economic Substance Rules



## "crack down on perceived abuses"

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## Relevant Sectors - Further details

- Banking
- Insurance
- Shipping
- Fund management (not including Collective Investment Vehicles)
- Finance and leasing
- Headquartering
- Distribution and Service Centres
- Operation of a Holding Company
- Holding intangible property (Intellectual Property)

### Finance and Leasing

This category includes companies which offer credit or financing of any kind for consideration, including intra-group financing.

### Insurance Company

This category encompasses companies undertaking both life and non-life insurance business within or from one of the islands as an insurer (including reinsurance). Other non-insurance companies undertaking activities connected with insurance (such as insurance managers or brokers) are not in scope.

### Holding Company

The guidance on holding companies specifically focuses on "pure equity" situations, with the simplified compliance noted previously. Pure equity holding companies have the sole function of acquiring and holding equities that are controlling stakes in other companies. They are subject to the substance requirements if they are the beneficial owner of the shares.

## Background

Guernsey, Jersey and the Isle of Man have all recently introduced "economic substance" rules which come into effect for accounting periods commencing on or after 1 January 2019. The rules are in response to an European Union and Organisation for Economic Co-operation and Development (OECD) initiative to increase transparency and to crack down on perceived abuses in certain sectors. The rules apply to all companies which are tax resident in one of the Crown Dependencies.

So far, the Crown Dependencies have published joint Guidance Notes as the issues faced by all three jurisdictions are similar. Each location has also made some additional information available.

## The Rules

To fall within the scope of these rules, a company which is tax resident in one of the Crown Dependencies must have income from operating in one of the nine relevant sectors identified by the OECD (see box opposite).

Where the rules apply, a company must demonstrate that it has adequate substance where it is tax resident during a reporting period. If it does not, sanctions may apply.

## Adequate Substance

For an affected entity, adequate substance generally means that it:

- is managed and directed in the island where it is tax resident
- has a physical presence there
- conducts Core Income Generating Activities (CIGA) on the island
- has an adequate number of (qualified) employees there to support its activities
- has adequate expenditure proportionate to the level of its activities

In general, the management/direction function involves holding board meetings on island, with a quorum of directors physically present; minutes and other company records must also be kept there. As the CIGAs vary by relevant sector, they should be reviewed in more detail if a company is within scope. It is possible to outsource activities to another entity, as long as the outsourced activities are adequately supervised and are undertaken where the company is tax resident.

## Measuring Compliance

Compliance information will generally be reported via the local income tax filing process. This includes:

- Relevant activity
- Income by relevant activity
- Operating expenditure by relevant activity
- Business address
- Number of employees
- CIGA for each relevant activity
- Financial statements
- Details of outsourcing for any CIGA
- Value of Tangible Assets

## Impact on Client Companies

We anticipate that BWCI client companies will probably fall into one of three relevant sectors; finance and leasing, insurance, or holding company. In particular, non-commercial trust companies do not fall into any of the relevant sectors.

## Exemptions

Clause 6 of The Income Tax (Substance Requirements) (Implementation) Regulations, 2018 provides for some Guernsey companies to be exempt from economic substance rules. In particular, the rules will not apply for accounting periods where a company had no income from relevant activities. While not yet explicitly stated, a similar principle will probably apply in Jersey and the Isle of Man.

A company classified as a holding company may have simplified reporting. In particular, it will only need to comply with the Corporate Law Filing Requirements, and demonstrate that there are adequate people and premises in the appropriate jurisdiction (including outsourced activities).

We will be working with affected companies to ensure compliance with the new rules. Please contact your usual consultant for more information.