

# Economic Substance

July 2019

Following our brief update in December 2018 on Economic Substance Legislation in Guernsey, Jersey and the Isle of Man, we are now able to provide more detailed information on complying with the requirements introduced by this important development.

## Background to Economic Substance

In 2017, the European Union Code of Conduct Group (CoCG) analysed the tax policies of non-EU countries, including the Crown Dependencies of Jersey, Guernsey and Isle of Man (as well as other financial centres such as the Bahamas, BVI, Bermuda and the Cayman Islands). This work focused upon the concept of “tax good governance” and the standards adopted within the Crown Dependencies on tax transparency, fair taxation and anti-BEPS (Base Erosion and Profit Shifting) measures. Whilst the CoCG had no concerns with most of the principles of good tax governance adopted by the Crown Dependencies they did express a wish that economic substance be more clearly defined going forward.

The Crown Dependencies subsequently committed to enacting new legislation effective 1 January 2019, as did the other financial centres that engaged with the CoCG. The legislation was adopted on 1 January 2019, with the detailed guidance notes, which support and direct the application of the legislation, following some time after, at the end of April 2019.

## What does this mean?

These new economic substance rules apply to all companies (irrespective of their jurisdiction of incorporation) that are tax resident in a Crown

Dependency. In principle, a company is regarded as being tax resident if it is centrally managed and controlled within a Crown Dependency.

All companies tax resident in a Crown Dependency will have to identify whether they carry on “Relevant Activities.” These are defined as:

- Banking Business
- Insurance Business
- Fund Management
- Finance and Leasing
- Headquarters
- Shipping
- Holding Company (Pure Equity)
- Distribution and Service Centre
- Intellectual Property

If a company is engaged in one, or more, of the Relevant Activities, and derives income from it, the company will need to demonstrate adequate economic substance within the Crown Dependency of residence.

A simple example of relevant activity would be a company that has provided a loan to a counter-party on interest-bearing terms, with the loan interest being paid back to the lender by the counter-party. On this basis the company would have the relevant activity of ‘Finance and Leasing’ and it would be in scope by virtue of the receipt or accrual of the loan interest.

Companies that carry out a Relevant Activity, will need to meet the following substance requirements:

- The company must be directed and managed in the jurisdiction;
- The board must display collective competence and relevant experience;
- Board minutes must record strategic decisions;
- The majority of board meetings must take place in the jurisdiction, with a majority of directors being physically present for quorum purposes;
- Corporate records must be maintained within the jurisdiction;
- The company's 'Core Incoming Generating Activity' (CIGA) must be carried out within the jurisdiction; and
- The company must have resources available to conduct its business, such as access to premises, qualified staff, and local expenditure.

It is important to note that meeting this last requirement can be outsourced to a third party. Trident Trust is already working with numerous clients to provide an outsourced solution for their needs.

In addition, the tax filing requirements for all Crown Dependency resident companies are changing. Companies that claim tax residency will now be required to file their annual accounts accompanied by their tax return, which will now be a more substantial document. These filings, including the accounts, are not a matter of public record and there is no change in the tax rates in the Crown Dependencies.

There may be circumstances whereby substance compliance filings may be required in two jurisdictions. An example would be a BVI incorporated company that is tax resident in a Crown Dependency.

#### What needs to happen now?

Aspects of this new legislation remain unclear and we await further official guidance.

However, every company that is resident in a Crown Dependency will need to undertake an analysis of its

activities to determine if it falls within one of the defined categories and, if so, whether or not it is in scope by virtue of an income flow from the activity.

If the analysis shows that a company is within one of the defined categories, changes may need to be made to its operations to ensure it can adequately meet these new requirements.

Failure to comply with this new legislation can expose a company to potentially significant financial sanctions and being struck from the register.

#### How can Trident assist?

Trident is undertaking an initial economic substance analysis for every company that its Crown Dependency offices provide services to.

Many companies will be unaffected by these new rules. However, we are mindful that activities can change and income flows can commence that may bring a company into scope of the new rules. Therefore we will be making recommendations to all companies as to the minimum steps they need to consider to provide a basic readiness to meet the rules.

Once our initial analysis is complete we will contact you to discuss the results, the steps required for compliance and the associated costs.

We have opted to keep this briefing note to a high level at this stage and will provide more detailed information once we have completed our analysis.

If you would like to gain a more in-depth understanding of this new legislation before this, please contact your local Trident representative. In addition, if you have other companies that we do not provide services to and you are concerned about the impact of these new rules, please do not hesitate to contact us for help.

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