

GUERNSEY'S NEW SUBSTANCE REQUIREMENTS

30 NOVEMBER 2018

Like other offshore jurisdictions, Guernsey is currently working towards implementing legislative substance requirements by the end of this year. In the latest contribution for [Offshore Red](#) by experts in Guernsey's legal sector, [Carey Olsen](#) Senior Associate Chris Hutley-Hurst considers Guernsey's proposed substance rules, paying particular attention to their application in the funds sector.

Following the screening of non-EU jurisdictions to assess their compliance for tax purposes, the EU Code of Conduct Group on Business Taxation (the "COCG") found Guernsey (and a number of other jurisdictions) to be a co-operative jurisdiction which complied with the general principles of "fair taxation" and raised no concerns regarding Guernsey's standards of transparency or implementation of anti-BEPS measures. However, the COCG requested that Guernsey and certain other jurisdictions take further steps to ensure that their tax systems do not facilitate offshore structures aimed at attracting profits which do not reflect real economic substance.

Guernsey has committed to address these concerns by implementing legislative substance requirements by the end of 2018 and has been working with other jurisdictions, EU Member States and the COCG to achieve this goal.

This article provides a high-level summary of Guernsey's proposed substance rules based upon the public consultation in August 2018 and the proposals outlined in the 2019 Budget Report released on 9 October 2018, and focuses on their application to the funds industry. At the time of writing, Guernsey is due to release its draft substance legislation and guidance during November 2018, which could differ from the proposals outlined previously, with a goal of having the legislation passed by 31 December 2018. The COCG is due to review the legislation and guidance in February 2019.

Substance requirements will apply from 1 January 2019 to all Guernsey tax resident companies that carry out "relevant activities". These requirements will vary depending on the relevant activity undertaken and will be enhanced for intellectual property companies and reduced for collective investment vehicles and pure equity holding companies. Penalties and other sanctions will apply for non-compliance.

Fund managers licenced by the Guernsey Financial Services Commission ("GFSC") are already subject to substantial substance requirements under law and GFSC rules, and in most cases have full administration services provided to them in Guernsey. We therefore expect that Guernsey fund managers will comply with the substance proposals. Other jurisdictions that are adopting similar substance rules may need a material change to how business is conducted.

Guernsey Resident Companies

The substance rules only apply to companies. Other entities such as limited partnerships, limited liability partnerships and trusts are not within the scope of the rules.

The company must be tax resident in Guernsey for the rules to apply. Currently, a company is tax resident in Guernsey if it is incorporated in Guernsey or if, broadly, it is directly or indirectly controlled by one or more Guernsey resident individuals.

Where a Guernsey company is tax resident in another jurisdiction with which Guernsey has a double tax treaty, such as the UK, then that company may be non-Guernsey resident under the terms of the applicable treaty. Guernsey has announced amendments to its tax residence rules that are to take effect from 1 January 2019 and the new Guernsey/UK double tax treaty is also expected to take effect from this date. Guernsey is considering amending its corporate tax resident rules further in 2019 with the possible replacement of the current shareholder control test that causes non-Guernsey companies to be Guernsey tax resident with a central management and control test, similar to the UK common law tax residence concept, that looks to location of strategic management and decision making.

Where a company is non-Guernsey resident, it will not be subject to substance requirements. However, if a company remains resident in Guernsey whilst being resident in the other jurisdiction, it will be subject to Guernsey's substance rules, which could conflict with the steps that the company has taken to be tax resident in the other jurisdiction. Dual resident companies will therefore need to carefully consider their residence position in

analysing the application of the substance rules.

Relevant Activities

The substance rules will apply to a Guernsey resident company that carries out "relevant activities", being activities that the COCG has identified as being geographically mobile and which have typically been the focus of preferential tax regimes and structures that seek to shift profits into low tax jurisdictions with no corresponding economic activity. These activities are banking, insurance, fund management, financing and leasing, headquarters, shipping, intellectual property ("IP") and holding company activities. Companies carrying on relevant activities will therefore need to demonstrate Guernsey substance in relation to those activities.

Collective investment vehicles ("CIVs") are generally accepted by the OECD and the EU as being different in nature when compared to companies with mobile activities. It is expected that CIVs will be subject to reduced substance requirements involving ensuring that Guernsey regulatory requirements are complied with.

Further, companies which purely hold shares in subsidiaries and earn dividends ("pure equity holding companies") are seen as 'low risk'. It is expected that pure equity holding companies will just need to confirm they meet all applicable corporate law and tax filing requirements and ensure they have adequate personnel and premises in Guernsey, which may be provided by the Guernsey administrator. However, where holding companies also conduct other relevant activities they will additionally be subject to the requirements associated with that activity as set out below.

Conversely, the COCG has classified companies with income from IP as being 'high risk' and so will be subject to enhanced substance requirements.

A company that is not carrying out any relevant activity is not within the scope of the substance rules. Companies that directly hold real estate, therefore, are not within scope unless they also carry out a relevant activity.

Substance Requirements

Companies that carry out relevant activities, other than IP and pure equity holding companies, must comply with the following:

- the company is directed and managed in Guernsey, which includes:
 - there must be board meetings in Guernsey at adequate frequencies (given the level of decision making required) during which there must be a quorum physically present in Guernsey;
 - strategic decisions of the company must be set at these board meetings and the minutes must reflect those decisions;
 - all company records and minutes must be kept in Guernsey; and
 - the board, as a whole, must have the necessary knowledge and expertise to discharge their duties as a board;
- the company's core income generating activities ("CIGA") are undertaken in Guernsey;
- there are adequate and appropriately skilled personnel in Guernsey;
- the company has adequate annual expenditure and physical presence in Guernsey to reflect the amount of profits attributed to Guernsey.

The CIGA referred to above will depend on the relevant activity carried out and will reflect the different needs of the companies involved and the risk exposure, and will be aligned to international standards identified by the OECD's Forum on Harmful Tax Practices ("FHTP"). The States of Guernsey Revenue Service (the "Revenue Service") will provide public guidance that will, where appropriate, build on any existing regulatory requirements relating to local substance.

It is expected that outsourcing of CIGA and other activities to another entity within or outside Guernsey will be permitted. Therefore, a company should be able to meet requirements relating to premises and personnel where a Guernsey-based administrator provides the appropriate premises and personnel. Companies that outsource CIGA will need to ensure that they are properly supervising and overseeing the outsourced activity. An anti-avoidance provision will be introduced to ensure that outsourcing cannot undermine the principles and purpose of the regime.

Application to the Guernsey funds industry

As stated above, funds that are corporates are expected to have reduced substance requirements (involving ensuring that Guernsey regulatory requirements are complied with) and funds that are limited partnerships, unit trusts and other non-corporates are not within the scope of the substance rules.

Fund managers, including general partners of funds, will be carrying on the relevant activity of fund management, which is expected to comprise any activity that constitutes "management" under the Protection of Investors (Bailiwick of Guernsey) Law 1987 ("POI Law") where that management is carried out in relation to funds.

Fund management CIGA will include taking decisions on the holding and selling of investments, calculating risks and reserves, interest fluctuations and/or hedging positions and preparing relevant regulatory and/or other reports for government authorities and investors. Given both the POI Law and the rules and guidance issued by the GFSC already require all POI Law licensees to have a high level of substance from a regulatory perspective, it is expected that Guernsey regulated fund managers will comply with the new substance rules.

It is anticipated that some fund management CIGA, or some activities related to fund management CIGA, may be outsourced outside of Guernsey, although any outsourcing must be within a set of parameters laid out by the Guernsey fund manager who must retain oversight over the activity. It is also worth bearing in mind that the principal aim of the substance requirements is to ensure that the level of profits that are attributed to the Guernsey company in relation to its CIGA are commensurate with its economic activity and economic presence. Accordingly, a fund manager that outsources CIGA or other activities should ensure that the related fees are appropriately priced such that the resulting profit attributable to Guernsey reflects the level of activities carried out in Guernsey.

Compliance and monitoring

The corporate income tax return for companies subject to substance requirements will be enhanced for 2019 to include details of the company's business activity, amount and type of gross income, expenses and assets, premises and number of employees (specifying the number of full time (equivalent) employees). This will allow the Revenue Service to monitor compliance with the regime. The information provided in the return will be monitored on a risk (of profit shifting) basis as well as by random selection of companies for audit each year in line with the existing practice for the monitoring of domestic tax compliance.

The Revenue Service will be given the appropriate powers to enable further enquiries to be made as may be necessary in order to determine if the company is subject to, and satisfies, the substance requirements. The law will be updated to include sanctions for non-compliance that can be applied progressively including:

- financial penalties;
- audit for continued non-compliance;
- spontaneous exchange of information regarding the company with any EU Member States where the immediate and ultimate parent entities or the ultimate beneficial owners are tax resident; and
- (where applicable) strike off from the Guernsey corporate register.

The Future

As a key member of the global community committed to transparency, Guernsey continues to implement developments in transparency and best practice, building upon its early adoption of FATCA and the Common Reporting Standard ("CRS") and also being compliant with the BEPS minimum standards.

A number of enhancements to Guernsey's transparency measures are therefore expected in the near future. These include the introduction of legislation for mandatory disclosure rules for CRS Avoidance Arrangement and Opaque Offshore Structures. The goal of Guernsey and EU Member States is to implement these rules by 31 December 2019. These rules will require promoters of avoidance arrangements and service providers to disclose information on the arrangement or structure to the Revenue Service, including the identity of any user or beneficial owner, which will then be exchanged with the tax authorities of the jurisdiction in which the users and/or beneficial owners are resident where there is a relevant information exchange agreement. Whilst not currently one of the BEPS minimum standards, the rules effectively set out "best practice" on countering CRS avoidance and is therefore part of the compliance strategy of the Revenue Service.

Proposals are also being developed for the introduction of legislation to enable real-time or close to real-time reciprocal access to beneficial ownership information by EU tax and law enforcement authorities, subject to ensuring appropriate data and safeguarding measures are in place. As with Guernsey's current beneficial ownership rules, this would not be a public register. It is understood that EU Member States are currently working towards the establishment of interconnected central registries by 2021.

An original version of this article first appeared in [Offshore Red](#).

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