



Guernsey economic substance rules: the current picture of the group company perspective

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The Income Tax (Substance Requirements) (Implementation) Regulations, 2018 (the Regulations) came into force on 1 January 2019, requiring all Guernsey tax-resident companies to confirm, for tax periods commencing on 1 January 2019 or later, whether they are in scope of the Regulations and, if so, how they meet the substance requirements set out in the Regulations. Italicised words in this note are terms used in the Regulations.

The Regulations were approved by the EU's ECOFIN council on 12 March 2019 and as a result, Guernsey was re-affirmed as a co-operative jurisdiction in terms of tax transparency and for action 5 of BEPS.

The substance requirements apply to Guernsey tax-resident companies that carry on certain specified geographically mobile activities, including the following relevant activities, which are the subject of this article:

- Acting as a *pure equity holding company*
- Providing *headquartering services* to non-resident intra-group companies, which includes providing senior management, providing substantive advice on or assuming or controlling material risk for those other entities; and
- Acting as a *distribution or service centre* for non-resident intra-group companies.

Please see [here](#) for Ogier's briefing applicable to fund managers and [here](#) for Ogier's briefing in respect of banks, insurance businesses and finance and leasing companies.

The Crown Dependencies issued joint Guidance Notes on aspects of the Substance Requirements on 26 April 2019 which were updated on 22 November 2019 (the **Guidance Notes**).

Limited substance requirements apply to companies that are solely carrying on *pure equity holding company* activities. Where such companies are carrying on other commercial activities, they will

fall out of scope of being a *pure equity holding company*, but could be in scope if they carry on any *relevant activity*.

Companies carrying on the *relevant activities of headquartering* or a *distribution and service centre* will be subject to the substance requirements in full, unless their activities are already subject to such requirements under other *relevant activities*, such as *banking, insurance, fund management or finance and leasing*.

A company tax-resident in Guernsey will only be required to comply with the substance requirements for the tax period in relation to which it is reporting where it receives income for undertaking a *relevant activity* or for being a *pure equity holding company* or *IP Business* during the relevant tax period.

The Substance Requirements

Guernsey tax-resident companies carrying on *headquartering* or *distribution and service centre* activities and receiving income for such activities will be required to demonstrate that, for the relevant period:

- they were *directed and managed* in Guernsey
- they undertook their relevant *core income generating activities* (CIGA) in Guernsey; and
- they had *adequate persons, expenditure and presence* in Guernsey, by reference to the activities carried on in Guernsey

The *directed and managed* Test

The regulations provide that the test as to whether a company was *directed and managed* in Guernsey would be met if the following are adhered to:

- There must be meetings of the Board of Directors in Guernsey at adequate frequencies given the level of decision making required
- During these meetings, there must be a quorum of the Board of Directors physically present in Guernsey (note that the Directors do not have to be Guernsey resident) - where a meeting is called to consider a CIGA, a majority of directors at the meeting must be physically present in Guernsey
- Strategic decisions of the company must be set at meetings of the Board of Directors and the minutes must reflect those decisions
- All company records and minutes must be kept in Guernsey; and
- The Board of Directors, as a whole, must have the necessary knowledge and expertise to discharge their duties as a board

While it is not necessary for all of the company's meetings to be held in Guernsey, the Guidance Notes state that it is expected that the majority of board meetings will be held in the Island. It is acknowledged that it may be necessary for certain meetings to be held outside Guernsey, with the revised Guidance Notes providing a welcome confirmation that isolated decisions may be taken outside Guernsey provided "it can be evidenced that the decisions taken and the CIGA undertaken in the Island are of a quality and quantity to clearly outweigh the question that the CIGA involving the decisions is undertaken outside the Island."

Core Income Generating Activities (CIGAs)

Guernsey tax-resident companies which carry on *relevant activities* will need to demonstrate that the *core income generating activities* that they carry on are carried out in Guernsey, either directly or through outsourced entities in Guernsey.

Where the CIGA comprises the company undertaking an act, that act must be undertaken in Guernsey. Where the CIGA comprises the company making a decision, then the majority of those making the decision must be in Guernsey at the time that decision is taken for the CIGA to be determined as having occurred in Guernsey.

CIGAs for Headquartering

Guernsey tax-resident companies undertaking *headquartering* activities will need to demonstrate that, where it is undertaking one or more *core income generating activities* in connection with their headquartering activities, those CIGA take place in Guernsey. The following comprise the list of CIGAs specified for *Headquartering*:

- taking relevant management decisions. This relates to making decisions on the substantive functions of and significant risks for other intra-group companies, including strategic planning, marketing strategies and acquiring premises.
- incurring expenses on behalf of group entities. This includes taking specialist advice or procuring technology on behalf of the group.
- co-ordinating group activities. This includes situations where group activities are coordinated to produce the best outcome for the group as a whole, rather than for individual companies in each group.

CIGAs for distribution and service centres

This *relevant activity* relates to two distinct areas:

- dealings between intra-group companies involved in the physical distribution of materials or products (*distribution centres*); and
- dealings between intra-group companies involving the provision of consulting or other

administrative services (*service centres*)

The CIGAs relevant to *distribution centres* are:

- transporting and storing goods, products and materials. This refers to the movement and storage of raw materials or finished products and managing risks associated with this
- managing stocks. This includes considering minimum acceptable stock levels, managing frequency of stocktaking, consideration of appropriate use of storage space and ensuring security procedures are in place; and
- taking orders. This includes the provision of the order processing element of the entire fulfilment process.

The CIGAs relevant to *service centres* are:

- providing consulting or other administrative services. This includes providing such services, usually with a mark-up.

Each Guernsey tax-resident company carrying on such operations or providing such services will need to analyse what functions need to be carried out in Guernsey to demonstrate adequate substance in Guernsey.

Adequate persons, expenditure and presence

All Guernsey tax-resident companies will be required to submit a tax return for periods commencing 1 January 2019 or later. Companies carrying on the *relevant activities of headquartering and distribution and service centres* must be able to demonstrate on their tax returns:

- An adequate number of employees in Guernsey, or adequate level of expenditure on outsourcing to service companies in Guernsey, proportionate to the activities of the company carried on in Guernsey.
- An adequate level of annual expenditure incurred in Guernsey proportionate to the activities of the company carried on in Guernsey.
- Adequate physical offices and/or premises in Guernsey, or adequate level of expenditure on outsourcing to service companies in Guernsey, proportionate to the activities of the company carried on in Guernsey.

Further detail of the items required to be identified on the tax returns are out of scope of this briefing.

Requirements for *Pure Equity Holding Companies*

The law requires *pure equity holding companies* to have adequate persons and physical presence in Guernsey to hold and manage the shares and equitable interests and requires the company to comply with the relevant companies legislation applicable to it (noting that certain companies may be tax resident in Guernsey but domiciled outside Guernsey). This will require each *pure equity holding company* to carry out an analysis as to what functions need to be carried out in Guernsey, which is likely to vary depending on the function and purpose of the holding company. It should be noted that holding companies that carry on other commercial activities fall out of scope of the definition of *pure equity holding company*, but may, then, fall into scope of a *relevant activity* pursuant to which it will need to comply with the substance requirements.

Sanctions

The new law proposes sanctions for non-compliance to include financial penalties, strike-off from the register of Guernsey companies, and reporting to any relevant tax or regulatory authorities.

The Ogier view

- Affected companies should review outsourcing arrangements (where relevant) in respect of Guernsey tax-resident companies that fall within the scope of the Regulations and whether the third-party service provider agreements in place meet the tests set out therein.
- It is anticipated that many structures will be compliant with the new requirements already but consideration should still be given to whether amendments and updates are required to any policies and procedures as a result of the Regulations.
- IP income generating companies (ie Guernsey tax-resident companies with income from intellectual property) will be subject to enhanced requirements and are the subject of a separate briefing.

If you require further information or would like to discuss how the proposals may impact your business, please get in touch with your usual Ogier contact.

Bulletin on the 2020 Guernsey Substance Amendment Regulations and the treatment of funds under the substance regime can be found [here](#).

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