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Substance in Guernsey from 2019

Guernsey Revenue Services has introduced a number of new tax measures that will impact companies in Guernsey from 1 January 2019.

These measures include widening the definition of corporate residence and introducing legislation that will require certain companies to demonstrate they have sufficient substance in the Island to substantiate Guernsey tax residence.

Consequently, there will be changes in the way some companies file information annually. For details of the changes to corporate residence please see our factsheet "Corporate Tax Residence in Guernsey from 2019".

Economic substance

The Income Tax (Substance Requirements) (Guernsey) (Amendment) Ordinance, 2018 affects Guernsey resident companies with accounting periods starting after 31 December 2018 has recently been introduced. This addresses key concerns that companies could be used to artificially attract profits to low tax jurisdictions, that are out of step with the actual economic activity the company undertakes in that jurisdiction.

Where a Guernsey tax resident company receives income from a 'relevant activity' it is required to meet specific economic requirements. The relevant activities are:

- Banking;
- Insurance;
- Shipping;
- Fund Management (Collective Investment Vehicles are excluded);
- Financing & leasing;
- Headquarters;
- Distribution and service centres;

In addition Guernsey resident companies with income from Intellectual Property and pure equity holding companies must also demonstrate they have appropriate substance in Guernsey.

Economic substance requirements

Broadly a company must ensure that :

1. it is directed and managed in Guernsey (a slightly different test to central management and control).
2. It carries on core income generating activities ('CIGA') in Guernsey (the legislation does not prohibit a company from outsourcing some or all of its activity).
3. It has adequate employees, expenditure and physical presence in Guernsey.

Practical Guidelines

It is only Guernsey tax resident companies that fall within these new Economic Substance Rules, as such companies that are Guernsey incorporated but are not tax resident as they are managed and controlled elsewhere, such as the UK, should not be caught.

Conversely, foreign incorporated companies may be subject to Economic Substance Rules if they are managed and controlled or shareholder controlled in Guernsey as this is likely to make the company tax resident in Guernsey. For example, a BVI company that is managed and controlled in Guernsey by its local board, or owned by Guernsey residents (including local corporate directors), is resident in Guernsey.

For Guernsey tax purposes it is likely that companies may need to register/de-register with the Guernsey Revenue Service should its tax residence change under the new central management and control test. Please see our Corporate Tax Residence factsheet for further information.

In regard to Economic Substance, companies will be required to keep good records of activities undertaken on Island, especially those relating to CIGA, including the level and seniority of staff, the amount of time spent on an activity and all decisions made relevant to such activity. For decisions taken, detailed records should be kept to include notes of all matters considered when reaching a decision.

Not all CIGA needs to be performed by the company as outsourcing and delegation is permitted. However it should be undertaken on Island and any outsourcing should be adequately supervised by the company.

The term adequate is undefined in the legislation and guidance. As such its ordinary meaning should be used. What is adequate will be fact and circumstance dependant and will be different from company to company. It should be for the Board to decide whether the activity is adequately based for its particular circumstances.

The sanctions for non-compliance are graduated and penal, and can lead to a company being struck off. In this connection the Guernsey Revenue Service have wide powers and will conduct annual reviews to ensure the substance requirements are being met.

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To enable the Guernsey Revenue Service to monitor whether companies are within the "Economic Substance" regime and comply, there will be a requirement to provide additional information when completing annual tax returns. The level of information required to be returned is not yet known, however where relevant activity is undertaken the guidance indicates that the return will require:

- Amount and type of gross income;
- A breakdown of income streams in order to identify the type by relevant activity;
- Confirmation of the CIGAs conducted for each relevant activity;
- Confirmation of whether any CIGA have been outsourced and if so relevant details;
- Number of (qualified) employees, specifying the number of full-time equivalents;
- The amount of operating expenditure by relevant activity,
- Details of premises.
- Financial Statements.

This additional information will also be required from former certificate 3 companies. As such the former practice of filing composite tax returns by corporate service providers for multiple entities will come to an end. Companies will need to file their own return to demonstrate substance.

As a result of the changes to Guernsey corporate residence and also Economic Substance, a large number of companies will now be within the Guernsey tax regime for the first time as they will be tax resident.

LTS Tax Limited are able to assist with queries on the Substance requirements and provide tax compliance services in respect of registration and filing of tax returns.
Please get in touch with any of the below, or your usual contact for further information.

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