

Economic substance requirements for Guernsey companies

Last reviewed: December 2019

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Introduction

Guernsey has implemented the Income Tax (Substance Requirements) (Implementation) Regulations, 2018 (the **Substance Regulations**) to address the concerns of the EU Code of Conduct Group that certain Guernsey companies could be used to artificially attract profits that are not commensurate with economic activities and substantial economic presence in Guernsey.

EU Finance Ministers signalled their approval of the Substance Regulations by 'whitelisting' Guernsey on 12 March 2019. More recently, the Organisation for Economic Co-operation and Development (**OECD**) endorsed Guernsey's domestic legal framework as being in line with the relevant standard and therefore 'not harmful' – a positive endorsement for Guernsey.

The Substance Regulations impose economic substance requirements on companies that:

- (a) are tax resident in Guernsey or, incorporated in Guernsey and are tax exempt (see paragraph 1 below) **and**
- (b) have income from carrying on a relevant activity (see paragraph 3 below) in respect of accounting periods commencing on or after 1 January 2019 (and every following accounting period).

Essentially, a company which is in-scope of the Substance Regulations will have to demonstrate that it has adequate substance in Guernsey by:

- (a) being directed and managed in Guernsey
- (b) having adequate people, premises and expenditure in Guernsey **and**
- (c) conducting core income generating activities (**CIGA**) in Guernsey.

A protected cell company will be required to satisfy the economic substance requirements at a whole entity level including the relevant activities and resources of its protected cells (as the protected cells are not separately incorporated). An incorporated cell company and each of its incorporated cells will have to separately satisfy the economic substance requirements by reference to their own resources in respect of the relevant activities they each undertake (as they are each separately incorporated).

Collective investment schemes (funds) regulated by the Guernsey Financial Services Commission (the **Commission**) under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (the **POI Law**) are not caught and neither are other types of services which funds require such as administration, advisory or custodian services. Subsidiaries of a fund will however have to ensure they meet the substance requirements in relation to any relevant activities undertaken.

Note that the substance requirements that apply to a company operating as a (pure equity) holding company are reduced (see paragraph 9 below) and those which apply to a company that holds intellectual property assets (**IP assets**) are enhanced (see paragraphs 7 and 8 below).

The Director of the States of Guernsey Revenue Service (the **Director**) has issued various information, including guidance notes (jointly with the tax authorities in Jersey and the Isle of Man) on the scope and application of the Substance Regulations (the **Guidance Notes**) together with guidance setting out the additional questions that will be included on the Guernsey company annual tax return. The latest guidance notes were issued on 22 November 2019 to add guidance on, among other things, insurance, shipping and intellectual property holding business.

1 Is the company tax resident in Guernsey or tax exempt for the purpose of the Substance Regulations?

Criteria for Guernsey tax residence

A company will be treated as tax resident in Guernsey in a year of charge (and as such, in-scope of the Substance Regulations), if:

- (a) it is controlled, or is centrally managed and controlled (generally where the directors meet and exert control), in Guernsey in that year of charge or
- (b) it is incorporated in Guernsey and has not been granted an exemption from tax under the Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989 (the **Tax Exempt Bodies Ordinance**) for that year of charge.

A company will not however be treated as tax resident in Guernsey in a year of charge, even if it is incorporated or controlled in Guernsey, if it is proved to the satisfaction of the Director that, in that year of charge:

- (a) the company is, under the domestic law of another territory (**Territory A**), tax resident in Territory A **and**
- (b) the company is centrally managed and controlled in Territory A **and**
- (c) either:
 - (i) the company is tax resident in Territory A under the domestic law of Territory A by virtue of:
 - (1) a double taxation arrangement entered into with Territory A or
 - (2) an international tax measure made with Territory A in which a tie-breaker clause applies or
 - (ii) the highest rate of tax on a company in Territory A is at least 10 per cent **and**
- (d) the company's tax resident status in Territory A is not motivated by the avoidance, reduction or deferral of the liability of any person to tax.

Criteria for Guernsey tax exempt status

A Guernsey incorporated company which is eligible for exemption from tax under paragraph 3 or 5 of Schedule 1 to, and has been granted exemption under section 3 of, the Tax Exempt Bodies Ordinance will also be in-scope of the Substance Regulations, ie it excludes funds regulated by the Commission under the POI Law but includes any Guernsey tax exempt subsidiary of a fund (which is not itself regulated). As noted above, collective investment schemes (funds) regulated by the Commission the POI Law are excluded and out of scope.

2 Does the company have any gross income?

If a tax resident or tax exempt company (as per paragraph 1 above) does not have any gross income in a particular accounting period then it will not be subject to the substance requirements in the year of assessment in which that accounting period ends. Note however that:

- (a) the Guidance Notes contain anti-avoidance rules for instances where companies seek to manipulate or artificially suppress income to avoid being subject to the substance requirements and
- (b) a company in liquidation that has gross income from a relevant activity is still subject to the substance requirements albeit it will be the liquidators of the company that are required to demonstrate that the substance requirements are met.

3 Is the company undertaking a relevant activity?

A tax resident or tax exempt company (as per paragraph 1 above) with gross income (paragraph 2) arising from a relevant activity is in-scope of the Substance Regulations and therefore subject to the applicable substance requirements.

For the purposes of the Substance Regulations, the relevant activities and specified business (each a **relevant activity**) are, as follows:

- (a) **banking**: deposit-taking business within the meaning of the Banking Supervision (Bailiwick of Guernsey) Law, 1994 carried on by a licensed institution within the meaning of that Law (and, in this regard, a company that does not take deposits but is part of a banking group will not be undertaking banking business although it may be undertaking another relevant activity)
- (b) **insurance**: insurance business within the meaning of the Insurance Business (Bailiwick of Guernsey) Law, 2002 carried on by a licensee within the meaning of that Law. This encompasses companies which are regulated in the conduct of insurance business in Guernsey as an insurer in both the life and non-life sectors, including reinsurance. Companies which undertake activities connected with insurance (eg insurance brokers or other intermediaries) or provide services to insurers (eg insurance managers) but which are not themselves insurers, do not fall within this definition
- (c) **fund management**: exercising any managerial function in relation to an investment or in relation to the assets underlying an investment, when carried on in connection with a collective investment scheme within the meaning of the POI Law under the authority of a licence issued under that Law. All companies that provide fund management services are subject to the substance requirements. This is anticipated to include, in due course, where the fund manager and the fund are part of the same legal entity, although further legislative change will be required to bring this provision into force

(d) **financing and leasing:** the provision of credit facilities of any kind (including intra-group loans) for consideration (such as interest or a lending fee, but not the grant of security) to any person (the **customer**). Loans under which interest payments are not in fact made, either because payment is deferred (eg where interest is compounded) or because loans are written off, are caught. Companies, which purchase debt securities as an investment, are not caught. A provider of credit includes a company that becomes the transferee of a loan. The provision of credit may be by way of instalments for which a separate charge is made and disclosed to the customer in connection with:

- (i) the supply of goods by hire purchase
- (ii) financial leasing (excluding land and interests in land) or
- (iii) conditional sale or credit sale.

Where credit is offered without expectation of consideration when the credit is provided, it is not caught (such as where an interest free credit period is given on a sale of goods but late payment interest is charged thereafter). Banking, insurance and fund management are excluded from being within the scope of financing and leasing

(e) **headquartering:** the provision of any of the following services to non-resident intra-group persons:

- (i) the provision of senior management
- (ii) the assumption or control of material risk for activities carried out by, or assets owned by, any of those intra-group persons and
- (iii) the provision of substantive advice in relation to the assumption or control of risk for such activities or assets,

but does not include any such business undertaken as part of banking, insurance, fund management, financing and leasing, shipping or a distribution and service centre (to prevent duplicate reporting). It also excludes the business of holding IP assets. For the purposes of the Substance Regulations, the term 'intra group' is a collection of enterprises related through ownership or control such that it is either required to prepare consolidated financial statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public securities exchange

(f) **shipping:** the operation of ships in international traffic for income from the transport of passengers or cargo, and includes any of the following activities where directly connected with, or ancillary to, such operation:

- (i) the rental on a charter basis of ships
- (ii) the sale of tickets or similar documents and the provision of services connected with the sale of tickets or similar documents, either for the enterprise itself or any other enterprise
- (iii) the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise
- (iv) the management of the crew of ships.

A ship for these purposes does not include fishing vessels, harbour craft, vessels used for sport or recreation or any vessel under 24 meters in length overall. A company that undertakes the activities in paragraphs (i) to (iv) above (eg a crew management business) which does not also operate ship(s) in international traffic does not fall in the definition. The chartering of ships on a bareboat basis does not constitute shipping business because the ship owner does not operate the ship that is chartered. A bareboat charter may, however, constitute financing and leasing

(g) **distribution and service centre:** a business the sole or main activity of which is:

- (i) to purchase raw materials and finished products from other non-resident members of the same group and to re-sell them for a profit or
- (ii) the provision of services (such as administrative, advisory, consulting or employee services) to other non-resident members of the same group,

but does not include purchasing from, or providing services to, third parties or any such activity undertaken as part of banking, insurance, fund management, financing and leasing, shipping or headquartering (to prevent duplicate reporting). The scope of distribution and service centre business does not extend to cases where the distribution and service centre activity is not the main activity of the company provided it is recharged at cost or less (eg staff sent on secondment for a limited time are recharged at cost rather than for a profit)

- (h) **holding IP assets:** income or profits derived from, or from the holding, development or exploitation of, IP assets (eg copyright, design right, trademark, patent, brand or similar asset) including royalties, income from franchise agreements and income from licensing such assets. Such income must, however, be separately identifiable from any income generated from any tangible asset in which the right subsists (for example, a fizzy drinks manufacturer is not an intellectual property holding business because its income is generated by sales of fizzy drinks to third parties, not the exploitation of IP assets (ie the use of the trademark is incidental)). If an IP asset is purchased or developed with the intention of reselling it at a profit, the proceeds of sale will constitute gross income. A company with more than one IP asset must consider the substance requirements in respect of each IP asset it has in a financial period
- (i) **pure equity holding:** a company which has as its sole function the acquisition and holding of shares or equitable interests in other companies, which does not carry on any commercial activity and which is a holding company within the meaning of the Companies (Guernsey) Law, 2008 (the **Companies Law**) (see paragraph 9 below).

4 The substance test: is the company directed and managed in Guernsey?

Paragraphs 1 to 3 above are intended to provide guidance as to whether a company may (or may not) be in-scope of the Substance Regulations. If a company is in-scope, ie Guernsey tax resident or tax exempt with gross income from a relevant activity in respect of accounting periods commencing on or after 1 January 2019 (and every following accounting period), then it must satisfy the substance test.

This first limb of the substance test is satisfied if:

- (a) the company's board of directors meet in Guernsey at an adequate frequency given the level of decision-making required. It is not necessary for all board meetings to be held in Guernsey provided that a majority are and even companies with a minimal level of activity should hold at least one board meeting in Guernsey each year
- (b) during each such board meeting, a quorum of directors is physically present in Guernsey (quorum being determined in accordance with the Companies Law and a company's articles of incorporation). While it is not necessary that a quorum of directors is always present in Guernsey, best practice will be to ensure that it is
- (c) strategic decisions of the company are set at board meetings and the minutes reflect those decisions (and such minutes should refer to all relevant decisions taken, even where a course of action has been considered and rejected). Where a company has a sole director, written resolutions are considered and signed by that director when physically present in Guernsey
- (d) the board of directors, as a whole, have the necessary knowledge, expertise and experience to discharge their duties as a board (and they are not giving effect to decisions taken outside of Guernsey whether by the directors or others) and
- (e) all minutes of board meetings and all other relevant company records are kept in Guernsey (eg constitutional documents, financial statements, operating licences, copies or originals of major funding documentation and mortgages and other documents required by a board of directors to make decisions; and in the case of a non-Guernsey company that is Guernsey tax resident, additional requirements apply).

In the case of corporate directors, the requirements will apply to the individual officers of the corporate director who actually perform the duties.

5 The substance test: does the company conduct Guernsey core income generating activities (CIGA)?

The second limb of the substance test is a requirement that a company's CIGA are performed in Guernsey. CIGA are the key essential and valuable activities that generate the income of the company.

The CIGA for:

- (a) **banking** includes raising funds, managing risk (including credit, currency and interest risk), taking hedging positions, providing loans, credit or other financial services to customers, managing regulatory capital and preparing regulatory reports and returns
- (b) **insurance** includes predicting and calculating risk (which includes oversight of the determination of the quantification and likelihood of an insured event occurring and the likely costs, and ensuring that the premiums charged are commensurate with the risks accepted), insuring or re-insuring against risk

and providing client services (which includes taking strategic decisions regarding the commissioning of client services relevant to insurance and ensuring oversight of systems and processes put in place for the provision of support services)

- (c) **fund management** includes taking decisions on the holding and selling of investments (and the majority of those making the decision should be physically present in Guernsey), calculating the overall risk across a fund and the reserves required on a strategic basis, taking decisions on currency or interest fluctuations and hedging positions in relation to a fund's position as a whole and ensuring that systems and processes are in place to ensure timely and accurate preparation of regulatory reports and returns
- (d) **finance and leasing** includes agreeing funding terms, identifying and acquiring assets to be leased (in the case of leasing), setting the terms and duration of any financing or leasing, monitoring and revising any agreements and managing any risks
- (e) **headquartering** includes taking relevant management decisions for other group companies (and the majority of those making the decisions should be physically present in Guernsey), incurring expenditures on behalf of group entities and co-ordinating group activities to produce the best outcome for the group rather than individual companies
- (f) **shipping** includes managing crew (including hiring, paying and overseeing crew members), hauling and maintaining ships, overseeing and tracking deliveries of cargo, determining what goods to order and when to deliver them (being activities which determine how a ship is to be utilised as regards types of cargo and scheduling of voyages) and organising and overseeing voyages (including the logistical aspects of operating ships such as which routes to use and when)
- (g) **distribution and service centre** includes transporting and storing goods, components and materials, managing stocks, taking orders and providing consulting or other administrative services and
- (h) **IP assets** see paragraph 7 below.

The following should be noted in relation to CIGA:

- (a) it is not necessary for a company to perform all of the CIGA listed in the Substance Regulations for the particular relevant activity in order to demonstrate substance, but all the CIGA that is undertaken should be undertaken in Guernsey
- (b) a company may undertake or outsource all or part of an activity outside of Guernsey only if it does not generate income for the company (eg IT support or HR functions)
- (c) the taking of decisions outside Guernsey would generally indicate performance of CIGA outside Guernsey. However, isolated decisions may be taken outside Guernsey provided that it can be evidenced that the decisions taken and the CIGA undertaken in Guernsey are of a quality and quantity to clearly outweigh the question that the CIGA involving the decisions is undertaken outside Guernsey
- (d) the CIGA requirements do not preclude companies seeking expert professional advice or engaging the services of specialists in other jurisdictions
- (e) so far as providing non-life insurance business services to clients is concerned, the appointment of service providers outside Guernsey (such as claims handlers and loss adjusters) will not affect the ability of a company undertaking insurance business from meeting the requirement for CIGA to be conducted in Guernsey provided that the taking of strategic decisions regarding the commissioning of such client services and the oversight of systems and processes put in place for the provision of support services both take place in Guernsey
- (f) a fund manager can appoint one or more brokers outside Guernsey to buy and sell investments and may even give those brokers some discretion to execute trades without breaching the requirement for CIGA to be conducted in Guernsey provided that the brokers act within investment parameters set by the fund manager which are carefully monitored and controlled by the fund manager
- (g) a company undertaking financing and leasing business will need to evidence decision making by its board in relation to decisions to lend, setting the terms of loans and monitoring and managing the risk of loans
- (h) whether a company will be undertaking headquartering will depend on the extent to which management and responsibility for subsidiaries by the company is in fact taking place
- (i) the maintenance of ships by independent shipyards close to where ships are operated is industry standard and, if such maintenance takes place outside Guernsey, it will not affect the ability of a

company undertaking shipping business from meeting the requirement for CIGA to be conducted in Guernsey

- (j) the CIGA required to be undertaken for an IP asset will depend on the nature of the asset and how it is used to generate income. For IP assets such as patents, it is expected that the CIGA will include research and development. For non-trade intangible assets such as brand, trademark and customer data, it is expected that the CIGA will include marketing, branding and distribution activities. In exceptional circumstances, a company holding IP assets will be able to demonstrate that it is undertaking the other types of CIGA (which are listed at paragraphs 7(b)(i) to (iii) below) in order to meet the economic substance requirements. A company is not required to undertake all of the CIGA provided it undertakes in Guernsey the CIGA relevant to the type(s) of IP assets it holds in an accounting period. Credit will be given for research and development, or marketing, branding and distribution undertaken in Guernsey by the company in earlier accounting periods, the value of which is being realised by the exploitation of the IP asset in the current period. Periodic decisions by non-resident directors or local staff of a company passively holding intangible assets will not be capable of demonstrating CIGA for intellectual property
- (k) where CIGA is undertaken for the company by another entity in Guernsey (eg by an administrator or another group company), the company must be able to demonstrate that it supervises the carrying on of that activity by the other entity and, to meet the substance test, that it undertakes such supervision in Guernsey
- (l) where a CIGA is outsourced, the resources of the service provider in Guernsey will be taken into consideration when determining whether the people and premises test is met (see paragraph 6 below) but there must be no double counting if the services are provided to more than one company and
- (m) the income subject to tax in Guernsey must be commensurate to the CIGA undertaken in Guernsey.

6 The substance test: does the company meet the adequacy test?

The third limb of the substance test is satisfied if the company is able to demonstrate that:

- (a) it has an adequate number of appropriately qualified employees in Guernsey proportionate to the level of relevant activity carried on in Guernsey, whether or not employed by it or another entity and whether on temporary or long-term contracts
- (b) it has adequate expenditure proportionate to the level of relevant activity carried on in Guernsey **and**
- (c) it has an adequate physical presence in Guernsey (including, without limitation, offices and/or premises) proportionate to the level of that relevant activity carried on in Guernsey.

For the purposes of assessing adequacy:

- (a) what is adequate will be assessed by reference to its ordinary dictionary meaning being 'enough or satisfactory for a particular purpose' which will be dependent on the particular facts of the company and its business activity
- (b) owner-managers and directors will be treated as employees
- (c) employees must collectively demonstrate appropriate qualifications, experience, competency and a broad, complementary skill set relevant to the relevant activities undertaken
- (d) when considering what an adequate number of qualified employees is, this must relate to the employees needed to conduct the relevant activity as a whole and not just the CIGA (and employing qualified staff, and adopting digitisation and automation of processes, may mean that fewer staff are needed)
- (e) the employee count is based on the number of full time equivalents (**FTE**) working a 35 hour week (so, if two people worked part time for 17.5 hours a week for or on behalf of a company during an accounting period, this would equal one FTE and, for these purposes, directors should be counted as a fraction of a FTE reflecting the time committed to the role)
- (f) where a company outsources its CIGA to a service provider in Guernsey (and provided that the company adequately supervises the outsourced activities):
 - (i) the time spent by the staff of that service provider providing services to the company will count towards assessing whether the company has an adequate number of employees
 - (ii) where the service provider makes available meeting rooms for board meetings to be held in Guernsey, that this will count towards assessing whether the company has adequate premises and

- (iii) the cost of outsourcing to a service provider in Guernsey will count towards assessing whether the company has an adequate level of expenditure.

A company will be responsible for ensuring accurate information is reported on its tax return including precise details of the resources employed by its service providers (eg based on the use of timesheets or another allocation methodology). A company will therefore have to ensure it maintains and retains appropriate records to demonstrate the adequacy of the resources utilised and expenditure incurred.

7 Is the company an IP company?

As noted in paragraph 3 above, a tax resident company with income from IP assets (an **IP company**) is also subject to the substance test, albeit an enhanced form. For the purpose of the Substance Regulations, income from IP assets includes income or profits derived from, or from the holding, development or exploitation of, IP assets (including, without limitation, royalties, income from franchise agreements and income from licensing such assets).

The three limbs of the substance test listed in paragraphs 4 to 6 above equally apply to an IP company, except that:

- (a) in relation to the first limb of the substance test (the directed and managed test), an IP company is directed and managed in Guernsey if its board of directors meets in Guernsey with adequate frequency given the level of decision-making required of the board and, for these purposes, periodic decisions of non-resident board members of an IP company are **not** taken into account and
- (b) in relation to the second limb of the substance test (CIGA), the CIGA in relation to IP assets include:
 - (i) in respect of a business exploiting IP assets which are patents and assets that share the same feature of a patent, any research and development
 - (ii) in respect of a business exploiting IP assets which are marketing intangibles such as trademarks, any marketing, branding and distribution and
 - (iii) in exceptional cases, and other than in the case of a high risk IP company other CIGA relevant to the business and the IP assets, which may include:
 - (1) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the IP asset
 - (2) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the third party acquisition and subsequent exploitation and protection of the IP asset and
 - (3) carrying on the underlying trading activities through which the IP asset is exploited and which lead to the generation of revenue from third parties.

8 Is the company a high risk IP company?

A 'high risk' IP company is a company which:

- (a) holds IP assets
- (b) did not create the intellectual property in the IP assets which it holds
- (c) acquired the IP assets from an intra-group person or in consideration of funding research and development by another person situated in a territory other than Guernsey and
- (d) licences the IP asset to one or more non-resident intra-group persons or otherwise generates income from the asset in consequence of activities (such as facilitating sale agreements) performed by non-resident intra-group persons.

As the risks of artificial profit shifting are considered to be greater, there is a rebuttable presumption that a high risk IP company has failed the substance test, even if there are CIGA being carried on in Guernsey relevant to the business and the IP assets.

The information required to rebut the presumption includes:

- (a) materials which explain how the development, enhancement, maintenance, protection and exploitation (DEMPE) functions have been under its control, and that this has involved people who are highly skilled and perform their core activities in Guernsey
- (b) detailed business plans which clearly lay out the commercial rationale for holding the IP assets in Guernsey

- (c) concrete evidence that the decision making is taking place in Guernsey and not elsewhere and
- (d) information on employees in Guernsey, their experience, their contractual terms, qualifications and length of service.

As already noted, periodic decisions by non-resident directors or board members, or local staff passively holding intangible assets, will not rebut the presumption.

9 What is the substance test for a (pure equity) holding company?

A 'pure equity holding company' is a company which:

- (a) has as its sole function the acquisition and holding of shares or equitable interests, which are controlling stakes, in other companies (provided such equities are held beneficially and not, for example, as trustee)
- (b) does not carry on any commercial activity (and, for these purposes, placing dividend monies on deposit or using them to acquire and passively hold other securities will not constitute a commercial activity) and
- (c) is a holding company within the meaning of the Companies Law. Essentially, it controls the composition of the board of directors of other companies, ie the power to appoint or remove directors, or it holds more than half in value of the equity share capital of those companies (or more than half of the total voting rights in the case of a company which is not limited by shares).

A tax resident or tax exempt company (see paragraph 1 above) which meets the criteria of a (pure equity) holding company (above) with gross income from that relevant activity, is also subject to the Substance Regulations, albeit a reduced form of the substance test applies.

A (pure equity) holding company is required to:

- (a) comply with all obligations applicable to it under the applicable company legislation in the jurisdiction of its incorporation **and**
- (b) have:
 - (i) an adequate level of persons in Guernsey proportionate to the level of activity carried on in Guernsey and
 - (ii) an adequate physical presence in Guernsey (including, without limitation, offices and/or premises) proportionate to the level of that activity carried on in Guernsey,

for holding and managing the shares or equitable interests.

If a company carries on any other relevant activity (whether or not for profit), then it would not fall in the definition of holding company. It would remain subject to the higher substance requirements of the other relevant activity.

Self-assessment and reporting

A company will be required to provide any information reasonably required by the Director to assist the Director in determining whether the applicable substance test has been met. Certain information will be required to be provided by a company in its tax return each year for these purposes. The Guernsey corporate income tax return itself has not yet been released however, as already noted above, the Director has issued guidance setting out the additional questions that will be included on the Guernsey company tax return (available [here](#)). Based on that guidance, the information required includes details of a company's relevant activities, confirmation of the CIGA for each relevant activity, the amount and type of gross income, amount and type of expenses and assets, net book value of tangible assets, premises, number of full time equivalent employees (and their qualifications) and outsourcing. All companies will also be required to submit their financial statements. Consolidated financial statements will be accepted provided that they include a profit and loss account for the company itself. If a company carries on a relevant activity, then a balance sheet for the company itself should also be submitted.

Exchange of information

If the Director is of the opinion that a company has not met the substance test for a particular accounting period, the Director will, in accordance with any approved international agreement or international tax

measure relating to the spontaneous exchange of information, disclose to a competent authority any information which relates to the company.

In the case of a high risk IP company, whether or not it meets the substance test for any accounting period, the Director must disclose to a competent authority any information which relates to a high risk IP company for that period.

For the purposes of the Substance Regulations, a 'competent authority' means a person, body or authority designated as a competent authority by the Director in respect of:

- (a) a country in which the immediate or ultimate parent company, or the beneficial owner, of the relevant company is resident or
- (b) where the relevant company is not a registered Guernsey or Alderney company, the territory in which the company is registered or otherwise incorporated,

for the purposes of an approved international agreement or international tax measure or the Substance Regulations and includes competent authority within the meaning of the Income Tax (Guernsey) Law, 1975.

Penalties

If the Director determines that a company has failed to meet the substance test in respect of its first accounting period of default, the Director will issue a notice to the company imposing a penalty not exceeding £10,000.

The notice must state:

- (a) the grounds of the Director's decision
- (b) set out particulars of the substance requirements which, in the opinion of the Director, are applicable in that accounting period and which the company has not complied with; explain the sanctions (civil or criminal) that may arise or be imposed in respect of non-compliance and
- (c) set out the particulars of any right of appeal that may be applicable.

The notice may also require the provision of such documents or information as the Director may require for the purpose of the Director's functions under the Substance Regulations.

The same applies in relation to a company's failure to meet the substance test in respect of its third and fourth accounting period of default, the penalty for such being up to £50,000 and £100,000 respectively.

The Director may, in addition to the imposition of a financial penalty, take measures which may ultimately lead to the company being struck off.

Conclusion

Companies which are subject to the substance requirements should start making preparations now or early in their next accounting period commencing on or after 1 January 2019 to ensure that the substance test can be met during that, and subsequent, accounting periods. Mourant can assist Guernsey companies carrying on relevant activities which need advice on complying with the Substance Regulations.

Things to think about

It is recommended that consideration is given to the following matters if the substance requirements apply to a company:

- (a) assessing where board meetings are held and whether quorum requirements in articles of incorporation or other corporate documentation (eg shareholders' agreements) might prevent meetings being held in Guernsey
- (b) assessing whether directors of the company have the necessary qualifications and expertise to discharge the duties of the board (the rubber stamping of decisions taken elsewhere is unlikely to pass the substance test)
- (c) improving the way board meetings are minuted so that the detail of a board's deliberations are captured and that decisions not to take action are minuted as well as decisions to take action
- (d) assessing what CIGA is undertaken in Guernsey and what is undertaken outside Guernsey

- (e) evidencing in board minutes where CIGA are discharged, or otherwise documenting at board level where decisions in relation to CIGA are to be made
- (f) assessing where the company's statutory and non-statutory records are located to ensure that they are located in Guernsey or accessible from Guernsey
- (g) assessing the company's staff, premises and expenditure in Guernsey and outside Guernsey and assessing whether this is proportionate and adequate
- (h) reviewing outsourcing arrangements to see whether relevant CIGA is or can be undertaken in Guernsey
- (i) considering how to complete the company's tax return (because this return is more complex than previously owing to the substance changes)
- (j) ensuring that administration agreements are amended to:
 - (i) require the administrator to ensure adequate service provision by employees of the administrator both in terms of time and qualifications/experience
 - (ii) require the administrator to make adequate premises available when needed
 - (iii) require the administrator to report to the company the necessary information as regards time allocation, qualifications and experience of staff, premises and expenditure
 - (iv) require the administrator to maintain procedures that enable levels of input to be measured and ascertained including, for example, the use of timesheets and
 - (v) agree the fees for assessing whether a company is in- or out-of-scope and, if it is in-scope, the fees for any additional service required to meet the substance test
- (k) assessing the adequacy of the supervision and monitoring by the company of any outsourced CIGA
- (l) assessing the way the company makes decisions, how decisions are implemented and how execution of decisions and outsourcing is monitored as well as making an assessment of the adequacy of the same
- (m) implementing procedures now to ensure that information required to be provided to the Director will be available to be included in future returns and
- (n) documenting policies and procedures to improve decision making, implementation and oversight.

Contacts



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