

## Briefing note – Introduction of substance requirements



Following the commitment by the Crown Dependencies in November 2017 to introduce substance requirements into local law, Guernsey has published draft legislation in the form of The Income Tax (Substance Requirements) (Implementation) Regulations, 2018.

These apply only to companies undertaking designated activities, details of which are set out overleaf.

The legislation is largely as expected, and there are still a number of matters which will become clearer once the guidance notes are published, which we expect to follow in relatively short order.

However, having the legislation does allow us more clarity over precisely the areas where substance will be required. In addition to more specific 'hallmarks' of substance for the specific activities that the legislation considers, there are some general requirements.

- Companies must be directed and managed in Guernsey (adequate board meetings by a quorum of directors, who make informed, strategic decisions)
- Companies must carry on their 'core income generating activities' in Guernsey – these are set out by activity in the table overleaf
- The company must have an adequate level of appropriately qualified employees locally
- The company must incur an appropriate and proportionate level of expenditure locally
- There must be adequate physical presence in Guernsey

As set out in the Budget, the legislation also provides for the presumption that 'IP companies' do not have substance, which may be rebutted if sufficient evidence is provided.

For pure equity holding companies, the company must have adequate physical presence, and local persons (note, not employees), proportionate to their income generating activities.

Perhaps the only startling aspect to the legislation is the level of penalties which may be assessed.

- For failure to meet the requirements in a given period, a penalty of £10,000 may be levied.
- For failure in three consecutive periods (2 for IP companies), a penalty of £50,000 may be levied.
- For failure in four consecutive periods (3 for IP companies), a penalty of up to £100,000 may be levied, and the company may be struck off the register.

The rules come into force for accounting periods beginning on or after 1 January 2019. As such, the time to effect any structural changes required is short. Please contact us if you would like to discuss this matter further.

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<b>Activity</b>	<b>Core income generating activities</b>
Banking	Raising funds Managing risk including credit, currency and interest risk Taking hedging positions Providing loans, credit and other financial services to customers Managing regulatory capital Preparing regulatory reports and returns
Insurance	Predicting and calculating risk Insuring or re-insuring against risk Providing client services
Fund Management	Taking decisions on the holding and selling of investments Calculating risks and reserves Taking decisions on currency or interest fluctuations and hedging positions Preparing relevant regulatory or other reports for governmental or regulatory authorities and investors
Financing and leasing	Agreeing funding terms Identifying and acquiring assets to be leased Settling the terms and duration of any financing or leasing Monitoring and revising any agreements Managing any risks
Headquarters	Taking relevant management decisions Incurring expenditure on behalf of group entities Co-ordinating group activities
Shipping	Managing crew Hauling and maintaining ships Overseeing and tracking deliveries Determining what goods to order and when to deliver them Organising and overseeing voyages
Distribution and service centres	Transporting and storing goods, components and materials Managing stock Taking orders Providing consulting or other administrative services
IP companies	Research and development Marketing, branding and distribution Taking strategic decisions and managing the principal risks relating to (third party acquisition and) development and exploitation of the IP Carrying on underlying trading activities through which the IP is exploited

N.B. Outsourcing of activities is allowed, but those activities must be outsourced to, and performed in Guernsey in order to qualify.