



FORWARD GROUP
Private Client | Corporate | Funds

GUIDANCE NOTE

ECONOMIC SUBSTANCE

Introduction

This Guidance Note is a summary of the economic substance tax legislation in Jersey.

The guide will not be able to answer all of the detailed questions that clients may have and it is not intended to be comprehensive advice. The primary legislation in Jersey is the Taxation (Companies - Economic Substance) (Jersey) Law 2019 (as amended) which was adopted on 6 December 2018 (“the Law”).

The Law also states that the Jersey Comptroller of Taxes may issue guidance on how the economic substance test may be satisfied; regard should be given to guidance that the Jersey Tax Office maintains on its website.

Self-managed funds structured as companies are required to satisfy the economic substance test in respect of their activities in financial periods commencing on or after 1 January 2021.

What is Economic Substance?

The Crown Dependencies have enhanced their commitment to meet the principles of the Organisation of Economic Co-operation and Development (“OECD”) for improving global tax transparency by introducing an economic substance test.

The legislation is designed to protect the reputation of offshore jurisdictions by ensuring that income streams from certain activities are based on actual local activity to substantiate the use of low tax jurisdictions.

Substance legislation doesn’t apply to all entities in each jurisdiction – rather, it applies to certain ‘relevant entities’ carrying out certain ‘relevant activities’. Affected entities are required to be managed and directed, to have adequate employees, expenditure and physical presence and to conduct their ‘core income-generating activities’ in the local jurisdiction.

There are two key stages to establishing how an entity might be impacted by substance legislation in any given jurisdiction:

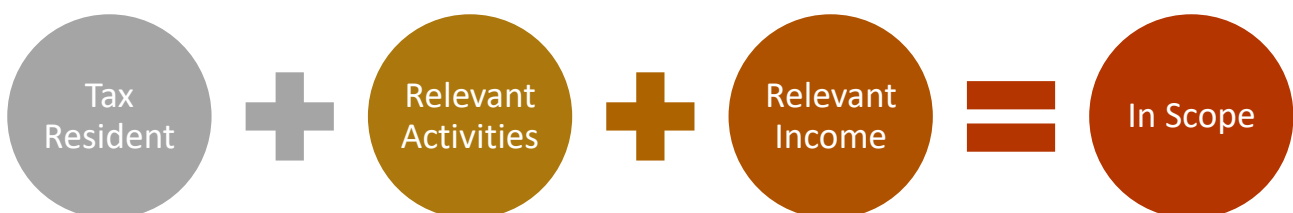
1. Is the entity in scope of the Law – i.e. is the entity a relevant entity carrying out a relevant activity?
2. If it is in scope, does it meet the substance requirements?

Each jurisdiction has its own subtle variances which may cause challenges if a client group has multiple entities registered in different jurisdictions.

Scope

The Jersey economic substance test applies to companies that are **tax resident in Jersey** and **generating gross income** from **relevant activities** in a financial period commencing on or after 1 January 2019.

There are nine relevant activities, some of which take precedence over others. The economic substance test will be triggered for a relevant entity in any given financial year commencing on or after 1 January 2019 if it has gross income (on an accruals basis) from a relevant activity.



Tax residency

The Jersey economic substance test applies to companies that are tax resident in Jersey, whether they are incorporated in Jersey or not. Under Jersey law, a company is considered tax resident in Jersey if it is either:

- a Jersey incorporated company that is not centrally managed and controlled and recognised as tax resident in another jurisdiction where the highest rate of corporate income tax is at least 10%; or
- a non-Jersey incorporated company that is centrally managed and controlled in Jersey.

Entities can evidence that they are tax resident outside Jersey by providing:

- A tax assessment or certificate of tax residency.
- Showing that the highest rate of tax at which any company may be charged within that country is 10% or higher.
- That the entity is not tax resident in a jurisdiction which is on the EU's list of non-cooperative jurisdictions <https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/>



Relevant activities

Each category of relevant activity has its own definition that should be considered in detail but can be summarised as follows:

RELEVANT ACTIVITY	CORE INCOME-GENERATING ACTIVITY
Banking business	means a deposit-taking business required to be registered under article 9 of the Banking Business (Jersey) Law 1991.
Distribution and service centre business	means the business of: <ul style="list-style-type: none"> • purchasing parts, materials or goods from foreign connected persons and reselling them; or • providing services to foreign-connected persons in connection with the business, except where such activities fall within another category of relevant activity except holding company business.
Finance and leasing business	means the business of providing credit facilities of any kind for consideration, except where such activities fall within banking business, fund management business or insurance business. <ul style="list-style-type: none"> • consideration may include consideration by way of interest; • 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: <ul style="list-style-type: none"> ○ the supply of goods by hire purchase; and/or ○ leasing other than any lease granting an exclusive right to occupy land; or conditional sale or credit sale.
Fund management business	means the provision of management services (specifically regarding investment and risk) to a fund.
Headquarters business	means the business of providing certain services to one or more foreign-connected persons: <ul style="list-style-type: none"> • including the provision of senior management, • the assumption or control of material risk for activities carried out by, or assets owned by, any of those connected persons, • and the provision of substantive advice in relation to those matters <p>in each case except where such activities fall within finance and leasing business, intellectual property holding business, insurance business or banking business.</p>
Holding company business	means the business of being a controlling parent vehicle that has as its primary function the acquisition and holding of shares or equitable interests in other companies and does not carry on any commercial activity (which includes any other relevant activity). <p>i.e. means a resident company which:</p> <ul style="list-style-type: none"> • is a holding body; • has as its primary function the acquisition and holding of shares or equitable interests in other companies; and • does not carry on any commercial activity. <p>In respect of holding company business, all activities related to that business.</p>
Insurance business	means long-term business or general business within the meaning of and requiring a category A permit or category B permit under the Insurance Business (Jersey) Law 1996.



Intellectual property holding business	<p>means the business of holding intellectual property assets:</p> <p>“Intellectual property asset” means any intellectual property right in intangible assets, including but not limited to copyright, patents, trademarks, brand, and technical know-how, from which identifiable income accrues to the business (such income being separately identifiable from any income generated from any tangible asset in which the right subsists).</p> <p>“high risk IP entity” is a company which carries on an intellectual property holding business and the company:</p> <ul style="list-style-type: none"> • did not create the intellectual property in an intellectual property asset which it holds for the purposes of its business; • acquired the intellectual property asset: <ul style="list-style-type: none"> ○ from a connected person, or ○ in consideration for funding research and development by another person situated in a country or territory other than Jersey; and • licences the intellectual property asset to one or more connected persons or otherwise generates income from the asset in consequence of activities (such as facilitating sale agreements) performed by foreign connected persons; or the company does not carry out research and development, branding or distribution as part of its Jersey core income-generating activities.
Shipping business	<p>means certain activities involving the operation of a ship anywhere in the world other than solely between Jersey and Guernsey or within the territorial waters of Jersey, including the business of transporting persons, animals, goods or mail by sea (or renting or chartering ships for such purpose), selling travel tickets or equivalent, ancillary operation services, the use, maintenance or rental of shipping containers, and the management of the crew of a ship.</p>



The Economic Substance Test

A Jersey tax resident company must satisfy the Jersey economic substance test in relation to any relevant activity carried on by it that generates gross income in a financial period commencing on or after 1 January 2019.

The Law provides that a resident company meets the economic substance test in relation to any such relevant activity if:

- the company is **directed and managed** in Jersey in relation to that activity;
- having regard to the level of **relevant activity** carried on in Jersey:
 - there are an adequate number of employees (which can include directors) in relation to that activity who are physically present in Jersey (whether or not employed by the resident company or by another entity and whether on temporary or long-term contracts);
 - there is adequate expenditure incurred in Jersey; and
 - there are adequate physical assets in Jersey;
- all of the company's **core income-generating activities (CIGA)** are carried out in Jersey; and
- if any CIGA are carried out in Jersey for the company by another entity, the company is able to monitor and control the carrying out of that activity by the other entity.

Directed and managed

The Law provides that a company is directed and managed in Jersey in relation to a relevant activity if:

- the company's board of directors meets in Jersey at an adequate frequency having regard to the amount of decision-making required at that level;
- at such board meetings, there is a quorum of directors physically present in Jersey;
- the minutes of such board meetings described record the making of strategic decisions of the company at the meeting;
- the directors of the company have the necessary knowledge and expertise to discharge the duties of the board; and
- the minutes of all board meetings and the records of the company are kept in Jersey.

What is 'adequate' will depend on the specific circumstances!

Where there are corporate directors, these will be looked through, to the individuals (officers of the corporate director) actually performing the duties of the director.

Where company law permits the company to have a sole director, that sole director will conduct the board business by written resolution instead of holding a board meeting. In such cases, the director must be physically present in Jersey when they consider the points and sign each resolution. In these specific circumstances, this will be taken to be equivalent to a quorate board meeting for the purposes of the economic substance test.



Meetings and minutes of the board of directors

The 'directed and managed' assessment is designed to ensure that there are an adequate number of board meetings held and attended in Jersey, although it is not necessary for all board meetings to be held in Jersey, or that a quorum of directors is always present in Jersey.

Quorum in this context will be determined in accordance with The Companies (Jersey) Law 1991, as amended ("the Companies Law") and the entity's Articles.

What constitutes an adequate number of meetings in Jersey will be dependent on the relevant activities of the entity. Although it is also expected that even for companies with a minimal level of activity there will be at least one meeting of its board of directors held in Jersey in each year.

The requirement also looks to ensure that the board is a decision making body, in that it has the necessary knowledge and experience, and is not simply giving effect to decisions taken outside of Jersey whether taken by the directors or others.

It is unlikely to be accepted that the board of directors is making the strategic decisions if there is evidence that substantive decision making is taking place in any forums, or by any persons, without reference to or the oversight to the board of directors.

The minutes of the board meetings should refer to all the relevant decisions taken, even where the board considers courses of action and rejects them.

Core income-generating activities (CIGA)

Where the Jersey economic substance test applies, the Law provides that all relevant CIGA are required to be carried out in Jersey, whether carried out by the company itself or by another entity. Where any CIGA are carried out by another entity, the company must also be able to monitor and control them doing so.

The guidance further provides that where CIGA involves making a decision the majority of those making the decision must be present in Jersey when the decision is made for it to be considered made in Jersey. This broadly reflects the centrally managed and controlled principles relevant to tax residency (see above re meetings and minutes of board of directors).

Activities undertaken outside the Island must not be CIGA. For example, general support functions such as IT support or HR functions are a necessary activity for the majority of companies, but they do not generate income for the company.

The taking of decisions outside the Island would generally indicate performance of CIGA outside the island. However, isolated decisions may be taken outside the Island provided that 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.

The following CIGA are drawn from the legislation. Whilst not an exhaustive list these activities need to be carried out in Jersey to demonstrate economic substance.



RELEVANT ACTIVITY	EXAMPLES OF CORE INCOME-GENERATING ACTIVITY
Banking business	<ol style="list-style-type: none"> 1. Raising funds, managing risk including credit, currency and interest risk. 2. Taking hedging positions. 3. Providing loans, credit or other financial services to customers. 4. Managing capital and preparing reports or returns, or both, to investors or the local authorities.
Distribution and service centre business	<ol style="list-style-type: none"> 1. Transporting and storing goods, components and materials. 2. Managing stocks. 3. Taking orders. 4. Providing consulting or other administrative services.
Financing and leasing business	<ol style="list-style-type: none"> 1. Negotiating or agreeing funding terms. 2. Identifying and acquiring assets to be leased. 3. Setting the terms and duration of financing or leasing or lending. 4. Monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements.
Fund management business	<ol style="list-style-type: none"> 1. Taking decisions on the holding and selling of investments. 2. Calculating risk and reserves. 3. Taking decisions on currency or interest fluctuations and hedging positions. 4. Preparing reports or returns, or both, to investors or local authority, or both.
Headquarters business	<ol style="list-style-type: none"> 1. Taking relevant management decisions. 2. Incurring expenditures on behalf of other entities in the group. 3. Co-ordinating activities of the group.
Holding company business	<ol style="list-style-type: none"> 1. Companies which purely hold equities will need to confirm they comply with all applicable requirements under the jurisdictional law in which it was incorporated. 2. Where holding companies also conduct other relevant activities, they will additionally be subject to the requirements associated with that activity.
Insurance business	<ol style="list-style-type: none"> 1. Predicting or calculating risk or oversight of prediction or calculation of risk. 2. Insuring or re-insuring against risk. 3. Preparing reports or returns, or both, to investors or local authority, or both.
Intellectual property business	<ol style="list-style-type: none"> A. Where the intellectual property asset is a: <ol style="list-style-type: none"> 1. Patent or an asset that is similar to a patent, research and development; or 2. Non-trade or intangible (including a trademark), branding, marketing and distribution. B. In exceptional cases, except if the relevant activity is a high risk intellectual property business, other core income-generating activity relevant to the business and the intellectual property assets, which may include: <ol style="list-style-type: none"> 1. Taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the intangible asset generating income. 2. Taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the intangible asset. 3. Carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of income from third parties.
Shipping business	<ol style="list-style-type: none"> 1. Managing crew (including hiring, paying and overseeing crew members). 2. Overhauling and maintaining ships. 3. Overseeing and tracking deliveries. 4. Determining what goods to order and when to deliver them, organising and overseeing voyages.



Penalties

The legislation includes specific powers to request additional information in relation to any economic substance information provided on or with the income tax return.

The legislation also includes specific sanctions to address circumstances where companies have acted so as to avoid or seek to avoid the application of the economic substance requirements.

Penalties for failure to comply with the new substance legislation range from increasing fines, removal from the register through to imprisonment.

- £10,000 for the first non-compliance.
- Any subsequent failure can increase to £100,000 per notice issued.
- Removal from the Jersey Company Registry.
- Further provision has been included for the introduction of a penalty of £3,000 to be levied on any person who fails to provide information requested by the Comptroller of Income Tax.





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