

Substance Requirements in the Isle of Man and Guernsey - Are You Compliant?

19th January 2021

Background

In 2017, the European Union ("EU") Code of Conduct Group (Business Taxation) ("COCG") investigated the tax policies of a large number of non-EU countries, including the Isle of Man (IOM) and Guernsey, against the concept of "good tax governance" standards of tax transparency, fair taxation and anti-Base Erosion and Profit Shifting ("BEPS") measures.

Although the COCG had no concerns with most of the principles of good tax governance as they relate to the IOM and Guernsey and a number of other jurisdictions that subject corporate profits to zero or near zero rates, or have no corporate tax regimes, they did express concerns regarding the lack of economic substance requirement for entities doing business in and through these jurisdictions.

As a consequence, in November 2017 the IOM and Guernsey (along with several other jurisdictions) committed to address these concerns. This commitment manifested itself in the form of the Substance Requirements which were approved on 11 December 2018. The legislation applies to accounting periods commencing on or after 1 January 2019.

The Crown Dependencies (defined as the IOM, Guernsey and Jersey), issued final guidance ("Substance Guidance"), regarding the Substance Requirements on 22 November 2019, to supplement the key aspects document that had been issued in December 2018.

What are the Economic Substance Regulations?

The core requirement of the Substance Regulations is that an Isle of Man or Guernsey (referred to each as "the Island") tax resident company must, for each accounting period in which it derives any income from a relevant sector, have "adequate substance" in its jurisdiction.

Relevant sectors include

- Banking
- Insurance
- Shipping
- Fund Management (this does not include companies that are Collective Investment Vehicles)
- Financing & leasing
- Headquarters
- Distribution and service centres
- Pure Equity Holding Companies; and
- Intellectual Property (for which there are specific requirements in high risk

At a high level, companies with relevant sector income, other than pure equity holding companies, will have adequate substance in the Island, if they are directed and managed in the jurisdiction, conduct core income-generating activities ("CIGA") in the jurisdiction and have adequate people, premises and expenditure in the jurisdiction.

Directed and Managed

Being 'directed and managed in the Island' is distinct from the residency test of 'management and control'.

Companies must ensure that there are an adequate number of board meetings* held and attended in the relevant Island to show that the company has substance. This

requirement does not mean that all meetings need be held in the relevant Island. The key points of consideration to meet this test are:

- the frequency of meetings – should be sufficient to meet the business needs of the company;
- how directors attend board meetings – a quorum should be physically present in the Island and tax authorities have recommended that the majority of directors should be physically present. Furthermore, directors are expected to physically attend the majority of meetings;
- the board should have relevant technical knowledge and experience;
- strategic and significant decisions must be made at the board meetings.

*Board minutes should at a minimum, evidence key strategic decisions being made in the meeting held at the appropriate location. If the board of directors does not, in practice, make the key decisions, tax authorities will look to understand who does, and where.

Core Income Generating Activities (CIGA)

- t all CIGAs that are listed in the relevant Islands' Regulations need to be carried out, but those that are, must comply with substance requirements.
- Certain back office roles such as IT and accounting support do not comprise CIGAs.
- In general, the substance requirements have been designed to respect outsourcing models, though where CIGAs are outsourced they should still be carried out in the Island and be adequately supervised.

Adequate Physical Presence

- Demonstrated by having adequately qualified employees, premises and expenditure on Island.

- It is common practice that the physical presence can be demonstrated through outsourcing to an Island-based administrator or corporate service provider, though such providers cannot double-count their resources provided.

What Information is Required to be Provided?

As part of the income tax filing process, companies carrying on relevant activities will be required to provide the following information:

- business/income types, in order to identify the type of relevant activity;
- amount and type of gross income by relevant activity – this will generally be the turnover figure from the financial statements;
- amount of operating expenditure by relevant activity – this will generally be the company's operating expenditure from the financial statements, excluding capital;
- details of premises – business address;
- number of (qualified) employees, specifying the number of full-time equivalents;
- confirmation of the Core Income Generating Activities (CIGA), conducted for each relevant activity;
- confirmation of whether any CIGA has been outsourced and if so relevant details;
- the financial statements; and
- net book value of tangible assets.

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

The legislation allows the Income Tax authorities to enquire into the income tax return of a corporate taxpayer, provided notice of the enquiry is given within 12 months of the receipt of the income tax return, or amendment to that return.

Failure to Comply

It is important too, that clients continue to monitor company activity to ensure ongoing compliance with the substance requirements, as a company may not be subject to the substance test in one year but fall into the regime in a subsequent year.

Sanctions can be imposed including penalties between £50k and £100k for a first offence, with additional financial penalties for a subsequent offence. In addition, where the Assessor believes there is no realistic possibility of a company meeting the substance requirements, he may seek to have the company struck off the register.

Can you Opt-out of Tax Residence in the Island?

In the Isle of Man, for instance, if, as is often the case, such companies are in fact tax resident elsewhere (and registered as such), the board of directors could elect (within section 2N(2) ITA 1970) to be treated as non-IOM tax resident. This means they will cease to be IOM corporate taxpayers and the Order will not apply to those companies, although the company will still exist.

Section 2N(2) states 'a company is not resident in the Isle of Man if it can be proven to the satisfaction of the Assessor that:

(a) its business is centrally managed and controlled in another country; and

(b) it is resident for tax purposes under the other country's law; and

(c) either —

- it is resident for tax purposes under the other country's law under a double taxation agreement between the Isle of Man and the other country in which a tie-breaker clause applies; or

- the highest rate at which any company may be charged to tax on any part of its profits in the other country is 15% or higher; and

(d) there is a bona fide commercial reason for its residence status in the other country, which status is not motivated by a wish to avoid or reduce Isle of Man income tax for any person.”

In Guernsey, as in the Isle of Man, if a company is and can evidence it is tax resident elsewhere, then it can file a ‘707 Company Requesting Non Tax Resident Status’, to be exempt from complying with the economic substance requirements.

Guernsey and the Isle of Man – How Can we Help?

Dixcart has offices in Guernsey and the Isle of Man and each are fully conversant with the measures that have been implemented in these jurisdictions and have been assisting its clients in ensuring adequate substance requirements are met.

Should you require additional information regarding economic substance and the measures adopted please contact Steve de Jersey in our Guernsey office:

advice.guernsey@dixcart.com, or Paul Harvey in the Dixcart office in the Isle of Man regarding application of the substance rules in this jurisdiction: advice.iom@dixcart.com

Should you have a general question regarding economic substance please contact:

advice@dixcart.com.

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