

# **Joint Guidance on the Application of the Economic Substance Rules to Partnerships**

## **1 Introduction and Purpose**

Legislation introducing economic substance requirements for partnerships in the Crown Dependencies<sup>1</sup> was approved by the respective parliaments in 2021.

The legislation applies to all partnerships resident for tax purposes in the Crown Dependencies and is effective at various dates depending on the type of provision and type of partnership.

This document is the third piece of guidance issued jointly by the Crown Dependencies. This document provides additional guidance on the scope and application of the economic substance legislation regarding partnerships.

The tax administrations from the Crown Dependencies will continue to work together to further develop this guidance, which will be updated periodically, and will be complemented by Island specific guidance.

The guidance is principles based and therefore cannot cover specific scenarios and will not replace the need to take independent professional advice.

Whilst the terms used within each Island's legislation may differ slightly, the text of this joint document is drafted in a generic manner so as to explain the scope and application of the legislation as it will be across all three Islands.

This document should be read in conjunction with the legislation applicable in each Island, which can be found at:

Jersey            [Taxation \(Partnerships – Economic Substance\) \(Jersey\) Law 2021](#)

Isle of Man    [Income Tax \(Substance Requirements\) Order 2021](#)

Guernsey       [The Income Tax \(Substance Requirements\) \(Implementation\) Regulations, 2021](#)

Any comments should be directed to the respective tax administrations in Guernsey, the Isle of Man or Jersey.

## **2 Overview of the Economic Substance Requirements**

The economic substance requirements apply to any resident partnership for any relevant activity for which it has gross income.<sup>2</sup> For the purposes of the economic substance requirement, the rules pertain to gross income, not taxable income/profit or accounting income/profit. Generally, the economic substance test will not apply to a resident partnership if all partners are individuals subject to income tax in the respective Island, or the resident partnership is not part of a multinational group.

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<sup>1</sup> Guernsey, the Isle of Man and Jersey.

<sup>2</sup> See Section 4 for further information regarding the determination of residence for partnerships.

If there is any indication that a partnership is seeking to manipulate or artificially suppress its income to avoid being subject to substance requirements, the respective Tax Administrations will take the appropriate action.

The Islands' respective guidance on economic substance requirements for companies, where relevant to the requirements for partnerships, is incorporated by reference.

### **3 Governing Body**

Partnerships will be required to demonstrate that the relevant activity is directed and managed by its "governing body" in the Islands.

The governing body is the person or group of persons responsible for making the partnership's strategic and management decisions, i.e. it has the general supervision of the affairs of the relevant partnership. If that person or group is not able to be identified, then all of the partners in the partnership will be deemed the governing body.

It is expected that any business will need to have meetings of its governing body in line with the levels of activities it conducts, and it is at those meetings that the decisions required to run the business are made.

The governing body should meet in the Island at an adequate frequency given the level of decision making required in respect of the relevant activity. Strategic decisions must be set at those meetings, with the minutes reflecting those decisions, even those where the board considers courses of action and rejects them. The governing body, as a whole, must have the necessary knowledge and expertise to discharge their duties. All minutes and relevant records must be kept in the Island.

If there is evidence that substantive decision making is taking place in any forums, or by any persons, without reference to or without the oversight of the identified governing body, it is unlikely to be accepted that this is the governing body for purposes of the economic substance test.

For a limited partnership, the governing body will be considered to be the board of directors of the body corporate which is the general partner.

For a limited liability partnership, the governing body will be its management committee or team (however constituted) as mandated pursuant to its partnership agreement.

For a general partnership, it will be necessary to have regard for the facts and circumstances of that partnership and its partnership agreement to determine what is the governing body. For example, the partnership may have mandated a group of "senior" partners that are akin to a management committee that for this purpose are considered to be the governing body. In other circumstances, all partners in the partnership may be considered the governing body.

For a limited liability company managed by its members, the governing body will be those members; for a limited liability company that has vested its management in another person, the governing body will be that person(s).

#### **4 The “Place of Effective Management” Test**

Generally, the Islands’ legislation treats a partnership as resident for purposes of the economic substance rules either if it is legally formed in the Island and its place of effective management is not elsewhere, or if it is foreign-formed but has its place of effective management in the Island.

The Islands’ legislation follows the OECD guidelines, which notes: “The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made.”<sup>3</sup>

One additional element allows partnerships to have only one place of effective management at any one time (even if there are multiple places of management).

In essence, a core question being examined is: where is the place that true control and management of the entity occur in conducting its business? The intent is to ascertain where the entity is *actually* managed.

Although there is no one set test, as each situation depends on its particular facts and circumstances, in the majority of cases the form, membership and location of the governing body can be clearly established, usually from the partnership agreement, partnership registers, minutes of meetings, or from the records at the registry, and from this follows the partnership’s place of effective management.

##### *Example 1*

##### Facts

Limited Partnership AB LLP was established under the Island’s Laws. It has under its partnership agreement appointed a single Managing Partner, CD Ltd which was itself incorporated and whose directors meet in the Island. The Board of CD Ltd are considered the Governing Body of AB LLP.

##### Analysis

AB LLP’s Governing Body, the Board of CD Ltd, meets in the Island to make the strategic decisions, making it a resident partnership. Consequently, it has its place of effective management in the Island.

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<sup>3</sup> [Commentary to Article 4 of the OECD Model Tax Convention \(2017\)](#).

### *Example 2*

#### Facts

Limited Partnership EF LP was established in an off-island jurisdiction. It has a General Partner, GH Ltd which was itself incorporated and whose directors meet in the Island. The Board of GH Ltd are considered the Governing Body of EF LP.

#### Analysis

EF LP's Governing Body, the Board of GH Ltd, meets in the Island to make the strategic decisions, making it a resident partnership. Consequently, it has its place of effective management in the Island.

### *Example 3*

#### Facts

Limited Partnership JK LP was established and is registered in the Island. It has a single General Partner, LM Inc., which was incorporated in and operates entirely from the Cayman Islands. The Board of LM Inc. is the Governing Body of JK LP.

#### Analysis

As the Board of LM Inc. manage the activities of JK LP from the Cayman Islands, the Island is not considered to be the place of effective management. As the Cayman Islands have substantially similar substance requirements as the Island (and is therefore a qualifying jurisdiction<sup>4</sup>), JK LP is not a resident partnership for purposes of the economic substance rules.

### *Example 4*

#### Facts

Limited Partnership NO LP was established and is registered in the Island. It has a single General Partner, PQ Inc., which was incorporated in and operates entirely from the USA. The Board of PQ Inc. is the Governing Body of NO LP.

#### Analysis

As the Board of PQ Inc. manage the activities of NO LP from the USA, the Island is not considered to be the place of effective management. As the rate of tax in the USA exceeds 10 percent, then the partnership will not be considered a resident partnership in the Island and will not be subject to any economic substance test.

#### *Relevant factors in cases of uncertainty*

In some cases, usually with general partnerships and in other situations where there is no clearly mandated governing body, uncertainty as to where a partnership has its place of effective management may arise. The following types of evidence may help demonstrate the correct position:

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<sup>4</sup> See Annex 1 for a list of qualifying jurisdictions which have substantially similar substance requirements.

- Where the majority of partnership meetings take place (i.e. if there is no mandated governing body)?
- Where the strategic decisions regarding the sale/purchase or dissolution/liquidation of assets takes place?
- Where the partnership has any permanent establishments (if any)?
- Are the partners, particularly those involved in its management, resident in the Island?
- Which jurisdiction's laws govern the legal status of the entity?
- Where are the legal titles/records and accounting records maintained/kept/located?
- If the partnership has a publicly designated headquarters, where is it located?

### *Example 5*

#### Facts

Partnership RS, a general partnership, is formed under the laws of Jurisdiction A, with 4 equal-share partners: 2 individual partners (X and Y) are resident in Jurisdiction A, partner B Ltd is a company resident in Jurisdiction B, and the final partner C Ltd is a company resident in Jurisdiction C. The partners hold an annual business meeting at a resort in Jurisdiction D, where the financial statements are reviewed (which are prepared by company staff and audited by an accounting firm, all in Jurisdiction A). RS has small offices in jurisdictions A and B, and the website lists the head office as being in located in Jurisdiction A (being the office which receives mail and legal notices). During the last taxable year, an attractive offer to enter a new venture came up, so an ad hoc meeting was held – the directors of C Ltd joined the call from Jurisdiction C, with all of the other partners, including the directors of B Ltd, participating from the head office in Jurisdiction A. In previous years where there were ad hoc partnership meetings, these always took place in Jurisdiction A.

#### Analysis

- Where the majority of partnership meetings take place? [ D & A ]
- Where key relevant strategic decisions takes place? [ D & A ]
- Where the partnership has any permanent establishments (if any)? [ B & A ]
- Where are the partners resident? [ B, C, majority A ]
- Which jurisdiction's laws govern the legal status of the entity? [ A ]
- Where are the legal titles/records and accounting records maintained/kept/located? [ A ]
- If the partnership has a publicly designated headquarters, where is it located? [ A ]

In this scenario, there seem to be multiple possible places of management of the partnership, yet there can only be one place of effective management. Based on the facts above, it is determined that RS's place of effective management is in Jurisdiction A.

## 5 Exemptions

A partnership is not required to satisfy the economic substance test if it is eligible for one of two exemptions which apply where:

1. all of the partners are individuals and subject to income tax in the Island in respect of their share of the profits of the partnership ('individual exemption');  
or
2. the partnership is not part of a multi-national group and carries out its activities<sup>5</sup> in the Island ('domestic exemption').

As with companies, the Collective Investment Vehicle (CIV) exemption will also apply to partnerships.<sup>6</sup>

The legislation in each Island includes definitions of certain terms used within the individual exemption and the domestic exemption as well as the specific text of the exemptions, and these must be read in conjunction with this guidance.

Each jurisdiction also uses a different term to define a multi-national group; however, in general a multi-national group is a collection of enterprises (which are not all tax resident in the same jurisdiction) that are required to prepare consolidated financial statements, in accordance with international accounting standards.

Unlike the definition of an MNE Group for the purpose of Country-by-Country reporting there is no specified turnover threshold; the group is simply comprised of one or more enterprises that are tax resident in different jurisdictions.

A partnership will be considered to carry out its activities from the fixed place of business/premises through which the trade or business is carried on.

For limited partnerships, only the general partner is permitted to conduct activity of the limited partnership<sup>7</sup>. The limited partnership will be considered to carry out its activities from the fixed place of business/premises through which the general partners trade or business activities are carried on.

Performing services for the benefit of the resident partnership (for example meeting with a bank outside the Island to agree more favourable lending terms), rather than a customer, are not considered part of the partnership's activities in this context.

### *Example 1 – Domestic Exemption*

The Shipping Limited Partnership operates ships in international traffic and falls within the relevant activity of 'shipping'. The general partner conducts the partnership's entire activity within the Island from the general partner's premises in the Island and has no premises elsewhere and does not conduct any other activity for the limited partnership.

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<sup>5</sup> See Taxation (Partnerships – Economic Substance) (Jersey) Law 202-, Art. 7(4)-(5).

<sup>6</sup> To the extent that a fund and fund manager is not one and the same entity.

<sup>7</sup> Tax administrations of the Islands consider that any partner, in their capacity as a partner, participating in any relevant activities would be a general partner.

It has four partners, all of which are companies. The general partner is resident in the Island, two limited partners are resident in the US, and one limited partner is resident in Germany. The Shipping Limited Partnership is not a member of a multinational group.

The Shipping Limited Partnership is eligible for the domestic exemption as it is not part of a multi-national group and because the general partner carries out all of its activities in the Island, and so consequently the partnership will not be required to satisfy the economic substance test.

#### *Example 2 – Individual Exemption*

The Loan Partnership advances loans carrying a commercial rate of interest, and so falls within the relevant activity of ‘finance and leasing’. It conducts some activity within the Island from its premises in the Island, and some activity from premises outside the Island.

It has three partners; all three are Island resident individuals.

The Loan Partnership is eligible for the individual exemption during the financial period because all of its partners are individuals, who are subject to tax in the Island in respect of their share of profits, and so the partnership will not be required to satisfy the economic substance test.

#### *Example 3 – No Exemption*

The Container Limited Partnership acting through its general partner operates ships in international traffic and falls within the relevant activity of ‘shipping’. The general partner conducts some of the partnership’s activities within the Island from its premises in the Island, and a significant proportion of its activity from premises outside the Island.

It has four partners; all are companies. The general partner is resident in the Island (and conducts its board meetings on the Island), two limited partners are resident in the US, and one limited partner is resident in Germany. The Container Limited Partnership is not part of a MNE group.

The Container Limited Partnership is not eligible for the individual exemption arising from having individual partners as all of the partners are companies.

Furthermore, although the Container Limited Partnership is not part of a multinational group, it conducts a significant proportion of its activities outside the Island, making it ineligible for the domestic exemption. Thus, it will be required to demonstrate that it satisfies the economic substance test.

#### *Example 4 – Domestic Exemption*

Financing Limited Partnership (that was established and registered in the Island) is part of a private equity structure and receives income from carrying on the relevant activity of “financing and leasing”.

The partnership’s general partner Fin GP Ltd is both incorporated and managed and controlled (through its board of directors) in the Island, conducting the partnership’s

activities from the general partner's premises on the Island. The general partner does conduct some activities in the UK, such as meeting with banks to agree favourable lending terms.

Under applicable accounting standards (which may include IFRS), Financing Limited Partnership would not be required to be consolidated (e.g. it instead uses fair value accounting under IFRS10).

As the financing activities are conducted in the Island and the partnership is not part of a multinational group (as it is not required to be consolidated), it is eligible for the domestic exemption.

## **6 Other Issues**

For clarification, under the economic substance test there is a requirement to demonstrate certain elements in each Island, such as adequate qualified employees, which includes all substance in the Islands used in the relevant activity.<sup>8</sup> For example, qualified employees would cover those working for:

- the partnership,
- the governing body, including a general partner, or any other partners,
- or for persons to whom activities have been outsourced,

provided those duties are performed or held in the Island.

This guidance document should also be read in conjunction with the following Island laws, as the intent is that the application of rules for the economic substance test to partnerships should be, where relevant, consistent with the similar rules applicable to companies:

- [Taxation \(Companies – Economic Substance\) \(Jersey\) Law 2019 amended](#)
- [www.gov.gg/economicsubstance](http://www.gov.gg/economicsubstance)
- [www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/economic-substance/](http://www.gov.im/categories/tax-vat-and-your-money/income-tax-and-national-insurance/economic-substance/)

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<sup>8</sup> See the specific legislation in place in each Island, as there are different elements required in each jurisdiction.



## **Annex 1**

### **List of qualifying jurisdictions which have substantially similar substance requirements**

The following are a list of qualifying jurisdictions which have substantially similar substance requirements at date of publication:

Anguilla	Cayman Islands
Bahamas	Guernsey
Bahrain	Isle of Man
Barbados	Jersey
Bermuda	Turks and Caicos Islands
British Virgin Islands	United Arab Emirates

\*Note that this list will be kept under review, with regard to continuing compliance with international tax standards, with jurisdictions added/removed as appropriate.