

Guidance on aspects in relation to the economic substance requirements as issued
by Guernsey, Isle of Man and Jersey

1	Introduction and Purpose.....	1
2	Overview of the Economic Substance Requirements	2
2.1	Sectors.....	2
2.2	Adequate Substance	3
2.3	Sanctions.....	3
2.4	Reporting of Information.....	4
3	Core Income Generating Activities – General Points.....	5
4	Relevant Sectors	6
4.1	(Pure Equity) Holding Company	6
4.2	Banking	8
4.3	Finance and Leasing	10
4.4	Fund Management	13
4.5	Insurance	16
4.6	Distribution and Service Centre.....	17
4.7	Headquartering	19
4.8	Shipping	21
4.9	IP Company.....	22
4.10	High Risk IP Company	23
4.11	Group/connected person.....	24
5	Directed and Managed.....	25
5.1	What is the directed and managed requirement?	25
5.2	Companies in liquidation	27
6	Employees	28
7	Outsourcing	30

1 Introduction and Purpose

Legislation introducing economic substance requirements for companies in the Crown Dependencies¹ was approved by the respective parliaments in December 2018.

The legislation applies to all companies resident for tax purposes in the Crown Dependencies and is effective for accounting periods commencing on or after 1 January 2019.

This document is the second piece of guidance to be issued jointly by the Crown Dependencies. This document provides additional guidance on the scope and application of the economic substance legislation.

This guidance is being published now, to enable industry to engage and provide feedback, however is to be treated as a work in progress recognising that further technical aspects will develop through further discussions with the Organisation for Economic Co-operation and Development Forum on Harmful Tax Practices and the European Union Code of Conduct Group on Business Taxation.

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 jointly issued document [Key aspects in relation to economic substance requirements](#) and the legislation applicable in each Island, which can be found at:

Jersey [Taxation \(Companies-Economic Substance\) Law 2019](#)

Isle of Man [isle-of-man-legislation-income-tax-substance-requirements-order-2018.pdf](#)

Guernsey <https://www.gov.gg/economicssubstance>

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

¹ Guernsey, the Isle of Man and Jersey

2 Overview of the Economic Substance Requirements

The economic substance requirements apply to all companies that are tax resident in the Island and which have income from a relevant sector in any accounting period commencing on or after 1 January 2019.

Income for the purposes of the economic substance requirement is gross income not taxable income/profit or accounting income/profit.

If there is any indication that a company 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.

2.1 Sectors

The relevant sectors are:

- Banking
- Insurance
- Shipping
- Fund management (not including Collective Investment Vehicles)
- Finance and leasing
- Headquartering
- Distribution and Service Centres
- Operation of a Holding Company
- Holding intangible property (Intellectual Property)

The legislation for each Island includes a definition of the activity that falls within each of these sectors.

2.2 Adequate Substance

All companies with activities and income in a relevant sector in an accounting period will be required to demonstrate that they have adequate substance in the Island.

The adequate substance requirements, will generally require that a company:

- (a) is directed and managed in the Island;
- (b) has an adequate number of (qualified) employees proportionate to the level of activity carried on in the Island;
- (c) has adequate expenditure proportionate to the level of activity carried on in the Island;
- (d) has an adequate physical presence in the Island; and
- (e) conducts core income-generating activity ('CIGA') in the Island

There are reduced requirements for (pure equity) holding companies, which will be outlined in later guidance.

2.3 Sanctions

If a company in a relevant sector cannot demonstrate that it has adequate substance in the Island in an accounting period, it will be subject to sanctions.

These sanctions include exchange of information with Competent Authorities in other jurisdictions, financial penalties and, ultimately, striking off the companies register.

2.4 Reporting of Information

As part of its 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 statements²;
- 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 - see section 6 below;
- confirmation of the Core Income Generating Activities (CIGA) conducted for each relevant activity;
- the financial statements; and
- confirmation of whether any CIGA have been outsourced and if so relevant details.

It is expected that the carrying on of relevant activities will result in the generation of income.

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 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.

² Gross income and operating expenditure should be the figures from the financial statements, provided they have been prepared in accordance with recognised accounting principles.

3 Core Income Generating Activities – General Points

CIGA are the key essential and valuable activities that generate the income of the company. It is not necessary for the company to perform all of the CIGA listed in the legislation for the particular sector, but it must perform the CIGA that generate the income it has.

In order to meet the economic substance requirement the CIGA that generate the income must be performed in the Island. Where the CIGA involves making relevant decisions, then the majority of those making the decisions must be present in the island when the decision is made, otherwise the decision will not be considered to be made in the Island.

4 Relevant Sectors

There follows for each relevant sector a summary of the scope, the applicable CIGA and some basic scenarios which meet the economic substance requirement and some basic scenarios which do not meet the economic substance requirement.

The full definitions are not repeated, so the Island specific legislation should be read in conjunction with this document.

4.1 (Pure Equity) Holding Company

A company will be regarded as a (pure equity) holding company if its primary function is to acquire and hold equities, and the equities in question are controlling stakes in other companies. It will be subject to the substance requirements if it receives income on its own behalf from those holdings (i.e. if it is the beneficial owner of the shares).

If a company also undertakes other commercial activities, then it is outside of this narrow definition and will instead need to meet the higher substance requirements, if applicable for any relevant activity it carries on.

For example if the company provides senior management, takes responsibility, control or provides substantive advice in respect of material risks to companies it controls, then it will not be a (pure equity) holding company. The company could be considered to carry on the activity of providing headquarters services if those services were provided to foreign companies.

In determining whether the company also undertakes other commercial activities, two aspects must be considered. Firstly, whether the activities are commercial (i.e. they are directly linked to the sale/exchange of goods or assets or services in pursuit of profit such as renting land or property).

Secondly, whether there is any activity taking place. Passively holding investments and receiving income or gains from them is not considered to be an activity for this purpose.

If a company meets the criteria to be regarded as a (pure equity) holding company, the placing of dividend monies received on deposit or using them to acquire and passively hold other securities such as gilts, will not constitute a "commercial activity" and therefore the company will still be regarded as a (pure equity) holding company and subject to substance requirements.

Examples:

1. Midco Ltd is an intermediary (pure equity) holding company in a group structure, it holds 100% of the shares in three other companies and receives dividends annually. This is Midco Ltd's only activity. Midco Ltd is a (pure equity) holding company.

2. Restaurant Ltd runs 2 restaurants, it also acquired all the shares in another company Bistro Ltd which is constructing a new restaurant. Restaurant Ltd will not be a (pure equity) holding company as besides holding shares it is in the business of running restaurants.
3. Trust Services Ltd acts as trustee to a number of unconnected trusts, holding assets in its capacity as trustee. As Trust Services Ltd commercially provides trustee services and is not the beneficial owner of the assets, it will not be a (pure equity) holding company, but should consider if it carries on any other relevant activities for its own account, not acting as trustee.

4.2 Banking

The companies within the scope of these activities are deposit taking businesses which are subject to regulation as banks in each of the Islands.

All such companies should be easily identifiable as they are required in all 3 Islands to hold a licence issued by the financial regulator.

Examples:

High Street Savings Ltd has a number of branches from which it offers current or savings accounts and other banking services. It is clearly a bank and regulated as such.

Banking Services Ltd is part of a banking group, however it does not take deposits, it only provides advisory and other services to clients of the banking group. Banking Services Ltd would not be conducting deposit taking activities although it may be conducting activities which fall into another relevant activity category.

4.2.1 Core Income Generating Activities (CIGA) for Banking

The legislation sets out a list of CIGA for banking, which are described below.

'raising funds, managing risk including credit, currency and interest risk' – these are the activities of ensuring the bank has an adequate capital base. Whilst raising funds clearly includes taking deposits it can also include going to the money markets, issuing bonds or new capital. The risks to be managed will be linked to ensuring that this capital base is not eroded.

'taking hedging positions' – banks need to ensure that where there is risk they mitigate it, this is often done by taking hedging positions. In such situations the bank must be able to show that it has taken the decisions.

'providing loans, credit or other financial services to customers' – banks will utilise the moneys they have received from deposits to provide other financial products and services, such as loans and mortgages, to customers. There is a wide range of products and services which may be offered. The term "customer" is not just limited to retail customers, but could also be corporate groups, or other financial institutions. The bank will need to be able to show it offers such financial products and services.

'managing capital and preparing reports and returns for bodies with supervisory and regulatory functions' - The banking sector is highly regulated, and there are substantial reporting requirements made of the sector. The bank would need to perform this reporting.

Whilst it is expected that regulated companies carrying on banking will already be able to demonstrate that they conduct the CIGA in the Island, those companies are still subject to the substance requirements.

The regulatory environment in the Islands for banking activities is such that where there is a possibility that there is a failure relating to CIGA, this would indicate serious regulatory risk, and in such situations discussions with the regulators and the priority of actions to protect the local economy would need to be considered.

4.3 Finance and Leasing

The definition encompasses any company which offers credit or financing of any kind for consideration, such as loans, hire purchase agreements, long term credit plans, and finance leases in relation to assets other than land. This includes intra-group financing.

The scope also extends to the situation where a loan advanced for consideration by one company, which is within the scope of this sector, is transferred to a different company which then receives the loan capital repayments and consideration.

The scope does not extend to cases where credit is offered and there is no expectation of consideration from the credit when providing it. A lending fee would be consideration, whereas the grant of security in favour of the lender would not constitute consideration.

The scope does not extend to cases where the company has purchased debt securities as an investment, as opposed to providing a credit facility, for example, where the company has purchased gilts, quoted bonds or similar securities which are actively traded on one of the major security exchanges.

In banking, insurance and fund management businesses it may be a normal part of their activities to provide credit, and so these sectors are excluded from being within the scope of Financing and Leasing, to prevent duplicate reporting.

Examples:

ABC Ltd lends £1,000,000 to its subsidiary, CDE Ltd, at a 5% interest rate. ABC Ltd's activities would come within the definition of financing and leasing.

The loan of £1,000,000 to CDE Ltd, is transferred by ABC Ltd to another company 123 plc. 123 plc's activities in relation to the loan now come within the definition of financing and leasing. If this was the only loan ABC Ltd held, then ABC Ltd would cease to be carrying on financing and leasing.

FGH Ltd is a trading company that provides its customers with 45 days trade credit on invoices. If the customers have not paid their invoice in the 45 days, FGH Ltd will charge late payment interest. This arrangement is not within financing and leasing, as the credit is not offered with the intention of generating interest.

4.3.1 Core Income Generating Activities (CIGA) for Financing and Leasing

The legislation sets out a list of CIGA for financing and leasing, which are described below.

'**Agreeing funding terms**' refers to funding of the lender or lessor itself and includes agreeing the type of funding (e.g. equity/preference shares/debt/bank borrowing etc.), the quantum of funding, the rates of interest payable, the security given (if any), and any covenants.

'Identifying and acquiring assets to be leased', includes agreeing a suitable price or quantity, identifying sources of those assets, and negotiating the acquisition and the terms of supply.

'Setting the terms and duration of any financing or leasing' includes the financial terms, the parameters as to acceptable counterparties, the amounts, rates of interest, the legal agreements and the period for which financing or leasing is to be provided.

'Monitoring and revising any agreements' includes the acquisition of data about a borrower or lessee (or group of them), testing against covenants, extending durations of loans, and feeding back into decision making on writing new terms.

'Managing risk' includes instigating debt collection, considering spreading of risk across sectors or consumer groups. In leasing it includes monitoring and maintaining the underlying assets.

Examples

ABC Ltd

ABC Ltd is considering the CIGA it performs in relation to its loan of £100,000,000 to its subsidiary CDE Ltd.

ABC Ltd had agreed its funding for the loan from a third party bank; its finance director and his deputy, had compiled the data required, met with a number of banks and negotiated a long term facility with one.

ABC Ltd's Board of Directors in setting the terms of the financing had set the amount it could lend to CDE Ltd, and the rate based on CDE Ltd's assets and expected income streams and ABC Ltd's own financial commitments and requirements for a return.

In order to do this, ABC Ltd had engaged the services of a professional to model different cashflow scenarios from the lending and the borrowing, so that ABC Ltd's Board could better understand the potential risks and rewards, enabling the Board to then ultimately make the final strategic decision.

ABC Ltd has set up a system in which a member of office staff on the Island ensures the information required to undertake the monitoring of both the payments of interest, and the financial data from CDE Ltd are provided in accordance with the agreement, with a process to escalate issues to the finance director.

The finance director takes the information provided and discusses with the Board of ABC Ltd the loan, and its own and CDE Ltd's performance, and ensures they take steps to manage any risks emerging.

ABC Ltd will be regarded for the purposes of the substance requirements as conducting the CIGA in the Island.

XYZ Ltd

XYZ Ltd is a finance leasing company, it has one crane which it leases to an overseas connected company, and is considering the CIGA it performs for this finance leasing.

XYZ Ltd was funded by capital for its initial shares, which it used to acquire the crane, and has determined that it requires no additional funding.

XYZ Ltd had been introduced to the previous crane owners to acquire the crane. XYZ Ltd's Board of Directors approved the proposal to purchase the crane, however, the asset had been identified prior to XYZ Ltd's incorporation and no alternatives were considered once XYZ Ltd had been incorporated.

Whilst the Board of directors of XYZ Ltd considered the finance lease agreement that had been drawn up prior to the incorporation, they did not have the necessary knowledge and expertise to understand the terms of that lease agreement, and they did not seek appropriate specialist advice. Ultimately the Board of directors accepted the agreement as drafted and did not properly consider the terms.

XYZ Ltd outsource their monitoring to a professional adviser, who has a member of staff who spends up to half an hour a week reconciling the monies received as well as sending invoices etc. XYZ Ltd relies on the professional adviser to raise any issues, it does not monitor the professional advisor at all.

XYZ Ltd did not include clauses within the lease agreement to mitigate the risk of the lessee not making the lease payments, or the risk of the crane not being properly maintained or improperly used throughout the duration of the lease.

XYZ Limited will not meet the substance requirement because the company is unable to demonstrate that the CIGA are being performed in the Island.

4.4 Fund Management

The definition of fund management encompasses companies which provide management services in relation to funds (i.e. Collective Investment Vehicles) but does not include the fund itself.

Those activities which are caught are the provision of fund management services to a fund, in relation to its investment decisions, and its risk decisions. Other types of services which funds require such as administration, advisory services or custodian services are not within the activities defined.

Examples

Black Ltd is a company which undertakes fund management activities in relation to a number of funds which requires it to be licensed, as a fund manager, with the regulator. Such fund management activities are within the scope of the definition, therefore Black Ltd is subject to the substance requirements.

White Ltd is a fund in the Island, it has an administrator in the Island, Red Ltd. Neither White Ltd nor Red Ltd perform fund management activities and so neither are subject to substance requirements.

4.4.1 Core Income Generating Activities (CIGA) for Fund Management

The legislation sets out a list of CIGA for fund management, which are described below.

'Taking decisions on the holding and selling of investments' - The CIGA is concentrated on the taking of decisions. A company which is implementing decisions of another entity, by selling investments, does not perform the CIGA. It is a commercial reality that in some circumstances a committee of directors, or an investment committee will take decisions when not all the members are physically present. For a decision to be determined as being taken in a jurisdiction for the purposes of this CIGA, the majority of those making the decision should be physically present in that jurisdiction.

'Calculating risk and reserves' - Funds are vehicles where capital is pooled and risks spread over a number of investments. In managing the fund consideration must be given to risk in a number of areas: market risk, credit risk (where applicable), liquidity risk as well as operational risks. The CIGA looks at risk as a whole, and so this CIGA will not be being performed if the calculations are limited to a marginal calculation for one area of applicable risk and do not encompass other areas of applicable risk. Rather this CIGA is calculating the overall risk across the fund and the reserves required on this strategic basis.

'Taking decisions on currency or interest fluctuations and hedging positions'- The activities are those required to determine if the fund is exposed to or if it is in the best interests of the fund to enter into hedging arrangements against currency or interest fluctuations, and take relevant decisions regarding those determinations. As with the other CIGA this is in

relation to the whole fund's position, and isolated decisions involving specific investments is not sufficient to meet the CIGA, it has to be a strategic approach.

'Preparing reports and returns to investors and the relevant financial services regulator or any body or entity with equivalent functions relating to the supervision or regulation of such business'

– This CIGA does not necessarily involve the administrative task of compiling the various routine annual or quarterly returns, albeit it is expected that the company would have the ultimate responsibility for this. Rather it is ensuring that the systems and processes are in place, including the contractual arrangement with the administrator, together with the understanding and knowledge within the company, such that the company is well placed to timeously and accurately convey the position of the fund(s) at any time.

Whilst especially in small companies, many of these decisions will ultimately be taken by the Board, the CIGAs require more than just the Board meeting, in that the company must be able to assess and react on behalf of the fund to risks and opportunities as they arise.

Examples

XYZ Ltd

A fund is established as a limited partnership in the Island and appoints a general partner (XYZ Ltd) who takes on the fund management role. XYZ Ltd outsources administrative activities to an administrator company, Service Ltd, which is also based on the Island. However, XYZ Ltd monitors and retains the ability to control the activities of Service Ltd. It is clear XYZ Ltd's directors collectively have the ability and knowledge to understand the fund and its investments, also to judge the activities of Service Ltd.

XYZ Ltd's Board takes the overarching strategic decisions as to the fund's investments, including such considerations as the mix of investment types, the markets and sector to be invested in. XYZ Ltd sets out these investment parameters and decides within these parameters how to implement these decisions. Two companies Euro GmbH (in the EU) and USA Inc (in the US) are appointed to acquire the investments in their regions, XYZ Ltd giving them limited discretion to act within the overall parameters it decided. The performance of Euro GmbH and USA Inc, including how they use this discretion, is carefully monitored by XYZ Ltd supported by Service Ltd.

XYZ Ltd requests frequent returns and reports to be provided to it from Service Ltd, Euro GmbH and USA Inc. These returns and reports assess the risks of the fund and also the reserves position. Service Ltd has to reassure XYZ Ltd that the processes and systems it has in place mean that the reports are accurate and comprehensive. Service Ltd collates these returns and reports so they give the overall risk position and overall reserves and provides to XYZ Ltd for incorporation in the Board's decision making, monitoring and control.

XYZ Ltd has taken the strategic view at the outset that hedging in respect of currency or interest rates was not appropriate based on the overarching strategy of the fund. This decision is however kept under review periodically by the Board.

If the directors and employees of XYZ Ltd are conducting the roles described above, XYZ Ltd will be regarded for the purposes of the substance requirements as carrying out CIGA in the Island. Euro GmbH and USA Inc's activities will not undermine the fact that CIGA is conducted in the Island.

Whisp Ltd

A fund is set up in the Island and a company tax resident in the Island, Whisp Ltd, is appointed as the fund manager.

Whisp Ltd in turn appoints an investment manager company in the US, FMB Inc. Whisp Ltd's Board has sufficient knowledge and experience of the fund management business. Whisp Ltd provides FMB Inc with the prospectus of the fund, with full discretion for FMB Inc to make investment decisions for the fund within the scope of the prospectus. Despite having an adequately comprised board of directors, Whisp Ltd does not take any strategic decisions regarding the execution of the fund's investment strategy, including such considerations as the mix of investment types and the markets and sectors to be invested in, and does not set out the parameters of investment to FMB Inc. Instead, Whisp Ltd leaves all such strategic decisions to FMB Inc. Whisp Ltd also does not oversee FMB Inc's activities. In such circumstances it will not be possible to say that Whisp Ltd is carrying out the CIGA of taking decisions on the holding and selling of investments.

FMB Inc provides commentary and content for the reports which are then collated and sent to investors and regulatory authorities without further reference to, or review by, Whisp Ltd.

FMB Inc also calculates the risks and reserves and makes any decisions on currency/interest rate hedging. Again, Whisp Ltd has not taken any strategic decision in relation to these activities, and has not set out any parameters within which FMB Inc must operate.

As the Board of Whisp Ltd has neither made any strategic decisions nor undertaken the relevant CIGA it has contracted to perform for the fund, Whisp Ltd has not satisfied the substance requirement.

4.5 Insurance

This section will be included in subsequent versions of this guidance.

4.6 Distribution and Service Centre

The definition encompasses companies which purchase raw materials and finished products from other non-resident members of the same group³/connected persons and re-sell them for a profit.

The definition also encompasses companies which provide services, consulting or other administrative services, to other non-resident members of the same group/connected persons.

The scope does not extend to cases where activities are not the main activity of a company.

The scope does not extend such activities to cases where a company purchases raw materials and finished products from, or provides services to third parties.

In banking, insurance, fund management, financing and leasing, shipping or headquartering businesses it may be a normal part of their activities to provide such services, and so these activities are excluded from being within the scope of Distribution and Service Centre, to prevent duplicate reporting.

Examples:

ABC Ltd buys CDs from other group companies based in Asia and re-sells them to other group companies and customers in Europe. These activities are within the scope of the definition, therefore ABC Ltd is subject to the substance requirements.

DEF Ltd's main activity is to provide administration services to another group company based in the UK, which are recharged at cost. These activities are within the scope of the definition, therefore DEF Ltd is subject to the substance requirements.

FGH Ltd is the service company for an audit and accountancy partnership that's main activity is to provide services to customers on the Island. FGH Ltd employs the staff and also owns the premises used for the business of the partnership. Another group company based in the UK requires specialist IT skills which sit within FGH Ltd and requests those skills for a period of 3 months, agreeing to reimburse costs. As FGH Ltd is not in the business of providing those services to other group companies, nor does it offer/solicit such services or maintain employees to provide such services, FGH Ltd is not considered to be providing services and is therefore not conducting the relevant activity.

4.6.1 Core Income Generating Activities (CIGA) for Distribution and Service Centres

The legislation sets out a list of CIGA for distribution and service centres, which are described below.

³ See section 4.11.

'Transporting and storing goods, components and materials'- refers to the movement and storage of raw materials or finished products and managing the risks associated with this.

'Managing stocks'- includes considering minimum acceptable stock levels, managing frequency of stocktake, whether using storage space effectively, perishability of stock and ensuring security procedures are in place.

'Taking orders'- includes the provision of the order processing element of the entire fulfilment process, whether that is manual or electronic.

These CIGA generally apply in relation to distribution centres.

'Providing consulting or other administrative services'- includes providing such services, which are offered or solicited to other group companies, usually with a mark-up.

This CIGA generally applies to service centres.

Examples

ABC Ltd

ABC Ltd provides administrative services to other non-resident group companies. It employs qualified individuals in the Island who record how their time is spent, in order that this can be billed to the relevant company at the agreed rate. The directors of ABC Ltd will recruit and train employees according to the anticipated needs of other group companies.

The company will be regarded for the purposes of the substance requirements as carrying out the CIGA of providing administrative services in the Island.

XYZ Ltd

XYZ Ltd is a distribution company based on the Island, responsible for the distribution of raw materials purchased from group entities in Asia, to other group entities based in Europe.

XYZ Ltd contract transportation of goods to another non-resident company LMN Ltd based off island. Goods are then stored in a UK warehouse by a third party company STO Ltd, who liaise directly with LMN Ltd over deliveries. The board of XYZ Ltd do not oversee the activities of LMN Ltd nor STO Ltd.

As the board of XYZ Ltd do not undertake the relevant CIGA at all, XYZ Ltd will not satisfy the substance requirements.

4.7 Headquartering

The definition encompasses companies which provide headquarters services to other non-resident members of the same group/connected persons⁴. A headquarters will take responsibility for the overall success of the group, or an important aspect of the group's performance, and ensure corporate governance. Such headquarters services include:

- The provision of senior management
- Taking responsibility or control of material risk for activities carried out by, or assets owned by, any of those persons
- The provision of substantive advice in relation to such risks

In banking, insurance, fund management, financing and leasing, shipping or distribution and service centre businesses it may be a normal part of their activities to provide headquarters services, and so these activities are excluded from being within the scope of Headquarters, to prevent duplicate reporting.

Examples:

ABC Ltd based on Island, is part of a group, with subsidiaries around the world. The senior management team each have responsibility for a different region, and will regularly spend time at the subsidiaries with the senior management teams providing strategic direction and helping manage material risks. These activities are within the scope of the definition, therefore ABC Ltd is subject to the substance requirements.

FGH Ltd is a trading company based on Island that has subsidiaries in the UK. Whilst the senior management team of FGH Ltd have regular dialogue with staff at the subsidiaries, the senior management team of each subsidiary set their strategic direction and manage risks in line with the corporate policy set by the headquarters based in the USA. FGH Ltd is not considered to be providing headquarters services and is therefore not subject to the substance requirements.

4.7.1 Core Income Generating Activities (CIGA) for Headquarters

The legislation sets out a list of CIGA for Headquarters, which are described below.

'Taking relevant management decisions' refers to making decision on the substantive functions, and significant risks for other group/connected companies including strategic planning, marketing strategies, acquiring premises, etc. For a decision to be determined as being taken in a jurisdiction for the purposes of this CIGA, the majority of those making the decision should be physically present in that jurisdiction.

'Incurring expenditures on behalf of group entities' includes the taking of specialist advice or procuring technology on behalf of the group as a whole, or purchasing significant assets / specific services for / on behalf of a group entity.

'Co-ordinating group activities' includes ensuring where there are specific advantages to the group, group entities activities are co-ordinated in a way

⁴ see section 4.11

that produces the best outcome for the group rather than the individual companies. E.g. If as a whole a group can get better terms from a supplier if they enter a Pan-European Deal, ensuring that all the group entities enter the deal, even if it is not the best deal for a specific company.

Examples

ABC Ltd

ABC Ltd based on Island, is the regional headquarters for a global group. The directors of ABC Ltd are responsible for the success of the region, setting the strategic direction and managing risk. The senior management team of ABC Ltd each have responsibility for a different area within the region, and regularly spend time with the leadership teams of the subsidiaries providing strategic direction and helping manage material risks.

ABC Ltd takes specialist advice on matters of compliance relevant to the region, with staff disseminating that advice and co-ordinating activities to ensure compliance by all subsidiaries.

Each quarter the directors will review the regional performance and risk profile, ensuring they take steps to manage any risks.

The company will be regarded for the purposes of the substance requirements as carrying out CIGA in the Island.

ZYX Limited

ZYX Ltd based in the Island is the headquarters for a small group of non-Island companies. ZYX provides the senior management team, assumes and controls risks for the activities and assets of the group companies and provides advice to the group companies on the control of risk.

The board of directors of ZYX Ltd act as the senior management team for the group companies. All members are resident outside the Island.

Although they hold an annual board meeting in the Island, all the relevant management decisions are taken outside the Island.

All meetings, deliberations and decisions in relation to the incurring of expenditures on behalf of group entities take place outside the Island.

As the board of ZYX Ltd do not undertake the relevant CIGA in the Island, ZYX Ltd will not satisfy the substance requirements.

4.8 Shipping

This section will be included in subsequent versions of this guidance.

4.9 IP Company

This section will be included in subsequent versions of this guidance.

In the meantime, please refer to the Updated Key Aspects issued jointly by the Crown Dependencies on 20 December 2018 for guidance on this matter.

4.10 High Risk IP Company

This section will be included in subsequent versions of this guidance.

In the meantime, please refer to the Updated Key Aspects issued jointly by the Crown Dependencies on 20 December 2018 for guidance on this matter.

4.11 Group/connected person

The legislation in Guernsey and the Isle of Man use the term group which 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.

The legislation in Jersey uses the term connected person which is defined in Article 3A Income Tax (Jersey) Law 1961, which looks at control through both a group of companies, and also the natural persons involved with such companies.

5 Directed and Managed

Generally tax resident companies undertaking relevant activities are required to be directed and managed in the Island in addition to undertaking CIGA in the Island.

5.1 What is the directed and managed requirement?

The requirement to be directed and managed in the Island ("the directed and managed test") is a separate test to the case law "central management and control" test used in determining the tax residence of a company.

Companies which meet the 'management and control' test for tax residence will still need to ensure that they also meet the directed and managed requirement in order to have adequate substance.

This requirement consists of the following parts, all of which must be complied with for each accounting period:

- the Board of Directors must meet in the Island at an adequate frequency given the level of decision making required;
- during the meeting in the Island, there must be a quorum of the Board of Directors physically present in the Island;
- strategic decisions of the company must be set at meetings of the Board of Directors and the minutes must reflect those decisions; If a company has one director, then they should evidence that written resolutions were passed by that director when he is physically present in the Island;
- the Board of Directors, as a whole, must have the necessary knowledge and expertise to discharge their duties as a board; and
- all minutes and company records must be kept in the Island

In cases 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.

5.1.1 Interactions with Company Law

There is an expectation that companies will meet the standards required under Company Law, and associated regulations, orders and guidelines, relevant to them.

In interpreting the directed and managed requirement the Revenue Authorities will have regard to the Company Law, and associated regulations, orders and guidelines applicable in their jurisdiction, the basis of which are:

Jersey -	Companies (Jersey) Law 1991
Guernsey -	Companies (Guernsey) Law, 2008 and Companies (Alderney) Law, 1994
Isle of Man-	Companies Act 1931, Companies Act 2006 and Foreign Companies Act 2014

5.1.2 Meetings of the Board of Directors

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

The directed and managed test is designed to ensure that there are an adequate number of board meetings held and attended in the Island, although it is not necessary for all board meetings to be held in the Island, or that a quorum of directors is always present in the Island. Quorum in this context will be determined in accordance with Companies Law and the company's Articles.

It is recognised that at times for any company, directors may be abroad for non-business reasons, or meetings may need to be held overseas, for example when completing certain transactions where face to face negotiations might be vital to a successful outcome.

What constitutes an adequate number of meetings in the Island will be dependent on the relevant activities of the company. However, it is generally expected that the majority of board meetings will be held in the Island, with a quorum of directors physically present in order to meet the requirement.

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 the Island 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 the Island whether taken by the directors or others.

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, it is unlikely to be accepted that the Board of Directors is making the strategic decisions.

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

Example

A board may have a standing item to review how well a major IT contractor is meeting their performance obligations. As there is a good relationship, generally nothing arises from this oversight review, however the fact it has been considered should have been minuted.

5.1.3 Keeping minutes of all board meetings and company records in the Island

The 'company records' referred to are those which comprise:

The company's certificates of incorporation, articles of association/incorporation, financial statements, relevant certifications to operate, as well as copies or originals of major funding documentation and mortgages and other the documentation required by the Board of Directors to make decisions.

Where a company is incorporated in the Island, the records should be kept and retained in line with the Company Law.

Where a company is incorporated outside of the Island, the company records must accord with both the applicable laws of that jurisdiction and the Island. Where it is not legally possible to hold a document, for example the share register in the Island, there must be a mirror copy, or access to the original, available in the Island.

It is expected that the original/ signed physical copies would be held in the Island. Where records are held electronically, it is sufficient that such records are maintained and accessible in the Island, and not that the relevant data centre is necessarily located in the Island.

5.2 Companies in liquidation

If a company in liquidation is still carrying on a relevant activity, for example it continues to generate income from financing and leasing, then it is subject to the substance requirements.

As generally when a liquidator is appointed all powers of the directors cease, it will be the liquidators of the company that are required to demonstrate that the company is directed and managed in the Island and for the directed and managed test the board of directors should be taken to be the liquidator.

6 Employees

For the purposes of the substance requirements, the term “employees” is not limited to individuals that are legally employed by the company itself.

Employees in this context is similar to the definition of employees used by the EU in relation to small to medium-sized enterprises (“SMEs”).

Employees for this purpose includes:

- (a) employees;
- (b) persons working for the enterprise being subordinated to it and deemed to be employees under Island law; and
- (c) owner-managers and directors

Apprentices or students engaged in vocational training with an apprenticeship or vocational training contract are not included,

The employee count will be based on the number of full time equivalents (FTEs), i.e. the number of persons who worked full time within the company in question, or on its behalf during the entire period under consideration.

If the company outsources, contracts or delegates some or all of its activity, then the resources of the service provider in the Island will be taken into consideration when determining whether the adequate people test is met. However, there must be no double counting if the services are provided to more than one company. The company remains responsible for ensuring accurate information is reported on its return and this will include precise details of the resources employed by its service providers, for example based on the use of timesheets.

The work of persons who have not worked the full year, the work of those who have worked part-time, regardless of duration, and the work of seasonal workers are counted as fractions of an FTE. For this purpose, a standard working week will be considered as 35 hours.

Directors should be counted as a fraction of an FTE commensurate with the time commitment of the role.

In most circumstances better qualified staff are more efficient and, as such, fewer may be required. Increases in digitalisation and automation of processes may, however, also mean that fewer staff are required.

When considering what an adequate number of qualified employees is, this must relate to the employees needed to be able to conduct the relevant activity as a whole (not just the CIGA).

The qualifications that are considered to be adequate will depend on the relevant sector that the company has activity in, the CIGA undertaken on the Island and the duties performed by those employees.

Qualifications taken into account could include academic qualifications, vocational qualifications, relevant industry technical qualifications and also qualification by relevant experience.

7 Outsourcing

The legislation does not prohibit a company from outsourcing some or all of its activity. Outsourcing, in this context, includes outsourcing, contracting or delegating to third parties or group companies.

If some or all of the CIGA is outsourced, the company must be able to demonstrate that it has adequate supervision of the outsourced activities and, to meet the substance requirements, that those activities are undertaken in the Island.

Where a CIGA is outsourced the resources of the service provider in the Island will be taken into consideration when determining whether the people and premises test is met.

However, there must be no double counting if the services are provided to more than one company.

The company remains responsible for ensuring accurate information is reported on its return and this will include precise details of the resources employed by its service providers, for example based on the use of timesheets.

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.