

# Guernsey economic substance guide 2023 (Lexology Getting the Deal Through)

**Briefing Summary:** In this guide, lawyers from our Guernsey office outline the latest economic substance requirements for businesses carrying on relevant activities in Guernsey, including the legal framework, enforcement and demonstrating compliance.

**Service Area:** Corporate, Corporate Regulation and Compliance, Taxation and Economic Substance Requirements

**Sector:** Trust and Company Business

**Location:** Guernsey

**Content Authors:** Ben Morgan

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## Legal framework

### Legislation

What legislation sets out the economic substance requirements in your jurisdiction?

The economic substance requirements are set out in the Income Tax (Substance Requirements) (Implementation) Regulations 2021 (the Substance Regulations), which were first implemented in December 2018 came into force on 1 January 2019 and were then amended on 15 June 2021. The Substance Regulations are issued pursuant to the Income Tax (Guernsey) Law 1975, as amended.

The Guernsey Revenue Service publishes the Substance Regulations at the following website: Economic Substance – States of Guernsey (gov.gg).

The law also makes clear that the director of the Guernsey Revenue Service (the Director) may issue guidance on the administration, implementation and enforcement of the Substance Regulations, including any expression used in them.

## Key Contacts



Ben Morgan  
PARTNER, GUERNSEY  
+44 (0)1481 741557



Russell Clark  
PARTNER, GUERNSEY  
+44 (0)1481 732049



Annette Alexander  
PARTNER, GUERNSEY  
+44 (0)1481 732067



Elaine Gray  
PARTNER, GUERNSEY  
+44 (0)1481 732035

[EMAIL BEN](#)

[EMAIL RUSSELL](#)

[EMAIL ANNETTE](#)

[EMAIL ELAINE](#)

## Relevant entities

What types of entity are subject to the economic substance requirements in your jurisdiction?

The following are within scope of the Substance Regulations:

- companies that are considered tax resident in Guernsey and generating gross income from relevant activities. The term 'companies' includes all vehicles treated as companies for tax purposes. An incorporated cell will be treated separately from its incorporated cell company and other incorporated cells. By comparison, a protected cell company and its cells will be treated as one entity; and
- partnerships – all types of partnerships are potentially within scope of the Substance Regulations to the extent that they derive gross income from certain specified activities including general partnerships, limited partnerships and limited liability partnerships. Foreign partnerships formed outside of Guernsey may also be required to comply to the extent that they have their 'place of effective management' in Guernsey and carry on business activity in Guernsey.

The following partnerships are not within scope of the Substance Regulations:

- partnerships comprised solely of individual partners subject to income tax in Guernsey on their share of the profits of the partnership;
- partnerships that are wholly domestic, that is, where a partnership substantially carries on its activities within Guernsey, and is not consolidated (for financial reporting purposes) as part of a multinational group; and
- partnerships where the place of effective management is in a qualifying jurisdiction outside of Guernsey. The term 'qualifying jurisdiction' means one where either the partnership is subject to substance requirements substantially similar to those in the Substance Regulations or the highest rate of tax on the income of any person in that jurisdiction is at least 10 per cent.

Regulated collective investment vehicles are outside of the scope of substance unless they are self-managed.

## Relevant activities

What activities trigger the economic substance requirements in your jurisdiction?

Under the Substance Regulations, there are specific categories of relevant activity' that bring an entity within scope and which are further defined in the Substance Regulations. By way of overview, these relevant activities are:

- banking – 'banking business' means a deposit-taking business within the meaning of the Banking Supervision (Bailiwick of Guernsey) Law, 2020 carried on by a licensed institution within the meaning of that law;

- distribution and service centre – means the business of:
- purchasing parts, materials or goods from other members of the same group that are non-Guernsey resident and reselling them for a percentage of profits
- providing services to other members of the same group that are non-Guernsey resident; or
- except in each case where such activities fall within another category of relevant activity except holding body and intellectual property business;
- financing and leasing means providing credit facilities of any kind for consideration, except where such activities fall within banking, fund management or insurance;
- fund management –means the provision of management services (meaning exercising any managerial function in relation to an investment or in relation to the assets underlying an investment) when carried on in connection with a collective investment scheme within the meaning of The Protection of Investors (Bailiwick of Guernsey) Law, 2020 by an entity licensed for the purpose;
- headquartering – means the business of providing certain services to non-resident intragroup persons of the Guernsey resident body, 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 intragroup persons, and the provision of substantive advice in relation to the assumption or control of risk for such activities or assets, in each case except where such activities fall within other definitions of relevant activities and intellectual property holding;
- insurance –means insurance business carried on in or from the island as an insurer (in both the long-term and general sectors, and this includes reinsurance) within the meaning of The Insurance Business (Bailiwick of Guernsey) Law, 2002 (as amended) carried on by a licensee under that law; and
- shipping – the operation of ships in international traffic for income from the transport of passengers or cargo, and includes (where directly connected with, or ancillary to, such operation) chartering, ticket sales, the use, maintenance or rental of containers (including trailers and related transport equipment) and crew management. There are exclusions for fishing vessels, pleasure craft, harbour craft and certain small ships.

Two further activities are also within scope:

- pure equity holding body – meaning a body that is a legal person within the meaning of the Beneficial Ownership of Legal persons (Guernsey) Law, 2017 or (as the case may be) the equivalent Alderney Law:
  - which has as its primary function the acquisition and holding of shares or equitable interests in other bodies;
  - which carries on no commercial activity; and
  - which holds a majority interest in those bodies; and
- intellectual property body – has income from intellectual property assets.

The activities of regulated externally managed collective investment vehicles under Guernsey law are exempted from the Substance Regulations. However, 'self-managed funds' (ie, funds with no separate manager) will be required to meet an economic substance test in respect of their activities to the extent those generate gross income in a financial period.

## Tax residence requirements

Must entities be tax resident (or deemed tax resident) in your jurisdiction to be subject to the economic substance requirements? If yes, what are the tax residence rules and requirements? If not, do the economic substance requirements in your jurisdiction differ with respect to non-resident entities?

The substance requirements apply to companies that are tax resident in Guernsey, whether or not they are incorporated in Guernsey.

Under Guernsey law, a company is considered tax resident in Guernsey if it is either a Guernsey 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 10per cent; or a non-Guernsey incorporated company that is centrally managed and controlled in Guernsey. Guernsey is also party to a number of double-taxation agreements, which may apply.

Partnerships are tax transparent entities meaning there is no tax residency test in the way that there is for a company.

Accordingly, partnerships formed in Guernsey and deriving gross income from relevant activities or conducting activities as intellectual property asset holding or pure equity holding are within scope of the substance requirements.

Partnerships formed outside of Guernsey may be within scope if they are doing in scope activities for gross income and have a 'place of effective management' in Guernsey. The place of effective management is the place 'where the management and commercial decisions necessary for the conduct of the business as a whole of that person are substantially made having regard to all relevant facts and circumstances'. It is, therefore, important for partnerships to understand where their place of effective management is, as well as assessing if the partnership is carrying on any in scope activities. In the context of limited partnerships, it is likely that the place where the general partner conducts business will be the place of effective management of the limited partnership itself.

## Guidance

Has the government published guidance on the economic substance requirements?

Yes. The primary guidance at the time of writing is that published jointly with Jersey and the Isle of Man on 22 November 2019 in respect of companies. Further joint guidance was issued on 21 December 2021 in respect of the application of economic substance rules to partnerships. It should be noted that, as joint guidance, the text is drafted in a generic manner so as to explain the scope and application of the legislation across all three jurisdictions. It is expected that new guidance will be released shortly to cover partnerships.

The Guernsey Revenue Service maintains links to relevant guidance online at Economic Substance – States of Guernsey (gov.gg) .

## Economic Substance requirements

### General requirements

What general economic substance requirements apply in your jurisdiction?

A relevant entity must satisfy the economic substance test in relation to any relevant activity carried on by it that generates gross income. The entity must be able to demonstrate that these requirements are, or were, complied with in each accounting period in which the requirements apply or applied in respect of it.

The law provides that a relevant entity meets the economic substance test in relation to a relevant activity if:

- the relevant activity is 'directed and managed' in Guernsey;
- it carries on core income-generating activity in Guernsey in relation to the relevant activity; and
- having regard to the level of relevant activity carried on in Guernsey:
  - there is an adequate level of appropriately qualified employees in Guernsey whether or not employed by the relevant body or another entity and whether on temporary or long-term contracts);
  - there is an adequate level of operating expenditure in Guernsey;
  - there is an adequate physical presence (including, without limitation, offices or premises, albeit that these maybe provided by a third party) in Guernsey; and
  - any core income-generating activities (CIGA) are carried out in Guernsey for the relevant body by another entity, the relevant body is able to monitor and control the carrying out of that activity by the other entity.

Intellectual property asset holding entities are subject to enhanced substance requirements.

Pure equity holding bodies are obliged to comply with reduced economic substance requirements.

In addition, a self-managed fund must satisfy the economic substance test in relation to any activity carried on by it that generates gross income in a financial period.

In each case, what is 'adequate' will depend on the specific circumstances.

## Directed and managed

What requirements apply in relation to board meetings and the location where entities are directed and managed?

While for a company the relevant governing body will be a board of directors, for partnerships the relevant governing body will be the relevant management committee or other similar governing body.

The law provides that the relevant activity carried on by an entity carrying on a relevant activity is directed and managed in Guernsey if:

- the governing board's meetings are conducted in Guernsey with adequate frequency (having regard to the level of decision-making required of the board);
- during such board meetings, there is a quorum of members of the board physically present in Guernsey;
- strategic decisions of the relevant body are set at these board meetings and the minutes record those decisions;
- the governing board, as a whole, has the necessary knowledge and expertise to discharge the duties of the board; and
- all minutes and company or partnership records are kept in Guernsey.

Pure equity holding bodies do not have to comply with the directed and managed test.

In each case, what is 'adequate' will depend on the specific circumstances.

## Core income-generating activities

What requirements apply in relation to core income-generating activities?

In relation to a relevant activity to which the economic substance test applies, all of the relevant body's CIGA are required to be carried out in Guernsey, whether carried out by the relevant body itself or by another entity. Where any CIGA are carried out by another entity, the relevant body must also be able to monitor or control performance of the activities.

The guidance further provides that where CIGA involve making a decision (as opposed to the implementation or acting within the parameters of such decisions), the majority of those making the decision must be present in Guernsey when the decision is made for it to be considered made in Guernsey.

## Premises

What requirements apply in relation to the physical premises of relevant entities?

When the Guernsey economic substance test applies, the law provides that with regard to the level of relevant activity carried on in Guernsey, the relevant body is required to ensure there is an adequate physical presence (including offices or premises) in Guernsey proportionate to the level of that activity carried on in Guernsey. Resources provided by local services providers, which may include the provision of registered office services may be taken into consideration. In each case, what is 'adequate' will depend on the specific circumstances.

## Employees and personnel

What requirements apply in relation to the employees and personnel of relevant entities?

Where the Guernsey economic substance test applies, having regard to the level of relevant activity carried on in Guernsey, the relevant body is required to have an adequate level of appropriately qualified employees in relation to that activity who are physically present in Guernsey (whether or not employed by the relevant body or another entity and whether on temporary or long-term contracts). The term 'employees' here has a wide meaning and includes directors. However, the guidance makes clear that, where the resources of a services provider are used, there must be no double-counting if the employee services are provided to more than one body. In each case, what is 'adequate' will depend on the specific circumstances.

## Expenditure

What requirements apply in relation to expenditure?

Where the Guernsey economic substance test applies, the law provides that, having regard to the level of relevant activity carried on in Guernsey, the relevant body is required to incur adequate expenditure in Guernsey. In each case, what is 'adequate' will depend on the specific circumstances.

## Enhanced requirements

Are there any instances where enhanced substance requirements apply?

Where a relevant body receives income from intellectual property, it will also have to consider if it is a 'high-risk IP body'. A high-risk IP body is one that:

- holds intellectual property it did not create;
- acquired the intellectual property either intragroup or in consideration of funding research and development by another person situated in a territory outside Guernsey; and

- licenses the intellectual property asset to one or more non-Guernsey resident intragroup persons or otherwise generates income from the intellectual property asset in consequence of activities (such as facilitating sale agreements) performed by non-Guernsey resident intragroup persons.

The law provides for a rebuttable presumption that a high-risk IP body has failed the substance requirements, which the guidance explains is because the risks of artificial profit shifting are considered to be greater.

To rebut the presumption, a high-risk IP body will have to produce materials that will explain how the development, enhancement, maintenance, protection and exploitation functions have been under its control, and that this has involved people who are highly skilled and perform their core activities in Guernsey. There is also a higher evidential threshold, which requires:

- detailed business plans that clearly lay out the commercial rationale for holding the intellectual property asset(s) in Guernsey;
- concrete evidence that the decision-making is taking place in Guernsey, and not elsewhere; and
- information on employees in Guernsey, their experience, the contractual terms, their qualifications and their length of service.

Periodic decisions by non-resident directors or governing board members, or local staff passively holding intangible assets, cannot rebut the presumption.

## Reduced requirements

Are there any instances where reduced economic substance requirements apply?

In Guernsey, reduced economic substance requirements apply to pure equity holding bodies, which must ensure that:

- they comply with all obligations applicable to them under the provisions of the applicable company or partnership legislation of the jurisdiction of its incorporation; and
- there is:
  - an adequate level of personnel in Guernsey proportionate to the level of activity carried on in Guernsey; and
  - an adequate physical presence in Guernsey (including, without limitation, offices or premises) proportionate to the level of activity carried on in Guernsey (which in each case may be provided by a third-party administrator) for holding and managing the shares or equitable interests concerned.

## Outsourcing

What requirements apply in relation to outsourcing activities to entities located in your jurisdiction and entities located outside your jurisdiction?

Where the Guernsey economic substance test applies, the law provides that all relevant CIGA are required to be carried out in Guernsey, which includes where those activities are carried on by another entity.

The guidance further notes that, in relation to the outsourcing of CIGA:

- the body must be able to demonstrate that it has adequate supervision of the outsourced activities and that those activities are undertaken in Guernsey;
- the resources of the service provider in Guernsey will be taken into consideration when determining whether the people and premises test is met, although there must be no double counting if the services are provided to more than one body;
- the body 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; and
- 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.

The guidance further notes that the outsourcing of activities not being CIGA will not affect a relevant body's ability to meet the substance requirement (for example, back-office functions such as IT support); nor are relevant bodies precluded from seeking expert professional advice or engaging the services of specialists in other jurisdictions. However, the income subject to tax in Guernsey must be commensurate to the CIGA undertaken in Guernsey.

## Enforcement and compliance

### Enforcement authorities

Which government authorities are responsible for the enforcement of economic substance requirements? What is the extent of their information-gathering powers?

Compliance is assessed by the Director of the Revenue Service in Guernsey (the Director), who also enforces the information and financial penalties.

The Director may by notice in writing require a person to deliver such documents in that person's possession or power that the Director considers may contain information relevant to an entity's compliance with the Substance Regulations.

The Director has various powers to enable further enquiries to be made as may be necessary to determine if the relevant body satisfies Guernsey's substance requirements. These include a right of entry onto business premises and the right to inspect documents (these are subject to certain provisos such as occupier consent, at least one week's notice and the approval of the Bailiff of Guernsey to the entry and inspection).

## Reporting formalities

What reporting formalities apply with respect to the economic substance requirements?

All partnerships, including relevant foreign partnerships, will need to register and file returns with the Guernsey Revenue Service (GRS), whether in scope for substance purposes or not. A partnership must register with the GRS by 14 July following the end of the first calendar year after it is required to file a tax return.

Compliance is assessed following submission of the Guernsey annual tax return (due by 30 November in the calendar year subsequent to the year of charge), which requires various confirmations including:

- business or income types to identify the relevant activity;
- amount and type of gross income, broken down by relevant activity;
- operating expenditure, broken down by relevant activity;
- premises – business address;
- number of (qualified employees, specifying the number of full-time equivalent employees;
- confirmation of the core income-generating activities (CIGA) conducted for each relevant activity (as applicable);
- confirmation of whether any CIGA have been outsourced and, if so, the relevant details of the outsourcing; and net book value of tangible assets.

The relevant body will also need to file its financial statements with the GRS.

In addition to including in its income tax returns the information that an IP body must include, a high-risk IP body is asked to include a statement as to whether it intends to rebut the presumption of non-compliance. If it does wish to rebut the presumption, it is required to attach certain evidence in support of that statement including detailed business plans as to the rationale for holding the intellectual property in Guernsey, evidence of decision-making taking place in Guernsey and information on employees in Guernsey regarding their experience, contractual terms and length of service.

## Demonstrating compliance

How does an entity in practice demonstrate its compliance with the economic substance requirements? How do the enforcement authorities assess compliance?

The annual tax return lodged with the GRS requires various confirmations together with the financial statements of the relevant body prepared in accordance with recognised accounting principles.

A relevant body should ensure that it has materials to support the statements given, including (as appropriate) governing board minutes that reflect the requirements and timesheets for employees, evidence of maintaining a registered office and such other assets in Guernsey as may be considered adequate given the nature of the relevant activity, and records of expenditure that reflect the financial statements provided by the relevant body and demonstrating adequate expenditure being incurred in Guernsey.

High-risk IP bodies will also be required to evidence compliance to the higher threshold, which includes a detailed business plan as to the commercial rationale for holding the IP in Guernsey.

Subject to being required to rebut the presumption of failure for high-risk IP bodies, the Director of the GRS has complete discretion based on the information received to make its determination and (subject to the relevant maximum) the fine to be imposed. However, that determination can be the subject of an appeal to a Guernsey Tax Tribunal within 30 days of the notice issued imposing the penalty, with either party then able to appeal to the Royal court of Guernsey, on the basis that the decision is erroneous on a point of law, within 21 days of the Guernsey Tax Tribunal's decision.

## Penalties

What are the potential penalties for failure to comply with the economic substance requirements?

The penalties for a relevant body not meeting the substance requirements are primarily financial being a fine of up to £10,000 for an initial failure rising to £100,000 for further failures, and the exchange of information with certain competent authorities. These are the authorities in the jurisdictions in which the relevant body has an immediate parent body, ultimate parent body and the jurisdiction of the ultimate beneficial owners (as well as the relevant body's jurisdiction of incorporation if outside of Guernsey), subject to being permitted to do so by international agreement. There is also the ultimate sanction that the relevant body be struck off the Guernsey corporate register or, if relevant, the register of limited liability partnerships where there are repeated periods of failure.

Financial and criminal penalties also apply to individuals for failure to provide information or for inaccurate information, or for obstructing the Director in the exercise of his or her powers.

## Update and Trends

### Recent developments

What have been the most significant recent developments in the law on economic substance in your jurisdiction, including any notable regulatory actions or legislative changes?

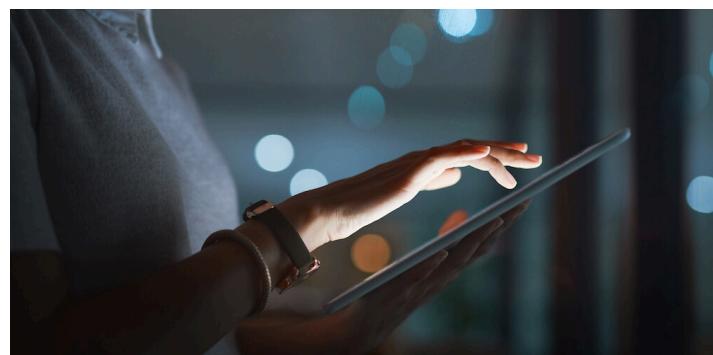
The economic substance regime in Guernsey is a fast-moving area of law that responds quickly to international developments and discussions, and legislation tends to be implemented quicker than in other areas of law. Since being adopted, the most notable amendments are that:

- since 1 October 2020, self-managed funds are required to meet the economic substance test; and
- partnerships have been brought into scope in their own right during 2021.

The covid-19 pandemic and the related restrictions on meetings and travel have also had some impact given the requirements of the economic substance test. The Guernsey Revenue Service (GRS) issued guidance that such matters would be taken into account, but the expectation remained that relevant bodies would continue to have adequate employees, expenditure and physical premises in Guernsey, as well as carry out all core income-generating activities in Guernsey. Resources provided by local services providers are permitted to be taken into consideration in determining the adequacy of physical premises and an adequate level of appropriately qualified employees in relation to the relevant activity. Detailed records are expected to be maintained by any relevant body, especially those wishing to rely on any concessions.

The GRS has withdrawn its guidance on the economic substance requirements and the implications of covid-19 for accounting periods commencing on or after 1 November 2022.

*Please note that this briefing is intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such. © Carey Olsen (Guernsey) LLP 2026*



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