

Jersey Economic Substance Guide 2023 (Lexology Getting the Deal Through)

Briefing Summary: In this guide, lawyers from our Jersey office outline the latest economic substance requirements for businesses carrying on relevant activities in Jersey, 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: Jersey

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Created Date: 21 April 2023

Legal Framework

Legislation

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

The primary economic substance legislation in Jersey is (as amended):

- the Taxation (Companies – Economic Substance) (Jersey) Law 2019; and
- the Taxation (Partnerships – Economic Substance) (Jersey) Law 2021.

The Jersey Legal Information Board maintains online versions of legislation at www.jerseylaw.je/Pages/default.aspx.

At the time of writing, official consolidated versions of the above laws are available. However, as it is a fast-moving area of law, care should be taken to ensure the legislation is up to date when reading.

The legislation also makes clear that the Comptroller may issue guidance on how the economic substance test may be met, including any expression in the law, and that regard must be had to such guidance. The Jersey Tax Office maintains links to relevant guidance at www.gov.je/TaxesMoney/IncomeTax/Companies/Guidelines/pages/

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

The Jersey economic substance requirements are relevant to certain companies and partnerships, specifically a 'resident company' or 'resident partnership' unless an exception applies.

Exceptions apply for a resident partnership where all partners are individuals subject to income tax in Jersey and a resident partnership not part of a multinational group that is not undertaking business activities (ie, performing services for customers, or manufacturing or producing goods for sale to or for use by customers rather than for the benefit of the partnership) outside Jersey.

Entities within scope will be required to confirm to the Comptroller when filing their returns for a relevant financial period whether they have gross income from relevant activity being carried on by or through it and, if so, whether they meet an economic substance test in respect of such activity. The activities of funds (as opposed to the fund manager) are generally not relevant activity, though an economic substance test will apply to a self-managed fund in respect of its activities generally.

For this purpose:

- 'company' and 'partnership' include a vehicle that may not expressly be such but are treated as such for income tax purposes, and therefore cells or non-Jersey vehicles should be assessed accordingly, and 'company' will include a Jersey LLC notwithstanding it may be transparent for Jersey tax purposes;
- 'resident company' is a company that is tax-resident in Jersey (being in summary: a Jersey incorporated company not centrally managed and controlled in and recognised as tax resident by another jurisdiction where the highest rate of corporate income tax is at least 10 per cent; or a non-Jersey incorporated company that is centrally managed and controlled in Jersey) and will include a Jersey LLC regarded as resident in Jersey notwithstanding it is transparent for Jersey tax purposes;

- 'resident partnership' is a partnership that is either:
 1. formed under Jersey law unless its place of effective management is in another jurisdiction with an income tax rate of at least 10 per cent or where the partnership is required to satisfy a test substantially the same as the Jersey economic substance test; or
 2. a partnership not formed under Jersey law with its place of effective management in Jersey;
- 'place of effective management' is the place where key management and commercial decisions that are necessary for the conduct of the partnership's business as a whole are in substance made; and
- 'multinational group' refers to where:
 1. under international financial reporting standards, the partnership would have its income and expenses part of the consolidated results of a group of enterprises; and
 2. one or more of the group is not tax resident in Jersey or has one or more permanent establishments outside of Jersey. The guidance provides for examples of these in practice.

Relevant Activities

What activities trigger the economic substance requirements in your jurisdiction?

The Jersey economic substance test is triggered by a resident company or resident partnership within scope of the regime having gross income in a relevant financial period from a relevant activity. The activities of a fund (as opposed to a fund manager) are generally considered not to be relevant activity, though an economic substance test will apply to a self-managed fund (ie, no separate manager appointed) in respect of its activities generally. If a partner in a partnership has been required to satisfy the economic substance test under the legislation in relation to an activity, then for the purpose of determining whether an activity carried on, by or through the partnership is a relevant activity, the partnership legislation must be read as if the partner's activity were undertaken by the partnership.

For this purpose, 'relevant activity' under the legislation for companies and partnerships is broadly the same, with some categories having priority over others to avoid duplicate reporting. The specifics of each definition should be considered in detail but, in summary, the categories are:

- 'banking business' – deposit-taking business for which registration is required under the Banking Business (Jersey) Law 1991;
- 'distribution and service centre business':
 1. purchasing goods, component parts or materials from foreign connected persons and reselling them; or
 2. providing services to foreign connected persons, other than activity forming part of another relevant activity except holding company or partnership business;
- 'finance and leasing business' – the provision of credit facilities of any kind for consideration other than, for example, a lease granting an exclusive right

- 'insurance business' – insurance business activities requiring a category A or B permit under the Insurance Business (Jersey) Law 1996;
- 'intellectual property holding business' – holding any intellectual property right in intangible assets from which identifiable income accrues to the business separately identifiable from any income generated from any tangible asset in which the right subsists;
- 'shipping business' – certain activities involving the operation of a ship anywhere in the world other than solely between Jersey and Guernsey or within the territorial waters of Jersey, including the business of transporting persons, animals, goods or mail by sea (or renting or chartering ships for such purpose), the sale of tickets or equivalent and ancillary services connected with the operation of a ship, the use, maintenance or rental of containers, and the management of the crew of a ship; and
- 'gross income' is on an accruals basis, not a paid basis. It is not taxable or accounting income or profit; it is all income in the financial period before any deductions, and will generally be the turnover figure from the financial statements provided prepared in accordance with recognised accounting principles.

'Relevant period' means a financial period starting on or after:

- 1 January 2019 for a resident company that is not a fund;
- 1 January 2021 for a resident company that is a self-managed fund;
- 1 July 2021 for a resident partnership formed between 1 July 2021 and 1 January 2022; and
- 1 January 2022 for all other resident partnerships.

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?

Yes, the Jersey economic substance requirements are relevant to a 'resident company' or 'resident partnership' unless an exception applies. Entities deemed to be resident elsewhere will therefore be out of scope but should consider the requirements that may apply in that jurisdiction.

For this purpose, 'company' and 'partnership' include a vehicle that may not expressly be such but treated as such for income tax purposes, and therefore cells or non-Jersey vehicles should be assessed accordingly, and 'company' will include a Jersey LLC notwithstanding it may be transparent for Jersey tax purposes.

'Resident company' is a company that is tax resident in Jersey, being, in summary:

- a Jersey incorporated company not centrally managed and controlled in and recognised as tax resident by another jurisdiction where the highest rate of corporate income tax is at least 10 per cent; or
- a non-Jersey incorporated company that is centrally managed and controlled in Jersey and will include a Jersey LLC regarded as resident in

'Resident partnership' is a partnership that is either:

- formed under Jersey law unless its place of effective management is in another jurisdiction with an income tax rate of at least 10 per cent or where the partnership is required to satisfy a test substantially the same as the Jersey economic substance test; or
- a partnership not formed under Jersey law with its place of effective management in Jersey.

'Place of effective management' is the place where key management and commercial decisions that are necessary for the conduct of the partnership's business as a whole are in substance made.

Jersey is also party to a number of double taxation agreements, which may apply.

Guidance

Has the government published guidance on the economic substance requirements?

Yes, and the legislation makes clear that regard must be had to any guidance published by the Comptroller on any expression in the law and how the Jersey economic substance test may be met.

The Jersey Tax Office maintains links to relevant guidance.

It should be noted that primary guidance has to date been published jointly with Guernsey and the Isle of Man. As such, the text in places refers to concepts in a generic manner so as to explain the scope and application of the legislation across all three jurisdictions, and may refer to terms that are not expressly included under Jersey law. Care should therefore be taken when interpreting from a Jersey perspective.

Economic Substance Requirements

General requirements

What general economic substance requirements apply in your jurisdiction?

The general economic substance requirements in Jersey are for entities within the scope of the legislation to confirm to the Comptroller when filing their returns for a relevant financial period whether they have gross income from relevant activity being carried on, by or through it and, if so, whether they meet an economic substance test in respect of such activity or (in the case of a self-managed fund) its activities generally. The return requires supporting answers and financial statements for the relevant period.

If an economic substance test does apply, the requirements for meeting it are as follows.

If an economic substance test applies to a resident company in respect of relevant activity, such test will be met if, in relation to the relevant activity:

- the company is directed and managed in Jersey in relation to that activity:

- all of the company's core income-generating activities (CIGA) are carried out in Jersey; and
- if any CIGA are carried out in Jersey for the company by another entity, the company is able to monitor and control the carrying out of that activity by the other entity.

If an economic substance test applies to a self-managed fund in respect of its activities generally, it will be met if:

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

If an economic substance test applies to a resident partnership in respect of relevant activity, such test will be met if, in relation to the relevant activity:

- it is managed in Jersey in relation to that activity;
- having regard to the level of relevant activity carried on in Jersey:
 1. there are an adequate number of people performing work in relation to that activity who are physically present in Jersey (whether partners or employees, whether employed by the resident partnership or another entity or partnership and whether on temporary or long-term contracts);
 2. there is adequate expenditure incurred in Jersey; and
 3. there are adequate physical assets in Jersey;
- all of the partnership's CIGA are carried out in Jersey; and
- the partnership's governing body is able to monitor and control the carrying out of CIGA carried out in Jersey for the partnership by another entity or partnership (if any).

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?

If an economic substance test applies to a resident company in respect of relevant activity, such test will be met if (among other things) the company is directed and managed in Jersey in relation to that activity, which will be satisfied if:

- the company's board of directors meets in Jersey at an adequate frequency having regard to the amount of decision-making required at that level;

- at such board meetings, there is a quorum of directors physically present in Jersey;
- the minutes of such board meetings record the making of strategic decisions of the company at the meeting;
- the directors of the company have the necessary knowledge and expertise to discharge the duties of the board; and
- the minutes of all board meetings and the records of the company are kept in Jersey.

Equivalent terminology applies for Jersey LLCs (eg, referring to managers instead of directors).

In addition and separate to the above, for a decision to be deemed, on centrally managed and controlled principles, to have taken place in Jersey, a majority of those voting on the decision must be physically present in Jersey. This should be borne in mind where the CIGA take the form of board decisions.

If an economic substance test applies to a self-managed fund in respect of its activities generally, an equivalent to the directed and managed test above does not apply as the combined result of Jersey's regulatory requirements for funds and the application of the CIGA requirements is such that such funds are directed and managed in Jersey. However, the considerations above for CIGA that take the form of board decisions will equally apply.

If an economic substance test applies to a resident partnership in respect of relevant activity, such test will be met if (among other things) the partnership is managed in Jersey in relation to that activity, which will be satisfied if:

- the partnership's governing body meets in Jersey at an adequate frequency having regard to the amount of decision-making required at that level;
- the majority of the partnership's governing body are physically present at those meetings;
- records are kept of the strategic decisions made at those meetings;
- the members of the governing body, as a whole, have the necessary knowledge and expertise to discharge their duties; and
- the records of the partnership are kept in Jersey.

For this purpose, the 'governing body' of a partnership means the person(s) responsible for making the partnership's strategic and management decisions; or, if such person(s) are not able to be identified, all of the partners in the partnership. For most limited partnerships, the governing body will therefore be the general partner and, if it is a company, its board of directors.

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

Covid-19 has also demonstrated that the Comptroller may make concessions for where operating practices have to be adjusted to compensate for such events. In the case of covid-19, for example, guidance provided that any such adjustments have to have been temporary and to the extent required to mitigate threats from the outbreak; that the expectation remains that there will continue to be adequate employees, expenditure and physical assets in Jersey; that all CIGA will be carried on in Jersey; and that those relying on such concession should disclose as such and maintain evidence in support.

Core Income-Generating Activities

The legislation includes examples of CIGA for each relevant activity. As examples, the activity listed may or may not be applicable but is equally not an exhaustive list. Entities in scope should, therefore, identify what constitute CIGA for their relevant activity.

The guidance also provides that where CIGA take the form of a decision (as opposed to the subsequent implementation or acting within the parameters of such decision), the majority of those making the decision must be present in Jersey when the decision is made for it to be considered as having been carried out in Jersey. This broadly reflects the centrally managed and controlled principles relevant to tax residency.

The guidance does make exception for isolated incidents of CIGA being performed outside Jersey but it must be evidenced that the CIGA being carried on in Jersey are of a quality and quantity to clearly outweigh the question that CIGA are undertaken outside Jersey.

Premises

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

Where a Jersey economic substance test applies, the law requires that, having regard to the level of relevant activity carried on in Jersey, the resident company or partnership has adequate physical assets in Jersey. In each case, what is 'adequate' will depend on the specific circumstances but, given the requirements for meetings to be held in Jersey, such assets will generally be taken to include a Jersey registered office. The guidance provides that resources provided by local services providers, which may include the provision of registered office services, will be taken into consideration.

Employees and Personnel

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

Where a Jersey economic substance test applies, the law provides that, having regard to the level of relevant activity carried on in Jersey, the resident company or partnership has an adequate number of people or employees in relation to that activity who are physically present in Jersey (whether or not employed by the resident company or partnership or by another entity and whether on temporary or long-term contracts). The term 'employees' can include 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 company. In each case, what is 'adequate' will depend on the specific circumstances.

Expenditure

What requirements apply in relation to expenditure?

Where a Jersey economic substance test applies, the law provides that, having regard to the level of relevant activity carried on in Jersey, there is adequate expenditure incurred in Jersey. In each case, what is 'adequate' will depend on

Are there any instances where enhanced substance requirements apply?

Yes: where an economic substance test applies to a resident company or partnership carrying on intellectual property holding business, a higher evidential threshold will apply if such entity is classified as a high-risk IP company or partnership. There is also a rebuttable presumption that the test has not been met because the risks of artificial profit shifting are considered to be greater.

For the purpose of the above, a 'high-risk IP company or partnership' is one that, in summary, is either one that:

- did not create the relevant IP, obtained it from a connected person or in return for funding research and development by someone outside Jersey, and licenses it to connected persons or otherwise generates income from the IP as a result of activities (such as facilitating sale agreements) performed by foreign connected persons; or
- does not carry out research and development, branding or distribution as part of its CIGA.

The 'higher evidential threshold' requires the resident company or partnership to produce or keep:

- materials that 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 Jersey;
- a detailed business plan that clearly lays out the commercial rationale for holding the IP in Jersey;
- concrete evidence that the decision-making is taking place in Jersey, and not elsewhere; and
- information on employees in Jersey, their experience, the contractual terms, their qualifications and their length of service.

Periodic decisions by non-resident directors or board members, or local staff passively holding intangible assets, are stated as being insufficient to rebut the presumption.

Reduced Requirements

Are there any instances where reduced economic substance requirements apply?

Not as such, though what is considered to be 'adequate' in any given circumstances will depend on the circumstances. If an economic substance test applies to a self-managed fund in respect of its activities generally, a specific directed and managed test does not apply, though that is because the combined result of Jersey's regulatory requirements for funds and the application of the CIGA requirements is such that self-managed funds should be directed and managed in Jersey.

Outsourcing

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

Jersey substance legislation does not prohibit outsourcing, in this context including outsourcing, contracting or delegating activities to third parties or group companies. The requirements for any outsourcing will depend on the nature of the activities.

Where a Jersey economic substance test applies, the legislation provides that all relevant CIGA are required to be carried out in Jersey, which includes where those activities are carried on by another entity. Where such CIGA are carried out by another entity, the legislation provides that the resident company or partnership must be able to monitor and control them doing so. The guidance further provides that:

- the resident company or partnership must be able to demonstrate that it has adequate supervision of the outsourced activities and that those activities are undertaken in Jersey;
- the resources of a service provider in Jersey may 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 person;
- the resident company or partnership 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 the ability to meet the substance requirement (for example, back-office functions, such as IT support); nor is a resident company or partnership precluded from seeking expert professional advice or engaging the services of specialists in other jurisdictions. However, the income subject to tax in Jersey must be commensurate to the CIGA undertaken in Jersey.

Self-managed funds should also note that the Jersey Financial Services Commission requirement on outsourcing will apply.

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?

The Jersey Comptroller of Taxes is responsible for the enforcement of the Jersey economic substance requirements in the first instance, with the Minister of Treasury and Resources having related powers and (ultimately) the Jersey courts having jurisdiction.

With regard to information-gathering powers generally under the legislation, a resident company or partnership must provide any information reasonably required by the Comptroller to assist the Comptroller in making a determination.

The Comptroller may also, for the purpose of investigating any issue relating to compliance, examine and take copies of any business document that is located on business premises and, to exercise such power, enter business premises at any reasonable hour and, by notice require any person to produce any specified business document at the business premises where the document is located.

A statutory limitation period for determinations of six years after the end of the relevant financial period applies unless the Comptroller is not able to make a determination within that period by reason of any deliberate misrepresentation or negligent or fraudulent action by any person.

Reporting Formalities

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

Entities within scope of the Jersey economic substance requirements are required to confirm to the Comptroller by way of filing an annual return for a relevant financial period the information required by that return, including whether they have gross income from relevant activity being carried on, by or through it and, if so, whether they meet an economic substance test in respect of such activity (or in the case of a self-managed fund, its activities generally). The return requires supporting answers and financial statements prepared in accordance with Jersey law for the relevant period. Additional information may also be submitted.

For this purpose, 'relevant period' means a financial period starting on or after:

- 1 January 2019 for a resident company that is not a fund;
- 1 January 2021 for a resident company that is a self-managed fund;
- 1 July 2021 for a resident partnership formed between 1 July 2021 and 1 January 2022; and
- 1 January 2022 for all other resident partnerships.

Returns are generally due by 31 December in the calendar year subsequent to financial year-end, though the Comptroller may specify a different date.

Outside of that standard reporting requirement, a resident company or partnership must provide any information reasonably required by the Comptroller to assist the Comptroller in making a determination. The Comptroller may also serve notice on any person requiring the person to provide, within the period specified in the notice and at such place as is specified in the notice, such documents and information as the Comptroller may reasonably require for the purpose of facilitating the Comptroller's exercise of functions under the legislation. A person served with such notice must provide the information in the manner and within the period specified in the notice.

Demonstrating Compliance

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

The return requires financial statements prepared in accordance with Jersey law to be included. Those should support the answers given in the return, for example, with regard to the amount of gross income and relevant expenditure. If such amounts are not easily identifiable (for example, because the accounts are consolidated) the resident company or partnership may wish to submit additional management accounts on a standalone basis.

The resident company or partnership should also ensure it has the records and materials to support its answers should the Comptroller request further information. This includes detailed minutes evidencing strategic decisions and CIGA in Jersey, employee records and (as applicable) timesheets, and, in cases where a concession has been relied upon, evidence as to why such concession should apply.

As applicable, a high-risk IP company or partnership should also ensure it has the records and materials to evidence compliance with the higher evidential threshold, which includes a detailed business plan as to the commercial rationale for holding the IP in Jersey.

The Comptroller has the discretion to assess compliance based on the information provided in the return and through its inquiries. However, the Comptroller must determine that a high-risk IP company or partnership has not met the economic substance test where it applies unless provided with sufficient information to satisfy the Comptroller otherwise. Accordingly, there is a rebuttable presumption that a high-risk IP company or partnership has not met the requirements.

If the Comptroller determines that the economic substance test has not been met, that determination can be appealed to a Commission of Appeal within 30 days of the notice of determination, with either party then able to appeal within 21 days of its determination to the Royal Court of Jersey.

Penalties

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

The penalties under the legislation for a resident company not meeting the economic substance test are primarily:

- financial, being a fine of:
 1. up to £10,000 for a failure in any given financial period; and
 2. up to £100,000 for a failure in a financial period following one in which notice of a failure to meet the test has not been met has been issued; and
- the automatic exchange of information by the Comptroller with the authorities in each jurisdiction in which the company has a holding body, ultimate holding body and ultimate beneficial owner (as well as its jurisdiction of incorporation if outside Jersey) subject to being permitted to do so by international agreements and protocols.

The penalties under the legislation for a resident partnership not meeting the economic substance test are primarily the same as for companies except that:

- the maximum fine for a failure in a financial period following one in which

For serious or repeat offences, there is also the possibility that a court order be sought regulating the affairs of the company or partnership, or for its winding up or dissolution.

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

Updates 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?

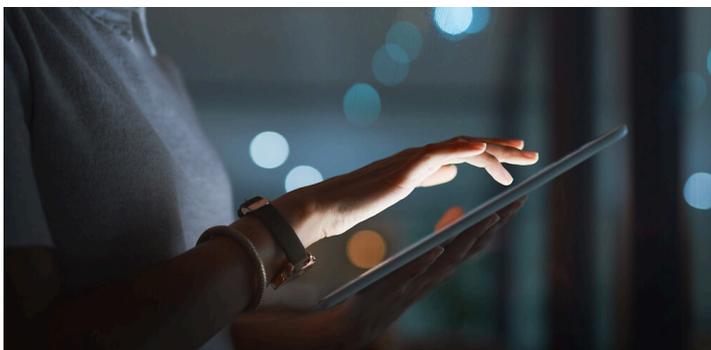
Economic substance is a fast-moving area of law that responds quickly to international developments and requirements. Since the original legislation, the most notable developments have been that:

- all relevant core income-generating activities are to be carried on in Jersey;
- funds were confirmed as being generally out of scope but self-managed funds required to meet an economic substance test for financial periods commencing on or after 1 January 2021; and
- the Jersey regime has been extended to partnerships.

Covid-19 has also demonstrated that the Comptroller may make concessions for where operating practices have to be adjusted to compensate for such events.

Carey Olsen Jersey LLP is registered as a limited liability partnership in Jersey with registered number 80.

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