

Jersey lodges draft legislation to introduce substance requirements for certain Jersey tax resident companies

Service area / [Banking and Finance](#)

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Jersey has lodged the draft Taxation (Companies – Economic Substance) (Jersey) Law 201- (the “**Law**”). The Law, once adopted, is intended to meet the commitment made by Jersey to address certain concerns raised by the EU Code of Conduct Group on Business Taxation (the “**Code Group**”) in relation to the need for relevant businesses to demonstrate economic substance in Jersey. This briefing note summarises the key provisions of the Law and the rationale for its introduction.

Overview

1. The Law was prepared by the Government of Jersey in consultation with industry and following dialogue with the Code Group, individual EU Member States, the EU Commission and the OECD. Similar concerns on substance were raised by the Code Group in relation to the other Crown Dependencies and Jersey has also worked closely with Guernsey and the Isle of Man in developing the Law.
2. The new substance requirements will only apply to certain companies and will not need to be met if a company has no gross income in relation to a relevant activity carried on by it. Trusts and partnerships are out of scope (although trustees and general partners that are themselves companies may be within scope).
3. While the introduction of statutory substance requirements is noteworthy, it is expected that current high standards in Jersey mean that most companies that will fall within the scope of the Law will be able to demonstrate that they meet such requirements.
4. The draft Law is due to be debated by the States Assembly (Jersey’s parliament) on 4 December 2018 and is expected to take effect for financial periods starting on or after 1 January 2019. The Law, once adopted, will be administered by the Jersey Comptroller of Taxes (the “**Comptroller**”).

5. Jersey, together with Guernsey and the Isle of Man, has issued a document setting out key aspects of the proposed Law and the equivalent proposed laws in those jurisdictions (the “**Preliminary Guidance**”). It is expected that more comprehensive guidance in relation to the practical operation of the Law will be released in due course.

Scope

The Law provides that “*a resident company must satisfy the economic substance test in relation to any relevant activity carried on by it*”. However, “*a resident company is not required to meet the economic substance test if it has no gross income in relation to a relevant activity carried on by it*”. In order to determine whether a company will be within the scope of the new legislation the following questions must, therefore, be considered:

1. Is the company a “resident company”?

A “resident company” is any company (whether incorporated in Jersey or not) that is regarded as resident in Jersey for Jersey tax purposes.

2. Is the company carrying on a “relevant activity” in relation to which it has gross income?

“Relevant activities” is defined in the Law to mean any of the following: banking business, insurance business, fund management business, finance and leasing business, headquarters business, shipping business, holding company business, intellectual property holding business and distribution and service centre business. Detailed definitions are provided in respect of each type of business.

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3. If the company is a resident company carrying on a relevant activity in relation to which it has gross income, does it meet the “economic substance test”?

The Law provides that a resident company will meet the “economic substance test” in relation to a relevant activity if:

Direction and management: the company is directed and managed in Jersey in relation to that relevant activity. The Preliminary Guidance makes clear that this test is separate to the management and control test that is applied when determining tax residency in Jersey. The direction and management test 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 (the Preliminary Guidance provides that even those companies with a minimum level of activity are expected to have at least one board meeting in each financial period), there is a quorum of directors physically present in Jersey for such meetings, strategic decisions are made at such meetings and the minutes of such meetings record those decisions, the directors have the necessary knowledge and expertise to discharge their duties as a board and the minutes of all board meetings and records of the company are kept in Jersey. The Preliminary Guidance explains that this test does not necessarily require every board meeting to be held in Jersey. While what will be required will depend on the type of relevant activity being undertaken by the company, it is generally expected that a majority of board meetings will be held in Jersey;

Core-income generating activity: core-income generating activity in respect of that relevant activity is carried on from within Jersey (either by the company or for the company by another entity). What amounts to a core-income generating activity for the purposes of the Law will depend on the type of relevant activity being undertaken and the circumstances of the company. While the draft Law sets out the core-income generating activities that companies conducting a relevant activity could carry on, the Preliminary Guidance clarifies that not all of those core-income generating activities need to be performed to demonstrate economic substance. The Preliminary Guidance further confirms that companies are not precluded from seeking professional advice and services from specialists in jurisdictions outside Jersey provided that the income subject to tax in Jersey is proportionate to the core-income generating activities undertaken in Jersey. In addition, the outsourcing of activities that are not core-income generating activities (e.g. back office support functions) to jurisdictions outside Jersey will not impact the assessment of whether the economic substance test has been met. In the case of core-income generating activities carried out for the company by another entity, the company must be able to monitor and control the carrying out of those activities in order to satisfy the economic substance test; and

Adequacy: having regard to the level of relevant activity carried on in Jersey: (a) there are an adequate number of employees physically present in Jersey in relation to that relevant activity (whether or not employed by the company or by another entity and whether on temporary or long-term contracts); (b) there is adequate expenditure incurred in Jersey; and (c) there are adequate physical assets in Jersey. The Preliminary Guidance confirms that where core-income generating activity is outsourced to a services provider in Jersey, the resources of that services provider can be taken into account for the purposes of determining whether the resident company has adequate people and premises.

Rationale for the Law

In December 2017, Jersey’s commitment to cooperation in international tax transparency and compliance with BEPS (Base Erosion Profit Shifting) requirements saw the Code Group confirm Jersey as a cooperative tax jurisdiction after a year-long screening process involving over 90 jurisdictions.

The declaration came just one month after Jersey was given the highest possible rating in all ten areas reviewed by the OECD’s Global Forum on Transparency and Exchange of Information on Tax Matters when assessing Jersey’s compliance with global standards on tax transparency and information exchange.

While Jersey was determined to be a cooperative tax jurisdiction, the Code Group expressed concern that the absence of a general statutory substance requirement in Jersey increased the risk of profits being registered in Jersey which do not reflect real economic activity in the jurisdiction.

Jersey, therefore, made a written commitment to address the Code Group’s concerns by the end of 2018 in order to ensure it maintains its position as a cooperative tax jurisdiction. The adoption of the Law is intended to meet that commitment and is reflective of Jersey’s long-standing “good neighbour” policy towards the EU and its reputation as a well-regulated and transparent jurisdiction.

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Guidance

The Law makes provision for the Comptroller to issue guidance on the application of the economic substance test including, in particular, the meaning of “adequate” as used in that test. While more comprehensive guidance is expected to be issued in due course, the Preliminary Guidance explains that “adequate” is to be given its ordinary meaning (i.e. enough or satisfactory for a particular purpose). What will be regarded as “adequate” will vary depending on the type of relevant activity being undertaken and the circumstances of the resident company. For example, while not addressed in the Preliminary Guidance, it is understood that pure equity holding companies may not require much in the way of substance in order to exercise their main activity of holding and managing equity participations. It is anticipated that such companies would need to confirm they meet all corporate and tax filing requirements and have adequate people and premises (which may be provided by a Jersey corporate services provider) necessary to carry on holding company business. In the case of companies carrying on banking, insurance or fund management business, the Preliminary Guidance confirms that existing stringent regulatory requirements that apply in Jersey overlap significantly with the proposed substance requirements meaning that such companies are likely to be able to demonstrate that they satisfy the adequacy requirements in respect of resources and expenditure.

Penalties and exchange of information

A resident company will be required to provide information to the Comptroller by way of its Jersey tax return to enable the Comptroller to determine if the company has met the economic substance test for a financial period. Where the test is not met, a progressive penalty system applies. Failure to meet the economic substance test will also result in exchange of information with relevant EU competent authorities.

Conclusion

While Jersey resident companies should consider the Law and its potential application to their particular business and circumstances, Jersey’s long standing commitment to the highest standards of tax transparency and financial regulation mean that the new requirements are largely consistent with existing good practice in Jersey. It is, therefore, expected that most companies that fall within the scope of the Law will be able to demonstrate that they meet the economic substance test.

Carey Olsen has been closely involved with the consultation process for the Law. Our lawyers are, therefore, able to provide helpful perspective in relation to its development and scope. If you have any queries in relation to the potential impact of the changes to be introduced, please get in touch with your usual Carey Olsen contact.



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