



Economic substance requirements in Jersey

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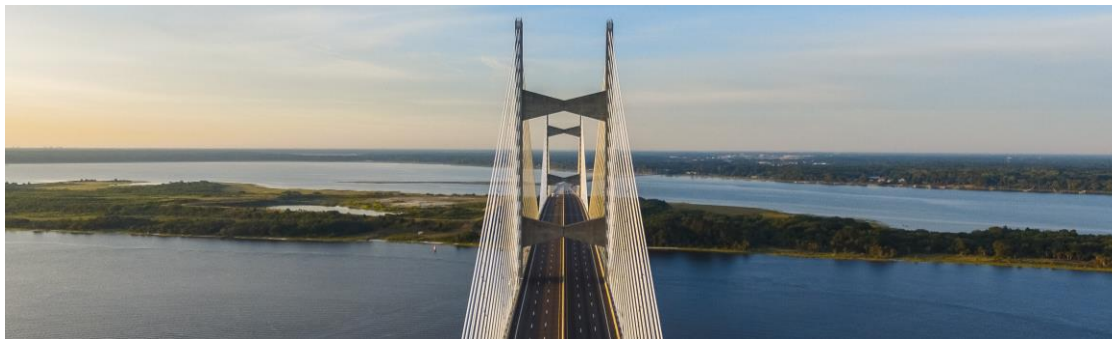
Last year, the European Union (“EU”) Code of Conduct Group (Business Taxation) (“COCG”) investigated the tax policies of non-EU countries, including Jersey, against the concept of “tax good governance” standards on tax transparency, fair taxation and anti-BEPS measures. Although the COCG had no concerns with most of the principles of tax good governance as they relate to Jersey, Guernsey the Isle of Man and a number of other jurisdictions that subject corporate profits to zero or near zero rates or have no corporate tax regimes, they did express concerns regarding the lack of economic substance requirement for entities doing business in and through these jurisdictions.

As a result of those concerns, Jersey along with the other Crown Dependencies, made a commitment to address the concerns by the end of December 2018.

On **23 October 2018**, the draft **Taxation (Companies – Economic Substance) (Jersey) Law 201 –** (“ESL” or “Economic Substance Law”) was lodged for debate, with a view to ensure that Jersey addresses its commitment in relation to the lack of economic substance requirement for doing business in and through Jersey.

In this document, we present a descriptive summary of the key features of what is proposed under the ESL, of which we highlight the following stages:

- **Stage 1:** Identify companies carrying on “relevant activities”
- **Stage 2:** Impose economic substance requirements on companies undertaking relevant activities
- **Stage 3:** Enforcement of the substance requirements



Introduction

The COCG was set up in 1998 by the EU with a view to assess tax measures and regimes that may fall within the scope of the Code of Conduct for business taxation, which had been adopted in 1997 by the EU and was designed to detect measures that unduly affect the location of business activity in the EU by targeting non-residents and providing them with a more favourable tax treatment than that which is generally available in the jurisdiction.

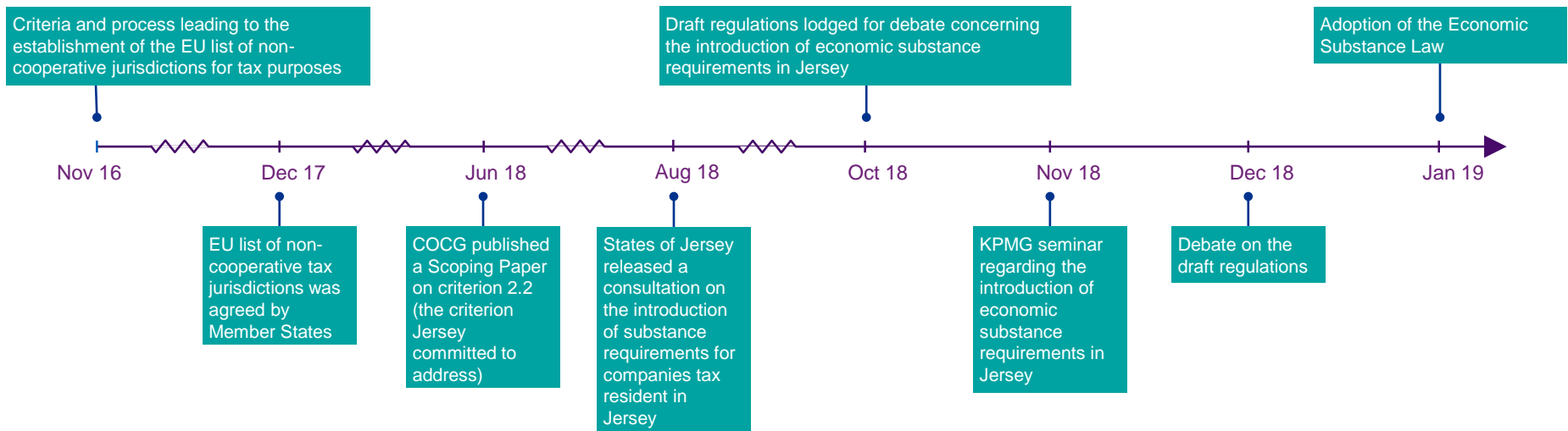
On investigating the tax policies of non-EU countries against the principles of tax good governance, the COCG expressed concerns regarding the lack of economic substance requirement for entities doing business in and through Jersey requiring Jersey to address such concerns by the end of December 2018.

COGC, in consultation with the Global Forum and the OECD, published a Scoping Paper on the matter of substance in June 2018, which provides technical guidance on how to comply with the commitments made by the jurisdiction on the matter of substance.

In August 2018 a consultation was issued by the Government of Jersey regarding the introduction of substance requirements and sought feedback from interested parties. Following the conclusion of the consultation, draft legislation – Economic Substance Law – was lodged by the Minister on 23 October 2018.

It is important to iterate that Jersey has not been blacklisted by the EU. Jersey has been included in a 'grey list', which included other jurisdictions that had made various commitments to implement all aspects of the tax good governance principles. In total 142 commitments have been made by 67 jurisdictions. The COCG has been monitoring these commitments ensuring that appropriate legislation is enacted. It is expected that following the enactment of the ESL, Jersey will be fully compliant with all aspects of the tax good governance principles.

A timeline of events leading up to the ESL can be found below.



Stage 1 | Identify companies carrying on “relevant activities”

The Economic Substance Law applies to Jersey resident companies. Companies are resident for tax purposes in Jersey if they are incorporated in the island unless their business is centrally managed and controlled outside Jersey, in a jurisdiction where the highest rate at which any company may be taxed is 10% or higher and the company is treated as resident for tax purposes in that jurisdiction. Furthermore, non-Jersey incorporated companies whose business is managed and controlled in Jersey will also be treated as Jersey resident companies.

Jersey branches of non-Jersey resident companies are outside the scope of the ESL.

All Jersey resident companies will have to identify whether they carry on “relevant activities” in Jersey. The term has been derived from categories of geographically mobile income identified by the OECD forum on harmful tax practices and include:



Each category of relevant activities is defined under the ESL as follows:

Banking business

A Jersey resident company registered to carry on deposit taking business under Article 9 of the Banking Business (Jersey) Law 1991 will be viewed as carrying on “banking business”.

Banking business does not however include banking business carried on by a company which the Financial Services Commission is satisfied is registered under the Banking Business (Jersey) Law 1991 solely for business continuity and liable to pay a reduced annual fee accordingly under the Commission’s published fees under Article 15 of the Financial Services Commission (Jersey) Law 1998.

Insurance business

Insurance business is defined as a resident company undertaking long-term business or general business within the meaning of Article 1 of the Insurance Business (Jersey) Law 1996 which the resident company must be authorized to carry on by a category A permit or category B permit under that Law.

Fund management business

The definition of “fund management business” is widely defined and includes all companies that are registered under the Financial Services (Jersey) Law 1998 (“FSJL”) to carry on fund services businesses as a manager or an investment manager, but also those companies that would be required to register if it was not for a specific exemption within the FSJL, such as where the company provides fund management services to a scheme that is not offered to the public.

Where there is no investment manager appointed, in or outside of Jersey, the company acting as a trustee to the scheme or a corporate member of a partnership will be the entity carrying on fund management business.

Stage 1 | Identify companies carrying on “relevant activities” (continued)

Finance and leasing business

A Jersey resident company will be viewed as carrying on finance and leasing business if it makes loans, provides credit or in any other way lends, for consideration to any person, including connected persons. In addition, the provision of credit may be by way of instalments for which a separate charge is made and disclosed to the customer in connection with:

- a) the supply of goods by hire purchase,
- b) leasing other than any lease granting an exclusive right to occupy land, or
- c) conditional sale or credit sale.

If a Jersey resident company carries on banking business, insurance business or fund management services, it will not be viewed as carrying on finance and leasing business, even where it undertakes any of the above.

Headquarters’ business

Where a Jersey resident company provides any of the following services to one or more foreign connected persons of a Jersey resident company, it will be viewed as carrying on headquarters business.

- a) The provision of senior management;
- b) The assumption or control of material risk for activities carried out by, or assets owned by, any of those connected persons;
- c) The provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (b).

If a Jersey resident company carries on financing and leasing business, intellectual property holding business, insurance business, or banking business, it will not be seen to undertake headquarters business, even where it undertakes any of the above.

Shipping business

Shipping business is defined as involving the operation of a ship anywhere in the world other than solely between Jersey and Guernsey:

- a) the business of transporting, by sea, persons, animals, goods or mail;
- b) the renting or chartering of ships for the purpose described in paragraph (a);
- c) the sale of travel tickets or equivalent and ancillary services connected with the operation of a ship;
- d) the use, maintenance or rental of containers, including trailers and other vehicles or equipment for the transport of containers, used for the transport of anything by sea;
- e) the management of the crew of a ship.

Holding company business

A company will be viewed as carrying on holding company business activities if it is a resident company which broadly, holds the majority shares in another entity, has as its primary function the acquisition and holding of shares or equitable interests in other companies, and which does not carry on any commercial activity.

Intellectual property (“IP”) holding business

The definition of “IP holding business” is extensive and includes all Jersey resident companies holding IP assets, such as copyright, patents, trade marks, brand, and technical know-how, from which identifiable income accrues to the business (such income being separately identifiable from any income generated from any tangible asset in which the right subsists).

The ESL further highlights a subcategory of IP holding business companies, referred to as “high risk IP holding companies”.

Stage 1 | Identify companies carrying on “relevant activities” (continued)

IP holding business (continued)

A high risk IP business company or an IP holding company that:

- did not create the IP in the IP asset which it holds for the purposes of its business;
- acquired the IP asset either from a connected person or in consideration for funding research and development by another person situated outside of Jersey, and that licences the IP asset to one or more connected persons or otherwise generates income from the asset in consequence 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 Jersey core-income generating activities.

Clearly identifying whether a company falls within the definition of a high risk IP company is key as it will have a significant impact in stage 2, as explained later in this document.

Distribution and service centre business

A company will be viewed as carrying on distribution and service centre business if its business consists of either or both of the following:

- purchasing from a foreign connected person component parts or materials for goods, or goods ready for sale, and reselling such component parts, materials or goods;
- providing services to foreign connected persons in connection with the business.



Stage 2 | Impose economic substance requirements on companies undertaking relevant activities

Once a Jersey resident company has been identifying as undertaking relevant activities, the ESL requires the company to satisfy the 'economic substance test'.

The test is split in three parts. However a company is not required to meet the test if it has no gross income in relation to a relevant activity carried on by it.

1. It is directed and managed in Jersey in relation to that activity

The first part of the test is that the company will be required to demonstrate that it is "directed and managed" in Jersey.

This part of the test is met if:

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

2. It conducts Jersey Core Income Generating Activities ("CIGA")

The second part of the test for the company to demonstrate that the CIGA associated with the specific relevant activity are undertaken in Jersey (either by the company or a third party).

Where Jersey CIGA are carried on by another entity, the Jersey company has to be able to *monitor and control* the carrying on of that activity by the other entity.

The expression "Jersey CIGA" means relevant activities being carried on from within Jersey and includes the following in respect of each of the relevant activities:

Banking business

Raising funds, managing risk including credit, currency and interest risk; taking hedging positions; providing loans, credit or other financial services to customers; and managing capital and preparing reports and returns to the Jersey Financial Services Commission or any body or entity with equivalent functions relating to the supervision or regulation of such business.

Insurance business

Predicting and calculating risk; and insuring or re-insuring against risk and providing insurance business services to clients.

Fund management business

Taking decisions on the holding and selling of investments; calculating risk and reserves; taking decisions on currency or interest fluctuations and hedging positions; and preparing reports and returns to investors and the Jersey Financial Services Commission or any body or entity with equivalent functions relating to the supervision or regulation of such business.

Finance and leasing business

Agreeing funding terms; identifying and acquiring assets to be leased (in the case of leasing); setting the terms and duration of any financing or leasing; and monitoring and revising any agreements and managing any risks.

Headquarters business

Taking relevant management decisions; incurring expenditures on behalf of group entities; and co-ordinating group activities.

Stage 2 | Impose economic substance requirements on companies undertaking relevant activities (continued)

Shipping business

Managing crew (including hiring, paying and overseeing crew members); overhauling and maintaining ships; overseeing and tracking deliveries; and determining what goods to order and when to deliver them, organising and overseeing voyages

Holding company business

All activities related to that business.

IP holding business

Taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the intangible asset generating income; taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the intangible asset; carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of revenue from third parties and research and development, branding or distribution

There is a **rebuttable presumption** that a high risk IP company will fail the economic substance test unless the company provides the Comptroller with sufficient information to satisfy the Comptroller that the test has been met.

Distribution and service centre business

Transporting and storing goods, components and such materials; managing stocks; taking orders; and providing consulting or other administrative services.

3. It meets the adequate requirements with regard to the level of relevant activity carried on in Jersey

The final part of the economic substance test is for the require the company to demonstrate that in relation to the level of relevant activity carried on in Jersey:

- i. there are an adequate number of employees in relation to that activity who are physically present in Jersey (whether or not employed by the resident company or another entity and whether on temporary or long-term contracts),
- ii. there is adequate expenditure incurred in Jersey, and
- iii. there are adequate physical assets in Jersey.

Stage 3 | Enforcement of the substance requirements

In order to demonstrate meaningful enforcement of the economic substance requirements, a formal hierarchy of sanctions for non-compliant companies is introduced with increasing severity of sanctions imposed for persistent non-compliance.

Reporting

The ESL requires a Jersey company to provide to the Comptroller any information reasonably required to assist the Comptroller in determining whether or not a resident company has met the economic substance test. Although the legislation is currently silent on what type of information is required, it would seem from the EU Scoping Paper and the Jersey consultation that the following is likely to be requested:

- Business activities;
- Amount and type of gross income;
- Amount and type of expenses and assets;
- Premises;
- Number of employees specifying the number of fulltime equivalent employees with necessary qualifications.

Furthermore, it is likely that such companies will be required to self-assess themselves as to whether or not they have passed the economic substance test.

Penalties

Under the ESL, the Comptroller will have the power to issue a notice determining that a company has failed the economic substance test, providing the company with reasons for the determination and applying a penalty of up to £10,000.

If the Comptroller is of the view that the company fails the substance test in two consecutive years, then the penalties increase to a maximum of £100,000. Furthermore, a report may be made to the Minister of Finance and Resources enabling him to consider applying to the Royal Court to have the company struck off.

Exchange of information to competent authorities

Where the Comptroller determines that a resident company has not met the economic substance test for a financial period, the Comptroller must provide certain information relating to that company for that period to:

- a) the competent authority of the country or territory in the European Union in which resides a holding body, the ultimate holding body of the resident company and an ultimate beneficial owner; and
- b) if the resident company is incorporated outside Jersey, the competent authority of the country or territory in which the resident company is incorporated.

In respect of a high risk IP company, regardless of whether or not the Comptroller has made an assessment of whether the economic substance test has been met, the Comptroller must provide the information provided to the Comptroller in respect of that company for each financial period of the company starting on or after 1 January 2019 to:

- a) the competent authority of the country or territory in the European Union in which resides a holding body, the ultimate holding body of the resident company and an ultimate beneficial owner; and
- b) if the high risk IP company is incorporated outside Jersey, the competent authority of the country or territory in which the company is incorporated.

How KPMG can assist your business

Members of the tax leadership team across the Crown Dependencies have been working closely with the relevant authorities to produce the law and guidance. As such, KPMG are in an ideal position to assist with your requirements.

The Tax team at KPMG is a dedicated team of highly skilled professionals providing advisory services to groups, companies and individuals. Our comprehensive knowledge of local and international regulations, combined with extensive experience, allow us to serve our clients in a tailored, responsive and value-added manner.

Our services can be customised to meet your needs



Scalable services

We take a pragmatic and tailored approach to providing a comprehensive range of services that meet your requirements.



Meeting your evolving needs

KPMG has developed a set of methodologies to assist with delivering and testing all requirements of the Economic Substance Law.



Multi-jurisdictional

We use our KPMG network to source the correct team who are experts with the required experience to service your specific needs.

Potential Benefits

KPMG's experience and **innovative** use of KPMG's global methodology and tools, tailored to the Channel Islands, combine to provide **insight** into your requirements and identify **deficiencies** that could impact your **reputation and credibility**.

Why KPMG?

A leader in its field

- KPMG have worked closely with the relevant authorities in the Crown Dependencies on the introduction of the substance requirements.
- KPMG is a leading provider of audit, tax and advisory services
- Through our clients, we have significant insight into your business
- KPMG in the Channel Islands has over 240 professionals working locally and links into one of the largest professional services firms in the world

HOW KPMG can assist your business



Impact analysis

Identify the extent to which the law may impact on your business



Diagnostic reviews

Gap analysis and advice of the requirements for your business to ensure compliance with the law



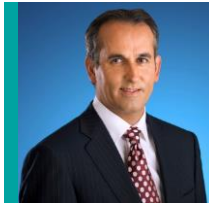
Training sessions

Tailored training sessions for your staff



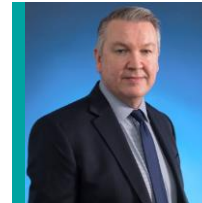
Implementation of the law

Assistance with the implementation of the law and review /assistance in completing the requirements of the tax return



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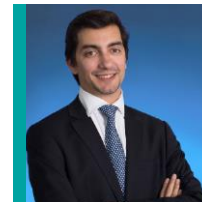
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