

**C22 BANKING BUSINESS (INCLUDING THE PROVISION OF “CREDIT FACILITIES”)
(section 2(2) and Fourth Schedule to the Income Tax (Guernsey) Law 1975)**

Introduction

Banks and providers of credit facilities receive income from a number of discrete income streams. Although the company standard rate of income tax is 0%, the income from certain specified banking activities will be subject to the 10% intermediate rate.

The underlying principle is that any company having more than one class of income chargeable to income tax at more than one rate will compute its tax liability accordingly.

The categorisation of banking profits which are subject to income tax at the 10% rate of income tax is set out below.

Banking Profits Chargeable at 10%

The categorisation under the Fourth Schedule imposing the 10% rate on banking profits is based on an analysis of how the assets giving rise to those profits have been funded.

- Only profits derived from assets funded by way of customer deposits or funded by the amount of capital needed to satisfy the bank's minimum regulatory requirement will be liable for tax at 10%.
- Profits derived from assets funded in other ways (e.g. from inter-group funding, including fiduciary deposits, or by capital that is excess to a bank's minimum regulatory requirement) will be liable to tax at 0%.
- The profits for these purposes will include interest on income, gains and losses (including exchange gains and losses) on the relevant assets, payments and receipts from transactions in related derivatives together with any associated fee income.
- The profits concerned will be computed after allowing for the relevant cost of funding and after allowing for the appropriate proportion of the bank's overhead costs and allocation of any specific costs.
- A bank will be allowed to specify which assets and related sources of profit will be associated with which source of funds. However a bank will, by way of default, be allowed to deduct such costs on a rateable basis.
- Any free funds available to a branch of a bank trading in Guernsey will be treated for these purposes as though it was capital that was in excess of its regulatory requirement.
- From 1 January 2013, income from domestic insurance business, fiduciary business (in respect of regulated activities), insurance intermediary business and insurance manager business will be liable to tax at 10%.
- From 1 January 2015, income from fund administration business will be liable to tax at 10%.
- From 1 January 2016, income from the provision of custody services (as defined in the Protection of Investors (Bailiwick of Guernsey) Law, 1987) to unconnected third parties will be liable to tax at 10%, when undertaken by a bank (please refer to Statement of Practice C54 for the meaning of connected).

The 10% rate will therefore apply to the income derived from customer deposits and the minimum regulatory capital, including but not limited to:

- Net mainstream interest income.
- Fees and commissions from banking services, such as foreign exchange, account management charges, payment transfer fees, etc.
- Trading income from the purchase and sale of securities and liquid assets held on the balance sheet.
- That part of net interest income arising from the minimum regulatory capital requirement by the GFSC, i.e. applying the same proportion of net interest income which relates to the proportion of total liabilities which is represented by the minimum regulatory capital.

Profits chargeable at 0%

The 0% rate will therefore apply to all categories of banking income other than those derived from customer deposits and the minimum regulatory capital. The following will therefore NOT be chargeable at the 10% rate:

- That part of net interest income, fees, commission, foreign exchange, management charges, etc, which arises from the capital base of the bank (made up of Tier 1 and Tier 2 capital) which is surplus, i.e. in excess of the minimum regulatory capital requirement of the GFSC (applying the same proportion of total liabilities represented by “surplus capital” to net interest income).
- That part of net interest income represented by intra-group activities, including group funded treasury and group funded lending business (syndicated and non-syndicated).
- That part of fee and commission income represented by group funded activities – both achieved by using the proportion of total liabilities represented by group deposits applied to net interest income and fee and commission income respectively.
- That part of net interest income represented by fiduciary deposits (regarded as inter-bank deposits in Guernsey), i.e. the proportion of total liabilities represented by fiduciary deposits applied to net interest income.
- Non-banking services and administration charges. This would cover all activities that would be charged at the standard rate of 0% if carried on by a non-banking entity.
- Income from non-Guernsey land and property.

Further Guidance

The Director is aware that different institutions attach different descriptions to income streams for their own internal or group purposes. It is the Director’s intention that, irrespective of the descriptions used by the respective institutions, income streams which are of fundamentally the same nature will be taxed at the same rate of income tax.

Income from deposit taking

Customer deposit taking and its related activities represents a primary business stream of a bank or provider of credit facilities. All income arising from the re-investment or utilisation of client deposits will be subject to tax at 10% irrespective of how that income is earned. The phrase “client deposits” should be construed as including current, call, omnibus, notice, and fixed deposit accounts, certificates of deposit, bonds, structured products and other similar investment products.

Ancillary income arising from deposit taking activities will also be charged at the 10% rate; e.g. income from the issuing of cheque books, transaction fees, account management and servicing fees, foreign exchange charges, debit and credit card fees, money transmission fees (BACS/CHAPS/SWIFT) etc.

Income from capital and reserves

One of the regulatory conditions attached to the holding of a banking licence is for a minimum amount of capital to be held (a combination of share capital and such other reserves as are required for risk asset ratio purposes). As this minimum regulatory capital is related to banking business, income arising from it will be taxed at the 10% rate. Income arising from capital surplus to regulatory requirements will be chargeable at the standard income tax rate of 0%.

Income arising other than from client deposits

Income arising from sources of funding other than client deposits, such as group funded lending, is not banking business as defined and will therefore be chargeable at the standard 0% rate. Similarly where group funds or funds other than client deposits are used for activities such as leasing and hire purchase, participation in syndicated loan business, sub-participation lending and asset securitisation, income arising will be chargeable at the standard 0% rate.

Fiduciary deposits

Fiduciary deposits involve the specific commissioning by a client of their own bank to invest their assets with a third party bank.

As the interest is paid by the third party bank to the client bank, and subject to the Director being satisfied that a Guernsey bank is acting in a bona fide third party fiduciary capacity, it is accepted that the funds involved will be inter-bank placements and not client deposits and that income earned from them will be chargeable at the general 0% rate.

Other non-banking business

It is recognised that many banks will provide services and generate income from activities such as assurance, foreign exchange and investment management services. However, if any such activities would be charged at 0% rate of tax if undertaken by any other company, it follows that the 0% rate will apply to such income received by banks. Where a bank is in receipt of other income (e.g. from land or property in Guernsey) which is taxed for all companies at the 20% rate, the bank will be taxed on that income at 20%.

Centres of excellence

When groups restructure or create centres of excellence, new business activities may be undertaken by a pre-existing bank and initially might appear to be ancillary income arising from banking business within the terms of this document and therefore taxable at 10% (e.g. proprietary dealing as compared to a group treasury function). Subject to agreement with the Director, where banking group functions are being centralised, income arising from group functions will normally be recognised as not being ancillary to the taking of deposits and therefore will be subject to the standard 0% rate.

Credit Facilities

Paragraph 1 of the Fourth Schedule extends the definition of “banking business” to include “any business that, in the usual course of its business, provides or makes available credit facilities”.

““Credit facilities” means the making of any advance or the granting of any credit to customers and includes:

- (1) the provision, in connection with the supply of goods by hire-purchase, conditional sale or credit sale, of credit in instalments for which a separate charge is made and disclosed to the customer, and
- (2) any assignment to the business of an advance or credit repayable to a third person.”

For the avoidance of doubt, when income has been taxed under the provisions of paragraph 2(1) and (2) of the Fourth Schedule, it will not also be taxed under paragraph 1(1) and (2).

Concessional Treatment

The strict application of the definitions in paragraph 1(1) and (2) would catch a wide variety of activities, many of which would not ordinarily be regarded as “banking”, for example intra-group financing or lines of credit in a retail business. The Director will, by concession, not seek to apply the company intermediate rate in the following situations:

- Where credit facilities are made available by a company to other companies within the same group of companies.
- Where the making of credit facilities is ancillary to the company’s business, such as when a retail or wholesale business allows extended payment terms to customers.
- Where the borrower has no income or profits that are liable, under any part of the Law, to the individual standard rate, the company standard rate, the company intermediate rate or the company higher rate of income tax.
- In the case of providing credit facilities to a company that is subject to the company standard rate, a business will not be treated as falling within the definition of banking business if the business of the immediate borrower itself is comprised substantially of providing credit facilities that, under the terms of this concession, is not treated as a banking business.
- In any other circumstances, taking into account the principles set out above, if the Director considers it appropriate to do so.

Tax computations

Administration and general expenses should be allocated on a pro rata basis to the gross profits chargeable at the 0% or 10% rates of tax. This method of allocation will also apply to claims for annual allowances.

Where a bank or provider of credit facilities has income from land and property, it should submit a tax computation specific to that income source showing specific expenses.

Group/loss relief and brought forward losses

Group and loss reliefs will continue to be permitted but they will be restricted to profits chargeable at the same rate of tax; i.e. losses arising on activities subject to the general rate of 0% will not be relievable against profits taxed at 10%.

Any bank or provider of credit facilities requiring further clarification concerning income streams liable at the 10% rate should contact the Director.

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