C55 <u>EXTENSION OF 20% RATE TO INCOME FROM LARGE RETAIL BUSINESS</u> (sections 2(2), 6(3A), 37, 47G, 67, 114(2), 115, 133A, 139, Fourth Schedule and SOP M45)

<u>Introduction</u>

The States resolved on 29 October 2015 (Resolution 3, Billet XIX, 2015) that with effect from 1 January 2016 the company higher income tax rate (20%) is extended to income from large retail business carried on in Guernsey.

Large retailers are those whose taxable profits arising or accruing in any year of charge exceed the limit of £500,000. If the £500,000 limit is exceeded in a year of charge, all of the taxable profits will be chargeable at 20% in that year of charge, not just that proportion which exceeds £500,000. If the £500,000 limit is not exceeded in a year of charge, the taxable retail profits will be chargeable at 0% in that year of charge.

The 20% rate will apply to Guernsey tax resident companies and also non-resident companies which carry on a retail business in Guernsey through a permanent establishment.

<u>Further explanation</u>

The Director will consider any company that sells goods for consumption or use, whether or not by the buyer, for purposes unconnected with a trade or business, as carrying on a retail business. Retail business will therefore include supermarkets, garden centres, car sales, petrol sales, convenience stores, online sales, etc.

The Director will not consider the provision of services (such as travel agents or hairdressers) or the provision of goods for consumption at the point of sale (such as pubs, restaurants, kiosks, irrespective of whether food is served to eat in or takeaway) as retail business, as they are primarily service providers.

Wholesale

Profits from wholesale trade, where goods are sold to other businesses for onward resale, will be chargeable at the 0% company standard rate. The Director may ask companies to demonstrate that goods are sold to other businesses for resale.

Customer base

If more than 95% of the customers of the Guernsey retail business are outside Guernsey at the time of purchase, the retail business will not be considered as being carried on in Guernsey and the taxable retail profits will be chargeable at 0% in that year of charge.

If 95% or less of the customers are outside Guernsey at the time of purchase, the retail business will be considered to be carried on in Guernsey, so if the £500,000 limit is exceeded, all of the taxable profits will be chargeable at 20% in that year of charge, i.e. the profits will not be proportioned on the basis of the percentage of customers outside of the island.

Example 1

An online retailer carries on business in Guernsey with £750,000 taxable profits for the accounting period ended 31 December 2016. Only 1% of its customers are based in Guernsey. This is not considered to be a large retail business carried on in Guernsey (as more than 95% of its customers are outside of Guernsey) and so its profits are subject to the 0% standard company rate.

Example 2

A UK resident company operates a retail business in Guernsey through a shop on the High Street. The taxable profits of the Guernsey branch are £600,000 for the accounting period ended 31 December 2016. As all of the profits arose from customers buying items from the shop based in Guernsey, it is considered a large retail business in the year of charge 2016 and therefore the profits of the Guernsey branch are subject to the 20% company higher rate in the year of charge 2016.

Associated companies

In determining whether the profits of a retail business exceed £500,000 in a year of charge, the taxable profits from associated companies carrying on retail business in Guernsey for that year of charge shall be aggregated. Where the aggregated profits exceed £500,000 in a year of charge, all of the taxable retail profits of those associated companies, that are carried on in Guernsey, will be chargeable at 20% in that year of charge, with the liability to tax based on their respective profits (even if, individually, those companies had profits of £500,000 or less).

Companies shall be considered to be associated in this context if one of the companies has control over the other or both companies are under the control of the same person or persons, for which purposes the Director would look to the beneficial members of companies. "Control" is defined in section 122 as the power of a person to secure, by means of the holding of shares, being a loan creditor or the possession of voting powers, that the affairs of the company are conducted in accordance with the wishes of that person or persons.

Example 3

Mr X wholly owns Guernsey Companies A Ltd, B Ltd and C Ltd. A Ltd and B Ltd both carry on retail business in Guernsey and each have taxable profits of £300,000 for the accounting period ended 31 December 2016. C Ltd carries on business as a hairdresser.

As the aggregated profits of A Ltd and B Ltd exceed £500,000 in the year of charge 2016, they are each considered to be a large retail business and are therefore subject to tax at the 20% company higher rate in the year of charge 2016. C Ltd is not considered to be a large retail business (because its business is the provision of services) and is therefore subject to the 0% company standard rate.

Accounting period of less than 12 months

If a company has an accounting period of less than 12 months, the £500,000 threshold shall be pro-rated accordingly.

Identifying income from retail business

The underlying principle is that any company having more than one class of income chargeable to income tax at more than one rate, for example if they carry on a large retail business (taxable at 20%) and also run a café (taxable at 0%, because they retail goods for consumption at the point of sale), must compute their income and resulting tax liability accordingly. Companies will therefore be required to clearly show the different income streams in their computation of taxable profits.

Where the company has maintained separate accounts for the separate income streams, these should continue to be submitted with the company's income tax return, but if the company does not maintain separate accounts then administration and general expenses should be allocated on a pro rata basis to the gross profits chargeable at the 0% or 20% rates of tax. This method of allocation will also apply to claims for annual allowances.

Annual allowances

If a company has not submitted full income tax computations for the Years of Charge 2008-2015 and wishes to claim annual allowances for the Year of Charge 2016, it will be necessary for the company to submit a schedule showing the notional annual allowances that should have been claimed for those years in order to calculate the correct tax written down value for 2016. If, however, there is any unused allowance for a year of charge to be carried forward and added to the allowances for the following year (and so on for succeeding years, in accordance with section 114(2) of the Law), full amended computations should be submitted under section 37 (subject to the relevant time limit).

Non 31 December year end

The extension of the company higher rate applies with effect from 1 January 2016. Companies with a non 31 December year end should therefore time apportion the results shown in the accounts, for the purposes of computing the profits subject to the 20% rate, unless the Director agrees that another apportionment method would be more appropriate.

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 standard rate of 0% will not be relievable against profits taxed at 20%.

Companies will be able to carry forward and offset losses that arose from retail business prior to 1 January 2016 (provided the company is carrying on the same business) even though those losses arose at a time when the income was taxable at 0%.

Undistributed income and distributions

From 1 January 2013, following the repeal of deemed distributions, actual distributions are deemed to have been made from the company's undistributed income and only from the company's other income (i.e. pre 2008 income, post 2008 income taxed at "20% or more" reserve pools) and capital to the extent that the company's undistributed income is insufficient to cover the amount of the distribution, in accordance with section 81B(17) of the Income Tax Law.

Income which has been taxed at the 20% company higher rate does not fall within the definition of undistributed income. Therefore if a company makes a distribution from their "large retail business" pool of income, as Guernsey tax has been suffered by the company at 20%, no further deduction is required on distribution.

Avoidance

In order to protect the Island's revenues, the Director may invoke section 67 of the Income Tax Law (Legal Avoidance) if the effect of a transaction or series of transactions is the avoidance, reduction or deferral of the liability of any person.

These are some examples where the provisions of section 67 of the Income Tax Law would be invoked:

- Company A, whose profits are subject to tax at 20%, sets up a related Company B that charges a premium for providing staff to Company A. This has the effect of diverting income that would have been subject to tax at 20% in Company A to Company B whose income is subject to tax at 0%.

- The payment of a management fee, commission or other similar payment, where such a payment had not been a feature of the retail business prior to the extension of the 20% rate to large retail business.

- The increase in the amount of management fees, commission or other similar payment, over and above inflationary increases, which are not characteristic of previous fluctuations in the payments of this nature, prior to the extension of the 20% rate to large retail business.

- Arrangements with associated companies or persons, which have been made so as to minimise the profits from the retail business.

Please also refer to Statement of Practice M45.

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