

GSCCA Circular 11

17 June 2019

Proposed changes to economic substance regulations

This circular provides information on proposed changes to The Income Tax (Substance Requirements) (Implementation) Regulations, 2018 and The Income Tax (Substance Requirements) (Implementation) (Amendment) Regulations, 2018 (hereinafter collectively referred to as “the Regulations”) that it is intended will be made by the Policy and Resources Committee in July, coming immediately into operation.

Further information and guidance on the economic substance requirements can be found at www.gov.gg/economicssubstance.

1. Exempt Companies (that are not regulated funds) will be brought within scope

Regulation 1 will be amended so that both companies tax resident in Guernsey and Guernsey incorporated companies that have been granted exemption under paragraph 3 or 5 of Schedule 1 to the Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989 will be subject to the substance requirements.

Collective investment vehicles regulated by the Guernsey Financial Services Commission under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 will continue to be out of scope of the substance requirements, however any subsidiaries of the fund (that are not themselves regulated) will be in scope.

Exempt companies with income from a relevant activity for an accounting period commencing on or after 1 January 2019, will be required to demonstrate they have substance in Guernsey with effect from the date the amending regulations come into operation. This will not change the tax position of such exempt companies.

2. Intellectual Property (IP)

Regulation 7 will be amended to clarify that the core income generating activities (CIGA) for companies with income from IP assets (which includes without limitation, royalties, income from franchise agreements and income from licensing such assets) should be focussed dependent on the nature of the IP asset as follows:

- For IP assets such as patents - the CIGA are based on the research and development activities.
- For non-trade intangible assets such as brand, trademark and customer data - the CIGA should be based on the marketing, branding and distribution activities.
- In exceptional cases, and other than in the case of a high risk IP business (being a specifically defined term in Regulation 31) - the CIGA should be based on other activities relevant to the business and will depend on how that intellectual property asset is being used to generate income for the company. CIGA in such exceptional cases may include:



- (i) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the intellectual property asset,
- (ii) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the third party acquisition and subsequent exploitation of the intellectual property asset, and
- (iii) carrying on the underlying trading activities through which the intellectual property asset is exploited and which lead to the generation of revenue from third parties.

This was set out in section 6.1 of the Key Aspects Guidance notes (version 2) issued on 21 December 2018.

The definition of IP assets in Regulation 31 will also be amended to reflect the above linking of CIGA to the asset, and will mean an intellectual property right, design right, trademark, brand, patent and similar asset.

3. High Risk IP

As the CIGA will be linked to the IP asset, the definition of high risk IP in Regulation 31 will be amended to remove (b).

The information required to rebut the presumption that a high risk IP company has failed the substance requirement will also be set out in the Regulations. This is as set out in section 4 of the Key Aspects Guidance notes:

Materials which will explain how the DEMPE (Development, enhancement, maintenance, protection and exploitation) functions have been under the company's control, and that this has involved people who are highly skilled and perform their core activities in Guernsey.

The additional information should include:

- *Detailed business plans which demonstrate the commercial rationale for holding the IP assets in Guernsey,*
- *Evidence that the decision making is taking place in Guernsey, and not elsewhere, and*
- *Information on employees in Guernsey, their experience, the contractual terms, their qualifications, and their length of service.*

4. Other miscellaneous amendments

There are a number of other miscellaneous amendments proposed:

- Requirement for pure equity holding companies to comply with the applicable companies law of the jurisdiction of incorporation, as regulations currently just refer to Guernsey and Alderney Companies Laws.



- Expand scope of Competent Authorities to whom relevant information may be exchanged, to recognise that economic substance is now a global, not just EU, standard.
- Define intra-group in the regulations - this will match the definition in the Guidance notes issued on 26 April 2019.

The amending Regulations will be added to the economic substance pages once made, with any other further amendments highlighted.

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