Notification of upcoming changes to The Income Tax (Approved International Agreements (Implementation) (United Kingdom and United States of America) Regulations, 2014 Guidance Notes

Bulletin 2014/1

The following are some of the changes which are due to be incorporated in the next edition of the Taxation (International Tax Compliance) (Crown Dependency [CD]) Regulations Guidance Notes published by Guernsey.

The following text is the full revised text for the respective sections of the Guidance Notes (which update the current version of the Guidance Notes dated 28 July 2014):

3.2.1 [CD] Financial Institution

A [CD] Financial Institution is any Financial Institution resident in [CD] as well as any non-resident Financial Institution which has a permanent establishment located in [CD] through which it conducts a business of a Financial Institution.

A Financial Institution will be resident in [CD] if it is tax resident in [CD]. A dual resident entity that is tax resident in [CD] and resident for these purposes in another jurisdiction will have to apply the [CD] Regulations in respect of any Reportable Accounts maintained in [CD] unless it has actual knowledge that it is undertaking the appropriate reporting in the other jurisdiction (see 7.3 and 19.4). A Financial Institution will have actual knowledge where it holds written confirmation that the Reportable Accounts have been reported for FATCA purposes or under an agreement equivalent to the UK Agreement. Although tax residence in [CD] determines whether an entity falls within the scope of these Agreements, other influences may determine whether an entity is also within the scope of IGAs in other jurisdictions. For example an entity could fall within the scope of an IGA in another jurisdiction in which it is established.

For these purposes resident in [CD] means the following:

- For a company, if it is incorporated or otherwise resident in Guernsey under Guernsey Income Tax Law or a published Statement of Practice.
- For a company not resident in [CD], where it carries on a business of a Financial Institution through a permanent establishment in [CD].
- For trusts, if any of the trustees are resident in [CD], even if there are no [CD] resident settlors, beneficiaries or protectors.
- For partnerships, if the business of the partnership is managed and controlled in [CD].

  An Entity that is not otherwise resident in Guernsey for the purposes of the Agreements and has one or more Guernsey regulated service providers (i.e. Guernsey Financial Services Commission ("GFSC") licensed), which provide regulated services to the Entity, (e.g. Corporate Service Provider/Trust Service Provider/GFSC-licensed manager, custodian or adviser) can be treated as being resident in Guernsey for the purposes of the Agreements.

The GFSC issue licenses to Guernsey regulated service providers under the following laws:

(a) the Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended;

(b) the Banking Supervision (Bailiwick of Guernsey) Law, 1994, as amended;

(c) the Regulations of Fiduciaries Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 as amended;

(d) the Insurance Business (Bailiwick of Guernsey) Law, 2002 as amended; and

(e) the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 as amended,

A [CD] Financial Institution will be classified as a Non-Reporting [CD] Financial Institution or a Reporting [CD] Financial Institution.

A Reporting [CD] Financial Institution is required to:

- Undertake due diligence procedures to identify Reportable Accounts (see Sections 14-18) and report these annually to the [Comptroller/Assessor/Director] the required information in the prescribed time and manner (see Section 19)
- Report annually to the [Comptroller/Assessor/Director] payments made to Non-Participating Financial Institutions (see Section 19.6)

7.13 Employee Benefit Trusts (EBTs)

There is no definition of an EBT in the Income Tax Law. Trusts established in the context of employment arrangements to provide benefits for employees should be considered in the same way as any trust and categorised accordingly.

Shares held in trust under an employee equity incentive arrangement may be a Financial Account and therefore subject to reporting by the Financial Institution that maintains the account. Such trusts should be considered in the same way as any trust and categorised accordingly.

Where an Employee Benefit Trust holds shares for the future benefit of employees, but the shares are not allocated to a named or identified employee, then under most circumstances this right to a future allocation would not fall to be either a Custodial Account or an Equity Interest.

An unallocated right does not constitute a Financial Account. EBTs will have reporting obligations, but only when they have Reportable Accounts. In most cases

this will be where the EBT holds assets (of whatever type) either in the name of the employee, or for the benefit of an identified employee.

In cases such as Employee Benefit Trusts, or other similar structures which do NOT maintain financial accounts, when shares are allocated and the trustee is directed as soon as reasonably possible to transfer the assets (to the beneficiary, broker, custodian etc), the Trust will not be treated as maintaining a Financial Account for the duration of time it takes to complete the transfer.

In circumstances where reporting is required and this is carried out by a non-CD administrator or company, for an EBT resident in the [CD], the information would be required to be reported to the Comptroller/Director/Assessor, albeit by a non-CD administrator on behalf of the trust.

Notwithstanding this, provided that reporting does take place to the Comptroller/Director/Assessor on behalf the [CD] FIs it is agreed that these EBTs (although not technically a domestically sponsored FI as per the UK Agreement) are fully compliant with their obligations where the reporting is undertaken through a third party provider.

12.9 Equity or Debt Interests regularly traded on an established securities market – UK Agreement

Equity or Debt Interests of an Investment Entity that meet the test of being "regularly traded" on an "established securities market" are not Financial Accounts for the purposes of the Agreements.

The IGA defines what is meant by "regularly traded" and "an established securities market" and introduces a series of tests in order to then meet these definitions, as follows (for the avoidance of doubt, both tests must be met):

<u>Test 1</u>
Equity or Debt Interests are "regularly traded" if they are listed or quoted and/or available for trading on an established securities market. There is no need to check annually whether any transactions have been undertaken.

<u>Test 2</u>
An "established securities market" means an exchange that is officially recognized and supervised by a governmental authority in which the market is located;

<u>Specific guidance regarding Test 2</u>
An exchange that is "officially recognized and supervised by a governmental authority in which the market is located" can be considered to take its meaning from the definition of recognised stock exchange in the Companies (Recognised Stock Exchanges) Regulations, 2009, for the avoidance of doubt this includes the Channel Islands Securities Exchange (CISE) and any regulated market as defined by the Markets in Financial Instruments Directive 2004/39/EC (MiFID).

An Equity or Debt Interest that meets both of the tests above will not be a Financial Account.

Restrictions applying to regularly traded on an established securities market
To prevent the risk that an entity could circumvent the appropriate IGA reporting by seeking a listing where there is no intention of the investment vehicle being widely available the [CD] Competent Authority will in all cases treat as Financial Accounts those equity or debt interests established with a purpose of avoiding reporting in accordance with the Agreement - including interests that nevertheless meet the underlying criteria for regularly traded on an established securities market.
Where there is an attempt to set up a particular interest or class of interest to avoid reporting under the Agreement then all debt and equity interests will become reportable. This also should achieve the objectives of not requiring major financial institutions to report on their interests but targets reporting at where it will be of most relevance.

In assessing whether a class of interest has been set up to avoid reporting the [CD] Competent Authority will consider a number of factors, such as, for example:

- *whether the Investment Entity is subject to regulation in the [CD],*
- *whether the investor has any right to redeem their holding at net asset value,*
- *the degree to which the assets held in the underlying portfolio are exposed to investment or trading risk and whether the product is publically advertised through the issuance of a prospectus.*

Please note the above is not an exhaustive list and where appropriate the [CD] Competent Authorities will consider each case on its particular circumstances.

12.10 Debt or Equity Interests regularly traded on an established securities market – US Agreement

Equity or Debt Interests of an Investment Entity that are "regularly traded" on an "established securities market" are not Financial Accounts for the purposes of the Agreements. The IGA defines what is meant by "regularly traded" and "an established securities market" and introduces a series of tests in order to then meet these definitions, as follows (for the avoidance of doubt, all tests must be met):

Test 1
Subject to the note below on Holders that are registered on the books after 30 June 2014, Equity or Debt Interests are "regularly traded" if there is a meaningful volume of trading with respect to the interests on an ongoing basis.

Applying these tests
In regards to the equity or debt interest itself, whether there is a "meaningful volume of trading" will be a question of fact and degree, and may be interpreted as being interests which are "available for trading and actively marketed for trading". It may be considered, for instance, that where interests are traded on an established securities market and relate to a "widely held company", there can be a presumption that a meaningful volume of trading has occurred, unless this presumption is rebutted by evidence to the contrary.

A company may be viewed to be 'widely held' in this context if there are 25 or more unconnected shareholders, and no majority (greater than 50%) interest in the company is ultimately held by five or fewer persons and persons connected with them.

Holders that are registered on the books after 30 June 2014
An interest is not "regularly traded" if the holder of the interest (other than a Financial Institution acting as an intermediary) is registered on the books of such Financial Institution. This exclusion does not apply to interests registered on the books of the Financial Institution prior to 1 July 2014 and, with respect to interests so registered on or after 1 July 2014, a Financial Institution is not required to apply this exclusion prior to 1 January 2016.

Test 2
Test 2 comprises of two further test (a) and (b), both of which must be satisfied. An "established securities market" means an exchange:
(a) that is officially recognized and supervised by a governmental authority in which the market is located; and
(b) that has a meaningful annual value of shares traded on that exchange.

Specific guidance regarding Test 2(a)
An exchange that is "officially recognized and supervised by a governmental authority in which the market is located" can be considered to include those exchanges recognised by the Registrar of Companies in The Companies (Recognised Stock Exchanges) Regulations, 2009 for the avoidance of doubt this includes the Channel Islands Securities Exchange and any regulated market as defined by the Market in Financial Instruments Directive 2004/39/EC (MiFID).

Specific guidance regarding Test 2(b)
A "meaningful annual value of shares traded on that exchange" will be determined on a case by case basis and in most instances it is expected that meeting the requirement will be self-evident.

An Equity or Debt Interest that meets all of the tests above will not be a Financial Account.

In view of the requirement to satisfy all of the above tests it is anticipated that, currently, the Channel Islands Securities Exchange will not be considered to be an established securities market for the purposes of the US Agreement.

For example, applying 12.9 and 12.10 to a [CD] fund which is listed on the London Stock Exchange, in respect of which there is meaningful trading:-

- For the purposes of the UK agreement (see section 12.9), because the interest is listed on an established securities market, the "regularly traded" exemption should apply and no interests in the fund should be treated as financial accounts.

- For the purposes of the US agreement :-

- Where the holder of the interest is a Financial Institution acting as intermediary (e.g. a nominee or other platform), then the "regularly traded" exemption should apply and the fund should not need to report on this financial account. The Financial Institution acting as intermediary may need to report on the ultimate beneficial owner under its own FATCA obligations.

- Where the holder of the interest is an individual investing directly into the fund in their own name, or an entity other than a financial institution, then for accounts registered prior to 1 July 2014 the "regularly traded" exemption should apply and the fund should not need to report on this financial account.

- Where the holder of the interest is an individual investing directly into the fund in their own name, or an entity other than a financial institution, then for accounts registered on or after 1 July 2014, the "regularly traded" exemption does not apply and the fund will need to comply with the US Agreement obligations in respect of these financial accounts. However, they will not be treated as financial accounts until the 2016 period, and therefore reporting will not be required until 30 June 2017 (in respect of the 2016 period). There will however be an obligation for the fund to obtain the requisite information in respect of these new interests, in accordance with sections [16] and [18] of these guidance notes. Such information will need to be obtained for these interests on or after 1 July 2014, even though they will not be treated as financial accounts until the 2016 period.

19.6. Format of reporting

US Agreement

The format in which reporting will be required, for the purposes of the IGA between the United States of America and Guernsey is the US FATCA XML schema published by the IRS (currently version 1.1). The method by which Financial Institutions will be required to submit the reports is via bespoke software known as the Information Gateway Online Reporter ("IGOR"). The format to be used will be mandatory and returns in any other format will not be accepted by IGOR , as the IGOR software will validate data uploaded into it against the US FATCA XML schema and any failures in that validation process will be automatically reported to the Financial Institution, which may prohibit the Financial Institution from being able to submit the report until the data is in accordance with the schema. This could, therefore, result in the information not being submitted to the other authority. Further information relating to IGOR, together with any updates, will be published on the Intergovernmental Agreements sections of the States of Guernsey Taxation website.

The US FATCA XML schema, together with a user guide for this, can be found on the IRS website at the following address:

http://www.irs.gov/Businesses/Corporations/The-Intergovernmental-FATCA-XML-Schema-version1-1

UK Agreement

The format in which reporting will be required, for the purposes of the IGA between the United Kingdom is still to be finalised. The method by which Financial Institutions will be required to submit the reports is via IGOR. The format to be used, once finalised, will be mandatory and returns in any other format will not be accepted by IGOR, as the IGOR software will validate data uploaded and any failures in that validation process will be automatically reported to the Financial Institution, which may prohibit the Financial Institution from being able to submit the report until the data is in accordance with the schema. This could, therefore, result in the information not being submitted to the other authority. Further information relating to IGOR, together with any updates, will be published on the Intergovernmental Agreements sections of the States of Guernsey Taxation website.

CRS

The format in which reporting will be required, for the purposes of the CRS is still to be finalised. The method by which Financial Institutions will be required to submit the reports is via IGOR. The format to be used will be published at a later date but will be mandatory and returns in any other format will not be accepted by IGOR, as the IGOR software will validate data uploaded and any failures in that validation process will be automatically reported to the Financial Institution, which may prohibit the Financial Institution from being able to submit the report until the data is in accordance with the schema. This could, therefore, result in the information not being submitted to the other authority. Further information relating to IGOR, together with any updates, will be published on the Intergovernmental Agreements sections of the States of Guernsey Taxation website.

21 November 2014