

EU Code of Conduct Minimum Substance and Direction Requirements for Holding Companies and Funds.

Guernsey and Jersey have both carried out consultations on proposals to introduce substance and direction requirements for tax resident companies. The Isle of Man has announced that it has been working with Jersey and Guernsey to develop these proposals.

The proposals are in response to concerns from the EU's Code of Conduct Group on Business Taxation (the "Group") which reviewed the tax policies of a large number of non EU jurisdictions in 2017. While the UK Crown Dependencies of Jersey, Guernsey and the Isle of Man were considered fully or largely compliant with most of the good governance criteria of the Group, there were some concerns raised that there was no minimum substance requirement for companies resident in these jurisdictions.

A key feature of the proposals is that companies carrying out "relevant activities" which appears to mean banking, insurance, fund management, financing and leasing, headquarters activities, shipping, or holding company activities, must demonstrate that the relevant company satisfy an economic substance test which means that its activities are directed and managed in the relevant Crown Dependency in which it is tax resident as follows:

- There must be meetings of the Board of Directors in the relevant Crown Dependency at adequate frequencies given the level of decision making required.
- During these meetings, there must be a quorum of the Board of Directors physically present in the relevant Crown Dependency.
- Strategic decisions of the company must be made at meetings of the Board of Directors and the minutes must reflect those decisions.
- All company records and minutes must be kept in the relevant Crown Dependency.
- The Board of Directors, as a whole, must have the necessary knowledge and expertise to discharge its duties as a board.

In addition, the company will need to ensure that its "core income generating activities" are undertaken in the relevant jurisdiction. These core income generating activities are expected to be set out in legislation and will depend on the sector in which the company operates. The consultations provide examples of core income generating activities which must take place in the jurisdiction, including the following for holding companies and fund management companies, which Zedra are most likely to administer, respectively:

- Holding Company Activities - companies which purely hold equities will need to ensure that they meet all applicable corporate law and tax filing requirements. Where holding companies also conduct other "relevant activities" they will additionally be subject to the requirements associated with that activity.
- Fund Management activities include taking decisions on the holding and selling of investments, calculating risks and reserves, taking decisions on currency, interest fluctuations and/or hedging positions, preparing relevant regulatory and/or other reports for government authorities and investors.

In the context of fund management, it remains to be seen how the core income generating activities definition will apply in situations where portfolio management is delegated to an entity operating in another jurisdiction and only the risk management and supervision of the portfolio management activities remain with the fund manager in the relevant Crown Dependency.

Companies carrying on relevant activities will also be required to demonstrate that there is:

- An adequate level of (qualified) employees, or expenditure on outsourcing to service companies providing such staff in the relevant Crown Dependency proportionate to the activities of the company;
- An adequate level of annual expenditure, including the cost of outsourcing to service companies in the relevant Crown Dependency, proportionate to the activities of the company; and
- Adequate physical offices and/or premises, or an appropriate level of expenditure on outsourcing to service companies providing such facilities in the relevant Crown Dependency, in respect of the activities of the company.

It is acknowledged that collective investment vehicles (which are not defined) should have reduced substance requirements which are aligned with the local regulatory framework.

In practice, promoters and their administrators will need to review the activities carried on by each tax resident company carrying out a relevant activity. The proposed substance requirements do not appear to be particularly onerous, but a key area to note will be how rigidly the core income generating activities are defined. It is hoped that they will be sufficiently flexible to cater for differences in the commercial and regulatory models adopted by Crown Dependency companies, for example, as highlighted above, to allow a fund manager to delegate portfolio management, outside a jurisdiction.

The Crown Dependencies have been proactive in their response to the publication of the EU's Code of Conduct. However, the Code is likely to be incorporated into the tax policies of over 90 other jurisdictions reviewed by the Group As part of their review. These jurisdictions will also need to review their own tax resident companies who carry on relevant activities to bring them into line with the requirements of the Group and generally accepted practice.

The EU's Code of Conduct on Substance and Direction regulations are expected to come into force on the 1st January 2019 and tax returns will need to be filed for certain tax resident companies in the relevant Crown Dependency in respect of the 2019 tax year.

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