



## Guernsey's new substance requirements – application to the insurance industry

Service area / [Insurance](#)

Location / [Guernsey](#)

Date / [November 2019](#)

### Background

Like other offshore jurisdictions, Guernsey has implemented legislative economic substance requirements, which came into force on 1 January 2019, to meet a commitment to address concerns raised by the EU Code of Conduct Group on Business Taxation that Guernsey's corporate tax system could facilitate offshore structures aimed at attracting profits that do not reflect real economic substance.

Our earlier briefing on [the substance requirements as set out in Guernsey's 2019 Budget](#) includes a detailed background on the rules.

The legislation for Guernsey's substance requirements is contained in The Income Tax (Substance Requirements) (Implementation) Regulations, 2018, as amended (the Regulations), and guidance on the key aspects of the economic substance requirements was updated on 21 December 2018.

On 12 March 2019, the EU Council confirmed that Guernsey had met its commitment to introduce economic substance requirements and therefore did not place Guernsey on the 'blacklist' of non-cooperative jurisdictions.

The States of Guernsey Revenue Service (the Revenue Service) has worked with the tax authorities of Jersey and the Isle of Man to produce comprehensive guidance notes, the first iteration of which was issued on 26 April 2019. This guidance continues to be developed and was updated in relation to insurance in November. Further [amendments to Guernsey's economic substance legislation](#) were made with effect from 1 August 2019.

This briefing note focuses on the application of the substance requirements to the insurance industry and takes into account the latest developments in guidance and legislation.

### What is in scope?

A Guernsey tax resident company (Resident Company) is subject to substance requirements where and to the extent that it carries on insurance business within the meaning of the Insurance Business (Bailiwick of Guernsey) Law, 2002 as a licensed insurer. This would include companies that undertake insurance business in both life and non-life sectors, as well as reinsurance. Insurance brokers, intermediaries and managers, which provide insurance-related services but are not insurers themselves, fall outside this category of in scope companies.

A company that is not resident for tax purposes in Guernsey is not subject to substance requirements, even if it is incorporated in Guernsey. However, in order for a Guernsey incorporated company to cease to be Guernsey tax resident, it must meet certain criteria and make a specific application to Guernsey Revenue Service to that effect.

A number of Guernsey licensed insurers are Guernsey registered companies but are tax resident in the UK. In consequence, many of those companies' management activities take place in the UK. This would make it impossible for them to comply with Guernsey substance requirements. Therefore, such companies must make an application to the Revenue Service in order to cease being Guernsey tax resident from 1 January 2019 and thereby avoid being subject to (and in breach of) applicable Guernsey substance requirements.

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A Resident Company is exempt from the requirements for a particular accounting period where in that period it derives no income from the activities that would otherwise cause it to be subject to the substance requirements.

## In-Scope Companies

In order for a Guernsey tax resident licensed insurance company (In-Scope Company) to comply with the substance requirements it must:

- be directed and managed in Guernsey;
- carry on applicable core income generating activity (CIGA) in Guernsey;
- have an adequate level of appropriately qualified employees in Guernsey (whether or not employed by the In-Scope Company or another entity and whether on temporary or long-term contracts) proportionate to the level of activity carried on in Guernsey;
- have an adequate level of expenditure in Guernsey that is proportionate to the level of that activity carried on in Guernsey; and
- have an adequate physical presence (including offices and/or premises) in Guernsey proportionate to the level of that activity carried on in Guernsey.

## Directed and managed in Guernsey

To meet this requirement, board meetings of the In-Scope Company must be held in Guernsey with adequate frequency (having regard to the level of decision-making required of the board) during which there must be a quorum of directors physically present in Guernsey. Strategic decisions of the In-Scope Company must be set at these board meetings and the minutes must record those decisions. The board, as a whole, must have the necessary knowledge and expertise to discharge their duties as a board and all minutes and company records must be kept in Guernsey.

This does not mean that every board meeting must occur in Guernsey, but that an adequate number of meetings will need to occur in Guernsey. What is “adequate” will depend on the relevant facts and circumstances.

The Guernsey substance requirements operate independently of the tax and regulatory laws of other countries. If an In-Scope Company does have a board meeting outside of Guernsey whilst remaining compliant with Guernsey substance requirements it must still take care that it does not become subject to tax or breach regulatory requirements in the jurisdiction in which the meeting takes place.

## CIGAs

The possible CIGAs for companies that are subject to substance requirements are aligned to international standards identified by the OECD’s Forum on Harmful Tax Practices. Back office functions, such as IT support, do not comprise CIGAs. An In-Scope Company does not need to be carrying out all CIGAs that are listed in the Regulations but must comply with substance requirements in relation to the CIGAs that it undertakes.

For insurance, the CIGAs are<sup>1</sup>:

- predicting and calculating risk. This includes oversight of the determination of the quantification and likelihood of the insured event and the likely costs and ensuring that the premiums charged are commensurate with the risks accepted;
- insuring or re-insuring against risk. This includes insuring policy holders against specific risks and providing reinsurance to insurers insuring policy holders against risks;
- providing client services. This includes taking strategic decisions regarding the commissioning of client services relevant to insurance and ensuring oversight of systems and processes put in place for the provision of support services.

Where CIGAs are conducted at a board meeting or by a committee of the board, a majority of the persons involved in making the decision must be physically present in Guernsey when making the decision. This may be more than the quorum and is an additional requirement to the directed and managed requirement that the quorum be physically present in Guernsey. However, isolated decisions may occasionally be taken outside the Island provided that the bulk of the substantive decision-making occurs in Guernsey.

## Outsourcing

The outsourcing of relevant activities must be considered carefully under the new regime and Carey Olsen has advised a number of clients on this aspect in particular. Our experience to date indicates that the current business models of Guernsey licensed insurers, including those that deploy outsourcing, are capable of achieving compliance with the economic substance requirements.

## Adequate physical presence, level of appropriately qualified employees and proportionate expenditure in Guernsey

Whether these adequacy requirements are met will be a question of fact and degree, taking into account the activities of the In-Scope Company. Where an In-Scope Company relies on a Guernsey-based insurance manager to meet these requirements the resources of that manager will be taken into account and there can be no double counting of personnel.

## Written resolutions

Except in the case of a company which has a sole director, written resolutions are best avoided. Written resolutions of the board or a committee do not count towards satisfying the directed and managed requirement although CIGA decisions can be passed by this method. However, written resolutions also increase the risk of a company inadvertently taking a decision outside of Guernsey. A written resolution is passed when signed by all of the directors. Since this includes resolutions approved by electronic signature a written resolution can be passed by email. A written resolution is deemed to have been passed in the place where the majority of directors were present at the time they assented to it. If the majority of the directors are in the UK at the time they assent to

<sup>1</sup> Regulation 7(b) of the Substance Regulations and paragraph 4.5.1 of the Guidance.

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a resolution, that decision will have been taken in the UK. Not only could this be in breach of Guernsey substance requirements it may also give rise to regulatory and tax issues in the UK.

In the case of a company with a sole director, decisions by the board cannot be taken in a meeting. Instead, they are evidenced by written resolutions. These must be passed by the sole director whilst physically present in Guernsey in order to count towards substance requirements. Where the sole director is a corporate entity, its functions will be deemed to be exercised by the individual officers acting on its behalf.

## Compliance and monitoring

### Tax returns

The corporate income tax return will be enhanced for accounting periods beginning on or after 1 January 2019. Resident Companies subject to substance requirements will need to include in their corporate income tax returns details of their business activities, amount and type of gross income, expenses and assets, premises and number of employees (specifying the number of full time (equivalent) employees), details of the CIGAs conducted, details of any outsourced CIGAs and financial statements. This will allow the Revenue Service to monitor compliance with the regime. The information provided in the return is expected to be monitored on a risk (of profit shifting) basis as well as by random selection of Resident Companies for audit each year in line with the existing practice for the monitoring of domestic tax compliance.

### Information powers

The Regulations give the Director of the Revenue Service various powers to enable further enquiries into a Resident Company, including a right of entry onto business premises and a right to inspect documents. However, these are subject to certain provisos such as obtaining the occupier's consent, giving at least one week's notice and obtaining the prior approval of the Bailiff to the entry and inspection.

The Director of the Revenue Service cannot exercise these powers to inspect documents that are subject to legal professional privilege.

### Sanctions

Various sanctions apply for non-compliance with substance requirements, and these include:

- financial penalties which increase depending on the number of consecutive accounting periods the Resident Company is in default. These range from up to £10,000 for the first accounting period of default to up to £100,000 for the fourth consecutive accounting period of default;
- audit for continued non-compliance;
- spontaneous exchange of information by the Revenue Service regarding the Resident Company with any jurisdiction where the immediate parent entity, ultimate parent entity or the ultimate beneficial owners are tax resident, provided that Guernsey and that jurisdiction have an appropriate information exchange arrangement in place; and

- (where applicable) strike off from the Guernsey corporate register, which can occur from the first accounting period of default if the Director of the Revenue Service decides that there is no realistic possibility of the Resident Company complying with applicable substance requirements.

Penalties for failure to supply information or for providing false information can also apply and there are criminal penalties for providing false statements or false documents. Companies may appeal penalties levied by the Director of the Revenue Service provided certain grounds are met.

## Anti-avoidance

The Regulations contain a broad anti-avoidance rule which can disregard any transaction, or series of transactions entered into with the main purpose of avoiding any obligation or liability under the substance rules. "Transaction" is broadly defined and captures any arrangement, omission and decision, whether or not legally enforceable.

## Practical steps

Guernsey insurers and their managers should consider taking the following steps to ascertain whether they or their clients are compliant with the substance rules:

- check the tax residence status of the company – a company incorporated in Guernsey may qualify for treatment as a non-Guernsey resident. Equally, a non-Guernsey incorporated company may be a Resident Company if it is centrally managed and controlled in Guernsey;
- carry out a detailed review of the company's activities to ascertain whether it is an In-Scope Company;
- maintain records of the applicable CIGAs and the income and profits allocated to those CIGAs;
- where the company is an In-Scope Company, ensure that sufficient board meetings are held in Guernsey and that detailed minutes of all board meetings are maintained;
- consider maintaining a substance register which summarises key facts about each board meeting, including who attended, when they were physically present, details of CIGAs conducted, etc.;
- In-Scope Companies should analyse the terms of all their outsourcing arrangements to ensure that the parameters of the outsourced activity are appropriately drafted and the activity is properly overseen from Guernsey and that sufficient CIGA is carried on in Guernsey; and
- insurance managers should review their staff structure, internal systems, records, staff time sheets and outsourced activities to ensure that they have the on-island resources and systems to allow their clients to comply and demonstrate compliance with substance requirements and prepare for tax return disclosures.



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