

Guernsey Economic Substance extended to certain partnerships as from 1 July 2021

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In a further amendment to the economic substance regulations, The Income Tax (Substance Requirements) (Implementation) Regulations, 2021 were made by the Policy and Resources Committee of the States of Guernsey on 15 June 2021 (the **Regulations**), and came in to force on 30 June 2021. The Regulations update and consolidate the previous amendments to the original economic substance regulations made in 2018.

The headline amendment made to the Guernsey economic substance regime is that the Regulations will apply to certain newly formed Guernsey partnerships as from 1 July 2021 and to many other Guernsey partnerships existing on 30 June 2021 as from 1 January 2022.

Which types of partnerships are in scope of the Regulations?

As with companies, the Regulations do not apply to collective investment vehicles structured as partnerships, unless they are self-managed.

With the further exceptions of **wholly domestic** partnerships and partnerships all of whose partners are subject to income tax under the Income Tax (Guernsey) Law, 1975 which are out of scope of the Regulations, a partnership is in scope if it is:

1. a partnership which is not a limited partnership or a limited liability partnership which carries on business activity in Guernsey (a **general partnership**);
2. a limited partnership registered under the Limited Partnerships (Guernsey) Law, 1995, unless its place of effective management is in **qualifying jurisdiction** (a **limited partnership**);
3. a limited liability partnership registered under the Limited Liability Partnerships (Guernsey) Law, 2013, unless its place of effective management is in a qualifying jurisdiction (a **limited liability partnership**); and
4. a general partnership, limited partnership or limited liability partnership or a corresponding person, entity or arrangement which is registered formed or entered into outside Guernsey and which has its place of effective management in Guernsey and carries on business activity in Guernsey (a **foreign partnership**).

Wholly domestic means that a partnership substantially carries on its activities within Guernsey and is not a part of an intra-group collection of persons, any other member of which is either (i) tax resident in a different jurisdiction or (ii) resident for tax purposes in one jurisdiction and subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction.

Qualifying jurisdiction means a jurisdiction other than Guernsey in respect of which either (i) the partnership is subject to the application of substance requirements under the law of that jurisdiction that are substantially the same as the substance requirements of Guernsey; or (ii) the highest rate of tax on the income of any person in that jurisdiction is at least 10%.

In scope partnerships must comply with the Regulations in the same way as in scope companies.

What are the economic substance requirements if a partnership is in scope?

Affected partnerships that carry on **relevant activities** (being banking, insurance, fund management including self-managed funds, financing and leasing, headquartering, shipping or acting as a distribution and service centre) or derive income from holding intellectual property assets or being a pure equity holding vehicle will each need to comply with the applicable substance requirements unless, in the applicable accounting period, it has no income from such business or activity.

When assessing the business and activities of the partnership for the purposes of assessing whether the substance requirements apply, the tax authority will look at the business and activities of the partnership as a whole and not those

of the individual partners as such (although these may be taken into account for determining the business activities of the partnership as a whole). In addition, the individual partners will not be required to comply with the requirements of the Regulation in respect of any income received from a partnership carrying on relevant business.

As for companies, partnerships carrying on relevant activities must comply with the following economic substance requirements:

1. the relevant activity must be **directed and managed in Guernsey**;
2. core income generating activity (**CIGA**) relating to the relevant activity must be carried on in Guernsey;
3. there is an adequate level of appropriately qualified employees in Guernsey;
4. there is an adequate level of operating expenditure in Guernsey; and
5. there is an adequate physical presence in Guernsey.

The principle change to the Regulations to accommodate partnerships is in relation to what constitutes the "board" for the purposes of the managed and directed test. The Regulations provide that the relevant management committee or other similar governing body constitutes the **governing board** for the purposes of the relevant requirements.

As such, by way of clarification of what this means for partnerships, **directed and managed in Guernsey** means that the governing board meets in Guernsey with adequate frequency and that, during those meetings, a quorum of the members of the governing board are physically present in Guernsey, strategic decisions of the partnership are made which are suitably recorded in the minutes of that meeting and the minutes and records of the partnership are kept in Guernsey. As with company boards, the governing board, as a whole, must have the necessary knowledge and expertise to make strategic decisions for the partnership.

The substance requirements relating to partnerships deriving income from IP assets or from being a pure equity holding vehicle are similarly identical to those relating to companies, save for the clarification of what constitutes the governing board for partnerships for the purposes of the directed and managed test in the case of a partnership deriving income from holding IP assets.

What are the reporting requirements and potential sanctions for in-scope partnerships?

Partnerships that are in scope of the Regulations, whether or not they earn income from a relevant activity or from holding IP Assets or being a pure equity holding vehicle for the relevant accounting period, will be required to submit a return to the Director of Revenue Services indicating whether or not the economic substance requirements applied to them during the relevant period and, if they did apply, report on how they complied with the economic substance requirements during the relevant period.

Failure to comply with the reporting required and/or the economic substance requirements for any relevant period causes the partnership to be liable to fines rising from £10,000 for the first year, £50,000 for the third year and £100,000 for the fourth year, the spontaneous exchange of information by the Director of Revenue Services to relevant competent authorities and, ultimately, where it is a registered partnership, being struck off the relevant register. Where the partnership is not a registered entity, the fine for the fourth year of failure to comply is increased to £150,000 and is levied annually thereafter while the partnership continues to be in breach.

Summary

The application of the Regulations to partnerships is more nuanced than for companies. While many partnerships, by their nature, will either fall out of scope of the Regulations altogether or will not be carrying on activities that require them to comply with the economic substance requirements, most will need to undertake a legal analysis of their structure and activities to ensure that they are either out of scope or that they comply with the Regulations.

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