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Delegations will find attached the declassified version of the above document.

The text of this document is identical to the previous version.

Council of the
European Union

**Brussels, 24 January 2019**
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**NOTE**

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| From: | Commission Services |
| To: | Code of Conduct Group (Business Taxation) |
| Subject: | The EU list of non-cooperative jurisdictions for tax purposes<br>– Progress Report - Crown Dependencies |

Delegations will find attached a document by the Commission services.

**ANNEX**

**PROGRESS REPORT CROWN DEPENDECIES (JERSEY, GUERNSEY AND THE ISLE OF MAN)**

**Code of conduct subgroup – 25 January 2018**

## Background

The Code of Conduct Group (the COCG) found that the Crown Dependencies (the "CDs") tax system failed to meet listing criterion 2.2 due to a lack of substance requirements. Following their commitment to remedy the deficiencies identified, the CDs were put on Annex II in December 2017.

This report assesses the overall implementation of the commitments undertaken by the CDs.

The dialogue with the CDs was constant and constructive with several conference calls and meetings. The Commission Services reported regularly to Member States on the progress of the discussion with the CDs. The CDs shared several version of their draft legislation and sought feedback from the COCG.

## Assessment of the CDs implementation of commitment under criterion 2.2

This assessment is based on the Terms of Reference (the "TOR") agreed by the Code of Conduct Group in July 2017 which is the basis for the decision taken by Member States on the compliance of jurisdictions under criterion 2.2, as further clarified in the Scoping Paper (the "2.2 SP") agreed in June 2018.

For Jersey, the Taxation (Companies – Economic Substance) (Jersey) Law 201- was adopted on 6 December 2018.

For Guernsey, the Income Tax (Substance requirements) (Guernsey) (Amendment) Ordinance, 2018 was adopted on 28 November 2018. The Income Tax (Substance requirements) (Implementation) Regulations, 2018 was adopted on 13 December 2018. A further amendment was made on 19 December 2018.

For the Isle of Man, the Income Tax (Substance requirements) Order 2018 was passed on 11 December 2018.

On 21 December 2018, all three CDs have published a common guidance on key aspects in relation to proposed economic substance requirements.

The following assessment highlights the remaining issues identified and still pending following the last progress reports presented to the COCG.

## 1 – Identification of the relevant included entities

The substance requirements are applied in the CDs to corporate taxpayers. As explained in a note from the CDs that was previously circulated to Member States, partnerships are fully transparent in those jurisdictions and therefore were not included, the profits being directly taxed in the hands of the partners.

The Commission services asked to the CDs to further clarify the treatment of partnerships in each jurisdiction.

### 1.1 – The Isle of Man

The Isle of Man partnership laws support two types of partnership:

- General Partnerships: does not have a separate legal personality and therefore cannot own assets or enter into legal arrangements in its own right. Any assets are held jointly by the partners and they are mainly used domestically by individuals undertaking local trading activity.

- Limited Partnerships Limited partnership may elect to have a legal personality. In such case, the partnership has the ability to own assets in its own right but remains tax transparent. Of the 217 limited partnerships currently on the Isle of Man Register, only 57 have elected to have separate legal personality.

- In addition, the Isle of Man law also provides for the formation of Limited Liability Companies (LLCs) which are treated in all respects as partnerships. A LLC is not legally a partnership, but it is treated as a partnership for income tax purposes. It has legal personality and can own assets in its own right but is transparent for tax purposes. There are currently 132 LLCs on the Isle of Man Register.

The Isle of Man confirmed that partnerships and LLCs are tax transparent. All profits of the partnership/LLC are attributable to, and therefore taxable in the hands of the partners/members. This applies regardless of whether the partnership has a separate legal personality.

If a company is a partner in both types of partnership or an LLC, it is in all cases required to register with the Isle of Man income tax administration. Any partner/member that is a tax resident company and is in receipt of income from a relevant sector, in the form of a share of profit from a partnership or LLC undertaking business in that relevant sector, will be subject to the Isle of Man substance requirements under Part 6A of the Income Tax Act 1970.

**1.2 – <u>Guernsey</u>**

There are three types of Partnership in Guernsey law:

- General Partnerships are primarily formed for the purposes of providing services within the jurisdiction in respect of various areas of activity such as medical professionals or legal services. An Ordinary Partnership does not have separate legal personality and therefore cannot own assets in its own right. A partner within an Ordinary Partnership may be a body corporate; however, all persons carrying on business in Guernsey by way of an Ordinary Partnership are required to register with the Revenue Service. The Revenue Service has reviewed its records and as at the end of 2017, there were no corporate partners of an Ordinary Partnership.

- Limited Partnerships are primarily used as collective investment vehicles and, to a lesser extent, are also engaged in local trading activities. All LPs must be registered. An LP must have one or more general partners, who are jointly and severally liable for all debts of the partnership without limitation. It must also have one or more limited partners, whose liability for the debts of the partnership is limited to the amount contributed, or agreed to be contributed to its capital. Only a general partner can participate in the conduct or management of the LP and only general partners can bind the partnership. All LPs must have a registered office in Guernsey and submit annual valuation returns confirming various particulars, including its registered office, its principal place of business, the nature and purpose of its business and details of General Partners. LPs can have legal personality if, at the time of registration, the general partners so elect. An election to have legal personality is irrevocable. LPs with legal personality can therefore own assets in their own name. For the avoidance of doubt, LPs without legal personality cannot own assets in their own name.

- Limited Liability Partnerships must be registered. A LLP may be formed in Guernsey for the carrying on within Guernsey or elsewhere of any lawful business with a view to profit, or any other lawful activity. An LLP must have two or more members who are admitted to the LLP in accordance with the members' agreement. An LLP has legal personality separate from that of its members, as such LLPs are able to own assets in their own name. A natural person or a body corporate may be a member of an LLP. Every LLP shall have a members' agreement. Unless the members' agreement provides to the contrary, a member of an LLP is not liable for any debt of the LLP, or of any other member of the LLP, by virtue solely of his/her membership of the LLP. All LLPs must have a registered office in Guernsey and submit annual valuation returns to the Registrar confirming various particulars, including its registered office, its principal place of business and the nature and purpose of its business.

All partnerships in Guernsey (whether or not they have legal personality) are treated as transparent for tax purposes.

Where the partner/member is a resident company and the business, being carried on in partnership, is an economic activity that is a relevant activity under the Economic Substance Regime these partners will have to comply with the legal substance requirements as detailed in Regulation 1 of the Income Tax (Substance Requirements) (Implementation) Regulations, 2018.

**1.3 – <u>Jersey</u>**

There are three types of partnerships in Jersey law:

- Ordinary Partnerships are not legal entities, and the term describes the common law position where two or more persons operate a trade in common. The activities of the partnership are the joint activities of the partners. Partners are jointly and severally liable in relation to the activities of the partnership. Ordinary partnerships are generally only involved in the domestic market, conducting trading activities as small, independent, often family businesses for example as farmers, retailers, restaurants, and building firms. They also involve some professions where there is a legal requirement to demonstrate that there is unambiguously an unlimited liability for their members, such as with Jersey Advocates.

- Limited Partnerships are not legal entities rather they are partnerships as above, but there is an option for some of the partners to limit their liabilities if they act within certain parameters. From the information available to the authorities these type of partnerships are generally used as Collective Investment Vehicles.

- Separate Limited Partnerships are a variation of the Limited partnership above – it has a legal personality but is not a body corporate. This allows it to hold in its name partnership property, but this property remains the partners beneficially, as undivided shares to be distributed in line with the partnership agreement, or if silent in equal share. Again from the information available to the authorities these type of partnerships are generally used as Collective Investment Vehicles.

- Incorporated Limited Partnerships are a further variation of the limited partnership above – it has a legal personality and is also a body corporate. However the Incorporated Limited Partnership itself explicitly has unlimited liability. This type of vehicle has been rarely used, to date there are only 13 Incorporate Limited Partnerships. From the information available to the authorities, it is only useful where the partnership needs to hold assets based in jurisdictions for which there may be legal complications / additional burdens if a limited or indeed separate limited partnership was used. In all terms the rights and responsibilities of partners in an Incorporated Limited Partnership match those of partners in a limited partnership. The tax treatment is the same as for a limited partnership in that these are transparent bodies and the members are subject to tax. Again from the information available to the authorities these type of partnerships are generally used as Collective Investment Vehicles.

- Limited Liability Partnerships ( LLP ) have a legal personality, and the liability of the partnership (rather than the partners ) is limited, but it is not a corporate body. This type of vehicle is designed to be used by certain professional services type firms, particularly where they have reached a size where the partners may not personally know each other. The tax treatment is that the LLP is transparent and the partners are taxable on their share of the income.

Partnerships are not, themselves, liable to tax. Our understanding is that if a partner is a corporate body and the activity is a relevant activity, it will be subject to substance requirements in Jersey.

Jersey does not at this time have Limited Liability Companies. Primary legislation has been passed but it is not in force, and there is no specific timetable for this to happen. At present Limited Liability Companies cannot be created. The Jersey Government is still considering what further regulations and allied legislative changes we would be required to make, including those to the tax legislation. If Limited Liability Companies are practically introduced, they will not provide an opportunity to conduct activities without being subject to the economic substance test, no matter the tax treatment.

*Suggested way forward*

We suggest concluding that this issue is clarified and that the risk of BEPS should be limited. However the CoCG should monitor the situation over the coming months, to determine whether all partnerships should be in the scope of substance requirements.

**2 – Imposition of substance requirements**

**2.1 – Income threshold**

We remind the Member States that, at first, the CDs wanted to introduce a general threshold of £100,000 income from a relevant sector of activity for the application of substance requirements. Some Member States stressed that this threshold was not envisaged in the Scoping Paper and that companies in the CDs might decide to split up in order to avoid the substance requirements.

The CDs have eliminated this reference. However, instead, they have excluded entities that do not derive income from a relevant activity.

The Commission services have explained to the CDs that the triggering criterion for substance requirements should be the carrying on of a relevant activity and not the recording of income from such activities.

After discussion, the CDs have modified their common guidance to clarify that there is an expectation that carrying relevant activities will result in the generation of income and if there is any indication that a company is seeking to manipulate/artificially supress their income to avoid the substance requirements action will be taken.

*Suggested way forward*

We suggest concluding that this issue is settled.

**2.2 – Tax residence**

The CDs have relied on their pre-existing definition of tax residence as a nexus for the application of substance requirements.

After the December meeting, the Commission services reported that there should be exchange of information of the information concerning entities considered as non-resident.

In a joint email dated 21 December 2018, the CDs have agreed to spontaneously exchange information concerning tax residence with the EU MS in which the company is tax resident, in order that the MS can cross check that status against its own records. The CDs also agreed to exchange the same information with the jurisdiction in which there is a legal or beneficial owner as long as there is appropriate legal basis under the provisions of Article 7 of the Convention and are exploring this point.

In this respect, the CDs propose that each MS notify them if the exchange of this information would be relevant to them, when they are the jurisdiction of residence of the legal or beneficial owner.

*Suggested way forward*

We suggest concluding that this issue is settled. Member States should notify the Crown Dependencies that, where they are the jurisdiction of residence of the legal or beneficial owner, exchange of this information would be relevant to them for the administration of their tax regime under Article 7 of the Convention.

**2.3 – Specific core-income generating activities (CIGAs) for IP assets**

After the December meeting, the Commission services reported that the CDs legislation does not link specific CIGAs to the type of IP assets concerned. This could create cases in which a company holding a patent would be compliant if it perform marketing as a CIGA. This would be counterproductive and risky in dealing with IP assets that have been particularly subject to profit shifting.

Following this discussion, the CDs have amended their common guidance with a new subsection 6.1. This subsection makes it clear that for IP assets such as patents, it is expected that the CIGA include R&D activities. For non-trade intangible assets such as brand, trademark and customer data, it is expected that the core income generating activities include marketing, branding and distribution activities.

However, the core income generating activities associated with an intangible asset will ultimately depend on the nature of the asset and will also depend on how that asset is being used to generate income for the company.

*Suggested way forward*

We suggest concluding that this issue is settled.

**2.4 – <u>CIGAs in or from within the jurisdiction</u>**

This issue arose only in relation to Jersey legislation (Article 4) that uses the wording "the company conducts Jersey core-income generating activity", meaning "from within Jersey".

We discussed this issue with Jersey that showed willingness to address the Member States concerns on this wording, despite the fact that its legislation was already adopted.

In this respect, the letter sent to the Chair of the Code of conduct Group on 21 December 2018 reiterates Jersey's commitment to changing the wording by amending their legislation to make clear that for a relevant activity carried out by an included entity, the CIGAs should be performed in Jersey.

*Suggested way forward*

We suggest concluding that this issue is settled. The amendment by Jersey of the legislation to reflect the agreed wording should be monitored.

**2.5 – <u>CIGAs to be performed</u>**

Some jurisdictions, including the CDs, had provided a draft guidance stating that it is not necessary for a relevant entity to perform all of the CIGAs listed for a particular relevant activity in order to demonstrate substance.

"*For each sector the proposed legislation provides a list of the core activities a company operating in such a sector could carry on but it is not necessary for the company to perform all of the CIGA listed in order to demonstrate substance*."

Following the December meeting, we reported that the performing of the appropriate CIGAs for the type of relevant activity carried out by the entity should be carefully considered as part of the assessment its substance in the jurisdiction.

Considering this, the CDs have modified their guidance to clarify that CIGA are the key essential and valuable activities that generate the income of the company and that it is not necessary for the company to perform all the CIGA listed in order to demonstrate substance. Consideration must however be given as to whether the appropriate CIGA are being undertaken in the Island.

*Suggested way forward*

We suggest concluding that this issue is settled

## 3 – Enforcement and sanctions

### 3.1 – Filing obligations

Following the December meeting, the Commission services reported to the CDs that information to be filed by included entities should be clarified. The CDs indicated that it would technically be difficult to produce the new tax return in time for the assessment. They however modified their common guidance to clarify that all companies will be required to provide the following details:

- Business/income types in order to identify the type of relevant activity; and
- Amount and type of gross income;
- Amount of operating expenditure;
- Details of premises;
- Number of (qualified) employees, specifying the number of full time equivalents;
- Confirmation of the CIGAs conducted for each relevant activity;
- The financial statements; and
- Confirmation of whether any CIGA have been outsourced and if so relevant details (see section 7). In this respect, section 7 provides that the company remains responsible for ensuring accurate information is reported on its return and this will include precise details of the resources employed by its service providers, for example based on the use of timesheet

*Suggested way forward*

We suggest concluding that this issue is settled

**3.2 – <u>Sanctions framework</u>**

Following the December meeting, the Commission services reported that the sanctions framework were improved but still not very dissuasive (especially in the case of Guernsey for which strike-off may only be considered after four years of non-compliance) and that the strike-off procedure remained unclear.

The CDs have shared internal guidance on the strike-off procedure showing how they intend to implement the sanctions framework (guidance attached to this report).

In our view, this additional guidance is an element showing the intention of the CDs to implement an operational progressive sanctions framework ultimately leading to the strike-off of non-compliant entities.

*Suggested way forward*

We suggest concluding that this issue is settled. The efficient enforcement of the substance legislation should be monitored in the coming years.

**<u>Conclusion</u>**

We propose to conclude that Jersey, Guernsey and the Isle of Man have implemented their commitment under criterion 2.2 and to remove them from Annex II.