

# Economic Substance Rules / where are we now?

## STEP Lunchtime Talk



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Ian Perrett, 5th October 2021

## Points to be covered

- Overview of economic substance rules
- Initial differences in implementing legislation
- Updates by jurisdiction
- What next?



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## **PART 1 - RECAP**



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### **– Overview of Economic Substance Rules**

## Which jurisdictions are involved and where are we in the process?

- Initial jurisdictions introducing legislation
  - Bahamas
  - Bermuda
  - BVI
  - Cayman Islands
  - Guernsey, Jersey & Isle of Man (Crown Dependencies)
- Subsequently
  - United Arab Emirates (UAE)
  - Marshall Islands
- Guidance issued and updated

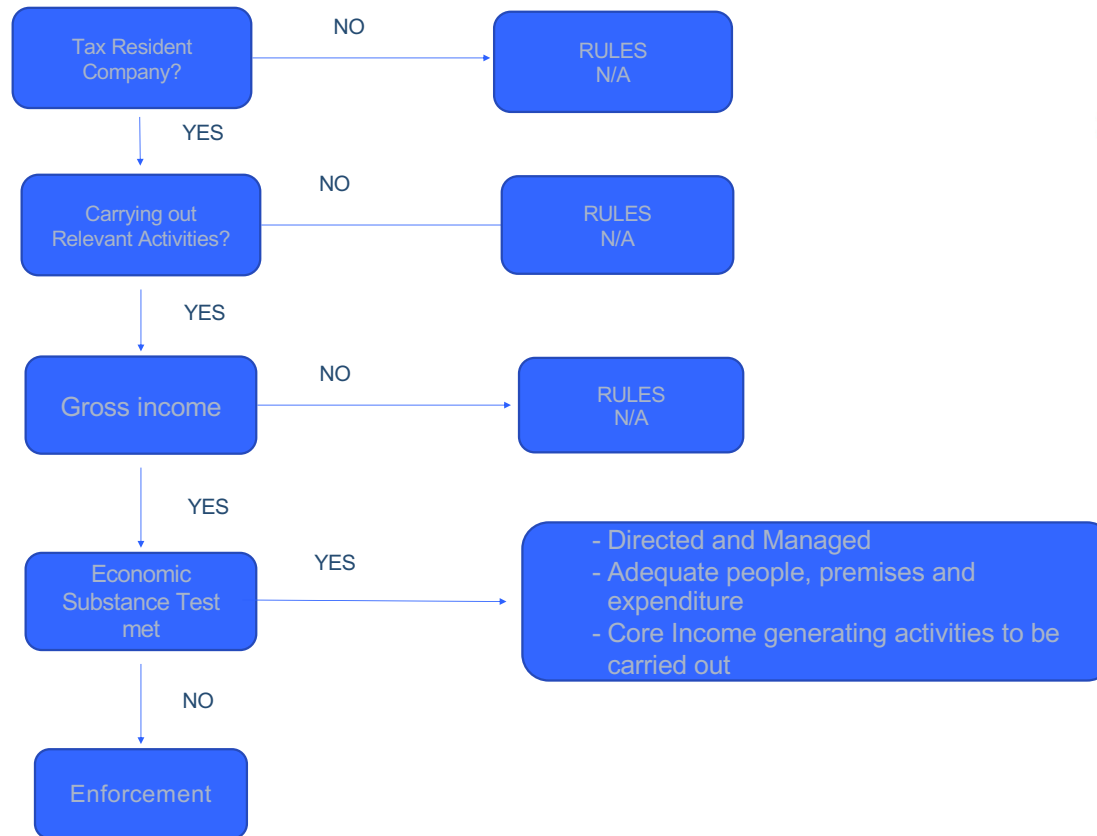


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# Overview of legislation



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## What are Relevant Activities?

- Relevant Activities are:
  - Banking
  - Insurance
  - Fund management
  - Financing / leasing
  - Headquarters
  - Shipping
  - Holding Companies
  - Intellectual property



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# Full Substance Requirements (1)

## – Direction and Management



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- Tax resident companies carrying on Relevant Activities required to demonstrate:
  - Meetings of Board of Directors in jurisdiction at adequate levels of frequency
  - During meetings quorum of Board of Directors physically present in jurisdiction
  - Strategic decisions of company set at meeting of Board of Directors and reflected in minutes
  - All company records and minutes must be kept in the jurisdictions
  - Necessary knowledge and expertise of Board of Directors

## Full Substance Requirements (2)

### – Adequate People Premises and Expenditure



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- Companies caught by the legislation must also demonstrate that there is:
  - An adequate level of qualified employees in the jurisdiction, or adequate level of expenditure on outsourcing to service companies proportionate to activities of company
  - An adequate level of annual expenditure incurred in the jurisdiction
  - Adequate physical offices and/or premises in the jurisdiction (or outsourced)



## Full Substance Requirements (3) – Core Income Generating Activities

- Company within rules must demonstrate that core income generating activities carried out in jurisdiction
  - Legislation / guidance contains examples for each Relevant Activity - broadly the essential / valuable activities that generate the income of the company
  - Not necessary for all activities to be carried out in relevant jurisdiction
  - May seek professional advice / specialist services outside jurisdiction but income must be commensurate with activity undertaken in jurisdiction



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## Enforcement – Penalties



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- Return rejected and remedial action required
- Fines – for entity and potentially for its directors and employees as well
- Striking off entity
- Report to EU Member States in which parent entity or beneficial owner is located
- Report to regulator where entity carrying on regulated activity



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## **PART 2**

### **– Initial Differences**

## Initial differences in implementing legislation (1)

- Tax residence
  - Bermuda - incorporated
  - BVI & Cayman - incorporated and resident
  - Crown Dependencies - resident



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## Initial differences in implementing legislation (2)



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- Holding company
  - Bermuda - initially difference between 'holding entity' and 'pure equity holding'
  - BVI & Cayman Islands
    - Mixed portfolio and alternative assets outside scope
    - Pure equity holding companies - reduced reporting
  - Crown Dependencies
    - Mixed portfolios and alternative assets outside scope
    - Pure equity holding companies / reduced reporting

## Initial differences in implementing legislation (3)



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- Leasing and finance
  - Bermuda - uncertainty as to whether intra/company loans in trust caught
  - BVI & Cayman Islands
    - Lending for consideration but only if main activity
    - Only if main activity
  - Crown Dependencies
    - Any lending for consideration
    - Full rules applicable



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## **PART 3**

### **– Update by Jurisdiction**

## Standard Requirements

- Harmonisation of rules
- Each jurisdiction imposes 'Standard Requirements'
  - Managed and directed
  - Core income generating activities
  - Physical presence
  - Adequate full-time employees
  - Adequate operational expenditure
  - BUT - some variations



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## Bermuda

- Updated guidance effective from July 2021
  - Holding company ‘relevant activity’ limited to pure equity holding entities
  - Financing and leasing
  - Shipping



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## BVI



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- Updated guidance effective from February 2020
  - Proof required as to residence if outside BVI
  - Requirement re 'Directed and Managed'
  - Outsourcing core income generating activities
  - Gross income

## Cayman Islands



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- Updated guidance effective from July 2021
  - Every Cayman entity must submit notification even if not a 'relevant entity'
  - Circumvention and non-compliance regime
  - Outsourcing core income generating activities

## Crown Dependencies



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- Updated guidance effective from November 2019
  - Collective investment vehicles
  - Outsourcing core income generating activities
  - COVID

## United Arab Emirates



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- Economic substance regulations introduced in 2019 and revised in 2020
  - Minimum substance requirements
  - Specific exemptions
  - Investment funds
  - Entities resident in foreign jurisdiction
  - Branches
  - UAE residents/nationals



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# **PART 4**

## **– What Next?**

## What should we be doing now (1)?

- Informing clients
- Reviewing structures (again...)
  - Identify whether companies likely to be carrying our Relevant Activities
  - Identify whether economic substance test will be met and take action if seems unlikely
- Consider whether structures can be streamlined i.e. is it necessary to have a holding company in the structure?



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## What should we be doing now (2)?

- Ensure that company has additional substance if necessary
- Continue to monitor developments in jurisdictions
- Reporting (deadlines vary by jurisdiction)
  - Specific portals
  - Via tax return



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**Any questions?**

**Thank you**



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