057489/EU XXVI. GP
Eingelangt am 12/03/19

Council of the
European Union

Brussels, 12 March 2019
(OR. en)

7223/19

FISC 156

OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Delegations
Subject:	The EU list of non-cooperative jurisdictions for tax purposes • Crown Dependencies (Guernsey, Isle of Man and Jersey): final legislation and assessment under criterion 2.2

A/ FINAL LEGISLATION:

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.

https://www.gov.gg/economicsubstance

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

https://www.gov.im/media/1363889/approved-isle-of-man-legislation-income-tax-substance-requirements-order-2018.pdf

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

https://www.gov.je/TaxesMoney/IncomeTax/Companies/Guidelines/Pages/EconomicSubstanceForCompanies.aspx

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

https://www.gov.je/SiteCollectionDocuments/Tax%20and%20your%20money/ID%20Economic%20Substance%20Key%20Aspects%2020181221.pdf

B/ FINAL ASSESSMENT:

The dialogue with the UK Crown Dependencies (Guernsey, the Isle of Man and Jersey, hereafter "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.

The following assessment only highlights the remaining issues identified and still pending at the beginning of 2019 following such feedback.

1 – Identification of the relevant included entities

The substance requirements are applied in the CDs to corporate taxpayers. Partnerships are fully transparent in those jurisdictions and therefore were not included, the profits being directly taxed in the hands of the partners.

The CDs were asked 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.

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- 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 – Guernsey

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

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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.

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Partnerships are not, themselves, liable to tax. It is understood 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.

Conclusion:

This issue is clarified and the risk of BEPS should be limited. However the COCG will 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

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 suppress their income to avoid the substance requirements action will be taken.

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Conclusion:

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.

It was 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.

Conclusion:

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

It was reported to the CDs that their 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.

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Following this, 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.

Conclusion:

This issue is settled.

2.4 – CIGAs in or from within the jurisdiction

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*".

The issue was discussed with Jersey, which 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.

Conclusion:

This issue is settled. The amendment by Jersey of the legislation to reflect the agreed wording will be monitored.

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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*."

It was 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.

<u>Conclusion:</u>

This issue is settled

3 <u>– Enforcement and sanctions</u>

3.1 – <u>Filing obligations</u>

It was 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;

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- 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

Conclusion:

This issue is settled

3.2 – Sanctions framework

It was 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). 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.

Conclusion:

This issue is settled. The efficient enforcement of the substance legislation will be monitored in the coming years.

Conclusion

Jersey, Guernsey and the Isle of Man have implemented their commitment under criterion 2.2.

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ANNEX 1: assessment of Guernsey by COCG experts in 2017

ANNEX 2: assessment of the Isle of Man by COCG experts in 2017

ANNEX 3: assessment of Jersey by COCG experts in 2017

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ASSESSMENT OF GUERNSEY BY COCG EXPERTS IN 2017

	1a	1b	2a	2b	3	4	5
GUERNSEY	X	?	X	?	V	X	X
Criterion 2.2: "The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction" In light of the assessment made under all Code criteria applied by analogy, the tax system of GUERNSEY should be considered overall harmful from a Code of Conduct point of view. The main concerns on deviations from the Code of Conduct criteria as applied by analogy relate to the lack of legal substance requirements and the de facto lack of substance.						Overall: V	

Explanation

Absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero:

In this respect, where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero", then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2 has been met.

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Relevant questions (Q 1.2)
Companies which are incorporated or controlled in GUERNSEY are subject to a corporate tax. However, the general nominal corporate tax rate, known as "Company Standard Rate", is equal to zero. 10% and 20% tax rates are only applied to income deriving from specific activities. *We therefore suggest that this jurisdiction meets the gateway test of the criterion 2.2.*

Criterion 1: "whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"
Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,) *The absence of CIT is de lege available to both residents and non-residents and does not require that the beneficiaries carry out transactions only with non-residents. We would therefore propose a cross ("X" - not harmful) for criterion 1a).* *The question whether the advantages of the absence of CIT de facto are accorded only or almost only to non-residents was not answered. GUERNSEY has indicated that 62% of entities are controlled by no-residents legal entities or individuals. This number by itself does not show that such advantage is accorded only or almost only to non-residents. However, no data were submitted concerning the share of profits recorded in Guernsey and taxed at 0% belonging to these entities.* *We would propose a cross ("X" – not harmful) for criterion 1a) and a question mark ("?") for criterion 1b).*

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Criterion 2:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

By analogy to the assessment against criterion 1a/b. We would propose a cross ("X" – not harmful) for criterion 2a) and a question mark (“?”) for criterion 2b).

Criterion 3:

“whether advantages are granted even without any real economic activity and substantial economic presence within the jurisdiction offering such tax advantages”

Relevant questions (Q 1.1, Q 1.7, Q 1.9, Q 2.4, Q 2.5, Q 2.6, Q 2.7, Q 2.8)

- Facts :

In its answer to question 2.4,

GUERNSEY highlights that incorporation of a company requires a registered office and a resident agent. Such agent can be a Corporate Service Provider. Moreover, certain types of entities, those regulated by the Guernsey Financial Commission, are required to keep a sufficient local management oversight and control of their activities.

According to GUERNSEY, local management and control is demonstrated where the balance of the board of directors is resident in Guernsey and the Guernsey element of the board is actively engaged in the governance of the business. Companies need to evidence that they will be adequately resourced, including in term of staff and/or service providers, to conduct their regular activities.

Regarding the monitoring of economic substance requirements, GUERNSEY indicated in its answer to question 2.6, GUERNSEY that the Income Tax Service has “very wide investigative powers” to investigate “into the affairs of any business or person in Guernsey where the effect of a transaction or series of transaction is the avoidance reduction or deferral of the liability of

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any person to tax under the Law".

Regarding the consequences that authorities would draw if they were to conclude that a company has no sufficient level of economic substance in the jurisdiction, GUERNSEY stated in its answer to question 2.7 that :

- *According to section 7 and 56 of the Income Tax Law, a company who would overstate in its tax returns profits from transactions with entities belonging to the same group, would be incorrect.*
- *According to section 191, a person who delivers a return of income which is incorrect shall, if he acted negligently, he shall be liable to a penalty not exceeding a sum equal to three time the difference of the amount of tax which would have been chargeable if a correct return had been made ant the amount of tax he actually paid. According to section 192, if he acted fraudulently, he shall be liable to a penalty not exceeding a sum equal to three time the total amount of tax which h would be be liable for the year to which the return relates.*
- *The Guernsey Registry monitors compliance with the obligations to register.*

GUERNSEY provided the assessment team with the following statistics :

Registered legal entities: 18,750 (15,142 in the financial sector)

Employees (2016): 32,027 (6,828 in the financial sector)

Population (2016): 63,026

GDP: £2,355m (in 2015)

- Assessment :

The majority of the members of the Panel would propose a tick ("V" - harmful) for criterion 3.

The requirements provided for by Guernsey for incorporation of companies cannot be considered as sufficient because:

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- *the code has assessed in the past that the requirement to keep a registered office was not sufficient;*
- *the presence of a resident agent in Guernsey does not demonstrate by itself a substantial economic presence in the jurisdiction. This is highlighted by the fact that such agent can be a Corporate Service Provider. Should the substance requirements attached to the regulated entities, be considered sufficient, they do not cover the whole scope of entities that can benefit from zero taxation.*

Moreover, GUERNSEY's responses on monitoring and its consequences do not relate to substance but to profit determination and accuracy of registry's data, and are therefore not relevant for this exercise.

Therefore, the advantage sat stack, ie *zero rate-income tax for all incorporated entities, are not linked to any effective real economic activity or substantial economic presence requirement. This alone justifies a conclusion on the lack of substance.*

From this it follows that there is no adequate link between profits and underlying substance.

One expert of the Panel provided the following assessment:

The agreed terms of reference for the assessment of jurisdictions under Criterion 2.2 states the following:

A jurisdiction can only be deemed to have failed the assessment under this criterion when 'offshore structures and arrangements attracting profits which do not reflect real economic activity in the jurisdiction' are due to rules or practices, including outside the taxation area, which a jurisdiction can reasonably be asked to amend, or are due to a lack of those rules and requirements needed to be compliant with this test that a jurisdiction can reasonably be asked to introduce.

The introduction of a CIT system or a positive CIT rate is not amongst the actions that a third country jurisdiction can be asked to take in order to be in line with the requirements under this test, since the absence of a corporate tax base or a zero or almost zero level tax rate cannot by itself be deemed as criterion for evaluating a jurisdiction as non-compliant.

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- This states that a jurisdiction can only be deemed to have failed the assessment under Criterion 2.2 where reasonable/proportionate actions have been identified that a jurisdiction could take to avoid being listed.

- It remains unclear what exactly we would be asking jurisdictions to amend/introduce in response to their deemed failure under Criterion 3. It might be suggested that a jurisdiction should have a de jure requirement for substance as part of their company law, but it's not clear what that would entail i.e. what the test of substance would be, when that test of substance would be applied, what the implication would be of a company failing that test.

- Those are important questions in being able to test the reasonableness of such a requirement.

- If we can't demonstrate that such requirements are reasonable, and we can't demonstrate that they are commonly replicated by other countries/Member States, then the failing of a jurisdiction due to the lack of such a requirement would amount to a failing of a jurisdiction on the basis of it not having a CIT regime which is incompatible with the terms of reference. This part of Panel III would therefore propose a question mark ("?") for Criterion 3 until this has been discussed further.

Criterion 4:

"whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"

<u>Relevant questions (Q 2.9, Q 2.10, Q 2.11, Q 2.12)</u>

GUERNSEY does not apply neither OECD transfer pricing rules nor alternative transfer pricing rules for profit determination in line with internationally accepted principles. It should be noted that as GUERNSEY has a 10% and 20% rate corporate tax on specific incomes, such rules would be relevant for domestic purposes.

However, GUERNSEY indicates that it has a General Anti-Avoidance Rule (GAAR) that is used to assess if income reported by a Guernsey's taxpayer has been artificially reduced.

Furthermore, the Guernsey Companies Law 2008 requires a director of every company to sign the company's account for the financial year confirming that the accounts give a true and fair view and were prepared in accordance with generally accepted accounting principles, stating which principles have been adopted.

We would therefore propose a cross ("X" – not harmful) for criterion 4.

Criterion 5:

"whether the features of the tax system lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

Relevant questions (Q 2.13, Q 2.14, Q 2.15, Q 2.16)

All the elements of the legal system which are relevant for benefiting from the advantages at stake (including rules for the granting of tax residence or the setting up of companies) are clearly set by the law and the practice does not involve any administrative discretion. We would therefore propose a cross ("X" – not harmful) for criterion 5.

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ANNEX 2

ASSESSMENT OF THE ISLE OF MAN BY COCG EXPERTS IN 2017

<table>
<tr><th></th><th>1a</th><th>1b</th><th>2a</th><th>2b</th><th>3</th><th>4</th><th>5</th></tr>
<tr><td>Isle of Man</td><td>X</td><td>X</td><td>X</td><td>X</td><td>V</td><td>X</td><td>?</td></tr>
<tr><td colspan="6">Criterion 2.2: "The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction"

In light of the assessment made under all Code criteria applied by analogy, the tax system of Isle of Man should be considered overall harmful from a Code of Conduct point of view.

The main concerns on deviations from the Code of Conduct criteria as applied by analogy relate to the lack of legal substance requirements for all the entities which can set up and conduct business in the jurisdiction.</td><td colspan="2">Overall: V</td></tr>
</table>

Explanation

Absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero:

In this respect, where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero", then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2 has been met.

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Relevant questions (Q 1.2)

The Isle of Man has no special tax regimes for different classes of company. All companies are required to file an income tax return on an accounting period basis.

Isle of Man incorporated companies and foreign companies which are managed and controlled in the Isle of Man are resident for income tax purposes and are liable to income tax on their worldwide income. Non-resident companies are liable to income tax on their Isle of Man source income. The standard income tax rate for both resident and non-resident companies is 0%. The standard rate generally applies to all forms of income received by all companies except:

- licensed banks, which are taxed at 10% on income from their banking business;
- income derived from mining and quarrying, landfill, property development, commercial property letting and rental income in the Isle of Man which was taxed at 10% until 6 April 2015 when the rate increased to 20%; and
- with effect from 6 April 2013, companies which carry on retail business in the Isle of Man and have taxable income of more than £500,000 from such business, became subject to a 10% rate of tax.

The nominal corporate tax rate in the Isle of Man is generally 0%.

None of the tax features of the Isle of Man meet the gateway criterion under Paragraph B of the Code of Conduct. We therefore suggest this jurisdiction to meet the gateway test of the criterion 2.2

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Criterion 1:

“whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

Facts

Tax treatment generally does not discriminate between resident and not resident. Conditions for doing business apparently are the same for resident and non-resident

The zero taxation is de lege available to both residents and non-residents and does not require that the beneficiaries carry out transactions only with non-residents.

We would therefore propose a cross (“X” - not harmful) for criterion 1a)." [de lege]

Companies owned by non-resident are 70%

Number of companies owned by non resident is not sufficiently high to trigger the de facto ring fencing . We would therefore propose a cross (“X” – not harmful) for criterion 1b

Criterion 2:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

By analogy with criterion 1a/ 1b, The zero taxation is de lege available to both residents and non-residents and does not require that the beneficiaries carry out transactions only with non-residents. However some tax advantages are accorded only to non-residents by the law We would therefore propose a cross (“X” - not harmful) for criterion 1a)." [de lege]

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Manx foreign owned companies are not sufficient to trigger de facto ring fencing We therefore propose a cross ("X" – not harmful) for criterion 2b." [de facto]

Criterion 3:

"whether advantages are granted even without any real economic activity and substantial economic presence within the jurisdiction offering such tax advantages"

Relevant questions (Q 1.1, Q 1.7, Q 1.9, Q 2.4, Q 2.5, Q 2.6, Q 2.7, Q 2.8)

Facts

The IOM legislation applicable to persons undertaking regulated activities requires substance in order to be granted a licence. Section 6 of the Financial Services Act 2008 states that the IOMFSA (Isle of Man Financial Services Authority) may not issue a licence unless "the applicant is managed and controlled in the Island" (similar provisions apply under the Insurance Act 2008).

Section 2.8 of the Licensing Policy for Regulated Activities under the Financial Services Act 2008 guidance (issued by IOMFSA) specifies those requirements, stating, among others (2.8.1), "It is a fundamental requirement that a licence holder should not be a mere shell; an applicant must establish a real presence in the Isle of Man …". Management and control will always require major operational decisions to be made by the entity's Board in the Island, and the regulated activity to be taken, undertaken in or from the Island. A branch of a company incorporated in another jurisdiction must demonstrate real presence by registering as a foreign company that has established a place of business in the Isle of Man. There should be 2 or 3 Isle of Man resident officer (2.8.4).

Capital requirements vary according to the regulated activity undertaken. Apparently, no minimum expenditure level is required.

Numbers of staff will depend upon the nature of business performed, reviewed by IOMSA on a case-by-case basis. However, certain roles must be in place (the holders of which must also must be fit and proper), for example, directors, compliance officer, money laundering reporting officer, etc. Qualitative requirements relating to staff, are laid out in the Authority's

Training and Competence Framework guidance (dated July 2017) according to the different roles held.

The IOMFSA regulates financial services businesses (including banks, insurance, investment business, providers of services to funds, TCSPs, money service business and pensions trustees). IOM states that business like holding company (i.e. holding shareholdings in other companies) although not regulated entities is very likely that would have a local regulated service provider (regulated and overseen by the IOMFSA).

As regards the gambling sector, the quantitative requirement for a gambling company is 2 local directors and either a resident designated official or his/her operations manager. The equipment (typically computer servers) must be based in an Isle of Man hosting centre.

IOMFSA has the power to issue discretionary civil penalties in respect of a serious regulatory failing, such as deficiencies in the entity's corporate governance, systems and internal controls, or fitness and propriety of any of the entity's directors, controllers or key persons. The GSC has the power to inspect its licensees in respect of all areas of status and conduct, and conducts regular audits of its licensees. Where an operator fails deliberately to meet the requirements the GSC would revoke the licence on the ground of unfit and improper control of the licence. Moreover GSC conduct investigation where the economic activity of the supervised company is inconsistent with expectations. Registration with the company register implies also that the entity should have a registered office.

IOMFSA in the last five years has issued two suspensions and no revocations for failing licence requirements. The GSC has issued 18 suspensions/revocations of licenses

IOM states that there are entities under-taking non-regulated business activities so that the above mentioned requirements are not applicable, however, they most conduct businesses which the physical presence, the management and employees are essential for (eg. retail and manufacturing). On the other hand, holding company for instance are non regulated entities and the substance requirement does not apply.

Whether activity is regulated or not, the business would still be registered with the tax authority. Regular tax audits are conducted on companies located in the Isle of Man and the ITD is responsible for monitoring obligations in respect of income tax. Those companies that fail to file annual tax return on time are pursued and civil penalties are issued.

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Major sector of IOM economy

E- gaming 19%

Insurance 15%

Other Finance & Business Services 9%

Banking 8%

Registered companies 27,168

No. employees 41,636

Most of the Financial services and the e-gaming sector which are the main sector of IOM economy are subject to IOMFSA and GSC approval and oversight.

The profits before tax (compared to the number of people working in the sector)

e-Gaming 574,523,259 no employees 658

Insurance 296,416,555 no. employees 1,872

IT 304,555,475 no. employees 697

Other Financial & Business Services 195,780,646 no. employees 1,109 + 1,283

Banking 255,842,749 no. employees 2,282

Professional Services (inc. TCSP Services) 306,038,763 no. employees 554 + 713+ 630+1,563

Assessment

The majority of the members of the Panel would propose a tick ("V" - harmful) for criterion 3.

The substance requirements provided for by the Isle of Man can not be considered as sufficient.

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Indeed, even if the conditions attached to conducting financial and e-gaming business in the Isle of Man include an express requirement for minimum adequately qualified employees, capital requirements and that management and control should be in the Isle, these requirements are solely applicable to entities regulated by a regulatory body and not to all the types of companies located in the jurisdiction.

Therefore, the advantages at stake, ie *the benefit of a zero-rate income tax, are not linked to an effective real economic activity or substantial economic presence requirement. This alone justifies a conclusion on a lack of substance.*

From this it follows that there is no adequate link between profits and underlying substance.

One expert of the Panel provided the following assessment:

The agreed terms of reference for the assessment of jurisdictions under Criterion 2.2 states the following:

A jurisdiction can only be deemed to have failed the assessment under this criterion when 'offshore structures and arrangements attracting profits which do not reflect real economic activity in the jurisdiction' are due to rules or practices, including outside the taxation area, which a jurisdiction can reasonably be asked to amend, or are due to a lack of those rules and requirements needed to be compliant with this test that a jurisdiction can reasonably be asked to introduce.

The introduction of a CIT system or a positive CIT rate is not amongst the actions that a third country jurisdiction can be asked to take in order to be in line with the requirements under this test, since the absence of a corporate tax base or a zero or almost zero level tax rate cannot by itself be deemed as criterion for evaluating a jurisdiction as non-compliant.

- *This states that a jurisdiction can only be deemed to have failed the assessment under Criterion 2.2 where reasonable/proportionate actions have been identified that a jurisdiction could take to avoid being listed.*

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- *It remains unclear what exactly we would be asking jurisdictions to amend/introduce in response to their deemed failure under Criterion 3. It might be suggested that a jurisdiction should have a de jure requirement for substance as part of their company law, but it's not clear what that would entail i.e. what the test of substance would be, when that test of substance would be applied, what the implication would be of a company failing that test.*

- *Those are important questions in being able to test the reasonableness of such a requirement.*

- *If we can't demonstrate that such requirements are reasonable, and we can't demonstrate that they are commonly replicated by other countries/Member States, then the failing of a jurisdiction due to the lack of such a requirement would amount to a failing of a jurisdiction on the basis of it not having a CIT regime which is incompatible with the terms of reference. This part of Panel III would therefore propose a question mark ("?") for Criterion 3 until this has been discussed further.*

Criterion 4:

"whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"

Relevant questions (Q 2.9, Q 2.10, Q 2.11, Q 2.12)

The Isle of Man does not apply any specific TP legislation, however Isle of Man companies are required to comply with generally accepted accounting principles or practice when preparing companies' profit and loss account (or income and expenditure account) and balance sheet. ""generally accepted accounting principles or practice" means IFRS, United Kingdom Accounting Standards) UK GAAP, Federal Accounting Standards Advisory Board (US GAAP). Pursuant the international accounting standard, companies must prepare its accounts on a fair value basis.

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Companies are taxable on their worldwide income and the starting point for determining their taxable profit is their accounting profi, adjusted to remove amounts that are not allowable, and to include reliefs that are specifically provided for in statute

All companies undertaking business or registered (i.e. tax resident) in the Isle of Man are required to keep internal accounting records for general purposes. However only public companies incorporated under the Companies Act 1931 are required to file audited financial statements with the Companies Registry annually (there were 107 such companies as at 30 September 2016). All other Isle of Man companies are required to make a declaration about their compliance with accounting record keeping requirements in their annual return to the Companies Registry.

TP issues may arise as part of the application articles of DTAs and request for relief from double taxation. Where relief from Isle of Man tax is requested under one of these DTA articles, due regard is given to the application of recognised TP methodologies used by the company or its associated enterprise in the calculation of its taxable profits in the other state. These TP methodologies follow the OECD guidelines for Transfer Pricing Methods.

However, no TP documentation requirements applies to companies.

The Isle of Man is a signatory to the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports and will begin reciprocally exchanging information in 2018. Isle of Man states its intention to use the CbCR information received for economic and statistical analysis and to help determine whether it may be necessary to introduce specific TP legislation in the future to help combat base erosion and profit shifting related risks in the Isle of Man.

The Income Tax (Country-by-Country Reporting) Regulations 2017 (based on the OECD model regulations), were passed by the Parliament in March 2017.

Even if the Isle of Man does not apply OECD transfer pricing rules for profit determination, it applies international accounting standard, which requires to prepare the accounts on a fair value basis. Those rules are in line with internationally accepted principles. Moreover, TP principles are taken into account when assessing the right for tax relief by IoM company

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pursuant a DTA. *We would therefore propose a cross ("X" – not harmful) for criterion 4."*
Criterion 5: "whether the features of the tax system lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"
Relevant questions (Q 2.13, Q 2.14, Q 2.15, Q 2.16) The authorities in the Isle of Man do not have any discretionary authority to deviate from the law. The authorities are not entitled to make any discretional decision regarding the application of the general rules applicable to the setting up of a company. The processes for setting up a company are available on the Companies Registry website. The procedures for the setting up of companies do not include advance rulings or any other form of preliminary dialogue save, of course, that the Companies Registry provides basic guidance on how to complete the relevant procedures at its public counter as well as publishing guidance on its website. There are no other elements of the Isle of Man legal system which can be regulated on the basis of an advance ruling or any other form of preliminary dialogue with the relevant authorities, save that, like the Companies Registry, authorities will frequently provide guidance on how to complete procedures The Companies Registry is charged with providing a facility for the public to view all statutory documents that have been filed by Isle of Man companies All Isle of Man primary legislation is publicly available and in English. Guidance to apply the law are also available on the relevant oversight authority website. However some aspects of setting up a business may arise some concerns, where the oversighting Authority may have consideration on a case by case for example on the number of qualified employees suitable for the company to be licensed *All the elements of the legal system which are relevant for benefiting from the advantages at stake are clearly set by the law and the practice does not involve any administrative discretion. However some aspect of the procedure to grant a licence may be discretional We*

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would therefore propose a cross ("?") for criterion 5.

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ASSESSMENT OF JERSEY BY COCG EXPERTS IN 2017

In light of the assessment made under all Code criteria applied by analogy, the 0% regime of Jersey should be considered overall harmful from a Code of Conduct point of view. The main concerns on deviations from the Code of Conduct criteria as applied by analogy relate to the lack of legal substance requirements.

	1a	1b	2a	2b	3	4	5
Jersey	X	X	X	X	V	X	X
Criterion 2.2: "The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction" In light of the assessment made under all Code criteria applied by analogy, the 0% regime of Jersey should be considered overall harmful from a Code of Conduct point of view. The main concerns on deviations from the Code of Conduct criteria as applied by analogy relate to the lack of legal substance requirements.						Overall: V	

Explanation

Absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero:

In this respect, where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero", then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2 has been met.

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Relevant questions (Q 1.2)

Examples of wording:

The nominal corporate tax rate in Jersey is 0% with the exception of the income earned by an utility company (20%) or income earned by a financial services company (10%). The 0% regime meets the requirement to be assessed under criterion 2.2.

Criterion 1:

"whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

Jersey has three regimes with different tax rates:
- 20% for certain specified utility companies and rental income and property development profits from Jersey
- 10% for financial services (investment business, trust company, banking and collective investment)
- 0% for all the other activities (amongst others investment holding)

All companies are required to file a tax return on an annual basis. These boxes are related to certain activities but does not make a difference between resident and non resident companies.

The law does not segregate between resident vs non-resident shareholders. We therefore propose a cross (X – not harmful) for criterion 1.a.

Based on the received information Jersey has a total of 32,249 registered legal entities of which 23,826 are controlled by non residents which means a ratio of 89,45%. This number is lower than the criterion "enjoyed only or almost only by non-residents" We therefore propose a cross (X – not harmful) for criterion 1.b.

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Criterion 2: "whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"
Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,) *By analogy to the assessment against criterion 1a/b. We would propose a cross ("X" – not harmful) for criterion 2.a. and 2.b.*
Criterion 3: "whether advantages are granted even without any real economic activity and substantial economic presence within the jurisdiction offering such tax advantages"
Relevant questions (Q 1.1, Q 1.7, Q 1.9, Q 2.4, Q 2.5, Q 2.6, Q 2.7, Q 2.8) • *-Facts* *All Jersey companies must have a registered office in Jersey. Jersey has firm laws and supervision on anti money laundering and countering the financing of terrorism. Furthermore, there are accounting laws regulating that all companies must prepare annual accounts in accordance with internationally accepted accounting principles.* *With regard to the 0% regime, according to Jersey authorities, the vast majority of Jersey Companies owned by non-residents are investment holding companies ranging from pension holding, portfolio share holding or immovable property. According to Jersey, Jersey service providers will be involved in the decision making and are required to hold the information for AML and CRS purposes. As holding companies do not seem to entice an active management one can only assume that the level of risk will be minimal as the work related to such a company. The Jersey explanation does not furnish any clear rules on substance regarding these kind of activities.* *Regarding Financial Services Activities (taxed at 10%) the Jersey explanation does provide clear substance requirements especially on the presence of (high) quality of the staff.*

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- *Assessment*

The majority of the panel considers that the conditions attached to the 0% regime (e.g. requirements for incorporation or operations) do not include any express requirement for real economic activity or substantial economic presence.

Therefore, the advantages at stake, ie *the benefit of a zero-rate income tax, are not linked to an effective real economic activity or substantial economic presence requirement. This alone justifies a conclusion on a lack of substance.*

From this it follows that there is no adequate link between profits and underlying substance.

We would therefore propose a tick ("V") for criterion 3.

Jersey is asked to introduce legal substance requirements for the incorporation of an entity and to make sure that in practice, tax advantages are not granted to entities without any real economic activity and substantial economic presence in Jersey.)

One expert of the panel provided the following assessment:

- The agreed terms of reference for the assessment of jurisdictions under Criterion 2.2 states the following:

A jurisdiction can only be deemed to have failed the assessment under this criterion when 'offshore structures and arrangements attracting profits which do not reflect real economic activity in the jurisdiction' are due to rules or practices, including outside the taxation area, which a jurisdiction can reasonably be asked to amend, or are due to a lack of those rules and requirements needed to be compliant with this test that a jurisdiction can reasonably be asked to introduce.

The introduction of a CIT system or a positive CIT rate is not amongst the actions that a third country jurisdiction can be asked to take in order to be in line with the requirements under this test, since the absence of a corporate tax base or a zero or almost zero level tax rate cannot by itself be deemed as criterion for evaluating a jurisdiction as non-compliant.

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- *This states that a jurisdiction can only be deemed to have failed the assessment under Criterion 2.2 where reasonable/proportionate actions have been identified that a jurisdiction could take to avoid being listed.* - *It remains unclear what exactly we would be asking jurisdictions to amend/introduce in response to their deemed failure under Criterion 3. It might be suggested that a jurisdiction should have a de jure requirement for substance as part of their company law, but it's not clear what that would entail i.e. what the test of substance would be, when that test of substance would be applied, what the implication would be of a company failing that test.* - *Those are important questions in being able to test the reasonableness of such a requirement.* - *If we can't demonstrate that such requirements are reasonable, and we can't demonstrate that they are commonly replicated by other countries/Member States, then the failing of a jurisdiction due to the lack of such a requirement would amount to a failing of a jurisdiction on the basis of it not having a CIT regime which is incompatible with the terms of reference. This part of Panel III would therefore propose a question mark ("?") for Criterion 3 until this has been discussed further.*

Criterion 4: "whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"
Relevant questions (Q 2.9, Q 2.10, Q 2.11, Q 2.12) *Due to the structure Jersey's corporate income tax regime, there are very few occasions where there is a need for specialized transfer pricing expertise. Where required the Taxes Office buys in the transfer pricing expertise from external sources. The Taxes Office fully expects that this approach of only agreeing prices in very limited circumstances will continue*

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to be adopted in the future.

However, companies incorporated in Jersey are required to prepare accounts in accordance with generally accepted accounting principles and, furthermore, the accounts must specify the generally accepted accounting principles that have been adopted in their preparation. The Jersey answer did not specify whether "fair value" should also be part of this assessment.

Jersey is a signatory to the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports. Jersey has enacted the Country-by-Country Reporting in Regulations 2106 which apply to all periods commencing on or after 1 January 2016.

Jersey does not apply OECD transfer pricing rules for all cases nor does Jersey seem to a apply alternative transfer pricing rules for profit determination in line with internationally accepted principles. However, as Jersey does apply Transfer Pricing rules if needed and as Jersey does apply the CBCR rules we would therefore propose a cross ("X" – not harmful) for criterion 4.

Criterion 5:

"whether the features of the tax system lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

Relevant questions (Q 2.13, Q 2.14, Q 2.15, Q 2.16)

All the elements of the legal system which are relevant for benefiting from the advantages at stake (including rules for the granting of tax residence or the setting up of companies) are clearly set by the law and the practice does not involve any administrative discretion. We would therefore propose a cross ("X" – not harmful) for criterion 5.

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