



## Economic Substance Requirements for entities in The Turks and Caicos Islands

### Overview

In response to the requirements of the European Union (“EU”) Code of Conduct Group for Business Taxation, the Companies and Limited Partnerships (Economic Substance) Ordinance 2018 and accompanying Regulations (the “**Substance Legislation**”) came into force on 1 January 2019 in the Turks and Caicos Islands (“TCI”). Similar legislation was introduced in other key offshore jurisdictions, such as the Cayman Islands, British Virgin Islands, Isle of Man, Jersey, Guernsey and others.

New tests are introduced for entities carrying out specified types of business, or “relevant activity”, such as financial and other service activities, to satisfy legal economic substance requirements. Extended reporting and sharing of information obligations are also included in the Substance Legislation. In order to demonstrate economic substance, an entity must be “directed and managed” and conduct “core income-generating activities” in the TCI, and must also meet standards of “adequacy”.

The Substance Legislation applies to all newly incorporated entities from 1 January 2019, and from 1 July 2019 for existing entities already registered in the TCI as at 1 January 2019.

Our view is that entities and structures, including arrangements with outsourced third party service providers, should carry out an internal review with a view to determining whether the Substance Legislation tests are met. Consideration should also be given as to whether any intra-group financing arrangements and holding companies within group structures are within the scope of the legislation. Directors should be considering some essential questions.

Griffiths & Partners experts can assist you to consider and assess the impact of the Substance Legislation and will be able to guide you through the questions you may have.

### Applicability

A resident TCI entity carrying out a “relevant activity” in the TCI is captured by the Substance Legislation. A resident “TCI entity” is:

- (a) a TCI company incorporated under the Companies Ordinance;
- (b) a TCI limited partnership incorporated under the Limited Partnership Ordinance; or
- (c) a foreign company registered under the Companies Ordinance.

An entity is non-resident in the TCI if it is resident for tax purposes in a jurisdiction outside of the TCI. An entity cannot claim to be non-resident in the TCI if it is tax resident in a jurisdiction which is included in the EU’s list of non-cooperative jurisdictions for tax purposes.

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A resident TCI entity which does not carry out a “relevant activity” does not need to have economic substance in the TCI under the Substance Legislation.

Owning real estate in the TCI by way of a TCI entity is not a “relevant activity” and as such not captured by the Substance Legislation. TCI producer-owned reinsurance companies (PORCs) are also similarly not captured by the Substance Legislation as they are usually tax resident in the US, even though the entity is incorporated in the TCI.

## **Relevant Activities**

The nine categories of “relevant activities” are:

- (1) banking business;
- (2) distribution and service centre business;
- (3) finance and leasing business;
- (4) fund management business;
- (5) headquarters business;
- (6) holding entity business;
- (7) insurance business under the Insurance Ordinance;
- (8) intellectual property holding business; and
- (9) shipping business.

## **The Economic Substance tests**

A resident TCI entity carrying out “relevant activities” must undertake defined “core income-generating activities” in the TCI and demonstrate economic substance by reference to the criteria relating to “direction and management” and “adequate” requirements. Economic substance will be measured by reference to reporting periods.

Holding companies are required to meet a reduced test for economic substance, whilst intellectual property entities face more onerous requirements on the basis that such entities are considered to present greater risks.

### ***Direction and management***

A TCI entity is “directed and managed” in TCI if:

- (a) meetings of the board of directors take place in the TCI at adequate frequencies given the level of decision making required;
- (b) during these meetings, a quorum of directors is physically present in the TCI;
- (c) strategic decisions must be made at these meetings, with the minutes reflecting those decisions;

- (d) the board of directors, as a whole, have sufficient knowledge, experience and expertise to discharge the duties of the board; and
- (e) all required board meeting minutes and other company records are kept in the TCI.

### ***Adequate requirements***

A TCI entity must demonstrate, proportionate to the level of the “relevant activity” carried out:

- (a) an “adequate” number of appropriately experienced and, if appropriate, qualified full-time employees in the TCI;
- (b) an “adequate” level of operating expenditure incurred in the TCI; and
- (c) “adequate” physical assets or presence in the TCI.

We are expecting guidance notes from the TCI Exchange of Information Unit (“**EOIU**”) on the definition of “adequate” in order to provide a clearer picture. The EOIU is the TCI Competent Authority.

### ***Core Income-Generating Activities (“CIGAs”)***

A TCI entity carrying out “relevant activities” must conduct CIGAs in the TCI associated with the specific activity. The meaning of CIGAs varies by industry and sector, and are listed in detail in the Substance Legislation.

Outsourcing of CIGAs is permitted in certain circumstances.

### **Reporting obligations**

All TCI entities must provide to the EOIU information to enable it to monitor and determine whether the entity is carrying on relevant activities and, if so, has met the economic substance requirements.

An annual return must be submitted to the EOIU setting out prescribed information relating to the entity. Each entity must certify if it has passed the economic substance test. The annual return must be submitted within 3 months of the end of the accounting period.

The form of annual return is not yet available from the EOIU.

Existing entities which were already registered in the TCI on 1 January 2019 must comply with the economic substance requirements from 1 July 2019. The first accounting period of review is from 1 July 2019 up to and including 31 December 2019.

New entities incorporated or registered on or after 1 January 2019 are required to comply with the requirements immediately. The first accounting period of review is from the date of incorporation or registration up to and including 31 December 2019 or 31 December 2020 (depending on whether the entity was incorporated or registered during the first or second half of 2019).

### **Penalties**

Penalties and sanctions may be imposed for failure to provide required information, and for failing to satisfy the economic substance requirements, including fines (from \$25,000 for the first year of non-compliance up to \$150,000 in the second and subsequent years), strike-off or removal from the Register

of Companies, and/or liquidation or dissolution.

### Exchange of information

Where a TCI entity claims to be tax resident in a jurisdiction outside the TCI, or has not met the economic substance requirements, during an accounting period, the EOIU has discretion to provide information it has received to the relevant authority of the EU Member State in which:

- (a) the TCI entity claims to be resident; or
- (b) each holding entity, or ultimate holding entity, of the TCI entity is located; or
- (c) each ultimate beneficial owner of the TCI entity is located.

Disclosure of information to the relevant EU authority would be in accordance with existing exchange of information agreement permitting the automatic exchange of information.



This Note is for guidance purposes only and should not be relied on as legal advice. For more information and detailed advice, please get in touch with your usual Griffiths & Partners professional, or contact any of the following attorneys:

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