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Economic substance: Can you still comply?

APRIL 2020

The continued spread of Coronavirus (COVID-19) has led to some of the greatest restrictions on people movements and gatherings ever imposed globally, including lockdowns, closure of borders and suspension of air and other forms of travel.

An immediate consequence of this is that it may be difficult for boards of offshore entities to meet physically in the relevant jurisdiction, as a result of self-isolation, lockdowns or other restrictions. This, in turn, has led to questions being raised by companies as to whether they will still be able to satisfy 'directed and managed' and other tests set out in economic substance legislation which require a certain number of board meetings to be carried out, with a quorum and majority of those voting being present physically in the jurisdiction.

What is the view of the offshore tax authorities?

At the time of writing, the tax authorities in each of Cayman, Guernsey and Jersey have issued certain guidance as to how they will view changes in a company's operating practice necessitated by the outbreak in light of the economic substance tests.

Jersey

As set out in our briefing on 13 March 2020 the Jersey tax authorities have looked to allay business concerns to make it clear that where a company has had to put in place changes as a result of the outbreak (for example, making board meetings which would otherwise be held physically in Jersey, take place virtually) then, provided that the changes are as a result of the outbreak and to mitigate the threats from it and on a temporary basis, then these changes will not in themselves be sufficient for a company to fail the relevant economic substance test.

Guernsey

The Guernsey International Business Association has released a statement (link here) that following discussions with the Guernsey Revenue Service, they understand that the Revenue Service would take a similar pragmatic approach as in Jersey. The Chief Minister of Guernsey has also endorsed this approach. The statement also confirms that this approach would apply to core income-generating activity (**CIGA**) meetings.

The Guernsey statement does also make some additional points which are worth noting:

- Companies should maintain and retain relevant records showing what the policy was in respect of restrictions on travel for the company officers and the period of time for which that policy was in place. This will ensure that companies can demonstrate where COVID-19 restriction measures prohibited the

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company from holding an adequate number of board meetings in Guernsey or required meetings to temporarily be held virtually, such as by conference call, video conferencing, Skype or similar. Normal protocols for any meetings held by these alternative methods should be observed, as far as possible.

- Businesses should also give consideration to the ability to appoint alternate directors in Guernsey who can attend meetings.

Cayman

On 21 March 2020, the Ministry of Financial Services issued an industry advisory covering a number of areas including economic substance. In that advisory, it noted that the Department for International Tax Cooperation (**DITC**) was conscious that COVID-19 may impact travel arrangements and therefore the ability to hold meetings in Cayman.

The advisory states that the DITC will 'take into consideration', on a case-by-case basis, the fact that meetings may have been held virtually in determining whether an entity has met the economic substance test. It is unclear whether any leeway will be given in respect of CIGA.

While it is clear that the DITC will take into account the current uncertainty, businesses may need to consider other options in order to achieve certainty from an economic substance perspective; for example, as noted by the Guernsey tax authorities, the appointment of alternate directors who are physically resident in Cayman.

BVI

On 19 March 2020, the International Tax Authority in the BVI (ITA) indicated that it intended to adopt a reasonable and practical approach where entities were obliged to make adjustments to their operating practices as a result of the pandemic and that the ITA would not seek to prejudice those entities in respect of economic substance compliance where they have made those temporary adjustments.

On 27 March 2020, the ITA issued further clarification:

- Where possible, entities should appoint alternate directors in the BVI to ensure ongoing substance requirements are met.
- It is only required that the number of directors attending board meetings in the BVI are enough to form a quorum of directors. Any other directors are not required to attend in the BVI. The guidance also notes that physical meetings need not occur and board meetings may be virtual.
- The only board meetings which are required to be held in the BVI are those relating to CIGA.
- If it is still not possible to hold a board meeting in the BVI or to meet any other substance requirement due to restrictions (in the BVI or elsewhere) caused by the pandemic, then the entity is urged to retain documentation to support any such claim for the affected period.

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- Affected entities may make individual requests for any extension of time to comply with notices, together with any supporting evidence.

The ITA has also made clear that this is temporary and entities are urged to otherwise comply fully with substance requirements (including filing deadlines) as the approach above will only be available where entities need to make adjustments to their usual operating practices and only so far as these are necessary to manage threats from the pandemic.

Existing corporate governance arrangements

Together with the above, all entities must ensure that their own corporate governance arrangements are robust enough to enable them to function, despite the ever increasing restrictions on movement and social interaction.

Constitutional documents and other governance documents should be reviewed to ensure that meetings can be held remotely (for example, by telephone, video conferencing or other platform) rather than any requirement for physical meetings to take place.

Further, as mentioned expressly in the Guernsey advisory, but in our view relevant for all entities; consideration should also be made to appointing resident alternate directors.

What can businesses do?

The pace of the Coronavirus (COVID-19) pandemic means that this is a rapidly evolving situation. Even since the advisories were issued, we have seen further restrictions on travel imposed (including in some jurisdictions a blanket restriction on leaving home except in specific limited circumstances) and therefore this is an area subject to further development with the tax authorities.

Irrespective of which jurisdiction an entity is established in, the following should be considered:

- Do existing corporate governance arrangements allow for remote or virtual meetings to take place? If not, consider whether these can be amended to include these provisions.
- Ensure detailed records are kept of travel policies restricting travel for company officers, the reasons for those restrictions (for example, government advice prohibiting travel) and the periods for which those restrictions where in place. A company should assume,as the Guernsey statement makes clear, that evidence will need to be provided as to how operating practices have been affected by the disruption.
- For as long as the disruption continues, can alternate directors be appointed, who are physically resident in the jurisdiction?

How Collas Crill can help you

Collas Crill prides itself on being easy to do business with. We take a hands-on approach and are here to help you and your business in these uncertain times.

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We are able to advise you on any actions which you may need to take in order to ensure compliance with the economic substance tests applicable in your jurisdiction, not just as a result of the Coronavirus (COVID-19) pandemic but on an ongoing basis.

Please feel free to reach out to any of the contacts listed in this briefing or any of your usual Collas Crill contacts.

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