

ECONOMIC SUBSTANCE

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”). The TCI is compliant with these EU and other OECD substance requirements, i.e. it is a *white listed* jurisdiction. Similar substance legislation exists in other international financial centres, such as the Cayman Islands, British Virgin Islands, Bermuda, Isle of Man, Jersey and others.

Tests are introduced for entities carrying out specified types of business, or **relevant activities**, to satisfy legal economic substance requirements and those entities that are caught must comply with extended reporting requirements and sharing of information obligations. The penalties for non-compliance include financial penalties, spontaneous exchange of relevant information with relevant EU Member States and (eventually) removal from the Register of Companies, and/or liquidation or dissolution.

Directors should consider certain key questions and carry out assessments of the underlying business activities carried out by their companies to comply with the reporting obligations and deadlines.

Our team of specialists can map, review and advise on existing holding company and other structures, contracts and governance arrangements, including with outsourced third-party service providers, agreements and other documentation. We are experienced in working closely with boards, shareholders, family offices and company administrators and can assist and guide clients in navigating through the Substance Legislation and reporting requirements.

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 registered under the Limited Partnership Ordinance; or
- (c) a foreign company registered in the TCI under the Companies Ordinance.

An entity is *non-resident in the TCI* if it is tax resident 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. If an entity wishes to claim non-resident status, it must produce original documentation from the relevant authority in the jurisdiction in which it is tax resident, including: (a) a Tax Identification Number; (b) a tax residence certificate; (c) an assessment or evidence of payment of corporate income tax liability on all of the entity’s income in the TCI from the relevant activity; and (d) details of its parent company, ultimate parent company, and ultimate beneficial owners.

The nine **relevant activities** captured by the Substance Legislation are (i) banking business; (ii) distribution

and service centre business; (iii) finance and leasing business; (iv) fund management business; (v) headquarters business; (vi) holding entity business; (vii) insurance business; (viii) intellectual property holding business; and (ix) shipping business. These are defined and explained in the Substance Legislation.

A resident TCI entity which does not carry out a **relevant activity** in the TCI does not need to comply with the Substance Legislation. By way of example, owning real estate in the TCI by way of a TCI entity is not a **relevant activity**. A TCI producer-owned reinsurance company (PORC) also does not carry out a **relevant activity** as PORCs are typically tax resident in the US, even though the entity is incorporated in the TCI.

SUBSTANCE REQUIREMENTS

A TCI entity carrying out a **relevant activity** must be **directed and managed** and conduct its **core income-generating activities** in the TCI, and must also meet standards of **adequacy**. Economic substance will be measured by reference to reporting periods.

Holding entities are required to meet a reduced test for economic substance, whilst intellectual property entities face more onerous requirements as these 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 with adequate frequency given the level of decision-making required;
- (b) during these meetings, a quorum of directors is physically present in the TCI;
- (c) strategic decisions are made at these meetings, with minutes recording 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) board meeting minutes and other company records are maintained in the TCI.

Core Income-Generating Activities

A TCI entity carrying out a **relevant activity** must conduct **core income-generating activities** (“CIGAs”) in the TCI associated with the specific activity. CIGAs varies by industry and sector, and are listed in detail in the Substance Legislation.

Whilst outsourcing of CIGAs is permitted in certain limited circumstances, CIGAs must still be undertaken in the TCI and adequately supervised by the relevant service provider or group entity.

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, including those employed by third parties;
- (b) an adequate level of operating expenditure incurred in the TCI; and
- (c) adequate physical assets or presence in the TCI.

The TCI Exchange of Information Unit (“**EOIU**”) has issued Guidance Notes to assist in understanding the requirements of the economic substance test and on the meaning of adequate. Adequate is defined as being contingent on the nature, scale and complexity of the business that the relevant entity is carrying on. An entity must maintain and retain records to demonstrate the adequacy and appropriateness of the resources utilized and expenditure involved in order to determine “adequacy”.

REPORTING OBLIGATIONS

All TCI entities must provide on an annual basis to the EOIU information to enable the EOIU to determine whether the entity is carrying on relevant activities and, if so, whether it has met the requirements. The EOIU may in certain circumstances apply for a search warrant to obtain further information.

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 first reporting period and round of submissions of Annual Returns commences in 2021.

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 up to \$150,000), spontaneous exchange of relevant information (see below) and (eventually) 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 substance requirements, the EOIU may provide information it has received to the relevant authority of the EU Member State in which the TCI entity claims to be resident, or in which each holding entity, or ultimate holding entity, or each ultimate beneficial owner, of the TCI entity is located.

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Contact Us

Griffiths & Partners experts can assist and guide you through the questions you may have on the Substance Legislation. For more information, please reach out to your regular G&P Group contact, or any of our specialists listed below.



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