



# Building for the future

**KPMG Economic Substance Tool**

[kpmg.com/isleofman](https://kpmg.com/isleofman)



# Background

In 2017, the European Union (“EU”) Code of Conduct Group (Business Taxation) (“COCG”) investigated the tax policies of non-EU countries, against the concept of “tax good governance” standards on tax transparency, fair taxation and anti-BEPS measures.

Although the COCG had no concerns with most of the principles of tax good governance as they relate to Anguilla, Bahamas, Bermuda, BVI, Cayman Islands, Guernsey, Isle of Man, Jersey and a number of other jurisdictions that subject corporate profits to zero or near zero rates or have no corporate tax regimes, they did express concerns regarding the lack of economic substance requirement for entities doing business in and through these jurisdictions.

As a result of those concerns, the above mentioned jurisdictions, made a commitment to address the concerns of the EU and in 2019, such jurisdictions implemented economic substance requirements, with a view to ensure that their commitment in relation to the lack of economic substance requirement for doing business therein was addressed.

The key features of the economic substance requirements can be split into 3 stages:

## Stage 01

Identify entities carrying on “relevant activities”

01

## Stage 02

Impose economic substance requirements on entities undertaking relevant activities

02

## Stage 03

Enforcement of the substance requirements

03



## Stage 01

All entities that are tax resident in one of the above mentioned jurisdictions have to identify whether they carry on “relevant activities” in their respective jurisdictions of tax residency. The term “relevant activities” has been derived from categories of geographically mobile income identified by the OECD forum on harmful tax practices and include:



Banking



Headquarters



Distribution and service centre



Insurance



Shipping



Finance and leasing



Fund management



Holding company



Intellectual property



## Stage 02

Once an entity that falls within the scope of the economic substance requirements of one of the jurisdictions has been identified as undertaking relevant activities, the entity will be required to satisfy the economic substance test. The test is split into three parts:

**i. It is directed and managed in the jurisdiction where economic substance requirements apply**

This part of the test is similar, but not identical, to the familiar “central management and control” test, but is more prescriptive in its application.

**ii. It conducts its Core Income Generating Activities (“CIGA”) in the jurisdiction where the economic substance requirements apply**

Entities are required to conduct their CIGA in the jurisdiction where the economic substance requirements apply to it. The ESL provides a non-exhaustive list of what constitutes CIGA separately for each relevant activity.

Where CIGA is carried out by another entity, the relevant entity is required to monitor and control the carrying out of that activity. CIGA cannot be outsourced outside of the jurisdiction in which the economic substance requirements apply to the relevant entity.

**iii. It meets the adequate requirements with regard to the level of relevant activity carried on in the jurisdiction where economic substance requirements apply**

Entities carrying on a relevant activity must demonstrate adequate levels of (qualified) employees (whether or not employed by the relevant company or by another entity) and annual expenditure in the jurisdiction in which the economic substance requirements apply, as well as that there are adequate physical assets in the jurisdiction.



## Stage 03

In order to demonstrate meaningful enforcement of the economic substance requirements, a formal hierarchy of sanctions for non-compliant companies is introduced with increasing severity of sanctions imposed for persistent non-compliance.

# KPMG Economic Substance Tool

KPMG have designed a dynamic Economic Substance Tool in order to assist clients to assess their requirements under the new economic substance rules in a number of jurisdictions.

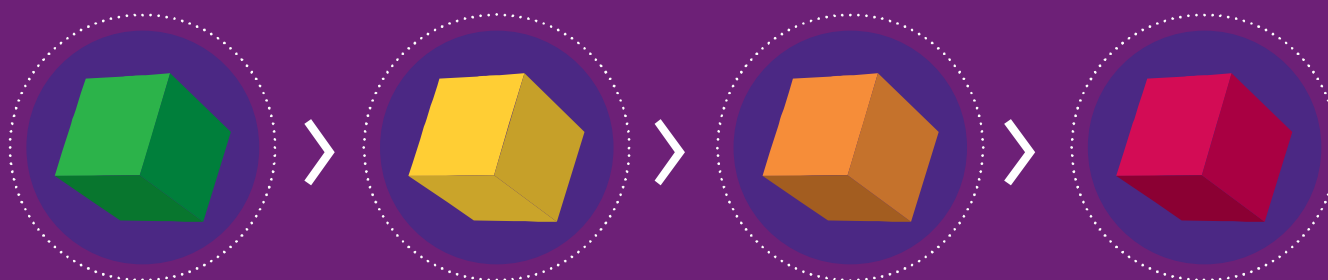
The KPMG Economic Substance Tool ("the Tool") has been designed to assist the user to:

- Determine whether a certain entity satisfies the gateway conditions to be subject to the economic substance requirements and identify the relevant activities (if any) that apply;
- For entities subject to the economic substance requirements, the Tool will ask a tailored series of questions to assess the likelihood the entity will pass the applicable test. The results will be presented with a form of risk rating identifying any areas of concern; and
- It will provide you with the option to upload back-up information to support the answers provided which will assist with your internal review process.

The Tool can be completed on an estimated basis at any point during a year, then updated multiple times throughout (and after) the year with additional data as it becomes available.

A dashboard displays the current position for all entities, enabling it to be used as a management tool in conjunction with any other policies in place to ensure compliance with the requirements for each entity.

## For each entity, the Tool will identify the following risk categories:



### Green:

These are entities which are outside the scope of the economic substance requirements.

### Light amber:

These are entities that are within the scope of the economic substance requirements, however, based on the answers provided are likely to pass the applicable economic substance tests, i.e. pass the directed and managed test, pass CIGA test (performs CIGA in relation to each relevant activity undertaken and has supporting evidence of this) and pass the adequacy test. These entities of course need to be monitored as there will be a reporting requirement.

### Dark amber:

These are entities that are within the scope of the economic substance requirements but based on the answers provided there are certain aspects of the applicable tests that the entity does not meet. For example it passes the CIGA test (perhaps because it performs one CIGA in relation to each relevant activity undertaken and has supporting evidence of this) but fails an aspect of the directed and managed test. The Tool will identify the issues so that you can rectify matters where possible. The expectation is that you will be able to help your clients to resolve these matters without having to receive substantial third party advice, although we will always be available to assist.

### Red:

These are entities that are within the scope of the economic substance requirements but fail the tests or are other very high risk entities, e.g. High Risk IP companies. It is anticipated that these entities will need to engage external advisers to provide appropriate guidance on the next steps.

By using the Tool it will be possible to target the Dark Amber and Red entities, in order to make the necessary remediations to improve the likelihood of these entities meeting the economic substance requirements.

The Tool will provide an audit trail of the changes that occur throughout the year and a report can be prepared at any time setting out the analysis for each entity along with its risk rating. A dashboard will present this information in real-time, facilitating an appropriate controls environment.

# Key features of the KPMG Economic Substance Tool

**Rating:**

RAG rating system

**Flag areas of concern:**

The Tool will flag what the areas of concern for each entity are based on the answers provided in the assessments.



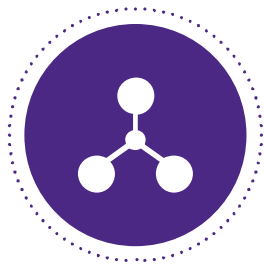
Bulk upload of entities functionality.

**Role configuration:**

Tool linked to active directory of workers – catering for 3 different levels of users that will have different accessibility and permissions.

**Review mechanism:**

There is an embedded review mechanism within the assessments that will allow an approval process to exist within the organisation.



Allocate specific users to certain entities.



### **Audit Trail**

Entity and Assessment Audit Trails.



Possibility to attach links and attachments as evidence to questions.



### **Dashboard**

A dashboard can be used as a management tool.



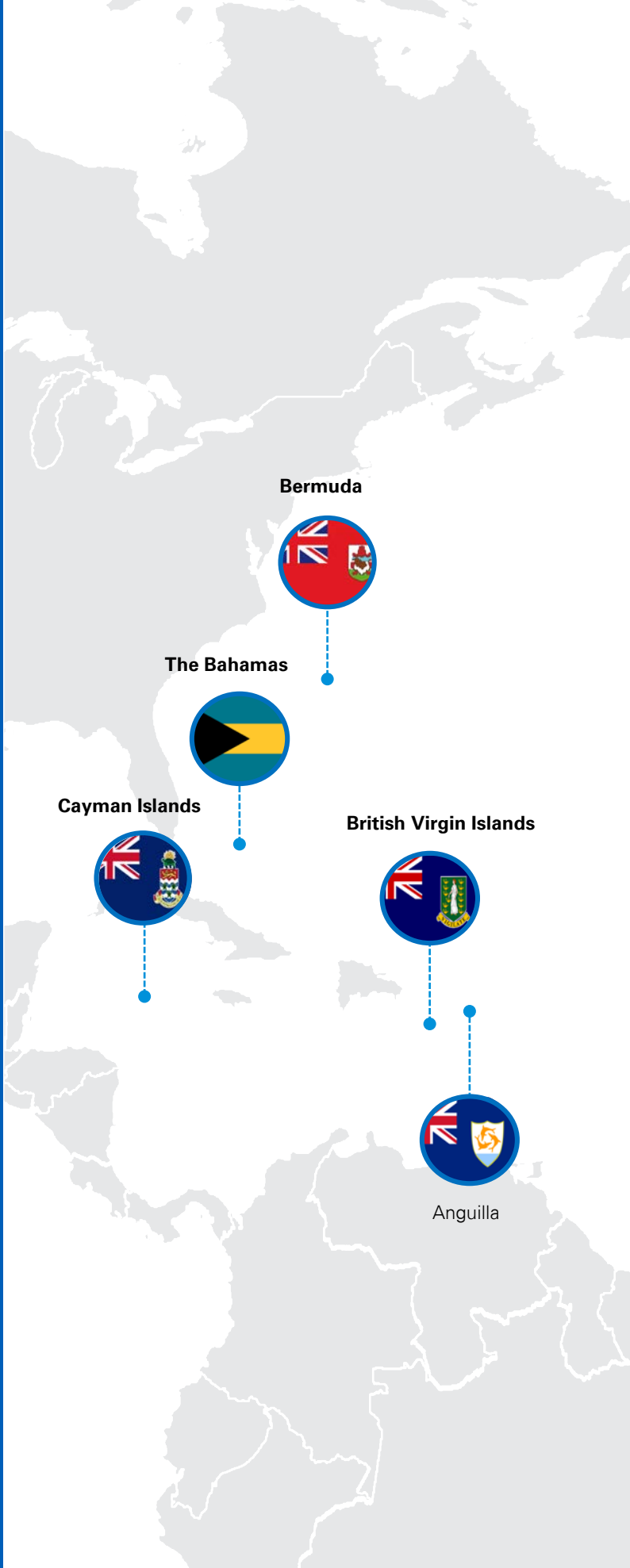
KPMG Helpdesk to assist.



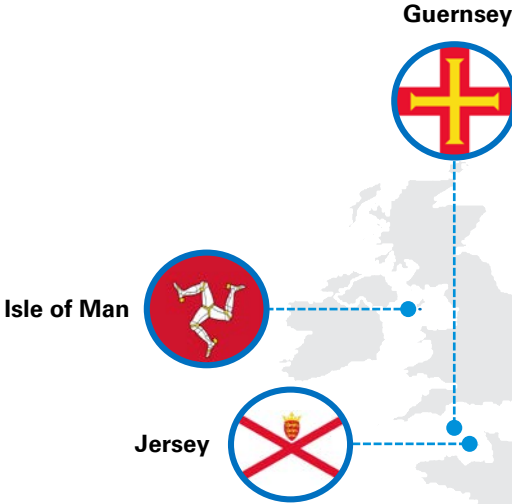
# KPMG Islands Group

KPMG Islands Group (“KIG”) is a regional network of KPMG member firms providing Audit, Tax and Advisory services.

We have more than 2,000 outstanding professionals working together to deliver value across a range of International Financial Centres including Anguilla, The Bahamas, Barbados, Bermuda, BVI, Cayman Islands, Guernsey, Isle of Man, Jamaica, Jersey, Malta, Trinidad and Tobago and Turks and Caicos Islands. We are therefore ideally placed to advise on the position for entities incorporated in another jurisdiction and tax resident in the Isle of Man.







# Your team

KPMG Isle of Man has a leading tax team with experienced individuals who have deep knowledge of international tax.



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