

**GUERNSEY'S ZERO 10 LEGISLATION
EFFECTIVE FROM 1 JANUARY 2008
A SUMMARY**

Contents

Section	Title	Section	Title
1	Introduction	17	The introduction of a new general anti-avoidance provision
2	Rates of tax on company profits	18	The restriction of the Exempt Company Regime
3	The taxation of company distributions	19	Tax capping for wealthy residents
4	Deemed Distributions and Investment Holding Companies	20	The treatment of income payable to non residents
5	Credit for overseas tax suffered	21	Statutory backing for Statements of Practice
6	Transitional arrangements	22	Interest Relief
7	The operation of ETI on “service” company income	23	Groups of companies
8	Loans to participators and qualifying loans	24	Contact details for further advice
9	Relief for trading losses		
10	Rights in relation to “nil” assessments		
11	Directors fees paid to non residents		
12	Employee Benefit Trusts (EBT)		
13	Changes to the Statutory Repairs Allowance Rates in relation to let Guernsey property		
14	A revised definition of “settlor”		
15	Duty on settlor to notify the Administrator of a trusts existence		
16	The charge to tax on a person entitled to income under a settlement		

1. Introduction

- 1.1 At the end of November 2007 the States of Guernsey approved the second raft of legislation implementing its much publicised “Zero 10” initiative. The legislation is contained within two Projets, “The Income Tax (Zero 10) (Guernsey) Law 2007” which was approved by the States in September 2007, and “The Income Tax (Zero 10) (Guernsey) (No 2) Law 2007”.
- 1.2 The legislation will fundamentally change how the Island collects its revenues with effect from 1 January 2008. In short, the Government has reduced corporation tax to 0%. Companies thereafter are required under the legislation to act as agents for Guernsey resident shareholders (“participators”). Whenever a distribution (usually dividends) is made to a Guernsey resident participator, the company is required to withhold tax at the rate of 20% from the dividend and to pay this over to the States Income Tax Office.
- 1.3 The legislation also restricts the Exempt Company regime (exempt companies currently pay £600) and abolishes the International Company regime (where a company can elect to pay a rate of tax between ½% and 30%).
- 1.4 The States of Guernsey has also taken the opportunity to amend the anti avoidance legislation in certain areas including the extension of the general anti-avoidance provision.
- 1.5 The Legislation is now “consolidated” on the States Income Tax website which can be accessed through www.gov.gg.

2. Rates of tax on company profits

- 2.1 The new legislation identifies different classes of company income, in respect of which companies will continue to be taxable, as follows:
- (a) income from banking business and lending activities (**taxed at 10%**)
 - (b) income from activities regulated by the Office of Utility Regulation (OUR) (**taxed at 20%**)
 - (c) income from ownership of land and buildings in Guernsey, including rental income, Guernsey property development and the extraction of solid material (**taxed at 20%**)
 - (d) income from other businesses and other sources (**taxed at 0%**).

3. The taxation of company distributions

- 3.1 The current rules on deduction of tax from Guernsey dividends are now abolished. Dividends are treated as being declared gross. While companies will be taxed at 0% on their profits, the new tax law makes each company responsible to deduct tax at the rate of 20% from dividend payments to **Guernsey resident shareholders**. The company must then report to the Administrator of Income Tax on a quarterly basis (in the same way as applies for the Employees Tax Instalment (ETI) Scheme for employees) and remit the tax deducted.
- 3.2 Where dividends are paid out of income already taxed on the company, for instance income from ownership of land and buildings in Guernsey, there will be no further tax charged at the time of the distribution. Guernsey and non Guernsey resident shareholders will be entitled to a credit for the tax suffered.
- 3.3 The company will be required to provide a certificate to the shareholder detailing the gross dividend, the tax deducted and the net amount. The certificate must be provided at the time of payment. The tax deducted can be applied against the liability of the shareholder, but only to the extent that the distribution has been included in a tax assessment. The new legislation provides for penalties for companies failing to comply. If a company fails to deduct tax from a distribution, it will still be required to pay the tax. The law allows for the tax paid to subsequently be recovered from the shareholder as a civil debt.
- 3.4 It may be considered difficult for companies to monitor the residence status of shareholders. In doing so, it is expected that companies will follow the equivalent rules to Know Your Client (KYC) procedures to establish whether the beneficial owner is Guernsey resident.
- 3.5 Where no distributions have been made during a quarter, the company is not required to submit a quarterly “nil” return.

4. Deemed Distributions and Investment Holding Companies

- 4.1 The new Law introduces the concept of “deemed distributions” and sets out the events that create a deemed distribution. For tax purposes a deemed distribution is dealt with in the same way as a dividend payment.

A deemed distribution will occur if there is undistributed income arising on or after 1 January 2008 which has been accumulated within the company. If a shareholder owns 1% or less in a company the deemed distribution rules will not be applied.

- 4.2 “Undistributed income” does not include any income that has been taxed at the 20% rate, for instance, income from land and property or income that has been taxed at 20% or higher in any other jurisdiction. If the overseas tax suffered is less than 20%, the company will be required to deduct 20% tax on a deemed distribution of this income and pay it over to the Income Tax Office. Income taxed as a deemed distribution will not be taxed again, i.e. on distribution, and the company will need to maintain careful records of the “pool” of “deemed distribution” income.
- 4.3 Where the company is a category B or C exempt collective investment scheme, the deemed distribution rules do not apply.
- 4.4 A distribution or deemed distribution will, to the extent that there is undistributed income be treated as being made out of that income, in priority to being made out of capital.
- 4.5 The Law identifies various “trigger events” that will be treated as deemed distributions of undistributed income. The trigger events are as follows:
- the disposal, repurchase and/or redemption of shares in the company
 - the death of a shareholder, although a tax deferral scheme will be available in certain circumstances
 - the departure from the Island of a shareholder
 - the migration of a company
 - the amalgamation of a company, although there will be an exemption where the members and their interests are the same before and after the amalgamation i.e. in a paper for paper transaction
 - a dissolution of a company
 - there being undistributed net investment income at the end of a calendar quarter (although it may only be necessary to make returns on a half yearly basis). This will not apply if the net annual investment income is £500 or less.
 - the cessation of a business or substantially the whole of the business.
- 4.6 **The net untaxed income arising to investment companies will always be deemed to be distributed to Guernsey**

resident shareholders pro rated in accordance with their percentage shareholding.

5. Credit for overseas tax suffered

- 5.1 The Law has been amended to allow for credit for any overseas tax suffered by a company to flow through to the individual who is ultimately taxed on the income. Without the amendments, credit could only be given to the person (i.e. the company) that suffered the tax.

6. Transitional arrangements

- 6.1 Where companies are subject to the 0% or 10% rates of tax, the business will be treated as ceasing on 31 December 2007. This deemed cessation will have no impact on the calculation of capital allowances on business plant and machinery.
- 6.2 Distributions made after 31 December 2007 will be treated as being made out of income arising before 1 January 2008 in priority to income arising after that date. The “pre 31 December 2007” distributions will be from profits taxable on the company and will not be subject to further deduction of tax by the company.
- 6.3 In **limited circumstances** the undistributed profit at 31 December 2007 will be treated as distributed to the shareholders. These circumstances arise where companies **historically have failed to pay the tax due** and it is assumed by the Income Tax Office that they will continue to do so. Where profits have been assessed as at 31 December 2007 on the company and the company has failed to pay the tax, and the profits remain undistributed, they will be treated as having been distributed on 1 January 2008. The effect of this is that the liability switches from the company to the beneficial members.
- 6.4 It should be noted that under the new Zero 10 regime, **all Guernsey resident companies will be required to file an annual Guernsey tax return**. Where Guernsey registered companies are able to show that they do not have any Guernsey resident shareholders, have no taxable Guernsey sources of income and have no employees resident in Guernsey (other than directors), they will not be required to submit annual financial statements to the Income Tax Office. This will be established on completion of the annual tax return for the calendar year 2008 (which will be issued in January 2009).

- 6.5 Those companies unable to fulfil the conditions in 6.4 will be required to file annual financial statements in the future. For the purposes of calculating the pool of taxable profits that will be brought into charge when distributions or deemed distributions are made to shareholders, a tax computation will be required for each year. The computation will be prepared in the same way as under the pre 2008 regime.
- 6 months will not be treated as a qualifying loan. If a loan is made to an officer or employee of the company it will not be treated as a qualifying loan if the borrower controls 5% or less of the share capital of the company.
- 7. The operation of ETI on “service” company income**
- 7.1 The new Law introduces the concept of a “service company”. Taxpayers may set up a company and provide their services through the company to defer paying tax until distributions are taken. The Law is brought in to deter the use of personal and managed service companies.
- 7.2 The company will be required to account for ETI on payments it receives where those payments, if they had been made to an individual, would have been subject to ETI deductions by the payer. Generally, this should not catch situations where the company has a number of clients such that it can legitimately claim to be carrying on a business. The intention is to catch those situations where the individual works for just one or two “employer” entities, providing labour only.
- 8.4 Any loan made which was not originally a qualifying loan will become a qualifying loan if the circumstances of the borrower change such that the conditions are met.
- 8.5 Loans which are in existence at 31 December 2007 are not caught by these rules.
- 8.6 A qualifying loan is chargeable to income tax in the quarter that it is made, or becomes a qualifying loan. **The loan will be treated as being made net of tax.** The company must pay the tax at the 20% rate.
- 8.7 The company will be required to make a quarterly return which must disclose
- The borrowers name and address
 - The date and amount of the loan
 - The date and amount of tax due/paid
 - The dates and amounts of loan repayments
 - The balance of the loan outstanding at the reporting dates
- 8.8 The return must be submitted within 15 days of the end of the quarter. If the company fails to pay the tax on the loan, the Administrator can pursue payment from the borrower.
- 8. Loans to participators and qualifying loans**
- 8.1 The new Law introduces the concept of loans to “participators” and “qualifying loans”. Broadly the Law defines a “participator” of a company as any member of the company or any person having a share or interest in the capital of the company, any officer of the company, any person connected to a participator or officer of the company, or any third person receiving a loan for the benefit of a participator.
- 8.2 A “qualifying loan” is any loan made to any of the above. Where a loan is made to a person connected to a participator or officer of the company who is non resident, the loan will be treated as having been made to the relevant participator or officer.
- 8.3 A loan arising in consequence of a debt incurred for supply of goods or services in the normal course of its business unless the credit period exceeds 6 months will not be treated as a unless the credit period exceeds
- 8.9 Where the loan is repaid **within 6 years** of being made, the company can reclaim that tax. The loan does not need to be fully repaid. A partial repayment will give rise to a partial tax repayment. Loans are treated as being repaid on a FIFO basis so repayments are set against the earliest loans advanced in priority to later loans. Loans existing at 31 December 2007 will be treated as repaid first. Where a loan is written off, the borrower will be treated as having received income of the amount written off. The tax paid will be available as a credit against the borrower’s tax liability.
- 8.10 If the loan is not repaid within 6 years, it will be deemed to have been written off.
- 9. Relief for trading losses**
- 9.1 Trading losses will now only be available for set off against profits from the same class of income i.e., those taxed at the same rate. It prevents the set off of losses in a 0% income stream against profits in the 10% or 20%

streams. **A benefit of the new system is that undistributed trading profits carried forward can be relieved by losses arising in later years.**

10. Rights in relation to “nil” assessments

10.1 Under the new legislation, the Administrator is not required to issue an assessment on a company which is taxed at 0%. However, the company has the right to request the issue of a “nil” assessment when it sends in the relevant tax return.

11. Directors fees paid to non residents

11.1 Where director’s fees are paid to non residents, the new Law exempts the director’s fees from a charge to tax. Previously the fees were taxable.

12. Employee Benefit Trusts (EBT)

12.1 Under the new Law no deduction will be available to companies for any contributions to an EBT until the contribution is paid out to beneficiaries in the form of taxable income. Relief will only be available when the benefits come out of the scheme and are taxed in the hands of the employee. This does not apply to approved pension schemes and EBTs used as part of a share option scheme. Deductions will continue to be available in relation to contributions funding the maintenance and administration of the EBT. It also does not apply to contributions made before 2008.

12.2 Where an employee is non Guernsey resident and his earnings are not subject to Guernsey tax because the employment is wholly carried on abroad, a deduction would still be available to the company despite the fact that the employee will not be taxable in Guernsey.

13. Changes to the Statutory Repairs Allowance Rates in relation to let Guernsey property

13.1 The amount of Statutory Repairs Allowance available in relation to rental income will reduce. For rent arising in respect of land, the allowance reduces from 5% to 2.5%, for furnished dwellings the allowance will reduce from 25% to 15% and for all other buildings the allowance will reduce from 15% to 10%. The concessionary allowance of 33⅓% in respect of furnished lettings will no longer be available. Capital allowances will also no

longer be available in respect of furnishings.

14. A revised definition of “settlor”

14.1 The Law extends the definition of “settlor”. The definition now includes any person who has provided funds or other property directly or indirectly to a settlement or for any entity owned or controlled directly or indirectly by the trustees of the settlement. Any transaction on “arms length” commercial terms would not be caught by the new definition.

15. Duty on settlor to notify the Administrator of a trust’s existence

15.1 There is also now a duty on a person, who at any time has been the settlor of a trust which has been in existence at any time during a year in which the settlor was resident in Guernsey, to declare the trust.

15.2 The annual personal tax return for the Year of Charge 2008 (to be issued in January 2008) and future years has been redesigned to allow for this declaration.

16. The charge to tax on a person entitled to income under a settlement

16.1 The new Law clarifies the basis on which a person entitled to income under a settlement may be charged to tax in their own name. It clarifies that “the person beneficially entitled” to income from the trust can include the settlor if the settlement is revocable. It also clarifies that income arising within a settlement will include the income of any company or other entity which is vested in or otherwise under the control of the trustees.

16.2 Further anti-avoidance measures are introduced to “catch” any sheltering of assets in trusts including without limitation, the making of any loan, advance or other transfer of funds or other assets on terms under which those assets will be repaid, or reimbursement will be made, or consideration will be provided in money or money’s worth, but not including a bona fide transfer made at arm’s length.

16.3 Income received by a settlement retains its taxable status **even if accumulated to capital by the trustees.**

17. The introduction of a new general anti-avoidance provision

17.1 Somewhat controversially a new general

anti-avoidance provision has been introduced. The new powers given to the Administrator go well beyond the previous powers available. The Administrator can now make any adjustment to assessments that are considered appropriate where the **effect** of a transaction or series of transactions is the avoidance, reduction or deferral of a liability to tax.

- 17.2 This can apply regardless of whether or not there was any intention to avoid tax and whether the transaction was initiated by another person. For instance, a management charge levied on a Guernsey subsidiary could be reversed under the new provisions.

18. The restriction of the Exempt Company Regime

- 18.1 The new Law amends the **Income Tax (Exempt Bodies) Ordinance** to restrict the exempt company regime as required by the EU Code of Conduct Group with effect from 1 January 2008. After 31 December 2007, it will not be possible to claim exempt status under Category D. Those companies unable to claim exemption under Category D will be chargeable to tax at 0% unless the income is taxable at the 10% or 20% rates.
- 18.2 It should be remembered that the tax regime only affects companies and so unit trusts which apply for exemption under Category A will not be affected and they will be able to continue applying for exemption as in previous years.
- 18.3 The restriction also does not apply in relation to collective investments schemes (CIS) for which the current arrangements will continue. Companies which are currently exempt under Category B (Guernsey registered companies) or Category C (non Guernsey registered companies) will continue to be able to apply for exemption.
- 18.4 There are circumstances where it would be advantageous for a CIS to continue applying for exemption. Where there is for instance a Guernsey resident investor who has invested in more than 1% of the fund, the investor will be taxed **only on the actual distributions received**. Such an investor will not be taxed on the underlying investment income of the company nor on any deemed distributions where the company is exempt. Where exempt status has not been claimed, the investor may be taxed on the underlying investment income

of the company and the deemed distribution rules may apply.

- 18.5 A CIS may also consider that it would be advantageous to continue claiming exempt status because it would allow the company to disclose in the scheme prospectus that it is exempt from Guernsey tax. Whilst it would not necessarily be material in financial terms for the company whether it is "charged" tax at the 0% rate, it may be perceived by potential investors that the 0% rate of tax may, in the future, increase.
- 18.6 Applications for exempt status under Categories A, B or C will continue to be made at the beginning of the year and the Income Tax Office will send application forms to those bodies that are currently exempt under these categories to establish whether they will wish to apply for exemption for 2008. If the company does not wish to apply, it will be issued with an annual tax return for 2008 to complete. The annual tax return will not be issued until January 2009.
- 18.7 Companies which have previously claimed exempt status under Category D will receive annual tax returns for 2008 and thereafter again, the first return will be issued in January 2009. Such a company may not necessarily be required to submit annual financial statements to the Income Tax Office. If it is able to meet the conditions described in 6.4 above, i.e. that the company has no Guernsey resident shareholders, Guernsey employees (other than local directors) and has no taxable Guernsey source of income, the company will not be required to submit accounts to the Income Tax Office.

19. Tax capping for wealthy residents

- 19.1 The new Law introduces a cap to restrict an individual's tax liability on certain forms of income. It provides details of the tax capping arrangements for individuals. There will be a maximum liability of £250,000 on qualifying income. The qualifying income is any income derived from **non-Guernsey sources** including income from business, income from offices and employments, income from ownership of land and buildings and income from other sources. Qualifying income also includes **investment income from Category A, B or C exempt bodies and Guernsey deposit interest**.
- 19.2 The qualifying income is calculated net of allowances, reliefs and deductions. If

an individual is resident in Guernsey for only part of a year, the limit is pro-rated accordingly. The limit will be the same for a single person as it will be for a married couple. However, rather unusually, separately assessed married couples will each have a separate £250,000 limit.

19.3 In determining whether any income arises in Guernsey the income can be traced through any number of companies, partnerships, trusts, agreements and arrangements. The conditions relating to the tax cap will be reviewed once statistical information is available relating to 2008.

20. The treatment of income payable to non residents

20.1 The new Law changes the way income arising to non residents is dealt with to ensure that most such income is not taxable. The objective is to retain the ability for income such as dividends, deemed distributions, interest and royalties to be paid to non residents without any liability or deductions in respect of Guernsey income tax. The income arising to non Guernsey residents which is not liable to Guernsey tax is called "disregarded individual income" and is in general, distributions and deemed distributions, deposit interest, royalties, any other income of a similar nature (not income from land and buildings) and director's fees.

21. Statutory backing for Statements of Practice

21.1 A large number of Statements of Practice are to be introduced to clarify the Income Tax Office practice and policies in relation to the new legislation and these are yet to be published. The Law has been amended to give statutory backing to Statements of Practice. However, in accordance with this section, the Administrator has the power to amend Statements of Practice. Any amendments must be sanctioned by the Treasury & Resources Department and it will only sanction changes provided there has been proper consultation with interested bodies, for instance the GSCCA.

22. Interest relief

22.1 Legislation is still to be introduced by the States in relation to the availability of tax relief for interest paid. However, it is expected that relief will be available as described in the Treasury & Resources Policy letter dated 26 June 2007. **If so, the relief is likely to be restricted to the following circumstances:**

- Interest charged on the first £400,000 of a mortgage on an individual's principal private residence.
- Interest charged to businesses on loans secured for business purposes.
- Interest charged on funds borrowed for the purpose of making a loan to a business (subject to certain restrictions applying in relation to shareholders).
- Interest charged on loans to buy Guernsey and foreign rental property. The relief is restricted to the amount of the rental income (although income received and interest relief can be aggregated into one income tax computation).
- Interest charged on loans to acquire an interest in a business provided the borrower is actively engaged within the business.

22.2 There is likely to be a further restriction which will apply only on loans in relation to a principal private residence relief will only be available provided the loan is from a Guernsey lender. It is intended that relief will be available for the acquisition, construction, reconstruction, extension or repair of the property (including for instance, the construction of a conservatory or swimming pool). Relief would also be available on a loan taken out to acquire the shares in a company if the property is held in the company.

23. Groups of companies

23.1 Whilst no legislation currently exists in relation to the treatment of groups of companies, it is understood that there should be no tax implications in relation to transactions within a group.

24. Please note that this is a brief general overview of some rather complex legislation and further regulations and statements of practice will be published by the Treasury and Resources Department in due course. Whilst every effort has been made to ensure the accuracy of the information provided, it should not be relied upon. Anyone requiring further specific advice is strongly recommended to call or email André Trebert at andre.trebert@praxisfiduciaries.com

**André Trebert
Senior Manager
11 December 2007**



Praxis Group

PO Box 296, Sarnia House, Le Truchot,
St Peter Port, Guernsey, GY1 4NA

Tel: +44 (0) 1481 737600, **Fax:** +44 (0) 1481 710511, **Website:** www.praxis.gg