

## ECONOMIC SUBSTANCE

### The Turks and Caicos Islands

#### OVERVIEW

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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 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 considering certain key questions and carry out assessments of the underlying business activities carried out by their companies in anticipation of the reporting obligations and deadlines.

To support compliance with the Substance Legislation, our specialists can map, review and advise on existing holding company and other structures, contracts and governance arrangements, arrangements with outsourced third-party service providers, agreements and other documentation. Our team is experienced in working closely with boards, shareholders, family offices and company administrators which are caught by the Substance Legislation, and can assist and guide you in navigating these issues.

#### APPLICABILITY

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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 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.

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.

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.

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

## SUBSTANCE REQUIREMENTS

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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 reflecting those decisions are recorded;
- (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. The meaning of CIGAs varies by industry and sector, and are listed in detail in the Substance Legislation.

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

### *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.

Guidance notes from the TCI Exchange of Information Unit (“EOIU”) to assist in understanding the requirements to satisfy the economic substance test and on the definition of adequate are expected shortly. The EOIU is the TCI Competent Authority.

## REPORTING OBLIGATIONS

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All TCI entities must provide to the EOIU information to enable the EOIU to monitor and 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 annual return must be submitted within 3 months of the end of the accounting period.

## PENALTIES

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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.

An entity may appeal against the determination of a failure to satisfy the substance requirements and/or against the imposition of penalty, but the appeal does not stay the enforcement of the penalty.

## EXCHANGE OF INFORMATION

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Where a TCI entity claims to be tax resident in a jurisdiction outside the TCI, or has not met the economic substance requirements, the EOIU may 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.

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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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