



Guidance Notes on Sections 5(A), 5(1B), 5(5) and Schedule 11 - Business Tax Act (2009)



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1. Introduction

These guidance notes have been prepared by the Seychelles Revenue Commission (“SRC”) concerning the amendments to the sourcing rules introduced by the Business Tax (Amendment) Act, 2020. These notes provide guidance on the new conditions imposed for “covered companies” in respect of the Seychelles’ sourcing rules set out in Sections 5(1A), 5(1B) and 5(5) of Business Tax Act (Cap 20), including a substance test for foreign passive income in Schedule 11. “Covered companies” are those companies that meet the test set out in Paragraph 1 of Schedule 11. Where a covered company fails to meet the new conditions, including the new substance test, the foreign income derived by the company will be deemed to be Seychelles sourced income.

These guidance notes supplement those on the Seychelles sourcing rules in general which are set out in the SRC guidance notes [“Income sourced in and from Seychelles”](#).¹ The sourcing rules set out in Section 5(1) will continue to apply to companies that are not “covered companies”. The broad guiding principles set out in that guidance will also be helpful in considering the new conditions applying to the sourcing rules for “covered companies”. Many of the key concepts around what is, and is not, Seychelles’ sourced income apply as much to the new sourcing rules in Section 5(1A) as they do to the rest of Section 5.

The Seychelles operates a self-assessment tax regime. As with other tax provisions, it is the responsibility of a company incorporated or operating in Seychelles to determine if it has Seychelles sourced income in a tax year. These guidance notes are intended to assist in understanding when and how to apply the new provisions at Section 5(1A). Where the provisions apply, a company may need to account for tax on additional sources of income in its annual Business Tax Return (see the SRC’s [“Business Tax Guide”](#) on completing these returns). In some cases, companies may be completing a Business Tax Return for the first time.

1.1 Background on the Seychelles territorial regime

The Seychelles has historically operated a territorial tax regime, meaning that only income sourced in Seychelles was liable to tax in Seychelles. Income was considered Seychelles’ sourced income exclusively where it arose from business “activities conducted, goods situated or rights used” within the physical territory of Seychelles. This meant that income was considered non-Seychelles sourced income (i.e. “non-taxable business income”) where the income was:

- from activities conducted by a Seychelles business in an overseas jurisdiction (through a branch, office, shop or otherwise); and
- in the form of dividends, interest, royalties, rents and other “passive income” received by a Seychelles resident from a non-resident.

The changes of law applying from 16 September 2021 adopts a revised approach for covered companies, including the adoption of an economic substance test for passive income received from a non-resident.

¹ [Hyperlink]

1.2 Changes to the Seychelles territorial regime given Presidential assent on 28 December 2020

On 28 December 2020, the President of the Republic of Seychelles gave his assent to the Business Tax (Amendment) Act, 2020 which amended the Business Tax Act (Cap 20). However, the Business Tax (Amendment) Act, 2020 only came into operation on 15 September 2021, and Schedule 11 was amended by Regulation the next day.

Consequently, Sections 5(1A), 5(1B) and 5(5) and Schedule 11 (and consequential amendments) therefore came into effect on same aforementioned dates.

1.3 Outline of these guidance notes

These guidance notes are designed to help a company's directors or, where applicable, registered agents to understand when and how to apply the new rules.

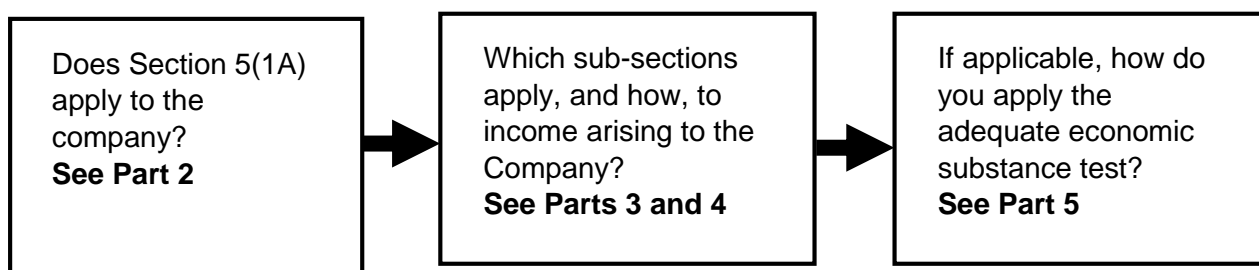
It does this, by:

- a) Focusing on when a company will need to consider the application of Section 5(1A) Business Tax Act (Cap 20), and
- b) How it should apply its provisions to income arising to the company in the year.

In doing so, it also:

- a) Discusses the application of Sections 5(1B) and 5(5), and
- b) Considers the application of the adequate economic substance test in Schedule 11.

All legislative references in these guidance notes are to the Business Tax Act (Cap 20), unless otherwise stated.



2. When to apply Section 5(1A): Is the company both a ‘resident company’ and a ‘covered company’?

As a first step, it will be necessary to determine whether Section 5(1A) applies at all. This Part provides some guidance on when to apply Section 5(1A).

Section 5(1A) only applies to:

- (i) a resident company;
- (ii) to which Schedule 11 applies (i.e. a “covered company”).

2.1 Is the company tax resident in Seychelles?

Any company incorporated in Seychelles is tax resident in Seychelles under Seychelles law.

However, tax treaties may apply to deem a Seychelles-incorporated company to be tax resident outside Seychelles. This will be the case where:

- the “place of effective management” of the company is located in an overseas jurisdiction with which Seychelles has a double tax treaty, and
- that overseas jurisdiction asserts taxing rights according to where the company is “managed and controlled”.

The terms of the specific tax treaty should be checked to confirm the relevant treatment.

The place where a company is managed and controlled is likely to be the same as the “place of effective management”. This is likely to be where the head office is located or, where different, where the board of directors meets. This is not necessarily where the income-generating business activities and day-to-day operations take place.

2.2 Is the company a “company to which Schedule 11 applies” (i.e. a “covered company”)?

A company will only be a “covered company” if it is an enterprise that is “a member of a multinational group”.

The definition of multinational group follows that used by the Organisation for Economic Co-operation and Development (“OECD”) for Country-by-Country Reporting (“CbCR”), as set out in the Base Erosion and Profit Shifting (“BEPS”) Action 13 Final Report.² The definition of multinational group is built on the standards used for determining whether the operation of two enterprises or business units should be consolidated for financial reporting purposes.

The test of membership of a “multinational group” is set out in further detail below.

For the avoidance of doubt, a company may become, or cease to be, a covered company at any point through a tax year, including when it first becomes a member or ceases to be a member of a multinational group at any point through the tax year.

² [Final Report on Action 13](#). The CbCR report requires an MNE Group to report information such as the income earned, taxes paid, and business activities carried out in each jurisdiction. The CbCR definition has been modified in places for the purposes of simplification and to fit within Seychelles law.

2.2.1 STEP 1: Meaning of “group”

The first step is, to determine if the Seychelles company is part of a group. This test is based on a control test used for accounting. In general, the effect of this test is that two enterprises (e.g. companies) will be treated as part of the same Group where one enterprise controls the other or both enterprises are controlled by another enterprise.

2.2.2 STEP 2: Meaning of “multinational”

The next step is to determine whether this is a group which spans multiple jurisdictions.

A group will be a “multinational” group where there are two or more enterprises the tax residence for which is in different jurisdictions.

This will typically require that a Seychelles company is part of a consolidating group (see below) with a parent or subsidiary that is resident in another jurisdiction outside Seychelles (further explanation of the meaning of a “consolidating group” is set out in the following subsection).

Consistent with the OECD definition used for CbCR, the definition of “multinational” also includes circumstances where an enterprise that is resident for tax purposes in one jurisdiction is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction.³

2.2.3 STEP 3: Accounting consolidation

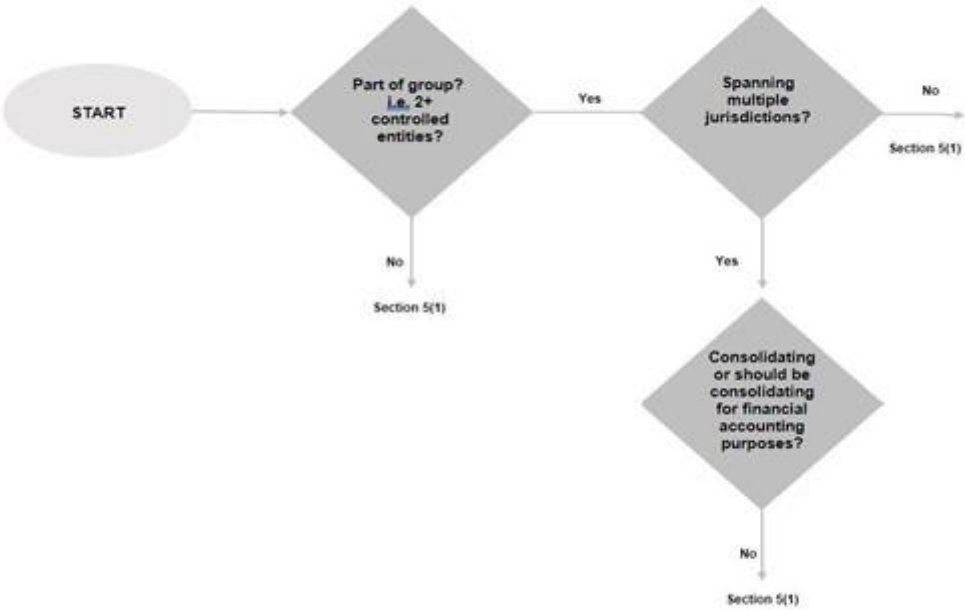
A group is defined as a collection of enterprises that are consolidated for financial accounting purposes. The final step is therefore to determine whether the group produces or would be required to produce consolidated financial statements. Consolidation involves the assets, liabilities, income, expenses and cash flows of the group being presented as a single economic entity in the group’s financial statements at the level of the “ultimate parent entity” of the group.

The definition of consolidated financial statements and ultimate parent entity follow the OECD CbCR definition. Whether consolidated financial statements of the group are required depends on the nature of the group in question and the jurisdiction of the ultimate parent entity, if it exists. Clearly any groups which already publish consolidated financial statements that consolidate the results of Seychelles companies will fall within Section 5(1A).

The rules also require that, any group which could be listed, but has chosen not to do so, would also fall within Section 5(1A).

³ A definition of “permanent establishment” is provided in Section 2 BTA. The Seychelles has recently updated this definition to align as closely as possible with the definition used in Article 5 of the OECD Model Tax Convention (2017). See further comment at Section 4.2 of this guidance.

Flowchart to determine if a “covered company” to which Section 5(1A) applies



3. How to apply Section 5(1A) to income: which sub-section applies?

Once in Section 5(1A), it is necessary to look at the types of income that arise to the company to see whether the income falls into subsections (a), (b), (c), or (d).

An explanation of each of subsections (a) to (d) and how they determine whether or not the income is Seychelles' sourced is given in Part 4, below.

This Part sets out how to determine which subsection should apply. This determination is based around the nature of the income, and how and from where it arises. A flowchart is also provided at the end of this Part for illustration purposes.

For these purposes, income needs to be categorised between "active" income, "passive" income and specified forms of intellectual property income.

3.1 Q1: Is there income arising in the tax year?

Section 5(1A) is only relevant to the extent that income is received in the tax year, that could be considered Seychelles sourced. If there is no income in the tax year, then there will be no need to go any further in determining how the Section 5(1A) rules apply.⁴

3.2 Q2: Does the income arise from "activities" (whether inside or outside Seychelles)?

If the company does have income in the tax year, does this arise from an active trade or business carried on by the company, either in the Seychelles or abroad? Such income may arise through sale of goods or the provision of services.

If the answer to this question is "YES", then it will be necessary to consider whether the activities take place inside or outside Seychelles (Question 2.1). If the answer to this question is "NO", then the company will need to proceed to Question 3 to determine which sub-section should apply to that passive income.

Note that income from assets not used in a trade or business, including dividends from subsidiaries (or interest, rent and royalties from other investment assets), will not arise from "activities". Such income is classed as "passive income".

3.3 Q2.1: If "YES", do the activities take place outside Seychelles?

As with Section 5(1), it needs to be determined if the income relates to business activities taking place abroad. This will be the case where the income relates to an office, shop or factory that is based abroad, and the income directly arises to the Seychelles resident company itself, rather to a separate legal entity (e.g. a local subsidiary or third-party local contractor). It will not be the case where a company in Seychelles sells goods to an

⁴ A company that has never received any Seychelles sourced income in a tax year will not be required to register as a person liable to Business Tax and therefore will not need to furnish a tax return in relation to that tax year (per Section 57(1)). Where a company has no income in that particular tax year but remains registered for Business Tax (e.g. because it has had Seychelles' sourced income in the past), it will need to lodge a nil tax return even when it has no income for a tax year (Section 57(3)). Such a company may however deregister as a person liable to Business Tax.

overseas merchant. It is the location of the activities that is relevant, rather than the place where a payment is made.

If the answer to this question is “NO”, and the income relates to activities taking place in the Seychelles, then Section 5(1A)(a) will apply. Income from activities conducted, goods situated or rights used in Seychelles is deemed Seychelles sourced taxable business income.

Further consideration of the application of this subsection is set out in Part 4 below.

3.4 Q2.2: If outside Seychelles, do the activities take place in a foreign permanent establishment?

If the income relates to activities taking place outside Seychelles, then Section 5(1A)(b) will apply. Section 5(1A)(b) provides that overseas active income will be treated as Seychelles sourced taxable income unless it is attributable to an overseas permanent establishment.

See Part 4 below for further discussion on Section 5(1A)(b) and the meaning of “permanent establishment”.

3.5 Q3: If income is passive, is it generated outside the Seychelles?

This question pertains to any income excluded from the test of active income in Question 2, which will therefore be of a “passive” nature. It asks whether any of this income is “generated outside the Seychelles”? Typically, this will include dividends, interests, rents, royalties, and capital gains where the gains arise from a core income generating activity of holding and managing shares or equitable interests (Paragraph 7 Schedule 11).

When considering whether the income is generated outside the Seychelles, it is necessary to look at the location of the company making payments in respect of the asset. For example, if a Seychelles resident company holds shares in a company incorporated and tax resident overseas, any dividends from that company will be generated outside the Seychelles. If a Seychelles resident company lends money to an individual or company tax resident overseas, any interest income will be generated outside the Seychelles. Rental income will be generated outside Seychelles if in respect of a property located overseas.

If the income is generated outside the Seychelles, then it is necessary to consider whether Section 5(1A)(c) or (d) applies. This can be determined through QUESTION 3.1.

3.6 Q3.1: Is any part of the passive income derived from an intellectual property right held in Seychelles?

Special rules apply to passive income from intellectual property. Income from intellectual property will include royalty or licence payments, including franchise fees.

If the answer to this question is “YES”, and the income is derived from intellectual property, Section 5(1A)(c) will determine whether the income is considered to be sourced in the Seychelles. Only “qualifying income” derived from patents and “rights functionally equivalent to patents” are permitted to benefit from the Seychelles territorial regime (i.e. are not considered to be Seychelles sourced income by 5(1A)(c)). Further guidance on the application of this subsection is set out in Part 4 below.

If the answer to this question is “NO”, and the passive income does not derive from intellectual property, then Section 5(1A)(d) will apply.

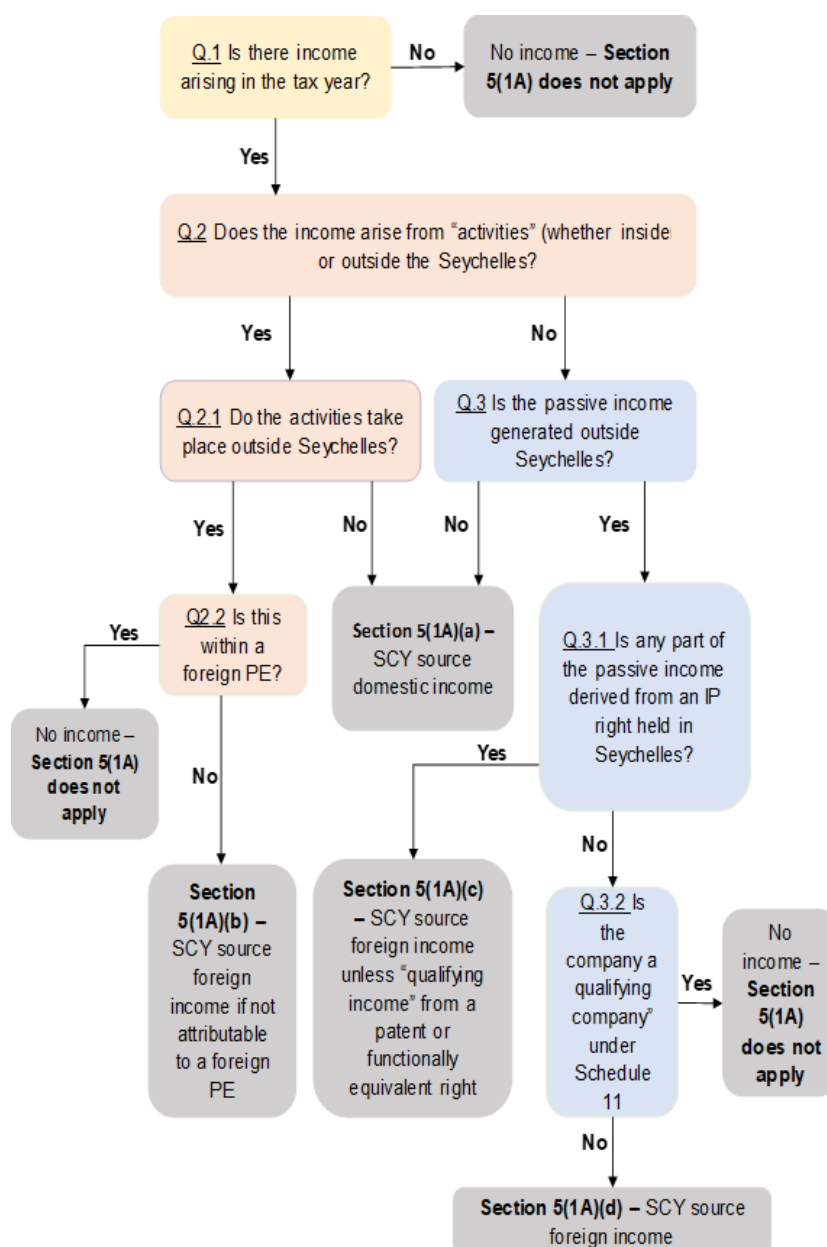
A company may have some passive income derived from an intellectual property right held in Seychelles, and some passive income derived from another source (e.g. dividends). In such circumstances, Section 5(1A)(c) will apply to the income derived from intellectual property, and Section 5(1A)(d) will apply to the rest.

The treatment of income under Section 5(1A)(d) will be determined by whether the company is a “qualifying company” under Schedule 11. Further guidance on the application of this is set out in Part 5 below.

3.7 Q3.2: Is the passive income earned by a “qualifying company”?

The final question in determining the treatment of the passive income is whether the passive income is earned by a qualifying company, being one that satisfies the substance requirements in Schedule 11. This is discussed in Part 4 and 5.

Flowchart showing how to apply Section 5(1A) to ascertain whether income arising in a tax year is Seychelles sourced.



4. How to apply Section 5(1A) to income: ss (a) to (d)

This Part provides guidance on each of the subsections in Section 5(1A) in turn.

In determining whether income is Seychelles Sourced under Section 5(1A), the Act provides that “An amount derived by a resident person that is a covered company is derived from sources in Seychelles if derived from” the following activities/situations listed below in parts (a) to (d):

4.1 (a) activities conducted, goods situated or rights used in Seychelles;

Income derived from business activities taking place in Seychelles are treated as Seychelles sourced. This is the same as the existing sourcing rule in Section 5(1). See the guidance notes [“Income sourced in and from Seychelles”](#) for a further discussion of a number of key concepts.

There are three conditions that must be satisfied for income to be derived from “activities conducted in Seychelles” and therefore be Seychelles’ sourced under this subsection. Those are that:

- a) The person must carry on a trade, profession or business in Seychelles;
- b) The income to be charged must be from such trade, profession or business carried on by the person in Seychelles; and
- c) The income must be income arising in or derived from Seychelles.⁵

Income may arise in or be derived from Seychelles, even if the payment originates from abroad.

For example, if a company in Seychelles sells its goods to an overseas merchant in State X, the income on the transaction arises in, and is derived from, the manufacturing operations in Seychelles. Even though the payment originates from State X, the income is treated as Seychelles’ sourced because it derives from activities taking place in Seychelles.⁶

4.2 (b) activities conducted outside Seychelles unless attributable to business carried on through a permanent establishment of the person outside Seychelles;

Income derived from business activities taking place outside Seychelles is deemed Seychelles’ sourced where it is not connected to a foreign permanent establishment.

Section 5(1A)(b) applies where a Seychelles resident company is carrying on business activities in an overseas jurisdiction. Such activities might typically (but not always) be carried on through a local office, shop or other premises by employees of the Seychelles’ resident company.

⁵ See Paragraph 63, SRC Guidance Notes: ‘Income sourced in and from Seychelles’.

⁶ See Paragraph 58, SRC Guidance Notes: ‘Income sourced in and from Seychelles’.

Any overseas income that is attributable to an overseas permanent establishment may be taxed in that overseas jurisdiction under international principles. Section 5(1A)(b) therefore ensures that there is no double taxation of any active income that taxes place abroad.

The table below provides a summary of the above.

Description of activities	Section	Source
Activities <u>inside</u> Seychelles	5(1A)(a)	Seychelles sourced income (See Section 4.1 above)
Activities <u>outside</u> Seychelles and connected to a foreign permanent establishment	5(1A)(b)	Foreign source income = non-taxable business income
Activities <u>outside</u> Seychelles and not connected to a foreign permanent establishment	5(1A)(b)	Seychelles sourced income = taxable business income

A “covered company”, with income arising from overseas business activities, will need to assess whether this income is connected to an overseas permanent establishment in order to determine if this income is Seychelles’ sourced. If the income is connected to an overseas permanent establishment, then it will continue to be considered as non-Seychelles sourced and hence will be non-taxable business income.

The definition of “permanent establishment” exists in Sections 2A, 2B and 2C of the Business Tax Act (Cap 20) (as amended by the Business Tax (Amendment) Act, 2020). The definition closely follows the definition of a permanent establishment used in Article 5 of the OECD’s Model Tax Convention (2017). This aligns with the permanent establishment definition used in Seychelles’ tax treaties and in the domestic law of many of the jurisdictions with which Seychelles does business. Broadly, a permanent establishment will arise where a Seychelles resident company has a fixed place of business, a construction site or dependent agent acting for it in a foreign jurisdiction. The permanent establishment definition also includes a “services permanent establishment”, adopting the approach used in the UN Model Tax Convention.

Whether or not an overseas permanent establishment exists depends on the nature of the business activities that are undertaken by or on behalf of the Seychelles’ resident company overseas. The rules consider the substantive business activities from which income derives.

4.3 (c) income derived from an intellectual property right held in Seychelles other than qualifying income from (i.) a patent, or (ii.) a right functionally equivalent to a patent;

For “covered companies”, only “qualifying income” from patents or rights functionally equivalent to a patent are entitled to benefit from the Seychelles’ territorial regime (meaning that they may not be liable for tax). Whether income is “qualifying income” is determined by the formula set out in Section 5(1B), i.e.:

$$\frac{A}{B} \times C$$

Where:

- “A” is qualifying expenditures,
- “B” is overall expenditures, and
- “C” is the overall income arising from the intellectual property right.

This formula follows the “nexus ratio” test outlined for intellectual property (IP) regimes in the Organisation for Economic Cooperation and Development’s (OECD’s) Action 5 Final Report, a part of its Base Erosion and Profit Shifting (BEPS) initiative.⁷ Broadly, the approach required by the OECD for IP is that tax benefits (such as those that arise to foreign income under a territorial regime) should not be granted unless there is a commensurate amount of substantial activities in connection with the income qualifying for the tax benefits. The relevant substantial activities for IP are the research and development (R&D) that is directly connected with the creation, invention or significant development of the patent or right functionally equivalent to a patent. The OECD’s “nexus ratio” uses R&D expenditures as a proxy for substantial activities.

The nexus ratio looks at “qualifying expenditures” (being the expenditures to fund R&D activities undertaken by the Seychelles resident company) against the “overall expenditures” (being the wider costs of developing the patent). The purpose of the nexus approach is to ensure that income only qualifies for tax benefits where connected to actual R&D activities undertaken by the resident company in the Seychelles.⁸

If a company only had one IP asset and had itself incurred all of the expenditures to develop that asset, the nexus approach would simply allow all of the income from that IP asset to qualify. Once a company’s business model becomes more complicated, however, the nexus approach also by necessity becomes more complicated, because the approach must determine a nexus between multiple strands of income and expenditure, only some of which may be qualifying expenditures.

Any costs of acquiring a patent right is included in the “overall expenditures”, reducing the amount of qualifying income. Outsourcing of development only qualifies where it is to an unrelated party (against the inclusion of both related and unrelated party expenditure in overall costs).

“Qualifying income” can only arise from patents or IP assets that are “functionally equivalent to patents”.

A right “functionally equivalent to a patent” means a right that is both legally protected and subject to a similar approval and registration process to a patent, including copyrighted software. Rights functionally equivalent to patents are:

- (i) patents defined broadly;
- (ii) copyrighted software; and
- (iii) other IP assets that are non-obvious, useful and novel.

⁷ See paragraphs 39 to 45 OECD Action 5 Final Report (2015).

⁸ Paragraphs 29 and 30 OECD Action 5 Final Report (2015).

On the other hand, income from other types of IP assets (such as trademarks and marketing intangibles) are not permitted to qualify for territorial treatment. In contrast to the approach taken in relation to patents, paragraphs 34 to 38 of the BEPS Action 5 Report states that marketing-related IP assets such as trademarks should not qualify for tax benefits under an IP regime, regardless of the level of economic activity taking place in a jurisdiction in relation to that IP. This is due to the difficulty of connecting them to measurable substance in a jurisdiction and the perceived lack of positive economic externalities from these other forms of IP.

This means that income arising from abroad in respect of trademarks and other marketing intangibles based in Seychelles should be treated as Seychelles source income, so that such foreign income of covered companies is always brought into an assessment for tax (irrespective of whether the company is a qualifying company under Paragraph 2 Schedule 11.

Example 1: A Seychelles company (Company X) designs a new widget which it patents and licences to a manufacturing company in India. The research and development of the widget was all undertaken by Company X's employees in the Seychelles. The company does not have any other income other than from the licence of this widget design. Company X spent 1 million Seychelles Rupees in designing the widget. All this expenditure constitutes "qualifying expenditure" on the basis that it is directly connected with the invention of the widget. As Company X has not acquired the design or outsourced its development to a third party, this would also represent the amount of "overall expenditure" incurred by Company X. As qualifying expenditure and overall expenditure are the same, 100% of the licence income received by Company X from the Indian manufacturer would be "qualifying income". All the income from the licence would therefore be treated as foreign sourced non-taxable business income.

Example 2: If, instead, Company X had acquired the widget design from a third party for 500,000 Seychelles Rupees, and then spent 300,000 Seychelles Rupees developing and enhancing that design in house and another 200,000 Seychelles Rupees contracting out the development to an associated entity outside Seychelles, only the 30% of overall expenditures spent on in-house development would be "qualifying expenditure". Consequently, only 30% of future revenues from the licence would be "qualifying income". The other 70% would be treated as Seychelles' sourced income.

Example 3: Company Y owns the brand rights to a popular fizzy drinks business and licenses the brand rights to associated entities around the world. The foreign income will not be qualifying income as it does not arise from a patent or IP assets that are "functionally equivalent to patents". Therefore, all the income will be treated as Seychelles' sourced income.

Example 4: Company Z designs and patents a new tuna tin which it manufactures in Seychelles for the export market. Any income from selling the tuna tins overseas arises from the manufacturing activities in Seychelles, rather than from licencing the intellectual property abroad. As such, that income will be Seychelles' sourced income under Section 5(1) or 5(1A)(a).

4.4 (d) other passive income generated outside Seychelles except to the extent that the resident company is a qualifying company in accordance with Schedule 11

Passive income arising from a person or entity resident outside the Seychelles is considered Seychelles' sourced unless the Seychelles resident recipient meets the substance requirements for this income that are set out in Schedule 11.

5. Schedule 11 substance test

5.1 Entity-based approach

Paragraphs 1 to 7 of Schedule 11 set out the substance test in respect of foreign passive income (the source of which is determined by Section 5(1A)(d)⁹) as follows:

- **Paragraph 1** states that Schedule 11 applies to an enterprise that is a member of a multinational group. The definition of multinational group, and the application of Paragraph 1 are covered at section 2.2 of this guidance.
- **Paragraph 2** contains the substance test itself. A company shall be considered to be a qualifying company for the purposes of Section 5(1A)(d) if that company has adequate economic substance in the tax year. What is “adequate economic substance” for each company will depend on the particular facts of the company and the nature of business.
- **Paragraph 3** provides examples of when adequate economic substance can be considered to be met. These examples are based on classifying companies into broad categories depending on the general nature of the passive assets they hold as follows:
 - A pure equity holding company (defined in Paragraph 6);
 - A real estate holding company (defined in Paragraph 6);
 - A company “other than a pure equity holding company or real estate holding company”. This category covers companies with debt assets (i.e. loans and interest-bearing financial instruments), and/or a diversified portfolio of assets.

Companies with intellectual property assets will also need to consider Section 5(1A)(c) as discussed above at Section 4.3.

- **Paragraph 4** notes that the “adequate economic substance” test may be fulfilled where the economic substance is fulfilled by third parties acting on behalf of the company, provided certain conditions are met.

It is important to note that for tax reporting purposes, the substance test in Schedule 11 Paragraph 2 is designed to be self-assessed by the company. As such, the company’s directors or representatives should make a decision as to whether the substance test is met and make a determination in good faith.

The entity-based approach in Paragraph 3 is intended to make it easier to self-assess whether the substance test is met. Under this approach, the general nature of the company rather than the nature of each passive income-producing asset can be considered.

Pure equity and real estate holding companies can be considered to have “adequate economic substance” where they meet the examples set out in:

- Paragraph 3(a), complying with applicable company filing requirements; and

⁹ See part 4.4 (d) **other passive income generated outside Seychelles except to the extent that the resident company is a qualifying company in accordance with Schedule 11** - Passive income arising from a person or entity resident outside the Seychelles is considered Seychelles’ sourced unless the Seychelles resident recipient meets the substance requirements for this income that are set out in Schedule 11.

- Paragraph 3(b), having adequate human resources and premises in Seychelles for holding and managing their investments;

All other companies (such as those with loans and interest-bearing financial instruments) will also need to demonstrate the substance set out in Paragraph 3(c) of Schedule 11. These “other companies” therefore need to meet a high burden of proof than pure equity and real estate holding companies in demonstrating that they satisfy the “adequate economic substance” tests.

The rest of this Part sets out further guidance on how to apply Schedule 11, including on the categorisation of companies and the particulars of the different burdens of proof.

5.1.1 Meaning of “pure equity holding company”

A pure equity holding company is a company which, as its primary function, acquires and holds shares or equitable interests in one or more other companies and performs no substantial commercial or investment activity.

The acquiring and holding of shares must be the “primary function” of the company. This means that a pure equity holding company can carry out ancillary activities, so long as these are not the main part of the company’s business.

The main income arising to a pure equity holding company is likely to be from dividends. However, this does not mean that the income of the company needs to exclusively be in the form of dividends.

The placing of dividend monies received in a foreign bank account will not preclude a company from still being regarded as a pure equity holding company, where the “primary function” of the company is still to acquire and hold shares.

A company that frequently trades in equity interests, and thereby performs trading or dealing activity in Seychelles, would have income arising from “activities conducted” in Seychelles which would be treated as Seychelles’ sourced income under Section 5(1) or 5(1A)(a).

5.1.2 Meaning of “real estate holding company”

A real estate holding company is a company which, as its primary function, acquires and holds interests in immovable property, such as land or buildings. Such interests may be in the freehold or leasehold of a property. Where it is leasehold, the ownership may be in the primary head lease or any secondary or reversionary lease interest. The main income arising to a real estate holding company should be rental income.

The same comments in relation to pure equity holding companies also applies to real estate holding companies. The acquiring and holding of interests in immovable property must be the “primary function” of the company. This means that a real estate holding company can carry out ancillary activities, so long as these are not the main part of the company’s business.

5.1.3 “Other companies” covered under Paragraph 3(c)?

All other companies that are not pure equity holding companies or real estate holding companies will need additionally to demonstrate the substance set out in Paragraph 3(c). Other companies in this context includes companies with debt assets (i.e. loans and interest-bearing financial instruments), and/or a diversified portfolio of assets.

Debt assets means those assets that produce interest income, such as loan receivables or interest-bearing financial instruments, such as:

- intra-group corporate loan notes and debentures;
- government or corporate bonds; and
- interest-bearing derivatives.

Debt assets do not include loans from banking or financing activities conducted in Seychelles. Such loans derive from activities conducted in Seychelles and should therefore any income will be treated as Seychelles' sourced income under Section 5(1A)(a).

Companies holding a diversified portfolio of assets cannot be classed as having their "primary function" of holding shares or real estate.

5.2 Tests for "pure equity holding company" and "real estate holding company"

If a company is a "pure equity holding company" or a "real estate holding company", it will be considered to have economic substance where it has:

1. complied with all applicable filing requirements under the Companies Act 1972, or the International Business Companies Act 2016, as applicable, and
2. adequate human resources and premises in the Seychelles for holding and managing its investment assets (be that equity participations or real estate).

5.2.1 Compliance with applicable filing requirements

Compliance with applicable filing requirements includes:

In the case of a company incorporated under the **Companies Act 1972**:

- Updating Register of Companies with changes to the company's secretary, members or directors; and
- Submitting an annual return.

In the case of a company incorporated under the **International Business Companies Act 2016**:

- Keeping the register up-to-date for changes to the company's members or directors;
- Paying annual fees; and
- Submitting an annual return / accounting records.¹⁰

Occasionally, companies may be in technical breach of the filing requirements rule because of late filing, or because of an inadvertent error or omission in documents that are filed on time. In spite of such technical breaches, there may be circumstances where it is reasonable to consider a company still meets the test of having adequate economic substance. This is more likely to be the case where there is an inadvertent omission or error made in good faith, or where a delay is only brief and can be swiftly remedied. However, where an omission is deliberate or a delay is ongoing this is unlikely to be considered reasonable.

¹⁰ See International Business Company Guidelines

The reference to filing requirements is considered to include both external requirements (such as with the ROC) and internal filing requirements (such as maintaining records at the company's registered office).

5.2.2 Adequate human resources and premises

A company must have adequate human resources and premises in the Seychelles for holding and managing its investment assets (be that equity participations in the case of a pure equity holding company, or real estate interests in the case of a real estate holding company).

What is "adequate" in this context will depend on the facts of the company in question. As is recognised by the OECD in its substance requirements for holding companies, such companies "may not in fact require much substance in order to exercise their main activity of holding and managing equity participations".¹¹ The requirements for adequate people and premises should be assessed accordingly.

In relation to people, "adequate" means a sufficient number of suitably qualified employees. These people must have access to premises provided by the company, that enables them to carry out their functions. Alternatively, the company could have a local agent which is genuinely carrying out these active management activities on its behalf.

5.3 Tests for other types of company

In addition to complying with the requirements described above (paragraph 5.2), in the case of any other company, other than a pure equity holding company or a real estate holding company, in order to be regarded as having adequate economic substance it must also ensure that it:

- (i) takes necessary strategic decisions; and
- (ii) manages and bears principal risks in Seychelles; and
- (iii) incurs adequate expenditure, relating to the acquisition, holding or disposal, as the case may be.

5.3.1 Meaning of "strategic decisions"

"Strategic" takes its ordinary meaning. "Strategic" can generally be taken to be "part of a long-term plan to achieve a specific purpose".¹² In this context, "strategic decisions" are those taken with a view to the long-term purposes of a company. Such "strategic decisions" are therefore likely to be taken by those persons authorised to make long-term decisions on behalf of the company. Who those persons are will depend on the facts, particularly the size and nature of a company's asset portfolio.

In the case of a holding company with one asset class, the strategic-decision maker is likely to be the board of directors, since the holding of the assets in question will be central to a company's long-term purpose and value. This would also apply to a company that holds a loan note in a subsidiary.

In such circumstances, covered companies will demonstrate strategic decision making where board meetings are held in Seychelles in relation to the key decisions affecting the assets held by the Seychelles company. Key decisions are likely to include the acquisition

¹¹ OECD Action 5 Final Report, para 87.

¹² Oxford English Dictionary [confirm edition etc.]

or disposal of an asset, or changes to the way that an asset is managed or exploited. A board meeting will need to take place in Seychelles in respect of these key decisions, as and when the decisions are made.

A company with a diverse range of assets, including highly liquid assets traded on a public marketplace (such as government bonds) might authorise employees or even third-party agents to undertake decision-making functions. This is more likely to be the case where there is a part disposal of an asset class, or where the board of directors provides a framework with the long-term strategy of the company, within which individual decisions are made.

However, the frequent trading of assets is likely to mean that income arises from “activities” in Seychelles, which would mean the income would be treated as Seychelles’ sourced under Section 5(1A)(a).

“Strategic” decision-making, can be distinguished from:

- Research/recommendations undertaken that feed into a decision taken to buy or sell an asset;
- Smaller, day-to-day decisions such as the decision to put a dividend on deposit in a bank current account.

5.3.2 Meaning of “manages and bears principal risks in Seychelles”

The principal risks in relation to the assets must be genuinely managed and born by the company holding the assets in Seychelles. The principal risks in relation to holding assets includes the potential economic loss of value in those assets. Where an asset is beneficially owned by a company in Seychelles, it is likely that the economic risk will be borne by the company in Seychelles.

The management of risks may be outsourced, provided that the outsourcing is adequately supervised and is undertaken in Seychelles (see Part 5.4 below on Outsourcing).

5.3.3 Meaning of “incurs adequate expenditure”

Adequate expenditure must be incurred in Seychelles in relation to the acquisition, holding or disposal of the assets held by the company. Where an asset is truly beneficially owned by a company in Seychelles, it is likely that an “adequate” amount of expenditure will have been incurred in acquiring it.

Zero (or minimal) expenditure may be “adequate” depending on the circumstances in which the asset was acquired: for example, if the asset was contributed to the share capital of the company by its shareholder, or if it was distributed to the company from a subsidiary.

Expenditure on the acquisition of an asset also includes ancillary expenditure, such as payments for transfer taxes, legal fees, and updates to legal registers.

An adequate amount of expenditure should be incurred in relation to the holding of the asset. For a real estate asset, this might include expenditure on maintenance or improvements to the underlying property. For an equity asset, this might include expenditure on stewardship activities (e.g. time and expenses attending shareholder meetings and reviewing performance). In either case, the expenditure should be proportionate to the level of investment.

An adequate amount of expenditure would also be expected to be incurred in relation to the disposal of the asset. This is likely to include the costs of third-party advisors, any taxes and legal fees for registration processes.

5.4 Outsourcing

The activities that a company must carry out in respect of holding and managing investments and managing risks may be outsourced to third party contractors or agents, provided certain conditions are met. These conditions are that the outsourcing company must be able to demonstrate that it has adequate supervision in the Seychelles, of the outsourced activities; and that those activities are undertaken in the Seychelles.

A company will be able to outsource activities to the extent that these conditions are fulfilled. The types of activities that can be outsourced in respect of holding and managing investments and managing risks will depend on the nature of the investment activities carried out by a company. In the case of a company holding investments for the long term, the outsourced activities may simply comprise making annual filings on behalf of the company.

Where a company actively manages its investments, and outsources some or all of that active management, then those activities must be genuinely undertaken by agents on behalf of the company. Those agents should be based in Seychelles and adequately supervised by the outsourcing company in Seychelles. Where a third party is undertaking outsourced investment management activities in Seychelles on behalf of several Seychelles clients, such outsourced activities may only be considered in relation to one client at a time.

6 Miscellaneous

6.1 Interaction of the substance test in Paragraph 2 Schedule 11

Paragraph 2 of Schedule 11 is not the only Seychelles legislation to contain an economic substance test.

Substantial activity requirements were introduced by the Securities Act (i.e. Securities (Amendment) Act, 2018) and the Mutual Fund and Hedge Fund Act (i.e. Mutual Fund and Hedge Fund (Amendment) Act, 2018). Further guidance on the substantial activity requirements is contained in the “Substantial Activity Requirements Guidelines” issued by the Financial Services Authority.

There should be no overlap between the Securities Dealers/Mutual Fund substantial activity requirements and the substance test in Schedule 11. The Securities Dealers/Mutual Fund substantial activity requirements apply to the active business conducted by licensees in those specific industries. In contrast, the Schedule 11 substance test applies only to the passive income of “covered companies”.

Appendix – Flowchart of application of sourcing rules to Seychelles entity with income of all types

Seychelles activities, foreign activities, intellectual property income and foreign passive income

