



PORTCULLIS NEWS

MCI (P) 019/06/2018

28 January 2019

CAYMAN ISLANDS - ECONOMIC SUBSTANCE

We inform that the Cayman Islands has recently enacted the *International Tax Co-operation (Economic Substance) Law, 2018*, ("ES Law") which came into force 1 January 2019. Guidance Notes to be issued by the Cayman Islands Tax Information Authority ("TIA") are currently in circulation for consultation and it is anticipated that the Guidance Notes will be issued very shortly. This legislation affect any company, LLC or LLP registered or incorporated in the Cayman Islands and such entities will need to consider if its current activities falls within the scope of the ES law. If so, the entity will be required to take measures to ensure it complies with the Law for each relevant activity that it undertakes. It is possible for certain functions to be outsourced to a Cayman based Service Provider provided the entity is able to monitor and control the conduct to the function.

What is the Economic Substance Test

Under the provisions of this ES Law, entities that carry on Relevant Activity are required to satisfy an Economic Substance ("ES") test unless tax resident outside the Cayman Islands. Relevant Activities are:-

- Banking business
- Distribution and service centre business
- Financing and leasing business
- Fund management business
- Headquarters business
- Holding company business
- Insurance business
- Intellectual property business
- Shipping business

The ES test requires that a relevant entity:

- (a) Conducts Cayman Islands core income generating activities (*defined term*) in relation to that relevant entity;
- (b) Is directed and managed in an appropriate manner in the Islands in relation to that relevant activity; and
- (c) Having regard to the level of relevant income derived from the relevant activity carried out in the Islands:-



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- (i) Has adequate amount of operating expenditure incurred in the Islands;
- (ii) Has adequate physical presence (including maintaining a place of business or plant, property and equipment) in the Islands; and
- (iii) Has an adequate number of full time employees or other personnel's with appropriate qualifications in the islands.

Date by which Entities must Comply

The Act makes it incumbent upon all companies incorporated on or after 1 January 2019 to meet these requirements. Existing companies (companies incorporated prior to 1 January 2019) have until 1 July 2019 to comply.

Holding Entities/Investment, Mutual Funds/Non-Tax Resident Companies

Pure equity holding companies are subject to a reduced ES test which is satisfied if the relevant entity confirms that:-

- (a) It has complied with all applicable filing requirements under the Companies Law (2018 Revision); and
- (b) It has adequate human resources and adequate premises in the islands for holding and managing equity participation in other entities.

It is anticipated that pure equity holding companies may engage its registered office service provided to satisfy these reduced substance requirements in the Islands where the pure equity holding company is passively holding equity interests in other entities.

Investment and Mutual Funds licensed or registered with CIMA will not be considered a relevant entity for ES purposes nor will entities that are tax resident outside the Islands by reason of its domicile, residence or any other criteria of a similar nature will not be a relevant entity for ES purposes. The Authority may require such non-tax resident entities to produce satisfactory evidence to substantiate its non-resident status. In the absence of evidence, an entity may be regarded as a relevant entity that is subject to ES Law.



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Reporting

From 2020, each entity will be required to declare their financial year and whether they are conducting Relevant Activities in their annual return. Relevant entities are required to provide in prescribed format (a portal is being developed) information to enable the TIA to determine each year if the ES requirements are being met. The timing of such returns will be confirmed when the Guidance Notes issue.

Consequences of not meeting the ES requirements

If the Authority determines that an Entity has failed to meet its ES requirements, it shall issue a notice giving reasons, details regarding any penalty, directing action to be taken to satisfy the ES test and advising the entity of the right to appeal. It is anticipated that an initial fine of CI10,000 will apply followed by a subsequently larger fine of CI100,000 if the test is not satisfied in the subsequent financial year after the initial notice of failure.

The Authority shall also notify the Registrar of any failure to meet the ES requirements after 2 consecutive years. The Registrar shall then seek a Court Order to:-

1. Require the company to take specific action including comply with the ES law or
2. In the case of a relevant entity that is
 - a. a company that is registered under the Companies Law (2018 Revision), an order that it is a defunct company;
 - b. an LLC registered under the Limited Liability Companies Law (2018 Revision), an order that it is a defunct company; or
 - c. an LLP registered under the Limited Liability Partnership Law, 2017, an order that the LLP be struck off in accordance with section 31 of the Law as if it is an LLP that the Registrar has reasonable cause to believe is not carrying on business or is not in operation.

We will update you further upon receiving the finalised Guidance on the matter.

In the interim, we strongly urge you to familiarise yourself with the requirements under the ES Law, a copy of which may be downloaded http://www.tia.gov.ky/pdf/Economic_Substance.pdf together with OECD and EU Reference Materials. Please seek appropriate legal and tax advice if deemed necessary.

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