

Cayman Islands



Economic Substance Requirements in the Cayman Islands

The information in this article has been superseded by a government update. See the updated article here: <https://marburys.com/economic-substance-requirements-in-the-cayman-islands>

The Economic Substance Law

On Monday 17 December 2018, a new economic substance bill was passed by the Cayman Islands legislature in an attempt to avoid, *inter alia*, a European Union (EU) tax blacklisting. This comes after the Cayman Islands were included in a list of countries whose tax policies and economic substance caused some concern for the EU Code of Conduct Group. Joining the Cayman Islands on this list are the British Virgin Islands, Bermuda, Guernsey, Jersey and Isle of Man (the **Listed Countries**).

This new legislation, entitled The International Tax Co-operation (Economic Substance) Law, 2018 (the **Economic Substance Law**), will only affect Relevant Entities (as defined below) in the Listed Countries who, effective 1 January 2019, will be required to demonstrate 'adequate economic substance' in the Cayman Islands.

Step 1: Classification of a Relevant Entity

The Economic Substance Law will only apply to Relevant Entities. Relevant Entities will generally include most Cayman LLC's, Cayman exempted companies and registered foreign companies, except for: (a) investment funds; (b) entities through which investment funds invest or operate, whether directly or indirectly; or (c) registered

Cayman Islands Economic Substance Requirements

foreign companies that are centrally managed and controlled outside of Cayman and are tax compliant in other relevant jurisdictions.

A Relevant Entity is thus defined as any of the below, except for (a), (b) and (c) above:

- (a) a company, other than a domestic company, that is:
 - (i) incorporated under the Companies Law or
 - (ii) a limited liability company registered under the Limited Liability Companies Law, unless its business is centrally managed and controlled outside of Cayman and it is tax resident outside of the Islands
- (b) a limited liability partnership that is registered under the Limited Liability Partnership Law, 2017, unless its business is centrally managed and controlled outside of Cayman and it is tax resident outside of the Islands
- (c) a company that is incorporated outside of the Islands, registered under the Companies Law and centrally managed and controlled in Cayman (unless it is tax resident outside the Cayman Islands).

Step 2: Relevant Activities conducted by Relevant Entities

If an entity is deemed as a Relevant Entity as per Step 1 above, this Relevant Entity will be required to file a notice with the designated authority stating whether or not it has carried out any of the following activities (the **Relevant Activities**) in the previous financial year:

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

Filing of Relevant Activities

All Relevant Entities will be required to file notice, whether conducting Relevant Activities or not. Those conducting Relevant Activities will need to provide a basic return detailing particulars including, but not limited to, income, expenses, assets, management, employees and physical presence. The economic substance of the Relevant Entity will be assessed by applicable authorities with the assistance of this notice. Relevant Entities who fall short of the Substance Test requirements will be given some direction to improve. Should a Relevant Entity fail

Cayman Islands Economic Substance Requirements

to meet the requirements, a fine of up to USD10,000 may be issued. Should the Relevant Entity continue to fail to meet the requirements in following years, it may be subject to increased fines and a potential striking-off.

Step 3: The Economic Substance Test

A Relevant Entity conducting any of the above Relevant Activities will be required to satisfy a three-tiered economic substance test (the **Substance Test**). To pass the Substance Test, a Relevant Entity must:

- (a) conduct Cayman Islands core income generating activities in relation to that Relevant Activity
- (b) be directed and managed in an appropriate manner in or from within the Cayman Islands in relation to that Relevant Activity
- (c) taking into account the level of income generated from that Relevant Activity carried out in or from within the Cayman Islands:
 - (i) have an adequate number of full-time employees / personnel with appropriate qualifications in the Cayman Islands
 - (ii) have adequate physical assets or physical presence in the Cayman Islands (including maintaining a place of business)
 - (iii) have adequate operating expenditure incurred in or from within the Cayman Islands

Cayman Islands Core Income Generating Activities

Core income generating activities are defined as activities that are being carried out in Cayman and are of central importance to a Relevant Entity in terms of generating income. Depending on the Relevant Activity, core income generating activities will differ. Marbury advises that each Relevant Entity carefully decipher which of its activities constitute as the core income generating ones.

Outsourcing of Core Income Generating Activities

The Substance Test above is satisfied in relation to a Relevant Activity if the Relevant Entity outsources its Cayman Islands core income generating activities, in relation to that Relevant Activity, to a third-party within the jurisdiction. The Relevant Entity must, however, be able to prove that it is able to monitor and control the Cayman Islands core income generating activities being carried out.

Holding Companies

Holding companies will experience exceptions to the above Substance Test, either with a reduced test (for standard holding companies), or with a more stringent test (in the case of higher risk intellectual property holding companies). Provisions for holding companies will need to be assessed on a case-by-case basis.

Additional Guidelines

Additional guidelines will be provided at a later date which are anticipated to assist all Relevant Entities with the requirements of the Substance Test.

Cayman Islands Economic Substance Requirements

Achieving Compliance

Marbury would advise that all entities undergo a review as per the steps laid out herein in order to decipher whether they are deemed as Relevant Entities, and if so, whether such Relevant Entities conduct Relevant Activities. From there, Relevant Entities are advised to take the necessary steps to ensure compliance.

For further information on any aspect of this guide please contact your usual Marbury adviser.

Disclaimer

This guide provides an overview of economic substance in the Cayman Islands and should not be read as legal advice. For more information, please contact Marbury.