

## Cayman Islands economic substance requirements - an overview

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Along with its fellow Overseas Territories, Crown Dependencies and other international financial centres, the Cayman Islands has comprehensive legislation and regulations requiring legal entities domiciled or registered in the Islands and carrying on certain activities to have demonstrable substance in Cayman.

The International Tax Co-operation (Economic Substance) Act (**Act**) reflects Cayman's commitment to its obligations as a member of the OECD/G20 global Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and corresponding EU requirements for no or nominal tax jurisdictions.

This briefing summarises the key elements of the Act, which has been subject to various updates since its introduction, and draws upon guidance (**Guidance**) and enforcement guidelines (**Enforcement Guidelines**) issued by the Cayman Islands Tax Information Authority (**TIA**) which has responsibility for the supervision and implementation of the Act.

Ogier is experienced in advising on the economic substance regimes of Cayman, Jersey, Guernsey and the British Virgin Islands and on cross-border queries that often arise in the context of global groups. Please get in touch with your usual Ogier contact or one of the key contacts listed [here](#).

### Overview

- **Before 31 January each year:** All entities must submit an Economic Substance Notification to the Cayman Islands Registrar
- **Within 12 months after financial year end:** All Relevant Entities that carried on one or more Relevant Activities must submit an Economic Substance Return to the TIA
- **Within 12 months after financial year end:** All entities that claimed to be tax resident

outside of the Islands and that carried on one or more Relevant Activities must submit an Economic substance return - tax resident in another jurisdiction form (**TRO Form**) to the TIA

The Act requires that each legal entity domiciled or registered in the Cayman Islands must make an annual notification (referred to as an **Economic Substance Notification** or **ESN**) as to whether or not it was carrying on one or more of a defined list of activities (**Relevant Activities**) in the prior year and if it was, the date of its financial year end, whether it is tax resident in a jurisdiction outside of the Cayman Islands and certain identification and contact information. Entities which are in scope (**Relevant Entities**) and which were conducting any Relevant Activity are required to meet an economic substance test (**ES Test**) in respect of such Relevant Activity. The requirements of the ES Test vary depending on the Relevant Activities conducted, and each Relevant Entity must make an annual report (referred to as an **Economic Substance Return**) in order to enable their compliance with the requirements of the ES Test to be assessed. The TIA is responsible for determining whether a Relevant Entity has satisfied the ES Test.

## Relevant Entities

Relevant Entities include all Cayman companies (including foundation companies), LLCs, LLPs, registered foreign companies and partnerships (including exempted limited partnerships, general partnerships, limited partnerships and foreign limited partnerships), except:

- a. investment funds or entities through which investment funds directly or indirectly invest or operate
- b. entities which are tax resident outside the Islands (including, subject to certain conditions, entities which are disregarded entities for US income tax purposes)
- c. entities which are authorised to carry on business locally in the Cayman Islands as a domestic company or local partnership

Cayman Islands trusts are not currently subject to the Act and, as such, are neither subject to the requirements to make annual notifications nor any requirements to meet the ES Test. However, the trustee should assess whether it is itself required to make annual notifications and meet the ES Test.

An entity which carried on a Relevant Activity in the reporting year and which claims tax residency outside the Islands must submit an annual return declaring the jurisdiction in which it is tax resident and providing documentary evidence of its tax residency outside the Islands. This return also includes information on the entity's immediate parent, ultimate parent and ultimate beneficial owner. All information submitted by such an entity to the TIA will be shared with tax authorities in the jurisdiction in which they are claiming residence and the jurisdictions of their immediate parent, ultimate parent and ultimate beneficial owner.

An entity which meets the definition of an investment fund in the Act, which may be the investment fund itself or an entity through which an investment fund directly or indirectly invests or operates (which would also generally include the general partner of an investment fund), is not a Relevant Entity and is not subject to an ES Test. It is, however, required to file an annual Economic Substance Notification to notify the TIA of its classification as an investment fund and to provide fund registration details (where relevant).

## **Relevant Activities**

The Relevant Activities are fund management business, banking business, insurance business, financing and leasing business, shipping business, distribution and service centre business, headquarters business, intellectual property business and holding company business.

The Guidance issued by the TIA provides detailed information and sector-specific examples regarding the scope of each of these Relevant Activities and, other than investment funds, all entities will need to consider their operational activities carefully in order to determine whether they may be conducting a Relevant Activity.

## **The ES Test**

Relevant Entities that carry on a Relevant Activity must satisfy the ES Test and, where a Relevant Entity carries on more than one Relevant Activity, it must satisfy, and report on its compliance with, the ES Test in respect of each such Relevant Activity. To satisfy the ES Test in relation to a particular Relevant Activity, a Relevant Entity must:

- a. carry on its "core income generating activities" in relation to that Relevant Activity in the Cayman Islands
- b. be "directed and managed" in an appropriate manner in the Cayman Islands in relation to that Relevant Activity
- c. having regard to the level of relevant income derived from the Relevant Activity carried out in Cayman
  - i. have an adequate amount of operating expenditure incurred in Cayman
  - ii. have adequate physical presence (which may include maintaining a place of business or plant, property and equipment) in the Cayman Islands
  - iii. have an adequate number of full-time employees or other personnel with appropriate qualifications in Cayman (note that these may include outsourced personnel provided they are located in Cayman)

A Relevant Entity may satisfy the requirement that its core income generating activities be

carried out in Cayman if those activities are conducted by any person and the Relevant Entity is able to monitor and control the carrying out of the core income generating activities by that other person - i.e. it is permissible for Relevant Entities to implement appropriate outsourcing arrangements with service providers in Cayman. Core income generating activities should not be outsourced to service providers outside Cayman. Wherever an entity outsources core income generating activities, the outsourced service provider will be required to verify certain information regarding the outsourcing arrangement to the TIA.

The concept of holding company business (which is one of the nine Relevant Activities) is limited to Relevant Entities that only hold equity participations in other entities and only earn dividends and capital gains (known as **Pure Equity Holding Companies**). A Pure Equity Holding Company is subject to a reduced ES Test which is satisfied if it confirms that it has complied with all applicable filing requirements under relevant Cayman Islands legislation and has adequate human resources and premises in Cayman for holding and managing equity participations in other entities. In practice a Pure Equity Holding Company will commonly be able to satisfy the reduced ES Test by appointing a reputable registered office in Cayman.

Relevant Entities conducting "high risk intellectual property business" are subject to a higher burden of proof in demonstrating that they maintain adequate economic substance in Cayman. High risk intellectual property business generally includes scenarios where an entity did not create the IP which it holds and now generates income from that IP either by licensing it to other group entities or as a consequence of the activities of other group entities. In order to meet the ES Test, an entity conducting high risk IP business must provide the TIA with materials which demonstrate that there is, and historically has been, a high degree of control over the development, exploitation, maintenance, protection and enhancement of relevant IP assets, exercised by an adequate number of full-time employees with the necessary qualifications that permanently reside and/or perform their activities within Cayman.

The Guidance issued by the TIA provides further information as to the meaning of "adequate" and "appropriate" for the purposes of the ES Test. Notably, such Guidance accepts that what is adequate or appropriate for each Relevant Entity will be dependent on the particular facts of the Relevant Entity and its business activity and requires that the directors (or equivalent) of each Relevant Entity make a determination on these matters in good faith.

## **Core income generating activities**

- a. The Act defines "core income generating activities" (**CIGA**) as activities that are of central importance to a Relevant Entity in terms of generating relevant income (ie income derived from the Relevant Activity) and requires that these be carried on in Cayman. The Act provides examples of core income generating activities for each Relevant Activity. For example, for financing and leasing business, CIGA include:

- i. negotiating or agreeing funding terms
- ii. identifying and acquiring assets to be leased
- iii. setting the terms and duration of financing and leasing
- iv. monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements

These lists of CIGA are not prescriptive and it is not the case that a Relevant Entity which conducts the Relevant Activity **must** conduct all of the listed CIGA. However, to the extent the Relevant entity **does** conduct the relevant CIGA, that CIGA must be conducted in the Cayman Islands. It should also be noted that where a Relevant Entity contracts to conduct a CIGA, it will be considered to be doing such an activity notwithstanding any delegation arrangement.

## **Directed and managed**

To be considered to be "directed and managed" in an appropriate manner in Cayman generally requires that:

- a. the Relevant Entity's board of directors, as a whole, has the appropriate knowledge and expertise to discharge its duties as a board
- b. meetings of the board are held in Cayman at adequate frequencies given the level of decision making required
- c. the minutes of the board of directors record the making of strategic decisions of the Relevant Entity at the board meetings held in Cayman
- d. the minutes of all meetings of the board, together with other appropriate records of the Relevant Entity, are kept in Cayman

A meeting will be considered to be validly held in Cayman for these purposes only if:

- a. the situation of that meeting would be deemed to be in Cayman under the constitutional documents of the Relevant Entity (this is commonly decided by the location of the chairman of the relevant meeting)
- b. at least that number of directors of the Relevant Entity constituting a quorum are physically present in Cayman for the meeting

## **Key dates**

The Act and accompanying regulations provide a timetable for compliance, notification and reporting.

- a. **Compliance:** The ES Test must be satisfied from the date on which the Relevant Entity commences the Relevant Activity until the date that the Relevant Entity ceases carrying on the Relevant Activity (or ceases to be a Relevant Entity)
- b. **Notification:** By 31 January in each calendar year, all legal entities domiciled or registered in the Cayman Islands must file an Economic Substance Notification to notify the TIA as to whether they conducted any Relevant Activities and whether they were a Relevant Entity during their financial year which commenced in the prior calendar year (ie the notification in 2024 would relate to financial years commenced in 2023, whether that be 1 January 2023 or 1 September 2023, for example). This notification is made via the entity's registered office to the Cayman Islands Registrar. Notwithstanding the 31 January deadline, no penalties accrue unless the notification has not been submitted by 31 March. Any legal entity which intends to terminate, migrate to another jurisdiction, deregister as a foreign company or be merged or consolidated with one or more other entities, is required to submit a notification for the current year before it becomes deactivated by the Cayman Islands Registrar
- c. **Reporting for Relevant Entities:** Each Relevant Entity conducting a Relevant Activity must submit an Economic Substance Return to the TIA within 12 months of the end of its financial year regarding its compliance with the ES Test during that financial year. This return includes various financial, ownership and other data and any Relevant Entity conducting a Relevant Activity must also provide its books of account or financial statements for the relevant financial year
- d. **Reporting for entities claiming tax residency outside of the Islands:** Each entity that carried on a Relevant Activity but which is not a Relevant Entity by reason of its tax residency in a jurisdiction other than the Cayman Islands must submit a TRO Form to the TIA within 12 months of the end of its financial year. As noted above, this includes providing documentary evidence of its tax residency outside the Islands and providing information on the entity's immediate parent, ultimate parent and ultimate beneficial owner

## **Record keeping**

A Relevant Entity that is required to satisfy the ES Test in relation to a Relevant Activity must retain for six years after the end of its financial year records that relate to the information required to be provided to the Authority.

## **Penalties**

The penalty for failure to satisfy the ES Test for a Relevant Activity in a given financial year is up to US\$12,195. The penalty for failure to satisfy the ES Test for a Relevant Activity in a subsequent financial year after an initial notice of failure can rise to up to US\$121,950 and, in addition, the Registrar must make an application to the Grand Court for an order for the Relevant Entity

either to take such actions as may be specified or to be struck off.

In addition, where a Relevant Entity is required to satisfy the ES Test and fails to comply with its annual reporting obligations, the TIA may impose a penalty of up to US\$6,098, with an additional fine of up to US\$610 accruing for each day the failure to comply continues. Separately, any failure to provide the TIA with information requested (assuming such information is in the control of the relevant person) can lead to a fine of up to US\$12,195 or to imprisonment for a term of two years, or to both.

The Enforcement Guidelines confirm that where the TIA becomes aware that an entity has misclassified itself under the Act and as a result has not submitted a required Economic Substance Return for a reporting period, the TIA will consider the entity to have missed the reporting deadline and the entity will have 30 days to file an Economic Substance Return. If the entity then fails to submit an Economic Substance Return within the extended deadline, the entity will be deemed to have failed the ES Test and will be subject to the maximum penalties outlined above. Similarly, if an entity fails to respond to a request by the TIA for clarification or additional information, the TIA will make a determination as to whether the entity is required to satisfy an ES Test and whether it has satisfied such test on the basis of the information provided, again being subject to maximum penalties if the TIA determines that the entity failed to satisfy the ES Test.

If you would like to discuss the application of the Cayman Islands economic substance regime to your business and/or how to comply with the requirements of the Act, please get in touch with your usual Ogier contact or any of our partners listed [here](#).

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