Cayman Islands Economic Substance Requirements - Overview
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From 1 January 2019, new legislation came into effect in the Cayman Islands, requiring in-scope entities that carry on particular activities to have demonstrable economic substance in Cayman.

The International Tax Co-operation (Economic Substance) Law (Law), 2018 was enacted after an extensive process of consultation with the EU Code of Conduct Group, the OECD and Cayman stakeholders.

The Law is the latest in a series of steps by Cayman to meet its 2017 commitment as an Inclusive Framework member under the OECD’s global Base Erosion and Profit Shifting (BEPS) initiative, and corresponding EU requirements encompassing no or nominal tax jurisdictions. Other international financial centres such as the British Virgin Islands, Guernsey, Jersey, the Isle of Man and Bermuda have implemented similar legislation.

This briefing summarises the main elements of the Law. In addition, please see our briefing here for recent updates in respect of the Law. More detailed guidance for particular categories of entity and activity, together with commentary on corresponding laws in the British Virgin Islands, Guernsey and Jersey is available on ogier.com or from your usual Ogier contact.

Overview

1. The Law defines which Cayman entities are in-scope (Relevant Entities). Relevant Entities must make an annual report as to whether or not they are carrying on one or more of a defined list of activities (Relevant Activities). If they are, they must satisfy an economic substance test in Cayman in respect of such Relevant Activities. Cayman’s Tax Information Authority is responsible for determining if a Relevant Entity satisfies the economic substance test.

Relevant Entities

2. Relevant Entities include most Cayman exempted companies, Cayman LLCs and registered foreign companies except:

   a) investment funds or entities through which investment funds directly or indirectly invest or operate;

   b) entities which are tax resident outside the Cayman Islands;

   c) entities which are authorised to carry on business locally in the Cayman Islands as a domestic company; or

   d) Cayman exempted limited partnerships and trusts.

Relevant Activities

3. All Cayman entities will have to make an annual declaration as to whether they are a
Relevant Entity and whether they have conducted any Relevant Activities in the preceding financial period. Relevant Activities are fund management, banking, insurance, finance and leasing, distribution and service centre business, headquarters business, intellectual property business, shipping, and holding company business.

**Economic Substance Test**

4. Relevant Entities that carry on Relevant Activities must satisfy the economic substance test. To satisfy the economic substance test in relation to a Relevant Activity, a Relevant Entity must:

   a) conduct "Cayman Islands core income generating activities";
   
   b) be "directed and managed" in an appropriate manner in Cayman; and
   
   c) having regard to the level of relevant income derived from the Relevant Activity carried out in Cayman:

      - have an adequate amount of operating expenditure incurred in Cayman;
      - have adequate physical presence (including maintaining a place of business or plant, property and equipment) in Cayman; and
      - have an adequate number of full-time employees or other personnel with appropriate qualifications in Cayman.

5. A Relevant Entity satisfies the economic substance test in relation to a Relevant Activity if its Cayman Islands core income generating activities in relation to that Relevant Activity are conducted by any other person and the Relevant Entity is able to monitor and control the carrying out of the Cayman Islands core income generating activities by that other person.

6. Holding companies that only hold equity participations in other entities and only earn dividends and capital gains are subject to a reduced substance test. Conversely, Relevant Entities carrying on "high risk intellectual property business" are subject to a higher burden of proof in demonstrating they maintain adequate economic substance in Cayman.

7. The Tax Information Authority has published an updated form of Guidance on satisfying the economic substance test, including as to the meaning of "adequate" and "appropriate". Rather than providing a prescriptive formula, the Guidance notes 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. A Relevant Entity will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy and appropriateness of the resources utilised and expenditures incurred. In addition, the updated Guidance includes sector specific commentary on Relevant Activities. For a further discussion of the updated guidance see our [briefing note here](#).

**Core Income Generating Activities**

8. The Law defines "Cayman Islands core incoming generating activities" (CIGAs) as activities that are of central importance to a Relevant Entity in terms of generating income and that are being carried out in Cayman. For each Relevant Activity, the Law provides particular included activities. For example:

   a) For fund management business, CIGAs include:

      - taking decisions on the holding and selling of investments;
      - calculating risks and reserves;
- taking decisions on currency or interest fluctuations and hedging positions; and
- preparing reports or returns to investors and the Cayman Islands Monetary Authority.

b) For financing and leasing business, CIGAs include:
- negotiating or agreeing funding terms;
- identifying and acquiring assets to be leased;
- setting the terms and duration of financing or leasing;
- monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements.

Directed and Managed

9. To be considered to be “directed and managed” in an appropriate manner in Cayman will require:

a) that the Relevant Entity’s board of directors, as a whole, have the appropriate knowledge and expertise to discharge its duties as a board;

b) that meetings of the board be held in Cayman at adequate frequencies given the level of decision making required, and that there be a quorum of the board of directors present in Cayman at such meetings;

c) that minutes of such board meetings record the strategic decisions made at these meetings; and

d) retention of all board minutes and appropriate records in Cayman.

Key Dates

10. The Law and accompanying Regulations provide a timetable for compliance, notification and reporting:

a) Compliance:
- Relevant Entities in existence prior to 1 January 2019 must satisfy the economic substance test in relation to a Relevant Activity from 1 July 2019;
- Relevant Entities formed on or after 1 January 2019 must satisfy the economic substance test in relation to a Relevant Activity from the date on which the Relevant Entity commences the Relevant Activity.

b) Notification: starting in 2020, all Cayman entities must notify the Tax Information Authority whether or not they are a Relevant Entity and whether or not they are conducting a Relevant Activity and provide certain additional details including as to the date of their financial year.

c) Reporting: within 12 months of the end of their financial year, Relevant Entities carrying on a Relevant Activity must submit to the Tax Information Authority a report setting forth prescribed details as to their compliance with the economic substance test.
Penalties for Insufficient Substance

11. The penalty for failure to satisfy the economic substance test for a Relevant Activity in a financial year is US$12,200. The penalty for failure to satisfy the economic substance test for a Relevant Activity in the subsequent financial year is US$122,000, and in addition application must be made to the Grand Court for an order requiring the Relevant Entity to take such action as is specified, or to be struck off.

If you would like to discuss how the proposals may impact your business, please get in touch with your usual Ogier contact or any of our partners listed here.

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