

Cayman Islands Economic Substance Update

August 2020

On 13 July 2020, updated Guidance Notes (Guidance v3.0) were issued by the Cayman Islands Tax Information Authority (the "Authority") in relation to the jurisdiction's economic substance legislation. This new guidance was developed in response to feedback from statutory private sector consultations, the secretariat to the OECD Forum on Harmful Tax Practices (FHTP) and the EU Commission, and was released to further supplement the Economic Substance Law and replace Guidance v2.0 that was issued on 30 April 2019. Also, since the issue of Guidance v2.0, amendments have been made to the Economic Substance Law, culminating in the International Tax Co-operation (Economic Substance) Law, 2020 as amended ("ES Law").

Economic Substance in Brief

The ES Law imposes an obligation to examine and determine whether an entity is carrying on a "relevant activity" and, if it is, whether that entity is a "relevant entity". Where the answer to both is yes, the entity will be required to satisfy an economic substance test ("ES Test") under the ES Law.

Takeaways from the Latest Updates

- Circumvention has been addressed. The Authority will monitor arrangements and will investigate cases in which a person has entered any

arrangement, the main purpose or one of the main purposes of which is to circumvent any obligation under the ES Law, for example an entity that seeks to manipulate or artificially suppress its income to circumvent substance requirements.

- Entities that are registered with the Cayman Islands Monetary Authority (CIMA) under the Private Funds Law, 2020 will be considered investment funds for the purposes of the ES Law.
- Guidance v2.0 provided sector-specific guidance examples, to assist in determining whether a "relevant entity" is conducting a "relevant activity" in relation to holding company business, intellectual property business and shipping business. Guidance v3.0 extends this sector-specific guidance to the remaining "relevant activities", i.e., banking business, distribution and service centre business, financing and leasing business, fund management business, headquarters business and insurance business.
- Generally, a domestic company is not a "relevant entity" for purposes of the ES Law, as generally such entities are carrying on business only in the Cayman Islands. Guidance v3.0 clarifies that a "domestic company" means a company that is not part of a Multi-National Enterprise (MNE) group, meaning a group of companies operating and tax resident in multiple jurisdictions with total

consolidated revenue of at least US\$850 million. Further, companies limited by guarantee are no longer considered domestic companies, unless they otherwise satisfy the criteria in the definition of that term under the ES Law.

- Earlier this year it was announced there is an annual verification for any Cayman Islands entity claiming tax residency elsewhere in respect of the ES Law. A form must be filed with the Authority as support of the tax residency outside of the Islands.
- A “relevant entity” outsourcing its core income generating activities (CIGA) must have the outsourced service provider verify their authenticity to the Authority within a 30-day timeframe.
- Samples of both the tax residency form and outsource provider form can be found on the Department for International Tax Cooperation (DITC) [website](#).

Reporting and Penalty Reminder

A “relevant entity” carrying on a “relevant activity” that is required to satisfy an ES Test, must prepare and submit to the Authority annually an economic substance return (“ES Return”). The ES Return must be made within 12 months after the last day of the end of each financial year of the “relevant entity”, commencing on or after 1 January 2019. ES Returns will be filed on a newly developed electronic portal of the DITC, expected to launch in late Q3 2020. The portal is intended to encompass not only economic substance but also other legislative frameworks (FATCA, CRS, country-by-country reporting) and is expected to facilitate the sharing of information with other countries’ tax authorities.

Where a “relevant entity” is required to file an ES Return, the failure to do so by the applicable time will generate a penalty of CI\$5,000 (US\$6,098) and an additional penalty of CI\$500 (US\$609.75) for each additional day during which the failure to comply continues.

A further update will be provided on the practicalities of the reporting process when more information is available.

Action

Responsibility for compliance with the economic substance legislation rests with the directors of companies and the general partners of limited liability partnerships. More on the Cayman Islands economic substance regulatory framework can be found on the DITC [website](#). Trident recommends seeking legal advice for further direction on the legal aspects of economic substance. Trident can refer you to legal counsel as you may require. Depending on the outcome of any assessment and the nature of the economic substance requirements that may apply, Trident can assist with complying with the requirements.

Please contact the Trident Cayman ES team with any questions at CaymanSubstance@tridenttrust.com.

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