

# Cayman Islands



MARBURY



## Economic Substance Requirements in the Cayman Islands

### The Economic Substance Law

The International Tax Co-operation (Economic Substance) Law, 2018 (the **ES Law**) came into effect on 1 January 2019 requiring 'relevant entities' engaged in certain 'relevant activities' and receiving 'relevant income' to demonstrate 'adequate economic substance' in the Cayman Islands.

The ES Law is the latest measure by the Cayman Islands to meet its 2017 obligations as an Inclusive Framework member under the OECD's global Base Erosion and Profit Shifting (BEPS) initiative, and related EU requirements on jurisdictions that impose little or no income tax.

The ES Law is supplemented by the 'Economic Substance For Geographically Mobile Activities' Guidance (the **Guidance**) issued by the Cayman Islands Tax Information Authority (**TIA**) to aid understanding of, and compliance with, the ES Law.

This summary replaces our previous releases of [21 December 2018](#), [11 March 2019](#) and [20 May 2019](#) and provides an updated overview of the key aspects of the legislation by outlining steps to identify which Cayman entities are in scope and how to achieve compliance.

### Step 1: Classification of a Relevant Entity

The ES Law applies to Relevant Entities. **Relevant Entities** are defined in the ES Law as:

- (a) a company, other than a domestic company, that is:
  - (i) incorporated under the Companies Law (Revised); or
  - (ii) a limited liability company registered under the Limited Liability Companies Law (Revised);
- (b) a limited liability partnership that is registered under the Limited Liability Partnership Law, 2017;
- (c) a company that is incorporated outside of the Islands and registered under the Companies Law (Revised);

but does not include:

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- (i) investment funds (including any entity through which an investment fund directly or indirectly invests or operates); or
- (ii) an entity that is tax resident outside the Cayman Islands.

All other entities and legal arrangements, including trusts and other types of partnership, are not included in the current ES Law and are therefore considered out of scope.

## Investment funds

An investment fund is defined in the ES Law as an entity whose principal business is the issuing of investment interests to raise funds or pool investor funds with the aim of enabling a holder of such an investment interest to benefit from the profits or gains from the entity's acquisition, holding, management or disposal of investments and includes any entity through which an investment fund directly or indirectly invests or operates (but not an entity that is itself the ultimate investment held).

## 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 TIA 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

The [Guidance](#) provides further information on the definition of each type of Relevant Activity.

## Step 3: The Economic Substance Test

A Relevant Entity conducting one or more of the above Relevant Activities is required to satisfy a three-tiered economic substance test (the **ES Test**) in respect of each Relevant Activity. To pass the ES Test, a Relevant Entity must:

- 1) conduct Cayman Islands core income generating activities (**CIGA**) in relation to that Relevant Activity;
- 2) be directed and managed in an appropriate manner in the Cayman Islands in relation to that Relevant Activity; and
- 3) taking into account the level of relevant income generated from that Relevant Activity carried out in the Cayman Islands:

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

## What is Relevant Income

Relevant income is all of an entity's gross income from its relevant activities and recorded in its books and records under applicable accounting standards. Any income that is not generated from Relevant Activities is not to be considered when determining adequate substance in the Cayman Islands.

## Cayman Islands Core Income Generating Activities (Cayman Islands CIGA)

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. A Relevant Entity must conduct an adequate amount of the appropriate elements under the Cayman Islands CIGA for the particular type of Relevant Activity that it is undertaking in order to show economic substance. Depending on the Relevant Activity, Cayman Islands CIGA will differ and Marbury advises to carefully decipher which of its activities constitute as the core income generating ones. The [Guidance](#) includes a non-exhaustive list of Cayman Islands CIGA for each Relevant Activity.

## Holding Companies

Holding companies are subject to exceptions to the above ES Test, either with a reduced test (for pure equity holding companies; see below), 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.

### Pure equity holding company

The term 'pure equity holding company' means a company that only holds equity participations in other entities and only earns dividends and capital gains.

A Relevant Entity that is *only* carrying on a Relevant Activity that is the business of a pure equity holding company is subject to a reduced ES Test which is satisfied if it 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 Cayman Islands for holding and managing equity participations in other entities.

A pure equity holding company maintaining a registered office in the Cayman Islands engaging its registered office service provider in accordance with the Companies Law (2018 Revision) may be able to satisfy these reduced substance requirements in the Cayman Islands where the pure equity holding company is passively holding equity interests in other entities, depending on the level and complexity of activity required to operate its business. A pure equity holding company is not required to be directed and managed in the Cayman Islands.

## Notification and reporting

Starting from 2020 all Relevant Entities must notify the TIA annually:

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- (a) whether or not they are carrying on a Relevant Activity;
- (b) if the Relevant Entity is carrying on a Relevant Activity, whether or not all or any part of the Relevant Entity's gross income in relation to the Relevant Activity is subject to tax in a jurisdiction outside of the Cayman Islands and, if so, shall provide appropriate evidence to support that tax residence as may be required by the TIA; and
- (c) the date of the end of its financial year.

Relevant Entities carrying on Relevant Activities that are required to satisfy the ES Test must also prepare and submit to the TIA a report for assessment detailing particulars including, but not limited to, income, expenses, assets, management, employees and physical presence. The Relevant Entity is required to file the report no later than 12 months after the last day of the end of each financial year.

For the avoidance of doubt, the timing for compliance with the notification and reporting obligations are separate from timing of compliance with the ES Test.

A Relevant Entity that carries on a Relevant Activity but which has no relevant income is not obliged to meet the requirements of the ES Test. That Relevant Entity will still, however, be required to satisfy its notification and reporting obligations under the ES Law (eg the report filed will be akin to a 'nil' return).

The ES notification is to be filed separately and will be a prerequisite to the General Registry's annual return. It should be noted that where an entity claims an exemption, eg domestic company, investment fund, or tax resident outside the Cayman Islands, further information will be required to validate the claim.

The specific time, form and manner of such notification has yet to be finalised and Marbury will provide further updates when they become available.

## Penalties for non-compliance

The penalty for not satisfying the ES Test is USD12,200 (KYD10,000). In the event of failing the ES Test in the subsequent financial year, the penalty increases to USD122,000 (KYD100,000). Such failure after two consecutive years may result in court involvement and ultimately the Cayman Islands entity being struck-off.

## Achieving Compliance

A Relevant Entity is subject to the ES Test under the ES Law from the date on which it commences a Relevant Activity unless the Relevant Entity was in existence prior to 1 January 2019, in which case it must comply by 1 July 2019.

Marbury would advise that all existing 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 by the deadline.

Marbury will advise clients individually on next steps based on the current legislation and guidance.

For further information on any aspect of this updaters 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. Links to the Cayman Islands Economic Substance legislation and related Guidance can be found here: [http://www.tia.gov.ky/pdf/Economic\\_Substance.pdf](http://www.tia.gov.ky/pdf/Economic_Substance.pdf).