

## Alert

# Cayman Islands – The International Tax Co-operation (Economic Substance) Law 2018

Author: Alan Dickson, Partner

## Introduction of Substance Requirements for Certain Cayman Islands Entities

The Cayman Islands Government has passed legislation, with effect from 1 January 2019, requiring certain entities incorporated or registered in the Cayman Islands to maintain economic substance in the jurisdiction. We set out below a summary of the entities and activities which may be affected by this new legislation and of the resulting compliance issues that require consideration.

The *International Tax Co-Operation (Economic Substance) Law, 2018* (the “ES Law”) was enacted in response to a scoping paper issued by the European Union’s Code of Conduct Group (Business Taxation) in June 2018 in respect of initiatives to combat global base erosion and profit shifting. The paper set out jurisdictional substance requirements that certain jurisdictions outside the EU must adopt. Similar legislation has been enacted in other major offshore jurisdictions.

### Relevant Entities

The ES Law applies to a defined class of **relevant entities**. This includes Cayman Islands exempted companies, foreign companies that are registered in Cayman, as well as Cayman Islands LLCs and LLPs. Excluded from the defined relevant entities are (i) any entity whose business is centrally managed and controlled outside the Cayman Islands and which is tax resident outside the Cayman Islands, (ii) investment funds, including entities through which any such fund invests or operates, (iii) Cayman Islands companies limited by guarantee, and (iv) Cayman Islands not-for-profit companies.

- Insurance business
- Intellectual property business
- Shipping business

Relevant entities will be required to meet the **economic substance test** (“ES Test”) set out in the ES Law in respect of their relevant activities in the Cayman Islands. The ES Test is described in general terms only in the ES Law and is anticipated to be further defined in guidance notes to be issued by the Cayman Islands authorities in due course.

For relevant entities carrying out most relevant activities, the ES Law requires that they:

- (a) conduct Cayman Islands core income generating activities (“Cayman Islands CIGA” – further defined below) in relation to the relevant activity;
- (b) be directed and managed appropriately in the Cayman Islands related to the relevant activity; and
- (c) with regard to the level of relevant income from the relevant activity carried out in the Cayman Islands -
  - (i) have an adequate amount of operating expenditure incurred in the Cayman Islands;

### Relevant Activities

The categories of **relevant activities** include the following broad categories, each further defined in the ES Law:

- Banking business
- Distribution and service centre business
- Financing and leasing business
- Fund management business
- Headquarters business
- Holding company business

- (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.

A relevant entity may satisfy the ES Test by outsourcing the conduct of its Cayman Islands CIGA to another person provided that the relevant entity is able to monitor and control the carrying out of the Cayman Islands CIGA. The term “**Cayman Islands CIGA**” is defined in the ES Law to mean activities that are of central importance to a relevant entity in terms of generating income and that are being carried out in the Cayman Islands. It is anticipated that guidance notes when published will elaborate upon the ES Test requirements for Cayman Islands CIGA.

The ES Test for a relevant entity that is only carrying on the business of a pure equity holding company has reduced criteria, requiring that such an entity comply with all applicable filing requirements under the Companies Law (2018 Revision) and have adequate human resources and adequate premises in the Cayman Islands for holding and managing equity participations in other entities. A pure equity holding company

is defined in the ES Law as a company that only holds equity participations in other entities and only earns dividends and capital gains.

Each relevant entity, whether or not carrying on relevant activities, will be required to file an annual report with the Cayman Islands Tax Information Authority in respect of their status under the ES Law including, in case of those entities carrying on relevant activities, their obligation to meet the applicable ES Test.

### How can we help?

We are monitoring closely the development of the ES Law and the related guidance notes in the Cayman Islands and are available to assist clients in understanding their new obligations under the ES Law. For further information please contact one of our lawyers listed below or your usual Conyers lawyer.

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#### Author:

**Alan Dickson**  
Partner  
alan.dickson@conyers.com  
+1 345 814 7790

#### Other Contacts:

**Kevin Butler**  
Partner, Head of Cayman Islands  
Office and Corporate Practice  
kevin.butler@conyers.com  
+1 345 814 7374

**Richard Fear**  
Partner  
richard.fear@conyers.com  
+1 345 814 7759

**Craig Fulton**  
Partner  
craig.fulton@conyers.com  
+1 345 814 7372

**Derek Stenson**  
Partner  
derek.stenson@conyers.com  
+1 345 814 7392

**Matthew Stocker**  
Partner  
matthew.stocker@conyers.com  
+1 345 814 7382

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For further information please contact: [media@conyers.com](mailto:media@conyers.com)