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Economic Substance in the Cayman Islands

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From 1 January 2019, The International Tax Co-operation (Economic Substance) Law 2018 (the “Law”), came into effect. It requires entities conducting certain activities that are within scope of the Law to demonstrate economic substance in the Cayman Islands. These entities will be required to report annually on certain activities to the Cayman Islands Tax Information Authority. Additional Regulations and Guidance were issued on 22 February 2019.

Background

The Cayman Islands is a transparent, tax neutral jurisdiction, compliant with international tax laws. This new Law demonstrates the commitment of the Cayman Islands as a member of the OECD’s Inclusive Framework on Base Erosion and Profit Shifting (“BEPS”) and importantly BEPS Action 5. It supports the Cayman Islands’ commitment to the EU by having legislation in place by 31 December 2018.

Economic substance regulation is not only limited to the Cayman Islands. Over 125 jurisdictions are members of the OECD BEPS Inclusive Framework, and similar Economic Substance laws have been passed in other offshore jurisdictions such as the British Virgin Islands and Bermuda.

In Scope

The Law applies to “Relevant Entities”. It requires Relevant Entities that conduct Relevant Activities to satisfy the Economic Substance Test in relation to each Relevant Activity. Relevant Entities will also have obligations under the new Law in relation to notification and reporting.

What are Relevant Entities?

As per the Law, a “Relevant Entity” means -

- a company, other than a domestic company, that is either incorporated under the Companies Law (2018 Revision) or a limited liability company registered under the Limited Liability Companies Law (2018 Revision);
- a limited liability partnership that is registered in accordance with the Limited Liability Partnership Law, 2017;
- a company that is incorporated outside of the Islands and registered under the Companies Law (2018 Revision).

The following entities are NOT included:

- investment funds or entities through which investment funds directly or indirectly invest or operate;
- entities which are tax resident outside the Cayman Islands;
- entities which are authorised to carry on business locally in the Cayman Islands as a domestic company; or
- Cayman exempted limited partnerships and trusts.

All Relevant Entities will have to make an annual declaration as to whether they have conducted any Relevant Activities in the preceding financial period.

What are Relevant Activities?

The Law applies economic substance requirements to Relevant Entities with any of the following “Relevant Activities”:

- banking business;
- distribution and service centre business;
- financing and leasing business;
- fund management business;
- headquarters business;
- holding company business;
- insurance business;
- intellectual property business; or
- shipping business (excluding pleasure yachts).

It does not include investment fund business.

Economic Substance Requirements

Relevant Entities that conduct Relevant Activities must comply with the ‘Economic Substance Test’, i.e. Relevant Entities must be:

- conducting “Cayman Islands core income generating activities”;
- “directed and managed” in an appropriate manner in Cayman; and
- demonstrating an adequate amount of expenditure, physical presence and suitably qualified employees or other personnel in Cayman.

Timeline for compliance – key dates

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.

In addition, starting in 2020, all Relevant Entities must notify the Tax Information Authority whether or not they are conducting a Relevant Activity and provide certain additional details including the date of the financial year.

The reporting deadline is within 12 months of the end of their financial year. All Relevant Entities conducting Relevant Activities must submit a report to the Tax Information Authority detailing their compliance with the Economic Substance Test.

Disclaimer

The information contained in this article is a summary only. It does not constitute legal advice. Appropriate professional advice should be sought for any specific matter.

Penalties and Fines

Penalties for failure to satisfy the Economic Substance Test include:

- a penalty of \$10,000 (c. US\$12,200) for default in the first accounting period;
- a penalty of \$100,000 (c. US\$122,000) in a subsequent accounting period. Further, an order from the Grand Court could be obtained requiring the Relevant Entity to take such action as is specified, or to be struck off;
- Directors, managers or managing members of Relevant Entities may also be liable for offenses, including neglecting their duties.

What should I be doing now?

The first step should be to determine whether the terms ‘Relevant Entity’ and ‘Relevant Activity’ apply to the entity in question.

An internal review should be undertaken to determine the measures required to achieve compliance with the new Law.

Grant Thornton provide advisory services to help you understand the requirements and ensure your business is compliant.

Contact us

If you would like Grant Thornton’s assistance on how these requirements will impact your business, please reach out to Dara Keogh, Managing Partner or Niall McAuliffe, Director.



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