

Tax Express - Immediate attention

April 2019

New Economic Substance Law in Cayman Islands

In response to the European Union ("EU")'s pressure especially on tax transparency and compliance with OECD's Base Erosion and Profit Shifting ("BEPS") package, Cayman Islands ("Cayman") passed the International Tax Co-operation (Economic Substance) Law, 2018 ("ES Law") which came into force on 1 January 2019.

Corresponding to the ES Law, the Cayman Tax Information Authority ("Cayman Authority") issued, on 22 February 2019, the Guidance of Economic Substance For Geographically Mobile Activities ("Guidance") to provide support and explanation for the scope, and how to comply with the ES Law.

Under the ES Law, the "relevant entities" carrying on the "relevant activities" are subject to the ES Law and required to comply with the ES

requirements. For the existing entities incorporated prior to 1 January 2019, they must comply with the law by 1 July 2019. For the newly set-up entities, they must comply with the law immediately upon commencing a relevant activity.

This express briefly provides an introduction of the Economic Substance ("ES") requirements under the ES Law with an aim at drawing immediate attention of the entities and individuals that have or will set up companies in Cayman for the purpose of meeting the ES requirements.

A brief introduction on scope of the ES Law

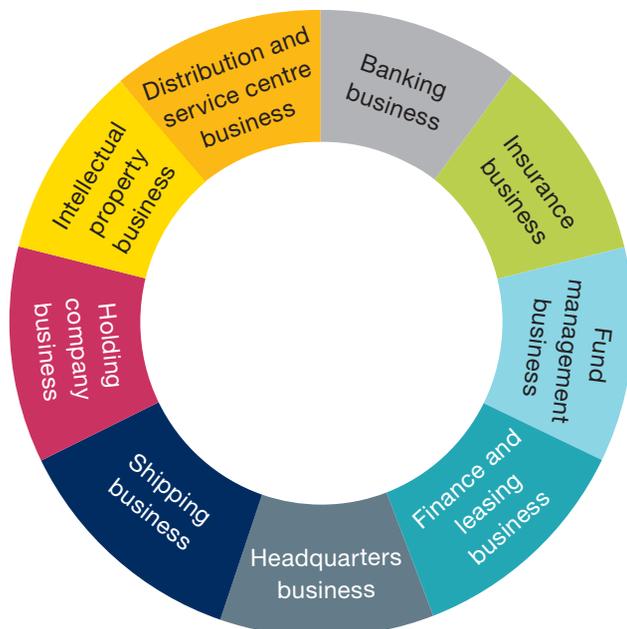
Relevant entities

The table below provides a brief summary on the meaning of a "relevant entity" :

A relevant entity means		Does not include
(a) a company (other than a domestic company)	(i) incorporated under the Companies Law (2018 Revision); or	(i) an investment fund; or (ii) an entity that is tax resident outside Cayman (Details refer to section of Tax resident outside Cayman)
	(ii) a limited liability company registered under the Limited Liability Companies Law (2018 Revision)	
(b) a limited liability partnership registered under the Limited Liability Partnership Law, 2017		
(c) a company incorporated outside of Cayman and registered under the Companies Law (2018 Revision)		

Relevant activities

The relevant activities are:



ES requirements

The Guidance provides general principles in respect of how to comply with the ES requirements :

A relevant entity satisfies the ES requirements in relation to a relevant activity provided that it fulfills the following in relation to the relevant activities :

- conducts Cayman core income generating activities;
- is directed and managed in an appropriate manner in Cayman; and
- having regard to the level of relevant income derived from the relevant activity carried out in Cayman in term of adequate amount of operating expenditure, adequate physical presence and adequate number of full-time employees or other qualified personnel.

Pure equity holding company

Pure equity holding company means a company that only holds equity participations in other entities and only earns dividends and capital gains.

For a pure equity holding company, the ES Law specifically provides reduced ES requirements in Cayman if its activity falls into the definition of "pure equity holding". Such reduced requirements require that the entity confirms that it has complied with all applicable filing requirements AND has adequate human resources and adequate premises in Cayman for holding and managing equity participations in other entities, for which it may engage the service of its registered office service provider to satisfy these requirements.

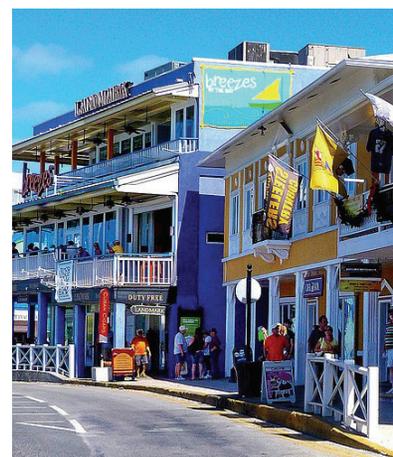
For a relevant entity that is carrying on more than one relevant activity (i.e. holding company business), it is required to satisfy the ES requirements in relation to each relevant activity.

Tax resident outside Cayman

An entity incorporated or established in Cayman is not regarded as a relevant entity for the ES Law purpose if it is a tax resident outside Cayman. In determining whether a Cayman company is resident outside the Cayman, the Cayman authority will look at whether the entity is subject to tax in another jurisdiction by reason of its domicile, residence or any other criteria of a similar nature. **Evidence to substantiate the claim for tax resident outside Cayman may include tax identification number, tax residence certificate, and assessment or payment of tax. Details of its parent company, ultimate parent company, and ultimate beneficial owners are required to be submitted.**

Spontaneous exchange of information will be made by the Cayman authorities with the relevant overseas tax authorities in respect of the information of the company where it claims to be tax resident and those of its parent company, ultimate parent company, and ultimate beneficial owners.

The Guidance further provides that the ES requirements must be satisfied with respect to any part of the relevant income that is not subject to income tax anywhere.



Notification and reporting

- A relevant entity is required, starting in 2020, to notify the Cayman Authority annually of the matters according to the requirements specified by the Guidance;
- A relevant entity that is carrying on a relevant activity and is required to satisfy the ES requirements must submit a report to the Cayman Authority within 12 months after the last day of the end of each financial year regarding whether the ES requirements have been satisfied in relation to that relevant activity.

Penalty

Penalties for failure to comply with the ES requirements are heavy: C\$10,000 (US\$12,200) in the first year and C\$100,000 in subsequent year, and followed by possible striking off of the entity.

Provision of false information knowingly or wilfully is an offence and is liable to a fine of C\$10,000, and / or imprisonment for 5 years.

Where the offence is committed due to the negligence or consent or connivance of any director, manager, secretary or other officer, such person shall be so liable to punishment accordingly.

Our observations

It is a world-wide trend that all entities operating anywhere in the world are required, unless statutory exempted, to subject their income to a certain degree of taxation. All



offshore centres are now required to comply with requirements under BEPS package otherwise they would be blacklisted as non-co-operative tax jurisdiction. According to the relevant requirements, they are also enforcing stringent disclosure requirements including automatic exchange of information between the tax jurisdictions and spontaneous disclosure of the information upon confirmation of the company's non-compliance or non-resident status.

Although a number of legal, tax and / or practical questions in respect of the ES Law are still subject to further clarifications or elaborations, the potentially affected entities may consider to take immediately the following actions:

- Reviewing their shareholding and / or operation structure which includes Cayman entity to evaluate and assess possible impacts of the ES Law;
- Considering what kind of actions should be undertaken for the purpose of complying with the ES requirements (if applicable);

- Evaluating feasibility and applicability of establishing a tax resident status in a tax jurisdiction (e.g. Hong Kong) which is not on the OECD / EU list of non-cooperative jurisdictions for tax purpose.

Hong Kong is a financial center in Asia-Pacific and has adopted a simple and friendly taxation system. In addition, Hong Kong has world class financial infrastructure, excellent banking system, top quality professionals such as lawyers, accountants, financiers, and fairly extensive tax treaties for avoidance of double taxation.

- Monitoring any new developments closely as the EU will review the ES legislations issued by Cayman and the latter may issue further legislations or guidance which may affect the relevant entities;
- Consulting with professional(s) for legal and tax advices in respect of how to fulfill and comply with the ES Law in relation to your operations.

Any readers or clients who would like to know further information and / or understand more, please contact our Tax Partners / Principal Advisors (Tax or Wealth Succession Consulting). They may visit the following link for more information:
http://www.tia.gov.ky/pdf/Economic_Substance.pdf.



Contact us

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