

OCORIAN

# GUIDE TO ECONOMIC SUBSTANCE

CAYMAN ISLANDS

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## INTRODUCTION TO ECONOMIC SUBSTANCE

The International Tax Co-operation (Economic Substance) Law, 2018 and the regulations promulgated under such law apply to certain entities that are not tax resident outside Cayman Islands and which conduct relevant activity.

The legislation is designed to protect the reputation of the Cayman Islands by ensuring that income streams from certain activities are based on local activity, which substantiates the use of the Cayman Islands.

The legislation does not apply to all entities in the Cayman Islands – rather, it applies to certain ‘relevant entities’ carrying out certain ‘relevant activities’. The majority of affected entities are required to: (i) be managed and directed; (ii) have adequate employees; (iii) have expenditure and physical presence; and (iv) conduct their ‘core income generating activities’ in the Cayman Islands.

The importance of compliance with the new economic substance legislation cannot be understated given the potential liability for extensive penalties. Our experts can help you navigate the complexities of the new legislation and ensure that you are meeting the requirements.

**For more information please contact**



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**DISCLAIMER:**

OCORIAN IS NOT TYPICALLY A PROVIDER OF LEGAL OR TAX CONSULTANCY SERVICES. IF YOU ARE UNSURE OF YOUR LEGAL OBLIGATION OR TAX POSITION PLEASE GET IN TOUCH WITH YOUR USUAL OCORIAN CONTACT WHO WILL BE HAPPY TO ARRANGE FOR INDEPENDENT LEGAL AND/OR TAX ADVICE FOR YOU.

## HOW CAN OCORIAN HELP?

Ocorian has a significant presence in jurisdictions affected by the implementation of the economic substance legislation, including the Cayman Islands. Alongside this, we have comprehensive experience in gathering and reporting entity data in those jurisdictions. As a result, we are uniquely placed to help our clients understand and respond accordingly to the new economic substance legislation.

We address the following questions to deal with substance requirements.

### 1. Is the entity in question in scope of the new law?

Our experts can provide professional (non-legal) advice to help identify relevant entities conducting relevant activities.

### 2. Does the entity meet the substance requirements?

We will perform an economic substance test on entities in scope, which may include a request for additional information from clients. The substance requirements differ depending on the type of relevant activity conducted by the entity. Our tests include a gap-analysis of the current measures in place versus the requirements for adequate control, people, facilities and expenditure. Should the substance test not be met, enhanced substance may be required based on the relevant activity conducted by the entity.

### 3. How can the entity enhance its substance?

Clients whose entities do not meet the substance requirements will receive a proposal from Ocorian highlighting enhanced substance solutions. For standard structures, solutions may be straightforward, including additional corporate services or director activities. For more complex structures, we can facilitate the development and implementation of tailor-made solutions, including the consideration of functions which could be outsourced to Ocorian.

### 4. Submissions of notifications and reports

All Cayman Islands entities will be required to submit notifications to the Cayman Islands General Registry, confirming whether they are in or out of scope.

Entities that are claiming an exemption (i.e. investment fund, domestic company or tax resident outside of the Cayman Islands) will be required to produce additional information to substantiate such claim.

Entities that are in scope are required to file an economic substance report. Ocorian can assist in the preparation and submission of your notification and / or report in the formats required by the Cayman Islands General Registry and /or the Cayman Islands Tax Information Authority.

The economic substance legislation includes specific powers to request additional information in relation to any substance information provided to the Cayman Islands Tax Information Authority in mandatory notification filings and / or upcoming reports.

## PENALTIES FOR NON-COMPLIANCE

Penalties for non-compliance with the economic substance legislation ranges from increasing fines, removal from the companies register, through to imprisonment. Penalty particulars include:

- an initial non-compliance penalty of USD 12,200;
- a subsequent non-compliance penalty of USD 122,000;
- removal from the companies register; and

- a potential five years imprisonment for any person who provides false or misleading information to the Cayman Islands Tax Information Authority.

## WHICH ENTITIES ARE AFFECTED?

### Relevant entities

The economic substance legislation defines which Cayman Islands entities are relevant entities. Relevant entities include Cayman Islands Exempted Companies, Cayman Islands Limited Liability Companies, Cayman Islands Limited Liability Partnerships and companies registered as Foreign Companies in the Cayman Islands, except:

- investment funds or entities through which investment funds directly or indirectly invest or operate (excluding the ultimate investment held);
- entities which are tax-resident outside the Cayman Islands; and
- entities which are authorised to carry on business locally in the Cayman Islands as domestic companies.

Cayman Islands Exempted Limited Partnerships and Cayman Islands law governed Trusts have been excluded from the definition of a relevant entity under the legislation.

It is important to carefully review and consider the implications of the following defined terms when claiming an exemption from the requirement to satisfy the substance:

DEFINED TERM	MEANING
<b>Carrying on business in the islands</b>	<p>has the meaning given to that expression by section 2(2) of the Cayman Islands Local Companies (Control) Law (2015 Revision) as follows:</p> <p>The expression “carry on business in the Islands” in relation to a company, includes carrying on business of any kind or type whatsoever by that company, either alone or in partnership or otherwise, except:</p> <ol style="list-style-type: none"> <li>carrying on, from a principal place of business in the Islands, business exterior to the Islands;</li> <li>doing business in the Islands with any person, firm or corporation in furtherance only of the business of that company carried on exterior to the Islands;</li> <li>buying or selling or otherwise dealing in shares, bonds, debenture stock, obligations, mortgages or other securities, issued or created by any exempted company, a foreign partnership or a resident corporation incorporated abroad;</li> <li>transacting banking business in the Islands with and through a licensed bank;</li> <li>effecting or concluding contracts in the Islands and exercising in the Islands all other powers, so far as may be necessary for the carrying on of the business of that company exterior to the Islands;</li> </ol>

	<ul style="list-style-type: none"> <li>f. the business of an exempted company with another exempted company, a foreign partnership or a resident corporation incorporated abroad;</li> <li>g. the administration of mutual funds by a person licensed as a mutual fund administrator under the Mutual Funds Law (2015 Revision); or</li> <li>h. business carried on by a mutual fund, as defined by the Mutual Funds Law (2015 Revision), in the course of the acquisition, holding, management or disposal of investments.</li> </ul>
<b>Exempted Company</b>	means a company that is incorporated under the Cayman Islands Companies Law (2018 Revision) as amended from time to time.
<b>Domestic Company</b>	<p>means a company that is not part of an MNE Group and that is:</p> <ul style="list-style-type: none"> <li>a. only carrying on business in the Islands and which complies with section 4(1) of the Cayman Islands Local Companies (Control) Law (2019 Revision) or section 3(a) of the Cayman Island Trade and Business Licensing Law (2019 Revision); or</li> <li>b. a company referred to in section 9 of the Cayman Islands Companies Law (2018 Revision) (i.e. a company limited by guarantee) or 80 of the Cayman Islands Companies Law (2018 Revision) (i.e. a not for profit company).</li> </ul> <p>Note that a company that is not carrying on business in the Islands or a company that carries on business both in the Islands and exterior to the Islands cannot be a domestic company for the purposes of the economic substance legislation.</p>
<b>Foreign Company</b>	means a company incorporated outside of the Cayman Islands and registered in the Cayman Islands under Part IX of the Cayman Islands Companies Law (2018 Revision) as amended from time to time.
<b>Group</b>	means a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public securities exchange.
<b>Limited Liability Company</b>	means a limited liability company registered under the Cayman Islands Limited Liability Companies Law (2018 Revision) as amended from time to time.
<b>Limited Liability Partnership</b>	means a limited liability partnership registered in accordance with the Cayman Islands Limited Liability Partnership Law, 2017 as amended from time to time.
<b>Limited Liability Company</b>	means a limited liability company registered under the Cayman Islands Limited Liability Companies Law (2018 Revision) as amended from time to time.
<b>MNE Group</b>	means any Group that includes two or more enterprises for which the tax residence is in different jurisdictions or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction.

<b>Investment Fund</b>	means 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), but does not include a person licensed under the Banks and Trust Companies Law (2018 Revision) or the Insurance Law, 2010, or a person registered under the Building Societies Law (2014 Revision) or the Friendly Societies Law (1998 Revision).
<b>Investment Interests</b>	means a share, trust unit, partnership interest or other right that carries an entitlement to participate in the profits or gains of the entity.
<b>Tax resident outside of the Cayman Islands</b>	means that the entity is subject to corporate income tax on all of its income from a relevant activity by virtue of its tax residence, domicile or any other criteria of a similar nature in that other jurisdiction.

## WHAT ARE RELEVANT ACTIVITIES?

The economic substance legislation specifies nine categories of relevant activity that an entity is assessed against, which are:

- c. Banking business
- d. Distribution and Service Centre business
- e. Finance and Leasing business
- f. Fund Management business
- g. Headquarters business
- h. Holding Company business (i.e. pure equity holding company)
- i. Insurance business
- j. Intellectual property business
- k. Shipping business

It is possible for an entity to conduct multiple relevant activities. If this is the case, the substance requirements will need to be applied to each activity.

A relevant entity that does not conduct a relevant activity is not subject to the requirements of the economic substance test, however this needs to be evidenced in writing and submitted to Ocorian in order to satisfy the notification requirements.

The extent of the substance requirements for those entities which are conducting one or more relevant activities depends on the nature and the scale of each relevant activity.

In order to assist with classifying if an entity is performing a relevant activity, the economic substance legislation defined the typical core income generating activities that the business would be conducting.

## MEASURING SUBSTANCE

Once it has been determined that an entity is a relevant entity, conducting a relevant activity and has income, it must satisfy the applicable economic substance test.

- The substance requirements differ depending on the type of relevant activity conducted by an entity. Generally, an entity that is conducting a relevant activity will meet the substance requirements if:
- it conducts core income generating activities in the Cayman Islands;
- it is directed and managed in an appropriate manner in the Cayman Islands; and
- having regard to the level of income derived from the relevant activity:
  - a. it has adequate operating expenditure;
  - b. has adequate physical presence in the Cayman Islands; and
  - c. has adequate number of (qualified) employees in the Cayman Islands.

Once substance is established, the entity must file an economic substance report with the Cayman Islands Tax Information Authority.

## RELEVANT ACTIVITY DEFINITIONS AND CORE INCOME GENERATING ACTIVITY

Core income generating activities are the key essential and valuable activities that generate the income of the entity. It is not necessary for the entity to perform all of the core income generating activities listed in the legislation for the relevant activity.

The following core income generating activities must be carried out in the Cayman Islands to demonstrate substance:

RELEVANT ACTIVITY	CAYMAN ISLANDS CORE INCOME GENERATING ACTIVITY
<b>Banking Business</b>	<p>has the meaning given to that expression by section 2 of the Banks and Trust Companies Law (2018 Revision)</p> <p>[where “banking business” means the business of receiving (other than from a bank or trust company) and holding on current, savings, deposit or other similar account money which is repayable by cheque or order and may be invested by way of advances to customers or otherwise]</p> <ul style="list-style-type: none"> <li>– Raising funds, managing risk including credit, currency and interest risk</li> <li>– Taking hedging positions</li> <li>– Providing loans, credit or other financial services to customers</li> <li>– Managing capital and preparing reports and returns, or both, to investors or the Cayman Islands Monetary Authority, or both</li> </ul>



<b>Distribution and service centre business</b>	<p>means the business of either or both of the following –</p> <ul style="list-style-type: none"> <li>a. purchasing from an entity in the same Group - <ul style="list-style-type: none"> <li>i. component parts or materials for goods; or</li> <li>ii. goods ready for sale, and</li> <li>iii. reselling such component parts, materials or goods outside the Islands;</li> </ul> </li> <li>b. providing services to an entity in the same Group in connection with the business outside the Islands,</li> </ul> <p>but does not include any activity included in any other relevant activity except holding company business. For the avoidance of doubt, (b) above only falls within the definition in the specific circumstances where the relevant entity is operating as a service centre for entities in the same Group</p> <ul style="list-style-type: none"> <li>– transporting and storing goods, components and materials;</li> <li>– managing stocks;</li> <li>– taking orders;</li> <li>– providing consulting or other administrative services</li> </ul>
<b>Financing and leasing business</b>	<p>means the business of providing credit facilities for any kind of consideration to another person but does not include financial leasing of land or an interest in land, banking business, fund management business or insurance business</p> <ul style="list-style-type: none"> <li>– negotiating or agreeing funding terms;</li> <li>– identifying and acquiring assets to be leased;</li> <li>– setting the terms and duration of financing or leasing;</li> <li>– monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements</li> </ul>

<b>Fund management business</b>	<p>means the business of managing securities as set out in paragraph 3 of Schedule 2 to the Securities Investment Business Law (2015 Revision)* carried on by a relevant entity licensed or otherwise authorised to conduct business under that Law for an investment fund</p> <p>["Managing Securities" means managing securities belonging to another person in circumstances involving the exercise of discretion.] *now the Securities Investment Business Law (2019 Revision)</p> <ul style="list-style-type: none"> <li>— taking decisions on the holding and selling of investments;</li> <li>— calculating risk and reserves;</li> <li>— taking decisions on currency or interest fluctuations and hedging positions;</li> <li>— preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both</li> </ul>
<b>Headquarters business</b>	<p>means the business of providing any of the following services to an entity in the same Group –</p> <ul style="list-style-type: none"> <li>— the provision of senior management;</li> <li>— the assumption or control of material risk for activities carried out by any of those entities in the same Group; or</li> <li>— the provision of substantive advice in connection with the assumption or control of risk referred to the paragraph above,</li> </ul> <p>but does not include banking business, financing and leasing business, fund management business, intellectual property business, holding company business or insurance business</p>
<b>Holding company business</b>	<p>the business of a pure equity holding company</p> <p>["pure equity holding company" means a company that only holds equity participations in other entities and only earns dividends and capital gains]</p> <p>For the avoidance doubt, an investment fund is not regarded as a pure equity holding company.</p> <p>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 economic substance test which is satisfied if the relevant entity confirms that –</p> <ul style="list-style-type: none"> <li>— it has complied with all applicable filing requirements under the Companies Law (2018 Revision); and</li> <li>— it has adequate human resources and adequate premises in the Islands for holding and managing equity participations in other entities</li> </ul>

<b>Insurance business</b>	<p>has the meaning given to that expression by section 2 of the Insurance Law, 2010</p> <p>[where “insurance business” means the business of accepting risks by effecting or carrying out contracts of insurance, whether directly or indirectly, and includes running-off business including the settlement of claims]</p> <ul style="list-style-type: none"> <li>— predicting or calculating risk or oversight of prediction or calculation of risk;</li> <li>— insuring or re-insuring against risk;</li> <li>— preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both</li> </ul>
<b>Intellectual property business</b>	<p>means the business of holding, exploiting or receiving income from intellectual property assets;</p> <p>[“intellectual property asset” means an intellectual property right including a copyright, design right, patent and trademark.]</p> <ul style="list-style-type: none"> <li>a. where the intellectual property asset is a - <ul style="list-style-type: none"> <li>i. patent or an asset that is similar to a patent, research and development; or</li> <li>ii. non-trade or intangible (including a trademark), branding, marketing and distribution</li> </ul> </li> <li>b. in exceptional cases, except if the relevant activity is a high risk intellectual property business, other core income generating activities relevant to the business and the intellectual property assets, which may include – <ul style="list-style-type: none"> <li>i. taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the intangible asset generating income;</li> <li>ii. taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the intangible asset;</li> <li>iii. carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of income from third parties</li> </ul> </li> </ul>

<b>Shipping business</b>	<p>means any of the following activities involving the operation of a ship anywhere in the world other than in the territorial waters of the Islands or between the Islands</p> <p>–</p> <ul style="list-style-type: none"> <li>a. the business of transporting, by sea, passengers or animals, goods or mail for a charge;</li> <li>b. the renting or chartering of ships for the purpose described in paragraph (a);</li> <li>c. the sale of travel tickets and ancillary ticket related services connected with the operation of a ship;</li> <li>d. the use, maintenance or rental of containers, including trailers and other vehicles or equipment for the transport of containers, used for the transport of anything by sea; or</li> <li>e. the functioning as a private seafarer recruitment and placement service,</li> </ul> <p>but does not include a holding company business or the owning, operating or chartering of a pleasure yacht</p> <ul style="list-style-type: none"> <li>– managing crew (including hiring, paying and overseeing crew members);</li> <li>– overhauling and maintaining ships;</li> <li>– overseeing and tracking deliveries;</li> <li>– determining what goods to order and when to deliver them, organising and overseeing voyages</li> </ul>
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## DIRECTED AND MANAGED

Generally, entities conducting relevant activities are required to be directed and managed in the Cayman Islands, in addition to undertaking core income generating activities in the Cayman Islands.

This consists of the following requirements, which must be complied with for each accounting period:

- the board of directors or such other body or person in whom the management of the entity is vested (the Controller(s)) must meet in the Cayman Islands at an adequate frequency given the level of decision making required;
- during the meeting in the Cayman Islands, there must be a quorum of the Controller(s) physically present in the Cayman Islands;
- strategic decisions of the entity must be set at meetings of the Controller(s) and the minutes must reflect those decisions. If an entity has one Controller, then they should evidence that written resolutions were passed by that Controller when he or she is physically present in the Cayman Islands;
- the Controller(s), as a whole, must have the necessary knowledge and expertise to discharge their duties as a board; and

- all minutes and entity records must be kept in the Cayman Islands.

Where there are corporate Controller(s) (e.g. corporate director or corporate managing partner), these will be looked through, to the individuals (officers of the corporate Controller(s)) actually performing the duties of the Controller(s).

## **MEETINGS AND MINUTES OF THE BOARD OF DIRECTORS**

The directed and managed assessment is designed to ensure that there are an adequate number of Controller(s) meetings held and attended in the Cayman Islands, although it is not necessary for all meetings to be held in the Cayman Islands, or that a quorum of Controller(s) is always present in the Cayman Islands.

Quorum in this context will be determined in accordance with economic substance legislation and the entity's constitutional documents.

What constitutes an adequate number of meetings in the Cayman Islands will be dependent on the relevant activities conducted by the entity. Although, it is also expected that even for entities with a minimal level of activity, there will be at least one meeting of its Controller(s) held in the Cayman Islands in each year.

The requirement also looks to ensure that the controlling body (e.g. board of directors) is a decision making body, in that it has the necessary knowledge and experience, and is not simply giving effect to decisions taken outside of the Cayman Islands whether taken by the Controller(s) or others.

It is unlikely to be accepted that the Controller(s) are making the strategic decisions if there is evidence that substantive decision making is taking place in any forums, or by any persons, without reference to or the oversight to the Controller(s).

The minutes of the Controller(s) meetings should refer to all the relevant decisions taken, even where the board considers courses of action and rejects them.

Entity records expected to be maintained and physically reside, or be electronically available, in the Cayman Islands and consist of: certificates of incorporation; articles of association; memorandum of association; financial statements; all relevant certifications to operate; and major funding documentation.

## **REPORTING SUBSTANCE**

As a pre-requisite to filing the annual return, Ocorian will be required to submit a notification filing to confirm whether the entity is a relevant entity and falls in scope of the economic substance legislation, thus needing to satisfy the economic substance test and comply with detailed reporting requirements.

As part of the detailed reporting process, such entities will be required to provide the following information via the Cayman Islands Tax Information Authority's economic substance portal:

- the type of relevant activity conducted;
- the amount and type of relevant income in respect of the relevant activity conducted;
- the amount and type of expenses and assets in respect of the relevant activity conducted;
- the location of the place of business or plant, property or equipment used for the relevant activity of the relevant entity in the Cayman Islands;
- the number of full-time employees or other personnel with appropriate qualifications who are responsible for conducting the relevant entity's relevant activity;

- information showing the Cayman Islands core income generating activities in respect of the relevant activity that has been conducted;
- a declaration as to whether or not the relevant entity satisfies the economic substance test in accordance with the economic substance legislation;
- in the case of a relevant activity that is an intellectual property business, a declaration as to whether or not it is a high risk intellectual property business and, if it is, whether or not the relevant entity will provide the following information to rebut the presumption that it has not met the economic substance test within the specified time:
  - detailed business plans which demonstrate the commercial rational for holding the intellectual property assets in the Cayman Islands;
  - employee information, including levels of experience, types of contracts, qualifications and duration of employment;
  - evidence that decision making is taking place within the Islands, and
  - any other information as may be reasonably required by the Authority to determine whether the relevant entity meets the economic substance test;
  - details of any MNE Group in respect of which the relevant entity is a Constituent Entity for the purposes of the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017; and
  - such other information as may be prescribed.

It is expected that conducting relevant activities will result in the generation of income.

## FREQUENTLY ASKED QUESTIONS

### 1. What information will be required to complete the substance assessment?

In order to complete the full economic substance test you will require:

- financial statements with accounting that demonstrate the entity's gross income and expenditure and also that incurred in that Cayman Islands during the accounting period;
- full time equivalent (FTE) employee calculations. Ocorian will provide information where it relates to its employees, however information will be required for alternate outsource providers not contracted by Ocorian and also external directors; and
- the qualifications of directors and employees to evidence the Direction and Managed requirements. Ocorian will provide information where it relates to its employees, however information will be required for external directors.

### 2. The entity is tax resident outside of Cayman Islands, does it still need to perform the assessment?

Entities that claim they are tax resident outside the Cayman Islands will need to evidence:

- a tax identification number, tax assessment or certificate of tax residency; and

- that the entity is not tax resident in a jurisdiction which is on the EU’s list of non-cooperative jurisdictions, which is accessible at: <https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/>.

### 3. Can the entity be incorporated and managed & controlled in different jurisdictions?

If the entity is not a relevant entity or if the entity is a relevant entity that is not conducting a relevant activity, it is possible for the entity to be incorporated in the Cayman Islands and managed and directed outside of the Cayman Islands. For example, many Cayman Islands investment funds, which are not relevant entities under the legislation, are managed and directed outside of the Cayman Islands.

Also, if the entity is a relevant entity, which is conducting the activity of a holding company business, it is not required to be directed and managed in the Cayman Islands.

However, if the entity is a relevant entity, which is conducting a relevant activity (other than that of a pure equity holding company business) it will be required to be directed and managed in the Cayman Islands in accordance with the economic substance legislation.

### 4. What does ‘Adequacy’ and ‘Appropriate’ mean?

The economic substance legislation refers to the term “adequate” and “appropriate”. However, this term is not defined and therefore guidance states:

- “adequate” shall mean “as much or as good as necessary for the relevant requirement or purpose”; and
- “appropriate” shall mean “suitable or fitting for a particular purpose, person, occasion”

What is adequate or appropriate for each entity will be dependent on the particular circumstances of the entity and its business activity. An entity will have to ensure it maintains and retains appropriate records to demonstrate the adequacy of the resources utilised and expenditure incurred.

### 5. What constitutes outsourcing?

Outsourcing some or all of an entity’s activities is not prohibited. Outsourcing, in this context, includes outsourcing, contracting or delegating to third parties or group companies.

Outsourcing activities must be performed in the Cayman Islands.

If core income generating activities are outsourced, the entity must be able to demonstrate that it has adequate supervision of the outsourced activities.

Where a core income generating activity is outsourced, the resources of the service provider in the Cayman Islands will be taken into consideration when determining whether the people and premises test is met.

However, there must be no double counting if the services are provided to more than one entity.

The entity remains responsible for ensuring accurate information is reported on its return and this will include precise details of the resources employed by its service providers, for example based on the use of timesheets.

### 6. What is the definition of consolidated financial statements?

Consolidated Financial Statements means the “financial statements of a Group in which the assets, liabilities, income, expenses and cash flows of the ultimate parent company and the Constituent Entities are presented as those of a single economic entity.”

In this context:

- Group means a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public securities exchange.
- Constituent Entity means (a) any separate business unit of a Group that is included in the Consolidated Financial Statements of the Group for financial reporting purposes, or would be so included if equity interests in such business unit of a Group were traded on a public securities exchange; (b) any such business unit that is excluded from the Group's Consolidated Financial Statements solely on size or materiality grounds; and (c) any permanent establishment of any separate business unit of the Group included in (a) or (b) provided the business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes.

## 7. What is a (pure equity) holding company?

An entity will be regarded as a pure equity holding company if it only holds equity participations in other entities and only earns dividends and capital gains.

A relevant entity that is only carrying on the business of a pure equity holding company is subject to a reduced economic substance test which is satisfied if the relevant entity confirms that:

- it has complied with all applicable filing requirements under the Cayman Islands Companies Law; and
- it has adequate human resources and adequate premises in the 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 Cayman Islands Companies Law, 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.

## 8. What are the rules around "High Risk Intellectual Property"?

Where an entity receives income from intellectual property, it will also have to consider if it is a "high risk intellectual property entity".

There is a rebuttable presumption that a high risk intellectual property entity is presumed not to have met the economic substance requirement. A relevant entity may rebut this presumption if it can produce materials to the Cayman Islands Tax Information Authority which demonstrate that there is, and historically has been, a high degree of control over the development, exploitation, maintenance, protection and enhancement of the intangible asset, exercised by an adequate number of full-time employees with the necessary qualifications that permanently reside and conduct their activities within the Cayman Islands.

The high evidential threshold requires:

- detailed business plans which sets out the commercial rationale for holding the intellectual property asset(s) in the Cayman Islands;
- information on employees in the Cayman Islands, their level of experience, the contractual terms, their qualifications, and their length of service;



- concrete evidence that the decision making is taking place in the Cayman Islands, and not elsewhere; and
- any other information as may be reasonably required by the Cayman Islands Tax Information Authority to determine whether the relevant entity meets the economic substance test.

Periodic decisions by non-resident directors or board members, or local staff passively holding intangible assets, cannot rebut the presumption.

#### **9. The entity is in liquidation – do I still need to undertake the assessment and reporting?**

If an entity in liquidation is still conducting a relevant activity and continues to generate income, then it is subject to the substance test.

If a liquidator is appointed all powers of the directors cease, it will be the liquidators of the entity that are required to demonstrate that the entity continues to satisfy all of its obligations under the economic substance legislation, including ensuring it is directed and managed in the Cayman Islands

#### **10. Who do I classify as an employee?**

Employees for this purpose includes employees / personnel of the entity and includes employees of services providers attributable to a relevant activity.

As a matter of Cayman Islands Labour Law, an employee means “any individual who enters into or works under or stands ready to enter into or work under a contract of employment with an employer whether the contract be oral or written, express or implied; and the term includes a person whose services have been interrupted by a suspension of work during a period of leave or temporary lay-off.”

The employee count will be based on the number of full time equivalents (FTEs), i.e. the number of persons who worked full time within the entity in question, or on its behalf during the entire accounting period.

The work of persons who have not worked the full year, the work of those who have worked part-time, regardless of duration, and the work of seasonal workers are counted as fractions of an FTE. For this purpose, a standard working week will be considered as 35 hours.

Directors, including Non-Executive Directors, should be counted as a fraction of an FTE commensurate with the time commitment of the role.

If the entity outsources, contracts or delegates some or all of its activity to a service provider in the Cayman Islands, then the resources of such service provider will be taken into consideration.

When considering what an adequate number of qualified employees is, this must relate to the employees needed to be able to conduct the relevant activity as a whole (not just the core income generating activities).

#### **11. What does ‘appropriate qualifications’ mean?**

The Cayman Islands Tax Information Authority issued guidance, which states that a relevant entity must have an adequate number of full-time employees or other personnel with appropriate qualifications in the Cayman Islands. Within the guidance, “appropriate” is defined as suitable or fitting for a particular purpose, person, and occasion.

What is appropriate for each relevant entity will be dependent on the particular facts of the relevant entity and its business activity. As such, the Controller(s) of each relevant entity should address their minds to these questions and make their determination in good faith.

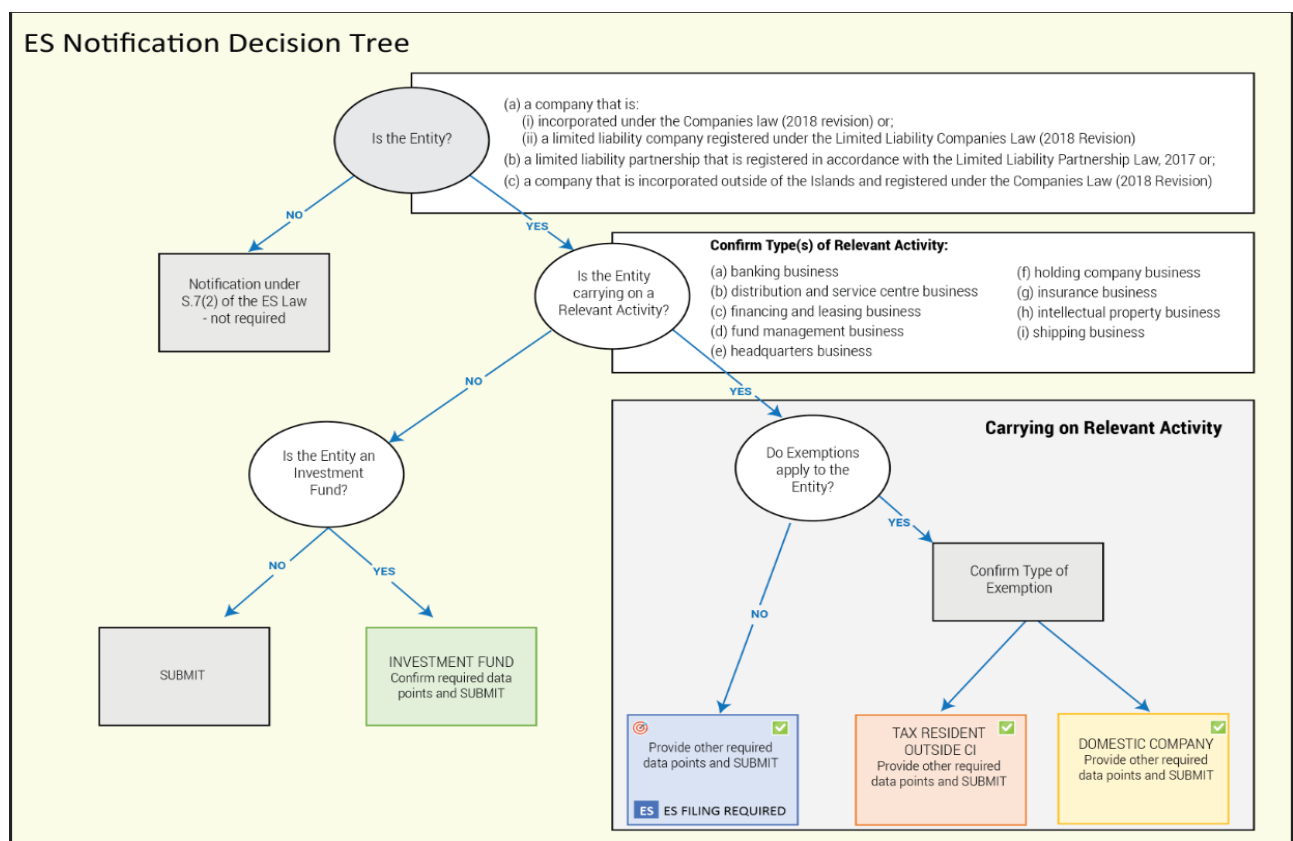
The qualifications that are considered to be adequate will depend on the relevant sector that the entity has activity in, the core income generating activities undertaken in the Cayman Islands and the duties performed by those employees.

Cayman Islands guidance provides that qualifications taken into account could include academic qualifications, vocational qualifications, relevant industry technical qualifications and also qualification by relevant experience.

## 12. Who is my information shared with?

The Cayman Islands Tax Information Authority will systematically spontaneously exchange information provided to it under the economic substance legislation, as permitted under Cayman Islands Law. Information will be shared with other competent authorities in respect of relevant entities that fail to satisfy the economic substance test. Information will also be shared with the competent authority of the jurisdiction where an entity claims to be tax resident or subject to income tax on its relevant income.

## ECONOMIC SUBSTANCE FLOW CHARTS



<sup>1</sup> These flow charts were produced and circulated by the Cayman Islands Tax Information Authority, which are accessible at [www.tia.gov.ky/](http://www.tia.gov.ky/).

## ES Notification Reference Document

Each entity will be in one of these 8 categories

ENTITY #	ES STATUS	EXEMPTION TYPE	RELEVANT ACTIVITY	TBL	LCCL	NOT FOR PROFIT / NPO	CIMA	GIN	FI	FINANCIAL YEAR-END	CONTACT INFO
	N/A		No relevant activity								
	N/A	INVESTMENT FUND	No relevant activity				*	*	*		
	N/A	TAX RESIDENT OUTSIDE CI	Distribution and Service Centre, Financing and Leasing, Hddqts, Holding Company, IP, Shipping								*
	N/A	TAX RESIDENT OUTSIDE CI	Banking, Fund Management, Insurance				*	*	*		*
	N/A	DOMESTIC	Distribution and Service Centre, Financing and Leasing, Hddqts, Holding Company, IP, Shipping		*	*					
	N/A	DOMESTIC	Banking, Fund Management, Insurance		*	*	*	*	*		
	ES		Distribution and Service Centre, Financing and Leasing, Hddqts, Holding Company, IP, Shipping				*	*	*	*	*
	ES		Banking, Fund Management, Insurance				*	*	*	*	*

**ES Notification is required for the following entity types:**  
Resident Company, Resident NPO, Non-Resident NPO, Exempt Company, Exempt Segregated Portfolio, Exempted NPO, Exempted Limited Duration, Exempted SEZ, Foreign Company, LLC, LLP, Exempted Foundation

**PLEASE NOTE:** Partnerships and Trusts are not to be included

**ES FILING REQUIRED** **N/A** **NO ES FILING REQUIRED**

**RELEVANT ENTITY** **RELEVANT ACTIVITY**

**\* REQUIRED FIELD**

**Contact Info is:**  
(a) the name, email and mobile phone of an active director for the entity or  
(b) the registered office of the entity.