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# PLANTING ECONOMIC SUBSTANCE IN THE CAYMAN ISLANDS

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*by Brian Tang*

The Cayman Islands has always subscribed to uphold and maintain international best practices and the recent enactment of the International Tax Co-operation (Economic Substance) Law, 2018 further strengthens that commitment. The purpose of the law is to address concerns from the European Union and adhere to global initiatives from the Organisation for Economic Co-operation and Development.

Effective 1 January 2019, relevant companies and in-scope activities will be required to maintain adequate local economic substance. Companies incorporated or registered under the Companies Law, limited liability companies, and limited liability partnerships are considered relevant companies unless it is an investment fund or an entity that is a tax resident in a jurisdiction outside the Cayman Islands. A relevant entity is subject to the economic substance requirements if it conducts any relevant activity, which are:

- 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

Pre-existing companies will be given a grace period up to 1 July 2019 to meet the requirements while newly formed companies will need to comply immediately. The new legislation will require the submission of an annual report. The Tax Information Authority will then conduct a principles-based review to determine whether the 3-branch economic substance test has been satisfied. **According to the guidance notes, this test involves determining whether the relevant entity:**

- a. conducts Cayman Islands core income generating activities in relation to that relevant activity;
- b. is directed and managed in an appropriate manner in the Islands in relation to that relevant activity; and
- c. having regard to the level of relevant income derived from the relevant activity carried out in the Islands,
  - i. has an adequate amount of operating expenditure incurred in the Islands;
  - ii. has an adequate physical presence (including maintaining a place of business or plant, property and equipment) in the Islands; and
  - iii. has an adequate number of full-time employees or other personnel with appropriate qualifications in the Cayman Islands.

**There is a considerable effect on Cayman-based entities in the intellectual property holding business.** The guidance notes state that these type of businesses will have not satisfy the economic substance test “unless the relevant entity can demonstrate that there was a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intangible asset, exercised by an adequate number of full-time employees with the necessary qualifications that permanently reside and perform their activities within the Islands.”

**Specific supporting documentation will need to be produced** to evidence the commercial rational for holding these assets in the Cayman Islands, the suitable qualifications and experience of the local personnel, and that the strategic decisions were made within the Cayman Islands.

**All relevant companies conducting relevant activities**, and particularly intellectual property holding companies, should understand and review the guidance notes as soon as possible. Local counsel should be approached to determine the legal ramifications and full operational impact. Directors should exercise their fiduciary duty to be aware of the necessary steps to ensure compliance and be ready to implement best practices.

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Brian has a unique background working at investment management firms, family offices, hedge funds, and private banks. He has advised senior management on strategic and investment decisions, led department-wide change initiatives, and is always looking to improve efficiency, teamwork, and collaboration.

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