

Tax Information Authority



CAYMAN ISLANDS

Economic Substance For Geographically Mobile Activities

GUIDANCE

Issued pursuant to section 5 of
The International Tax Co-operation (Economic Substance) Law, 2018
("ES Law")

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I. Legislative Framework

A. ES Law

1. Introduction

This Guidance for the International Tax Cooperation (Economic Substance) Law, 2018 (the “**ES Law**”) provides support for understanding the law’s scope, and how to comply with the law.

The economic substance concepts underpinning the ES Law are similar to those found in legal systems of other jurisdictions.

The common denominator for these systems is the OECD Forum on Harmful Tax Practices (“**FHTP**”), which sets the global standard that requires companies to have substantial activities in a jurisdiction (also known as “economic substance”).

Over 125 jurisdictions around the world are members of the OECD BEPS Inclusive Framework. The FHTP is a sub-body of the Inclusive Framework, and is responsible for assessing and monitoring the substantial activities standard for all member jurisdictions.

2. Background

The ES Law was enacted in response to the work of the OECD and the European Union (EU) on fair taxation. Please refer to the Section VII below headed “**External Reference Materials**” for background information on that work. This is useful context for gaining insight into the international standard developed by the FHTP. That standard requires geographically mobile activities to have substance regardless of whether the activities are conducted in a no or nominal tax jurisdiction or in a preferential tax regime of a jurisdiction that has corporate income tax.

3. Summary of the ES Law

The ES Law came into force on 1 January 2019.

A “relevant entity” is subject to the ES Law from the date on which the relevant entity commences a “relevant activity” unless the relevant entity was in existence prior to 1 January 2019, in which case it must comply with the ES Law by 1 July 2019.

The ES Law requires a relevant entity to satisfy the economic substance test (“**ES Test**”). The ES Test requires that a relevant entity:

- (a) conducts Cayman Islands core income generating activities (“**Cayman Islands CIGA**”) 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 Islands.

The ES Test is described in more detail in Section III below headed **“The Economic Substance Test (“ES Test”)**”.

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. Cayman Islands CIGA means activities that are of central importance to a relevant entity in terms of generating income and that are being carried out in the Islands.

Please refer to Section II.A headed **“Relevant Entity”**, Section II.B below headed **“Relevant Activities”** and to Section III.A.2 below headed **“Cayman Islands Core Income Generating Activities (Cayman Islands CIGA)”** for the meaning of those key terms.

4. The Authority

The Tax Information Authority is the “Authority” for the purposes of the ES Law. The Authority’s functions under the ES Law include administering the ES Law, determining whether a relevant entity satisfies the ES Test in respect of its relevant activities, monitoring compliance with the ES Law, and sharing information with other competent authorities.

The Authority is the sole dedicated channel in the Cayman Islands for international cooperation on matters involving the provision of tax related information. The Authority is a function of the Department for International Tax Cooperation (DITC) within the Cayman Islands Government’s Ministry of Financial Services and Home Affairs. The Authority has statutory responsibilities under the Tax Information Law (2017 Revision) in addition to those under the ES Law.

5. Notification and Reporting

Starting in 2020, relevant entities must notify the Authority annually

- (a) whether or not they are carrying on a relevant activity,
- (b) if the relevant entity is carrying on a relevant activity, whether or not all or any part of the relevant entity’s gross income in relation to the relevant activity is subject to tax in a jurisdiction outside of the Islands and, if so, shall provide appropriate evidence to support that tax residence as may be required by the Authority, and
- (c) the date of the end of its financial year.

The Authority will specify the time, form and manner of such notification.

Relevant entities carrying on relevant activities that are required to satisfy the ES Test must prepare and submit to the Authority a report for the purpose of the Authority’s determination whether the ES Test has been satisfied in relation to that relevant activity within twelve months after the last day of the end of each financial year commencing on or after 1 January 2019. Such report shall be in the form approved by the Authority with the prescribed information as of the end of the relevant financial year.

For the avoidance of doubt, the timing for compliance with the notification and reporting obligations are separate from timing of compliance with the ES Test specified in Section III.A.1 below headed “**Compliance with the economic substance test**”.

B. ES Regulations

The Cabinet may make regulations (“ES Regulations”) regarding any matter that may be prescribed under the ES Law, amending the Schedule to the ES Law, further defining the scope of relevant entities that are required to satisfy the ES Test, further defining the scope of relevant activities, and providing for such matters as may be necessary or convenient for carrying out or giving effect to the ES Law and its administration.

The ES Regulations may -

- (a) make different provision in relation to different cases or circumstances; or
- (b) contain such transitional, consequential, incidental or supplementary provisions as appear to Cabinet to be necessary or expedient for the purposes of the ES Regulations.

The ES Regulations may also provide for such savings, transitional and consequential provisions to have effect in connection with the coming into operation of any provision of the ES Law as are necessary or expedient.

The International Tax Co-operation (Economic Substance) (Prescribed Dates) Regulations, 2018 came into force on 1 January 2019. Those ES Regulations prescribe the date from which the ES Test must be satisfied and the date for the purposes of submitting a report to the Authority.

The International Tax Co-operation (Economic Substance) (Amendment of Schedule) Regulations, 2019 came into force on 22 February 2019. Those ES Regulations amended the definition of “relevant entity” in the Schedule to the ES Law. This Guidance uses the new definition of relevant entity as stated in Section II.A below headed “**Relevant Entity**”.

C. This Guidance

This Guidance has been issued by the Authority pursuant to section 5 of the ES Law with the approval of the Cabinet and after private sector consultation. This Guidance has been published in the Gazette and on the “Economic Substance” webpage of the Authority’s website along with other relevant materials:

- http://www.tia.gov.ky/pdf/Economic_Substance.pdf

This webpage may be updated from time to time.

The Authority may, after private sector consultation and with the approval of the Cabinet, revise this Guidance from time to time.

Relevant entities are encouraged to seek professional advice if they are uncertain in any way of their obligations under the ES Law.

1. Purpose of this Guidance

The purpose of this Guidance is to assist relevant entities carrying on relevant activities to understand how to satisfy the ES Test, including guidance as to the meaning of “adequate” and “appropriate” for the purposes of the ES Law. A relevant entity shall have regard to this Guidance for the purpose of satisfying the ES Test.

2. Interpretation in this Guidance

Various terms used in this Guidance are defined in the Glossary for the reader’s convenience and where that term is already defined in the ES Law the definition in this Guidance is intended to be the same as in the ES Law except where the ES Law makes it clear that the term is to be defined by this Guidance. The Guidance may elaborate on some of these terms in furtherance of the ES Law itself or otherwise to aid with interpretation.

The hyperlinks in this Guidance to any reference materials are subject to change and the reader is responsible for checking that any particular resource has not been superseded so that a new hyperlink must be used.

II. Scope of the ES Law

A. Relevant Entity

The International Tax Co-operation (Economic Substance) (Amendment of Schedule) Regulations, 2019 replaced the definition of “relevant entity” in the Schedule to the ES Law with the following definition.

A “relevant entity” means -

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

but does not include:

- (i) an investment fund; or
- (ii) an entity that is tax resident outside the Islands.

1. Relevant Entity carrying on relevant activities

The ES Law requires a relevant entity that is carrying on relevant activities to satisfy the ES Test in relation to each relevant activity. Such a relevant entity will also have notification and reporting obligations under the ES Law.

A relevant entity that is carrying on more than one relevant activity is required to satisfy the ES Test in relation to each relevant activity.

2. Entities that are not Relevant Entities

a) *Domestic Companies*

A domestic company is not a relevant entity for the purpose of the ES Law and is not required to satisfy the ES Test and does not have notification and reporting obligations under the ES Law.

A “domestic company” means a company that is not part of an MNE Group and that is -

- (a) carrying on business in the Islands and which complies with section 4(1) of the Local Companies (Control) Law (2015 Revision) or section 3(a) of the Trade and Business Licensing Law (2018 Revision);
- (b) a company referred to in section 9 or 80 of the Companies Law (2018 Revision),
or a subsidiary company of any such company.

The key elements of this definition of domestic company are explained below.

(1) MNE Group

A company is not a “domestic company” if it is part of an MNE Group.

The Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017 provide the technical definition of the term “MNE Group”. In summary, an MNE Group is a Group with annual revenues of at least US\$850 million total consolidated group revenue and “Group” means a collection of two or more enterprises that are tax resident in different jurisdictions and are related through ownership or control such that it is (or would be if traded on a public securities exchange) required to prepare Consolidated Financial Statements for financial reporting purposes.

(2) Companies carrying on business in the Islands

A company that complies with either section 4(1) of the Local Companies (Control) Law (2015 Revision) or section 3(a) of the Trade and Business Licensing Law (2018 Revision) is a domestic company if it is carrying on business in the Islands; a company that is not carrying on business in the Islands cannot be a domestic company for the purposes of the ES Law even if it is complying with those provisions.

“Carrying on business in the Islands” has the meaning given to that expression by section 2(2) of the Local Companies (Control) Law (2015 Revision), where it is defined to include carrying on business of any kind or type whatsoever by that company, either alone or in partnership or otherwise, except-

- (a) carrying on, from a principal place of business in the Islands, business exterior to the Islands;
- (b) 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;
- (c) 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;
- (d) transacting banking business in the Islands with and through a licensed bank;
- (e) 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;
- (f) the business of an exempted company with another exempted company, a foreign partnership or a resident corporation incorporated abroad;
- (g) the administration of mutual funds by a person licensed as a mutual fund administrator under the Mutual Funds Law (2015 Revision); or
- (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.

(a) **Section 4(1) of the Local Companies (Control) Law (2015 Revision)**

In summary, this provision prohibits any company from carrying on business in the Islands unless:

- (a) it is a local company which, at the relevant time, is complying with section 5 or is a wholly owned subsidiary of such a company;
- (b) it is licensed under the Local Companies (Control) Law and under the Trade and Business Licensing Law and, at the relevant time, is carrying on such business in accordance with the terms and conditions imposed in such licence and not otherwise;
- (c) it is licensed under the Banks and Trust Companies Law; or
- (d) it is a company operating under a franchise granted by the Government.

(b) **Section 3(a) of the Trade & Business Licensing Law**

This provision states that the Trade and Business Licensing Law (2018 Revision) does not apply to any trade or business licensed or registered to be carried on as a trade or business under another Law without reference to the Trade and Business Licensing Law, including where that other Law exempts a person to whom it applies from registering, being licensed or paying a fee.

For example:

- (1) An insurance company that is licensed by the Cayman Islands Monetary Authority to carry on “domestic insurance business” under the Insurance Law (2010 Revision) is a “domestic company” for the purposes of the ES Law.
- (2) In contrast, an insurance company that is licensed to carry on insurance business other than domestic insurance business is not a domestic company for the purposes of the ES Law and is therefore classified as a relevant entity which is carrying on relevant activities – insurance business - for the purposes of the ES Law.
- (3) **Companies limited by guarantee and associations not for profit**

The Companies referred to in sections 9 and 80 of the Companies Law, namely companies limited by guarantee and associations not for profit, are not relevant entities for the purposes of the ES Law.

b) Investment Funds

An investment fund is not a relevant entity for the purpose of the ES Law and is not required to satisfy the ES Test.

The ES Law defines an “investment fund” 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 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). “Investment fund business” is defined as the business of operating as an investment fund. “Investment interests” means a share, trust unit, partnership interest or other right that carries an entitlement to participate in the profits or gains of the entity.

(1) Mutual Funds

The Authority will regard mutual funds licensed or registered with the Cayman Islands Monetary Authority as investment funds for the purposes of the ES Law because the definition of investment fund under the ES Law is broader than the definition of mutual fund under the Mutual Funds Law, both in terms of the investment interests (versus equity interests) which it issues and also the entities through which an investment fund invests.

The Mutual Funds Law (2015 Revision) includes these definitions:

- “mutual fund” means a company, unit trust or partnership that issues equity interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors in the mutual fund to receive profits or gains from the acquisition, holding, management or disposal of investments but does not include a person licensed under the Banks and Trust Companies Law (2013 Revision) or the Insurance Law, 2010, or a person registered under the Building Societies Law (2010 Revision) or the Friendly Societies Law (1998 Revision);
- “equity interest” means a share, trust unit or partnership interest that-
 - (a) carries an entitlement to participate in the profits or gains of the company, unit trust or partnership; and
 - (b) is redeemable or repurchasable at the option of the investor and, in respect of a company incorporated in accordance with the Companies Law (2013 Revision) (including an existing company as defined in that law), in accordance with but subject to section 37 of the Companies Law (2013 Revision) before the commencement of winding-up or the dissolution of the company, unit trust or partnership, but does not include debt, or alternative financial instruments as prescribed under the Banks and Trust Companies Law (2013 Revision).

(2) Investment Entities under the Common Reporting Standard (CRS)

The definition of “Investment Entities” under the CRS is much broader in scope than the definition of mutual funds under the Mutual Funds Law. Generally speaking, most investment funds under the ES Law will also be “Investment Entities” under the CRS unless they are investment managers under part (a) of the CRS definition (see below). There are exceptions to this general position and so it is necessary for entities classified as Investment Entities under the CRS to consider whether or not they are also classified as investment funds for the purpose of the ES Law.

The Tax Information Authority (International Tax Compliance) (Common Reporting Standard) Regulations (2018 Revision) defines an “Investment Entity” as any Entity:

- a) that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer:
 - i) trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
 - ii) individual and collective portfolio management; or
 - iii) otherwise investing, administering, or managing Financial Assets or money on behalf of other persons; or
- b) the gross income of which is primarily attributable to investing, reinvesting, or trading in Financial Assets, if the Entity is managed by another Entity that is a Depository Institution, a Custodial Institution, a Specified Insurance Company, or an Investment Entity described in subparagraph (a).

(3) Entities through which an investment fund directly or indirectly invests or operates

The term investment fund includes the investment fund itself and also any entity through which the investment fund directly or indirectly invests or operates. For example, this means that any entities through which a mutual fund or other collective investment vehicle invests or operates will not be relevant entities, and therefore would not be regarded as relevant entities, for the purpose of the ES Law and this Guidance.

c) Tax resident outside the Islands

A company, limited liability company or limited liability partnership incorporated or established in the Islands is not regarded as a relevant entity for the purposes of the ES Law if it is tax resident outside the Islands. Likewise, a foreign company that is registered in the Islands is not regarded as a relevant entity if it is tax resident outside the Islands.

The Authority may regard an entity as tax resident outside the Islands if the entity is subject to tax in another jurisdiction by reason of its domicile, residence or any other criteria of a similar nature. The Authority will require any entity claiming to be tax resident outside the Islands to produce satisfactory evidence to substantiate the same, such as a Tax Identification Number, tax residence certificate and assessment or payment of a tax liability. The entity must also provide details of its parent company, ultimate parent company, and ultimate beneficial owners, including their respective jurisdictions of tax residence.

In the absence of such evidence, the Authority will regard the entity as a relevant entity that is subject to the ES Law. The ES Test must be satisfied with respect to any part of relevant income that is not subject to income tax of a jurisdiction other than the Islands.

A relevant entity should take care that it does not claim to be tax resident in a jurisdiction such that the result would be a circumvention of the ES Test.

The Authority will also regard any branch of a relevant entity as tax resident outside the Islands if the branch is subject to tax on its relevant income in another jurisdiction by reason of its domicile, residence or any other criteria of a similar nature. The Authority will require any relevant entity which claims that

its branch is tax resident outside the Islands to produce, with respect to its branch, satisfactory evidence of the type described above in relation to an entity claiming to be tax resident outside the Islands. In this context, a “branch” refers to a business unit or division of the relevant entity that is not a separate legal person from the relevant entity.

For example, the Authority would not require a Cayman Islands incorporated company which carries on a leasing business from an UK branch which is subject to UK tax on its relevant income to satisfy the ES Test in the Islands with respect to the leasing business carried on by that UK branch.

See Section V.B.1 below headed “**Other Competent Authorities**”.

B. Relevant Activities

1. Types of relevant activities

“Relevant activities” includes each of the following:

- (a) banking business;
- (b) distribution and service centre business;
- (c) financing and leasing business;
- (d) fund management business;
- (e) headquarters business;
- (f) holding company business;
- (g) insurance business;
- (h) intellectual property business; or
- (i) shipping business;

but does not include investment fund business.

Table 1: Cayman Islands CIGA for each type of relevant activity under Section III.A.2 below includes definitions of the various types of relevant activities and their corresponding Cayman Islands CIGA. The terms “investment fund business” and “investment fund” are explained in Section II.A.2.b) above headed “**Investment Funds**”.

In addition, Section III.B below headed “**Sector-Specific Guidance on Relevant Activities**” describes how the ES Test may be satisfied for certain types of relevant activities.

2. Liquidation or otherwise ceasing to carry on relevant activities

A relevant entity will, so long as it exists, continue to have any obligations which the ES Law imposes on it. Liquidators (or equivalent) must ensure that the relevant entity continues to satisfy all its obligations under the ES Law. If a relevant entity is in liquidation or being wound up, it must continue to satisfy the ES Test for any period during which it carries on relevant activities but is not required to satisfy the ES Test after it ceases to carry on relevant activities. Reporting will continue to be required with respect to any period during which the relevant entity carried on relevant activities; reporting will not be required for any period during which the relevant entity was no longer carrying on relevant activities.

For the avoidance of doubt, the Authority will not expect a relevant entity which is finally dissolved or wound up before it is possible to comply with the notification obligation on the ES Portal to register there or to report for the purposes of the ES Law before reporting is possible.

Any liquidators (or equivalent) or other representatives of a relevant entity who were responsible for the final liquidation or dissolution of the relevant entity have duties to maintain the relevant entity's records and to respond to the Authority's information requirements under the ES Law for six years after dissolution. These records may be held by a service provider if located in the Islands.

For the purpose of this Guidance, final dissolution or winding up refers to the date on which that takes effect as evidenced by a Certificate of Dissolution in the case of a company or equivalent, where available, for other types of relevant entities.

C. Relevant Income

A relevant entity must satisfy the ES Test having regard to the level of relevant income derived from any relevant activity carried out in the Islands. A relevant entity's report to the Authority must include the amount and type of relevant income in respect of the relevant activity.

For these purposes, "relevant income" means all of a relevant entity's gross income arising from its relevant activities.

This definition is subject to any guidance promulgated by the OECD FHTP on the meaning of the term "gross income" referred to in the OECD (2018), Resumption of application of substantial activities for no or nominal tax jurisdictions – BEPS Action 5, OECD, Paris.

D. Ultimate Parent Company and Group

It is important for any relevant entity which is carrying on relevant activities to identify its ultimate parent company as this could be required in the report made to the Authority.

“Ultimate parent company” means a Constituent Entity of a Group that meets the following criteria -

- (a) it owns directly or indirectly a sufficient interest in one or more other Constituent Entities of the Group such that it is required to prepare Consolidated Financial Statements under accounting principles generally applied in its jurisdiction of tax residence, or would be so required if its equity interests were traded on public securities exchange in its jurisdiction of tax residence; and
- (b) there is no other Constituent Entity of the Group that owns directly or indirectly an interest described in paragraph (a) in the first mentioned Constituent Entity.

The meaning of the term “Group” must therefore be understood for that purpose and it also appears as an element in the definitions of “headquarters business”, “distribution and service centre business and “high risk intellectual property business”.

“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.

In this context, “Consolidated Financial Statements” means the financial statements of a Group in which the assets, liabilities, income, expenses and cash flows of the Ultimate Parent Entity and the Constituent Entities are presented as those of a single economic entity. Also, “Constituent Entity” means 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 the Group were traded on a public securities exchange. Any such business unit that is excluded from the Group’s Consolidated Financial Statements solely on size or materiality grounds; and any permanent establishment of any such separate business unit of the Group provided the business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes.

III. The Economic Substance Test (“ES Test”)

A. General Principles

1. Compliance with the ES Test

A relevant entity must satisfy the ES Test in relation to any relevant activities which it is carrying on.

A relevant entity is subject to the ES Law from the date on which the relevant entity commences the relevant activity unless the relevant entity was in existence prior to 1 January 2019 in which case it must comply with the ES Law by 1 July 2019.

A relevant entity satisfies the ES Test in relation to a relevant activity, if 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 Islands.

There is a reduced ES Test for pure equity holding companies, as described in Section III.B.1.a) below headed “**Pure equity holding company**”.

2. Cayman Islands Core Income Generating Activities (Cayman Islands CIGA)

A relevant entity carrying on relevant activities must conduct Cayman Islands CIGA. Cayman Islands CIGA means activities that are of central importance to a relevant entity in terms of generating income and that are being carried out in the Islands.

A relevant entity must conduct the appropriate elements under the Cayman Islands CIGA for the particular type of relevant activity that it is carrying on; it is not necessary for the relevant entity to perform every element listed for the relevant activity in the definition of Cayman Islands CIGA. The assessment of substance in the Islands will include careful consideration of what elements of Cayman Islands CIGA the relevant entity is carrying on in the Islands.

For example, a relevant entity that holds a patent does not have to carry on the Cayman Islands CIGA of marketing, branding and distribution as well as the research and development.

Some relevant entities may currently be undertaking or outsourcing all or part of a relevant activity outside the Islands. If that activity is not part of the Cayman Islands CIGA this will not affect the company’s ability to pass the ES Test (for example, back office functions, IT, payroll or legal services).

The ES Test does not preclude relevant entities seeking expert professional advice or engaging the services of specialists in other jurisdictions provided that any activities performed by such advisors or specialists in other jurisdictions is not Cayman Islands CIGA and that the relevant income (i.e. income being subject to no corporate income tax in the Islands) is commensurate with the Cayman Islands CIGA undertaken in the Islands.

The following table includes the definition (expanded where appropriate) of each type of relevant activity and the corresponding Cayman Islands CIGA.

Table 1: Cayman Islands CIGA for each type of relevant activity

Relevant activity	Definition	Cayman Islands CIGA
banking business	<p>has the meaning given to that expression by section 2 of the Banks and Trust Companies Law (2018 Revision)</p> <p><i>[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]</i></p>	<ul style="list-style-type: none"> (i) raising funds, managing risk including credit, currency and interest risk; (ii) taking hedging positions; (iii) providing loans, credit or other financial services to customers; (iv) managing capital and preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both
distribution and service centre business	<p>means the business of either or both of the following -</p> <ul style="list-style-type: none"> (a) purchasing from an entity in the same Group - <ul style="list-style-type: none"> (i) component parts or materials for goods; or (ii) goods ready for sale, and reselling such component parts, materials or goods outside the Islands; (b) providing services to an entity in the same Group in connection with the business outside the Islands, <p>but does not include any activity included in any other relevant activity except holding company business</p>	<ul style="list-style-type: none"> (i) transporting and storing goods, components and materials; (ii) managing stocks; (iii) taking orders; (iv) providing consulting or other administrative services

Relevant activity	Definition	Cayman Islands CIGA
financing and leasing business	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	<ul style="list-style-type: none"> (i) negotiating or agreeing funding terms; (ii) identifying and acquiring assets to be leased; (iii) setting the terms and duration of financing or leasing; (iv) monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements
fund management business	<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 under that Law for an investment fund</p> <p><i>["Managing Securities" means managing securities belonging to another person in circumstances involving the exercise of discretion.]</i></p>	<ul style="list-style-type: none"> (i) taking decisions on the holding and selling of investments; (ii) calculating risk and reserves; (iii) taking decisions on currency or interest fluctuations and hedging positions; (iv) preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both

Relevant activity	Definition	Cayman Islands CIGA
headquarters business	<p>means the business of providing any of the following services to an entity in the same Group -</p> <p>(a) the provision of senior management;</p> <p>(b) the assumption or control of material risk for activities carried out by any of those entities in the same Group; or</p> <p>(c) the provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (b),</p> <p>but does not include banking business, financing and leasing business, fund management business, intellectual property business, holding company business or insurance business</p>	<p>(i) taking relevant management decisions;</p> <p>(ii) incurring expenditures on behalf of other entities in the Group;</p> <p>(iii) co-ordinating activities of the Group</p>
holding company business	<p>the business of a pure equity holding company</p> <p><i>["pure equity holding company" means a company that only holds equity participations in other entities and only earns dividends and capital gains]</i></p>	all activities related to that business
insurance business	<p>has the meaning given to that expression by section 2 of the Insurance Law, 2010</p> <p><i>[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]</i></p>	<p>(i) predicting or calculating risk or oversight of prediction or calculation of risk;</p> <p>(ii) insuring or re-insuring against risk;</p> <p>(iii) preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both</p>

Relevant activity	Definition	Cayman Islands CIGA
intellectual property business	<p>means the business of holding, exploiting or receiving income from intellectual property assets;</p> <p><i>["intellectual property asset" means an intellectual property right including a copyright, design right, patent and trademark]</i></p>	<ul style="list-style-type: none"> (i) where the intellectual property asset is a - <ul style="list-style-type: none"> (A) patent or an asset that is similar to a patent, research and development; or (B) non-trade or intangible (including a trademark), branding, marketing and distribution (ii) 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"> (A) taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the intangible asset generating income; (B) 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; (C) carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of income from third parties.

Relevant activity	Definition	Cayman Islands CIGA
shipping business	<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> <p>(a) the business of transporting, by sea, passengers or animals, goods or mail for a charge;</p> <p>(b) the renting or chartering of ships for the purpose described in paragraph (a);</p> <p>(c) the sale of travel tickets and ancillary ticket related services connected with the operation of a ship;</p> <p>(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</p> <p>(e) the functioning as a private seafarer recruitment and placement service,</p> <p>but does not include a holding company business or the operating of a pleasure vessel</p>	<p>(i) managing crew (including hiring, paying and overseeing crew members);</p> <p>(ii) overhauling and maintaining ships;</p> <p>(iii) overseeing and tracking deliveries;</p> <p>(iv) determining what goods to order and when to deliver them, organising and overseeing voyages</p>

3. Meaning of “adequate” and “appropriate”

The ES Law provides that the Authority shall provide guidance on what is meant by “adequate” and “appropriate”, which are used in the instances listed below in the context of the ES Test:

- Having regard to the level of relevant income derived from the relevant activity carried out in the Islands, the relevant entity -
 - has an adequate amount of operating expenditure incurred in the Islands;
 - has an adequate physical presence (including maintaining a place of business or plant, property and equipment) in the Islands; and
 - has an adequate number of full-time employees or other personnel with appropriate qualifications in the Islands.
- A relevant entity is directed and managed in an appropriate manner in the Islands in relation to that relevant activity if, among other things, meetings of the board of directors are held in the Islands at adequate frequencies given the level of decision making required.
- A relevant entity that is a pure equity holding company is subject to a reduced ES Test which is satisfied if the pure equity holding company confirms that it has complied with all applicable filing requirements under the Companies Law (2018 Revision) and that it has adequate human resources and adequate premises in the Islands for holding and managing equity participations in other entities.

The Authority’s guidance is that in each case the words shall have the meaning set out beside them:

- “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 relevant entity will be dependent on the particular facts of the relevant entity and its business activity. A relevant entity will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.

The application of these words to a particular type of relevant activity may be included in Section III.B below headed “**Sector-Specific Guidance on Relevant Activities**”.

Given the stringent regulatory requirements in the Cayman Islands, which result in significant overlap with the substance requirements, it is expected that relevant entities licensed to carry on banking business, insurance business or licensed fund management business will already generally be operating in the Islands with adequate resources and expenditure. However, those relevant entities will still be subject to the ES Law (i.e. filing requirements, Cayman Islands CIGA performed in the Islands, and monitoring by the Authority).

4. Outsourcing

a) Outsourcing Cayman Islands CIGA

A relevant entity satisfies the ES Test in relation to a relevant activity if its Cayman Islands CIGA in relation to that relevant activity are conducted by any other person in the Islands and the relevant entity is able to monitor and control the carrying out of the Cayman Islands CIGA by that other person, and only that part of the relevant activity of that other person which are attributable to generating income for the relevant entity shall be taken into account in considering whether the relevant entity satisfies the ES Test.

That is, the ES Law does not prohibit a relevant entity from outsourcing some or all of its activity. Outsourcing, in this context, includes outsourcing, contracting or delegating to third parties or to entities in the same Group.

However, if some or all of the Cayman Islands CIGA is outsourced, the relevant entity must be able to demonstrate that it has adequate supervision of the outsourced activities and, to satisfy the ES Test, that those Cayman Islands CIGA are undertaken in the Islands. The reason for the requirement that a relevant entity can only outsource its Cayman Islands CIGA to service providers that perform the outsourced Cayman Islands CIGA in the Islands is to prevent income being located in a no or nominal tax environment which is separated from the jurisdiction from where the activities have taken place, undermining the premise of the economic substance (or “substantial activities”) factor.

Where a Cayman Islands CIGA is outsourced the resources of the service provider in the 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 relevant entity carrying out relevant activities.

The relevant 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.

b) Outsourcing must not circumvent the ES Test

A relevant entity must not use outsourcing to circumvent compliance with the ES Test.

c) Outsourcing activities other than Cayman Islands CIGA

A relevant entity is not required to satisfy the ES Test with respect to any activities that are not Cayman Islands CIGA. The ES Law does not prevent a relevant entity from outsourcing any activities that are not Cayman Islands CIGA to delegates that perform those activities entirely outside the Islands.

d) Outsourcing by CIMA-regulated relevant entities

Relevant entities that are carrying on banking business, insurance business, and fund management business will be subject to the Cayman Islands Monetary Authority’s “Statement of Guidance: Outsourcing Regulated Entities” in addition to the principles set out above under the ES Law.

5. Directed and managed

A relevant entity complies with the requirement to be directed and managed in an appropriate manner in the Islands in relation to a relevant activity if -

- (a) its board of directors, as a whole, has the appropriate knowledge and expertise to discharge its duties as a board of directors;
- (b) meetings of the board of directors are held in the Islands at adequate frequencies given the level of decision making required;
- (c) there is a quorum of directors present in the Islands during any such meetings;
- (d) the minutes of those meetings record the making of strategic decisions of the relevant entity at the meeting; and
- (e) it keeps all such minutes and appropriate records in the Islands.

The directed and managed test is designed to ensure that there are an adequate number of board meetings held and attended in the Islands (although it is not necessary for all of those meetings to be held in the Islands).

What constitutes an adequate number of meetings in the Island will be dependent on the relevant activities of the company. However, it is generally expected that the majority of board meetings will be held in the Island.

It is also expected that even for companies with a minimal level of activity there will be at least one meeting of its board of directors per year.

The test also looks to ensure that the associated minutes and records are kept in the Island and that the board is a decision-taking body with the appropriate knowledge and experience.

In the case where there are corporate directors, the requirements will apply to the individual(s) (officers of the corporate director) actually performing the duties.

B. Sector-Specific Guidance on Relevant Activities

1. Holding Company Business

a) Pure equity holding company

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 ES Test which is satisfied if the relevant entity confirms that -

- (a) it has complied with all applicable filing requirements under the Companies Law (2018 Revision); and
- (b) 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 may engage its registered office service provider to satisfy these reduced substance requirements in the Islands where the pure equity holding company is passively holding equity interests in other entities.

b) Holding companies carrying on other relevant activities

A relevant entity that is carrying on more than one relevant activity is required to satisfy the ES Test in relation to each relevant activity. It follows that a relevant entity that is carrying on relevant activities in addition to holding company business must satisfy the ES Test in relation to each of its relevant activities, in addition to satisfying the ES Test in relation to its holding company business.

2. High Risk Intellectual Property (“IP”) Business

A relevant entity that is carrying on a relevant activity that is a high risk IP business is presumed not to have met the ES Test for a financial year, even if there are Cayman Islands CIGA relevant to the business and the IP assets being carried out in the Islands, 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, and provides sufficient information to the Authority in relation to that financial year to rebut this presumption.

To rebut the presumption, a relevant entity with a high risk IP business will have to produce materials to demonstrate that there was, and historically has been, development, enhancement, maintenance, protection and exploitation functions have been under its control, and that this has involved people who are highly skilled and perform their core activities in the Islands.

The Authority’s approach regarding the rebuttable presumption will be aligned with the policy articulated by the FHTP in the following document in paragraphs 32 to 39 under the heading “**IP income – exceptional cases and rebuttable presumption**”:

- OECD (2018, Resumption of application of substantial activities for no or nominal tax jurisdictions – BEPS Action 5, OECD, Paris.
<http://www.oecd.org/tax/beps/resumption-of-application-of-substantial-activities-factor.pdf>

This high risk IP company evidential threshold requires:

- (a) detailed business plans which demonstrate the commercial rational for holding the IP assets in the Islands;
- (b) employee information, including level of experience, type of contracts, qualifications and duration of employment; and
- (c) 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 ES Test.

Periodic decisions by non-resident directors or board members, or local staff passively holding intangible assets would not be sufficient to satisfy the ES Test in respect of any IP business and therefore cannot rebut the presumption in the case of high risk IP business.

3. Cayman Enterprise City's Special Economic Zones (SEZ)

Entities operating within the SEZ must consider whether they are relevant entities for the purposes of the ES Law and, if so, whether they are carrying on relevant activities and required to satisfy the ES Test under the ES Law. The SEZ's requirement for a business in the SEZ to have at least one employee based in the Islands does not necessarily satisfy the ES Test under the ES Law. Recall that the ES Law requires a relevant entity to have an adequate number of full-time employees or other personnel with appropriate qualifications in the Islands having regard to the level of income derived from the relevant activity carried out in the Islands.

The SEZ includes:

- Tech City Cayman:
 - Cayman Internet Park
 - Cayman Media Park
 - Cayman Science & Technology Park
- Commodities & Derivatives City, for companies that undertake:
 - Financial services activities other than those conducted by monetary institutions, directly or indirectly related to commodities, derivatives, futures, and options
 - Fund management and prop trading for own account (including facilitating and supporting such businesses)
 - Investment management, including:
 - activities relating directly or indirectly to commodities, derivatives, futures and options;
 - commodities and derivatives fund management and advisory services;
 - security and commodity contracts brokerage or proprietary trading for own account, including facilitating and supporting such businesses; and
 - the provision of an electronic marketplace for the purpose of facilitating the buying and selling of commodities, derivatives, futures and options products, including commodities contracts, futures commodity contracts and commodity options.
 - Physical electronic marketplaces for buying, selling of stocks, stock options, bonds or commodity contracts
- Maritime & Aviation City

IV. Notification and Reporting

A. Notification to the Authority

Starting in 2020, a relevant entity shall notify the Authority annually of -

- (a) whether or not it is carrying on a relevant activity;
- (b) if the relevant entity is carrying on a relevant activity, whether or not all or any part of the relevant entity's gross income in relation to the relevant activity is subject to tax in a jurisdiction outside of the Islands and, if so, shall provide appropriate evidence to support that tax residence as may be required by the Authority; and
- (c) the date of the end of its financial year.

The notification shall be made at the time specified by the Authority and in the form and the manner approved by the Authority.

For the avoidance of doubt, the timing for compliance with the notification obligation is separate from timing of compliance with the ES Test specified in Section III.A.1 above headed "**Compliance with the economic substance test**".

The Authority expects to develop and launch a Cayman Islands Economic Substance Portal ("**ES Portal**") to facilitate relevant entities' electronic notification and reporting to the Authority and the Authorities' sharing of information with other competent authorities pursuant to the ES Law. The Authority will publish an ES Portal User Guide specifying the rules and procedures for use of the ES Portal by relevant entities and their representatives.

The ES Portal and ES Portal User Guide would be based on standardized XML Schema, exchange mechanisms and other detailed technical guidance developed by the OECD and/or the EU for reporting and exchange of required information.

B. Reporting to the Authority

A relevant entity that is carrying on a relevant activity and is required to satisfy the ES Test must prepare and submit to the Authority a report for the purpose of the Authority's determination whether the ES Test has been satisfied in relation to that relevant activity. The report must be made within twelve months after the last day of the end of each financial year of the relevant entity commencing on or after 1 January 2019.

For the avoidance of doubt, the timing for compliance with the reporting obligation is separate from timing of compliance with the ES Test specified in Section III.A.1 above headed "**Compliance with the economic substance test**".

Such report shall be in the form approved by the Authority and shall include the following information with respect to the relevant entity as of the end of the relevant financial year -

- (a) the type of relevant activity conducted by it;
- (b) the amount and type of relevant income in respect of the relevant activity;
- (c) the amount and type of expenses and assets in respect of the relevant activity;
- (d) the location of the place of business or plant, property or equipment used for the relevant activity of the relevant entity in the Islands;
- (e) the number of full-time employees or other personnel with appropriate qualifications who are responsible for carrying on the relevant entity's relevant activity;
- (f) information showing the Cayman Islands CIGA in respect of the relevant activity that have been conducted;
- (g) a declaration as to whether or not the relevant entity satisfies the ES Test in accordance with the ES Law;
- (h) 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 information under paragraph (j) to rebut the presumption that it has not met the ES Test within the specified time;
- (i) 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;
- (j) in the case of a relevant entity that is carrying on a high risk intellectual property business:
 - (A) detailed business plans which demonstrate the commercial rational for holding the intellectual property assets in the Islands;
 - (B) employee information, including level of experience, type of contracts, qualifications and duration of employment;
 - (C) evidence that decision making is taking place within the Islands, and
 - (D) and any other information as may be reasonably required by the Authority to determine whether the relevant entity meets the ES Test; and
- (k) such other information as may be prescribed.

A relevant entity shall provide the Authority with such additional information (including a copy of a relevant book, document or other record, or of electronically stored information) as shall be reasonably required by the Authority in making a determination whether the relevant entity has passed or failed the ES Test. Such information shall be in the form approved by the Authority and shall be provided within a reasonable time specified by the Authority.

The Authority may, by notice served on any person that the Authority reasonably believes to have relevant information, require that person -

- (a) within a reasonable time specified by the Authority in the notice, to provide the Authority with information (including a copy of a relevant book, document or other record, or of electronically stored information); or
- (b) at a reasonable time, during office hours, specified by the Authority, to make available to the Authority for inspection, a book, document or other record, or any electronically stored information,

that is in the person's control or possession that the Authority reasonably requires in discharging its functions under the ES Law.

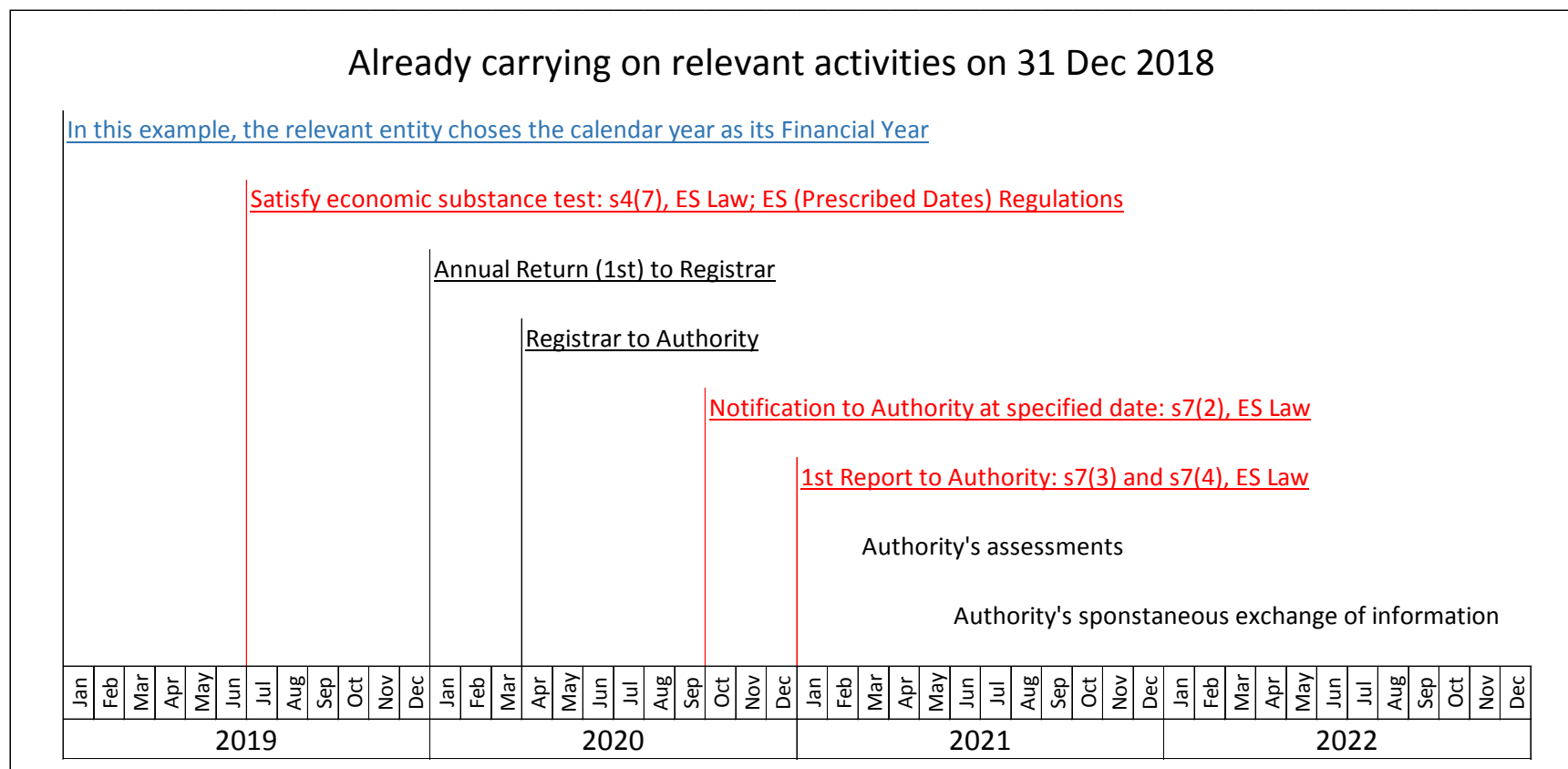
A relevant entity that is required to satisfy the ES Test in relation to a relevant activity must retain for six years after the end of a financial year a book, document or other record, including any information stored by electronic means that relates to the information required to be provided to the Authority.

A person who fails to provide or make certain information to the Authority without lawful excuse within the specified time or who knowingly or willfully alters, destroys, mutilates, defaces, hides or removes any such information may be criminally liable.

C. Example timetables for existing and new relevant entities

The timetables on the following two pages illustrate the timing for compliance, notification and reporting obligations by a relevant entity that has chosen the calendar year as its financial year, so that the first year in scope commences on 1 January 2019 and ends on 31 December 2019.

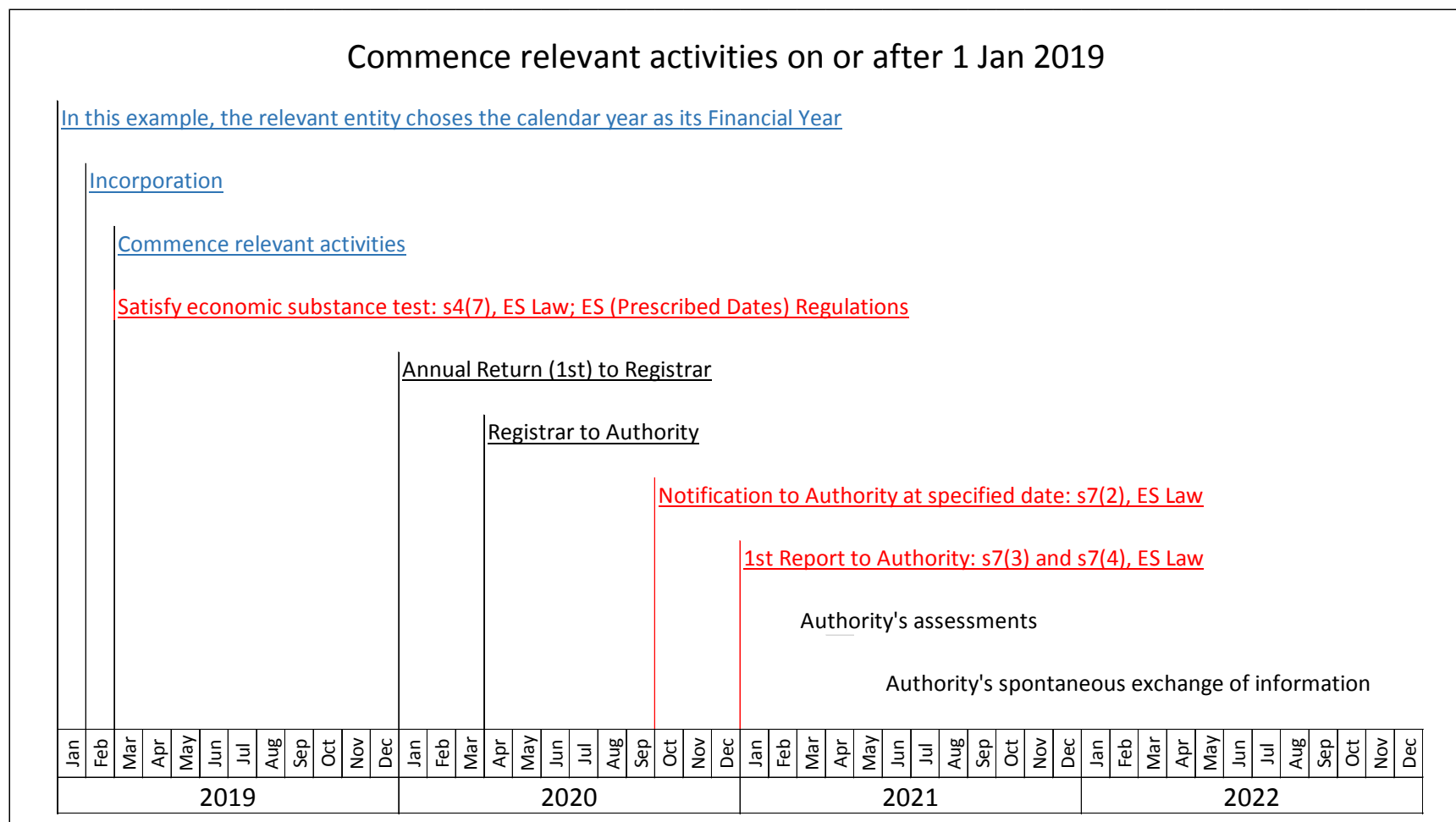
1. Example timetable for an existing relevant entity



A relevant entity must report no later than 12 months after the last day of each financial year commencing on or after 1 January 2019.

In this example the first financial year commences on 1 January 2019 and ends on 31 December 2019.

2. Example timetable for an new relevant entity



A relevant entity must report no later than 12 months after the last day of each financial year commencing on or after 1 January 2019.

In this example the first financial year commences on 1 January 2019 and ends on 31 December 2019.

V. Authority's functions

A. Determination of whether ES Test is satisfied

The Authority shall have the power, in accordance with the ES Law, the ES Regulations and this Guidance, to make a determination as to whether a relevant entity satisfies the ES Test for any financial year in respect of which a report is required under the ES Law.

The Authority will take a "principles-based" approach to determining whether or not a relevant entity has satisfied the ES Test with respect to its relevant activities. This Guidance does not prescribe a minimum number of full time employees for a particular level of relevant income either generally or for or any particular type of relevant activity because that would be arbitrary and would prove uneconomical in many cases.

Simply put, the principles are that (a) those individuals who in fact conduct a relevant entity's Cayman Islands CIGA that generates its relevant income must do so in the Islands, not elsewhere, and (b) the relevant entity must be directed and managed in the Islands.

For the purpose of conducting an assessment, the Authority may consider various factors, including the following:

1. Cayman Islands CIGA refers to those activities that are essential to generating relevant income in the sense that those are the activities from which the relevant entity's other activities proceed or upon which relevant entity's other activities depend.
2. Such activities for any particular relevant entity may naturally fluctuate during the course of a financial year and from one financial year to the next with the result that what is an adequate level of employees/personnel may not be constant during the period or periods.
3. The Authority may consider timesheets or other evidence of relevance when assessing whether a relevant entity has an adequate number of full-time employees or other personnel with appropriate qualifications in the Islands, including the hours spent by different employees/personnel with appropriate qualifications to generate such Cayman Islands CIGA, the statutory or contractual hours any such individuals are required to work during the relevant financial year, and relevant comparable statistics for the business sector, such as the average revenue per employee.
4. The directors (or equivalent) of a relevant entity may sometimes perform Cayman Islands CIGA in addition to performing their fiduciary duties for the relevant entity and thereby reduce or even eliminate the relevant entity's practical need for full-time employees or an outsourcing arrangement. In these cases, the Authority may consider evidence of the Cayman Islands CIGA performed by the directors in the Islands. The Authority will take this type of activity into account as a risk factor in making the determination whether a relevant entity meets the ES Test.
5. The Authority will need to take outsourcing activity into account as a risk factor in making its determination whether a relevant entity meets the ES Test, and this may include:
 - a. identifying cases where outsourcing has taken place;

- b. verifying the accuracy of reports of employee numbers attributable to a relevant entity where this includes employees of a service provider (rather than counting all employees of a service provider for each entity that engages the service provider);
 - c. verifying if outsourcing of Cayman Islands CIGA has taken place outside the Islands;
 - d. distinguishing cases of genuine outsourcing of non-core activities; and
 - e. ensuring that enforcement powers apply to information held by service providers.
6. A relevant entity may request the Authority to take account of evidence regarding normal business practices for a particular relevant activity which are permitted in other jurisdictions subject to the FHTP's "substantial activities" requirements for preferential regimes. This may include, for example, where there are commercial (i.e. non-tax) reasons for cross-border business to be conducted outside the jurisdiction to acquire or to utilize specialist goods or services that are exclusively available in a particular location or to serve clients or to deal with counterparties that are located outside the jurisdiction.

1. Failure to satisfy ES Test

If the Authority determines that a relevant entity that is required to satisfy the ES Test in relation to a relevant activity has failed to satisfy such ES Test for a financial year, the Authority shall issue a notice to the relevant entity notifying the relevant entity of such determination, giving the reasons, details regarding any penalty, directing any action to be taken to satisfy the ES Test and advising of the relevant entity's right to appeal.

The Authority shall impose a penalty of ten thousand dollars on a relevant entity for failing to satisfy such ES Test or one hundred thousand dollars if it is not satisfied in the subsequent financial year after the initial notice of failure.

The Authority shall also notify the Registrar of any such failure after two consecutive years. The Registrar shall then apply to the Grand Court, which may make an order including -

- (a) an order requiring the relevant entity to take a specified action, including for the purpose of satisfying such ES Test; or
- (b) in the case of a relevant entity that is -
 - (i) a company that is registered or incorporated under the Companies Law (2018 Revision), an order that it is a defunct company to which Part VI of that Law applies;
 - (ii) a limited liability company that is registered under the Limited Liability Companies Law (2018 Revision), an order that it is a defunct company to which section 40 of that Law applies; or
 - (iii) a limited liability partnership that is registered under the Limited Liability Partnership Law, 2017, an order that the limited liability partnership be struck off in accordance with section 31 of that Law as if it is a limited liability partnership that the Registrar has reasonable cause to believe is not carrying on business or is not in operation.

There is a six year limitation period which applies unless the Authority is not able to make a determination by reason of any material misrepresentation, action taken in bad faith or fraudulent action by or on behalf of the relevant entity.

2. Misleading information

It is an offence for a person to knowingly or wilfully supply false or misleading information to the Authority under the ES Law. Such an offence is punishable on summary conviction by a fine of ten thousand dollars or with imprisonment for a term of five years, or both.

3. Offence by officers of a body corporate

Where an offence under the ES Law that has been committed by a body corporate is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of any director, manager, secretary or other officer of the body corporate, or any person who was purporting to act in such a capacity, the officer or any person purporting to act in that capacity, as well as the body corporate, commits that offence and is liable to be proceeded against and punished accordingly. Where the affairs of a body corporate are managed by its members, the foregoing shall apply in relation to defaults of a member in connection with the member's functions of management as if the member were a director of the body corporate.

B. Sharing of information

1. Other Competent Authorities

The Authority will systematically spontaneously exchange information provided to it under the ES Law, in accordance with relevant international standards and scheduled agreements under the Tax Information Authority Law (2017 Revision), with other competent authorities in respect of each relevant entity that fails to satisfy the ES Test in relation to relevant activities, in relation to high risk IP business, and in cases where an entity claims to be tax resident in a jurisdiction outside the Islands. These competent authorities will include the jurisdiction of tax residence of the relevant entity's parent company, ultimate parent company, and ultimate beneficial owner, and the jurisdiction where the entity claims to be tax resident outside the Islands, as applicable. The Authority will also share information with other competent authorities in other circumstances established by the OECD Forum on Harmful Tax Practices (FHTP).

2. FHTP Monitoring Process

The OECD Forum on Harmful Tax Practices (FHTP) will conduct annual monitoring of the enforcement of the “substantial activities” requirements in practice by no or nominal tax jurisdictions, such as the Cayman Islands, in addition to monitoring of preferential regimes of most other jurisdictions that are members of the Base Erosion and Profit Shifting (BEPS) Inclusive Framework. This monitoring process considers details on the monitoring mechanism to ensure compliance, and statistical data to support this. The monitoring mechanism includes information on how the relevant entities and activities are identified, how non-compliance is identified, how high risk-IP cases are identified, and how it is ensured that out-sourcing rules are complied with.

The Authority expects to provide the FHTP with statistics for each sector, on:

- the number of entities engaged in that business sector,
- number of full time equivalent qualified employees,
- amount of operating expenditure,
- amount of gross income, and
- results of compliance actions in practice for the purpose of assessing effectiveness.

3. Confidentiality

The ES Law expressly permits the following types of disclosures:

- (a) lawfully made in accordance with section 3(1) of the Confidential Information Disclosure Law, 2016;
- (b) if the information disclosed is or has been available to the public from any other source;
- (c) where the information disclosed is in a summary or in statistics expressed in a manner that does not enable the identity of any relevant entity, or of any officer, customer, investor, member, client or policyholder of a relevant entity to which the information relates to be ascertained; or
- (d) by the Authority under the ES Law.

There are criminal sanctions for improper disclosure of any information relating to the affairs of the Authority, a relevant entity or any officer, customer, investor, member, client or policyholder of a relevant entity. The offence is punishable with fines and imprisonment.

VI. Glossary

“Authority” means the Tax Information Authority designated under section 4 of the Tax Information Authority Law (2017 Revision) or a person designated by the Authority to act on behalf of the Authority;

“Cayman Islands Monetary Authority” means the Authority established as such under section 5(1) of the Monetary Authority Law (2018 Revision);

“director”, in relation to an entity, means any director, officer, member or other person in whom the management of the entity is vested and “board of directors” shall be construed accordingly;

“economic substance test” shall be construed in accordance with section 4 of the ES Law;

“ES Law” means The International Tax Co-operation (Economic Substance) Law, 2018;

“ES Portal” means the electronic portal to be developed by the Authority for the purpose of receiving notifications and reports from relevant entities to facilitate the Authority performing its statutory functions under the ES Law and ES Regulations, including the sharing of information with other competent authorities;

“ES Regulations” means regulations made by Cabinet under the ES Law

“Registrar” -

- (a) in the case of a company that is incorporated or registered under the Companies Law (2018 Revision), has the meaning given to that expression by section 2(1) of that Law;
- (b) in the case of a limited liability company that is registered under the Limited Liability Companies Law (2018 Revision), has the meaning given to that expression by section 2 of that Law; or
- (c) in the case of a limited liability partnership that is registered under the Limited Liability Partnership Law, 2017, has the meaning given to that expression by section 2(1) of that Law.

“adequate” shall be construed in accordance with this Guidance;

“appropriate” shall be construed in accordance with this Guidance;

“arrangement” includes -

- (a) a scheme, agreement or understanding, whether or not it is legally enforceable; and
- (b) a convention, custom or practice of any kind,

but something does not count as an arrangement unless there is at least some degree of stability about it (whether by its nature or terms, the time it has been in existence or otherwise);

“banking business” has the meaning given to that expression by section 2 of the Banks and Trust Companies Law (2018 Revision);

“carrying on business in the Islands” has the meaning given to that expression by section 2(2) of the Local Companies (Control) Law (2015 Revision);

“Cayman Islands core income generating activities” means activities that are of central importance to a relevant entity in terms of generating income and that are being carried out in the Islands including -

- (a) in relation to banking business -
 - (i) raising funds, managing risk including credit, currency and interest risk;
 - (ii) taking hedging positions;
 - (iii) providing loans, credit or other financial services to customers;
 - (iv) managing capital and preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both;
- (b) in relation to a distribution and service centre business -
 - (i) transporting and storing goods, components and materials;
 - (ii) managing stocks;
 - (iii) taking orders;
 - (iv) providing consulting or other administrative services;
- (c) in relation to financing and leasing business -
 - (i) negotiating or agreeing funding terms;
 - (ii) identifying and acquiring assets to be leased;
 - (iii) setting the terms and duration of financing or leasing;
 - (iv) monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements;
- (d) in relation to fund management business -
 - (i) taking decisions on the holding and selling of investments;
 - (ii) calculating risk and reserves;
 - (iii) taking decisions on currency or interest fluctuations and hedging positions;
 - (iv) preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both;
- (e) in relation to headquarters business -
 - (i) taking relevant management decisions;
 - (ii) incurring expenditures on behalf of other entities in the Group;
 - (iii) co-ordinating activities of the Group;
- (f) in relation to insurance business -
 - (i) predicting or calculating risk or oversight of prediction and calculation of risk;
 - (ii) insuring or re-insuring against risk;
 - (iii) preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both;
- (g) in relation to intellectual property business -

- (i) where the intellectual property asset is a -
 - (A) patent or an asset that is similar to a patent, research and development; or
 - (B) non-trade or intangible (including a trademark), branding, marketing and distribution
- (ii) 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 –
 - (A) taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the intangible asset generating income;
 - (B) 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;
 - (C) carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of income from third parties;
- (h) in relation to shipping business -
 - (i) managing crew (including hiring, paying and overseeing crew members);
 - (ii) overhauling and maintaining ships;
 - (iii) overseeing and tracking deliveries;
 - (iv) determining what goods to order and when to deliver them, organising and overseeing voyages; or
- (i) in relation to holding company business, all activities related to that business;

“competent authority” means, for each respective jurisdiction, the persons and authorities authorised pursuant to a scheduled agreement;

“Consolidated Financial Statements” has the meaning given to that expression by section 2(1) of the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017;

“Constituent Entity” has the meaning given to that expression by section 2(1) of the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017;

“distribution and service centre business” means the business of either or both of the following -

- (a) purchasing from an entity in the Group -
 - (i) component parts or materials for goods; or
 - (ii) goods ready for sale, and
 reselling such component parts, materials or goods outside the Islands;
- (b) providing services to an entity in the same Group in connection with the business outside the Islands,

but does not include any activity included in any other relevant activity except holding company business;

“domestic company” means a company that is not part of an MNE Group and that is -

- (a) carrying on business in the Islands and which complies with section 4(1) of the Local Companies (Control) Law (2015 Revision) or section 3(a) of the Trade and Business Licensing Law (2018 Revision);
- (b) a company referred to in section 9 or 80 of the Companies Law (2018 Revision),
or a subsidiary company of any such company;

“financing and leasing business” 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;

“fund management business” 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 under that Law for an investment fund;

“Group” has the meaning given to that expression by section 2(1) of the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017;

“headquarters business” means the business of providing any of the following services to an entity in the same Group -

- (a) the provision of senior management;
- (b) the assumption or control of material risk for activities carried out by any of those entities in the same Group; or
- (c) the provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (b),

but does not include banking business, financing and leasing business, fund management business, intellectual property business, holding company business or insurance business;

“high risk intellectual property business” means an intellectual property business carried on by -

- (a) an entity that -
 - (i) did not create the intellectual property in an intellectual property asset that it holds for the purposes of its business,
 - (ii) acquired the intellectual property asset -
 - (A) from an entity in the same Group; or
 - (B) in consideration for funding research and development by another person situated in a country or territory other than the Islands; and
 - (iii) licences the intellectual property asset to one or more entities in the same Group or otherwise generates income from the asset in consequence of activities (such as facilitating sale agreements) performed by entities in the same Group; or
- (b) an entity that does not carry out research and development, branding or distribution as part of its Cayman Islands core income generating activities;

“holding company business” the business of a pure equity holding company;

“insurance business” has the meaning given to that expression by section 2 of the Insurance Law, 2010;

“intellectual property business” means the business of holding, exploiting or receiving income from intellectual property assets;

“intellectual property asset” means an intellectual property right including a copyright, design right, patent and trademark;

“investment fund” means 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 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);

“investment fund business” means the business of operating as an investment fund;

“investment interests” means a share, trust unit, partnership interest or other right that carries an entitlement to participate in the profits or gains of the entity;

“joint arrangement” means an arrangement between the holders of shares (or rights) that they will exercise all or substantially all the rights conferred by their respective shares (or rights) jointly in a way that is pre-determined by the arrangement;

“MNE Group” has the meaning given to that expression by section 2(1) of the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017;

“parent company”, in relation to a relevant entity, means a body corporate that -

- (a) holds a majority of voting rights in the relevant entity;
- (b) is a member of the relevant entity and has the right to appoint or remove a majority of the board of directors of the relevant entity;
- (c) is a member of the relevant entity and controls alone, pursuant to a joint arrangement with other shareholders or members, a majority of the voting rights in the relevant entity; or
- (d) has the right to exercise, or actually exercises, dominant direct influence or control over the relevant entity;

“pleasure vessel” has the meaning given to that expression by section 2 of the Merchant Shipping Law (2016 Revision);

“pure equity holding company” means a company that only holds equity participations in other entities and only earns dividends and capital gains;

“relevant activity” means -

- (a) banking business;
- (b) distribution and service centre business;
- (c) financing and leasing business;
- (d) fund management business;

- (e) headquarters business;
- (f) holding company business;
- (g) insurance business;
- (h) intellectual property business; or
- (i) shipping business;

but does not include investment fund business;

“relevant entity” means -

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

but does not include

- (i) an investment fund; or
- (ii) an entity that is tax resident outside the Islands;

“relevant income” shall be construed in accordance with guidance issued under section 5;

“relevant jurisdiction” means a country or territory that is a party to a scheduled agreement;

“scheduled agreement” means an agreement that is scheduled to the Tax Information Authority Law (2017 Revision) in accordance with the provisions of that Law;

“seafarer recruitment and placement service” has the meaning given by Maritime Labour Convention, 2006, as amended from time to time;

“shipping business” 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 -

- (a) the business of transporting, by sea, passengers or animals, goods or mail for a charge;
- (b) the renting or chartering of ships for the purpose described in paragraph (a);
- (c) the sale of travel tickets and ancillary ticket related services connected with the operation of a ship;
- (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
- (e) the functioning as a private seafarer recruitment and placement service,

but does not include a holding company business or the operating of a pleasure vessel;

“subsidiary company” means, with respect to another company, a company of which that other company is the parent company;

“ultimate beneficial owner” has the same meaning given to “beneficial owner” in section 244 of the Companies Law (2018 Revision); and

“ultimate parent company” means a Constituent Entity of a Group that meets the following criteria -

- (a) it owns directly or indirectly a sufficient interest in one or more other Constituent Entities of the Group such that it is required to prepare Consolidated Financial Statements under accounting principles generally applied in its jurisdiction of tax residence, or would be so required if its equity interests were traded on public securities exchange in its jurisdiction of tax residence; and
- (b) there is no other Constituent Entity of the Group that owns directly or indirectly an interest described in paragraph (a) in the first mentioned Constituent Entity.

VII. External Reference Materials

The ES Law is designed to implement the work of the Forum on Harmful Tax Practices (FHTP) under Action 5 of the OECD's Base Erosion and Profit Shifting (BEPS) Project.

The OECD 1998 Report on Harmful Tax Competition: An Emerging Global Issue ("the 1998 Report") set out a framework for approaching the problem of how certain no or only nominal tax jurisdictions and harmful preferential tax regimes "affect the location of financial and other service activities, erode the tax bases of other countries, distort trade and investment patterns and undermine the fairness, neutrality and broad social acceptance of tax systems."

The 1998 Report (OECD, 1998) referred to certain no or only nominal tax jurisdictions and harmful preferential regimes collectively as "harmful tax practices," (although each discipline is mutually exclusive) and built a framework for how to assess these practices. There was a need to include both aspects of these practices, in order to deliver a level playing field between jurisdictions in a context where taxpayers can easily relocate their mobile activities in response to tax considerations.

In December 2018, the FHTP agreed that it was appropriate to resume the application of the substantial activities requirement set out in the 1998 Report (OECD, 1998) for no or only nominal tax jurisdictions and to provide guidance on the application of the requirement. The OECD reference materials listed below provide context for the application of the FHTP's work to the Cayman Islands.

In late 2017, the European Union had already persuaded certain no or nominal tax jurisdictions to commit to introduce FHTP-like economic substance requirements for geographically mobile businesses by the end of 2018. The EU reference materials also listed below provide background for the EU's work on this issue. They are listed after the OECD reference materials because, on the issue of economic substance, they were derived from and place reliance on the FHTP's approach.

A. OECD Reference Materials

The following OECD documents contain the core elements of ES and should be referred to:

- **Members of the Inclusive Framework on BEPS**
<https://www.oecd.org/ctp/beps/inclusive-framework-on-beps-composition.pdf>
- **BEPS Actions (see BEPS Action 5).**
<http://www.oecd.org/tax/beps/beps-actions.htm>
- **OECD (2015), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.**
<http://dx.doi.org/10.1787/9789264241190-en>
- **OECD (2017), Harmful Tax Practices - 2017 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.**
<http://dx.doi.org/10.1787/9789264283954-en>
- **BEPS Action 5 peer review and monitoring.**
<http://www.oecd.org/tax/beps/beps-action-5-peer-review-and-monitoring.htm>
- **OECD (2018, Resumption of application of substantial activities for no or nominal tax jurisdictions – BEPS Action 5, OECD, Paris.**
<http://www.oecd.org/tax/beps/resumption-of-application-of-substantial-activities-factor.pdf>

B. EU Reference Materials

The following EU documents contain the EU’s requirements for “2.2 jurisdictions” (including the Cayman Islands) to introduce ES requirements consistent with the substantial activities requirements under the OECD’s BEPS Action 5 by 1 January 2019:

- **Scope of criterion 2.2 and Terms of reference for the application of the Code test by analogy (Annex VII of The EU list of non-cooperative jurisdictions for tax purposes)**
<http://data.consilium.europa.eu/doc/document/ST-15429-2017-INIT/en/pdf>
- **Scoping paper on criterion 2.2 of the EU listing exercise (Annex 4 Code of Conduct Group (Business Taxation) Report to the Council Endorsement)**
<http://data.consilium.europa.eu/doc/document/ST-9637-2018-INIT/en/pdf>

*** END ***