



Economic Substance – The Cayman Islands

In response to global developments in financial services, on December 17, 2018 The Cayman Islands Government passed The International Tax Co-operation (Economic Substance) Law, 2018 (the "Law") which is effective January 1, 2019.

The Law is built upon the OECD's Forum on Harmful Tax Practices ("FHTP"), which falls under the OECD's BEPS (Base Erosion and Profit Shifting) Inclusive Framework. The Law seeks to provide for an economic substance test to be satisfied by certain entities and provides for incidental and connected purposes.

The Economic Substance Law covers relevant entities engaged in any of the relevant activities. Relevant entities include most Cayman exempted companies, Cayman limited liability companies and partnerships, subject to certain residency requirements. Relevant entities also include registered foreign companies that are centrally managed and controlled in the Cayman Islands.

Relevant activities cover nine FHTP categories of business (as further defined in the Law):

	Banking business		Financing or leasing business
	Insurance business		Shipping business
	Fund management business		Holding companies business
	Headquarters business		Intellectual property business
	Distribution and service centre business		

It is worthy to note that relevant entities and relevant activities do not include investment funds and investment fund business.

If a Cayman entity is conducting relevant activities in one or more of these categories and if that entity is not a tax resident in another jurisdiction, the Law would require the entity to have 'economic substance' in the Cayman Islands.

A relevant entity that carries on one or more relevant activities will be required to submit an annual report with the Cayman Islands' Tax Information Authority declaring if they are carrying on one or more relevant activities and if so, whether they meet the economic substance test.

The Law requires relevant entities to submit their first report to the Tax Information Authority outlining how they have satisfied the economic substance test twelve months after the entity's first financial year-end after the effective date of the Law (i.e. entities with a June 30 year-end will be required to submit their first report by June 30, 2020).

The economic substance test will assess the extent to which the core income generating activities related to the relevant activity are conducted in the Cayman Islands, specifically:

- 1** is the relevant entity directed and managed in an *appropriate* manner in or from within the Cayman Islands related to that relevant activity and
- 2** regarding the level of relevant income derived from the relevant activity:
 - i) has an *adequate* amount of operating expenditure been incurred in the Cayman Islands; and
 - ii) is there an *adequate* physical presence; and
 - iii) are there an *adequate* number of full-time employees or other personnel with appropriate qualifications in the Cayman Islands.

The accompanying guidance to the Law is expected to be finalized by the end of January 2019, which aims to provide clarity on the definitions of '*appropriate*' and '*adequate*'.

This is not only limited to the Cayman Islands, similar laws are passed in the British Virgin Islands and Bermuda. The PwC firms operating in the Caribbean region are here to answer your questions and assist throughout this process. Please reach out to any of our team below with any questions or concerns on how to respond to economic substance requirements your business is subject to.

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