Cayman Islands Economic Substance Update

The European Union Council has reviewed the Cayman legislation on Economic Substance and on March 12th announced an updated list on tax co-operation which included the following comments relevant to the Cayman Islands:

The following jurisdictions, which committed to addressing the concerns relating to economic substance in the area of collective investment funds, have engaged in a positive dialogue with the Group and have remained cooperative, but require further technical guidance, were granted until end 2019 to adapt their legislation:

Bahamas, British Virgin Islands and Cayman Islands

Separately, the Commission acknowledged that further work will be needed to define acceptable economic substance requirements for collective investment funds under criterion 2.2 and invites the Group to continue the dialogue and provide further technical guidance to the jurisdictions concerned by mid-2019.

KPMG Observations

- While Cayman had hoped to be on the cleared (approved) list, based on the above, it is status quo in Cayman for now through until the end of 2019.
- We note that there are no economic substance requirements for collective investment funds in the laws of most other countries, including several countries that have published substance law and were named on the cleared list.
- Cayman has always adapted to regulatory change in a leading manner and will continue to do so. This will be a “watch and see” area as industry awaits more information from Cayman Government expected over the next month and from the EU Council by mid-year.
The Law

On December 27, 2018, the Cayman Islands released the anticipated EU Economic Substance Bill. The bill is effective on formation for newly-formed entities (entities formed January 1, 2019 or later) and for pre-existing entities (in existence prior to January 1, 2019) it is effective as of July 1, 2019.

The economic substance measures are intended to apply to certain Cayman-based entities (“Relevant Entities”) engaging in relevant activities, depending on the nature of the business (“Relevant Activities”).

**Relevant Entities** definition includes Cayman Companies, LLCs and LLPs. Additionally, some foreign companies registered under the Cayman Companies Law (2018) may be impacted.

Notably, limited partnerships as well as investment funds are not included in the scope of the Law.

Additionally, Cayman entities that are tax resident outside of Cayman are not considered to be a relevant entity. Tax residency outside of Cayman is expected to require supporting evidence (e.g. tax residency certificate or letter from foreign tax authority).

**Relevant Activities** definition includes the following types of businesses:

- Banking business
- Financing & leasing business
- Fund management business
- Holding company business
- Insurance business
- Intellectual property business
- Headquarters business
- Distribution & service centre business
- Shipping business

As specifically stated in the current law, the Relevant activities definition does not include an investment fund business.

**A relevant entity satisfies the economic substance test in relation to a relevant activity if the relevant entity:**

1. Conducts Cayman Islands core-income generating activities;
2. Is directed and managed in an appropriate manner from the Cayman Islands; and
3. Carries out certain operating functions in Cayman adequately (expenditure, physical presence, full time employees or other personnel in the Cayman Islands).
Failure to Comply: Penalties for not meeting the substance requirements are $10,000 in year one and $100,000 in year two. Continued failure to meet substance requirements may result in a possible court-ordered strike-off of the Cayman entity.

Cayman law, regulations and Guidance Notes on Substance are available on Cayman Islands Tax Authority website at:


KPMG Observations

Each Cayman business needs to consider if they are a relevant entity conducting a relevant activity.

- It appears the intellectual property businesses will be most impacted by Cayman Substance Law. There is published commentary on this particular area in Version 1.0 of the Guidance Notes.
- Insurance industry awaits more guidance on how the law impacts them, which is expected in the next 1-2 months.
- A Cayman entity which is tax resident outside of Cayman is not a Relevant Entity under the law. Thus a 953d insurance company is not impacted by the law.

Next Steps

- OECD review of Cayman Economic Substance Law is expected by end of June.
- Version 2.0 of the Cayman Economic Substance Guidance Notes is expected to be released in the next 1-2 months.
- Cayman financial services industry awaits further developments from Cayman Government and the EU Council.

How KPMG in the Cayman Islands can assist

KPMG Cayman has been working closely with the Cayman Tax Information Authority and Industry Groups to provide clarity around the Cayman Economic Substance legislation and guidance notes.

- We can provide an analysis of the extent to which the Law may impact your business and organizational structure. With the transition period for existing entities ending in July reviewing your organizational structure now is recommended.
- We can also provide assistance with the implementation of the Law including:
  - Compliance with the economic substance annual notification and reporting requirements for relevant entities.
Advice on the requirements for your business to ensure compliance with the Law.

Have questions on how this impacts your Cayman entities?
Please contact your KPMG Cayman contact or one of our tax advisors below to assist with all your questions and concerns. Contact us here.

David Conen
Partner, Tax

Catherine Houts
Director, Tax

Todd Armstrong
Director, Tax

Andrew Blevins
Senior Manager, Tax

Jigna Patel
Senior Manager, Tax

kpmg.com/socialmedia

kpmg.com/app

Privacy | Legal

If you have any questions, please send an email to marketing@kpmg.ky.
KPMG, P.O. Box 493, Century Yard, Cricket Square, Grand Cayman KY1-1106, Cayman Islands

© 2019 KPMG a Cayman Islands partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.