

# LEGAL UPDATE

## The Deadline for filing the first Economic Substance Law Annual Report for Cayman companies is 31 December 2020

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### Background

The economic substance test (“**ES Test**”) under the International Tax Co-operation (Economic Substance) Law (2020 Revision) as amended (the “**ES Law**”) requires that a “*relevant entity*” (i.e. a Cayman company including, an exempted company, SPC, or LLC) conducting a relevant activity:

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

A relevant entity is subject to the ES Test from the date on which the relevant entity commences a relevant activity unless the relevant entity was in existence prior to 1 January 2019 (i.e. the date when the ES Law came into force), in which case it must have started compliance with the ES Law by 1 July 2019. **However, Cayman companies which are carrying on business as investment funds (or entities through which investment funds directly or indirectly invest or operate) and Cayman exempted limited partnerships and trusts are excluded from the scope of the ES Law. Cayman companies which are tax domiciled outside the Cayman Islands do not have to pass the ES Test but are nonetheless required to make a filing to show that they are tax domiciled overseas.**

CIGA means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Cayman Islands. A relevant entity conducting a relevant activity may satisfy the ES Test by outsourcing the conduct of its CIGA to another person in the Cayman Islands. A relevant entity that outsources its CIGA must be able to monitor and control the carrying out of the CIGA.

### What are “Relevant Activities”?

Relevant activities are **Insurance Business, Fund Management Business, Finance and Leasing Business, Headquarters Business, Shipping Business, Banking Business, Intellectual Property Business, Holding Company Business, and Distribution and Service Centre Busi-**

ness and each relevant entity is required to satisfy the ES Test by preparing and submitting to the Cayman Tax Information Authority (“TIA”) an annual report containing prescribed information for the purpose of the TIA’s determination of whether the ES Test has been satisfied in relation to that relevant activity. The TIA will make the assessment as to whether the ES Test has been satisfied within twelve (12) months after the last day of the end of each financial year commencing on or after 1 January 2019 based on the evidence provided by the relevant entity.

**A relevant entity with a financial year of 1 January 2019 to 31 December 2019 will be required to submit its first annual report to the TIA on or before 31 December 2020.**

In determining whether or not a relevant entity satisfies the ES Test for any financial year with respect to its relevant activities, the TIA will take a “*principles-based approach*”. If the TIA determines that a relevant entity has failed to satisfy the ES Test for a financial year it shall issue a notice to the relevant entity notifying the relevant entity of such determination, giving the reasons, directing any action to be taken to satisfy the ES Test and advising of the relevant entity’s right to appeal.

#### **Penalty fines for non-compliance**

The TIA will impose a penalty of US\$12,500 on a relevant entity for failing to satisfy the ES Test or US\$125,000 if it is not satisfied in the subsequent financial year after the initial notice of failure. Following failure after two consecutive years the Cayman Islands Grand Court may make an order requiring the relevant entity to take specified action to satisfy the ES Test or an order that the relevant entity is defunct or to be struck off.

#### **Get in touch with our team**

We have a dedicated team of lawyers that can offer in-depth legal analysis, advice and guidance on all aspects of the ES Law regime including reporting to the TIA before 31 December 2020 and look forward to advising you as the 31 December 2020 deadline approaches.

*For specific advice on the Economic Substance Law regime and compliance, please contact your usual Loeb Smith attorney or any of:*

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