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OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group
Subject:	The EU list of non-cooperative jurisdictions for tax purposes - Cayman Islands: amended legislation and assessment under criterion 2.2

A/ AMENDED LEGISLATION:

On 3 May 2019, the Cayman Islands adopted a new Regulation and a new Guidance, amending the legislative framework on economic substance requirements that had previously been cleared by the COCG. The new legislation included:

(i) The International Tax Co-Operation (Economic Substance) (Amendment of Schedule) (No.2) Regulations, 2019;
http://www.tia.gov.ky/pdf/International_Tax_Cooperation_(Economic_Substance)_(Amendment_of_Schedule)_(No.2)_Regulations_2019.pdf
and

(ii) The Economic Substance for Geographically Mobile Activities, Guidance Version 2.0.
http://www.tia.gov.ky/pdf/Economic_Substance_-_Guidance_-_v2.0.pdf

The Cayman Islands Cabinet subsequently approved on 10 September 2019 the International Tax Co-operation (Economic Substance) (Amendment of Schedule) (No. 3) Regulations, 2019, which were published in the official gazette on 11 September 2019 and took immediate effect:

http://www.gov.ky/portal/pls/portal/docs/1/12852496.PDF

B/ FINAL ASSESSMENT:

The Commission services reported to the COCG in July 2019 some concerns regarding the amendments made by the Cayman Islands to its previously approved legislation:

1/ New definition of relevant income by reference to "applicable accounting standards"

The first version of the new Regulation and Guidance included a definition of relevant income for a relevant entity as meaning "*all of that entity's gross income arising in the Islands from a relevant activity*".

The Commission services raised concerns about the condition "arising in the Islands" for income of a relevant entity to be considered as relevant income.

The newly adopted version of the Regulation and Guidance defines relevant income as meaning "*all of that entity's gross income from its relevant activities and recorded in its books and records under applicable accounting standards*". This definition no longer makes reference to a geographical link with the Cayman Islands for income to be relevant with respect to entities in the scope of substance requirements.

In the discussion with the Cayman Islands, the Commission services enquired about the accounting standards that are applicable in the Cayman Islands. The Cayman Islands confirmed that there were no defined accounting standards in the Cayman Islands and entities were free to choose their accounting standards. The Cayman Islands have provided statistics showing that 63% of regulated entities follow US GAAP, 31% follow IFRS and 3% use the Luxembourg GAAP. This leaves open the question of unregulated entities, as well as the remaining 3% of regulated entities that use neither the US GAAS, IFRS nor Luxembourg GAAP.

The Cayman Islands agreed that this information would be useful to monitor and will consider how to incorporate the collection of this data in the reporting requirements for relevant entities.

Conclusion:

This issue is conditionally settled, upon monitoring, in the coming years, of the accounting standards used by relevant entities to recognise expenditure and revenues.

2/ New definition of Cayman CIGAs

The newly adopted Regulation and Guidance defined Cayman CIGAs as "*activities that are of central importance to a relevant entity in terms of generating relevant income and, if carried on by a relevant entity in respect of a relevant activity, must be carried on in the Islands*".

The Commission services had concerns that this new circular definition may create a conditionality, whereby a CIGA has to be carried out by a relevant entity for it to be obliged to carry it out in the jurisdiction. In other words, if the relevant activity is not conducted by the relevant entity but is outsourced – which is allowed – then the substance test would not need to be complied with and the outsourcing could take place outside the Cayman Islands. This wording could allow an entity to carry out its CIGAs in another jurisdiction if these are not carried out by a relevant entity. This created opportunities for outsourcing without the outsourcing safeguards. The words "*and if*" therefore created a condition to the application of the rule "*must be carried out in the Cayman Islands*", and opened a potential loophole.

Cayman Islands amended its legislation accordingly in September 2019:

"*Cayman Islands core income generating activities" means activities that are of central importance to a relevant entity in terms of generating relevant income and~~, if carried on by a relevant entity,~~ must be carried on in the Islands including —*"

The COCG concluded that it addresses its concerns regarding the risk of circumvention of the outsourcing safeguards

Conclusion:

The issue is settled.

3/ New definition of domestic companies

The new definition of "domestic companies" that are excluded from the scope of substance requirements has removed the stipulation that a domestic company cannot be part of a MNE Group. This new wording could open a loophole in the substance requirements in cases where a domestic company undertakes both local and foreign business.

The Cayman Islands explained that the key requirement for an entity to qualify as a domestic company for the substance test purpose is that it must be "carrying on business in the Islands". The Cayman Islands clarified that the Local Companies (Control) Law (2015 Revisions) provided a definition of "carrying on business in the Islands". The definition specifically excluded "*the carrying on, from a principal place of business in the Islands, business exterior to the Islands*".

However, the Cayman Islands also explained that this new definition is based on the fact that a large number of local businesses also have presence in the USA, where they will be subject to tax on their income. With the previous definition, they would also fall into the scope of Cayman Island's substance requirements.

This argument related to businesses being taxed in the US contradicted the previous explanation that Cayman companies "*carrying on, from a principal place of business in the Islands, business exterior to the Islands"* cannot qualify as domestic companies.

- Either domestic companies that are part of an MNE Group cannot carry out business exterior to the Islands and, in such case, the example of a Cayman company also doing business in the US should not qualify as domestic company.
- Or domestic companies that are part of an MNE Group can carry out business exterior to the Islands (mixed business) and this then opens a loophole in the substance requirements framework that should be addressed.

Cayman Islands amended its domestic company definition accordingly in September 2019:

"*"domestic company" means a company that is not part of an MNE Group and that is —*

(a) only carrying on business in the Islands and which complies with section 4(1) of the Local Companies (Control) Law (2019 Revision) or section 3(a) of the Trade and Business Licensing Law (2019 Revision); or

(b) a company referred to in section 9 or 80 of the Companies Law (2018 Revision)"

The Cayman Islands also updated its definition of MNE Group to remove the cross reference to the CbCR Regulations. The reason for the cross reference to the CbCR definition for MNE Groups was a result of the information required for statistical reporting as outlined in S.7(4)(i) of the ES Law. All other cross references to the CbCR Regulations were removed in April 2019. The new definition of MNE Group was taken from the Cayman Islands' CbCR Regulations but has removed any reference to the threshold.

"MNE Group" means any Group that includes two or more enterprises for which the tax residence is in different jurisdictions or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction".

Conclusion:

The issue is settled.

4/ New definition of high-risk IP cases

The former definition of high-risk IP cases included entities that do not carry out R&D, branding or distribution CIGAs, irrespective of whether the IP was acquired and licensed to related parties. This definition went further than the EU standard on high-risk IP.

The new definition of high-risk IP cases removed this additional element and now only related party IP cases are covered as high-risk IP scenarios. The COCG agreed that this is still in line with the EU definition of high-risk IP scenarios.

Conclusion:

This issue is settled.

5/ Tax Residence

The new Guidance Note includes additional wording stating that: *"In the event that the entity is a disregarded entity for U.S. income tax purposes, and has a U.S. corporation as its parent, the Authority will consider the entity as tax resident outside of the Islands if satisfactory evidence is provided (...). For example, the evidence may include a Tax Identification Number, tax residence certificate and assessment or payment of a corporate income tax liability on all of that entity's income in the Islands from a relevant activity, or, in the case of a disregarded entity for U.S. income tax purposes, a signed statement under penalty of perjury from an external tax advisor or 'C' level officer stating that all of that entity's income has been included on the corporate tax return of the U.S. parent company*".

The Cayman Islands have explained that certain Cayman subsidiaries of U.S. companies file a tax election with the IRS, in order to be considered a disregarded entity (DE) for U.S. income tax purposes. The U.S. tax impact of the DE election is that the Cayman subsidiary is treated as a branch of the U.S. owner and the U.S. owner is required to report, on an annual basis, all the income and expenses of the Cayman subsidiary on their U.S. corporate tax return. Therefore, in this particular case, the Cayman entity is not considered tax resident in the U.S, however, it is subject to tax in the U.S.

Conclusion:

This issue is settled.

6/ Exchange of information template for high-risk IP

The new Guidance Note mentions that the modalities for the exchange framework, including the terminology used in the framework, timing for such exchanges, the precise data points, the mechanism for opting in, and the development of a standardised template and XML schema, will be used by the Authority in the form approved by the OECD.

The Commission services requested confirmation that in all cases of high risk IP an entity would be required to provide full reporting in one-step and that this information would be subject to spontaneous exchange with the relevant Member States.

The Cayman Islands have confirmed that Section 7(4) of their legislation outlines the specific information to be reported by high-risk IP entities, as well as the additional information required from entities who wish to rebut the presumption of non-compliance.

They confirmed that the information to be exchanged will be in line with the proposed NTJ XML schema being developed by the Forum on Harmful Tax Practices (FHTP) WP10.

Considering that the Cayman Islands have been assessed by the OECD FHTP as having a 'fully equipped monitoring mechanism" (FEMM), it was very important to make sure that, in relation to Member States, they would still be able to provide a full report to relevant Member States in a one-step process, in all cases of high-risk IP.

In recent discussions at the FHTP WP 10, it was agreed that a number of changes would be introduced in the XML schema and the opt-in template for notification, to enable exchange of information in the context of the EU standard on high-risk IP scenarios.

Conclusion:

Considering that the mechanism developed by the FHTP (WP10) should include all information needed for the EU standard on high-risk IP and will allow for an exchange with Member States in a one-step process, the issue is considered as settled.

Conclusion

Leaving aside the issue of collective investment funds, the Cayman Islands remains compliant with criterion 2.2.