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) Act (2021 Revision) as amended

("ES Act")

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Version 3.2

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I. Legislative Framework

A. ES Act

1. Introduction

This Guidance for the International Tax Co-operation (Economic Substance) Act (2020 Revision) as amended by the International Tax Co-operation (Economic Substance) (Amendment) Act, 2020 **(the "ES Act")** provides support for understanding the law's scope, and how to comply with the law.

The economic substance concepts underpinning the ES Act 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 135 jurisdictions are members of the OECD BEPS Inclusive Framework including the Cayman Islands and all other UK Crown Dependencies and Overseas Territories **("UK CDOTs")**. The FHTP is a sub-body of the Inclusive Framework, and is responsible for assessing and monitoring the BEPS Action 5 (which can impose substance requirements) for all member jurisdictions.

In November 2018, the OECD BEPS Inclusive Framework agreed to resume the application of the substantial activities factor to no or only nominal tax jurisdictions, and agreed guidance on how this factor was to be interpreted. That decision is recorded in OECD (2018), Resumption of application of substantial activities for no or nominal tax jurisdictions – BEPS Action 5, OECD, Paris. All UK CDOTs with no or nominal corporate income tax are now included in the FHTP's work. The FHTP does not consider that the absence of a corporate tax rate, or any particular level of corporate income tax, is in itself harmful. The purpose of considering nominal tax jurisdictions along with zero tax jurisdictions is to ensure that there is not an incentive for zero rate jurisdictions to shift to a rate near zero.

The FHTP will review compliance with the substance requirements to ensure that the requirements are implemented effectively, and to ensure a level playing field (as between the no or only nominal tax jurisdictions, as well as with jurisdictions offering preferential regimes).

2. Background

The ES Act 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 BEPS Action 5 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 Act

The ES Act came into force on 1 January 2019.

The economic substance test **("ES Test")** requires that a relevant entity conducting a relevant activity:

(a) conducts core income generating activities **("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.

A "relevant entity" is subject to the ES Test under the ES Act 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 Act by 1 July 2019.

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. The definition lists activities included in CIGA in respect of each type of relevant activity.

A relevant entity conducting a relevant activity may satisfy the ES Test by outsourcing the conduct of its CIGA to another person in the Islands. A relevant entity that outsources its CIGA must be able to monitor and control the carrying out of the CIGA.

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

4. The Authority

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

The Authority is the sole dedicated channel in the Cayman Islands for international co-operation 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 Authority Act (2017 Revision) in addition to those under the ES Act.

5. Notification and Reporting

The ES Act imposes an annual notification obligation on every "entity" which, in summary, includes all legal persons that are registered with the General Registry. Section II.A below headed "**Entity**" defines the term "entity" and describes the notification process.

A "relevant entity" is an entity that is not a domestic company, an investment fund or an entity that is tax resident outside the Islands. A relevant entity carrying on a relevant activity is required to satisfy the ES Test and is also required to prepare and submit to the Authority a report ("ES return") for the purpose of the Authority's determination whether the ES Test has been satisfied.

The ES return must be submitted within twelve months after the last day of the end of each financial year commencing on or after 1 January 2019. The ES return shall be in the form approved by the Authority with the prescribed information as of the end of the relevant financial year. Section IV.B below headed **"Reporting to the Authority"** describes the reporting process.

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 below headed "**Compliance with the ES Test**".

6. Circumvention

The Authority will monitor arrangements which appear to be circumvention mechanisms and will investigate cases where a person has entered into any arrangement the main purpose or one of the main purposes of which is to circumvent any obligation under the ES Act. An example could include an entity which seeks to manipulate or artificially suppress its income to circumvent substance requirements.

B. ES Regulations

The Cabinet may make regulations **("ES Regulations")** regarding any matter that may be prescribed under the ES Act, amending the Schedule to the ES Act, 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 Act 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 Act as are necessary or expedient.

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

C. This Guidance

This Guidance has been issued by the Authority pursuant to section 5 of the ES Act after private sector consultation and supersedes any previous version of the Guidance. This Guidance has been published in the Gazette and on the "Economic Substance" webpage of the Authority's website along with other relevant materials.

This webpage may be updated from time to time.

The Authority may, after private sector consultation, 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 Act.

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 Act. A relevant entity that is subject to the ES Test 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 Act the definition in this Guidance is intended to be the same as in the ES Act except where the ES Act 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 Act itself or otherwise to aid with interpretation.

This Guidance refers to the same revision version of other Acts or Regulations as the ES Act. Readers should consider whether any subsequent amendments or revisions to such Acts or Regulations affect interpretation of this Guidance.

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 Act

A. Entity

The ES Act imposes an annual notification obligation on every entity. Section IV.A below headed "**Notification to the Authority**" describes the requirements. In that context and in section 10 of the ES Act, "entity" is defined to mean —

(a) a company that is —

(i) incorporated under the Companies Act (2020 Revision); or

(ii) a limited liability company registered under the Limited Liability Companies Act (2020 Revision);

(b) a limited liability partnership that is registered in accordance with the Limited Liability Partnership Act, 2017; or

(c) a company that is incorporated outside of the Islands and registered under the Companies Act (2020 Revision).

B. Relevant Entity

The ES Act imposes a reporting obligation on every relevant entity carrying on a relevant activity. Section IV.B below headed "**Reporting to the Authority**" describes the requirements.

A "relevant entity" means -

(a) a company, other than a domestic company, that is -

(i) incorporated under the Companies Act (2020 Revision); or

(ii) a limited liability company registered under the Limited Liability Companies Act (2020 Revision);

(b) a limited liability partnership that is registered in accordance with the Limited Liability Partnership Act, 2017;

(c) a company that is incorporated outside of the Islands and registered under the Companies Act (2020 Revision);

but does not include -

(i) an investment fund; or

(ii) an entity that is tax resident outside the Islands.

Section II.A.2.c) below headed **"Tax resident outside the Islands"** describes the requirements for a company, limited liability company or limited liability partnership incorporated or established in the Islands not to be regarded as a relevant entity for the purposes of the ES Act because it is tax resident outside the Islands.

1. Relevant Entity carrying on relevant activities

The ES Act 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 Act.

2. Entities that are not Relevant Entities

a) Domestic Companies

A domestic company is not a relevant entity for the purpose of the ES Act. It does have the notification obligation under the ES Act but is not required to satisfy the ES Test.

A "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) Act (2019 Revision) as amended (**"LCCA"**) or section 3(a) of the Trade and Business Licensing Act (2019 Revision) (**"TBA"**); or

(b) a company referred to in section 80 of the Companies Act (2020 Revision).

The term "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.

The International Tax Co-Operation (Economic Substance) (Amendment of Schedule) Regulations, 2020 removed the reference to section 9 of the Companies Act from part (b) of the definition of "domestic company" so that companies limited by guarantee will not be domestic companies unless they otherwise satisfy the criteria in the definition of that term.

For clarification, the term "business" does not require an entity to be actively engaged in day-to-day operations and can include the passive collection of income. Also, ownership is only one aspect of the definition of "domestic company"; this means that it is possible that a company which is wholly owned by persons who are resident in the Islands will not meet the domestic company definition, e.g. because the company is not "only carrying on business in the Islands".

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

(1) Companies carrying on business in the Islands

A company that complies with section 4(1) of the LCCA or section 3(a) of the TBA is a domestic company if it is not part of an MNE Group and is only carrying on business in the Islands; a company that is not carrying on business in the Islands or a company that carries on business both in the Islands and exterior to the Islands cannot be a domestic company for the purposes of the ES Act.

"Carrying on business in the Islands" has the meaning given to that expression by section 2(2) of the LCCA, 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 where the carrying on of business, in each case, is in furtherance only of business carried out exterior to the Islands;

(g) the administration of mutual funds by a person licensed as a mutual fund administrator under the Mutual Funds Act (2020 Revision); or

(h) business carried on by a mutual fund, as defined by the Mutual Funds Act (2020 Revision), in the course of the acquisition, holding, management or disposal of investments.

(a) Section 4(1) of the Local Companies (Control) Act (2019 Revision) as amended

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

(a) it is (i) a local company or (ii) an exempted company carrying on business in the Islands which, at the relevant time, is complying with section 5 of the LCCA;

(b) it is licensed under the LCCA and under the TBA 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 Act; or

(d) it is a company operating under a franchise granted by the Government.

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

The LCCA provides that "local company" means a company as defined in section 2 of the Companies Act and includes a foreign company registered under that law and a controlled strata title corporation but does not include an exempted company or a non-resident company. An "exempted company" means a company registered as such under section 164 of the Companies Act.

This provision states that the TBA does not apply to any trade or business licensed or registered to be carried on as a trade or business under another Act without reference to the TBA, including where that other Act 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 and which only carries on "domestic insurance business" under the Insurance Act (2010 Revision) [Act 32 of 2010] would constitute a "domestic company" for the purposes of the ES Act.

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 Act and is therefore classified as a relevant entity which is carrying on the relevant activity, insurance business, for the purpose of the ES Act.

(2) A bank which has a mix of customers, including customers resident outside the Islands, will not be a domestic company notwithstanding that it complies with section 3(a) of the TBA because it is not only carrying on business in the Islands.

(2) Associations not for profit

Associations not for profit registered under section 80 of the Companies Act are not relevant entities for the purposes of the ES Act.

The domestic company exception only applies to section 80 companies where the activities carried on are those for which the entity was formed, i.e. the promotion of charitable, philanthropic, religious, cultural, educational, social or fraternal purposes or objects, including, for the avoidance of doubt, a group of persons sharing a common profession or interest which, to the satisfaction of the Registrar, qualifies the company or association for registration under section 80. The Registrar monitors associations not for profit to ensure that they are only carrying on the activities for which they were formed.

Section 80(2) of the Companies Act provides that the Registrar shall only approve an application for designation under section 80 if the memorandum and articles of association of a company registered under the Companies Act or an association being registered under the Companies Act and applying for designation, contain language to the effect that -

(a) the assets, profits, if any, and other income of the company or association applying for designation, shall be applied exclusively in the furtherance of the objects of the company or association; and

(b) no portion of the assets and income of the company or association shall be distributed as profit or dividend directly or indirectly to the controllers, shareholders, owners or members of the company or association, unless such distribution is intended for the legitimate purpose of compensating a person for services to further the objects of the company or association or to pay the liabilities incurred on behalf of the company or association.

Furthermore, section 80(B) of the Companies Act requires that a section 80 company shall:

(a) File an annual return confirming the objects and activities of the company with the Registrar

(b) Notify the Registrar of any change in

a. The objects or activities of the company; or

b. The address of the registered office or the location of the company,

within 30 days of the date of the change

(c) Maintain proper books of account for a minimum period of 5 years

(d) Comply with any conditions imposed by the Registrar upon registration

(e) Establish and maintain internal controls and systems appropriate for the company to identify conduct which may involve the financing of terrorism

(f) Notify the Registrar of any change in the ownership of the company within 30 days of the date of the change; and

(g) Pay the appropriate fee.

b) Investment Funds

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

The ES Act 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 not an entity that is itself the ultimate investment held), but does not include a person licensed under the Banks and Trust Companies Act (2020 Revision) or the Insurance Act, 2010 [Act 32 of 2010], or a person registered under the Building Societies Act (2020 Revision) or the Friendly Societies Act (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.

For the avoidance of doubt, an entity which is carrying on "fund management business" for the purposes of the ES Act cannot be classified as an "investment fund" for the purpose of the ES Act.

(1) Mutual Funds

The Authority will regard mutual funds licensed or registered with the Cayman Islands Monetary Authority ("CIMA") as investment funds for the purposes of the ES Act because the definition of investment fund under the ES Act is broader than the definition of mutual fund under the Mutual Funds Act, 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 Act (2020 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 Act (2020 Revision) or the Insurance Act, 2010 [Act 32 of 2010], or a person registered under the Building Societies Act (2020 Revision) or the Friendly Societies Act (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 Act (2020 Revision) (including an existing company as defined in that law), in accordance with but subject to section 37 of the Companies Act (2020 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 Act (2020 Revision).

(2) Private Funds

The Authority will regard private funds registered with CIMA pursuant to the Private Funds Act, 2020 as investment funds for the purposes of the ES Act.

(3) 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 Act. Generally speaking, most investment funds under the ES Act 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 Act.

The Tax Information Authority (International Tax Compliance) (Common Reporting Standard) Regulations (2018 Revision) **("CRS Regulations")** define 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).

(4) 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 an investment fund directly or indirectly invests or operates (but not an entity that is itself the ultimate investment held). That is, any Cayman Islands entity through which an investment fund directly or indirectly invests or operates is not a relevant entity. For the avoidance of doubt, the words "through which an investment fund directly or indirectly invests or operates" refer to any entity which functions solely as part of the investment fund structure which is not carrying on an operating business (i.e. its purpose is passive in nature). That type of entity should be distinguished from an entity that is itself the ultimate investment held by an investment fund which would not be included in the term "investment

fund"; that ultimate investment may be a relevant entity and, if it is, would be subject to the ES Act if it is carrying on relevant activities.

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 Act if it is tax resident outside the Islands. The Authority will regard an entity as tax resident in a jurisdiction other than the Islands if the entity is subject to corporate income tax on all of its income from a relevant activity by virtue of its tax residence, domicile or any other criteria of a similar nature in that other jurisdiction. Additionally, in the event that the entity is a "disregarded entity" for U.S. income tax purposes, and has a U.S. corporation or U.S. individual as its parent, the Authority will consider the entity as tax resident outside of the Islands if satisfactory evidence is provided.

As a general rule, the Authority requires any entity claiming to be tax resident outside the Islands to produce satisfactory evidence to substantiate the claim of residence in that other jurisdiction and documentation must be provided as follows:

(a) Proof that the entity is tax resident in the other jurisdiction

Sufficient proof includes one or more of the following documents:

- Certificates or letters issued by the competent tax authority of the other jurisdiction;
- Tax assessments, demands, or evidence of payment issued by the competent tax authority of the other jurisdiction;
- Tax returns submitted to the competent tax authority of the other jurisdiction; or
- Rulings issued by the competent tax authority of the other jurisdiction.

and

(b) Proof that the entity is subject to the jurisdiction's corporate income tax system

Sufficient proof includes the following documents:

- Tax assessments, demands, or evidence of payment issued by the competent tax authority of the other jurisdiction
- Tax returns submitted to the competent tax authority of the other jurisdiction;
- Confirmation that the entity is required to submit a corporate tax return to the competent tax authority of the other jurisdiction.

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.

Where an entity claims to be tax resident in the following jurisdictions it will not be accepted, given the lack of a corporate income tax system: Anguilla, Bahamas, Bahrain, Barbados, Bermuda, British Virgin Islands, Turks and Caicos Islands, and the United Arab Emirates.

In the absence of the evidence as set out above, the entity will be regarded as a relevant entity that is subject to the ES Act. The ES Test must be satisfied with respect to any part of relevant income that is not subject to corporate income tax imposed by a jurisdiction other than the Islands.

The Authority will systematically exchange this information as described in Section V.B.1 below headed **"Other Competent Authorities"**.

In the case of an entity that is tax resident in a jurisdiction outside of the Islands, the Authority shall, in accordance with relevant international standards and scheduled agreements, provide the information provided to it under the ES Act to the competent authority in —

(a) the jurisdiction in which that entity is tax resident;

(b) the jurisdiction in which the immediate parent, ultimate parent and ultimate beneficial owner of the entity resides; and

(c) if the relevant entity is incorporated outside the Islands, the competent authority of the relevant jurisdiction in which the entity is incorporated.

A relevant entity should take care that it does not falsely claim to be tax resident or subject to corporate income tax in another jurisdiction on all of that entity's income in the Islands from a relevant activity 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 corporate income tax on all of that branch's 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 in the previous paragraph. 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 financing and leasing business from an UK branch which is subject to UK tax on all of that UK branch's income to satisfy the ES Test in the Islands with respect to that 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 Act and, if so, whether they are carrying on relevant activities and required to satisfy the ES Test under the ES Act.

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 proprietary 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

C. 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.

The term "relevant activity" does not require an entity to be actively engaged in the businesses listed above, i.e. passive collection of income from one of the foregoing businesses would be a relevant activity. **Figure 1: 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 CIGA. The terms "investment fund business" and "investment fund" are explained in Section II.A.2.b above headed "**Investment Funds**".

In addition, **"The Schedule: Sector Specific Guidance"** describes how the ES Test may be satisfied for each of the 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 Act imposes on it. Where such relevant activities continue during the liquidation or winding up process, the liquidators (or equivalent) must ensure that the relevant entity continues to satisfy all its obligations under the ES Act. 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. Notification to the Authority and reporting to the Authority will continue to be required with respect to any period during which the relevant entity carries on relevant activities; such notification and reporting will not be required with respect to any period during which the relevant entity is no longer carrying on relevant activities that generate relevant income.

Any liquidators (or equivalent) or other representatives of a relevant entity who were responsible for the liquidation, winding up 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 Act for six years after final dissolution. These records may be held by a service provider if located in the Islands.

For the purpose of this Guidance, final dissolution refers to the date on which the certificate of dissolution in the case of a company or equivalent, where available, for other types of relevant entities is issued.

D. 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 ES return to the Authority must include the amount and type of relevant income in respect of the relevant activity.

"Relevant income", in relation to an entity, means all of that entity's gross income from its relevant activities and recorded in its books and records under applicable accounting standards.

The Authority may, when considering the application of this term in practice, take into account any guidance promulgated by the OECD FHTP on the meaning of the term "gross income".

E. Ultimate Parent and Group

It is important for any relevant entity which is carrying on relevant activities to identify its ultimate parent as this will be required in the ES return and on a claim of tax residency outside the Islands, made to the Authority.

"Ultimate parent" 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.

"Consolidated Financial Statements" means the financial statements of a Group in which the assets, liabilities, income, expenses and cash flows of the ultimate parent and the Constituent Entities are presented as those of a single economic entity. "Constituent Entity" means (a) 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 a Group were traded on a public securities exchange; (b) any such business unit that is excluded from the Group's Consolidated Financial Statements solely on size or materiality grounds; and (c) any permanent establishment of any separate business unit of the Group included in (a) or (b) 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 is subject to the ES Act 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 Act by 1 July 2019. This means that, from the applicable date, a relevant entity must satisfy the ES Test in relation to the relevant activities which it is carrying on.

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

(a) conducts 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 **The Schedule: Sector Specific Guidance**, under the heading **"Holding Company Business"**.

A relevant entity that carries on a relevant activity but which has no relevant income is not obliged to meet the requirements of the ES Test as set out in section 4 of the ES Act. That relevant entity will still, however, be required to satisfy its notification and reporting obligations under the ES Act (e.g. the ES return filed will be akin to a 'nil' return).

2. Core Income Generating Activities (CIGA)

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 Islands. A relevant entity must conduct the appropriate elements of CIGA. The elements listed in the definition of CIGA in relation to each relevant activity are neither exhaustive nor mandatory. It is a question of fact in each case which elements are actually undertaken to generate relevant income. The assessment of substance in the Islands will include careful consideration of what CIGA are being undertaken by the relevant entity in the Islands.

For example, a relevant entity that is carrying on banking business and is only generating income from deposit-taking need not carry on other listed elements of CIGA for banking business, such as hedging or providing loans or credit.

The ES Act requires a relevant entity that is carrying on more than one relevant activity to satisfy the ES Test in relation to each relevant activity.

Section III.A.4 below headed **"Outsourcing"** describes the manner in which a relevant entity is permitted to outsource its CIGA and clarifies that there are no restrictions on outsourcing activities that are not CIGA.

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

Figure 1: CIGA for each type of relevant activity

Relevant activity	Definition	CIGA
banking business	has the meaning given to that expression by section 2 of the Banks and Trust Companies Act (2020 Revision) *[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) 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	means the business of either or both of the following - (a) purchasing from an entity in the same 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	(i) transporting and storing goods, components and materials; (ii) managing stocks; (iii) taking orders; (iv) providing consulting or other administrative services

Relevant activity	Definition	CIGA
	For the avoidance of doubt, (b) above only falls within the definition in the specific circumstances where the relevant entity is operating as a service centre for entities in the same Group	
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	(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	means the business of managing securities as set out in paragraph 3 of Schedule 2 to the Securities Investment Business Act (2020 Revision) carried on by a relevant entity licensed or otherwise authorised to conduct business under that Act for an investment fund *["Managing Securities" means managing securities belonging to another person in circumstances involving the exercise of discretion.]*	(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	CIGA
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	(i) taking relevant management decisions; (ii) incurring expenditures on behalf of other Group entities; (iii) co-ordinating Group activities
holding company business	the business of a pure equity holding company *["pure equity holding company" means a company that only holds equity participations in other entities and only earns dividends and capital gains]* *For the avoidance doubt, an investment fund is not regarded as 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 economic substance test which is satisfied if the relevant entity confirms that - (a) it has complied with all applicable filing requirements under the Companies Act (2020 Revision); and (b) it has adequate human resources and adequate premises in the Islands for holding and managing equity participations in other entities.

Relevant activity	Definition	CIGA
insurance business	has the meaning given to that expression by section 2 of the Insurance Act, 2010 [Act 32 of 2010] *[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) predicting or calculating risk or oversight of prediction or 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
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.]*	(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 –

Relevant activity	Definition	CIGA
		(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	CIGA
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 owning, operating or chartering of a pleasure yacht	(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

3. Meaning of "adequate" and "appropriate"

The ES Act 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 Act (2020 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. As such, the directors (or equivalent) of each relevant entity should address their minds to these questions and make their determination in good faith. A relevant entity must 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 **The Schedule: Sector Specific Guidance**.

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 Act (i.e. filing requirements, CIGA performed in the Islands, and monitoring by the Authority).

4. Outsourcing

a) Outsourcing CIGA

A relevant entity satisfies the ES Test in relation to a relevant activity if its 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 CIGA by that other person.

Only that part of the relevant activity of that other person which is 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 Act 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 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 both the supervision and those CIGA are undertaken in the Islands. The reason for the requirement that a relevant entity can only outsource its CIGA to service providers that perform the outsourced CIGA in the Islands is to prevent income being located in a no or nominal tax environment which is separated from the jurisdiction where the activities have taken place, undermining the premise of the economic substance (or "substantial activities") factor.

Where 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. The employees of the service provider can be counted for the purpose of identifying the employees of the relevant entity used to satisfy the ES Test. This must be verified to ensure that only the portion of full time equivalent employee time directly used in the service of the relevant entity is counted.

There must be no double counting if the services are provided to more than one relevant entity carrying out relevant activities. For example, if an employee of a service provider spends an hour performing CIGA for a relevant entity, the same employee cannot spend the same hour performing CIGA for a different relevant entity. Staff of a service provider should not, when carrying out CIGA, do one task for multiple relevant entities (such as combined board meetings). Rather, tasks should be specific to each relevant entity so that there is no double counting of any specific task.

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. The Authority will require a person who provides outsourced services to a relevant entity to verify the information on outsourcing within thirty days.[1] The Authority will provide details on this procedure in the ES module of the DITC Portal User Guide (referred to in Section IV.B below headed "**Reporting to the Authority**"). The Authority may not accept a relevant entity's claim to have satisfied the ES Test by means of domestic outsourcing unless that information is verified by the service provider within that timeframe.

[1] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 4(c).

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 CIGA

A relevant entity may outsource activities which are not CIGA to service providers which are located outside the Islands. Such activities may include, for example, back office functions, IT, payroll, legal services, or other expert professional advice or specialist services provided, in each case, they are not of central importance to the relevant entity in terms of generating relevant income in respect of a relevant activity.

d) Outsourcing by CIMA-regulated relevant entities

Relevant entities that are conducting 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 Act.

5. Directed and managed

A relevant entity satisfies the ES Test regarding 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 in relation to the relevant activity;

(b) meetings of the board of directors are held in the Islands at adequate frequencies given the level of decision making required in relation to the relevant activity;

(c) there is a quorum of directors present in the Islands during the meetings described in (b) above;

(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 director meeting minutes and appropriate records in the Islands.

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

What constitutes an adequate frequency of meetings in the Islands will be dependent on the relevant activities of the relevant entity.

The test also looks to ensure that the associated minutes and records are kept in the Islands and that the board is a decision making 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

Please refer to **"The Schedule: Sector Specific Guidance"** for additional guidance on the practical application of the ES Test to various types of relevant activities.

IV. Notification and Reporting

A. Notification to the Authority

Every entity shall, by means of an Annual Economic Substance Notification ("ESN"), notify the Authority annually of —

(a) whether or not it is carrying on a relevant activity;

(b) if it is carrying on a relevant activity, whether or not it is a relevant entity;

(c) in the case of an entity that is carrying on a relevant activity and is tax resident in a jurisdiction outside the Islands —

  (i) the name and address of its immediate parent, ultimate parent and ultimate beneficial owner and any other information reasonably required to identify its immediate parent, ultimate parent and ultimate beneficial owner;

  (ii) the date of the end of its financial year; and

  (iii) the jurisdiction in which the entity is claiming to be tax resident and any other information as may reasonably be required to support that claim;

(d) in the case of a relevant entity that is carrying on a relevant activity:

  (i) the date of the end of its financial year, and

  (ii) the name and address of the officer who is responsible for providing information to the Authority,

and shall provide appropriate evidence to support the information provided in the notification as may be reasonably required by the Authority.[2]

For clarification, the details in subparagraph (c) above are not required with respect to an entity's owners who do not meet the definition of immediate parent, ultimate parent and ultimate beneficial owner. The same principle will apply regarding the requirement to provide these ownership details in an ES return.

The ESN is required as a prerequisite to the entity filing its Annual Return via the General Registry's Corporate Administration Platform, as applicable for the particular type of entity. The deadline for submitting the ESN is the date after which the General Registry can impose penalties for late payment of the Annual Return fees, namely 31 March each year[3]. There is a different process for entities using the

[2] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 4(a).
[3] The deadline for filing annual returns in 2020 was extended until 30 June 2020 as a result of the coronavirus (COVID-19) pandemic.

Cayman Business Portal ("CBP"). Entities filing their annual return on the CBP are asked to confirm if they are carrying on a relevant activity.

Foreign Companies are required to file the ESN despite not being required to file an annual return. All foreign companies should file their ESN before 31 March i.e. 2019 ESN is due 31 March 2020[4].

The Authority provides the following User Guides, together with other materials, under the heading "Cayman Islands Resources" on the Economic Substance webpage of its website:

- Economic Substance Notification User Guide
- Economic Substance Notification Bulk Submit User Guide

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 an ES return for the purpose of the Authority's determination whether the ES Test has been satisfied in relation to that relevant activity. The ES return 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.

The Authority will launch a Cayman Islands DITC Portal ("**DITC Portal**"), inter alia, to facilitate electronic reporting to the Authority and the Authority's sharing of information with other competent authorities pursuant to the ES Act. The Authority will publish a DITC Portal User Guide with a module for Economic Substance specifying the rules and procedures for use of the DITC Portal by relevant entities and their representatives.

The ES return by a relevant entity 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;

(ea) the name and address of any person other than the relevant entity who is conducting the relevant entity's core income generating activities in relation to its relevant activity;[5]

(f) information showing the 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 Act;

[4] The deadline for filing annual returns in 2020 was extended until 30 June 2020 as a result of the coronavirus (COVID-19) pandemic.

[5] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 4(b).

(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[6];

(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) 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.

Regulations will prescribe other information which the Authority requires to determine whether a relevant entity has satisfied the ES Test.

A relevant entity shall provide the Authority with appropriate evidence to support the above-mentioned information provided to the Authority as may be reasonably required by the Authority.

A relevant entity must also 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 Act.

[6] Note that the definition of "MNE Group" under the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017 applies to Groups with a total consolidated revenue of at least US$850 million.

Where a relevant entity that is required to satisfy the economic substance test fails to prepare and submit to the Authority the required ES return within the specified time, the Authority shall by notice in writing impose a penalty of five thousand dollars and an additional penalty of five hundred dollars for each day during which the failure to comply continues. The penalty must be paid within 30 days, subject to the permitted appeal process.[7]

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 available to the Authority without lawful excuse within the specified time or who knowingly or wilfully alters, destroys, mutilates, defaces, hides or removes any such information may be criminally liable.

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 ES Test**".

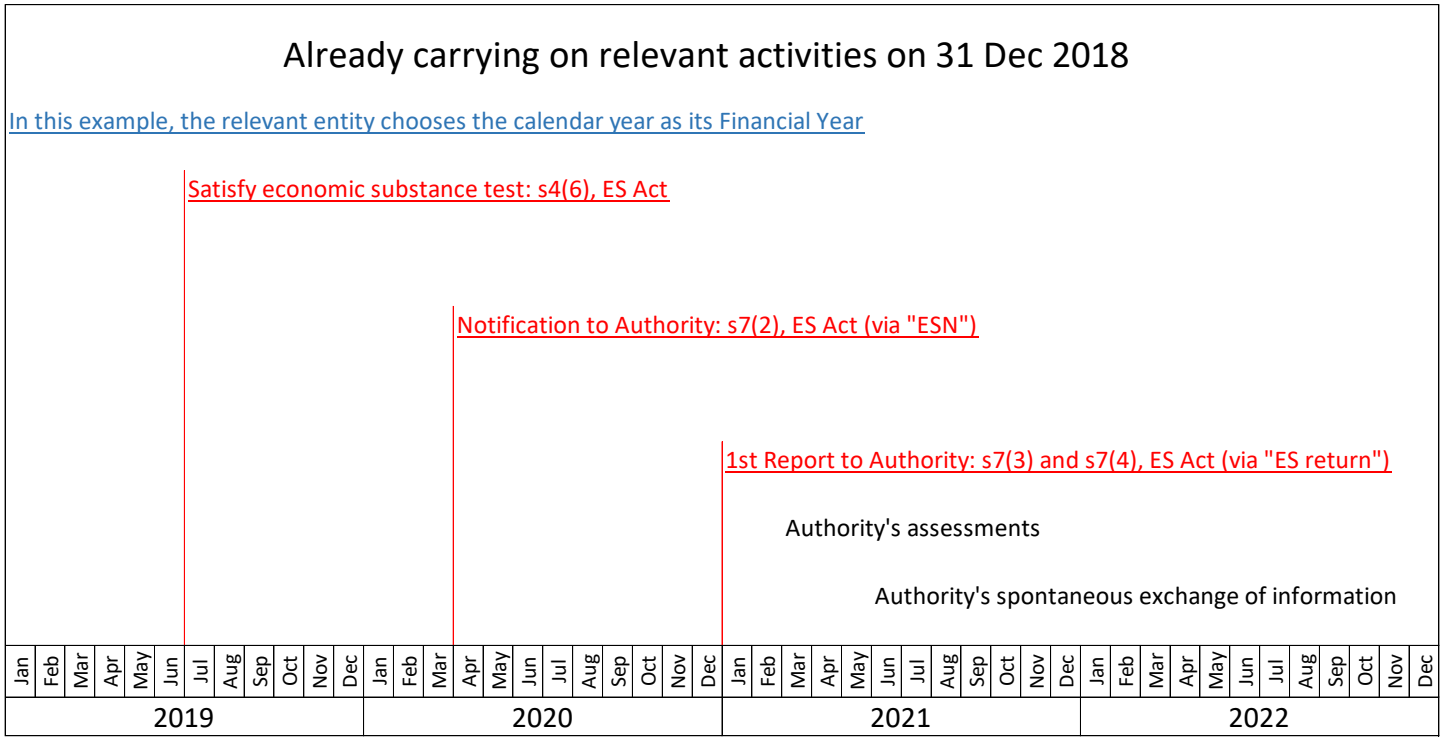
The DITC Portal and the ES module to the DITC Portal User Guide would be based on, but not limited by, the standardized XML Schema, exchange mechanisms and other detailed technical guidance developed by the FHTP for reporting and exchange of required information. For example, the Authority will collect additional data needed to determine whether a relevant entity has satisfied the ES Test. Section VII.A below headed "**OECD Reference Materials**" has a link to OECD (2019), Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information, OECD, Paris which includes information on the XML Schema which no or nominal tax jurisdictions must use to exchange required information with other Competent Authorities.

C. Example timetables for existing and new relevant entities

"**Figure 2: Example timetable for an existing relevant entity**" and "**Figure 3: Example timetable for an new relevant entity"** below 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.

[7] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 4(d).

Figure 2: Example timetable for an existing relevant entity

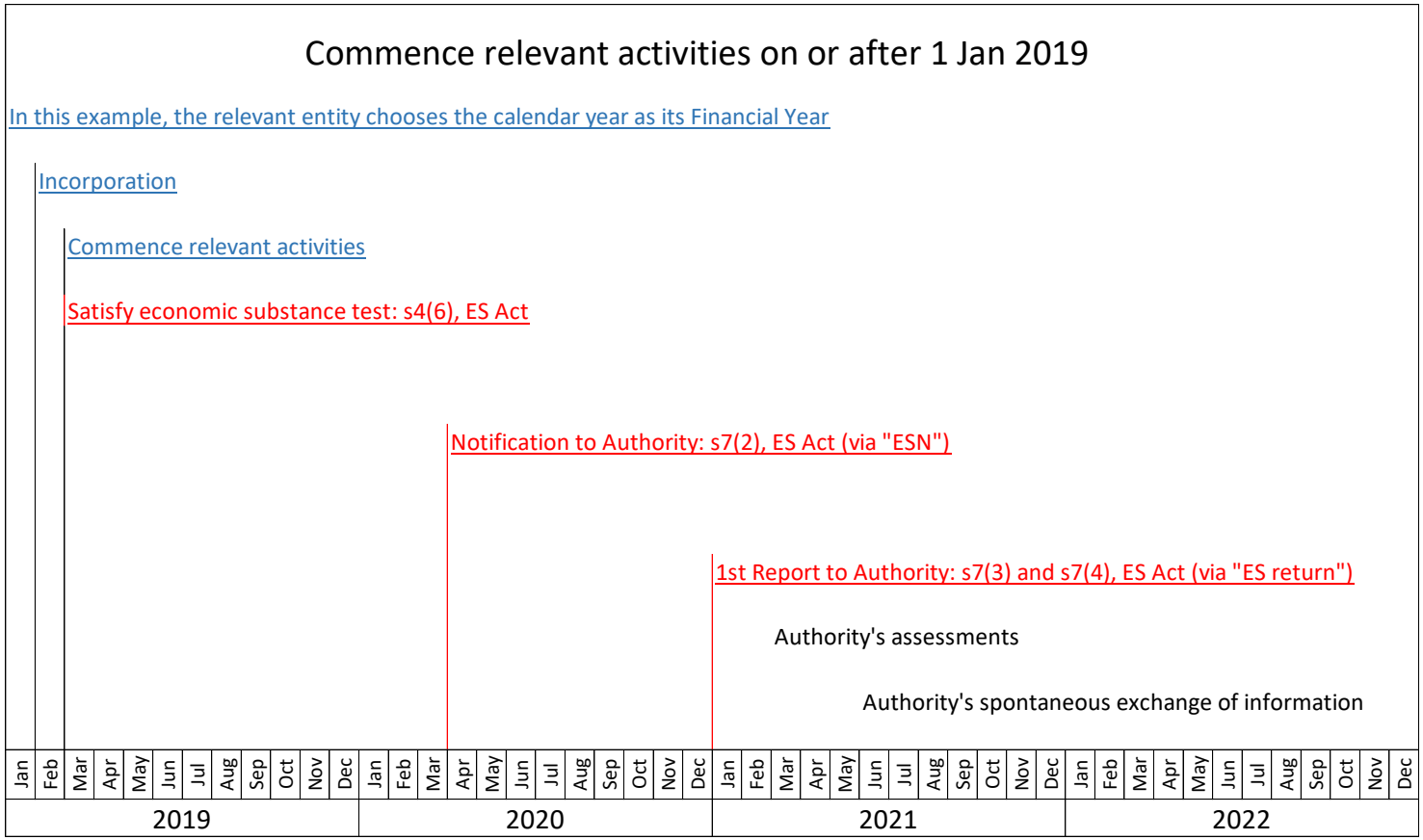


The deadline for ESNs due in 2020 was extended to 30 June 2020 as a result of the COVID-19 pandemic.

A relevant entity that is carrying on a relevant activity 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.

Figure 3: Example timetable for an new relevant entity



The deadline for ESNs due in 2020 was extended to 30 June 2020 as a result of the COVID-19 pandemic.

A relevant entity that is carrying on a relevant activity 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 Act, 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 an ES return is required under the ES Act.

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 or other personnel for a particular level of relevant income either generally or for any particular type of relevant activity because that would be arbitrary and would prove uneconomical in many cases.

In summary, the principles are that (a) those individuals who in fact conduct a relevant entity's 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. CIGA includes those listed activities which in relation to a relevant activity, are of central importance in terms of generating relevant income and must be carried out in the Islands.
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
    a. the hours spent by different employees/personnel with appropriate qualifications to generate such CIGA, the statutory or contractual hours any such individuals are required to work during the relevant financial year, and
    b. 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 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 CIGA performed by the directors (or equivalent) in the Islands. The Authority will take this type of activity into account in making the determination whether a relevant entity meets the ES Test.
5. The Authority will need to take outsourcing activity into account 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 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. The Authority will not take account of any practices that would undermine the requirement for the applicable CIGA for a relevant activity to be performed the Islands.

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 Act (2020 Revision), an order that it is a defunct company to which Part VI of that Act applies;

(ii) a limited liability company that is registered under the Limited Liability Companies Act (2020 Revision), an order that it is a defunct company to which section 40 of that Act applies; or

(iii) a limited liability partnership that is registered under the Limited Liability Partnership Act, 2017, an order that the limited liability partnership be struck off in accordance with section 31 of that Act 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 Act. 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 Act 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 Act in accordance with relevant international standards and scheduled agreements under the Tax Information Authority Act (2017 Revision) with other competent authorities in respect of relevant entities that fail to satisfy the ES Test in relation to relevant activities and in relation to high risk IP business. Information will also be shared with the competent authority of the jurisdiction where an entity claims to be tax resident or subject to income tax on its relevant income.

Recipient competent authorities could be in the jurisdiction of residence of the relevant entity's immediate parent, ultimate parent, and ultimate beneficial owner and could also be in the jurisdiction where the relevant entity (or the entity claiming not to be a relevant entity by reason of its tax residence) itself is incorporated or claims to be tax resident, if that is outside the Islands. To activate the exchanges set out above, recipient jurisdictions would need to opt in to receive spontaneously exchanged information.

The modalities of the above 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.

2. Monitoring Processes

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.

Implementation of economic substance requirements by the Cayman Islands will also be monitored by EU Member States.

3. Confidentiality

The ES Act expressly permits the following types of disclosures:

(a) lawfully made in accordance with section 3(1) of the Confidential Information Disclosure Act, 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 Act.

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 Act (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 Act (2020 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;

"DITC Portal" means the electronic portal developed by the Authority for the purpose of receiving, inter alia, reports (i.e. ES returns) from relevant entities carrying on relevant activities and also the data points under section 7(1)(c) of the ES Act with respect to an entity which would otherwise be in scope but is claiming to be tax resident outside the Islands to facilitate the Authority performing its statutory functions under the ES Act and ES Regulations, including the sharing of information with other competent authorities;

"economic substance test" shall be construed in accordance with section 4 of the ES Act;

"entity" means (for the purposes of both sections 7 and 10 of the ES Act)[8] -

(a) a company that is -

  (i) incorporated under the Companies Act (2020 Revision); or

  (ii) a limited liability company registered under the Limited Liability Companies Act (2020 Revision);

(b) a limited liability partnership that is registered in accordance with the Limited Liability Partnership Act, 2017; or

(c) a company that is incorporated outside of the Islands and registered under the Companies Act (2020 Revision).

"ES Act" means The International Tax Co-operation (Economic Substance) Act (2020 Revision) as amended by the International Tax Co-operation (Economic Substance) (Amendment) Act, 2020;

"ES Regulations" means regulations made by Cabinet under the ES Act;

"ES return" means the report under section 7(3) of the ES Act in the form approved by the Authority which relevant entities carrying on relevant activities are required to submit to the Authority for determination whether the ES Test has been satisfied;

"Registrar" -

(a) in the case of a company that is incorporated or registered under the Companies Act (2020 Revision), has the meaning given to that expression by section 2(1) of that Act;

(b) in the case of a limited liability company that is registered under the Limited Liability Companies Act (2020 Revision), has the meaning given to that expression by section 2 of that Act; or

(c) in the case of a limited liability partnership that is registered under the Limited Liability Partnership Act, 2017, has the meaning given to that expression by section 2(1) of that Act.

[8] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, sections 4(e) and 5(b).

"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 Act (2020 Revision);

"carrying on business in the Islands" has the meaning given to that expression by section 2(2) of the Local Companies (Control) Act (2019 Revision);

"core income generating activities" means[9] activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on 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;

[9] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 6.

(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" means[10] the financial statements of a Group in which the assets, liabilities, income, expenses and cash flows of the ultimate parent and the Constituent Entities are presented as those of a single economic entity;

"Constituent Entity" means -

(a) 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 a Group were traded on a public securities exchange;

(b) any such business unit that is excluded from the Group's Consolidated Financial Statements solely on size or materiality grounds; and

(c) any permanent establishment of any separate business unit of the Group included in (a) or (b) provided the business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes;

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

(b) a company referred to in section 80 of the Companies Act (2020 Revision);

"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 Act (2020 Revision) carried on by a relevant entity licensed or otherwise authorised to conduct business under that Act for an investment fund;

[10] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 6.

"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;

"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;

"holding company business" the business of a pure equity holding company;

"immediate parent", in relation to an entity, means[11] a person that owns directly twenty-five percent or more of the ownership interests or voting rights in the entity;

"insurance business" has the meaning given to that expression by section 2 of the Insurance Act, 2010 [Act 32 of 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

[11] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 6.

and includes any entity through which an investment fund directly or indirectly invests or operates (but not an entity that is itself the ultimate investment held), but does not include a person licensed under the Banks and Trust Companies Act (2020 Revision) or the Insurance Act, 2010 [Act 32 of 2010], or a person registered under the Building Societies Act (2020 Revision) or the Friendly Societies Act (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" 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;

"pleasure yacht" has the meaning given to that expression by section 11(6) of the Merchant Shipping Act (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 Act (2020 Revision); or

  (ii) a limited liability company registered under the Limited Liability Companies Act (2020 Revision),

(b) a limited liability partnership that is registered in accordance with the Limited Liability Partnership Act, 2017;

(c) a company that is incorporated outside of the Islands and registered under the Companies Act (2020 Revision),

but does not include -

(i) an investment fund; or

(ii) an entity that is tax resident outside the Islands;

"relevant income", in relation to an entity, means all of that entity's gross income from its relevant activities and recorded in its books and records under applicable accounting standards;

"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 Act (2017 Revision) in accordance with the provisions of that Act;

"seafarer recruitment and placement service" has the meaning given by Maritime Labour Convention, 2006;

"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 owning, operating or chartering of a pleasure yacht;

"subsidiary company" means[12], with respect to another company, a company of which that other company is the immediate parent;

"territorial waters" has the same meaning given to "territorial sea" in The Cayman Islands (Territorial Sea) Order 1989 of the United Kingdom [UKSI 1989 No. 2397];

"ultimate beneficial owner" has the same meaning given to "beneficial owner" in section 244 of the Companies Act (2020 Revision); and

"ultimate parent" means[13] 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

[12] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 6.
[13] International Tax Co-operation (Economic Substance) (Amendment) Act, 2020, section 6.

(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 Act 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
- **OECD (2019), Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.**
  https://doi.org/10.1787/9789264311480-en
- **OECD Glossary of Tax Terms:**
  http://www.oecd.org/ctp/glossaryoftaxterms.htm#G
- **OECD (2019), Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information, OECD, Paris.**
  www.oecd.org/tax/beps/substantial-activities-in-no-or-only-nominal-tax-jurisdictions-guidance-for-the-spontaneous-exchange-of-information.htm

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

The Schedule: Sector Specific Guidance

Note - Examples outlined in the Sector Specific Guidance are intended to provide high-level guidance to industry and will not bind the Authority in any way. Whether a relevant entity passes or fails the ES Test will be dependent on that entity's specific fact pattern and will be determined against the principles of the ES Act on a case by case basis. Given this and to avoid any unnecessary confusion, the Authority has deliberately not included any fact specific examples which conclude with the entity passing the ES Test.

For clarification, the term "business" does not require an entity to be actively engaged in day-to-day operations and can include the passive collection of income.

A. Banking Business

1. Scope of Banking Business

Banking business is a type of relevant activity. The ES Act provides that "banking business" has the meaning given to that expression by section 2 of the Banks and Trust Companies Act (2020 Revision) ("BTCA"). There, "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.

All persons carrying on banking business in the Islands must obtain the relevant class of bank licence from the CIMA pursuant to the BTCA. The Authority will follow CIMA's classification of banking business for the purpose of the ES Act.

Every bank licensed by CIMA under the BTCA is required to have a place of business in the Islands, approved by the CIMA, which will be its principal office in the Islands and two individuals (appointed to act either separately or jointly) or a body corporate, approved by CIMA, resident or incorporated in the Islands to be its agent in the Islands.

a) Banking categories under the BTC Act

CIMA regulates several different categories of banking business under the BTCA. A relevant entity must possess a valid licence granted by CIMA in order to carry on banking business in the Islands.

(1) Class A Banking

A Class "A" licence permits the carrying on of banking business with customers both within and outside the Islands subject to any conditions imposed by CIMA. A bank with an "A" Licence should consider if it meets the definition of a "domestic company".

Where a Class "A" bank is not part of an MNE Group, is only carrying on business with customers in the Islands and complies with section 3(a) of the Trade and Business Licensing Act (2019 Revision) it would qualify for the domestic company exemption.

A Class "A" bank is required to meet the CIMA requirements to obtain this licence. Where such a bank does not meet the definition of a "domestic company" but does meet these CIMA requirements, it is expected that the entity would meet the requirements of the ES Test. In terms of filing requirements, a bank with a Class "A" license will be required to file the ESN as normal (i.e. relevant entity carrying on the relevant activity of banking business) however, when filing the ES return there will be an option to select Class "A" Bank and once this option is selected no further information will be required on the ES return.

(2) Class B Banking licence

A bank with a Class "B" Licence or Restricted Class "B" Licence is in scope for the ES Act. It is a relevant entity and carrying on a relevant activity, banking business, for the purpose of the ES Act.

The Class "B" Licence permits the carrying on of banking business with the following restrictions by virtue of section 6(6) of the BTCA. The holder is not permitted to:

(a) take deposits from any person resident in the Islands, other than another licensee, or an exempted or an ordinary non-resident company which is not carrying on business in the Islands;

(b) invest in any asset which represents a claim on any person resident in the Islands, except a claim resulting from –

(i) a loan to an exempted or an ordinary non-resident company not carrying on business in the Islands;

(ii) a loan by way of mortgage to a member of its staff or to a person possessing or being deemed to possess Caymanian status under the Immigration Act (2015 Revision) for the purchase or construction of a residence in the Islands to be owner-occupied;

(iii) a transaction with another licensee; or

(iv) the purchase of bonds or other securities issued by the Government, a body incorporated by statute, or a company in which the Government is the sole or majority beneficial owner; or

(c) without the written approval of CIMA, carry on any business in the Islands other than one for which the Class "B" licence has been obtained.

Section 6(6) of the BTCA also requires a holder of a Class "B" Licence to have such resources (including staff and facilities) and such books and records as CIMA considers appropriate having regard to the nature and scale of the business unless it is a subsidiary or branch of a bank licensed in a country or territory outside the Islands.

The holder of a Restricted Class "B" Licence is subject to a further restriction that the licensee shall not receive or solicit funds by way of trade or business from persons other than those listed in any undertaking accompanying the application for the licence (section 6(5)(d), BTCA).

The effect of the ES Act is that, subject to the exception in the paragraph below headed "Tax resident outside the Islands" every bank with a Class "B" Licence or a Restricted Class "B" Licence will be required to satisfy the ES Test, even if CIMA does not require the bank to have a physical presence under the BTCA because the bank is a subsidiary or branch of a bank licensed in a country or territory outside the Islands. Therefore, compliance with CIMA's requirements will not necessarily be sufficient to meet the ES requirements.

b) Tax resident outside the Islands

A bank with a Class "B" Licence or a Restricted Class "B" Licence that would otherwise be in scope for the ES Act will be out of scope, on the basis that it is not a relevant entity for the purposes of the ES Act, if it establishes to the Authority that it is tax resident outside the Islands. For example, a bank with a Class "B" Licence would be out of scope for the ES Act on this basis if it is the Cayman Islands branch of a foreign bank which is subject to corporate income tax on all of the entity's income in a jurisdiction outside the Islands. The DITC will require any entity which claims that it is tax resident outside the Islands to produce satisfactory evidence to substantiate this claim. Further information on this exemption is outlined in Section II.B.2.c) above.

The above exception is not available to a Cayman subsidiary bank where the foreign parent pays tax on a Cayman subsidiary bank's income under the Controlled Foreign Corporations (CFC) or similar rules and the Cayman subsidiary is not itself subject to corporate income tax in a jurisdiction outside the Islands.

c) Banks and Trust Companies Act licensees not carrying on banking business

The BTCA also regulates trust business; the business of acting as trustee, executor or administrator. Trust business is not a relevant activity under the ES Act. This means that a bank which has either a Trust Licence or Restricted Trust Licence in addition to either a Class "B" Licence or a Restricted Class "B" Licence need not satisfy the ES Test with respect to its trust business and should omit information in relation to its trust business (e.g. number of employees and income) from the ES return it makes to the Authority with respect to its banking business.

2. CIGA for Banking Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to banking business, CIGA includes —

(a) Raising funds, managing risk including credit, currency and interest risk;

These are the activities of ensuring the bank has an adequate capital base; "raising funds" includes taking deposits, going to the money markets, issuing bonds or raising new capital. The risks to be managed will be linked to ensuring that the capital base is not eroded.

(b) Taking hedging positions;

These hedging activities may form part of a bank's risk management strategy.

(c) Providing loans, credit or other financial services to customers; and

Banks will utilise the moneys they have received from deposits to provide other financial products and services, such as loans and mortgages, to retail, corporate or institutional customers.

(d) Managing capital and preparing reports or returns, or both, to investors or CIMA

Banks have substantial reporting requirements to CIMA and this activity should be performed in the Islands by the bank or its domestic service provider.

The DITC may disclose to CIMA any bank's failure to satisfy the ES Test.

3. Outsourcing

The BTCA does not require a bank with a Class "B" Licence or Restricted Class "B" Licence to have a physical presence in the Islands if it is a subsidiary or branch of a bank licensed in a country or territory outside the Islands. However, the ES Act requires such a bank (unless tax resident outside the Islands) to satisfy the ES Test by conducting its CIGA in the Islands.

Like other relevant entities required to satisfy the ES Test, a bank may utilize domestic outsourcing if it is able to monitor and control that the service provider is carrying out the bank's CIGA in the Islands. Only that part of the domestic service provider's activities that are attributable to generating relevant income for the relevant entity will be taken into account in considering whether the relevant entity satisfies the ES Test.

4. Examples

(a) Class "B" Bank with physical presence

- This type of bank should consider whether it needs to enhance its physical presence in order to satisfy the ES Test by conducting all CIGA for its banking business in the Islands and is directed and managed in the Islands.

(b) Class "B" Bank with no physical presence, but subject to tax in another jurisdiction

- This type of bank is a subsidiary or branch of a banking group that is regulated in another jurisdiction. This type of bank will not be a relevant entity for the purpose of the ES Act if it satisfies the DITC that it is subject to tax on all of its Cayman income in another jurisdiction.

(c) Class "B" Bank with no physical presence, but not subject to tax in another jurisdiction

- This type of bank is a subsidiary or branch of a banking group that is regulated in another jurisdiction. The bank will need to satisfy the ES Test, which will entail establishing a physical presence, or ensuring that all CIGA is performed by domestic service providers, such that it conducts all CIGA for its banking business in the Islands and is directed and managed in the Islands.

(d) Different types of income

- The bank earns different types of income, including interest income, non-interest income, and net gains (or losses) on financial instruments. Both interest income (e.g. interest on loans and interest and dividends on investments) and interest expense (e.g. on deposits due to customers, interest on trading portfolio and on debt securities issued by the bank) are elements of CIGA for banking business. Certain types of non-interest income, such as income from trust business and investment management may not be elements of CIGA for banking business. If appropriate, the bank should report any income from fund management business separately for that relevant activity rather than with respect to its banking business.

(e) CayCo Ltd receives deposits from other banks and trust companies. This is CayCo Ltd's only activity.

- CayCo Ltd is not required to have a bank licence for this activity and therefore, this is not banking business for the purpose of the BTCA or the ES Act. CayCo Ltd will still be required to file an ESN as outlined in the Guidance. CayCo Ltd should also consider whether it may be conducting activities which fall into another relevant activity category.

5. Reporting on Banking Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ503 – Banking".

B. Distribution and Service Centre Business

1. Scope of Distribution and Service Centre Business

Distribution and service centre business is defined as meaning "the business of either or both of the following –

(a) purchasing from an entity in the same 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".

Group in this context is defined as "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".

It is apparent from the definition that for a relevant entity to be carrying on the business of distribution and service centre for the purposes of the ES Act, it must be purchasing component parts, materials for goods, or goods ready for sale (together "items") from other entities in the same Group and reselling these items outside the Islands. The definition also encompasses relevant entities which operate as a service centre for non-Cayman entities in the same Group.

The scope of the definition does not extend to the following cases:

i. Where the distribution and service centre activities are provided to a group company on an incidental basis (i.e. occasional, minor activity with no profit making purpose).

ii. Where the relevant entity purchases the items from or provides the services to a third party.

iii. The business of purchasing and reselling items from, or providing services to, entities in the same Group both of which are located in the Islands.

Where a relevant entity undertakes one of the other relevant activities, it may be a normal part of their business to provide distribution and service centre activities and so these activities are excluded from being within the scope of distribution and service centre, to prevent duplicate reporting.

2. CIGA for Distribution and Service Centre Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to distribution and service centre business, CIGA includes -

(a) Transporting and storing goods, components and materials

This includes inbound and or outbound transportation management; fleet management; materials handling; storage of raw materials or finished products and managing the associated risks.

(b) Managing stocks

This includes considering the stock mix and minimum acceptable stock levels, managing the frequency of the stocktake, managing storage warehouses and whether the space is used effectively, perishability of stock and ensuring adequate security procedures are in place.

(c) Taking orders;

This includes the provision of the order processing element of the entire fulfilment process, whether that is manual or electronic.

Note - items (i)-(iii) typically apply in relation to a distribution centre while item (iv) generally relates to a service centre.

(d) Providing consulting or other administrative services

This includes providing consulting or other administrative services to other Group companies in connection with business outside the Islands.

3. Examples

(a) CayCo Ltd, a relevant entity, provides administrative services to a Group company also based in the Islands. This is CayCo Ltd's only activity.

- CayCo Ltd is not carrying on a relevant activity for the purposes of the ES Act as the services are provided solely to another Cayman entity. CayCo Ltd will still be required to file an ESN as outlined in the Guidance.

(b) CayCo Ltd, a relevant entity, provides administrative services to another Group company based in the US. This is CayCo Ltd's only activity.

- CayCo Ltd is a relevant entity carrying on the relevant activity of Distribution and Service Centre business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

(c) CayCo Ltd, a relevant entity, is responsible for the distribution of raw materials purchased from Group entities in Asia, to other entities based in the US. CayCo Ltd contracts the transportation of goods to LMN Ltd which is based outside the Islands. Goods are stored in a US warehouse by a third party company STO Ltd, who liaises directly with LMN Ltd over deliveries.

- CayCo Ltd is a relevant entity carrying on the relevant activity of distribution and service centre business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

(d) CayCo Ltd, a relevant entity, is a service company responsible for taking manufacturing orders from Group entities based in the US and Europe for goods to be manufactured by another Group entity in Asia. CayCo Ltd's gross revenue is earned based on the percentage of orders executed. This is CayCo Ltd's only activity.

- CayCo Ltd is a relevant entity carrying on the relevant activity of distribution and service centre business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

(e) CayCo Ltd, a relevant entity, is a service company responsible for the payroll function of the Group's entities located outside the Islands. CayCo Ltd employs globally mobile workers and is responsible for managing payroll. CayCo Ltd earns gross income from other entities in the Group for payroll services provided. This is CayCo Ltd's only activity.

- CayCo Ltd is a relevant entity carrying on the relevant activity of distribution and service centre business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

4. Reporting on Distribution and Service Centre Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ505 – Distribution and service centre".

C. Financing and Leasing Business

1. Scope of Financing and Leasing Business

Financing and leasing business is defined as 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".

Although the activity is described as financing and leasing, the essence of the activity is the provision of credit facilities. The definition makes it clear that a relevant entity which offers credit or financing for any kind of consideration is in scope. An entity which provides credit as an incidental part of a different sort of business will not be treated as carrying on financing and leasing business. In this context "incidental" means occasional, minor activity with no profit making purpose.

Where the provision of credit is separated from the consideration received, this may also be in scope i.e. where a loan advanced for consideration by one company, which is within the scope of this relevant activity, is transferred to a different company which then receives the loan capital repayments and consideration.

Credit facilities includes loans, hire purchase agreements, long term credit plans, and finance leases in relation to assets other than land. The consideration may take different forms but would typically include interest and/or lending fees in the case of financing and lease payments and, where applicable, residual value payments, in the case of a lease. The definition does not extend to cases where credit is offered and there is no expectation of consideration from the credit.

The scope does not extend to cases where a relevant entity has purchased debt securities as an investment, as opposed to providing a credit facility, for example, where the relevant entity has purchased gilts, quoted bonds or similar securities.

For entities that engage in banking, insurance and fund management businesses it may be a normal part of their activities to provide credit facilities, and so these sectors are excluded from being within the scope of Financing and Leasing business, to prevent duplicate reporting. For example, a captive insurer that loans funds to a parent or affiliate company is not engaging in financing and leasing business since such loans are ancillary to the insurance business and a normal aspect of captive insurance business.

2. CIGA for Financing and Leasing Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to financing and leasing business, CIGA includes -

(i) negotiating or agreeing funding terms;

This CIGA includes negotiating or agreeing the type of funding (e.g. equity / preference shares, debt, convertible debt, bank borrowing etc.), the terms of the agreement, the quantum of funding, the rates of interest payable, the security given (if any), and any covenants.

(ii) identifying and acquiring assets to be leased;

This CIGA includes agreeing a suitable price or quantity, identifying sources of those assets, and negotiating the acquisition and the terms of supply.

(iii) setting the terms and duration of financing or leasing;

This includes setting the financial terms and the parameters as to acceptable counterparties, the amounts, rates of interest, the legal agreements and the duration for which the financing or leasing is to be provided.

(iv) monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements;

This CIGA includes the acquisition of data about a borrower or lessee (or group of them), testing against covenants, extending durations of loans, and feeding back into decision making on writing new terms. With regard to managing risks, this includes instigating debt collection, considering spreading of risk across sectors or consumer groups. In leasing it includes monitoring and maintaining the underlying assets.

3. Examples

General examples on scope:

In scope:	**Not in scope:**
Entities which carry on a factoring activity, by which they purchase and then collect another business's book debts	Ancillary business or incidental to a different business for example the supply of goods or services "on account" in respect of which the supplier anticipates payment within a reasonable period in accordance with customary business practice.
In scope:	**Not in scope:**
A relevant entity provides credit facilities to customers and charges interest and/or a lending fee. This would constitute "consideration." The entity is in scope regardless of whether the creditor takes security (collateral) for the credit.	Credit is offered with a grant of security in favour of the lender but the credit is interest free and there are no lending fees or other consideration. For the avoidance of doubt, the grant of security by any party in favour of the lender would not constitute consideration.

Further examples:

(a) CayCo Ltd, a relevant entity, operates as a treasury centre for a multi-national group of companies and provides interest-bearing credit facilities to subsidiaries and affiliated entities.

- CayCo Ltd is carrying on the relevant activity of financing and leasing business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

(b) CayCo Ltd, a relevant entity, lends $2,000,000 to CDE Ltd at a 5% interest rate. This is CayCo Ltd's only activity.

- CayCo Ltd is carrying on the relevant activity of financing and leasing business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

Extension of example (b) – in Yr 2, the loan of $2,000,000 to CDE Ltd, is then transferred by CayCo Ltd to another company CayCo II LLC which is also a relevant entity.

- CayCo II LLC would now be carrying on the relevant activity of financing and leasing business. Thus, CayCo II LLC will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

If this was the only loan CayCo Ltd held, then CayCo Ltd would cease to be carrying on financing and leasing business. If following the transfer of the loan CayCo Ltd. is no longer carrying on any financing and leasing business then when CayCo Ltd files its ESN for year 2, it would classify itself as not carrying on a relevant activity and thus, no ES return would be required.

(c) CayCo Ltd, a relevant entity, lends $2,000,000 to one of its subsidiaries, CDE Ltd. This is an interest free loan and no lending or other fee is charged and there is no other kind of consideration.

- CayCo Ltd would not come within the definition of financing and leasing business as the definition does not extend to cases where a credit facility is provided and there is no consideration from the borrower. CayCo Ltd will be required to file an ESN as outlined in this Guidance.

(d) CayCo Ltd, a relevant entity, is a trading company that provides its customers with 50 days trade "credit" on invoices. CayCo Ltd's terms of business state that if the customers have not paid within the period of 50 days, CayCo Ltd may charge late payment interest.

- CayCo Ltd is not carrying on the relevant activity of financing and leasing business as consideration is not payable in respect of the "credit" arrangement (the late payment interest is to deter payment being made later than 50 days and not as consideration for the provision of credit). Even if consideration were payable for the "credit" the provision of credit in these circumstances is an incidental part of Cayco Ltd's trading business and would not constitute financing and Leasing business. CayCo Ltd will be required to file an ESN as outlined in this Guidance.

(e) AVFin Ltd, a relevant entity, is an aircraft finance company. Its business is the financing of aircraft for its customers, whereby it purchases aircraft and leases the relevant aircraft to the relevant customer.

- AVFin Ltd is carrying on financing and leasing business. Thus, AVFin Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

4. Reporting on Finance and Leasing Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ502 – Finance and Leasing".

D. Fund Management Business

1. Scope of Fund Management Business

Fund management business is a type of relevant activity. The ES Act defines fund management business as the business of managing securities as set out in paragraph 3 of Schedule 2 to the Securities Investment Business Act (2020 Revision) ("SIBA") carried on by a relevant entity licensed or otherwise authorised to conduct business under that Act for an investment fund.

In summary, the definition of fund management business encompasses relevant entities which, as a business, manage securities belonging to another person, being an investment fund, in circumstances involving the exercise of discretion pursuant to paragraph 3 of Schedule 2 of SIBA.

For the avoidance of doubt, an entity which is carrying on "fund management business" for the purposes of the ES Act cannot be classified as an "investment fund" for the purpose of the ES Act.

a) Managing securities

SIBA provides that "managing securities" is a type of securities investment business and means: (i) managing securities; (ii) belonging to another person; (iii) in circumstances involving the exercise of discretion. SIBA defines securities as the assets, rights or interests specified in Schedule 1 of SIBA. In summary, securities include shares, instruments creating or acknowledging indebtedness, warrants and similar instruments entitling the holder to subscribe for such shares or debt securities, certificates representing certain securities, options, futures, and contracts for differences.

The ES Act does not apply to other types of securities investment business listed in Schedule 2 to SIBA.

b) For an investment fund

The concept of fund management business in the ES Act applies to a relevant entity that is managing securities belonging to another person, being an investment fund, in circumstances involving the exercise of discretion by the relevant entity and where the relevant entity is licensed or otherwise authorized to conduct securities investment business under SIBA.

Fund management business does not include managing securities belonging to other persons that are not investment funds (e.g. private wealth management), although that activity may well be regulated by SIBA. Such persons may include both entities and individuals.

In this context, the term "investment fund" has the meaning given to it in the ES Act, as described in Section II.B.2.b) above headed "**Investment Funds**". The ES Act defines the term "investment fund" to mean 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 licenced under the Banks and Trust Companies Act (2020 Revision) or the Insurance Act, 2010 [Act 32 of 2010], or a person registered under the Building Societies Act (2020 Revision) or the Friendly Societies Act (1998 Revision). The ES Act defines the term "investment interests" to mean a share, trust unit, partnership interest or other right that carries an entitlement to participate in the profits or gains of the entity.

c) Licensed or otherwise authorised by the Cayman Islands Monetary Authority

The ES Act applies to relevant entities that are carrying on fund management business. If a relevant entity is licensed or otherwise authorised to carry on securities investment business under SIBA, and the relevant entity also manages securities as set out in paragraph 3 of Schedule 2 of SIBA for another person, being an investment fund, then it will be subject to the ES Test in respect of such. SIBA prohibits a person from carrying on securities investment business unless that person holds a licence or is registered under SIBA or is exempt from holding a licence or being so registered. Non-registrable persons (as well as persons conducting excluded activities under Schedule 3 of SIBA) are exempt from holding a licence or registration under SIBA because such persons are not regarded under SIBA as conducting securities investment business. CIMA authorises all registered persons under SIBA. This means that all relevant entities that are registered persons under SIBA and that carry on fund management business are subject to the ES Act and this Guidance

(1) Registered persons under SIBA, section 5(4) and Sch. 4

SIBA permits certain persons to carry on securities investment business without a licence if they register with CIMA. Registered persons include:

1. A company within a group of companies carrying on securities investment business exclusively for one or more companies within the same group.

2. A person carrying on securities investment business exclusively for one or more of the following classes of persons —

   (a) a sophisticated person;

   (b) a high net worth person; or

   (c) a company, partnership or trust (whether or not regulated as a mutual fund) of which the shareholders, unit holders or limited partners are one or more persons falling within (a) or (b),

   and who has a registered office or a place of business in the Islands for which services are provided by a person licensed to provide such services.

3. A person to whom section 4(1) of SIBA applies but who is regulated in respect of securities investment business by a recognised overseas regulatory authority in the country or territory (other than the Islands) in which the securities investment business is being conducted.

(a) Transitional period for registered "excluded persons" to become "registered persons"

Section 42 of SIBA provides that any person who is registered with CIMA pursuant to paragraphs 1, 4 and 5 of Schedule 4 on the day immediately before 18th June, 2019, the commencement date of the Securities Investment Business (Amendment) Act, 2019 [Act 8 of 2019], shall —

(a) provide such information as CIMA may request by 15th August, 2019; and

(b) take such steps to re-register with CIMA as a registered person by 15th January, 2020 if that person wishes to continue carrying on securities investment business.

(2) A person described under subsection (1) who —

(a does not provide the required information to the Authority by 15th August, 2019; or

(b) does not complete the re-registration process under this section by 15th January, 2020,

shall cease conducting securities investment business in or from within the Islands and shall be deregistered by CIMA.

(b) Application of the ES Act to SIBA's "registered persons"

A relevant entity that was registered with CIMA as an excluded person pursuant to paragraphs 1, 4 and 5 of Schedule 4 of SIBA prior to 18 June 2019 (being the effective date of the SIBA 2019 Amendment) is not considered by the Authority to be 'authorised' for the purposes of the 'fund management business' definition until such relevant entity converts and becomes a 'registered person' with CIMA as prescribed in the SIBA 2019 Amendment (a "SIBA re-registration"), subject also to the following provisions of this Guidance.

(c) Non-registrable persons under SIBA, Sch. 2A

The "non-registrable persons" listed in paragraph 2 of Schedule 2A of SIBA are not required to register with (i.e. they do not need to be authorised by) CIMA and are not considered under SIBA to be conducting securities investment business. This means that any non-registrable persons which, in their capacity as such, manage securities for investment funds will not, in so doing, be carrying on fund management business for the purpose of the ES Act.

Non-registrable persons include, among others, persons carrying on securities investment business only in the course of acting in certain constitutional or legally mandated capacities (e.g. directors, partners, LLC managers, liquidators, and trustees) provided that they are not separately remunerated for any of the activities which constitute the carrying on of such securities investment business (otherwise than as part of any remuneration such person receives for acting in that capacity) and either:

(a) do not hold themselves out as carrying on securities investment business other than as a necessary or incidental part of performing functions in that capacity, or

(b) are acting on behalf of a company, partnership or trust that is otherwise licensed or exempted from licensing under this SIBA.

Non-registrable persons also include single family offices, joint enterprises, the Cayman Islands Stock Exchange, CIMA, and the Government of the Islands or any public authority created by the Government.

2. CIGA for Fund Management Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to fund management business, CIGA includes —

(i) Taking decisions on the holding and selling of investments

This head of CIGA is focused on the actual taking of decisions regarding the acquisition, disposal or trading of investments. The decisions would need to be taken in the Islands by an investment committee, board of directors or equivalent. It is necessary for a quorum of directors to be physically present in the Islands in order to treat their decisions as being made in the Islands.

(ii) Calculating risk and reserves

A fund manager can satisfy this head of CIGA by assessing its client investment fund's risk as a whole, and calculating the overall risk across the investment fund and the reserves required on a strategic basis. An investment fund's risks typically include market risk, credit risk (where applicable), liquidity risk as well as operational risks.

A fund manager is unlikely to satisfy this CIGA if calculations are limited to a marginal calculation for one area of applicable risk and do not encompass other areas of applicable risk or if the fund manager routinely accepts the calculations made by other entities.

(iii) Taking decisions on currency or interest fluctuations and hedging positions

A fund manager can satisfy this CIGA by taking a strategic approach on risk management of its client investment fund's overall position arising from currency or interest rate fluctuations. For example, the fund manager's CIGA could include conducting FX, interest rate or other hedging functions, or similar, with a view to controlling risks or optimising exposures of the client investment fund.

A fund manager is unlikely to satisfy this CIGA by taking isolated decisions involving specific investments of its client investment fund.

(iv) Preparing reports or returns, or both, to investors or the Cayman Islands Monetary Authority, or both

A fund manager can satisfy this head of CIGA by ensuring that there are systems and processes in place so that the fund manager is able to provide its client investment fund with accurate information on the investment fund's financial position on a timely basis. It is acceptable for the investment fund's administrator or other person to perform the administrative task of compiling the various routine reports and returns for the investment fund to its investors and any regulatory returns to the Cayman Islands Monetary Authority, however the fund manager should ensure that such contractual arrangements are in place so as to allow for appropriate reporting to be available in a timely manner.

a) Outsourcing outside the Islands

A relevant entity conducting fund management business must satisfy the ES Test for that relevant activity with respect to the particular heads of CIGA for fund management business that it undertakes. If a relevant entity outsources certain aspects of its CIGA to a person within the Islands, that is deemed to remain part of and to satisfy that part of the relevant entity's CIGA to the extent it is supervised appropriately by the relevant entity.

If a relevant entity is not able to satisfy the ES Test for a head of CIGA due to it having outsourced the CIGA to a foreign service provider, (for example an investment manager resident in the US, UK or Hong Kong) then the relevant entity should not receive the relevant income for this activity. In practical terms this means that the Authority would not expect to see the relevant entity having fee income in respect of such head of CIGA.

3. Reporting on Fund Management Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ508 – Fund management".

E. Headquarters Business

1. Scope of Headquarters Business

Headquarters business is defined as "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;"

Group in this context is defined as "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".

The definition of headquarters business makes it clear that whether an entity carries on a headquarters business is not determined by its position in the group structure but rather by reference to the services that it provides to other companies in the group.

In conducting banking, financing and leasing, fund management, intellectual property, holding company, and insurance businesses a relevant entity may provide, in addition, services that fall within the definition of headquarters business. To prevent duplicate reporting, relevant entities conducting those relevant activities will not also be regarded as conducting headquarters business. It is possible for a relevant entity to be regarded as carrying on both headquarters business and another relevant activity if the activities form two distinct business activities.

2. CIGA for Headquarters Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to headquarters business, CIGA includes -

i. Taking relevant management decisions;

This includes making decisions on the substantive functions and significant risks for other group companies such as strategic planning, marketing strategies, information technology, acquiring premises, etc.

ii. Incurring expenditures on behalf of Group entities;

This includes taking specialist advice, the purchase of significant assets or the procurement of technology on behalf of the Group as a whole. Other common shared expenses include marketing, IT and HR.

iii. Co-ordinating Group activities;

This includes co-ordinating activities to aggregate demand for the Group in order to realize synergies and cost savings.

3. Examples

(a) CayCo Ltd, a relevant entity, is part of a Group that includes certain subsidiary entities incorporated variously within the Islands and in certain jurisdictions outside the Islands. Each subsidiary entity within the Group has its own board of directors that makes strategic and managerial decisions for that entity. Relevant management decisions to implement that strategy and manage risk are taken by the relevant subsidiary, there are no service contracts in place between CayCo Ltd and any subsidiaries within the Group and CayCo Ltd does not provide any other services to any other subsidiaries within the Group.

CayCo Ltd provides a parent company guarantee in respect of the loans and other obligations of certain subsidiaries within the Group, which obligation is secured by a debenture charging the assets of CayCo Ltd.

- CayCo Ltd is a relevant entity but it is not carrying on the relevant activity of headquarters business. Thus, CayCo will be required to file an ESN as outlined in this Guidance.

(b) CayCo Ltd, a relevant entity, is the headquarters for a global Group. CayCo Ltd determines the strategic planning and direction of the Group and manages Group risk. The senior management team, employed by CayCo Ltd, regularly spends time with each Group subsidiary advising on the implementation of the Group's strategy and the management of risk. CayCo Ltd does not receive fees for the services provided but instead benefits through interest, dividends and capital gains from its equity and debt investments.

- CayCo Ltd is a relevant entity carrying on the relevant activity of headquarters business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance. As CayCo Ltd is carrying on a relevant activity for gain, it should be reporting the relevant income on its ES return.

(c) The facts of this example are the same as for (b) above except that CayCo Ltd is tax resident in Canada.

- CayCo Ltd is not regarded as a relevant entity where it is tax resident outside the Islands. CayCo Ltd will be required to file an ESN and to provide evidence that it is tax resident outside the Islands, as outlined in this Guidance.

(d) CayCo Ltd, a relevant entity, is a member of a Group. Other members of the Group are incorporated in various jurisdictions, and the ultimate parent of the Group is a US Corporation. The board of the US Corporation sets the broad strategic direction and corporate policy for the Group.

CayCo employs certain senior management, legal, risk, IT professionals and CayCo Ltd provides management, legal, risk, and IT services to other members of the Group pursuant to one or more services agreements. CayCo Ltd is remunerated for such services pursuant to the services agreements.

- CayCo Ltd is a relevant entity carrying on the relevant activity of headquarters business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

4. Reporting on Headquarters Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ501 – Headquarters".

F. Holding Company Business

1. Scope of Holding Company Business

Holding company business is a type of "relevant activity". The ES Act defines holding company business as “the business of a pure equity holding company”. The term “pure equity holding company” means a company that only holds equity participations in other entities and only earns dividends and capital gains. Dividend income will be interpreted to encompass any income payments made to a pure equity holding company in respect of equity participations and will include distributions made by non-corporate entities that are equivalent to dividends. Equity participations include shares in a company, but will also include other forms of investment in the equity of an entity which give the investor the right to participate in the profits of that entity. Equity participations do not include investments made by way of debt or other non-equity participations.

As part of the functions of a pure equity holding company, activities may include, for example, ownership of a bank account, governance decisions, entering into contractual arrangements with professional or other service providers, and the payment of fees and expenses.

The ownership of any other form of investment or asset (for example, an interest bearing bond, government securities, legal or beneficial interests in real property), even if held in addition to one or more equity participations, will result in the entity falling outside this definition. Similarly, where a relevant entity undertakes other activities or earns other income that is not part of, or incidental to, its business as a pure equity holding company, it is outside the scope of the pure equity holding company business definition and will instead need to meet the higher substance requirements, if applicable, for any relevant activity it carries on.

For the avoidance of doubt, as mentioned in Section II.B.2.b) above headed “**Investment Funds**”, an investment fund is not a pure equity holding company.

2. The ES Test for Holding Company Business

A relevant entity that is only carrying on the business of a pure equity holding company is subject to a reduced ES Test, which is satisfied if the relevant entity –

(a) has complied with all applicable filing requirements under the Companies Act (2020 Revision); and

(b) has adequate human resources and adequate premises in the Islands for holding and managing equity participations in other entities.

What is required for compliance with limb (b) of the reduced ES Test, as with the ES Act in general, will be dependent on how the pure equity holding company business is being conducted. A pure equity holding company maintaining a registered office in the Islands engaging its registered office service provider in accordance with the Companies Act (2020 Revision) may be able to satisfy the reduced ES Test, depending on the level and complexity of activity required to operate its business.

For the avoidance of doubt, a pure equity holding company is not required to be directed and managed in the Islands.

3. Examples

(a) CayCo Ltd, a relevant entity, is an intermediary pure equity holding company in a group structure; it holds 100% of the shares in two other companies and receives dividends annually, which are

paid into an interest bearing bank account. The bank account is used for the purpose of receiving the dividends and to pay the company's expenses. This is CayCo Ltd's only activity.

- CayCo Ltd is a pure equity holding company; the receipt of incidental interest income on the bank account does not affect CayCo Ltd's classification as a pure equity holding company. Thus, CayCo Ltd will be required to file an ESN, to satisfy the reduced ES Test and to file an ES return as outlined in this Guidance.

(b) CayCo Ltd, a relevant entity, has a brokerage account. The brokerage account only holds equity participations in underlying entities. This is CayCo Ltd's only activity.

- CayCo Ltd is not a pure equity holding company because CayCo Ltd's only asset is a claim against the broker. CayCo Ltd does not directly hold or manage equity participations; these are held by the broker. CayCo Ltd is therefore not conducting holding company business. CayCo Ltd will be required to file an ESN as outlined in this Guidance.

(c) CayCo Ltd is a shipping company; it also acquired all the shares in another company, Y Ltd.

- CayCo Ltd is not a pure equity holding company as it is conducting shipping business, which is clearly not an activity that is incidental to the holding of equity participations. CayCo Ltd should consider whether it is carrying on the relevant activity of shipping business. CayCo Ltd will be required to file an ESN as outlined in this Guidance.

(d) Trust Services Ltd acts as a professional trustee to a number of trusts, holding assets (comprising equity participations) in its capacity as trustee. Trust Services Ltd provides trustee services and is not the beneficial owner of the assets.

- Trust Services Ltd is not a pure equity holding company as it does not hold the assets for its own account and receives fees for acting as trustee (i.e. income other than from dividends and capital gains), but it should consider if it carries on any other relevant activities for its own account, not acting as trustee. Trust Services Ltd will be required to file an ESN as outlined in this Guidance.

(e) GP Ltd is the general partner of an exempted limited partnership and only holds equity participations in other entities in its capacity as general partner on behalf of the exempted limited partnership, and receives all dividends and capital gains in respect of those equity participations on behalf of the exempted limited partnership. In addition, and as is usual, GP Ltd (as the general partner of the exempted limited partnership) is involved in the administration and conduct of the business of the exempted limited partnership.

- GP Ltd is not a pure equity holding company for the purposes of the ES Act because: (i) GP Ltd does not hold the assets for its own account. Such assets are held by GP Ltd on behalf of the exempted limited partnership pursuant to the terms of the partnership agreement; and (ii) GP Ltd's administration and conduct of the business of the exempted limited partnership will mean that the GP is conducting activities which are clearly not incidental to its ownership of equity participations (the general partner interest) in the exempted limited partnership. GP Ltd should consider whether it is carrying on a relevant activity for its own account. GP Ltd will be required to file an ESN as outlined in this Guidance.

4. Reporting on Holding Company Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ507 – Holding".

G. Insurance Business

1. Scope of Insurance Business

Insurance business is a type of relevant activity. The ES Act provides that "insurance business" has the meaning given to that expression by section 2 of the Insurance Act, 2010 [Act 32 of 2010], as amended ("Insurance Act"). There, "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. For avoidance of doubt, reinsurance business is also included in the definition of insurance business and is in scope for the ES Act.

All persons carrying on insurance business in the Islands must obtain the relevant class and category of insurance licence from CIMA pursuant to the Insurance Act.

a) Insurance categories under the Insurance Act

CIMA regulates several different categories of insurers under the Insurance Act, along with other insurance related activities, such as insurance management. A relevant entity must possess a valid licence granted by CIMA in order to carry on insurance business in the Islands.

(1) Class A insurer licence

The Class A Insurer licence is required for the carrying on of domestic insurance business by a local insurer or external insurer, or limited reinsurance business as approved by CIMA. The Insurance Act defines "domestic business" as insurance business where the contract is in respect of the life, safety, fidelity or insurable interest, other than in respect of property, of a person who at the time of effecting the contract is ordinarily resident in the Islands, or property that at the time of effecting the contract is in the Islands or, in the case of a vehicle, vessel or aircraft, or other movable property is ordinarily based in the Islands.

A "local insurer" is a class A insurer incorporated in and having its place of business in the Islands.

An "external insurer" is a class A insurer who is not a local insurer and whose principal or registered office is in a jurisdiction outside the Islands where the legislation for the regulation and supervision of insurers is acceptable to CIMA.

An insurance company with an "A" Licence should consider if it meets the definition of a "domestic company".

Where a Class "A" insurer is not part of an MNE Group, is only carrying on business in the Islands and complies with section 3(a) of the Trade and Business Licensing Act (2019 Revision) it would qualify for the domestic company exemption.

A Class "A" insurer is required to meet CIMA requirements to obtain this licence. Where such an insurer does not meet the definition of a "domestic company" but does meet these CIMA requirements, it is expected that the entity would meet the requirements of the ES Test. In terms of filing requirements, an insurer with a Class "A" license will be required to file the ESN as normal (i.e. relevant entity carrying on the relevant activity of insurance business) however, when filing the ES return there will be an option to select Class "A" insurer and once this option is selected no further information will be required on the ES return.

(2) Class B insurer licence

A Class B insurer is in scope for the ES Act. It is a relevant entity and is carrying on a relevant activity, insurance business, for the purpose of the ES Act.

The Class B Insurer licence is designed for carrying on of insurance business other than domestic business. This is typically used for captive insurance. Class B insurance licences are subdivided into four types depending on the percentage of net written premiums from "related business". Most class 'B' insurers will retain the services of an insurance manager to be the local representative of the insurer and to manage the day to day operations of the insurer and to fulfil their insurance, financial, legal and regulatory obligations. In some instances, Class B insurers will be approved to be self-managed which will require the establishment of an office in the Islands and the hiring of employees to oversee the operations of the insurer.

(3) Class C insurer licence (Catastrophe Bonds or Special Purpose Insurers)

A Class C insurer is in scope for the ES Act. It is a relevant entity and is carrying on a relevant activity, insurance business, for the purpose of the ES Act.

The Class C insurer Licence is for the carrying on of insurance business involving the provision of reinsurance arrangements in respect of which the insurance obligations of the Class C insurer are limited in recourse to and collateralised by the Class C insurer's funding sources or the proceeds of such funding sources which include the issuance of bonds or other instruments, contracts for differences and such other funding mechanisms approved by CIMA. Most class 'C' insurers will retain the services of an insurance manager to be the local representative of the insurer and to manage the day to day operations of the insurer and to fulfil their insurance, financial, legal and regulatory obligations. In some instances, Class C insurers will be approved to be self-managed which will require the establishment of an office in the Islands and the hiring of employees to oversee the operations of the insurer.

(4) Portfolio Insurance Company ("PIC") registration

A PIC insurer is in scope for the ES Act. It is a relevant entity and is carrying on a relevant activity, insurance business, for the purpose of the ES Act.

The PIC Regulations permits a segregated portfolio licensed insurance company (an "SPC insurer") to establish, for the account of a segregated portfolio, an exempted company limited by shares as a subsidiary. The PIC must be controlled, at all times, by the SPC insurer. An SPC insurer can only control one PIC on behalf of any relevant segregated portfolio.

Once registered with CIMA, the PIC is permitted to carry on insurance business without requiring a separate insurance licence. A PIC may enter into any contract with any person including: (i) the SPC insurer acting on behalf of any of its segregated portfolios; (ii) its SPC insurer acting otherwise than on behalf of any of its segregated portfolios; or (iii) any other PIC. The PIC has separate legal identity and its own board of directors, who may be different from the SPC, facilitating a reduction in apparent or real conflicts of interest.

(5) Class D insurer licence (Reinsurance)

A Class D insurer is in scope for the ES Act. It is a relevant entity and is carrying on a relevant activity, insurance business, for the purpose of the ES Act except in the case of a Class D insurer that is a domestic company as defined in the ES Act.

The Class D Insurer Licence is for the carrying on of reinsurance business and such other business as may be approved in respect of any individual licence by CIMA.

b) Tax resident outside the Islands

An insurer that establishes to the Authority that it is tax resident outside the Islands is not considered to be a relevant entity for the purposes of the ES Act. Further information on this exemption is outlined in Section II.B.2.c) above.

For example, where a Cayman insurance company makes an irrevocable tax election under Section 953(d) of the Internal Revenue Code to be taxed as if it were a US corporation, the TIA will consider the entity as tax resident outside the Islands if satisfactory evidence is provided. The TIA understands that when the 953(d) election is made, the Cayman insurance company is required to file an annual US insurance company income tax return directly with the IRS and pays income tax as appropriate. This filing and / or proof of payment of income tax will be satisfactory evidence to avail of the exemption. Other evidence may include a Tax Identification Number or tax residence certificate.

A Segregated Portfolio Company (SPC) typically does not make the 953(d) election for the entire SPC. However, the core and each Segregated Portfolio (SP) of the SPC may individually make its own election. Each SPC which is in-scope for purposes of the ES Act will be required to notify the TIA of which of its SPs or the core have made the 953(d) election and which have not. The ES Act will apply and the ES Test will need to be met in relation to any insurance business conducted by the core or any SPs which have not taken a 953(d) election or are not otherwise tax resident in another jurisdiction outside of the Islands. PIC's actively conducting insurance business are stand-alone relevant entities for the purposes of the ES Act and will need to comply with the ES Test independent of their controlling SPs or their SPC unless they have taken a 953(d) election or are otherwise tax resident in another jurisdiction outside of the Islands.

c) Licensees not carrying on insurance business

Insurance agent licences, insurance broker licences and insurance manager licences do not entitle the licensee to carry on insurance business for the purpose of the Insurance Act. These licences do not permit the holder to accept risks by effecting or carrying out contracts of insurance. This means that these licensees are not carrying on a relevant activity for the purposes of the ES Act and are therefore out of scope in so far as their business under the Insurance Act is concerned. Separately, some of these licensees are in scope for the ES Act because they are carrying on other types of relevant activities, such as banking business.

Similarly, the general assets, segregated portfolios, and PIC's of an SPC that per their approved business plan do not conduct insurance business are not considered to be in scope for the ES Act. Insurance managers play an important practical role in assisting client insurers that are in scope under the ES Act to satisfy the ES Test by performing substantially all the clients' CIGA in the Islands by means of domestic outsourcing. This is described in the section below headed "Domestic outsourcing to insurance managers".

2. CIGA for Insurance Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to insurance business, CIGA includes —

(i) Predicting or calculating risk or oversight of prediction or calculation of risk.

Predicting and calculating risk includes oversight of the determination of the quantification and likelihood of the insured event occurring and the likely costs, and ensuring that the premiums charged are commensurate with the risks accepted.

Some examples could include:

1. Preparation of risk assessments and underwriting submissions.
2. Approval of loss runs, management of claims, and reports on losses and claims.
3. Preparation of actuarial funding and loss picks.
4. Rate setting for life or annuity contracts.

(ii) Insuring or re-insuring against risk.

An example could include analysis and agreement of underwriting submissions, insurance policy(ies), reimbursement agreements, reinsurance agreements and/or other similar contracts, such as commutations, novation, and loss portfolio transfers.

(iii) Preparing reports or returns, or both to investors or CIMA.

Some examples could include:

1. Preparation of regulatory filings to CIMA under the Insurance Act.
2. Preparation of financial statements.
3. Preparation of manager reports and executive summaries issued to investors.

a) Outsourcing

(i) Domestic outsourcing to an insurance manager

The Insurance Act requires a Class B insurer, a PIC or a Class C insurer, unless it maintains permanently a place of business in the Islands, to appoint an insurance manager in the Islands and maintain, at the insurance manager's place of business in the Islands or at another location approved by CIMA, full and proper records of the business activities of the class B insurer, a PIC or class C insurer, sufficient to -

(a) explain the transactions of the class B insurer, a PIC or class C insurer;

(b) disclose, with reasonable accuracy, at any time the state of the affairs of the class B insurer or class C insurer; and

(c) enable the class B insurer, a PIC or class C insurer to prepare annual financial statements.

CIMA's "Statement of Guidance: Responsibilities of Insurance Managers of August 2017" ("SOG") explains the role of insurance managers and their relations with CIMA and with client insurers. The purpose of CIMA's SoG is to provide for compliance with prudential regulation of insurance managers and their client insurers under the Insurance Act. CIMA's SoG is not designed to address compliance with the ES Test under the ES Act. This means that an insurance manager which satisfies CIMA's requirements for its client insurer will not automatically ensure that its client insurer meets the separate requirements of the ES Act.

It is possible for a relevant entity which is licensed as a Class B or C insurance company, or registered as a PIC under the Insurance Act to satisfy the ES Test in relation to section 4(2)(a) of the ES Act on the basis contemplated by section 4(4) of the ES Act by outsourcing performance of its CIGA in the Islands to its CIMA-licenced insurance manager. In this situation, the insurer should authorise and direct the insurance manager to perform the insurer's CIGA in the Islands pursuant to the management agreement between the insurer and the insurance manager or a resolution of the board of directors of the insurer. Relevant

entities carrying on insurance business should review their existing management agreements to ensure the substantial activities requirement is satisfied.

(ii) Actuarial valuations

The Insurance Act requires some insurers with Class A, B, and D insurer licences to provide actuarial valuation reports to CIMA. Class C insurers are exempt from this requirement under the Insurance Act. CIMA has rules and statement of guidance on actuarial valuations which include the professional qualifications which actuaries must have in order to prepare these reports. In line with the principles of the ES Act, this actuarial work should be carried on in the Islands; however, in exceptional circumstances, for example, where it is commercially impossible for this to take place in the Islands, the actuarial work may be performed outside the Islands. The relevant entity must ensure that this is supervised appropriately; the relevant entity must also be able to justify its approach to the Authority.

b) Board Meetings

For relevant entities licensed or registered as PICs, Class B, C or D insurers under the Insurance Act who have appointed a licensed Cayman Islands insurance manager, the term "adequate frequencies" under section 4(3)(b) of the ES Act in relation to the holding of board meetings in the Cayman Islands shall mean as often as deemed appropriate by the Board of Directors of the company and subject to the requirements of the Companies Act and the Insurance Act. A quorum of directors for the purposes of any such meeting required under section 4(3)(c) of the ES Act shall mean a quorum of directors present in person.

The Authority may accept that an insurer can be directed and managed in the Islands if decisions are made by an executive committee of its board of directors if the insurer has an unusually large number of directors, for instance where it is member-managed.

3. Reporting on Insurance Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ504 – Insurance".

H. Intellectual Property Business

1. Scope of IP Business

IP business is a type of relevant activity. The ES Act defines IP business as the business of holding, exploiting or receiving income from IP assets. An IP asset is defined in the ES Act as an IP right including a copyright, design right, patent and trademark. The term IP asset will be interpreted by the Authority consistently with section II.B. Chapter 4 of the Action 5 Report (OECD, 2015).

For the purposes of the ES Act, the Authority regards the term IP asset as including any such right from which identifiable income accrues to the business (i.e. such income being separately identifiable from any income generated from any tangible asset in which the right subsists). That is, the term does not apply to a business which owns IP assets merely as an adjunct to its business or sells a product or services having aspects derived from IP assets. This interpretation applies to IP business generally (i.e. including high risk IP business). Typical sources of separately identifiable income in respect of an IP asset include income from licensing the IP asset, such as royalties or licence fees, and income from the assignment/sale of IP assets.

A relevant entity should take care that it does not falsely disguise IP income as embedded sales income such that the result would be a circumvention of the ES Test.

A relevant entity that is not the legal or economic owner of the IP asset will not be within the scope of the definition of IP business. Thus, for instance, a relevant entity that is a licensee in relation to rights in an IP asset will not ordinarily be regarded as holder/owner of that IP asset. However, a licensee whose licence confers full and exclusive rights (including the right to sub-licence), so that it is in effect an assignment, will be regarded as the legal or economic owner of the underlying IP asset.

2. Economic Substance Test (ES Test) for IP Business

An entity satisfies the ES Test with respect to IP business if it:

(a) conducts core income generating activities (CIGA) in the Islands in relation to its IP business;

(b) is directed and managed in an appropriate manner in the Islands in relation to its IP business; and

(c) having regard to the level of relevant income derived from the IP business -

  (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.

As outlined below, high risk IP has a more onerous ES Test.

3. CIGA for IP Business:

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

Income derived from IP assets can pose a higher risk of artificial profit attribution or profit shifting than non-IP assets and as such the CIGA for IP business are specific in nature. The legislation sets out the 'primary' CIGA for IP business which is outlined below.

a) Patent or an asset that is similar to a patent:

(i) Where the IP asset is a –

A. Patent or an asset that is similar to a patent, research and development ("R&D")

This CIGA refers to a relevant entity earning income from exploiting a patent or other IP assets that are functionally equivalent to patents. IP assets that are functionally equivalent to patents are (i) patents defined broadly, (ii) copyrighted software, and (iii) other IP assets that are nonobvious, useful, and novel. Such IP assets must be subject to a similar approval and registration process (where such processes are relevant) as patents and must be legally protected. Legal protection includes exclusive rights to use the IP asset, legal remedies against infringement, trade secret law, and contractual and criminal protections against use of the IP asset or unauthorised disclosure of information related to the IP asset. For further information on IP assets that are functionally equivalent to patents, see paragraphs 34 – 37 under Chapter 4.II.B. of the Action 5 Report (OECD, 2015).

In line with the general ES Test, the relevant entity will be required to demonstrate that it has conducted the R&D activities with the adequate number of employees and operating expenditures. A relevant entity will not satisfy this requirement where it simply acquires or outsources (outside the Islands) R&D. Provided that the IP business is not in the high risk category, 'exceptional case' CIGA may be of application to IP business founded on acquired IP asset(s).

b) Non-trade intangible:

(i) Where the IP asset is a –

B. Non-trade intangible (including a trademark), branding, marketing and distribution

This CIGA refers to a relevant entity earning income from exploiting IP assets in the trademark category. In line with the general ES Test, the relevant entity will be required to demonstrate that it has conducted the branding, marketing and distribution activities with the adequate number of employees and operating expenditures and the adequate degree of control.

The CIGA required for both A and B above will depend on the nature of the asset and how that asset is being used to generate income for the relevant entity

c) Exceptional Cases:

In certain situations, a relevant entity may be able to prove it is conducting substantial activities even if this did not involve R&D (for patents and similar assets) or branding, marketing and distribution (for trademark IP assets) where it undertakes the CIGA as outlined in part (ii) of the definition below.

(ii) In exceptional cases, except if the relevant activity is a high risk IP business, other core income generating activities relevant to the business and the IP 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.

The definition makes clear that such situations will be the exception rather than the rule and that this provision does not apply in the case of high risk IP business (further detail below). An example of where 'exceptional case' CIGA may apply is where a relevant entity purchases an already developed IP asset from a (non-Group) third party. At this stage in the life cycle of the IP asset, the R&D to create it has already occurred, rendering only the elements of exploitation, maintenance, protection and enhancement (i.e. subsequent development) of application.

As with all relevant activities the ES Test will be determined on a case by case basis however, the substantial activities requirements for IP income will always be insufficient if the relevant entity only passively holds IP assets created and exploited on the basis of decisions made and activities performed outside the Islands. Furthermore, the ES Test will never be met if the only activities contributing to the income are the periodic decisions of non-resident board members in the jurisdiction.

4. High Risk IP:

The ES Test is more difficult for IP business that is high risk IP business.

"High risk intellectual property business" is defined as IP business carried on by an entity that –

i. did not create the IP in an IP asset that it holds for the purposes of its business,

ii. acquired the IP 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 IP 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;

Group in this context is defined as "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".

A relevant entity that is carrying on high risk IP business is presumed not to have met the ES Test for a financial year, even if there are CIGA relevant to the business and the IP assets being carried out in the Islands. A relevant entity may rebut this presumption if it can produce materials to the Authority which demonstrate that there is, and historically has been, a high degree of control over the development, exploitation, maintenance, protection and enhancement (also referred to as "DEMPE") of the IP asset, exercised by an adequate number of full-time employees with the necessary qualifications that permanently reside and/or perform their activities within the Islands.

A relevant entity will not be conducting high risk IP business where it is the sole creator of the IP asset and undertook the CIGA in the Islands. The Authority recognises that it is a question of fact as to who is the creator of an IP asset and that there may be more than one creator of such IP and creation may take place over time over the course of a chain of ownership. However, where there is more than one creator of the IP asset and the relevant entity entered into a cost sharing agreement this could be considered high risk IP business.

The Authority's approach regarding the rebuttable presumption will be aligned with the policy articulated by the FHTP in paragraphs 32 to 39 of their report; Resumption of application of substantial activities for no or nominal tax jurisdictions.

This high risk IP company evidential threshold requires:

a) detailed business plans which demonstrate the commercial rationale 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.

As outlined above, periodic decisions by non-resident directors or board members, or local staff passively holding IP 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.

The Authority will systematically spontaneously exchange information provided to it by relevant entities carrying on high risk IP business in accordance with relevant international standards and scheduled agreements under the Tax Information Authority Act (2017 Revision) with other competent authorities.

The table in "Figure 4. Application of substance requirements for IP income" below provides an overview of the requirements as they apply for IP income and high risk IP business. In that table, reference to "foreign related parties" in the context of the higher risk scenario means an entity that is not incorporated or established in the Islands and that is in the same Group as the high risk IP company.

Figure 4. Application of substance requirements for IP income

Lower risk scenarios					Higher risk scenarios (i.e. involvement of foreign related parties)			
1. IP assets (e.g. patents and similar to patents) Substantial activity = R&D	+	Necessary staff, premises, equipment, expenditure, decision-making, etc.	+	<u>Filing information</u> Type A. Business type, gross income, expenses and assets, premises, employees, proof of CIGA, etc.	= ☑			
2. Other IP assets (e.g. trademarks) Substantial activity = branding and marketing	+	Necessary staff, premises, equipment, expenditure, decision-making, etc.	+	<u>Filing information</u> Type A. Business type, gross income, expenses and assets, premises, employees, proof of CIGA, etc.	= ☑			
3. In exceptional cases Substantial activity = Strategic decision-making, managing and bearing principal risks, underlying trading activities, etc.	+	Necessary staff, premises, equipment, expenditure, decision-making, etc.	+	<u>Filing information</u> Type A. Business type, gross income, expenses and assets, premises, employees, proof of CIGA, etc.	= ☑	**3. In exceptional cases** Substantial activity = • High degree of DEMPE; & • Full time highly skilled employees that permanently reside and perform CIGA in the Cayman Islands	+ Necessary staff, premises, equipment, expenditure, decision-making, etc.	+ <u>Filing information</u> Type A. information PLUS Type B information: • Detailed business plans • Employee information • Proof of decision making in jurisdiction = ☑
Scenarios which are <u>not</u> sufficient to meet substance requirements for IP income								
4. Merely passively holding the IP asset in the Islands = ☒								
5. Periodic decisions of non-resident board members = ☒								

5. Examples

(a) CayCo Ltd, a relevant entity, holds an IP asset which it did not create, acquired from ABC Ltd, and which it licenses to DEF Ltd. CayCo Ltd, ABC Ltd and DEF Ltd are entities in the Group. CayCo Ltd does not currently earn any income from this IP asset.

- CayCo Ltd is a relevant entity carrying on high risk IP business and thus will be required to file an ESN and an ES return as outlined in this Guidance. So long as Cayco Ltd. has no income derived from the IP asset it is not obliged to meet the requirements of the ES Test as set out in section 4(2) of the ES Act. The ES return filed would be akin to a nil return.

  Since CayCo Ltd is a relevant entity carrying on high risk IP business, the Authority would need to understand why CayCo Ltd has no income. For example, where CayCo Ltd is still developing the IP which is not yet profitable, the Authority recommends that CayCo Ltd retains the information as outlined in s4(7) of the ES Act so that, in the future when relevant income is earned by CayCo Ltd, information on the historic activity that contributed to that profitability is available to the Authority.

(b) CayCo Ltd, a relevant entity, is a professional services accountancy firm. CayCo Ltd has a number of intangible assets on its balance sheet including:

I. technical know-how relating to processes;

II. copyright of advertising material; and

III. trademark protection.

- The intangible assets listed in I. above would not be IP assets as it is not a copyright, design right, patent and trademark or similar kind of right issued by a governmental authority or by law providing legal protection and exclusive rights. Secondly, II and III above would be considered similar to tangible assets such as premises or plant and machinery in that they do not earn separately identifiable revenue but rather contribute to (or protect) the general profitability of CayCo Ltd's business. As such, CayCo Ltd would not be carrying on IP business under the ES Act purely as a result of holding the assets listed above. CayCo Ltd will be required to file an ESN as outlined in this Guidance.

(c) CayCo Ltd, a relevant entity, has the North American licence to manufacture and sell IT products based on a patent owned by Onshore University ("OU") in another jurisdiction. CayCo Ltd's income is from the sale of the IT products and it pays royalties to OU under the licensing agreement.

- CayCo Ltd's manufacture and sale of a product based on an IP asset does not constitute IP business, as it does not own the IP and there is no separately identifiable income in that regard. CayCo Ltd will be required to file an ESN as outlined in this Guidance. CayCo Ltd will be required to file an ESN as outlined in this Guidance but is not required to file an ES return in respect of IP business.

(d) CayCo Ltd. has a trademarked a range of fizzy beverages, which it manufactures and markets to unrelated third parties.

- CayCo Ltd. is not carrying on IP business because its income is derived from the sale of finished goods to third parties, not the exploitation of IP assets (i.e. the use of the

trademark is incidental). CayCo Ltd will be required to file an ESN as outlined in this Guidance but is not required to file an ES return in respect of IP business.

(e) CayCo Ltd. developed a unique IT software platform for accepting, processing and tracking online orders that it holds and uses within its own business of online marketing and also licenses to others to use within their online marketing business. The users pay CayCo Ltd. a licence fee in order to use the copyrighted software.

- CayCo Ltd. is carrying on IP business. CayCo Ltd will be required to file an ES and will be required to file an ES return in respect of its IP business as outlined in this Guidance

6. Reporting on IP Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ509 – Intellectual Property".

I. Shipping Business;

1. Scope of Shipping Business

Shipping business is a type of relevant activity. The ES Act defines shipping business as "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 owning, operating or chartering of a pleasure yacht".

As made clear by the definition, the relevant entity will have to be carrying on at least one of the above activities involving "the operation of a ship" to be in scope for the ES Act.

The employment of seafarers by a company, or other ownership structure owned, directly or indirectly, by a ship-owner solely to crew vessels owned by the ship-owner or by an entity within the ship-owner's group of companies or a related entity does not constitute functioning as a private seafarer recruitment and placement service on the basis that it is facilitating the employment of crew for the related ship owner's group and not for third party ship owner. Seafarer recruitment and placement service is defined in the Maritime Labour Convention 2006 and means any person, company, institution, agency or other organization, in the public or the private sector, which is engaged in recruiting seafarers on behalf of ship-owners or placing seafarers with ship-owners.

A company which undertakes any of the activities referred to above where the company does not also operate a ship, or ships, in international traffic is not "shipping business" for the purposes of the ES Act because the company which charters the ship (i.e. the lessor) is not operating the ship.

Shipping business does not include holding company business or the owning, operating or chartering of a pleasure yacht. The Merchant Shipping Act (2016 Revision) defines "pleasure yacht" to include a pleasure vessel and any vessel to which regulations made in respect of vessels in commercial use for sport or pleasure are stated to apply. The Merchant Shipping Act (2016 Revision) also defines "pleasure vessel" as meaning -

a. a vessel which at the time it is being used is-

  i. (A) in the case of a vessel wholly owned by an individual or individuals, used only for the sport or pleasure of the owner or the immediate family or friends of the owner;

  (B) in the case of a vessel owned by a body corporate, one on which the persons on the vessel are employees, officers or shareholders (including beneficial owners of shares) of the body corporate, or their immediate family or friends; or

(C) in the case of a vessel owned by a trust or other ownership arrangement, one on which the persons on the vessel are beneficiaries under the trust or beneficial owners of the ownership arrangement, or their immediate family or friends; and

ii. in private use; or

b. a vessel wholly owned by or on behalf of a club formed for the purpose of sport or pleasure which, at the time it is being used, is used only for the sport or pleasure of members of the club or their immediate family, and for the use of which any charges levied are paid into club funds and applied for the general use of the club; and

in this definition "immediate family" means, in relation to an individual, the husband or wife of the individual, or a relative of the individual, or of the individual's husband or wife; "relative" means brother, sister, ancestor or lineal descendant; "owner" includes charterer; and "private use" means that the vessel is used on a private voyage or excursion, and during such use is not engaged in trade by transporting merchandise or carrying passengers for reward or remuneration (other than as a contribution to the actual cost of the vessel or its operation for the period of the voyage or excursion), and is not offered to the public for use.

Pleasure yachts are acquired and used by their owners, disponent owners or charterers for the sport or pleasure of the shareholder/ultimate beneficial owner, employees, officers or charterers and their respective families and friends and are not operated as a genuine commercial enterprise. The function of chartering a pleasure yacht serves only to defray the costs of owning and operating the vessel. Hence, the ownership, chartering and operation of a "pleasure yacht" as defined in the Merchant Shipping Act does not fall within the definition of "shipping business". Likewise, a charter by demise or bareboat charter for sport or pleasure by the charterer, his family and friends does not constitute shipping business.

As a result, the ownership, operation or chartering of yachts, whether used privately or chartered, does not fall within the definition of shipping business and as such the owners or operators of same are not required to meet the economic substance test.

2. CIGA for Shipping Business

CIGA with respect to every type of relevant activity means activities that are of central importance to a relevant entity in terms of generating relevant income and must be carried on in the Islands.

In relation to shipping business, CIGA includes -

(i) managing crew (including hiring, paying and overseeing crew members);

- This CIGA includes compliance with the Maritime Labour Convention, 2006 by either a ship owner or a private seafarer recruitment and placement service.

(ii) overhauling and maintaining ships;

- This CIGA includes procuring and/or overseeing the overhauling and/or maintenance of ships.

(iii) overseeing and tracking deliveries;

- This CIGA includes tracking package and cargo deliveries as part of the business services of the vessel.

(iv) determining what goods to order and when to deliver them, organising and overseeing voyages;

- This CIGA includes negotiating contracts for delivery of goods, managing shipping schedules and organising and overseeing voyages. These activities can be carried out by an agent, manager or the master of the ship.

The Authority will consider whether activities which may appear to fall within the CIGA as listed above, do in fact constitute a shipping business, or whether they are merely incidental to what is properly regarded as a different sort of business. The following examples provide further clarity on this point.

A foreign company, carrying on shipping business, that is registered in the Islands and which is tax resident outside the Islands, is not regarded as a relevant entity. Section II.B.2.c) above explains what is required to meet this exemption.

3. Examples

(a) CayCo Ltd, a relevant entity, carries on the business of a general travel agent. As part of its business, CayCo Ltd sells tickets for passenger cruises.

- CayCo Ltd will not be treated as carrying on a shipping business merely because, amongst other things, it sells tickets for passenger cruises. This would be regarded as incidental to what is properly regarded as CayCo Ltd's main business (i.e. travel agent). CayCo Ltd will be required to file an ESN as outlined in this Guidance.

(b) CayCo Ltd, a relevant entity, manufactures goods for export. CayCo Ltd arranges for those goods to be dispatched by sea, in containers or otherwise.

- CayCo Ltd will not be treated as carrying on shipping business merely because it arranges for those goods to be dispatched by sea. Similar to the above example, this would be regarded as incidental to what is properly regarded as CayCo Ltd's main business (i.e. manufacturing business). CayCo Ltd will be required to file an ESN as outlined in this Guidance.

(c) CayCo Ltd is registered as a foreign company in the Cayman Islands which is carrying on shipping business as defined in the ES Act.

- CayCo Ltd is not regarded as a relevant entity where it is tax resident outside the Islands. CayCo Ltd will be required to file an ESN and also to provide evidence that it is tax resident outside the Islands, as outlined in this Guidance.

  If CayCo Ltd is not tax resident outside the Islands and it is carrying on shipping business as defined in the ES Act, it will be treated as a relevant entity carrying on a relevant activity and will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

(d) CayCo Ltd, a relevant entity, bareboat charters out a ship on a long term charter, which is typically for a period of between 2 and 10 years. CayCo Ltd. does not operate that ship or any other ship.

- CayCo Ltd is not carrying on the relevant activity of shipping business by chartering out its ship because it is not operating the ship. Thus, CayCo Ltd will be required to file an ESN as outlined in this Guidance. Cayco should also consider whether it is carrying on any other relevant activity, such as financing and leasing business.

(e) CayCo Ltd, a relevant entity, owns and runs an international shipping pool.

- If CayCo Ltd acts as agent for the ship-owners participating in the pool and does not, itself, charter in or out the ships, takes no economic risk and does not operate any ships in that regard, this would not constitute shipping business. CayCo Ltd will be required to file an ESN as outlined in this Guidance.

  However, if CayCo Ltd takes economic risk and is involved in the operation of the ship with respect to the charter in the form of bareboat chartering in or time chartering out ships, this is carrying on the relevant activity of a shipping business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

(f) ShipOwnCo Limited owns a ship and charters it on a bareboat charter basis to CharterCo Limited. ShipOwn Co Limited does not operate that ship, or any other ship. CharterCo Limited uses the ship it has chartered on a bareboat charter basis in its own ship operation business to carry cargo internationally.

- ShipOwn Co Limited is not carrying on shipping business for the purpose of the ES Act because the rental on charter basis of the ship is not directly in connection with or ancillary to its own operation of a ship. Thus, ShipOwn Co Limited will be required to file an ESN as outlined in this Guidance. ShipOwn Co Limited should also consider whether it is carrying on any other relevant activity, such as financing and leasing business.
- In contrast, CharterCo Limited is carrying on shipping business for the purpose of the ES Act because it is operating a ship in international traffic for the transport of cargo. CharterCo Limited will be treated as a relevant entity carrying on a relevant activity and will be required to file an ESN, to satisfy the ES Test and to file an ES return as outlined in this Guidance.

4. Reporting on Shipping Business

The OECD's Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information requires this type of relevant activity to be reported using the code "NTJ506 – Shipping".

Appendix to Guidance

General Partnerships, Limited Partnerships, Exempted Limited Partnerships & Foreign Limited Partnerships

This Appendix is part of the Guidance for Economic Substance for Geographically Mobile Activities ("Guidance") issued pursuant to section 5 of The International Tax Co-operation (Economic Substance) Act ("ES Act"). It has effect from 30th June 2021.

It explains the effect of the International Tax Co-operation (Economic Substance) (Amendment of Schedule) Regulations, 2021 ("**2021 Amendment of Schedule Regulations**") and the International Tax Co-operation (Economic Substance) (Prescribed Dates) (Amendment) Regulations, 2021 ("**2021 Prescribed Dates Amendment Regulations**"). The Guidance must be read subject to this Appendix when applying the Guidance to general partnerships, limited partnerships, exempted limited partnerships and foreign limited partnerships.

An updated DITC Portal User Guide will be published to assist compliance with filing obligations for general partnerships, limited partnerships, exempted limited partnerships and foreign limited partnerships.

A. 2021 Amendment Regulations and 2021 Prescribed Dates Amendment Regulations

1. Overview

The 2021 Amendment of Schedule Regulations amended the Schedule to the ES Act to bring partnerships, exempted limited partnerships and foreign limited partnerships within the scope of the ES Act. For the purpose of this Appendix, and as defined in the Partnership Act (2013 Revision), the term "partnership" includes both general partnerships and limited partnerships. Exempted limited partnerships and foreign limited partnerships are governed by the Exempted Limited Partnerships Act (2021 Revision).

The 2021 Prescribed Dates Amendment Regulations prescribed the dates from which a relevant entity that is a partnership, exempted limited partnership or foreign limited partnership and that is carrying on a relevant activity must satisfy the economic substance test.

2. Commencement

The 2021 Amendment of Schedule Regulations came into force on 30th June 2021.

Pursuant to the 2021 Prescribed Dates Amendment Regulations, a partnership, exempted limited partnership, or foreign limited partnership that is a relevant entity is subject to the ES Act from the date on which it commences the relevant activity unless it was in existence prior to 30th June 2021 in which case it must comply with the ES Act by 1st January 2022. This means that, from the applicable date, such a relevant entity must satisfy the ES Test in relation to the relevant activities which it is carrying on.

3. Amendments

The 2021 Amendment of Schedule Regulations made the following changes to the ES Act:

a) Entity

For the purposes of sections 7 and 10 of the ES Act, the definition of "entity" has been expanded to include a partnership under the Partnership Act (2013 Revision) and both an exempted limited partnership under section 2 the Exempted Limited Partnership Act (2021 Revision).and a foreign limited partnership under section 42 of the Exempted Limited Partnership Act (2021 Revision).

This means that under section 7 all partnerships, exempted limited partnerships and foreign limited partnerships will be required to file an Economic Substance Notification as described in the Guidance in section IV.A above headed **Notification to the Authority**. Also, for example, under section 10 where a general partner claims that its partnership or exempted limited partnership is tax resident outside the Islands the Authority may share that information with any other relevant Competent Authority.

b) Relevant Entity

The definition of "relevant entity" has been expanded to include a partnership under the Partnership Act (2013 Revision) and both an exempted limited partnership under section 2 of the Exempted Limited Partnership Act (2021 Revision).and a foreign limited partnership under section 42 of the Exempted Limited Partnership Act (2021 Revision), except where the partnership meets the definition of "local partnership", is an investment fund, or meets the requirements to be tax resident outside the Islands.

This means that subject to these exceptions, a partnership, exempted limited partnership or foreign limited partnership which conducts or which is used to conduct a relevant activity is required to satisfy the Economic Substance Test (or the reduced Economic Substance Test if it is a pure equity holding company), and to make an Economic Substance Return as described in the Guidance in section IV.B headed **Reporting to the Authority**.

c) Local Partnership

A "local partnership" means a partnership as defined under section 3 of the Partnership Act (2013 Revision) that is not part of an MNE Group and —

(a) that is only carrying on business in the Islands and is empowered by its partnership agreement to carry on business in the Islands; and

(b) that —

  (i) is licensed under the Trade and Business Licensing Act (2021 Revision) and, at the relevant time, is carrying on such business in accordance with the terms and conditions imposed in such licence and not otherwise;

  (ii) is operating under a franchise granted by the government; or

  (iii) complies with section 3(a) of the Trade and Business Licensing Act (2021 Revision).

In relation to paragraph (b)(i) of the definition of "local partnership", in order to obtain a licence under the Trade and Business Licensing Act (2021 Revision), a partnership must comply with the requirements of the Trade and Business Licensing Board Policy No. 4 of 18th September 2018. This policy ensures that all partnerships comply with the same rules as are applicable to companies under section 5 of the Local Company (Control) Act (2019 Revision) namely that a company must be: (a) Caymanian controlled; (b) have at least sixty per cent of its shares beneficially owned by Caymanians; and (c) have at least sixty per cent of its directors being Caymanians.

For the avoidance of doubt:

- A local partnership will be required to submit an Economic Substance Notification form but will not be required to submit an Economic Substance Return or Tax Resident Outside the Islands form.
- Neither an exempted limited partnership nor a foreign limited partnership can be a local partnership.

d) Carrying on business in the Islands

"Carrying on business in the Islands" has the meaning given to "carry on business in the Islands" by section 2(2) of the Local Companies (Control) Act (2019 Revision) save that references therein to "company" and "exempted company" shall be interpreted to include "partnership". Exempted limited partnerships and foreign limited partnerships have been omitted from the definition of "carrying on business in the Islands" because they cannot be local partnerships.

e) Pure equity holding company

The definition of "pure equity holding company" has been revised to mean an entity that only holds equity participations in other entities and only earns dividends and capital gains. For the avoidance of doubt, partnerships, exempted limited partnerships and foreign limited partnerships are included in the definition of entity.

f) Registrar

The definition of Registrar has been expanded to include:

(a) in relation to a partnership, means the Registrar of Limited Partnerships under section 48 of the Partnership Act (2013 Revision); and

(b) in relation to an exempted limited partnership and a foreign limited partnership, means the Registrar of Exempted Limited Partnerships under section 8 of the Exempted Limited Partnership Act (2021 Revision).

g) Ultimate beneficial owner

The definition of "ultimate beneficial owner" has been amended so that, in relation to each of a general partnership, a limited partnership, an exempted limited partnership, a foreign limited partnership, and a limited liability partnership, it has the same meaning as "beneficial owner" in section 51 of the Limited Liability Partnership Act (2021 Revision) except that references to "limited liability partnership" in section 51 and 54 of the Limited Liability Partnership Act (2021 Revision) shall be interpreted to mean a reference

to a partnership, an exempted limited partnership, or a foreign limited partnership, as the case may be.

Section 51 (1) of the Limited Liability Partnership Act (2021 Revision) provides that "beneficial owner", in relation to a limited liability partnership, has the meaning assigned by sections 54(3), (4) and (5), namely:

> "(3) An individual ("X") is a beneficial owner of a limited liability partnership ("Y") if the individual meets one or more of the following conditions in relation to the limited liability partnership–
>
> (a) X must hold, directly or indirectly, a partnership interest in Y representing a right to share in more than 25 percent of any surplus limited liability partnership property of Y on a winding up of Y;
>
> (b) X must hold, directly or indirectly, a partnership interest in Y representing more than 25 percent of the rights to vote on those matters that are to be decided by a vote at meetings of the partners of Y; or
>
> (c) X must hold the right, directly or indirectly, to appoint or remove a majority of the managing partners of Y or those persons who hold a majority of the voting rights at meetings of the partners.
>
> (4) If no individual meets the conditions in subsection (3), X is a beneficial owner of limited liability partnership Y if X has the absolute and unconditional legal right to exercise, or actually exercises, significant influence or control over Y through the interests described in subsection (3) other than where that influence or control is solely in the capacity of a professional advisor or professional manager.
>
> (5) If no individual meets the conditions in subsections (3) and (4) but the trustees of a trust (or the members of a partnership or other entity that under the law by which it is governed is not a legal person) meet one of those conditions in relation to limited liability partnership Y in their capacity as such, X is a beneficial owner of Y if X has the absolute and unconditional legal right to exercise, or actually exercises, significant influence or control over the activities of that trust (or partnership or other entity) other than where that influence or control is solely in the capacity of a professional advisor or professional manager."

Essentially, the ultimate beneficial owner of a partnership, exempted limited partnership or foreign limited partnership is the natural person who ultimately owns or controls any general partner or any limited partner of the partnership, exempted limited partnership or foreign limited partnership, as the case may be. Any such general partner or limited partner may have more than one ultimate beneficial owner for the purposes of the ES Act.

B. Modifications for partnerships, exempted limited partnerships and foreign limited partnerships

Partnerships, exempted limited partnerships, and certain foreign limited partnerships are legal arrangements, meaning that they do not have a legal personality that is separate from that of their partners.

Furthermore, the Partnership Act (2013 Revision) and the Exempted Limited Partnership Act (2021 Revision) have provisions in relation to the position of limited partners of partnerships and exempted

limited partnerships, for example:

- A limited partner shall not take part in the conduct of the business of an exempted limited partnership in its capacity as a limited partner.
- All letters, contracts, deeds, instruments or documents whatsoever shall be entered into by or on behalf of the general partner (or any agent or delegate of the general partner) on behalf of the exempted limited partnership.
- Any rights or property of every description of the exempted limited partnership, including all choses in action and any right to make capital calls and receive the proceeds thereof that is conveyed to or vested in or held on behalf of any one or more of the general partners or which is conveyed into or vested in the name of the exempted limited partnership shall be held or deemed to be held by the general partner and if more than one then by the general partners jointly, upon trust as an asset of the exempted limited partnership in accordance with the terms of the partnership agreement.

For these reasons, only a general partner of a limited partnership, an exempted limited partnership or certain foreign limited partnerships can carry on the business of a limited partnership or an exempted limited partnership. Accordingly, the filing mechanisms on the DITC Portal will be modified for these types of partnership in order to facilitate compliance with the ES Act, and to meet a general principle of non-duplicative reporting.

1. Economic Substance Notification form (ESN)

The ESN will be modified so that it can be submitted with respect to a general partnership, a limited partnership, an exempted limited partnership or a foreign limited partnership.

2. Economic Substance Return (ES Return)

The Economic Substance Return will be modified to enable a general partner to make an Economic Substance Return in respect of its limited partnership, exempted limited partnership, or foreign limited partnership. The general partner will not be required to make a separate Economic Substance Return for itself if it declares (a) that it is not conducting any relevant activity for itself which is different from the relevant activity it conducts for a limited partnership, exempted limited partnership, or foreign limited partnership, and (b) that its relevant income for such relevant activity is only derived from the relevant income it receives for any such limited partnership, exempted limited partnership, or foreign limited partnership, as the case may be.

3. Tax Resident Outside the Islands form (TRO)

The Tax Resident Outside the Islands form will be modified to enable a general partner to include the name and registration number of any limited partnership, exempted limited partnership, or foreign limited partnership in respect of which it is the general partner, and to declare (a) that it is not conducting any relevant activity for itself which is different from the relevant activity it conducts for a limited partnership, exempted limited partnership, or foreign limited partnership and (b) that its relevant income for such relevant activity is only derived from the relevant income it receives for any such limited partnership, exempted limited partnership, or foreign limited partnership, as the case may be. The Authority will regard a limited partnership, exempted limited partnership, or foreign limited partnership as tax resident in a jurisdiction other than the Islands if the general partner provides objective and sufficient evidence that the place of effective management of the partnership is in that other jurisdiction

and the partnership –

(a) is subject to tax in that other jurisdiction, or

(b) is required to satisfy a test in that other jurisdiction which is substantially the same as the economic substance requirements under the ES Act.

The Authority will consider such evidence to be sufficient and objective if it is issued by a Government authority and includes a tax identification number, tax residence certificate and assessment or payment of an income tax liability on all of the partnership's income in the Islands from a relevant activity. Where the claim of TRO is accepted by the Authority, the general partner will not be required to make a separate TRO form for itself.

*** END ***