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Cayman Islands Included on EU List of Non-Cooperative Tax Jurisdictions

The European Union (EU) has, for the first time, included the Cayman Islands on its list of non-cooperative jurisdictions for tax purposes (the EU list).

At its meeting on February 18, 2020, the Council of the European Union (the Council) concluded that the "Cayman Islands does not have appropriate measures in place relating to economic substance in the area of collective investment vehicles."

In addition, the Council was not satisfied that the Cayman Islands had taken sufficient steps to demonstrate a continued commitment to address the issue, nor had it engaged in meaningful dialogue in relation to enacting measures to meet that commitment. It is this second conclusion that has resulted in the Cayman Islands being moved to the EU black list from the grey list (where it has been since the first iteration of the EU list, adopted in December 2017).

The EU List

The EU list is intended to encourage "positive change" in countries that fall short of certain criteria (broadly based on international tax standards), and so, in the view of the EU, facilitate abusive tax practices. The EU list is part of the EU's global strategy to promote effective taxation by tackling fraud, evasion, abusive avoidance and money laundering.

The Cayman Islands has been included on the EU list under criterion 2, Fair Taxation. More specifically, the Council has concluded that the Cayman Islands has failed to fulfill criterion 2.2 that requires it "should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction."

In evaluating compliance, the absence of a corporate tax system or the application of a corporate tax rate equal to zero or almost zero by a jurisdiction is considered as an indicator of non-compliance, but cannot alone be sufficient reason to conclude the criterion applies. The alleged refusal to engage in dialogue, or provide information or explanations to the EU, is crucial.

The EU list is due to be next reviewed and updated in October 2020.

Defensive Measures

The EU list is taken into account by the European Commission (EC) when carrying out its financing and investment operations. The EU list is also intended to inform EU Member States in their bi-lateral dealings with listed jurisdictions and to provide a framework for coordinated (so-called) "defensive measures." The Council has effectively instructed the EC and the Member States to take the EU list "into account in foreign policy, economic relations and development cooperation" with listed countries.

It is for individual Member States to determine how to legislate for defensive measures, in both tax and administrative matters. However, the EU encourages Member States to introduce proportionate and "efficient protection mechanisms that help to fight against the erosion of Member States' tax bases through tax fraud, evasion and abuse."

According to guidance published by the EU, Member States should adopt at least one administrative measure. Possibilities include:

- Reinforced monitoring of transactions concerning listed jurisdictions, and
- Increased audit scrutiny of taxpayers benefiting from regimes, structures or arrangements in listed jurisdictions

Defensive measures directly relating to tax might include integrating the EU list into domestic tax law in various areas, including:

- Disallowance of certain costs for tax purposes
- Reinforced Controlled Foreign Company (CFC) rules (e.g., adopting the EU list to automatically "blacklist" jurisdictions)
- Enhanced withholding tax measures
- access to participation exemption regimes, and
- Reversing the evidential burden of proof (e.g., requiring a taxpayer to prove arrangements do not have a main purpose of obtaining a tax benefit)

In addition, it should be noted that the EU's mandatory disclosure rules (referred to generally as DAC6) might be triggered. Taking effect from July 1, 2020 (but covering arrangements stretching back to June 25, 2018), DAC6 requires "intermediaries" to disclosure cross-border arrangements that meet certain "hallmarks" to their local tax authority. One of the hallmarks is any arrangement that involves deductible cross-border payments between "associated enterprises" where the recipient is resident for tax purposes in a listed jurisdiction. No tax avoidance motive is required; inclusion on the EU list is enough to trigger the disclosure obligation.

Practical Considerations

The EU has been stepping up efforts to ensure the EU list has consequential effect. After its gradual introduction of the list in 2017, and soft implementation during 2018 and 2019, the EU now intends to be more proactive in ensuring listed jurisdictions are comply with the EU's principles of tax good governance. At the same time as publishing the revised EU list, the Council asked Member States to introduce defensive measures with effect from January 1, 2021.

The Cayman Islands government moved swiftly to begin the process of delisting. On February 7, 2020, the Cayman Islands' Private Funds Law and Mutual Funds (Amendment) Law came into force. This was just three days after the meeting of the EU's Code of Conduct Group that advised on revisions to the EU list. The Cayman Islands position is that the two laws address the EU's concerns and satisfy its economic substance requirements. In a statement, Cayman Islands Premier, the Hon. Alden McLaughlin, stated, "…the Cayman Islands … remains fully committed to cooperating with the EU, and will continue to constructively engage with them with the view to be delisted as soon as possible."

Given this statement and the passing of the two new laws, the EU's position that the Cayman Islands government has been unable to continue to convince the EU of its commitment to enhance tax good governance appears strange. It is possible the listing is simply a case of miscommunication and unfortunate timing. However, the fact remains that the Cayman Islands is now a listed jurisdiction, will remain so until October 2020 at least, and there can be no guarantee it will be delisted at that point.

Taxpayers involved with collective investment schemes in the Cayman Islands should be alert to these developments. They should expect EU Member States to adopt domestic legislation in the coming months (taking effect from January 1, 2021, at the latest), targeting structures that either are located in, or make use of, the Cayman Islands. In relevant scenarios, they should also consider the potential application, and impact, of DAC6. Such taxpayers might wish to consider reviewing, and possibly re-structuring, their arrangements as a result.

We Can Help

Our dedicated and multidisciplinary team can provide a full range of timely advice and assistance based on decades of practical experience, attuned to the relevant context and tailored to the specific needs of each client.

We are uniquely situated – geographically and substantively – and qualified to assist clients in all manner of policy and legal matters. We can help clients navigate and adapt to the changing international tax framework.

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