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EU Blacklist – Cayman Islands: Impact for Asset Managers

The Cayman Islands has been placed on the EU list of non-cooperative tax jurisdictions (the “EU blacklist”) as a result of a failure to introduce new laws relating to private funds within the necessary timescale. The Cayman Islands government has, however, already contacted EU officials to begin the process of being removed from the EU list, which is expected to be October 2020.

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What has caused the Cayman Islands to be blacklisted?

- The Cayman Islands was originally on an EU grey list on the basis of the existence of “tax regimes that facilitate offshore structures which attract profits without real economic activity”. In response, the Cayman Islands engaged with the EU and introduced new economic substance rules from 1 January 2019 requiring in-scope entities that carry on particular activities to have demonstrable economic substance in the Cayman Islands. Investment funds or entities through which investment funds directly or indirectly invest or operate and Cayman exempt limited partnerships were outside these rules. The government of the Cayman Islands then passed new legislation on 4 February 2020 (the “Private Funds Law 2020”) to further enhance its regime for private funds. However, it was not enacted before the EU’s Code of Conduct Group met and the EU has stated that the “Cayman Islands does not have appropriate measures in place relating to economic substance in the area of collective investment vehicles”.

What impact will blacklisting have?

- Members States are encouraged to apply additional administrative measures, such as increased transaction monitoring and more frequent audits for taxpayers who benefit from a regime in a blacklisted jurisdiction or who use structures that involve a blacklisted jurisdiction.
- EU Member States are requested to take at least one legislative measure against blacklisted jurisdictions by 1 January 2021. These potential measures include:
 - denying tax deductions for payments to entities in blacklisted jurisdictions;
 - amending CFC rules to target CFCs in blacklisted jurisdictions;
 - applying withholding taxes at higher rates on interest, royalties and other payments received in a blacklisted jurisdiction;
 - denying or limiting the “participation exemption” to dividends or profits from blacklisted jurisdictions.
- Stricter reporting obligations under the EU Directive on mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (DAC 6). Where a payee is resident in a blacklisted jurisdiction, the “main benefits” test for reporting deductible cross-border payments is effectively deemed to be satisfied. There will also be stricter reporting requirements for country-by-country reporting (imposed by EU legislation).
- The non-tax defensive measures include restricting access to EU funding for groups taking advantage of blacklisted jurisdictions.

What should funds do?

- The EU blacklisting of the Cayman Islands is likely to be short-lived. Therefore, fundamental change to existing structures should be considered in this light.
- Funds which have Cayman entities in their structures (which may include a Cayman limited partnership) and invest directly (or indirectly) into EU Member States or the UK should monitor any changes in tax legislation in those jurisdictions. In particular, it is necessary to monitor whether the Cayman Islands will be included on the French list of Non-cooperative States and Territories (the “French blacklist”). However, the inclusion of the Cayman Islands on the French blacklist requires a Ministerial Executive Order and it appears unlikely this would take effect before the Cayman Islands is removed from the EU blacklist (if this occurs in October 2020) as the French blacklist was only recently updated. Any update to the French blacklist only has effect three months after the Ministerial Order.
- Some LPs may have increased reputational concerns about investing in Cayman funds. New funds, or funds looking for new investors, may therefore wish to consider an EU alternative for the fund vehicle (although they may already have an EU fund vehicle if they are seeking to rely on an EU passport for marketing the fund).
- LPs may also have increased concern over the audit risk and risk of increased tax leakage if there are Cayman blockers or other Cayman corporate vehicles in fund structures. Funds may wish to consider alternative jurisdictions for such vehicles if the Cayman Islands remains on the blacklist.
- Side letter requests which mention the EU blacklist should be reviewed.
- DAC 6 reporting obligations should be addressed in every transaction involving a cross-border deductible payment between an EU or UK entity and a Cayman entity.
- Funds with Cayman companies in their structure may need to factor in additional compliance costs. The Private Funds Law 2020 requires certain private funds to register and file audited accounts and it is conceivable that, to address the EU’s concerns on the economic substance of collective investment vehicles, the Cayman Islands may also take further steps to amend its economic substance rules further, which could result in additional compliance costs for Cayman companies.

Further details of the revised EU blacklist can be found on the [EU Council website](#).

If you have further questions, please contact [Brenda Coleman](#) or [Andrew Howard](#).