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Legal Update: Tax **February 2020**

Fund Alert – EU adds Cayman Island to Tax Blacklist

The EU Council has revised its list of non-cooperative jurisdictions for tax purposes to include the Cayman Islands.

The Cayman Islands was part of the “gray list”, made up of countries that have committed to adopt reforms to their tax laws. Since the Cayman Islands does not apply any corporate tax system, the EU Council's main concern was related to the lack of legal (and de facto) substance requirements, and the legal (and de facto) mechanisms that enable the granting of advantages only to non-residents or in respect of transactions carried out with non-residents.

As a result of a failure to timely introduce appropriate measures relating to economic substance in the area of **collective investment vehicles** (**CIV**), the EU added the Cayman Island to its tax haven blacklist.

With Palau, Panama and Seychelles also added to the blacklist, it is now comprised of 12 jurisdictions. In addition, Turkey was granted until December 2021 to resolve all open issues for the automatic exchange of information to be implemented effectively with all EU Member States, otherwise it will be added to the blacklist.

Certain Implications of being included in the blacklist

1. EU Member States should apply at least one of the following defensive measures in the tax area:
   - reinforced monitoring of certain transactions
   - increased audit risks for taxpayers benefiting from the regimes at stake
   - increased audit risks for taxpayers using structures or arrangements involving these jurisdictions
2. In addition, Member States may apply any of the following defensive measures in the tax area:
   - 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
- reversal of the burden of proof
- special documentation requirements
- stricter mandatory disclosure by tax intermediaries of specific tax schemes with respect to cross-border arrangement.

3. As a non-tax defensive measure, EU funding for sustainable development is not available to or through entities established in a non-cooperative tax jurisdiction and further non-tax defensive measures are likely to be added in the future.

What Investment Funds can do to mitigate the tax risk?

1. The blacklisting of the Cayman Islands is likely to be temporary because of the Cayman Islands Government’s continued commitment to cooperate with the EU. Therefore, fundamental changes to existing structures should be considered carefully.
2. In light of the increased tax and audit risks, and in order to maintain good investors' relationship –
   - new funds may wish to consider alternative jurisdictions for their fund vehicle
   - new and existing funds may wish to consider alternative jurisdictions for their blocker vehicles
3. Limited partnership agreements or side letters which restrict investments in an EU blacklist's jurisdictions should be reviewed
4. Funds with Cayman Island entities in their structure may need to factor in additional compliance costs.

Sincerely,

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