

## Banking Business

- Relevant Activity – What is a “banking business”?
- Banking Categories under the BTC Act
- Economic Substance Test
- CIGA for Banking Business
- Outsourcing
- Examples
- Economic Substance Reporting

### Relevant Activity – What is a “banking business”?

The International Tax Co-operation (Economic Substance) Act (2021 Revision), as amended (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) (the “**BTC Act**”).

An entity therefore engages in a ‘banking business’ where it is in 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.”

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 18*

### Banking Categories under the BTC Act

The Cayman Islands Monetary Authority (“**CIMA**”) regulates several different categories of banking business under the BTC Act. A relevant entity must possess a valid license 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 Economic Substance Test (“**ES Test**”). In terms of filing requirements, a bank with a Class “A” license will be required to file the Economic Substance Notification (“**ESN**”) as normal (i.e. relevant entity carrying on the relevant activity of banking business) however, when filing the Economic Substance Return (“**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 License

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 BTC Act. 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” license has been obtained.

Section 6(6) of the BTC Act 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), BTC Act).

The effect of the ES Act is that 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 BTC Act because the bank is a subsidiary or branch of a bank licensed in a country or territory outside the Islands. This is subject to the exception found in Section A.1.b) of the *Cayman Islands Economic Substance Guidance Notes v3.1* (the “**Guidance**”) on page 50.

Therefore, compliance with CIMA’s requirements will not necessarily be sufficient to meet the ES requirements.

*Banks and Trust Companies Act Licensees not carrying on banking business*

The BTC Act 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 [Tax Information Authority](#) (the "Authority") with respect to its banking business.

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, pages 49-51*

### **Economic Substance Test**

A 'relevant entity' that conducts one or more 'relevant activity', will need to satisfy the ES Test in respect of each relevant activity conducted.

The ES Test requires that a relevant entity:

**(a) conducts 'Core Income Generating Activities' ("CIGA") in relation to its relevant activity(ies);**

'Core Income Generating Activities' means activities that are of central importance to the relevant entity in terms of generating relevant income and must be carried on in the Cayman Islands.

A relevant entity will satisfy the ES Test in relation to a relevant activity if its core income generating activities in relation to that relevant activity are conducted by any other person and the relevant entity is able to monitor and control the carrying out of the Cayman Islands core income generating activities by that other person.

**(b) is directed and managed in an appropriate manner in the Islands in relation to its relevant activity(ies); and**

The ES Act provides that a relevant entity satisfies this limb of the ES Test if in relation to the relevant activity:

- (i) the relevant entity's 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;
- (ii) 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;
- (iii) during a meeting of the board of directors described in paragraph (ii), there is a quorum of directors present in the Islands;
- (iv) the minutes of the meetings of the board of directors described in paragraph (ii) record the making of strategic decisions of the relevant entity at the meeting; and
- (v) the minutes of all meetings of the board of directors and appropriate records of the relevant entity are kept in the Islands.

**(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.**

What is adequate or appropriate for each relevant entity will depend on the particular facts of the relevant entity and its business activity. A relevant entity will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 16*

### **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**

Banks will utilize 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 the Cayman Islands Monetary Authority, or both**

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

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 51*

### **Outsourcing**

The BTC Act 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.

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 51*

## **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 Received deposits from other banks and trust companies. This is CayCo Ltd' 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 BTC Act 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.

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, pages 51-52*

### **Economic Substance Reporting**

Entities that are in-scope under the ES Act (i.e. ‘relevant entities’ conducting ‘relevant activities’) will be required to report certain information on their relevant activities in the Cayman Islands, in particular the extent to which core income generating activities are being conducted in the Cayman Islands, on an annual basis to the Authority.

An ES Return must be submitted each year within twelve months of the relevant entity’s financial year end. Together with the ES Return, the entity will be required to upload appropriate documents (i.e. financial statements or books of account) that give a true and fair view of the state of the entity’s affairs and to explain its transactions.

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 28*

Contact your Campbells attorney or [regulation@campbellslegal.com](mailto:regulation@campbellslegal.com) if you have questions about Economic Substance Reporting.

For more information about Relevant Activity, CIGA, the ES Test and Economic Substance Reporting, please review the Guidance and additional DITC-issued Resources available [here](#).

### **Disclaimer**

*The contents of this website are not intended to constitute legal, tax, investment or other advice and you are advised to seek independent legal counsel regarding your particular circumstances.*