

## Distribution and Service Centre Business

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### Relevant Activity – What is a “distribution and service centre business”?

An entity engages in ‘distribution and service centre business’ where it conducts the business of either or both of the following:

- (a) purchasing from an entity in the same corporate group –
  - (i) component parts or materials for goods; or
  - (ii) goods ready for sale, and  
reselling such component parts, materials or goods outside the Cayman Islands;
- (b) providing services to an entity in the same corporate group in connection with the business outside the Cayman Islands,

but does not include any activity included in any other relevant activity except holding company business.

For the avoidance of doubt, (b) above only falls within the definition in the specific circumstances where the relevant entity is operating a service centre for entities in the same Group.

“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.

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

### Economic Substance Test

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

The economic substance 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 economic substance 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 economic substance 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 v3.1, page 16*

### **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.

**(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.

*Source: Cayman Islands Economic Substance Guidance v3.1, pages 53-54*

**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 *Cayman Islands Economic Substance Guidance v3.1* (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 the 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 the 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 the 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 the Guidance.

*Source: Cayman Islands Economic Substance Guidance v3.1, pages 54-55*

### **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 filed within one year 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 v3.1, page 28*

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

More information about Relevant Activity, CIGA, the ES Test and Economic Substance Reporting is available [here](#).