

## Financing and Leasing Business

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### Relevant Activity – What is a “financing and leasing business”?

An entity engages in a ‘financing and leasing business’ where it is in the “business of providing credit facilities for any kind of consideration to another person but does not include financial leasing of land or an interest in land, banking business, fund management business or insurance business”.

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 19*

### Economic Substance Test

A 'relevant entity' that conducts one or more 'relevant activity', will need to satisfy the Economic Substance Test (“**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 International Tax Co-operation (Economic Substance) Act (2021 Revision), as amended (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 Financing and Leasing 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 financing and leasing business, CIGA includes -

**(a) Negotiating or agreeing funding terms**

This CIGA includes negotiating or agreeing the type of funding (e.g. equity / preference shares, debt, convertible debt, bank borrowing etc.), the terms of the agreement, the quantum of funding, the rates of interest payable, the security given (if any), and any covenants.

**(b) Identifying and acquiring assets to be leased**

This CIGA includes agreement a suitable price or quantity, identifying sources of those assets, and negotiating the acquisition and the terms of supply.

**(c) Setting the terms and duration of financing or leasing**

This includes setting the financial terms and the parameters as to acceptable counterparties, the amounts, rates of interest, the legal agreements and the duration for which the financing or leasing is to be provided.

**(d) Monitoring and revising financing or leasing agreements and managing risks associated with such financing or leasing agreements**

This CIGA includes the acquisition of data about a borrower or lessee (or group of them), testing against covenants, extending durations of loans, and feeding back into decision making on writing new terms. With

regard to managing risks, this includes instigating debt collection, considering spreading of risk across sectors or consumer groups. In leasing it includes monitoring and maintaining the underlying assets.

*Source: Cayman Islands Economic Substance Guidance Notes v3.1, pages 56-57*

## Examples

General examples on scope:

In scope:	Not in scope:
Entities which carry on a factoring activity, by which they purchase and then collect another business’s book debts.	Ancillary business or incidental to a different business for example the supply of goods or services “on account” in respect of which the supplier anticipates payment within a reasonable period in accordance with customary business practice.
In scope:	Not in scope:
A relevant entity provides credit facilities to customers and charges interest and/or a lending fee. This would constitute “consideration.” The entity is in scope regardless of whether the creditor takes security (collateral) for the credit.	Credit is offered with a grant of security in favour of the lender but the credit is interest free and there are no lending fees or other consideration. For the avoidance of doubt, the grant of security by any party in favour of the lender would not constitute consideration.

Further examples:

- (a) CayCo Ltd, a relevant entity, operates as a treasury centre for a multi-national group of companies and provides interest-bearing credit facilities to subsidiaries and affiliated entities.
  - CayCo Ltd is carrying on the relevant activity of financing and leasing business. Thus, CayCo Ltd will be required to file an Economic Substance Notification (“**ESN**”), to satisfy the ES Test and to file an Economic Substance Return (“**ES Return**”) as outlined in the *Cayman Islands Economic Substance Guidance Notes v3.1* (the “**Guidance**”).
- (b) CayCo Ltd, a relevant entity, lends \$2,000,000 to CDE Ltd at a 5% interest rate. This is CayCo Ltd’s only activity.
  - CayCo Ltd is carrying on the relevant activity of financing and leasing 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.

Extension of example (b) – in Yr 2, the loan of \$2,000,000 to CDE Ltd, is then transferred by CayCo Ltd to another company CayCo II LLC which is also a relevant entity.

- CayCo II LLC would now be carrying on the relevant activity of financing and leasing business. Thus, CayCo II LLC will be required to file an ESN, to satisfy the ES Test and to file an ES Return as outlined in the Guidance.

If this was the only loan CayCo Ltd held, then CayCo Ltd would cease to be carrying on financing and leasing business. If following the transfer of the loan CayCo Ltd. is no longer carrying on any financing and leasing business then when CayCo Ltd files its ESN for year 2, it would classify itself as not carrying on a relevant activity and thus, no ES Return would be required.

- (c) CayCo Ltd, a relevant entity, lends \$2,000,000 to one of its subsidiaries, CDE Ltd. This is an interest free loan and no lending or other fee is charged and there is no other kind of consideration.
- CayCo Ltd would not come within the definition of financing and leasing business as the definition does not extend to cases where a credit facility is provided and there is no consideration from the borrower. CayCo Ltd will be required to file an ESN as outlined in the Guidance.
- (d) CayCo Ltd, a relevant entity, is a trading company that provides its customers with 50 days trade "credit" on invoices. CayCo Ltd's terms of business state that if the customers have not paid within the period of 50 days, CayCo Ltd may charge late payment interest.
- CayCo Ltd is not carrying on the relevant activity of financing and leasing business as consideration is not payable in respect of the "credit" arrangement (the late payment interest is to deter payment being made later than 50 days and not as consideration for the provision of credit). Even if consideration were payable for the "credit" the provision of credit in these circumstances is an incidental part of Cayco Ltd's trading business and would not constitute financing and leasing business. CayCo Ltd will be required to file an ESN as outlined in the Guidance.
- (e) AVFin Ltd, a relevant entity, is an aircraft finance company. Its business is the financing of aircraft for its customers, whereby it purchases aircraft and leases the relevant aircraft to the relevant customer.
- AVFin Ltd is carrying on financing and leasing business. Thus, AVFin 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 Notes v3.1, pages 57-58*

### **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 [Tax Information 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](#).

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