

Headquarters Business

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What is a “headquarters business”?

An entity engages in ‘headquarters business’ where it is in the business of providing any of the following services to an entity in the same corporate group –

- (a) the provision of senior management;
- (b) the assumption or control of material risk for activities carried out by any of those entities in the same corporate group; or
- (c) the provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (b),

but does not include banking business, financing and leasing business, fund management business, intellectual property business, holding company business or insurance business.

Group in this context is defined as “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 Notes v3.1, page 20

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 Headquarters 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 headquarters business, CIGA includes -

(a) Taking relevant management decisions

This includes making decisions on the substantive functions and significant risks for other group companies such as strategic planning, marketing strategies, information technology, acquiring premises, etc.

(b) Incurring expenditures on behalf of Group entities

This include taking specialist advice, the purchase of significant assets or the procurement of technology on behalf of the Group as a whole. Other common shared expenses include marketing, IT and HR.

(c) Co-ordinating Group Activities

This includes co-ordinating activities to aggregate demand for the Group in order to realize synergies and cost savings.

Source: Cayman Islands Economic Substance Guidance Notes v3.1, page 63

Examples

- (a) CayCo Ltd, a relevant entity, is part of a Group that includes certain subsidiary entities incorporated variously within the Islands and in certain jurisdictions outside the Islands. Each subsidiary entity within the Group has its own board of directors that makes strategic and managerial decisions for that entity. Relevant management decisions to implement that strategy and manage risk are taken by the relevant subsidiary, there are no service contracts in place between CayCo Ltd and any subsidiaries within the Group and CayCo Ltd does not provide any other services to any other subsidiaries within the Group.

CayCo Ltd provides a parent company guarantee in respect of the loans and other obligations of certain subsidiaries within the Group, which obligation is secured by a debenture charging the assets of CayCo Ltd.

- CayCo Ltd is a relevant entity but it is not carrying on the relevant activity of headquarters business. Thus, CayCo will be required to file an Economic Substance Notification (“**ESN**”) as outlined in the *Cayman Islands Economic Substance Guidance Notes v3.1* (the “**Guidance**”).
- (b) CayCo Ltd, a relevant entity, is the headquarters for a global Group. CayCo Ltd determines the strategic planning and direction of the Group and manages Group risk. The senior management team, employed by CayCo Ltd, regularly spends time with each Group subsidiary advising on the implementation of the Group's strategy and the management of risk. CayCo Ltd does not receive fees for the services provided but instead benefits through interest, dividends and capital gains from its equity and debt investments.
- CayCo Ltd is a relevant entity carrying on the relevant activity of headquarters business. Thus, CayCo Ltd will be required to file an ESN, to satisfy the ES Test and to file an Economic Substance Return (“**ES Return**”) as outlined in the Guidance. As CayCo Ltd is carrying on a relevant activity for gain, it should be reporting the relevant income on its ES Return.
- (c) The facts of this example are the same as for (b) above except that CayCo Ltd is tax resident in Canada.
- CayCo Ltd is not regarded as a relevant entity where it is tax resident outside the Islands. CayCo Ltd will be required to file an ESN and to provide evidence that it is tax resident outside the Islands, as outlined in the Guidance.

- (d) CayCo Ltd, a relevant entity, is a member of a Group. Other members of the Group are incorporated in various jurisdictions, and the ultimate parent of the Group is a US Corporation. The board of the US Corporation sets the broad strategic direction and corporate policy for the Group.

CayCo employs certain senior management, legal, risk, IT professionals and CayCo Ltd provides management, legal, risk, and IT services to other members of the Group pursuant to one or more services agreements. CayCo Ltd is remunerated for such services pursuant to the services agreements.

- CayCo Ltd is a relevant entity carrying on the relevant activity of headquarters 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.

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 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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