Debevoise & Plimpton

The Debrief

Cayman Islands Removed from EU Tax "Blacklist" — But Have All the Consequences of Its Blacklisting Been Removed?

23 October 2020

CHANGES TO THE EU BLACKLIST

- Following its semi-annual review, the EU Council has removed the Cayman Islands and Oman from its list of non-cooperative jurisdictions for tax purposes, the EU's so-called tax haven "blacklist", given improvements made to their tax policy frameworks. Meanwhile, the Council has added Anguilla and Barbados to the list. Both changes apply as from **6 October 2020**.
- The Council's decision reverses its earlier announcement made on **18 February 2020**, which initially added the Cayman Islands to the blacklist. Please see our earlier Debevoise Update on the significance of blacklisting with a focus on consequences for Cayman investment funds and their fund sponsors. Similar considerations may now apply to fund structures that make use of vehicles established in Barbados or Anguilla, although these are rarely encountered.
- Placement of a jurisdiction on the list of non-cooperative jurisdictions for tax purposes is expected to have a dissuasive effect on jurisdictions that are seen as having abusive tax practices that erode the tax revenues of Member States.

ARE THERE LASTING CONSEQUENCES FROM THE CAYMAN ISLANDS' BLACKLISTING?

Enhanced Disclosures to EU Tax Authorities Under DAC6

Advisers and their clients alike should be familiar in outline with the EU's new mandatory disclosure regime on cross-border arrangements ("DAC6"). However, variations in the implementation and application of the DAC6 Directive (Council Directive (EU) 2018/822 of 25 May 2018) across EU Member States may cause differing results as to the potential disclosure of cross-border transactions involving the Cayman Islands during its period of blacklisting.

The "Blacklist Hallmark". DAC6 contains hallmarks that identify when transactions (or "arrangements") are reportable. Notably, hallmark C1(b)(ii) triggers an automatic obligation to report any deductible cross-border payments (such as interest, fees, etc.) made between associated enterprises, where the recipient is resident in a blacklisted jurisdiction. Some EU Member States' draft guidance currently suggests that affected cross-border payments with a Cayman recipient should be reportable if the Cayman Islands were blacklisted as at the date of a reporting trigger, i.e. when:

- an arrangement was made available for implementation;
- an arrangement was ready for implementation;
- an arrangement's first implementation step was made; or
- advice in respect of the arrangement was provided by an adviser or other "intermediary".

It remains to be seen whether guidance issued by EU Member State tax authorities will be updated to account for the specific circumstances of the Cayman Islands' temporary blacklisting.

The UK tax authorities' guidance appears to suggest that any such arrangements with the Cayman Islands since 18 February 2020 should not be reportable in the UK, provided that the Cayman Islands are not on the blacklist on both (i) the date of any reporting trigger and (ii) the filing date (being 1 January 2021 given recent deferrals to the reporting deadline). If this reading is correct, this should simplify the burden on advisers and their clients alike in identifying reportable arrangements.

The "Zero Tax Hallmark". It should be noted that where deductible cross-border payments between associated enterprises involve a recipient in a zero-tax (or almost zero-tax) jurisdiction such as the Cayman Islands, they may be reportable under hallmark C1(b)(i) in any event. The crucial difference is that, unlike the blacklist hallmark, this zero tax hallmark allows for consideration of the main benefit test (the "MBT"), such that only arrangements where the main benefit (or one of the main benefits) involved is a tax advantage should be reportable under DAC6. In practice, therefore, the ultimate compliance burden caused by the blacklisting of the Cayman Islands may depend upon a combination of the application of the blacklist hallmark across EU Member States (in terms of the timing) and the scope of the MBT.

Sanctions at the National Level Against Blacklisted Jurisdictions

The EU Code of Conduct Group's guidance (published 25 November 2019) encouraged Member States to adopt at least one tax defensive measure with regards to transactions with non-cooperative jurisdictions — including (i) limiting tax deductions, (ii) adopting controlled foreign company ("CFC") rules, (iii) applying higher withholding taxes, or (iv) limiting the benefits of a participation exemption. Such measures are to be applied by Member States "from 1 January 2021 at the latest".

The negative consequences from such measures should not affect Cayman structures to the extent that measures only come into effect in Member States from 1 January 2021, such as Luxembourg's draft law number 7547 limiting tax deductions otherwise allowable on some royalties and interest payments from Luxembourg entities to entities or persons in a blacklisted jurisdiction. Some Member States in practice already have similar measures at domestic law with regards to low or zero-tax jurisdictions; the blacklisting, however, should not have caused any additional adverse consequences.

CONCLUSIONS

While Cayman investment funds may have narrowly avoided the impact of any defensive measures taking effect from 1 January 2021 in EU Member States as a direct result of being blacklisted, it remains to be seen whether the blacklisting will result in increased compliance caused by DAC6 reporting obligations pending clarity on the application of the rules in all Member States for the blacklisted period and the scope of the MBT.

Richard Ward
Partner, London
+44 20 7786 9070
rward@debevoise.com

Jennifer Wheater
International Counsel, London
+44 20 7786 3045
jwheater@debevoise.com

Tom Berry
Associate, London
+44 20 7786 5458
tberry@debevoise.com

Charles Cartiglia
Associate, London
+44 20 7786 5501
ccartiglia@debevoise.com

Paul Eastham
Associate, London
+44 20 7786 5538
peastham@debevoise.com

Christopher Gossage
Trainee Associate, London
++44 20 7786 5414
cgossage@debevoise.com