

Snapshot: Economic substance considerations for tech businesses in the Cayman Islands

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If you are opening or operating a technology business in the Cayman Islands then you need to consider whether in doing so you will be holding, exploiting, or receiving income from an intellectual property asset which your business, being a relevant entity in the Cayman Islands, either owns or has an exclusive licence to use.

What is an intellectual property asset?

Intellectual property (IP) assets include copyrights, design rights, patents and functional equivalents such as 'copyrighted software', and trade marks. In most jurisdictions, including the Cayman Islands, software is protectable under copyright laws. However, in others, it is afforded patent protection or a combination of both copyright and patent protection for certain aspects of the technology. This brief refers to 'software' as an IP asset generally, whether protected via copyright or patent laws in any given jurisdiction.

Economic substance in the IP context

If your business will involve a Cayman entity receiving income from IP assets, such as software, then you will need to ensure that such entity operates in compliance with regulatory requirements imposed under the International Tax Co-operation (Economic Substance) Act (**ES Act**) and meet its 'economic substance' test as applicable to intellectual property business (**ES Test**).

The overarching goal of the economic substance regime in the IP context is to act as a deterrent to the artificial shifting of profits from countries where the value in the IP asset was created to low or no tax jurisdictions, such as the Cayman Islands, by requiring core income generating activities relating to IP assets held or exploited by relevant entities in the Cayman Islands to be conducted locally (i.e. in the Cayman Islands).

Most types of Cayman entities are required to meet the ES Test if they carry out 'intellectual

property business' (as defined under the ES Act), although there are exceptions in respect of domestic companies, local partnerships, investment funds and/or where the relevant Cayman entity can demonstrate to the Cayman Islands Tax Information Authority (TIA) that it is tax resident outside of the Cayman Islands.^[1] Penalties for failure to satisfy the ES Test (where applicable) can be up to US\$12,200 for the first financial year and can rise to up to US\$122,000 in a subsequent financial year.

How might this affect tech businesses?

Technology businesses often receive income from the licensing or sale of software. This could be in the form of traditional software applications, software as a service (SaaS), software libraries or platform as a service (PaaS), for example. If your technology business is going to receive income in the Cayman Islands from the licensing or sale of software by a Cayman entity (or entities), then you will need to identify where in the world the research and development of the relevant software was or is to be conducted so that expert legal advice can be sought on the position of such Cayman entity (or entities) under the ES Act. Relevant factors will include any relevant Cayman entity's operating expenditure, physical presence, location of decision-making and number of employees, amongst others. The manner of exploitation of any relevant software is also a key factor; for example, will the software be sold or licenced to non-group third parties or to entities within the same group as the relevant Cayman entity?

How can Ogier assist?

This is a complex and evolving area of law and Ogier's team of regulatory and intellectual property experts are ready to assist.

Ogier's Regulatory team has extensive experience advising all kinds of Cayman Islands entities on economic substance requirements and works closely with Ogier's Intellectual Property team, who can assist with the identification of any relevant IP assets.

For further information on this please reach out to the authors, or to your usual Ogier contact.

[1] Note: Recent updates made to the latest (July 2022) Version (3.2) of the TIA's *Guidance Notes on Economic Substance for Geographically Mobile Activities* indicate that where a relevant entity claims to be tax resident in one of the following jurisdictions such claim will not be accepted by the TIA: Anguilla, Bahamas, Bahrain, Barbados, Bermuda, British Virgin Islands, Turks and Caicos Islands, and the United Arab Emirates.

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