

KIRKLAND & ELLIS

Kirkland Alert

Cayman Islands Added to EU Blacklist

19 February 2020

In an [EU Press Release](#) issued on 18 February 2020, the ECOFIN committee of the European Union (“EU”) resolved to move the Cayman Islands to the EU blacklist of non-cooperative jurisdictions for tax purposes (the “EU Blacklist”). The reason given by the EU is that the Cayman Islands does not have appropriate measures in place relating to economic substance in the area of collective investment vehicles (“CIVs”). On 31 January 2020, Cayman passed The Private Funds Law and The Mutual Funds (Amendment) Law, both of which address the EU concerns for CIVs, and which were enacted on 7 February 2020. A separate *Alert* will follow on this topic.

The EU Blacklist was set up as part of the EU’s strategy on effective corporate taxation, with a view to improving tax governance on a global level. Currently (as at 18 February 2020), the other members of the EU Blacklist are: American Samoa, Fiji, Guam, Oman, Palau, Panama, Seychelles, Samoa, Trinidad and Tobago, US Virgin Islands and Vanuatu.

The EU Blacklist does not impose specific penalties on blacklisted jurisdictions. However, the addition of the Cayman Islands to the EU Blacklist may have implications for fund and holding structures located in Cayman, particularly for those funds that invest into Europe. While the full impact and consequences of the addition of Cayman to the Blacklist will become clearer in the coming weeks and months, we have set out below some of the key instant considerations for fund structures with a Cayman element.

Potential Increased Taxes

- Some European jurisdictions already have their own local “blacklist” that imposes adverse tax consequences on entities resident in certain non-cooperative jurisdictions. These local blacklists often very closely resemble the EU Blacklist. If Cayman is added to the EU Blacklist, it would generally be expected that Cayman

would be added to local blacklists (although this would not be automatic and could take a number of months).

- Where such jurisdictions update their local blacklist by reference to the EU Blacklist, consideration would need to be given as to whether the use of (i) Cayman limited partnerships as fund vehicles or (ii) Cayman corporate entities as financing or holding companies may trigger the imposition of (or increase in the rate of) taxes on the repatriation of returns through European structures to Cayman.
- By way of example, France (i) imposes withholding tax on interest and higher rates of withholding tax on dividends when the corresponding payments are made to bank accounts located in blacklisted jurisdictions, and (ii) denies deductions of interest payable to creditors established in those jurisdictions with the effect that this interest may be reclassified as constructive dividends subject to a 30% withholding tax. France's non-resident capital gains tax, which ordinarily only applies to holdings of more than 25%, also applies where blacklisted entities hold 25% or less holdings in French investee companies.
- The "controlled foreign company" rules in certain EU jurisdictions can also act to attribute certain income generated in (and retained by) an entity in a blacklisted jurisdiction to the tax base of its related corporate taxpayers.
- In addition, EU member states have politically committed (through their endorsement of guidance issued by the European Council in November 2019) to introduce at least one of the following specific legislative measures toward EU Blacklisted jurisdictions by January 2021 (or July 2021 in certain cases), to the extent they have not already: non-deductibility of costs; CFC rules; withholding tax measures; and/or limitation of participation exemption on profit distribution.

Side Letters Agreed With Third Party Investors

- Sponsors are often required to agree side letter provisions with third party investors to the effect that no investments should be made through a non-cooperative jurisdiction (or that notice will be given if such an investment is made/due to be made). It would be prudent, therefore, to conduct a review of side letters agreed in prior funds to confirm whether any such undertakings exist and, if so, which investors are affected.

As a general point, Cayman's presence on the EU Blacklist may cause more European institutional investors to avoid investing in, or through, a Cayman vehicle. Indeed, certain investors (such as certain European regulated investors) are already required to invest into OECD or EU funds, so cannot invest into Cayman funds. Therefore, the addition of Cayman to the EU Blacklist adds to the list of issues that should be considered when using Cayman fund vehicles.

The EU Blacklist is based on a continuous and dynamic process of listing and delisting countries as they make commitments to, or take action to comply with, the EU requirements. The EU adopted the first EU Blacklist in December 2017, and it has since been updated several times. The Cayman Islands government has stated that Cayman remains fully committed to cooperating with the EU, and will continue to constructively engage with the EU with the goal of being delisted as soon as possible. However, the 18 February announcement makes clear that updates to the EU Blacklist will now be limited to a maximum of twice per year, with the next update expected in October 2020. We are continuing to monitor the discussions between the EU and the Cayman Islands government, and expect to provide further updates as developments warrant.

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Suggested Reading

- 21 April 2020 - 24 April 2020 Speaking Engagement ABA International Law Section's 2020 Annual Meeting
- 28 February 2020 Sponsored Event Kirkland to Host Wharton MBA's 19th Annual Buyout Case Competition
- 19 February 2020 Blog Post How Anti-Corruption Issues Can Derail a Project: A Case Study on the Recent Cancellation of the Codelco Desalination Project in Chile

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