

Updates to EU tax blacklist: alternative options for investors

The Economic and Financial Affairs Council (ECOFIN) of the EU has announced on the 18th February 2020 the addition of four jurisdictions to the list of non-cooperative jurisdictions for tax purposes (commonly referred to as the “EU blacklist”), namely the Cayman Islands, Panama, Seychelles and Palau.

The inclusion of the Cayman Islands in particular (a British overseas territory and a popular investment funds jurisdiction) comes within less than one month from the UK’s departure from the EU. Although not likely to cause a massive outflow of funds out of the Cayman Islands, the blacklisting is bound to cause some level of demand for alternative jurisdictions, either for the relocation of existing Cayman funds, or for the setting up of new ones. In this respect, Cyprus constitutes a prime choice and a reliable jurisdiction for such purposes.

Reason for blacklisting and consequences

The Cayman Islands were previously included in the EU ‘grey list’, due to the existence of tax regimes facilitating offshore structures which attract profits without real economic activity. The Cayman Islands had committed to adapt its legislation and to implement the required economic substance reforms by the end of 2019. Although most of the required reforms were enacted and the economic substance requirements were satisfied, the delay in enacting legislation regarding economic substance for collective investment funds is what apparently has led to the blacklisting of the jurisdiction.

The inclusion of a jurisdiction in the EU blacklist does not give rise to specific penalties or sanctions. However, apart from the obvious reputational issues, blacklisted jurisdictions are faced with a number of adverse implications such as:

- As of 1 January 2021, EU member states will be required to adopt at least one of four tax legislative measures in their transactions with blacklisted jurisdictions, namely (a) CFC rules, (b) limitation of participation exemption on profit distributions, (c) limitation of deductibility of costs, or (d) withholding taxes.
- Denying of certain EU funding to (or through) entities established in blacklisted jurisdictions.
- Increased scrutiny and monitoring of transactions and/ or structures involving blacklisted jurisdictions.

- Increased risk of local tax audits for taxpayers benefitting from structures or arrangements in blacklisted jurisdictions.
- Under the EU Directive for mandatory disclosure of reportable cross-border arrangements (commonly known as DAC6), related-party payments to entities in blacklisted jurisdictions may be reportable to the relevant tax authorities of the source country.

In the particular case of the Cayman Islands, a popular offshore funds jurisdiction with a substantial share of the world's offshore funds, its inclusion in the EU blacklist is likely to cause European investors to avoid investing in, or through, Cayman Islands fund vehicles.

It should be mentioned that, from now on, updates to the EU blacklist will be limited to a maximum of twice per year, with the next update being expected in October 2020. The Cayman Islands have already enacted relevant legislation to address the issue of economic substance for collective investment funds, and have expressly stated their commitment to cooperate and to constructively engage with the EU, with the view to be delisted.

Opportunities for Cyprus

Although far from the end of the Cayman Islands as an investment fund jurisdiction, its inclusion in the EU blacklist may cause European institutional investors to consider alternative jurisdictions, either for the setting up of new investment funds, or for the redomiciliation of existing ones.

Cyprus constitutes an eminently suitable jurisdiction for this purpose. The Cypriot legal and regulatory framework governing investment funds has recently been updated and modernised, taking into account best practices followed by jurisdictions with long tradition in the field, and is fully compliance with all relevant EU Directives, including the Alternative Investment Fund Managers Directive.

The above, in combination with several advantages such as its competitive and attractive tax regime, solid legal framework, strategic location, comparative cost advantage and high level of professional services, constitute Cyprus a prime choice for institutional investors wishing to expand their business. It is also worth mentioning that the Cyprus tax legislation provides significant personal tax benefits, providing an incentive for senior managers of foreign investment funds to physically relocate to Cyprus and conduct their business from here.

The redomiciliation of foreign investments funds into Cyprus is a relatively simple and straightforward process, and all types of investment vehicles can be redomiciled, both from offshore as well as from other European jurisdictions. Various options are available, including the complete transfer of the registered office to Cyprus, a merger with a Cyprus Mutual Fund or with a Cyprus Investment Company, or the contribution by a foreign fund of all assets and liabilities to a Cyprus entity.

Of course, it needs to be borne in mind that Cyprus is not comparable to offshore jurisdictions such as the Cayman Islands, nor is it in direct competition with them. Cyprus has taken considerable steps in recent years to shed the stigma of being considered a tax haven, to improve its professional services sector and to further enhance its image as an international business centre. Moreover, and as mentioned above, the blacklisting of the Cayman Islands may be short-lived, and does not necessarily equate to a massive outflow investments funds. Nevertheless, in cases of institutional investors with Cayman vehicles who are considering alternative jurisdictions, Cyprus provides a stable, reliable and trustworthy option for consideration.