

## Client Memorandum

### FATCA in the Cayman Islands

July 2014

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The serious doubts expressed by many, most recently Professor Christians of McGill University, as to the Constitutional authority cited by the US Treasury<sup>1</sup> in support of each Inter Governmental Agreement (an "IGA") entered into by it on behalf of the United States government to implement FATCA have been rendered practically irrelevant in so far as Cayman Islands legal entities, including all companies, funds, partnerships and trusts, are concerned by the passage, with effect from 1<sup>st</sup> July 2014, of the enabling amendments to the relevant Cayman Islands legislation. These extensive revisions to the Cayman Islands Tax Information Authority Law 2014 and attendant Regulations introduce into Cayman Islands domestic law, the provisions of the Model 1(B) IGA with the United States (signed on 29<sup>th</sup> November 2013) and the similar (not constitutionally doubtful) IGA signed with the United Kingdom on 5<sup>th</sup> November 2013.

Whilst a legal eyebrow may also well be raised at the shorthand methodology which seeks to introduce into the domestic law of the Cayman Islands provisions of US tax regulation, and whilst doubts are unquestionably raised as to how expert evidence as to the meaning and effect of what are essentially matters of US tax law will be introduced into Cayman Islands legal proceedings, given the criminal sanctions also thereby introduced into Cayman Islands law with respect to non-compliance with FATCA, no doubt should exist as to the practical efficacy of FATCA in the Cayman Islands with effect from 1<sup>st</sup> July 2014. (Had the due date been 4<sup>th</sup> July, the irony of an initiative to impose global fiscal imperialism and on this particular bastion of colonial rule would have been complete)

However, public policy considerations about the extraterritorial application of domestic tax legislation apart, to cut to the bottom line, the positive conclusion we draw is that in practice the application of the Cayman Islands FATCA rules on a case by case basis are by no means problematic. In our view the apparent complexities of the one hundred and ninety nine pages of Guidance Notes, describing the similarly lengthy revisions to the Cayman Islands Tax Information Authority Law 2014 and the attendant Regulations, resolve with simplicity on an analysis of the fact pattern of the specific Cayman Islands legal entity under consideration. It is also our view that those somewhat self interested suggestions that a new division of the Cayman Islands financial services industry needs now to be created to deal with the application of these provisions is wholly unwarranted. Whilst, no doubt, the development of the necessary systems by Banks has been hugely time consuming, participants in the Cayman Islands financial services industry, in particular administrators of funds and fiduciary service providers, already have highly developed due diligence procedures and systems for KYC which can be simply adapted to the slightly different but additional requirements of the FATCA regime. Nor is it our view that industry specific memoranda or any other generalizations about FATCA are of much assistance. The application and effect of FATCA in the Cayman Islands is specific to each Cayman Islands legal entity and only solves on an analysis of:

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<sup>1</sup> 22 USC Section 2656; IRC Code Sections 1471, 1474 (f), 6011 and 6103 (k) (paragraph 4) and subtitle F, Chapter 61, subchapter A, part III and subpart B

1. The type of Cayman Islands entity, whether a company, partnership or trust and whether it is defined as a Foreign Financial Institution (an “FFI”) or a Non-Financial Foreign Entity (an “NFFE”) (basically every other non exempted entity);
2. The identity of its investors or account holders, i.e. are they US citizens or UK residents (the distinction between citizenship and residence is fundamental under the US as compared to the UK provisions);
3. The type of income the entity generates, i.e. active trading or passive income and the value of the account;
4. In relation to private client matters, the type of trustee; and
5. Whether particular exemptions and exclusions apply.

Broadly, the foregoing analysis will dictate whether the Cayman Islands company, partnership or trust is an FFI, defined as a Custodian, Depository (mainly banks), a Fund (most open ended funds will be included in this definition of an FFI although there are specific provisions for institutional funds and retirement funds, and many private equity funds will find themselves excluded from the definition) and certain Insurance companies. These FFIs, although some are exempted, will otherwise obtain a GIIN number from the IRS portal. Globally to date some 77,000 have done so. Each other Cayman Islands entity is termed an NFFE and may be active or passive, does not require a GIIN number, does not have reporting obligations to the Cayman Islands Tax Information Authority as to controlling persons, may self certify to any FFI where it has an account that there is no US or UK investor involvement and may file the relevant US forms as to beneficial ownership with any US financial institution with which it has an account.

When undertaken the foregoing suggested analysis will answer the following essential questions:

- 1) Is the Cayman Islands entity an FFI or an NFFE?
- 2) Does it maintain Financial Accounts?
- 3) Does it need to register with the IRS and by when and how?
- 4) What information, if any, needs to be reported to the Tax Information Authority (and this may include financial filings relating to payments made to a Non-Participating Financial Institution) or directly to any US financial institution with which it has an account?
- 5) Must it self-certify to an FFI with which it has an account?

As important as is the foregoing specific analysis to the Cayman Islands entity so too are the amendments required to the contractual, constitutional and offering documents of the entity which may well now need to include specific wording dealing with FATCA and the issues that can arise from the application of US withholding tax under FATCA, should that withholding under s.1471 US IRC come to pass. We have developed specific wording to suit all Cayman Islands entities and would be pleased to advise any of our clients on request.

Each of our Partners is ready to provide you with specific and focused advice as to the application of FATCA to a Cayman Islands entity and the additional obligations that now arise. Given the highly developed and positively reviewed infrastructure that has been developed in the Cayman Islands on the issue of beneficial ownership, the additional due diligence enquiries that will now need to be undertaken should not prove problematic in practice. How though, given the current difficulties the IRS apparently has in locating information on its computer systems, all of this information will be processed by the Tax Information Authority and the IRS and with what results is a discussion that falls outside of the ambit of this advisory. It can though be said with a high degree of certainty, given the statistically insignificant number of US and UK taxable individuals with accounts in the Cayman Islands, that US and UK tax

revenues generated from the Cayman Islands as a result of FATCA will be a fraction of the costs of implementation.

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