Cayman Finance

OCTOBER 2021

Cayman Tax Neutrality Prevents Double Taxation FACT SHEET

Cayman Islands Tax Neutrality Offers the Simplest, Most Straightforward and Transparent Approach to Prevent Double Taxation

Diminishing the risk of double taxation has been a major focus of concern for the UN, OECD and EU. Entities that are tax resident in Cayman avoid double taxation through the simplest, most straightforward and most transparent way possible: a tax neutral system that means they do not pay any tax in Cayman while still being responsible for tax in home jurisdictions and those in which they invest. By offering a cost effective way for entities to avoid double and triple taxation, while ensuring through TIEAs and other commitments that tax information is reported to the tax authorities in other jurisdictions, Cayman facilitates greater levels of economic activity around the world than would otherwise be the case.

DOUBLE TAXATION A MAJOR CHALLENGE IN THE EU

The European Commission and EU member states have made considerable efforts to address problems of double taxation, double non-taxation, and other cross-border tax issues. Yet different tax systems, complex double taxation treaty provisions and a lack of transparency have prevented a resolution of the challenge and created major costs for businesses.

- European Commission (2011): "**Double taxation** in a cross-border context as a **result of inconsistent interaction of different domestic tax systems**, is a **major impediment and a real challenge** for the internal market."
- Center for European Policy Studies (2010): "[Multinational Enterprises] in the EU are confronted with **huge compliance costs in trying to meet the requirements of twenty-seven different tax systems and considerable uncertainty as to the correct application of the rules**."

TAX TREATIES CREATE COMPLEXITY, UNFAIRNESS

The most common approach for dealing with the risk of double taxation on cross-border investments in the EU are double tax treaties. Mutual, or double, tax treaties offer investors the ability to obtain substantial reductions in withholding taxes, but create highly complex arrangements and unfair advantages for some companies.

- **Tax treaties create compliance issues**, with companies required to withhold different amounts of taxes from different kinds of investors depending on the nature of their holding and their jurisdiction.
- **Tax treaties can also cause distortions**, as when companies are incentivised to issue debt in preference to equity because interest on debt is not subject to tax withholding under certain treaties.

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- According to research by Oxford Economics, German rules for applying withholding taxes highlight the **complexity and unfairness that can exist in tax treaty regimes**:
  - Under German rules, ordinary investors from France, Hungary, Italy, Poland and Switzerland can have their withholding taxes on portfolio dividends reduced from 25% to 15% -- but EU investors (individuals or companies) with substantial holdings (typically more than 10% of the stock) can **have those taxes eliminated entirely**.
  - Ordinary investors from the US and Japan get similar treatment, while investors from those countries with substantial holdings can **reduce their withholding tax only to 5%**.
  - **Swiss investors get the same withholding tax** for portfolio dividends.
  - Meanwhile, for all investors general interest is untaxed under the tax treaties.
- Center for European Studies (2010): **"Tax authorities are confronted by similarly intractable problems** in verifying the proper application of ALP [arms' length pricing]; conflicting claims on tax bases, **double taxation and tax loopholes are widespread.**"

TAX TREATIES ENCOURAGE 'TREATY SHOPPING'

Headline and effective rates of corporate tax in the EU vary considerably among Member States and, as noted above, tax treaty provisions offer different investors and investments varying tax benefits. As a result, companies have strong incentives to "treaty shop" by establishing tax residency in a jurisdiction that will provide the best benefits for the individual situation.

- Choice of jurisdiction is **primarily an issue for larger multinational entities**, which take into account tax treatment as well as investor protection, bankruptcy rules and etc.
- To take advantage of tax treaty provisions:
  - Owners of an IP business might **choose to become tax resident in a Luxembourg** to try to reduce a **headline tax rate of 21% down to 3.85%**.
  - Owners of a company with mostly passive income might **choose to become tax resident in Poland** to try to reduce a **headline tax rate of 19% down to 3.76%**.