



## Barbados Tax Alert

12 February 2020

# Economic Substance - Barbados' legislation is now in place

## Background

By now most businesses are well aware of the Organisation for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) Action Plan. Simply put, it is an initiative designed to prevent international companies from evading tax by shifting profits to no-tax or low-tax jurisdictions where they carry on no substantive economic activity.

Barbados has spent the better part of two years changing its tax legislation to comply with BEPS, literally dismantling a decades old tax structure that enabled international businesses to be taxed at far lower rates than local companies. Offshore and internationally licensed entities are now things of the past. As of 1 January 2019, all companies are now regular Barbados companies governed by one tax regime. At the same time another piece of legislation was introduced to ensure that Barbados clearly articulated the demands for "economic substance" stipulated by Action 5 of the BEPS initiative. That legislation, known officially as the Business Companies (Economic Substance) Act 2018- 41 was then repealed and replaced by the Companies (Economic Substance) Act 2019-43, which came into effect on 1 January 2020.

The new Act, commonly called the ESA, stipulates that any company "resident" in Barbados which derives income from "relevant activities", must demonstrate "economic substance" in Barbados. In essence, this means the company must conduct a substantive business - one that occupies and operates from permanent offices, hires the requisite number of managers and employees with the skills needed to run the business, and is managed from here.

Furthermore, companies must take a test to determine whether or not they meet the economic substance requirements on an annual basis.

In this bulletin, we have tried to anticipate and answer some of the questions you might have about the ESA and what it might mean for businesses. As usual, there is more to the Act than we can include in a bulletin. So we encourage you to contact us to answer questions and fill in the details.

## What is a resident company?

According to the Act a resident company is one that is incorporated in Barbados, or elsewhere, but is managed and controlled from Barbados. This includes a Society with Restricted Liability (SRL).

There are specific governance factors which help to determine whether the company would be deemed to be directed and managed in Barbados such as:

- ▶ The company's board of directors, as a whole, has the appropriate knowledge and expertise to discharge its duties;
- ▶ Board meetings are held in Barbados at "adequate" frequencies, given the level of decision-making required;
- ▶ A quorum of directors must be physically present at the meetings;
- ▶ Strategic decisions must be included in the minutes of meetings; and
- ▶ Those minutes, together with the records of the company, must be kept in Barbados.

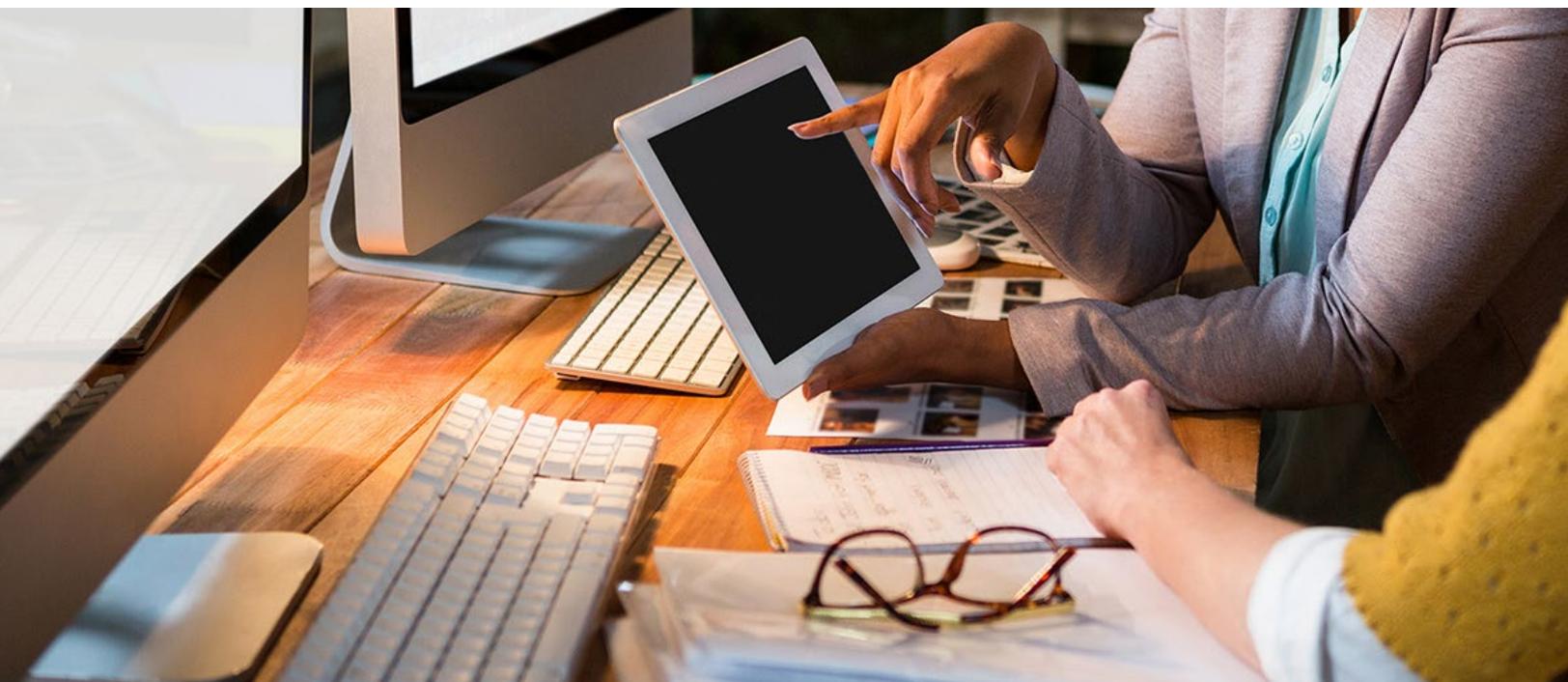
The ESA also considers resident companies to be entities incorporated in Barbados which are not tax resident in another jurisdiction as well as companies registered here as external companies which are not tax resident in the jurisdiction where they are incorporated.

## When is a company not considered to be resident in Barbados?

If the company is a tax resident in another country, and this includes a company incorporated in Barbados, the ESA doesn't consider it be resident here. In effect, a company that can prove that it is paying taxes as a resident of another jurisdiction based on income it derives from a "relevant activity" is not considered to be a resident of Barbados under the ESA.

Also excluded from the definition of "resident company" is any unincorporated body or association that does not have separate legal personality, including a general partnership and a limited partnership. A trust is also excluded from the definition.

In essence, none of the entities listed above are required to meet the economic substance test (ES Test) stipulated by the ESA.



## What is the ES Test?

The ESA has set specific requirements that a resident company must meet if it is to demonstrate economic substance. The resident company must satisfy the ES Test in relation to any income derived from any relevant activities it carries on, and make an annual declaration to the Director of International Business.

There is a reduced ES Test for companies that are beneficially owned by residents of Barbados, carry on relevant activities exclusively in Barbados, and derive income solely from those activities. Such companies won't be required to provide additional documents or information unless requested by the Director of International Business. Single purpose equity holding companies also have reduced requirements under the ESA.

What is considered to be a "relevant activity"?

The ESA considers the following activities to be "relevant":

- ▶ Banking business;
- ▶ Insurance business;
- ▶ Fund management business;
- ▶ Finance and leasing business;
- ▶ Headquarters business;
- ▶ Shipping business;
- ▶ Holding company business;
- ▶ Distribution and service centre business; and
- ▶ Intellectual Property business.

### ES Test Requirements

To pass the test a resident company must conduct its Core Income Generating Activities (CIGA) in Barbados. Furthermore, the company must be directed and managed in Barbados. In addition, taking into account the level of income derived from its relevant activities, the company must:

- ▶ Hire an adequate number of qualified full-time employees to match to the specific activity in Barbados;
- ▶ Make sure there is an adequate number of employees who are physically present in Barbados;
- ▶ Incur an adequate level of operating expenses in Barbados; and
- ▶ Maintain adequate physical assets in Barbados.

## What is the meaning of the term "adequate"?

The Economic Substance Guidelines, which act as a companion piece to the Act, stipulate that, in the case of each resident, the term "adequate" means "as much or as good as necessary for the relevant requirement or purpose".

In effect, the term is sufficiently flexible as to place a responsibility on a company's directors and management to honour the intent and meaning of "economic substance". Put more plainly, the element of good faith comes into play. However, companies will need to maintain appropriate records to demonstrate that their expenditures, premises of business and staff complement are indeed "adequate" to carry on business.

## What does the Act consider to be Core Income Generating Activities (CIGA)?

The Act contains lists of CIGAs attached specifically to each relevant activity. There are simply too many to address here. However, in general, a CIGA is an activity that is of central importance to a resident company's ability to generate income.

For example, in Banking CIGAs would include raising funds, managing risk, taking hedging positions, proving loans, credit and other financial services to customers.

In the case of a distribution business CIGAs would include transporting and storing goods, managing stocks, and taking orders.

In the case of headquarters business, CIGAs would include taking decisions on the holding and selling of investments, incurring expenditures on behalf of group entities, and coordinating group activities.

The guidelines issued by the Ministry of International Business make it clear that the list of CIGAs is not exhaustive. In other words, resident companies may expect the Ministry to pay close attention to which activities actually generate income.

## What happens if a company fails the ES Test?

If the Director of International Business determines that a company has failed the ES Test within the fiscal year, he/she shall notify the company to that effect within 21 days. Such notice will include the reason and the amount of the penalty. The Director will also notify the company as to what actions it should take to meet the requirements of ES Test.

The penalty for failing the test in any given year can be up to but not exceeding US\$150,000. The company has 12 months in which to rectify the breach. If it fails to do so, it will receive a second notification from the Director and face the possibility of another similar penalty. The penalty for withholding information or providing inaccurate information is US\$75,000.

If a company fails the test, the Director must also provide the Barbados Revenue Authority (BRA) with the information filed by that company. Based on existing exchange of information agreements or requirements, the BRA can then provide that information to the tax authorities in jurisdictions where the owner and ultimate beneficial owner of that company are located.

Where a company is classified as a high-risk intellectual property company, the Director must automatically make a determination that it fails the ES test and the onus would be on the company to rebut that presumption with sufficient information. However, the Director must automatically provide the BRA with all information filed by that company. That information can then be exchanged with the relevant jurisdictions of the shareholders as well.

Any company which fails the ES test for two consecutive years can be struck off the register of companies.

## Are there other penalties?

Yes, there are penalties that apply to individuals who fail to provide the Director of International Business with information requested, who provide inaccurate information. The penalty in both cases is US\$5,000. The penalties can be appealed, and in cases where the individual can provide an excuse for failure that satisfies the Director, the penalty will be waived.

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