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**Introduction of Economic
Substance Requirements**

5 March 2020

About the presenters

Chris Sulaiman, CPA, CA **Manager – Tax & Legal**

Chris is a Tax Manager in the Barbados office, currently on a secondment from Deloitte Canada. With 5+ years of practical full-time experience, Chris has had a helping hand in dealing with a variety of owner-managed and public companies, specifically dealing with various compliance engagements, estate planning and corporate re-organizations. His client base has included companies in industries varying from medical practitioners and local manufacturing companies to real estate conglomerates and multi-national distributors.



Chris has proven to provide clients with:

- Extensive experience in Canadian and Barbados tax legislation and tax accounting under ASPE and IFRS.
- Strong foundation of technical knowledge, specializing in domestic and international taxation, serving a wide range of large public and private enterprises.
- Proficient researching, interpretation and application of tax legislation in a wide range of scenarios and providing solutions to clients.

Catherine Drummond **Assistant Manager – Corporate Services**

Catherine is an Assistant Manager working in the Tax & Legal department with over 10 years of experience in the areas of corporate services, international tax advisory, corporate advisory and regulatory matters including anti-money laundering rules and compliance procedures.

Her professional experience also extends to the areas of corporate governance, global trade and customs advisory and indirect tax.

Catherine has assisted companies with corporate governance including ensuring clients meet their statutory and recently substance requirements in Barbados and Eastern Caribbean.



About the presenters

Kishmar Lorde **Associate – Tax & Legal**

Kishmar works in the Tax & Legal Department in the areas of tax advisory and compliance, which include business tax, cross border tax, mergers & acquisitions, VAT and withholding tax. He has been closely involved in the Department's technical research of developments related to economic substance since the introduction of substance legislation in Barbados in December of 2018.

Kishmar received his Bachelor's in Economics from the University of the West Indies. Prior to joining Deloitte, he has contributed to economic research publications in the area of fiscal policy. He continues to add to his knowledge through continuing his education. Currently, he is studying to become a Chartered Professional Accountant (CPA).



Agenda

- 01 Introduction of Economic Substance requirements in Barbados
- 02 Scope of Economic Substance Act
- 03 Compliance with Economic Substance Test
- 04 Penalty for non-compliance

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Background

Defining Economic Substance – Generally understood under international standards as relating to guidelines developed to prevent tax avoidance, under which a transaction is required to have a substantial purpose aside from taxation purposes to exhibit economic substance.

Context of Barbados substance guidelines – Barbados introduced economic substance standards in response to the work of the Organization for Economic Cooperation and Development (OECD) as part of the Base Erosion and Profit Shifting (BEPS) Action 5 and the European Union (EU) Criterion 2.2 initiatives.

Legal framework on Economic Substance - The Companies (Economic Substance) Act, 2019-43 (ESA) introducing economic substance requirements for Barbados companies was passed on 27 November 2019. The original legislation on economic substance was the Business Companies (Economic Substance) Act (Act 2018 -41) which was passed in December 2018, and is now repealed.



Scope of the ESA

Key terms in the application of the ESA

Tax resident outside of Barbados

- A company incorporated in Barbados is not regarded as a resident company if it is tax resident outside of Barbados.
- A company incorporated outside of Barbados, that is registered in Barbados as an external company is not regarded as a resident company if it is tax resident outside Barbados.

Defining a tax resident

Tax resident outside of Barbados: a company that is subject to tax on income from a relevant activity in another jurisdiction.

Proof of tax residence: A company claiming to be tax resident outside Barbados is required to produce evidence of tax residence and evidence that an appropriate tax return has been submitted to the relevant authority in the other jurisdiction.

What happens in the event that a resident company is liquidating or otherwise ceases to conduct business and carry on relevant activities?

Once a resident company continues to exist, it will continue to be subject to its obligations under the ESA. Reporting will be required with respect to any period during which the resident company earns income derived from carrying on relevant activities. An existing company in the process of liquidating is still required to file the ES declaration.



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Scope of the ESA

Key terms in the application of the ESA

Resident company

The following are included in the definition of “resident company”:

- A resident company means a company, whether incorporated in Barbados or elsewhere, which is managed and controlled in Barbados.
 - ❖ The definition also includes a society with restricted liability organised in Barbados or an association formed in Barbados, or an association formed in Barbados (other than an association of underwriters).
- A company incorporated outside of Barbados, that is registered in Barbados as an external company that is not regarded as a tax resident company in the jurisdiction of incorporation.
- A company incorporated in Barbados as an entity but which is not tax resident in any other jurisdiction.

Not considered a resident company

The following are excluded from the definition of “resident company”:

X any unincorporated body or association which does not have separate legal personality, including a general partnership, and a limited partnership;

X a trust

X a company (or entity) that is tax resident outside of Barbados; and

X a public Director.

The Director of International Business will require any company claiming to be tax resident outside Barbados to produce satisfactory evidence to support the same.

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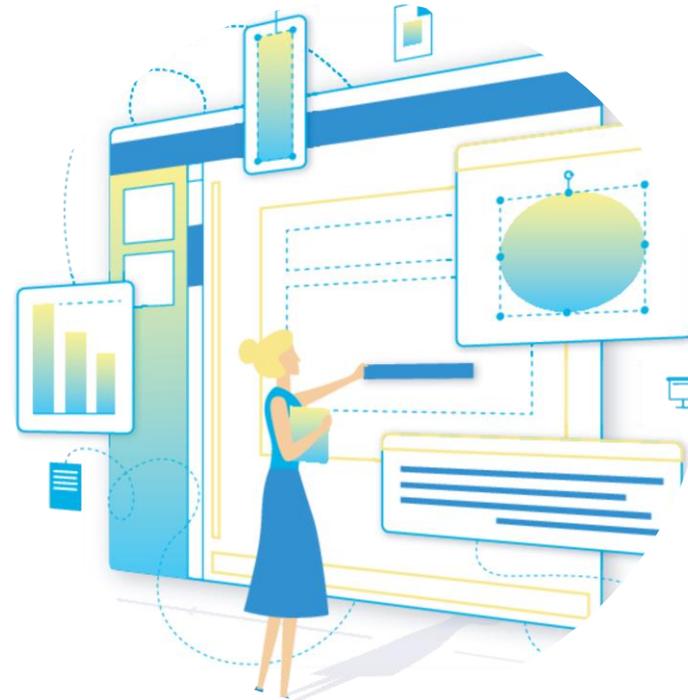
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Overview of ES test requirements

- i. Companies should be directed, managed and controlled in Barbados.
- ii. Core income-generating activities (CIGA) are undertaken in Barbados with respect to the 'relevant business activity'.
- iii. Adequate local employees (and may have outsourced human resources, as long as certain conditions are met. Having regard to the level of income derived from the relevant activity).
- iv. Incurs adequate operating expenditure and has adequate physical assets in Barbados (Having regard to the level of income derived from the relevant activity).



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Directed, managed and controlled in Barbados

- Individual directors have the appropriate knowledge and expertise to discharge their duties as a Board. *Instances where there are corporate directors, the requirements will apply to the individual officers (of the corporate directors) actually performing the duties.*
- Board of directors meet in Barbados at a 'satisfactory frequency' having regard to the level of decision-making required of the board.
- Quorum of directors must be physically present at the board meeting in Barbados.
- Minutes of the board meetings record the execution of strategic decisions of the company.
- Minutes of the Board Meeting and appropriate records are maintained in Barbados



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Relevant business activities & Core Income Generating Activities (CIGA)

The substance test is applicable to resident companies engaged in “relevant business activities”. Core-income generating activities should be carried on with respect to the relevant activity.

Relevant activities include:



Any other activities as the Minister of International Business may prescribe by order to be relevant activities.

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Relevant business activities & Core Income Generating Activities (CIGA)

| Relevant activities | Core income-generating activities |
|---------------------|--|
| Banking | <ol style="list-style-type: none">i. Raising funds, and managing risk, including credit risk, currency risk and interest riskii. Taking hedging positionsiii. Providing loans, credit or other financial services to customersiv. Managing capital and preparing reports and returns to the Central Bank of Barbadosv. any other similar financial services activity carried on by a regulated financial institution |
| Insurance | <ol style="list-style-type: none">i. Predicting and calculating riskii. Insuring or re-insuring against riskiii. providing insurance business services to client |
| Fund management | <ol style="list-style-type: none">i. Taking decisions on the holding and selling of investmentsii. Calculating risk and reservesiii. Taking decisions on currency or interest fluctuations and hedging positionsiv. Preparing reports and returns for submission to investors and to the Financial Services Commission |

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Relevant business activities & Core Income Generating Activities (CIGA)

| Relevant activities | Core income-generating activities |
|---------------------------------|---|
| Headquarters | <ul style="list-style-type: none">i. Taking relevant management decisionsii. Incurring expenditures on behalf of group entitiesiii. Co-ordinating group activities |
| Shipping | <ul style="list-style-type: none">i. Managing crew (including hiring, paying and overseeing crew members);ii. Overhauling and maintaining shipsiii. Overseeing and tracking deliveriesiv. Determining what goods to order and when to deliver them;v. organizing and overseeing voyages |
| Holding company | <ul style="list-style-type: none">i. All activities related to that business |
| Distribution and service centre | <ul style="list-style-type: none">i. Transporting and storing goods, components and materials;ii. Managing stocks;iii. Taking orders;iv. Providing consulting or other administrative services. |

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Relevant business activities & Core Income Generating Activities (CIGA)

| Relevant activities | Core income-generating activities |
|---|---|
| Finance and leasing | <ul style="list-style-type: none"> i. Agreeing funding terms; ii. Identifying and acquiring assets to be leased (in the case of leasing); iii. Setting the terms and duration of any financing or leasing; iv. Monitoring and revising any agreements; Managing any risks. |
| Intellectual property (not high-risk) | <p>Relevant activities for intellectual property business conducted by a company that is not a high-risk include:</p> <ul style="list-style-type: none"> i. exploiting patent assets and assets that share similar features of a patent, research and development ii. exploiting assets which are marketing intangibles such as trademarks, marketing, branding and distribution |
| Intellectual property holding (high-risk) | <ul style="list-style-type: none"> i. Taking strategic decisions, managing and bearing the principal risks relating to acquisition by third parties and subsequent exploitation of the intangible asset generating income ii. Taking the strategic decisions, managing and bearing the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the intangible assets iii. Carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of revenue from third parties iv. Research and development, branding or distribution |

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Core Income Generating Activities (CIGA)

CIGA must be undertaken in Barbados by the resident company: these include the activities listed in the previous slides that generate income of the resident company.

'Outsourcing' CIGA as an option: a resident company is permitted to outsource its CIGA to another entity. However, certain conditions hold:

- a) the resident company must be able to monitor and control the carrying out of the CIGA by that other person.
- b) only the part of the relevant activity of that other person which generates income for the resident company is taken into account in considering whether the resident company satisfies the ES Test.
- c) outsourcing the CIGA includes outsourcing, contracting or delegating to third parties or to entities in the same group.



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Adequate physical presence

Physical Assets Test - Adequate physical assets include but are not limited to maintaining an appropriate place of business or plant, property and equipment.

Employee Test - There must be adequate qualified employees proportionate to the level of activity carried on in Barbados. Currently, the substance guidelines does not prescribe a minimum/maximum number of full-time employees for any relevant activity.

- **'Adequate' qualifications** - depends on the relevant activity that the entity is engaged in as well as the CIGA and the duties performed by those employees. Qualifications could include academic qualifications, vocational qualifications, relevant industry technical qualifications and also qualification by relevant experience.
- **Outsourcing** - If the company outsources or contracts its activity, then the resources of the service provider in the Barbados used in the provision of the outsourced CIGA are expected to be taken into consideration.
- **Directors** can account for a fraction of a full time employee based on the time commitment of the role in relation to the relevant activity.



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Adequate physical presence

Employee Test

Does an adequate level of employees need to be kept constant over any period?

'Adequate' level of employees/personnel need not be constant during a period or periods, but should not fluctuate artificially.

What forms of evidence should be kept to support the employee test?

Timesheets or other evidence of relevance can be used when assessing whether a resident company has an adequate number of full-time employees or employees with appropriate qualifications or experience in Barbados. Payroll records as well as records confirming that the employees have adequate qualifications such as academic and vocational qualifications should suffice. Relevant industry technical qualifications would also support the employee test.

How is the employee test met when CIGA are outsourced?

The service provider would be required to have accurate reports of employee numbers attributable to a particular resident company, rather than counting all employees of the service provider.



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Sector-specific guidance

Single purpose equity holding company

- a resident company that only holds equity in other entities and only earns dividends and capital gains.
- It will be subject to the substance requirements if it is the beneficial owner of the shares.
- There is a reduced ES Test for single purpose equity holding companies. The reduced test is satisfied where the company submits confirmation that it:
 - complies with all applicable filing requirements under the Companies Act, Cap. 308, Societies with Restricted Liabilities Act, Cap. 318B, and the Income Tax Act, Cap. 73;
 - has adequate human resources and adequate physical assets in Barbados for holding and managing equity participations in other entities; and

Placing dividends received on deposit or using them to acquire and passively hold other securities such as government bonds does not constitute a "relevant activity".



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Sector-specific guidance

Holding companies carrying on other relevant activities

- A resident holding company must meet the substance requirements applicable for any other relevant activity.
- If the resident company provides senior management, takes responsibility, control or provides substantive advice in respect of material risks to companies it controls, then it will not be a single purpose equity holding company. The resident company could be considered to carry on the activity of providing headquarters services.

IP Holding Company

- In the case of a high risk IP company, the Director must determine that the economic substance test was not met during a fiscal period unless the high risk intellectual property company provides sufficient information to satisfy the Director that the test was met.

Sufficient information is information which:

- Demonstrates that the high risk IP company exercises a high degree of control over the development, exploitation, maintenance, enhancement and protection of the IP asset.
- This control must have historically been, and is, exercised by suitably qualified employees who are physically present in Barbados.



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Sector-specific guidance

Headquartering

Companies which provide headquarters services to other non-residents of the same group. Headquarters services include:

- the provision of senior management;
- taking control of material risk for activities carried out by, or assets owned by, any of those persons; or
- the provision of substantive advice in relation to such risks

Banking, insurance, fund management and other relevant activities are excluded from being within the scope of Headquarters to prevent duplicate reporting.



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Distribution and service centre

- Companies which purchase raw materials and finished products from other non-resident to the same connected persons and re-sell them for a profit.
- Companies which provide services, consulting or other administrative services, to other non-resident of the same group or connected person.
- The scope does not extend to cases where a company purchases raw materials and finished products from, or provides services to third parties.

Banking, insurance, fund management and other relevant activities are excluded from being within the scope of service centres to prevent duplicate reporting.

Future guidance is expected to address the following sector-specific activities:

1. Insurance Business
2. Fund Management Business
3. Shipping Business
4. Banking Business



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Reporting requirements

Filing of Economic Substance Declaration

A resident company is required to file an Economic Substance Declaration (“declaration”) annually within twelve months after the last day of the end of each fiscal period.

The declaration indicates that the resident company should be:

- Carrying on a relevant activity;
- Deriving income from that relevant activity;
- Where subject to tax in a jurisdiction outside of Barbados, provide appropriate evidence to support the liability to tax;
- Where compliant with economic substance requirements in a jurisdiction outside of Barbados, provide appropriate evidence to support that economic substance as may be required by the Director;
- Whether beneficially owned or controlled by residents of Barbados;
- Whether it carries on a relevant activity exclusively in Barbados and derives income solely from such relevant activities; and
- The date of the end of its fiscal period.

A resident company must provide the following information:

- Business/income type identifying the type of relevant activity;
- Amount and type of income by relevant activity;
- Amount of operating expenditure by relevant activity;
- Details of business address;
- Number of qualified full time employees;
- Confirmation of the CIGA conducted for each relevant activity; and
- Confirmation of whether any CIGA have been outsourced.

The Director may give notice stipulating additional documents and information required to determine whether the resident company has passed or failed the ES Test.

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- The penalty for failing to meet the economic substance test is USD150,000. However, if a resident company fails to meet the economic substance test on account for failure to meet the adequate number of employees who are physically present in Barbados, depending on the breach, the Director may issue a notice and permit the resident company to rectify the breach within 12 months of the date of the issue of the notice.
- Should the resident company fail to rectify the breach within 12 months, the Director will issue a second notice. The CES Act makes provisions for the resident company to improve its economic substance requirements, under certain circumstances, prior to the imputation of any financial penalties.
- If a resident company fails to meet the economic substance tests after two consecutive years, the Director will notify the Registrar of Corporate Affairs to have the company struck off the register of companies.
- The penalty payment for failing to provide information or if the information provided is deemed inaccurate is USD5,000.



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Timelines for Operational Compliance

For non-grandfathered entities:

- A resident company must comply with the ESA from the date on which the resident company commences the relevant activity, unless the resident company was in existence prior to 1 January 2019 in which case it must comply with the ESA by 1 January 2020.

For grandfathered entities:

- A grandfathered resident company shall not be required to comply with the ESA until 1 January 2021, even where the provisions of the ESA contain requirements or criteria that are described as necessitating "historical compliance". A grandfathered resident company must demonstrate that it is in compliance and complies with the provisions of the ESA from 2 January 2021 onwards.



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How can we assist?

It is our view that potentially affected entities should take the necessary steps to ensure compliance with the economic substance requirements. To assist you in this capacity, we can provide the following services:

1. Classify structures on an entity-by-entity basis to flag those that undertake a 'relevant activity'.
2. Conduct a gap analysis to consider the current and future compliance for those entities that undertake 'relevant activities'.
3. Consider the means by which compliance with the economic substance tests will be documented and evidenced.
4. Consider any operational or structural changes that may be required to meet the substance requirements outlined including recruitment of new staff and assessing qualifications of existing staff.



For more information or if you have any questions, please contact a member of Deloitte Barbados' leadership team:



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