



CHANCERY
CORPORATE SERVICES



Chancery Corporate Services Limited ("CCSL")

Client Update December, 2019 - Economic Substance Update

Overview:

Since our previous update in May, Barbados has continued to work with the OECD to complete all required changes with respect to the BEPS initiative and in response to its' Action 5 thereof. Barbados has concluded its negotiations, amended or repealed certain preferential regimes and has now updated its Economic Substance legislation and issued Guidelines in support.

Kindly therefore note that the Business Companies (Economic Substance) Act, 2018-41 has been repealed. In its place the **Companies (Economic Substance) Act, 2019-43 has been passed effective November 29, 2019** and the **Barbados Economic Substance Guidelines have been issued on December 4, 2019.**

CCSL is committed to ensuring that our clients are updated on the changes, and the impact on how one does business through any relevant corporate entity. Within this document are the main highlights of the changes ushered in by these pieces of legislation. The following information represents the information available to us as at December 12, 2019. **Details may be subject to change should any additional guidance be issued following the date of this update.**

Additionally please note for your general information that we have also included a copy of the Act and the Guidelines.

Companies (Economic Substance) Act, 2019-43 **(the "ESA")**

Section 5.(1) - "A **resident company** which **derives income** from the carrying on of a **relevant activity** must satisfy the **economic substance test** in relation to that relevant activity."

This summary statement in essence sets out the requirements of the ESA and identifies to whom the act will apply to and who it will not apply to. By breaking down the key terms it becomes easy to track the applicability of the ESA to any particular entity.

1. TO WHICH ENTITIES DOES IT APPLY?

A resident company:

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

Which derives income:

- Income means **gross income** as recorded in an entity's books and records under the relevant accounting standards.

From the carrying on of a relevant activity:

The relevant activities noted in the ESA are as follows:

- (a) banking business;
- (b) insurance business;
- (c) fund management business;
- (d) finance and leasing business;
- (e) headquarters business;
- (f) shipping business;
- (g) holding company business;
- (h) intellectual property business; and
- (i) distribution and service centre business.

2. TO WHICH ENTITIES DOES IT NOT APPLY?

The ESA will not apply:

- if an entity is not directed, managed and controlled from Barbados and is not tax resident in Barbados;
- if an entity does not carry on any relevant activity;
- if an entity is tax resident outside of Barbados;
- to an external company or branch of a resident company that carries on a relevant activity in a jurisdiction with economic substance legislation;
- if an entity derives no income from its relevant activity*;
- to a trust;
- to any unincorporated body/association that does not have separate legal personality (including general and limited partnerships); or
- to a public director (a person who exercises the duties of custodian, receiver, judicial manager, public trustee or otherwise in respect of the administration of the affairs of a resident company under the authority of law).

*(This is meant to cover incorporated but dormant entities or entities in liquidation which are no longer earning income. The general expectation is that carrying on a relevant activity will generate income and any attempt to manipulate or artificially suppress income to avoid the requirements of the ESA will be addressed by the Director of International Business.)

3. WHAT IS THE TEST?

If the ESA applies to the entity then it must satisfy the Economic Substance Test ("ES Test") in relation to the activity that it carries on.

The ES Test is met where:

1. the **Core Income Generating Activities ("CIGA")** of the relevant activity (as identified in section 4 of the ESA) are **conducted in Barbados**;

Broken down

The CIGA is deemed to be conducted in Barbados where having regard to the level of income derived from the relevant activity carried on

- there is an adequate number of qualified full-time employees in relation to that activity in Barbados;
- there is an adequate number of employees who are physically present in Barbados in relation to that activity;
- there is adequate operating expenditure incurred in Barbados; and
- there are adequate physical assets in Barbados.

Additionally it is noted that the CIGA may be conducted by any other person in Barbados if the resident company is able to monitor and control the carrying out of the CIGA by that other person.

2. the **company is directed, managed and controlled in Barbados** in relation to the activity.

Broken down

An entity is directed managed and controlled where:

- the board of directors of the company hold meetings in Barbados at an adequate frequency having regard to the amount of decision-making required at that level and there is a quorum of directors physically present;
- the minutes of the board meetings referred to above record the making of strategic decisions of the company at the meeting;
- the directors of the company have the necessary knowledge and expertise to discharge the duties of the board; and
- the minutes of all board meetings and the records of the company are kept in Barbados.

4. TIMING AND OTHER MATTERS

When is the ESA Generally applicable?

Entities formed in 2019 to which the ESA applies, must be in compliance with the ESA from the date on which it commenced the relevant activity. Entities formed prior to January 1, 2019 to which the ESA applies, must comply with the ESA by January 1, 2020.

Does this Apply to Grandfathered Entities?

Grandfathered resident companies to which the ESA applies, must comply with the ESA from January 2, 2021.

How is this Monitored and Administered?

The ESA is administered by the Director of International Business (the "Director"). The Director may determine that a resident company has not met the economic substance test during any fiscal period from which the resident company commences the relevant activity. This determination must be made no later than 4 years after the date of filing the relevant economic substance declaration.

What information must be provided?

A resident company shall file an economic substance declaration annually in the prescribed form within 12 months after the last day of the end of each fiscal period commencing on the dates prescribed in the Regulations. The Director may request the filing of additional documents and will give notice of the same. The information required to be provided with the declaration includes:

- business/income types 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 and if so relevant details.

Any Penalties for not meeting the test?

1. Where the Director determines that a resident company has not met the ES Test for a fiscal period, the Director must provide the Barbados Competent Authority, currently the Barbados Revenue Authority ("BRA"), with the declaration and information filed by the company. Additionally, in accordance with any law or international agreement relating to exchange of information, when BRA receives the information from the Director it must exchange relevant information for each fiscal period of the resident company commencing on or after January 1, 2019 to the foreign competent authority of the country in which,
 - (i) a holding company;
 - (ii) the ultimate holding company of the resident company; and
 - (iii) an ultimate beneficial owner,of the resident company is resident.
2. Additionally the Director may impose a penalty which shall not exceed BBD\$300,000 payable within 30 days of the date of notice of the imposition of the penalty.
3. Where there has been a failure to satisfy the ES Test for two (2) consecutive years, the Director must notify the Registrar of Companies and the Registrar may issue an order that the company be struck off the Register of Companies.
4. It should be noted that in circumstances where the failure to meet the economic substance test was due to failure to have an adequate number of employees who are physically present in Barbados; then depending on the nature of the breach, the Director may issue a notice and allow the entity to rectify the breach.

Entities will have a right of appeal against the penalty or against the amount of the penalty as the case may be.

5. SPECIFIC HIGHLIGHTS AND CLARIFICATIONS

Lastly we thought it best to highlight a few matters made clear from the ESA and Guidelines that are of note.

Any reduced requirements and exceptions?

1. Single purpose equity holding companies will be subject to a reduced ES Test. (These are resident companies that only hold equity participations in other entities and only earns dividends and capital gains.)
2. A resident company which is beneficially owned or controlled by residents of Barbados, that is not part of an MN group (as defined within the ESA) and which carries on a relevant activity exclusively in Barbados and derives income solely from such relevant activity, is subject to a reduced ES Test.

Adequate employees, expenditure and physical Assets...but what is "adequate"?

Adequate means “as much or as good as necessary for the relevant requirement or purpose”. Therefore what is adequate for each resident company will be dependent on the particular facts and circumstances of the resident company and its business activity.

Are any employees satisfactory?

No. Employees have to be suitably qualified for the activity that is being done by the resident company. Qualifications that are considered to be adequate will depend on the relevant sector in which the company conducts its activity, the CIGA and the duties performed by those employees. Qualifications taken into account could include academic qualifications, vocational qualifications, relevant industry technical qualifications and also qualification by relevant experience.

Are directors counted as employees?

Yes, directors may be counted but only as a fraction of a full time employee commensurate with the time commitment of the role, and to the extent that they are performing the relevant CIGA for the business. Additionally it is acknowledged that directors can perform both fiduciary functions and those of the employees of the resident company which can reduce or eliminate the need for full time employees or the need for outsourcing. **However kindly note that this will be based on the facts and circumstances of each company.**

What about outsourcing of the CIGA or other activities?

There are no restrictions on outsourcing of activities that **are not** CIGA.

However with respect to the CIGA, a resident company may have another person conduct these activities provided such other person is in Barbados and the resident company can monitor and control the carrying out of the CIGA. Outsourcing can be done with 3rd parties or entities in the same group and the employees and physical assets of such persons will be taken into consideration when determining if the ES Test for the resident company is being met.

It must also be stressed and highlighted that in all cases, **outsourced or not, the CIGA must be conducted in Barbados** and those **activities listed in the definition of the CIGA** (section 4 of the ESA) **are not exhaustive**. It is a question of fact in each case as to which activities are actually undertaken to generate income.

Is there sector specific guidance?

Yes for all of the relevant activities with the exception of shipping business, banking business, fund management business and insurance business which will be provided in the future versions of the Guidelines.

Key points with respect to High Risk Intellectual Property ("IP") Business

Please note that there is a heavy burden on high risk IP companies (as defined in the ESA) such that the Director **must determine that the ES Test was not met** during a fiscal period unless the high risk IP company provides sufficient information to satisfy the Director that the test was met.

Additionally whether or not the Director determines that the ES Test was or was not met, he must provide the BRA with the information in the same manner explained previously as though he had made the determination that the ES Test was not met.

Conclusion: Does your entity satisfy the ES Test? Do you need to satisfy the ES Test?

Any determination as to whether your entity satisfies the economic substance requirements should be reviewed in detail with your tax and legal advisors. Chancery Chambers LLP remains available to assist in this regard.

Other Queries

Should you have any questions or concerns about the changes and how they may impact on you and your company or society, please do not hesitate to reach out to us.

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Our Team

The Board of Directors and management team of CCSL is comprised of attorneys and professionals who have been providing a high caliber of focused guidance, services and counsel to both international and domestic clients for decades. The Company is managed by a Chief Executive Officer with years of experience in the financial services sector of Barbados and a background in Corporate Law, International Tax Law, Company Management and Compliance. Client portfolios are managed by a group of highly motivated and experienced corporate administrators who blend knowledge with dedication to the details of clients' business affairs. The group is made up of STEP professionals, Lawyers, Corporate Secretaries and general administrators with years of service in the field. This offers a wide variety of expertise and knowledge for our clients.

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