EXTRAORDINARY

OFFICIAL GAZETTE
THE BAHAMAS

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1. OVERVIEW

The Commercial Entities (Substance Requirements) Act, 2018 (No. 32 of 2018) (the "Act") was enacted to ensure that a commercial entity - that could be used to artificially attract profits that are not commensurate with its economic activities - has a substantial economic presence in The Bahamas, where the entity claims it is resident in The Bahamas for tax purposes (see Guideline 4: Tax Residence). This concept of economic substance for commercial entities which underpins the Act is based on the global standard on fair taxation promulgated by the Organization of Economic Cooperation Development ("OECD") Forum on Harmful Tax Practices ("FHTP") and the European Union ("EU") which has been adopted by many jurisdictions around the world.

2. THE COMPETENT AUTHORITY

The competent authority for the purposes of the Act is the Minister of Finance (the "Authority"). The Authority's functions under the Act include administering the Act, determining whether an included entity satisfies the Act in respect of its relevant activities, monitoring compliance with the Act and sharing information with other competent authorities and jurisdictions.

3. LEGAL ENTITIES IN SCOPE

The Act applies to commercial entities which are incorporated, registered or continued under:-

(a) Companies Act (Ch. 308), including foreign entities registered under Part VI thereof;

(b) International Business Companies Act (Ch. 309);

(c) Partnership Act (Ch. 310);

(d) Partnership Limited Liability Act (Ch. 311); or

(e) Exempted Limited Partnership Act (Ch. 312),

which conduct relevant activities and are tax resident in The Bahamas (see Guideline 4: Tax Residence).

If a commercial entity is part of a group and any direct or indirect subsidiary of that group conducts a relevant activity, each included entity must comply with applicable substance requirements to be in compliance with the Act. The group may not aggregate their substance requirements for the purposes of complying with the Act.

Under the Act, a commercial entity conducting relevant activities ("included entity") must:

i. conduct Core Income Generating Activity (CIGA);

ii. have adequate people, premises and expenditure; and

iii. be directed and controlled,

in The Bahamas in order to demonstrate that it has adequate substance in The Bahamas.

Non-included entities

The substance requirements of the Act do not apply to any entity that conducts relevant activities in The Bahamas, which is 100% directly or indirectly beneficially owned by one or more natural persons treated as resident in The Bahamas for Exchange Control purposes, and conducts its core income generating activities within The Bahamas.

The substance requirements of the Act do not apply to any entity that is centrally managed and controlled outside of The Bahamas and is tax resident in a jurisdiction other than The Bahamas; however, such an entity must demonstrate to the Authority that it is tax resident in the jurisdiction that it asserts (see Guideline 4: Tax Residence).

4. TAX RESIDENCE

The substance requirements of the Act shall only apply to included entities that are tax resident in The Bahamas pursuant to Bahamian common law as developed by the courts of the Bahamas and other common law jurisdictions, including England & Wales, which are persuasive authority in The Bahamas. The primary test of tax residency at common law is that an entity resides where its real business is carried on, and the real business is carried on where the central management and control actually abides.[1]

Where an entity claims to be tax resident in a jurisdiction outside The Bahamas, the Authority will have regard to where such entity is centrally managed and controlled. The entity will have to certify in writing to the Authority its tax residency in the foreign jurisdiction and substantiate its claim with satisfactory evidence. This tax residency test may be satisfied by the entity providing the following documents to the Authority:

i. tax identification number issued by a foreign jurisdiction;
ii. tax residence certificate issued by a foreign jurisdiction;
iii. official receipt or statement issued by a foreign tax authority;
iv. certification by the entity that the majority of meetings of the Board of Directors, or controlling persons of a non-corporate entity, in any financial year, took place in the foreign jurisdiction;
v. the ordinary residence of the majority of the Board of Directors, or controlling persons of a non-corporate entity.

This certification of foreign tax residence must be filed by the entity as part of its annual filing requirement under section 10 of the Act.

[1] De Beers Consolidated Mines, Limited v. Howe (Surveyor of Taxes) [1906] A.C. 455.

An entity claiming foreign tax residency must declare in its annual filing under section 10 of the Act details of its jurisdiction of tax residence, and the jurisdiction of its legal or beneficial owner.

The Authority will exchange all information received from an entity claiming foreign tax residence with the relevant jurisdiction(s) to enable cross-checking by the relevant jurisdiction(s).

In the absence of such evidence the entity will be regarded as an included entity that is subject to the substance requirements of the Act.

5. RELEVANT ACTIVITIES

Relevant activities are defined in section 4 of the Act as follows:

1. Banking business;
2. Insurance business;
3. Fund management business;
4. Financing and leasing business;
5. Headquartering business;
6. Distribution and service centres business;
7. Shipping business;
8. Commercial use of intellectual property; or
9. Holding company engaged or where one or more of its subsidiaries is engaged in one of the activities listed above.

6. GENERAL SUBSTANCE REQUIREMENTS

An included entity carrying on any of the aforementioned relevant activities, except a holding company (see guideline 8. Holding Company Reduced Substance Requirements), must be able to demonstrate the following:

i. An adequate level of qualified full-time employees in The Bahamas, or adequate level of expenditure on outsourcing to service providers in The Bahamas proportionate to the activities of the included entity;

ii. An adequate level of annual expenditure incurred in The Bahamas, or adequate level of expenditure on outsourcing to service providers in The Bahamas, proportionate to the activities of the included entity;

iii. Adequate physical offices and/or premises in The Bahamas, or adequate level of expenditure on outsourcing to service providers in The Bahamas, proportionate to the activities of the included entity;

iv. Adequate levels of board direction and control.

7. CORE INCOME GENERATING ACTIVITIES ("CIGA")

Pursuant to section 5 of the Act, any included entity engaged in any of the above referenced relevant activities must have core income generating activities ("CIGA") in The Bahamas, which may include, but is not limited to, the following:

(a) Banking business - the core income generating activities may include raising funds; managing risk including credit, currency and interest risk; taking hedging positions; providing loans, credit or other financial services to customers; managing regulatory capital; and preparing regulatory reports and returns.

(b) Insurance business - the core income generating activities may include predicting and calculating risk, insuring or re-insuring against risk, and providing client services.

(c) Fund Management business - the core income generating activities may include taking decisions on the holding and selling of investments; calculating risks and reserves; taking decisions on currency or interest fluctuations and hedging positions; and preparing relevant regulatory or other reports for government authorities and investors;

(d) Financing & leasing business - the core income generating activities may include agreeing funding terms; identifying and acquiring assets to be leased (in the case of leasing); setting the terms and duration of any financing or leasing; monitoring and revising any agreements; and managing any risks;

(e) Headquarters business - the core income generating activities may include taking relevant management decisions; incurring expenditures on behalf of group entities; and coordinating group activities;

(f) Distribution and service centres business - the core income generating activities may include activities such as transporting and storing goods; managing stocks and taking orders; and providing consulting or other administrative services;

(g) Shipping regime - the core income generating activities may include managing the crew (including hiring, paying, and overseeing crewmembers); hauling and maintaining ships; overseeing and tracking deliveries; determining what goods to order and when to deliver them; and organizing and overseeing voyages; and

(h) Commercial use of Intellectual Property- for patents and similar intellectual property assets the core income generating activities include research and development; and for intangible intellectual property assets such as brand, trademark and customer data the core income generating activities include marketing, branding and distribution.

For each relevant activity, section 5 of the Act provides an illustrative list of the core income generating activities that an included entity undertaking such relevant activity may carry on. The Act does not prescribe the type of activity that constitutes CIGA, rather it identifies certain activities that may qualify as CIGA. There are undoubtedly other forms of CIGA that have not been captured in the wording of section 5. It is not necessary for the included entity to perform every CIGA listed under section 5. However, the assessment of whether the entity meets the

substance requirement in The Bahamas will include a careful analysis of which CIGA elements the included entity is conducting in The Bahamas.

It is the primary responsibility of the included entity to demonstrate that it conducts CIGA in The Bahamas proportionate to its business activities.

An entity may undertake or outsource all or part of an activity in The Bahamas provided that the included entity is able to monitor and control the carrying out of CIGA by that outsourcing service provider. If that activity is not part of the CIGA this will not affect the included entity's ability to meet the substance requirements. In addition, the substance requirement does not preclude entities seeking expert professional advice or engaging the services of specialists in other jurisdictions as is common world-wide and based on commercial necessity.

8. REDUCED SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES

Section 8 of the Act provides that an included entity which only engages in business as a pure equity holding company is subject to reduced substance requirements, as follows:

(a) it shall comply with all applicable laws and regulations of The Bahamas;

(b) it shall have adequate human resources and adequate premises in The Bahamas for holding and managing equity participation in other entities.

A non-included entity that is a passive holding entity is subject to the reduced substance requirements of complying with all applicable laws and regulations of The Bahamas.

Further, the laws of The Bahamas require that companies incorporated, registered or continued in The Bahamas must maintain books and records, which must be available in The Bahamas, and must maintain a registered office in The Bahamas.

Where a holding company engages in any relevant activity, that holding company will be required to satisfy substance requirements in accordance with this Act.

The Minister will use the power vested in him under section 12 of the Act to spontaneously exchange information to the relevant jurisdiction of the claimed tax residency of the entity or of the legal or beneficial owner of such entity (which includes a pure equity holding company) in the event of non-compliance with the specified reduced substance requirements applicable thereto.

9. HIGH-RISK AND LOW-RISK INTELLECTUAL PROPERTY ("IP")

An included entity engaged in an intellectual property business will have to determine if it is a high-risk intellectual property business or low risk intellectual property business. A business is categorized as high-risk intellectual property business when the:

i. IP asset is acquired from a related party; **or**
ii. IP asset is obtained through the funding of overseas research and development activities (e.g. under a cost-sharing agreement); **or**
iii. IP asset is licensed to a related party; **or**
iv. IP asset is monetized through activities performed by foreign related parties.

In this scenario, there is a rebuttable presumption that a high-risk IP included entity has failed the substance requirement, as the risks of artificial profit shifting are considered to be greater. To rebut the presumption, the high-risk IP included entity will have to produce materials which explain how the included entity's income being generated in these higher risk situations is directly linked and substantiated by activities undertaken in The Bahamas. The included entity has to evidence that "in addition or alternatively to research and development, branding and distribution activities, a high degree of control over the DEMPE ("Development, Enhancement, Maintenance, Protection and Exploitation") have been under its control and that this historically has been,

exercised by full time highly skilled employees that permanently reside and perform their core activities" within The Bahamas.

The high evidential threshold requires:

i. detailed business plans which clearly lay out the commercial rationale for holding the Intellectual Property asset(s) in The Bahamas;
ii. evidence that the decision making related to the DEMPE is taking place in The Bahamas;
iii. information on employees in The Bahamas, their experience and their qualifications.

An included entity is a low risk intellectual business if the intellectual property asset is:

i. developed in-house;
ii. acquired from an unrelated party;
iii. licensed to unrelated parties.

In this scenario research and development activities are expected to take place in The Bahamas. For non-trade assets (brand, trademarks, customer data) the core income generating activity should include marketing, branding and distribution activities. If these activities are not taking place in The Bahamas, there is a presumption of non-compliance. The included entity, however, can still prove that other core income generating activities are taking place within The Bahamas by:

1. taking the strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the intangible asset; or

2. taking the strategic decisions and managing (as well as bearing) the principal risks relating to the third-party acquisition and subsequent exploitation of the intangible asset; or

3. carrying on the underlying trading activities through which the intangible assets are exploited, and which lead to the generation of revenue from third-parties.

In any case, all these activities would require the necessary staff, premises and equipment. They would require more than local staff passively holding intangible assets whose creation and exploitation is a function of decisions made and activities performed outside of The Bahamas.

The Minister will use the power vested in him under section 12 of the Act to spontaneously exchange information to the relevant jurisdiction of the legal or beneficial owner of an included entity categorized as high risk intellectual property business.

10. DIRECTION AND CONTROL OF INCLUDED ENTITIES

The direction and control requirement of the Act applicable to included entities is designed to ensure that an adequate number of meetings of the Board of Directors are conducted in The Bahamas having regard to the level of decision making required to be made.

What constitutes an adequate number of meetings in The Bahamas will be dependent on the relevant activities of the company. Being directed and controlled in The Bahamas means ensuring that the minutes and records are kept in The Bahamas and that the Board of Directors is a decision-taking body with the necessary knowledge and experience.

11. MEANING OF ADEQUATE

The Act refers to the term "adequate". However, as this term is not defined in the Act, the word "adequate" therefore carries its ordinary meaning.

For the purposes of the Act, the ordinary meaning of "adequate" is: "as much or as good as necessary and sufficient for a specific need or requirement".

What is adequate for each company will be dependent on the particular facts of the company and its business activity. An included entity will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy of staffing, resources utilized in respect of

CIGA and expenditure incurred in The Bahamas, having regard to the size, nature and complexity of the relevant activity.

12. OUTSOURCING

Under the Act, an included entity demonstrates that it has adequate economic substance if its CIGA in relation to the relevant activity that it engages in are conducted by any other person in The Bahamas provided that the included entity is able to monitor and control the undertaking of that CIGA by that other person. Only that part of the relevant activity of that other person which is attributable to generating income for the included entity shall be taken into account in considering whether the included entity has demonstrated adequate economic substance.

Where an included entity outsources CIGA to any other person, there must be no double counting of the resources of the service provider if outsourcing services are provided to more than one included entity. Additionally, the resources of the service provider in The Bahamas will be taken into consideration when determining whether the people and premises test is met as well as precise details of the resources employed by service providers, for example based on the use of worksheets or other details of the scope of the engagement as the Authority may request.

An included entity must not use outsourcing to circumvent the substance requirements of the Act. The included entity remains responsible for ensuring accurate information is reported to the Authority as required and this should include precise details of the resources employed by its service providers.

The substance requirements of the Act do not preclude entities from seeking expert professional advice or engaging the services of specialists in other jurisdictions provided that any activities

performed by such advisors or specialists in other jurisdictions is not CIGA and that the income allocated to those services is commensurate with the CIGA undertaken in The Bahamas.

The Act does not prevent an included entity from outsourcing any activities that are not CIGA to any other person.

An included entity which is regulated in The Bahamas must also have regard to the outsourcing guidelines issued by the relevant regulator.

Whether an included entity has adequate economic substance in The Bahamas under the Act is always based on facts and circumstances applicable to the included entity. It is the responsibility of the included entity to demonstrate that it has adequate substance and conduct its business accordingly even when outsourcing.

13. SPONTANEOUS EXCHANGE OF RELEVANT INFORMATION

The Competent Authority will spontaneously exchange relevant information with the relevant jurisdiction of the legal or beneficial owner of the included entity if the included entity:

i. engages in high-risk IP activities; or

ii. has failed to satisfy substance requirements of the Act; or

iii. has declared that it is tax resident in another jurisdiction.

14. RETENTION OF INFORMATION

An included entity is required to retain the books, documents electronically stored information or other record that relates to the information reported and required to be reported to the Authority for a period of five (5) years.

15. METHOD OF REPORTING FOR COMPLIANCE PURPOSES

An entity is required to file the requisite Form(s) to the Department of Inland Revenue.

An outsourcing service provider shall report on its compliance with the Act to the Department of Inland Revenue.

An included entity shall report on its compliance with the Act to the Department of Inland Revenue within nine months of its fiscal year end.

A non-included entity shall report on its status to the Department of Inland Revenue within nine months of its fiscal year end.

16. SANCTIONS AND INTERNATIONAL REPORTING

The Act includes robust and dissuasive sanctions for failure to meet the substance requirements, with the ultimate sanction leading to the striking off of the included entity from the Companies Register.

Where the Authority deems an included entity to have failed to meet the substance requirements, the Authority has the power to request onsite inspections and an audit at the expense of the company.

In the event the audit reveals deficiencies, the entity shall be issued a notice of noncompliance from the Authority stating the areas where remedial measures are required and a deadline for compliance.

Where the entity fails to comply, the Authority has the power to impose an administrative penalty of $150,000, pursuant to Section 16(4), with a possible further administrative penalty of $300,000, or striking-off the Register pursuant to Section 16(6)(a) of the Act.

If the Authority concludes that the entity is in willful noncompliance with the notice, the Authority shall direct the Registrar General to strike the included entity off the Companies Register, pursuant to Section 23(2) of the Act.

Further, where an included entity fails to satisfy the substance requirements rules, the Authority has the power to forward to the relevant reportable jurisdiction the findings of any inspection or audit conducted or commissioned in respect of any report in accordance with the schedules set out in the Act.

17. TRANSITION PERIOD

Only included entities incorporated prior to 31st December 2018 have six (6) months from the 1st January, 2019 to meet or comply with the substance requirements of the Act.

18. COMPLIANCE WITH THE GUIDELINES

Section 26 of the Act requires that any person or entity subject to the Act must comply with the Guidelines issued by the Authority.

Dated the 22nd day of February, 2019.

Signed
KEVIN PETER TURNQUEST
Minister of Finance