

New Economic Substance Legislation in the Bahamas

June 2019

The Commercial Entities (Substance Requirements) Act, 2018 (“CESRA” or the “Act”), has entered into force in the Bahamas with effect from 1 January 2019. CESRA requires commercial entities engaged in certain relevant activities to have economic substance in the Bahamas. This legislation is similar to other substance laws being introduced in numerous other jurisdictions worldwide, in response to the European Union and OECD initiatives to prevent harmful tax practices and profit shifting.

CESRA seeks to ensure that commercial entities resident in the Bahamas for tax purposes have adequate substance in the jurisdiction. This memo sets out some of the key points of the legislation.

Who Does the Act Affect?

CESRA is applicable to “commercial entities”, which are companies and partnerships incorporated, registered or continued under the:

- Companies Act
- International Business Companies Act
- Partnership Act
- Partnership Limited Liability Act
- Exempted Limited Partnership Act

The substance requirements will depend on whether a commercial entity is an “included entity” or “non-included entity”.

Included Entities

An included entity is defined as a commercial entity that is engaged in one or more “relevant activities”.

Relevant Activities

The substance requirements are imposed on those commercial entities which are engaged in any of the following relevant activities, namely:

- banking business
- insurance business
- fund management business
- financing and leasing business
- headquarters business
- distribution and service centers business
- shipping business
- commercial use of intellectual property
- as a holding company engaged in one of the activities listed in the above bullet points (or if a subsidiary of the holding company is engaged in one of the activities)

An included entity carrying on a relevant activity must demonstrate economic substance in the Bahamas by satisfying a two-pronged test:

- Its core income generating activities (“CIGA”) must take place in the Bahamas. This means that the included entity will need to have, within the Bahamas, adequate:

- amounts of annual operating expenditure;
- levels of qualified full-time employees;
- physical offices; and
- levels of board management and control.

The CIGA may be outsourced to a service provider in the Bahamas if the included entity is able to demonstrate supervision and control of the outsourcing service provider in respect of the outsourced CIGA.

- The direction and management of the included entity must be within the Bahamas. To satisfy this requirement, the entity must ensure that:
- an adequate number of meetings of the Board of Directors is conducted in the Bahamas, given the level of decision making required;
 - a quorum of the Board of Directors is physically present in the Bahamas during meetings;
 - strategic decisions made at the meetings of the Board of Directors are recorded in minutes;
 - records and meeting minutes are kept in the Bahamas; and
 - the Board of Directors has the necessary knowledge and expertise to discharge its duties.

Reduced Substance Requirements

A pure equity holding company is a company which only holds equity participations (e.g., shares in another legal entity) and only earns dividends and capital gains or incidental income. Pure equity holding companies have reduced substance requirements in that they are only required to:

- comply with all applicable laws and regulations of the Bahamas; and
- have adequate human resources and adequate premises in the Bahamas for holding and managing equity participation in other entities.

A passive holding entity (e.g., an entity that holds only a bank account) is an entity which does not by itself, or by any of its subsidiaries, conduct any

relevant activity. Collective investment vehicles are not classified as passive holding entities. As with a pure equity holding company, a passive holding entity is also subject to reduced substance requirements in that it is only required to comply with all applicable laws and regulations of the Bahamas.

Non-Included Entities

A non-included entity is any entity which is not an included entity and which is incorporated, registered or continued under the:

- Companies Act and includes a foreign entity registered under Part IV thereof
- International Business Companies Act
- Partnership Act
- Partnership Limited Liability Act
- Exempted Limited Partnership Act

A non-included entity does not engage in a relevant activity (e.g., a passive holding company that directly holds only real estate) and will not be required to comply with economic substance requirements, but it will be required to register as a non-included entity and to submit annual reports.

Enhanced Substance Requirements for Intellectual Property

Included entities carrying on intellectual property activities are subject to enhanced substance requirements. These entities have to satisfy the two-pronged test and also have to demonstrate that additional activities as specified under the CESRA are undertaken in the Bahamas.

Reporting Requirements

Both included entities and non-included entities are required to report to the Minister of Finance within nine months of the entity’s fiscal year end by completion of the following prescribed forms (as relevant):

- Form A - to be completed by the outsourcing service provider
- Form B - to be completed by the included entity
- Form C - to be completed by the pure equity holding company
- Form D - to be completed by the non-included entity

Exchange of Relevant Information

CESRA gives the Minister of Finance the power to exchange relevant information with the competent authority of a reportable jurisdiction of a legal or beneficial owner of an included entity if the included entity:

- is engaged in high-risk intellectual property activities; or
- has failed to satisfy the CESRA substance requirements; or
- has declared that it is tax resident in another jurisdiction.

Failure to Meet Substance Requirements

The Act provides for administrative penalties up to \$150,000 to be applied where an included entity has been found to be non-compliant with the applicable substance requirements.

Summary conviction of an offence under CESRA carries penalties of up to \$10,000 and/or six (6) months' imprisonment.

In addition, if an entity fails to comply with the Act, the Minister of Finance may request onsite inspection and an audit at the expense of the company. Failure to comply with the substance requirements could also lead to the entity being struck off the Companies Register in the Bahamas.

Transition

The economic substance requirements are applicable from 1 January 2019 for all new entities incorporated on or after that date. For existing entities incorporated prior to 31 December 2018, the substance requirements will be applicable six (6) months from 1 January 2019.

All entities described within the Act are impacted and, as such, will have to be assessed in respect of their particular reporting and substance requirements.

All entities should start to evaluate whether or not they are tax resident in the Bahamas (or elsewhere) and whether they are engaged in any relevant activity to determine what measures, if any, they might need to take in order to achieve compliance. Legal advice should be sought, if required, on interpreting and

ensuring compliance with the Act. We can refer and/or liaise with legal counsel to assist clients as necessary.

For further information or assistance in relation to the substance requirements, please contact your usual corporate services administrator in our Bahamas office. We will continue to keep clients updated with further information on complying with the requirements as it emerges.

This update is intended for informational purposes only and does not constitute legal or tax advice.

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