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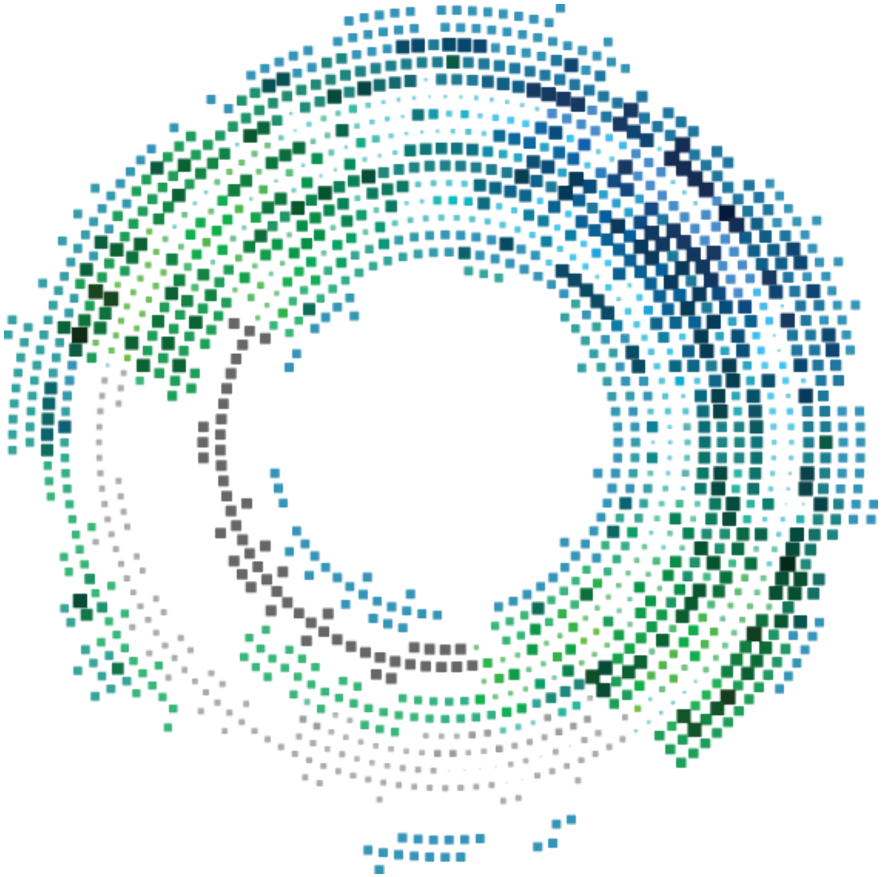

Tax Strategy for The Bahamas as an IFC

2 March 2018

Agenda

Tax Strategy for The Bahamas

Current global environment

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Summary

Amid growing international focus on tax transparency, The Bahamas risks falling behind other IFCs

Since the turn of the new millennium, there has **been increased scrutiny of national tax policies**:

- OECD standards for transparency.
- Base Erosion and Profit Shifting (BEPS) initiative.
- National government and IMF initiatives.

The Bahamas has recently prioritised alignment with international standards: it is rated as **"largely compliant"** by the OECD and it has **joined the BEPS initiative;** however, it has a **limited network of DTTs** and information-sharing agreements.

Globally, there has been convergence towards lower rates of corporate tax and networks of DTTs

A review of the tax strategies of other leading international financial centres indicates the following trends:

- Relatively **low corporate tax rates**.
- **Tax incentives or exemptions** to encourage economic activity in certain sectors.
- Use of **DTT networks** to allow multinationals to benefit from tax relief and mitigate impacts on competitiveness.

Despite the absence of corporate tax, the effective tax rate is relatively high at 33.8% due to other taxes and charges. However, this has not been seen to deliver corresponding benefits.

Further consideration should be given to the design of a potential corporate tax and the benefits and costs

The IMF has recently advised the introduction of a low rate of corporate income tax, which could have the following benefits:

- **Revenue raising potential**, supporting the domestic economy and helping achieve the government's deficit targets.
- Ability to **tax foreign owners** of firms operating in The Bahamas.
- The opportunity to **align with other jurisdictions and with international best practice.**

Consideration should also be given to the potential costs associated with such as tax, such as the risk of deterring inward investment.

The increased prevalence of policies to provide relief for tax paid overseas, while taxing profits registered in untaxed locations, partially reduces this risk. The experience of other financial centres suggests that judicious **use of DTTs and targeted incentives** can mitigate these concerns.

This study

This report considers options for fiscal reform in The Bahamas based on the experience of other international financial centres

- In the context of slowing GDP growth and increased pressure on government finances in The Bahamas – along with greater international scrutiny – this study considers options for reforming fiscal strategy while maintaining international competitiveness.
- While the effective tax rate on companies is 33.8%, this has not delivered corresponding benefits or exempted The Bahamas from international criticism of its policy. There is therefore a case for change.
- Our work included analysis of the international environment and the policies of competitor financial centres in order to develop initial recommendations.
- In conducting this analysis and developing policy options, we have engaged with local groups and representatives to understand their concerns and priorities. These include:
  - The Bahamas Financial Services Board
  - The Bahamas Chamber of Commerce and Employer Confederation
  - Bahamas Institute of Chartered Accountants
  - Association of International Banks and Trust Companies
  - And representatives from leading financial institutions, asset management companies, legal firms and professional services firms.

Current global environment

Since the turn of the new millennium, the OECD has increased its efforts to influence national tax policies, with recent support from the IMF

OECD standards for tax transparency

- Monitored by the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes.
- Established the Common Reporting Standards (CRS) to allow automatic information exchange between jurisdictions.

✓ Taking steps to implement CRS

Bahamas is rated "largely compliant" by the OECD.

Base Erosion and Profit Shifting (BEPS)

- Tax avoidance by exploitation of gaps in tax rules to shift profits to low corporate tax regimes, away from where real economic activity is taking place.
- OECD BEPS package introduces minimum standards to improve coherence of rules and transparency.

✓ Bahamas has recently signed up to BEPS, joining other IFCs such as Singapore, Hong Kong and Bermuda.

National government initiatives

Increased efforts by jurisdictions to reduce harmful tax practices, for example:

- EU screening process for tax purposes.
- United States Foreign Account Tax Compliance Act (FATCA).

✓ Bahamas has implemented FATCA and is awaiting re-evaluation by the EU.

IMF initiatives

- The IMF has recently strengthened its remit in tax related matters as part of its mandate to promote macroeconomic stability.

The recent IMF Article IV Consultation urged strong compliance with AML/CFT and tax transparency standards to stem the withdrawal of CBR.

Lessons from tax strategies of other IFCs

The experiences of other IFCs provide insights into how The Bahamas may align with international standards while maintaining competitiveness

Corporate taxes are relatively low

- Range between 10% to 35% for jurisdictions with corporate tax
- Effective rates can be lower after concessions or exemptions for certain activities are accounted for
- BVI, The Cayman Islands and Bermuda do not apply a corporate tax.

DTT networks vary among IFCs

Generally IFCs are seen to have:

- Long-term extensive DTT networks
- Short-term expedited DTT networks
- Limited DTT networks

Recently, **higher standards** are being sought **internationally** following increasing **pressure from supranational bodies** such as the OECD to levy minimum levels of certain taxes and meet common standards.

The Bahamas' strategy is similar to regional competitors

BVI, Bermuda and the Cayman Islands also have no corporate tax, withholding tax or stamp duty

Tax incentives can encourage investment

Exemptions or reduced corporate tax rates are sometimes applied to certain activities to maintain competitiveness

Tax rates aren't the only factor

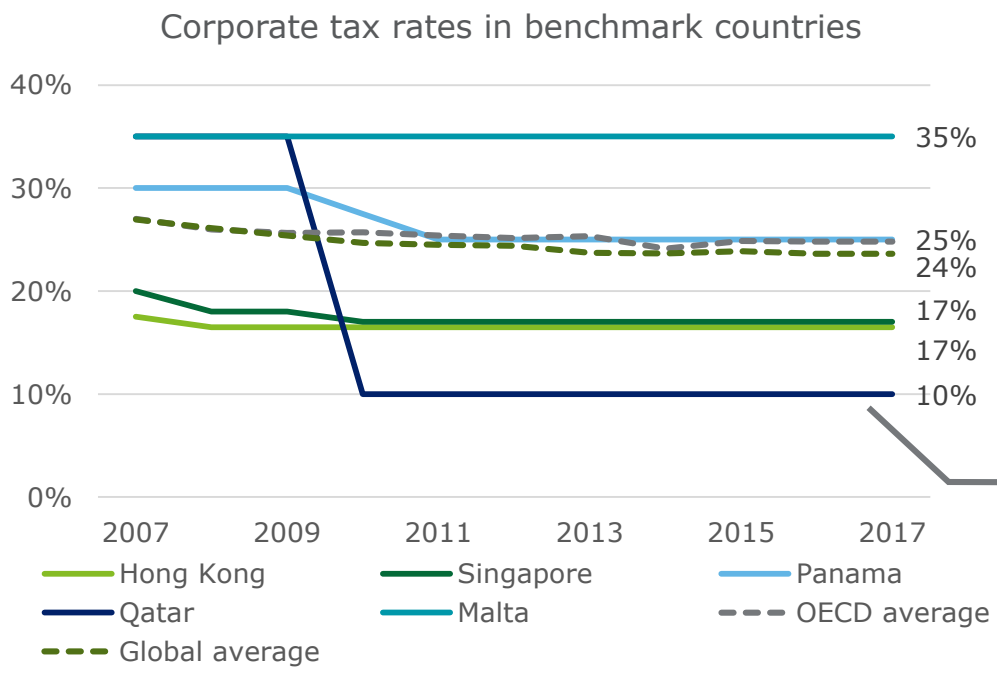
Competitors are improving the ease of doing business through streamlined and transparent tax, legal and regulatory environments.

Qatar Financial Centre, Singapore Financial Centre, Hong Kong, Dubai International Financial Centre, Panama, Malta, British Virgin Islands, Bermuda, Cayman Islands were included in this analysis.

Corporate tax strategies of other IFCs

Worldwide, there has been a trend towards lower rates of corporate tax, alongside measures to increase international tax transparency

- There has been a downtrend in corporate tax rates for those countries that levy a corporate tax.
- Countries have introduced policy measures that broaden the tax base in order to reduce the negative impact that a lower corporate tax rate could have on government revenues.
- Singapore, Malta and Qatar have all prioritised expanding their network of DTTs; more recently, Hong Kong has pursued a similar policy. This enables companies to obtain domestic relief on taxes in these markets.
- Policies such as Controlled Foreign Company regimes have been introduced to tax profits in zero-tax jurisdictions at domestic rates, limiting erosion of the tax base.



Country	CT rate	Revenue as share of GDP
Hong Kong (2015-16)	16.5%	5.6%
Singapore (2015-16)	17%	3.4%
Qatar (2013-14)	10%	1.7%
Panama (2015)	25%	3.7%
Malta (2015)	35%	6.3%

Reduction in CT from 35% to 10% by Qatar to reduce barriers to FDI and diversity economy

Tax models of IFCs (1/3)

What does the tax structure look like in other IFCs?

		Bahamas	Qatar	Singapore	Hong Kong
Corporate tax		0%	10% on local source taxable profits of firms registered in QFC.	17% on local source profits with exemptions at certain levels of income.	16.5% local source profits (15% for unincorporated businesses).
Other taxes on income		N/A	N/A	N/A	N/A
VAT		7.5%	0%	7% (GST[1])	0%
Withholding taxes (dividends, interest, royalties)	Resident	0%, 0%, 0%	0%, 0%, 0%	0%, 0%, 0%	0%, 0%, 0%
	Non-resident	0%, 0%, 0%	0%, 7% (0% QFC), 5% (0% QFC)	0%, 15%, 10%	0%, 0%, 4.95%
Capital gains tax		0%	Participation exemption on qualifying shares	N/A	0%
Stamp duty		Imposed at various rates, with exemptions available.	N/A	0.2% for shares transferred; 3%-18% for buyers/ sellers of immovable property.	Charged on transfer of HK stock at 0.2% per transaction; various rates for property; exemptions available.
DTT network		0	74	85	30
TIEA network		33	81 (inc. 74 DTTs)	86 (inc. 85 DTTs)	36 (inc. 30 DTTs)
Bilateral relationships under the Common Reporting Standard		0	0	0	2
Financial service specific factors		Financial services exempt from VAT, other than those provided for a specific fee.	Offers internationally competitive environment for captive insurers, reinsurance companies, collective investment funds and local or regional holding companies.	Range of incentives, including: FS exempt from GST; Insurance Business Development scheme applies concessionary tax rate of 10% to some insurance activities; incentives for licensed banks or fund managers under Financial Sector Incentive Scheme; specified income of non-residents arising from Singaporean fund not taxed.	Exemptions available for certain offshore funds; 50% exemption on profit tax for certain reinsurance businesses and authorised captive insurers for offshore operations; 50% concession for qualifying debt instruments.

[1] VAT and GST are both indirect consumption taxes levied on the value of a product.

Tax models of IFCs (2/3)

What does the tax structure look like in other IFCs?

		Bahamas	Dubai	Panama	Malta
Corporate tax		0%	0%, with 50 year guarantee of zero taxes from the year of inception of the firm in the DIFC.	25% on local source profits; alternative minimum tax 1.17% of gross taxable income.	35% (companies are subject to income tax).
Other taxes on income		N/A	N/A	Dividends (5%-20%); 2% retained earnings tax if company in free-trade zone.	Capital gains and dividends received are classified as income, and hence subject to company income tax.
VAT		7.5%	0%	7%	18%
Withholding taxes (dividends, interest, royalties)	Resident	0%, 0%, 0%	N/A	5%-20%, 0%, 0%	0%, 0% or 35%, 0%
	Non-resident	0%, 0%, 0%	N/A	5%-20%, 12.5%, 12.5%	0%, 0%, 0%
Capital gains tax		0%	Capital gains of a DIFC company are not taxable.	10%	Gains on transfer of capital assets are classified as income so that the total of capital gains and income is charged to income tax.
Stamp duty		Imposed at various rates, with exemptions available.	N/A	US $0.10 per US $100 on certain commercial contracts.	2% or 5% on transfers of immovable property, marketable securities and/or interest in a partnership. Certain exemptions apply.
DTT network		0	89	17	76
TIEA network		33	95 (inc. DTTs)	28 (inc. DTTs)	80 (inc. DTTs)
Bilateral relationships under the Common Reporting Standard		0	0	0	49
Financial service specific factors		Financial services exempt from VAT, other than those provided for a specific fee.	Corporate tax of 20% on foreign banks. Registration and annual licencing fees for setting up in DIFC. Tax holidays of 15-50 days offered in several of the free zones within the UAE.	Annual banking institution tax levied based on asset value.	Financial services and insurance exempt from VAT. Special rules apply to determination of income for insurance companies. Full imputation system and participation exemption schemes exist, enhancing position as holding company location and a gateway to EU markets.

Tax models of IFCs (3/3)

What does the tax structure look like in other IFCs?

		Bahamas	British Virgin Islands	Bermuda	Cayman Islands
Corporate tax		0%	0%	0%	0%
Other taxes on income		N/A	Interest, dividend and royalty income not taxable.	7% tax on revenues earned on corporate services. Employer payroll tax.	Interest, dividend and royalty income on foreign and local investments not taxable.
VAT		7.5%	0%	0%	0%
Withholding taxes (dividends, interest, royalties)	Resident	0%, 0%, 0%	N/A	N/A	N/A
	Non-resident	0%, 0%, 0%	N/A	N/A	N/A
Capital gains tax		0%	N/A	N/A	N/A
Stamp duty		Imposed at various rates, with exemptions available.	4-12% on transfer of real estate and shares in a BVI company owning real estate in the BVI. 0.2-5% on other instruments and transfers.	Levied on transfer of Real Estate.	7.5% or 9% on land/property transfer.
DTT network		0	2	3	1
TIEA network		33	30 (inc. 2 DTTs)	44 (inc. 3 DTTs)	36 (inc. 1 DTT)
Bilateral relationships under the Common Reporting Standard		0	41	40	40
Financial service specific factors		Financial services exempt from VAT, other than those provided for a specific fee.	Licence fees chargeable for banking, insurance and trust company licences.	Registration and annual fees chargeable on insurance, funds and bond/securities issuing activities.	Annual fees chargeable based on share capital for banks, insurers, trusts and funds.

Impacts of a corporate tax

The benefits in terms of revenues and alignment with international standards should be considered against potential risks

Revenue potential

- The IMF has recommended the introduction of a low rate of tax to support the administration's target of reducing the deficit to 1.1% of GDP over the next two years.
- Enable expenditure and investment in key areas such as infrastructure and social spending.

Ability to tax foreign owners

- Enable taxation of local subsidiaries of foreign corporations, largely owned by non-residents.
- Tax paid could be subject to relief in the foreign corporation's resident country, mitigating impacts on The Bahamas' competitiveness.

Align The Bahamas with competitive IFCs

- There is a trend for countries to introduce policy measures that broaden the tax base.
- Most typical approach to corporate tax is to tax resident companies on worldwide profits and non-resident companies on local source profits.

Potential impacts on FDI

- There are concerns that the introduction of a corporate tax could deter inward investment
- However, OECD initiatives mean that multinational corporations now expect to pay at least some level of corporate tax, and that other non-tax factors are more important

Structure of tax could mitigate the risks

- Mitigation of risks and costs will depend on the design of the corporate tax and DTT network.
- Downsides could be reduced if the tax is part of a wider strategy to increase the ease of doing business through more effective and streamlined taxation, as an alternative to other fees

[1] Qatar Financial Centre, Singapore Financial Centre, Hong Kong, Dubai International Financial Centre, Panama, Malta, British Virgin Islands, Bermuda, Cayman Islands were included in this analysis.

Tax strategy of The Bahamas

There are a number of supporting policies that could be considered alongside a potential corporate tax

- The Bahamas should consider the specific design of the tax and complementary policies. These may include unilateral tax relief, expansion of the DTT network, rationalization of other revenue sources and the use of concessions or exemptions as incentives.
- These elements can limit the potential impact of the tax on the domestic economy and reduce the risk of deterring inward investment.

Unilateral tax relief

Tax relief offered to resident firms who have been taxed in both their own jurisdiction and abroad

Establishing a DTT network

Where two countries have a DTT agreement, companies operating across borders can avoid double taxation, hence reducing tax burden of companies operating in The Bahamas

Concessions or exemptions as incentives

Activities that make a large economic contribution could benefit from lower effective tax rates as part of the tax strategy

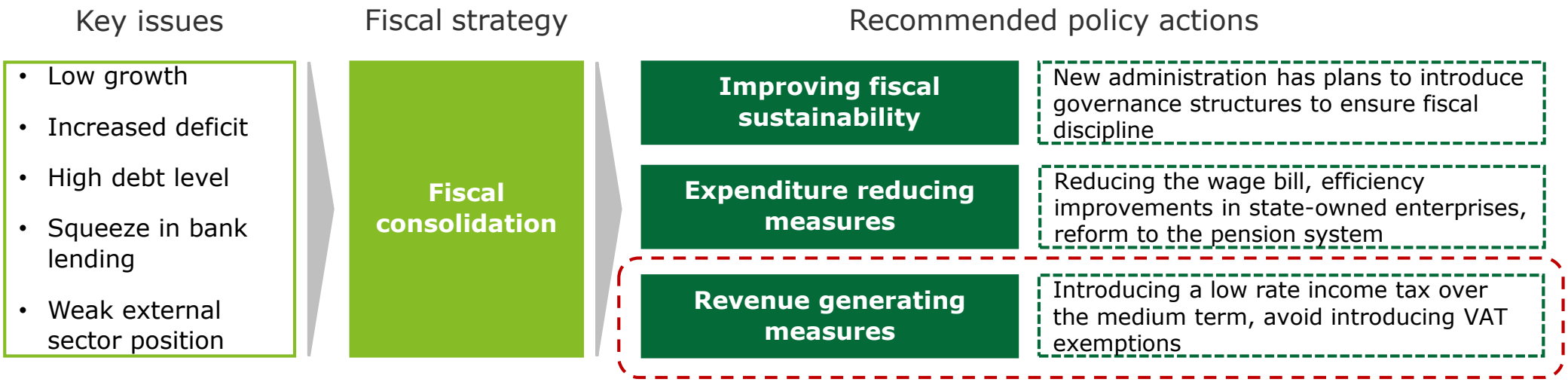
Rationalization of the tax system

Creates scope to streamline other fees, charges and taxes to create a more efficient tax system that minimizes the overall burden on business.

Next steps

In the wake of IMF recommendations for a low rate income tax to be introduced in The Bahamas, there are key issues to consider

In the current context, IMF recommendations were focused on **"policies to restore fiscal and external buffers, raise growth and strengthen financial stability."**



Key issues to consider:

- What are the potential revenues that could be generated?
- What are the design features that should be considered?
- What is the cost of implementing such a system?
- What is the impact of corporate tax on inward investment and trade?
- How will the corporate tax affect key sectors?
- What will be the cost of a corporate tax to businesses in The Bahamas?

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