FAOS COMMERCIAL ENTITIES (SUBSTANCE REQUIREMENTS) ACT, 2018 ("CESRA").

1. HOW DO I KNOW IF MY COMPANY FALLS WITHIN THE SCOPE OF CESRA?

The first step to is ascertain if the company is a commercial entity. Under CESRA s.2, a commercial entity is any company that is incorporated, registered or continued under the Companies Act, the IBC Act and the Exempted Limited Partnership Act. The next step is to ascertain if the company is an included entity. An "included entity", that is a commercial entity engaged in a relevant activity, must have substance in the Bahamas. There are reduced substance requirements for non-included entities. Non included entities will be required to register as such.

Relevant activities are as follows:

- a) Banking business
- b) Insurance business
- c) Fund management business
- d) Finance and leasing business
- e) Headquarters business
- f) Distribution and service centre business
- g) Shipping business
- h) Commercial use of intellectual property or
- As a holding company engaged, or where one or more of its subsidiaries is engaged in one of the activities listed under paragraphs (a) to (h).

2. MY COMPANY IS INCORPORATED IN THE BAHAMAS BUT DOES ALL OF ITS WORK OUTSIDE OF THE BAHAMAS. DO I NOW NEED TO OPEN AN OFFICE AND HIRE STAFF IN THE BAHAMAS?

If your company is an included entity engaged in relevant activity, it must have "Adequate" levels of qualified full time employees in The Bahamas. (CESRA s.5).

3. WILL MY COMPANY HAVE TO MEET ALL OF THE REQUIREMENTS PROVIDED IN CESRA (AS PER S. 5 AND S. 7) CUMULATIVELY TO DEMONSTRATE SUBSTANCE?

Yes, an included entity must have substantial economic presence (CESRA s.3). It must carry on core income generating activities

in The Bahamas (CESRA s.5) and the entity must be directed and managed within The Bahamas (CESRA s.7).

4. ARE PURE EQUITY HOLDING COMPANIES REQUIRED TO SATISFY THE SUBSTANCE REQUIREMENTS?

Pure equity holding companies have reduced substance requirements. They must satisfy the requirements as set out in CESRA s.8 .

5. COMPANY X HAS SEVERAL SUBSIDIARIES OPERATING IN THE BAHAMAS. DOES EACH ENTITY NEED TO DEMONSTRATE SUBSTANCE OF ITS OWN, OR IS IT LOOKED AT IN AGGREGATE?

One must look at the activity that the subsidiary is engaged in. If it is a relevant activity, does the subsidiary fall within the definition of an included entity? If the answer is yes, then the subsidiary will have to demonstrate substance. The test will apply to each subsidiary. Associated companies or entities which are part of the same parent cannot count the substance of the parent as demonstrative of substance at the subsidiary.

6. WHAT IS THE TIMELINE FOR COMPLIANCE? WHEN MUST AN ENTITY DEMONSTRATE SUBSTANCE?

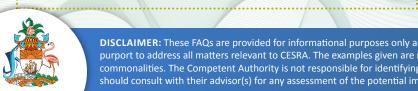
CESRA s.10 sets the timeline for entities to submit the appropriate form at "within nine months of its fiscal year end...".

7. WHAT ARE THE PENALTIES FOR NONCOMPLIANCE?

The entity can face administrative penalties (CESRA s.16 and s.18) of up to \$150,000 in first instance, and/or \$1,000 per day thereafter, or striking-off. Unless the entity can prove it has paid taxes in some other jurisdiction (CESRA s.15).

8. WHAT TYPE/LEVEL OF EMPLOYEES (I.E., DIRECTORS OR MANAGEMENT) ARE REQUIRED TO DEMONSTRATE SUBSTANCE?

The term used in the legislation is "adequate". Adequacy is not a quantitative measure but rather a qualitative measure. It is about having the competence to do the job, to make decisions, to manage the business etc., having regard to the size, nature and complexity of the business.



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9. DO EMPLOYEES NEED TO BE RESIDENT IN THE BAHAMAS OR ONLY HAVE TO BE IN THE BAHAMAS FOR A CERTAIN PERIOD OF TIME PER YEAR, FOR EXAMPLE DURING BOARD MEETINGS OR PERIODS OF PRINCIPAL ACTIVITY?

Employees must be resident in The Bahamas. There is no residency requirement for board members, who need only be in The Bahamas whenever a board meeting is required.

10. TO DEMONSTRATE SUBSTANCE, WHICH EMPLOYEES SHOULD BE ATTENDING THE BOARD MEETINGS IN THE BAHAMAS?

CESRA is not prescriptive in stipulating which employees should attend board meetings, this will be at the determination of the company.

11. DOES CESRA ONLY CAPTURE THOSE COMPANIES THAT ARE CARRYING ON "RELEVANT ACTIVITY" THAT IS CORE INCOME GENERATING? IF MY IBC IS IN THE BUSINESS OF PROVIDING BEAUTY SUPPLY AND SPA PRODUCTS AND/OR SERVICES, WILL MY COMPANY ALSO BE REQUIRED TO MEET SUBSTANCE REQUIREMENTS?

The sale and supply of goods as a "retail" operation is captured as a relevant activity under CESRA. The legislation does, however, speak to operating "distribution (and service) centres business" which may capture the activity set out in the given set of facts. Distribution centre entities purchase raw materials and finished products from other group members and re-sell them for a small percentage of profits. Retail or wholesale trading activities are not listed as relevant activities.

12. IF A SUBSIDIARY OF A PASSIVE HOLDING ENTITY MAKES INTEREST BEARING LOANS TO RELATED ENTITIES, IS THAT MAKING OF LOANS TREATED AS CARRYING ON A CORE INCOME GENERATING ACTIVITY?

The provision of loans is an example of a banking "core income generating activity". That said, if the subsidiary of the passive holding company is providing loans for commercial gain, it will be required to demonstrate substance as it would be deemed an included entity performing a relevant activity (i.e. banking business).

13. IF A PASSIVE HOLDING ENTITY DOES NOT HAVE A PHYSICAL ADDRESS, WOULD IT BE ABLE TO USE THE ADDRESS OF ITS DIRECTOR, SHAREHOLDER OR CORPORATE SECRETARY?

Holding companies are subject to reduced substance requirements pursuant to CESRA s.8. A passive holding company, that is not an included entity, is not required to have physical premises .

14. HOW ARE TRUST COMPANIES AFFECTED BY SUBSTANCE REQUIREMENTS?

Trust companies which are regulated entities must already meet minimum physical presence requirements and would also meet the requirement for management and control set out in CESRA s.7. The extent to which passive or pure equity entities are used for holding Trust assets would detemine whether they would have to meet the requirements set out in s.8.

15. IS THERE A MINIMUM NUMBER OF CRITERIA THAT MUST BE MET TO DEMONSTRATE SUBSTANCE?

Included entities meet the substance requirements when the criteria in CESRA s.7 are met. The test is Adequacy. Please see the answer to question 3, above.

16. ARE NON-INCLUDED ENTITIES REQUIRED TO SUBMIT ANY INFORMATION?

Yes. At present Form D.

17. WHY HAS THE BAHAMAS MADE ECONOMIC SUBSTANCE A REQUIREMENT?

Every international financial centre is being urged to implement substance requirements by the EU and the OECD. The objective is to prevent international businesses from benefiting from different tax laws between countries by artificially transferring profits to jurisdictions that impose little or no income tax.

18. HOW WILL FOREIGN EXCHANGE BE AFFECTED BY REMOVAL OF PREFERENTIAL EXEMPTIONS?

It will not be. Persons seeking to access the Bahamian Dollar payment system will still need exchange control permission.

19. HOW WILL THE EXCHANGE OF INFORMATION OCCUR?

The Minister of Finance as Competent Authority will exchange information with any reportable jurisdiction with whom we have a reporting agreement. Currently those countries are identified in the Second Schedule of CESRA.

20. WHAT AMOUNT OF BOARD MEETINGS MUST BE HELD IN THE COUNTRY?

No number is prescribed in the Act. Entities should comply with the requirements set out in relevant legislation.

21. DOES THE DOCUMENT RETENTION MANDATE MEAN THAT COMPANIES CAN NO LONGER STORE THEIR FILES IN THE CLOUD?

Section 13 (5) refers also to retaining for five years "electronically-stored information"; which would also apply to Cloud-based electronic storage.



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