

# LEGAL UPDATE

## COMMERCIAL ENTITIES (SUBSTANCE REQUIREMENTS) ACT, 2018

### Introduction

The Commercial Entities (Substance Requirements) Act, 2018 (the "Act") came into force on 31 December, 2018, to ensure compliance with international standards on tax governance and transparency. In particular, the Act was enacted in response to guidance from the European Union's Code of Conduct Group and the Inclusive Framework on Base Erosion and Profit Shifting ("BEPS") of the Organization for Economic Co-operation and Development ("OECD"). BEPS refers to tax planning strategies which exploit gaps and mismatches in tax rules to artificially shift profits to low or non-tax locations where there is little or no economic activity. The Act provides for substantial economic presence and annual reporting of a commercial entity carrying on relevant activities in The Bahamas.

### Entities subject to the Act

The Act stipulates special requirements for two types of commercial entities: "Included Entities" and "Non-Included Entities". A "Commercial Entity" is defined as an entity which is incorporated, registered or continued under the following Acts (the "Relevant Acts"):

- a) Companies Act (Ch. 308);
- 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).

A Commercial Entity does not include an entity incorporated, registered or continued under the Relevant Acts:

- a) (i) which is resident owned in The Bahamas, i.e. one hundred percent beneficially owned (either directly or indirectly) by one or more natural persons who are ordinarily resident and domiciled in The Bahamas, or who have been issued a certificate of annual or permanent residence and physically reside in The Bahamas for a cumulative period of at least three months per year, and
  - (ii) conducts its core income generating activities in The Bahamas; or
- b) which is centrally managed and controlled outside The Bahamas and tax resident in a jurisdiction other than The Bahamas.

Included Entities are Commercial Entities engaged in "Relevant Activities", which are listed in the Act as:

- a) banking business;
- b) insurance business;
- c) fund management business;
- d) financing and leasing business;
- e) headquarters business;
- f) distribution and service centres business;
- g) shipping business; or
- h) commercial use of intellectual property.

An Included Entity is also engaged in a Relevant Activity if that entity carries out any of the above activities as a holding company, or where one or more of its subsidiaries is engaged in one of those activities.

Non-Included Entities are entities which are not Included Entities and which are incorporated, registered or continued under any of the Relevant Acts.

## Substance requirements

Included Entities must have substantial economic presence in The Bahamas, by satisfying the following requirements:

- 1) Core Income Generating Activities ("CIGA") in The Bahamas, which presupposes adequate amounts of annual operating expenditure, adequate levels of qualified full-time employees, adequate physical offices and adequate levels of board management and control within The Bahamas.
- 2) Direction and management in The Bahamas, by ensuring that:
  - a) an adequate number of meetings of the Board of Directors are conducted in The Bahamas;
  - b) there is a quorum of the Board of Directors physically present within The Bahamas during board meetings held here;
  - c) strategic decisions of the Included Entity made at Board meetings in The Bahamas must be recorded in the minutes of the meetings;
  - d) all records and minutes of the Included Entity are kept in The Bahamas; and
  - e) the Board of Directors, as a whole, must have the necessary knowledge and expertise to discharge its duties.

Included Entities may only outsource their CIGA to an outsourcing service provider in The Bahamas, provided that the Included Entity is able to demonstrate supervision and control of the outsourcing service provider in respect of such outsourced CIGA.

It should be noted that an Included Entity which only engages in business as a pure equity holding company (meaning that it only holds equity participations and only earns dividends and capital gains or incidental income) is subject to certain reduced substance requirements. However, where a holding company engages in any Relevant Activity, that company will be required to satisfy all of the substance requirements set out above. Further, a Non-Included Entity which is a passive holding entity (meaning that it does not by itself, or by any of its subsidiaries, conduct any Relevant Activity) is subject to the reduced substance requirements of only complying with all applicable laws and regulations of The Bahamas.

## Reporting obligations and penalties

All Included Entities, Non-Included Entities and holding companies/entities must report their status to the Minister of Finance, in the prescribed form under the Act, within nine months of the fiscal year end. Any entity which fails to report to the Minister of Finance will be subject to an administrative penalty of one hundred and fifty thousand dollars (B\$150,000.00) or the removal from the applicable register of incorporation.

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