

Economic Substance 2021

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Bahamas

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LEGAL FRAMEWORK

Legislation

- 1 | What legislation sets out the economic substance requirements in your jurisdiction?

The legislation that sets out the economic substance requirements in The Bahamas is the Commercial Entities (Substance Requirements) Act 2018 (CESRA). CESRA came into force on 31 December 2018.

Relevant entities

- 2 | What types of entity are subject to the economic substance requirements in your jurisdiction?

All entities incorporated, registered or continued under the Companies Act, International Business Companies Act, Partnership Act, Partnership Limited Liability Act or Exempted Limited Partnership Act are subject to CESRA.

However, only an 'included entity' is required to have substantial economic presence in The Bahamas. An included entity is a 'commercial entity' that is engaged in 'relevant activities'.

A commercial entity is an entity incorporated, registered or continued under the Companies Act, International Business Companies Act, Partnership Act, Partnership Limited Liability Act or Exempted Limited Partnership Act but does not include an entity that is either 'resident owned in The Bahamas' and conducts its core income-generating activities in The Bahamas, or centrally managed and controlled outside The Bahamas and is tax resident in a jurisdiction other than The Bahamas.

Relevant activities are defined in CESRA as banking business, insurance business, fund management business, financing and leasing business, headquartering business, distribution and service centres business, shipping business and commercial use of intellectual property.

Holding companies are subject to reduced substance requirements. However, where a subsidiary of a holding company is engaged in a relevant activity, the holding company is deemed to be engaged in a relevant activity and is required to have substantial economic presence in The Bahamas if it is a commercial entity.

Relevant activities

- 3 | What activities trigger the economic substance requirements in your jurisdiction?

A commercial entity engaged in any of the following activities will be required to have substantial economic presence in The Bahamas:

- banking business;
- insurance business;
- fund management business;
- financing and leasing business;

- headquartering business;
- distribution and service centres business;
- shipping business;
- commercial use of intellectual property; or
- a holding company that has a subsidiary engaged in any of the activities listed above.

Tax residence requirements

- 4 | Must entities be tax resident (or deemed tax resident) in your jurisdiction to be subject to the economic substance requirements? If yes, what are the tax residence rules and requirements? If not, do the economic substance requirements in your jurisdiction differ with respect to non-resident entities ?

Entities do not have to be tax resident in The Bahamas to be subject to economic substance requirements.

If an entity is tax resident in a jurisdiction other than The Bahamas and is centrally managed and controlled outside of The Bahamas, then it will not be required to have substantial economic presence in The Bahamas.

Where an entity claims to be tax resident in a jurisdiction other than The Bahamas, it is required to substantiate this claim by providing the following information:

- a tax identification number issued by a foreign jurisdiction;
- a tax residence certificate issued by a foreign jurisdiction;
- official receipt or statement issued by a foreign tax authority;
- certification by the entity that the majority of meetings of the board of directors, or controlling persons in the case of a non-corporate entity, in any financial year took place in the foreign jurisdiction; and
- the ordinary residency of the majority of the board of directors, or controlling persons in the case of a non-corporate entity.

Guidance

- 5 | Has the government published guidance on the economic substance requirements?

CESRA allows for the Minister of Finance to issue guidelines for complying with CESRA and any person or entity subject to CESRA is required to comply with such guidelines. On 25 February 2019, the Minister of Finance issued guidelines pursuant to CESRA.

The Minister of Finance has also issued various public notices that do not have the force of law but provide further guidance on certain issues regarding CESRA.

ECONOMIC SUBSTANCE REQUIREMENTS

General requirements

6 | What general economic substance requirements apply in your jurisdiction?

The general economic substance requirements under the Commercial Entities (Substance Requirements) Act 2018 (CESRA) are:

- conducting core income-generating activities in The Bahamas; and
- having adequate levels of board management and control within The Bahamas.

Conducting core income-generating activities in The Bahamas presupposes adequate:

- levels of annual operating expenditure within The Bahamas;
- levels of qualified full-time employees within The Bahamas; and
- physical offices within The Bahamas.

Having adequate levels of board management and control within The Bahamas is demonstrated by:

- having an adequate number of board meetings conducted in The Bahamas given the level of decision making required;
- having a quorum of the board of directors physically present within The Bahamas during board meetings;
- having the strategic decisions made at the board meetings recorded in the minutes of the meetings;
- keeping all records and minutes in The Bahamas; and
- having a board of directors that, as a whole, has the necessary knowledge and expertise to discharge its duties.

'Directed and managed'

7 | What requirements apply in relation to board meetings and the location where entities are directed and managed?

An adequate number of board meetings must be conducted in The Bahamas given the level of decision making required. At those meetings, a quorum of the board should be physically present within The Bahamas and the strategic decisions made should be recorded in the minutes. Further, all records and minutes of board meetings should be kept in The Bahamas and the board of directors, as a whole, must have the necessary knowledge and expertise to discharge its duties.

Guidelines issued by the Minister of Finance under CESRA indicate that the central management and control of an entity will be determined pursuant to the common law as developed by the Courts of The Bahamas and other common law jurisdictions, including England and Wales.

Core income-generating activities

8 | What requirements apply in relation to core income-generating activities?

An entity that is required to have substantial economic presence in The Bahamas must conduct its core income-generating activities within The Bahamas.

An entity may outsource any of its core income-generating activities to an outsourcing service provider in The Bahamas, provided that it is able to demonstrate supervision and control of the outsourcing provider with respect to the outsourced activities.

Premises

9 | What requirements apply in relation to the physical premises of relevant entities?

An entity that is required to have substantial economic presence in The Bahamas must have adequate physical offices or premises in The Bahamas, or an adequate level of expenditure on outsourcing to service providers in The Bahamas, proportionate to the activities of the entity.

Employees and personnel

10 | What requirements apply in relation to the employees and personnel of relevant entities?

An entity that is required to have substantial economic presence in The Bahamas must have an adequate level of qualified full-time employees in The Bahamas, or an adequate level of expenditure on outsourcing to service providers in The Bahamas, proportionate to the activities of the entity.

Expenditure

11 | What requirements apply in relation to expenditure?

An entity that is required to have substantial economic presence in The Bahamas must have an adequate level of annual expenditure incurred in The Bahamas, or an adequate level of expenditure on outsourcing to service providers in The Bahamas, proportionate to the activities of the entity.

Enhanced requirements

12 | Are there any instances where enhanced substance requirements apply?

There are enhanced substance requirements under CESRA for entities that are required to have substantial economic presence in The Bahamas and are engaged in intellectual property income-generating activities. The enhanced substance requirements vary depending on whether the intellectual property business is considered low or high risk.

Low-risk intellectual property activities are defined as those in which the intellectual property asset is:

- developed in-house;
- acquired from an unrelated party; or
- licensed to unrelated parties.

Businesses engaged in low-risk intellectual property activities are required to have substantial economic presence in The Bahamas but must also demonstrate that:

- the strategic decisions and management of the intellectual property and the bearing of principal risks in relation to the development and exploitation, or the acquisition and subsequent exploitation, take place within The Bahamas; and
- the underlying trading activities through which the intellectual property asset is exploited and which leads to the generation of revenue from a third party are conducted in The Bahamas.

High-risk intellectual property activities are defined as those in which the intellectual property asset is:

- acquired from a related party;
- not obtained through research and development activities within The Bahamas;
- licensed or sold to a related party; or
- monetised through activities performed by a related party outside of The Bahamas.

Businesses engaged in high-risk intellectual property activities are required to have substantial economic presence in The Bahamas but must also demonstrate that:

- the strategic decisions and management of principal risks are undertaken in The Bahamas;
- the underlying trading activities are conducted within The Bahamas; and
- there is a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intellectual property asset in The Bahamas.

Reduced requirements

13 | Are there any instances where reduced economic substance requirements apply?

Holding companies are subject to reduced economic substance requirements.

A 'pure equity holding company' is defined in CESRA as a company that only holds equity participations and only earns dividends and capital gains or incidental income. Pure equity holding companies only need 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' is defined in CESRA as an entity that does not by itself, or by any of its subsidiaries, conduct any relevant activity but does not include a collective investment vehicle. Passive holding entities only need to comply with all applicable laws and regulations of The Bahamas.

Outsourcing

14 | What requirements apply in relation to outsourcing activities to entities located in your jurisdiction and entities located outside your jurisdiction?

An entity that is required to have substantial economic presence in The Bahamas may outsource any of its core income-generating activities to a service provider within The Bahamas provided that it is able to demonstrate supervision and control of the outsourcing provider with respect to the outsourced activities.

The outsourcing of core income-generating activities to a service provider outside of The Bahamas by an entity that is required to have substantial economic presence in The Bahamas is expressly prohibited under CESRA.

CESRA does not have any restrictions with respect to the outsourcing of activities which are not core income-generating activities.

ENFORCEMENT AND COMPLIANCE

Enforcement authorities

15 | Which government authorities are responsible for the enforcement of economic substance requirements? What is the extent of their information-gathering powers?

The Minister of Finance, as Competent Authority under the Automatic Exchange of Financial Account Information Act 2016, is responsible for the enforcement of economic substance requirements in The Bahamas. The Minister of Finance has the authority from time to time to conduct on-site inspections of the business of a reporting entity, as well as appoint an auditor to conduct audits of the accounts of the reporting entity.

Reporting formalities

16 | What reporting formalities apply with respect to the economic substance requirements?

All entities incorporated, registered or continued under the Companies Act, International Business Companies Act, Partnership Act, Partnership Limited Liability Act or Exempted Limited Partnership Act are required to file a substance report within nine months after the end of the relevant financial year end. The classification of the entity under the Commercial Entities (Substance Requirements) Act 2018 (CESRA) determines what information is required to be included in the substance report.

The information required to be provided by non-included entities includes a description of the nature of the business, registered address, physical address, jurisdiction of tax residence, the names, addresses and contact information of the directors, and the names, addresses, contact information and jurisdiction of tax residence of the registered shareholders.

The information required to be provided by included entities and regulated entities includes the same information required of non-included entities along with details of the amount and type of gross income, amount and type of expenses and assets, number of full-time employees, core income-generating activities and management and control activities.

Holding companies are only required to provide their registered and physical address.

Substance reports are filed electronically using an online portal. The online portal uses a 'smart form', which automatically generates the information required depending on the responses provided.

Demonstrating compliance

17 | How does an entity in practice demonstrate its compliance with the economic substance requirements? How do the enforcement authorities assess compliance?

Compliance with the relevant economic substance requirements is demonstrated by the filing of an annual substance report.

Whether an entity is compliant with the substance requirements is determined by Minister of Finance.

Penalties

18 | What are the potential penalties for failure to comply with the economic substance requirements?

Penalties range from an entity being required to conduct a formal audit at the entity's expense, to penalties of up to B\$150,000 with further penalties of up to B\$1,000 for every day the entity remains non-compliant.

If the entity is required to take certain remedial measures and fails to do so, it may be subject to a further fine of B\$300,000 and is subject to being struck from the register of companies in The Bahamas.

Where an included entity is engaged in high-risk intellectual property activities or fails to fulfil its substance requirements, then the Minister of Finance shall spontaneously exchange the substance report filed by the entity with a reportable jurisdiction of the legal or beneficial owner(s) of the entity.

UPDATE AND TRENDS**Recent developments**

19 | What have been the most significant recent developments in the law on economic substance in your jurisdiction, including any notable regulatory actions or legislative changes?

Entities under the Commercial Entities (Substance Requirements) Act 2018 were required to file their first substance report in 2020. Because of the covid-19 pandemic, the reporting deadline was extended to 31 January 2021. All entity filings for the 2019 financial year should by now have been completed and submitted, with the 2020 substance filings to follow nine months after the entity's financial year end.

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