

Tax News

International Tax



Even playing field restored – Barbados EICs and the revised view of the Canada Revenue Agency

On Wednesday November 10, 2010 the Canada Revenue Agency (“the CRA” or “the Authority”) released its revised view on the ability of Barbados Exempt Insurance Companies (“EICs”) that are affiliates of Canadian corporations to have their retained earnings be eligible for exempt surplus treatment. The revised review is now favourable for Barbados EICs.

The CRA has concluded that although EICs are not eligible for benefits under the Canada-Barbados Double Tax Agreement (“the DTA”), EICs are eligible for exempt surplus treatment in the event that the entity is liable to taxation in Barbados and is resident in Barbados in accordance with principles applied by the CRA.

The Authority has issued a comprehensive explanation as to the basis of its findings, providing details on the issues of liability to tax, eligibility under the DTA and finally the vital issue of exempt surplus treatment under Part LIX of the Canada Income Tax Regulations (“the Regulations”).

Liability to taxation

In summary, it is the CRA’s position that to be considered “liable to taxation” for the purposes of the residence article of Canada’s tax treaties, a person must generally be subject to the most comprehensive form of taxation as exists in the relevant country.

This does not necessarily mean that a person must pay tax to a particular jurisdiction. There may be situations where a person’s worldwide income is subject to a contracting state’s full taxing jurisdiction, but that state’s domestic law does not levy tax on a person’s taxable income or taxes it at low rates. In these cases, the CRA will generally accept that the person is a resident of the other Contracting State unless the arrangement is considered to be abusive.

The CRA has noted that the Barbados Exempt Insurance Act (“BEIA”) exempts EICs from taxation under the Barbados Income Tax Act (“BITA”) and that these entities are charged an annual licence fee of Bds\$5,000 (Bds\$20,000 from January 1, 2009) for the first 15 years of their existence. The BEIA provides that income taxes applicable to EICs are as follows:

- for the first 15 financial years of a licensee, at the rate of 0% on the profits and gains of the licensee derived from an exempt insurance business conducted in Barbados; and
- after the first 15 years, at the rate of 2% (8% from January 1, 2009) of the first Bds\$250,000 of taxable income, and at the rate of 0% in respect of all other taxable income in excess of Bds\$250,000, thus the maximum tax payable is Bds\$5,000 (Bds\$20,000 from January 1, 2009) per year.

As such, the maximum amount payable by an EIC as a fee or tax in any given year is Bds\$5,000 (Bds\$20,000 from January 1, 2009).

The Authority has concluded that an EIC that is managed and controlled in Barbados is liable to taxation in Barbados within the meaning of Article IV(1) of the DTA, notwithstanding that it is eligible for a time-limited exemption from actual taxation. This is because an EIC that is managed and controlled in Barbados is resident in Barbados for BITA purposes, and hence taxable on its worldwide income, but for the exemption under BEIA. Barbados asserts its jurisdiction to tax EICs that are managed and controlled in Barbados based on criteria set out in the DTA, and the fact that Barbados imposes only a low rate of taxation, or provides an exemption from taxation in the manner set out in the BEIA, has been deemed irrelevant.

Eligibility under the DTA

The DTA does not apply to companies entitled to any special tax benefit under the Barbados International Business Companies Act, Cap. 77 or to companies entitled to any special tax benefit under any similar law enacted by Barbados.

The CRA has re-iterated the well established position that Barbados legislation governing EICs is similar to the Barbados legislation governing international business companies, and that as a result, an EIC is a company described in Article XXX(3) to which the DTA would not apply.

Eligibility for exempt surplus treatment

To qualify for exempt surplus treatment, a foreign affiliate must be:

- generally deemed resident in a designated treaty country; and
- deemed so resident under specific provisions of the Regulations.

A Barbados EIC must be considered to be resident in Barbados in order to qualify for exempt surplus treatment under Canada's Income Tax Act. For the purpose of determining whether an affiliate is resident in a designated treaty country for CRA purposes, it is necessary to determine where the affiliate is resident applying Canadian tax principles.

The relevant test is the Canadian common law test for residency, which is the same as the Barbados common law test, as articulated in the UK case of De Beers Consolidated Mines Limited v Howe, [1906] AC 455 (HL), which considers a company to be resident in the jurisdiction where its central management and control is in fact located.

- With respect to a conclusion of residency under the Regulations, the Authority has made specific reference to the provisions of subsection 5907(11.2) thereof. A foreign affiliate is deemed by this subsection not to be resident in a treaty country, at any time, unless it can meet one of the conditions stipulated therein. Paragraph (c) of the relevant subsection states as follows:

“(c) where the treaty entered into force before 1995, the affiliate would, at that time, be a resident of that country for the purpose of the treaty but for a provision in the treaty that has not been amended after 1994 and that provides that the treaty does not apply to the affiliate.”

The CRA has concluded that where an EIC is “liable to taxation” in Barbados under the DTA, the EIC would meet the requirements of paragraph (c) above such that the entity would not be deemed not to be resident in a treaty country by subsection 5907(11.2) of the Income Tax Regulations.

Relief for dividends paid

The release also states that where a dividend was paid by an EIC after February 26, 2007 to a Canadian shareholder and such dividend was treated as being out of taxable surplus the Canadian taxpayer may file an objection to have that dividend reclassified as a dividend out of exempt surplus, provided the dividend was in fact paid out of exempt surplus based on the calculation of exempt surplus.

For a dividend paid before February 26, 2007, a tax payer will be permitted to request a change only if there already exists a valid objection or appeal in respect of the treatment of the dividend.

Conclusion

The substantive conclusion of the CRA's ruling is, therefore, that since EICs are technically liable to taxation in Barbados, those EICs that are resident in Barbados - i.e. under the Canadian common law test of residency and as per the provisions of the Regulations - will qualify for exempt surplus treatment under Part LIX of the Canada Income Tax Regulations.

Subsequent to the implementation of a Tax Information Exchange Agreement ("TIEA") between Bermuda and Canada, Bermuda has promoted this beneficial treatment as an advantage available to Bermuda EICs to the exclusion of such entities incorporated and licenced under Barbados Law. The CRA's ruling has served to unequivocally clarify that this advantage is very much available to Barbados EICs and as such the main income tax advantage Bermuda has been pressing in recent months no longer exists.

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