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OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	Curacao's foreign source income exemption regime (CW006) – Final description and assessment

ROLLBACK REVIEW PROCESS (JANUARY 2020)

On 30 December 2020, Curacao adopted the Ordinance 92/2019 with effect as from 1 January 2020 (see doc. 7423/20 ADD1).

The Code of Conduct Group (business taxation) (COCG) meeting of 4 February 2020 assessed it as follows:

	1a	**1b**	**2a**	**2b**	**3**	**4**	**5**
Curacao – Foreign Source Income Exemption	X	?	X	?	X	X	X

V = harmful
X = not harmful

This conclusion was endorsed by the ECOFIN Council on 18 February 2020.

doc. 7423/2020 ADD 1: Ordinance 92/2019 (translated version)

Annex 1: Assessment of the CW006 regime in 2019 (standstill)

Explanation

Gateway criterion - Significantly lower level of taxation:

"*Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code*"

The general tax rate in Curacao is 22%. Under the Ordinance on Profit Tax of 1940, certain foreign sourced incomes were tax exempted. As the COCG looks at the effects that tax legislation may have on the location of business activities in general terms, a full tax exemption may be regarded as a reason for businesses to establish in one jurisdiction over another. In this sense, these provisions are relevant for the COCG.

The Code of Conduct uses a broad term ('tax measures') to describe what should be assessed under its criteria. This definition is not limited to specific pieces of legislation nor does define what is intended as a 'tax measure'. In the specific case of the measures of the Ordinance on Profit Tax of 1940, it is relevant to take into account the general tax system, in order to understand whether the legislation provides for a significantly lower level of taxation. This is the case here, as certain types of income with foreign source are exempted from taxation.

Criterion 1 and 2– Ring-fencing

"*whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents*"

"whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"

Art. 1D of the Ordinance 92/2019 amended Art. 4 of the Ordinance on Profit Tax, whereby it was foreseen that foreign active and passive income should not be subject to tax. The amended Art. 4 states that only income from a domestic enterprise is subject to tax. The definition of domestic enterprise is provided in the Decree on determination of profits from domestic enterprises, which also entered into effect on 1 January 2020. Further binding interpretation is included in the Explanatory Memorandum, accompanying the Ordinance.

With regard to passive income (e.g. dividends, interests, royalties, etc.), Curacao's amended Ordinance includes *de lege* this type of income in the domestic income, regardless of whether they have a foreign or domestic source. An exception is made for interest and dividends received by banks and insurance companies. These are subject to different rules, as they are considered active income for this type of business.

With regard to active income, if it does not qualify as income from a domestic enterprise, it is excluded from Curacao's tax base. Therefore, this income is not subject to tax, in particular if it has a foreign source.

The COCG on Foreign Sourced Income Exemption regimes acknowledges that it is acceptable to exempt active income as a mean of avoiding double taxation, so long as additional criteria are met. These criteria are the implementation of adequate substance requirements; the existence of robust anti-abuse rules; and the removal of any administrative discretion in determining the income to be exempted from tax. If a regime is in line with these criteria, its remaining and inherent features, such as ring-fencing elements, should not lead to the conclusion that the regime is harmful.

In the case of Curacao, the exemption applies to income of a foreign company that qualifies as a PE in Curacao or a PE of Curacao's companies in another jurisdiction. If this is not the case, the income is considered domestic and therefore subject to tax. This also includes situations where there is mixed income.

Based on the above, a cross is proposed (‘X’ – non-harmful) for criterion 1.a and 2.a and a question mark (“?” – Insufficient information under the criterion) for criterion 1.b and 2.b. as there are no data available at this stage on the effect of the measures.

Criterion 3 - Substance

“*whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages*”

Regarding active income (i.e. still tax exempt), Curacao has amended the Ordinance so that all entities with income not generated from a domestic enterprise must fulfil substance requirements, in line with COCG requirements. This is to ensure real economic presence before the tax benefit is granted. Furthermore, if these entities are considered as foreign taxpayers, their activities have to qualify as those of a permanent establishment in Curacao. This PE definition is set out in Article 1 paragraphs 5-14 of the amended Ordinance on Profit Tax, which now follows the OECD Model Convention. An exception is made with regard to the DTA with the Netherlands, to take into account the specific legal status of Curacao within the Kingdom of the Netherlands.

The amendments introduced mitigate the risk of double-non taxation and address the concerns previously raised by the COCG.

With regard to passive income, this is always subject to tax, as indicated above. In the specific case of royalty income, Curacao introduced an IP regime (Innovation Box) in 2018. This regime was deemed not harmful by the COCG. To ensure that the provisions of the Innovation Box are in line with the amended legislation, in terms of treatment of royalties, the Explanatory Memorandum clarifies that royalty income has to be regarded as passive income and is therefore subject to tax unless it complies with the modified nexus approach, as introduced by the Innovation Box regime.

Curacao already had a GAAR in place, which is broad enough to cover abusive situations. It has now introduced sanctions for companies that do not meet substance requirements. An exception is made for companies that can demonstrate tax residence in a jurisdiction that has comparable CIT to Curacao[1]. This includes EU and OECD Member States.

In light of the above, a cross (“X” – non-harmful) is proposed for criterion 4.

[1] Based on Article 11, paragraph 4, of the National Ordinance on Profit Tax 1940 and the Decree Designating Foreign Tax Regimes with Similar Profit Tax

Criterion 4 – Internationally accepted principles:

"*whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD*"

As described under criterion 1, Curacao has modified the definition of permanent establishment, in line with the OECD Model Convention. Curacao has also amended its legislation to ensure that costs cannot be deducted from the profits of a domestic enterprise if they do not relate to the activities attributable to that domestic enterprise. With regard to costs that have a foreign source, the Explanatory Memorandum includes the following categories of costs:

- costs that are directly related to non-domestic profits, for example, travel costs, but also costs of depreciation and financing of assets abroad or the interest and other expenses of moneys borrowed which are then used loans to or deposits with non-residents.

- costs that do not have such an immediate connection with the profits that are not include in the tax base, such as administration costs, costs of annual accounts and tax returns, management rewards, costs of financing of general working capital etc. Such costs must be attributed on a group basis according to the ratio of non-domestic direct cost /global direct cost, as evidenced by the group's annual accounts to the profits not obtained from domestic enterprise. The group, in this respect, only consists of entities that are tax resident in Curacao and non-resident companies insofar as they conduct their enterprise through a permanent establishment in Curacao.

Curacao has also introduced an amendment to allow companies to offset tax paid abroad on the income that qualifies as domestic in Curacao but may have a foreign source. This provision is applicable on the condition that no other measures to avoid double taxation have been applied (such as allocation based on a DTA or the specific credit method in the Ordinance).

As the amendments introduced do not contradict any internationally accepted principles, a cross ("X" – non-harmful) is proposed for criterion 4.

Criterion 5 - Transparency

"whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

All preconditions necessary for granting the tax benefits are clearly laid out in the legislation and the administration has no discretional power to grant or deny preferential tax treatment. A cross ("X"- not harmful) is proposed for criterion 5.

Grandfathering

No grandfathering has been foreseen for the regime, in line with the COCG's request for replacement regimes.

Overall assessment

In light of the analysis above, Curacao's Foreign Source Income Exemption regime can be considered not harmful and compliant under criterion 2.1.

ANNEX 1

Assessment of the CW006 regime in 2019 (standstill)

Curacao's exemption of foreign income regime (CW006)

Gateway criterion - Significantly lower level of taxation:

"*Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code*"

The general tax rate in Curacao is 22%. Under the Ordinance on Profit Tax of 1940, certain foreign sourced incomes are tax exempted.

If a jurisdiction has introduced a general exemption / zero taxation in the general tax system, to replace the previous harmful regime, it needs to be considered whether the new measures pass the Gateway criterion of the Code. This Gateway criterion covers "*tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply". That level "may operate by virtue of the nominal tax rate, the tax base or any other relevant factor*".

In the case of the Ordinance on Profit Tax of 1940, no tax is levied, compared to the general rate of 22%.

The provisions at issue operate by exempting foreign income from taxation. The beneficial tax treatment therefore seems only to apply to companies previously covered by the reformed regimes, which are only foreign companies. The tax base of domestic companies will therefore in effect be untouched.

As the Code of Conduct looks at the effects that tax legislation may have on the location of business activities in general terms, a full tax exemption may be regarded as one of the reasons for a business to establish in one jurisdiction over another. In this sense, the new provisions are relevant for the Code.

The Code of Conduct uses a broad term ('tax measures') to describe what should be assessed under its criteria. This definition is not limited to specific pieces of legislation nor does it circumscribe the meaning of what should be intended as a 'tax measure'. In the specific case of the measures introduced by Curacao, it is relevant to take into account the tax in order to understand whether the legislation provides for a significantly lower level of taxation.

A full exemption is lower than 22%. The measures cannot be viewed as generally applicable, as they result in only certain types of income being untaxed. Furthermore, the exemption is applied exclusively to transactions carried out with non-residents and almost exclusively concerns foreign entities. The intended result is a significantly lower level of taxation than the levels which generally apply.

	1a	**1b**	**2a**	**2b**	**3**	**4**	**5**
Curaçao - Exemption of foreign income	V	?	V	?	V	X	X

V = harmful
X = not harmful

<u>Explanation:</u>

Criterion 1 – Targeting non-residents:

"*whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents*"

Criterion 1a: The exemption from taxation of foreign source income is only applied in respect of transactions carried out with non-residents and it does not affect the national tax base. The measures are therefore ring-fenced.

Criterion 1.b: More information should be gathered from Curacao to be able to make an assessment.

Criterion 2 – Ring-fencing:

"whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"

As the exemption on taxation applies only to transactions with non-residents, the national tax based is not affected.

What has been written above under criterion 1a and 1b also applies to criterion 2a and 2b.

Criterion 3 - Substance:

"*whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages*"

According to the standard practice for the evaluation of a measure against criterion 3, a measure is found harmful under this criterion if there are no specific requirements with regard to real economic activities and notably any requirement with respect to employment obligations.

Art. 1A of Ordinance on Profit Tax of 1940 does not impose substance requirements for companies benefitting from the tax exemption. Some pieces of legislation may impose substance requirements for certain type of companies, e.g. profits deriving from insurance and reinsurance services, income deriving from IP and from investment companies. However, the tax exemption on foreign source income under the Business Tax Act covers a broader range of income.

It should also be noted that the new provisions in Curacao are broadly similar to participation exemption regimes in other jurisdictions. Regimes such as these should be properly contained by appropriate anti-abuse measures, in order to tackle tax-planning opportunities.

Paragraph L of the Code of Conduct states that anti-abuse provisions or countermeasures contained in tax laws and in double taxation conventions play a fundamental role in counteracting tax avoidance and evasion. In past assessments, the Code Group has taken into account, in the overall assessment of various regimes, the existence of appropriate anti-abuse rules. Such measures would include CFC rules or a switchover clause, in line with the agreed Code Guidance and previous assessments. It is unclear whether certain measures included in the legislation are applicable.

Criterion 4 – Internationally accepted principles:

"*whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD*"

The measures do not contain such elements that would be relevant from the point of view of internationally accepted principles as referred to in criterion 4 of paragraph B of the Code.

Criterion 5 - Transparency

"whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

Overall assessment:

In the light of the assessment made under all Code criteria, the regime is overall harmful.