A 'cliffhanger': Caribbean corporate service providers prepare for OECD's lasting impact on the Curaçao gaming regime

In the July 2018 edition of *Online Gambling Lawyer*, Bas Jongmans, Peter Muller and Frederik van Eijk provided their analysis on the Organization for Economic Cooperation and Development ('OECD')-inspired changes in legislation on the island of Curaçao within the Dutch Caribbean, which heavily impact corporate service providers. With the transitional period already winding down, market participants are scrambling to make the necessary arrangements, providing them with a 'cliffhanger' situation. Following up on their first article, here the authors take a more in-depth look at how things came to pass, and discuss how the local community is coping.

Introducing minimum standards for a level playing field

By request of the G20 Finance Ministers and Central Bank Governors in 2013, the OECD produced its 15 standards ('Actions') on Base Erosion and Profit Shifting ('BEPS') in 2015. These Actions are aimed at enhancing an international 'level playing field.'

Those who benefit from preferential tax regimes, e.g. members of the corporate services industry in Curaçao, should have been on high alert since that time. One could have seen the storm coming, so to speak. After all, as an inclusive framework member ('Member'), the Curaçao Government committed in 2016 to the minimum BEPS Actions.

Outline of the Actions that the Government committed to:

- Action 5/6 requires the identification of preferential features and/or the granting of treaty benefits under inappropriate circumstances, which can facilitate base erosion and profit shifting and therefore have the potential to unfairly impact the tax base of other jurisdictions[1].
- Action 13 requires Curaçao to implement country-by-country reporting for multinational enterprises ('MNEs'). An obligation to annually report transfer pricing documentation for each jurisdiction in which the MNE has established entities/business relationship[2].
- Action 14 calls for an effort to make dispute resolution mechanisms more effective. It includes a commitment to implement a minimum standard to ensure that treaty-related disputes are resolved in a timely, effective and efficient manner[3].
- Action 15 requires a mandate for the development of a 'multilateral instrument,' designed to provide an innovative approach to international tax matters. The goal of this instrument is to modify existing bilateral tax treaties to implement tax treaty-related BEPS measures, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly[4].

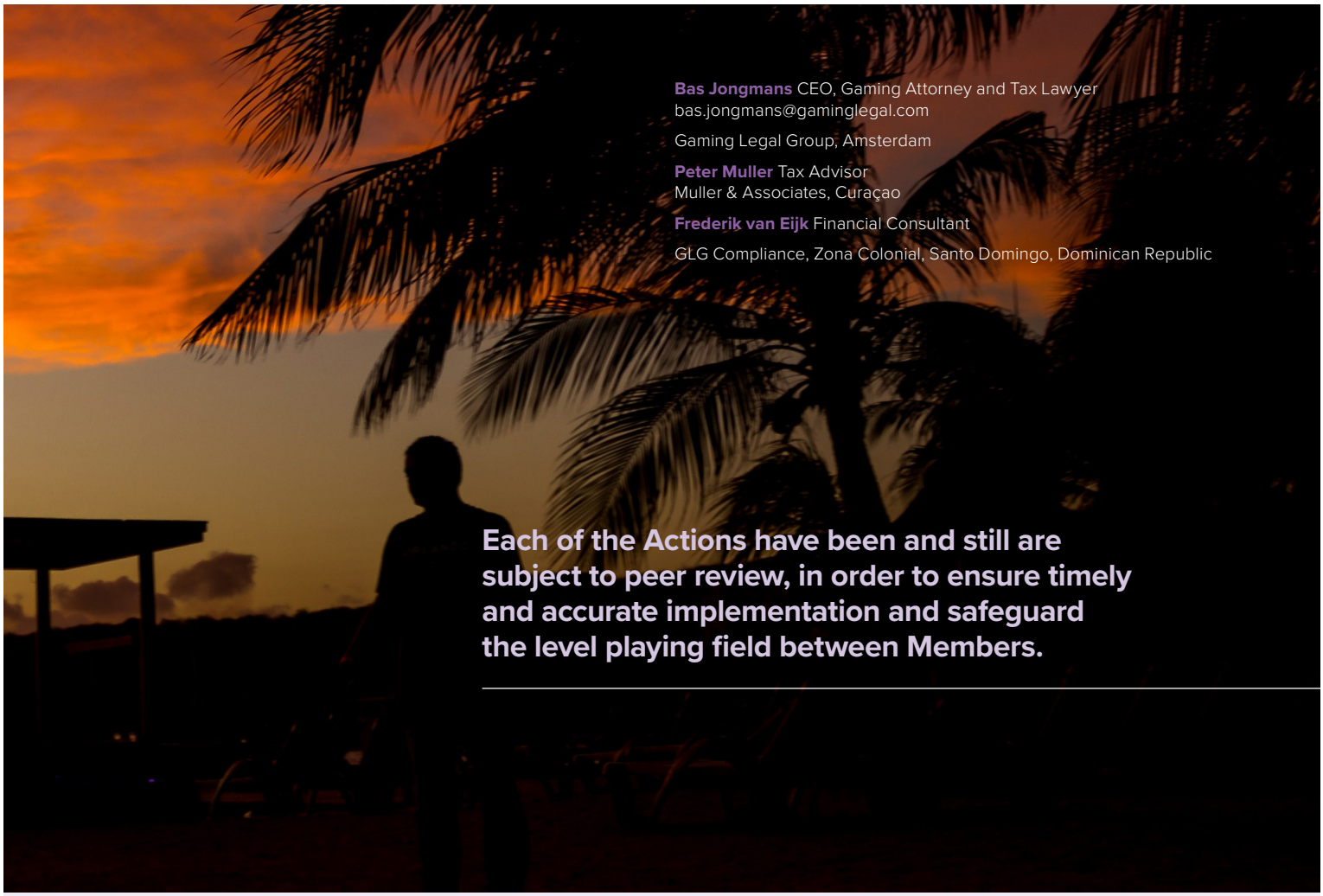
Peer review: three preferential features deemed inappropriate

Each of the Actions have been and still are subject to peer review, in order to ensure timely and accurate implementation and safeguard the level playing field between Members. Such a peer review on Action 5/6 led the OECD to the identification of three preferential features within the Curaçao jurisdiction, deemed inappropriate according to BEPS standards, being:

1. the 'Exempt Company';
2. the 'Export Exemption,' both of which were flagged for lacking substance; and
3. the 'E-zone.'

The Government was 'invited' to make the necessary changes for the implemention of the agreed upon Actions. This *de facto* started the clock for the Government of Curaçao on a countdown from two years to a deadline of 1 July 2018. Failure to properly and timely implement these Actions would place Curaçao on a blacklist for trade with the European Union. Such a dark scenario becoming reality could, overnight, make economies that are heavily based on corporate services, such as that of Curaçao, fall out of grace with well-established international clientele.

On the other hand, the Government could not just abolish these regimes but rather needed to find a way to retain a favourable business climate, hence presenting it with a pretty pickle. It then became silent for a long time. With the deadline of 1 July 2018 approaching rapidly, the Government realised that it was compelled to act in order to avert immediate financial disaster.



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First wave: the Curaçao Private Foundation obliterated, the Exempt Company and Export Exemption stripped

A first wave of change hit the island on 6 June 2018, when a proposal was presented to Parliament. It was approved the next day, without any comments or changes[5]. The ordinance, the arrival of which came unannounced, significantly affects legislation governing Curaçao's corporate taxation in various ways. Firstly, it introduces the obligation for member entities of a (larger) group MNE to provide information on entities that are not based in Curaçao (country-by-country). The ordinance introduces the obligation to include a list of all ultimate beneficial owners with each corporate tax return.

From the perspective of privacy protection, the Curaçao Private Foundation ('SPF') is affected by this measure in particular. The SPF is a popular vehicle that is used for the management of wealth, e.g. in matters of inheritance in which structure participants enjoy certain privileges of privacy. Even though the SPF is not allowed to operate a business, it has now been included in the obligation to file a yearly corporate income tax return, apparently only for the purpose of triggering the annual disclosure of all of its participants. This effectively renders the SPF useless for privacy purposes. The OECD did not earmark the SPF as inappropriately preferential, the Government felt compelled to make this important and costly change without any notification or debate. It is expected that this particular measure shall result in an exodus of foreign SPF participants to other jurisdictions. Policy makers might not have been able to sufficiently acknowledge the potential economic ramifications. Changes have entered into force retrospectively, as of 1 January 2018.

The preferential regime of the Exempt Company may, on the penalty of forfeiture of its preferential status, no longer (formally of materially) pursue the licensing of intellectual and industrial property rights and similar property rights or user rights. As a consequence, income generated from acquired intellectual property shall no longer be treated in a preferential manner and taxed at a 22% rate. A transitional period of six months applies for existing entities.

This measure is designed to encourage entities to develop their own intellectual property. This principle is based on the so-called Productivity-Inclusiveness Nexus ('Nexus'), which is meant to expand the productive assets in an economy by tapping into the local workforce and investing in an environment where all firms and regions have a chance to succeed[6]. Entities are, however, allowed to outsource development of intellectual property under strict (supervisory) conditions. Income from qualifying intellectual property is subject to a new reduced tax rate of 5%.

The Nexus measure also affects the Export Exemption, which as a result has been stripped as well in a sense that licensing activities shall no longer be deemed export related.

To top it all off, Curaçao authorities may now also freely and without any notification, without the necessity to obtain any consent, distribute information on (potential) tax payers. Furthermore, no rulings may be requested without making payable a fee of €250, however there are no measures in place to force the Government to expeditiously formulate an answer. At the same time, fines have been increased exponentially.

Second wave: Preferential regimes abolished, introduction of substance criteria

A second wave came in on 14 June 2018,

1. https://www.oecd.org/tax/beps/beps-action-5-harmful-tax-practices-peer-review-transparency-framework.pdf
2. http://www.oecd.org/tax/beps/guidance-on-country-by-country-reporting-beps-action-13.htm
3. http://www.oecd.org/tax/beps/beps-action-14-on-more-effective-dispute-resolution-peer-review-documents.pdf
4. https://www.oecd.org/tax/beps/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf
5. P.B. 2018, no. 30, Wijziging van de Landsverordening houdende aanvullende documentatieverplichting verrekenprijzen.
6. http://www.oecd.org/economy/new-nexus-approach-needed-to-tackle-productivity-and-inequality-challenges.htm
7. P.B. 2018, no. 30, Wijziging van de Landsverordening houdende aanvullende documentatieverplichting verrekenprijzen.

Although the E-zone, with a tax rate of only 2% has not been abolished in the strict sense of the word, it has been stripped of all benefits, since its function shall be strictly limited to the sales of goods only, also including a 9% sales tax (no deductions allowed) for goods sold in Curaçao.

continued

when a second proposal was presented to Parliament. It was approved on 28 June 2018, which is one business day away from the deadline. Again, without any (significant) comments or changes[7].

The Exempt Company as well as the Export Exemption now have been abolished altogether. The Exempt Company has been renamed to the Curaçao Investment Company ('CIC') and shall no longer be exempt. Instead, a (conditional) 0% tax rate shall apply, which makes sure that the CIC stays obligated to comply for corporate income tax purposes including the filing of the annual return. The CIC, under the strict conditions of the Nexus principle, is allowed to develop and utilise self-developed intellectual property against a 0% rate. After this second wave, the Export Exemption was abolished as well. Under the new legislation, the definition of foreign income has, based on a principle of territoriality, been redefined to include income connected to sales of goods and rendered services to clients abroad. Excluded from this principle, however, is income connected to services rendered in connection with legal and financial advice, insurance and shipping. A 3% sales tax shall be levied on qualifying income in connection with sales to foreigners.

Under the new legislation, companies shall only be deemed to have a 'factual presence' on the island if sufficient local and operational costs have been allocated to the local entity. Furthermore, the local entity is required to employ a sufficient number of qualified full-time employees who are locally assigned. Although the E-zone, with a tax rate of only 2% has not been abolished in the strict sense of the word, it has been stripped of all benefits, since its function shall be strictly limited to the sales of goods only, also including a 9% sales tax (no deductions allowed) for goods sold in Curaçao. If one keeps in mind that E-zones tend to be small in size and are especially focused on the rendering of services, one may conclude that it has *de facto* been abolished, noting that it shall be allowed to continue in its old form until the end of this year.

Proverbial frogs in a heated pot of water

In our first article, we focused on increased legal exposure for local service providers in connection with anti-money laundering legislation. Such a service provider should not primarily fear the local Curaçao authorities. After all, they may be held liable by any authority worldwide. Combined with the measures as described here, it is fair to compare the legal impact on the local service providers as a double wave. Privacy, tax benefits and flexibility on substance are all gone within in a period of six weeks.

Additionally, the unchecked obligation to report information to governments, not only by governments themselves to other governments but also by private parties, feels Orwellian. Aside from this notion, it can be seen that at some point measures were being taken that do guarantee a certain amount of substance. A corporate services director that hosts 2,000 companies cannot seriously be expected to be truly involved, and from this perspective the OECD-imposed changes seem reasonable. Also, the time frame has been more than reasonable. Documentation on how to implement is publicly and abundantly present.

With all this in mind, the future of the gaming industry seems somewhat gloomy in Curaçao. It is not, in our opinion, that international customers are not prepared to contribute, pay taxes, and otherwise invest in the island's economy. It is very much like the proverbial frog in a pot of water. If one heats up the pot slowly enough, the frog will remain in the pot and not contemplate to jump. Changes might not be felt as significant at all if certain time frames are respected. Service providers have had a good run for all these years, but the time has arrived to become more responsible, educate clients and follow a strict regime. The alternative is to retire.

The same, mitigating circumstances in a sense, apply to the Government. A jurisdiction that is not prepared or able to (in a timely fashion) see what is coming and does not feel the responsibility to prepare local and international parties cannot avoid financial disaster by imposing on its business community a staggering number of measures at the last moment.

If the extensive services industry is to survive in Curaçao, it shall only be for the happy few. The rest of them is expected to share the fate of the proverbial frogs.