

Curaçao amends profit tax legislation from a worldwide tax system to territorial system

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Executive summary

The Curaçao tax legislation has undergone several changes in recent years to align with Organisation for Economic Co-operation and Development (OECD) and European Union (EU) requirements. For example, the so-called nexus approach for income from intellectual property was introduced as of 1 July 2018, the export regime was abolished, and the e-zone regime was amended to eliminate those aspects that were considered ringfencing or harmful.

On 1 February 2019, the Code of Conduct Group of the EU (the EU COCG) required further changes to certain aspects of the Curaçao Profit Tax Ordinance 1940. This led to draft legislation that was presented to and approved by the EU COCG and should therefore be considered compliant with the current minimum requirements of the EU. This draft legislation was presented to and passed by the Curaçao Parliament on 30 December 2019 and will enter into force as of 1 January 2020.

The main new feature in the amended profit tax legislation is the change from a worldwide tax system with exemptions for foreign permanent establishments, sales to foreign buyers and foreign real estate, to a stricter territorial system where only income from a domestic enterprise is included in the taxable basis. The territorial system will not apply to passive income or any kind of royalty income as defined by the OECD. In addition, certain domestic activities such

as ship building and the repair of ships and airplanes; warehousing and logistics; support services; and fund management and administration will be subject to a reduced rate of tax at 3%.

Detailed discussion

Change to a territorial system

The foreign-sourced income exemption as it existed until 31 December 2019 has been replaced by a new tax regime that solely includes income from a domestic enterprise. Income that is considered derived from foreign entrepreneurial activity is excluded from the taxable base for profit tax purposes. To determine whether income is considered domestic or foreign, the profit before indirect cost is allocated based on direct expenses but excluding costs of materials. A simplified example may illustrate the allocation between domestic and foreign source income:

Turnover	1,000
Raw/ready materials	(200)
Net turnover	800
Local direct cost	150
Foreign direct cost	<u>350</u>
Total direct cost	(500)
Gross profit	300
Indirect cost	(200)
Entity net profit	100

When the activities are conducted by a single entity in Curaçao, the domestic net profit of the entity can now be calculated as $[\text{local direct cost}/\text{total direct cost}] * \text{net profit} = 100 * (150/500) = 30$. This 30 is taxed at the headline tax rate of 22%. If there are more entities in the Curaçao group, the indirect costs need to be allocated based on group direct cost rather than entity direct cost.

For financial services companies such as banks and finance companies, the source of the income is determined based on the place of (non) residence of the counterparty and in the case of insurance companies on the location of the risks to be insured.

Passive income, income that is not generated through active business activity, will be considered domestic income. This may include interest, rents and portfolio dividend income. Royalty income will always be considered passive income.¹

Reduced profit tax rate for designated activities

A reduced profit tax rate of 3% has been introduced for income from certain designated domestic activities conducted by taxpayers in Curaçao. Income from the following activities may be subject to the reduced profit tax rate:

- ▶ The building or improvement of aircrafts and vessels as well as the maintenance and repair of aircrafts and vessels with a length of at least 10 meters and machinery and other materials used onboard of these vessels and aircrafts.
- ▶ Support services such as administrative service, back office services, call or data centers insofar these activities are rendered to an enterprise with a turnover of at least ANG50 million (approx. US\$28 million).
- ▶ Warehousing and ancillary logistic services performed to third parties.
- ▶ Fund management and fund administration services in Curaçao provided to unaffiliated investment funds and the managers of such investment funds.

Anti-avoidance measures

The above changes to the profit tax legislation also come with several measures that are aimed at curbing abuse of the new tax system.

Use of Curaçao Investment Company (CIC) regime by bank or similar enterprises

Banks and other regulated credit institutions are prohibited from investing in a CIC, which is subject to 0% profit tax, unless the activities of the CIC are limited to investing the excess cash of the bank or similar credit institution and provided that all other requirements for the application of the CIC regime are satisfied.

Deemed dividends by bank-held CIC and passive foreign investment companies

Passive investment companies held by a bank or other regulated credit institutions are considered to have distributed their annual profits to the extent of the banks interest in the passive investment company. For domestic passive investment companies this deemed distribution is 50% and for foreign passive investment companies this dividend is 100%.

Substance requirements

- ▶ The substance requirements for CICs that were established in discussion with the OECD in 2018 have not changed. Real presence is deemed to exist if the taxpayer performs income generating activities and meets the following two requirements:

- Employs an adequate number of qualifying full-time employees, which is appropriate for the nature and extent of the activities of the entity or the group.
- Has an adequate amount of annually recurring local operating costs, which is appropriate for the nature and extent of the activities of the entity or the group.
- ▶ As from 1 January 2020, taxpayers deriving income that is not generated from a domestic enterprise, must have real presence in Curaçao as required for a CIC however their presence should also arise to the level of a permanent establishment if the activities would have been conducted by a foreign enterprise. Failure to meet these substance requirements can result in penalties ranging from ANG50,000 to ANG500,000.
- ▶ Companies that conduct activities under the new reduced profit tax regime of 3% must meet the CIC substance requirements and must perform their core income generating activities in Curaçao.

Failure to meet regular accounting requirements

Taxpayers that do not meet the requirement of regular accounting or regular annual closing will be considered to have derived all their income from a domestic enterprise and as a result be subject to profit tax at the rate of 22% (in 2019) for their complete income.

Abolishment of special e-zone tax rate

The reduced profit tax rate applicable to e-zone companies (2%) will be abolished as of 1 January 2020.²

Foreign tax relief

The relief for foreign source tax will be limited to that part of the foreign tax which is levied at source in relation to income derived from a domestic enterprise operated in Curaçao. Relief for foreign sourced tax will be granted by means of a tax credit which will be limited to:

- ▶ The amount of tax which is levied at source during the respective financial year, increased with such amounts levied in the preceding 10 years insofar these amounts have not been used to reduce the Curaçao profit tax; or, to the extent that this amount is lower.
- ▶ The profit tax liability based on the Profit Tax Ordinance 1940 if and to the extent that the benefits derived from the domestic enterprise in Curaçao and taxed at source reduced by the deductible expenses attributable to this income would be the only income of the taxpayer.

Expansion of the permanent establishment definition

The so-called permanent establishment (PE) definition has been modernized to realign it with international developments and to improve any future treaty negotiations involving Curaçao. The PE definition has been aligned with the PE concept in the OECD Model Tax Convention on Income and Capital and the Tax Arrangement between the Netherlands and Curaçao.

Broadening tax incentives on domestic investments

The proposed changes to the domestic tax incentives ordinance can be summarized as follows.

- ▶ The scope of taxpayers who may claim a tax holiday for qualifying investments will be broadened to include taxpayers incorporated and established abroad and which are similar to the Curaçao public limited liability company (in Dutch: *Naamloze Vennootschap*) or the Curaçao private limited liability company (in Dutch: *Besloten Vennootschap*).

The aforementioned amendment is intended to enter into force on the day following the date of publication of the new legislation and will have retroactive effect to 1 January 2017. The following amendments will enter into force on 1 January 2020:

- ▶ The period within which a taxpayer must invest the minimum investment amount in a qualifying project will be extended from two years to three years following the initial date on which the domestic tax incentive ordinance is applied.
- ▶ The reduced profit tax rate under tax incentive regime will be increased from 2% to 3%.
- ▶ Exemption from real estate tax and profit tax will be granted for a period of five years if the investment in the qualifying project does not exceed ANG10 million. To the extent that the investment in the qualifying project exceeds ANG10 million, the exemption of real estate tax and profit tax will be granted for a period of 10 years, under the condition that at least ANG10 million has been invested within 5 years after receiving the Tax Holiday.

The amendments to the Tax Incentives Ordinance shall not apply to taxpayers who obtained a Tax Incentive prior to the date on which the new legislation enters into force or whom filed a Tax Incentive request prior to this date, but which has not been processed at the date on which the legislation enters into force.

Implications

For Curaçao profit taxpayers in general but especially those with cross-border activity, the changes in the profit tax may have considerable effect. Also, the new substance requirements as well as the change in the method of calculating the taxable base may require taxpayers to reassess their operating models and their financial systems. Therefore, taxpayers should expeditiously start analyzing the potential impact for each specific case.

Endnotes

1. If and to the extent that the royalty income can be regarded as "qualifying income" from "qualifying intangible assets," the royalties may be subject to a profit tax rate of 0% in Curaçao.
2. The proposed changes to the National Ordinance Economic Zones are intended to enter into force on 1 January 2020. Based on a transitional arrangement, the current wording as contained in the National Ordinance Economic Zones will however remain applicable to taxpayers who are subject to the e-zone regime on 31 December 2019 and ultimately up to 31 December 2022.

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