THE CURAÇAO TERRITORIAL PROFIT TAX REGIME; LACK OF PRACTICAL GUIDANCE

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In this article, we briefly discuss the territorial profit tax regime that was introduced in Curaçao on January 1, 2020. Even though it has been in place for about two years already, there is still quite some unclarity and discussion about it.

TERRITORIAL PROFIT TAX REGIME IN A NUTSHELL

The Curaçao offshore tax regime was terminated on December 31, 2019. The worldwide tax system was no longer valid in the amended profit tax legislation. As per January 1, 2020 all Curaçao companies became subject to the territorial profit tax regime. This entails that only income from a domestic enterprise is included in the taxable base. Domestic profit consists of income from a domestic business where the income generating activities take place in Curaçao and where the income is generated with assets linked to Curaçao. Profit is subject to the Curaçao profit tax rate of 22%.[1] Non-domestic profit is excluded from the tax base if the taxpayer is willing to apply the non-domestic income exemption.

The main rule is that all taxable profit qualifies as domestic profit. The same applies for passive income, which can best be explained as income that is not generated with the core activities of the company (for example: dividend, interest, rent and royalty income). [2] Non-domestic profit (to be exempted) can be calculated based on the formula below.

Non-domestic profit = (non-domestic causal costs / total causal costs) * total profit they operate.

Causal costs are costs which companies make to achieve turnover. Non-causal costs do not have a direct connection with turnover achieved. See below examples of costs that can be appointed as causal costs and non-causal costs:

CAUSAL COSTS	NON-CAUSAL COSTS
Production costs (excluding materials)	Daily management
Transportation and logistic costs	Secretarial services
Specific product advertisement	Bookkeeping
Licenses	IT costs
Marketing	External consultants

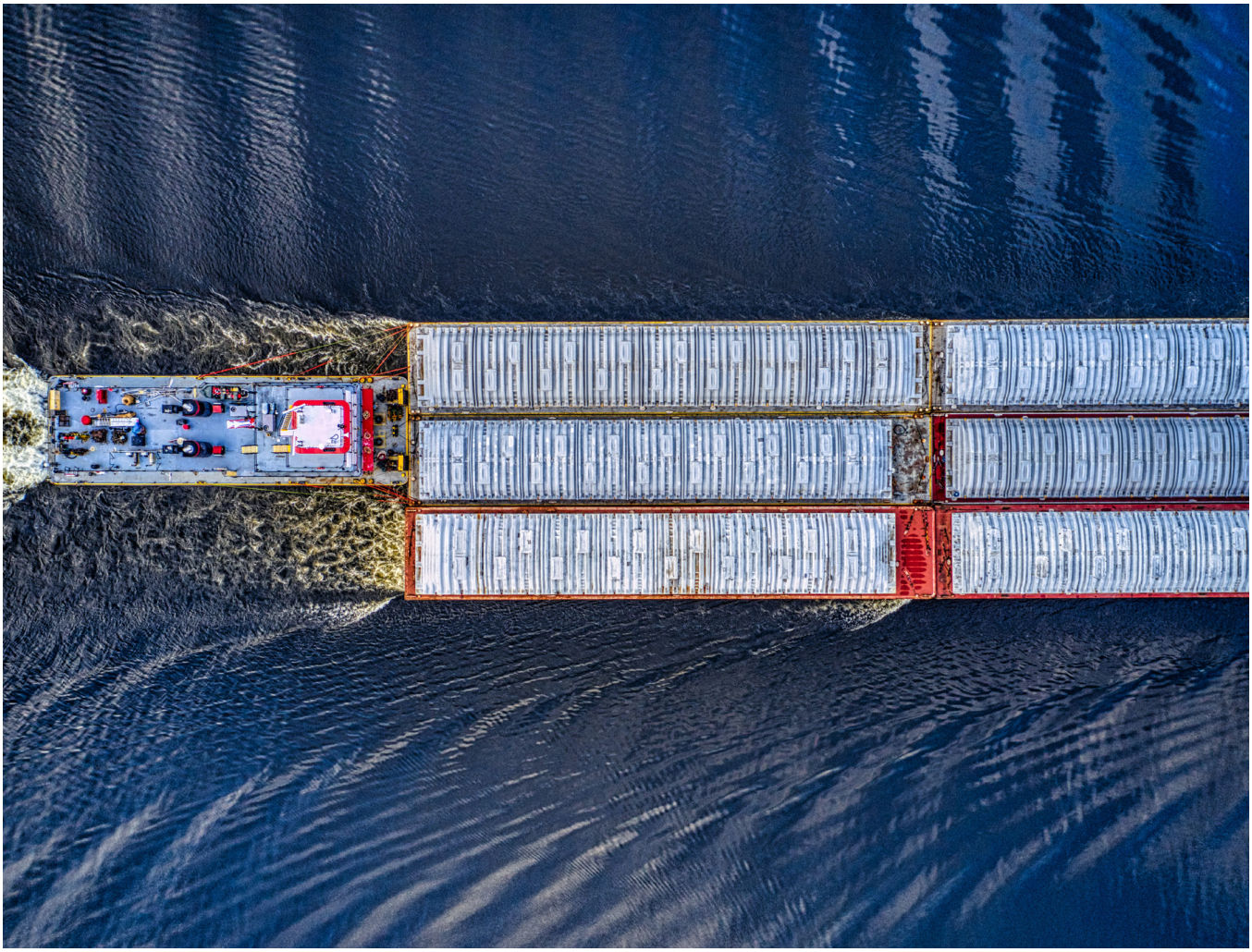
To determine whether causal costs are domestic or non-domestic, it should be analyzed where the value is added. More specifically, where the activities are performed, and costs are made that added value to the delivery of goods or services of the company. Costs for which underlying value adding activity is performed in Curaçao can be appointed as domestic costs. Costs for which underlying value added activity is performed in another jurisdiction can be appointed as non-domestic costs.

When a taxpayer for profit tax purposes is willing to exempt non-domestic profit, the taxpayer should meet the following (additional) circumstances:

1. SUBSTANCE REQUIREMENTS: the company should employ (directly or indirectly) a number of qualified employees that commensurate with the nature and extent of the activities of the company. In addition, the company should have annual recurring expenses in Curaçao that commensurate with the nature and size of the company's activities. [3]

2. PERMANENT ESTABLISHMENT: the company's activities should (if the company was a foreign taxpayer) qualify as a permanent establishment. [4]

A fine of ANG 50,000 up to a maximum of ANG 500,000 can be imposed to companies that do not meet the substance requirements intentionally or resulting from gross negligence. It should be noted that it is still possible to exempt non-domestic profit in case the substance position of the company is not fulfilled.



A PROFIT TAX REGIME THAT MEETS INTERNATIONAL CONDITIONS AND SHOULD BE SIMPLE

The territorial profit tax regime is introduced to meet (international) conditions of the Organisation for Economic Co-operation and Development (hereinafter: OECD) and the EU Code of Conduct Group. It also was the intention to improve and simplify the Curaçao profit tax regime.[5] Nevertheless, we cannot imagine that this simplification really worked out as intended.

The Profit tax Ordinance 1940 and the Explanatory Notes leave (too) much room for interpretation and discussion. If you would look for it, you cannot find a definition of non-domestic profit in the tax legislation. Taxpayers may encounter situations of uncertainty regarding labeling costs as causal and non-causal. It may also be difficult in practice to determine whether costs are foreign or domestic. This can be illustrated with the following examples. An online gaming company based in Curaçao owns a digital file with information of all online players. This file is being used by the company in Curaçao and its subsidiaries abroad. When this file is sold, the question arises how the capital gain on this file should be labeled. Is this capital gain considered as domestic profit or non-domestic profit? The answer to this question may have different outcomes, since the file was being used locally and abroad. Another example is the determination of profits of a bank versus that of an international trading company. For a bank, the source of income is determined based on the place of residence of the counterparty. Is the counterparty or customer located outside of Curaçao, the profit is considered non-domestic. For international trading companies, the source of income may not be determined on the basis of the place of the counterparty. The formula should be used here, looking at the location of the causal costs. This may raise all sorts of questions. For instance, if costs allocated to a provision of doubtful accounts or costs of sales should be considered as causal costs or indirect costs or domestic or non-domestic?

Taxpayers can and will therefore encounter situations of uncertainty regarding labeling of costs and the question whether the company meets the required substance requirements or not. We cannot imagine that any taxpayer would like to risk a penalty with a maximum of ANG 500,000! And then we haven't even touched upon the administrative burden and additional costs which are associated with the territorial profit tax regime, which was introduced to make things simple.

CONCLUSION AND FINAL WORD

The lack of clear guidance for taxpayers, the Tax Authorities, Trust Offices and Tax Advisors, could be a result of the rush in which the authorities were involved with the introduction of the territorial profit tax regime. For example, the changes of the profit tax law were introduced as per December 30, 2019 with effect as per January 1, 2020.

At this moment we still need to explain the territorial profit tax regime as the "new" profit tax regime, despite the fact that it was introduced almost two years ago. In our opinion, it is completely detrimental for all parties concerned (i.e. taxpayer, Tax Authorities, Trust Offices and Tax Advisors) and for the business climate of Curaçao that the profit tax regime is not clear.

Question is whether the authorities can introduce such guidance without complaints of the OECD that safe harbours are being created. We refer to the introduction of further guidance with regard to the substance requirements, which was introduced in the Substance Decree of September 10, 2019 and already rejected in the Ministerial Decree of July 23, 2020 under pressure of the OECD.[6]

Clear tax law and guidance in which definitions, calculations and examples are included to explain the territorial profit tax regime, cannot only be a wish but definitely are a must-have. More specific guidance on the criteria to determine where the income generating activities of specific sectors of industry have taken place would be welcome. And lastly, stakeholders would benefit if detailed guidance on the substance requirements for the specific sectors of industry in Curaçao will be provided.

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[1]Article 4, paragraph 4 of the Profit tax Ordinance 1940.
[2]Article 4, paragraph 5 of the Profit tax Ordinance 1940.
[3]Article 1C, paragraph 1 sub a and sub b of the Profit tax Ordinance 1940.
[4]Article 1C, paragraph 2 of the Profit tax Ordinance 1940.
[5]2019-92, nr. 3, Explanatory Notes.
[6]P.B. 2019, no. 56 and P.B. no. 77.