University of Miami Inter-American Law Review

6-1-1972

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1972 SURVEY OF CARIBBEAN TAXATION

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It is difficult to generalize about the tax picture in the Caribbean. There are some 25 separate taxing jurisdictions and nearly as many tax systems, ranging from the most basic to the most sophisticated. Several jurisdictions qualify as *tax havens* and impose virtually no taxes at all. At the opposite end of the pendulum are Puerto Rico and the U.S. Virgin Islands which follow—with modifications—the complex U.S. Internal Revenue Code.

Caribbean Tax Havens

Some of the world's leading tax havens are located in the Caribbean area. People come from all over the world to these Caribbean havens to organize companies which, in turn, carry on business operations and make investments throughout the world. The Bahamas and Bermuda, although technically in the Atlantic rather than the Caribbean, are generally included in any discussion of Caribbean tax havens. Other Caribbean countries which can be considered as tax havens include the British Virgin Islands, Cayman Islands, Montserrat, Netherlands Antilles and Turks and Caicos. Antigua, Barbados, Jamaica and St. Vincent also offer special privileges to certain types of companies.

Tax havens are not homogeneous. They may be broadly classified into four separate categories:

First, there are the traditional tax havens with virtually no taxes at all, such as the Bahamas, Bermuda, the Cayman Islands and Turks and Caicos.

Second, there are those havens which impose taxes, but do so at a

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relatively low rate. Included in this category are the British Virgin Islands and Montserrat.

Third, there are the havens which tax income from domestic sources, but exempt all income from foreign sources. This type is found primarily outside the Caribbean, in places such as Hong Kong, Liberia and Panama.

Fourth, there are those countries which allow special privileges. These include some countries which are not traditionally considered to be tax havens—such as Antigua, Barbados, Jamaica and St. Vincent—which have international business companies or international finance companies.

Commonwealth Caribbean Tax Havens

The *Bahamas, Bermuda,* the *Cayman Islands* and *Turks* and *Caicos* all have a complete absence of direct taxation, with no income tax or capital gains tax. Nor do they presently have gift, inheritance or estate taxes, except for a small probate duty in Turks and Caicos. They do impose stamp duties on the incorporation of companies and yearly government fees are generally required to be paid by companies. These jurisdictions have no tax treaties requiring them to furnish information to other governments.

Bermuda and the Cayman Islands both have *exempted* companies which can obtain long-term guarantees against possible future taxes. In the Cayman Islands these guarantees run for 20 years. The Cayman Islands also offer 50-year guarantees against taxes for *exempted trusts.* The Bahamas presently has no comparable guarantees. Turks and Caicos may try to enact legislation similar to that of the Cayman Islands shortly. However, efforts to develop the tax haven facilities of Turks and Caicos have been made difficult because the islands are remote and hard to reach.

Antigua, Barbados, Jamaica and *St. Vincent* all impose taxes at high rates on regular companies. Each of them also has either international business companies or international finance companies. An international business company is typically exempt from income tax, and dividends paid by such a company to nonresident shareholders are also exempt from income tax. International business companies which are investment companies generally pay 2½% income tax on investment income after deducting management expenses. Dividends from such an investment company to nonresident shareholders are similarly subject to a 2½% withholding tax. International business companies do not appear to have succeeded in attracting much offshore business to these countries.

A 1971 Jamaican law does away with new international business companies, but provides instead for international finance companies. It is designed to attract banks and finance companies to Jamaica which hopes to become the financial center of the Caribbean. A few U.S. banks have already qualified under the new law.

The Bahamas—Still an Important Tax Haven

Despite controversy during the last few years, the Bahamas remains one of the best known tax havens in the world. It still has the largest volume of tax haven business in the Caribbean. Thousands of companies and trusts have been established there. Many of them came to the Bahamas at a time when it was the major Caribbean tax haven actively seeking such business.

The Bahamas now imposes a yearly fee amounting to US$250 on all companies. This is unreasonably high when compared with other jurisdictions. Countries charging that much generally give guarantees against taxation—the Bahamas does not.

The location of the Bahamas is a big plus. Not only is it close to Florida, but it also has good airline connections with Europe as well as with North and South America. One minus factor is the reluctance of the Bahamas immigration authorities to grant or renew work permits to qualified foreigners, even though there are few Bahamians qualified for the jobs held by these foreigners. Some expatriates are now receiving "terminal" work permits. The Bahamas Companies Act is more than 100 years old and is archaic.

The distinct tax haven status of Freeport on Grand Bahama Island under the Hawksbill Creek Act has been tarnished. The Bahamian Government has stripped The Grand Bahama Port Authority Limited of control over immigration into the Freeport area. This has caused grave concern to investors in Freeport. Some investors feel that if the government can abrogate concessions relating to immigration, it might later do the same to tax concessions.

Recent developments are not all bad, however. The Bahamian Government has taken pains during the past few years to improve the image of the Bahamas by driving away undesirable elements. Banking legislation has succeeded in eliminating undesirable persons who had previously operated banks from the Bahamas. The Bahamas has become one of the world's important offshore banking centers and large Eurodollar transactions are now handled through Nassau.

Insurance legislation has been enacted to control and protect the image of insurance companies operating from the Bahamas. Many offshore mutual funds have been established or operated from Nassau, and the Bahamian Government enacted a comprehensive Securities Act in 1971 which controls mutual funds as well as all offerings of securities made from the Bahamas. There is also a new Industries Encouragement Act designed to encourage manufacturing throughout the Bahamas, by offering guarantees against taxes to new manufacturers.

Bermuda—For the Carriage Trade

Bermuda has always been regarded as an outstanding tax haven. Until 1970, the only way to incorporate a Bermuda company was by a private act of the Bermuda legislature. This was often a slow process as well as somewhat expensive. A new procedure was introduced by the Companies Act of 1970. Under it, foreign-owned companies may be incorporated without a private bill if approved by the Member of the Bermuda Executive Council responsible for Finance.

Nothwithstanding this new procedure, Bermuda will never be a tax haven for the masses. Whether for reasons of snob appeal or to protect the name and reputation of the colony, or both, a careful screening process is still followed. Bank references are required as a condition to incorporation and only persons of standing and integrity are permitted to incorporate a Bermuda company. Advertising requirements and the necessity for obtaining discretionary approval by the Member for Finance assure that the Bermuda Government will have ample time and opportunity to consider the background and the integrity of persons applying to incorporate a Bermuda company.

The time and expense involved may be justified because the Bermuda Government offers something in return—a guaranteed tax exemption. An exempted company formed by non-Bermudians can obtain a written guarantee from the Governor-in-Council, guaranteeing against the imposition of possible local taxes until 1996. Even now, Bermuda has no income tax, capital gains tax nor death duty, and none is likely to be imposed.

Bermuda is a self-governing British colony located in the mid-Atlantic, less than two hours by jet from New York. Bermuda is a great favorite with many Canadians because decisions of the Bermuda courts have held against Canadian governmental bodies which have sought to pierce Bermuda companies to determine their true ownership and the source of their assets.

Foreign-owned exempted companies pay about US$480 to the Government upon incorporation and a like amount annually thereafter. The overall cost of forming a Bermuda company, including advertising and legal fees, runs about US$2,000. The availability of a 25-year guarantee against taxes and the general reputation and stability of the Bermuda Government may make this expenditure worthwhile.

The Cayman Islands—An Important New Haven

The Cayman Islands is fast emerging as one of the world's leading tax havens. Ten years ago only stamp collectors and skindivers had heard of the Cayman Islands. Today, leading publications all over the world are reviewing the tax shelter possibilities in the Cayman Islands, and hundreds of companies and trusts are being established there each year. Political change and upheaval in some of the traditional tax havens have forced investors to seek new bases for companies and trusts. The Caymanian Government has taken positive steps to welcome these offshore investors.

The Cayman Islands is a British Crown Colony and it is likely to retain such status indefinitely. Thus, it has inherent political stability. The Governor is chief executive officer and he is appointed by the British Government. The English common law prevails and, of course, the language of the Colony is English.

The Cayman Islands has no taxes other than import duties and stamp duties required on deeds conveying local land and on most documents. There is little likelihood that income taxes will exist at any foreseeable time. And, if you form an *exempted company,* the Governor-in-Council guarantees it against possible future taxes for 20 years. If you create an *exempted trust,* the Governor-in-Council guarantees it against taxes for 50 years.

As recently as five years ago there was no telephone service in the Cayman Islands and none connecting the Islands with the outside world. Today there is a modern local telephone system which is connected by a forward scatter system to Jamaica and from there to the rest of the world. Overseas telex facilities are also available. Overseas telephone service still leaves much to be desired because of difficulties which arise from routing calls through Kingston, Jamaica. However, an undersea cable is being installed between Grand Cayman and Jamaica which is designed to connect with a communication satellite by early 1972. It should then be possible to dial overseas telephone calls directly to and from Grand Cayman. Transportation service has also improved in recent years. There are one or two non-stop jet flights daily between Miami and Grand Cayman and the flying time is only about one hour.

There are now approximately 50 banks and trust companies in Grand Cayman. Of these, some 15 carry on local business and the remaining 35 are offshore banks and trust companies. Several of the banks are putting up or planning to erect modern office buildings. A number of other banks are now studying the possibility of opening offices in Grand Cayman. Thus, Grand Cayman is fast becoming an important international financial center.

There are already nearly 2,500 companies incorporated in the Cayman Islands. This is a rather sizable number when you consider that the total population of the Islands is only about 10,000 persons. It may well be the highest per capita number of companies in any territory in the world. Many of these companies have been incorporated by offshore investors during the last five years, and new companies are being incorporated at the rate of about 50 each month. A substantial number of them are *exempted companies.*

An exempted company incorporated in 1972 won't be subject to taxes in the Cayman Islands (even if such taxes are eventually imposed) until at least 1992. In return for this "guarantee" against taxes, the Caymanian Government charges an incorporation fee of about US$500 for an exempted company. Legal fees and other costs — including obtaining nonresident status and the 20-year tax guarantee — should not exceed US$1,000, for a total cost of approximately US$1,500. The annual Government fee for such a company is about US$250. In addition, you have to pay a local bank or attorney for keeping the company in good order and furnishing a registered office and local directors and officers. The annual fees for these services range from about US$400 up to US$1,000. However, these fees and costs represent a relatively small price to pay for the assurance that you won't be taxed for at least 20 years. We generally consider such fees and costs as being tantamount to an insurance premium.

The Cayman Islands has modern Companies and Trusts Laws, both enacted during the last decade. Based on English law, they are easily understood by American businessmen and their lawyers. Cayman also has bank secrecy which is mandatory under the Banks and Trust Companies Regulation Law. Unlike Switzerland and some other jurisdictions having bank secrecy, Cayman does not have treaty obligations which might require a violation of bank secrecy.

Turks and Caicos—A Potential New Tax Haven

The Turks and Caicos Islands also enjoy the absence of general taxation. Turks and Caicos was previously a dependency of Jamaica. When Jamaica chose independence, Turks and Caicos elected to separate from Jamaica and to become a British Crown Colony. The Turks and Caicos Islands have a Governor and an Administrator, both of whom are appointed by the British Government. The Administrator functions, together with a State Council which has both executive and legislative powers. A majority of its members are elected and a minority are appointed. The State Council sets policy and passes legislation, subject to the Administrator's approval.

There is virtually no industry in the islands. At one time the islands exported salt, but they are no longer able to compete. Since there is virtually no tourism, the islands survive on revenues from customs duties, grants-in-aid from the United Kingdom, and money sent back to the islands from former residents who have moved abroad.

The local population is estimated at about 6,500. The seat of Government is on Grand Turk, one of the seven main islands. Some 1,500 persons reside on Grand Turk and an equivalent number on South Caicos. The islands are situated at the southern extremity of the Bahamas Islands chain, relatively close to Cuba and Hispaniola.

Transportation and mail service to and from the islands are erratic. The islands were previously served by Bahamas Airways until its sudden demise. The gap has been filled by Air Caicos which flies to and from Nassau three times each week, and also operates daily flights from island to island. Communication by telephone, telex and cable are reasonably good. By late 1972 it should be possible to dial direct from Grand Turk to any place in the world.

From a tax standpoint, the islands compare favorably with the other "nil-tax" havens, such as the Bahamas, Bermuda and Cayman Islands. There are basically no taxes other than import duties and stamp duties. However, there is a "probate fee" amounting to 2% of the value of a decedent's estate. This is something that the Bahamas did away with a number of years ago in an effort to improve its image as a tax haven. Turks and Caicos should do the same.

There is a comprehensive banking ordinance and banking regulations which provide for the establishment of banks and other financial institutions. There apparently is no special trust legislation, nor is there any legislation dealing with insurance companies or mutual funds.

A new companies ordinance was enacted recently. Unlike the Cayman Islands and Bermuda, it does not provide for exempted companies. Government fees for incorporation are based upon the capital structure of the company and are quite reasonable, provided that the authorized capital is kept at a minimum. However, in order to use bearer shares, the company must have a minimum capital of J50,000, which would require a J$1,000 (approximately US$1,250) registration fee. The registered office of a company must be kept in the islands, but meetings need not be held in the islands, nor are there any citizenship or residence requirements for officers, directors or shareholders.

The Turks and Caicos Islands should one day develop into an important tax haven, but much will depend on what the Government and the people do to encourage tourism and tax haven business. At the moment there is little reason why anyone should go out of his way to handle tax haven activities in Grand Turk, when it is so easy to do such business in other places. It should be noted, however, that tax haven countries do not always remain such year after year. Some of them come and go. A list of tax haven countries made 10 or 12 years ago would probably have included Canada, Cuba, Tangier, Uruguay and Venezuela, none of which could be put in the tax haven category today. The Government of the Turks and Caicos Islands and its people should take steps to develop the tax haven image of the islands. They need to improve transportation to the islands. Hopefully, they will soon have direct non-stop flights from Miami. The adoption of a modern trust law and the establishment of trust companies and trust facilities would also help. There is little question but that the number of companies incorporated could be substantially increased if the Government was able to authorize exempted companies with guarantees against possible future taxation.

B.V.I. and Montserrat—Low-Tax Jurisdictions

During recent years both the British Virgin Islands and Montserrat have succeeded in attracting some tax haven business. These jurisdictions recognized that it would be difficult for them to compete with the more established and better known tax havens. They felt that their best opportunity to generate such business would come from a combination of favorable tax treaties and relatively low tax rates.

Both the British Virgin Islands and Montserrat impose taxes on companies and individuals. The rates are low. The British Virgin Islands taxes companies at a flat rate of 12%. Individuals pay 3% of gross income plus another 12% of net income after deductions. Montserrat taxes companies at a flat rate of 20% and individuals at graduated rates with a maximum of 20%. Dividends are not taxed twice. Companies pay the income tax on profits and recover the tax by withholding from the shareholder when they pay dividends.

Both jurisdictions are covered by the United States-United Kingdom income tax treaty. Until recently both also had double tax agreements with the United Kingdom. However, the double tax agreement between the British Virgin Islands and the United Kingdom was terminated by the U.K. in 1971, apparently because the British Government felt that the 12% B.V.I. rate was unreasonably low. The Montserrat double tax agreement with the United Kingdom remains in force and from every indication the British Government does not object to Montserrat's 20% tax rate.

By virtue of the double tax agreement between Montserrat and the United Kingdom, an offshore investor can make favorable use of a Montserratian company to invest in United Kingdom company shares. Dividends will be subject to the customary U.K. withholding tax of 41¼%. However, upon proof being furnished to the U.K. Inland Revenue that the Montserratian company is paying income tax in Montserrat, the entire 41¼% U.K. tax withheld will be refunded to the company. Thus, the company will end up paying only the 20% Montserrat tax.

Similar possibilities exist with respect to investments in U.S. securities. Under the United States-United Kingdom income tax treaty as extended to a number of U.K. colonies, dividends and interest from a U.S. payor to a Montserratian company are subject to 15% U.S. withholding tax instead of the customary 30% tax. A credit is then taken for this 15% against the Montserratian tax rate of 20%, so that only the difference of 5% is payable to the Montserratian Government. Thus, the overall combined tax rate is only 20%. This same provision should apply equally to the British Virgin Islands, but it is likely that if extensive use is made of the treaty by B.V.I. companies, the U.S. will cancel the application of the treaty to the B.V.I. just as the U.K. Government already has. There is apparently much less likelihood that Washington will be unhappy with the 20% Montserrat tax rate.

Both the British Virgin Islands and Montserrat are tiny British Crown Colonies, with only limited self-government. Both have incentive legislation to encourage new industries and hotels, and each has exciting tourist possibilities. They hope that their low rates of income tax will help to attract offshore investors.

High Tax Commonwealth Caribbean Jurisdictions

Most of the remaining Commonwealth Caribbean jurisdictions have high income tax rates on both companies and individuals. These "high-tax" jurisdictions include Antigua, Barbados, British Honduras (Belize), Dominica, Grenada. Guyana, Jamaica, St. Kitts/Nevis, St. Lucia, St. Vincent and Trinidad/Tobago.

Company tax rates vary from country to country, but most have a flat rate of about 40%. Income tax rates on individuals are quite high. They graduate very rapidly to as much as 65% on income in excess of about US$7,500. Most of these jurisdictions broadly follow the United Kingdom system of income taxation. Dividends are usually taxed once, not twice. Nearly all of these jurisdictions are covered by the United States-United Kingdom income tax treaty and most of them also have double tax agreements with the United Kingdom itself.

All of these jurisdictions have adopted incentive legislation designed to encourage certain types of investment. The most common are pioneer industries and hotels aid laws. Some of them also have specific incentive laws designed to attract particular industries. A characteristic feature of the pioneer industries and other incentive laws is that they enable each government to select those industries or firms to which these aids are to be given. Pioneer firms are often entitled to "tax holidays" with a complete exemption from company tax, generally for a period of five years.

The typical 40% company tax rate in these "high-tax" jurisdictions is high enough to scare off some potential off-shore investors. Thus, in these jurisdictions, it is the incentive legislation which must be used to attract investors. Anyone proposing to invest in these countries is therefore well advised to make a thorough study of not only the tax laws, but also the available incentive laws, including the manner in which they are actually applied on a practical basis.

Late in 1971, an announcement was made to the effect that the Co-operative Republic of Guyana and five of the six Associated States — Dominica, Grenada, St. Kitts/Nevis, St. Lucia and St. Vincent — would join in forming a new nation in 1973. Later developments shed some doubt on whether this merger will actually take place. From a tax standpoint, all of these jurisdictions fit into the "high-tax" category and their tax laws are essentially similar. Presumably, if the merger does take place, there will eventually be complete harmonization of their tax laws.

The Netherlands Antilles—An Important Tax Haven

The most important non-Commonwealth Caribbean tax haven is unquestionably the Netherlands Antilles. The Netherlands Antilles is a major tax haven, and although its status as a haven began only about 15 years ago, it has become an important base for mutual funds and other investment companies, both public and private. Such companies pay a small local tax, which is generally more than offset by other advantages, including those obtained under tax treaties. Substantial benefits are also available for holding companies, shipping and aviation companies and companies investing in real estate abroad.

Netherlands Antilles subsidiaries are used by major international companies to float Eurobond issues. Income from many of these activities is taxed at a rate of 3% or less. Substantial advantages are also available with respect to United States real estate investments by Netherlands Antilles companies and sophisticated nonresident aliens investing in United States real property often do so through Curaçao companies.

The destructive riots which took place in Curaçao in 1969 appear to have had relatively little effect on the use of the Netherlands Antilles as a base for offshore operations. Early in 1971, the U.S. Congress enacted legislation designed to permit the creation of international finance subsidiaries within the United States itself. The purpose of this legislation is to eliminate the need for U.S. companies to form their international finance subsidiaries in jurisdictions such as the Netherlands Antilles. However, the new U.S. legislation is technically insufficient to accomplish the desired purpose and, thus far at least, most Eurobond offerings continue to be made through Netherlands Antilles finance subsidiaries. It is understood that the U.S. Treasury Department favors the enactment of legislation designed to cure the present defects in the U.S. law and, if such legislation is in fact enacted during 1972, it will undoubtedly reduce substantially the amount of such business going to the Netherlands Antilles.

Haiti—Principally a Question of Stability

During the regime of the late "Papa Doc" Duvalier, there was a total lack of political stability in Haiti which reduced foreign investment in Haiti to a minimum and eliminated the possible use of Haiti as a tax haven. Investors hesitate to put their assets in places lacking in political stability. The successor regime of his son shows signs of encouraging and welcoming foreign investment in Haiti and there are also rumors to the effect that legislation is being drafted to encourage offshore investors to use Haiti as a tax haven.

Puerto Rico Follows the Old U.S. Tax Law

Puerto Rico is a self-governing commonwealth associated with the United States. The Puerto Rican Income Tax Act of 1954 generally follows the old U.S. Internal Revenue Code of 1939. In addition, there is a broad program of incentives which are designed to stimulate manufacturing in Puerto Rico. The Puerto Rican industrial tax exemption program has been extremely successful in promoting the development of industries in Puerto Rico and has served as a model for other jurisdictions both in the Caribbean and elsewhere.

Although the Puerto Rican income tax law started out the same as the U.S. Internal Revenue Code, the Puerto Rican Legislature has been grafting on amendments for the past 18 years and some portions of the law are almost unrecognizable from their original form. For example, the Puerto Rican capital gains tax is now one of the most complicated capital gains taxes in the world, with numerous separate categories designed in part to curb land speculation.

U.S. Virgin Islands—A Mirror of the U.S. Tax Law

The U.S. Virgin Islands are a possession of the United States. Under legislation adopted in 1922, a "mirror law" theory applies. The U.S. Internal Revenue Code of 1954, as amended from time to time, applies to the U.S. Virgin Islands as though it were the Virgin Islands Internal Revenue Code. Whenever the words "United States" appear in the Code, or in any regulation issued thereunder, the same law and regulation are *generally* deemed to apply in the U.S. Virgin Islands as though the words "Virgin Islands" had appeared instead. This has led to peculiar rulings and special exceptions.

As a result of this, the tax laws of the Virgin Islands are often even more complicated than those of the United States. Notwithstanding this, there was until recently important industrial incentive legislation under which subsidies of up to 75% of the tax due could be rebated by the U.S. Virgin Islands Government to qualified manufacturing and tourist-oriented businesses. The old Industrial Incentive Law expired in December of 1970. A new one was passed by the Legislature in January 1971, but was vetoed by the Governor. The Legislature and the Governor are still trying to reach agreement on the contents of a proposed new industrial incentive law.

Some U.S. businessmen doing business in the U.S. Virgin Islands have done so through Western Hemisphere Trade Corporations in an effort to reduce income taxes. A qualified Western Hemisphere Trade Corporation pays a maximum U.S. tax of 34%, compared to the 48% rate applicable to other corporations. A recent decision of the United States Court of Appeals confirmed the application of this 34% tax rate on Western Hemisphere Trade Corporation activities in the U.S. Virgin Islands. The U.S. Supreme Court refused to interfere with this decision. However, the U.S. Virgin Islands Government claimed that this decision would result in substantial revenue losses and it asked the U.S. Congress for legislative relief overruling the results of the court decision. Such a provision was enacted by the U.S. Congress in the Revenue Act of 1971, which became law in December 1971. Under the terms of the new provision, a Western Hemisphere Trade Corporation doing business in the U.S. Virgin Islands will pay taxes to the U.S. Virgin Islands Government at the full 48% rate, just as though the Western Hemisphere Trade Corporation provisions had been repealed.

Conclusion

It is evident from the foregoing survey that the many different Caribbean jurisdictions have many different tax systems. With the growth of tourism and business activities throughout the Caribbean area, our understanding of the tax laws of these jurisdictions becomes increasingly more important. It is hoped that this survey and future ones of a similar nature will contribute to such understanding.