GREEN PAPER ON CORPORATE INCOME TAX STRATEGIES FOR THE BAHAMAS

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Ministerial foreword

I am pleased to announce the publication of the Green Paper on Corporate Income Tax (CIT) Strategies for The Bahamas, which sets out the options under consideration for transitioning away from the existing business licence tax (BTL) regime, as well as implementing changes to address the Organization for Economic Cooperation and Development's requirements related to Pillar Two international tax reforms. Confronting these challenges are as much about ensuring greater fairness, efficiency and effectiveness in our tax policy regime as it is about supporting fiscal resilience, economic growth and development.

As it now stands, we have a BLT that is inherently bias, given that it is calculated on revenues (turnover) instead of profits or ability to pay. Consequently, the regime may discourage domestic investment and limit economic growth; and it is not aligned with international best practices. At the same time, the imminent adoption of international tax rules for the convergence to a global minimum level of business taxation for large multinational groups require that our business tax regime is aligned with the new rules. As a government, we have already signed on to these rules, and failure to conform will result in the potential loss of revenue.

It is clear to the government that we must introduce changes in this area, and in the Green Paper we are laying out the case for this change. Stakeholder feedback is important to the process, hence this consultation exercise which reinforces the government's commitment to transparent, responsive and accountable governance.

Because of the impact of the proposed CIT implementation, we seek to obtain the widest possible range of views from businesses, investors and the public to further shape and support our approaches on the way forward. Our goal is to ensure that we explore all the right options and properly align our choices to support growth, investment and development.

Allow me to take this opportunity to thank those of you who have already contributed to the initial process of developing a framework for how we could implement a CIT regime in The Bahamas. My sincere gratitude is extended to the members of the Business Advisory Group who worked along with our consultants, Deloitte & Touche Bahamas, to define the range of preliminary options outlined in the Green Paper. Your continued contribution and the extended participation of the public is extremely critical for the work that lies ahead. We hope that those who will be affected by the CIT will play a role in helping us crystalize some of the crucial issues highlighted in this document, and advancing other considerations you deem to be important. Together, we can begin to bring about the desired changes needed to make our tax regime more effective and supportive of the government's overarching macroeconomic goals.

Hon Philip E. Davis
Prime Minister and Minister of Finance

Objective of the consultation

The Government of The Bahamas intends to modernize business taxation. Whilst a move to corporate income tax has been under consideration for some time, recent changes, both domestically and internationally have intensified the need for action.

Recent economic shocks have caused an increase in the nation's debt-to-GDP ratio, and the cost of borrowing is increasing. Internationally, business taxation for multinational entities is converging to adopt a global minimum rate in 2024 in accordance with the Organization for Economic Cooperation and Development (OECD) Pillar Two rules to which The Bahamas is a signatory.[1] Domestically, the existing approach to business taxation may be considered out of step with international norms by not accounting for a business' profit margins and due to the relatively low revenue it accrues for the Government. Each of these factors limit productive investment in the Bahamian economy.

The Government believes that a re-design of the approach to business taxation could improve the overall fiscal responsibility of The Bahamas, whilst being favourable to domestic business and aligned to global tax standards.

Against this background, the overarching objectives of this Green Paper are to:

- Identify what an appropriate Corporate Income Tax (CIT) policy in The Bahamas might look like, highlighting the most important design features and keeping in alignment with the OECD Pillar Two rules (broadly, proposals for a global minimum level of corporate income tax).
- Assess the potential impacts of the policy options considered in terms of the cost to businesses, economic impacts (economic output, employment, and investment), and Government revenues.

The Government has identified a set of CIT policy options for The Bahamas which are covered in this Green Paper. The Government engaged Deloitte & Touche Bahamas to:

- Provide information about the design features of a corporate tax policy, including those which would ensure compliance with the OECD Pillar Two rules.
- Assess the potential economic impacts, risks, and ease of implementation for the set of policy options using quantitative and qualitative data provided by the Government. The data considered includes business level tax data, economic data, and the observed experiences of other jurisdictions.

The policy options outlined in this paper are high level and summary in nature, considering only the potential effects of broad corporate income tax system design features. The details of the design features considered here will be developed in a subsequent phase of work following this consultation, with the outcome of the consultation feeding into the final policy design. *Therefore, any policy assumptions made in this Green Paper are subject to change*. Finally, it should be noted that the Green Paper does not consider a full reform of the system of taxes and Government fees.

The views of the public are important in the Government's decision about future corporate tax policy. During the first stage of assessment, the Government engaged with a Business Advisory Committee on all findings of the work. The Green Paper now extends this engagement and should

[1] It is anticipated that many countries will implement OECD Pillar Two rules by January 2024. Please see Appendix A of this document for a brief summary of the OECD Pillar Two Rules.

be read by businesses, or representatives of businesses, operating in The Bahamas since they are the stakeholders who will be most affected by the policy change.

Consultation Process

Throughout the document, there are a series of questions to assist interested parties in preparing their submissions to the key issues identified. Submissions are to be forwarded using the Response Template that may be accessed online at the Ministry of Finance website by clicking here.

The Government is inviting responses to this consultation by **July 3, 2023**. The completed Response Template should be forwarded to either:

Email: GPCIT@bahamas.gov.bs

or

Mailed/Hand Delivered to the attention of: The Financial Secretary
Ministry of Finance
Cecil Wallace-Whitfield Centre
West Bay Street
P.O. Box N-3017
Nassau, Bahamas

Following the closing date, all responses will be analyzed and considered, and the government will publish a summary report of the responses on its website.

The structure of this Green Paper reflects its scope which, following the **Executive Summary (Section 1),** can be outlined as follows:

- **The domestic context (Section 2).** This section considers the economic and fiscal position of The Bahamas, including the effects of the most recent economic shocks (Hurricane Dorian and COVID-19) and trends prior to 2019.
- **Business taxation domestically and globally (Section 3).** This section outlines the current state of business taxation in The Bahamas and provides an overview of comparable corporate income tax systems for a selection of benchmark countries. This section then provides an overview of the OECD Pillar Two rules and their implications for The Bahamas and concludes with feedback from consultation with business leaders.
- **Policy options for CIT in The Bahamas (Section 4).** This section presents the main conclusions from Sections 2 and 3 and outlines the strategic priorities of the Government. The section concludes with an outline of the policy options defined for assessment.
- **Assessment of the policy options (Section 5).** This section presents the results of the quantitative and qualitative impact assessments across the policy options chosen by the Government.
- **Concluding remarks and next steps (Section 6).** This section summarises the Government's conclusions to date and outlines the implementation steps which will follow this consultation.

1 Executive summary

The Government's goal is to transform business taxation in The Bahamas, and this Green Paper is the first step in defining the principles for a corporate income tax. The consultation is motivated by a background of inefficiencies in the existing Business Licence Fee system and international business taxation developments.

The existing Business Licence Fee (BLF) system generates relatively low revenues for the Government, whilst also creating disincentives for investment for some firms. As a proportion of economic activity, fees obtained from the BLF system represented around 1.0% of GDP in 2019.[2] This compares to revenues from corporate taxation representing 3.0% of GDP, on average, across the OECD. Additionally, **the BLF system is levied on gross turnover regardless of profit margins**, meaning that, in some instances, it must be paid by firms even in loss making years. In sectors where profit margins are variable and relatively low, this feature may be limiting incentives to invest domestically and acting as a barrier to economic growth.

Globally, the approach to business taxation is converging towards a minimum level of business taxation for large multinational groups. This convergence is guided by the OECD Pillar Two agreement, to which The Bahamas is a signatory along with around 140 countries.[3] **The current BLF system does not align with the international rules proposed under the agreement**, and The Bahamas could potentially lose Government revenues as a result.[4]

This background presents an opportunity for The Bahamas to re-design its business taxation. A new CIT policy should seek to achieve four overarching strategic objectives.

First, any system should be **competitive domestically and internationally**. That is, The Bahamas should remain internationally attractive as a place to invest and create incentives domestically for local businesses to invest and compete.

Second, in maintaining international attractiveness, **the system should be compliant with international guidance for minimum levels of taxation** (i.e., the OECD Pillar Two rules). The number of signatories to Pillar Two makes it a global gold standard and The Bahamas has an opportunity to develop a system which fairly taxes multinational entities operating in its jurisdiction.

Third, there is a **need to increase the Government's revenue raising ability** given long-term spending objectives and the increasing global cost of servicing debt. Reducing the overall debt-to-GDP ratio will require a sustained increase in revenues to achieve the budget surplus forecast by the Ministry of Finance by 2024/25,[5] combined with growth in the economy.

Fourth and finally, **any system should be grounded in simplicity**. International guidance gives governments the flexibility to apply a tiering approach for small versus large businesses. This is an important consideration for The Bahamas, given the large number of small and medium-sized

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[2] 2019 is used as a reference year throughout the document since the disruption caused by COVID-19 means that much economic data for 2020 and 2021 is not reflective of historical outcomes.

[3] Statement on Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, October 2021 and Members of the OECD/G20 Inclusive Framework on BEPS joining the October 2021 Statement on a Two-Pillar Solution

[4] Further details on the mechanism by which this could happen is provided in Section 3.3 and Appendix A.

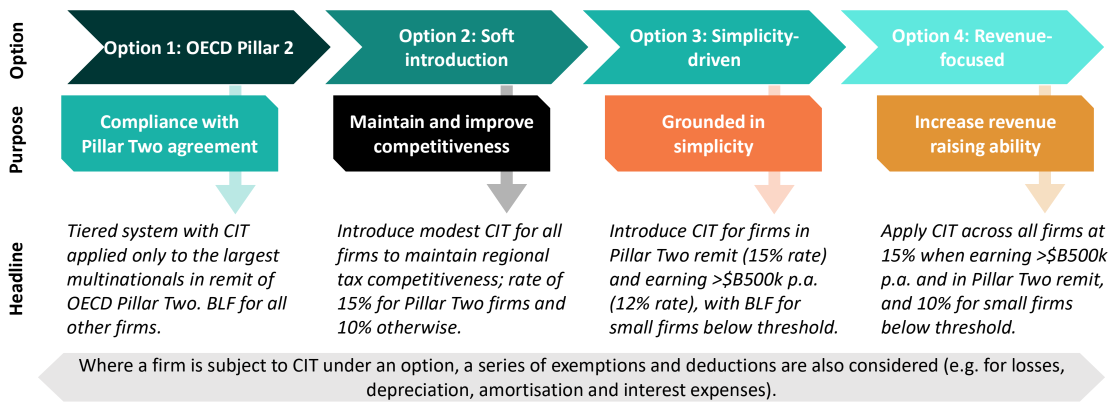
[5] Fiscal Strategy Report 2022

enterprises (SMEs) that contribute to the domestic economy but may not be able to manage complex tax reporting.

This Green Paper presents a series of CIT policy options which reflect trade-offs between these four strategic objectives and reflect the approaches to corporate taxation globally.

The Government has identified a set of policy options, summarized in Figure 1, and engaged Deloitte & Touche Bahamas to assess the potential impacts of these options. The policy options reflect typical design features of a corporate income tax and are diverse in respect of simplicity, revenue raising ability and competitiveness. At this stage, the policy options should be considered as representative and a guide to understanding the key impacts of different types of corporate income tax systems. Variations around the policy options presented in this document will be considered in the future design stage, for example the exact application of common deductions and exemptions. Each option follows the OECD Pillar Two rules, whereby firms within the remit of Pillar Two rules are subject to a 15% effective rate of CIT.

Figure 1: Identified policy options and examples of how they meet the objectives of the Government of The Bahamas



The statutory rate of 15% is levied on income net of deductions with the objective of achieving an effective tax rate of 15% in line with OECD Pillar Two rules; the greater the magnitude of deductions, the higher the statutory rate

Each of the policy options is assessed to be revenue increasing and compliant with the OECD Pillar Two agreement. The economic impacts of the policy options vary according to the change in the tax burden for different sectors and business sizes.

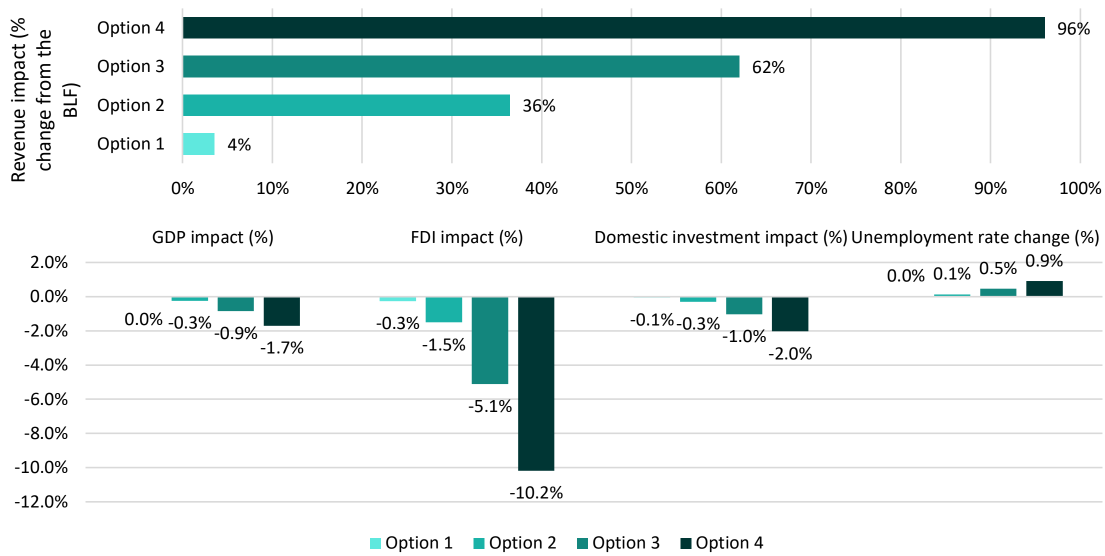
Figure 2 summarises the output of the quantitative assessment. The variation between options is representative of the trade-off between raising Government revenue at the expense of economic activity. Across metrics, Option 1 has a relatively small impact since it represents a limited change from the status quo. Option 4 has a relatively large impact, as it covers a larger proportion of firms with a higher rate.

Comparatively, Options 2 and 3 represent relatively small increases in effective tax rates compared to the current system.[6] The difference between Options 2 and 3 in respect of the economic impacts emerges because Option 3 has a greater impact on larger firms, which have a higher propensity to invest. An important channel of the GDP and employment impact is investment, the reduction of which has a multiplying effect on GDP. Additionally, Option 2 represents a step-change in terms of

[6] For comparison purposes, effective tax rates have been estimated as the amount of tax paid relative to earnings before deductions for interest, depreciation, and amortisation.

administrative requirements for businesses by including small firms in a corporate tax system. Assessing the appetite for such a change is an important element of this consultation, and the finer details for such a policy will be considered in more detail in the design stage.

Figure 2: Summary of impact assessment on revenues and economy



Further, whilst the impacts presented in this study are on an annual basis, there is the possibility of a staggered implementation of a corporate tax which would lead to gradual impacts. For instance, introducing certain OECD Pillar Two rules for large MNEs ahead of a wider reform of the business taxation system for smaller domestic firms may balance the objective of revenue collection against introducing a system that suits the needs of all firms in The Bahamas and allow more flexibility in the approach to domestic tax reform.

In terms of the sector-level results (presented in the main report), the impact of a CIT depends on the amount of BLF currently paid relative to turnover, and whether a profits-based system improves this. The wholesale and retail sector, for instance, is currently paying disproportionately more in BLF compared to its estimated profit margin. Therefore, across the options, wholesale and retail activities are estimated to experience a net gain from a change in business taxation. Comparably, real estate and financial services are estimated to experience the greatest net increase in revenue paid, due to their relatively high margins.

Similarly, across business sizes, larger firms earning at least B$6 million in revenues per annum (representing approximately 1% of total firms) are estimated to experience the largest increase in revenue contributions. For the smallest firms, the impact is zero under Options 1 and 3 since they remain subject to the BLF to minimise additional administrative burden.

Although the quantified impacts cannot reflect the convergence of corporate tax systems globally, and the non-tax characteristics of the Bahamian economy, the assessment should be fit for the purpose of choosing the right option for The Bahamas.

The quantified impacts should be taken as ballparks rather than point estimates. The number of signatories to the OECD Pillar Two rules and the general global trend towards tax transparency means that the gap between different tax systems is closing. Other jurisdictions will face similar global pressures to increase CIT rates and under each of the identified policy options, The Bahamas will remain a low-tax jurisdiction.

Additionally, the modelling does not account for non-tax characteristics of the Bahamian economy. The Bahamas enjoys high levels of human capital, political stability, and a well-developed financial system. The impacts on employment may further be moderated by virtue of The Bahamas being a service-based economy. Labour-intensive activities, such as financial services or tourism, are generally less sensitive to declines in investment. Furthermore, the trend towards tax transparency means that many multinational entities have been expecting some form of corporate taxation, and the OECD Inclusive Framework implies that this trend is set to continue. Against this backdrop, the estimated impacts on FDI may not be so large.

Finally, it should be recognised that these are direct impacts only in respect of the implementation of CIT, and do not account for the mitigating effects of the Government reinvesting their additional revenues into the economy. For example, if the Government reinvested 50% of their additional revenue across the economy in productive capital, it is estimated that this could negate up to a third of the estimated economic decline.

The chosen policy design should seek to balance the Government's revenue goals, whilst mitigating the domestic economic impact and establishing a tax system that is of global standard. With this in mind, the Government welcomes engagement with this Green Paper and responses to the questions set out in this document.

Given these strategic considerations, the Government must consider whether Options 1 and 4 meet this balance. Whilst Option 1 is not estimated to cause significant impact to the economy, it does not address the existing inefficiencies of the BLF system for low margin businesses nor achieve long term revenue goals. In contrast, Option 4 achieves revenues goals though at the expense of greater complexity and large potential economic impacts. Options 2 and 3 are considered to strike a more nuanced balance and may be observed as potential long-term solutions for The Bahamas.

On the road to deciding the appropriate policy and implementing change in the business tax system, there are further steps to be taken. This consultation seeks to solicit opinions on this area.

The Government is particularly mindful of the possible reputational impact on The Bahamas internationally, both in terms of acting on a CIT policy and not acting. Both the reputation of The Bahamas and a future CIT system will determine the competitiveness of the country as a place to do business. It is with this in mind that all of the options considered seek to comply with the OECD Pillar Two rules.

Further, regardless of the option which is ultimately identified as the preferred approach to take forward, there are a series of additional steps which will be required to design and implement the new CIT regime. These steps will develop the chosen policy approach by:

- deep dive studies into sector specific impacts;
- a detailed assessment into the effects of staggering implementation, including consideration of a cash flow system for smaller businesses;
- a detailed assessment of the proposed tax regime design, including the exact specifications of common deductions and exemptions; and

- examination of the legislative, administrative, communication, and technology requirements of the chosen CIT regime.

This process, in its totality, is expected to be lengthy and resource intensive. Countries implementing the Pillar Two rules as a supplement to established tax regimes are typically taking a minimum of 12 months to bring forward legislation. We, therefore, anticipate that the introduction of a new CIT regime will take substantially more than 12 months.

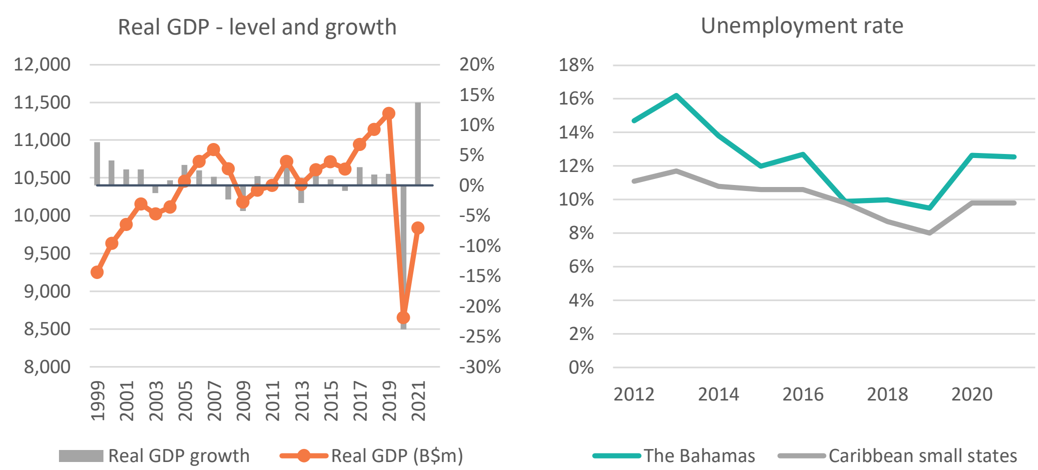
2 The Domestic Context

Hurricane Dorian and COVID-19 have adversely impacted economic growth, employment, and tourism, though prior to these shocks real GDP followed an upward trend. This section outlines the state of The Bahamian economy and headline trends for the past decade, followed by an outline of the overall fiscal status of the economy and the contribution to GDP of offshore activities.

2.1 State of the economy

Over the two decades prior to 2019, the path of real GDP in The Bahamas has been trending upwards and unemployment has been in decline (Figure 3). Economic activities related to tourism make up a growing share of GDP, with the contribution of accommodation and food services increasing from 6% to 12% between 1999 and 2019. For the same period, the contribution of financial and insurance activities declined from 15% to 9% of total GDP.

Figure 3: Real GDP growth and unemployment rate of The Bahamas



Source: Ministry of Finance, Bahamas National Statistical Institute, World Bank (World Bank estimates used for unemployment for 2020 and 2021 due to data availability). Caribbean small states are defined by the World Bank as Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Suriname and Trinidad and Tobago.

Economic activity in tourist-related sectors is less mobile than financial services; however, it is less resilient to shocks such as natural disasters and COVID-19. Following the disruptions of 2019 and 2020, the Bahamian economy has shown a robust recovery with overall growth in 2021 at 13.7% led by tourism. The IMF is forecasting 8.0% growth in real GDP for 2022, though medium-term forecasts are uncertain given the stage of the recovery, global inflationary pressures, and the country's vulnerability to natural disasters.[7]

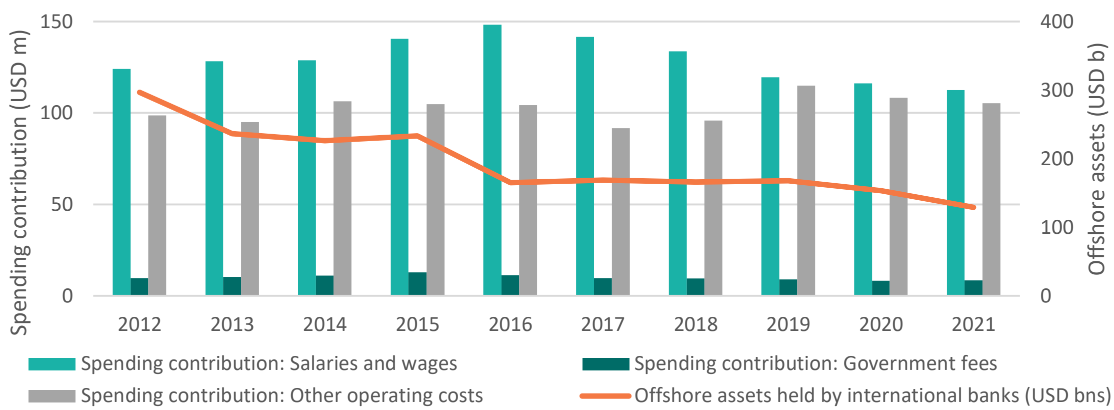
2.2 The offshore economy

The Bahamas is host to a number of international businesses which contribute to domestic GDP but do not serve the local economy (Figure 4). Many of these businesses are international banks, though their presence has been in decline over the past decade in parallel with a global push for greater transparency in offshore activities.[8] Similar declines have been seen in the Cayman Islands, a local

[7] IMF Staff Country Reports, May 2022
[8] IMF – The Bahamas Financial System Stability Assessment

competitor for offshore activities. In 2021, international banks operating in The Bahamas paid around B$8 million in fees to the Government compared with almost B$13 million in 2015.

Figure 4: Economic contribution of international banks and trust companies



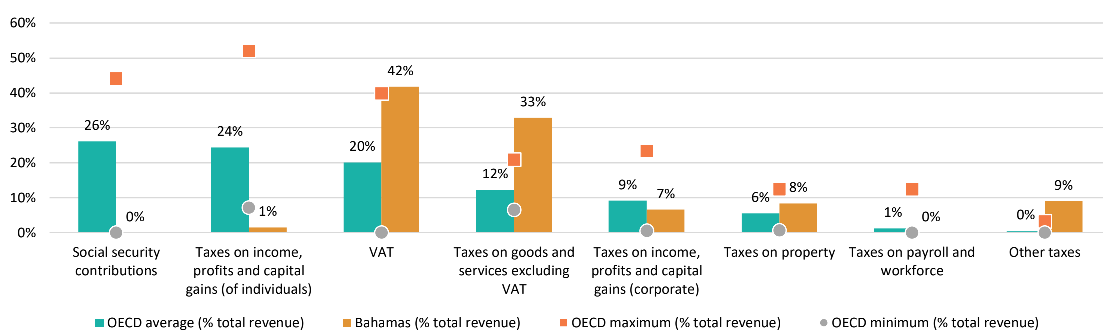
Source: Central Bank of The Bahamas

2.3 Fiscal status

2.3.1 Government revenue sources

The main source of Government revenue is indirect tax, namely, value added tax (VAT) (Figure 5). VAT has increased in importance as a revenue stream since its introduction in 2015, there have been a series of rate adjustments to the VAT rate. Revenues from excise taxes are also important, though declining since the application of VAT (9.8% of total revenues in 2019 compared with 15.0% in 2014) and it is anticipated that customs duties will continue to be reduced as the government seeks to shift away from trade taxes.

Figure 5: Tax revenues by type as a proportion of total, OECD average, maximum and minimum compared with The Bahamas (2019)



Source: OECD Statistics and Department of Inland Revenue

The BLF is the main form of taxation on businesses, levied on gross turnover. Its contribution to total revenues was 6.6% in 2019, compared to taxes of corporations on income, profits and capital gains making up 9.1% of government revenues, on average, across the OECD (Figure 5).[9] Revenues accrued via the BLF are also low by international standards when compared to GDP; between 2012

[9] OECD Statistics

and 2020, the BLF comprised 1.0% of GDP, on average. This compares to tax on corporate profits comprising 3.0% of GDP on average across the OECD.[10]

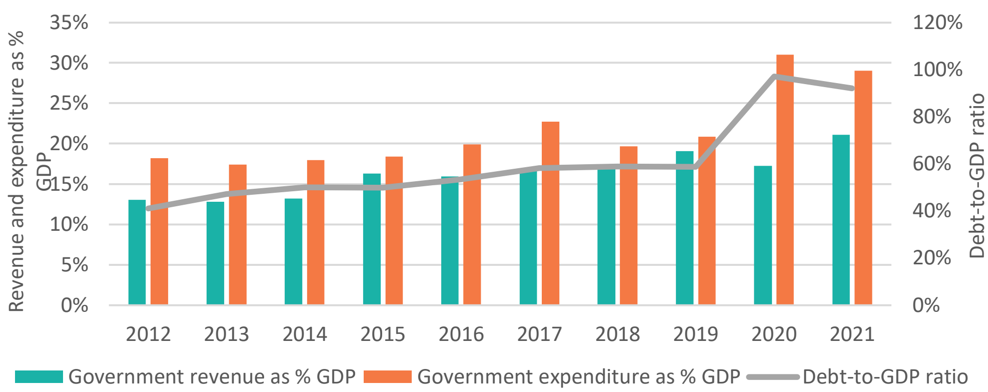
2.3.2 Fiscal position of The Bahamas

In 2020, the adverse economic shock of COVID-19 caused a simultaneous drop in Government revenues, increase in spending, and fall in GDP. This led to an increase in the debt-to-GDP ratio in 2020 (Figure 6). Considering this increase, there are two further factors which are making servicing this debt more expensive and thus limiting the investment and spending power of the Government.

First, global interest rates are now increasing from relatively low levels as central banks aim to contain inflation (for example, in January the 10-year yield in the US was around 3.4% after sitting below 3% for much of the past decade). In addition to this increase in the reference rate, spreads on emerging market bonds have also been seen to increase.[11] Second, The Bahamas has experienced a series of credit downgrades over the past decade.[12] This is partly attributed to the recent erosion in fiscal strength following the pandemic,[13] and means a further increase in the cost of borrowing for The Bahamas.

Against these two points, The Bahamas has experienced significantly higher yields on its international bonds, making international bond markets an unattractive source of financing. Outreach work to explain the Government's funding strategy for FY2022/23 has had some effect in alleviating this pressure, though a successful consolidation of the fiscal position and reduction in the debt-to-GDP ratio should improve The Bahamas' creditworthiness. Ultimately, this should lead to a reduction in the cost of borrowing. Addressing the Government's revenue raising ability by re-designing the approach to business taxation is one method by which this can be achieved.

Figure 6: The fiscal position of The Bahamas



Source: Ministry of Finance, Central Bank of The Bahamas

[10] OECD Data
[11] Specifically, there has been an increase in the J.P. Morgan Emerging Market Bond Index; see The Bahamas Medium-Term Debt Management Strategy FY2023/24 – FY2025/26, Debt Management Office, Ministry of Finance.
[12] Most recently, Moody's downgraded their previous rating of A3 in 2013 to B1 in October 2022 (Moody's), and S&P affirmed their rating of B+ in November 2022.
[13] Moody's

2.3.3 Fiscal responsibility

In this context, the Blueprint for Change,[14] on which this Government was elected, sets out a series of steps to Recover, Rebuild, and Revolutionise the economy. An important focus of this plan is stabilisation of the public finances and management of the national debt, whilst simultaneously modernising infrastructure to deliver public goods and services in an efficient, transparent, and accountable manner. Capital investment by the Government into domestic infrastructure (e.g., hospitals and ports) and small businesses (e.g., through support in disaster recovery) is necessary to foster long-term and organic economic growth.

[14] PLP Bahamas Blueprint for Change

3 Business Taxation Domestically and Globally

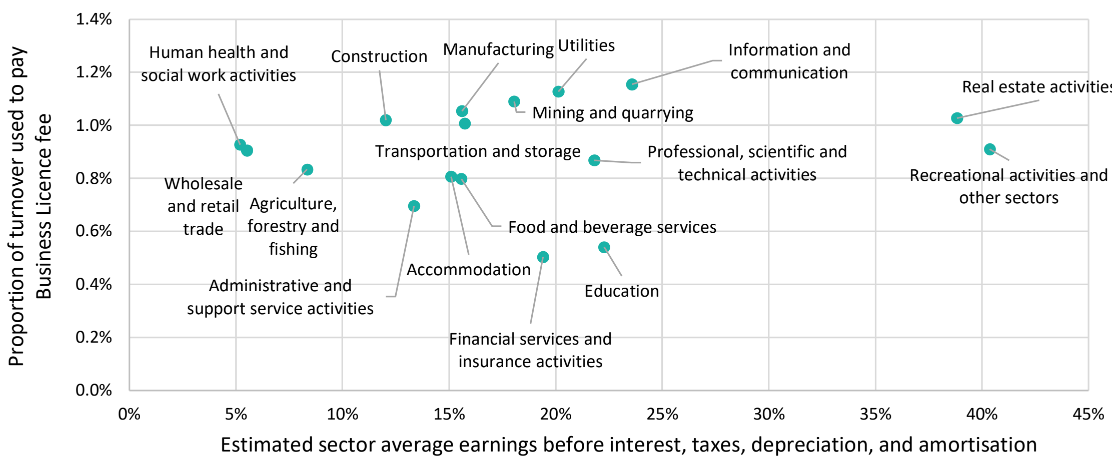
Corporate taxation in The Bahamas currently falls under the BLF, though the system does not necessarily provide the appropriate incentives for businesses to invest. Further, the BLF may not be recognised as a covered tax under the OECD Pillar Two minimum tax requirements since, among other factors, it is not a profits-based tax. A profits-based system could address this by taxing businesses based on their annual profit margin and adhering to international guidelines.

3.1 Business taxation in The Bahamas

The main form of business taxation in The Bahamas is the BLF, which is based on gross turnover and has a range of reliefs and incentives. Appendix B presents the rate schedule of the BLF.

Although the rates applied to different businesses are tiered, these are levied on gross turnover, so the BLF system does not account for the affordability of the fee to businesses in terms of annual profits. This means that the BLF does not necessarily create the appropriate incentives for growth or investment and results in disparity across sectors in terms of the share of BLF paid relative to total turnover (Figure 7). For example, the wholesale and retail trade sector and recreational activities sector each pay 0.9% of turnover, on average, to the BLF. However, businesses in the wholesale and retail trade sector are estimated to have a lower profit margin than businesses operating in the recreational activity sector (6% compared to 40%). ***A recurring theme emerging from the Business Advisory Committee is that the BLF's inflexibility may be limiting to growth***.

Figure 7: Comparison of estimated profit margins against proportion of turnover used to pay BLF.



Source: Department of Inland Revenue

Some businesses in key sectors are subject to relief from BLF. For example, businesses based in the Grand Bahama Port Area do not pay taxes on income, capital gains, real estate, and private property under the Hawksbill Creek Agreement. Additionally, Heads of Agreement[15] have been used to incentivise investment and contributions to society (e.g., employment) in return for tax exemptions.

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[15] Heads of Agreement are legal agreements which the Government enters into with investors who have proposed large-scale developments (e.g., hotel developments, residential property developments for second homeowners or cruise line island development) in The Bahamas. The respective agreements document the commitments of both parties, with commitments from the Government including the lease of Government

Question 1: Do you agree with the characteristics of the existing Business Licence Fee system outlined here? Please provide any comments you have on the existing system.

Question 2: If your business benefits from reliefs to the Business Licence Fee (e.g., Heads of Agreement), what type of investment or employment activities has the benefit enabled your business to pursue?

3.1.1 Recent developments

Since 2018, there have been actions to align the system with global standards. In particular:

- **Commercial Entities Substance Requirement Act** of 2018 requires businesses operating in The Bahamas to prove economic substance or identify their country of tax residence. This Act is a response to the OECD Base Erosion and Profit Shifting initiative.
- **Multinational Entities Reporting Act** of 2018 requires reporting entities resident in The Bahamas to exchange information with partnering jurisdictions and impose a notification obligation on all constituent entities that are resident in The Bahamas. This applies to those that are part of a multinational group with minimum consolidated revenues of USD 850m.
- **Removal of Preferential Exemptions Act** of December 2018 repealed tax exemptions for certain categories of companies or entities incorporated under several Acts. This applied to several tax types, though predominantly the BLF and stamp tax. The impacted entities were International Business Companies (IBCs), Exempted Limited Partnerships, Investment Condominiums and Executive Entities.

Substance requirements and the removal of preferential exemptions are similar to other laws being introduced in jurisdictions globally, and consistent with the overall trend seen internationally that tax residency and the payment of taxes should be aligned to where economic value is generated.

3.2 Business taxation internationally

3.2.1 Key dimensions of a CIT policy

Jurisdictions have a relatively large amount of discretion as to the design of their corporate tax system. Broadly speaking, the design of corporate income tax policies can vary across four key dimensions, outlined in Table 1.

Table 1: Key dimensions of a corporate income tax system

	Tax base	Location of tax base	Tiering options	Tax rate
Description	This refers to the type of corporate income that is subject to taxation. The tax base can vary according to design features, such as the utilisation of losses, deduction of capital allowances, R&D tax credits, limits on deductible funding costs, and exemptions for	The location of the tax base considers where tax base extends to geographically and the taxation of non-source profits. For The Bahamas, this might vary by taxing income which is accrued in The Bahamas, or taxing income which is accrued globally by	It is possible in a corporate tax regime to levy differentiating tax rates across different cross-sections of businesses. This is at the discretion of the jurisdiction, for example x% for large firms only, or x% on large firms and y% on SMEs (where firm size	Simply, the rate applied on the defined tax base. The tax rate is variable, though 15% is the minimum effective (i.e., not merely headline statutory) rate recommendation

property and exemption from certain fees and taxes. Commitments from investors tend to be in respect of a contribution to Bahamian society, either environmentally or socially.

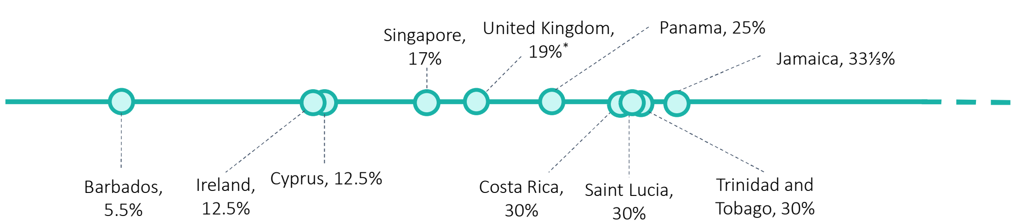
	dividend income, amongst other attributes. The tax base can also be affected by requirements on the use of accruals vs cash basis (cash basis being an approach sometimes favoured by smaller businesses as it can be administratively simpler).	firms that are headquartered in The Bahamas.	is determined by turnover/profit).	under the OECD's Pillar Two.[16]
Key considerations	The potential complexity of various deductions and exemptions, and the resulting administrative burden this might have on both businesses and the Government.	Distortions in the location of capital/profit; ability of large firms to relocate its holding company.	Such a structure might produce difficulties in enforcement for SMEs, and there is a risk of administrative burden due to added complexity.	This variable is typically the headline of a corporate tax regime, and so there are implications for tax competitiveness if being used as a benchmark against international competitors.

The considerations above are high level and would require the addition of more detailed stipulations in the more detailed design phase, such as exemptions and tax credits and also consideration of the treatment of tax relief (e.g., group relief) and transfer pricing, both of which introduce a group dimension to the operation of a domestic tax system. In particular the design phase should give consideration to the basic unit of taxation e.g., entity level or group level, something in which approaches vary internationally.

3.2.2 Approaches to CIT in other jurisdictions

To understand what a CIT policy could look like for The Bahamas, the Government has considered a sample of benchmark jurisdictions who have comparably developed international financial industries. Standard CIT rates for the sample of benchmarked jurisdictions range from 5.5% to 33½% (Figure 8).[17] Inclusion of income types in the tax base also varies considerably (please refer to Appendix C), with exemptions including dividends, foreign income, and rental income depending on the investment types a jurisdiction is seeking to incentivise.

Figure 8: Headline corporate tax rates of benchmarked jurisdictions



[16] 'Effective' rate differs from the 'headline' or 'statutory' rate in that it is the average amount of CIT paid across the total tax base. The headline rate is the rate before application of any deductions or exemptions.
[17] Note these are only headline statutory rates, and some jurisdictions have other rates that apply for certain business (e.g., Ireland has a 25% rate for non-trading/investment income) or industry (e.g., Singapore has lower rates than 17% for certain sectors such as financial services), all of which is being reviewed in light of Pillar Two implications.

** Increasing to 25% from 1 April 2023*

3.2.3 Common deductions and exemptions

In addition to varying the income types included in the tax base, the design of the CIT can be customised further through tweaks to more granular elements such as tax base deductions and exemptions. Deductions and exemptions are typically used to incentivise certain types of business activity. The most common types are set out below, along with their respective advantages and disadvantages.

Deducting historical losses from taxable profits. This can incentivise investment by offsetting losses against future profits and insulating businesses against earnings volatility. Reducing the number of years of losses that may be offset reduces complexity. For instance, trading losses of firms in Trinidad and Tobago may be carried forward indefinitely with no cap, whilst in Costa Rica losses may be carried forward for three years, and in Jamaica deductions of losses from the previous year are capped at 50% of the taxpayer's chargeable income.

Tax depreciation for goodwill/capital expenditure. This can incentivise capital investment, though the legislation must be sufficient to prevent accounting methods being used to take advantage of the system. For example, firms in Saint Lucia are permitted 20% capital allowance on acquisition of industrial buildings, whilst those in Cyprus are permitted accelerated tax depreciation at 20% on property and equipment acquired during relevant tax years.

Research and development (R&D) tax credits. R&D deductions encourage the location of these activities within a nation's jurisdiction; however, their effect may be limited in economies that are not driven by R&D intensive sectors. Of the benchmark jurisdictions, Ireland, and Singapore permit deduction of specific R&D expenditures (in Singapore only for certain years of assessment. Consideration should be given to whether any tax credits adopted as part of the corporate tax regime are compatible with the Pillar Two rules.

Limits on interest deduction. Such rules seek to prevent the use of debt structures to extract profits without paying CIT, though are required to be relatively complex to have the desired policy impact. Most of the benchmark jurisdictions permit the deduction of interest payable on borrowings at least to the extent that borrowing is used for business purposes, some with limits (e.g., UK).

Question 3: Does your business have the relevant systems in place (e.g., accounting capabilities, technology) to benefit from the common deductions and exemptions for a corporate income tax listed here? If the answer is no, is this something which you would be able to achieve in the next 12-24 months?

Question 4: Considering the common deductions and exemptions for a corporate income tax system listed here (loss deduction, tax depreciation for goodwill/capital expenditure, R&D tax credits, limits on interest deduction), which would be of most relevance to your business? Please explain why.

Question 5: Considering types of business income, are there any exemptions that would incentivise investment or employment in your business? Please explain why.

3.3 Proposals for a global minimum effective CIT rate

As part of the global Base Erosion and Profit Shifting (BEPS) project, the OECD and G20 have developed the Pillar Two rules to ensure that large multinationals are subject to a minimum level of taxation in every jurisdiction they operate in. Along with around 140 countries, The Bahamas is a signatory to this initiative.[18]

The BEPS Project intends (among other things) to address tax challenges arising from the digitalisation of the global economy. A two-pillar proposal has been developed to do this. Pillar One is focused on providing a new taxing right for market jurisdictions and Pillar Two is focused on global anti-base erosion by introducing a global minimum level of tax for large multinational enterprises. Pillar One only applies to very few groups, i.e., those with a consolidated group turnover of over EUR 20 billion and is of less immediate focus.

Pillar Two is the immediate focus for The Bahamas and introduces the Global Anti-Base Erosion (GloBE) Rules. These rules seek to ensure large multinationals pay a minimum level of tax on the income arising in the jurisdictions in which they operate and applies to groups with consolidated group revenue exceeding EUR 750 million (or the equivalent amount in a different currency).

Pillar Two provides for a co-ordinated system of taxation for large multinational enterprises which imposes a top-up tax on a group parent company in respect of profits arising in a jurisdiction where the effective tax rate (ETR) is below the minimum rate of 15%. For example, in the absence of CIT in The Bahamas, a 15% top-up tax would, in principle, be payable on profits of a Bahamian subsidiary of such a multinational group and such tax would be payable to the tax authority where the ultimate parent company is resident. Further details on the Pillar Two rules are presented in Appendix A.

3.3.1 Requirements for The Bahamas

As a signatory to the Pillar Two proposals, there are two main considerations for The Bahamas tax regime going forward.

I. Although The Bahamas is not required to create domestic rules implementing the Pillar Two rules,[19] any rules it does implement for multinational entities should align with the principles set out under the OECD model.

II. Although The Bahamas is not required to establish a domestic minimum level of taxation, if it does not, then Bahamian resident subsidiaries of both non-Bahamian resident multinational groups and Bahamian resident multinational groups with revenue of EUR 750m or more will be liable to top-up tax elsewhere to increase their effective rate of tax to 15%.

The second point implies that there is a financial incentive for The Bahamas to create a minimum level of taxation for groups in scope of the Pillar Two rules, at least from January 2024 when it is expected that certain jurisdictions will implement Pillar Two rules.[20] This could take the form of a qualifying domestic minimum top-up tax ('QDMTT'), which would be creditable against liability to top-up tax elsewhere (referred to in 2. above). This would therefore preserve The Bahamas' primary right to taxation over amounts arising from its own tax base. Otherwise, it must accept that other countries may tax the profits accrued by the relevant entity resident in The Bahamas. This amounts to potential Bahamian tax revenues being leaked to other jurisdictions, which would be inefficient

[18] Statement on Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, October 2021 and Members of the OECD/G20 Inclusive Framework on BEPS joining the October 2021 Statement on a Two-Pillar Solution
[19] Specifically, an income inclusion rule or an undertaxed payment rule.
[20] For example, the UK has indicated that the rules will be implemented from January 2014 in the Autumn Statement 2022.

for the Government's future investment plans to the extent that lower Government revenues limit long-term investment.

3.3.2 Responses of other jurisdictions

There are several other jurisdictions which have signed up to the Pillar Two rules that have CIT regimes which are not currently compliant with the published guidance. Some countries have already announced actions they propose to take to align with the minimum requirements of Pillar Two. Of the benchmark countries, Ireland has announced that it intends to increase its corporation tax rate to 15% for those groups within the scope of Pillar Two. For those groups outside of the remit of Pillar Two, the statutory 12.5% rate for trading income will be retained.

Outside of the benchmark jurisdictions, the UAE is a case to note.[21] There has not historically been a CIT in the UAE, though in January 2022 it was announced that a federal corporate tax rate would be introduced. Multinational companies with revenue greater than EUR 750m per annum would be levied a rate of 15%, whilst other businesses with profits in excess of a threshold of AED375,000 would be subject to CIT at a statutory rate of 9%. Businesses which do not meet the revenue or profit thresholds above would be subject to 0% rate of CIT.

Question 6: If your business is part of an organisation which falls into the remit of Pillar Two, are you aware that certain jurisdictions are seeking to implement Pillar Two rules with effect from January 2024? If yes, in which jurisdiction is your parent company located, and has there been an impact to your future business plans? Please outline your business response to the OECD Pillar Two initiative.

3.4 Preliminary feedback on business taxation from the Business Advisory Committee

To inform the preliminary research, a series of workshops were conducted with a Business Advisory Committee (BAC). The organisations involved in this process are listed in Appendix D, and the approach to engagement with the BAC is summarised in Figure 9.

Figure 9: Approach to engagement with the Business Advisory Committee

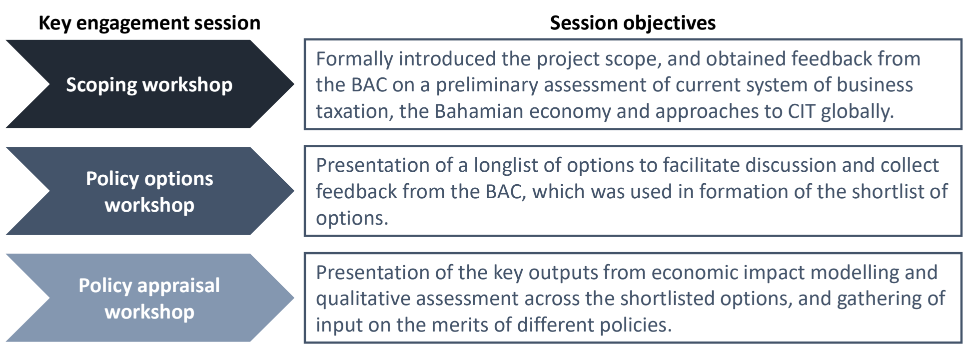


Table 2 summarises the key feedback points from the workshops and highlights the implications for the CIT design features. Broadly, participants were enthusiastic about a profit-based CIT over the existing turnover-based BLF. Additionally, there was strong support for mechanisms to allow

[21] The UAE is not included as a benchmark country largely due to different economic composition, though commented on here in respect of Pillar Two due to relevant learnings for The Bahamas.

historical losses to be deducted from current profits whilst keeping design features relatively simple (particularly for smaller businesses with limited accounting capabilities).

Table 2: Key feedback points from BAC workshops and interviews with key sector representatives

Relevant feedback point	Implications for CIT design features
BLF based on revenue represents a challenge for firms operating with small margins; sometimes represented very high effective tax rates (close to 100% in some cases)	A more equitable **profit-based corporate income** tax would support firms with a **large revenue base but smaller margins**
Concerns around how MoF will be able to manage a complex corporate tax policy	Any tax regime should be introduced alongside **clear governance** and **reassurance that the system will be robust**
Introduction of corporate tax should not discourage economic growth and positive business activity	The introduction of **deductibles for desirable business activity** (e.g., R&D, supporting local economy) should be considered
Tax should support the volatile nature of the business in The Bahamas (due to natural disasters); current BLF does not account for loss making years	The tax regime should seek **to ensure losses can be smoothed across years** (e.g., relief from financial losses in previous year)
Corporate income tax represents a greater challenge for smaller firms with limited accounting resources	**A tiered corporate tax system** which supports **smaller firms** would ensure they are not disproportionately impacted
Lack of transparency and clear communication from the MoF may cause uncertainty and speculation; particularly for small firms without accounting experience	MoF should ensure policy-making process is **clearly communicated** and **should avoid ambiguous comments that could lead to speculation**

Question 7: Considering the feedback from the Business Advisory Committee, which points are of most relevance to your business, and why? Are there any feedback points which you strongly agree or disagree with?

Question 8: Are there any points of the preliminary feedback which you would like to elaborate on, or are there any omissions you would like to highlight?

4 Policy Options for CIT in The Bahamas

4.1 Strategic priorities for a CIT in The Bahamas

Using the findings from the reviews of the domestic economic context and the overall fiscal context, the Government of The Bahamas has four strategic priorities.

First, there is the need to **maintain and improve competitiveness of the system**. Competitiveness must be maintained in terms of the international attractiveness of The Bahamas as a place to invest. At the same time, it must be improved by creating incentives for existing businesses to invest. The current system presents a challenge for local firms with volatile profit margins, and there are disparities across industries in respect of the amount of tax paid relative to profits. Any CIT system should represent a net improvement when compared to the existing BLF system in this respect.

Second, in maintaining international attractiveness, **the system should be compliant with Pillar Two rules**. The number of signatories to Pillar Two makes it a global gold standard, though the current format of the BLF system is unlikely to be compliant. Given the shift globally towards tax transparency, multinational entities are likely to face taxation wherever they are located. This global commitment produces a financial incentive to The Bahamas to follow suit and fairly tax multinational entities operating in the jurisdiction.

Third, there is the need to **increase the Government's revenue raising ability** given long-term spending objectives, which have been set to achieve goals of long-term economic growth. Whilst revenues are expected to grow in the near-term as the economy recovers from the pandemic, there is a further objective of reducing the overall debt-to-GDP ratio. It has long been acknowledged that The Bahamas does not collect sufficient revenues relative to its overall economic activity.

Finally, **any system should be grounded in simplicity**. Pillar Two rules give governments the flexibility to apply a tiering approach for small versus large businesses. This is an important consideration for The Bahamas given the large number of SMEs that contribute to the domestic economy and may not be able to manage complex tax reporting.

Question 9: Considering the evidence presented on the domestic and international landscape, and given your own experience, are there any considerations for a CIT in The Bahamas missing from this list?

4.2 Policy options for assessment

Given these objectives, **The Bahamas has an opportunity to establish a globally recognized tax system**. To this end, a diverse set of policy options has been identified by the Government, each of which aims to be compliant with OECD Pillar Two and present a trade-off between the Government's strategic objectives (Figure 10). It should be noted that where Option 3 is described as 'simplicity driven', this is primarily in respect of the administrative burden introduced to businesses (e.g., compliance and accounting requirements). Consideration of the burden on the Government across options will be assessed in detail in the design and implementation phase.

Figure 10: Illustration of trade-offs between the policy options on the strategic priorities of the Government

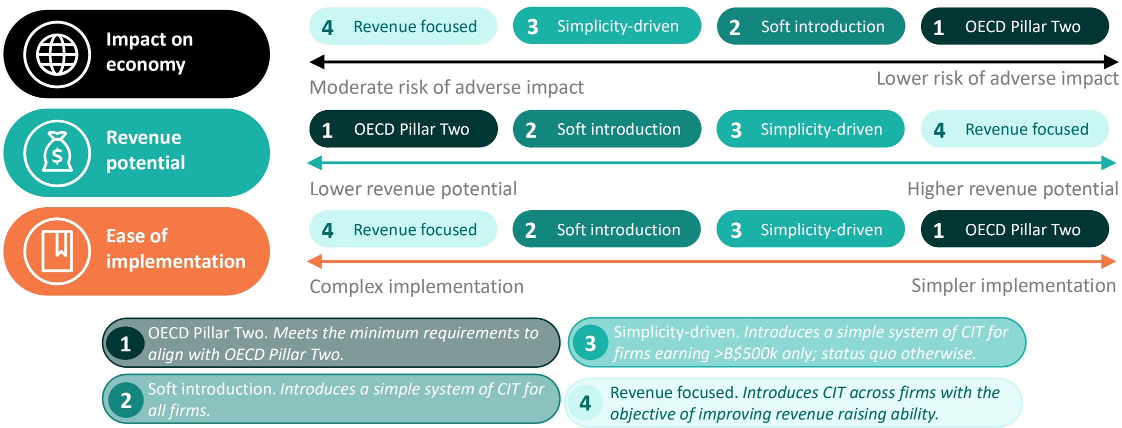


Table 3 summarizes the policy options included in the assessment, with definitions of the policy design features presented in Appendix E. Each option aims to comply with OECD Pillar Two requirements by including a statutory rate of CIT of 15% for multinational entities operating in The Bahamas and earning consolidated turnover of at least EUR 750m per annum.

Following this consultation, the chosen policy option will go into a detailed design phase (the next steps are summarized in Section 6). It should therefore be acknowledged that, for the purposes of the consultation, the policy options are high level only and the proposed statutory rate may need to be higher if deductions to the tax base go beyond those recognised by the OECD.[22] In addition, the assumptions underlying the deductions and exemptions characterizing the policy options outlined in Table 3 are subject to change following the outcome of the consultation, and the introduction of systems for different business sizes may be staggered to ease the legislative burden.

Policy Option 1 represents the minimum of the options in terms of actions taken and seeks to align the existing system closely with the OECD Pillar Two requirements by levying a statutory CIT rate of 15% for firms in the Pillar Two remit, with the objective of achieving an effective rate of 15%. In addition to compliance with global standards, this approach is grounded in simplicity by maintaining the existing BLF system for the majority of businesses operating in The Bahamas who are out of scope of Pillar Two. The Pillar Two aspects of Policy Option 1 provide the basis of the framework for

[22] We note that the OECD Pillar Two guidance requires an effective tax rate of 15%, where the effective rate is estimated as adjusted covered taxes and deferred taxes divided by adjusted net GloBE income, see OECD Pillar Two rules. Given data challenges, it has been necessary to approximate net GloBE income using a series of deductions which are representative of those recognised under Pillar Two. Therefore, whilst the Options here state a statutory minimum rate of 15%, the inclusion of deductions and exemptions beyond those defined by the OECD for the purposes of GloBE income may require this to be greater to achieve an effective tax rate of 15%. A further design phase will follow this piece of work in which such details will be refined.

the other three policies. This element of a CIT system may comprise the first phase of implementation if the Government decides to take a staggered approach, with any subsequent elements from Options 2 to 4 following as a second phase. Implications of a staggered approach are considered in Section 5.4, with a more detailed assessment to be carried out in the design phase.

Comparatively, **Policy Option 2 introduces a modest CIT across all businesses in The Bahamas** and seeks to minimize deviation from the tax systems of other Caribbean economies, maintaining tax competitiveness. This option introduces a simple form of CIT across the whole economy, with a statutory rate of 15% (with the objective of achieving an effective rate of 15%) for those in scope of Pillar Two and 10% otherwise. This option represents a step-change in terms of administrative requirements for all businesses; the public appetite for such a change is an important focus of this consultation.

Policy Option 3 maintains some degree of the existing BLF system for smaller businesses, thus also maintaining simplicity. Larger firms with turnover of at least B$500,000 per annum are subject to CIT, with a statutory rate of 15% (with the objective of achieving an effective rate of 15%) for those in scope of Pillar Two and 12% outside of Pillar Two. Firms subject to CIT are eligible for certain exemptions and deductions. Smaller businesses with turnover of less than B$500,000 per annum remain in the existing BLF system, which could also be reconfigured.

Finally, the revenue focused **Policy Option 4 is the most complex, by applying CIT across all firms regardless of turnover**. This policy takes the maximization of Government revenues to the limit, producing a more complex system across each dimension of CIT policy though aligning with tax rates internationally. All large firms with turnover of at least B$500,000 per annum are subject to a statutory rate of 15%, whilst firms below this threshold are subject to a statutory rate of 10%. Certain exemptions and deductions are permitted for all firms.

Where the existing BLF system is incorporated in the CIT policy, this is assumed to be unchanged from that outlined in Appendix B. There is the possibility that should the BLF remain in place following the introduction of a new CIT regime, it could be reconfigured. Alternatively, the BLF could be replaced by a system which addresses the Strategic Priorities outlined in Section 4.1.

If a CIT system is adopted for smaller businesses, this could take the form of a simpler version of CIT such as a cash flow system (instead of an accrual-based system). Smaller businesses can find it administratively simpler to administer tax compliance in a cashflow tax system by being required to only calculate their tax position in respect of paid expenses and income (as opposed to accrued income and expenses). However, for larger businesses the international norm is for an accrual accounting basis to be the required standard when calculating any tax liability. This may be more appropriate for purely domestic businesses, as consideration should be given to the compatibility of such a system for international groups seeking to claim double relief for local tax suffered.

It should additionally be noted that the tax treatment of specific business forms (e.g., limited companies, partnerships) will be addressed in the design stage.

Question 10: If a CIT regime were adopted for all businesses, if your business is a small or medium sized business under the existing BLF system, would it be beneficial for businesses to have the option to elect to use a cash-flow based tax system (rather than one based on accruals accounting)? Please provide details of the potential advantages and disadvantages such a system may give rise to for your business.

Question 11: What are your views on the potential to remove the Business Licence fee system for all businesses and replace it with a CIT regime?

Question 12: Considering the design features of the CIT policy options outlined in Table 3, are there any assumptions that you agree or disagree with from the perspective of your business? For example, the treatment of losses, the treatment of depreciation and amortization, R&D tax credits or interest rate deduction. Please explain.

Table 3: Summary of policy options considered for assessment

Design feature	Option 1: OECD Pillar Two	Option 2: Soft introduction	Option 3: Simplicity-driven	Option 4: Revenue focused
Number of taxable groups	Two	Two	Three	Three
Turnover thresholds for tiers	Pillar Two	Pillar Two	Pillar Two; B$500,000	Pillar Two; B$500,000
Tax type	CIT for Pillar Two entities; BLF otherwise	CIT for all firms	CIT for firms in groups above each threshold; BLF otherwise	CIT for all firms
The below applies only for those businesses subject to CIT; BLF system assumed unchanged where it continues to apply				
Statutory tax rate	15%	15% if in Pillar Two scope; 10% outside Pillar Two scope	15% if in Pillar Two scope; 12% outside Pillar Two scope	Pillar Two and B$500,000 firms: 15% Small firms: 10%
Location of tax base	Source-based; considers profits generated within The Bahamas	Aligned to regional comparator (Barbados); tax levied on global profits for resident businesses and domestic profits for non-residents	Source-based; considers profits generated within The Bahamas	Tax levied on global profits of businesses, with relief available for tax paid in foreign jurisdictions
Treatment of losses	Capped on duration up to 5 years	Pillar Two firms: capped on duration up to 5 years. Other: capped on duration up to 10 years	Pillar Two firms: duration up to 5 years with no EBITDA limit; B$500,000 firms: percentage, up to 50% of EBITDA	All firms: duration up to 5 years
Treatment of depreciation and amortization	Capital allowance, up to 20% capital depreciation or 10% amortisation deduction	Capital allowance for all firms, up to 20% capital depreciation or 10% amortisation deduction	Pillar Two firms: capital allowance, up to 20% capital depreciation or 10% amortisation deduction B$500,000 firms: 20% depreciation and 0% amortisation	Pillar Two and B$500,000 firms: capital allowance, up to 20% capital depreciation or 10% amortisation deduction Small firms: N/A
R&D tax credits	0% relief for R&D expenditure	0% relief for R&D expenditure	0% relief for R&D expenditure	Pillar Two firms: 0% relief for R&D expenditure B$500,000 and small firms: up to 30% of R&D expenditure
Interest expense deduction	100% deduction up to 30% of EBITDA	100% deduction up to 30% of EBITDA	100% deduction up to 30% of EBITDA	All firms: 100% deduction up to 30% of EBITDA

Please refer to Appendix E for definitions of the design features. Firms in the Pillar Two threshold are MNEs with consolidated earnings of at least EUR 750m. Number of taxable groups refers to the different groups of businesses which are given different treatment for tax purposes. To achieve a 15% effective tax rate as defined by the OECD Pillar Two rules, the statutory tax rate may need to be higher in the case that further deductions are included.

5 Assessment of the Policy Options

This section outlines the approach taken in assessing the policy options and presents the output of the assessment. The output of the assessment is organized by an assessment of revenue impacts, an assessment of economic impacts, and a qualitative assessment of domestic and international risk factors.

5.1 Approach to assessment

The assessment approach considers the range of strategic priorities defined by the Government (Table 4) using quantitative and qualitative information. The strategic priorities are organised into three categories of revenue potential, impact on the economy and ease of implementation. Deloitte & Touche Bahamas supported the Government by producing an impact assessment of these categories using the information provided, as described in Table 5.

Table 4: Summary of strategic priorities and assessment approach

	Revenue potential	Impact on economy	Ease of implementation
Key factors considered	Potential impact on fiscal position	By sector and business size; consideration of competitive and distortionary effects	For businesses and Government
Assessment Approach	Quantitative assessment of Government revenue data	Quantitative economic impact model plus qualitative assessment of the response of businesses	Qualitative assessment across both government and businesses
Impacts measured	Expected tax revenue, including as a % GDP. Criteria requires CIT at least revenue-neutral compared to BLF	GDP, unemployment, domestic investment, FDI by sector and business size	Comparison of administrative, technology and legislative requirements across options, both in terms of implementation and compliance

Table 5: Outline of analytical support provided to the Government of The Bahamas by Deloitte & Touche Bahamas

The different approaches to assessment depend on the availability of data. The **quantitative impact analysis** uses:

- Business-level data on tax revenues (Business Licence Fee and VAT revenues provided by the Ministry of Finance).
- Economic statistics (e.g., GDP, employment) provided by the Ministry of Finance.
- Data on company financials.

The economic impact assessment further uses assumptions grounded in the economic literature. For example, elasticities between investment and economic output are used to ascertain the GDP impact. Since granular economy-wide data for The Bahamas over a sustained period is not available, there are some limitations to the economic impact modelling. This means that it cannot account for certain effects, such as:

- **Feedback loops between different elements of the economy.** For example, the initial shock to investment should dissipate over time as the economy adjusts (e.g., via an increase in the price level or higher investment in sectors where the effective rate of tax has decreased).

- **Unmeasured effects of introducing CIT from scratch**. The academic literature on CIT primarily covers the effect of increasing or decreasing effective rates, and limited evidence exists on the effect of an entirely new system.
- **Behavioural changes in response to certain policy design features.** For example, a new capital allowance could incentivize businesses who have not previously heavily invested to increase their capital expenditure.
- **Effects on the price level due to an increase in the effective tax rate.** In theory, a change in the cost of doing business may be passed on to consumers via a change in prices. Such a change should be immaterial given the relatively small, estimated changes in the effective tax rate.
- **Underlying economic distortions due to COVID-19.** The assessment uses data from the last year unaffected by the pandemic (2019), and it should be recognised that (as is the case globally) future growth rates are uncertain.
- **The effect of staggering the introduction of CIT systems.** The results presented represent an annual impact; the revenue effects of staggered introduction will be considered at the design phase.

Notwithstanding the above points, this high-level assessment is fit for the purposes of understanding the trade-offs between the Government's strategic objectives ahead of the more detailed design phase. The high-level assessment intends to serve as a guide for possible mitigating actions following a change in the effective tax rate across businesses, and to highlight the areas in which more granular assessment may be required.

Further, since completion of this analysis the OECD has published its own economic impact assessment of the Two-Pillar Solution.[23] The OECD assessment takes a more top-down approach and is based on a different set of data, most notably Country-by-Country Reports, which may lead to a difference in the results of the impact assessment. The subsequent design and implementation phase of this work will look to refine the impact assessment in consideration of the data sources used by the OECD.

The **qualitative impact analysis** considers how these caveats may affect the analysis and identifies possible economic impacts which are not quantifiable. Additionally, a **risk assessment** has been conducted in the context of the existing domestic tax system and the international tax landscape. Each of these aspects draw on the experience of other jurisdictions and the knowledge of subject matter experts engaged for the purpose of this research.

In the following section, the impacts under the revenue potential evaluation criteria are considered first since this value also enters the economic impact assessment. The economic impact assessment forms the core of the quantitative impact assessment, and the qualitative assessment considers the potential risks of introducing a corporate tax and the high-level implementation requirements.

[23] Economic impact assessment of the Two-Pillar Solution - OECD

Question 13: Keeping practicalities with respect to data availability in mind, are there any other areas that might reasonably be assessed (quantitatively) in respect of the impact of CIT? Are there any other impacts which you would expect to see assessed?

5.2 Assessment of revenue impacts

On the basis of the BLF revenues received in 2019, it is estimated that each of the policy options could be revenue increasing relative to the existing Business Licence fee system (Table 6). The results indicate that as the effective tax rate increases, tax revenues will increase roughly proportionately (i.e., doubling the effective tax rate will double the tax revenue). This effect weakens as the effective tax rate increases since at higher levels of effective tax, the marginal increases in the tax rate may suppress economic activity. However, academic literature has found that at low statutory tax rates (below 20%), tax revenues indeed increase proportionately to corporate tax rates.[24]

Table 6: Impact of CIT on Government revenues, compared to the existing BLF system

Impact	Business Licence Fee	Option 1: OECD Pillar Two	Option 2: Soft introduction	Option 3: Simplicity-driven	Option 4: Revenue focused
Tax revenue (B$, millions)	140	145	191	226	274
Tax revenue as % of GDP	1.1%	1.1%	1.5%	1.7%	2.1%
Effective tax rate (%)	5.4%	5.6%	7.4%	8.7%	10.6%
Net change in revenue vs. BLF (%)	N/A	4%	36%	62%	96%

Note: The effective tax rates measure the tax paid as a proportion of total profits and are hence lower than the statutory (headline) corporate tax rates for each option. The effective tax rate is an aggregated figure representing an average across all firms in the economy (that is, total tax revenues over total profits). In reality there will be significant disparity across firms within each policy option.

The additional revenues estimated to accrue from a corporate tax system would move The Bahamas to be more in line with the OECD, where tax on corporate profits make up 3.0% of GDP on average. Under Options 2 and 3, revenues as a share of GDP are estimated to be 1.5% or 1.7%, respectively compared to 1.1% under the existing BLF.

These additional revenues would be deployed by the Government to either pay down the debt-to-GDP ratio, or to invest in capital for the wider economy. Whilst debt payments will not have a direct economic impact, capital investment could improve productivity of the economy by creating jobs or infrastructure projects with longer term impacts. These positive impacts are considered in the economic impact assessment.

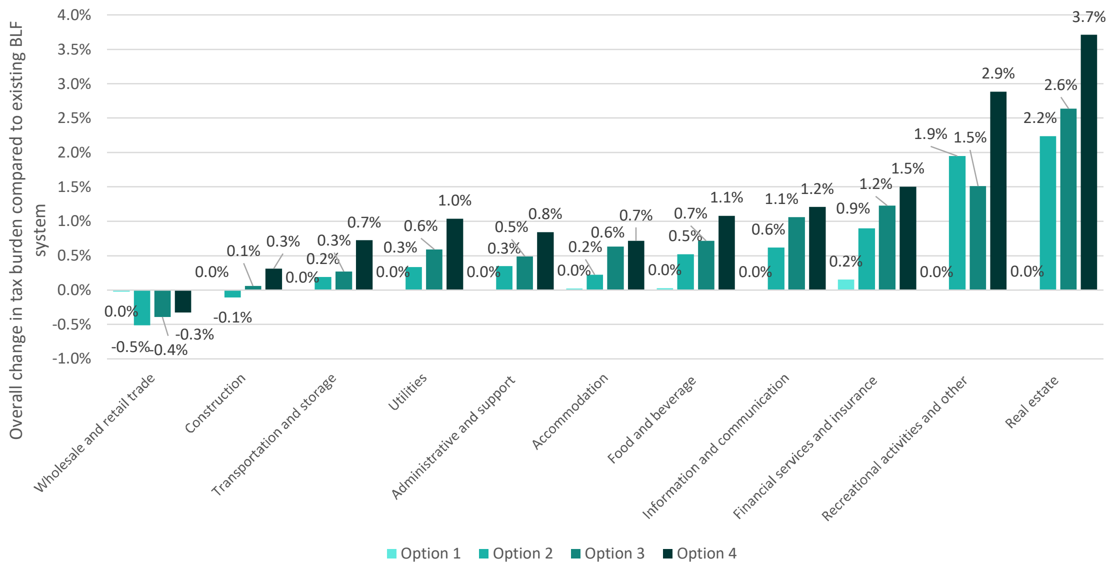
Differentiated revenue impacts by industry

Although the tax burden across the economy is at least as high as under the current BLF for each option, it is estimated that tax revenues from the Wholesale and Retail Trade would be reduced across all options (Figure 11). This reflects the relatively high effective tax rate paid by this sector now compared to other sectors, which are estimated to face an increase in their tax burden across

[24] Peters, A. (2017). "Estimating the Size of the Informal Economy in Caribbean States" *Inter-American Development Bank*

most options. This is particularly the case for the Financial Services (excluding insurance activities) and Real Estate sectors.

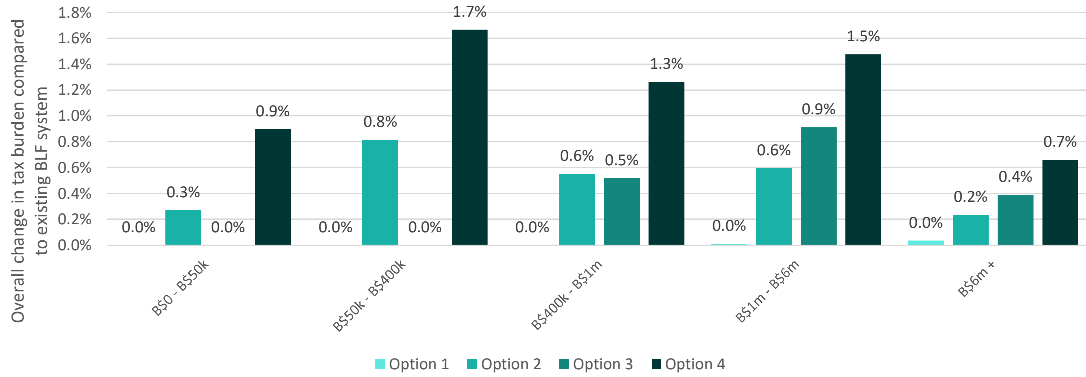
Figure 11: Increase in tax burden as a proportion of gross turnover across the CIT options compared to the current Business Licence Fee, grouped by sector



Differentiated revenue impacts by business size

Across the options, the tax burden for very large businesses (turnover greater than B$6m) is estimated to increase (Figure 12). For businesses earning less than B$400,000, the tax burden is estimated to increase only under Options 2 and 4 where CIT is levied on all businesses and thus there is a change from the existing BLF system. Comparatively, under Option 3 the CIT applies only to larger firms (earning more than B$400,000) and the existing BLF system remains for smaller firms. It is recognised however that Options 2 and 4 imply the introduction of CIT even for small businesses; the viability of this is an important topic of this consultation, and business costs associated with implementation will be considered in detail in the design phase.

Figure 12: Increase in tax burden by business size as a proportion of gross turnover across the CIT options compared to the current Business Licence fee, grouped by Policy Option



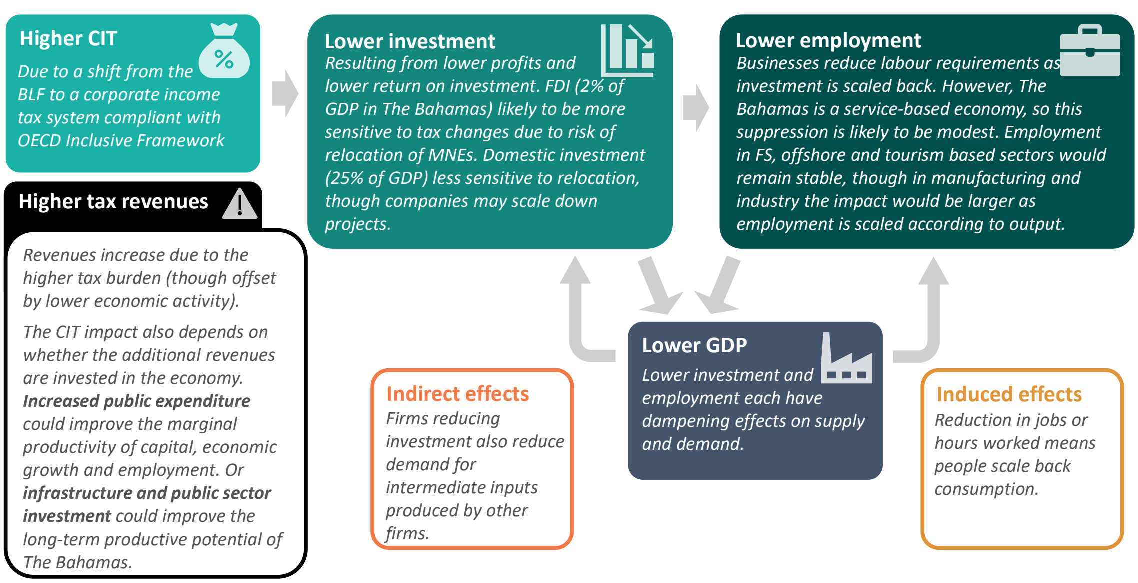
Question 14: Given your understanding of the Bahamian economy, which of these options do you think increases the average tax burden for different firm types (size or sector) by an amount that best reflects economic activity?

5.3 Impact on economy

5.3.1 Estimating the economic impacts

The economic impact estimates are based on how businesses in The Bahamas will respond to a change in their effective tax rate, for instance by changing their approach to investment or employment. The economic mechanism by which this happens is described in Figure 13.

Figure 13: Overview of economic impact mechanism



The headline economic impacts represent the direct effect of an increase in corporate tax rates. Following estimation of this direct impact, the secondary effect of the reinvestment of additional Government revenues is estimated. A review of the corporate tax literature finds that in the case of countries with relatively low levels of government spending, an increase in government spending as the result of larger tax revenues can have substantial economic benefits and will likely mitigate these impacts outlined above.[25]

Additionally, it should be acknowledged that the increase in the tax burden is relatively small. In fact, the increase applies only when the business in question makes a profit such that its tax payment is pushed beyond the payment made under the BLF system. Under a profits-based system, no business will be required to pay tax unless it is affordable to do so.

5.3.2 Estimated economic impacts

The direct impact of the policy options varies according to the size of the increase in the tax burden (Panel A of Table 7). As a result of this increase, investment (particularly FDI) is the key channel by which GDP and employment is estimated to decline. The relatively large GDP impact differential between Options 2 and 3 emerges because Option 3 has a greater impact on larger firms, which are more likely to invest profits into the economy. If the tax burden for these firms increases and some of this investment is lost, then the economic impact could be greater.

In respect of the impact on investment, it is also important to consider evidence which suggests that FDI in Caribbean countries may be less sensitive to tax changes. This is compared to countries studied in the wider literature on which the modelling assumptions are based, though is based on a period which pre-dates OECD BEPS initiatives.[26] The impacts on employment are also likely to be relatively moderate compared to the GDP impacts since The Bahamas is a service-based economy. This means that employment is less sensitive to declines in investment or GDP, so employment in a sector such as financial services should remain relatively stable. The effect should be further limited for wholesale and retail, a labour-intensive activity, where the tax burden is estimated to decline under the CIT policy options.

Table 7: Economic impacts across the corporate income tax options

Impact	Option 1: OECD Pillar Two	Option 2: Soft introduction	Option 3: Simplicity-driven	Option 4: Revenue focused
Panel A Economic impacts				
GDP impact (%)	0.0%	-0.3%	-0.9%	-1.7%
FDI impact (%)	-0.3%	-1.5%	-5.1%	-10.2%
Domestic investment impact (%)	-0.1%	-0.3%	-1.0%	-2.0%
Unemployment rate change (%)	0.0%	0.1%	0.5%	0.9%
Panel B Potential mitigating impact of reinvesting Government revenues: Net GDP impact				
50% of revenues reinvested	0%	-0.1%	-0.5%	-1.2%
* GVA estimates include the direct effect only using Type 1 Multipliers (weighted average across the economy). GVA is equal to GDP less net taxes on products. The net impact figure is the GDP impact if X% of revenues are reinvested.				

[25] Hunady and Orviska (2015) – The non-linear effect of corporate taxes on economic growth

[26] Though no specific data on this exists for The Bahamas, an IMF study of the Eastern Caribbean Currency Union (ECCU) found that a large number of tax concessions between 1991-2003 did not correlate with an increase in the FDI to GDP ratio of respective countries. This could be due to non-tax benefits such as high levels of human capital, or by virtue of already being a low-tax jurisdiction such that marginal changes in taxation actually have little to no impact. See IMF (2008) 'Tax Concessions and Foreign Direct Investment in the Eastern Caribbean Currency Union'

Panel B presents an estimate of what the net GDP impact could be if 50% of Government revenues were reinvested into the domestic economy (with the remainder used to pay down public debt). Investment into Bahamian projects such as infrastructure or healthcare provision could mitigate some of the negative economic impacts via creation of jobs or by improving productivity. However, the size of these impacts depends on the actual projects chosen by the Government – for example, expenditure on infrastructure may have greater long-term impacts in terms of transport or logistics, whereas expenditure on healthcare could improve long-term health of the population and thus the productivity of the workforce.

Regardless of the level of additional tax revenues that are reinvested, it is still estimated that Option 3 would have a larger negative impact on GDP than Option 2 as a result of a higher tax burden. However, this is not to say that Option 3 may have improved outcomes in respect of societal impacts (including health and education) and long-term planning (for infrastructure), subject to the Government's reinvestment decisions.

Considering how the level of investment drives these economic impact estimates, there are two limiting factors which cannot be captured by the data. First, the **global tax landscape may mitigate the estimated adverse impacts**. Around one hundred and forty countries are signatory to the OECD Pillar Two initiative. This could close the gap between tax systems globally and thus marginalise the role of tax factors in investment decision making, at least for large multinational groups. This is particularly relevant for FDI, and thus the impacts on GDP may be more moderate as investors are less likely to relocate to jurisdictions with lower effective tax rates as the gap between respective systems appears to be closing.

Second, against this backdrop, **non-tax factors should become the main driver to attract investment** from overseas: The Bahamas benefits from high levels of human capital, political stability, and an internationally recognised financial system, which will be important considerations in investment decisions. IMF research cites the strength of legal and economic institutions as a reason many international financial service entities hold assets and lending operations in The Bahamas.[27] Even when tax factors are considered, under all policy options, The Bahamas will remain a relatively low-tax jurisdiction on the global scale.

Of course, the journey towards a modern corporate income tax system is not well-defined and there are a series of trade-offs which the Government and the public will need to account for. This document represents the Government's first step in understanding variation between the policy options, and the practical concessions between raising additional revenues at the expense of negative effects on businesses.

Considering the economic impacts against the additional Government revenues by option, the Government is minded to focus attention on Options 2 and 3. The respective economic impacts and revenue raising ability of Options 1 and 4 are not well balanced when considering the strategic priorities of the Government. Comparatively, the balance between the effects of Options 2 and 3 go further in achieving a solution to fiscal stability whilst limiting the impact on the wider economy.

Question 15: Considering the sector in which your business operates, and the formulation of the options being assessed, are the economic impacts as you would expect? Would you expect the impact on your sector of change from BLF to corporate income tax to be

[27] IMF – The Bahamas Financial System Stability Assessment

smaller or greater than that estimated for the economy? Please consider employment, investment, and output separately.

Question 16: If your business is part of an organisation which falls into the remit of Pillar Two, do you agree with the view that the introduction of a corporate income tax would not lead to a large change in direct investment into The Bahamas due to similar policy responses in competitor jurisdictions? Please explain your answer.

Question 17: If your business is part of an organisation which falls into the remit of Pillar Two, would your business consider relocating activity out of The Bahamas as a result of the introduction of a corporate income tax system such as those suggested in this consultation document? Please explain your answer, and where possible state the size of the impact in terms of employment and/or annual investment.

5.4 Qualitative risk assessment

The key considerations in the qualitative risk assessment are how a CIT policy might interact with existing domestic tax policies and legislation, and the responses of international firms and of firms operating in the Free Trade Zones in The Bahamas. Each consideration is outlined below at a high level. Other considerations include reputational impact for The Bahamas, competitiveness of the new CIT regime and greater sensitivity of tax revenue to economic performance.

Interaction with current domestic tax policies and legislation

A CIT policy would interact with existing fees and taxes levied on business. Taxes that represent a cost of doing business (such as irrecoverable VAT or administrative fees) may benefit from some relief from CIT when this is the ultimate expense of the Bahamian business. A common approach taken in jurisdictions with CIT regimes in respect of such costs would be to provide relief by making such fees deductible for CIT purposes.

Since no form of personal income tax exists in The Bahamas, there is a potential risk for some owner managed businesses to minimise their CIT liability by opting for increased salaries (which is not taxed and would potentially be a deductible expense for CIT purposes) rather than receiving distributions from the post-CIT earnings of the business. To circumvent this risk, there are certain anti-avoidance features a tax system can apply to combat non-commercial salaries to owners.

Additionally, businesses under the Hawksbill Creek Agreement in Freeport are exempt from paying the BLF, alongside the elimination of property taxes and import duties. For these free trade zones, appropriate Bahamian legal advice would be required to determine whether the application of CIT would be legally possible, though any application of CIT would likely erode the competitive advantage afforded to this area.

Potential response of international firms currently operating in The Bahamas (e.g., relocation risks), and possible mitigations

The imposition of a new CIT regime in The Bahamas is likely to increase the overall cost of doing business in The Bahamas. In addition to the change in the tax burden, there may be increased administrative costs which will vary according to business size and complexity. For entities operating in The Bahamas that fall in scope of Pillar Two, this burden will likely exist even if The Bahamas does not impose CIT where jurisdictions of the associated ultimate parent companies require top-up taxes.

Additionally, the advent, internationally, of increased anti-tax avoidance legislation over the last 10-15 years (not least the OECD's original 15 actions in 2015 to combat 'base erosion and profit shifting' (BEPS)) means that many multinational entities (even outside of Pillar Two) will already have been required to meet business substance requirements in low tax jurisdictions. As such, there should not be any substantial shifts of business on the introduction of a CIT system, thus limiting the risk of reduced government revenues. As Pillar Two is introduced across different jurisdictions e.g., the UK for accounting periods commencing on or after 1 January 2024, international groups seeking jurisdictions with lower tax regimes will have increasingly limited options.

Timing of the implementation of CIT across The Bahamas

As noted above, certain jurisdictions (including the UK) are seeking to implement Pillar Two from January 2024. It is very unlikely that The Bahamas would be able to introduce a full new CIT system by then. However, it may be possible to stagger implementation of a CIT system by introducing, as a first phase, a QDMTT, with any remaining parts of a new CIT system following as a second phase. This would help prevent the diversion of tax revenues to other jurisdictions under Pillar Two and help prevent double taxation for companies within the scope of Pillar Two (who might otherwise be subject to BLF in The Bahamas and Pillar Two top-up tax in a different jurisdiction). Due to the limited months remaining until January 2024, it is likely that introducing a QDMTT from January 2024 would involve some retroactive legislation (e.g., legislation passed in 2024 with effect from January 2024).

Question 18: If your business is within the scope of Pillar Two, would you be in favour of staggering the implementation of a new CIT system so that a QDMTT could be implemented with effect from January 2024? Please explain why. Would your view be different if implementing a QDMTT from January 2024 involved retroactive legislation?

Question 19: If your business is not within the scope of Pillar Two, do you have any concerns about staggering the implementation of a new CIT system? If so, please explain why?

Question 20: Is there any evidence missing from this qualitative risk assessment that should be considered by the Government?

6 Concluding remarks and next steps

Against the backdrop of the twin challenges we face, The Bahamas is face with the adoption of a CIT that supports the objectives of improving revenues, improving the existing approaches to business taxation and one that meets the OECD's requirements in respect of Pillar Two.

Based on the initial analysis undertaken, the Government is of the view that this is achieved through a balanced policy that adopts a two-tiered system as outlined by Options 2 or 3. Under this approach, the impact on the economy is estimated to be moderate, though the policy is estimated to have important incremental revenue raising benefits for the overall fiscal situation.

This consultation has presented a holistic assessment of what a corporate income tax system would mean for the Bahamian economy. Establishing such a system from the ground up is a significant undertaking, the details for which will need to be defined in a series of next steps. We outline an indicative timeline below (assuming a non-staggered implementation of a new CIT system). In the event that implementation of a new CIT system is staggered, the timeline will need to be adjusted accordingly:

Key Stage	Timeframe
Public consultation on CIT policy *Obtaining views of the public on initial proposals for a CIT regime, as set out in this paper.*	Responses requested by July 3, 2023
Review of responses received to consultation *Assessment of public consultation responses by the Government.*	1-3 months
Decision taken on future CIT policy *Government decision on appropriate CIT regime, based on information set out in this document and responses to the consultation.*	1 month
Internal design stage and sector specific deep dives *Consideration of the detailed framework and rules of the CIT regime, taking into account (amongst other things) the source jurisdictions of MNEs operating in The Bahamas, tax deductions, allowances, use of tax losses and tax incentives that would be compatible with international best tax practices.*	12-18 months
Public consultation *Obtaining views of the public on the detailed proposals for the CIT regime.*	3-6 months
Drafting of legislation *Drafting a corporate income tax act and associated secondary legislation, as required, that will form the statutory basis of the new CIT regime.*	3-6 months
Legislative enactment *Allowing time for the government and parliament to consider and review draft legislation.*	3-6 months
First returns made *Filing of first accounts and tax returns with the Department of Inland Revenue*	12-24 months after legislation takes effect

Along with the outlined high level implementation stages described above there are several other areas which would require consideration, namely:

- Communication with key stakeholders;
- Identification of the technological requirements for a new CIT regime; and
- Identification of the administrative requirements required to ensure the smooth functioning of a new CIT regime.

Question 21: In your view, are there any additional steps that the Government should take in the planning and implementation stage of a corporate income tax?

Question 22: In the design stage with sector specific deep dives, which sectors would you expect to be considered? Please justify your answer and suggest areas which the Government might look at.

Following the closing date for the consultation period, all responses to the questions will be analyzed and considered, and the Government will publish a summary report of the responses on its website.

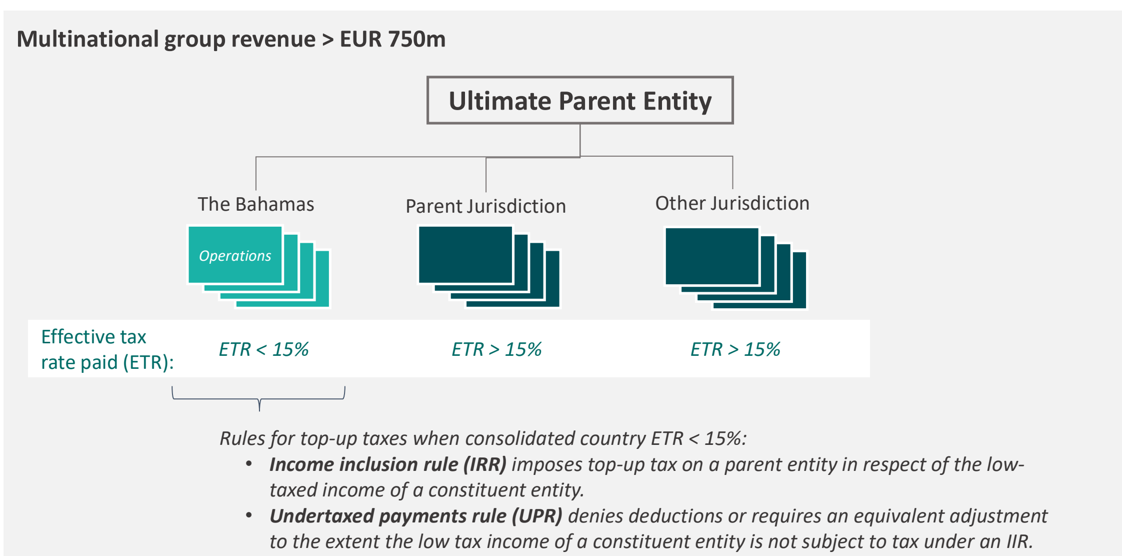
Appendix

Appendix A OECD Pillar Two

The objective of Pillar Two is to impose a 15% minimum ETR on the earnings of multinational groups with revenues of EUR 750 million or higher, in each jurisdiction that they operate in. This will be done by deploying two interlocking rules, the income inclusion rule (IIR) and the undertaxed payment rule (UTPR) (Figure 14).

The ETR is estimated by dividing 'covered taxes' (which are generally domestic and foreign taxes payable on the entity's profits or losses during the year) over the tax base determined by reference to the parent company's consolidated financial statements. Common design features such as adjusting for acceptable tax exemptions or deductions (e.g., for dividend income, substantial shareholdings, and regulatory capital of banks) are included within the calculation of ETR under Pillar Two rules. If this effective rate of tax paid by the entity in a jurisdiction (such as The Bahamas) is less than 15%, then a top-up tax can be required to be paid in the jurisdiction of the parent entity with the IIR or UTPR. The current envisaged timetable for the implementation of the Pillar Two rules in many jurisdictions is for the IIR to apply from 2024 and the UTPR to apply from 2025.

Figure 14: Illustration of application of proposed Pillar Two rules for multinational entities with group revenues greater than EUR 750m



Appendix B Current Business Licence Fee

Table 8: Rate schedule of the Business Licence Fee, including exemptions and incentives

Type of business	Treatment*
General (turnover threshold)	
$0 - $100,000	0
$100,001 - $500,000	0.5%
$500,001 - $5m	0.75%
> $5m	1.25%
Other[28]	
Telecommunication service	3% (used in impact modelling), reduced to 1.25% in July 2022
Gasoline Stations	A range of flat fees are applied; lowest rate of $1,000 up to highest rate of $35,000
Agriculture, fisheries, and food processing	0.75%
Hotels licenced under the Hotel Encouragement Act (turnover >$400m)	0.75%

** Percentages are on annual gross turnover; fixed amounts are paid annually*

Appendix C Approaches to CIT in other jurisdictions

Table 9: Inclusions in the tax base for other jurisdictions

Country	General business income	Capital gains	Rental income	Interest	Dividends	Royalties	Foreign income
United Kingdom	✔	✔	✔	✔	✔	✔	✔
Barbados	✔			✔	✔	✔	✔
Costa Rica	✔	✔		✔	✔	✔	
Cyprus	✔		✔	✔		✔	✔
Ireland	✔	✔	✔	✔	✔	✔	✔
Jamaica	✔			✔	✔	✔	✔
Panama	✔			✔	✔	✔	
Saint Lucia	✔		✔	✔		✔	
Singapore	✔		✔	✔	✔ *	✔	✔
Trinidad and Tobago	✔	✔		✔		✔	✔

** Dividend exemptions available*

[28] The model input assumptions are based on the BLF schedule at the start of 2022, as reflected in this table. It is recognized that subsequently, in July 2022, revised rates for Financial Services were reintroduced, and the rate for telecommunications services was reduced to 1.25%.

Appendix D Members of the Business Advisory Committee

Business and Commerce	Financial Services
Business and Commerce • Chamber of Commerce and Employers' Confederation • Grand Bahama (GB) Chamber of Commerce (Domestic & Offshore) • Bahamas Light Industries Development Council	**Financial Services** • Bahamas Financial Services Board (BFSB) & Association of International Banks & Trust Companies (AIBT) • Representative from the Insurance sector • Securities Commission
Tourism and Hospitality • Bahamas Hotel Tourism Association (BHTA) • Representatives from the Restaurateurs sector	**Other** • Grand Bahama Port Authority (GBPA) • Petroleum Association • Civil Society

Appendix E Corporate income tax design feature definitions

Design feature	Description
Tiering system	A tiering system refers to whether businesses with different levels of turnover or profit are treated differently for corporate tax purposes. For example, businesses within scope of the OECD Pillar Two agreement may be treated differently to the rest of the economy.
Number of taxable groups	Number of groups of businesses for tax purposes under the tiering system.
Turnover threshold	Relevant turnover threshold to define the different groups of businesses for tax purposes.
Tax type	Relevant tax system for each group, either corporate income tax or Business Licence Fee.
Treatment of losses	Approach to loss utilization. This may be in terms of duration (i.e., number of years losses can be carried over) or as a percentage of profit (i.e., in a profitable year, how much profit can be offset).
Treatment of depreciation and amortization	Describes relief for fixed asset capital expenditure (depreciation) and intangible asset expenditure (amortization). A higher allowance for depreciation or amortization deduction means relief is given quickly.
R&D tax credits	Additional relief given for R&D expenditure.
Interest expense deduction	Relief given for interest payments or financial losses, which can be capped to a relevant amount of profit.
Statutory tax rate	Tax rate on taxable profits, net of relevant deductions.