

The Offshore Trust in Barbados

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Barbados is a high-tax jurisdiction, with an Income Tax Act dating from its colonial days and tax rates rising to 40%. Like the United Kingdom – but more radically – it offers a privileged tax regime for trusts established by non-residents.² More exactly – and indeed more confusingly – it offers two such regimes. One governs the trust established under the International Trusts Act, and this is referred to in the Act (and here) as an “international trust”. An international trust used to be regarded for tax purposes as non-resident, but it is now regarded as resident in Barbados, but not domiciled there³. It is therefore fully liable to tax on such income as has its source in Barbados, but it is now liable only on the “remittance basis” on income arising outside Barbados.⁴ The other regime is provided by the Offshore Banking Act.⁵ Here, the statute provides that the trust is ... “exempt from any tax, duty or impost in Barbados.” It is here referred to as an “exempt trust”, though the expression is not used in the Act. The conditions to be satisfied are slightly different in each case,⁶ but the essential fiscal difference is between exemption and the remittance basis. The particular attraction of Barbados as a host jurisdiction for trusts⁷ lies in the possibilities it offers of taking advantage of the tax treaties to which it is party – notably those with Canada, the United Kingdom and the United States.⁸

In the treaty between Barbados and Canada, a resident of Barbados is defined as a:

... person who, under the law of [Barbados] is liable to taxation by reason of his residence ...⁹

And the General Definitions Article provides that:

... unless the context otherwise requires ... the term “person” includes ... a trust ...¹⁰

The international and the exempt trust are each, therefore, a “person” for the purposes of the treaty, but only the international trust is “liable to taxation” in Barbados – albeit on a remittance basis. But is it liable to taxation *by reason of his residence*? Section 40(1) of the Income Tax Act says:

For the purposes of this Act, a trust ..., other than a unit trust, shall, in respect of the trust ... property and in respect of the income arising therefrom, be deemed to be a separate individual.

Where does this *separate individual* reside?” Clearly, one cannot ask about an imaginary individual, whether or not he spent 182 days in Barbados during the income year or whether he has a permanent home in Barbados.¹¹ It is a requirement of the Act¹² that an international trust has at least one resident trustee; typically, a company resident in Barbados will be the sole trustee, and it submitted that in such a case there could be no serious argument that the trust was resident anywhere else.¹³ It is entitled to the benefit of the treaty with

Canada, whether income is remitted or not: if the income is not remitted, it may be distributed without a tax charge, because of the exemption expressly provided by the International Trusts Act.¹⁴ Those who feel that this exemption is too good to last may prefer to make a distribution while the going is good. The recipient of a distribution does not, of course, need to be an individual: an exempt trust could be the recipient, or a distribution might be made to a trust or company in another jurisdiction which levies no tax on such receipts.¹⁵

Treaties which follow the OECD 1977 Model require the recipient of dividends, interest and royalties to be the “beneficial owner” thereof. It seems that the use of this expression is intended to make it clear that treaty relief will not be afforded where the recipient is a mere agent or nominee for another person – and that other person is resident elsewhere, or for some other reason not entitled to the benefit of the treaty¹⁶, but it is submitted that such agent or nominee is not entitled to treaty benefit whether the expression is used or not. A trustee, however, is not a nominee or agent for his beneficiaries (though see note 23 below), and the trust income is accordingly entitled to treaty benefit so long as one of the criteria of taxability required for the trustee to be “resident” is satisfied.

The treaty with the United Kingdom has a definition of “resident” similar to the one in the treaty with Canada, but identification of the *person* resident is not here complicated by the definition of “person” including a trust, and in consequence it is simply the trustee whose residence is to be determined. The

UK treaty is, however, different from the Canadian in two further respects. First, it offers no effective capital gains tax exemption¹⁷ - but this, in the present context, is not important, because the United Kingdom does not tax the capital gains of a non-resident¹⁸. Second, and more importantly, Article 5 of the UK treaty provides that “where any income is exempt from tax ... in [the United Kingdom] if ... it is subject to tax in [Barbados] and that income is subject to tax in [Barbados] by reference to the amount thereof which is remitted ..., the exemption ... shall apply only to the amounts so remitted ...” To obtain the benefit of the treaty, therefore, the income has to be remitted to Barbados. But such income does not have to suffer tax: the international trust has a feature which it shares with domestic trusts – that its taxable income is calculated after deduction of the distributions it makes. Subsections (2) and (3) of section 40 of the Income Tax Act provide as follows –

(2) In calculating the assessable income of a trust ... other than a unit trust, for an income year, there shall be deducted such part of the amount that would otherwise form its assessable income for the income year as is payable to a beneficiary in that income year.

(3) For the purposes of this section ..., an amount shall not be considered to be payable in an income year unless it was paid in the income year to the person to whom it was payable or that person was entitled in that year to enforce payment thereof.

In a domestic trust, the deductibility of the distribution in the hands of the trustee is balanced by the chargeability of the distribution in the hands of the beneficiary. The same is true of an international trust which makes distributions to beneficiaries resident in Barbados. But, as noted above, distribution to non-

resident beneficiaries out of international trusts are exempt from tax. Thus, for example, where the income takes the form of a royalty whose source is outside Barbados, the international trust may remit this income to Barbados and then distribute virtually all of it in the same year: the trust income is then fully subject to tax, but, after deducting the amount distributed, the taxable amount will be only a nominal sum¹⁹.

The treaty with the United States includes a trust in the definition of “person”²⁰ and provides that the term “resident of Barbados” means:

“any person ... resident in Barbados for the purposes of Barbados tax, but in the case of a ... trust, only to the extent the income derived by such ... trust is subject to Barbados tax as the income of a resident either in its hands or in the hands of its partners or beneficiaries.”

So far, so good. Article 22, however, which is an early – and relatively unsophisticated – version of the “Limitation of Benefits” article, effectively prevents the international trust from obtaining the benefit of the treaty, unless it carries on an active business. The treaty is nevertheless used – notably in connection with royalties, by interposing a “shield company” between an exempt trust and the user of the copyright, patent etc. The shield company is a regular, tax-paying company, engaged in the business of taking and granting licences²¹. It takes a small “turn” on each transaction, on which Barbados tax is duly paid. Exempt trusts in high-tax jurisdictions generally confine their tax advantage to foreign income,²² which precludes the use of the shield company, but this is not true of the exempt trust in Barbados. The shield company

structure does not have to be confined to transactions taking advantage of the treaty with the United States. It may also be used in relation to sources of income in Canada or the United Kingdom.

The traditional offshore trust is a settlement, generally holding shares and cash on accumulating and discretionary trusts. The Barbados regimes, however, are expressed in terms of trusts, and are not therefore simply confined to settlements of this kind. A settlement with a life tenant or other beneficiary with an interest in possession²³ may take advantage of the capital gains article in the Canadian treaty, or a settlement with powers to carry on a trade may take advantage of the business profits articles in the Canadian and UK treaties.²⁴ There are also possibilities for the use of unit trusts and trusts for joint ventures.

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² Under the International Trusts Act 1995 (as amended) and the Offshore Banking Act; *Cf* the UK Taxation of Chargeable Gains Act 1992 s.69(2).

³ International Trusts Act 1995 (as amended) s.29(5).

⁴ Income Tax Act s.17.

⁵ S.105.

⁶ The Offshore Banking Act requires that the ... “funds of the trust consist solely of foreign currency or foreign securities.” There appears to be nothing to prevent the trustee of an exempt trust holding assets which do not come under the heading of “funds” – e.g. a copyright. The restriction applying to the trustee of an international trust is that it may not hold any interest in immovable property situate in Barbados. The required status of the two trustees is also slightly different: the trustee of an exempt trust must be licensed under the Offshore Banking Act, whereas the trustee of an International Trust – or at least one of the trustees – merely needs to be resident in Barbados.

⁷ If a corporate vehicle is preferred, consideration may be given to the use of an English (or Scottish or Northern Irish) company resident in Barbados – see Income Tax Act s.17 and UK Finance Act 1994 s.249.

⁸ Barbados also has treaties with China, Cuba, Finland, Norway, Sweden, Switzerland, Venezuela and the 11 CARICOM countries.

⁹ Art IV.1

¹⁰ Art III.1(c)

¹¹ Income Tax Act s.85(5).

¹² s.2(1)(c)(ii).

¹³ Such an argument could run if, to take an unlikely example, there were four trustees, one resident in Barbados and three resident in the Bahamas.

¹⁴ s.29(1) and (2).

¹⁵ Grenada is geographically the closest of these. See, in Grenada, International Trusts Act 1996 s.49 and International Companies Act s.110.

¹⁶ See Draft Contents of the 2002 Update to the Model Tax Convention (OECD, 2 October 2001) and the discussion of the point in Philip Baker: *Double Tax Conventions and International Law* (Sweet & Maxwell, 1994) paras.10-05 to 10-07.

¹⁷ The exemption is conditional on liability to capital gains tax in Barbados – which does not have a tax on capital gains. See Art 13 of the UK treaty, and *cf.* Art XIV of the Canadian and Art 13 of the US one.

¹⁸ Unless he has a branch or agency in the United Kingdom: UK Taxation of Chargeable Gains Act s.10.

¹⁹ Can the UK treaty be used to exempt a UK beneficiary from UK tax on e.g. business profits arising to a Barbados international trust? The decision in *IRC v. Padmore* (62 TC 341) might lead one to suppose that trust income attributed to a UK-resident individual under s.739 Income and Corporation Taxes Act would be protected by the priority accorded to treaty exemption by s.788. The view of the Special Commissioner in *IRC v. Willoughby* [1995] STC 143 was that in the hands of the individual the income loses its original character and is therefore not exempted by the terms of the treaty (see paragraph 14 of the case stated – page 169 at letter C). Perhaps a distinction is to be drawn between income attributed to a taxpayer by a deeming provision and income attributed to a beneficiary by the rules of equity – see *Archer-Shee v. Baker* 11 TC 749, and especially the analysis of Lord Wrenbury at pages 779-781.

²⁰ Art 3.1(b).

²¹ The company is not entitled to the benefit of paragraph (d) or (e) of Article 22(1), but is intended to fall within paragraph (c).

²² See e.g. in Cyprus, The International Trusts Law of 1992; in New Zealand, the Income Tax Act 1994, subpart HH.

²³ Where the settlor is the life tenant, with a power of appointment over the reversion, the settlement is sometimes referred to as a “Thin” trust. In countries which have adapted the English rules of equity (including Barbados), the trust income in such a case is income of the life tenant, and although it is the trustee who may be entitled to the benefit of a capital gains tax article, it is the life tenant who needs to claim the benefit of articles relating to income.

²⁴ Art VII in the Canadian and Art 6 in the UK treaty.