

2

The Barbados International Business and Financial Services Sector

2.1 Origins and development of the IFS sector in Barbados

The Barbados international financial services (IFS) sector, of which international business companies (IBCs) are the dominant area of activity, has grown steadily over the last decade. Even with the slowdown in the year 2000, resulting from the uncertainty surrounding the Organisation for Economic Co-operation and Development (OECD) initiative and other global economic developments, the level of activity in the sector has grown considerably since 1965 when the first International Business Company (IBC) Act was passed.

The IBC Act was designed to allow non-residents of Barbados to invest or trade internationally from Barbados. These non-resident entities were afforded a low rate of taxation, but prohibited under the Act from trading goods or services in Barbados or the Caribbean Community (CARICOM) Area. The primary beneficiaries of the Act were residents of the UK, who were allowed tax refunds from the UK Treasury under the provisions of the tax treaty (1970) between the two countries (see table 2.1).

In 1977, the IBC Act was modified in order to make its provisions more attractive to global investors and thereby expand the sector. As the needs of the sector changed, amendments were made in 1979, 1981 and 1985. In 1991, the Act was further amended to allow IBCs to conduct a broader range of activities. An IBC was redefined as: 'a company that is engaged in manufacturing, international trade and commerce from within Barbados'. Registered IBCs received a number of tax incentives and unlike companies registered under the Companies Act¹, IBCs pay tax on income on a sliding scale, with rates varying between 1 per cent on profits over US\$15 million and 2.5 per cent on profits under US\$5 million. IBCs are also exempt from exchange control regulations and from import duties, Value Added Tax (VAT) and stamp duty on the import of plant and machinery and business inputs.

The climate was further enriched by a number of tax and bilateral investment treaties that encouraged an investment and commercial presence by foreign companies. Subsequent legislation aimed at capitalising on new opportunities has expanded the product offering of the sector, which is now comprised of international business companies, international (offshore) banks, exempt insurance companies, exempt insurance management companies and societies with restricted liability. From its inception, Barbados' highly reputable and well-regulated IFS industry has benefited from a

partnership between government and the private sector on legislative reforms and promotion.

The International Financial Services Act (IFSA) 2002-05, which replaced the Offshore Banking (1979) Act, establishes the regulatory framework for the operations of licensed offshore banks. Under the IFSA, licensing requirements are fairly rigorous and the degree of regulation and supervision is high, as was confirmed by the favourable reviews during the Financial System Stability Assessment (FSSA) completed by the International Monetary Fund (IMF) and the World Bank in February 2003. A wide range of activities is conducted within the offshore banking and wider financial services fields, including investment wealth management, investment banking, portfolio management, derivative and commodity trading and foreign currency lending, investment advisory fiduciary services, trustee services and estate and tax administration. The majority of offshore banks in Barbados are private banks, and the remainder either branches, subsidiaries or affiliates of international banks.

The insurance industry is a vibrant and growing part of the global economy and so the addition of insurance services to the offering of the IFS sector was a natural extension. In Barbados, international insurance business is defined as: 'the business of insuring risks located outside of Barbados, in respect of whether premiums originate outside of Barbados or CARICOM'. This includes the business of an underwriter, broker, agent, dealer or salesman, where beneficial ownership is outside CARICOM. These entities are established under the Exempt Insurance Act Cap308A, which was designed to allow Barbados to develop as a meaningful alternative to Bermuda for international insurance purposes, particularly captive insurance companies. Exempt insurance companies are regulated and supervised by the Supervisor of Insurance and Pensions within the Ministry of Finance.

In recognition of the possibility for further growth within the IFS sector, through the provision of other vehicles to minimise the tax burden of companies, the Society with Restricted Liability (1983) Act was passed establishing societies with restricted liability (SRLs) or hybrid entities that have the status of a corporation in Barbados, but are classified as a partnership in the US for tax reasons. An SRL can be set up either as an exempt or a non-exempt company, with limited liability status and are required to maintain a registered office and agent in Barbados. Exempt SRLs, which are used mainly for international transactions, benefit from a similar range of duty and tax concessions as IBCs and offshore/international banks (OSBs) and are prohibited from transacting business in Barbados or CARICOM. Non-exempt SRLs are not subject to these prohibitions and pay tax on profits at the domestic corporate rate.

During the past two decades, the Barbados economy has been challenged by the mounting pressures of an increasingly competitive global environment. Indeed, with the traditional sectors, agriculture, manufacturing and tourism, grappling with the harsh realities resulting from trade liberalisation, the need to maintain Barbados as a high-branded international financial services centre becomes even more critical in the efforts to further restructure and diversify the economy. Against this backdrop, the creation of a

more effective and enabling environment for the expansion of international business, financial and other services is necessary to generate increased employment and to enhance the country's foreign exchange earning potential.

Unlike a number of 'offshore' jurisdictions, which depend upon zero tax rates to attract international business, Barbados offers low tax rates supported by a network of tax treaties and bilateral investment treaties that allow companies to benefit from aspects of the tax code in the source countries relating to foreign source income. The attractiveness of the treaties varies. For instance, the treaties with the Scandinavian countries (Finland, Norway and Sweden) contain extensive limitation on benefits articles and include provisions excluding international business sector entities from the treaty. On the other hand, treaties with Cuba and China have few limitations on benefits clauses, which make these treaties more attractive. The Cuba treaty (April 1999), in particular, positions Barbados to be a major conduit for investment funds to Cuba. A list of tax treaties and investment agreements is shown in table 2.1, below.

The Canadian treaty is the most widely used, with international business activity heavily skewed towards the Canadian market for this reason. The attractiveness of the Canada-Barbados taxation treaty is largely due to the fact that it allows Canadian parent firms of Barbados IBCs, SRLs and other corporate entities to earn and repatriate 'exempt surplus' (that is, profit which is not subject to Canadian corporation tax) from their Barbados-based operations, under the 'foreign affiliate' rules of the Canadian tax code. In recent years the treaty has come under close scrutiny by Canadian authorities and

Table 2.1 Tax treaties and investment agreements

<i>Investment Agreement</i>	<i>Tax Treaty</i>
Canada - May 1996	Botswana - February 2005
China - July 1998	Canada - January 1980
Cuba - February 1996	CARICOM - July 1995
Germany - December 1994	China - 2000
Italy - October 1995	Cuba - April 1999
Mauritius - September 2004	Finland - June 1989
Switzerland - March 1995	Malta - December 2001
United Kingdom - April 1993	Mauritius - September 2004
Venezuela - July 1994	Norway - November 1990
	Sweden - July 1991
	Switzerland - Extended to Barbados from UK, 1954
	United Kingdom - March 1970
	United States - December 1984
	Venezuela - November 1998

Source: <http://www.barbadosbusiness.gov.bb/miib/legislation/treaties/bilateral.cfm>

negotiation of a protocol to the tax treaty commenced in 1997. There are also substantial non-tax benefits for Canadian firms domiciled in Barbados².

Discussions with industry participants also revealed that generally US multinational firms only use Barbados in special circumstances, largely because the US authorities do not allow the tax-free repatriation of profits. Consequently, few of the US-parented firms operating in Barbados are believed to be tax-driven. One previous exception to this was in the case of foreign sales corporations (FSCs). At the end of 2000, almost 3,000 FSCs were domiciled in Barbados. However, a World Trade Organization (WTO) ruling against the use of these 'offshore' entities by US exporters, which followed complaints from the EU that such arrangements constituted an unfair export subsidy, and subsequent revisions to the US tax code, have ended the use of FSCs.

The opportunities created by the network of tax treaties and other legislative support, coupled with the Barbadian government's business facilitation efforts, have resulted in fairly decent growth of the IFS sector over the last two decades. Apart from its contribution to employment and foreign exchange earnings, the sector is also an important contributor to government revenue, even with the low rate of taxes paid. In 1985, around 500 active companies made payments of US\$0.25 million for incorporation and US\$0.50 million for licence fees. By end-2003, approximately 5,403 offshore companies were licensed with annual application and licensing fees totalling US\$4.9 million and tax revenue of US\$93.6 million³.

Notwithstanding the gains achieved over the years, the IFS sector in Barbados faces a number of challenges. Apart from the highly competitive nature of this market in the Caribbean/Atlantic region, there have been a number of adjustments to doing business, which have arisen from concerns advanced by the international organizations, particularly with respect to terrorism financing and other illegal financial activities (anti-money laundering and countering the financing of terrorism [AMLA/CFT] initiatives). The OECD Harmful Taxation initiative, the implementation of the US Patriot Act and the globalisation process have also added to the complexity of the global environment for international business, prompting ongoing legislative and supervisory changes in the industry. The various tax treaties entered into by Barbados include provisions for the exchange of information relating to tax matters, and that international business income is generally fully declared to the domestic tax authorities. Consequently, meeting the OECD initiatives for information exchange and transparency requirements was not too onerous for Barbados. However, there have been increased costs related to these measures⁴, including the increased paperwork needed for large financial transactions and the additional due diligence (DD) requirements for establishing companies and establishing client bona fides.

2.2 The importance of the IFS sector in Barbados

There is a paucity of available statistical information on the various aspects of activity in the IFS sector in Barbados. The agencies with regulatory and supervisory oversight collect basic data, such as new registrations, renewal of licences, partial employment

information, national insurance contributions, fees and taxes paid to the government. However, the data is not compiled in a format that allows a proper analysis of the sector's contribution to the domestic economy to be readily undertaken⁵.

The total number of registered companies, excluding foreign sales corporations, has exhibited a general upward trend since 1996, increasing at an average annual rate of approximately 4.7 per cent from 4,604 companies to 6,163 by the end of 2005 (see table 2.3). The number of new registrations was higher in the 1996 to 1998 period, moderating somewhat in the 1998 to 2000 period, but total new registrations fell sharply in 2001. This was largely because of the uncertainty created by the inclusion of Barbados by the OECD in its harmful tax competition list of tax havens in 2000, coupled with the fallout from the foreign sales corporations sub-sector (see table 2.2). On the positive side, this development brought into sharp focus the vulnerability of the industry and prompted the authorities to further enhance the regulatory and supervisory infrastructure in order to safeguard Barbados' high reputation and credibility as a clean jurisdiction. As a result, during the four years since 2005 new registrations were on the increase.

The international business company (IBC) as the dominant foreign business entity recorded the highest growth rate in new registrations, and at the end of 2003 accounted for roughly 80 per cent of active companies. Overall, the IFS sector continues to make an important contribution to foreign exchange earnings and government tax revenue.

Table 2.2 New registrations issued in the IFS industry, 1996-2005

<i>Entity</i>	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
International business companies	437	372	441	326	456	210	260	274	297	372
Foreign sales corporations	393	384	317	249	118	0	0	0	0	0
Exempt insurance companies	23	17	23	5	13	7	11	15	15	9
Exempt insurance management companies	1	3	0	1	0	1	3	1	1	3
Societies with restricted liabilities	14	18	33	32	47	22	26	31	64	42
Offshore banks	7	6	1	5	7	5	3	2	4	0
Total	875	800	815	618	641	245	303	323	445	426

Sources: Ministry of Industry and International Business, Central Bank of Barbados, Supervisor of Insurance.

The removal of Barbados from the OECD's harmful tax competition list of tax havens reduced some of the concerns of sector participants, but the subsequent growth of the sector slowed, with an average growth rate in registered companies of about 7 per cent in the period 2002–05 as compared to an average growth rate of 12.5 per cent between 1996 and 2000 (see table 2.3). Societies with restricted liability (SRLs) recorded the highest growth (71.3 per cent) during the period 2002–2005 while international business companies grew by 21.8 per cent. Exempt insurance companies (EICs) and exempt insurance management companies (EIMCs) increased by 9.8 per cent and 8.7 per cent during the same period.

The number of licensed offshore banks more than doubled from 26 to 54 between 1996 and 2005. It is estimated that approximately two-thirds of Barbados' offshore banks are from Canada and the remainder out of the US and Latin America. Canada

Table 2.3 Total number of registered companies in the IFS Industry, 1996-2005

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
International business companies	2,260	2,632	3,073	3,399	3,855	4,065	4,325	4,599	4,896	5,268
Foreign sales corporations	1,907	2,291	2,608	2,857	2,975	2,975		
Exempt insurance companies	322	339	362	367	380	387	398	413	428	437
Exempt insurance management companies	61	64	64	65	66	66	69	70	71	75
Societies with restricted liabilities	14	32	65	97	144	166	192	223	287	329
Offshore banks	40	44	43	45	52	57	56	51	55	54 ^a
Total registered	4,604	5,402	6,215	6,830	7,468	4,741	5,090	5,406	5,801	6,163
Memo Items:										
% increase in the number of registered companies		17.3	15.0	9.9	9.3	-36.5	7.4	6.2	7.3	6.2
<i>Offshore banks:</i>										
Total assets (% of GDP)	401	749	786	818	839	1,104	1,324	1,165	1,107	

Sources: Ministry of Industry and International Business, Central Bank of Barbados, Supervisor of Insurance and Pensions, Barbados FSSA 2003, IMF <http://www.imf.org>

Note: a. The operations of one offshore bank were terminated in 2005.

is reported to be the primary market for offshore banking business, with a number of licensees indicating that on average three-quarters of their business comes from this market. However, there was a more recent contraction in the number of licensed offshore banks, which reduced from 57 in 2001 to 54 at the end of 2005.

The total assets to GDP ratio of offshore banks rose from 401 per cent in 1996 to a high of 1,324 per cent in 2002, subsequently declining to 1,107 by 2004 (see table 2.3). Activity in the offshore banking sector is fairly concentrated, with the ten largest offshore banks accounting for approximately 87.6 per cent of total assets in 2005.

Since the establishment of the SRL (1995) Act, the number of these licensed entities increased from 14 in 1996 to 329 at the end of 2005 (table 2.3). After 2000, there was a reduction in the number of new registrations, but growth picked up from 2003 following the country's removal from the OECD harmful tax competition list of tax havens, indicating a renewed interest in Barbados-domiciled SRLs within the global investment community.

The growth of EICs and EIMCs in Barbados was limited during the second half of the 1990s. Other jurisdictions, including the British Virgin Islands, have been more successful in attracting captive insurance companies, challenging Bermuda's market leadership position. The US market is the largest potential source of captives. However, given that the international insurance sector is driven primarily by the various taxation treaties between Barbados and, in particular, the US and Canada, the uncertainty surrounding the continuation of these taxation arrangements, which are currently being renegotiated, may have led to the reduction in the number of new licenses issued.

A number of current initiatives spearheaded by the public and private sectors should serve to rejuvenate sectoral growth in the international business and financial services sector over the medium term. A consultant's report focussing on the marketing of the sector internationally has been commissioned, which should chart the way forward, particularly with respect to improved targeting of the US market. In addition, innovative legislation designed to facilitate the development of 'protected cells' within captive insurance companies should increase the attractiveness of Barbados as a captive insurance domicile⁶. Combined with a number of other advantages, particularly the large pool of competitively priced skilled workers and professionals available in Barbados, which reduces the need for expensive expatriate professionals, this should provide some impetus for growth over the medium term.

Contribution to Gross Domestic Product

Based on the latest available data, unofficial estimates of the economic contribution of the IFS sector in 2000 put the value-added generated by the activities of international business and financial services firms at approximately 400 million Barbados dollars (Bds\$), or approximately 7 per cent of GDP at market prices. EICs and IBCs were the main contributors to the sector's GDP, accounting for approximately 2.3 per cent and 3.1 per cent of total GDP, respectively. In contrast, while total offshore bank assets

were sizeable, their contribution to GDP, as measured by their operating surplus and wages/salaries, was estimated to be relatively small.

Employment

Presently, labour force data collected by the Barbados Statistical Service (BSS) by industry group do not include a separate category for the IFS sector. The informatics sub-sector is the only area of international business for which employment data is available.⁷

Preliminary data suggest that IBCs, given their absolute number, are the major employers, with more than one-third of the persons employed in IBCs engaged in informatics. Although comparable wages information for other areas is not available, it is estimated that average wages paid by employers in the IFS sector is relatively high. The sub-sector with the most attractive remuneration appears to be EICs and SRLs.

Contribution to government revenue

A significant contribution of the IFS sector is to tax revenue. Based on the available information given in table 2.4, the industry accounted for approximately 6.5 per cent of the Barbadian government's tax revenue and more than 30 per cent of the total corporate taxes in 2000. More recent data obtained from the Inland Revenue Department, estimates the industry's contribution to total corporation tax revenue in 2004 at approximately 60 per cent, up considerably from the 34.1 per cent in 2000.

Unofficial estimates of personal income taxes paid are about 3.1 per cent of total personal income taxes collected. Personal income tax remittances from the offshore sector for the period 2003–2005 were reported at Bds\$15.7 million. The majority of this income was collected from persons employed in IBCs and EICs. IBCs also provided the bulk of the corporate taxes collected from companies operating in the IFS sector.

Table 2.4 Estimated contribution to government revenue (income year 1999/2000)

<i>Revenue categories</i>	<i>Government revenue (Bds\$ millions)</i>	<i>IFS sector revenue</i>	<i>IFS sector (% of respective revenue category)</i>
Corporation tax	223.1	76.1	34.1
Personal income tax	272.2	8.4	3.1
License fees	79.6	2.7	3.4
Indirect taxes and other fees	879.5	7.8	0.9
Total	1454.4	95.0	6.5

Sources: Inland Revenue Department, Government estimates 2001/2002.

Linkages with other domestic sectors

Apart from its significant direct economic contribution, as measured by value-added, the IFS sector also has important linkages with other economic sectors. Services rendered to the sector include utilities, accommodation, restaurants and transportation. An unofficial estimate puts the contribution of the sector at in excess of Bds\$45.0 million, or approximately 12 per cent of the tourism sector GDP at market prices in 2000. The telecommunication sub-sector was also a major beneficiary of business activity, as were other persons involved in the renting of properties to international companies, with contributions estimated at Bds\$81.0 million and Bds\$75.5 million, respectively.

Challenges facing the IFS sector in Barbados

In spite of a slow down in business activity immediately after being listed by the OECD, Barbados still enjoys a good reputation as an international business jurisdiction. The main incentives international firms cite for choosing Barbados for their business operations are its low tax rate, double tax treaties, good infrastructure and its highly educated and trainable workforce. However, there are some issues and challenges that need to be addressed to ensure that the sector remains viable and the related benefits accrue to Barbados.

The prescriptions of international agencies and some industrialised countries have had a profound impact on the industry through increasing the cost of doing business. Added to this challenge are the uncertainties surrounding changes to existing tax treaties and legislative reforms. The Anti-money Laundering and Countering the Financing of Terrorism (AML/CFT) initiative has increased the operating cost burden of companies and has been cited as a major concern among industry participants. The paperwork for deposits of Bds\$10,000 (a small amount by most such companies' standards) or more and the increased due diligence required for companies to be licensed are two of the many complaints. The additional regulatory and supervisory requirements of this initiative have also been undertaken at a cost to the authorities, at a time when other international financial system soundness standards were required to be implemented.

The OECD ring-fencing issue prompted the Government of Barbados to explore tax convergence, which could remove one of the principal incentives for locating in this jurisdiction. Although the removal of the ring-fencing issue from the agenda of the OECD may have resulted in some loss of urgency for tax convergence, fiscal reform is still recognised as vital to the process of engendering a competitive private sector. While acknowledging that total convergence will not be feasible and that domestic companies will likely bear a higher tax burden, the Government of Barbados has implemented a systematic downward revision in the domestic corporate tax rate. In addition, policy officials are exploring other fiscal incentives that can be introduced without violating WTO free-trading rules. Characterised as a relatively high cost

jurisdiction, the low tax rate currently enjoyed by offshore companies gives Barbados an edge over competing jurisdictions with lower operating costs.

Apart from the tax burden, entities desirous of doing business in Barbados also face an administrative burden related to setting up and doing business. As a jurisdiction with high telecommunications costs, Barbados is challenged to be competitive. However, with the ongoing liberalisation of the telecommunications sector some reduction in costs is expected. Further work is needed to expand the technical infrastructure to facilitate large digital transactions critical for exploiting business opportunities in e-commerce and software development.

Limited resources have impeded the Government of Barbados' ability to effectively deliver services to the industry. A computer information network that proposes to link 15 public sector entities responsible for facilitating and promoting foreign investment is intended to improve the efficiency of government services. Greater flexibility in the legal structure, to allow for more expeditious provision of services, would also enhance business facilitation.

The interaction between Government and the private sector has generally been good. The Barbados Investment and Development Corporation has been praised for its role in the initial setting up of international companies and its co-operative efforts with the private sector in the marketing of Barbados as a viable international business jurisdiction, but an overall strategic plan for further development of the sector is needed and this is currently being prepared.

Relevant tax treaties, particularly revisions to sections of the double taxation treaty between Barbados and Canada, need to be finalised and other pieces of legislation completed. Over half of the international business that Barbados has been able to attract is the result of a favourable bilateral tax treaty with Canada. However, the current uncertainty surrounding the outcome of the renegotiation of this treaty has slowed the flow of Canadian business and hence the rate of new business formations in Barbados. The conclusion of these negotiations with Canada is essential for the long-term growth of Canadian business in Barbados. Although Canada is a major source of business, additional marketing efforts should also be geared towards the US and European markets.

Labour market issues and human resource development also need to be addressed. The educational level in Barbados is good and generally fits into the needs of the sector. However, there is some room for more specialised training in areas such as investment trading, treasury operations, actuarial science and information technology, as well as for the creation of formal links between tertiary institutions and representatives of the international business sector. Greater private sector involvement in curriculum development and training at the tertiary level could assist in the matching of the human resource needs within the various sub-sectors. It is also important that the accounting/finance and legal professionals maintain strong international standards and continually strive to keep their knowledge and skills current in the constantly evolving international environment.

To address some of these issues and challenges, which constrain the growth of the IFS industry in Barbados, in March 2004, the Ministry of Industry and International Business formed a joint working committee with the broad mandate of identifying and recommending feasible solutions to improve facilitation and support for the international business services industry in Barbados. Through consultations with the Barbados Investment and Development Corporation (BIDC), the Barbados International Business Association (BIBA) and the international business community, the various sub-committees were able to ascertain that considerable work was still needed to facilitate an effective environment for international business activity. The working committee made a number of recommendations, including greater information sharing sessions between the Government and the private sector, the provision of comprehensive corporate information brochures or manuals, strengthening the registrar of corporate affairs' office and streamlining immigration and customs procedures to ensure efficiency. A review of the double taxation treaties, with a view to expanding the network of dual tax treaties and the current regulatory controls, particularly those restricting the flow of foreign currency funds, were also cited. With regard to the labour market, the key issues mentioned were high employment costs, such as hiring and firing costs, and the inability to work on public holidays. There was also a call to review the labour laws. A concise exposition of the constraints to the growth of the sector is given in a BIDC report entitled 'Constraints to Doing Business in Barbados'. The itemised operating costs included high data transmission and telecommunication costs, high utilities and transportation costs, as well as the high costs of funds. The future expansion of the industry therefore hinges on the ability of the Government to effectively address these issues.

Notes

1. During the period 2002–06, the nominal rate of corporate tax under the Companies Act was systematically lowered from 40 per cent to 25 per cent.
2. In interviews with Canadian industry participants, non-tax benefits cited included lower operating costs, ease of access from Toronto and cultural links with Canada.
3. See document 'Working Together – Stronger Together' produced by a joint policy working group set up to critically examine business facilitation in the international business and financial services sector, Barbados International Business Association.
4. Based on discussions with representatives of the private sector and regulatory agencies.
5. The problem of data unavailability is currently being addressed. The Barbados Statistical Services Department, in collaboration with the Central Bank of Barbados, The Office of the Supervisor of Insurance and Pensions, the Corporate Affairs and Intellectual Property Office, the Ministry of International Business and the Barbados International Business Association, is in the process of conducting an extensive survey of the sector, not only to fill the existing data gaps but also to establish a formal mechanism to have data readily available for policy analysis.
6. Protected cells are similar to the 'rent a captive' concept. They allow a number of parents to share the infrastructure and costs of a single captive insurance company, whilst protecting the

asset position of each participant and allowing separate identification of individual loss ratios and similar statistics for reinsurance purposes.

7. Employment data for this sub-sector is collected by the Barbados Investment & Development Corporation.