CARIBBEAN TAX LAW UPDATE
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The Implications of the Decision in the Bank of Nova Scotia Case for Withholding Tax in the Caribbean

1. Multinational corporations operating in the Caribbean have an enduring concern and exposure to withholding tax arising from the provision of technical and support services to their subsidiaries in that region.

2. The normal structure which is employed is that Head Office supplies centralized technical and support services such as procurement, finance, information technology, marketing, regulatory and the like for subsidiaries worldwide including those operating in the Caribbean, and the cost of such services is shared among the subsidiaries who benefit from same. These costs which are allocated to subsidiaries are normally recovered by way of what are called "operational recharges" which are regarded as a reimbursement of the expenses incurred by the parent company at its head office in providing same.

3. The common issue which arises is whether the reimbursement by subsidiary companies in the Caribbean is to be subject to withholding tax. This invariably requires such payments to be regarded as being of an **income** nature before the withholding tax obligation could be triggered. This is probably one of the most important and enduring issues in the withholding tax regime operating in the Caribbean.

4. This matter was dealt with by the Court of Appeal for the Eastern Caribbean as well as the Privy Council[1] in the case of **Bank of Nova Scotia v. The Appeal Commissioners**[2] **("the BNS case")**. In that case the Court of Appeal **held** that the monies paid by way of reimbursement of the taxpayer's share of expenses incurred by the head office in Canada were not income. In delivering the judgment of the Court, Justice of Appeal Mitchell stated succinctly at **paragraph 36** as follows:

> **"The payments in question having been a reimbursement of expenses and not having been of income, are not subject to deduction of withholding tax."**

5. The question which arises is whether this decision has been recognized and respected in the Caribbean since it was delivered. The answer to this question would appear to be in the negative. This is because of the recent decision in July 2014 of the Appeal Commissioners in St. Lucia in the case of **Windward and Leeward Brewery v. Comptroller of Inland Revenue**[3] **("the WLBL case")** which will be dealt with

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1. 13 UKPC19
2. HCVAP 2011/012
3. Claim No. SLUHCV2014/0540

hereunder.

The BNS Decision

6. When the matter came up before the Privy Council in May 2013 on an appeal by the Government of Grenada, the Board had to consider 2 issues. First, whether the funds paid from the branch office in Grenada to the head office in Canada as the Grenada branch office share of expenses constituted a payment from one person to another for the purposes of withholding tax. Secondly, whether withholding tax was chargeable in respect of repayment or reimbursement of expenses by the branch office in relation to its share of the cost of expenses incurred by head office.

7. In relation to the first issue, the Board unequivocally upheld the judgment of Mitchell J.A. in the Court of Appeal, and held that the transfer of funds within one entity could not constitute a payment by one person to another person so as to trigger an obligation to deduct withholding tax.

8. As regards the second issue in relation to withholding taxes, the Privy Council was more circumspect. Whilst recognizing that a repayment of expenses does not constitute income generated within the particular jurisdiction, the Board declined to pronounce further on the issue because it was not necessary to do so.

9. However despite the Privy Council's reluctance to deal with the issue, the legal position is quite clear from the judgment of the Court of Appeal. It is that a payment by way of reimbursement of expenses is not of an income nature on which withholding tax is payable. But when the **WLBL** case was considered by the Appeal Commissioners, they did not appreciate or realize the presence of the issues involved in the **BNS** case.

10. This lack of recognition of the binding nature of the **BNS** decision arose, because when the **WLBL** case came before the Appeal Commissioners in St. Lucia they did not appreciate that there were 2 issues involved in the **BNS** decision. This was largely attributed to the fact that they took the unusual step of not conducting a hearing, as was required to be done, and merely issued a decision based on the documents filed in the Notice of Appeal.

Facts of the WLBL Case

11. WLBL is one of the subsidiaries in the Heineken Group and derived benefits from the centralized information technology services provided by its parent company, Heineken International, at its head office in Amsterdam. WLBL shared the cost of the service along with other Heineken International operating companies. One of the questions at issue in the appeal was whether the reimbursement by WLBL of such costs to its head office was of an income nature, so as to be subject to withholding tax.

12. Although the decision of the Court of Appeal in the Eastern Caribbean in the **BNS** case was referred to, the Appeal Commissioners, having not conducted a hearing, proceeded to dismiss the **BNS** decision as one which was irrelevant because it **"essentially concludes that an entity cannot pay expenses to itself..."** That was one of the issues in the case which related to whether the same entity could pay itself; where both the Court of Appeal and Privy Council held it could not. But the more relevant issue was the Court of Appeal decision which held that a reimbursement of expenses was not of an **income** nature, and therefore the withholding tax obligation was not triggered in such circumstances.

13. The failure of the Appeal Commissioners to appreciate the foregoing distinction caused it to fall into error, and to ignore a binding decision of the Court of Appeal. The question which arises is what is the future of the **BNS** decision.

Future of the BNS Decision

14. The action taken by the Government of Grenada within a matter of 5 months after the decision of the Privy Council in the **BNS** case, is one example of an attempt of passing amending legislation to override the decision of the Court of Appeal in the **BNS** case. In December 2013 the **Income Tax Act of Grenada** was amended in **Section 50** to provide that there was an obligation to deduct withholding tax in respect of payments which were **"expenses allocated to a resident branch or agency by a non-resident company"**.

15. The question which will arise is whether that amendment is the final word on the matter in the context of Grenada, and points the way forward for other territories in the Caribbean who may be confronted by the same issue, as to a withholding tax obligation in relation to payments made by subsidiaries of multinationals as reimbursement of expenses incurred in providing them with technical and support services from head offices. That is quite unlikely to be the case!

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This publication was prepared in conjunction with Mrs. Donna Denbow and Mr. Jerome Rajcoomar.

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