

APPENDIX A

PROTOCOL¹

amending the Convention between

BARBADOS

and

THE UNITED STATES OF AMERICA

FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE
PREVENTION OF FISCAL EVASION WITH RESPECT TO
TAXES ON INCOME SIGNED ON DECEMBER 31, 1984

Barbados and the United States of America, desiring to conclude a Protocol to amend the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed on December 31, 1984, (hereinafter referred to as "the Convention") have agreed as follows:

¹. The Amendments made by articles I to VII of this Protocol have been incorporated in the Convention. The remaining provisions appear in Appendix A of the Convention.

Article I to Article VII

These provisions have been incorporated in the Convention.

Article VIII

1. This Protocol shall be ratified and instruments of ratification shall be exchanged as soon as possible.

2. The Protocol shall enter into force upon the exchange of instruments of ratification, and shall have effect

(a) in respect of taxes imposed in accordance with Articles 10 (Dividends), 11 (Interest) and 12 (Royalties) for amounts paid or credited on or after the first day of the second month next following the date on which this Protocol enters into force;

(b) in respect of other taxes, for taxable years beginning on or after the first day of January next following the date on which the Protocol enters into force.

IN WITNESS WHEREOF, the undersigned, duly authorized thereto by their respective Governments, have signed this Protocol.

Done at Washington, in duplicate, this 18th day of December, 1991.

for Barbados:

for the United States of America:

Rudi. Y. Webster *Ray J McAllister*

**UNDERSTANDING REGARDING THE SCOPE OF THE
LIMITATION ON BENEFITS ARTICLE IN THE
U.S. - BARBADOS PROTOCOL**

A. Business Connection

Paragraph 1(c) of Article 22 (Limitation on Benefits) of the U.S. - Barbados Income Tax Convention, as amended by the Protocol, provides that benefits will be granted with respect to income derived in connection with or incidental to an active trade or business in the State in which the income recipient resides. This provision is self executing; unlike the provisions of paragraph 2, discussed in section B, below, it does not require advance competent authority ruling or approval.

The following examples illustrate the intention of the negotiators with respect of the interpretation of the provisions of paragraph 1(c). The examples are not intended to be exhaustive of the kinds of cases which would fall within the scope of the paragraph. All of the examples are intended to be understood reciprocally.

Paragraph 1(c) is relevant only in cases in which the entity claiming treaty benefits is not entitled to benefits under either the ownership and base erosion tests of paragraph 1(e) or the public trading test of paragraph 1(d).

Example I

Facts: A Barbadian resident company is owned by three persons, each resident in a different third country. The company is engaged in an active international marketing business in Barbados. It purchases goods in Asia and sells them throughout the Western Hemisphere, including the United States. It has a trade or business in the United States but no permanent establishment under Article 5 of the treaty. The Barbadian company is engaged in the United States in selling the goods which it has purchased in Asia. The active purchasing and selling business in Barbados of the Barbadian company is substantial in relation to the activities of the company's trade or business in the United States. Is the Barbadian company, by virtue of Articles 5 and 7 of the treaty, exempt from U.S. tax on its income effectively connected with its U.S. trade or business?

Analysis: Treaty benefits would be allowed, and the income would be exempt because the treaty requirement that the U.S. income is "derived in connection with or is incidental to" the Barbadian active business is satisfied. This conclusion is based on two elements in the fact pattern presented: (1) the income is connected with the active Barbadian business – in this example in the form of a "downstream" connection; and (2) the active Barbadian business is substantial in relation to the business carried on in the United States.

Example II

Facts: The facts are the same as in Example I except that while the income is derived by a Barbadian company of which the U.S. trade or business is a part, the relevant business activity in Barbados (i.e., the worldwide purchasing and selling activity) is carried on by a Barbadian subsidiary company of the first company. The Barbadian subsidiary's activities meet the business relationship and substantiality tests of the business connection provision, as described in the preceding example. Is the effectively connected U.S. income of the U.S. trade or business exempt from U.S. tax under Articles 5 and 7 of the treaty?

Analysis: The income is exempt because the two Barbadian entities (i.e., the one deriving the income and the one carrying on the substantial active business in Barbados) are related. Benefits are not denied merely because the income is earned by one Barbadian company and the relevant activity is carried on in Barbados by a related Barbadian company.

The existence of a similar multiple company structure in the United States would not affect the right of the Barbadian company receiving the income to treaty benefits. If, for example, a Barbadian company owns a subsidiary in the United States which is, itself, a holding company for the group's U.S. activities, and those activities are connected with the business activity of the parent or a related company in Barbados, dividends paid by the U.S. holding company to the Barbadian parent holding company would be tested for eligibility for benefits, in the same way as described above, ignoring the fact that the activities are carried on by one entity and the income in respect of which benefits are claimed is paid by another, related, entity.

Example III

Facts: A U.S. resident company is owned by three persons, each resident in a different third country. The company is the worldwide headquarters and parent of an integrated international business carried on through subsidiaries in many countries, including Barbados. The company's wholly owned U.S. and Barbadian subsidiaries manufacture, in their countries of residence, different products, each of which is part of the group's product line. The Barbadian subsidiary has been capitalized with debt and equity. The active manufacturing business of the U.S. subsidiary is substantial in relation to the activities of the Barbadian subsidiary. The U.S. parent manages the worldwide group and also performs research and development to improve the manufacture of the group's product line. Are the Barbadian subsidiary's dividend and interest payments to its U.S. parent eligible for treaty benefits in Barbados?

Analysis: Treaty benefits would be allowed because the treaty requirement that the Barbadian income is "derived in connection with or is incidental to" the U.S. active business is satisfied. This conclusion is based on two elements in the fact pattern presented: (1) the income is connected with the U.S. active business because the Barbadian subsidiary and the U.S. subsidiary each manufacture products which are part of the group's product line, the U.S. parent manages the worldwide group, and the parent performs research and development that benefit both subsidiaries; and (2) the active U.S. business is substantial in relation to the business of the Barbadian subsidiary.

Example IV

Facts: A third-country resident establishes a Barbadian company for the purpose of acquiring a large U.S. manufacturing company. The sole business activity of the Barbadian company (other than holding the stock of the U.S. company) is the operation of a small retailing outlet in Barbados which sells products manufactured by the U.S. company. Is the Barbadian company entitled to treaty benefits under paragraph 1(c) with respect to dividends it receives from the U.S. manufacturer?

Analysis: The dividends would not be entitled to benefits. Although there is, arguably, a business connection between the U.S. and the Barbadian businesses, the "substantiality" test described in the preceding examples is not met.

Example V

Facts: U.S., French and Canadian companies create a joint venture in the form of a partnership organized in the United States to manufacture a product in a developing country. The joint venture owns a Barbadian sales company which pays dividends to the joint venture. Are these dividends eligible for reduced Barbadian withholding under the U.S.-Barbados treaty?

Analysis: Under Article 4, only the U.S. partner is a resident of the United States for the purposes of the treaty. The question arises under this treaty, therefore, only with respect to the U.S. partner's share of the dividends. If the U.S. partner meets the public trading or ownership and base erosion tests of subparagraph 1(d) or (e), it is entitled to benefits without reference to paragraph 1(c). If not, the analysis of the previous examples would be applied to determine eligibility for benefits under 1(c). The determination of Barbadian treaty benefits available to the French and Canadian partners will be made under Barbadian treaties with France and Canada, or, in the absence of such treaties, under the provisions of Barbados law.

Example VI

Facts: A Barbadian company, a Jamaican company and a Trinidadian company create a joint venture in the form of a Barbadian resident company in which they take equal share holdings. The joint venture company engages in an active data processing business in Barbados. Income derived from that business that is retained as working capital is invested in U.S. Government securities and other U.S. debt instruments until needed for use in the business. Is interest paid on these instruments eligible for U.S.-Barbados treaty benefits?

Analysis: The interest would be eligible for treaty benefits. Interest income earned from short-term investment of working capital is incidental to the business in Barbados of the Barbadian joint venture company.

B. Competent Authority Discretion under Paragraph 2

As indicated above, treaty benefits may be claimed by the taxpayer under the provisions of paragraph 1 (ownership, base erosion, public trading and business connection) without reference to competent authority. It is anticipated that in the vast majority of cases, eligibility for treaty benefits will be determinable without resort to competent authorities. The tax authorities of the Contracting States may, of course, in reviewing a case determine that the taxpayer has improperly interpreted the provisions of paragraph 1, and that benefits should not have been granted. Furthermore, under paragraph 2 the competent authority of the source State may determine that, notwithstanding failure to qualify for benefits under paragraph 1, benefits should be granted.

It is assumed that, for purposes of implementing paragraph 2, taxpayers will be permitted to present their cases to the competent authority for an advance determination based on the facts, and will not be required to wait until the tax authorities of one of the Contracting States have determined that benefits are denied. In these circumstances, it is also expected that if competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant treaty provision or the establishment of the structure in question, whichever is later.

In making determinations under paragraph 2, it is understood that the competent authorities will take into account all relevant facts and circumstances. The factual criteria which the competent authorities are expected to take into account include the existence of a clear business purpose for the structure and location of the income earning entity in question; the conduct of an active trade or business (as opposed to a mere investment activity) by such entity; and a valid business nexus between that entity and the activity giving rise to the income. The competent authorities will, furthermore, consider, for example, whether and to what extent a substantial headquarters operation conducted in a Contracting State by employees of a resident of that State contribute to such valid business nexus, and should not, therefore, be treated merely as the "making or managing (of) investments" within the meaning of paragraph 1(c) of Article 22.

The discretionary authority granted to the competent authorities in paragraph 2 is particularly important in view of, and should be exercised with particular cognizance of, the developments in, and objectives of, international economic integration, such as that among the member countries of the CARICOM and under the proposed North American Free Trade Agreement.

The following example illustrates the application of the principles described in Section B, above.

Example VII

Facts: Barbadian, Jamaican and Antiguan companies, each of which is engaged directly or through its affiliates in substantial active business operations in its country of residence, decide to co-operate in the development and marketing of a new computer spreadsheet program through a corporate joint venture with its statutory seat in Barbados. The development and marketing aspects of the project are carried out by the individual joint venturers. The joint venture company, which is staffed with significant number of managerial and financial personnel seconded by the joint venturers, acts as the general headquarters for the joint venture, responsible for the overall management of the project including coordination of the functions separately performed by the individual joint ventures on behalf of the joint venture company, development of sales strategies, and the investment of working capital contributed by the joint venturers and the financing of the project's additional capital requirements through public and private borrowings. The joint venture company derives portfolio investment income from U.S. sources generated by working capital investments. Is this income eligible for benefits under the U.S.-Barbados treaty?

Analysis: If the joint venture company's activities constitute an active business and the income is connected to that business, benefits would be allowed under paragraph 1(c). If not, it is expected that the U.S. competent authority would determine that treaty benefits should be allowed in accordance with paragraph (2) under the facts presented, particularly in view of (1) the clear business purpose for formation and location of the joint venture company; (2) the significant headquarters functions performed by that company in addition to financial functions; and (3) the fact that all of the joint venturers are companies resident in CARICOM member countries in which they are engaged directly or through their affiliates in substantial active business operations.

The competent authorities will consult further on these issues and develop additional standards for the application of the Article as they gain experience with the application of these rules.