



GOVERNMENT OF BERMUDA
Ministry of Finance

Ministry of Finance

Guidance Notes

For Payroll Tax Act 1995

1st April 2018

Pursuant to Payroll Tax Act 1995 (Section 24B)

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TABLE OF ABBREVIATIONS AND ACRONYMS

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| Act | Payroll Tax Act 1995 |
| Amendment Acts | Payroll Tax Amendment Act 2018 and Payroll Tax Amendment (No. 2) Act 2018 |
| Court | Supreme Court of Bermuda |
| Commissioner | Tax Commissioner |
| Minister | Minister of Finance |
| MoF | Ministry of Finance |
| OTC | Office of the Tax Commissioner |
| Public Companies | Companies with shares that can be publicly traded on a stock market |
| Rates Act | Payroll Tax Rates Act 1995 |
| Regulations | Tax (Accounts and Records) Regulations 1991 |
| Taxes Management Act | Taxes Management Act 1976 |

PREFACE

The 2018 Budget outlined amendments to the Payroll Tax Act 1995 (the “Act”), including efforts to combat long standing abuse of the application of notional salaries (notionals), for payroll tax purposes, in owner-managed businesses.

Historically, “deemed employees” and “self-employed persons” who received income partly or wholly derived through sharing the profits of the business, instead of only through salaried remuneration, were subject to payroll tax based on the greater of their:

- a) actual remuneration; or
- b) notional remuneration.

Notional remuneration was previously defined by the Act, as the amount which represented a fair and equitable valuation of the services provided by such owner-managers to the business.

In practice this was being abused by tax payers and the degree of subjective judgement involved in determining a fair and equitable valuation of these services made enforcement impracticable.

In order to simplify the legislation and ensure that everyone pays their fair share of taxes, the concept of notionals has now been repealed, and effective 1st April 2018, deemed employees and self-employed persons will be subject to payroll tax on their actual remuneration, which includes dividends or any other form of profit distribution. *Note: the amendments also provide relief for (see further detail in section 6): 1) the first \$10,000 of dividends paid to each deemed employee, 2) dividends from exempt undertakings; and 3) dividends from listed companies.*

These changes to the Payroll Tax Act have been effected through the Payroll Tax Amendment Act 2018 and the Payroll tax Amendment (No. 2) Act 2018 (the “Amendment Acts”).

Purpose and scope of the Guidance Notes

These guidance notes (“Guidance Notes”) seek to clarify the legislation around deemed employees, and the amendments thereto. The purpose of the Guidance Notes is to assist tax payers in complying with the relevant provisions of the Act. This document provides guidance with respect to the following specific matters:

1. Relevant legislation
2. Who is affected by these Guidance Notes?
3. Who constitutes a deemed employee?
4. Who constitutes a self-employed person?
5. What constitutes remuneration of a deemed employee or self-employed person?
6. Dividends
7. What would be considered by the Commissioner to be an avoidance measure?
8. Record-keeping requirements
9. Assessed remuneration
10. Penalties
11. Legal status of the Guidance Notes

1. Relevant legislation

The following legislation should be read with respect to the subject of Payroll Tax:

- a) The Payroll Tax Act 1995 (The “Act”).
- b) The Payroll Tax Amendment Act 2018, and Payroll Tax Amendment (No. 2) Act 2018 (the “Amendment Acts”);
- c) Payroll Tax Rates Act 1995 (the “Rates Act”), which sets out the rate of payroll tax payable;
- d) Taxes Management Act 1976 (the “Taxes Management Act”), which sets out certain practicalities, responsibilities, rights and penalties; and
- e) Tax (Accounts and Records) Regulations 1991 (the “Regulations”), which sets out the records that taxpayers are required to maintain, and the locations where those records are to be made available.

2. Who is affected by these Guidance Notes?

These guidance notes affect: all deemed employees, employees and their employers; and self-employed persons.

3. Who constitutes a deemed employee?

A deemed employee is anyone who provides services to an entity and also shares directly or indirectly in the profits of that entity. See also section 6 of the Act for further definition.

This may include, for example:

- Lawyers and accountants who work for, and also share in the profits of their businesses;
- Medical practitioners who work for, and also share in the profits of their businesses;
- An owner-manager of a local business;
- A member of a limited liability company or an association who works for, and also shares in the profits of their businesses.

Note that directors are considered to be employees under section 5(6) of the act.

Another important element of the definition is the reference to sharing “directly or indirectly” in the profits. For example:

Mr. X provides services to Company A Limited. If Mr. X shares directly in the profits of Company A Limited, he would be considered a deemed employee. Similarly, if Company A Limited is wholly or partly owned by Company B Limited which is in turn owned directly or indirectly by Mr. X, then Mr. X would be considered a deemed employee of Company A.

Therefore if Mr. X ultimately receives the benefits from a distribution from Company A to Company B, such benefit would be included in the taxable remuneration of Mr. X.

So, following from the example above: if Company A pays a dividend of \$100,000 to its 100% parent Company B, and Company B in turn pays a dividend of \$50,000 to Mr X (who is a 50% shareholder in Company B) then such \$50,000 dividend would form part of Mr X's remuneration in relation to Company A. This would be the case regardless of whether Company B is domiciled in Bermuda, is an exempt undertaking, or a trust.

See paragraph 7 below for examples of anti-avoidance measures.

4. Who constitutes a self-employed person?

Section 14 (3) of the Act states that a self-employed person is an individual who carries on business otherwise than as an employee, and benefits from the income or profits of such business.

5. What constitutes remuneration of a deemed employee or self-employed person?

Sections 11 and 14 of the Act define what constitutes the remuneration of a deemed employee. Previously this was the greater of their notional remuneration and actual remuneration. For the reasons described in the preface, the concept, definition, and explanatory paragraphs on notional remuneration, previously covered in sections 12 and 13 of the Act have now been repealed, and sections 11 and 14 have been amended to state that the remuneration of a deemed employee and self-employed person is now considered to be their actual remuneration for the purposes of calculating payroll taxes.

Remuneration (actual remuneration) is defined in the Act under section 7 (1), and includes^o:

- (a) any wages, salary, leave pay, commission, gratuity, fee, bonus, perquisite or allowance;
- (b) any money paid under a profit-sharing scheme^o;
- (c) any money or other thing of value paid or given as an employee or an ex-employee in connection with the permanent termination of employment on account of redundancy or otherwise;
- (d) any amount paid with respect to a non-approved retirement or provident fund, scheme or society, or under a hospital or health insurance scheme;
- (e) the value of any meals, board or lodging, and whether provided in cash or otherwise than in cash;
- (f) the rental value of any place of residence provided rent-free;
- (g) where a place of residence is provided at a rent less than the rental value, the excess of the rental value over that rent;

- (h) any gain obtained by the exercise of, or the assignment or release of, a right to acquire shares or stock in a body corporate, being a right arising out of services rendered (whether in the capacity of director otherwise) to that body corporate; and
- (i) any other benefit of any kind whatsoever, whether provided in cash or otherwise than in cash.

(1) Please refer to section 7(2) for specific exclusions to the definition of remuneration

(2) The definition of “profit-sharing scheme” in section 2 (a) of the Act, has been amended through the Amendment Acts to “a scheme or arrangement under which an employee or deemed employee in any way whatsoever shares his employer’s profit, including by way of dividend”.

6. Dividends

The Amendment Acts specifically excludes from the definition of dividends, under section 7(2):

- h) any dividends relating to shares in—
 - i. an exempt undertaking, paid to an employee or deemed employee of the exempt undertaking;
 - ii. a company listed on the Bermuda Stock Exchange, or any other stock exchange recognised by the Minister for the purposes of this section, paid to an employee or deemed employee of the company or of a company in the same group;
- i) in relation to a company not falling within paragraph (h), the first \$10,000 per annum of any dividends relating to shares in the company paid to an employee or deemed employee of the company.

The Amendments under 7(2)(h), referred to above, are self-explanatory. As an example:

Employee X works for Company B, a wholly owned subsidiary of Company A which is listed on the Bermuda Stock Exchange. Employee X receives some compensation in the form of shares in Company A. While the issuance of the shares to Employee X is taxable, the dividends subsequently received from such shares is excluded from the definition of dividends for the purposes of payroll tax.

The Amendment to 7(2)(i) provides relief for the first \$10,000 of dividends paid to any employee or deemed employee. For example:

Company B pays an annual dividend of \$300,000 to each of its 3 shareholders (all of whom are also deemed employees) in the amount of \$100,000 each. The first \$10,000 of each dividend would be excluded from remuneration, but the remaining \$90,000 would be subject to payroll tax and added to the other remuneration of each deemed employee.

Capital transactions, such as sales of shares or return of capital that results in a reduction of a deemed employee’s economic interest in their employer company, would not be considered remuneration of such deemed employee.

For the avoidance of doubt all other dividends paid to deemed employees would be considered remuneration of such deemed employee.

7. What would be considered by the Commissioner to be an avoidance measure?

The Amendment Acts add to the anti-avoidance provisions in the Act. Section 24A (2A) of the Act now provides that the “Commissioner may take such action as he considers appropriate under the Taxes Management Act if it appears to the Commissioner that an employer or employee is not accurately declaring an employee’s remuneration in order to reduce the amount of payroll tax which would otherwise be payable under this Act.”

Examples of such payroll tax avoidance might include:

- Use of the annual cap on taxable remuneration, as set out in section 3 (3) of the Act, to reduce payroll tax liability: *For example, deliberately manipulating the timing of payments to utilize the annual cap;*
- Company A loans its shareholder, or a related party to that shareholder, a sum of money, the main purpose of which appears to be reducing or avoiding the payroll tax which would otherwise be payable on such distribution;
- A deemed employee loans Company B a sum of money at a higher than market rate of interest, or Company B loans deemed employee a sum of money at below market rate of interest;
- Repurchase of shares in a company, for which it appears that the main purpose is to avoid paying payroll tax on a distribution;
- Payments to family members or related parties of the deemed employee with no commercial substance which have the appearance that the payments were made with an intent to reduce the amount of payroll tax which would otherwise be payable under the Act;
- Making personal payments through a company or trust and not including them as part of the remuneration of the beneficiary of such payments, or the person on whose behalf such payments are made;
- Receiving any distribution as a beneficiary or otherwise from a trust, which owns any shares of a company, partnership, or other entity in which a person is considered to be an employee or deemed employee, with the objective of avoiding the payment of payroll tax which would otherwise be payable by a person considered to be a deemed employee;
- Payments received by a company, trust, partnership or other entity established outside of Bermuda, where that entity receives or is deemed to have received such payments from any company, person, trust, partnership or other entity to which a person residing in Bermuda provides services and would otherwise be considered to be deemed remuneration of a deemed employee residing in Bermuda for purposes of the Act and therefore subject to payroll tax on such payments in accordance with the Act;
- Dividends paid to employees who are not shareholders, or other payments disguised or labelled as dividends, solely in order to gain benefit of the \$10,000 dividend exclusion.

8. Record-keeping requirements

Section 14 (1) of the Taxes Management Act stipulates that any person who is “chargeable to tax” shall keep in Bermuda, at such place or places as may be prescribed, such documents of account and other records as may be prescribed as being documents and records necessary or expedient to be available so that the Taxes Acts, or any requirement made under those Acts, may be complied with or enforced. The penalties for failure to maintain and retain such accounts has been increased to \$100,000 under the Amendment Acts.

Further, the Regulations define the records that taxpayers are required to make available; and the places where those records are to be available. The Amendment Acts make significant changes to these Regulations.

- First, records are to be kept by employers for payroll tax, including financial statements and business operating account statements. These payroll records must set out the gross remuneration for each employee or deemed employee; the deductions made therefrom; and the net remuneration paid to each employee or deemed employee.
- Further, “supplementary records” are to be kept by employers for payroll tax records setting out details of all types of remuneration falling within each paragraph of section 7(1) of the Act, which were paid to, or in respect of, each employee or deemed employee, including the nature of each type of remuneration and details as to how each of those amounts were calculated.

9. Assessed Remuneration

Assessed remuneration is based on the assumed value of remuneration withdrawn from the business by deemed employees/self-employed persons and is determined by the OTC staff only. As per Section 16 (1) of the Taxes Management Act, in the absence of appropriate records, the Commissioner may make an assessment of the amount of tax, or further tax, to which, in his opinion, such person is chargeable.

10. Penalties

Penalties for offences defined in the Taxes Management Act have been significantly increased by the Amendment Acts with effect from 1st April 2018.

It is also worth noting that under section 36 (3) of the Taxes Management Act, it is an offence to assist in, or induce the making or delivery, for any purposes, of tax, any return, or accounts which he knows to be incorrect. Punishment on summary conviction comprises a fine of \$100,000 (or 6 months imprisonment).

The penalties for criminal tax evasion (as prescribed under section 37 of the Taxes Management Act) through willful act or willful default have now been increased to \$100,000 (or 6 months imprisonment), and for fraudulent evasion \$500,000 (or 5 years imprisonment).

11. Legal status of the Guidance Notes

The Court, in determining whether a person has committed an offence under the Act, or an offence under the Taxes Management Act, relating to payroll tax, is required to consider whether a person has followed any relevant guidance issued under section 24B of the Act, approved by the Minister and issued by the Commissioner.

Departures from the Guidance Notes, and the rationale for so doing, should be documented, and institutions should stand prepared to justify such departures to the Commissioner.

The Guidance Notes are not a statutory instrument for the purposes of the Statutory Instruments Act 1977.

The Guidance Notes may be amended and updated as necessary, once they are approved by the Minister and issued by the Commissioner.

The OTC will be increasing the number and rigor of their audits and inspections. The appropriate application of the Act and this guidance, where applicable, will be a key focus of such audits and inspections.