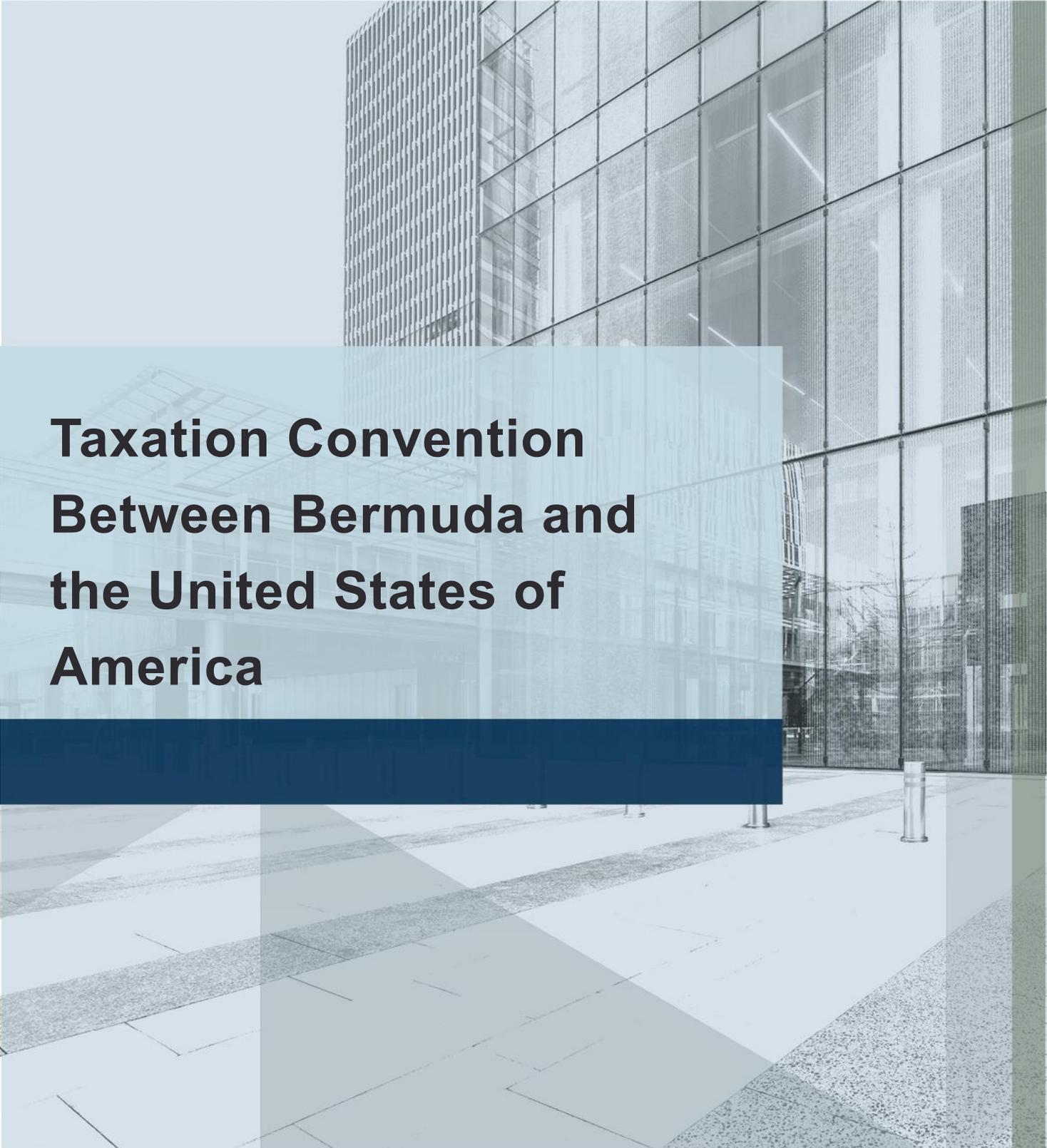


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A photograph of a modern glass skyscraper with a grid-like facade, viewed from a low angle. The building is partially obscured by a semi-transparent blue overlay containing text. The foreground shows a paved plaza with geometric patterns and a few stanchions.

Taxation Convention Between Bermuda and the United States of America

Preface

This publication has been prepared for the assistance of those who have established, or are considering the establishment of, operations or activities in Bermuda. It deals in broad terms with the provisions of the tax convention between Bermuda and the United States of America and its impact on Bermuda and persons in Bermuda. It is not intended to be exhaustive but merely to provide brief details and information which we hope will be of use to our clients. In particular, it must not be construed as advice on the tax laws of the United States. We recommend that our clients and prospective clients seek legal advice in Bermuda on their specific proposals, and consult with their tax, legal and other professional advisers in their respective jurisdictions.

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1. INTRODUCTION

On 11th July, 1986 representatives of the Government of Bermuda and the Government of the United States signed a convention (the "Treaty") which relates to the taxation of insurance enterprises and to mutual assistance in tax matters. The Treaty was ratified by the U.S. Government on 22nd October, 1988, subject to certain reservations (the "Reservations") and Instruments of ratification bringing the Treaty into force were exchanged on 2nd December, 1988.

The U.S.A. - Bermuda Tax Convention Act 1986 (the "Act") was passed on 29th August, 1986 for the purpose of enforcing in Bermuda certain of the provisions of the Treaty and became operative on 2nd December, 1988.

The Treaty is unique in many senses, particularly because Bermuda imposes no taxes whatsoever on income or business profits. In this regard, the Treaty has not set out to relieve double taxation of persons in two jurisdictions.

The following is a brief discussion of the provisions of the Treaty and the Notes incidental thereto so far as they relate to Bermuda based operations.

2. SCOPE OF THE TREATY RELIEF

2.1. Insurance Business

The U.S. taxes covered by the Treaty are federal income taxes imposed by the Code (other than accumulated earnings tax and personal holding company tax) and excise taxes in relation to insurance business.

- **Excise Tax** - With certain limitations, insurance premiums paid or credited as paid between 1st January, 1986 and December 31, 1989, to a qualified Bermuda insurance company were not subject to U.S. excise taxes.

Pursuant to the Reservations, the excise tax exemption ceased as of 31st December, 1989.

- **Business Profits** - Business profits of a qualified Bermuda insurance company derived from insurance business shall not be taxable in the U.S. unless the insurance company carries on or has carried on business in the U.S. through a permanent establishment. Where such an insurance company carries on or has carried on insurance through a permanent establishment in the U.S., the business profits of that company attributable to that permanent establishment may be taxed in the U.S.

The Treaty has effect for profits derived in taxable years beginning on or after 1st January, 1988.

2.2. Requirements applicable to the Treaty Relief of income taxes

- (i) **Ownership.** Only Bermuda insurance companies which are beneficially owned, directly or indirectly, more than 50 percent by a combination of individuals resident in Bermuda or the United States or citizens of the United States are entitled to benefits under the Treaty. In determining whether an individual is

"indirectly" the beneficial owner of a Bermuda insurance company, the Notes indicate that bearer form certificates of ownership will not be sufficient evidence for this purpose.

A person is defined to be a resident of Bermuda if such person is an individual who has the status of a legal resident of Bermuda or is a company, partnership, trust or association created under the laws of Bermuda. A resident of the United States is defined to include a company created under the laws of the United States or a political subdivision thereof and a person who is resident in the United States for the purposes of United States tax.

- (ii) **Use of Income.** Benefit is denied where the income of a Bermuda insurance company is used in substantial part, directly or indirectly, to make distributions to or to meet liabilities (other than insurance obligations) to persons who are not resident in Bermuda or the United States or citizens of the United States. The Notes indicate that the term "liabilities" includes reinsurance premiums paid by a Bermuda insurance company but not the payment of claims or expenses due under a policy issued by a Bermuda insurance company. The foregoing provisions with respect to ownership and the use of income do not apply where there is substantial and regular trading on a recognised stock exchange in the principal class of shares of the Bermuda insurance company.
- (iii) **Permanent Establishment.** The term "permanent establishment" is defined as a regular place of business through which the business of the company is wholly or partly carried on. In particular, it expressly includes a "place of management, branch, office and premises used as a sales outlet". The term also includes the furnishing of services in the United States by the Bermuda insurance company through its employees or other persons if such other persons are associated with the Bermuda insurance company or such activities continue for periods aggregating more than 90 days in any twelve-month period. Further, a person acting in the United States on behalf of a Bermuda insurance company shall be deemed to be a "permanent establishment" in the United States if he has and habitually exercises in the United States authority to conclude contracts on behalf of the Bermuda insurance company.

However, the maintenance of a regular place of business solely for the purpose of purchasing goods or merchandise or for collecting information for the Bermuda insurance company or for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character for the Bermuda insurance company shall be deemed not to be a permanent establishment. Further, a Bermuda insurance company shall not be deemed to have a permanent establishment in the United States merely because it carries on business in the United States through a broker, general commission agent or other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

It is expressly provided that the fact that a resident in the United States controls a Bermuda insurance company which carries on business in Bermuda shall not in itself constitute either company a permanent establishment of the other.

- (iv) **United States Residents.** The Treaty does not in any way prevent the United States from taxing its residents and citizens. However, the Technical Corrections Act of 1988 allows a CFC that is engaged in insurance business to elect to be taxed as a United States domestic corporation and the branch profits tax and excise taxes on premiums will not apply to such a foreign insurer.

2.3. Foreign Sales Corporations

The Government of the United States has agreed that subject generally to the provisions of the Treaty and the understandings set forth in the Notes, Bermuda will be designated as an appropriate jurisdiction for the incorporation by United States' companies of Foreign Sales Corporations ("FSC").

2.4. Business Convention Tax Benefit

The United States Government has also agreed that Bermuda will be designated as within the "North American area" for the purposes of eligibility for convention tax benefits under the Internal Revenue Code. United States' persons incurring expenses in attending business conventions in Bermuda will be entitled to claim deduction for such expenses.

3. DISCLOSURE OF INFORMATION

The Treaty contains provisions relating to the disclosure of information by the Governments. The Governments have agreed to provide information and assistance in carrying out the laws of the other jurisdiction relating to the prevention of tax fraud and the evasion of taxes.

Any information provided by Bermuda pursuant to the exchange of information provisions will be treated as confidential in accordance with the laws of the United States. Disclosure of such information in the United States is only authorised to persons or authorities involved in the assessment, collection or administration of, the enforcement of prosecution in respect of, or the determination of appeals in relation to, taxes.

The Treaty provides for the exchange of information in two categories, (i) that which relates to the prevention of tax fraud and tax evasion and (ii) that which relates to the carrying out of the fiscal laws of the jurisdiction (other than tax fraud or tax evasion). In general, the Treaty and the Notes provide that information may only be requested in respect of matters relating to taxable years not barred by statute of limitations. In no case can information be requested with respect to taxable years beginning prior to 1st January, 1977.

Where information is being requested in connection with the carrying out of the fiscal laws of the United States (as opposed to being in connection with the prevention of tax fraud and the evasion of taxes), Bermuda is not obliged to supply information relating to taxable years beginning prior to 1988 if the provision of such information would result in the breach of an obligation to maintain confidentiality under the laws of Bermuda in effect on the date of signature of the Treaty.

The obligation of Bermuda to make information available to the United States is further limited by the following rights of confidentiality:

- (1) Documents or information entitled to confidentiality by virtue of the laws of Bermuda relating to lawyer-client privilege will, in all cases, continue to be entitled to confidentiality.
- (2) Documents and information requested in connection with civil tax matters (other than civil fraud) relating to taxable years beginning before 1988 will continue to benefit from the Bermuda statutory and common law rules relating to confidentiality. Information obtained by banks in the course of a banker-client relationship will continue to be protected by virtue of this provision.
- (3) In respect of documents or information created in or derived from periods prior to 1st January, 1988, but required in respect of taxable years beginning on or after that date, they will continue to benefit from the statutory and common law rules relating to confidentiality as in effect on the 11th July, 1986, unless such a document or information is of a kind that has a "continuing operational effect".

The Notes set out in greater detail the manner in which the Governments propose to operate the exchange of information provision. In particular, there are provisions designed to protect persons who are non-resident in the United States or Bermuda from disclosure of information relating to themselves.

Where a request is made for information which relates to a person who is not resident in either jurisdiction, a senior official designated by the United States Treasury must certify that the request is relevant to and necessary for the determination of the tax liability of a United States tax payer or the criminal tax liability of a person under United States law. Further, the United States authority must satisfy the Bermuda authority that the information is necessary for the proper administration and enforcement of United States fiscal law.

Where information is being requested in relation to a matter which does not constitute a United States criminal or tax fraud investigation, a senior official must certify that the request is relevant to and necessary for the determination of the tax liability of a United States taxpayer.

The Act provides for the mechanism through which a request for information will be processed. The request must be in writing and contain particulars indicating, amongst other things,

- (i) that the information is in Bermuda and in the possession of a person in Bermuda,
- (ii) that the information relates to the carrying out of the relevant United States tax laws,
- (iii) that the information relates to the person in respect of whom it is made,
- (iv) whether or not the taxpayer is resident in Bermuda or the United States, and
- (v) the taxable period under examination.

Further, the request submitted to Bermuda must contain or be accompanied by the following:

- (i) where it relates to the prevention of tax fraud and the evasion of taxes, particulars indicating the act justifying the request;
- (ii) where it does not relate to a criminal or tax fraud investigation, a certification from a senior United States tax official that the information is relevant to and necessary for the determination of the tax liability of a United States taxpayer or the criminal tax liability of a person under United States law;
- (iii) where the information sought also relates to a time outside the stated taxable period under examination, particulars establishing the connection between the taxable period and that time;
- (iv) where it relates to a person who is not a resident of either Bermuda or The United States,
 - a certification from a senior United States tax official that the information is relevant to and necessary for the determination of the tax liability of a United States tax payer or the criminal tax liability of a person under United States law and
 - the Bermuda authorities must be satisfied that the information is necessary for the proper administration and enforcement of United States tax laws.

This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.

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