

Alert

Important Amendments to Bermuda’s Economic Substance Legislation

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On 24 December 2019, both the Economic Substance Amendment (No.2) Act 2019 and the Economic Substance Amendment (No.3) Regulations 2019 (the Amendment Legislation) came into force. The Amendment Legislation makes key changes to Bermuda’s economic substance regime, principally to harmonise the legislation with the legislation of other British Overseas Territories and Crown Dependencies. Simultaneous with the introduction of the Amendment Legislation, the Minister of Finance released Guidance Notes on the scope and application of the economic substance legislation.

The most significant changes under the Amendment Legislation are related to:

- Holding entities
- Financing and leasing
- Shipping
- Insurance
- Local entities

Holding Entities

The definition of “holding entity” has been narrowed in line with other jurisdictions to limit the relevant activity to being a pure equity holding entity.

An entity will be regarded as a “pure equity holding entity” if its primary function is to acquire and hold shares or an equitable interest in other entities, it performs no commercial activity and the shares or equitable interests are controlling stakes in such other entities. The main effect of this change is that entities which carry on another commercial activity other than being a pure equity holding entity will, as long as that activity is not a relevant activity, be out of scope of the economic substance legislation.

Furthermore, a pure equity holding entity need only comply with the minimum economic substance requirements meaning the entity must comply with corporate governance requirements set out in the Companies Act 1981 (or equivalent legislation) and complete and file an annual economic substance declaration form. A pure equity holding entity must also have adequate “people” (rather than adequate “employees”) for holding and managing its equity participations, and adequate premises in Bermuda.

Financing and Leasing

The hitherto separate activities of financing and leasing have been combined. The relevant activity of “financing and leasing” now encompasses providing to any person for consideration credit facilities of any kind, such as loans, hire purchase arrangements, finance leases (excluding in relation to land) and conditional sale or credit sale arrangements.

Financing and leasing will also include situations where any credit receivable is assigned to another person. The assignee will be considered to be the person providing the credit facility, and will therefore be in scope.

However, banking, insurance and fund management activities will not constitute financing and leasing.

Shipping

The relevant activity of shipping has been redefined. Under the new definition, shipping consists of activities involving the operation of a ship anywhere outside Bermuda territorial waters, including transporting, by sea, passengers or animals, goods or mail for a charge. Ownership of ships alone will no longer bring an entity within scope, although entities operating cruise ships, being involved in the transportation of passengers, have now been brought in scope.

Other activities relating to the operation of a ship that are in scope now include renting or chartering of ships for the purpose of transporting, by sea, passengers or animals, goods or mail for a charge, as well as the sale of travel tickets or related services, the use, maintenance or rental of containers, and functioning as a private seafarer recruitment and placement service.

For this purpose, the definition of “ship” does not include a pleasure vessel.

Insurance

An insurance entity will now only be in scope if it engages in insurance business in accordance with the Insurance Act 1978. Previously all entities engaged in business for which registration is required under that Act were in scope.

Consequently, insurance agents, brokers and managers, and other intermediaries that are regulated under the Insurance Act 1978, will be out of scope of the economic substance regime as long as they are not carrying on insurance business or another relevant activity.

Local Entities

Local entities that are carrying on a relevant activity (with the exception of banking and insurance business) and which (i) are required to be at least 60% beneficially owned and controlled by Bermudian persons, (ii) carry on business only in Bermuda, and (iii) are not part of a multinational enterprise group¹, are subject to reduced economic substance requirements.

Such local entities will be required only to comply with corporate governance requirements set out in the Companies Act 1981 (or equivalent legislation) but will not be required to complete and file an annual economic substance declaration form.

Guidance Notes

Carrying on as a business

The Guidance Notes have clarified that carrying on an activity “as a business”, which is a requirement of the definition of each relevant activity, means earning any gross income in respect of such activity. Accordingly, an entity which earns no gross income will be out of scope of the economic substance regime.

Core Income Generating Activities (CIGA)

Additionally, the Guidance Notes have clarified that where activities being undertaken by an entity outside of Bermuda result in a foreign permanent establishment (as understood under the OECD model tax convention), such that the entity can evidence that it is earning income and performing CIGA within that foreign permanent establishment, that may be taken into consideration by the Registrar of Companies in its assessment. In any event, an entity must ensure that CIGA is undertaken in Bermuda to meet the economic substance requirements.

Activities other than CIGA

Activities which are not CIGA will only need to be carried on in Bermuda where they are of central importance to the entity in terms of generating gross income from a relevant activity. Otherwise, activities may be carried on in, or outsourced to, a jurisdiction other than Bermuda.

Annual filing

All Bermuda entities (whether exempted or local) and permit companies, whether or not subject to the economic substance laws, will be required to include as part of their annual declaration to the Registrar of Companies a statement of whether or not the relevant entity carries on or proposes to carry on a relevant activity for purposes of the Economic Substance Act 2018, and, if so, the type of relevant activity carried on or proposed to be carried on by the entity.

¹ A multinational enterprise group is a group of companies that includes two or more enterprises for which the tax residence is in different jurisdictions or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction.

Economic substance filing

All entities in scope of the economic substance requirements (except certain local companies referred to above) are required to file an economic substance declaration no later than six months after the last day of each relevant financial period. For entities with a financial year ending on 31 December 2019, the first filing will be required on or before 30 June 2020. That declaration must demonstrate compliance with the economic substance requirements in respect of the period ending 31 December 2019. We understand that the Registrar is in the process of building an e-registration system to accept and manage the economic substance filings.

This bulletin is intended to alert clients and practitioners to the principal changes made by the Amendment Legislation. A more detailed summary of Bermuda's economic substance regime as updated by the Amendment Legislation will be distributed in January 2020.

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