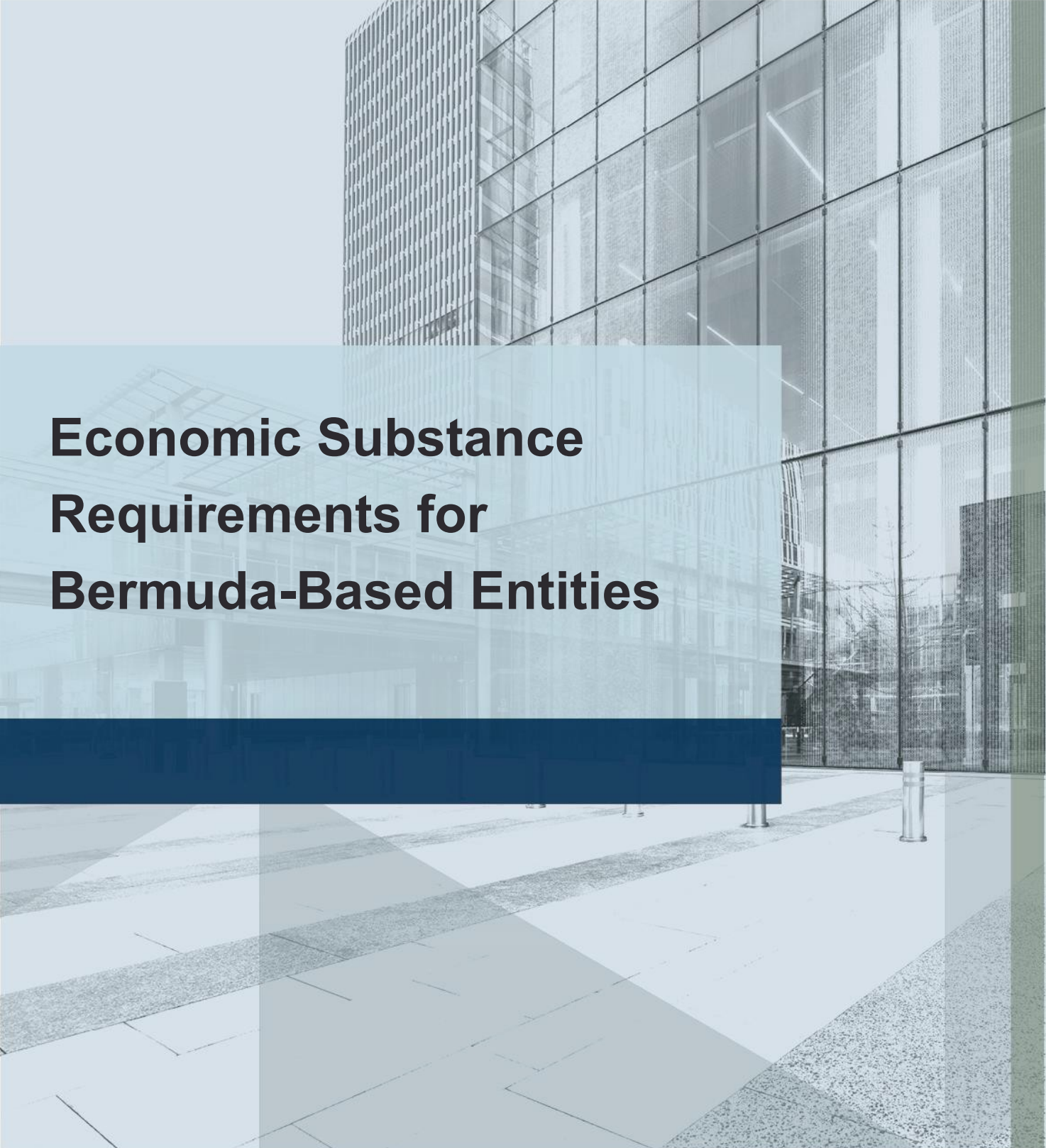


# CONYERS

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 small trees.

## **Economic Substance Requirements for Bermuda-Based Entities**

## Preface

This publication has been prepared for the assistance of those who are considering the formation or continued operation of a Bermuda-based entity. It deals in broad terms with the Bermuda law requirements for such entities to have economic substance in Bermuda. It is not intended to be exhaustive but merely to provide an overview of the legislation which we hope will be of use to our clients. We recommend that our clients and prospective clients seek legal advice in Bermuda on their specific circumstances and proposals before taking steps to implement them.

**Conyers Dill & Pearman**

**January 2020**

## TABLE OF CONTENTS

|           |  |           |
|-----------|--|-----------|
| <b>1.</b> | <b>INTRODUCTION</b>  | <b>4</b>  |
| <b>2.</b> | <b>ENTITIES REQUIRED TO HAVE ECONOMIC SUBSTANCE</b>  | <b>4</b>  |
| <b>3.</b> | <b>ECONOMIC SUBSTANCE REQUIREMENTS</b>   | <b>5</b>  |
| <b>4.</b> | <b>CORE INCOME GENERATING ACTIVITIES</b>   | <b>6</b>  |
| <b>5.</b> | <b>COMPLIANCE PROCESS</b>  | <b>7</b>  |
|           | <b>APPENDIX A - ECONOMIC SUBSTANCE DECISION-MAKING FLOW CHART</b>                            | <b>9</b>  |
|           | <b>APPENDIX B - LIST OF CORE INCOME GENERATING ACTIVITIES FOR EACH RELEVANT<br/>ACTIVITY</b> | <b>10</b> |

## 1. INTRODUCTION

The Economic Substance Act 2018 and the Economic Substance Regulations 2018 were enacted on 31 December 2018 (subsequently amended on 4 March 2019, 28 June 2019 and 24 December 2019) in response to a scoping paper issued by the European Union's Code of Conduct Group (Business Taxation) in June 2018. The scoping paper set out requirements that certain jurisdictions<sup>1</sup> outside the EU must adopt with regard to the economic substance of entities based in those jurisdictions, in order to avoid being included on a list of non-cooperative jurisdictions for tax purposes. Broadly equivalent legislation has been passed in all of the major offshore jurisdictions in addition to Bermuda, including the Cayman Islands, BVI and the Channel Islands. This memorandum updates that of July 2019 to reflect the 24 December 2019 amendments and the Guidance Notes issued by the Minister of Finance on the same date.

## 2. ENTITIES REQUIRED TO HAVE ECONOMIC SUBSTANCE

### 2.1. Entities in Scope

Entities within the scope of the legislation ('registered entities') include exempted and local companies, permit companies (overseas companies with a permit to carry on business from Bermuda), exempted and local LLCs and partnerships that have elected to have separate legal personality, where those entities are carrying on a 'relevant activity' as a business but do not include non-resident entities. For this purpose, a non-resident entity is an entity which is resident for tax purposes in a jurisdiction outside Bermuda which is not designated by the EU as a non-cooperative jurisdiction for tax purposes.

### 2.2. Relevant Activities

In scope entities which carry on as a business any one or more of the following relevant activities are required to comply with economic substance requirements:

- Banking
- Insurance
- Fund management
- Finance and leasing
- Headquarters
- Shipping
- Intellectual property
- Distribution and service centres
- Holding entity

These terms are defined in the legislation and a summary is included in Appendix B.

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### 3. ECONOMIC SUBSTANCE REQUIREMENTS

#### 3.1. Entities with minimum economic substance requirements

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 group<sup>2</sup>, are, along with pure equity holding entities, subject to reduced economic substance requirements. These requirements include (i) compliance with the applicable corporate governance requirements of the Companies Act 1981 (for companies) or the Limited Liability Companies Act 2016 (for LLCs), or the Partnerships Acts (for partnerships that elect to have separate legal personality) including keeping records of account, books and papers and financial statements; and (ii) for pure equity holding entities, filing an economic substance declaration (see section 5.1 below). Pure equity holding entities will also be required to have adequate people for holding and managing equity participations, and adequate premises in Bermuda.

#### 3.2. All other Entities

For all other entities carrying on relevant activities, the legislation requires that they maintain a substantial economic presence in Bermuda, and in that regard comply with full economic substance requirements. These requirements will be met if:

- the entity is managed and directed in Bermuda;
- core income generating activities are undertaken in Bermuda with respect to the relevant activity;
- the entity maintains adequate physical presence in Bermuda;
- there are adequate full time employees in Bermuda with suitable qualifications; and
- there is adequate operating expenditure incurred in Bermuda in relation to the relevant activity.

The Bermuda Registrar of Companies (the “Registrar”) is responsible for monitoring compliance with the economic substance regime. The Registrar will determine whether or not the economic substance requirements are met, based upon the following information provided by the entity:

- the nature and extent of the relevant activity engaged in by the entity including, in particular, its core income generating activities undertaken with respect to such relevant activity;
- the nature and extent of the entity’s presence in Bermuda including physical offices or other premises occupied by the entity or its affiliate in Bermuda and an adequate level of annual expenditure of the entity in Bermuda;
- whether the entity is managed and directed in Bermuda or from Bermuda, having regard to:

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<sup>2</sup> 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.

- the location of strategic or risk management and operational decision-making, or where management of the entity meets to make decisions regarding business activities
  - the presence of an adequate number of senior executives, employees or other persons in Bermuda who are suitably qualified and responsible for oversight/execution of its core income generating activities
  - the location and nature and frequency of board, manager or partnership meetings held in Bermuda in relation to the overall number of meetings
- the nature and extent of outsourcing arrangements (if any) to affiliates or service providers in Bermuda including whether and to what extent (i) the employees or other persons in the entity who are responsible for, or involved in, oversight and assessment of the implementation or execution of the outsourcing are suitably qualified and able to monitor and control the adequate carrying out of the outsourcing, and (ii) the persons carrying on the outsourced services are suitably qualified and have adequate capacity for the implementation and execution of those services, and whether the outsourced service provider complies with the economic substance requirements applicable to the outsourcing entity (noting that employees, premises and expenditure may not be counted multiple times by multiple entities with respect to such compliance).

The Registrar will also consider any other information provided in the economic substance declaration (see section 5.1 below).

This information should be viewed collectively, and not prescriptively. In other words, for all registered entities that are in-scope, a combination of some or all information will be considered. In practice, this means that what constitutes compliance with economic substance requirements will necessarily differ from entity to entity, depending on each entity's relevant activity and the nature, scale and complexity of the entity's business.

## **4. CORE INCOME GENERATING ACTIVITIES**

### **4.1. General**

The core income generating activities ("CIGA") that should be undertaken by the entity in Bermuda will differ between the various relevant activities. The core income generating activities identified in the legislation in respect of each relevant activity are set out in Appendix B, and it will be necessary for entities to be conducting those activities in Bermuda, whether directly or through outsourcing arrangements in Bermuda (noting the comments above regarding the nature of any such outsourcing). Where activities 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. For the avoidance of doubt, activity resulting in gross income reported in Bermuda (and not in the foreign permanent establishment) would be subject to economic substance requirements in Bermuda.

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, such activities may be carried on in, or outsourced to, a jurisdiction other than Bermuda.

#### 4.2. Regulated entities: insurance and banking

It is recognised that certain regulated sectors, notably insurance and banking, are already subject to substance requirements in Bermuda by virtue of their existing regulatory requirements. As such, to the extent that entities are carrying on insurance or banking as a relevant activity, the Registrar will have regard to such entities' compliance with their existing regulatory requirements in assessing compliance with economic substance requirements. Such companies will be required to complete and file an economic substance declaration (see section 5.1 below) and the Registrar will also have regard to the information provided in the declaration in making the assessment.

#### 4.3. Intellectual Property

Entities carrying on IP business as a relevant activity are subject to certain enhanced requirements and will be presumed not to comply with economic substance requirements unless those enhanced requirements are met. In particular, those entities carrying on high risk IP activity (namely, owning an IP asset that has been acquired from an affiliate or been obtained through the funding of overseas research and development and which is then licensed to a foreign affiliate or used to generate revenue through activities performed by a foreign affiliate) must provide additional information to the Registrar, including a detailed business plan, in order to rebut the presumption of non-compliance. Registered entities undertaking IP business as a relevant activity are advised to seek legal advice regarding these enhanced requirements.

### 5. COMPLIANCE PROCESS

#### 5.1. Annual Economic Substance Declaration

All entities undertaking relevant activities, which includes all holding entities (i.e. pure equity holding entities), must file annually with the Registrar an Economic Substance Declaration ("ESD"), providing information in relation to the previous financial year (the "relevant financial period").

The ESD will require the disclosure of certain key information applicable to an analysis of economic substance requirements. At a minimum this will include:

- whether or not the entity is carrying on a relevant activity and the type of relevant activity being undertaken;
- whether the entity is engaging in high risk IP activity;
- whether the entity will outsource the relevant activity and to whom;
- the core income generating activities that are undertaken in Bermuda with respect to the relevant activity;
- the gross income for the relevant financial year;
- the premises in Bermuda;
- the names and physical addresses of the directors/managers/partners resident in Bermuda;



- the holding entity, ultimate parent entity, owner or beneficial owner of the entity;
- the operating expenses and assets for the relevant financial year and number of full time employees; and
- such other information as the Registrar may require.

The form of ESD is expected to be prescribed in early 2020 with the first filing for most entities expected to be required on or after 1 July 2020.

## **5.2. Certification of Residence for Tax Purposes in a Foreign Jurisdiction**

Where an entity that claims to be resident for tax purposes in a jurisdiction outside Bermuda (non-resident entity) carries on a relevant activity (see section 2.2), such non-resident entity must file annually with the Registrar providing the name of the relevant jurisdiction and evidence to support such claim. Such jurisdiction must not be on the European Union's list of non-cooperative jurisdictions for tax purposes.

## **5.3. Monitoring and enforcement**

The Bermuda Registrar of Companies is responsible for monitoring and enforcing the economic substance regime. The legislation provides for civil penalties, subject to rights of appeal, up to BD\$250,000 to be applied in relation to non-compliance with the applicable economic substance requirements. If, after the civil penalties have been exhausted, an entity continues its failure to comply, the Registrar may apply to the Court for an order in such terms as it thinks fit. This may include an order for striking off the entity. There is also an offence created of knowingly providing false declaration information to the Registrar, with penalties up to BD\$10,000 or imprisonment for two years, or both.

## **5.4. Confidentiality**

In the collection of information or documents pursuant to the legislation (whether through the ESD or otherwise), the Registrar is expressly obliged to preserve the confidentiality of such information or documents, other than as may be required in connection with its duties (see section 5.5 below).

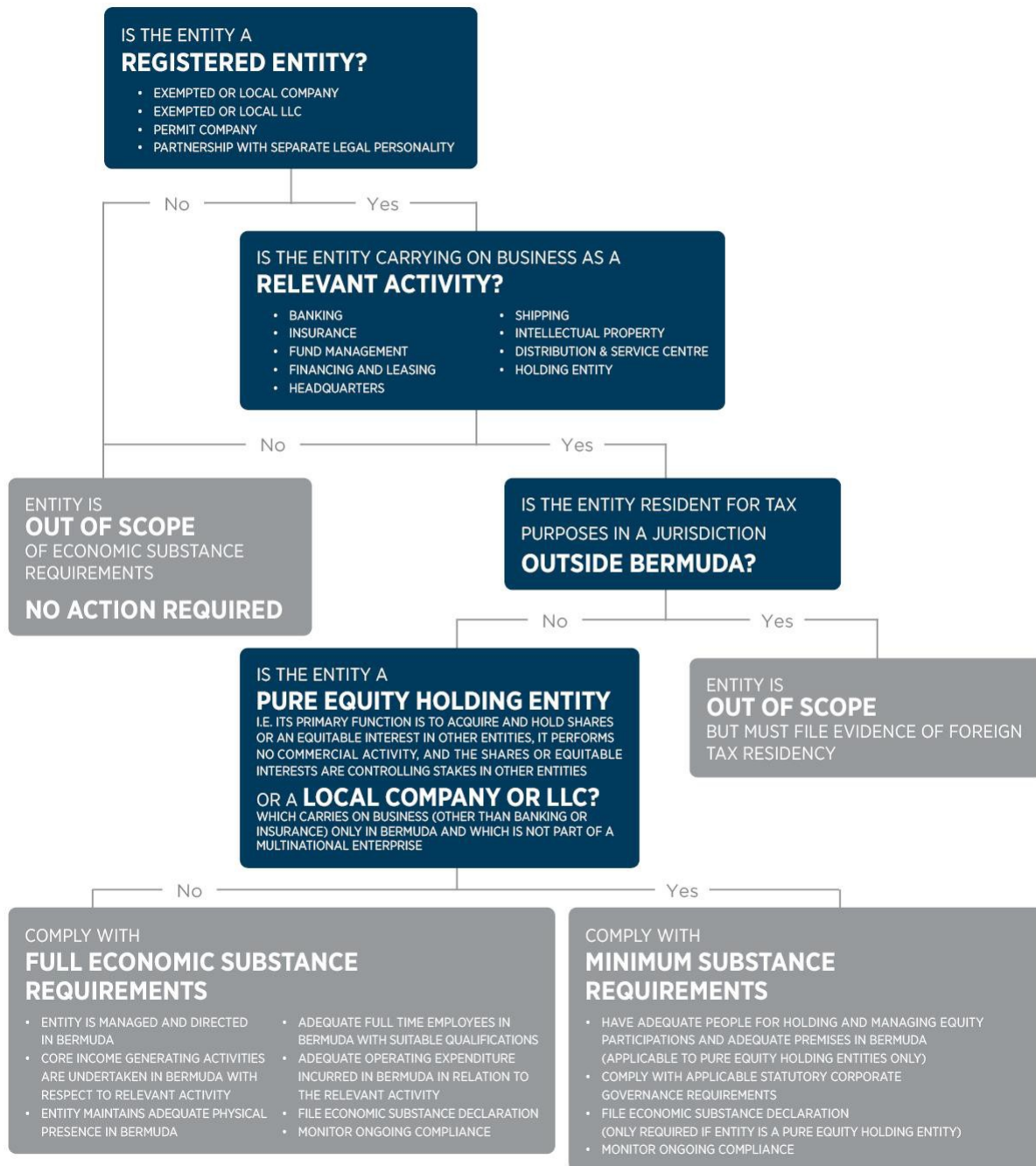
## **5.5. Information sharing with competent authorities**

As an extension of Bermuda's existing obligations to share information in connection with international Tax Information Exchange Agreements, the legislation provides for the automatic provision of information in relation to economic substance in certain circumstances. In particular, where an entity is found by the Registrar not to be in compliance with economic substance requirements for a relevant financial period, or is engaged in high risk IP activities (as described above) or claims to be tax resident in a foreign jurisdiction, the Registrar is required automatically to provide the filed information to the foreign jurisdiction in which the entity's holding entity, ultimate parent, owner or beneficial owner is incorporated, formed, resident or registered and, in the case of a non-resident entity, the foreign jurisdiction in which such entity claims to be resident for tax purposes.



**APPENDIX A - ECONOMIC SUBSTANCE DECISION-MAKING FLOW CHART**

**CONYERS** | **ECONOMIC SUBSTANCE DECISION-MAKING FLOW CHART - BERMUDA**



**APPENDIX B - LIST OF CORE INCOME GENERATING ACTIVITIES FOR EACH RELEVANT ACTIVITY**

| Relevant Activity            | Definition and Core Income Generating Activities   |
|------------------------------|--|
| <b>BANKING</b>               | <p>Engaging in deposit-taking business for which a licence is required in accordance with the Banks and Deposit Companies Act 1999</p> <ul style="list-style-type: none"> <li>• raising funds</li> <li>• managing risk including credit, currency and interest risk</li> <li>• taking hedging positions</li> <li>• providing loans, credit or other financial services to customers</li> <li>• managing regulatory capital</li> <li>• preparing regulatory reports</li> </ul>  |
| <b>INSURANCE</b>             | <p>Engaging in insurance business in accordance with the Insurance Act 1978</p> <ul style="list-style-type: none"> <li>• predicting and calculating risk</li> <li>• insuring or reinsuring against risk</li> <li>• providing client services</li> <li>• preparing regulatory reports</li> </ul>  |
| <b>FUND MANAGEMENT</b>       | <p>Managing investments for funds and in respect of which a licence is required in accordance with the Investment Business Act 2003 or for which a licence would be required if such activity were taking place in Bermuda</p> <ul style="list-style-type: none"> <li>• taking decisions on the holding and selling of investments</li> <li>• calculating risk and reserves</li> <li>• taking decisions on currency or interest fluctuations and hedging positions</li> <li>• preparing relevant regulatory or other reports for government authorities and investors</li> </ul> |
| <b>FINANCING AND LEASING</b> | <p>Providing credit facilities of any kind for consideration to any person including the supply of goods by hire purchase, financial leasing (excluding in relation to land) and conditional sale or credit sale arrangements.</p> <p>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,</p>  |

| Relevant Activity                         | Definition and Core Income Generating Activities  |
|---|---|
|   | <p>and will therefore be in scope.</p> <ul style="list-style-type: none"> <li>• agreeing funding terms</li> <li>• identifying and acquiring assets to be leased (in the case of leasing)</li> <li>• setting the terms and duration of any financing for leasing</li> <li>• monitoring and revising agreements</li> <li>• managing risk associated with such agreements</li> </ul>   |
| <b>HEADQUARTERS</b>                       | <p>Engaging in the general management and administration of its affiliates within or outside Bermuda</p> <ul style="list-style-type: none"> <li>• taking relevant strategic or management decisions</li> <li>• incurring expenditures on behalf of affiliates</li> <li>• coordinating group activities</li> </ul>   |
| <b>SHIPPING</b>                           | <p>Engaging in 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. Other activities involving the operation of a ship that are in scope include renting or chartering of ships for the purposes of transporting passengers or animals, goods, or mail for a charge, as well as the sale of travel tickets and ancillary ticket-related services, the use, maintenance or rental of containers, and functioning as a private seafarer recruitment and placement service</p> <ul style="list-style-type: none"> <li>• managing the crew (including hiring, paying and overseeing crew members)</li> <li>• hauling and maintaining ships</li> <li>• overseeing and tracking deliveries</li> <li>• determining what goods to order and when to deliver them</li> <li>• organising and overseeing voyages</li> </ul> |
| <b>DISTRIBUTION &amp; SERVICE CENTRES</b> | <p>Engaging in resale of goods purchased from a foreign affiliate (distribution centre); or primarily providing consulting or administrative services to a foreign affiliate (service centre)</p> <ul style="list-style-type: none"> <li>• transporting and storing goods (distribution centre)</li> <li>• managing stock and taking orders (distribution centre)</li> <li>• providing consulting or administrative services to a foreign affiliate (service centre)</li> </ul>   |

| Relevant Activity            | Definition and Core Income Generating Activities  |
|------------------------------|---|
| <b>INTELLECTUAL PROPERTY</b> | <p>Engaging in the exploitation of IP assets</p> <ul style="list-style-type: none"> <li>• conducting research and development in relation to IP assets</li> <li>• marketing, branding, and distribution of IP assets</li> <li>• taking the strategic decisions and managing and bearing the principal risks related to (i) the development and subsequent exploitation of an IP asset and (ii) any third party acquisition and subsequent exploitation of an IP asset</li> <li>• carrying on the underlying trading activities through which IP assets are exploited and which lead to the generation of IP income from third parties</li> </ul> <p>Where the activities described in bullets 1 and 2 (above) are not undertaken in Bermuda during a relevant financial period it is presumed that the entity does not comply with economic substance requirements unless it is shown to the contrary that the entity undertakes the activities described in bullets 3 and 4 (above).</p> |
| <b>HOLDING ENTITY</b>        | <p>Means a pure equity holding entity whose primary function is to acquire and hold shares or an equitable interest in other entities, performs no commercial activity, and the shares or equitable interests are controlling stakes in other entities</p> <ul style="list-style-type: none"> <li>• Have adequate people for holding and managing equity participations, and adequate premises in Bermuda</li> </ul>  |

*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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