



ADVISORY
Industry Information

Overview of Bermuda Economic Substance Requirements

7 January 2020

Legislation requiring a “relevant entity” conducting “relevant activity” to report and maintain economic substance has been introduced in Bermuda.

The Economic Substance Act (2018) (the “ES Act”) came into force on 31 December 2018 and was amended by the Economic Substance Amendment Act on 28 June 2019 and by the Economic Substance Amendment (No. 2) Act 2019 on 24 December 2019. The Economic Substance Regulations came into force on 31 December 2018 and were amended by the Economic Substance Amendment Regulations 2019 on 22 February 2019; the Economic Substance Amendment (No. 2) Regulations 2019 on 4 March 2019 and the Economic Substance Amendment (No. 3) Regulations 2019 on 24 December 2019 (collectively, the “ES Regulations” and together with the ES Act, the “ES Law”).

Guidance Notes on general principles relating to economic substance requirements in Bermuda were published in draft on 28 May 2019 and in revised final form on 24 December 2019 (“ES Guidance”).

This advisory provides an overview of key aspects of the Bermuda ES Law only and we would be happy to advise in further detail, if required.

Bermuda is a member of the OECD Inclusive Framework on Base Erosion and Profit Shifting (“BEPS”) and enacted the ES Law in response to requirements for geographically mobile activities to have economic substance developed under BEPS Action 5, consistent with the European Union timeframe to have such requirements in place on 1 January 2019. Similar legislation has been enacted in all OECD-compliant jurisdictions with no or nominal tax, including the British Virgin Islands, the Cayman Islands, Guernsey and Jersey. The ES Law and ES Guidance were issued following consultation with the OECD, the EU and Bermuda stakeholders. International standards are continuing to develop and it is anticipated that the ES Law and ES Guidance will evolve and be subject to further clarification.

Scope

The ES Law applies to any “relevant entity” that conducts any “relevant activity” in a “relevant financial period”. A “relevant entity” which does not conduct “relevant activity” is required only to submit an annual declaration of that fact to the Registrar of Companies in Bermuda (the “Registrar”). An entity which is not a “relevant entity” is out of scope and has no obligations under the ES Law.

What is a “relevant entity”?

The ES Law applies to Bermuda ‘registered entities’ being:

- >> companies incorporated or registered under the Bermuda Companies Act, 1981 (as amended) (“Bermuda Companies Act”), including a



permit company and an overseas company;

- >> limited liability companies registered under the Bermuda Limited Liability Company Act, 2016 (as amended) (the “Bermuda LLC Act”);
- >> partnerships that are registered as exempted partnerships, exempted limited partnerships or overseas partnerships that have elected to have separate legal personality in accordance with section 4A of the Partnership Act, 1902.

A ‘non-resident entity’ is excluded from the definition of ‘registered entity’ and is therefore not subject to the Bermuda ES Requirements. A ‘non-resident entity’ means an entity which is resident for tax purposes in a jurisdiction outside Bermuda that is not in Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes (the so-called ‘black list’). Non-resident entities will be required to make an annual declaration confirming whether or not they are conducting any relevant activities and, if they are, to provide sufficient evidence to the Registrar to support their tax residence in a jurisdiction outside Bermuda. In addition, the information received by the Registrar will be provided to the foreign competent authority of an EU member state or other jurisdiction where a holding entity, the ultimate parent entity, an owner or the beneficial owner of the entity is incorporated, formed, registered or resident.

What is a “relevant activity”?

Each of the following activities, which have been identified by the OECD as “geographically mobile” is a “relevant activity” if carried on as a business under the ES Law:

- >> banking;
- >> insurance;
- >> fund management;
- >> financing and leasing;
- >> headquarters;
- >> shipping;
- >> distribution and service centre;
- >> intellectual property; and
- >> holding entity.

The Registrar will consider that the above activities are being carried on as a business if the relevant entity earns a gross income in respect of such activity during the relevant financial period.

What is a “relevant financial period”?

A relevant financial period under the ES Law is the financial year of the relevant entity. The first financial period in respect of which a relevant entity is required to report to the Registrar as to its economic substance is the first financial period commencing on or after 1 January 2019.

The ES Requirements

A relevant entity that conducts a relevant activity must satisfy the economic substance requirements under the ES Law (the “ES Requirements”) in relation to that relevant activity. If a relevant entity is carrying on more than one relevant activity, it must meet the ES Requirements with respect to each relevant activity that is carrying on. A relevant entity complies with the ES Requirements if:

- (a) the relevant entity is managed and directed in Bermuda;
- (b) core income generating activities (“CIGA”) are undertaken in Bermuda with respect to the relevant activity;
- (c) the relevant entity maintains adequate physical presence in Bermuda;
- (d) there are adequate full-time employees in Bermuda with suitable qualifications; and



(e) there is adequate operating expenditure incurred in Bermuda in relation to the relevant activity.

Further details of the relevant activities and the corresponding Bermuda CIGA are set out at the end of this advisory.

Minimum ES Requirements

A relevant entity may be subject only to “minimum economic substance requirements” (“Minimum ES Requirements”) if it is:

- (a) a “pure equity holding entity”; or
- (b) a “local entity” (subject to certain additional requirements where the local entity is conducting banking and insurance business).

A “pure equity holding entity” means an entity which as its primary function acquires and holds shares or an equitable interest in other entities, performs no commercial activity¹ and which:

- > holds the majority of the voting rights in another entity;
- > is a shareholder, member or partner in another entity and has the right to appoint or remove a majority of the board of directors, managers or equivalent of that other entity; or
- > is a shareholder, member or partner in another entity and controls alone, under an agreement with others, a majority of the voting rights in that other entity

A pure equity holding entity meets the Minimum ES Requirements if it complies with the applicable corporate governance requirements in the Companies Act, the LLC Act or the applicable partnership legislation; submits an economic substance declaration in respect of any relevant financial period in which it carries on the business of holding entity; and if it has adequate people for holding and managing equity participations, and adequate premises in Bermuda. The ES Guidance confirms that the maintenance of separate office space or a physical registered office (or equivalent) in Bermuda and the management of the equity participations by employees or the board of directors (or equivalent) in Bermuda or through appropriate service providers in Bermuda (e.g. corporate service providers or outsourced management service providers), may be adequate for these purposes.

A “local entity” is a local company or local limited liability company which is owned and controlled by Bermudians, which carries on business only in Bermuda and which is not part of an ‘MNE Group’ (as defined in the ES Act). A local entity meets the Minimum ES Requirements if it complies with the applicable corporate governance requirements set out in the Companies Act, the LLC Act or the applicable partnership legislation only and is not required to submit an economic substance declaration form.

Application of the ES Requirements to “high risk intellectual property business”

A “relevant entity” which conducts “high risk intellectual property business” is presumed not to have met the ES Requirements for a relevant financial period, even if there are CIGA relevant to the business and the intellectual assets being carried out in Bermuda, unless the relevant entity can demonstrate that it does not passively hold and generate intellectual property income but a high degree of control over the development, exploitation, maintenance, protection and enhancement of the intangible asset, exercised by an adequate number of full-time employees with the necessary qualifications that permanently reside and perform their activities within Bermuda, and provides sufficient specified information to the Registrar in relation to that relevant financial period to rebut this presumption. We would be happy to advise on the meaning of “high risk intellectual property business” and the evidential threshold, if required.

Bermuda CIGA

The CIGA of a relevant entity in respect of every relevant activity that it undertakes must be undertaken in Bermuda. Where the CIGA are undertaken by a service provider under an outsourcing arrangement or by an affiliate of the relevant entity, such activity must also be undertaken

¹ Investment funds and collective investment vehicles are not generally regarded pure equity holding entities as they may be regarded as carrying on a commercial activity. Therefore, provided that they are not carrying on any other relevant activities, they are out of scope.



in Bermuda. A relevant entity may outsource activities which are not CIGA to service providers which are located outside of Bermuda. Such activities may include, for example, back office functions, IT payroll, legal services, or other expert advice or specialist services provided that, in each case, they are not of central importance to the entity in terms of generating gross income from a relevant activity.

Managed and Directed

- >> A relevant entity that is carrying on a relevant activity is required to provide information to the Registrar confirming whether it is managed in directed in Bermuda in respect of each relevant financial period, having regard to:
- >> the location of strategic or risk management and operational decision-making or where the 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 or execution of its CIGA or both;
- >> the location of board/managers'/partners' meetings and the nature and frequency of those 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; and
- >> whether Minimum ES Requirements apply.

The number of meetings held should be proportionate to the nature, scale and complexity of the relevant activity that is being conducted. Minutes should be kept of all key meetings which should evidence the relevant strategic or risk management and operational decisions taken. Such minutes are expected to be made available to inspection by the Registrar (whether electronically or in hard copy).

What is "adequate"?

The ES Guidance is intended to assist relevant entities carrying on relevant activities to understand how to satisfy the ES requirements, including ES Guidance as to the meaning of "adequate" for the purposes of the ES Law. The ES Guidance does not prescribe a minimum number of full time employees for a particular level of relevant income either generally or for or any particular type of relevant activity because that would be arbitrary and would prove uneconomical in many cases. What is adequate or appropriate for each relevant entity will be dependent on the particular facts of the relevant entity and its business activity. A relevant entity will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.

Regulated entities

Given the stringent regulatory requirements in Bermuda, which result in significant overlap with the substance requirements, entities licensed under the Banks and Deposit Companies Act 1999 or the Insurance Act 1978 are generally considered to operate with adequate substance and the Registrar will have regard to such entities' compliance with such Acts in his assessment of compliance. However, such entities will be required to file an economic substance declaration form and the Registrar will also have regard to the information provided therein when making his assessment of compliance with the Bermuda ES Requirements.

Outsourcing

A relevant entity may satisfy the ES Requirements by outsourcing the conduct of its CIGA to an affiliate or service provider provided that the outsourced CIGA is undertaken in Bermuda. If a relevant entity does outsource any of its CIGA, it must maintain records in (or accessible from) Bermuda that evidence that there are suitably qualified employees or other persons in that entity in Bermuda who are responsible for the oversight and assessment of the implementation and execution of the outsourcing arrangement by the affiliate or service provider and that the affiliate or service provider has adequate suitably qualified employees and premises in Bermuda to be able to implement and execute the outsourcing arrangement.



Timing

A relevant entity is subject to the ES Law from the date on which the relevant entity commences a relevant activity unless the relevant entity was in existence prior to 1 January 2019, in which case it must comply with the ES Law by 1 July 2019.

Notification obligation (to be complied with by all relevant entities)

Starting in 2020, a relevant entity must notify the Registrar annually as to whether or not it is conducting a relevant activity. If it is conducting a relevant activity but its gross income in relation to that activity is subject to tax in a jurisdiction outside of Bermuda, the relevant entity will be required to providing appropriate supporting evidence. The Registrar will specify the time, form and manner of the notification, which is anticipated to commence in July 2020 via an electronic portal, in respect of entities whose relevant financial period ended on 31 December 2019 (such that the first filings due from such entities for the period from 1 January 2019 to 31 December 2019 demonstrating compliance with effect from 1 July 2019).

Reporting obligations (to be complied with only by relevant entities conducting relevant activities)

Relevant entities conducting relevant activities that are required to satisfy the ES requirements must prepare and submit to the Registrar an 'economic substance declaration form' containing prescribed information for the purpose of the Registrar's determination whether the ES Requirements have been satisfied in relation to that relevant activity in respect of each relevant financial period commencing on or after 1 January 2019.

Liquidation or otherwise ceasing to carry on relevant activities

A relevant entity will, so long as it exists, continue to have any obligations which the ES Law imposes on it (and which the liquidators or equivalent must ensure it satisfies). However, a relevant entity which is finally dissolved or completes winding up before it is possible to notify or report for the purposes of the ES Law will not be required to do so.

Determination of whether the ES Requirements are satisfied

The Registrar shall have the power, in accordance with the ES Law and the ES Guidance, to make a determination as to whether a relevant entity satisfies the ES Requirements in respect of a relevant financial period. The Registrar will apply a risk-based compliance assessment approach to determining whether or not a relevant entity has satisfied the ES Requirements with respect to its relevant activities.

Failure to satisfy the ES Requirements

The Registrar is required to issue first, second and third warning notices (including appeal rights) to entities regarding non-compliance with the ES Requirements and may enforce a civil penalty scheme for non-compliance with each such notice with penalties increasing from US\$7,500 to US\$50,000 for failure to comply with the first notice to US\$50,000 to US\$250,000 for failure to comply with the third and final notice.

In the event that a relevant entity still does not meet the Bermuda ES Requirements following this procedure, the Registrar will apply to the Supreme Court of Bermuda for an order pursuant to section 16A of the Registrar of Companies (Compliance Measures) Act 2017. The court may make an order:

- >> regulating the conduct of the Relevant Entity's business;
- >> restricting the relevant entity from carrying on business; or
- >> to authorise such proceedings, including strike-off.



Offences

It is an offence to knowingly provide false information to the Registrar. Punishment for this offence on summary conviction is a maximum fine of US\$10,000 or two years' imprisonment or both. Offences committed by a corporate entity with the consent or connivance of one of its officers, the officer as well as the corporate entity is considered to have committed the offence and will be punished accordingly. Note "officer" only refers to a director, not to a company secretary.

Further developments and next steps

International standards are continuing to develop and it is anticipated that the ES Law and ES Guidance may also evolve and subject to further clarification. The Minister of Finance may make regulations prescribing anything that may be prescribed under the ES Law and amending the ES Law, including to further define the scope of relevant entities that are required to satisfy the ES Requirements and the scope of relevant activities.

Contacts

Walkers has a dedicated Regulatory & Risk Advisory Practice Group that can offer legal advice and guidance in connection with all aspects of the economic substance regime as it continues to evolve. Through its affiliate, Walkers Professional Services, Walkers is also committed to providing economic substance solutions that will enable all clients that are impacted by the regime to satisfy the necessary requirements for substance in Bermuda.

For further information please speak with your usual contact at Walkers or the any of the following persons:

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Appendix

Economic Substance Requirements – Relevant Activities and Corresponding Bermuda CIGA

The meaning of each “relevant activity” is set out below. Only a “relevant entity” which is conducting “relevant activity” as defined in the left hand column is required to satisfy the ES Requirements (which includes a requirement for the “relevant entity” to conduct CIGA in Bermuda).

Definition	CIGA
Banking Business	
An entity engages in banking if it engages in deposit taking business for which a licence is required in accordance with the Banks and Deposit Companies Act 1999.	Includes: <ul style="list-style-type: none"> (i) raising funds; (ii) managing risk, including credit, currency and interest risk; (iii) taking hedging positions; (iv) providing loans, credit or other financial services to customers; (v) managing regulatory capital; and (vi) preparing regulatory reports.
Insurance	
An entity engages in insurance if it engages in business for which registration is required in accordance with the Insurance Act 1978 (as amended).	Includes: <ul style="list-style-type: none"> (i) predicting and calculating risk; (ii) insuring or reinsuring against that risk; (iii) providing client services; and (iv) preparing regulatory reports.
Fund Management	
An entity engages in fund management if it manages investments ¹ for funds and in respect of which a licence is required in accordance with the Bermuda Investment Business Act 2003 or for which a licence would be required if such activity were taking place in Bermuda.	Includes: <ul style="list-style-type: none"> (i) taking decisions on the holding and selling of investments; (ii) calculating risk and reserves; (iii) taking decisions on currency or interest fluctuations and hedging positions; and (iv) preparing relevant regulatory or other reports for government authorities and investors.

¹ For the purpose of the ES Regulations, ‘managing investments’ has the meaning given in the Investment Business Act 2003 ie. “managing or offering, or agreeing to manage, assets belonging to another person where those assets consist of or include investments”. ‘Investments’ are widely defined in Schedule 1 to the Investment Business Act, 2003, and include shares, debentures, warrants, certificates and other instruments which confer contractual rights, rights in investment funds, options, futures, partnership interests, contracts for differences, long term insurance business contracts and rights and interests in any of the foregoing.

Definition	CIGA
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Financing and Leasing

An entity engages in financing and leasing if it provides credit facilities of any kind for consideration to any person (“a customer”) and for the purposes of this definition:

- (a) consideration includes consideration by way of interest;
- (b) the provision of credit may be made by way of instalments for which a separate charge is made and disclosed to the customer in connection with:
 - (i) the supply of goods by hire purchase;
 - (ii) financial leasing (excluding land and interests in land); or
 - (iii) conditional sale or credit sale; and
- (c) where any credit repayable by a customer to a person is assigned to another person, that other person shall be considered to be the person providing the credit facility, but any activities falling with the definition of banking, insurance or fund management do not constitute financing and leasing.

Includes:

- (i) agreeing funding terms;
- (ii) identifying and acquiring assets to be leased (in the case of leasing)
- (iii) setting the terms and duration of any financing;
- (iv) monitoring and revising agreements; and
- (v) managing risk associated with such agreements.

Headquarters

An entity engages in business as headquarters if the entity engages in general management and administration of its affiliates within or outside Bermuda.

Includes:

- (i) taking relevant strategic or management decisions;
- (ii) incurring expenditures on behalf of affiliates;
- (iii) coordinating group activities.

Distribution and Service Centre

An entity engages in business as a distribution centre if it engages in resale of goods from a foreign affiliate.

An entity engages in business as a service centre if it primarily provides consulting or administrative services to a foreign affiliate.

Includes:

- (i) transporting and storing goods; and;
- (ii) managing stock and taking orders.

Includes providing consulting or administrative services to a foreign affiliate.

Definition**CIGA****Shipping**

An entity engages in shipping if it engages in any of the following activities involving the operation of a ship anywhere in the world other than in the territorial waters of Bermuda:

- (a) transporting, by sea, passengers or animals, goods or mail for a charge;
- (b) renting or chartering of ships for the purpose described in paragraph (a);
- (c) sale of travel tickets and ancillary ticket-related services in connection with the operation of a ship;
- (d) use, maintenance or rental of containers, including trailers and other vehicles or equipment for the transport of containers, used for the purposes of transporting anything by sea; or
- (e) functioning as a private seafarer recruitment and placement service.

For the purpose of this definition:

- (a) "ship" does not include a pleasure vessel; and
- (b) "pleasure vessel" has the meaning given in regulation 2 of the Merchant Shipping (Registration of Ships) Regulations 2003.

Includes:

- (i) managing the crew (including hiring, paying and overseeing crew members);
- (ii) hauling and maintaining ships;
- (iii) overseeing and tracking deliveries;
- (iv) determining what goods to order and when to deliver them; and
- (v) organising and overseeing voyages.

Holding Entity

An entity engages in business as a holding entity if it is a pure equity holding entity.

An entity is a pure equity holding entity if it is an entity which, as its primary function, acquires and holds shares or an equitable interest in other entities, performs no commercial activity and which:

- (a) holds the majority of the voting rights in another entity;
- (b) is a shareholder, member or partner in another entity and has the right to appoint or remove a majority of the board of directors, managers or equivalent of that entity; or
- (c) is a shareholder, member or partner in another entity and controls alone, under an agreement with others, a majority of the voting rights in that other entity.

Definition**CIGA****Intellectual Property**

An entity engages in IP business if it engages in the exploitation of IP assets held by the entity (including non-trade intangible assets).

CIGA for IP business depends on the nature of the IP asset (patent, technical know-how, trademark, customer lists or brand or goodwill) and how the asset is being used to generate income for the entity.

Includes:

- (i) conducting research and development in relation to IP assets such as patents;
- (ii) marketing, branding and distribution of non-tangible assets such as trademarks;
- (iii) taking the strategic decisions and managing and bearing the principal risks (or both) related to the development and subsequent exploitation of an IP asset;
- (iv) taking the strategic decisions and managing and bearing the principal risks (or both) related to any third party acquisition and subsequent exploitation of an IP asset; and
- (v) carrying on the underlying trading activities through which IP assets are exploited and which lead to the generation of revenue from third parties.