

Article

Economic Substance: An Overview for Bermuda Shipping Companies

Author: Victor Richards, Director

Bermuda’s Economic Substance Act 2018 and Economic Substance Regulations 2018 (and subsequent amendments) set out the requirements that Bermuda-based entities must adopt with regard to economic substance in the jurisdiction. Bermuda, along with all of the major offshore jurisdictions, passed this legislation in order to remain on the European Union’s ‘white list’ of cooperative jurisdictions for tax purposes. This article provides a general overview of economic substance as it applies to shipping entities in Bermuda.

Which shipping entities are in scope?

Entities within the scope of the legislation (‘registered entities’) include exempted and local companies, permit companies, 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 in or from within Bermuda. Non-resident entities are out of scope; for this purpose a non-resident entity is an entity which is resident for tax purposes in a jurisdiction outside Bermuda that is not designated by the EU as a non-cooperative jurisdiction for tax purposes.

Relevant Activities

Shipping is a ‘relevant activity’ under the Economic Substance Act. As defined in the sector-specific Guidance Notes, an entity will be carrying on the relevant activity of “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 (a);
- c. sale of travel tickets and ancillary ticket-related services connected with the operation of a ship;
- d. the use, maintenance or rental of containers, including trailers and other vehicles or equipment for the transport of containers, used for the transport of anything by sea; or
- e. functioning as a private seafarer recruitment and placement service.

The above listed activities constitute the relevant activity of “shipping” only if carried on by an entity in conjunction with the operation of a ship. For example, a crew management company that does not itself operate ships will not be carrying on shipping. Similarly, a travel agent selling passenger tickets, but which does not itself operate a ship, will also not be carrying on shipping.

Where a ship is chartered, the question of whether the ship owner or the entity chartering the ship (or both) is carrying on shipping may be determined by the terms of the relevant charter party. For example, a shipowner (“ShipCo”) chartered the ship that it owns to another entity (“CharterCo”) on a bareboat basis. CharterCo operates the ship in its international cargo transport business. ShipCo will generally not be carrying on shipping, because it does not operate the ship. CharterCo is operating the ship and will be carrying on shipping because it is transporting goods for a charge in connection with its operation of the ship. Where ShipCo chartered the ship to CharterCo on a time charter basis, it is possible that ShipCo and CharterCo each share certain aspects of the operation of the ship and may each be carrying on shipping.

Tonnage Tax

Where an entity carrying on shipping as a relevant activity submits evidence to the Registrar that it is liable to a tonnage tax regime in a jurisdiction outside of Bermuda in respect of its shipping activity, the Registrar may regard that entity as being a non-resident entity, and therefore out of scope.

Requirements for entities in scope

Shipping entities in scope of the economic substance legislation are required to 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, having regard to:
 - 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
- Core Income Generating Activities (CIGA) are undertaken in Bermuda with respect to the shipping 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 shipping activity.

Core Income Generating Activities

The CIGA related to shipping include:

- a. managing the crew, including hiring, paying and overseeing crew members (includes compliance with the Maritime Labour Convention 2006)
- b. hauling and maintaining ships (involves lifting ships from the water for maintenance, and includes procuring and/or overseeing the hauling or maintenance of ships)
- c. overseeing and tracking deliveries (includes the logistical aspects of the transportation of cargo, including tracking package and cargo deliveries as part of the business activities of the ship)
- d. determining what goods to order and when to deliver them (includes determining how a ship is to be utilized, the types of cargo acceptable and the scheduling of voyages for the delivery of such cargos, and ensuring contingency arrangements are in place)
- e. organizing and overseeing voyages (includes the logistical aspects of the operation of ships, determining which routes to use and when, and making adequate contingency arrangements)

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

Outsourcing

In determining whether an entity has met the economic substance requirements, the Bermuda Registrar of Companies will take into account the nature and extent of any outsourcing arrangements to affiliates or service providers in Bermuda. This includes whether (i) the persons in the entity who are responsible for oversight 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 execution of those services, and (iii) 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).

Compliance

All shipping entities within scope must file annually with the Registrar an Economic Substance Declaration providing information in relation to the previous financial year.

How can we help?

This is just a general overview. What constitutes adequate substance for any given entity will vary depending on the particular circumstances of each business. Legal advice is strongly advised to ensure compliance with the law. For further advice, please contact any of those listed below.

Author:

Victor Richards
Director
victor.richards@conyers.com
+1 441 299 4926

Other Contacts:

Marcello Ausenda
Director
marcello.ausenda@conyers.com
+1 441 299 4954

Guy Cooper
Director
guy.cooper@conyers.com
+1 441 299 4938

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For further information please contact: media@conyers.com