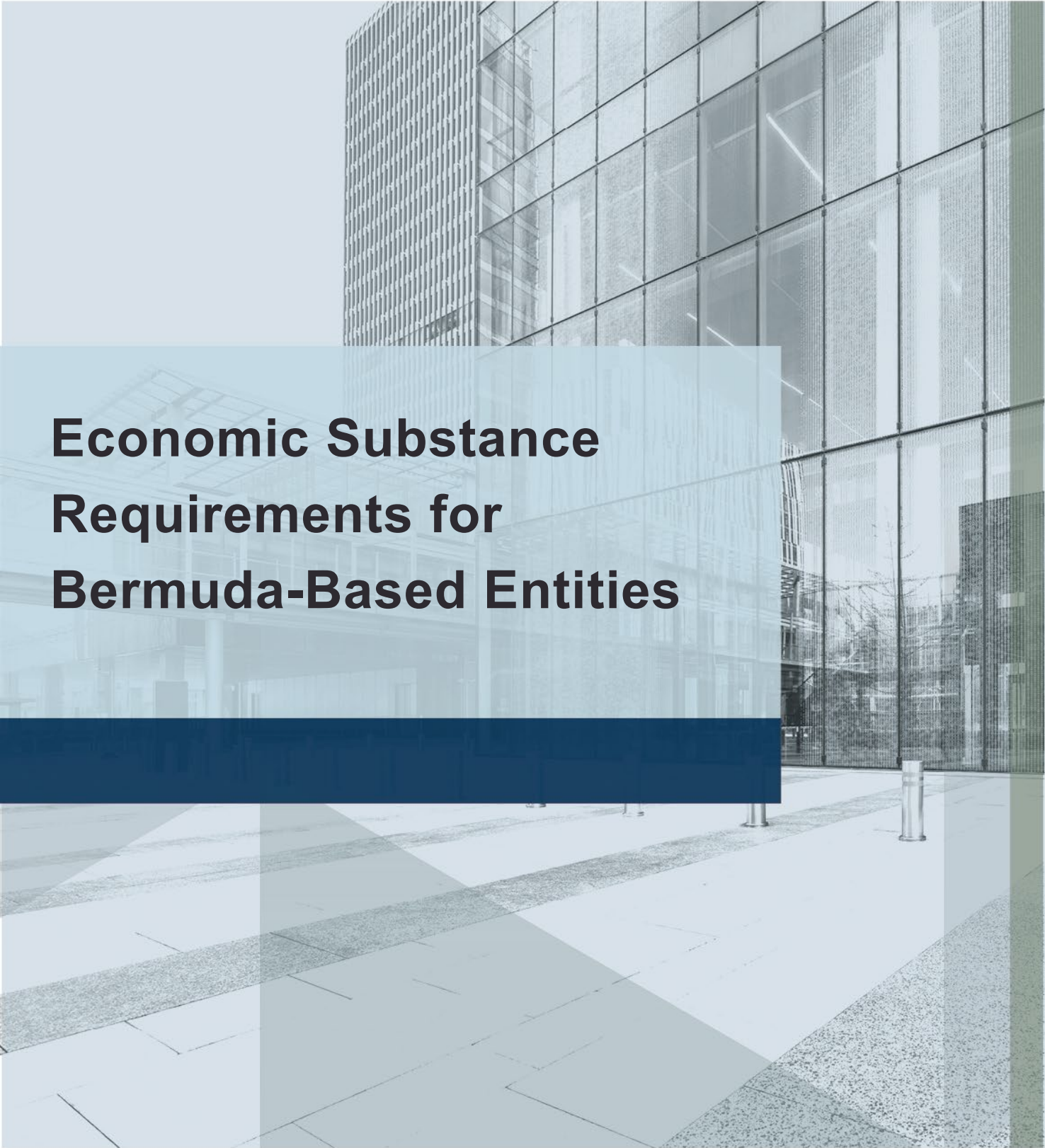


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A photograph of a modern glass skyscraper with a grid-like facade, reflecting the sky and surrounding environment. The building is partially obscured by a semi-transparent blue overlay containing text. The foreground shows a paved plaza with geometric patterns and a few small, cylindrical bollards.

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.

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1. INTRODUCTION

The Economic Substance Act 2018 and the Economic Substance Regulations 2018, each as amended, became operative on 31 December 2018 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 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. To assist with the application and implementation of the legislation in Bermuda, Guidance Notes were issued by the Minister of Finance on 24 December 2019 (most recently revised on 30 January 2023).

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 to which the Partnership Act 1902 applies (limited, exempted, exempted limited and overseas partnerships), 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 that is acceptable to the Registrar¹ and that 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
- Financing and leasing
- Headquarters
- Shipping
- Distribution and service centres
- Intellectual property
- Holding entity

¹ An entity will not be deemed by the Registrar to be resident for tax purposes in a jurisdiction if that jurisdiction does not have a corporate tax regime and/or residency for tax purposes in such jurisdiction does not result in the entity being subject to the equivalent economic substance requirements in that jurisdiction. The Registrar has advised that such jurisdictions may include Anguilla, Bahamas, Bahrain, Barbados, British Virgin Islands, Cayman Islands, Turks and Caicos Islands and the United Arab Emirates.

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

The Bermuda Registrar of Companies (the “**Registrar**”) will consider the above activities as being carried on as a business by an entity whether or not the entity earns any gross revenue in respect of such activity during a “**relevant financial period**” (such term further defined in section 5.1 below). However, an entity that earns no gross revenue in respect of such activity in any relevant financial period will not be required to satisfy the economic substance requirements in respect of that activity for that relevant financial period.

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 group², 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 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 in Bermuda, and adequate premises in Bermuda.

3.2. All other Entities

For all other in scope 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.

² 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 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:
 - 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/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 general, the Registrar will take a practical approach to the interpretation and application of the economic substance requirements. In the analysis of each entity, the Registrar will have regard to each entity's relevant activity and the nature, scale and complexity of the entity's business, and will apply criteria such as "adequacy" in that context. In practice, this means that what constitutes compliance with economic substance requirements will necessarily differ from entity to entity.

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. It will be necessary for entities to be conducting CIGA 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 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, already operate in Bermuda with adequate substance 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 still 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 must provide additional information to the Registrar, including a detailed business plan, in order to rebut the presumption of non-compliance. An entity will be carrying on high risk IP activity where it owns 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. 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 in scope entities undertaking relevant activities, which includes all holding entities (i.e. pure equity holding entities), which earn any gross revenue in respect of such activity during a relevant financial period, 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 include³:

- 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 CIGA 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 ordinarily 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;
- the number of full time employees; and
- such other information as the Registrar may require.

In scope entities undertaking a relevant activity that earn no gross revenue in respect of such activity in any relevant financial period will be allowed to file a simplified “N.I.” ESD.

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 that is acceptable to the Registrar (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 or confirmation of their tax residency and, unless the entity is publicly traded, details of their “beneficial owner” (as defined in the Companies Act). Such jurisdiction must not be on the European Union’s list of non-cooperative jurisdictions for tax purposes.

5.3. Entities not Subject to the Economic Substance Requirements

An entity that is not engaged in a relevant activity is not subject to the economic substance requirements. However, such an entity is required to indicate in its annual reporting to the Registrar that it is not engaged in any relevant activity. A non-resident entity is similarly not subject to economic substance requirements but is required to indicate in its annual reporting to the Registrar whether or not it is engaged in a relevant activity.

³ See also section 3.2

5.4. Timing and Filing Requirements

An ESD is prepared and filed on the Registrar's online register portal. Each in scope entity is required to file its ESD and each non-resident entity is required to file evidence of tax residency (see section 5.2) no later than six months after the last day of each relevant financial period.

5.5. Monitoring and enforcement

The Registrar 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 from the register. It is also an offence to knowingly provide false information to the Registrar, with associated penalties of a maximum fine of BD\$10,000 or two years imprisonment, or both.

5.6. Confidentiality

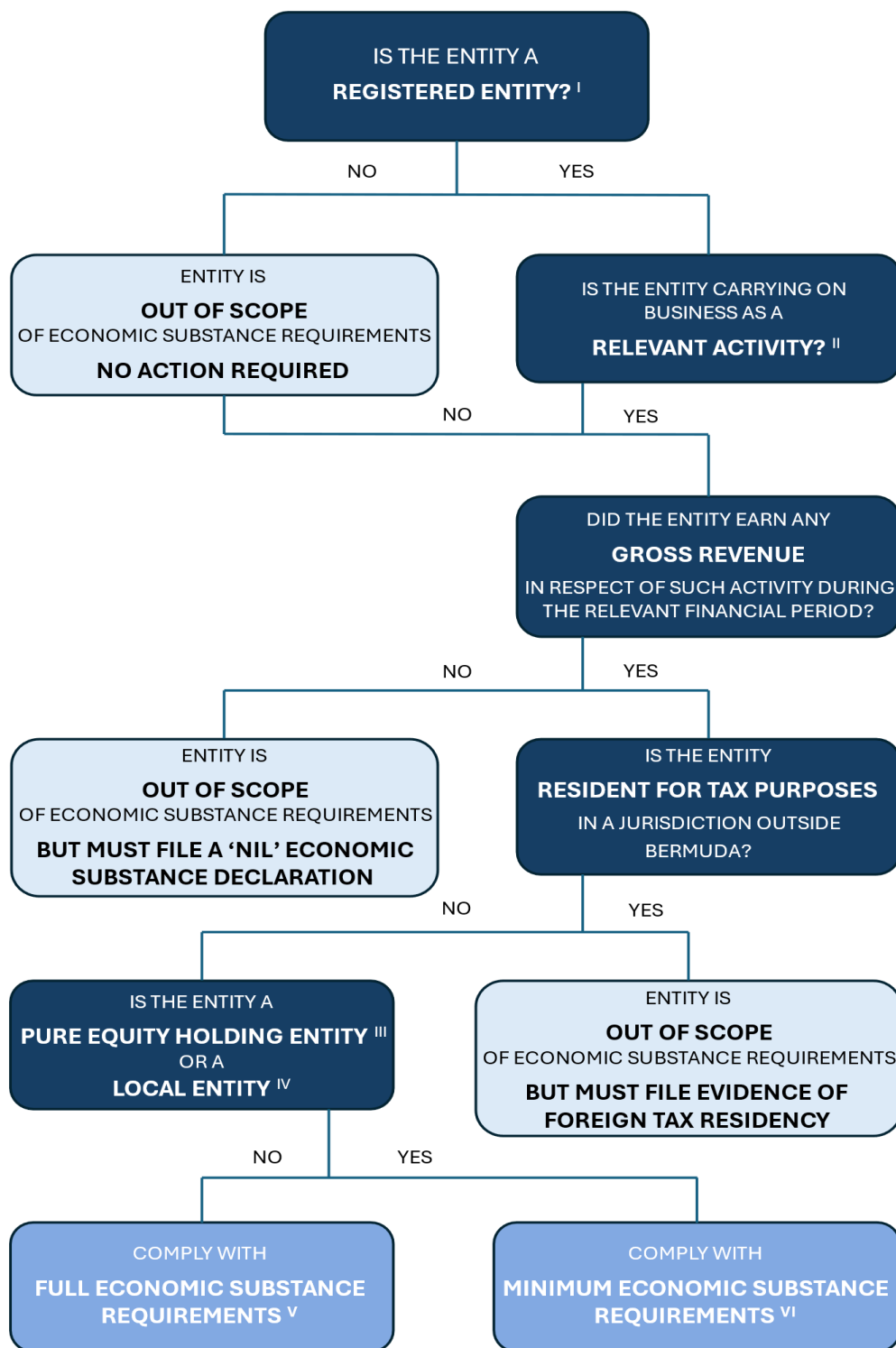
In the collection of information or documents pursuant to the legislation (whether through the ESD or otherwise), the Registrar is expressly obliged to preserve the confidentiality of such information or documents, other than as may be required in connection with its duties (see section 5.7 below).

5.7. Information sharing with competent authorities

As an extension of Bermuda's existing obligations to share information in connection with the International Cooperation (Tax Information Exchange Agreements) Act 2005, 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

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ECONOMIC SUBSTANCE
DECISION-MAKING FLOWCHART

I.

- Exempted or Local Company
- Exempted or Local LLC
- Permit Company
- Exempted, Exempted Limited or Overseas Partnership

II.

- Banking
- Insurance
- Fund Management
- Financing and Leasing
- Headquarters
- Shipping
- Intellectual Property
- Distribution and Service Centre
- Holding Entity

III.

- i.e. 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 other entities

IV.

- Which carries on business (other than banking or insurance) in Bermuda and which is not part of a multinational enterprise.

V.

- Entity is managed and directed in Bermuda
- Core income generating activities are undertaken in Bermuda with respect to relevant activity
- Adequate full time employees in Bermuda with suitable qualifications
- Adequate operating expenditure incurred in Bermuda in relation to the relevant activity
- File Economic Substance Declaration
- Monitor ongoing compliance

VI.

- Have adequate people for holding and managing equity participations and adequate premises in Bermuda (applicable to pure equity holding entities only)
- Comply with applicable statutory corporate governance requirements
- File Economic Substance Declaration (only required if entity is a pure equity holding entity)
- Monitor ongoing compliance

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

Relevant Activity	Definition and Core Income Generating Activities
BANKING	<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"> • raising funds • managing risk including credit, currency and interest risk • taking hedging positions • providing loans, credit or other financial services to customers • managing regulatory capital • preparing regulatory reports
INSURANCE	<p>Engaging in insurance business in accordance with the Insurance Act 1978</p> <ul style="list-style-type: none"> • predicting and calculating risk • insuring or reinsuring against risk • providing client services • preparing regulatory reports
FUND MANAGEMENT	<p>Managing investments for an investment fund. For these purposes, “investment fund” has the meaning given to such term in the Investment Funds Act 2006, and the phrase “managing investments” should be construed in accordance with the Investment Business Act 2003</p> <ul style="list-style-type: none"> • taking decisions on the holding and selling of investments • calculating risk and reserves • taking decisions on currency or interest fluctuations and hedging positions • preparing relevant regulatory or other reports for government authorities and investors
FINANCING AND LEASING	<p>Providing credit facilities of any kind for consideration to any person (a “customer”), which may be by way of instalments for which a separate charge is made and disclosed to the customer in connection with the supply of goods by hire purchase, financial leasing (excluding in relation to land) or conditional sale or credit sale arrangements.</p>

Relevant Activity	Definition and Core Income Generating Activities
	<p>Financing and Leasing will also include situations where any credit repayable by a customer to a person is assigned to another person. The assignee will be considered to be the person providing the credit facility, and will therefore be in scope.</p> <ul style="list-style-type: none"> • agreeing funding terms • identifying and acquiring assets to be leased (in the case of leasing) • setting the terms and duration of any financing for leasing • monitoring and revising agreements • managing risk associated with such agreements
HEADQUARTERS	<p>Engaging in the general management and administration of its affiliates within or outside Bermuda</p> <ul style="list-style-type: none"> • taking relevant strategic or management decisions • incurring expenditures on behalf of affiliates • coordinating group activities
SHIPPING	<p>Engaging in the following activities involving the operation of a ship anywhere outside Bermuda territorial waters: transporting, by sea, passengers or animals, goods, or mail for a charge; renting or chartering of ships for the purposes of transporting passengers or animals, goods, or mail for a charge; sale of travel tickets and ancillary ticket-related services connected with the operation of a ship; the use, maintenance or rental of containers; or functioning as a private seafarer recruitment and placement service</p> <ul style="list-style-type: none"> • managing the crew (including hiring, paying and overseeing crew members) • hauling and maintaining ships • overseeing and tracking deliveries • determining what goods to order and when to deliver them • organising and overseeing voyages
DISTRIBUTION AND SERVICE CENTRES	<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"> • transporting and storing goods (distribution centre) • managing stock and taking orders (distribution centre) • providing consulting or administrative services to a foreign affiliate (service centre)

Relevant Activity	Definition and Core Income Generating Activities
INTELLECTUAL PROPERTY	<p>Engaging in the exploitation of IP assets (including non-trade intangible assets)</p> <ul style="list-style-type: none"> conducting research and development in relation to IP assets, such as patents marketing, branding, and distribution of non-trade intangible assets such as trademarks 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 carrying on the underlying trading activities through which IP assets are exploited and which lead to the generation of income from third parties <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>
HOLDING ENTITY	<p>Means a pure equity holding entity which as its primary function acquires and holds shares or an equitable interest in other entities, performs no commercial activity, and the shares or equitable interests it holds are controlling stakes in other entities</p> <ul style="list-style-type: none"> Have adequate people for holding and managing equity participations, and adequate premises in Bermuda

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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