



## BERMUDA ECONOMIC SUBSTANCE REQUIREMENTS FOR *IN SCOPE* ENTITIES

Bermuda passed economic substance legislation in December 2018 as part of the international initiatives for fairer taxation globally and, in particular, to address the technical scoping paper of the European Union (EU) for jurisdictions designated by the EU as '2.2 Jurisdictions' (**Scoping Paper**). This 2.2 Scoping Paper set out criteria relating to 'economic substance' of certain entities doing business in or through these 2.2 Jurisdictions. Bermuda is a 2.2 Jurisdiction such as Guernsey, Jersey, Isle of Man and Cayman Islands.

All existing Registered Entities who are *in scope* of Bermuda's economic substance legislation (**ES Law**) have until 30 June 2019 to comply with the ES Law although notification and reporting will only commence in 2020.

### [Brief Summary of the ES Law](#)

The ES Law requires a Registered Entity that is carrying on Relevant Activities to satisfy an economic substance test (**ES Test**) in relation to each Relevant Activity carried on by it. Such a Registered Entity will also have notification and reporting obligations under the ES Law.

### [Who is a Registered Entity?](#)

The entities in Bermuda which are *in scope* are:-

- Companies to which the Companies Act 1981 applies and includes permit and overseas companies
- LLCs formed under the Limited Liability Company Act 2016
- Partnerships (exempted, limited and overseas) which have elected or elect to have separate legal personality <sup>1</sup>

Thus a trust is *out of scope* of the ES Test but local companies are *in scope*.

### [What are the Relevant Activities?](#)

A Relevant Activity means the carrying on as a business of any one or more of the following activities:

- Banking
- Insurance
- Fund Management
- Financing
- Leasing
- Headquarters

---

<sup>1</sup> This Memorandum will focus on companies and LLCs but apply equally to partnerships with legal personality and we can advise separately on any specifics regarding *in scope* partnerships.

- Shipping
- Distribution and service centre business
- Intellectual Property
- Holding entity

If the business carried on by a Registered Entity does not fall within the above Relevant Activities, then it is *out of scope* of the ES Test.

#### [How will this affect you?](#)

Bermuda companies are Registered Entities and will be *in scope* of the ES Test if they carry on one or more of the Relevant Activities.

The ES Test requires that a Registered Entity carrying on a Relevant Activity must comply with economic substance requirements in respect of each applicable Relevant Activity carried on by it (**ES Requirements**). The ES Requirements are that the *in scope* Registered Entity:

- (a) is managed and directed in Bermuda in an appropriate manner in relation to that Relevant Activity;
- (b) conducts core income generating activities (**CIGA**) in Bermuda in relation to that Relevant Activity; and
- (c) having regard to the level of relevant income derived from the Relevant Activity, has an adequate amount of operating expenditure, an adequate physical presence and an adequate number of full-time employees or other personnel in the Islands.

There is a reduced economic substance test for both 'Local Entities' and 'Pure Equity Holding Entities' as noted below. The CIGA for each type of Relevant Activity are set out in the enclosed CIGA Chart.

#### [Minimum Economic Substance](#)

There are minimum ES Requirements that apply to 2 types of Registered Entities as follows:

- a Local Entity (i.e. a local company or local LLC) carrying on Relevant Activities; and
- a Pure Equity Holding Entity (i.e. it only holds or manages equity participations, and earns passive income from dividends, distributions, capital gains and other incidental income)

The minimum or reduced ES Requirements that apply to both a Local Entity and a Pure Equity Holding Entity are to:

- (a) comply with the corporate governance requirements in the Companies Act 1981, LLC Act 2016 and (where applicable) Partnership legislation including keeping records of account, books & papers and financial statements;
- (b) complete the annual ES filing with the Bermuda Registrar of Companies which will come into force in 2020.

In addition, a Pure Equity Holding Entity will also need to have adequate employees for holding and managing equity participations and adequate premises in Bermuda. It is expected that Guidance will be provided on what is '*adequate*' in this context but in the meantime engaging a licensed corporate services provider (such as BeesMont Corporate Services Limited (**BCSL**)), as its registered office service provider should assist with satisfying these reduced substance requirements where the Pure Equity Holding Entity is passively holding equity interests in other entities. BCSL can also arrange the necessary notification and reporting requirements under the ES Law, although these filing requirements do not commence until 2020.

### Relevant Activities

Where a Registered Entity is conducting a Relevant Activity and does not fall within the minimum ES Requirements then it will need to satisfy the standard ES Requirements in respect to that activity. In general, this would be where the entity:

- (a) conducts CIGA in Bermuda in relation to that relevant activity – see Appendix for a CIGA Chart for each Relevant Activity and note that some CIGA can be outsourced to an affiliate or service provider in Bermuda;
- (b) is directed and managed in an appropriate manner in Bermuda in relation to that Relevant Activity – having directors and the meetings in Bermuda should satisfy this requirement; and
- (c) having regard to the level of relevant income derived from the applicable Relevant Activity, has an adequate amount of operating expenditure, an adequate physical presence and an adequate number of full-time employees or other personnel in the Islands. Guidance on this issue is expected but it is likely that this will be dependent on the particular facts of the relevant entity and its business activity.

### How will ES Requirements be assessed?

The ES Law does not provide any minimum thresholds of annual expenditure or number of employees which could be used as a guide for complying with the ES Requirements instead it is expected that the issue of 'adequacy' will be assessed based on the particular circumstances of each *in scope* entity. Guidance is expected to be issued by the Government which should facilitate this adequacy assessment.

The concept behind CIGA is that the activities which are of central importance to the applicable entity in terms of generating income should be carried on in Bermuda but what is important depends on the nature of the Relevant Activity (as to which please see the CIGA Chart in the Appendix). Hence if an activity is not considered a CIGA for that business then it can be conducted outside Bermuda as applicable.

Enhanced ES Requirements will apply to entities carrying on intellectual property (IP) business which is a High Risk IP activity namely owning an IP asset which has been acquired from an affiliate or been obtained through the funding of overseas research and development and is then licensed to a foreign affiliate or used to generate revenue through activities performed by a foreign affiliate.

### Reporting Obligation

The Registrar of Companies (RoC) will be responsible for monitoring and enforcing the ES Requirements and for this purpose all *in scope* Registered Entities will be required to file on an annual basis an economic substance declaration (**ES Declaration**) confirming that the entity complies with the ES Requirements.

The ES Declaration will require the disclosure of certain key information applicable to an analysis of ES Requirements for that entity with respect to the previous financial year which will include the following:-

- the nature of the Relevant Activity being carried on by the entity
- the CIGA being carried on by that entity in Bermuda
- the nature and extent of the entity's presence in Bermuda including any outsourcing

The ES Law provides that disclosure of economic substance information to the public will not be permitted and that the Public Access to Information Act will not be applicable to information relating to economic substance.



The first reporting of the ES Requirements to the RoC will occur in 2020.

### Compliance and Enforcement

The ES Law provides for civil penalties of up to BD\$250,000 for non-compliance with the applicable ES Requirements. If an entity continues its failure to comply then after civil penalties have been exhausted, the RoC may apply to the Bermuda Court for an order in such terms as it thinks fit which could include prohibiting business activity or striking off the non-compliant entity from the Register of Companies in Bermuda. Additionally, there is an offence for knowingly making a false ES Declaration with penalties up to BD\$10,000 or imprisonment for 2 years or both.

### Assistance

The ES Law may require change to some existing business models and BeesMont is keen to assist clients in understanding their obligations and with implementing any changes that may be needed. Please do not hesitate to contact the BeesMont team members below who are able to assist with your ES Law queries or your usual contact at BeesMont.

Sharon A. Beesley  
Director, CEO  
[sabeesley@beesmont.bm](mailto:sabeesley@beesmont.bm)  
+1 441 474 9001

Marco Montarsolo  
Managing Partner  
[mmontarsolo@beesmont.bm](mailto:mmontarsolo@beesmont.bm)  
+1 441 474 9002

Stephanie P. Sanderson  
Partner, Corporate  
[spsanderson@beesmont.bm](mailto:spsanderson@beesmont.bm)  
+1 441 474 9006

Kit Cunningham  
Corporate Attorney  
[kcunningham@beesmont.bm](mailto:kcunningham@beesmont.bm)  
+1 441 474 9017

Kimonea Pitt  
Corporate Attorney  
[kpitt@beesmont.bm](mailto:kpitt@beesmont.bm)  
+1 441 474 9012

Appendix

**CHART OF CIGA FOR EACH RELEVANT ACTIVITY**

21 May 19

Relevant Activity	Core Income Generating Activities
<p><b>BANKING</b> (ie engaging in deposit-taking business for which a licence is required in accordance with the <i>Banks and Deposit Companies Act 1999</i>)</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>
<p><b>INSURANCE</b> (ie engaging in business for which registration is required in accordance with the <i>Insurance Act 1978</i>)</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>
<p><b>FUND MANAGEMENT</b> (ie managing investments for funds and in respect of which a licence is required in accordance with the <i>Investment Business Act 2003</i> 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>
<p><b>FINANCING</b> (ie providing funds, other than by way of subscription for shares or other equity contributions, for the business activities of one or more other entities (whether or not affiliated))</p>	<ul style="list-style-type: none"> <li>• agreeing funding terms</li> <li>• setting the terms and duration of any financing</li> <li>• monitoring and revising agreements</li> <li>• managing risk associated with such agreements</li> </ul>
<p><b>LEASING</b> (ie Providing leasing arrangements in respect of which it is the lessor of one or more assets leased to one or more affiliates or third parties)</p>	<ul style="list-style-type: none"> <li>• identifying and acquiring assets to be leased</li> <li>• setting the terms and duration of any leasing</li> <li>• monitoring and revising agreements</li> <li>• managing any risk associated with such agreements</li> </ul>

<p><b>HEADQUARTERS</b> (ie 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>
<p><b>SHIPPING</b> (ie engaging in ownership, leasing, operation or management of a ship that is used to transport goods)</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>
<p><b>DISTRIBUTION &amp; SERVICE CENTRE</b> (ie 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>
<p><b>INTELLECTUAL PROPERTY</b> (ie the exploitation of IP assets held by the entity including non-trade intangible assets)</p>	<ul style="list-style-type: none"> <li>• conducting research and development in relation to IP assets such as patents</li> <li>• marketing, branding, and distribution of non-trade intangible assets such as trademarks</li> <li>• taking the strategic decisions and managing or bearing the principal risks, or both, related to the development and subsequent exploitation of an IP asset</li> <li>• taking the strategic decisions and managing or bearing the principal risks, or both, related to 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 revenue from third parties</li> </ul>
<p><b>HOLDING ENTITY</b> (ie may include a pure equity holding entity)</p> <p>A <b>pure equity holding entity</b><sup>2</sup> is an entity that only holds equity participations in one or more entities, and earns passive revenues from dividends, distributions, capital gains and other incidental income only.</p>	<ul style="list-style-type: none"> <li>• holding or managing any assets or equity participations</li> </ul>

<sup>2</sup> This term is not further defined in the legislation. It is currently unclear, but Government-issued guidance notes is expected which may provide further guidance