



BERMUDA

ECONOMIC SUBSTANCE REGULATIONS 2018

BR 154 / 2018

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The Minister of Finance, in exercise of the power conferred by section 11 of the Economic Substance Act 2018, makes the following Regulations:

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Citation

1 These Regulations may be cited as the Economic Substance Regulations 2018.

Interpretation

2 In these Regulations, unless the context otherwise requires—

“Act” means the Economic Substance Act 2018;

“Companies Act” means the Companies Act 1981;

“core income generating activity”, with respect to a relevant activity, means the core income generating activity set forth in regulations 7 to 16, as the case may be;

“economic substance requirements” means the requirements set forth in section 3 of the Act and regulation 3;

“entity” means an entity to which section 3 of the Act applies;

“foreign affiliate” means an affiliate incorporated, formed or registered outside Bermuda;

“high-risk IP activities” means the IP activities set forth in regulation 16(3);

“IP” means intellectual property;

“IP assets” means intellectual property rights held by an entity in relation to an intangible asset which includes patents, technical know-how, trademark, brand or goodwill;

“minimum economic substance requirements” means the requirements set forth in regulation 4(2);

“Partnerships Acts” means the Partnership Act 1902, the Exempted Partnerships Act 1992 and the Limited Partnership Act 1883;

“pure equity holding entity” has the meaning given in regulation 14(1);

“relevant activity” has the meaning given in section 2 of the Act;

“relevant financial period” means the financial year of the entity.

Economic substance requirements

3 (1) In respect of each relevant financial period, an entity shall provide the following information related to economic substance requirements—

(a) 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;

(b) the nature and extent of the entity’s presence in Bermuda including—

(i) the physical offices or other premises occupied by the entity or its affiliate in Bermuda; and

(ii) an adequate level of annual expenditure of the entity in Bermuda;

- (c) whether the entity is managed and directed in Bermuda or from Bermuda, having regard to—
 - (i) 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;
 - (ii) 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 core income generating activities or both;
 - (iii) the location—
 - (A) where the entity is a company, of its board meetings;
 - (B) where the entity is a limited liability company, of its managers' meetings;
 - (C) where the entity is a partnership, of its partnership meetings, and the nature and frequency of those meetings held in Bermuda in relation to the overall number of meetings;
 - (d) the nature and extent of outsourcing arrangements (if any) to affiliates or service providers in Bermuda; and
 - (e) whether minimum economic substance requirements set forth in regulation 4 apply with respect to the entity.
- (2) For the purposes of paragraph (1)(d), an entity must provide information as to whether—
 - (a) the employees or other persons in the entity who are responsible for, or involved in, oversight and assessment of the implementation or execution of such outsourcing arrangement—
 - (i) are suitably qualified and able to monitor and control the carrying out of the outsourcing arrangement by the affiliate or service provider; and
 - (ii) monitor each outsourcing arrangement in order to ensure that the outsourced entity has adequate capacity to execute the outsourcing arrangement;
 - (b) the affiliate or service provider responsible for, or involved in, the implementation and execution of such outsourcing arrangement—
 - (i) has adequate capacity for the implementation and execution thereof;
 - (ii) has employees who are suitably qualified to implement and execute the outsourcing arrangement;
 - (iii) complies with the economic substance requirements that apply to the outsourcing entity; and in respect of such compliance, employees,

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expenditure and premises must not be counted multiple times by multiple entities when evidencing such compliance.

Minimum economic substance requirements

4 (1) Minimum economic substance requirements set forth in paragraph (2) shall apply in relation to an entity if—

- (a) the entity is a pure equity holding entity;
- (b) subject where applicable to regulations 7 and 8, the entity is a local entity.

(2) For the purposes of paragraph (1), minimum economic substance requirements means—

- (a) compliance with applicable corporate governance requirements set forth in the Companies Act, the Limited Liability Company Act 2016 and Partnerships Acts including keeping records of account, books and papers and financial statements; and
- (b) submission of an annual economic substance declaration form.

Substance test for economic substance requirements: core income generating activities

5 (1) Where an entity engages in a relevant activity, economic substance requirements shall be applied in relation to the core income generating activities of the entity.

(2) To satisfy the economic substance requirements, the core income generating activities of an entity with respect to a relevant activity must be undertaken in Bermuda.

(3) Where an entity outsources any or all of its core income generating activities to an affiliate or service provider, the Minister shall take into account the outsourcing arrangement.

Exchange of information

6 (1) Subject to section 6 of the Act, the International Cooperation (Tax Information Exchange Agreements) Act 2005, in particular, section 4A, and any agreement made under that Act, information received by the competent authority for Bermuda under section 6 of the Act shall be exchanged by way of the spontaneous exchange of information.

(2) For purposes of paragraph (1), spontaneous exchange of information means an unrequested automatic exchange of information set forth in section 6 of the Act by the competent authority for Bermuda with the foreign competent authority (as those terms are defined in the Act).

Non-IP Related Relevant Activities

Banking

7 (1) 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.

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(2) The core income generating activities of an entity engaged in banking include the following—

- (a) raising funds;
- (b) managing risk including credit, currency and interest risk;
- (c) taking hedging positions;
- (d) providing loans, credit or other financial services to customers;
- (e) managing regulatory capital; and
- (f) preparing regulatory reports.

(3) A bank that is licensed under the Banks and Deposit Companies Act 1999 complies with the economic substance requirements if it complies with the requirements applicable to the matters in section 3 of the Act and regulation 3 as set forth—

- (a) in the Companies Act relating to corporate governance; and
- (b) in the Banks and Deposit Companies Act 1999, regulations, rules and other instruments made thereunder.

Insurance

8 (1) An entity engages in insurance if it engages in business for which registration is required in accordance with the Insurance Act 1978.

(2) The core income generating activities of an entity engaged in insurance include the following—

- (a) predicting and calculating risk;
- (b) insuring or re-insuring against risk;
- (c) providing client services; and
- (d) preparing regulatory reports.

(3) An entity engaged in insurance activities complies with the economic substance requirements if it complies with the requirements applicable to the matters in section 3 of the Act and regulation 3 as set forth—

- (a) in the Companies Act relating to corporate governance; and
- (b) in the Insurance Act 1978, regulations, rules or other instruments (including the code of conduct) made under that Act.

Fund management

9 (1) An entity engages in fund management if it manages 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.

(2) The core income generating activities of an entity that engages in fund management include the following—

- (a) taking decisions on the holding and selling of investments;
- (b) calculating risk and reserves;
- (c) taking decisions on currency or interest fluctuations and hedging positions; and
- (d) preparing relevant regulatory or other reports for government authorities and investors.

(3) For the purposes of paragraph (1), “managing investments” has the meaning given in the Investment Business Act 2003.

Financing and leasing

10 (1) An entity engages in financing if it provides 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).

(2) The core income generating activities of an entity that engages in financing include the following—

- (a) agreeing funding terms;
- (b) setting the terms and duration of any financing;
- (c) monitoring and revising agreements; and
- (d) managing risk associated with such agreements.

(3) An entity engages in leasing if it provides leasing arrangements in respect of which it is the lessor of one or more assets leased to one or more affiliates or third parties.

(4) The core income generating activities of an entity engaged in leasing include the following—

- (a) identifying and acquiring assets to be leased;
- (b) setting the terms and duration of any leasing;
- (c) monitoring and revising agreements; and
- (d) managing any risk associated with such agreements.

Headquarters

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

(2) The core income generating activities of an entity engaged in business as a headquarters include the following—

- (a) taking relevant strategic or management decisions;
- (b) incurring expenditures on behalf of affiliates; and
- (c) coordinating group activities.

Shipping

12 (1) An entity engages in shipping if it engages in ownership, leasing, operation or management of a ship that is used to transport goods.

(2) The core income generating activities of an entity engaged in shipping include the following—

- (a) managing the crew (including hiring, paying and overseeing crew members);
- (b) hauling and maintaining ships;
- (c) overseeing and tracking deliveries;
- (d) determining what goods to order and when to deliver them; and
- (e) organising and overseeing voyages.

Distribution and service centres

13 (1) An entity engages in business as a distribution centre if it engages in resale of goods purchased from a foreign affiliate.

(2) The core income generating activities of an entity engaged in business as a distribution centre include the following—

- (a) transporting and storing goods; and
- (b) managing stock and taking orders.

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

(4) The core income generating activities of an entity engaged in business as a service centre include providing consulting or administrative services to a foreign affiliate.

Holding entity

14 (1) A holding entity is a pure equity holding entity where it only holds equity participations in one or more entities, and earns passive revenues from dividends, distributions, capital gains and other incidental income only.

(2) A pure equity holding entity that is engaged in a relevant activity complies with the economic substance requirements if it—

- (a) complies with minimum economic substance requirements; and
- (b) has adequate employees for holding and managing equity participations, and adequate premises in Bermuda.

IP Related Relevant Activities

IP economic substance requirements

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

(2) For the purposes of paragraph (1), the Minister shall give due consideration to the following—

- (a) the nature of the asset, that is to say, whether it is a patent, technical know-how, trademark, customer lists or brand or goodwill; and
- (b) how the asset is being used to generate income for the entity.

(3) The core income generating activities for entities engaged in IP activities include the following—

- (a) conducting research and development in relation to IP assets such as patents;
- (b) marketing, branding and distribution of non-trade intangible assets such as trademarks;
- (c) taking the strategic decisions and managing or bearing the principal risks, or both, related to the development and subsequent exploitation of an IP asset;
- (d) 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; or
- (e) carrying on the underlying trading activities through which IP assets are exploited and which lead to the generation of revenue from third parties.

Enhanced IP economic substance requirements

16 (1) Where an entity engaged in IP activities owns an asset that—

- (a) was developed or created by the entity;
- (b) has been acquired from an entity other than an affiliate; or
- (c) is licensed to an entity other than an affiliate,

paragraph (2) applies.

(2) Where this paragraph applies with respect to an entity, and whether or not the core income generating activities set forth in regulation 15(3)(a) or (b) are undertaken in Bermuda during a relevant financial period, it is presumed that the entity does not comply with economic substance requirements in relation to IP activities, unless the entity demonstrates that it undertakes any of the core income generating activities set forth in regulation 15(3)(c) to (e) in Bermuda.

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(3) An entity engages in high risk IP activities where the entity is engaged in IP activities referred to in regulation 15(3)(a) or (b) and owns an IP asset that—

- (a) has been acquired from an affiliate or has been obtained through the funding of overseas research and development activities; and
- (b) is licensed to a foreign affiliate or is used to generate revenue through activities performed by such foreign affiliate,

paragraph (4) applies.

(4) Where this paragraph applies, it is presumed that an entity does not comply with the economic substance requirements in relation to its IP activities for the relevant financial period unless the entity demonstrates that—

- (a) the income generated is as a result of activities undertaken in Bermuda;
- (b) the entity does not merely passively hold and generate revenues from assets in Bermuda, and for this purpose the entity shall, in addition to and in conjunction with its economic substance declaration, provide such additional information as the Minister may reasonably require including the following—
 - (i) a detailed business plan;
 - (ii) information demonstrating the presence of an adequate number of senior executives or employees ordinarily resident in Bermuda during the relevant period who are suitably qualified and are responsible for oversight or execution of and decisions in respect of its core income generating activities, or for both;
 - (iii) details concerning the location—
 - (A) where the entity is a company, of its board meetings;
 - (B) where the entity is a limited liability company, of its managers' meetings;
 - (C) where the entity is a partnership, of its partnership meetings, and the nature and frequency of those meetings held in Bermuda in relation to the overall number of meetings in any relevant financial period;
- (c) an adequate number of full-time employees with the suitable qualifications who reside and perform the IP related relevant activities in Bermuda.

Powers of Registrar regarding non-compliance with economic substance requirements

17 For the avoidance of doubt, it is hereby declared that if it is determined that an entity has failed to comply with economic substance requirements, the Registrar shall exercise the powers by section 13 of the Act conferred on the Registrar for the purposes of ensuring compliance with the Act, and such powers shall include the following—

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- (a) the issue, under the Registrar of Companies (Compliance Measures) Act 2017, of a notice to the entity to comply with economic substance requirements;
- (b) if the entity does not comply with the notice to comply referred to in paragraph (a) or any further notice to so comply, the Registrar shall impose a civil penalty under the procedure set forth in the Registrar of Companies (Compliance Measures) Act 2017 with respect to each such failure; and
- (c) where an entity's non-compliance with economic substance requirements continues after the issue of a final notice to comply and the imposition of a civil penalty under the Registrar of Companies (Compliance Measures) Act 2017, the Registrar shall apply to the Court for—
 - (i) an order for regulation of the conduct of the affairs of the entity; or
 - (ii) an order restricting the entity from carrying on business, and a direction to exercise the power conferred on him under the relevant Act (as the term “relevant Act” is defined by the Registrar of Companies (Compliance Measures) Act 2017), to strike-off the entity.

Commencement

18 These Regulations shall come into operation on 31 December 2018.

Made this 28th day of December 2018

Minister of Finance

[Operative Date: 31 December 2018]