

Frequently asked questions: Bermuda economic substance requirements

Service area / [Taxation and Economic Substance](#)

Location / [Bermuda](#)

Date / [May 2020](#)

In this article, [Michael Frith](#) of Carey Olsen Bermuda Limited gives an overview of the economic substance requirements in Bermuda and answers the most frequently asked questions by companies filing their first economic substance declaration in the jurisdiction.

Where did the economic substance legislation come from?

The economic substance standards are a global tax policy initiative driven by the Organisation for Economic Cooperation & Development (OECD) (and specifically the OECD's Forum on Harmful Tax Practices (FHTP)) and by the European Union's Code of Conduct Group on Business Taxation.

The fundamental principle behind them is that jurisdictions that have no or only nominal corporate tax should not facilitate structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction. In other words, if an entity is able to benefit from low/no corporate tax by being incorporated or registered in a jurisdiction, the activities that generate its income should be performed in that jurisdiction.

The Economic Substance Act 2018 (and related Regulations) represents Bermuda's commitment to meet that standard, and creates a set of rules for Bermuda entities that are in scope to follow to ensure that the standard is met. You should apply

those rules in good faith, having regard to the principle that guides them.

"Jurisdictions that have no or only nominal corporate tax should not facilitate structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction."

How do I know if my entity is in scope?

That is actually quite a simple answer. If your entity is a **registered entity**, and it is carrying on one or more **relevant activities**, and it is not a **non-resident entity**, then it will be in scope and must satisfy the economic substance requirements. The complexity, of course, comes in determining what each of those key terms means.

A **registered entity** is any Bermuda company or permit company, any Bermuda LLC, or any Bermuda partnership that has elected to have separate legal personality.

Your registered entity will be carrying on a **relevant activity** if it earns any gross revenue from one or more of the nine defined activities. These include: *banking, insurance, fund management, financing and leasing, headquarters, shipping, distribution and service centre, intellectual property and holding entity*.

OFFSHORE LAW SPECIALISTS

Your entity will be a **non-resident entity** if it is resident for tax purposes in a jurisdiction outside of Bermuda (provided that it is not a jurisdiction that is on the EU's list of non-cooperative jurisdictions for tax purposes).

What are the economic substance requirements?

If your entity is a registered entity, carrying on a relevant activity, and is not a non-resident entity, it will be in scope, which means that it must:

- be *managed and directed* in Bermuda;
- undertake the *core income generating activities* in relation to its relevant activity in Bermuda;
- maintain an *adequate physical presence* in Bermuda;
- have *adequate full time employees* in Bermuda with suitable qualifications; and
- incur *adequate operating expenditure* in Bermuda in relation to its relevant activity.

It is important to note that an entity that is in scope must meet all of these requirements. The only exception to that is if your entity is a **pure equity holding entity** (i.e. your entity is carrying on the relevant activity of "holding entity"). A pure equity holding entity is not subject to the five economic substance requirements. Instead, it must demonstrate that it has *adequate people* to manage and hold its equity participations, and *adequate premises* in Bermuda.

How do I know if I am carrying on a relevant activity?

Each of the relevant activities listed above is defined in the Economic Substance Regulations. You should review those definitions, and carefully consider them in light of the activities that your entity carries on. The definitions can in some cases be quite detailed, and the analysis of them will always be very fact-based. We can assist you with considering the application of the definitions to your circumstances.

Importantly, the activity must be carried on as a business. That expression can have many meanings in other contexts, but for these purposes the principle is that if your entity is earning any gross revenue from one of the defined relevant activities, then it will be deemed to be carrying on that activity as a business, and your entity will be in scope.

But what if the "relevant activity" my entity is carrying on is not its main business? Is it still in scope?

Yes. Any gross revenue at all earned from the activity will bring your entity into scope, even if it is just a very small portion of the entity's overall revenue. It is also possible that your entity may be carrying on more than one relevant activity. If that is the case, then it will need to demonstrate compliance with the economic substance requirements in relation to each of them.

But bear in mind that compliance is assessed on a proportionate basis. If the level of activity is small, then the measure of what is "adequate" in relation to that activity will be correspondingly small. Conversely, if the activity level is high, you can expect that the assessment of what is adequate will also be high.

Who determines if my entity meets the economic substance requirements?

The Registrar of Companies is responsible for regulating the economic substance regime, and will assess every entity's compliance. However, it is your responsibility to ensure that the requirements are met, and you will be required to make an annual declaration to the Registrar that you believe your entity is in compliance. If you knowingly make a false declaration, you may be subject to severe penalties.

"Most importantly, don't panic! These new requirements can appear daunting but, with the right expertise, they can be quite manageable."

What information will I need to provide to the Registrar in order to show that my entity satisfies the economic substance requirements?

Every entity that is in scope must file an economic substance declaration each year that it is carrying on a relevant activity. The information required to be included with that declaration is quite detailed. You will be asked for information in relation to:

- what relevant activities you are carrying on;
- where your meetings are held, the types of decisions taken at those meetings, and how many meetings you hold each year;
- your directors and employees (and the time spent by those directors and employees in relation to your relevant activities);
- any core income generating activities that are outsourced, and to whom they are outsourced (whether to third parties or to other entities in your group);
- your revenue, income and expenditure in relation to each relevant activity, as well as your assets;
- your ownership structure (i.e. your immediate parent, ultimate parent and beneficial owners); and
- your offices and other premises.

In relation to certain intellectual property business (so-called "high-risk IP business"), additional information will also be required. This will include providing a detailed business plan setting out the commercial rationale for that IP business in Bermuda, and further details in relation to employees and decision-making in Bermuda.

Continued

If your entity is a non-resident entity, you will be required to submit evidence of its tax residency within the declaration, but you will not be required to complete the detailed information in relation to relevant activity (because non-resident entities are not in scope).

Much of the information provided in the declaration (other than the information which relates to the entity as a whole, such as offices, directors, etc.) will be provided specifically in relation to each relevant activity. This is important, as it ensures that the Registrar is able to assess your compliance in relation to each relevant activity. However, this may not be how you record and report the information in your financial statements and other records today, so it may require some effort to compile the information required. It is important to start doing so early, to avoid the risk of failing to file your declaration on time. You should also ensure that you keep careful records to support all of the information that you provide, as the Registrar may inspect those records in future.

When do I need to file the declaration, and where do I find it?

The declaration must be filed within six months of your financial year end. There are no extensions to this filing deadline, so it is important to be prepared early.

All information is collected, and the declaration is submitted electronically, through the Registrar's e-portal system at www.registrarofcompanies.gov.bm. You can register for the portal online, and complete the declaration yourself, or you can ask your service providers to assist. Paper filings are not accepted.

What happens to the information once I have submitted it?

The Registrar's compliance team will review the information you have provided and complete a risk-based assessment of it. If, following that assessment, it is determined that further review is required, the Registrar may make a request for further information and/or may conduct a physical inspection of your records at your offices.

If you are found to not be in compliance with the economic substance requirements, your declaration and its information will be automatically exchanged with each jurisdiction in which your owners and beneficial owners are located. This is effected through the OECD's information exchange portal.

If you have submitted evidence of your entity's tax residency outside of Bermuda, that evidence is also subject to automatic exchange, as is any information provided in respect of high-risk IP business, (irrespective of whether the entity carrying on that high-risk IP business is in compliance).

While we all hope this will be a rare occurrence, entities that are not in compliance may also incur significant civil penalties,

ranging from \$7,500 for first-time minor breaches, through to \$250,000 for persistent and significant breaches, and possibly even being struck off the register.

So, what should we do to prepare?

If you have not done so already, complete a careful analysis of your business to determine if your entity is carrying on one or more relevant activity, and start compiling the information you will need for the declaration. Where necessary, adjust your business and operations to ensure that the economic substance requirements are met. Document everything.

Most importantly, don't panic! These new requirements can appear daunting but, with the right expertise, they can be quite manageable. We are here to assist, and would be pleased to help with your analysis, advise on what steps you may need to take to meet the requirements and help you through the declaration process.

Key contact

For further information or professional advice please contact our lawyer below:



Michael Frith

Senior Counsel

D +1 441 542 4524

E michael.frith@careyolsen.com



PLEASE NOTE

Carey Olsen Bermuda Limited is a limited liability company incorporated in Bermuda and approved and recognised under the Bermuda Bar (Professional Companies) Rules 2009. The use of the title "Partner" is merely to denote seniority. Services are provided on the basis of our current terms of business, which can be viewed at: www.careyolsen.com/terms-business.

This briefing is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such. © Carey Olsen Bermuda Limited 2020