



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, copyright, technical know-how, trademark, brand or goodwill that generate IP income;

“IP income” means income which accrues to the business from IP assets and IP activities (such income being separately identifiable from any income generated from any tangible asset);

“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(2);

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

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

[Regulation 2 definitions "IP assets" and "pure equity holding entity" amended, and definition "IP income" inserted by BR 34 / 2019 reg. 2 effective 22 February 2019]

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 and control each outsourcing arrangement in order to ensure that the outsourced entity has adequate capacity to execute the outsourcing arrangement;

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

(3) For greater clarity, an entity engaged in one or more relevant activities during a relevant financial period shall comply with economic substance requirements in respect of each applicable relevant activity.

[Regulation 3 amended by BR 34 / 2019 reg. 3 effective 22 February 2019]

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 as set forth in regulation 14(2); or
- (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 to be applied pursuant to this regulation are—

- (a) in relation to a pure equity holding entity—
 - (i) 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
 - (ii) submission of an annual economic substance declaration form;
- (b) in relation to a local entity, compliance with applicable corporate governance requirements set forth in the Companies Act and the Limited Liability Company Act 2016 including keeping records of account, books and papers and financial statements.

(3) A local entity to which paragraph (1)(b) applies complies with the economic substance requirements if it complies with the minimum economic substance requirements set out in paragraph (2)(b).

[Regulation 4 amended by BR 34 / 2019 reg. 4 effective 22 February 2019; Regulation 4 paragraph (2) subparagraphs (a) and (b) revoked and replaced, and paragraph (3) inserted by BR 132 / 2019 reg. 2 effective 24 December 2019]

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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, core income generating activities so outsourced must be undertaken in Bermuda and the Minister shall take into account the outsourcing arrangement.

[Regulation 5 paragraph (3) amended by BR 34 / 2019 reg. 5 effective 22 February 2019]

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.

(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 insurance business 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.

[Regulation 8 paragraph (1) amended by BR 132 / 2019 reg. 3 effective 24 December 2019]

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 and leasing if it provides credit facilities of any kind for consideration to any person (a “customer”), and for the purposes of this definition—

- (a) consideration includes consideration by way of interest;
- (b) the provision of credit may be by way of instalments for which a separate charge is made and disclosed to the customer in connection with—
 - (i) the supply of goods by hire purchase;
 - (ii) financial leasing (excluding land and interests in land); or
 - (iii) conditional sale or credit sale; and
- (c) where any credit repayable by a customer to a person is assigned to another person, that other person shall be considered to be the person providing the credit facility,

but, any activities falling within the activities of banking, insurance or fund management do not constitute financing and leasing for the purposes of these Regulations.

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

- (a) agreeing funding terms;
 - (aa) identifying and acquiring assets to be leased (in the case of leasing);
 - (b) setting the terms and duration of any financing for leasing;
 - (c) monitoring and revising agreements; and
 - (d) managing risk associated with such agreements.
- (3) *[Revoked by BR 132 / 2019 reg. 4]*
- (4) *[Revoked by BR 132 / 2019 reg. 4]*

[Regulation 10 amended by BR 132 / 2019 reg. 4 effective 24 December 2019]

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 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 paragraph (a);
- (c) sale of travel tickets and ancillary ticket-related services connected with the operation of a ship;
- (d) 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.

(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.

(3) For the purposes of this regulation—

“ship” does not include a pleasure vessel;

“pleasure vessel” has the meaning given in regulation 2 of the Merchant Shipping (Registration of Ships) Regulations 2003.

[Regulation 12 paragraph (1) revoked and replaced, and paragraph (3) inserted by BR 132 / 2019 reg. 5 effective 24 December 2019]

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.

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(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) An entity engages in business as a holding entity if it is a pure equity holding entity.

(2) An entity is a pure equity holding entity if it is an entity which as its primary function acquires and holds shares or an equitable interest in other entities, performs no commercial activity and which—

- (a) holds the majority of the voting rights in another entity;
- (b) is a shareholder, member or partner in another entity and has the right to appoint or remove a majority of the board of directors, managers or equivalent of that other entity; or
- (c) is a shareholder, member or partner in another entity and controls alone, under an agreement with others, a majority of the voting rights in that other entity.

(3) A pure equity holding entity complies with the economic substance requirements if the entity—

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

(4) *[Revoked by BR 132 / 2019 reg. 6]*

[Regulation 14 revoked and replaced by BR 34 / 2019 reg. 6 effective 22 February 2019; Regulation 14 amended by BR 132 / 2019 reg. 6 effective 24 December 2019]

IP Related Relevant Activities

Intellectual property

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

(2) For the purposes of paragraph (1), the core income generating activities associated with an intangible asset will depend on the following—

- (a) the nature of the IP asset, that is to say, whether it is a patent, technical know-how, trademark, customer lists or brand or goodwill; and
- (b) how the IP 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;

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

[Regulation 15 amended by BR 34 / 2019 reg. 7 effective 22 February 2019; Regulation 15 paragraph (2) revoked and paragraph (3) renumbered as paragraph (2) by BR 34 / 2019 reg. 7 effective 22 February 2019; Regulation 15 paragraph (2) sub-paragraphs (c) to (e) revoked by BR 34 / 2019 reg. 7 effective 22 February 2019; Regulation 15 revoked and replaced by BR 38 / 2019 reg. 2 effective 4 March 2019]

Enhanced IP economic substance requirements

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

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

paragraph (2) applies.

(2) Where such entity's IP core income generating activities (as set forth in regulation 15(3)(a) and (b)) 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—

- (a) undertakes other core income generating activities associated with IP income in Bermuda as demonstrated by—
 - (i) taking the strategic decisions and managing and bearing the principal risks related to the development and subsequent exploitation of an IP asset;
 - (ii) taking the strategic decisions and managing and bearing the principal risks related to any third party acquisition and subsequent exploitation of an IP asset;
 - (iii) carrying on the underlying trading activities through which IP assets are exploited and which lead to the generation of IP income from third parties; and
- (b) has an adequate number of employees with the suitable qualifications who reside and perform the IP related relevant activities and adequate premises in Bermuda.

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(3) An entity engages in high risk IP activities where the entity 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 IP income through activities performed by such foreign affiliate,

and in such case, paragraph (4) applies.

(4) Where this paragraph applies, it is presumed (whether or not the entity's IP core income generating activities as set forth in regulation 15(3) are undertaken in Bermuda) that the entity does not comply with economic substance requirements unless it is also shown to the contrary that—

- (a) the entity satisfies the requirements set forth in paragraph (2)(a) and (b) above; and
- (b) the entity does not merely passively hold and generate IP income from IP assets in Bermuda, but a high degree of control over the development, exploitation, maintenance, enhancement and protection of the IP asset is, and historically has been, exercised by an adequate number of employees with suitable qualifications who reside and perform their IP related activities in Bermuda as demonstrated by the following—
 - (i) a detailed business plan;
 - (ii) information demonstrating the presence of an adequate number of employees in Bermuda during the relevant financial period who are suitably qualified and are responsible for control and oversight or execution of, and decisions in respect of, its IP core income generating activities; and
 - (iii) such additional information as the Minister may reasonably require for this purpose.

[Regulation 16 revoked and replaced by BR 34 / 2019 reg. 8 effective 22 February 2019; Regulation 16 amended by BR 38 / 2019 reg. 3 effective 4 March 2019]

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—

- (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

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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]

[Amended by:

BR 34 / 2019

BR 38 / 2019

BR 132 / 2019]