Agenda

1. Background
2. Economic Substance Act 2018
3. Relevant activities and core income generating activities
4. Potential implications to Bermuda
5. Comparative analysis of 2.2 jurisdictions
6. How KPMG can help
7. What’s next?
Background
The EU Code of Conduct Group ("COCG") begins investigating the tax policies of non-EU countries against "good tax governance" standards, including tax transparency and fair taxation.

Nov 16

COCG receives a commitment from certain low-tax jurisdictions ("2.2 jurisdictions") to introduce legal substance requirements to ensure that tax advantages are not granted to entities with no substantial economic presence.

Nov 17

Jun 18

COCG published a Scoping Paper for 2.2 jurisdictions.

Dec 17

Dec 18

EU list of non-cooperative tax jurisdictions was agreed by Member States.

Jan 19

Adoption of the Economic Substance Act

2018 ESA tabled and passed in the House of Assembly
Economic Substance Act 2018
Pursuant to the Economic Substance Act 2018 ("ESA"), an entity is required to meet the economic substance requirements in Bermuda to the extent it is engaged in any of the following “relevant activities”.

Leasing  
Banking  
Insurance  
Fund management  
Finance  
Distribution & service centre  
Intellectual property  
Holding company  
Headquarters  
Shipping
• Generally, the ESA applies to “registered entities” engaged in relevant activities, including:
  • companies to which the Companies Act 1981 applies (including permit companies and overseas companies),
  • limited liability companies formed under the Limited Liability Company Act 2016, or
  • partnerships that have elected separate legal personality, including:
    • exempted partnerships registered under the Exempted Partnerships Act 1992,
    • exempted limited partnerships registered under the Exempted Partnerships Act 1992 and the Limited Partnership Act 1883
    • overseas partnerships registered under the Overseas Partnerships Act 1995

• The ESA is effective January 2019, with a 6-month transition period for entities in existence prior to such date. Pursuant to the ESA, the Minister has the authority to extend the transition period.
Pursuant to the ESA, an entity complies with the economic substance requirements if:

- the entity is managed and directed in Bermuda,
- core income generating activities (as defined in regulations) 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.
Regulations - Economic Substance Requirements

- The Regulations require an entity to provide information related to the economic substance requirements (and, in doing so, provide further guidance regarding such requirements), including:
  
  - the nature and extent of the relevant activity conducted, including the core income generating activities undertaken
  
  - the nature and extent of the entity’s presence in Bermuda, including the physical offices or premises and an adequate level of operating expenditure in Bermuda
  
  - whether the entity is managed and directed in Bermuda, having regard to:
    
    - the location of strategic or risk management and operational decision making, or where management meets to make decisions regarding business activities
    
    - presence of an adequate number of suitably qualified senior executives, employees or other persons in Bermuda responsible for oversight and/or execution of core income generating activities
    
    - location of board meetings and the nature and frequency of the meetings held in Bermuda in relation to the overall number of meetings
Regulations - Outsourcing Arrangements

• The Regulations also require an entity to provide information related to the nature and extent of outsourcing arrangements, including as to whether:

  • employees of the outsourcing entity monitor and control the outsourcing arrangement, and are suitably qualified to do so

  • the affiliate or outsourced service provider:

    • has adequate capacity and suitably qualified employees

    • complies with the economic substance requirements that apply to the outsourcing entity (e.g. core income generating activities conducted in Bermuda, adequate employees, premises, and expenditure in the jurisdiction)

• The regulations specify that employees, expenditure and premises of the affiliate or outsourced service provider must not be counted multiple times by multiple entities when evidencing their compliance with the economic substance requirements
• The ESA requires entities to file an annual economic substance declaration with the Registrar, including information regarding:

• Whether or not the entity is carrying on a relevant activity, the type of activity, and the core income generating activities undertaken in Bermuda with respect to such activity

• Gross income, operating expenses, and assets for the relevant reporting period, as well as information regarding the entity’s premises in Bermuda and number of full time employees

• Names and addresses of directors (for companies), managers (for LLCs), and GPs (for partnerships) who are ordinarily resident in Bermuda

• Whether the entity is engaged in high risk IP activity

• Whether the entity will outsource the relevant activity and to whom

• Further specifics regarding the declaration, including the filing deadline, have yet to be released
As part of the annual economic substance declaration, an entity must provide information regarding certain direct and indirect owners (i.e. ultimate parent entity, holding entity, owner and beneficial owner). To the extent that:

- the Registrar determines that the entity has not met the economic substance requirements, or

- the entity is engaged in “high risk” IP related activities,

information from the annual economic substance declaration will be automatically exchanged with EU member states where such owners are incorporated, formed, registered, or resident.

An entity engages in “high risk” IP activities to the extent that it engages in certain specified IP related activities and owns an IP asset that has been acquired from an affiliate (or via funding of overseas research and development) and that is licensed to (or utilized by) a foreign affiliate.
In the event that an entity fails to meet the economic substance requirements, the Registrar shall:

- inform the Minister, who shall in turn instigate the automatic exchange of information regarding the noncompliant entity with relevant EU member states (as summarized above),

- issue a first written notice requiring the entity to, within a specified time frame, take such steps to remedy the failure as may be so specified in the notice,

- to the extent that such failure is not remedied, issue a second (and potentially a third) written notice requiring compliance with the economic substance requirements,

- to the extent that such failure is still not remedied, proceed with further action to ensure compliance, including an application to the court to regulate or restrict the activities of the non-compliant entity or, ultimately, to strike such entity off the Bermuda register

- Specifics regarding the expected timing of any such actions have not yet been released
ESA 2018 - Implications of Non-Compliance

- Civil penalties for failure to comply with the economic substance requirements include:
  - a penalty of **not less than** $7,500 and not exceeding $50,000 with respect to non-compliance resulting in the first notice summarized above
  - a penalty of **not less than** $25,000 and not exceeding $100,000 with respect to non-compliance resulting in the second notice
  - a penalty of **not less than** $50,000 and not exceeding $250,000 with respect to non-compliance resulting in the third notice
  - In addition to the above, any person who knowingly provides false information to the Registrar shall be liable to a fine not exceeding $10,000 and/or to imprisonment for two years
  - In the event that such an offence is committed by an entity with the consent or connivance of another person (e.g. director), such other person shall be punished accordingly
Relevant activities and core income generating activities
• Core income generating activities include raising funds, managing risk, taking hedging positions, providing loans, managing regulatory capital, preparing regulatory reports

• Generally, an entity licensed under the Banks and Deposit Companies Act 1999 complies with ESA if it complies with the substance requirements as set forth in the Banks and Deposit Act 1999
• The core income generating activities include predicting and calculating risk, (re)insuring against risk, providing client services, preparing regulatory reports

• Generally, entity complies with ESA if it complies with the substance requirements as set forth in the Insurance Act 1978

• Consider application to multinational reinsurance groups
• Includes entities which manage investments for funds and in respect of which a license is required in accordance with the Investment Business Act 2003 or for which a license would be required if such activity were taking place in Bermuda.

• Core income generating activities include taking decisions on the holding and selling of investments, hedging positions, currency/interest fluctuations, and preparing relevant regulatory or other reports for government authorities and investors.
• Higher burden of proof placed on IP activities, specifically high risk IP.

• Enhanced IP
  • Generally applies to an entity that owns an IP asset that it developed, has been acquired from or is licensed to a non-affiliated entity

• High Risk IP
  • Generally applies to an entity that owns an IP asset acquired from an affiliate and is licensed to (or used by) a foreign affiliate
  • Must demonstrate that the income generated is as a result of activities undertaken in Bermuda, the entity does not merely passively hold and generate revenues from assets in Bermuda, provide detailed business plan, location of board meetings, adequate number of full-time employees
• A pure equity holding company only holds equity participations in one or more entities, and earns passive revenues from dividends, distributions, capital gains and other incidental income only

• Subject to minimum economic substance requirements
  • Has adequate employees for holding and managing equity participations, and adequate premises in Bermuda
  • Submission of an annual declaration form
  • Compliance with the corporate governance requirements of the Companies Act
Includes entities which engage in the general management and administration of its affiliates within or outside Bermuda.

The core income generating activities include taking relevant strategic or management decisions, incurring expenditures on behalf of affiliates, and coordinating group activities.
Potential implications to Bermuda
ESA 2018 - Potential implications to Bermuda

• The overall net impact of the ESA on the jurisdiction remains uncertain, and may not be known for some time.

• Importantly, the ESA is intended to avoid Bermuda’s inclusion on the list of non-cooperative tax jurisdictions (generally regarded as an unacceptable result).

• Each affected entity in Bermuda will need to analyze the impact of the ESA based on its specific facts and circumstances, and on this basis may determine:
  
  • that the entity meets the substance requirements, with no further changes required to its structure or operating model (business as usual).

• that the entity does not meet the substance requirements, and:

  • changes are required to its business model to ensure that core income generating activities are conducted in Bermuda and/or to increase its employees, premises, and expenditures in Bermuda, or

  • the changes required to meet the substance requirements are not feasible, requiring the entity to liquidate, redomicile, or face penalties under the ESA.
ESA 2018 – Potential implications to Bermuda

• The ability to outsource core income generating activities within Bermuda may result in an increase in the number of outsourced service providers in the jurisdiction

• The scope of services offered by such providers will likely also increase to ensure that outsourced employees are “suitably qualified” to address the specialized needs associated with each relevant activity

• Entities currently located in other 2.2 jurisdictions will need to address their ability to meet the new substance requirements in those jurisdictions

• It is anticipated that some entities may find it difficult to meet the substance requirements, including in situations where the jurisdiction is not able to offer sufficient suitably qualified people, physical infrastructure, or outsourcing alternatives

• Bermuda would appear to be an attractive alternative for these entities to establish a substantial economic presence
Comparative analysis of 2.2 jurisdictions
Who are the 2.2 jurisdictions and where are they in their legislative process?

- **Bermuda**: ~13,000
- **BVI**: ~400,000
- **Cayman**: ~120,000
- **Guernsey**: ~19,000
- **Isle of Man**: ~27,000
- **Jersey**: ~30,000

- **Also:**
  - Anguilla ✓
  - Bahamas ✓
  - Bahrain ×
  - Marshall Islands ✓
  - T&C ✓
  - Vanuatu ×
  - UAE ×
## ESA2018 - jurisdictional comparative analysis

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ESA2018 - jurisdictional comparative analysis

Management and control inside of Bermuda?

- Not consistent with overseas tax residency

Overseas companies “tax resident” in Bermuda?

- Permit companies
- IP companies

What will the EU Code Group accept?
How KPMG can help
How KPMG can help

• Many unanswered questions remain, and it is possible that the technical goalposts will continue to shift over time with:
  • the introduction of additional guidance,
  • the development of standards of “adequate” employees, premises, expenditure, and
  • commentary resulting from oversight activity by the Registrar and/or the EU/OECD.

• Despite these challenges, all entities will need to ensure compliance with the substance requirements of the ESA no later than July 1, 2019 (for existing entities)

• KPMG can assist entities in:
  • Completing an impact assessment of the ESA based on specific facts and circumstances
  • Assistance in assessing “adequate” levels of people, premises, and expenditure
  • Monitoring continuing developments in the legislation, regulations, and other guidance (in Bermuda and abroad), tracking industry standards of “adequate” and other relevant data (e.g. BEPS 5 activity)
What's next
OECD substance requirements

AEOI between Bermuda Ministry of Finance and EU Member States regarding noncompliant entities and high risk IP

Issuance of additional economic substance guidance (Bermuda and elsewhere)

ESA effective for new Bermuda registered entities

Final list of non-cooperative jurisdictions to be published by the EU

Transition period ends, all affected Bermuda entities expected to be compliant with requirements

First economic substance declaration to be submitted to the Bermuda registrar and later

Final list of non-cooperative jurisdictions to be published

Looking forward

Other potential developments:

COCG expectation that additional legislation will be passed in 2.2 jurisdictions regarding beneficial ownership registries and additional information disclosure consistent with DAC6

Ongoing review and oversight of economic substance regimes by the EU and/or OCED

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