Council of the European Union

Brussels, 23 May 2019
(OR. en)

9671/19

FISC 276

OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group
Subject:	The EU list of non-cooperative jurisdictions for tax purposes - Bermuda: final legislation and assessment under criterion 2.2

A/ FINAL LEGISLATION:

The Economic Substance Act 2018 was given assent by the Governor of Bermuda on 21 December 2018 and thus is law from that date:

http://www.bermudalaws.bm/laws/Consolidated%20Laws/Economic%20Substance%20Act%202018.pdf

The Economic Substance Regulations 2018 were published in the Government Gazette on 28 December 2018:

http://www.bermudalaws.bm/laws/Annual%20Laws/2018/Statutory%20Instruments/Economic%20Substance%20Regulations%202018.pdf

Amended Economic Substance Regulation: BR 34/2019, effective 22 February 2019

http://www.bermudalaws.bm/laws/Annual%20Laws/2019/Statutory%20Instruments/Economic%20Substance%20Amendment%20Regulations%202019.pdf

Amended Economic Substance Regulation n°2: BR 38/2019, effective 4 March 2019

http://www.bermudalaws.bm/laws/Annual%20Laws/2019/Statutory%20Instruments/Economic%20Substance%20Amendment%20(No%202)%20Regulations%202019.pdf

B/ FINAL ASSESSMENT:

The dialogue with Bermuda was constant and constructive with several conference calls and meetings. The Commission Services reported regularly to Member States on the progress of the discussion with Bermuda. Bermuda shared several versions of their draft legislation and sought feedback from the COCG.

The following assessment highlights the remaining issues identified and still pending at the beginning of 2019 following such feedback:

1 – Identification of the relevant activities and included entities

1.1 – On relevant activities

i) Holding companies

It was reported to Bermuda that the substance requirements for pure equity holdings should include reference to having the people and premises to manage equity participations.

Section 14 of the December 2018 Regulation clarified that a pure equity holding complies with economic substance requirements if it complies with minimum economic substance requirements[1] and has adequate employees for holding and managing equity participations and adequate premises in Bermuda. Since Section 14(1) of the Act applies only to pure equity holdings (with minimum substance requirements), there was no more direct reference to active holding entities in Bermuda legislation.

Following the 30 January 2019 COCG meeting, the Commission services reported to Bermuda a negative assessment. The Act only referred to pure equity holding companies and did not make it clear that any holding entity that holds a variety of assets and earns different types of income must fulfil the substance requirements and carry out the core-income generating activities associated with the income earned (as required in the FHTP paper on non-IP regimes).

The Economic Substance Regulation[2] as amended now provides for an additional reference, in Regulation 14(4) that for a holding company that holds a variety of assets and earns different types of income (such as interest, rents and royalties), the core income generating activities are those activities that are associated with the income that the holding company earns.

[1] Section 4 of the Regulation: compliance with applicable corporate governance requirements including keeping records of account, books and papers and financial statements as well as submission of an annual economic substance form

[2] BR 34/ 2019 reg.6 effective 22 February 2019

Conclusion:

This issue is settled.

ii) Regulated activities

It was reported to Bermuda that while Member States assessed the Banking and Insurance sectors as having sufficient substance requirements, this could not be extended to Fund Management activities. The final Regulation does not include a reference to internal regulation for the fund management sector. Therefore, the entities carrying out fund management activities will have to comply with general substance requirements.

Conclusion:

This issue is settled.

1.2 – On included entities

Bermuda was asked to explain the reasons for no longer including all partnerships in the scope of substance requirements. The final legislation indeed includes in its scope:

- Companies, including permit companies and overseas companies;
- Limited liability companies;
- Partnerships, including exempted partnerships, exempted limited partnerships and overseas partnerships that have elected to have a separate legal personality.

Bermuda clarified that it did not consider appropriate to include partnerships that did not elect to have a separate legal personality. However, Bermuda confirmed that the substance requirements will apply to all partners that are themselves registered entities.

Conclusion:

This issue is clarified and the risk of BEPS should be limited. However, the COCG will monitor whether, in the coming months, it considers it necessary for Bermuda to include all partnerships in the scope of substance requirements.

2 – Imposition of substance requirements

2.1 – Income threshold

The final legislation does not refer to an income threshold for the application of substance requirements but only to being engaged in a relevant activity.

Conclusion:

This issue is settled.

2.2 – CIGAs for IP activities

While the COCG had allowed jurisdictions until 24 February 2019 to provide updates in view of addressing the remaining concerns identified during the 30 January 2019 COCG meeting, Bermuda has also used this opportunity to modify a wording previously approved by Member States.

The Scoping Paper requires the following CIGAs for IP activities:

- for patents, R&D activities are expected;
- for non-trade IP assets, branding, marketing and distribution activities are expected.

In its December 2018 Regulation, the wording used by Bermuda made a link between the type of IP asset and the CIGAs to be performed. Through an amendment to Regulation 15[3], Bermuda however subsequently considered that CIGAs for entities engaged in IP activities include:

- conducting R&D in relation to IP assets; and
- marketing, branding and distribution of IP assets.

Considering this new wording, an entity that owns a patent carry out marketing activities as CIGAs could be considered compliant by Bermuda tax authorities.

This was not in line with the Scoping Paper and Member States had asked other jurisdictions to make this clear link in their legislative framework. A negative assessment was therefore reported to Bermuda following the COCG meeting of 27 February 2019.

[3] BR 34/ 2019 reg. 7 effective 22 February 2019.

To remedy the issue, Bermuda adopted additional amendments to the Economic Substance Regulation on 4 March 2019 (after the cut-off date agreed by the COCG for the 12 March 2019 ECOFIN Council). Regulation 15 was redrafted to re-establish a direct link between the types of assets held in Bermuda and the types of CIGAs that are expected to be carried out in Bermuda.

Conclusion:

This issue is settled.

2.3 – Definition of high-risk IP scenarios

The wording in the December 2018 Regulation introduced a confusion between the CIGAs and the specific requirements for low-risk and high-risk IP scenarios.

On low risk, Section 16(2) provided that whether or not the main IP CIGAs[4] are undertaken in Bermuda, there is a presumption of non-compliance that can be rebutted if the entity demonstrates that it undertakes the other IP CIGAs:

- Taking the strategic decisions and managing or bearing the principal risks, or both, related to the development and subsequent exploitation of an IP asset;
- 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
- Carrying on the underlying trading activities through which IP assets are exploited and which lead to the generation of revenue from third parties.

Note: where 'or' is underlined, the Scoping Paper requires that it should be cumulative with a wording equivalent to "as well as". Bearing the principal risks without managing them should not be considered sufficient.

[4] For patents : R&D ; For non-trade intangibles such as trademarks : marketing, branding and distribution

Concerning the high-risk IP scenario, Section 16(3) provided that an entity engages in high-risk IP activities where the entity is engaged in the main IP CIGAs and owns an IP asset that has been acquired from an affiliate or has been obtained through the funding of overseas R&D activities and is licensed to a foreign affiliate or is used to generate revenue through activities performed by such foreign affiliate. This wording suggested that in a situation where an entity owns an IP asset acquired from a related party but does not undertake R&D or branding, marketing and distribution (the "and" condition not being fulfilled), it would not be considered as a high-risk scenario. This was not in line with the Scoping Paper: whether or not the entity carries out R&D or marketing, branding and distribution is irrelevant to the definition of high-risk IP scenarios that will trigger the enhanced evidential threshold as well as the automatic exchange of information with the relevant Member States.

Following the 30 January 2019 COCG meeting, the Commission services therefore reported to Bermuda a negative assessment of the wording of the IP core income generating activities (CIGAs) and the definition of high-risk IP scenarios:

- In low-risk IP scenarios, the alternative CIGAs that could be performed by a relevant entity were drafted with an alternative allowing entities to only bear the principal risk whereas the Scoping Paper required that bearing the risks should be a cumulative element together with taking strategic decisions and managing the principal risk.
- The definition of high-risk IP scenarios created a situation in which an entity that owns IP assets acquired from a related party but does not undertake R&D or branding, marketing and distribution, would not be considered as a high-risk.

Bermuda subsequently amended Section 16 of the Regulation[5]. This section now makes it clear that:

- for alternative CIGAs in low-risk IP scenarios, the entity shall demonstrate that it takes the strategic decisions, manages and bears the principal risks related to the IP asset;
- the definition of high-risk IP activities is now in line with the Scoping Paper without reference to carrying out R&D or marketing, branding and distribution.

Conclusion:

This issue is settled.

[5] BR 34/ 2019 reg.7 effective 22 February 2019

2.4 – CIGAs in or from within the jurisdiction

Section 3(2)(b) provides that CIGAs are undertaken in Bermuda with respect to the relevant activity.

Conclusion:

This issue is settled.

2.5 CIGAs to be performed

It was reported to Bermuda that it was necessary to have the appropriate CIGA for the type of relevant activity carried out by the entity.

As mentioned above, Section 3(2)(b) provides that CIGAs are undertaken in Bermuda with respect to the relevant activity.

Bermuda does not make a direct reference to CIGAs, so it remains vague and uncertain as to the necessity to have appropriate CIGAs for the type of relevant activity carried out by the entity.

Conclusion:

The performing of the appropriate CIGAs for the type of relevant activity carried out by the entity will be carefully considered as part of the assessment of substance in the jurisdiction. Considering this is a matter of explaining to the businesses how the jurisdiction will interpret the obligation for substance in the enforcement phase, this issue will be cleared in future guidance as other jurisdictions have already done and monitored as part of the general monitoring on the enforcement of the substance requirements framework by 2.2 jurisdictions.

2.6 – <u>Outsourcing safeguards</u>

According to section 3 of the December 2018 Regulation, the entity had to provide information on the nature and extent of outsourcing arrangements (if any) to affiliates or service providers in Bermuda. It was however still not clear whether it was prohibited to outsource outside of Bermuda. This provision could be understood as an obligation to file information on outsourcing arrangements in Bermuda only, leaving aside outsourcing arrangements made with service providers outside of Bermuda.

The Scoping Paper makes it clear that there needs to be substance in the jurisdiction. Therefore, one of the safeguards applicable to outsourcing is that is has to take place in the jurisdiction.

The Regulation further specified that an entity must provide information as to whether 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:

- are suitably qualified and able to monitor and control the carrying out of the outsourcing arrangement by the affiliate or service provider;
- and monitor each outsourcing arrangement in order to ensure that the outsourced entity has adequate capacity to execute the outsourcing arrangement.

The entity should also provide information as to whether the affiliate or service provider responsible for, or involved in, the implementation and execution of such outsourcing arrangement:

- has adequate capacity for the implementation and execution thereof;
- has employees who are suitably qualified to implement and execute the outsourcing arrangement;
- 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

There was a direct reference the prohibition of double counting of the resources of a service provider. However, the uncertainty as to the scope of outsourcing allowed in or outside Bermuda did not allow the Group to conclude that the outsourcing was properly safeguarded.

As a result, following the 30 January 2019 COCG meeting, the Commission services reported a negative assessment of the outsourcing safeguards to Bermuda: the wording of various provisions of the Regulation created an uncertainty as to whether outsourcing of CIGAs would only be allowed in Bermuda.

Bermuda has amended Section 5 of the Regulation[6] to make clear that where an entity outsources any of its CIGAs, to an affiliate or service provider, CIGAs so outsourced must be undertaken in Bermuda.

Conclusion:

This issue is settled.

2.7 – Scope of substance requirements

It was reported to Bermuda that the wording used respectively in Section 3 of the Legislation and of the Regulation allowed for a global approach to the assessment of substance with the possibility for the Minister to select some or all of the alternative criteria to determine whether an entity has substance in Bermuda. The Scoping Paper makes it clear that substance criteria are cumulative and not alternative or subject to a global approach.

Section 3 of the Act provides that a relevant entity engaged in a relevant activity complies with economic substance requirements if:

a) The entity is managed and directed in Bermuda;
b) Core-income generating activities (as may be prescribed) are undertaken in Bermuda with respect to the relevant activity;
c) The entity maintains adequate physical presence in Bermuda;
d) There are adequate full-time employees in Bermuda with suitable qualifications; and
e) There is adequate expenditure incurred in Bermuda in relation to the relevant activity.

[6] BR 34/ 2019 reg.5 effective 22 February 2019

Bermuda redrafted its Regulation so that it is no longer a list of elements that the Minister shall have regard to in determining whether an entity meets the substance test. It clarifies the elements that an entity will have to provide in relation to economic substance requirements concerning the relevant activities undertaken, the nature and extent of the entity's presence in Bermuda, information on management and direction in Bermuda as well as information on outsourcing arrangements.

Conclusion:

This issue is settled.

3 – Enforcement and sanctions

3.1 – Filing obligations

It was reported to Bermuda that the information to be filed by entities would not systematically include information on the amount and type of gross income, the amount and type of expenses and assets, the number of employees (specifying full-time employees) and CIGAs conducted in Bermuda. Details of any outsourcing arrangements were also not included.

Section 5 of the Act now provides for such information to be filed.

Conclusion:

This issue is settled.

3.2 – Sanction mechanism

It was reported that the maximum time for complying with the three notices of non-compliance is not specified and the striking-off the register does not clearly seem to be an option.

The Act now includes a reference for a possibility to order the strike-off of a non-compliant entity pursuant application to the Court for doing so. Bermuda has improved its sanction framework.

Conclusion:

This issue is settled. The COCG will monitor the evaluation of the efficient enforcement of the substance legislation over the coming years.

Conclusion

Bermuda has implemented its commitment to introduce substance requirements under criterion 2.2.

ANNEX 1: assessment by COCG experts in 2017

ANNEX 1: ASSESSMENT BY COCG EXPERTS IN 2017

	1a	1b	2a	2b	3	4	5
Bermuda	X	X	X	X	?	?	X
Criterion 2.2: "The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction" In light of the assessment made under all Code criteria applied by analogy the tax system of Bermuda should be considered overall harmful/not harmful from a Code of Conduct point of view. The main concerns which deviate from the Code of Conduct criteria as applied by analogy relate to the lack of legal substance requirements for companies which business is another than banking and insurance.						Overall: V	

Explanation

Absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero: In this respect, where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero", then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2 has been met.
Relevant questions (Q 1.2) Bermuda does not apply a Corporate Income Tax. Bermuda therefore meets the requirement to be assessed under criterion 2.2.

Criterion 1:

"whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents"

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

The absence of CIT applies de lege for all companies. The law does not segregate between resident vs non-resident shareholders. We therefore propose a cross (X – not harmful) for criterion 1.a.

Based on the received information Bermuda has a total of 16,327 registered legal entities of which 12,818 are controlled by non residents means a ratio of 78,5%. This number is lower than the criterion "enjoyed only or almost only by non-residents" We therefore propose a cross (X – not harmful) for criterion 1.b.

Criterion 2:

"whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

By analogy to the assessment against criterion 1a/b. We would propose a cross ("X" – not harmful) for criterion 2a)/2b).

Criterion 3:

"whether advantages are granted even without any real economic activity and substantial economic presence within the jurisdiction offering such tax advantages"

Relevant questions (Q 1.1, Q 1.7, Q 1.9, Q 2.4, Q 2.5, Q 2.6, Q 2.7, Q 2.8)

a) Facts

All companies must have either a resident representative or a local director or a secretary in Bermuda who has to maintain the offices meeting minutes, financial statements, and records of account relating to a company for which they act. However, it is not clear how much time is needed to fulfil these functions properly.

Bermudan law requires specific substance requirements for commercial insurance industry: the insurance business should directed and managed from Bermuda meaning that risk management, presence of responsible the senior executives and the meetings of the board of directors have to take place in Bermuda. Banks can only operate in Bermuda if they offer full retail banking services.

Bermuda imposes substance requirements on financial services businesses (around 2000

companies) through annual self assessment by the licensee which is supervised by 83 supervisors of the Bermuda Monetary Authority (BMA). The BMA performs on average 50 on-site reviews per year.

Furthermore, Bermuda requires disclosure of the beneficial ownership, presence of internal audit records and is judged compliant with FATF requirements.

Although Bermuda seems to have evolved substance rules for banking and insurance business the substance requirements for the other sectors seem more related to the integrity of the company and do not seem to link the substance to presence on Bermuda itself.

Officials from Bermuda have visited the review panel in person and confirmed the understanding of the panel about the substance requirements in Bermuda.

b) Assessment

Specific substance requirements with regard to banking and insurance business in Bermuda seem sufficient in Bermuda. However, they do not cover the whole scope of companies and entities that can be incorporated and thus benefit from zero taxation.

The majority of the members of the panel would propose a tick ("V" – harmful) for criterion 3 since businesses other than banking and insurance business do not have any substance requirement to satisfy..

The above described governance criteria, ie that companies have either a resident representative or a local director, do not include any express requirement for real economic activity or substantial economic presence, and notably any requirement with respect to employment obligation.

One expert of the Panel provided the following assessment:

- The agreed terms of reference for the assessment of jurisdictions under Criterion 2.2 states the following:

A jurisdiction can only be deemed to have failed the assessment under this criterion when 'offshore structures and arrangements attracting profits which do not reflect real economic activity in the jurisdiction' are due to rules or practices, including outside the taxation area, which a jurisdiction can reasonably be asked to amend, or are due to a lack of those rules and requirements needed to be compliant with this test that a jurisdiction can reasonably be asked to introduce.

The introduction of a CIT system or a positive CIT rate is not amongst the actions that a third country jurisdiction can be asked to take in order to be in line with the requirements under this test, since the absence of a corporate tax base or a zero or almost zero level tax rate cannot by itself be deemed as criterion for evaluating a jurisdiction as non-compliant.

- This states that a jurisdiction can only be deemed to have failed the assessment under Criterion 2.2 where reasonable/proportionate actions have been identified that a jurisdiction could take to avoid being listed.

- It remains unclear what exactly we would be asking jurisdictions to amend/introduce in

response to their deemed failure under Criterion 3. It might be suggested that a jurisdiction should have a de jure requirement for substance as part of their company law, but it's not clear what that would entail i.e. what the test of substance would be, when that test of substance would be applied, what the implication would be of a company failing that test.

- Those are important questions in being able to test the reasonableness of such a requirement.

- If we can't demonstrate that such requirements are reasonable, and we can't demonstrate that they are commonly replicated by other countries/Member States, then the failing of a jurisdiction due to the lack of such a requirement would amount to a failing of a jurisdiction on the basis of it not having a CIT regime which is incompatible with the terms of reference.

This part of Panel III would therefore propose a question mark ("?") for Criterion 3 until this has been discussed further.

Criterion 4:

"whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"

Relevant questions (Q 2.9, Q 2.10, Q 2.11, Q 2.12)

As a result of the absence of a CIT Bermuda does not apply OECD transfer pricing rules. Bermudan Law states the accountancy has comply to the Canadian GAAP rules. It is unsure whether fair value is incorporated in Canadian GAAP.

Bermuda is a signatory to the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports. Bermuda has enacted the Country-by-Country Reporting in the Country by Country Regulations 2017 which apply to all periods commencing on or after 1 January 2016.

It is unsure whether fair value is covered in the Canadian GAAP and as a result mandatory in Bermuda.

However, the panel is not sure, whether it is adequate to ask countries without a CIT-system to set rules for profit determination in respect of activities within a MNE in place or if the commitment to CbCR, which gives relevant information to the other states, should be enough to fulfil criterion 4.

Therefore, we propose a question mark ("?") for criterion 4.

Criterion 5: "whether the features of the tax system lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"
<u>Relevant questions (Q 2.13, Q 2.14, Q 2.15, Q 2.16)</u> "All the elements of the legal system which are relevant for benefiting from the advantages at stake (including rules for the granting of tax residence or the setting up of companies) are clearly set by the law and the practice does not involve any administrative discretion. We would therefore propose a cross ("X" – not harmful) for criterion 5."