

Bermuda consults on new corporate income tax regime in response to Pillar Two

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Issue 4

In brief

Bermuda launched a public consultation on 8 August 2023 regarding the introduction of a corporate income tax (CIT) regime in response to Pillar Two of Base Erosion and Profit Shifting (BEPS) 2.0¹. The consultation will end on 8 September 2023 with a more detailed second public consultation to be held later in the year.

This news flash provides an overview of the public consultation document and our observations thereon.

In detail

Proposed CIT regime in Bermuda

Effective date

The proposed CIT regime will be effective for tax years beginning on or after 1 January 2025.

Nature of the CIT

The proposed CIT should qualify as a covered tax for purposes of the Global Anti-Base Erosion Rules (GloBE rules), which would mitigate the amount of top-up tax payable to other jurisdictions with respect to profits earned in Bermuda.

CIT rate

Bermuda is considering a CIT rate between 9% and 15% and will conduct further analysis to determine the appropriate rate.

Scope

The proposed CIT regime will apply to tax resident entities and Bermuda permanent establishments (PEs) that are constituent entities (CEs) of a multinational enterprise (MNE) group with revenues of EUR750 million or more.

Tax resident entity

A tax resident entity refers to an entity created/organised in Bermuda, unless the entity provides sufficient evidence that it is tax resident in another jurisdiction based on the location of its central management and control.

Our observation: *With the introduction of a tax residency concept, it is possible for a Bermuda incorporated entity to be 'dual-located' for purposes of the GloBE rules, in which case the tiebreaker rules may kick in. Meanwhile, it is not yet clear how the proposed CIT regime will affect entities that are incorporated outside of*

Bermuda but with central management and control in Bermuda. Hopefully, more details will be available in the second public consultation.

Bermuda PE

A Bermuda PE refers to a PE (as defined in Article 5 of the OECD's *Model Tax Convention on Income and on Capital*, 'OECD MTC') located in Bermuda².

Exclusion

The following tax resident entities and Bermuda PEs will be exempt from the proposed CIT regime:

- (i) excluded entities as defined in Article 1.5 of the GloBE rules, such as governmental entities, non-profit organisations, pension funds and investment funds that are ultimate parent entities (UPEs)³;
- (ii) entities and PEs that are CEs of an MNE group that is in the initial phase of its international activity (as defined in Article 9.3 of the GloBE rules)⁴; and
- (iii) entities and PEs that are CEs of an MNE group that are less than 80% owned, directly or indirectly, by the UPE (by value).

Our observation: *Exclusion (iii) is not an exclusion provided in the GloBE rules. As the ownership threshold is tested at the UPE level, any Bermuda entities lower down the corporate structure may potentially fall outside the threshold. The Bermuda government has not provided its rationale behind the proposed exclusion, but one plausible consideration is that without such an exclusion, MNE groups with entities operating in Bermuda may suffer a greater tax charge than that would otherwise have been imposed under the GloBE rules in some situations (e.g. in situations where the parent entity applying the IIR does not own 100% of the ownership interests in the relevant Bermuda low-taxed CEs).*

Taxable income

Taxable income or loss of a tax resident entity will generally be determined based on its worldwide income or loss, with tax adjustments largely following the GloBE rules. Nonetheless, taxable income or loss of a non-Bermuda PE may be excluded from calculation of taxable income or loss of a tax resident entity. The principles of Article 7 of the OECD MTC shall be applied in determining the taxable income or loss of a Bermuda PE.

Intragroup cross-border transactions

Cross-border transactions between members of the MNE group should generally be conducted at arm's length.

Qualified refundable tax credits (QRTCs)

The proposed CIT regime is expected to provide for QRTCs as defined in the GloBE rules⁵. The QRTCs will be developed to support key policy initiatives of Bermuda, such as encouraging capital investments or research and development activities in Bermuda.

Filing basis

The Bermuda CIT return should generally be prepared on a consolidated basis (i.e. including all tax resident entities and Bermuda PEs in the MNE group which are subject to Bermuda CIT). However, a tax resident entity or Bermuda PE should be allowed to elect to file a separate Bermuda CIT return.

Relief from double taxation

Foreign tax credits will be available to the extent that profits earned in Bermuda are subject to both foreign taxes and Bermuda CIT. It is further proposed that a foreign tax credit may be permitted for controlled foreign corporation (CFC) taxes paid or accrued by the direct or indirect parent on Bermuda profits under the CFC regime of another jurisdiction.

Qualified domestic minimum top-up tax (QDMTT)

Bermuda has ruled out the introduction of a QDMTT in the near term. However, it remains possible that a QDMTT may be advisable for Bermuda in the future once the proposed CIT regime has been fully established and is functioning as intended.

Our observation: Bermuda has not indicated in the public consultation document whether it will introduce the Income Inclusion (i.e. IIR) or the Undertaxed Payment/Profits Rule (i.e. UTPR) under Pillar Two.

The takeaway

The proposed implementation of a new corporate tax regime in Bermuda comes on the back of the global minimum tax framework under Pillar Two, which is already a reality with over 50 jurisdictions taking steps towards implementation. As the Bermuda government admitted, maintaining the status quo (i.e. not levying a CIT) is an unattractive option because it will not only cause Bermuda to cede its taxing rights on profits generated in Bermuda to other jurisdictions, but also do nothing to allay concerns regarding the potential double taxation facing MNE groups subject to Pillar Two.

The latest design of the proposed tax regime may appear narrow in scope, as it will only apply to entities forming part of an MNE group that meets the EUR750 million threshold and several carve-outs are suggested. However, there may be further changes following feedbacks from the ongoing rounds of public consultation.

Taxpayers that are potentially in-scope for Bermuda CIT should note that unlike a QDMTT which is fully creditable against any top-up tax liability, any CIT paid in Bermuda only qualifies as covered taxes under the GloBE rules, which may accordingly result in some level of top-up tax still payable. Taxpayers are recommended to undertake at least a high-level modelling to assess the potential impact and map the way forward.

While Bermuda is home to many global insurers and reinsurers, the consultation paper provides little guidance on how the proposed CIT regime will apply to resident insurers and reinsurers and whether the special rules applicable to insurance companies under the GloBE rules will be incorporated. Insurers and reinsurers that would be affected by the proposal may wish to consider providing their feedbacks to this public consultation.

Endnotes

1. The public consultation document can be accessed via this link:
<https://www.gov.bm/sites/default/files/First-Public-Consultation.pdf>
2. The OECD MTC can be accessed via this link:
<https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm>
3. The GloBE model rules can be accessed via this link:
https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en
4. Under Article 9.3 of the GloBE rules, an MNE group is in the initial phase of its international activity if, for a fiscal year:
 - (a) it has CEs in no more than six jurisdictions; and
 - (b) the sum of the net book value (NBV) of tangible assets of all CEs located in all jurisdictions other than the reference jurisdiction does not exceed EUR50 million.

The reference jurisdiction of an MNE group is the jurisdiction where it has the highest total value of tangible assets for the fiscal year in which it originally comes within the scope of the GloBE rules. The total value of tangible assets in a jurisdiction is the sum of the NBV of all tangible assets of all the CEs that are located in that jurisdiction.

5. A QTRC refers to a refundable tax credit that must be paid as cash or available as cash equivalents within four years after a CE satisfies the conditions for receiving the credit under the laws of the relevant jurisdiction.

When computing the jurisdictional effective tax rate under the GloBE rules, a QTRC is treated as an addition to the GloBE income (which is included in the denominator), whereas a non-QTRC is treated as a reduction to the covered taxes (which is included in the numerator) if it is not already recorded as a reduction to the current tax expense.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

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