

British Virgin Islands: Economic Substance Requirements

December 2019

1. Introduction

The British Virgin Islands ("BVI") has enacted a new legislation through which it requires the establishment of relevant and adequate 'economic substance' for BVI companies and limited partnerships that are 'resident' in the BVI and carry on 'relevant activity'.

This is in response to the requirements of the EU Code of Conduct Group and BVI's own commitment to tax transparency and compliance with relevant international guidelines.

As there are ongoing developments on pending official clarifications and guidelines, entities that are affected by this new legislation are prompted to closely monitor these developments.

Potentially affected entities are also prompted to review their circumstances on an entity-by-entity basis in order to consider any necessary actions in line with the requirements of this new law and to take decisions accordingly that may or may not involve operational and/or structural changes. Totalserve will be pleased to assist on a case by case basis.

2. Economic Substance Test

The Economic Substance (Companies and Limited Partnerships) Act, 2018 ("the Act") has come into force on 1 January 2019. You may [click here](#) to access the actual Act.

The Act applies to all companies and limited partnerships (excluding limited partnerships which elected not to have a legal personality) registered in the BVI under the BVI Business Act 2004 or the Limited Partnerships Act 2017, that are tax resident in the BVI, as well as on foreign companies and limited partnerships doing business in the territory of BVI ("affected legal entities").

Excluded from the 'economic substance test' are legal entities that can demonstrate that they are tax resident in another jurisdiction which is not included in the EU list of non-cooperative jurisdictions (refer to Part 3 regarding their reporting obligation as per the Act).

In brief, the Act requires all affected legal entities that are tax resident in the BVI and that carry on 'relevant activity' to establish adequate and relevant economic substance in the BVI.

A **relevant activity** is defined by the Act as:

- Banking business
- Insurance business
- Fund management business
- Finance and leasing business
- Headquarters business
- Shipping business
- Holding business
- Intellectual property ("IP") business
- Distribution and service centre business

The aforementioned relevant activities are defined in the Rules on Economic Substance in the Virgin Islands (the "Rules"), which can be accessed by [clicking here](#). The Rules were published in October 2019 as a supplement to the Act, for the purpose of providing additional guidance and explanations on how to meet the economic substance requirements.

Outline definitions of the relevant activities are provided in **APPENDIX 1** of this Information Sheet.

Economic Substance Test:

Affected legal entities must demonstrate and pass the economic substance test on an annual basis within its determined financial period (refer to part 3 for clarification on financial period).

Essentially, with the exception of pure equity holding entities (as described below), each affected legal entity, after taking into account the nature and scale of its relevant activity, must show that it is adequately 'directed and managed' and carries out 'core income generating activities' in the BVI. In order to adequately demonstrate this, the Act requires that such affected legal entities have:

- adequate number of suitably qualified employees physically present in the BVI
- appropriate physical offices/ premises in the BVI to support its core income generating activities
- adequate expenditure in the BVI
- in the case of an intellectual property business that requires the use of specific equipment, such equipment to be located in the BVI

(note: outsourcing of the income generating activity is permitted in certain circumstances)

In the case of **pure equity holding entities**, carrying no relevant activity other than holding equity stakes (interests or shares) in other entities and earning dividends and capital gains, the relevant entity will be deemed to have adequate economic substance if it complies with its statutory obligations and by having adequate employees and premises in the BVI for holding and where necessary for carrying out the relevant management.

A high level **Flowchart** regarding the BVI Substance Requirements, as issued by BVI Finance, is provided in **APPENDIX 2** of this Information Sheet.

3. Reporting Obligations

The Act makes changes to the Beneficial Ownership Secure Search System Act 2017 ("BOSS"), whereby, in addition to the existing requirement to contain information concerning the beneficial owners of BVI registered entities, it is now also required that companies and limited partnerships provide information on an annual basis (through their registered agent) about their tax residency status and activities.

Where entities are **tax resident outside the BVI**, they are required to specify the jurisdiction in which they are tax resident and provide evidence to support so.

With respect to a legal entity that carries on relevant activity and is **tax resident in the BVI**, for each relevant activity and the relevant period, additional details must be provided as follows:

Total turnover, expenditure incurred, employees engaged in the activity, employees so engaged in the BVI, address of BVI premises, nature of equipment used in the BVI, details of persons directing/managing the activity. For 'intellectual property business' and any outsourcing arrangements, certain additional details may be required.

This will enable the competent authority, being the BVI International Tax Authority ("ITA"), to monitor compliance and whether entities carrying on relevant activity meet the economic substance test as per the Act.

Criminal and financial sanctions (substantial fines) and potential strike-off the Registry are possible in case of non-compliance.

Automatic notification will be made by the ITA to the relevant overseas competent authority in respect of a legal entity which is found to be in breach of the economic substance requirements, or if it carries an IP relevant activity under certain circumstances, or if it claims to be tax resident in a jurisdiction outside the BVI.

Financial Period:

Affected entities performing relevant activity within a financial period must meet the substance test requirements and report accordingly. An entity's financial period is determined by the Act as follows:

- For **new entities** formed on or after 1 January 2019, their financial period will be one year from the date of incorporation. These entities must comply with the Act's economic substance requirements and the relevant reporting obligation under BOSS is within one year of formation.
- For **existing entities** formed prior to 1 January 2019, their financial period is defined as a period of one year commencing on a date not later than 30 June 2019 and every following period of one year. In this respect, these entities must establish their financial period and have it notified to the ITA, being the competent authority. These entities must comply with the Act's economic substance requirements by 30 June 2019 and the relevant reporting obligation under BOSS must be met within one year of that date, i.e. not later than 30 June 2020.

An application to the International Tax Authority can be made to alter a company's financial period provided that the period does not exceed 12 months.

Notes

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve will be glad to assist you in this respect. Please do not hesitate to contact us.

APPENDIX 1: Outline definitions of “relevant activities” as per the Rules on Economic Substance in the Virgin Islands

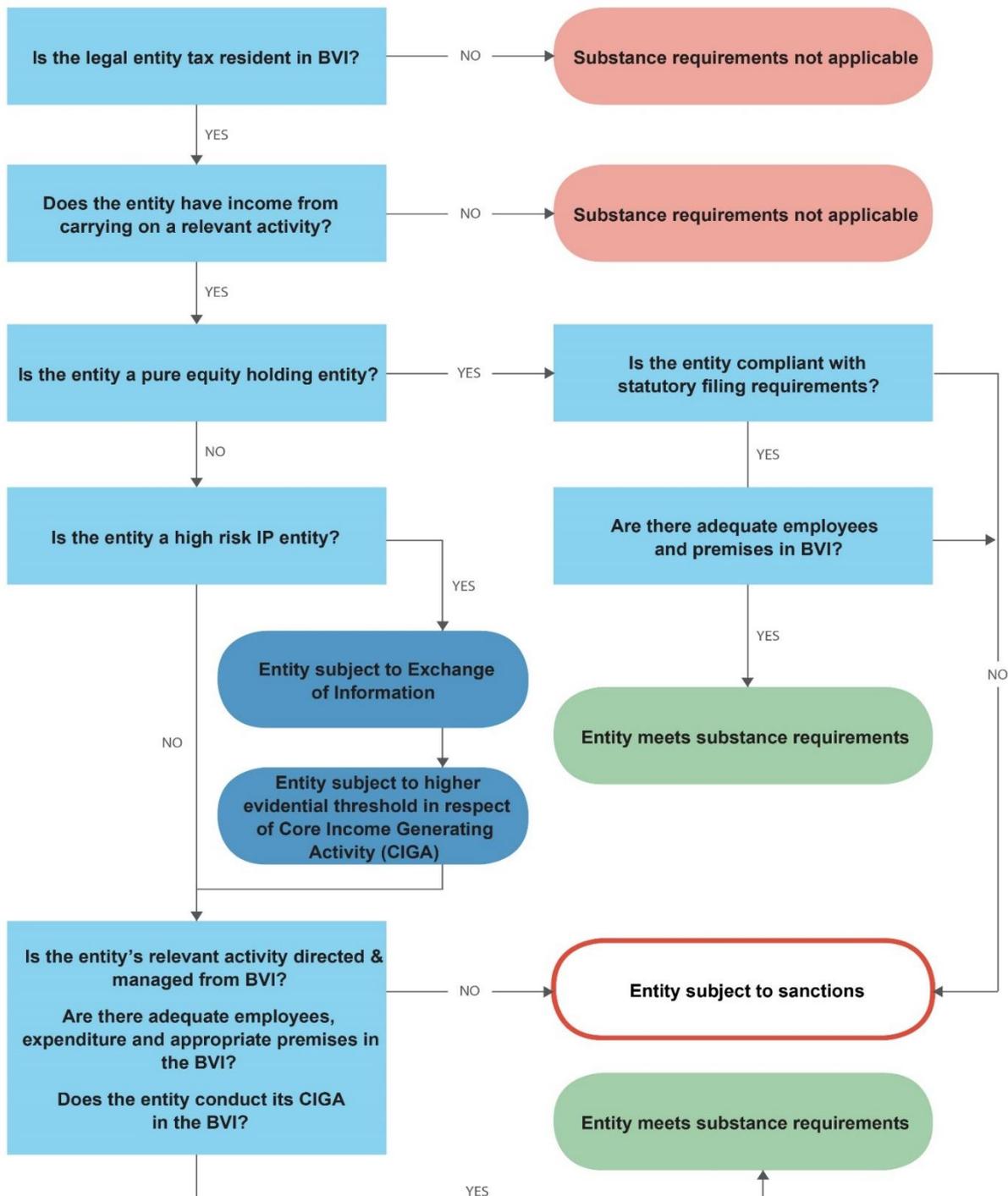
- **Banking business:** the business of accepting deposits of money which may be withdrawn or repaid on demand or after a fixed period or after notice, by cheque or otherwise and the employment of such deposits, either in whole or in part:
 - a. in making or giving loans, advances, overdrafts, guarantees or similar facilities, or
 - b. the making of investments, for the account and at the risk of the person accepting such deposits.
- **Insurance business:** the business of undertaking liability under a contract of insurance to indemnify or compensate a person in respect of loss or damage, including the liability to pay damages or compensation contingent upon the happening of a specified event, and includes life insurance business and reinsurance business.
- **Fund management business:** the conduct of an activity that requires the legal entity to hold an investment business license pursuant to section 4 and category 3 of Schedule 3 of the Securities and Investment Business Act, 2010 (“SIBA”). In particular, the “category 3” investment management business license contains the following subcategories:
 - Sub-category A: Managing Segregated Portfolios (excluding Mutual Funds)
 - Sub-category B: Managing Mutual Funds
 - Sub-category C: Managing Pension Schemes
 - Sub category D: Managing Insurance Products
 - Sub-category E: Managing Other Types of Investment.
- **Finance and leasing business:** the business of providing credit facilities of any kind for consideration. Any activity falling within the definition of banking, fund management or insurance business is excluded from this definition. Also, the provision of credit as an incidental part of a different sort of business will not be treated as carrying on a finance and leasing business.
- **Headquarters business:** the business of providing any of the following services to an entity in the same group:
 - a. The provision of senior management
 - b. The assumption or control of material risk for activities carried out by any of these entities in the same group
 - c. The provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (b)
- **Shipping business:** any of the following activities involving the operation of a ship anywhere in the world other than solely within the BVI waters (as defined in section 2(2)(a) of the Merchant Shipping Act, 2001):
 - a. The business of transporting, by sea, persons, animals, goods or mail

- b. The renting or chartering of ships for the purpose described in paragraph (a)
 - c. The sale of travel tickets or equivalent, and ancillary services connected with the operation of a ship
 - d. The 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
 - e. The management of the crew of a ship.
- **Holding business:** the business of being a pure equity holding entity, which itself is defined as a legal entity that only holds equity participations in other entities and only earns dividends and capital gains.
 - **Intellectual property business:** the business of holding intellectual property assets, which in turn are defined as any intellectual property right in intangible assets, including but not limited to copyright, patents, trademarks, brand, and technical know-how, from which identifiable income accrues to the business (such income being separately identifiable from any income generated from any tangible asset in which the right subsists).
 - **Distribution and service centre business:** the business of either or both of the following
 - a. Purchasing from foreign affiliates:
 - (i) Component parts or materials for goods; or
 - (ii) Goods ready for sale; and
 - (iii) Reselling such component parts, materials or goods;
 - b. Providing services to foreign affiliates in connection with the business,but does not include any activity included in any other relevant activity except holding business.

APPENDIX 2



BVI Substance Requirements



This flowchart is issued by BVI Finance and is intended to provide a high level illustration of the Economic Substance (Companies and Limited Partnerships) Act, 2018 in respect of its application to legal entities incorporated or formed under the law of the BVI. It should be read in conjunction with the Act and the Guidance Note issued by the International Tax Authority. Note that the legislation also applies to foreign companies and limited partnerships which do business in the BVI and which carry on relevant activities there. Those entities are not captured within this flow chart.