

British Virgin Islands



The information in this article has been superseded by a government update. See the updated article here: <https://marburys.com/economic-substance-requirements-in-the-bvi>

Economic Substance Legislation in the British Virgin Islands

The Economic Substance (Companies and Limited Partnerships) Act, 2018 (the **ES Act**) came into force on 1 January 2019 requiring British Virgin Islands companies and limited partnerships that are tax resident and carrying out 'Relevant Activities' (as defined below) to demonstrate economic substance. The new legislation, which applies to existing and new BVI entities, was introduced to address the concerns of the EU Code of Conduct Group and the OECD Forum on Harmful Tax Practices regarding economic substance.

This summary replaces our original release of 11 January 2019 and update from 31 May 2019 to provide a consolidated overview of the key aspects of the legislation.

The Economic Substance Code

The British Virgin Islands International Tax Authority (**ITA**), who is responsible for implementing, monitoring and enforcing the economic substance regime, published a draft Economic Substance Code (the **Code**) on 22 April 2019 providing initial guidance on the interpretation of the ES Act and the manner in which it will carry out its obligations under the legislation.

The Code comprises:

- extracts from legislation, including the ES Act
- rules made by the ITA, and
- guidance issued by the ITA.

The official Code was expected to be issued in early May 2019 following a brief education campaign. The ITA have stressed that the economic substance regime may evolve further and the EU have yet to issue "technical guidance" which may involve changes to the Act or the Code. We will update this article when further guidance becomes available. The draft Code is available [here](#).

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Classification of a resident 'legal entity'

Legal entities are defined as being BVI companies and limited partnerships with separate legal personality, and foreign companies and foreign limited partnerships registered in the BVI under the BVI Business Companies Act, 2004 or the Limited Partnerships Act, 2017, and that are resident in the BVI for tax purposes.

Companies and limited partnerships resident for tax purposes in a jurisdiction outside of the BVI are classed as 'non-resident', except for those claiming tax residency in jurisdictions included on the EU list of non-cooperative jurisdictions (also known as the 'EU Blacklist'), and thus fall out of scope of the economic substance requirements.

It should be noted that *all* BVI companies and *all* limited partnerships with legal personality, regardless of whether they are a 'legal entity' or carrying out a Relevant Activity, will need to make an annual report under the ES Act starting in 2020 regarding their compliance with the economic substance requirements or providing evidence of tax residency outside of the BVI for the previous financial period.

Financial periods

Under the ES Act, economic substance is assessed by reference to 'financial periods', usually a year in length. For entities in existence before 1 January 2019 the default first financial period starts from 30 June 2019. For all other entities, the first financial period starts on the day of incorporation or formation. However, a legal entity may apply to the ITA to alter its financial period, ie to bring it in line with its financial year end.

A legal entity is required to demonstrate economic substance in the BVI for a financial period in which it engages in any Relevant Activity.

Relevant Activities

A legal entity is subject to the economic substance requirements if it conducts any of the following Relevant Activities:

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

Each of the above activities is defined in the ES Act and we have put together a [summary table](#) of the definitions.

Investment funds

The draft Code notes that the business of being an investment fund is not a defined Relevant Activity, however it is possible that a fund may be carrying on holding company business if it only holds equity participations in other

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entities and only earns dividends and capital gains. The treatment of investment funds is still under review by the EU, and it is anticipated that further requirements/guidance will be provided by the ITA following the EU's feedback.

The Economic Substance Test

In order to have economic substance in the BVI, a legal entity that falls under the ES Act, with the exception of a pure equity holding entity (see below), must be able to demonstrate that:

- (a) the relevant activity undertaken is directed and managed in the BVI
- (b) the core income generating activities are carried out in the BVI
- (c) taking into account the level of income generated from that relevant activity carried out in or from within the BVI, it has
 - (i) an adequate number of full-time employees / personnel with appropriate qualifications in the BVI
 - (ii) adequate physical assets or physical presence in the BVI (including maintaining a place of business)
 - (iii) adequate operating expenditure incurred in or from within the BVI.

Core income generating activities

Core income generating activities (**CIGA**) are defined as activities that are being carried out in the BVI and are of central importance to the legal entity in terms of generating income. Depending on the relevant activity, the CIGA will differ. Marbury advises that each tax-resident legal entity carefully decipher which of its activities constitute as the core income generating ones.

The Substance Test above may be satisfied in relation to a relevant activity if the legal entity outsources its BVI CIGA, in relation to that relevant activity, to a third-party within the jurisdiction. The legal entity must, however, be able to prove that it is able to monitor and control the BVI CIGA being carried out.

The draft Code provides a non-exhaustive list of example CIGA for each Relevant Activity and we have included this in our [summary table](#).

Pure equity holding entities

The economic substance test for pure equity holding entities is lower than that applicable to other in-scope legal entities. Where the holding entity carries out no relevant activity other than holding equity participations in other entities and earning dividends and capital gains, it has adequate substance if it

- (a) complies with its statutory obligations under the BVI Business Companies Act, 2004 or the Limited Partnership Act, 2017 (whichever is relevant)
- (b) has, in the BVI, adequate employees and premises for holding equity participations and, where it manages those equity participations, has, in the BVI, adequate employees and premises for carrying out that management.

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Reporting obligations and mechanism

All legal entities will be required to provide information to enable the ITA to monitor whether the entity is conducting Relevant Activities, and if so, whether they are doing so in accordance with the economic substance requirements. The information will be integrated into the BVI's existing Beneficial Ownership Secure Search (BOSS) system which prescribes registered agents in the BVI to maintain up-to-date information on beneficial ownership which is searchable by competent authorities. The ES Act amends the Beneficial Ownership Secure Search System Act, 2017 to now require legal entities to also submit information in relation to any Relevant Activities and their tax residency status.

Reportable information

Legal entities carrying on Relevant Activities will be required to report the following information for the preceding financial period:

- (i) the total turnover generated by the relevant activity
- (ii) the amount of expenditure incurred on the relevant activity within the BVI
- (iii) the total number of employees engaged in the relevant activity
- (iv) the number of employees engaged in the relevant activity within the BVI
- (v) the address of any premises within the Virgin Islands which is used in connection with the Relevant Activity and the address of each such premises
- (vi) the nature of any equipment located within the Virgin Islands which is used in connection with the Relevant Activity, and
- (vii) the names of the persons responsible for the direction and management of the relevant activity, together with their relationship to the company and whether they are resident in the BVI.

Timing

Legal entities formed prior to 1 January 2019 and that fall in scope of the ES Act were required to comply with the economic substance requirements by 30 June 2019 and meet the BOSS reporting obligations within six months of the end of their first financial period ending no later than 30 June 2020. Legal entities formed on or after 1 January 2019 are required to comply with the ES Act immediately and to meet the BOSS reporting obligations within six months of the end of the first year (or financial period) of operation. Thereafter the reporting is an annual obligation.

Penalties

Legal entities who fail to provide information or persons who provide false information risk criminal penalties including a fine of up to USD75,000 and/or a prison term of up to five years for the individual.

Any legal entity carrying on a Relevant Activity and which fails to comply with the ES Test is subject to penalty, strike off, or both. The Code describes a three-stage approach to enforcement whereby upon the initial determination that a legal entity is non-compliant, the ITA will issue a notice and indicate steps to attain compliance, accompanied by a minimum USD5,000 fine. Failure to attain compliance in subsequent years will meet an escalating fine of up to USD200,000 (or USD400,000 in the case of intellectual property business). Striking off the legal entity will be the ultimate recourse.

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Next steps

The ES Act and the Code rely on a self-reporting regime, pursuant to which registered agents are required to take steps to collect the economic substance information from clients, and clients are required to provide the information. For the majority of clients, the first report will be due within six months of 30 June 2020, however in anticipation of many queries, Marbury will contact clients well in advance of the first reporting deadline.

In the meantime, Marbury would advise that all companies and limited partnerships undergo a review in order to determine whether they are or wish to be deemed as relevant legal entities, and if so, whether they conduct Relevant Activities. From there, relevant entities are advised to take the necessary steps to ensure compliance. We will keep our clients updated as further guidance and clarifications are issued.

For further information on any aspect of this guide please contact your usual Marbury adviser.

Disclaimer

This guide provides an overview of economic substance in the British Virgin Islands and should not be read as legal advice. For more information, please contact Marbury. A copy of the draft Economic Substance Code is available here:

<https://bvifinance.vg/Portals/0/xBlog/uploads/2019/4/24/DraftITACode.pdf>

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