

BVI Economic Substance

The British Virgin Islands (BVI) has passed legislation requiring certain legal entities which carry on 'Relevant Activities' to demonstrate that they have adequate economic substance in the BVI.

Any company (or limited partnership with separate legal identity) that is registered or incorporated in the BVI should be aware of this legislation and consider how it is affected.

The Economic Substance (Companies and Limited Partnerships) Act, 2018 (the Act) came into force on 1 January 2019. The Act demonstrates the BVI's continued commitment to international best practice, including the BVI's implementation of the OECD's Base Erosion and Profit Shifting (BEPS) framework and related EU initiatives. In order to implement an economic substance reporting regime, related amendments were made to the Beneficial Ownership Secure Search System Act 2017 (BOSS Act).

These amendments follow closely the approach taken to address the same issue in other international financial centres.

Which entities need to demonstrate economic substance in the BVI?

The Act imposes economic substance requirements on BVI companies and limited partnerships, with legal personality other than non-resident entities¹, which carry on a 'Relevant Activity' (as well as any foreign company or limited partnership which is registered in the BVI as a foreign entity²). Entities which do not carry out a Relevant Activity are not subject to the economic substance requirements, but they are subject to certain reporting obligations (see 'What are the reporting obligations?' below).

The Relevant Activities are:

- ✦ Banking business
- ✦ Insurance business
- ✦ Shipping business
- ✦ Fund management business
- ✦ Finance and leasing business
- ✦ Headquarters business
- ✦ Pure holding business (pure equity holding)
- ✦ Intellectual property business
- ✦ Distribution and service centre business

What will entities that carry on Relevant Activities need to do?

An analysis will need to be carried out to assess whether an entity is generating income from a Relevant Activity, and any affected entities will need to consider their position and take appropriate action.

Entities which are subject to the economic substance requirements (other than pure equity holding entities, as described below) must manage and direct the Relevant Activity and conduct core income-generating activity in the BVI. They must also, taking into account the nature and scale of the Relevant Activity, show that they have an adequate level of employees and expenditure in the BVI and appropriate physical offices or premises for the core income generating activity in the BVI. It should be noted that outsourcing of the income generating activity is permitted in certain circumstances.

Intellectual property businesses have a higher level of substance that needs to be achieved in order to satisfy the economic substance requirements.

A different test applies to a pure equity holding entity, which carries on no Relevant Activity other than holding equity participations in other entities and earning dividends and capital gains. Under this test, the relevant entity will be deemed to have adequate substance if it complies with its statutory obligations under the BVI companies / limited partnership laws and has adequate employees and premises for holding and, where relevant, managing those equity interests.

Relevant Activity

The BVI ITA has now published the final version of the Rules (and Explanatory Notes) on Economic Substance (the 'Rules'). They will become effective when the BOSS Act is amended. The Rules highlight the following key points:

- ✦ the initial financial period for new entities is 12 months from the date of formation. For existing entities, the initial financial period is 12 months from 30 June 2019. The financial period can be changed as long as the period is no more than one year
- ✦ a holding company will fall outside the scope of Holding Business if it holds any type of investment other than Equity Participations, including bonds and cash. This will mean that it is not a pure equity holding entity and providing no further Relevant Activities are undertaken will fall out of scope
- ✦ the business of being an investment fund (licensed by SIBA) is not a Relevant Activity and therefore outside of scope of the economic substance requirements. However, if the fund carries on other activities that are 'Relevant Activities' then this will bring it back in scope
- ✦ an entity which provides credit as 'an incidental part of a different sort of business' will not be treated as carrying on financing and leasing business. For example, a merchant which supplies goods on account, thereby offering short

term credit, will not be carrying on a finance and leasing business. Only where the provision of credit can be seen to be a business activity in its own right will the entity be treated as conducting financing and leasing business.

- ✦ entities which hold debt or debt instruments for the purposes of investment will not be regarded as being in the business of providing credit facilities (and therefore outside of financing and leasing business).

The Rules can be found by clicking [here](#)

Tax Residence

If the BVI entity is carrying out a Relevant Activity it must ascertain where it is resident, for tax purposes. If they are resident, for tax purposes:

- ✦ in the BVI, they will have to comply with the BVI ES Requirements
- ✦ in a jurisdiction that is on the EU's list of non-cooperative jurisdictions: <https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/> (an "Uncooperative Foreign Jurisdiction"), they must comply with the BVI ES Requirements
- ✦ in a jurisdiction that is neither the BVI nor an Uncooperative Foreign Jurisdiction, they will not have to comply with the BVI ES Requirements, provided they can provide proof of their foreign tax residency to the ITA

What are the reporting obligations?

The Act made changes to the BOSS Act, as a result of which all BVI and foreign registered companies and limited partnerships with legal personality will be required to report certain information to Nerine Trust Company (BVI) Limited (their BVI Registered Agent) to be uploaded onto the BOSS system.

This information will be provided to the BVI International Tax Authority (ITA) via the BOSS system on an annual basis.

Substantial fines and up to five years' imprisonment can be imposed for non-compliance and the relevant entity may be struck off the register.

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[1] Tax resident in a jurisdiction outside the BVI (which is not itself treated by the EU as non-cooperative for tax purposes). Proof of such alternative tax residence will be required.

[2] Other than certain limited partnerships registered without legal personality.

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