

BVI Economic Substance Guide 2023 (Lexology Getting the Deal Through)

Briefing Summary: In this guide, lawyers from our BVI office outline the latest economic substance requirements for businesses carrying on relevant activities in BVI, including the legal framework, enforcement and demonstrating compliance.

Location: British Virgin Islands

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Legal Framework

Legislation

What legislation sets out the economic substance requirements in your jurisdiction?

The Economic Substance (Companies and Limited Partnerships) Act, 2018 and the Economic Substance (Companies and Limited Partnerships) (Amendment) Act 2021 (the Substance Legislation).

Law stated - 31 January 2023

Relevant Entities

What types of entity are subject to the economic substance requirements in your jurisdiction?

All companies and limited partnerships that are registered or incorporated in the BVI (entities) must comply with the Substance Legislation. The Substance Legislation does not apply to trusts or general partnerships.

All entities must carry out an annual review of their assets, activities and tax residency, to determine:

- if they have carried on a relevant activity;
- where they are tax resident; and
- if they need to demonstrate substance in the BVI.

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The results of this annual review should be documented and provided to the entity's registered agent so that the annual economic substance declaration can be filed.

Law stated - 31 January 2023

Relevant Activities

What activities trigger the economic substance requirements in your jurisdiction?

There are nine relevant activities in the BVI:

- banking business;
- insurance business;
- shipping business;
- fund management business;
- finance and leasing business;
- headquarters business;
- holding business;
- intellectual property business (IP business); and
- distribution and service centre business.

For the avoidance of doubt, investment fund business is not a relevant activity.

Law stated - 31 January 2023

Tax Residence Requirements

Must entities be tax resident (or deemed tax resident) in your jurisdiction to be subject to the economic substance requirements? If yes, what are the tax residence rules and requirements? If not, do the economic substance requirements in your jurisdiction differ with respect to non-resident entities?

All entities, regardless of their tax residency, must submit an annual declaration. However, an entity's economic substance requirements will vary, depending on what (if any) relevant activity it carried on, and where it is tax resident.

No relevant activity

If an entity did not carry on a relevant activity, it can (regardless of its tax residency) satisfy its economic substance requirements by submitting a 'nil return' annual declaration.

Relevant activity

If an entity carried on a relevant activity, it must submit an annual declaration, confirming what relevant activity it carried on. An entity must also:

- demonstrate substance in the BVI; or
- prove it is tax resident in a cooperative jurisdiction (ie, any jurisdiction outside the BVI that is not included in Annexure 1 of the European Union's list of non-cooperative jurisdictions, for tax purposes).

To prove tax residency in a cooperative jurisdiction, an entity must provide a copy of its foreign tax certificate (or equivalent document). To demonstrate substance in the BVI, an entity must show it had adequate employees and appropriate premises in the BVI. The entity may also have to show it was managed and directed from the BVI, that it incurred adequate expenditure in the BVI and that it carried on its core income-generating activities (CIGA) in the BVI.

Law stated - 31 January 2023

Guidance

Has the government published guidance on the economic substance requirements?

The Substance Legislation is supported by the Rules on Economic Substance in the Virgin Islands (as amended on 10 February 2020, the Rules), issued under the authority of the International Tax Authority (ITA).

Law stated - 31 January 2023

Economic Substance Requirements

General Requirements

What general economic substance requirements apply in your jurisdiction?

No relevant activity

If an entity has not carried on a relevant activity, it can (regardless of its tax residency) satisfy its economic substance requirements by submitting a 'nil return' annual declaration.

Relevant activity

If an entity carried on a relevant activity, it must submit an annual declaration, confirming what relevant activity it carried on. The content of the annual declaration and how the entity can satisfy its economic substance requirements will vary, depending on where the entity is tax resident:

- If an entity is tax resident in a cooperative jurisdiction, the annual declaration must confirm where it is tax resident (with a supporting tax certificate) and provide information about its parent (name, incorporation number and jurisdiction). If an entity cannot prove its tax residency (or proof is not provided to the ITA), it will be treated as having failed to establish tax residency in a cooperative jurisdiction.
- If an entity cannot prove it is tax resident in a cooperative jurisdiction, it must demonstrate substance in the BVI. To do so, the entity must show that it employed an adequate number of suitably qualified employees (who were physically present in the BVI) and that it maintained appropriate premises in the BVI. The entity may also have to show that its relevant activity was managed and directed from the BVI, the entity incurred adequate expenditure in the BVI, and it carried on its core income-generating activities in the BVI. If the entity carried on IP business, it must also satisfy additional enhanced economic substance requirements.

The terms 'appropriate' and 'adequate' are subjective and vary according to the nature and scale of the relevant activity and the entity's general business activities. However, if an entity is a pure equity-holding entity (PEHE) that carries on holding business and passively holds its equity participations (ie, shares and other forms of investments that give the investor the right to participate in the profits), the PEHE can usually demonstrate substance by simply maintaining its registered agent and registered office in the BVI. Importantly, the PEHE will not have to show that its holding business was managed and directed from the BVI, that it incurred adequate expenditure in the BVI or that it carried on its core income-generating activities in the BVI.

Law stated - 31 January 2023

'Directed and Managed'

What requirements apply in relation to board meetings and the location where entities are directed and managed?

The management of an entity is the responsibility of the directors (if the entity is a company) or the general partners, (if the entity is a limited partnership).

If an entity carries on a relevant activity (other than holding business) and it cannot prove it is tax resident in a cooperative jurisdiction, the entity must show that its relevant activity was directed and managed from the BVI. The International Tax Authority will assess the entity's compliance with this requirement, having regard to the nature, scale and complexity of the entity's

For a management meeting to be held in the BVI, there must be a quorum of directors or general partners physically present in the BVI. The management attending such meetings should include persons with adequate expertise to direct the relevant activity. The meetings (and the decisions regarding the relevant activity, which are made at them) must be minuted, and the minutes should be kept in the BVI.

There are no prescriptive rules as to what constitutes sufficient direction or management, and there are no specific requirements in relation to the frequency of management meetings that need to be held in the BVI. Meetings (particularly strategic meetings) will be deemed adequate for the purposes of economic substance if they are held in the BVI at a frequency proportionate to the nature, scale and complexity of the relevant activity.

Importantly, it is the relevant activity itself, rather than the entity, that must be directed and managed in the BVI. However, if an entity's only business is carrying on a particular relevant activity, it is expected that both the relevant activity and the entity itself will be directed and managed from the BVI.

Law stated - 31 January 2023

Core Income-Generating Activities

What requirements apply in relation to core income-generating activities?

If an entity carries on a relevant activity (other than holding business) and it cannot prove it is tax resident in a cooperative jurisdiction, the entity must show that it carried out its core income-generating activities (CIGA) in the BVI. The International Tax Authority will assess an entity's compliance with this requirement, having regard to the nature, scale and complexity of the entity's particular business, and if the entity can demonstrate that its CIGA were:

- carried on by employees working in the BVI; or
- outsourced to persons whose employees work in the BVI as appropriate for the relevant activity it carried on.

There is no definition of what constitutes CIGA. However, the Substance Legislation provides a list of non-exclusive activities, which can be used for guidance.

Banking business

- Raising funds, managing risk including credit, currency and interest risk;
- taking hedging positions;
- providing loans, credit or other financial services to customers;
- managing regulatory capital; and
- preparing regulatory reports and returns.

Distribution and service centre business

- Transporting and storing goods;
- managing stocks;
- taking orders; and
- providing consulting or other administrative services.

Insurance business

- Predicting and calculating risk;
- insuring or re-insuring against risk; and
- providing insurance business services to clients.

Fund management business

- Taking decisions on the holding and selling of investments;
- calculating risks and reserves;
- taking decisions on currency or interest fluctuations and hedging positions; and
- preparing relevant regulatory or other reports for government authorities and investors.

Finance and leasing business

- Agreeing funding terms;
- identifying and acquiring assets to be leased (in the case of leasing);
- setting the terms and duration of any financing or leasing;
- monitoring and revising any agreements; and
- managing any risks.

Headquarters business

- Taking relevant management decisions;
- incurring expenditures on behalf of affiliates; and
- coordinating group activities.

Shipping business

- Managing the crew (including hiring, paying and overseeing crewmembers);
- hauling and maintaining ships;
- overseeing and tracking deliveries;
- determining what goods to order and when to deliver them; and
- organising and overseeing voyages.

IP business

- Where the business concerns intellectual property assets such as patents, research and development; and
- where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.

An entity must identify the total turnover generated by the relevant activity and the amount of expenditure incurred on the relevant activity (globally and in the BVI).

Law stated – 31 January 2023

Premises

What requirements apply in relation to the physical premises of relevant entities?

If an entity carries on a relevant activity and it cannot prove it is tax resident in a cooperative jurisdiction, the entity must have physical offices or premises in the BVI that are 'appropriate' for the nature and scale of its relevant activity and (if applicable) its CIGA. The International Tax Authority will assess an entity's compliance with this requirement, having regard to the nature, scale and complexity of the entity's particular business, and if the entity can show that the premises it had or used in the BVI were appropriate for the relevant activity it carried on.

The term 'appropriate' is not defined in the Substance Legislation, so it must be given its ordinary English meaning. However, the Rules do provide some guidance:

- for office-based business, appropriate premises should comprise an office in the BVI from which the employees can operate;
- where flexible working practices are adopted (eg, employees working from home), these premises should also be in the BVI if the time spent working from these premises needs to be counted as being carried out in the BVI;
- some relevant activities (eg, shipping and distribution and service centre business) need additional premises for their non-office-based activities (eg, ship maintenance or warehousing), which should be in the BVI;
- the premises do not need to be owned by the entity: they may be rented or used on licence; and
- businesses come in different sizes, so premises that are appropriate for a small business will not suffice for a large business; therefore an entity is not expected to have more premises than it really needs to carry on its relevant activity and (if applicable) its CIGA.

To satisfy the premises requirement, the annual declaration should include address details of the premises (both globally and in the BVI) where the entity carried on its relevant activity.

Law stated – 31 January 2023

Employees and Personnel

What requirements apply in relation to the employees and personnel of relevant entities?

If an entity carries on a relevant activity and it cannot prove it is tax resident in a cooperative jurisdiction, the entity must have an 'adequate' number of suitably qualified employees in the BVI, appropriate for the nature and scale of its relevant activity and (if applicable) its CIGA. The International Tax Authority will assess an entity's compliance with this requirement having regard to the

1. an employee who has worked for only part of a financial period shall be counted as part of an employee, proportionate to the amount of time he or she has worked during the financial period;
2. a part-time employee shall be counted as part of an employee, proportionate to the amount of time she or he has worked in the financial period when compared with a full-time employee of equivalent grade;
3. where an employee spends only part of his or her time working in connection with the relevant activity and part of his or her time working in connection with other activities, he or she shall be treated as a part-time employee, as regards the amount of time spent on the relevant activity;
4. an employee who is based in the BVI may be treated as physically present in the BVI throughout the period of his or her employment, notwithstanding that part of his or her duties (eg, visits to clients overseas) are performed outside the BVI, provided most of the employee's working time is spent within the BVI;
5. an employee who is not based in the BVI may not be treated as physically present in the BVI at any time, notwithstanding that part of his or her duties are performed within the BVI, so occasional work in the BVI that is carried out by an employee who is usually based outside the BVI will not be counted; and
6. an employee will be treated as being based in the BVI if he or she spends the majority of his or her working time in the BVI;

- employees do not have to be employed directly by the entity: they can be employed by a third party provided they are still managed by the entity, which covers agency work and temporary employees;
- an entity can outsource part of its relevant activity under an outsourcing arrangement;
- employees must be suitably qualified, and the qualifications of BVI-based employees must be commensurate with the relevant activity and the CIGA being carried on in the BVI – it is not enough to show a majority of an entity's employees are based in the BVI if the only employees with the technical qualifications (and therefore the ones who actually manage or transact the relevant activity) are based overseas; and
- businesses come in different sizes, so employees who would be adequate for a small business will not suffice for a large business; therefore an entity is not expected to have more employees than it really needs to carry on its relevant activity and CIGA.

To satisfy the employee requirements, when filing its annual declaration, an entity must provide information about its employees, including their name, if they are full or part-time, their qualifications, their years of relevant experience, if they are employed by the entity or through an outsourcing agreement and if they are on temporary or long-term contracts. The entity will also have to confirm:

- total number of employees (globally);
- total number of employees who are engaged in the relevant activity (both globally and in the BVI);
- what decisions were made by each employee;
- who is responsible for its CIGA and carrying on its relevant activity (a key employee); and
- where employees (including key employees) were based during the financial period

The term 'adequate' is not defined in the Substance Legislation, so it must be given its ordinary English meaning. However, the Rules do provide some guidance:

- if all (or substantially all) of an entity's expenditure is incurred in the BVI, the adequacy of its expenditure will be self-evident;
- an entity should not rely unduly on expenditure incurred outside the BVI to carry on its relevant activity and CIGA;
- expenditure can only be taken into account if it is incurred in the operation of a relevant activity;
- if an entity outsources part of its relevant activity, the expenditure incurred on outsourcing will be taken into account when assessing the adequacy of its expenditure in the BVI;
- the level of expenditure incurred must be proportionate to the activities of the entity; and
- businesses come in different sizes, so the expenditure for a small business will not suffice for a large business; therefore an entity is not expected to incur more expenses than it really needs if it is carrying on a relevant activity and CIGA.

To satisfy the expenditure requirements, an entity must confirm the following in the annual declaration:

- what expenses were incurred globally;
- what expenses were incurred in connection with the relevant activity (both globally and in the BVI); and
- where each expense was incurred.

The entity will also have to provide records of expenses incurred and copies of any outsourcing agreements.

Law stated - 31 January 2023

Enhanced Requirements

Are there any instances where enhanced substance requirements apply?

If an entity carries on intellectual property business (an IPE) and it cannot prove it is tax resident in a cooperative jurisdiction, it will have to satisfy enhanced economic substance requirements.

First, the IPE must satisfy the standard economic substance requirements and show that it:

- employed an adequate number of suitably qualified employees (who were physically present in the BVI);
- maintained appropriate premises in the BVI;
- managed and directed its IP business from the BVI;
- incurred adequate expenditure in the BVI in relation to its IP business; and
- carried on its CIGA in relation to its IP business in the BVI.

The IPE must then comply with the enhanced economic substance requirements and confirm:

- the nature of any equipment located within the BVI that is used in connection

- if its IP relates to patents and research and development;
- if its IP relates to non-trade intangible assets such as brand, trademarks, customer data, marketing, and branding and distribution; and
- if the IPE is a high-risk IPE.

A high-risk IPE is an IPE that has acquired IP from an affiliate, or acquired IP in consideration for funding research and development by another person outside the BVI, or has licensed IP to one or more affiliates or otherwise generates IP income from activities (such as facilitating sale agreements) performed by foreign affiliates.

The Substance Legislation presumes that IPEs do not conduct their CIGA in the BVI (and therefore have not complied with their economic substance requirements) if their IP business concerns:

- patents and research and development; or
- non-trade intangible assets such as brand, trademarks, customer data, marketing, branding and distribution.

This presumption of non-compliance may be rebutted if sufficient information and documents are provided to the ITA. For this to be successful, the ITA must be satisfied that the BVI-based activities of the IPE are more than local staff passively holding IP whose creation and exploitation are a function of decisions made and activities performed outside the BVI. To be clear, periodic decisions of non-resident management will not suffice.

Law stated - 31 January 2023

Reduced Requirements

Are there any instances where reduced economic substance requirements apply?

Yes. An entity that carries on holding business (and cannot prove it is tax resident in a cooperative jurisdiction) can satisfy reduced economic substance requirements. To do so, the entity only needs to show that it:

- employed an adequate number of suitably qualified employees (who were physically present in the BVI); and
- maintained appropriate premises in the BVI.

The terms 'appropriate' and 'adequate' are subjective and vary according to the nature and scale of the holding business and the entity's general business activities. However, if the entity passively holds its equity participations, it can usually satisfy its reduced economic substance requirements by simply maintaining its registered agent and registered office in the BVI. Importantly, the entity will not have to show that its holding business was managed and directed from the BVI or that it incurred adequate expenditure in the BVI or that it carried on its core income-generating activities in the BVI.

Law stated - 31 January 2023

Outsourcing

What requirements apply in relation to outsourcing activities to

- the name of the outsourced entity that carries out the core income-generating activities on its behalf;
- what activities are carried out by the outsourced entity;
- what proportion of the entity's total income-generating activity is carried out by the outsourced entity;
- the geographical location of the activities carried out by the outsourced entity;
- how the entity monitors and controls the relevant activity carried out on its behalf by the outsourced entity; and
- how resources are employed by the outsourced entity to perform the relevant activity.

Any work carried out by the outsourced entity will be taken into account when assessing the adequacy of the entity's expenditure and employees (both in terms of numbers and suitable qualifications) in the BVI. However, an outsourced entity can only carry out work provided:

- no core income-generating activities are carried on outside the BVI;
- the entity can monitor and control the outsourced entity; and
- the only activities taken into account (when considering if the entity meets its economic substance requirements) are those carried out by the outsourced entity that are solely attributable to generating income for the entity.

Law stated – 31 January 2023

Enforcement and Compliance

Enforcement Authorities

Which government authorities are responsible for the enforcement of economic substance requirements? What is the extent of their information-gathering powers?

The International Tax Authority is responsible for the enforcement of the economic substance requirements in the BVI, and it will review the annual declarations and all supporting documents (including tax certificates).

The International Tax Authority has six years to issue a determination (Determination) that an entity has not complied with its economic substance requirements. If issued, the International Tax Authority will specify the reasons for the Determination, any penalty imposed, and the actions the entity needs to take to bring it into compliance with the Substance Legislation. If an entity does not comply with the Determination, the International Tax Authority will issue a second determination.

Law stated – 31 January 2023

Reporting Formalities

What reporting formalities apply with respect to the economic substance requirements?

An entity's reporting formalities will vary, depending on what (if any) relevant activity it carried on and where it is tax resident.

Relevant activity

If an entity carried on a relevant activity, it can satisfy its reporting formalities by submitting an annual declaration, confirming what relevant activity it carried on. The content of the annual declaration and the supporting documents will vary, depending on where the entity is tax resident:

- If an entity is tax resident in a cooperative jurisdiction, the annual declaration must confirm where it is tax resident (with a supporting tax certificate) and provide information about its parent (name, incorporation number and jurisdiction). If an entity cannot prove its tax residency (or proof is not provided to the International Tax Authority), it will be treated as having failed to establish tax residency in a cooperative jurisdiction.
- If an entity cannot prove it is tax resident in a cooperative jurisdiction, it must demonstrate substance in the BVI. To do so, the entity must show that it employed an adequate number of suitably qualified employees (who were physically present in the BVI) and that it maintained appropriate premises in the BVI. In addition, all entities (other than PEHEs) must also confirm:
 1. the total turnover generated by the relevant activity;
 2. the total expenditure incurred (globally and in the BVI);
 3. the total expenditure incurred on its relevant activity (globally and in the BVI);
 4. the names of all persons responsible for the direction and management of the relevant activity, together with their relationship to the entity and if they are resident in the BVI; and
 5. if the entity's core income-generating activities were carried out by an outsourced entity (and if so, the name of the outsourced entity, together with details of the resources deployed by the outsourced entity in carrying out the relevant activity, on behalf of the entity).

If the entity carried on IP business, the annual declaration must also show how it has satisfied the enhanced economic substance requirements.

Law stated – 31 January 2023

Demonstrating Compliance

How does an entity in practice demonstrate its compliance with the economic substance requirements? How do the enforcement authorities assess compliance?

How an entity demonstrates substance and complies with its economic substance requirements will depend on what (if any) relevant activity it carries on, and where it is tax resident.

No relevant activity

If an entity has not carried on a relevant activity, it does not have to demonstrate substance in the BVI. The entity can (regardless of its tax residency) satisfy its reporting formalities and economic substance requirements by submitting a 'nil return' annual declaration.

Relevant activity

- If an entity can prove it is tax resident in a cooperative jurisdiction, it does not have to demonstrate substance in the BVI. The entity can satisfy its reporting formalities and economic substance requirements by submitting an annual declaration confirming where it is tax resident (with a supporting tax certificate) and providing information about its parent (name, incorporation number and jurisdiction). If an entity cannot prove its tax residency (or proof is not provided to the International Tax Authority, it will have to demonstrate substance in the BVI).
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 1. the total turnover generated by the relevant activity;
 2. the total expenditure incurred (globally and in the BVI);
 3. the total expenditure incurred on its relevant activity (globally and in the BVI);
 4. the names of all persons responsible for the direction and management of the relevant activity, together with their relationship to the entity and if they are resident in the BVI; and
 5. if the entity's core income-generating activities were carried out by an outsourced entity (and if so, the name of the outsourced entity, together with details of the resources deployed by the outsourced entity in carrying out the relevant activity, on behalf of the entity). If the entity carried on IP business, the annual declaration must also show how it has satisfied the enhanced economic substance requirements.

Once an annual declaration is submitted, the International Tax Authority will review the information and documents provided and assess the entity's compliance with its economic substance requirements, having regard to the nature, scale and complexity of the entity's particular business. The International Tax Authority has six years to issue a Determination if it thinks an entity has not complied with its economic substance requirements. If issued, the ITA will specify the reasons for the Determination, any penalty imposed, and the actions the entity needs to take, to bring it into compliance.

Law stated - 31 January 2023

Penalties

What are the potential penalties for failure to comply with the economic substance requirements?

Penalties for non-compliance with economic substance obligations and requirements can be severe

Failure to comply

If an entity does not comply with the terms of a Determination, the minimum penalty the ITA can impose is US\$5,000, with a maximum penalty of \$20,000 (unless it is an IPE). The maximum penalty for an IPE is \$50,000.

If an entity does not comply with the terms of a second determination, the

It is an offence to provide false information to the ITA or fail to provide information in response to a declaration or other ITA request. A person who is found guilty of these offences may be liable to a term of imprisonment of up to five years and a fine of up to \$75,000.

Law stated – 31 January 2023

Updates and Trends

Recent Developments

What have been the most significant recent developments in the law on economic substance in your jurisdiction, including any notable regulatory actions or legislative changes?

The Economic Substance (Companies and Limited Partnership) (Amendment) Act, 2021 (the Amendment Act) came into force on 30 June 2021 and introduced three notable amendments:

Partnerships

The Substance Legislation now applies to all limited partnerships (with or without legal personality).

Investment Funds

The Amendment Act introduced two new defined terms – 'investment fund' and 'investment fund business'. The Amendment Act also expressly excluded investment fund business from being considered a relevant activity, and removed any doubt as to the treatment of investment funds in the BVI.

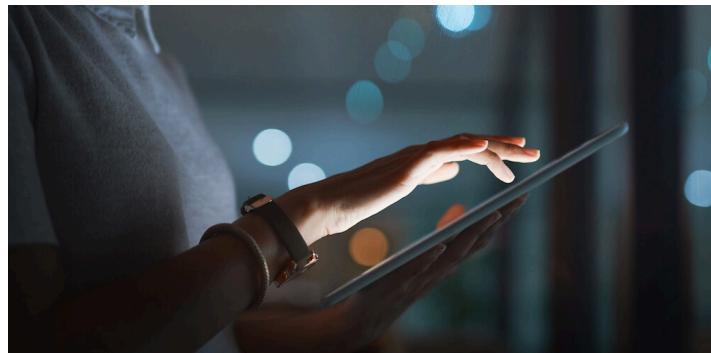
Distribution and service centre business

The Amendment Act changed the definition of 'Distribution and Service Centre Business' to include the provision of consulting or administrative services to foreign affiliates.

Law stated – 31 January 2023

Carey Olsen (BVI) L.P. is registered as a limited partnership in the British Virgin Islands with registered number 1950.

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