

British Virgin Islands
economic substance
2021

Legal framework

Legislation

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

The economic substance requirements were introduced in the British Virgin Islands under the BVI Economic Substance (Companies and Limited Partnerships) Act 2018 (as amended) (the ES Act) when it came into force on 1 January 2019. The ES Act was introduced in response to concerns on tax transparency from the Council of the European Union and the Organisation for Economic Cooperation and Development.

A copy of the updated economic substance legislation can be found on the Government of the Virgin Islands website.

Relevant entities

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

The ES Act applies to legal entities incorporated or continued under the BVI Business Companies Act 2004 (as amended) and the Limited Partnership Act 2017 (as amended) and entered on the register of companies or the register of partnerships, as appropriate. For example, the following entities are considered legal entities and are in scope of the ES Act:

- BVI companies incorporated under the BVI Business Companies Act 2004 (as amended);
- BVI limited partnerships registered under the Limited Partnership Act 2017 (as amended);
- non-BVI companies registered as foreign companies under the BVI Business Companies Act 2004 (as amended); and
- non-BVI limited partnerships registered as foreign limited partnership under the Limited Partnership Act 2017 (as amended).

However, the definition of legal entity does not include the following entities for these purposes:

- any non-resident company that is resident for tax purposes in a jurisdiction outside the Virgin Islands that is not on Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes;
- any non-resident limited partnership that is resident for tax purposes in a jurisdiction outside the Virgin Islands that is not on Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes; and
- any limited partnership where pursuant to the Limited Partnership Act 2017 (as amended) the limited partnership does not have a legal personality.

Any legal entity (whether relevant or non-relevant) is required to submit annually an economic substance declaration to the British Virgin Islands International Tax Authority (the ITA). This declaration must be completed and submitted using an online portal by the registered agent of the entity.

The scope of each of the above activities is defined in the ES Act. Where an entity carries on one or more of the nine relevant activities, that entity must satisfy the economic substance requirements in respect of each relevant activity. The Rules on Economic Substance in the British Virgin Islands published by the ITA provide additional guidance on how each definition should be construed, together with practical examples of the relevant activity.

Relevant activities

What activities trigger the economic substance requirements in your jurisdiction?

The economic substance requirements are triggered where a legal entity carries on a relevant activity and receives income from the relevant activity carried on during a financial period.

The economic substance legislation identifies nine types of relevant activities that a legal entity may carry on during a financial period:

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

The scope of each of the above activities is defined in the ES Act. Where an entity carries on one or more of the nine relevant activities, that entity must satisfy the economic substance requirements in respect of each relevant activity. The Rules on Economic Substance in the British Virgin Islands published by the ITA provide additional guidance on how each definition should be construed, together with practical examples of the relevant activity.

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?

Where a legal entity conducts a relevant activity during a financial period and cannot prove that it is tax resident in a cooperative jurisdiction, the entity must demonstrate substance and satisfy the economic substance reporting obligations in the British Virgin Islands. There is no requirement that a legal entity must be tax resident or deemed tax resident in the BVI in order to be in scope.

However, if a legal entity carries on a relevant activity during a financial period and can prove it is tax resident in a cooperative jurisdiction, the entity will not have to demonstrate substance in the British Virgin Islands. In order to be deemed a non-resident entity (and thereby be taken out of scope of the BVI economic substance requirements), the jurisdiction of tax residency must not be a jurisdiction that is on Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes. The entity must submit evidence of tax residency in the tax cooperative jurisdiction.

The guidance to the Rules on Economic Substance in the British Virgin Islands provides that the following entities are considered to be non-resident entities and deemed not relevant entities for tax purposes:

- non-resident company, which means a company that is resident for tax purposes in a jurisdiction outside the British Virgin Islands that is not on Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes; and
- non-resident limited partnership, which means a limited partnership that is resident for tax purposes in a jurisdiction outside the British Virgin Islands that is not on Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes.

A legal entity seeking to be deemed a non-resident entity must provide evidence to the ITA in the form of a letter or certificate or other document issued by the relevant tax authority based in the jurisdiction confirming that the entity is liable to tax in that jurisdiction.

Guidance

Has the government published guidance on the economic substance requirements?

The ITA published the Rules on Economic Substance in the Virgin Islands (the Rules), which came into force on 31 October 2019. The Rules provide guidance on the practical application and interpretation of the economic substance legislation and requirements. The most recent version of the Rules on Economic Substance can be found on the Government of the Virgin Islands website.

Economic substance requirements

General requirements

What general economic substance requirements apply in your jurisdiction?

All entities deemed to be in scope of the Economic Substance (Companies and Limited Partnerships) Act 2018 (the ES Act) are required to submit annually a declaration to the International Tax Authority (the ITA) using an online portal. A legal entity that carries on a relevant activity other than the business activity of holding business must satisfy the general economic substance requirements and reporting requirements.

A legal entity that carries on one or more relevant activities, other than holding business, complies with the economic substance requirements if:

- the relevant activity is directed and managed in the British Virgin Islands;
- having regard to the nature and scale of the relevant activity, there is adequate expenditure and employees, and appropriate premises and equipment for the core income-generating activities (CIGA); and
- CIGA is carried on in the British Virgin Islands.

A legal entity that is carrying on the business activity of holding business, and which carries on no other relevant activity, other than holding equity participations in other entities and earning dividends and capital gains, is deemed to be a pure equity holding entity (PEHE). PEHEs are not subject to the general economic substance requirements detailed above, and must instead comply with the minimum economic substance requirements.

A legal entity deemed to be a PEHE has adequate substance if it:

- complies with the legislative requirements imposed by the Business Companies Act 2004 (as amended) or the Limited Partnerships Act 2017 (as amended) as appropriate; and
- has, in the British Virgin Islands, adequate employees and premises for carrying out the management of the equity participations.

Directed and managed

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

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 board meetings to be held in the British Virgin Islands. The ITA will assess compliance by a legal entity with this requirement in the context of the nature, scale and complexity of the entity's specific business. A legal entity other than a holding business entity must be directed and managed in the British Virgin Islands.

It is important to note that what is required is for the relevant activity to be directed and managed in the British Virgin Islands and for strategic decisions for the relevant activity to be taken in the British Virgin Islands in order to comply with the requirement for direction and management. However, where the only business of the entity is the relevant activity, then the entity itself must be directed and managed in the BVI.

The notes on economic substance published by the ITA provides that a legal entity satisfies this requirement if:

- an adequate number of board meetings are held in the British Virgin Islands;

- a quorum of directors is physically present;
- the directors attending such meetings include in their numbers adequate expertise to direct the relevant activity; and
- decisions of the board are recorded in the form of minutes, and minutes of those decisions are kept in the British Virgin Islands.

In each case, the meetings held, and particularly the strategic meetings, may be deemed by the ITA to be adequate if they are held in the British Virgin Islands at a frequency proportionate to the nature, scale and complexity of the entity's relevant business for that reporting period.

Core income-generating activities

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

The core income-generating activities applicable to each relevant activity are set out in the economic substance legislation. Where a legal entity carries on a relevant activity, the CIGA of central importance to the business must be carried out in the BVI.

It is important to take into account the business practices for a relevant activity, since certain activities are not considered to be CIGA and these activities may be performed outside of the British Virgin Islands. It is possible that an entity may not undertake a particular CIGA because that activity is not applicable to the entity's business. The economic substance legislation is concerned with activities that contribute to generating gross income where a legal entity is carrying on a relevant activity. These types of activities are required to be carried out in the BVI.

Premises

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

An entity that is in scope of the economic substance requirements must have an adequate physical presence in the British Virgin Islands. There are no prescriptive rules as to what is deemed to be an adequate physical presence in the British Virgin Islands, and no specific requirements in relation to the size or scope of such presence. The ITA will assess compliance by an entity with this requirement in the context of the nature, scale and complexity of that entity's particular business. In that assessment, the ITA will have regard to whether the entity in question is able to demonstrate that its physical presence is adequate to carry on its relevant activity.

A physical presence may be maintained by the entity (for example, by owning or leasing its own office space) or through appropriately monitored outsourcing arrangements with a third-party service provider or affiliate which itself occupies adequate premises in the Virgin Islands. Premises may be

shared with other entities, provided that each entity is able to demonstrate that its share of those premises is adequate to undertake the relevant activity carried on by that entity. Premises, or share of premises, may not be double-counted for these purposes.

Employees and personnel

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

An entity that is in scope of the economic substance requirements must have adequate full-time employees in the Virgin Islands with suitable qualifications in relation to that entity's relevant activity. There are no prescriptive rules as to what may be deemed 'adequate' for these purposes. The ITA will assess compliance by an entity with this requirement in the context of the nature, scale and complexity of that entity's business. Provided that an entity can demonstrate that it has, either itself or through appropriate outsourcing arrangements, adequate employees with suitable qualifications in the BVI to carry out its CIGA, the requirement may be met.

Entities should maintain records of hours spent by each person on each relevant activity (whether an employee or an outsourced service provider), and should also have records of the qualifications and experience held by such persons, in order to demonstrate that this requirement has been met.

Expenditure

What requirements apply in relation to expenditure?

The requirement of expenditure can only be accounted for if it is incurred in the carrying out of the relevant activity. There are no prescriptive rules as to what may be deemed adequate for these purposes. The ITA will assess compliance by an entity with this requirement in the context of the nature, scale and complexity of the entity's business. The economic substance legislation does not provide an exhaustive definition of what constitutes expenditure in this context, although the rules on economic substance provide that 'expenditure' must be given its ordinary English meaning.

It would generally be expected to constitute business and employment expenses and fees for goods and services paid to persons or entities located in the British Virgin Islands.

Where an entity carries on one or more relevant activities, its expenses in relation to each relevant activity will be assessed separately.

Enhanced requirements

Are there any instances where enhanced substance requirements apply?

Where a legal entity that is in scope of the economic substance requirements is carrying on the relevant activity of intellectual property, in certain circumstances there may be enhanced requirements applicable to that entity, in addition to the

general economic substance requirements applicable. Enhanced substance requirements apply to IP business because the income generated from conducting this type of activity is considered to be at higher risk for profit shifting from higher to lower tax jurisdictions.

Reduced requirements

Are there any instances where reduced economic substance requirements apply?

There are important exceptions to the general economic substance requirements by way of reduced substance requirements for certain entities. The following entities are subject to reduced economic substance requirements:

- entities not conducting a relevant activity are not in scope of the economic substance requirements. Although these entities are not required to demonstrate substance in the BVI, these entities are required to comply with the reporting requirements;
- entities that did not receive income from a relevant activity during the reporting period (typically a 12-month period) are deemed not to be conducting a relevant activity and therefore are not in scope of the economic substance requirements;
- entities that are tax resident in another jurisdiction (other than an entity on Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes) are out of scope of the economic substance requirements. It is sufficient for this type of entity to evidence that it is a taxable resident in a cooperative jurisdiction; and
- entities that conduct holding business and own no other asset besides equity participations are subject to reduced economic substance requirements. There is no requirement for such an entity to be directed or managed in the BVI, or for the CIGA to be carried on in the BVI. Such an entity is deemed to be a pure equity holding entity, and has adequate substance if it:
 - a. complies with the legislative requirements imposed by the Business Companies Act 2004 (as amended) or the Limited Partnerships Act 2017 (as amended) as appropriate; and
 - b. has, in the Virgin Islands, adequate employees and premises for carrying out the management of the equity participations.

In most cases, a pure equity holding entity will satisfy the economic substance requirements by ensuring compliance with its legislative requirements prescribed by the Business Companies Act 2004 (as amended) or the Limited Partnerships Act 2007 (as amended) as appropriate and by having a BVI registered agent and a BVI registered office. This is usually the case where the equity participation is passive in nature and as such does not attract the requirements for adequate and suitable qualified employees and appropriate premises.

However, in rare cases, where the pure equity holding entity is active in the management of the equity participations, the ITA may require a greater level of substance in the BVI in order to reflect this, such as requirements for adequate and suitable qualified employees and appropriate premises.

Outsourcing

What requirements apply in relation to outsourcing activities to entities located in your jurisdiction and entities located outside your jurisdiction?

Any entity that is in scope of the economic substance requirements may generally outsource some or all of its CIGA to a third-party service provider or to affiliated entities, provided that the outsourced activity is nonetheless performed in the British Virgin Islands. The CIGA generating gross income may not be outsourced if the outsourced activity in question is to be performed outside of the BVI.

For the purposes of satisfying whether the legal entity is complying with the economic substance requirements with respect to a particular relevant activity, expenditure on the outsourcing will be taken into account when assessing the adequacy of the entity's expenditure in the BVI.

The following reporting requirements apply where the relevant activity is outsourced:

- identify the name of the third party that carries out the income-generating activity on its behalf;
- identify what activities, and what proportion of the entity's total income-generating activity, is carried out by the third party;
- identify the geographical location of the activities carried out by the third party;
- state how the legal entity monitors and controls the activity carried out on its behalf by the third party; and
- state the resources reemployed by the third party in performing the outsourced activity.

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 competent authority responsible for the enforcement of the economic substance requirements is the British Virgin Islands International Tax Authority (ITA). An entity, through its registered agent, is required to file an annual declaration to the ITA using an online portal, which allows the ITA to assess whether the entity has satisfied the economic substance requirements. Only the ITA can make an assessment of compliance following a review of the declaration required to be submitted by the registered agent for the entity.

The BVI Economic Substance (Companies and Limited Partnerships) Act 2018 (the ES Act) extends additional authority to the ITA to request additional documents and information reasonably required by the competent authority in order to make the determination. The ITA may serve a notice on any person it reasonably believes has relevant information and require the person to provide such documents and information for the purpose of discharging its functions and responsibilities prescribed by the ES Act.

Reporting formalities

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

The ES Act sets out a reporting regime that applies to all entities registered and continued in the British Virgin Islands and entered on the register of companies or register of partnership, as appropriate. The reporting regime introduced by the ES Act builds upon the pre-existing regime under the Beneficial Ownership Secure Search System (the BOSS System), to include additional information that enables the ITA to determine whether or not an entity is subject to any economic substance requirements (and, if so, whether the entity has complied with them). The BOSS System (Time Limit for Filing Prescribed Information) Regulations 2019 (the Regulations) came into force retrospectively on 1 October 2019. The Regulations stipulate the time limit for filing prescribed information on economic substance to be the period of six months following the end of the financial period in question. In order to comply with the obligations under the reporting regime, an entity, through its registered agent, is required to file an annual declaration of prescribed information to the ITA using an online portal, which allows the ITA to assess whether the entity has satisfied the economic substance requirements.

For entities incorporated before 1 January 2019, their first financial period began on 30 June 2019 and ended on 29 June 2020. Their first reporting deadline was 29 December 2020. For entities incorporated after 1 January 2019, there is a bespoke reporting deadline, linked to their incorporation date. For example, for an entity incorporated on 20 January 2019, the first financial period began on 20 January 2019 and ended on 19 January 2020, and its first reporting deadline was 19 July 2020.

The information that an entity and its registered agent has to provide is dependent on the type of business activities being carried on and the tax residency status of the entity. The declaration is required to confirm the following prescribed information:

- whether it carries on a relevant activity and, if so, details of the relevant activities it carries on;
- where an entity claims to be out of scope of the economic substance regime by virtue of being a non-resident company or limited partnership, confirmation of the jurisdiction in which that entity is tax resident, together with

supporting evidence; and

- with respect to each relevant activity carried on by a legal entity that is not a non-resident company or limited partnership:
 - a. the total turnover generated by the relevant activity;
 - b. the total amount of expenditure incurred on the relevant activity worldwide and the amount of that expenditure that is incurred within the BVI;
 - c. the total number of employees engaged in the relevant activity worldwide and the total number of those employees engaged in the BVI;
 - d. the address of any premises within the BVI used in connection with that relevant activity;
 - e. the nature of any equipment located in the BVI that is used in connection with the relevant activity;
 - g. the name of the persons responsible for the direction and management of the relevant activity, together with their relationship to the entity and confirmation of whether those persons are resident in the BVI; and
 - h. where CIGA are carried out on a legal entity's behalf by another entity, the name of the entity that carries out those activities, together with details of the resources deployed by that entity in carrying out the outsourced activities.

Demonstrating compliance

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

Compliance is demonstrated where an entity through its registered agent submits the relevant declaration containing all of the relevant prescribed information for the ITA's assessment. The ITA assesses the submitted declaration and makes a determination of whether an entity has carried on a relevant activity and, if so, whether the entity has complied with the economic substance requirements during the financial period in question. The ES Act allows the ITA to request such documents and further information as may reasonably be required in order to make a determination.

The ITA will not require further information in the following two instances:

- where the entity files a declaration that it does not carry on a relevant activity; and
- where the entity carries on a relevant activity but claims to be a non-resident company or a non-resident limited partnership (however, evidence of tax residency overseas is required).

Penalties

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

The ES Act outlines a notice process for non-compliance with economic substance requirements and reporting obligations and increased penalties for a second determination of non-compliance.

Where a legal entity has failed to satisfy the ES Act during a financial period, the ITA shall issue a notice of non-compliance to the legal entity containing the following:

- reasons for the determination of non-compliance;
- provisions of directives to be taken in order to comply with the economic substance requirements; and
- advice relating of the right to appeal available to the legal entity.

On a first determination of non-compliance, the ITA may impose a minimum penalty of US\$5,000 to a maximum of US\$200,000 (or in the case of a high-risk intellectual property legal entity, up to US\$50,000). On a second determination of non-compliance, the ES Act provides for an additional minimum penalty of US\$10,000 to a maximum of US\$200,000 (or up to US\$400,000 in the case of a high-risk IP legal entity), and the possibility of being struck from the register of companies or register of partnership, as appropriate.

The ITA may recommend to the Financial Services Commission to strike the entity from the register of companies or register of limited partnership following failure to comply with a notice where the ITA considers there is no possibility of compliance with the substance requirements and following a legal entity's failure to comply for two consecutive years.

Where a request for further information is served by the ITA and the entity fails to provide information required by the ITA, or intentionally provides false information, that entity commits an offence and is liable: on summary conviction, to a fine not exceeding US\$50,000 or imprisonment for a term not exceeding two years, or both; or on conviction on indictment, to a fine not exceeding US\$75,000 or to imprisonment for a term not exceeding five years, or both.

Update 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 BVI Economic Substance (Companies and Limited Partnerships) Act 2018 (as amended) has now been fully implemented in the British Virgin Islands, and the first economic substance declarations have now been submitted by all in-scope entities.

The most significant likely legislative change relates to the expected inclusion of partnerships without separate legal personality in the types of entities that are in scope of the economic substance requirements. (At the time of writing, only those partnerships that have elected separate legal personality are in scope.) The minimum fine for non-compliance with the economic substance requirements for all entities (including a high-risk IP legal entity) will be US\$500 (at the time of writing, the minimum fine is US\$5,000). Lastly, there is an expected change that allows the International Tax Authority (ITA) to recommend to the Financial Services Commission that the legal entity be wound up if it continues to be non-compliant after receiving a notice of non-compliance from the ITA.

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