

Economic substance – frequently asked questions

Service area / [Corporate](#)

Legal jurisdiction / [British Virgin Islands](#)

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This guidance note has been prepared in relation to: (1) the Economic Substance (Companies and Limited Partnerships) Act, 2018; (2) the Economic Substance (Companies and Limited Partnership) (Amendment) Act, 2021; and (3) the Rules on Economic Substance in the Virgin Islands, updated on 2 April 2024 (together the “**Substance Legislation**”).

Who has to comply with the Substance Legislation?

All companies and limited partnerships (“**Entities**”) that are registered or incorporated in the British Virgin Islands (“**BVI**”) must comply with the Substance Legislation. However, the Substance Legislation does not apply to trusts or general partnerships.

How does an Entity comply with the Substance Legislation?

The Entity should carry out an annual review of its assets, activities, and tax residency (an “**Annual Review**”) and then prepare a formal declaration confirming the results of its Annual Review (an “**ES Declaration**”). A copy of the ES Declaration should be given to the Entity’s registered agent (the “**Registered Agent**”), with instructions to file the relevant information and documents with the BVI International Tax Authority (the “**ITA**”).

How does an Entity conduct an Annual Review?

The Entity should consider and answer the following three questions:

1. Has the Entity carried on a Relevant Activity?

There are nine Relevant Activities (defined *Schedule 1*), namely: (1) Banking Business; (2) Insurance Business; (3) Shipping Business; (4) Fund Management Business; (5) Finance and Leasing Business; (6) Headquarters Business; (7) Holding Business; (8) Intellectual Property Business; and (9) Distribution and Service Centre Business.

The Entity must review its assets and activities, to determine what (if any) Relevant Activity it has carried on. We appreciate the Relevant Activity definitions are quite technical, but it is important to correctly determine whether or not the Entity has carried on a Relevant Activity. If required, we can help your Entity conduct its Annual Review and prepare its ES Declaration.

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2. Where is the Entity resident for tax purposes?

The Entity must consider where it is resident for tax purposes (“**Tax Resident**”). This is important because its economic substance requirements and obligations will vary, depending on where it is Tax Resident:

Tax Resident	Economic Substance Requirements
BVI	An Entity will be Tax Resident in the BVI if pays tax to the BVI Inland Revenue. Usually, this is restricted to Entities that: (1) own property in the BVI; or (2) physically operate in the BVI under a trade licence. If an Entity is Tax Resident in the BVI, it will be able to obtain a tax certificate from the BVI Inland Revenue, to support this classification.
Foreign Jurisdiction	An Entity will be Tax Resident in a jurisdiction outside the BVI (the “ Foreign Jurisdiction ”) if it pays tax in that jurisdiction. If an Entity is Tax Resident in a Foreign Jurisdiction, it will be able to obtain a tax certificate from the relevant tax authority, to support this classification.
Cannot prove	Many Entities cannot prove where they are Tax Resident. Provided this is confirmed in the ES Declaration, this should not cause any problems.

3. Does the Entity have to demonstrate substance in the BVI?

To determine if the Entity needs to demonstrate substance in the BVI, it needs to consider: (1) what (if any) Relevant Activity it carried on; and (2) where it is Tax Resident:

The Entity has not carried on a Relevant Activity

Tax Resident	Does the Entity have to demonstrate substance in the BVI?
BVI	No. If an Entity has not carried on a Relevant Activity, it does not have to demonstrate substance in the BVI.
Cannot prove	
Foreign Jurisdiction	

The Entity has carried on a Relevant Activity

Tax Resident	Does the Entity have to demonstrate substance in the BVI?
BVI	Yes. If an Entity carries on a Relevant Activity and it: (a) is Tax Resident in the BVI; or (b) unable to prove where it is Tax Resident, the Entity needs to demonstrate substance in the BVI. To demonstrate substance, the Entity must show it had adequate employees and appropriate premises in the BVI. The Entity may also have to show it: (a) was managed and directed from the BVI; (b) incurred adequate expenditure in the BVI; and (c) carried on its core income generating activities in the BVI.
Cannot prove	
Foreign Jurisdiction	No. If an Entity has carried on a Relevant Activity and it is tax resident in a cooperative Foreign Jurisdiction, it does not have to demonstrate substance in the BVI. However, the Entity may have to demonstrate substance in the relevant Foreign Jurisdiction.

Do all Entities have to carry out an Annual Review?

Yes. All Entities should carry out an Annual Review, even Entities that do not carry on a Relevant Activity and/or Entities that are Tax Resident in a Foreign Jurisdiction.

Do all Entities have to prepare an ES Declaration?

Yes. All Entities should prepare a formal written ES Declaration, confirming the results of their Annual Review, even Entities that do not carry on a Relevant Activity and/or Entities that are Tax Resident in a Foreign Jurisdiction.

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What requirements and obligations does an Entity have to comply with?

An Entity's economic substance obligations and requirements will vary, depending on what (if any) Relevant Activity it has carried on and where it is Tax Resident:

The Entity has **not** carried on a Relevant Activity

Tax Residency	What are the Entity's economic substance obligations and requirements?
BVI	The Entity will have simplified economic substance obligations and requirements, which means it just needs to:
Cannot prove	<ul style="list-style-type: none">• carry out an Annual Review and prepare an ES Declaration; and
Foreign Jurisdiction	<ul style="list-style-type: none">• give its Registered Agent a copy of the ES Declaration, together with instructions to file the relevant information and documents on its behalf.

The Entity has carried on a Relevant Activity

Tax Resident	What are the Entity's economic substance obligations and requirements?
BVI	The Entity needs to: <ul style="list-style-type: none">• carry out an Annual Review and prepare an ES Declaration;• prove it had adequate employees and appropriate premises in the BVI;• if required, prove: (a) its Relevant Activity was managed and directed from the BVI; (b) that it incurred adequate expenditure in the BVI, in relation to the Relevant Activity; and (c) its core income generating activities were carried on in the BVI; and• give its Registered Agent a copy of the ES Declaration, together with instructions to file the relevant information and documents on its behalf.
Cannot prove	
Foreign Jurisdiction	The Entity will have simplified economic substance obligations and requirements, which means it just needs to: <ul style="list-style-type: none">• carry out an Annual Review and prepare an ES Declaration;• give its Registered Agent a copy of its ES Declaration and foreign tax certificate; and• instruct the Registered Agent to file the relevant information and documents on its behalf.

What period of time does the annual review have to cover?

Economic substance is assessed by reference to financial periods, which cannot exceed one year. For most Entities incorporated before 1 January 2019, their financial period will be 30 June – 29 June each year. Limited partnerships (without personality) and Entities incorporated after 1 January 2019 will have bespoke financial periods, which are linked to their date of incorporation or registration in the BVI.

What is the deadline for filing an ES Declaration?

An Entity must file its ES Declaration within six months of its financial period ending. For most Entities incorporated before 1 January 2019, their filing deadline will be 29 December each year. Limited partnerships (without personality) and all other Entities incorporated after 1 January 2019 will have bespoke filing deadlines, which are linked to their date of incorporation or registration in the BVI.

Can an Entity change its financial period?

Yes, by submitting the relevant notice or application to the ITA. Many Entities elect to maintain a bespoke financial period that is linked to their fiscal accounting periods.

Is a financial period the same as a fiscal period?

No, these are different. A **financial period** is only used for ES Declarations. This term is prescribed by statute and is linked to the Entity's date of incorporation or registration in the BVI. A **fiscal period** is only used for companies filing annual returns (limited partnerships do not have to submit annual returns). The fiscal period is determined by the company and usually runs from 1 January to 31 December each year. For more information, please see our [Annual Returns Guide](#).

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Does a financial period have to be the same as a fiscal period?

No. A financial period is prescribed by the Substance Legislation and therefore does not have to (and usually does not) correlate with an Entity's fiscal period that is used for annual returns.

Is it possible to consolidate the economic substance and annual return filing deadlines?

Yes. An Entity can file a notice or request with the ITA to change its financial period, so it is the same as its fiscal period.

What happens if an entity does not comply with its substance obligations?

The Entity can be liable to significant fines (up to US\$ 400,000), as well as criminal and financial sanctions.

How do I get more information?

If you have any questions about your economic substance requirements, please reach out to your usual contact at Carey Olsen or bvi@careyolsen.com

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Schedule 1 – Relevant activities

There are nine relevant activities in the British Virgin Islands.

Banking Business

An Entity carries on “Banking Business” when it is in 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; and (b) the making of investments, for the account and at the risk of the person accepting such deposits. Only Entities that hold a licence issued by the BVI Financial Services Commission (**Commission**) can lawfully carry on Banking Business. The fact that an Entity may have a bank account does not mean (on its own) that the Entity carries on Banking Business.

Insurance Business

An Entity carries on “Insurance Business” when it is in 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. Only Entities that hold a licence issued by the Commission can lawfully carry on Insurance Business, even if their insurance business is located outside the BVI.

Fund Management Business

An Entity carries on “Fund Management Business” if it conducts activity that requires it to hold investment business license under the Securities and Investment Business Act, 2010. Importantly, investment funds are excluded from the definition of Fund Management Business (or indeed any other Relevant Activity). An Entity established to operate as an investment fund, which only carries on investment fund business, will not carry on a Relevant Activity. Only Entities that hold one of the following licences, issued by the Commission, can lawfully carry on Fund Management Business:

- Sub-Category A Licence, for Managing Segregated Portfolios (Excluding Mutual Funds)
- Sub-Category B Licence, for Managing Mutual Funds
- Sub-Category C Licence, for Managing Pension Schemes
- Sub-Category D Licence, for Managing Insurance Products
- Sub-Category E Licence, for Managing other Types of Investment

Finance and Leasing Business

An Entity carries on “Finance and Leasing Business” when it provides credit facilities of any kind, for consideration. The only exception to this rule is if the credit facility is merely “incidental” to a different sort of the Entity’s business.

Credit Facilities

The term “credit facilities” encompasses all types of lending and credit facilities. Providing any form of credit facility, even a one-off loan, can bring an Entity in-scope of Finance and Leasing Business. The provision of credit may be by way of instalments, for which a separate charge is made and disclosed to the customer in connection with: (i) the supply of goods by hire purchase; (ii) leasing other than any lease granting an exclusive right to occupy land; or (iii) conditional sale or credit sale.

Consideration

The term “consideration” is not defined in the Substance Legislation so it should be considered in the broadest terms. However, it is clear that consideration includes (but is not limited to) interest. If an Entity makes (or has made) a credit facility available to a third party, from which it receives income (i.e. interest) during a Financial Period, the Entity has carried on Finance and Leasing Business. This is true even if the income is very small and insignificant, when compared to the Entity’s other activities. If an Entity has provided a credit facility for nil consideration e.g. an interest-free loan to a third party, from which it receives no other form of consideration during the Financial Period, the Entity has not carried on Finance and Leasing Business.

Incidental

If an Entity provides a credit facility, as an incidental part of a different sort of its business, the Entity has not carried on Finance and Leasing Business. To determine if the credit facility is “incidental”, it is important to look at the relationship, link and interaction between the credit facility and the other activities of the Entity i.e. if the credit facility is incidental to the Entity’s main business activities. The provision of a credit facility cannot be “incidental” simply: (i) by reference to the Entity’s size; or (ii) because the credit facility only accounts for a particular fraction of the Entity’s overall income or output; or (iii) by reference to the relative value of the credit facility to the overall business of the Entity. If the provision of the credit facility can be seen as a business activity in its own right (even a very small one by comparison), the Entity will be treated as if part of its business is Finance and Leasing Business.

Headquarters Business

An Entity carries on “Headquarters Business” when it provides any of the following services to another entity in its group: (a) the provision of senior management; (b) the assumption or control of material risk for activities carried on by any of these entities in the same group; and (c) the provision of substantive advice in connection with the assumption or control of risk referred to in (b).

Whether an Entity carries on Headquarters Business is not dependent on its position in the group structure. It is entirely dependent on the services it provides to other entities in its

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group, whether parents or subsidiaries. Any activity falling within the definition of Banking Business, Finance and Leasing Business, Fund Management Business, Intellectual Property Business, Holding Business, or Insurance Business is excluded from the definition of Headquarters Business.

Shipping Business

An Entity carries on “Shipping Business” when it provides activities that involve operating a Ship (defined below) anywhere in the world, other than solely within the BVI i.e.: (a) transporting, by sea, persons, animals, goods or mail; (b) renting or chartering of Ships for the purpose described in (a); (c) selling travel tickets or equivalent, and ancillary services connected with the operation of a Ship; (d) using, maintaining or renting containers, including trailers and other vehicles or equipment for the transport of containers, used for transporting anything by sea; and (e) managing the crew of a Ship.

A “Ship” means every description of vessel used in sea navigation other than a: (a) fishing vessel, being any vessel used or, intended to be used, for or in connection with fishing for sea fish, other than a vessel used or intended to be used for fishing otherwise than for profit or a vessel for the time being used or intended to be used wholly for the purpose of conveying persons wishing to fish for pleasure; (b) pleasure vessel, being any vessel including a dive boat which at the time it is being used is: (i) in the case of a vessel wholly owned by an individual or individuals, used only for the sport or pleasure of the owner (which includes a charterer) or the immediate family (i.e. the husband or wife of the individual and a relative (being a brother, sister, ancestor or lineal descendant) of the individual or the relative’s husband or wife) or friends of the owner; or (ii) in the case of a vessel owned by a body corporate, one on which the persons are employees, officers or shareholders of the body corporate, or their immediate family or friends; and (iii) on a voyage or excursion for which the owner does not receive money for or in connection with operating the vessel or carrying any person, other than as a contribution to the direct expenses of the operation of the vessel incurred during the voyage or excursion; or (c) pleasure vessel being any vessel wholly owned by or on behalf of a club formed for the purpose of sport or pleasure which, at the time it is being used, is used only for the sport or pleasure of members of the club or their immediate family, and for the use of which any charges levied are paid into club funds and applied for the general use of the club.

Holding Business

An Entity carries on “Holding Business” when it is in the business of being a Pure Equity Holding Entity (a “PEHE”). A PEHE is an Entity that only holds Equity Participations in other entities and only earns dividends and capital gains. “**Equity Participations**” include shares in a company and other forms of investments in an entity, which give the investor the right to participate in the profits of that entity (and the interest of a limited partner in a limited partnership will usually be of this quality).

The definition of PEHE is deliberately framed in narrow terms. An Entity will only fall within the definition, if it holds nothing but Equity Participations, yielding dividends or capital gains. The ownership of any other form of investment such as an interest bearing bond or any other asset (e.g. bonds, government securities, legal or beneficial interests in real property) will take the Entity outside this definition. This is true even if the Entity holds Equity Participations, in addition to the other investments or assets. However, such Entity may be found to carry on other Relevant Activities e.g. if an Entity holds Equity Participations and a Ship, it will not carry on Holding Business, but it may carry on Shipping Business.

Intellectual Property Business

An Entity carries on “Intellectual Property Business” when it engages in the business of holding any IP Asset (defined below), from which identifiable IP Income (defined below) accrues to the business, such IP Income being separately identifiable from any income generated from any tangible asset in which the right subsists. The term “**IP Asset**” means any intellectual property right in intangible assets, including but not limited to copyright, patents, trade marks, brand, and technical know-how. The term “**IP Income**” means any royalties, capital gains and other income from the sale of an IP Asset, income from a franchise agreement, and income from licensing the intangible asset.

Distribution and Service Centre Business

An Entity carries on “Distribution and Service Centre Business” when it is in the business of: (a) purchasing from foreign affiliates: (i) component parts or materials for goods; or (ii) goods ready for sale, and reselling such component parts, materials or goods; and/or (b) providing consulting or administrative services to foreign affiliates, but does not include any activity included in any other Relevant Activity, except Holding Business.

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