



CAREY OLSEN

BVI economic substance: takeaways from the first economic substance reporting period

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For many companies incorporated in the British Virgin Islands (BVI), the first deadline for reporting on economic substance (ES) compliance was 29 December 2020.¹

Carey Olsen has advised numerous businesses in APAC on compliance with the BVI ES requirements and assisted them with reporting to the BVI International Tax Authority (ITA).

We set out below some key takeaways from the first reporting period.

Classification

The classification exercise determines whether a BVI legal entity (e.g. a company) is 'in scope' for the purposes of the relevant ES requirements and needs to be made with a detailed understanding of all the activities carried out by the BVI company.

Where a BVI company is (as is often the case) part of a larger corporate group, the activities of the group and the role of the BVI company within the group need to be fully understood in order to correctly classify the BVI company for ES purposes.

The BVI ES regime has particular nuances that need to be understood to ensure that the entity is correctly classified and that only the ES requirements to which it is actually subject are compiled with.

A good example of this is the reduced ES test that will apply to a 'pure equity holding entity' (being a legal entity that only holds equity participations in other entities and only earns dividends and capital gains). In some cases the reduced ES test may be satisfied by retaining a registered agent and registered office in BVI. If an entity holds other assets (e.g. real estate) it will not be a 'pure equity holding entity' and will either fall outside the ES requirements entirely or within one of the other categories of business subject to ES requirements.

Classification of a business is only the first step towards compliance. Once a business has been classified, it will either be 'in scope' or 'out of scope'. If 'out of scope', nothing further needs to be done (other than to report as such to the ITA). If in-scope, the next step involves consideration of the ES requirements applicable to that type of business and how to comply with such requirements.

¹ In the case of a BVI business company incorporated before 1 January 2019 which has not elected for an earlier commencement for its first financial period.

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Advice

Once a BVI company had been classified and determined to be in-scope, it was necessary to consider the level of ES required to be demonstrated in the BVI (in terms of employees, expenditure and premises) for that particular business over the financial period in question (which for companies subject to the reporting deadline of 29 December 2020, was 30 June 2019 to 29 June 2020).

As the level of substance is different for every business (it will vary according to the type of business carried on and, in some cases, the level of income derived from that business) each business needs to be considered on a case by case basis.

BVI companies are extremely popular in APAC and are widely used for commercial purposes as diverse as real estate holding, personal investment, asset finance and leasing and as funding vehicles for onshore businesses. We found that clients saw significant value in having a reasoned legal opinion from BVI lawyers outlining the applicable requirements for their individual business and, where relevant, providing a risk assessment of any compliance issues and offering solutions for remediation.

Having advice on file also provides comfort for directors and other stakeholders who are required to certify an ES reporting form to the ITA. It also positions those businesses to demonstrate that they have considered and taken advice on their applicable ES requirements.

Structuring and restructuring

The deadline has firmly focused the market on compliance with ES requirements and the implications of non-compliance (for in-scope businesses and also parties contracting with them).

In our corporate transactional practice, we have noticed that parties are increasingly considering the implications of ES requirements on new and existing transaction structures.

Where a corporate or finance transaction involves a BVI entity, it is sensible to examine the proposed structure and funds flow to anticipate and address any ES considerations early on.

For some businesses, an orderly unwind of certain in-scope activities (for example, assigning loan receivables from a BVI entity to an onshore group member) while continuing with other activities (e.g. real property holding or capital raising, both of which are often out of scope) can be considered. For other businesses, outsourcing certain business activities within the BVI or putting local management in place may represent a path to compliance.

Risk and mitigation

Businesses are understandably concerned to understand the risk in the case of any potential non-compliance.

As enforcement of the BVI ES regime is untested, it remains to be seen the approach the ITA will take in practice. The Organisation for Economic Co-operation and Development (OECD), whose base erosion and profit shifting (BEPS) framework provided the impetus for ES rules in BVI and elsewhere will be keen to see robust enforcement.

What is also clear is that the BVI authorities will be dealing with an unprecedented number of ES reports in early 2021. The fine for a first breach of ES requirements is a minimum US\$5,000. A determination of non-compliance by the ITA is appealable and must explain the reasons for the determination.

ES compliance is an ongoing requirement (BVI companies subject to the 29 December 2020 deadline are currently midway through their second financial period of 30 June 2020 to 29 June 2021 and will be required to report for the second financial period on or before 29 December 2021). As the activities of a business change over the financial period, the applicable ES requirements also change.

Having regularly updated legal advice on file will assist businesses to manage risk and to show that they are considering and actively managing their ES compliance in BVI. For new transactions and business structures involving BVI entities, considering and addressing ES requirements early on should become a matter of course.

If you have any questions about the above information or changes, please contact your daily contact lawyer at Carey Olsen.

Continued



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