

Regulatory Updates: BVI Economic substance Requirements

8th January, 2019



In 2016, the Council of the EU pledged to start advocating tax transparency and fairer taxation within Europe and consequently worldwide. After the EU's Code of Conduct Group (COCG) on taxation investigated BVI practices, they found a number of concerns regarding legitimate substance requirements for companies and limited partnerships doing business in and throughout the BVI.

The EU Economic & Financial Affairs Council placed BVI in a list of countries with concerns, however, BVI Government was actively working to resolve them. Appropriately, the BVI Government honoured this and made a commitment to implement reforms by the end of 2018 to ensure that BVI businesses have adequate economic substance.

The BVI Economic Substance (Companies & Limited Partnerships) Bill

The Economic Substance (Companies & Limited Partnerships) Bill shows the EU that BVI is willing to do its part in the global fight against base erosion and profit shifting and brought the legislation into force before December 31st2018.

Going forward, all entities registered in the BVI must provide the following information:

- Beneficial Owner details as previously agreed per section 10 (3) of the Beneficial Ownership Secure Search Act.
- Company status regulated by section 11 of the International Tax Authority Act.
- General activities of the business as regulated by section 11 of the International Tax Authority Act.
- Audited financial statements as per section 11 of the International Tax Authority Act.

The new information to be provided will be combined using the BVI's existing Beneficial Ownership Secure Search (or BOSS) arrangement. The BOSS Act effectively obligates all BVI-registered agents to submit their current contact information which is searchable for BVI officials anonymously.

Background

As an early adopter of the Common Reporting Standard and FATCA compliant, the BVI is recognised as a jurisdiction committed to tax transparency. The BVI anti-money laundering and anti-terrorist financing legislative regime meets or exceeds international standards and the BVI government and financial services industry have worked closely with intergovernmental organisations to maintain a sound regulatory framework.

In 2017 the EU Code of Conduct Group (the **Code Group**) assessed the tax policies of a range of jurisdictions, including the BVI. Following this assessment, the BVI was included in a list of jurisdictions which were required to address the Code Group's concerns about 'economic substance'. Like their counterparts in the Cayman Islands, Bermuda, Guernsey, Jersey and Isle of Man, the government of the BVI has been working closely with the Code Group to ensure that such concerns are adequately addressed. As a result of this engagement, the Economic Substance (Companies and Limited Partnerships) Act, 2018 (the **Act**), has been enacted, came into force on 1 January 2019.

Applicability

The Act applies to all "legal entities" carrying on "relevant activities", other than non-resident companies, non-resident limited partnerships and limited partnerships which have elected not to have legal personality.

Legal entities are defined as being BVI companies and limited partnerships, and foreign companies and foreign limited partnerships registered in the BVI under the BVI Business Companies Act, 2004 or the Limited Partnerships Act, 2017.

A non-resident company or non-resident limited partnership is a company or limited partnership which is resident for tax purposes in a jurisdiction outside the BVI (except for jurisdictions which have been included on the EU list of non-cooperative jurisdictions).

The effect is that the economic substance requirements are to be imposed on all legal entities carrying on "relevant activities" unless they can demonstrate that they are tax-resident elsewhere. A legal entity is subject to the economic substance requirements if it conducts any of the following "relevant activities":

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

Each of the above activities is defined in the Act, and we expect that further guidance will be issued to assist in determining if a particular entity is carrying on a relevant activity.

The Economic Substance Test

Each legal entity which is not tax resident outside the BVI (other than 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) must, in relation to any relevant activity, carry out defined core income-generating activities in the BVI and demonstrate economic substance by reference to the following criteria, having regard to the nature and scale of the relevant activity:

1. the relevant activity being directed and managed in the BVI;
2. adequate numbers of suitably qualified employees who are physically present in the BVI (whether or not employed by the relevant legal entity or by another entity and whether on temporary or long-term contracts);
3. adequate expenditure incurred in the BVI;
4. appropriate physical offices or premises in the BVI; and
5. where the relevant activity is intellectual property business and requires the use of specific equipment, the equipment is located in the BVI.

Outsourcing of core income generating activities is permitted in certain circumstances. Holding companies are required to meet a reduced test for economic substance, while at the other end of the scale, intellectual property companies will face more onerous requirements. There will not be a ‘one size fits all’ approach.

Obligations to Provide Information and Automatic Disclosure

All legal entities must provide information to enable the competent authority (the International Tax Authority in the BVI) to monitor whether the relevant entity is carrying on relevant activities and, if so, whether it is complying with the economic substance requirements. The information will be integrated into the BVI’s existing Beneficial Ownership Secure Search (BOSS) system which obliges registered agents in the BVI to keep up to date information on beneficial ownership and allows competent authorities to search the database. The new regime requires legal entities to submit information in relation to any relevant activities on an annual basis which can be analysed by competent authorities and used as a basis for a risk based investigation and enforcement of economic substance requirements.

Automatic notification will be made to the “relevant overseas competent authority” in respect of a relevant legal entity which:

- (1) is found to be in breach of the economic substance requirements;
- (2) carries on “IP relevant activity” in certain circumstances; or
- (3) claims to be tax resident in a jurisdiction outside the BVI.



Penalties

Penalties are imposed both for failure to provide required information, and for operating a legal entity in breach of the economic substance requirements, which may include fines, imprisonment and/or strike-off.

Non-compliance: Section 11 ITA & Section 16 BOSS

As per section 11 of the ITA and section 16 of the BOSS Act; both failure to provide required information and providing false or misleading information is punishable under the economic substance requirements warrants a fine of up to USD \$70,000 and up to five years jail time.

What Can Forward do to Help?

All relevant entities will need to undertake an internal review to determine what measures, if any, they should take in order to achieve compliance. In most cases, we believe that compliance will be a straightforward matter. We will have a clearer picture once further guidance is provided, following which we will be in touch with more information about how we expect this new legislation will impact our client base.

In the meantime, if you have any questions, please reach out to your usual Forward contact.

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