

Economic substance in the BVI: a guide for directors and operators of BVI companies and limited partnerships

The Economic Substance (Companies and Limited Partnerships) Act, 2018 (the **Act**) was introduced in the BVI, effective 1 January 2019, to address the concerns of the EU Code of Conduct Group and the OECD Forum on Harmful Tax Practices regarding economic substance. Related amendments to the Beneficial Ownership Secure Search System Act, 2017 (the **BOSS Act**) implement an economic substance reporting regime.

A draft Economic Substance Code was issued by the International Tax Authority in April 2019 containing Rules and Guidance relating to the interpretation of the Act and how the ITA will carry out its obligations. The final Rules and Explanatory Notes (the **Rules**) were published in October 2019 to reflect comments from BVI industry and the EU and OECD.

The Act introduces requirements for certain BVI entities that are carrying on one or more “*relevant activities*” to have adequate economic substance in the BVI. Entities which do not carry on any “*relevant activity*” are not subject to the economic substance requirements. Entities which are tax resident in a jurisdiction outside of the BVI (provided that jurisdiction is itself not on the EU taxation “blacklist”) are also not subject to the economic substance requirements, but still need to determine whether they carry on any “*relevant activities*”. The Rules expand the traditional concept of tax residence to include certain “transparent” entities and certain entities whose income from relevant activities is subject to tax.

For those entities which are subject to the requirements, the extent of the economic substance required (if any) depends on which of the relevant activities an entity conducts and the nature and scale of that relevant activity. Entities which are only conducting the business of being a “*pure equity holding entity*” are subject to a much reduced economic substance requirement.

The Act applies to BVI companies, foreign companies registered in the BVI, BVI limited partnerships with legal

personality and foreign limited partnerships registered in the BVI and which have legal personality (“*legal entities*”). BVI limited partnerships which have not elected to have legal personality are not subject to the Act.

Ongoing obligations for all BVI legal entities and BOSS “exempt persons”

All BVI companies and other legal entities which are subject to the Act need to consider the impact and report additional information to their registered agent which, in turn, is required to report certain information to the competent authority in the BVI (via the BOSS system, which has been updated to reflect EU and OECD guidance).

In particular, from 1 October 2019, there is an ongoing legal obligation on legal entities to identify whether the entity carries on one or more relevant activities (and, if so, which activities), under the BOSS Act. Existing business activities will therefore need to be reviewed and classified accordingly and future changes monitored to ensure compliance with the Act.

The Act came into force on 1 January 2019 and was effective immediately for relevant entities incorporated, formed or registered in the BVI on or after that date. Entities existing before 1 January 2019 were subject to a grandfathering period which ended on 30 June 2019 at the latest.

Since 1 October 2019, “exempt persons” which were previously exempt from beneficial ownership reporting

obligations under the BOSS Act are no longer exempt if they carry on any relevant activity. Broadly, the “exempt person” definition includes (i) certain licensees under BVI financial services legislation, (ii) entities whose securities are listed on recognised stock exchange and (iii) subsidiaries of entities within (i) or (ii). Entities affected by this change should contact Harneys to understand the new reporting obligations which are applicable to them.

Financial Periods

Compliance with the economic substance and related reporting requirements is assessed over periods of time of not more than 12 months (called “*financial periods*” by the Act). Default financial periods apply but an entity subject to the Act should consider whether it wishes to align its economic substance reporting period with its own financial year (or any other date). For relevant entities incorporated, formed or registered in the BVI on or after 1 January 2019, the first financial period will start from the date of incorporation, formation or registration and, by default, run for 12 months.

By default, the first financial period for entities incorporated, formed or registered in the BVI before 1 January 2019 was for 12 months from 30 June 2019.

The prescribed economic substance information under the BOSS Act must be submitted to the BVI registered agent to be uploaded to the BOSS(ES) system within six months of the end of the relevant financial period. The BOSS(ES) portal went live on 12 June 2020 and information regarding the data to be submitted is available via the ITA’s website.

Conversely, any beneficial ownership information which is required to be reported under the BOSS Act must generally be notified to the entity’s registered agent within 15 days of being identified (whether initially or in the case of any change to such matters).

What constitutes a “relevant activity”?

The Act specifies nine categories of relevant activity. All entities should consider now whether they are carrying on or intend in the near future to carry on one or more of the following relevant activities. An entity which does not carry on any relevant activity is not subject to the economic substance requirements.

Rule 1 of the Rules provides that an entity will be treated as carrying on a relevant activity during any reporting period which it receives income from that activity. It cannot be inferred from Rule 1 that the absence of any income during a period means that an entity is definitely not carrying on a relevant activity, although the level of gross income may be highly relevant to the degree of economic substance which is required.

The first three relevant activities listed below are defined by reference to existing regulatory licensing regimes. Any entity carrying on banking business, insurance business or fund management business will (or, to be accurate, should) already hold a licence issued by the Financial Services Commission to conduct such business. Conversely, if the activity is outside the scope of the regulatory regime then it will not be required to meet the economic substance requirement (with respect to that relevant activity).

The relevant activity of “holding business” is the most widespread amongst BVI companies. A reduced economic substance requirement applies in the case of an entity which only carries on holding business.

<p>“banking business”</p>	<p>has the meaning specified in the Banks and Trust Companies Act, 1990, s2(1), being 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,</p> <p>(a) in making or giving loans, advances, overdrafts, guarantees or similar facilities, or</p> <p>(b) the making of investments,</p> <p>for the account and at the risk of the person accepting such deposits.</p>
<p>“insurance business”</p>	<p>has the meaning specified in the Insurance Act, 2008, s3(1), being 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.</p>
<p>“fund management business”</p>	<p>means the conduct of an activity that requires the legal entity to hold an investment business license pursuant to section 4 and category 3 of Schedule 3 of the Securities and Investment Business Act, 2010, which includes the following sub-categories:</p> <p>Investment Management</p> <p><i>Sub-category A:</i> managing Segregated Portfolios (Excluding Mutual Funds);</p> <p><i>Sub-category B:</i> Managing Mutual Funds;</p> <p><i>Sub-category C:</i> Managing Pension Schemes;</p> <p><i>Sub-category D:</i> Managing Insurance Products; and</p> <p><i>Sub-category E:</i> Managing Other Types of Investment</p>
<p>“finance and leasing business”</p>	<p>means the business of providing credit facilities of any kind for consideration.</p> <p>Consideration may include consideration by way of interest.</p> <p>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:</p> <p>(i) the supply of goods by hire purchase</p> <p>(ii) leasing other than any lease granting an exclusive right to occupy land</p> <p>(iii) conditional sale or credit sale</p> <p>Where an advance or credit repayable by a customer to a person is assigned to another person, that other person is deemed to be providing the credit facility for these purposes.</p> <p>Any activity falling within the scope of “banking business”, “fund management business” or “insurance business” is excluded from this definition.</p>
<p>“headquarters business”</p>	<p>means the business of providing any of the following services to an entity in the same group:</p> <p>(a) the provision of senior management;</p> <p>(b) the assumption or control of material risk for activities carried out by any of those entities in the same group; or</p> <p>(c) the provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (b)</p> <p>but does not include “banking business”, “finance and leasing business”, “fund management business”, “intellectual property business”, “holding business” or “insurance business”.</p>

<p>“distribution and service centre business”</p>	<p>means the business of either or both of the following</p> <ul style="list-style-type: none"> (a) purchasing from foreign affiliates <ul style="list-style-type: none"> (i) component parts or materials for goods; or (ii) goods ready for sale; and (iii) reselling such component parts, materials or goods; (b) providing services to foreign affiliates in connection with the business, <p>but does not include any activity included in any other relevant activity except “holding business”.</p> <p>Broadly, an entity is affiliated with another entity if it is in the same group of the other entity.</p>
<p>“shipping business”</p>	<p>means any of the following activities involving the operation of a ship anywhere in the world other than solely within British Virgin Islands waters (as defined in section 2(2)(a) of the Merchant Shipping Act, 2001)</p> <ul style="list-style-type: none"> (a) the business of transporting, by sea, persons, animals, goods or mail; (b) the renting or chartering of ships for the purpose described in paragraph (a); (c) the sale of travel tickets or equivalent, and ancillary services connected with the operation of a ship; (d) the use, maintenance or rental of containers, including trailers and other vehicles or equipment for the transport of containers, used for the transport of anything by sea; (e) the management of the crew of a ship. <p>The definition of “ship” for these purposes does not include a “fishing vessel”, “pleasure vessel”, or a “small ship” (under 24m) as defined in the Merchant Shipping Act, 2001.</p>
<p>“holding business”</p>	<p>means the business of being a “pure equity holding entity”, meaning a legal entity that only holds equity participations in other entities and only earns dividends and capital gains.</p> <p>An entity which holds assets which are not equity participations is not a pure equity holding entity. An entity which holds a mixed asset portfolio (shares and real estate for example), or non-equity assets such as bonds or government securities, falls outside the definition of a pure equity holding entity.</p>
<p>“intellectual property business”</p>	<p>means the business of holding “intellectual property assets”, meaning any intellectual property right in intangible assets, including but not limited to copyright, patents, trademarks, brand, and technical know-how, from which identifiable income accrues to the business (such income being separately identifiable from any income generated from any tangible asset in which the right subsists).</p> <p>“income” in respect of an intellectual property asset includes:</p> <ul style="list-style-type: none"> (a) royalties; (b) capital gains and other income from the sale of an intellectual property asset; (c) income from a franchise agreement; and (d) income from licensing the intangible asset. <p>The focus here is on entities receiving income from licensing or otherwise exploiting the intellectual property rights, rather than owning IP relating to its business activities.</p>

Tax Residency and deemed “non-resident” entities

An entity that carries on a relevant activity during a financial period will not need to meet the economic substance requirements during that reporting period if it is resident for tax purposes in a jurisdiction outside the BVI which is not on the EU taxation “blacklist” for the entirety of that reporting period or treated as such under the Rules (a “non-resident” entity).

Broadly, the Rules confirm that tax residence may be demonstrated for entities which are tax “transparent” by reference to each of the participators or partners on whom the entity’s entire profits and gains are taxable. An entity (other than a “pure equity holding entity”) whose only sources of income from relevant activities are subject to tax in a jurisdiction outside the BVI will be regarded as resident for tax purposes in that jurisdiction.

Entities which carry on a relevant activity and claim to be non-resident for tax purposes will need to be able to supply evidence of their tax status to support that claim under the Rules. There is a mechanism to be treated as provisionally non-resident pending submission of the required evidence. In the event that such evidence cannot be made available the entity may be treated as having failed to establish tax residence outside the BVI and will need to meet the economic substance requirements.

What are the economic substance requirements?

There are three different economic substance requirements depending on the nature of the relevant activity:

The Holding Business Requirement:

The Act provides that a pure equity holding entity meets the economic substance requirements if:

- (a) it complies with its statutory obligations under the BVI Business Companies Act, 2004, or the Limited Partnerships Act, 2017 (whichever is relevant); and
- (b) it has in the BVI adequate employees and premises for holding equity participations and, where it manages those equity participations, it has in the BVI adequate employees and premises for carrying out that management.

The Rules acknowledge that holding of equity participations can be (and, in many cases, is) entirely passive in nature and that in such cases the requirement for adequate

employees and premises may be capable of being met by the BVI registered agent and the existing registered office.

The General Requirement:

An entity conducting a relevant activity (other than holding business or intellectual property business) meets the economic substance requirements if:

- 1 the relevant activity is directed and managed in the BVI;
- 2 having regard to the nature and scale of the relevant activity:
 - (a) there are an adequate number of suitably qualified employees physically present in the BVI (employed directly or employed by another entity);
 - (b) there is adequate expenditure incurred in the BVI; and
 - (c) there are physical offices or premises as may be appropriate for the core-income generating activities; and
- 3 the entity conducts core income generating activity in the BVI.

The Intellectual Property Business Requirement:

As income derived from intellectual property assets are considered to be at higher risk of profit shifting from higher to lower (or zero) tax jurisdictions, a more rigorous requirement applies to certain entities which carry on intellectual property business. The general economic substance requirement (as set out above) is enhanced by creating presumptions against compliance with the requirement to conduct core income generating activity in two scenarios. The presumptions against non-compliance may be rebutted in certain circumstances. The scenarios and the steps required to rebut the presumptions are detailed and outside the scope of this Guide. We recommend that any entity which believes it is carrying on intellectual property business contact a Harneys lawyer (see contacts below) for further guidance.

Direction and management of a relevant activity

The economic substance requirements (other than for holding business) include that the relevant activity be directed and managed in the BVI (noting that it is the relevant activity that must be directed and managed in the BVI, rather than the entity itself, unless the only business of the entity comprises relevant activity). The Rules indicate that this requires an adequate number of board meetings to be held in the BVI having regard to the nature of the relevant

activity and that for a meeting to be treated as being held in the BVI there must be a quorum of directors physically present in the BVI. The directors attending such meetings must include among their number adequate expertise to direct the relevant activity. Decisions of the board regarding the relevant activity must be minuted and such minutes kept in the BVI.

Core income generating activity (CIGA)

One part of the general economic substance requirement is that an entity (which conducts a relevant activity) must conduct core income generating activity in the BVI relating to such activity. The requirement does not apply to an entity which only carries on holding business. At least some of the CIGA must be carried out in the BVI (ie carried on by employees working in the BVI). Section 7 of the Act defines CIGA as including activities specific to each relevant activity. The definition is set out in whole in the Schedule to this Guide. Note that the definition comprises non-exhaustive examples of activities that comprise CIGA. Identifying the CIGA for a particular entity and its relevant activity will be a matter of fact.

CIGA can be outsourced within the BVI in certain circumstances, as long as the entity is able to monitor and control the outsourced activity. There is no restriction on outsourcing for an entity which only carries on holding business (although only outsourcing to a person operating in the BVI will be taken into account when assessing the adequacy of employees in the BVI).

Reporting Obligations

The Act and related amendments to the BOSS Act introduce new obligations on entities (and their registered agents) to collect and submit information so as to enable the International Tax Authority (*ITA*) to monitor compliance with the economic substance requirements.

Reporting is to be made via the Beneficial Ownership Secure Search System (**BOSS**). The BOSS system is the secure system which is currently used to hold beneficial ownership information on BVI entities.

Entities will be required to identify certain prescribed economic substance information related to the requirements under the Act and provide it to their registered agent. Registered agents, in turn, are required to take reasonable steps to collect such information and to submit the information through BOSS. Entities must notify their registered agent whether or not they carried on any relevant activity (and, if so, which relevant activities) within the

relevant financial period and, if they are, then whether or not they wish to claim to be non-resident for tax purposes during that period.

Where relevant activities are conducted by an entity that is not non-resident, the entity will need to report detailed prescribed information to its registered agent to demonstrate its compliance with the appropriate economic substance requirements. The registered agent will, in turn, file the data through the BOSS system. It is important to be aware that entities will have to report in relation to all relevant activity conducted in the relevant financial period, even if the relevant activity is not ongoing at the end of the financial period.

Enforcement and Sanctions

There are, broadly, three sets of circumstances where enforcement action may be taken and sanctions imposed:

- (a) a failure by the entity to identify certain matters required by the BOSS Act, which includes whether or not it carries on any relevant activity;
- (b) a failure by any person (which potentially includes directors or partners) to provide information or the provision of inaccurate or misleading information to the International Tax Authority (via BOSS or otherwise);
- (c) a failure of an entity to comply with the economic substance requirement.

A failure to identify the matters required by the BOSS Act without reasonable cause (including whether or not the entity carries on any relevant activity) or to provide information without reasonable excuse and the intentional provision of false information to the International Tax Authority is an offence. Potential penalties are severe, as would be expected. Enforcement action would be taken through the Courts and a criminal burden of proof will apply.

Failure to comply with the economic substance requirement is **not** a criminal offence. However, a breach can lead to financial penalties and directions to take corrective action and ultimately there is a possibility of an entity being struck off the relevant Corporate Register or liquidated via court order. The penalties are increased significantly in the case of any "high risk IP legal entity", which are also subject to strong presumptions of non-compliance with the Act which may be extremely difficult for such entities to rebut or disprove in practice.

Next steps

All BVI companies (and any limited partnerships with a corporate personality) should consider:

- Whether the entity is carrying on (or plans to carry on) a relevant activity.
- If so, whether the entity is resident for tax purposes in another jurisdiction or treated as such under the Rules and whether that jurisdiction is, or is at risk of being, “blacklisted” by the EU for tax purposes.
- If it is subject to the economic substance requirements, what steps (if any) it needs to take in order to meet them and the related reporting requirements.

The compliance periods and obligation to identify relevant activities have commenced for all legal entities, so legal entities (and their directors or general partners) are strongly recommended to classify themselves as soon as possible if they have not already done so.

Harneys has developed a low cost online interactive solution to assist clients with the classification of their BVI entities – more information is available at [economicsubstance.vg](https://www.harneys.com/economic-substance/vg). This solution is available at a fixed fee for all BVI legal entities and provides formal legal advice from Harneys on which entities can rely.

In the meantime, experts at Harneys are available should you need any assistance determining the classification for

your entity or changing or restructuring your entity in order to ensure compliance.



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SCHEDULE 1: Definition of Core Income Generating Activities in the Economic Substance (Companies and Limited Partnerships Act, 2018)

The CIGA examples for each relevant activity are detailed below, these are not exhaustive lists:

Banking business	<p>“Core Income Generating Activities” includes, in respect of banking business:</p> <ul style="list-style-type: none">(a) raising funds, managing risk including credit, currency and interest risk;(b) taking hedging positions;(c) providing loans, credit or other financial services to customers;(d) managing regulatory capital;(e) preparing regulatory reports and returns.
Distribution and service centre business	<p>“Core Income Generating Activities” includes, in respect of distribution and service centre business:</p> <ul style="list-style-type: none">(a) transporting and storing goods;(b) managing stocks;(c) taking orders;(d) providing consulting or other administrative services.
Insurance business	<p>“Core Income Generating Activities” includes, in respect of insurance business:</p> <ul style="list-style-type: none">(a) predicting and calculating risk;(b) insuring or re-insuring against risk;(c) providing insurance business services to clients.
Fund management business	<p>“Core Income Generating Activities” includes, in respect of fund management business:</p> <ul style="list-style-type: none">(a) taking decisions on the holding and selling of investments;(b) calculating risks and reserves;(c) taking decisions on currency or interest fluctuations and hedging positions;(d) preparing relevant regulatory or other reports for government authorities and investors.
Finance or leasing business	<p>“Core Income Generating Activities” includes, in respect of finance or leasing business:</p> <ul style="list-style-type: none">(a) agreeing funding terms;(b) identifying and acquiring assets to be leased (in the case of leasing);(c) setting the terms and duration of any financing or leasing;(d) monitoring and revising any agreements;(e) managing any risks;
Headquarters business	<p>“Core Income Generating Activities” includes, in respect of headquarters business:</p> <ul style="list-style-type: none">(a) taking relevant management decisions;(b) incurring expenditures on behalf of affiliates;(c) co-ordinating group activities.
Shipping business	<p>“Core Income Generating Activities” includes, in respect of shipping business:</p> <ul style="list-style-type: none">(a) managing the crew (including hiring, paying and overseeing crewmembers);(b) hauling and maintaining ships;(c) overseeing and tracking deliveries;(d) determining what goods to order and when to deliver them;(e) organising and overseeing voyages.
Intellectual property business	<p>“Core Income Generating Activities” includes, in respect of intellectual property business:</p> <ul style="list-style-type: none">(a) where the business concerns intellectual property assets such as patents, research and development;(b) where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.