

Economic substance for the British Virgin Islands

Insights - 14/07/2021

The Economic Substance (Companies and Limited Partnerships) Act, 2018 (**the Act**) came into force on 1 January 2019 (with certain retroactive revisions being made shortly thereafter) and applies to all companies and limited partnerships registered in the British Virgin Islands (or foreign companies and limited partnerships doing business in the territory), other than British Virgin Islands registered companies or limited partnerships that are "non-resident" in the British Virgin Islands. The Act applies to existing entities and new entities incorporated or formed from 1 January 2019.

The Act did not originally apply to limited partnerships without a legal personality. However, on 29 June 2021 the Economic Substance (Companies and Limited Partnerships) (Amendment) Act 2021 (**the Amendment Act**) came into force and this extended the scope of the Act to limited partnerships without a legal personality.

Following the enactment of the Amendment Act, there will be a transitional period of six months for existing limited partnerships without a legal personality, being those formed before 1 July 2021, in that the amended Act will apply to those partnerships for the financial years commencing no later than 1 January 2022. However, limited partnerships without legal personality that are formed on or after 1 July 2021 will be subject to the amended Act immediately.

The Act imposes economic substance tests for British Virgin Islands companies and limited partnerships that are "resident" in the British Virgin Islands and carry on "relevant activities".

In order to demonstrate economic substance, a company or limited partnership that falls within the scope of the Act by reason of (i) being resident in the British Virgin Islands and (ii) carrying out a relevant activity, must be "directed and managed" in and carry out "core income generating activities" within, the British Virgin Islands, and must also meet defined standards of "adequacy" and "appropriateness".

1. What constitutes a resident company or limited partnership?

"Resident" companies and limited partnerships are those registered in the British Virgin Islands under the Business Companies Act, 2004 or defined as such by the Limited Partnerships Act, 2017 (including foreign companies and foreign limited partnerships that are captured by such legislation), and which are not resident for tax purposes in a jurisdiction outside the British Virgin Islands (such companies or limited partnerships tax resident outside the British Virgin Islands being "non-resident" entities). An entity cannot however, claim to be non-resident in the British Virgin Islands by reason of being a tax resident in a jurisdiction which is included on the EU list of non-cooperative jurisdictions.

As stated above, the Amendment Act has now extended the economic substance regime under the Act to limited partnerships without a legal personality.

2. What is a relevant activity?

Relevant activities are defined by the Act as:

1. banking business;
2. insurance business;
3. fund management business;
4. financing and leasing business;
5. headquarters business;
6. shipping business;
7. holding business;
8. intellectual property business; and
9. distribution and service centre business.

The Amendment Act includes two further notable additions or amendments to the Act.

- The Amendment Act adds definitions of "investment fund" and "investment fund business" and expressly excludes investment fund business from being a relevant activity. This is a helpful development in that it removes some element of doubt as to the treatment of investment funds and particularly those all equities funds which might have otherwise been considered pure equity holding entities.
- The definition of "distribution and service centre business" is amended so as to add clarity to the second limb of the previous definition at Section 2 of the Act. The change confirms that for an entity to be considered as engaging in a distribution and service centre under limb (b)

of the definition, the provision of services to affiliated entities need not be linked to any related purchasing and resale business within the description at limb (a). The change then clarifies that the definition looks at such activities separately (there was some ambiguity in this respect in the previous definition) and states clearly that providing any "consulting or administrative" services to a foreign affiliate may be caught as a relevant activity. It may be worth noting, however, the definition did not previously use the descriptors "consulting or administrative" in respect of services and some thought may be given to whether this might also limit application of the definition (though this may not have been the intent).

3. What are core income generating activities?

The meaning of core income generating activities varies by industry and sector but generally includes the following:

Banking business: raising funds, managing risk (including credit, currency and interest risk); taking hedging positions; providing loans, credit or other financial services to customers; managing regulatory capital; and preparing regulatory reports and returns.

Distribution and service centre business: transporting and storing goods; managing stocks; taking orders; and providing consulting or other administrative services.

Insurance business: predicting and calculating risk; insuring or re-insuring against risk; and providing insurance business services to clients.

Fund management business: taking decisions on the holding and selling of investments; calculating risk and reserves; taking decisions on currency or interest fluctuations and hedging positions; and preparing regulatory and other reports for government authorities and investors.

Financing or leasing business: agreeing funding terms; identifying and acquiring assets to be leased (in the case of leasing); setting the terms and duration of any financing or leasing; monitoring and revising any agreements; and managing any risks.

Headquarters business: provision of senior management; assumption or control of material risk; or the provision of substantive advice in connection with risk, as each relate to any entity in the same group.

Shipping business: managing the crew (including hiring, paying and overseeing crew members); hauling and maintaining ships; overseeing and tracking deliveries; determining what goods to order and when to deliver them; and organising and overseeing voyages.

Intellectual property business: where the business concerns intellectual property assets such as patents, research and development; and where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.

4. Intellectual Property Companies

The Act sets out more prescriptive requirements in respect of legal entities whose relevant activity is carrying on intellectual property business from within the Virgin Islands, including a rebuttable presumption that a legal entity does not conduct core income generating activity (and thereby does not have economic substance in the jurisdiction) if:

- a) it does not carry on any of the activities described at 3 (intellectual property business) above; or
- b) if it is a high-risk intellectual property legal entity.

The Act sets out circumstances in which the above presumption may be rebutted and we anticipate further guidance being published in this regard in due course.

5. What are the economic substance tests?

With the exception of a pure equity holding entity (see below for further details), in order to have economic substance in the British Virgin Islands, an entity which falls within the scope of the Act must demonstrate that:

- (a) the relevant activity it carries out is directed and managed in the Virgin Islands;
- (b) it carries out core income generating activities in the jurisdiction;
- (c) it has economic substance in terms of adequacy and appropriateness; and
- (d) in the case of income generating activity carried out for the relevant legal entity by another entity, no core income generating activity (as related solely to the relevant legal entity) is carried on outside the Virgin Islands, and the relevant legal entity is able to monitor and control the carrying out of the activity performed.

An entity will have economic substance in terms of adequacy and appropriateness if, having regard to the nature and scale of the entity's relevant activity:

- (i) it has an adequate number of suitably qualified employees physically present in the Virgin Islands (employed directly by or working for the entity);
- (ii) it incurs adequate expenditure in the Virgin Islands;
- (iii) it has physical offices or premises in the Virgin Islands (as may be appropriate for its core income generating activities); and
- (iv) in the case of intellectual property business requiring the use of specific equipment, such equipment is located in the Virgin Islands.

In the case of 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, the entity will have adequate substance if:

(a) it complies with its statutory obligations according to the Business Companies Act, 2004 or the Limited Partnerships Act, 2017 (whichever is relevant); and

(b) it has in the British Virgin Islands adequate employees and premises for holding equity participations and, where it manages those equity participations, has adequate employees and premises for carrying out that management.

6. What will be required of you?

The Act makes certain amendments to the Beneficial Ownership Secure Search System Act, 2017 (the **BOSS Act**), which came into force on 30 June 2018. Currently, the BOSS Act requires that information concerning the beneficial owners of entities registered in the British Virgin Islands be shared with the registered agents of those entities and held on a secure search system.

The BOSS Act as amended pursuant to the Act also requires (in addition to the requirements referred to above) companies and limited partnerships to provide information about their tax residency status and activities, to enable the International Tax Authority to monitor whether the entity is carrying on relevant activity and, if so, whether the entity meets the economic substance tests within the meaning of the Act.

7. Consequences of non-compliance

The Act provides for both criminal and financial sanctions in the case of non-compliance. The International Tax Authority of the British Virgin Islands will have responsibility for monitoring and investigating compliance.

8. Further rules and guidance

The Act allows for related regulations and rules to be issued with respect to the obligations imposed by the Act, so as to further clarify the substance requirements prescribed by the Act and provide guidance on the interpretation of its terms. This guidance has been issued in the form of "Rules on Economic Substance in the Virgin Islands".

If you require further information or would like to discuss how the Act may impact your business, please get in touch with your usual Ogier contact.

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