

New substance legislation for the British Virgin Islands

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In response to the requirements of the EU Code of Conduct Group, the British Virgin Islands has enacted new legislation setting out an economic substance test for tax-resident entities.

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 (excluding limited partnerships without legal personality) 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 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 but excluding limited partnerships that do not have legal personality), 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.

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.

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 amendments 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 will also require (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.

Existing (in scope) companies and limited partnerships are required to comply with the economic substance requirements under the Act by 30 June 2019 and to meet reporting obligations under and the BOSS Act (as amended) by 30 June 2020.

New (in scope) companies and limited partnerships formed on or after 1 January 2019 are required to comply with the economic substance requirements under the Act immediately and to meet reporting obligations under and the BOSS Act (as amended) within one year of formation.

There is nothing to do at this stage but you should be prepared for registered agents to request additional information in due course and on an annual basis going forward.

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 – both to further clarify the substance requirements prescribed by the Act and provide guidance on the interpretation of its terms. We anticipate that such regulations, rules and related guidance will be issued in due course, and we will provide summary details of these when published.

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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