

ADVISORY | INDUSTRY INFORMATION

Overview of the British Virgin Islands Economic Substance Requirements

Introduction

Legislation requiring a “legal entity” conducting “relevant activity” to report and maintain economic substance has been introduced in the British Virgin Islands.

The Economic Substance (Companies and Limited Partnerships) Act, 2018 came into force on 1 January 2019 and was subsequently amended by the Economic Substance (Companies and Limited Partnerships) (Amendment) Act, 2019 and the Economic Substance (Companies and Limited Partnerships) (Amendment) Act, 2021 (together, the “ES Law”). The British Virgin Islands International Tax Authority (“ITA”) is the designated competent authority with power to make rules under the ES Law on how the economic substance requirements may be met. The ITA issued such rules on 9 October 2019, which have most recently been updated on 25 February 2023 (“ES Rules”). This advisory provides an overview of key aspects only and we would be happy to advise in further detail if required.

The British Virgin Islands is a member of the OECD Inclusive Framework on Base Erosion and Profit Shifting (“BEPS”) and enacted the ES Law in response to requirements for geographically mobile activities to have economic substance developed under BEPS Action 5, consistent with the European Union timeframe to have such requirements in place on 1 January 2019. Similar legislation has been or is being enacted in all OECD- compliant jurisdictions with no or nominal tax, including Bermuda, the Cayman Islands, Guernsey and Jersey. The ES Law and ES Rules were published following consultation with the OECD, the EU and British Virgin Islands stakeholders. International standards are continuing to develop and it is anticipated that the ES Law and ES Rules will evolve and be subject to further clarification.

Scope

The ES Law requires a “legal entity” conducting “relevant activity” to maintain economic substance and make reports to the ITA via its registered agent. A “legal entity” which does not conduct “relevant activity” is required only to submit notifications to the ITA. An entity which is not a “legal entity” is out of scope and has no obligations under the ES Law.

What is a “legal entity”?

All British Virgin Islands and registered foreign companies, and British Virgin Islands and registered foreign limited partnerships, are “legal entities”, unless the legal entity is tax resident in another jurisdiction, as set out below. Trusts and other forms of purely contractual arrangements are not “legal entities”.

An entity that carries out a relevant activity but that is tax resident in another jurisdiction is excluded from the definition of “legal entity”, provided that the other jurisdiction is not on the EU list of non-compliant jurisdictions. It is acknowledged that some jurisdictions (for example, the US) impose tax by reference to a criterion other than residence. What matters is whether the tax authority in the jurisdiction in question has accepted that the entity (or its participators in the case of a transparent entity) is chargeable to tax on its worldwide income.

What is a “relevant activity”?

Each of the following activities, which have been identified by the OECD as “geographically mobile”, is a “relevant activity” as defined further in the ES Law.

- (a) banking business;
- (b) distribution and service centre business;
- (c) finance and leasing business;
- (d) fund management business;
- (e) headquarters business;
- (f) holding business;
- (g) insurance business;
- (h) intellectual property business; and
- (i) shipping business.



A legal entity that carries on a relevant activity in the British Virgin Islands or receives income from such activity during a financial period must comply with the ES Requirements, as set out below, in relation to each relevant activity.

Although an investment fund may qualify as a “legal entity”, the business of an investment fund is not regarded as a relevant activity. Any activities that a legal entity conducts in the course of being an investment fund will not be treated as a relevant activity. For a legal entity that is an investment fund to be found to be conducting a relevant activity, it will need to be shown that the investment fund is conducting a relevant activity as a separate and distinct business activity in its own right.

The ES Requirements

A legal entity that conducts a relevant activity in a financial period must satisfy the economic substance requirements (“ES Requirements”) in relation to that relevant activity.

A legal entity satisfies the ES Requirements if it:

- (a) conducts core income generating activities (“CIGA”) in the British Virgin Islands;
- (b) the relevant activity is directed and managed in an appropriate manner in the British Virgin Islands; and
- (c) having regard to the nature and scale of the relevant activity:
 - (i) there is an adequate amount of expenditure incurred in the British Virgin Islands;
 - (ii) there are physical offices or premises as may be appropriate for the CIGA;
 - (iii) there are an adequate number of suitably qualified employees in relation to that activity (whether or not employed by the legal entity or by another entity and whether on temporary or long-term contracts) who are physically present in the British Virgin Islands; and
 - (iv) where the relevant activity is intellectual property business and requires the use of specific equipment, that equipment is located in the British Virgin Islands.

Reduced ES Requirements for pure equity holding entities

A legal entity that is only carrying on the relevant activity of holding business, that is, the business of a pure equity holding entity, is subject to reduced ES Requirements, which are satisfied if the legal entity confirms that it has complied with its statutory obligations under the British Virgin Islands Business Companies Act, 2004 or the Limited Partnership Act, 2017 and the legal entity has adequate employees in the British Virgin Islands and premises for holding equity participations, and, where it manages those equity participations, has adequate employees in the British Virgin Islands and premises for carrying out that management.

Application of the ES Requirements to “intellectual property business” and to a “high risk IP legal entity”.

A legal entity which does not conduct the specified CIGA corresponding to “intellectual property business” is presumed not to conduct CIGA in the British Virgin Islands unless it can satisfy the ITA that specified activities involving the taking of certain strategic decisions and risk management and trading activities are carried on in the British Virgin Islands.

Further, a legal entity which conducts “high risk intellectual property business” is presumed not to conduct CIGA in the British Virgin Islands unless the legal entity can demonstrate that there was a high degree of control over the development, exploitation, maintenance, protection and enhancement of the intellectual property asset, exercised by suitably qualified employees of the legal entity who are physically present and perform their functions within the British Virgin Islands and who are on long-term contracts.

In either case, the legal entity will need to provide sufficiently specific information to the ITA to rebut the presumption that it is not conducting CIGA in the British Virgin Islands. We would be happy to advise on the meaning of “high risk IP business” and the evidential threshold, if required.

Core income generating activities (“CIGA”)

CIGA means activities that are of central importance to a legal entity in terms of generating income from the relevant activity and which, if conducted, must be conducted in the British Virgin Islands. The examples of CIGA are not mandatory or exhaustive, so a “legal entity” need not perform every element of CIGA listed for the “relevant activity”.



Directed and managed

It is the relevant activity, as opposed to the legal entity, which must be directed and managed in the British Virgin Islands. However, according to the ES Rules, where the legal entity's only business is the relevant activity or activities in question, then that will mean that the entity itself must be directed and managed from the British Virgin Islands. For the relevant activity to be directed and managed from the British Virgin Islands, there must be an adequate number of board meetings held in the British Virgin Islands having regard to the actual frequency of meetings required for the relevant activity, the nature of the relevant activity and its importance in the overall business of the legal entity. For a board meeting to be held in the British Virgin Islands there must be a quorum of directors physically present in the British Virgin Islands. The directors of the legal entity 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 minutes of those decisions must be kept in the British Virgin Islands.

What is "adequate" and "appropriate"?

The meaning of the terms "adequate" and "appropriate" are not defined for the purposes of the ES Law. The ES Law and ES Rules do not prescribe a minimum number of full time employees for a particular level of relevant income either generally or for or any particular type of relevant activity, although the ES Rules do set out how the number of employees engaged in a relevant activity shall be computed. The ES Rules notes that the ITA will apply criteria such as the adequacy of expenditure and employment, the suitability of employee qualifications and the appropriateness of premises having regard to the usual way in which businesses carrying on the relevant activity on a commercial basis are structured and operate. The ES Rules acknowledge that businesses come in different sizes, and the employees, expenditure and premises which are adequate or appropriate for a small business will not suffice for a large business. The ES Rules observe that it is not the function of the legislation to require an entity to incur more expenditure or engage more employees than it really needs.

Outsourcing

A legal entity may satisfy the ES Requirements by outsourcing the conduct of its British Virgin Islands CIGA to another person in the British Virgin Islands, provided that the outsourced CIGA is carried on in the British Virgin Islands and that the legal entity is able to monitor and control the performance of that outsourced CIGA.

Timing

A legal entity which carries on or receives income from a relevant activity during any financial period must comply with the ES Requirements in relation to that activity. The definition of "financial period" depends on the type of legal entity, as follows:

- a company or limited partnership with legal personality incorporated or formed on or after 1 January 2019 – not more than one year from the date of incorporation or formation;
- a limited partnership without legal personality formed:
 - prior to 1 July 2021 – one year commencing no later than 1 January 2022;
 - on or after 1 July 2021 – one year from the date of formation; and
- in any other case – one year commencing no later than 30 June 2019.

Note that there are certain provisions in the ES Law allowing for alteration of a legal entity's financial period on notice to the ITA.

Reporting obligation

With effect from 1 October 2019, the ES Law amended the British Virgin Islands Beneficial Ownership Secure Search System Act, 2017 ("BOSS Act") to expand the existing BOSS Act reporting requirements of a legal entity and its registered agent to include prescribed information in relation to a legal entity's economic substance. The prescribed information relating to economic substance has been further expanded by subsequent amendments to the BOSS Act. The ES Law also expands the BOSS Act to include reporting requirements for limited partnerships without legal personality, which were hitherto not in scope of the BOSS Act. The legal entity must notify its registered agent of BOSS Act prescribed information, including information regarding the legal entity and its ownership, within 15 days of identifying such information. The legal entity must further identify which, if any, relevant activities it carries on and notify its registered agent of the prescribed information in relation to such activities. The registered agent must make the corresponding BOSS Act return within a period of six months following the end of the legal entity's financial period. The registered agent is under a separate duty to take reasonable steps to collect prescribed information (and, in the case of prescribed information regarding the legal entity and its ownership, to identify) and enter particulars of the prescribed information in the registered agent's database.



Determination of whether the ES Requirements are satisfied

The ITA has the power under the ES Law to determine that a legal entity has not satisfied its ES Requirements during a financial period. The ITA must ordinarily do so no later than six years after the end of the relevant financial period. The ITA will base its review on information filed by the legal entity's registered agent pursuant to the BOSS Act. The ITA may require further information following that review. To that effect, the ITA has the power under the ES Law to issue notices for information. These notices may be issued to any person, whether or not they are legal entities self-reporting under the BOSS Act. There are penalties for supplying false information or failing to supply any information.

Failure to satisfy the ES Requirements

If the ITA determines that a legal entity has failed to satisfy the ES Requirements during a financial period it shall issue a notice to the legal entity notifying the legal entity of such determination, giving the reasons, directing any action to be taken to satisfy the ES Requirements and advising of the legal entity's right to appeal.

The ITA shall impose a penalty of minimum US\$5,000 to maximum US\$20,000 (or maximum US\$50,000 in the case of a high risk IP legal entity) on a first determination of non-compliance and a second penalty of US\$10,000 to maximum US\$200,000 (or maximum US\$400,000 in the case of a high risk IP legal entity) on a second determination of non-compliance. Following failure after two consecutive years the ITA may recommend to the Financial Services Commission ("FSC") that the legal entity be struck off the register. If at any time following the service of a first determination the ITA decides there is no realistic possibility of the legal entity meeting the ES Requirements, it may require the FSC to strike the legal entity off the register.

Offences

It is an offence for a person to without reasonable excuse or intentionally supply false information to the ITA under the ES Law. Such an offence is punishable on summary conviction by a fine of US\$40,000 or with imprisonment for a term of two years, or both, or on conviction on indictment to a fine of US\$50,000 or with imprisonment for a term of five years, or both.

It is also an offence to fail to comply with the reporting obligations under the BOSS Act without reasonable excuse, for which a legal entity is punishable on summary conviction by a fine of US\$40,000 or with imprisonment for a term of six months, or both, or on conviction on indictment to a fine of US\$250,000 or with imprisonment for a term of five years, or both, and for which a registered agent is punishable on summary conviction by a fine of US\$20,000 or on conviction on indictment to a fine of US\$40,000.

Further developments and next steps

International standards are continuing to develop and it is anticipated that the ES Law and ES Rules may also evolve and are subject to further clarification. The Minister, with the approval of the Cabinet, may make regulations prescribing anything that may be prescribed under the ES Law and amending the ES Law, including expanding on the meaning of any defined terms or making more detailed provision for how a legal entity is to satisfy the ES Requirements. The Ministry of Finance has already issued regulations concerning filing and submission periods and intellectual property requirements.

Contacts

Walkers has a dedicated Regulatory & Risk Advisory Practice Group that can offer legal advice and guidance in connection with all aspects of the economic substance regime as it continues to evolve. Walkers is also committed to providing economic substance solutions that will enable all clients impacted by the regime to satisfy the necessary requirements for substance in the British Virgin Islands.

For further information please speak with your usual contact at Walkers or the any of the following persons:

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Appendix

Economic Substance Requirements – Relevant Activities and Corresponding CIGA

The meaning of each “relevant activity” is set out below. Only a “legal entity” which is conducting “relevant activity” as defined in the left hand column is required to satisfy the ES Requirements (which includes a requirement for the “relevant entity” to conduct the CIGA). The examples of CIGA as set out in the right hand column are not mandatory or exhaustive, so a “legal entity” need not perform every element of CIGA listed for the “relevant activity”.

The term “group” where applicable, is defined by reference to regulation 2(1) of the British Virgin Islands Business Companies Regulations, 2012 (the “Regulations”), modified so that references to a company include references to a limited partnership, and other expressions appropriate to companies shall be construed as including references to the corresponding persons, documents or organisations, as the case may be, appropriate to limited partnerships. In the Regulations, the term “group”, in relation to a company (the “first company”), means the first company and any other company that is (a) a parent of the first company; (b) a subsidiary of the first company; (c) a subsidiary of a parent of the first company; or (d) a parent of a subsidiary of the first company; or (e) is a parent of a parent of the first company. A “subsidiary”, in relation to the first company means a company of which the first company is a parent.

	Definition	CIGA
Banking Business	Banking business has the meaning given by section 2(1) of the Banks and Trust Companies Act where banking business means 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, (a) in making or giving loans, advances, overdrafts, guarantees or similar facilities; or (b) the making of investments, for the account and at the risk of the person accepting such deposits.	The CIGA in the context of banking business includes: (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; and (e) preparing regulatory reports and returns.
Distribution & Service Centre Businesses	Distribution and service centre business means the business of either or both of the following: (a) purchasing from foreign affiliates (as defined); (i) component parts or materials for goods; or (ii) goods ready for sale, and (iii) reselling such component parts, materials or goods; (b) providing consulting or administrative services to foreign affiliates, but does not include any activity included in any other relevant activity except holding business.	The CIGA in respect of distribution and service centre business includes: (a) transporting and storing goods; (b) managing stocks; (c) taking orders; and (d) providing consulting or other administrative services.
Insurance Business	Insurance business has the meaning specified in section 3(1) of the Insurance Act, where insurance business means 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.	The CIGA in respect of insurance business includes: (a) predicting and calculating risk; (b) insuring or re-insuring against risk; and (c) providing insurance business services to clients.



	Definition	CIGA
Fund Management Business	<p>Fund management business 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 ("SIBA").</p> <p>Category 3 of Schedule 3 of SIBA encompasses the management of segregated portfolios, mutual funds, pension schemes, insurance products and other types of investment. We would be happy to advise on SIBA if required.</p>	<p>The CIGA in respect of fund management business includes:</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; and (d) preparing relevant regulatory or other reports for government authorities and investors.
Finance & Leasing Business	<p>Finance and leasing business means the business of providing credit facilities of any kind for consideration. For the purposes of the above, but without limiting its generality:</p> <ul style="list-style-type: none"> (a) consideration may include consideration by way of interest; (b) 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: (i) the supply of goods by hire purchase; (ii) leasing other than any lease granting an exclusive right to occupy land; or (iii) conditional sale or credit sale. <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 the purposes of the definition.</p> <p>Any activity falling within the definition of "banking business", "fund management business" or "insurance business" is excluded from finance and leasing business.</p> <p>According to the ES Rules, an entity which provides credit as an incidental (i.e. occasional or minor) part of a different sort of business will not be treated as carrying on a finance and leasing business. Only where the provision of credit can be seen to be a business activity in its own right will the legal entity be treated as if its business involves finance and leasing business.</p> <p>Entities which hold debt or debt instruments for the purpose of investment will not be regarded as being in the business of providing credit facilities.</p> <p>Although the activity is described as finance and leasing, the essence of the activity, is the provision of credit facilities for consideration. So the mere fact that a legal entity leases items does not mean it is carrying on a finance and leasing business</p>	<p>The CIGA in respect of finance and leasing business includes:</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; and (e) managing any risks.



	Definition	CIGA
Headquarters Business	<p>Headquarters business means the business of providing any of the following services to an entity in the same group:</p> <ul style="list-style-type: none"> (a) the provision of senior management; (b) the assumption or control of material risk for activities carried out by any of those entities in the same group; or (c) the provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (b), but does not include banking business, financing and leasing business, fund management business, intellectual property business, holding business or insurance business. 	<p>The CIGA in respect of headquarters business includes:</p> <ul style="list-style-type: none"> (a) taking relevant management decisions; (b) incurring expenditures on behalf of affiliates; and (c) co-ordinating group activities.
Shipping Business	<p>The term "shipping business" means any of the following activities involving the operation of a ship anywhere in the world other than solely within British Virgin Islands waters:</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>We would be happy to advise on the meaning of the term "British Virgin Islands waters" and "ship", which does not include a fishing vessel, a pleasure vessel or a small ship, if required.</p>	<p>The CIGA in respect of shipping business includes:</p> <ul style="list-style-type: none"> (a) managing the crew (including hiring, paying and overseeing crew members); (b) hauling and maintaining ships; (c) overseeing and tracking deliveries; (d) determining what goods to order and when to deliver them; and (e) organising and overseeing voyages.
Intellectual Property Business	<p>Intellectual property business means the business of holding intellectual property assets.</p> <p>An "intellectual property asset" means 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 is defined in the ES Law as including: (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> <p>According to the ES Rules, the relevant activity consists of holding an intellectual property asset from which identifiable income accrues, so if no identifiable income accrues there is no intellectual property asset.</p>	<p>The CIGA in respect of intellectual property business includes:</p> <ul style="list-style-type: none"> (a) where the business concerns intellectual property assets such as patents, research and development; and (b) where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.



	Definition	CIGA
Intellectual Property Business	<p>The definition does not therefore apply to a business which owns intellectual property merely as an adjunct to its business. Most businesses will own some form of intellectual property but this does not earn specific amounts of revenue – it simply contributes to or protects the general profitability of the business.</p> <p>The relevant activity is focusing on businesses which make money from licensing or otherwise exploiting intellectual property rights. What is being targeted are entities which receive income from intellectual property rights which they have not developed themselves or, as the case maybe, are not actively exploiting.</p>	
Holding Business	<p>Holding business means the business of being a pure equity holding entity. A “pure equity holding entity” means a legal entity that only holds equity participations in other entities and only earns dividends or capital gains.</p> <p>According to the ES Rules, the definition of pure equity holding entity is deliberately framed in narrow terms. A legal entity will only fall within the definition if it holds nothing but equity participations, yielding dividends or capital gains. The ownership of any other form of investment (such as an interest-bearing bond) will take the legal entity outside this definition.</p> <p>Equity participation obviously includes shares in a company, but is wide enough to encompass other forms of investment in a legal entity which give the investor the right to participate in the profits of the legal entity.</p> <p>The word “dividends” will be construed broadly to encompass any payments made to an investor in respect of an equity participation.</p>	There is no CIGA for Holding Business