



Economic substance legislation



British Virgin Islands Economic Substance

On 28 December 2018, the Government of the British Virgin Islands published the Economic Substance (Companies and Limited Partnerships) Act, 2018 (the “Act”), which came into effect on 1 January 2019.

The Act was issued to impose substantive economic requirements on relevant legal entities (being those that are tax resident in the jurisdiction and which carry on relevant activities). It is responsive to concerns raised by the European Union Code of Conduct Group for Business Taxation (“COCG”), and recent OECD guidance, regarding the economic substance of entities in jurisdictions that subject corporate profits to zero or near zero rates (such as the BVI).

We understand that the British Virgin Islands International Tax Authority (“ITA”) will issue a draft of the Economic Substance Code (the “Code”) shortly. The Code is supplementary to the Act and contains rules on how the economic substance requirements may be met and, guidance on the interpretation of the legislation, as well as information relating to the manner in which the ITA will carry out its obligations.

The Act and the Code demonstrate the BVI’s commitment to international best practice and to meeting OECD Base Erosion and Profit Shifting Standards. As such it is expected that they will continue to consult with relevant industry groups.

KPMG Observations

The Act, supplemented by the Code, imposes economic substance requirements on an entity if it is;

- a) an entity which falls within the Act;
- b) tax resident in the BVI; and
- c) carrying on a relevant activity during any financial period in which it receives income from that activity (Rule 3 of the Code).

A key concept is that the Act only applies reporting and economic substance requirements to those ‘Legal Entities’ conducting ‘Relevant Activities’.

Legal Entities are defined as ‘a company and a limited partnership’ and include foreign companies and foreign limited partnerships that are incorporated outside of, but registered, in the BVI.

Relevant activity is defined under Part 6 of the Code and provides a list of the nine types of businesses:

- 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

Key Points to note

- **Investment fund:** The business of being an Investment fund is not a relevant activity. An Investment fund, therefore, is outside of the scope of the Act unless it is carrying on a relevant activity besides being an Investment fund.
- **Holding business:** Given the common use of holding businesses in the BVI, it is important to note that a holding business means 'the business of being a pure equity holding entity'. A pure equity holding entity is one that **only** holds equity participations in other entities and **only** earns dividends and capital gains.

Such legal entities are subject to a less rigorous substance regime than other forms of relevant activities. They will be deemed to have adequate substance if they comply with their statutory obligations and have adequate employees and premises for holding, and where relevant, managing those equity participations.

Those legal entities which hold assets other than equity participations will not fall within the definition of a pure equity holding company, but may be found to carry on other relevant activities.

- **Management of relevant activities:** For all legal entities that are resident in the BVI and conducting Relevant Activity, other than holding businesses, it is required that the relevant activity is directed and managed from the BVI. It should be noted that 'directed and managed' relates to the activity rather than the legal entity as a whole, unless the legal entity's only business is the relevant activity or activities in question.

The Code does not impose any requirement that directors are BVI resident, but it does state that there must be an adequate number of board meetings held in the BVI (which in turn would require a quorum of directors to be present at such meetings in the BVI).

- **Core Income Generating Activity ("CIGAs") is carried on in the BVI:** The lists of CIGAs set out in the Act will not be treated as exhaustive. The ITA will look to ensure that the core elements of the relevant activity that the legal entity does carry out are carried out in the BVI. CIGA is not a requirement for holding businesses.

For legal entities conducting relevant activities, the date from which they are obliged to comply with the Act is based upon whether they were formed prior to, or after, 1 January 2019 and, what is deemed to be the entity's initial financial period for the purpose of the Act.

- The initial financial period for new entities (formed after 1 January 2019) is deemed to be 12 months from the date of formation.
- For entities that were in existence on 1 January 2019, the initial financial period is deemed to be 12 months from 30 June 2019.

In either case, all legal entities must report to the ITA by 31 December 2020 at the latest. Filing and reporting is to be made via the Beneficial Ownership Secured Search System Act, 2017.

It is important to note that even if an entity concludes that it does not carry on Relevant Activities, or is not considered to be tax resident in the BVI, it still has an obligation to report these conclusions outlining (with support) the jurisdiction in which it is tax resident. Based on commentary provided to the industry over the last few months we anticipate this reporting obligation will be straightforward.

It is also important to note that where an entity is resident and carrying on Relevant Activities then the obligation to comply with the relevant substance requirements begins at the commencement of the initial financial period and not the reporting deadlines above.

Fines and Enforcement

Entities which carry on a relevant activity, which cannot demonstrate tax residence outside of the BVI, and which fail to meet the economic substance requirements, will be subject to enforcement action. This could result in substantial fines and potential strike off from the BVI Register of Companies. Likewise, if legal entities do not take steps to either change their activities so that they are outside of the scope of the legislation, or to bring themselves into compliance with the Act, they can expect to be subject to enforcement action.

The Act outlines a notice process with graduated penalties to be applied for failure to meet economic substance requirements following each subsequent notice. The maximum penalty is US\$400,000 for a high risk intellectual property legal entity and US\$200,000 for all other legal entities.

Next steps

- An immediate analysis should be undertaken by pre-existing entities to determine if they fall within scope of the Act's more stringent requirements, and if so, whether those requirements will be met. If there is uncertainty as to whether the requirements will be satisfied, remedial actions should be considered. For example, changes to BVI based activities or the structure of the entity (or its business).
- All BVI entities which are carrying on relevant activity and which are tax resident in the BVI should be demonstrating substance by 1 July 2019.
- The draft Code confirms the first reporting for relevant entities conducting activities will be due by 30 June 2020.

How KPMG in the BVI can help

KPMG in the BVI have been working closely with the ITA and industry groups in respect of both the Act and the Code. Using our understanding of the legislation we can provide the following assistance:

- An initial analysis of the extent to which the Act may impact your business and organisational structure. i.e. is your business captured until the Act?
- Assistance with compliance with the economic substance annual notification and reporting requirements;
- Advice on the requirements for your business to ensure compliance, including considering outsourcing within the BVI;
- A cost benefit analysis, utilising our global network, with respect to decisions regarding residency; and
- Other advice related to the BVI's Economic Substance legislation that our clients require.

Get in touch

Please contact one of our advisors below to assist with all your questions and concerns



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