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BVI Economic Substance

All companies and limited partnerships that are registered or incorporated in the British Virgin Islands ("BVI") must comply with annual economic substance requirements.

This guidance note has been prepared in relation to the: (1) the Economic Substance (Companies and Limited Partnerships) Act, 2018 (the "**Original Act**"); and (2) the new Economic Substance (Companies and Limited Partnership) (Amendment) Act, 2021 (the "**Amendment Act**"). Together, we shall refer to the Original Act and the Amendment Act as the "**Substance Legislation**".

All companies and limited partnerships registered or incorporated in the BVI ("**Entities**") must comply with the Substance Legislation, save for limited partnerships (without legal personality) formed before 1 July 2021, which must comply with the Substance Legislation by no later than 1 January 2022.

1. Background

The Original Act came into force on 1 January 2019, to address the concerns of the EU Code of Conduct Group (Business Taxation) regarding the existence of favourable tax regimes that facilitate offshore structures, which generate profits without real economic activity. The introduction of the Substance Legislation demonstrates the BVI's continued commitment to adhere to international best practices, as a member of the Organisation for Economic Co-operation and Development's Inclusive Framework on Base Erosion and Profit Shifting.

2. What changes have been made to the Substance Legislation in 2021?

The Amendment Act made three notable amendments to the Original Act:

(a) **Partnerships**

The Amendment Act brought all limited partnerships, exempted partnerships and foreign partnerships in-scope, irrespective of whether such partnerships have a separate legal personality. Under the Original Act, only: (a) companies; and (b) partnerships (with legal personality), were in-scope.

As a result of the Amendment Act, all limited partnerships formed on or after 1 July 2021 are now in-scope. For limited partnerships (without legal personality) formed before 1 July 2021, the Amendment Act introduced a six-month transition period, which will make them subject to the Substance Legislation by no later than 1 January 2022.

(b) Investment Funds

The Amendment Act created two new terms: "*investment fund*" and "*investment fund business*", which it expressly excludes from carrying on a Relevant Activity. This removed any doubt as to the treatment of investment funds in the BVI. In short, if an Entity is established to operate as an investment fund and it only carries on investment fund business, it will not carry out a Relevant Activity.

(c) Distribution and Service Centre Business

The Amendment Act amended the definition of "*Distribution and Service Centre Business*" to include the provision of consulting or administrative services to foreign affiliates.

The changes implemented by the Amendment Act are in line with evolving international requirements in relation to economic substance standards. Comparable jurisdictions, including the Cayman Islands, Bermuda and the Crown Dependencies, have implemented similar changes to their respective economic substance legislative frameworks (to the extent applicable).

3. What Entities need to comply with the Substance Legislation?

All Entities must comply with the Substance Legislation, save for limited partnerships (without legal personality) formed before 1 July 2021, which must comply with the Substance Legislation by no later than 1 January 2022.

4. Annual Review

To comply with the Substance Legislation, all Entities should carry out an annual review of their assets, activities and tax residency, to determine: (1) if they have carried on a Relevant Activity; (2) where they are tax resident; and (3) if they need to demonstrate substance in the BVI ("**Annual Review**").

5. Relevant Activities

There are nine "**Relevant Activities**" in the BVI, which are summarised in more detail in our Factsheet that can be found by clicking [here](#):

1. Banking Business	2. Insurance Business	3. Shipping Business
4. Fund Management Business	5. Finance and Leasing Business	6. Headquarters Business
7. Holding Business	8. Intellectual Property Business	9. Distribution and Service Centre Business

6. Financial Periods

Economic substance is assessed by reference to financial periods. Set out below are the financial periods, prescribed in the Substance Legislation. It is worth noting that Entities can adopt bespoke financial periods, provided the correct notice is given to the BVI International Tax Authority (the "**Tax Authority**"). The financial periods prescribed by the Substance Legislation do not have to (and usually do not) correlate with an Entity's accounting financial period.

(a) **Companies**

For companies incorporated or registered before 1 January 2019, their financial period is 30 June to 29 June each year. For companies incorporated or registered on or after 1 January 2019, their financial period will commence on their date of incorporation or registration and terminate a year (minus a day) later e.g. a company incorporated on 17 May 2021 will have a 17 May to 16 May financial period each year.

(b) **Partnerships**

For partnerships (with legal personality) formed or registered before 1 January 2019, their financial period is 30 June to 29 June each year. For partnerships (with legal personality) formed or registered on or after 1 January 2019, their financial period will commence on their date of formation or registration and terminate a year (minus a day) later e.g. a partnership formed on 15 October 2021 will have a 15 October to 14 October financial period each year.

For partnerships (without legal personality) formed or registered before 1 July 2021, their financial period must commence no later than 1 January 2022. We anticipate that most of these partnerships will elect to have a 1 January to 31 December financial period each year. For partnerships (without legal personality) formed or registered on or after 1 July 2021, their financial period will commence on their date of formation or registration and terminate a year (minus a day) later e.g. a partnership formed on 15 October 2021 will have a 15 October to 14 October financial period each year.

7. Annual Reporting Obligations

An Entity should carry out its Annual Review and then instruct its registered agent (Nerine) to file its annual substance declaration on the Database (*defined below*) (the "**Annual Declaration**"). The Annual Declaration should confirm the following:

(a) **No Relevant Activity**

If the Annual Review confirms that an Entity did not carry on a Relevant Activity, the Entity must instruct its registered agent to file a '*nil return*' Annual Declaration.

(b) **Relevant Activity**

If the Annual Review confirms that an Entity: (1) carried on any Relevant Activity; and (2) cannot prove that it was tax resident in a Cooperative Jurisdiction, the Entity must instruct its registered agent to file its Annual Declaration confirming: (1) what Relevant Activity the Entity carried on; and (2) that the Entity can demonstrate substance (*see below*) in the BVI for the relevant Financial Period.

(c) **Relevant Activity + Prove Tax Resident in Cooperative Jurisdiction**

If the Annual Review confirms that an Entity: (a) carried on any Relevant Activity; and (b) can prove it was tax resident in a Cooperative Jurisdiction, the Entity must instruct its registered agent to file its Annual Declaration confirming: (1) what Relevant Activity the Entity carried on; and (2) where it is tax resident. A copy of the Entity's foreign tax certificate (or other documentation supporting its foreign tax residency) must be filed with the Annual Declaration.

The Annual Declaration must be filed within six months of an Entity's Financial Period ending (the "**Annual Filing Requirements**").

The Annual Filing Requirements build upon the pre-existing reporting regime under the Beneficial Ownership Secure Search System Act, 2017 (the "**BOSS Act**"). The BOSS Act requires prescribed information (about an Entity's beneficial owners) to be entered on a database, established by the Tax Authority and maintained by the Entity's registered agent (Nerine) in the BVI (the "**Database**"). The content of the Database was expanded under the Substance Legislation, to include information that enables the Tax Authority to determine what substance requirements apply to each Entity and if each Entity has complied with them.

8. Annual Substance Requirements

An Entity should carry out its Annual Review and instruct its registered agent to file its Annual Declaration. The Annual Declaration must confirm if the Entity carried on a Relevant Activity, and what (if any) substance requirements it needs to comply with:

(a) No Relevant Activity

If the Annual Review confirms that the Entity did not carry on a Relevant Activity, the Entity will not have to demonstrate substance in the BVI for the relevant Financial Period. However, the Entity must still instruct its registered agent to file a '*nil return*' Annual Declaration.

(b) Relevant Activity – Cannot Prove Tax Resident in a Cooperative jurisdiction

If the Annual Review confirms that an Entity: (1) carried on any Relevant Activity; and (2) cannot prove that it was tax resident in a Cooperative Jurisdiction, the Entity will have to demonstrate substance in the BVI for the relevant Financial Period.

To demonstrate substance, the Entity will have to show that it employed adequate employees in the BVI and that it maintained adequate premises in the BVI. The Entity may also have to show that: (a) it was managed and directed from the BVI; (b) it incurred adequate expenditure in the BVI; and (c) it carried out its core income generating activities in the BVI.

The Entity must also instruct its registered agent to file its Annual Declaration confirming: (1) what Relevant Activity the Entity carried on; and (2) that the Entity was able to demonstrate substance in the BVI for the relevant Financial Period.

(c) Relevant Activity – Tax Resident in a Cooperative jurisdiction

If the Annual Review confirms that an Entity: (a) carried on any Relevant Activity; and (b) can prove it was tax resident in a Cooperative Jurisdiction, the Entity will not have to demonstrate substance in the BVI for the relevant Financial Period. The Entity may need to comply with economic substance requirements where it is tax resident, but this is outside the scope of this guidance note.

The Entity must instruct its registered agent to file its Annual Declaration confirming: (1) what Relevant Activity the Entity carried on; and (2) where it is tax resident. A copy of the Entity's foreign tax certificate (or other documentation supporting its foreign tax residency) must be filed with the Annual Declaration.

9. Holding Business

To carry on Holding Business, an Entity must be a Pure Equity Holding Entity i.e. an entity that only: (1) holds Equity Participations; and (2) earns dividends and capital gains, in respect of its holding of such Equity Participations.

The term "**Equity Participation**" includes shares in a company and other forms of investments in an entity, which give the investor the right to participate in the profits of that entity. The interest of a general partner in a limited partnership will usually be of this quality.

(a) Cannot Prove Tax Resident in a Cooperative jurisdiction

If the Annual Review confirms that an Entity: (1) carried on Holding Business; and (2) cannot prove that it was tax resident in a Cooperative Jurisdiction, the Entity will have to demonstrate substance in the BVI for the relevant Financial Period. To demonstrate substance, the Entity must show that it: (a) employed an adequate number of suitably qualified employees to carry on its Holding Business, who were physically present in the BVI; and (b) maintained adequate premises in the BVI to carry on its Holding Business. The Entity must also instruct its registered agent to file its Annual Declaration confirming: (1) that it is carried on Holding Business; and (2) that the Entity was able to demonstrate substance in the BVI for the relevant Financial Period.

The terms "*appropriate*" and "*adequate*" are subjective and vary according to the nature and scale of the Holding Business and the Entity's general business activities. However, assuming an Entity passively held the Equity Participations during the relevant Financial Period, it can usually demonstrate substance by simply maintaining Nerine as its registered agent and its registered office in the BVI, during the relevant Financial Period.

(b) Tax Resident in a Cooperative jurisdiction

If the Annual Review confirms that an Entity: (a) carried on Holding Business; and (b) can prove it was tax resident in a Cooperative Jurisdiction, the Entity will not have to demonstrate substance in the BVI for the relevant Financial Period. The Entity may need to comply with economic substance requirements where it is tax resident, but this is outside the scope of this guidance note.

The Entity must instruct its registered agent to file its Annual Declaration confirming: (1) it carried on Holding Business; and (2) where it is tax resident. A copy of the Entity's foreign tax certificate (or other documentation supporting its foreign tax residency) must be filed with the Annual Declaration.

10. Failure to Comply

The Substance Legislation provides for both criminal and financial sanctions for non-compliance or providing inaccurate information in a Declaration. The ITA has responsibility for monitoring and investigating compliance of the Substance Legislation.

For further information please email substance@nerinebvi.com or reach out to your usual contact at Nerine.