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BVI Economic Substance

This factsheet 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".

In short, 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.

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 (see below); (2) where they are tax resident; and (3) if they need to demonstrate substance in the BVI ("Annual Review").

RELEVANT ACTIVITIES

There are nine "Relevant Activities" in the BVI:

1. Banking Business

An Entity carries on "Banking Business" when it is in the business of accepting deposits of money, which may be withdrawn or repaid on demand or after a fixed period or after notice, by cheque or otherwise and the employment of such deposits, either in whole or in part: (a) in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; and (b) the making of investments, for the account and at the risk of the person accepting such deposits.

Only Entities that hold a licence issued by the BVI Financial Services Commission (the "Commission") can lawfully carry on Banking Business. The fact that an Entity may have a bank account does not mean (on its own) that it Entity carries on Banking Business.

2. Insurance Business

An Entity carries on "Insurance Business" when it is in 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.

Only Entities that hold a licence issued by the Commission can lawfully carry on Insurance Business, even if their insurance business is located outside the BVI.

3. Fund Management Business

An Entity carries on "Fund Management Business" if it conducts activity that requires it to hold investment business license under the Securities and Investment Business Act, 2010. Only Entities that hold one of the following licences, issued by the Commission, can lawfully carry on Fund Management Business:

- Sub-Category A Licence, for Managing Segregated Portfolios (Excluding Mutual Funds)
- Sub-Category B Licence, for Managing Mutual Funds
- Sub-Category C Licence, for Managing Pension Schemes
- Sub-Category D Licence, for Managing Insurance Products
- Sub-Category E Licence, for Managing other Types of Investment

The Amendment Act expressly excludes investment funds from the definition of Fund Management Business (or indeed any other Relevant Activity). An Entity established to operate as an investment fund, which only carried on investment fund business, will not carry on a Relevant Activity.

4. Finance and Leasing Business

An Entity carries on "*Finance and Leasing Business*" when it provides credit facilities of any kind, for consideration. The only exception to this rule is if the credit facility is merely "*incidental*" to a different sort of the Entity's business.

(a) Credit Facilities

The term "*credit facilities*" encompasses all types of lending and credit facilities. Providing any form of credit facility, even a one-off loan, can bring an Entity in-scope of Finance and Leasing Business.

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.

Where an advance or credit repayable by a customer is assigned to another person, that other person is deemed to be providing the credit facility for the purposes of Finance and Leasing Business.

Entities that hold debt or debt instruments for the purpose of investment will not be regarded as providing credit facilities. Further, although the activity is described as 'finance and leasing', the essence of the activity is the provision of credit facilities. The fact that an Entity leases items does not mean it carries on Finance and Leasing Business. Short term rentals/leases for properties, vehicles, boats or equipment do not fall in-scope of Finance and Leasing Business.

(b) Consideration

The term "*consideration*" is not defined in the Substance Legislation so it should be considered in the broadest terms. However, it is clear that consideration includes (but is not limited to) interest.

If an Entity makes (or has made) a credit facility available to a third party, from which it receives income (i.e. interest) during a Financial Period, the Entity has carried on Finance and Leasing Business. This is true even if the income is very small and insignificant, when compared to the Entity's other activities.

If an Entity has provided a credit facility for *nil consideration* e.g. an interest-free loan to a third party, from which it receives no other form of consideration during the Financial Period, the Entity has not carried on Finance and Leasing Business.

(c) Incidental

If an Entity provides a credit facility, as an incidental part of a different sort of its business, the Entity has not carried on Finance and Leasing Business. To determine if the credit facility is "*incidental*", it is important to look at the relationship, link and interaction between the credit facility and the other activities of the Entity i.e. if the credit facility is incidental to the Entity's main business activities.

The provision of a credit facility cannot be "*incidental*" simply: (i) by reference to the Entity's size; or (ii) because the credit facility only accounts for a particular fraction of the Entity's overall income or output; or (iii) by reference to the relative value of the credit facility to the overall business of the Entity. If the provision of the credit facility can be seen as a business activity in its own right (even a very small one by comparison), the Entity will be treated as if part of its business is Finance and Leasing Business.

(d) Intra-Group Loans

The Substance Legislation does not directly deal with how an Entity should be classified if it has issued an intra-group loan, which is interest-bearing. It is possible to argue that the loan should be considered incidental, but each loan needs to be reviewed and classified on its own merits.

5. Headquarters Business

An Entity carries on "Headquarters Business" when it provides any of the following services to another entity in its group: (a) the provision of senior management; (b) the assumption or control of material risk for activities carried on by any of these entities in the same group; and (c) the provision of substantive advice in connection with the assumption or control of risk referred to in (b).

Whether an Entity carries on Headquarters Business is not dependent on its position in the group structure. It is entirely dependent on the services it provides to other entities in its group, whether parents or subsidiaries.

Any activity falling within the definition of Banking Business, Finance and Leasing Business, Fund Management Business, Intellectual Property Business, Holding Business, or Insurance Business is excluded from the definition of Headquarters Business.

6. Shipping Business

An Entity carries on "Shipping Business" when it provides activities that involve operating a Ship (defined below) anywhere in the world, other than solely within the BVI i.e.: (a) transporting, by sea, persons, animals, goods or mail; (b) renting or chartering of Ships for the purpose described in (a); (c) selling travel tickets or equivalent, and ancillary services connected with the operation of a Ship; (d) using, maintaining or renting containers, including trailers and other vehicles or equipment for the transport of containers, used for transporting anything by sea; and (e) managing the crew of a Ship.

A "Ship" means every description of vessel used in sea navigation other than a: (a) fishing vessel, being any vessel used or, intended to be used, for or in connection with fishing for sea fish, other than a vessel used or intended to be used for fishing otherwise than for profit or a vessel for the time being used or intended to be used wholly for the purpose of conveying persons wishing to fish for pleasure; (b) pleasure vessel, being any vessel including a dive boat which at the time it is being used is: (i) in the case of a vessel wholly owned by an individual or individuals, used only for the sport or pleasure of the owner (which includes a charterer) or the immediate family (i.e. the husband or wife of the individual and a relative (being a brother, sister, ancestor or lineal descendant) of the individual or the relative's husband or wife) or friends of the owner; or (ii) in the case of a vessel owned by a body corporate, one on which the persons are employees, officers or shareholders of the body corporate, or their immediate family or friends; and (iii) on a voyage or excursion for which the owner does not receive money for or in connection with operating the vessel or carrying any person, other than as a contribution to the direct expenses of the operation of the vessel incurred during the voyage or excursion; or (c) pleasure vessel being any vessel wholly owned by or on behalf of a club formed for the purpose of sport or pleasure which, at the time it is being used, is used only for the sport or pleasure of members of the club or their immediate family, and for the use of which any charges levied are paid into club funds and applied for the general use of the club.

7. Holding Business

An Entity carries on "Holding Business" when it is in the business of being a Pure Equity Holding Entity (a "PEHE"). A PEHE is an Entity that only holds Equity Participations in other entities and only earns dividends and capital gains. "Equity Participations" include 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 (and the interest of a limited partner in a limited partnership will usually be of this quality).

The definition of PEHE is deliberately framed in narrow terms. An 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) or any other asset (e.g. bonds, government securities, legal or beneficial interests in real property) will take the Entity outside this definition. This is true even if the Entity holds Equity Participations, in addition to the other investments or assets. Although such Entity may be found to carry on other Relevant Activities (e.g. if an Entity holds Equity Participations and a Ship, it will not carry on Holding Business, but it may carry on Shipping Business).

If an Entity carries on Holding Business, it will have to demonstrate substance in the BVI, unless it can prove that it is resident for tax purposes in a Cooperative Jurisdiction. A "Cooperative Jurisdiction" is any jurisdiction outside the BVI that is not on Annexure 1 of the EU list of non-cooperative jurisdictions, for tax purposes, which can be found by clicking [here](#). To demonstrate substance, the Entity will need to 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 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. Assuming an Entity passively holds the Equity Participations, it can usually demonstrate substance by simply keeping Nerine as its registered agent and maintaining its registered office in the BVI during the relevant financial period. If the Entity actively manages the Equity Participations, it may need to fulfil additional requirements to demonstrate substance in the BVI.

8. Intellectual Property Business

An Entity carries on "Intellectual Property Business" when it engages in the business of holding any IP Asset (defined below), from which identifiable IP Income (defined below) accrues to the business, such IP Income being separately identifiable from any income generated from any tangible asset in which the right subsists. "IP Asset" means any intellectual property right in intangible assets, including but not limited to copyright, patents, trade marks, brand, and technical know-how. "IP Income" means any royalties, capital gains and other income from the sale of an IP Asset, income from a franchise agreement, and income from licensing the intangible asset.

If an Entity receives no IP Income, then it does not carry on Intellectual Property Business. However, the BVI International Tax Authority has confirmed that appropriate action will be taken against any Entity which seeks to manipulate its income, to avoid being subject to substance requirements by, for example, disguising royalties as part of sales income.

9. Distribution and Service Centre Business

The definition of Distribution and Service Centre Business was amended under the Amendment Act, to include the provision of consulting and administration services.

Now, an Entity carries on "Distribution and Service Centre Business" when it is in the business of: (a) purchasing from foreign affiliates: (i) component parts or materials for goods; or (ii) goods ready for sale, and reselling such component parts, materials or goods; and/or (b) providing consulting or administrative services to foreign affiliates, but does not include any activity included in any other Relevant Activity except Holding Business.

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