ARIFA
ARIAS, FABREGA & FABREGA Trust Co. BVI Limited

GUIDE ON BVI ECONOMIC SUBSTANCE REQUIREMENTS.

Following the introduction of the Economic Substance (Companies and Limited Partnerships) Act, 2018 (the "Act") in the British Virgin Islands (BVI) on 1st January 2019, BVI entities conducting certain business activities must meet economic substance requirements in the BVI. Legal entities carrying on relevant activities initially broadly speaking included all BVI companies and limited partnerships (except for limited partnerships without legal personality), excluding those which are tax resident in a jurisdiction outside the BVI that is not listed by the European Union as a non-cooperative jurisdiction. Entities which do not carry on a relevant activity are not subject to the economic substance requirements but may be subject to certain reporting obligations.

On July 2021, the Act was amended in order to include an update that ensures that that all limited partnerships (including foreign limited partnerships) registered in the BVI are relevant legal entities.

On 23 April 2019, the British Virgin Islands International Tax Authority (the "ITA") published a draft Economic Substance Code (the "Code") and was finalized on 9 October 2019 as Economic Substance and explanatory notes (the "Rules"). The Rules are supplementary to the Economic Substance (Companies and Limited Partnerships) Act, 2018 and contains rules on how the economic substance requirements may be met and guidance on the interpretation of the legislation, as well as the manner in which the ITA will carry out its obligations.

Relevant Activities and Core Income Generating Activities

The Act defines nine (9) categories of relevant activities. All BVI entities should now assess whether they are conducting or plan to conduct one or more of the following relevant activities.

The following chart displays the definitions of each of the relevant activities and the core income generating activities in respect to each relevant activity as defined under the Act and the Rules.

The list of core income generating activities is non-exclusive as the assessment of what constitutes a core income generating activity of a relevant activity will vary from business to business.

Definition	Core Income Generating Activity
1. Banking Business: Has the meaning specified in section 2 (1) of the Banks and Trust Companies Act, 1990. The banking business refers to receiving (other than from a bank or trust company) and holding current, savings, deposit or similar account money that is repayable by cheque or order and is capable of being invested by way of advances to customers or otherwise, but does not include the receiving on savings, deposit or similar account money which is paid by one company to another at a time when (a) one is the subsidiary of the other; or (b) both are subsidiaries of another company.	The core income generating activities in respect to the banking business are those listed in section 2 (1) of the Banks and Trust Companies Act, 1990 and include: ▪ 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.

ARIFA
ARIAS, FABREGA & FABREGA Trust Co. BVI Limited

Definition	Core Income Generating Activity
2. Insurance Business: Has the meaning specified in section 3 (1) of the Insurance Act, 2008 and is explained as 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 core income generating activities in respect to the insurance business are those listed in the Insurance Act, 2008 and include: ▪ predicting and calculating risk; ▪ insuring or re-insuring against risk; and ▪ providing insurance business services to clients.
3. 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, 2010 (the "SIBA"). Category 3 of Schedule 3 of SIBA includes sub-categories that refer to the management of segregated portfolios, mutual funds, pension schemes, insurance product and other types of investment.	The core income generating activities in respect to the fund management business include: ▪ taking decisions on the holding and selling of investments; ▪ calculating risks and reserves; ▪ taking decisions on currency or interest fluctuations and hedging positions; and ▪ preparing relevant regulatory or other reports for government authorities and investors.
4. Finance and leasing business: Refers to the provision of credit facilities of any kind for consideration (which may include consideration by way of interest). 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 (ii) conditional sale or credit sale. 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. Any activity falling within the definition of "banking business", "fund management business" or "insurance business" is excluded from the finance and leasing business. A company that provides credit facilities as an incidental part of a different sort of business is not considered as carrying a finance and leasing business.	This activity mainly includes the provision of credit facilities as a business. A company may provide credit facilities as an incidental part of a different sort of business, however, in order to fall within the definitions the main purpose of the company must be to provide credit facilities. The core income generating activities in respect to the finance and leasing business mainly include: ▪ 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.
5. Headquarters business: The business of providing any	The core income generating activities in respect

Definition	Core Income Generating Activity
of the following services to an entity in the same group: (a) the provision of senior management, (b) the assumption or control of material risk for activities carried out by any of these entities in the same group, (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 company business or insurance business.	to the headquarters business include: ▪ taking relevant management decisions; ▪ incurring expenditures on behalf of affiliates; ▪ the provision of senior management; ▪ the assumption or control of material risk for activities carried out by any of the entities in the same group; ▪ the provision of substantive advice in connection with the assumption or control of risk referred to in above; and ▪ coordinating group activities.
6. Shipping business: Means the following activities involving the operation of a ship anywhere in the world than solely within Virgin Islands waters (as defined in section 2 (2) (a) of the Merchant Shipping Act, 2001): (a) the business of transporting, by sea, persons, animals, goods or mail; (b) the renting or chartering of ships for the purpose described above; (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. The definition of "ship" for the purpose of the relevant activity definition does not include a "fishing vessel", "pleasure vessel", or a "small ship" (under 24m) as defined in the Merchant Shipping Act, 2001.	The core income generating activities in respect to the shipping business include: ▪ the business of transporting, by sea, persons, animals, goods or mail; ▪ the renting or chartering of ships for the purpose described above; ▪ the sale of travel tickets or equivalent, and ancillary services connected with the operation of a ship; ▪ 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; ▪ 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 ▪ organizing and overseeing voyages.
7. Holding business: Means the business of being a "pure equity holding entity" which in turn means a legal entity that only holds equity participations in other entities and only earns dividends and capital gains. Companies holding other types of assets that are not only equity participation (such as investments in the way of an interest-bearing bond) in other entities fall outside the definition.	There are no incoming generating activities for holding business.
8. Intellectual property business: The business of holding intellectual property assets, which are defined as any intellectual property right in intangible assets, including but not limited to copyright, patents, trademarks,	The core income generating activities in respect to the intellectual property business include: ▪ where the business concerns intellectual

Definition	Core Income Generating Activity
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). "Income" in respect of an intellectual property asset is defined in the Act 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. The Rules is clear as it indicates that the relevant activity for the intellectual property business consists of holding an intellectual property asset from which identifiable income accrues, so if no identifiable income accrues there is no intellectual property asset. The relevant activity only targets BVI entities that receive income from intellectual property rights which they have not developed themselves or, as the case may be, are not actively exploiting.	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.
9. Distribution and service centre business: Means the business of either or both of the following: (a) purchasing from foreign affiliates (i) component parts or materials for goods; or (ii) goods ready for sale; and (iii) reselling such component parts, materials or goods; (b) providing services to foreign affiliates in connection with the business, but does not include any activity included in any other relevant activity except "holding business". The scope of the relevant activity refers only to foreign affiliates, which means a foreign entity that is in the same group as the other entity.	The core income generating activities in respect to the distribution and service centre business include: ▪ transporting and storing goods; ▪ managing stocks; ▪ taking orders; and ▪ providing consulting or other administrative services.

Economic Substance Test

BVI entities must meet certain requirements in order to evidence their economic substance. In this respect, we can outline three categories of economic substance tests that apply depending on the nature of the relevant activity.

General Economic Substance Test

Each BVI entity, as defined in the Act, which is not tax resident outside the BVI (other than 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) must, in relation to any relevant activity, carry out defined core income generating activities in the BVI and demonstrate economic substance by reference to the following criteria, having regard to the nature and scale of the relevant activity:

1. the relevant activity being directed and managed in the BVI;

2. adequate numbers of suitably qualified employees who are physically present in the BVI (whether or not employed by the relevant legal entity or by another entity and whether on temporary or long-term contracts);
3. adequate expenditure incurred in the BVI;
4. appropriate physical offices or premises in the BVI; and
5. where the relevant activity is intellectual property business and requires the use of specific equipment, the equipment is located in the BVI.

The Holding Business Substance Test

Pure equity holding entities are required to meet a less stringent test for economic substance. The Act provides that 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, has adequate substance if it:

(a) complies with its statutory obligations under the BVI Business Companies Act, 2004 or the Limited Partnership Act, 2017 (whichever is relevant); and
(b) has, in the Virgin Islands, adequate employees and premises for holding equity participations and, where it manages those equity participations, has in the Virgin Islands, adequate employees and premises for carrying out that management.

The Rules acknowledges that the holding of equity participations in most cases can be considered as a passive activity in nature, and that in those cases, the substance requirements for adequate and suitably qualified employees and appropriate premises may be met by the performance of the services provided by the BVI registered agent and the existing registered office.

The Intellectual Property Business Test

Income derived from intellectual property assets can pose a higher risk of profit shifting from higher to lower tax jurisdictions. With this in mind, the substance requirements and the test itself is more rigorous for BVI entities conducting intellectual property businesses.

The general economic substance requirement become stringent by creating presumptions against compliance with the requirement to conduct core income generating activity in two scenarios. The presumptions against non-compliance may be rebutted in certain circumstances. The situations and steps required to rebut the presumptions are detailed and must be assessed on a case-by-case scenario. For this reason, should you believe that your entity is conducting intellectual property business, contact us at the email address seen below for further guidance.

Reporting Obligations

The Act amends the British Virgin Islands Beneficial Ownership Secure Search System Act, 2017 (the "BOSS Act") to add to the existing requirements such that a legal entity and its registered agent have obligations in respect of reporting prescribed information in respect to the legal entities compliance with the economic substance requirements.

The legal entity must notify its registered agent of prescribed information including information regarding the legal entity and its ownership, which must be provided within 15 days from the date of being identified. The legal entity must also identify which, if any relevant activities is conducted and notify its registered agent of such activities within a period to be fixed by regulators following the end of its financial period. The registered agent will be tasked to only enter the information provided by the legal entity on the RA database.

Pursuant to the Act and the Rules, the ITA shall have the power to assess whether a legal entity satisfies the economic substance requirements for any financial year. The ITA will be able to review the information entered into the BOSS system, and issue written requests for additional information.

As a result of the new version of the Rules on Economic Substance issued by the BVI International Tax Authority, questions in the BOSS system have expanded for all entities. Additional information pertaining taxpayer identification number, immediate and ultimate parent entity details, amount and type of gross income, amount of expenditures and information related to MNE Groups is required.

Reporting Periods

The Act measures economic substance by reference to financial periods of no longer than one year.

Entities incorporated in 2019 will have to comply for a reporting period ending on or after 31 December, 2019. Entities in existence prior to 2019 will need to comply for each reporting period starting no later than 30 June 2019.

Penalties

Penalties are imposed both for failure to provide required information, and for operating a legal entity in breach of the economic substance requirements.

The ITA shall be able to impose monetary penalties ranging from US$20,000.00 to US$400,000.00 (depending on first or second determination of non-compliance) for failure of a legal entity to satisfy the economic substance requirements. The ITA may also recommend to the BVI Financial Services Commission that a legal entity be struck off if it determines that it is not possible for the legal entity to meet the requirements.

If a person intentionally or without reasonable excuse provides false information to the ITA under the Act, he or she is committing an offence 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.

Audit of ES Reports by the ITA

The ITA is now in the process of auditing those reports to verify entities' declarations, including where an entity has submitted a "nil return". The audit request includes questions around the purpose of the entity, its assets and its activities. It also includes questions around how the entity made its determination as to whether it was carrying on any "relevant activity" for the purposes of the Act during the financial period.

There is a continuing obligation on every entity to identify and report on whether it carries on any relevant activity. Failure to comply with the classification and reporting obligations under the Act will result in the entity be subject to fines and sanctions. The directors and operators of each entity shall ensure that that they are able to produce robust documentary evidence that serve as the basis on which they classified their entity and to show that they have exercised all reasonable diligence in identifying and reporting the prescribed economic substance information. This could include formal legal opinion and minutes or resolutions evidencing their assessment and measures adopted.

Contact Us

Should you need additional information regarding your BVI entity, please contact us at bvisubstance@arifa.com