

UPDATES ON ECONOMIC SUBSTANCE REQUIREMENTS IN BVI



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The Economic Substance (Companies and Limited Partnership) Act 2018 (the Act) has been enacted in the British Virgin Islands (BVI) and came into force on 1 January 2019. The Act requires certain BVI legal entities carrying on relevant activities to demonstrate adequate economic substance in the BVI.

Which entities will be affected?

In general, the Act applies to all BVI companies or BVI limited partnerships carrying on any of the relevant activities unless they can demonstrate that they are tax-resident in another jurisdiction outside the BVI.

A BVI tax resident legal entity is subject to the economic substance requirements if it conducts any of the following relevant activities:

- ▶ 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

Under the Act, apart from a pure equity holding entity (that only holds equity participations in other entities and only earns dividend and capital gains) which is subject to a reduced test, each BVI tax resident legal entity must comply with the economic substance requirements which will be measured by reference to the reporting periods of no longer than one year.

Entities which are in existence on 1 January 2019 will need to demonstrate economic substance requirements no later than 30 June 2019 and meet reporting obligations within one year of that date.

New entities which are incorporated after 1 January 2019 must comply with the economic substance requirements immediately and meet the reporting obligations within one year of the date of incorporation.

What are the economic substance requirements?

Entities which are subject to the economic substance requirements (other than pure equity holding entities) must conduct core-income generating activity in the BVI by reference to the following criteria:

- a. the relevant activity is directed and managed in the BVI;
- b. there are an adequate number of suitably qualified employees who are physically present in the BVI (whether or not employed by the relevant entity or by another entity and whether on temporary or long-term contracts);
- c. there is adequate expenditure incurred in the BVI;
- d. there are physical offices or premises as may be appropriate for the core income-generating activities; and
- e. where the relevant activity is intellectual property business and requires the use of specific equipment, that equipment is located in the BVI.

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 companies laws; and
- b. has adequate employees and premises for holding and, where relevant, managing those equitable interests or shares.

Certain rebuttable presumptions of non-compliance will apply to entities carrying on intellectual property business that are classified as “high risk IP legal entity” or which do not carry on research and development or marketing, branding and distribution activities in the BVI, as appropriate to the type of intellectual property involved.

What are the reporting obligations?

All entities will be required to provide information to enable the International Tax Authority in the BVI to monitor whether the relevant entity is carrying on relevant activities and, if so, whether it is complying with the economic substance requirements. The information will be uploaded by the entity's registered agent and integrated into the BVI's existing Beneficial Ownership Secure Search (BOSS) system. The new regime requires legal entities to submit information on an annual basis with details of any relevant activities carried on during the relevant reporting period and how they satisfy the economic substance requirements. Entities which are not tax resident in the BVI will have to notify details of the jurisdiction where they are tax resident.



What are the consequences of non-compliance?

Penalties will be imposed for failure to provide required information or for operating an entity in breach of the economic substance requirements, which may include substantial fines, imprisonment and eventually the entity may be struck-off the Register.

What to do now?

In view of the above, you are advised to take the following actions immediately:

- a. to carry out an internal review to ascertain if the entity is carrying on any of the relevant activities and whether it is

considered tax resident outside of the BVI

- b. consider if any operational or structural changes are required
- c. entity which is tax resident in the BVI should plan and implement steps to ensure compliance of the economic substance requirements.

We expect further guidance will be issued by the BVI in due course, following which we will update you with more information about how we expect this new legislation will impact your business.

In the meantime, if you have questions regarding the above, please reach out to your usual contacts in BDO Hong Kong.

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