ECONOMIC SUBSTANCE (COMPANIES AND LIMITED PATNERSHIPS) ACT, 2018
(as amended)

RULES ON ECONOMIC SUBSTANCE IN THE VIRGIN ISLANDS

RELEASE DATE: 9th OCTOBER, 2019

ISSUED BY: INTERNATIONAL TAX AUTHORITY

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1. Introduction

1.1 These Rules are issued under the authority of the International Tax Authority pursuant to section 17 of the Economic Substance (Companies and Limited Partnerships) Act, 2018 ("ESA"). Section 17(3) of the ESA gives the International Tax Authority ("ITA") the power to issue rules on how the economic substance requirements may be met, including without prejudice to the generality of the foregoing, rules on the interpretation meaning of any expression used in this Act or in regulations made under section 17(1) of the ESA by the Minister. Section 17(4) of the ESA states that regard shall be had to any rules made under section 17(3) concerning the interpretation of any expression. It comprises:

(a) extracts from legislation, which appear in *italic font*;
(b) rules made by the ITA which appear in **bold font***; and*
(c) explanatory notes which appear in regular font.

1.2 Appendix 1 sets out the abbreviations used in these Rules.

1.3 These rules become effective following the entry into force of the Beneficial Ownership Secure System (Amendment) (No. 3) Act, 2019

1.4 Unofficial consolidations of the ESA and the BOSS Act as they stand at xx October, 2019 (the date of release of these Rules) can be found at:

1.5 The extracts from legislation in these Rules are reflected as at the date of release of these rules and it is the responsibility of the user to keep up to date with any amendments made to legislation.

1.6 These rules and explanatory notes are not intended to be a substitute for legal advice in particular circumstance of individual cases.

1.7 From time to time it may be necessary to revise or expand these rules and explanatory notes. Where any significant change in the content of rules or explanatory notes occurs, the ITA will take account of the fact that an entity may have relied upon the previous form of rules and explanatory notes in ordering its affairs and will afford a reasonable time for the entity to adjust to the new rules and explanatory notes.

2. An overview of the economic substance legislation

2.1 The basic obligation imposed by the economic substance legislation is set out in ESA section 5:

(1) A legal entity which carries on a relevant activity during any financial period must comply with the economic substance requirements in relation to that activity.

(2) A legal entity which carries on more than one relevant activity shall comply

with the economic substance requirements in respect of each activity.

Rule 1

A legal entity will be treated as carrying on a relevant activity during any financial period in which it receives income from that activity.

2.2 In order to be subject to the economic substance requirements, a legal entity must carry on a business which constitutes a relevant activity. Rule 1 makes it clear that the mere receipt of income during a financial period, if derived from that business, will be treated as carrying on the relevant activity. This situation could arise if business operations carried on in financial period 1 result in income which is only received in financial period 2. Even if the only activity which takes place in financial period 2 is the receipt of income, that will still be treated as the carrying on of the business in that financial period. Of course, if all the legal entity is doing in financial period 2 is receiving income, the degree of economic substance required (see below) will be assessed accordingly.

2.3 The following will be considered in order to determine whether an entity is obliged to comply with the economic substance legislation:

(a) is the entity of a type which falls within the economic substance legislation?

(b) if it is, is it carrying on a relevant activity?

(c) if it is carrying on a relevant activity, is it resident for tax purposes in a jurisdiction outside the BVI (and which is not on the EU list of non-cooperative jurisdictions for tax purposes)?

Only if the answers to (a) and (b) are affirmative and the answer to (c) is negative will the economic substance requirements apply to the entity.

2.4 If it has been determined that the entity is required to comply with the economic substance requirement it must be noted that, different substance requirements apply depending on whether the entity is carrying on:

(a) holding business,
(b) intellectual property business or
(c) any other type of relevant activity.

It is a common requirement for all three of the above categories that, in relation to the relevant activity in question, the legal entity has an adequate number of employees and has adequate premises. It is, in addition, a requirement for categories (b) and (c) that relevant activity is directed and managed from the BVI, that adequate expenditure is incurred in the BVI and that core income generating activity ("CIGA") is carried on in the BVI. Activities within category (b) may, in addition, be subject to presumptions against

compliance with the economic substance requirements which the legal entity may have to displace by evidence.

2.5 The various categories of relevant activities can be found in section 6 of the ESA and the economic substance requirements are explained in more detail below.

2.6 Economic substance is assessed over a financial period as defined in section 4 of the ESA.

2.7 It is possible for an entity to carry on more than one relevant activity at a time. In that situation the economic substance requirements must be satisfied in relation to each economic activity carried on. This has particular relevance for pure equity holding entities.

2.8 Entities which carry on a relevant activity, which cannot demonstrate tax residence outside the BVI, and which fail to meet the economic substance requirements will be subject to enforcement action. This can result in substantial fines, and the striking off of the entity.

2.9 Any entity carrying on a relevant activity which is potentially within the scope of the legislation has, broadly speaking, three options:

(a) it can ensure that the substance of the relevant activity is carried on within the BVI,
(b) it can discontinue the activity, or modify it so it no longer falls within the scope of a relevant activity, or
(c) it can demonstrate a tax residence in a jurisdiction outside the BVI.

An entity which does not take steps either to take its relevant activity outside the scope of the legislation, or to bring it into compliance with the legislation, can expect to be the subject of enforcement proceedings.

2.10 Although not specifically carved out of the definition of relevant activity, it will be noted that the business of being an investment fund is not a relevant activity. It is outside the scope of the economic substance requirements in the same way as all other forms of business activity which are not specifically mentioned. Of course, if a legal entity carries on other activities besides being an investment fund, and those activities do constitute a relevant activity, the economic substance requirements will have to be fulfilled in respect of those other activities.

2.11 Some legal entities which carry on a relevant activity will also hold a licence from the Financial Services Commission ("FSC") in respect of that activity (eg entities carrying on banking or insurance activities). The requirements imposed in order to be granted, and to maintain, that licence must continue to be observed, in addition to the economic substance requirements.

2.12 Below is a guide to the general approach which the ITA will take to the construction and application of the legislation.

(1) The ITA will take a pragmatic and commercially realistic approach to the interpretation of the legislation.

(2) The ITA will apply criteria such as the "adequacy" of expenditure and employment, the "suitability" of employee qualifications and the "appropriateness" of premises having regard to the usual way in which businesses carrying on the relevant activity on a commercial basis are structured and operate.

(3) In the event that a legal entity carrying on a relevant activity outside the BVI notifies the ITA of its intention to re-locate that activity to the BVI, so as to enable it to comply with the economic substance requirements, the ITA may agree with that legal entity a compliance plan, as prescribed or otherwise agreed with the ITA, which will set out a timetable which ensures that the relocation occurs as soon as practicable. In the event that an entity had not come into compliance by the end of the financial period in question, the breach of the economic substance requirements would trigger the spontaneous exchange of information with the relevant overseas competent authorities discussed in section 15.2 below.

3. Entities within the scope of the legislation

3.1 The basic obligation to comply with the economic substance requirements is imposed by ESA section 5(1) which reads:

A legal entity which carries on a relevant activity during any financial period must comply with the economic substance requirements in relation to that activity.

3.2 The key concept for determining which entities fall within the economic substance legislation is therefore the concept of "legal entity". That is defined as follows:

"legal entity" means a company and a limited partnership;

"company" is defined as follows:

"company" includes

(a) a company within the meaning of section 3(1) of the BVI Business Companies Act, 2004;

(b) a foreign company within the meaning of section 3(2) of the BVI Companies Act, 2004 which is registered under Part XI of that Act,

but does not include a non-resident company;

"limited partnership" is defined as follows:

"limited partnership" includes

(a) an existing limited partnership within the meaning of section 2 of the Limited Partnership Act, 2017;

(b) a limited partnership within the meaning of section 2 of the Limited Partnership Act, 2017; and

(c) a foreign limited partnership within the meaning of section 2 of the Limited Partnership Act, 2017 which is registered under Part VI of that Act,

but does not include a non-resident limited partnership or a limited partnership where the general partners have elected pursuant to either section 8(2)(b) or section 67(1)(c) of the Limited Partnership Act, 2017 that the limited partnership shall not have legal personality or where the limited partnership does not have legal personality for any other reason.

3.3 Leaving aside for the moment the concepts of non-resident company and non-resident limited partnership, legal entities comprise:

(1) BVI companies

(2) Non-BVI companies which are registered under Part XI of the Business Companies Act 2004

(3) All limited partnerships (BVI and foreign) which are registered as such under the Limited Partnerships Act 2017 <u>except</u> limited partnerships which do not have legal personality.

3.4 Limited partnerships which do not have legal personality, and non-limited partnerships, are outside the Act, as are other forms of purely contractual arrangements.

4. Tax residence outside the BVI

4.1 As noted above, the economic substance legislation applies to a legal entity. "Legal entity" is defined in ESA section 2 as meaning a company and a limited partnership. However, the definitions in ESA section 2 of "company" and "limited partnership" exclude from those concepts a "non-resident company" and a "non-resident limited partnership". Those concepts are defined in ESA section 2 in the following terms:

"non-resident company" means a company which is resident for tax purposes in a jurisdiction outside the Virgin Islands which is not on Annex 1 to the EU list of non-

cooperative jurisdictions for tax purposes;

"non-resident limited partnership" means a limited partnership which is resident for tax purposes in a jurisdiction outside the Virgin Islands which is not on Annex 1 to the EU list of non-cooperative jurisdictions for tax purposes;

4.2 The most recent EU list of non-cooperative jurisdictions can be found at:

https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/.

Rule 2

Any entity which claims to fall outside the definitions of company or limited partnership by reason of being a non-resident company or non-resident limited partnership, must make a claim to that effect and must support that claim to the ITA.

Rule 3

The ITA will accept the following evidence to support the claim in rule 2:

(a) a letter or certificate from, or issued by, the competent authority for the jurisdiction in question stating that the entity is considered to be resident for tax purposes in that jurisdiction, or
(b) an assessment to tax on the entity, a confirmation of self assessment to tax, a tax demand, evidence of payment of tax, or any other document, issued by the competent authority for the jurisdiction in question.

Rule 4

In the case of a transparent entity, tax residence in another jurisdiction must be demonstrated by reference to each of the participators or partners on whom the entity's profits are taxable. "Transparent entity" means an entity in respect of which the entire profits and gains are treated under the law of another jurisdiction as attributable to and taxable on some or all of the participators or partners in the entity in question.

Rule 5

An entity (other than a pure equity holding entity) whose only sources of income from relevant activities are subject to tax in a jurisdiction outside the BVI will be regarded as resident for tax purposes in that jurisdiction.

4.3 It is accepted that some jurisdictions charge tax by reference to a criterion other than residence. What matters is whether the tax authority in the jurisdiction in question has accepted that the entity (or its participators in the case of a transparent entity) is chargeable to tax (to the extent that the jurisdiction

charges tax on income) in that jurisdiction by reference to the relevant local criteria.

4.4 Economic substance is assessed by reference to financial periods, which will normally be one year in length. Where it is claimed that an entity is tax resident in a jurisdiction outside the BVI, it will be necessary to demonstrate this non-residence throughout the financial period under consideration. The financial period may not be the same period as an entity's tax accounting period, although the financial period (or the accounting period) can be adjusted so as to bring about that result if that is thought convenient. Some tax documents may relate to fiscal years, or years of assessment, which may be different again from the entity's tax accounting period. For an entity which is relying on the types of evidence specified in rule 3, and that evidence does not relate specifically to the entity's financial period, it will usually be necessary to produce evidence which spans the entire financial period.

Example:

An entity has a financial period beginning on 1 January each year. It claims to be tax resident in a jurisdiction whose fiscal year begins on 1 April. It is relying on tax assessments to demonstrate its tax residence. For the financial period commencing 1 January 2021, the entity would need to produce a tax assessment for the year of assessment ending on 30 March 2021, and a tax assessment ending on 30 March 2022.

Rule 6

Where an entity is unable to provide evidence of the sort required under Rule 3 in respect of any financial period within the period fixed by regulations for submission of information in respect of that financial period, the entity may apply to be treated as provisionally resident in a jurisdiction outside the BVI pending submission of the evidence required to establish that fact. The ITA shall accede to that application only if one or more of the conditions set out in rule 10 are met.

Rule 7

Where such an application is made, the ITA, if it accedes to the application, must specify a reasonable period within which the necessary evidence is to be submitted ("the provisional extension period").

Rule 8

During the provisional extension period, and during any period prior to the ITA taking a decision, the entity shall be treated for the purpose of the economic substance legislation as if it were resident for tax purposes in a jurisdiction outside the BVI.

Rule 9

In the event of the ITA refusing the application for provisional treatment, or in the event of the entity failing to supply the necessary evidence within the period fixed under rule 6, the entity shall, notwithstanding the provisional treatment afforded under rule 7, be treated as not being non-resident in the BVI throughout the financial period in question.

Rule 10

The conditions for granting provisional treatment as tax resident outside the BVI are as follows:

(1) The entity has established its tax residence in the jurisdiction in question for the previous financial period to the satisfaction of the ITA, and certifies that its tax residence has not changed in the intervening period, or

(2) The entity supplies (within the period fixed for the return of information following the end of the financial period) the most recent available documentary evidence of tax residence in that jurisdiction which complies with the requirements of rule 3, and certifies that its tax residence has not changed in the time since the period to which the documentary evidence relates, or

(3) The entity evidences either that it has been too recently formed, or that it has too recently assumed tax residence in the jurisdiction in question, for there to be any documentary evidence of its tax residence which satisfies the requirements of rule 3, and produces other evidence to demonstrate that it met the criteria for tax residence in that jurisdiction during the financial period in question.

In each case the evidence in support of the application of the condition must be supplied within the filing period of the financial period in question.

4.5 Documentary evidence of tax residence will often not be available for an entire financial period until some time after the financial period has ended, and outside the filing period. The ITA accepts that this will be the case, and will be prepared to treat the entity as provisionally tax resident outside the BVI during a reasonable period, which the ITA will specify, following the end of the financial period in question, provided certain conditions are met. This "reasonable period" mentioned in Rule 7 set by the ITA for an entity to submit the evidence required by Rule 3 typically would not extend beyond two financial periods inclusive of the financial period for which the entity has applied for provisional treatment in accordance with Rule 6. If the necessary documentary evidence is not provided during the specified period, or any extension which the ITA may permit, the entity will be treated as having failed to establish tax residence outside the BVI. The ITA will then require it to demonstrate economic substance in BVI in the usual way for that period. If the entity cannot do that, it will be subject to enforcement action.

4.6 The conditions for granting provisional treatment as tax resident outside the BVI are set out in rule 10.

4.7 An entity which establishes that it is impossible, for the reasons given in rule 10, to produce documentary evidence of its tax residence must produce other evidence to demonstrate that it met the criteria for tax residence in that jurisdiction during the financial period in question. The nature of the evidence to be supplied will depend on the criteria for tax residence laid down by the law of the jurisdiction in question. That evidence must be provided within the information time limit for the financial period in question.

4.8 The provision in rule 5 that an entity will be treated as non-resident if all its activities are taxed in another jurisdiction is intended to cater for an entity which, for example, is taxed on a branch or agency basis on all its activities in a jurisdiction outside the BVI, even if it is not necessarily tax resident in that jurisdiction.

4.9 It is possible that an entity may be tax resident in a jurisdiction subsequently placed on the EU list of non-cooperative tax jurisdictions. The ITA will consider allowing a reasonable time for an entity to adjust its business in these circumstances.

4.10 Entities should be aware that exchange of information will take place between the BVI and the tax authority of any jurisdiction in which an entity claims to be tax resident, as well as with any EU member state where the entity has one or more beneficial or legal owners resident.

5. Relevant activities

5.1 The relevant activities to which the economic substance requirements are set out in section 6 of the ERA:

In this Act, unless the context otherwise requires, "relevant activities" mean any of the following activities:

(a) banking business;

(b) insurance business;

(c) fund management business;

(d) finance and leasing business;

(e) headquarters business;

(f) shipping business;

(g) holding business;

(h) intellectual property business;

(i) distribution and service centre business.

These are discussed in more detail below.

5.2 Although the two concepts serve distinct purposes under the legislation, and are discussed separately in this Code, there is a clear relationship between a relevant activity and the CIGA which relates to it. The activities which form the CIGA are likely to be the most important activities which a business carrying on the related relevant activity will be undertaking. As such they can assist in an understanding of the scope of the relevant activity itself. In cases of difficulty the ITA will take account of the content of the CIGA in determining whether a particular business comprises a relevant activity.

Banking business

5.3 Banking business is defined in the ESA section 2

"banking business" has the meaning specified in section 2(1) of the Banks and Trust Companies Act, 1990.

That definition reads as follows:

"banking business" means 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, or

(b) the making of investments,

for the account and at the risk of the person accepting such deposits.

5.4 The effect of sections 3 and 4 of the Banks and Trust Companies Act, 1990 is that any entity which is either incorporated in the BVI or a foreign entity doing business in the BVI, which is carrying on banking business must have a licence from the FSC, in order to carry on the business lawfully.

5.5 The ITA will adopt any guidance or interpretation issued by the FSC concerning banking business.

Insurance business

5.6 Insurance business is defined in the ESA section 2

> *"insurance business" has the meaning specified in section 3(1) of the Insurance Act, 2008*

That definition reads as follows:

> *"Insurance business" means 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.*

5.7 Reference should be made to the Insurance Act 2008 for further definitions of life insurance business and reinsurance business. Section 4(1)(a) requires any person carrying on, or holding himself out as carrying on, insurance business of any kind in or from within the Virgin Islands to have a licence under section 8 of that Act. A BVI business company is deemed to be carrying on business in the BVI even if its insurance business is in fact located outside the BVI.

5.8 The ITA will adopt any guidance or interpretation issued by the FSC concerning insurance business.

Fund management business

5.9 Fund management business is defined in the ESA section 2

> *"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*

Category 3 of Schedule 3 of the Securities and Investment Business Act, 2010 reads as follows:

> Investment Management
> Sub-category A: Managing Segregated Portfolios (excluding Mutual Funds)
> Sub-category B: Managing Mutual Funds
> Sub-category C: Managing Pension Schemes
> Sub category D: Managing Insurance Products
> Sub-category E: Managing Other Types of Investment.

Reference should be made to SIBA and to the FSC Code for a more detailed understanding of these concepts. It should be noted that management of funds is contrasted with the business of being a custodian of investments, which falls within Category 5 of SIBA.

5.10 The ITA will adopt any guidance or interpretation issued by the FSC concerning Category 3.

Finance and leasing business

5.11 Finance and leasing business is defined in ESA section 3.

(1) In this Act, unless the context otherwise requires, "finance and leasing business" means the business of providing credit facilities of any kind for consideration.

(2) For the purposes of subsection (1) but without limiting the generality of that section

(a) consideration may include consideration by way of interest;

(b) 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.

(3) 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 paragraph (1).

(4) Any activity falling within the definition of "banking business", "fund management business" or "insurance business" is excluded from the definition in paragraph (1).

5.12 An entity which provides credit as an incidental part of a different sort of business will not thereby be treated as carrying on a finance and leasing business. Thus, for example, a merchant which supplies goods on account, thereby offering short term credit, will not be carrying on a finance and leasing business. Only where the provision of credit can be seen to be a business activity in its own right will the entity be treated as if its business, or part of its business, is a finance and leasing business. Entities which carry on a factoring activity, by which they purchase and then collect another business's book debts, will be treated as carrying on a finance and leasing business by virtue of subsection (3).

5.13 Entities which hold debt or debt instruments for the purpose of investment will not be regarded as being in the business of providing credit facilities.

5.14 Although the activity is described as finance and leasing, the essence of the activity, as the definition makes clear, is the provision of credit facilities. So the mere fact that an entity leases items does not mean it is carrying on a finance and leasing business. So short term hiring out of vehicles, boats or equipment is not caught.

Headquarters business

5.15 Headquarters business, and the related concept of a "group" are defined in ESA section 2:

"group" has the meaning specified in regulation 2(1) of the BVI Business Companies Regulations, 2012, modified so that references to a company include references to a limited partnership, and other expressions appropriate to companies shall be construed as including references to the corresponding persons, documents or organs, as the case may be, appropriate to limited partnerships;

"headquarters business" means the business of providing any 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.

5.16 Regulation 2(1) of the BVI Business Companies Regulations 2012, referred to in the definition of "group" reads as follows:

"group", in relation to a company (the "first company"), means the first company and any other company that is

(a) a parent of the first company;

(b) a subsidiary of the first company;

(c) a subsidiary of a parent of the first company; or

(d) a parent of a subsidiary of the first company;

5.17 The regulations define "parent" and "subsidiary" as follows:

"parent", in relation to a company (the "first company"), means another company that, whether acting alone or under an agreement with one or more other persons,

(a) holds, whether legally or equitably, a majority of the issued shares of the first company;

(b) has the power, directly or indirectly, to exercise, or control the exercise of, a majority of the voting rights in the first company;

(c) has the right to appoint or remove the majority of the directors of the first company;

(d) has the right to exercise a dominant influence over the management and control of the first company pursuant to a provision in the constitutional documents of the first company; or

(e) is a parent of a parent of the first company;

"subsidiary", in relation to a company (the "first company"), means a company of which the first company is a parent;

5.18 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 companies in the group, whether parents or subsidiaries. For example:

A group includes, as a subsidiary, a service company which employs all the employees in the group. If senior management in the group are employed by the service company it will be providing headquarters services to the group.

5.19 The concluding words of the definition of headquarters business make clear that any activity which might otherwise fall within the definition of headquarters' business, but which in fact forms part of another relevant activity, will fall outside the definition of headquarters' business. For example:

A subsidiary in a group which is a captive insurance company will not also be carrying on headquarters business simply because it assumes material risk on behalf of the group.

A subsidiary in a group which carries on banking business, and is the primary operating company in the group, will not also be carrying on headquarters business simply because the bank's senior management also sit on the board of the top company in the group.

5.20 That said, it is in theory possible for a company to carry on both headquarters business and another form of relevant activity if the activities form two distinct business activities. For example:

An entity carrying on the activity of a holding company (which consists of owning only equity participations in other companies) may also carry on headquarters business if it also employs, and then supplies to other entities in the group, the senior management of the group.

Shipping business

5.21 "Ship" and "shipping business" are defined in ESA section 2 as follows:

"ship" has the meaning specified in section 2(1) of the Merchant Shipping Act, 2001 but does not include a fishing vessel, a pleasure vessel or a small ship (in each case, as defined by section 2(1) of that Act);

"shipping business" means any of the following activities involving the operation of a ship anywhere in the world other 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 in paragraph (a);

(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.

Reference should be made to the Merchant Shipping Act for the precise definitions of "fishing vessel" and "pleasure vessel". A "small ship" is a ship less than 24 metres in length.

5.22 Each of the activities has to "involve the operation of a ship" if it is to constitute a relevant activity. However, the ship does not have to be operated by the same entity as the entity carrying out the activities listed at (a) to (e).

5.23 The ITA will always consider whether activities which may appear to fall within the letter of paragraphs (a) to (e) do in fact constitute a shipping business, or whether they are merely incidental activities to what is properly regarded as a different sort of business. The content of the CIGA for a shipping business (see below) is of particular relevance here. For example:

An entity which carries on the business of a general travel agent will not be treated as carrying on a shipping business merely because, amongst other things, it sells tickets for passenger cruises.

An entity which manufactures goods for export will not be treated as carrying on a shipping business merely because it arranges for those goods to be dispatched by sea, in containers or otherwise.

<u>holding business</u>

5.24 "Holding business" and the related term "pure equity holding entity" are defined in ESA section 2 as:

"holding business" means the business of being a pure equity holding entity

"pure equity holding entity" means a legal entity that only holds equity participations in other entities and only earns dividends and capital gains.

5.25 The definition of pure equity holding entity is deliberately framed in narrow terms. A legal 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) will take the legal entity outside this definition.

5.26 Equity participation includes shares in a company and encompasses other forms of investment in an entity which give the investor the right to participate in the profits of the entity. The interest of a general partner in a limited partnership will usually be of this quality.

5.27 Entities which own other forms of asset (eg bonds, government securities, legal or beneficial interests in real property) will clearly not be pure equity holding entities (even if they also own equity participations) and will not be treated as carrying on holding business.

5.28 Because it is possible for an entity to carry on more than one relevant activity, the fact that an entity is a pure equity holding entity does not preclude the possibility that it may carry on one or more other relevant activities.

5.29 Entities which hold assets which consist of or include assets which are not equity participations will not be pure equity holding companies, but likewise may be found to carry on other relevant activities.

Intellectual property business

5.30 "Intellectual property business" and the related concept of "intellectual property asset" are defined in ESA section 2 as follows:

"intellectual property business" means the business of holding intellectual property assets;

"intellectual property asset" means any intellectual property right in intangible assets, including but not limited to copyright, patents, trade marks, 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 ESA section 2 as follows:

"income" in respect of an intellectual property asset includes

(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;

5.31 The relevant activity consists merely of holding an intellectual property asset from which identifiable income accrues (if no identifiable income accrues there is no intellectual property asset at all). The definition does not therefore apply to a business which owns intellectual property merely as an adjunct to its business. Most businesses will own some form of intellectual property – trademark protection, copyright in their advertising material, technical know-how relating to their processes - but this property, like premises or plant and machinery, does not earn specific amounts of revenue – it simply contributes to (or protects) the general profitability of the business.

5.32 The relevant activity is focusing on businesses which make money from licensing or otherwise exploiting intellectual property rights. When read with the relevant CIGA it is clear that what is being targeted are entities which receive income (as defined) from intellectual property rights which they have not developed themselves or, as the case may be, are not actively exploiting.

Distribution and service centre business

5.33 "Distribution and service centre business" is defined in ESA section 2 as follows:

"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;

5.34 "Affiliate" is defined in ESA section 2 as follows:

"affiliate" bears the same meaning as an "affiliated company" specified in regulation 2(2) of the BVI Business Companies Regulations, 2012, modified so that references to a company include references to a limited partnership, and other expressions appropriate to companies shall be construed as including references to the corresponding persons, documents or organs, as the case may be, appropriate to limited partnerships;

Regulation 2(2) of the BVI Business Companies Regulations provides as follows:

... a company is affiliated with another company if it is in the same group as the other company

5.35 For an entity to carry on distribution and service centre business it must have a business which consists of purchasing assets from other entities in the same group, and/or a business providing services to entities in the same group. The affiliates in question must be "foreign" – that is to say an affiliate which is an entity which is not a legal entity for the purposes of the legislation.

5.36 It should be noted that the following do <u>not</u> constitute distribution and service centre business:

(a) the business of purchasing and reselling assets from, or providing services to, entities in the same group both of which are located in the BVI
(b) the business of purchasing and reselling assets from, or providing services to, entities which are not part of the same group as the entity carrying on the business, even if located outside the BVI, or
(c) occasional transactions within the description which do not form part of a business, but are undertaken ancillary to a different business.

5.37 Transactions which fall within any other type of relevant activity, as well as being capable of being distribution and service centre business, will be treated as falling within that other activity, and will not be treated as distribution and service centre business. Thus, for example, the provision, by way of business, of banking, insurance or shipping services to foreign affiliates will be treated as banking, insurance or shipping business, not distribution and service centre business. The exception to this rule is where the other type of relevant activity is holding company business.

6. Core income generating activity

6.1 A legal entity which carries on one or more relevant activities must conduct core income generating activity ("CIGA") in the BVI relating to each such activity (ESA section 8(1)(c)). This requirement does not apply to a holding business (ie the business of a pure equity holding company).

6.2 Section 7 of the ESA defines CIGA as including the following:

(a) in respect of banking business

(i) raising funds, managing risk including credit, currency and interest risk;

(ii) taking hedging positions;

(iii) providing loans, credit or other financial services to customers;

(iv) managing regulatory capital;

(v) preparing regulatory reports and returns;

(b) in respect of distribution and service centre business

(i) transporting and storing goods;

(ii) managing stocks;

(iii) taking orders;

(iv) providing consulting or other administrative services;

(c) in respect of insurance business

(i) predicting and calculating risk;

(ii) insuring or re-insuring against risk;

(iii) providing insurance business services to clients;

(d) in respect of fund management business

(i) taking decisions on the holding and selling of investments;

(ii) calculating risks and reserves;

(iii) taking decisions on currency or interest fluctuations and hedging positions;

(iv) preparing relevant regulatory or other reports for government authorities and investors;

(e) in respect of finance or leasing business

(i) agreeing funding terms;

(ii) identifying and acquiring assets to be leased (in the case of leasing);

(iii) setting the terms and duration of any financing or leasing;

(iv) monitoring and revising any agreements;

(v) managing any risks;

(f) in respect of headquarters business

(i) taking relevant management decisions;

(ii) incurring expenditures on behalf of affiliates;

(iii) co-ordinating group activities;

(g) in respect of shipping business

(i) managing the crew (including hiring, paying and overseeing crewmembers);

(ii) hauling and maintaining ships;

(iii) overseeing and tracking deliveries;

(iv) determining what goods to order and when to deliver them;

(v) organising and overseeing voyages;

(h) in respect of intellectual property business

(i) where the business concerns intellectual property assets such as patents, research and development;

(ii) where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.

6.3 The definition of core income generating activity is non-exclusive. Core income generating activity "includes" the activities listed but is not confined to them. What constitutes the CIGA of a particular activity is a fact sensitive issue which can vary from business to business. In some cases it may be possible to carry on a relevant activity without also conducting all the related core income generating activities listed in the statute.

7. Substance requirements - general

7.1 Section 8 of the ESA sets out the requirements which must be met if a legal entity is to have economic substance. Subsection (1)(a) to (d) sets out the requirements for relevant activities other than pure equity holding companies. This Part deals with these requirements. Part 9 sets out the requirements for pure equity holding companies.

7.2 Subsection (1) reads as follows:

(1) Subject to subsection (2), a legal entity complies with the economic substance requirements if:

(a) the relevant activity is directed and managed in the Virgin Islands;

(b) having regard to the nature and scale of the relevant activity

(i) there are an adequate number of suitably qualified employees in relation to that activity who are physically present in the Virgin Islands (whether or not employed by the relevant legal entity or by another entity and whether on temporary or long-term contracts);

(ii) there is adequate expenditure incurred in the Virgin Islands;

(iii) there are physical offices or premises as may be appropriate for the core income-generating activities; and

(iv) where the relevant activity is intellectual property business and requires the use of specific equipment, that equipment is located in the Virgin Islands;

(c) the legal entity conducts core income-generating activity in the Virgin Islands;

(d) in the case of income-generating activity carried out for the relevant legal entity by another entity

(i) no core income generating activity is carried on outside the Virgin Islands;

(ii) only that part of the activities of that other entity which are solely attributable to generating income for the relevant legal entity and not for any other legal entity shall be taken into account when considering if the relevant legal entity meets the economic substance requirements;

(iii) the relevant legal entity is able to monitor and control the carrying out of that activity by the other entity.

7.3 There are therefore three general aspects to economic substance under subsection (1):

(a) direction and management in the BVI,
(b) adequate expenditure and employees and appropriate premises in the BVI, and
(c) CIGA carried on in the BVI.

While each of these requirements must be fulfilled, there is a degree of overlap between them, and compliance with the economic substance requirements will require a judgment which takes account of the degree of compliance under each of these three heads. Each head will be discussed in turn. The impact of outsourcing is then considered.

Direction and management in the BVI

7.4 It should be noted that what is required is that the relevant activity is directed and managed in the BVI, not the legal entity which carries on the relevant activity. Where the legal entity's only business is the relevant activity or activities in question, then that will mean that the entity itself must be directed and managed from the BVI. In those circumstances the strategic decisions as to management of the entity must be taken by the Board in the BVI.

7.5 For the relevant activity to be directed and managed from the BVI there must be an adequate number of board meetings held in the BVI, having regard to the nature of the relevant activity, and its importance in the overall business of the legal entity. For a board meeting to be held in the BVI there must be a quorum of directors physically present in the BVI. The directors of the legal entity attending such meetings must include among their number adequate expertise to direct the relevant activity. Decisions of the Board regarding the relevant activity must be minuted, and minutes of those decisions are expected to be kept in the BVI.

Adequate expenditure, adequate number of suitably qualified employees and appropriate premises in the BVI

7.6 There are no definitions of the words "adequate", "suitable" or "appropriate", which must be given their ordinary English meaning.

7.7 Businesses come in different sizes, and the employees, expenditure and premises which are adequate or appropriate for a small business will not suffice for a large business. Nor is it the function of the legislation to require an entity to incur more expenditure or engage more employees than it really needs, if it is genuinely carrying on a relevant activity and carrying on CIGA in the BVI with the expenditure, staff and premises that it actually has.

Rule 11

The expression "expenditure" where it is used in section 8 of the ESA and section 10 of the BOSS Act means expenditure incurred in the operation of the relevant activity.

7.8 Expenditure can only be taken account of if it is incurred in the operation of the relevant activity.

7.9 Normally, if a business is carrying on a relevant activity, and all, or substantially all, of its expenditure is in the BVI, and all or substantially all of its employees work in the BVI, the adequacy of its expenditure and employees will be self evident. However, the ITA will be concerned to ensure that the business is not relying unduly on expenditure incurred, or employees based, outside the BVI, in order to enable its relevant activity and CIGA to be carried on in the BVI. Thus, the amount of expenditure incurred and the number of employees (and their qualifications) employed globally in the relevant activity, will be highly relevant

to the question whether expenditure and employment in the BVI is or is not adequate.

7.10 Where a legal entity outsources part of its relevant activity, and that work meets the requirements for outsourcing, the expenditure on the outsourcing will be taken into account when assessing the adequacy of the legal entity's expenditure in the BVI.

7.11 The following rules clarify how to compute the number of employees for the purpose section 8(1).

Rule 12

For the purpose of section 8 of the ESA, the number of employees engaged in a relevant activity shall be computed on the basis that

(i) an employee who has worked for only part of the financial period in question shall be counted as part of an employee, proportionate to the amount of time he has worked during the financial period,

(ii) a part-time employee shall be counted as part of an employee proportionate to the amount of time he has worked in the financial period when compared with a full time employee of equivalent grade.

(iii) where an employee spends only part of his time working in connection with the relevant activity in question and part of his time working in connection with other activities, he shall be treated as a part-time employee, as regards the amount of time spent on the relevant activity.

(iv) An employee who is based in the BVI may be treated as physically present in the BVI throughout the period of his employment, notwithstanding that part of his duties fall to be performed outside the BVI.

(v) An employee who is not based in the BVI may not be treated as physically present in the BVI at any time notwithstanding that part of his duties fall to be performed within the BVI.

(vi) For the purpose of paragraphs (iv) and (v), an employee will be treated as based in the BVI if he spends the majority of his working time in the BVI.

7.12 In order to count as an employee for the purpose of section 8(1), it is not necessary that the individual be an employee of the legal entity carrying on the relevant activity. But that individual must be the employee of somebody, and must be managed as an employee by the legal entity in question. This means that,

for example, a business which has engaged staff employed by an agency (perhaps for temporary cover) can count those staff as part of its employees.

7.13 Where a legal entity outsources part of its relevant activity, and that work meets the requirements for outsourcing, the extent of the work done under the outsourcing arrangement will be taken into account when assessing the adequacy of the number of the entity's employees, and the suitability of their qualifications. The more work is outsourced, the fewer the number of employees which need to be employed "in house" in order to have an adequate number of employees.

7.14 Rule 12 (i) to (iii) set out the approach to computing the number of employees in relation to a relevant activity in situations where the employee does not work solely in connection with the relevant activity.

7.15 Rule 12 (iv) to (vi) set out the approach to computing the number of employees in relation to a relevant activity where part of the employee's time is spent outside the BVI. As long as most of the employee's working time is spent within the BVI, the fact that his employment in connection with the relevant activity takes him outside the BVI (eg a sales representative, or a professional person who visits clients overseas) will not prevent the whole of his employed time being counted as within the BVI. But occasional work in the BVI by an employee based outside the BVI cannot be counted.

7.16 The requirement for employees to be suitably qualified is intended to ensure that the qualifications of employees in the BVI are commensurate with the relevant activity, and the CIGA, being carried on in the BVI. Thus, it would not be sufficient to show that the bulk of the employees employed in connection with the relevant activity are based in the BVI, if the only employees with the technical qualifications actually to manage or transact the relevant activity are based overseas.

7.17 The entity must have appropriate premises in the BVI for the carrying out of the CIGA related to the relevant activities. For an office-based business this should comprise an office premises from which the employees can operate. Account will be taken, where appropriate, of flexible working practices (provided that the homes or premises from which employees work when not in the office must themselves be in the BVI if time spent working there is to be counted). Some types of relevant activity (eg shipping and distribution and service centre business) will, in addition to office premises, require appropriate premises for non-office based activities (eg ship maintenance or warehousing).

7.18 The premises need not be owned by the legal entity – they may be rented or used on licence.

<u>Conducting core income-generating activity in the Virgin Islands</u>

7.19 The legal entity must conduct core income-generating activity in the Virgin Islands. CIGA will be carried on in the BVI if it is carried on by employees

working in the BVI, or is outsourced to a person whose own employees work in the BVI. As discussed above, the level of expenditure in BVI must be proportionate to the activities of the entity.

Outsourcing

7.20 It is recognised that many entities outsource at least part of their operations to a third party. There is nothing inherently objectionable in entities doing this. However, outsourcing may not be done in such a way that will pose a risk to the substance requirements.

7.21 ESA section 8(1)(d) is intended to address these risks, by permitting an entity to outsource income-generating activity to a third party, but only if certain conditions are satisfied. The first is that no part of the entity's CIGA may be outsourced outside the BVI – that requirement is designed to counter risk (i) above. The second is that when considering the extent of the outsourcing legal entity's economic substance in BVI, it can only count the work done by the entity to which work is outsourced which actually relates to the outsourcing legal entity.

Example

A BVI company with 5 employees carries out outsourced work for 5 other BVI legal entities carrying on relevant activities. Assuming the amount of work done for each legal entity is the same, each of the legal entities can claim that the outsourced work is being done by the equivalent of one employee. Section 8(1)(d)(ii) prevents each of the legal entities claiming that the company is doing work equivalent to 5 employees.

7.22 The requirement that the legal entity is able to monitor the outsourced activity is designed to ensure that there is genuine outsourcing, with work genuinely being done on behalf of the legal entity which has commissioned the outsourcing.

7.23 An entity conducting a regulated activity under licence from the FSC must comply with any relevant restrictions on outsourcing imposed by that licence, or by the relevant financial services law.

8. Substance requirements – pure equity holding entities

8.1 The substance requirement for a pure equity holding entity is outlined in section 8(2) provides as follows:

(2) 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);

(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.

8.2 For a pure equity holding entity there is no requirement that the entity is directed or managed in the BVI. Nor is there a requirement that the entity carries on CIGA in the BVI (there is no CIGA relating to holding business), although it remains necessary to have in the BVI adequate employees and premises for holding or managing its equity participations. There are no restrictions on the extent to which a pure equity holding entity may outsource its activity. Where activity is outsourced, the extent of the outsourcing will be taken into account in assessing the adequacy of the employees in the BVI, but only if the outsourcing is itself to a person operating in the BVI.

8.3 Condition (a) is met by complying with the legislative requirements imposed by the Business Companies Act or the Limited Partnerships Act, as appropriate.

8.4 What is required for compliance with condition (b), as with economic substance generally, will be a fact sensitive question, dependent on the nature of the activity being carried on. At one extreme, the requirement for being a pure equity holding entity is simply holding equity participations. If this is all the legal entity does during a given financial period, the relevant activity will be entirely passive in nature and the requirements for adequate and suitably qualified employees and for appropriate premises will be applied accordingly. Any legal entity will of course retain the services of a registered agent, and the performance of those services will be taken into account when assessing economic substance for pure equity holding entities.

8.5 On the other hand, the entity may actively manage its equity participations, in which case it should have adequate and suitably qualified employees, and appropriate premises, in the BVI to carry out this function.

9. Intellectual property business - presumptions against compliance

9.1 Income derived from intellectual property assets can pose a higher risk of artificial profit shifting than non-IP assets. This higher risk is reflected in the presumptions of non-compliance with the economic substance requirements which apply in the two scenarios identified in ESA section 9(2).

9.2 Those presumptions are rebuttable, and are intended to serve the purpose of addressing the higher risk of artificial profit shifting, whilst not inadvertently prohibiting activities that constitute real economic activity. What is required to rebut those presumptions is set out below.

<u>ESA section 9(2)(a)</u>

9.3 The principal core income-generating activities associated with intellectual property business are as follows (as set out in ESA section 7(h)):

(i) where the business concerns intellectual property assets such as patents, research and development;

(ii) where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.

9.4 ESA section 9(2)(a) establishes the following presumption:

> *There is a presumption that a legal entity does not conduct core income-generating activity if*
>
> *(a) the activities being carried on from within the Virgin Islands do not include any of the activities identified in section 7(h)*

9.5 That presumption (where it applies) may be rebutted in the circumstances described in ESA section 9(3):

> *The presumption in subsection (2)(a) may be rebutted where the activities being carried on from within the Virgin Islands include*
>
> *(a) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the intangible asset generating income;*
> *(b) taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation of the intangible asset;*
> *(c) carrying on the underlying trading activities through which the intangible assets are exploited and which lead to the generation of revenue from third parties.*

9.6 In determining whether the presumption has been rebutted, the ITA will need to be satisfied on the basis of the information provided by the entity that the activity taking place in the BVI is more than local staff passively holding intangible assets whose creation and exploitation is a function of decisions made and activities performed outside of the jurisdiction. Equally, periodic decisions of non-resident board members will not suffice. Instead, the entity must employ local, permanent and qualified staff who make active and ongoing decisions in relation to the generation of income in the BVI.

<u>ESA section 9(2)(b)</u>

9.7 ESA section 9(2)(b) establishes the following presumption:

> *There is a presumption that a legal entity does not conduct core income-generating activity if*
>
> *…*
> *(b) the legal entity is a high risk IP legal entity.*

9.8 A "high risk IP legal entity" is defined in ESA section 2 as:

a legal entity which carries on an intellectual property business and which

(a) acquired the intellectual property asset

(i) from an affiliate; or

(ii) in consideration for funding research and development by another person situated in a country or territory other than the Virgin Islands; and

(b) licences the intellectual property asset to one or more affiliates or otherwise generates income from the asset in consequence of activities (such as facilitating sale agreements) performed by foreign affiliates

9.9 There is a high evidential threshold for rebutting this presumption. As set out in ESA section 9(4):

> *The presumption in subsection (2)(b) may be rebutted where a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intellectual property asset is exercised by suitably qualified employees of the relevant legal entity who are physically present and perform their functions from within the Virgin Islands and who are on long-term contracts.*

9.10 In determining whether the presumption has been rebutted, the ITA will take into account the same factors which it takes into account when determining whether the presumption under ESA section 9(2)(a) has been rebutted. In addition, the ITA will need stronger evidence of the decision-making which is taking place in the BVI, and that there is (and historically has been) a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intangible asset.

10. Financial periods

10.1 The concept of "financial period" for the purposes of ESA is important in three respects:

(1) Economic substance is assessed by reference to financial periods. In particular, the question of whether an entity is required to comply with the economic substance requirements depends on whether it has carried on a relevant activity during a financial period (see ESA section 5(1)). Further, the issue of whether an entity has complied with the economic substance requirements is determined by reference to its activities (including its turnover, expenditure, staff, premises, location of equipment, and direction and management) over the course of a financial period.

(2) The trigger for the commencement of an entity's obligations to comply with the provisions of the ESA is the start of its first financial period.

(3) Time starts to run for the purposes of an entity's periodic reporting obligations from the end of the financial period (see section 9(6A) of the BOSS Act).

10.2 "Financial period" is defined in ESA section 4(1) as follows:

> *In this Act, unless the context otherwise requires, "financial period" means*
>
> *(a) in the case of a company incorporated on or after 1 January 2019, such period of not more than one year from the date of incorporation as the company shall notify to the competent authority and thereafter each successive period of one year running from the end of that period;*
>
> *(b) in the case of a limited partnership formed on or after 1 January 2019, such period of not more than one year from the date of formation as the limited partnership shall notify to the competent authority and thereafter each successive period of one year running from the end of that period;*
>
> *(c) in any other case such period of one year commencing on a date no later than 30 June 2019 as the legal entity shall notify to the competent authority and thereafter each successive period of one year running from the end of that period.*

10.3 As can be seen from this definition, for existing entities, there is a certain amount of flexibility as to when the first financial period begins, save that it must have begun no later than 30 June 2019.

Rule 13

The first financial period of a legal entity which has been incorporated or formed on or after 1 January 2019 shall commence on the date of incorporation or formation and shall terminate on the expiry of one year from that date, unless the legal entity gives notice to the ITA in accordance with rule 14 that it wishes to elect for an earlier termination of its first financial period.

Rule 14A legal entity which wishes to give notice to the ITA pursuant to rule 12 that it wishes its first financial period to terminate sooner than one year from the date of its incorporation or formation must give that notice within three months of the date of incorporation or, if later, within three months following 30 June 2019. Such a legal entity may not elect to terminate its first financial period on a date prior to the date of the notice.

Rule 15

The first financial period of a legal entity which has been incorporated or formed before 1 January 2019 shall commence on 30 June 2019 unless the legal entity gives notice to the ITA in accordance with rule 15 that it wishes to elect for an earlier commencement date.

Rule 16

A legal entity which wishes to give notice to the ITA pursuant to rule 15 that it wishes its first financial period to commence on a date prior to 30 June 2019 must give that notice on or before 31 December 2019. Such a legal entity may not elect to commence its first financial period on a date prior to 1 January 2019.

Rule 17

Any notice given under rule 13 or rule 15 must, in addition to stating the date when its first financial period is to commence or, as the case may be, end, include the following information:

- **(a) Its registered name;**
- **(b) Its registered number;**
- **(c) Its date of incorporation or formation (as appropriate);**
- **(d) The name and address of its registered agent.**

10.4 A response to a notification will only be given by the ITA where information is missing or the ITA requires further information from the entity concerning the alteration of its financial period. Entities must be in a position to comply with the requirements of the ESA as from the specified or deemed date of commencement of their first financial period.

10.5 An entity can at any time apply to alter its financial period. For example, it may wish to do so to bring its financial period into line with its tax accounting period. The power to make such an application is conferred by ESA section 4(2), which provides as follows:

> *On an application by the legal entity the competent authority may permit an alteration in the legal entity's financial period by shortening or (where the legal entity's existing financial period is less than 12 months) lengthening a financial period so as to alter the commencement date for successive financial periods but so that no such altered period shall exceed twelve months in length.*

Rule 18

An application by an entity to alter its financial period should be made by way of notice to the ITA containing the following information:

- **(a) Its registered name;**
- **(b) Its registered number;**
- **(c) The name and address of its registered agent;**
- **(d) The current commencement date of its next financial period;**
- **(e) The proposed new commencement date of its next financial period; and**
- **(f) Brief reasons for the proposed alteration in the commencement date.**

10.6 The ITA is likely to accede to an application by an entity to alter its financial period, provided that the effect of the alteration is not to extend the length of the

financial period beyond 12 months. It is only in limited circumstances that the ITA is likely to refuse such an application. Such circumstances include where the ITA is of the view that the entity is seeking to alter its financial period with a view to enabling itself to avoid the application of the economic substance legislation.

10.7 It is possible that a legal entity will only start a relevant activity part way through a financial period. That is especially likely to be true for new legal entities, which will typically have a period of minimal activity between date of incorporation or formation and commencing to do business. In those circumstances the economic substance requirements will only apply for that part of the financial period during which the relevant activity is being conducted.

10.8 It is expected that the economic substance requirements will be complied with during the time the entity is in liquidation.

11. Application of the substance legislation to foreign legal entities

11.1 The scope of the ESA extends not just to entities that are incorporated or formed in the BVI, but also to foreign legal entities in specified circumstances.

11.2 This follows from the definition of "legal entity" in ESA section 2. That provision defines "legal entity" as "a company and a limited partnership". For the purposes of ESA, the definition of company includes "a foreign company within the meaning of section 3(2) of the BVI Business Companies Act, 2004 which is registered under Part XI of that Act", and the definition of limited partnership includes "a foreign limited partnership within the meaning of section 2 of the Limited Partnership Act, 2017 which is registered under Part VI of that Act". These definitions are explored in more detail below.

<u>Foreign company</u>

11.3 A "foreign company" must have the following two characteristics in order to fall within the meaning of "company" for the purposes of ESA:

11.4 First, it must be a foreign company within the meaning of section 3(2) of the BVI Business Companies Act, 2004;

11.5 Secondly, it must be registered under Part XI of the BVI Business Companies Act, 2004.

11.6 So far as the former is concerned, section 3(2) of the BVI Business Companies Act, 2004 provides:

> *"foreign company" means a body corporate incorporated, registered or formed outside the Virgin Islands but excludes a company within the meaning of subsection (1).*

11.7 For the avoidance of doubt, a company within the meaning of section 3(1) of the BVI Companies Act, 2004 is also within the scope of ESA (see the definition of "company" in ESA section 2).

11.8 As for the latter, Part XI of the BVI Business Companies Act, 2004 concerns the registration of foreign companies, and contains the following general prohibition (in section 186(1)):

> *A foreign company shall not carry on business in the Virgin Islands unless*
>
> *(a) it is registered under this Part; or*
>
> *(b) it has applied to be so registered and the application has not been determined.*

11.9 Part XI contains detailed registration and ongoing requirements to which a foreign company which carries on business in the BVI is subject, including an obligation to have a registered agent in the BVI (BVI Business Companies, Act 2004, section 189(1)).

11.10 In summary, therefore, the provisions of the ESA apply to any body corporate incorporated, registered or formed outside the BVI which lawfully carries on business in the BVI.

<u>Foreign limited partnership</u>

11.11 In order to fall within the meaning of "limited partnership" for the purposes of ESA, a foreign limited partnership must have the following three characteristics:

11.12 First, it must be a foreign limited partnership within the meaning of section 2 of the Limited Partnership Act, 2017;

11.13 Secondly, it must be registered under Part VI of the Limited Partnership Act, 2017; and

11.14 Thirdly, it must have legal personality.

11.15 In relation to the first of these requirements, section 2 of the Limited Partnership Act, 2017 defines "foreign limited partnership" as follows:

> *"foreign limited partnership" means a partnership formed or established under the law of a jurisdiction other than the Virgin Islands with*
>
> *(a) one or more partners who are liable for all the debts and liabilities of the partnership; and*
>
> *(b) one or more partners whose liability for the debts and liabilities of the partnership is limited*

Reporting requirements

11.16 The reporting requirements under the BOSS Act apply to foreign companies and foreign limited partnerships as well as BVI companies and limited partnerships. This follows from the expansion of the definition of "corporate and legal entity" for the purposes of that act to include "a foreign company as defined under section 3 of the BVI Business Companies Act 2004" and "a foreign limited partnership as defined under section 2 of the Limited Partnership Act 2017".

11.17 Only those foreign companies which are registered under Part XI and those foreign limited partnerships which have applied to continue under Part VI are subject to the reporting requirements: it is only those companies and limited partnerships which are subject to ESA and accordingly in whose affairs the ITA is interested.

12. Reporting requirements

12.1 Central to the effective administration and enforcement of the economic substance requirements is the collection and submission of information that will enable the ITA to monitor whether an entity is carrying on relevant activities and (if so) whether it is complying with the economic substance requirements.

The BOSS Act regime

Reporting Duties

12.2 The reporting regime introduced by ESA by way of amendment to the BOSS Act builds upon the pre-existing regime for the collection of information relating to beneficial ownership under the BOSS Act.

12.3 Under the reporting regime, the content of the RA database, which a registered agent is obliged to establish and maintain in respect of each entity for which it acts as registered agent, has been expanded to include additional information which enables the ITA to determine (i) whether the relevant legal entity is subject to economic substance requirements and (ii) if so, whether the relevant entity is complying with them. It has also been expanded to include limited partnerships with legal personality, which hitherto have not been subject to the BOSS Act at all.

12.4 The information which the RA database must hold with respect to an entity is set out in section 10(3) of the BOSS Act, and is referred to as "the prescribed information". It comprises the following:

(a) the particulars of each corporate and legal entity including

(i) the name, including alternative names;

(ii) the incorporation number or its equivalent;

(iii) date of incorporation;

(iv) status;

(v) registered address;

(va) whether it carries on a relevant activity;

(vi) any relevant activities which it carries on; and

(vii) any other particulars as the Minister may by Order prescribe.

(b) with respect to each beneficial owner of the corporate or legal entity:

(i) name;

(ii) residential address;

(iii) date of birth; and

(iv) nationality.

(c) with respect to each registrable legal entity of the corporate and legal entity:

(i) details of the registrable legal entity as outlined in subsection (3)(a) (i) to (v);

(ii) jurisdiction in which the registrable legal entity is formed;

(iii) the basis or bases upon which the legal entity is designated as a registrable legal entity;

(iv) where the registrable legal entity is a foreign regulated person, the name of the jurisdiction of regulation and the name of the foreign regulator; or

(v) where the registrable legal entity is a sovereign state or a wholly owned subsidiary of a sovereign state the name of that sovereign state and (if applicable) wholly owned subsidiary.

(d) with respect to an exempt person

(i) the details of the exempt person as outlined in subsection (3)(a); and

(ii) the basis or bases upon which the exempt person is designated as an exempt person.

(e) with respect to the parent (if any) of any corporate and legal entity which carries on a relevant activity and which claims to be outside the scope of the economic substance requirements by reason of being a non-resident company or a non-resident limited partnership:

(i) details of the parent as outlined in subsection (3)(a) (i) and (ii);

(ii) jurisdiction in which the parent is formed;

(f) with respect to any corporate and legal entity which is registered on a recognised stock exchange, details of the stock exchange listing.

(g) with respect to any corporate and legal entity which carries on a relevant activity and claims to be outside the scope of the economic substance requirements by reason of being a non-resident company or a non-resident limited partnership, the jurisdiction in which it is tax resident together with evidence to support that tax residence.

(h) with respect to any corporate and legal entity which carries on a relevant activity, and which does not claim to be outside the scope of the economic substance requirements by reason of being a non-resident company or a non-resident limited partnership, in relation to each such activity which it carries on during a financial period, and in respect of that period

(i) the total turnover generated by the relevant activity;

(ia) the total amount of expenditure incurred on the relevant activity

(ii) the amount of expenditure incurred on the relevant activity within the Virgin Islands;

(iii) the total number of employees engaged in the relevant activity;

(iv) the number of employees engaged in the relevant activity within the Virgin Islands;

(v) the address of any premises within the Virgin Islands which is used in connection with the relevant activity and the address of each such premises;

(vi) in the case of a corporate and legal entity which carries on an intellectual property business, the nature of any equipment located within the Virgin Islands which is used in connection with the relevant activity;

(vii) the names of the persons responsible for the direction and management of the relevant activity, together with their relationship to the company and whether they are resident in the Virgin Islands;

save that where the relevant activity is holding business the prescribed information required under this paragraph (h) shall be limited to sub-paragraphs (iii), (iv) and (v).

(i) with respect to any corporate or legal entity which carries on an intellectual property business, and which does not claim to be outside the scope of the economic substance requirements by reason of being a non-resident company or a non-resident limited partnership, in addition to the particulars supplied under section 10(3)(h), in relation to that activity

(i) whether or not the corporate or legal entity is a high risk IP legal entity within the meaning of section 2 of the Economic Substance (Companies and Limited Partnerships) Act, 2018;

(ii) whether the corporate or legal entity wishes to contest the rebuttable presumption introduced by section 9(2)(a) or, as the case may be 9(2)(b) of the Economic Substance (Companies and Limited Partnerships) Act, 2018;

(iii) if the corporate or legal entity wishes to contest such a rebuttable presumption the facts and matters relied upon for that purpose.

(j) with respect to any corporate or legal entity which carries on a relevant activity and which does not claim to be outside the scope of the economic substance requirements by reason of being a non-resident company or a non-resident limited partnership, but for which core income-generating activity is carried out by another entity, the name of the entity which carries out that activity on its behalf, together with details of the resources deployed by that entity in carrying out the activity on its behalf.

12.5 Both the relevant entity and its registered agent have obligations in respect of the prescribed information. These duties are set out in section 9(1) to (4) of the BOSS Act.

(1) A registered agent shall take reasonable steps to

(a) identify the beneficial owners and registrable legal entities of each corporate and legal entity for which it acts as registered agent;

(b) collect the prescribed information with respect to each corporate and legal entity for which it acts as registered agent,

in accordance with this Act.

(2) A corporate and legal entity shall

(a) identify any person who is a parent, a beneficial owner or registrable legal entity of that corporate and legal entity, or, if it is registered on a recognised stock exchange, shall give details of its stock exchange registration;

(b) identify whether it carries on one or more relevant activities, and if so which relevant activities; and

(c) ascertain the information prescribed in sections 10(3)(e) and (f).

(3) A registered agent is not required to identify any beneficial owner of a corporate and legal entity under subsection (1) who holds its interest, directly or indirectly, in the corporate and legal entity through a registrable legal entity if the registered agent identifies that registrable legal entity for that purpose.

(4) For the purposes of this section, a registered agent who takes steps to identify and verify the identity of the beneficial owners of a corporate and legal entity in accordance with its obligations under the AML/CFT legislation shall have taken all reasonable steps in accordance with this section, and references to beneficial owners and registrable legal entities of a corporate and legal entity shall be interpreted accordingly.

12.6 The registered agent is required to take reasonable steps to "identify" the beneficial owners or registrable legal entities (as appropriate) of the corporate and legal entity. This obligation remains unchanged from the original BOSS Act (save that it is expanded to cover limited partnerships with legal personality). It is also liable to take reasonable steps to "collect" the prescribed information (which includes the beneficial owner and registrable legal entity information).

Consequently, so far as beneficial owners and registrable entities are concerned, the RA is obliged to take reasonable steps both to identify and collect this information. So far as the remainder of the prescribed information is concerned, the RA is only liable to take reasonable steps to collect it from the relevant legal and corporate entity. It has no duty to identify that information for itself, or to ascertain its truth. The RA is then under a duty to enter particulars of the prescribed information collected on the RA database (section 10(1)).

12.7 A corporate and legal entity must identify or ascertain all of the relevant prescribed information. That duty is not qualified by a requirement that it need only take "reasonable steps".

12.8 So far as the RA is concerned, section 9(4) of the BOSS Act outlines that an RA has identified and verified the identity of the beneficial owner for the purposes of AML/CFT legislation in the Virgin Islands shall have taken all reasonable steps for the purposes of that section.

12.9 Although the prescribed information is extensive, not all of it needs to be ascertained and collected for each corporate and legal entity. Thus:

(i) all corporate and legal entities need to ascertain and supply to the RA the information required by paragraphs (a) and, where applicable paragraphs (b) (c) (d) and (f) of section 10(3) of the BOSS Act(see paragraph 141 above).

(ii) if the corporate and legal entity returns that it does not carry on a relevant activity that is all the information relating to economic substance which is required;

(iii) if the corporate and legal entity carries on a relevant activity but claims to be a non-resident company or a non-resident limited partnership, the information required by paragraph (g), but not any information required by the remaining paragraphs;

(iv) if the corporate and legal entity carries on a relevant activity but does not claim to be a non-resident company or a non-resident limited partnership, the information required by paragraph (e) (h), and, where applicable (i) and (j), but not any information required by paragraph (g).

12.10 The definition of "parent" appears in section 7(3) of the BOSS Act. The obligation to give this information is clarified by rule 19.

Rule 19

References in the BOSS Act to the parent of a corporate and legal entity mean references to the immediate parent of the corporate legal entity, and to the ultimate parent of the corporate and legal entity.

Rule 20

The ultimate parent of a corporate and legal entity means the parent of the corporate and legal entity which itself has no parent.

12.11 The scope of prescribed information is clarified by rule 21.

Rule 21

Where the relevant activity being carried on by a corporate and legal entity is holding activity, of the information prescribed in section 10(3)(h), only that set out in paragraphs (iv) and (v) need be provided.

12.12 Registrable legal entity is defined in BOSS Act section 8.

12.13 The duty on a corporate and legal entity to ascertain prescribed information and notify its RA arises in two circumstances, as provided for in section 9(6A):

(6A) A corporate and legal entity shall notify the registered agent of information prescribed in section 10(3)(a) (va) and (vi) and section 10(3)(e) to (j) within a period following the end of the financial period to be fixed by regulations and shall notify the registered agent of any matters prescribed in section 10(3)(a) to (d), excluding section 10(3)(a)(va) and (vi), within 15 days of identifying those matters.

12.14 This means that for the purpose of determining when the corporate and legal entity's obligation to ascertain prescribed information and pass it on to the RA arises, prescribed information is divided into 2 categories:

(1) Information regarding the corporate and legal entity itself, and its beneficial owners and registrable legal entities.

(2) All other prescribed information (ie the carrying on of a relevant activity, exempt person details, parent company details, stock exchange listing details, tax residence details, turnover, employees, equipment and premises details, intellectual property business details and outsourcing details). The exception for information within section 10(3)(a)(vi) excludes information about relevant activities.

12.15 Prescribed information within (1) must be ascertained immediately and provided within 15 days of the information being ascertained to the RA. Corporate and legal entities which are subject to the BOSS Act before the amendments came into force should already have performed this initial duty as regards Information regarding the corporate and legal entity itself, and its beneficial owners and registrable legal entities, and need not repeat it. Corporate and legal entities which become subject to the BOSS Act as a result of the amendments in the ESA (due to the amended wider definition of "corporate and legal entity") will come under a duty to ascertain all the information within (1) as soon as the amendments come into force.

12.16 The duty to provide the information within (1) above about beneficial owners and registrable legal entities is a continuing duty, as a result of the terms of BOSS Act section 12(1), which reads as follows:

A corporate and legal entity shall within 15 days of becoming aware of a change of any of the prescribed information relating to beneficial owners or registrable legal entities notify its registered agent of such changes and the date such changes took place.

12.17 Information within (2) must be provided in respect of a financial period within 6 months of the end of the period.

Information and evidence which is required in support of specific submissions in the BOSS Act return.

12.18 Under the reporting regime, an entity is only required to submit documentary evidence where that is specifically asked for (eg in support of a submission that it is tax resident outside the BVI (BOSS Act, section 10(3)(g)) or under Rule 22, below). Otherwise it must submit the facts and matters on which it relies in the BOSS Act return, and should be prepared to evidence those facts and matters if the ITA requests that evidence following a review of the BOSS Act return

Intellectual property business

12.19 The following rules apply in relation to entities which carry on intellectual property business:

Rule 22

A legal entity which wishes to contest the rebuttable presumption introduced by ESA section 9(2)(a) must, as part of its submissions under section 9(6A) of the BOSS Act:

(a) identify the relevant intangible asset which it holds;

(b) explain how that intangible asset is being used to generate income;

(c) identify the staff in the BVI and (in each case) their qualifications, level of experience, the duration of their employment and the decisions for which they are responsible in respect of the generation of income from the intangible asset;

(d) the nature and history of the strategic decisions (if any) taken by the entity in the BVI;

(e) the nature and history of the risks (if any) being managed and borne by the entity in the BVI;

(f) the nature of the trading activities (if any) carried on in the BVI by which the intangible asset is exploited for the purpose of generating income from third parties.

Rule 23

A legal entity that wishes to contest the rebuttable presumption introduced by ESA section 9(2)(b) must, as part of its submissions under section 9(6A) of the BOSS Act:

(a) identify the relevant intellectual property asset which it holds;

(b) provide detailed business plans which explain the commercial rationale of holding the intellectual property asset in the jurisdiction;

(c) identify the staff in the BVI and (in each case) their qualifications, level of experience the duration of their employment and the decisions for which they are responsible in respect of the generation of income from the intellectual property asset; and

(d) provide concrete evidence that decision-making is taking place within the jurisdiction, for example in the form of detailed minutes of meetings which have taken place within the jurisdiction.

Outsourcing

12.20 The following rules apply where a legal entity carrying on a relevant activity outsources work to another person:

Rule 24

Where any aspect of relevant activity is carried out for a legal entity by a third party, the legal entity must, as part of its submissions under section 9(6A) of the BOSS Act:

(a) identify the name of the third party which carries out the income-generating activity on its behalf;

(b) identify what activities, and what proportion of the entity's total income-generating activity, is carried out by the third party;

(c) identify the geographical location of the activities carried out by the third party

(d) state how the legal entity monitors and controls the activity carried out on its behalf by the third party;

(e) state the resources employed by the third party in performing the outsourced activity.

Information requests by the ITA

12.21 In some instances, the information submitted under the reporting regime may not be sufficient to enable the ITA to determine whether an entity is complying with the economic substance requirements. In addition, the ITA may seek further information from a legal entity in order to check the accuracy of its return.

12.22 The ITA has the power under ESA section 11 to serve notice on any person, requiring that person to provide, within the period specified in the notice and at such place as is specified in the notice, such documents and information as the ITA may reasonably require for the purpose of facilitating the ITA's exercise of its functions under ESA. A failure to provide the information without reasonable excuse, or the provision of false information, is an offence.

12.23 Likewise, there is no restriction on the types of information which the ITA can ask for, save that in certain circumstances the recipient of a notice under section 11 may have a reasonable excuse for refusing to provide the information. For example, such an excuse includes where the person would be entitled to refuse to provide the requested information on grounds of legal privilege.

13. Enforcement and Penalties

13.1 The ITA is responsible for assessing and enforcing compliance with the requirements imposed by ESA.

13.2 The penalties imposed by ESA and the BOSS Act are intended to be rigorous, effective and dissuasive, ranging from financial penalties to striking off and (in the case of individuals) imprisonment. Broadly speaking, they arise in two circumstances:

(1) where there has been a failure to provide information, or information provided is inaccurate; and

(2) where there has been a failure to comply with economic substance requirements.

13.3 For the avoidance of doubt, the penalties set out in ESA and the BOSS Act are not exhaustive.

Assessment of compliance

13.4 Responsibility for assessing compliance is conferred on ITA by ESA section 10:

> *(1) The competent authority may determine that a legal entity has not complied with the economic substance requirements during any financial period of the legal entity ending on or after 31st December 2019, provided that such determination is made no later than 6*

years after the end of the financial period to which the determination relates.

(2) The time limit in subsection (1) does not apply if the competent authority is not able to make a determination within the 6 year period by reason of any deliberate misrepresentation or negligent or fraudulent action by the legal entity or by any other person.

Failure to provide accurate information

13.5 A failure to provide information without reasonable excuse and the intentional provision of false information, whether pursuant to an information request from the ITA under ESA section 11 or as part of the reporting regime under the BOSS Act, attracts penalties. The persons who may be liable for penalties include not only the relevant entities to whom the information relates and their registered agents but any person on whom the ITA serves a notice under ESA section 11.

13.6 Those penalties are severe:

(1) A person who fails to provide information without reasonable excuse or who intentionally provides false information in response to a request under ESA section 11 is liable: (i) on summary conviction, to a fine not exceeding forty thousand dollars or to imprisonment for a term not exceeding two years, or both; or (ii) on conviction on indictment, to a fine not exceeding seventy five thousand dollars or to imprisonment for a term not exceeding five years, or both (ESA section 11(3)).

(2) The same penalties apply where a registered agent intentionally provides false information relating to an entity on its RA database or where the entity intentionally provides false information under section 9(2) or 12(1) of the BOSS Act (BOSS Act section 16).

(3) Where an entity fails to comply with a requirement of section 9 of the BOSS Act without reasonable excuse, it commits an offence and is liable: (i) on summary conviction to a fine not exceeding forty thousand dollars or to imprisonment for a term not exceeding six months, or both; or (ii) on conviction on indictment, to a fine not exceeding two hundred and fifty thousand dollars or to imprisonment for a term not exceeding five years, or both (BOSS Act section 9(6)).

(4) Where a registered agent fails to comply with a requirement of section 9 without reasonable cause, it commits an offence and is liable: (i) on summary conviction to a fine not exceeding twenty thousand dollars; or (ii) on conviction on indictment, to a fine not exceeding forty thousand dollars (BOSS Act section 9(7)).

13.7 As can be seen, save where there has been an intentional provision of false information, there is a defence of 'reasonable excuse' (see ESA section 11(3); BOSS Act sections 9(6), 9(7) and 10(4)). Whilst ultimately this is a question for

the court, the ITA anticipates that what amounts to a reasonable excuse will depend on the facts and circumstances of the breach, including the identity of the infringer, on whom the burden of demonstrating 'reasonable excuse' will fall.

Failure to comply with the economic substance requirements

13.8 The regime which applies where an entity fails to comply with the economic substance requirements is intended to serve, at least in the first instance, the twin purposes of (i) penalising both the entity and those responsible for the breach and (ii) compelling the entity to take corrective action. If the latter purpose cannot be achieved, then the entity risks being struck from the register.

13.9 In the majority of cases there will be a three-stage regime for sanctions:

(1) On a first determination of non-compliance, the ITA will issue a first determination, explaining the reasons for the determination, the amount of the penalty and the date from which the penalty is due and the action which the ITA considers should be taken by the entity and the date by which such action needs to be taken. It will also notify the entity of its right of appeal under section 13 (ESA section 12(1).)

(2) If the entity fails to take the action demanded of it in the first determination within the prescribed time, or within such longer period as the ITA may allow, the ITA will issue a second determination. That notice will have the same elements as that issued on a first determination of non-compliance, save that it will also notify the entity that the ITA may make a report to the Financial Services Commission (ESA section 12(4)).

(3) Following the issue of a second determination of non-compliance, the ITA may, if it considers it appropriate to do so having regard to all the circumstances of the case, request that the legal entity be struck off the register.

13.10 In exceptional cases, the ITA may leapfrog this three-stage regime, and go straight to striking off. It may exercise this power at any time following the service of a first determination of non-compliance where it decides that there is no realistic possibility of the entity meeting the economic substance requirements (ESA section 12(8)).

13.11 Striking off is an extreme remedy. The ITA will not resort to that sanction without giving the entity in question a reasonable opportunity to state its case in opposition, and in every case will seek to ensure that the rights of third parties (such as customers of a bank or insurance company) are protected. On the other hand, the ITA will not hesitate to resort to this sanction where it considers that an entity has been guilty of clear, deliberate or egregious breaches of the economic substance requirements.

13.12 It is proposed to introduce legislation to provide that under the Insolvency Act and the Limited Partnership Act the ITA has the right to seek the winding up of a company and a limited partnership respectively on public interest grounds where a legal entity has been found to be in breach of the substance requirements.

13.13 Once it has determined that an entity is in breach of the economic substance requirements, the ITA has no discretion as to whether to impose a financial penalty, but must impose a minimum penalty of five thousand dollars on a first determination of non-compliance and ten thousand dollars on a second determination of non-compliance (ESA section 12(2) and 12(4)). If an entity wishes to challenge the imposition of the minimum penalty on the grounds that it is too high, it must submit an appeal under ESA section 13.

13.14 Subject to the requirement that the ITA must impose a minimum penalty on a determination of non-compliance, the ITA has a broad discretion as to the amount of any penalty, provided that it does not exceed the maximum penalty which: on a first determination of non-compliance, is fifty thousand dollars in the case of a high risk IP legal entity and twenty thousand dollars in all other cases (ESA section 12(2)); and, on a second determination of non-compliance, is four hundred thousand dollars in the case of a high risk IP legal entity and two hundred thousand dollars in all other cases (ESA section 12(5)).

13.15 In determining the amount of the penalty, the ITA will take into account the following factors:

(1) The nature and seriousness of the non-compliance;
(2) The reason for the breach;
(3) Whether this is the first financial period in which the entity has failed to comply with the economic substance requirements, or whether it has previously been deemed non-compliant;
(4) The total turnover of the entity;
(5) The entity's conduct during the assessment process and (where relevant) following the first determination of non-compliance, and in particular whether it has been cooperative with the ITA;
(6) What steps (if any) the entity has taken to prevent a recurrence of the breach.

<u>Appeal</u>

13.16 An entity who has been served with a notice of non-compliance by the ITA under ESA section 12 has a right of appeal against both the determination of non-compliance and against the amount of any penalty imposed, including where the amount of the penalty is the minimum prescribed (ESA section 13).

13.17 However, notice of the appeal stating the ground of appeal must be filed at the Court within 30 days of the date of the notice of non-compliance (ESA section

14(1)). The ITA, on whom the notice of appeal must be served, is entitled to appear and be heard at the hearing of the appeal (ESA section 14(2)).

13.18 The powers of the court on an appeal comprise the power to confirm, vary or revoke the determination of non-compliance, and to confirm, vary or cancel the penalty (ESA section 14(3)).

13.19 Where notice of appeal has been lodged, the time for complying with the requirements specified in the notice of non-compliance only starts to run from the date on which the appeal is finally determined or withdrawn (ESA section 15).

14. The ITA's obligations to disclose information to overseas authorities

14.1 In certain circumstances, Schedule 4 of the BOSS Act requires the ITA to disclose or procure the disclosure of the relevant information stored in the RA database in respect of an entity with a "relevant overseas competent authority". "Relevant overseas competent authority" is defined by paragraph 1 of Schedule 4 as follows:

> *"relevant overseas competent authority" means, in relation to any corporate or legal entity, the competent authority for each state in which*
> *(a) a beneficial owner resides; or*
> *(b) within which a registrable legal entity is registered; or*
> *(c) within which the corporate or legal entity is registered; or*
> *(d) within which a parent of the corporate or legal entity is registered; or*
> *(e) within which the corporate or legal entity claims to be tax resident;"*

14.2 The triggering events for the spontaneous exchange of information with the relevant overseas competent authorities are (i) there has been a breach of the economic substance requirements or (ii) the relevant entity carries on an intellectual property business and falls within the presumption that it does not conduct core-income generating activity in the BVI set out in ESA section 9(2).

14.3 In addition to these triggering events, where an entity claims to be tax resident in another jurisdiction, the competent authority of that jurisdiction will receive a notification. This is so as to bolster the policing of non-residence claims by the ITA.

14.4 Where an entity is carrying on relevant activities and claims to be tax resident outside the BVI:

(1) A notification of this claim should be sent to the jurisdiction in which the entity claims to be tax resident; and

(2) If a beneficial owner or legal owner of the entity is resident in an EU Member State, the competent authority of that Member State must also be

notified that the legal entity is claiming tax residence outside the BVI and be provided with the name of the jurisdiction in which tax residence is claimed.

15. Timing of the introduction of the economic substance and reporting requirements

15.1 Save for the new reporting regime under the BOSS Act introduced by ESA, the provisions of ESA came into effect on 1 January 2019. However, the date from which an entity is obliged to comply with the economic substance requirements depends upon when the entity was incorporated or formed.

15.2 In particular, as described in Part 2, the basic obligation to comply with the economic substance requirements is imposed by ESA section 5(1) which reads:

> *A legal entity which carries on a relevant activity during any financial period must comply with the economic substance requirements.*

15.3 The date on which an entity's first "financial period" for the purposes of ESA commences depends upon when the entity was formed or incorporated, as set out in section 4:

In this Act, unless the context otherwise requires, "financial period" means

(a) in the case of a company incorporated on or after 1 January 2019, such period of not more than one year from the date of incorporation as the company shall notify to the competent authority and thereafter each successive period of one year running from the end of that period;

(b) in the case of a limited partnership formed on or after 1 January 2019, such period of not more than one year from the date of formation as the limited partnership shall notify to the competent authority and thereafter each successive period of one year running from the end of that period;

(c) in any other case such period of one year commencing on a date no later than 30 June 2019 as the legal entity shall notify to the competent authority and thereafter each successive period of one year running from the end of that period.

15.4 It therefore follows that:

(1) A company or limited partnership incorporated or formed on or after 1 January 2019 must comply with the economic substance requirements as from the date of incorporation or formation, because its first financial period will begin on its incorporation or formation;

(2) A company or limited partnership incorporated or formed prior to 1 January 2019 is not obliged to comply with the economic substance requirements until 30 June 2019, save where it notifies the ITA that its

financial period for the purposes of ESA will commence on a date earlier than 30 June 2019.

15.5 The financial period that some entities have commenced prior to when the new reporting regime came into force i.e. 1st October, 2019. Where that is the case, the relevant entity must still comply with the economic substance requirements from the commencement of their financial period, notwithstanding the fact that the new reporting regime was not yet in force. This does not cause any difficulties, as the obligation to report on the relevant activity does not arise until after the end of each financial period.

15.6 Regulations concerning filing and submissions periods and intellectual property requirements are currently being drafted and will be available on the website of the ITA when they have been passed by the Minister.

APPENDIX 1

Abbreviations used in these Rules

Abbreviations

BOSS Act	The Beneficial Ownership (Secure Search System) Act 2017, as amended
BVI	British Virgin Islands
CIGA	core income generating activity (defined below)
ESA	The Economic Substance (Companies and Limited Liability Partnerships) Act 2018 as amended
EU	European Union
FSC	Financial Services Commission of the BVI
FSC Code	BVI Regulatory Code, 2009, issued under section 41(1) of the Financial Services Commission Act, 2001
ITA	International Tax Authority
SIBA	Securities and Investment Business Act, 2010