The BVI updated its economic substance rules

February 24, 2020
Issue 2

In brief

The International Tax Authority (ITA) of the British Virgin Islands (BVI) issued an updated version of “Rules on Economic Substance in Virgin Islands” (ES Rules) on February 10, 2020. The updated version of the ES Rules replaces the original version issued on October 9, 2019. This News Flash summaries the key changes and highlights the issues that business groups need to consider in view of the updated rules.

In detail

The updated version of the ES Rules

The update version of the ES Rules made various amendments to the explanatory notes while the rules remain substantially the same. The key changes or further clarifications in the updated version of the ES Rules (as compared to the original rules) are summarised in the table below.

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<thead>
<tr>
<th>Issue</th>
<th>Key changes or clarifications</th>
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| Timetable for relocating a relevant activity to the BVI | • The rules explain that the ITA will take a pragmatic approach to the interpretation of the ES legislation. In particular, in case of a legal entity which carries on a relevant activity outside the BVI but intends to re-locate that activity to the BVI, the rules stipulate that the ITA may agree with that legal entity a compliance plan within an agreed timetable.  
  • Explanatory note 2.12 of the updated ES Rules further specifies that  
    o the time given for a legal entity to re-locate its relevant activity to the BVI under its compliance plan agreed with the ITA would not typically extend beyond two financial periods; and  
    o non-compliance by the end of the first financial period (i.e. the financial period in which the entity notified the ITA of its intention to re-locate the relevant activity to the BVI) would trigger spontaneous exchange of information. |
<p>| Non-residency claim                        | • The rules provide that “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.”                                                                                                                                                                                                 |</p>
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<td>Non-residency claim (continued)</td>
<td>• Explanatory note 4.3 has been added to clarify that any non-residency claim and the supporting evidence will form part of the prescribed information that is required to be uploaded to the Registered Agent database under the Beneficial Ownership Secure Search (BOSS) System Act, 2017.</td>
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<td>Direction and management in the BVI</td>
<td>• Explanatory note 7.4 of the updated ES Rules clarifies that strategic decisions for the relevant activity need to be taken in the BVI in order to meet the requirement of being “directed and managed” in the BVI.</td>
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<td>Core income generating activities (CIGA)</td>
<td>• Explanatory note 7.19 of the updated ES Rules clarifies that a legal entity does not need to perform all the listed CIGA for a particular relevant activity, but it must perform the CIGA that generates its income.</td>
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<td>Outsourcing</td>
<td>• Explanatory note 7.22 of the updated ES Rules has been revised to clarify that monitoring of the outsourced activity has to be undertaken in the BVI.</td>
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<td>Holding business – equity participation</td>
<td>• The term “general partner” in explanatory note 5.26 has been changed to “limited partner” as the interest of a limited partner in a limited partnership will usually be an equity participation when interpreting “holding business”.</td>
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</table>
| Holding business - pure equity holding entity | • Explanatory note 5.28 previously stated that “because it is possible for a pure equity holding entity to carry on one or 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”. This has been deleted from the note in the updated ES Rules.  
• Explanatory note 8.2 previously stated that “there are no restrictions on the extent to which a pure equity holding entity may outsource its activity” and “the outsourcing to persons in the BVI will be taken into account in assessing the employee adequacy”. These have also been deleted from the note in the updated ES Rules. |
| Intellectual property (IP) business | • Explanatory note 5.31 on IP business has been revised and three illustrative examples have been added. The explanatory note previously specified that “The definition does not therefore apply to a business which owns intellectual property merely as an adjunct to its business”. This has been deleted from the note. Instead, an example is used to illustrate that holding of an IP merely as an adjunct to a business carried on by an entity will not constitute IP business.  
• Explanatory note 5.32 has been added to make it clear that appropriate action will be taken against any entity which seeks to manipulate its income to avoid being subject to the substance requirements by, for example, disguising royalties as part of sales income. |
| Distribution and service centre business | • The original explanatory note 5.36 explained that “occasional transactions within the description (of distribution and service centre business) which do not form part of a business but are undertaken ancillary to a different business” do not constitute distribution and service centre business. This explanatory note has been revised to further clarify that these occasional activities refer to activities that are recharged at cost or less (i.e. non-profit making). An example has also been added in the updated ES Rules to illustrate this. |
The takeaway

While most changes in the updated version of the ES Rules have clarified the application of the Economic Substance Act in practice, the reasons of making the two changes related to pure equity holding entity as mentioned above are not entirely clear and further clarifications from the ITA would be welcome.

As the updated rules have now made it clear that strategic decisions for the relevant activity and monitoring of the outsourced activities (if any) need to be undertaken in the BVI, business groups with BVI entities should revisit their current arrangements and reassess whether they are still in compliance with the economic substance requirements in view of the above changes.

Endnotes

1. The updated ES Rules v2 can be accessed via this link: https://bvi.gov.vg/sites/default/files/resources/ita_rules_v2.pdf
Let’s talk

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