

HARNEYS

PAYROLL TAX

For more than twenty years International Business Companies were exempt from the provisions of the Income Tax Act (“ITA”) save for payments made to residents of the British Virgin Islands and for this purpose an International Business Company was deemed to be non resident in the British Virgin Islands, whereas companies incorporated under the Companies Act (“CAP 285”) have been subject to the ITA. A company incorporated under CAP 285 that was resident in the British Virgin Islands was liable to tax at the rate of 15 per cent on its worldwide income whereas a company that was non-resident would be liable to a 15 per cent tax only on income that arose in or was remitted to the British Virgin Islands. Likewise, resident and domiciled individuals were subject to tax on a graduated scale of up to 20% on a worldwide basis on income from all sources. Resident but non-domiciled individuals were subject to tax on income arising outside the British Virgin Islands on a remittance basis as well as on income arising in the British Virgin Islands. Non-resident individuals were taxed on any income derived from or received in the British Virgin Islands.

To comply with the EU Tax Code of Conduct stipulation against ring fencing “offshore” entities from “onshore” entities, the British Virgin Islands moved at the beginning of 2005 to a zero rated income tax regime for all corporate entities in conjunction with a move to one corporate statute. To provide equity as between corporate and individual taxpayers, it was politically expedient to move to a zero rated tax regime for individuals at the same time. To recoup the lost revenue from the zero rated income tax regime, annual fees for companies were increased and a payroll tax was introduced in the Payroll Taxes Act, 2004 (No. 18 of 2004), which became effective 1 January 2005 and was amended by the Miscellaneous Amendments (SIGTAS) Act, 2005 (No.23 of 2005), the Payroll Taxes (Amendment) Act, 2005 (No. 24 of 2005), the Payroll Taxes (Amendment of Schedule) Order, 2006 (Statutory Instrument No. 88 of 2006) and the Payroll Taxes (Amendment) Act, 2007 (No. 4 of 2007) (together the “PTA”).

Whilst the International Business Companies Act has been repealed and CAP 285 will be repealed at the end of 2007, the tax exemption provisions in the International Business Companies Act have also been included in the successor BVI Business Companies Act. Notwithstanding the tax exemption provisions, the ITA has in fact been amended by the PTA to “zero rate” all taxes payable under the ITA. Therefore there is no longer any income tax, corporate or personal, in the British Virgin Islands. In addition, there is no withholding tax, capital gains tax, capital transfer tax, estate duty, inheritance tax or succession tax in the British Virgin Islands.

Scope of Payroll Tax

Payroll tax is charged on every employer who carries on business in the British Virgin Islands in respect of (i) remuneration paid by him to every employee and (ii) deemed remuneration paid by him to every deemed employee for services rendered by the employee or deemed employee

wholly or mainly in the British Virgin Islands whether or not the remuneration is paid in the British Virgin Islands. In addition a self-employed person is liable to payroll tax on his deemed remuneration.

A partner in a partnership carrying on business in the British Virgin Islands is a “deemed employee” of that partnership if he renders services to the partnership and otherwise than as an employee participates in income of the partnership. Likewise, a shareholder of a company which is carrying on business in the British Virgin Islands is a “deemed employee” of that company if he renders services to the company and otherwise than as an employee participates in income of the company.

For purposes of the Act “remuneration” is actual remuneration of a person including wages, salary, leave pay, bonus, gratuity, money paid under a profit-sharing scheme, severance pay, residential rent and other benefits in kind. However, the PTA stipulates that several things are not included in remuneration, such as dividends paid by a company registered in the British Virgin Islands and payments made by an employer for the benefit of an employee to any health insurance scheme or pension scheme approved by the Commissioner of Inland Revenue (“Commissioner”).

A “deemed employee” is deemed by the PTA to be employed and paid “deemed remuneration”. The “deemed remuneration” is the greater of his actual remuneration or his “notional remuneration”. The “notional remuneration” is the amount that represents a “fair and equitable valuation of the deemed employee’s services to the business”. In the first instance the employer must make an assessment of this “notional remuneration” by having regard to the following factors only:

- Nature and extent of services of deemed employee to the business
- Deemed employee’s experience and any special skill
- Nature of the business
- Emoluments of persons engaged in other businesses who render similar services to the employer’s business
- Emoluments of persons engaged in the employer’s business who render to the business services similar to those rendered by the deemed employee
- The financial records of the business which show the services of the deemed employee that generate revenue for the business and the allocation to him of benefits from the business

Each year the employer must submit an assessment of notional remuneration for each deemed employee for the previous financial year. The Commissioner may make enquiries as he thinks for the purpose of determining whether the employer’s assessment is adequate or he may increase the assessment.

A self-employed person is deemed to employ himself and to pay himself “deemed remuneration” which is the greater of his actual remuneration or his “notional remuneration”. A self-employed person is an individual who carries on business otherwise than as an employee and benefits from income of the business otherwise than by way of being paid actual remuneration.

Payroll Tax Rates and Contribution by Employee

Payroll tax is charged at the rate of 10% on every employer, known as a Class 1 Employer, who for a financial year if in that financial year his payroll does not exceed \$150,000, his annual turnover does not exceed \$300,000 and the total number of his employees and deemed employees, if any, does not exceed seven. An employer or self-employed person who does not fall within the Class 1 Employer category is automatically a Class 2 Employer and liable to payroll tax at the rate of 14%.

An employer may deduct and retain from the remuneration paid to an employee during any financial year 8% of the remuneration to cover the payroll tax liability. However, no deduction can be made with respect of the first \$10,000 of actual remuneration paid to an employee, deemed employee or self-employed person in any financial year.

It follows that that balance of the payroll tax liability for each employee, deemed employee and the self-employed is paid by the employer: 2% in the case of a Class 1 Employer and 6% in the case of a Class 2 Employer. By way of extra-statutory concession the employer too is not liable to pay any payroll tax on the first \$10,000 of remuneration of each employee, deemed employee or self-employed person.

Administration

A taxpayer must pay to the Commissioner payroll tax in respect of actual remuneration within 15 days of the end of a calendar month in respect of which remuneration has been paid to an employee, deemed employee or self-employed person. With respect to notional remuneration a taxpayer must pay to the Commissioner payroll tax within such period as he is required to do so by notice in writing from the Commissioner.

The Commissioner may by written notice require any person to provide him within a reasonable time, being not less than 30 days, with a true and correct return of his payroll or remuneration for any financial year.

With respect to administration of the PTA several sections deal with returns, extension of time for filing returns, assessment of tax, estimated assessments, interest, notice of objection, correction of assessment, time of assessment, set-off of over-payments, investigative powers, payment of tax, collection agreements, extension of due date, penalty for late filing of return, waiver of penalty and priority of penalties. In addition, sections in the ITA pertaining to appointment of inspectors and their functions, notices to be served on persons assessed, appeals, errors in assessments and notices, repayment of tax, general powers of the Commissioner, collection and recovery of tax, false statements and returns and penalties for offences have effect and apply *mutatis mutandis* for purposes of the PTA. For this purpose references in those sections of the ITA to tax are for the purposes of the PTA to be construed as references to payroll tax and references in those sections of the ITA to income or chargeable income are for the purposes of the PTA to be construed as reference to remuneration.

The rates of payroll tax referred to above may be amended by Executive Council by an Order published in the Gazette and in a newspaper published and circulated in the British Virgin Islands. The Order is subject to an affirmative resolution of the House of Assembly.

If you would like further information on the subject matter of this Guide please contact Richard Peters at richard.peters@harneys.com or your usual contact at Harneys. Alternatively, you can visit our website at www.harneys.com.

This Guide is general in scope and is not intended to be comprehensive. It is not a substitute for legal advice.

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