

British Virgin Islands (BVI) economic substance (ES) update – ITA Rules updated

The BVI International Tax Authority (**ITA**) published an updated version 3 of its rules and explanatory notes on ES in the BVI (the **Rules**) on 23 February 2023.

Background

The Economic Substance (Companies and Limited Partnerships) Act (the **ES Act**) was introduced in the BVI, effective 1 January 2019, to address the concerns of the EU Code of Conduct Group (**COCG**) and the OECD Forum on Harmful Tax Practices (**FHTP**) regarding ES.

The ES reporting regime was introduced via amendments to the Beneficial Ownership Secure Search System Act (the **BOSS Act**).

Why is this relevant?

All companies and limited partnerships registered in the BVI (**Entities**, which includes foreign entities) should ensure that they have adequate systems and controls in place to comply with their obligations under the ES Act and the BOSS Act and are aware of their compliance and reporting obligations, even if the Entity does not carry on any of the nine “relevant activities” or is otherwise able to claim exemption from the ES requirements due to their tax status.

This is now a requirement of BVI law following amendments to the International Tax Authority Act and the ITA has indicated that it expects to see robust written records (which may include resolutions of the director(s) or general partner(s) of the Entity) to evidence that Entities have properly considered their obligations and put systems in place to ensure compliance. Regard must be had to the Rules as the official guidance published by the ITA.

Entities should also ensure they have considered their reporting obligations as every Entity is required to submit an annual ES declaration to the ITA via its BVI registered agent (**RA**) within six months of the end of the relevant ES financial period (the **FP**, which is not the same thing as an accounting or fiscal year). The ES reporting regime has been expanded significantly for FPs commencing on or after 1 January 2022, following amendments to the BOSS Act in 2021.

What are the key changes in v3 Rules?

Version 3 of the Rules reflects certain significant amendments to the ES Act and BOSS Act made during the course of 2021 and includes helpful further guidance and worked examples.

The key changes in our view are broadly as follows:

- **Gross income guidance** - The guidance regarding Rule 1 makes clear that, in order to be subject to ES requirements, an Entity must be conducting a relevant activity which generates (or may be expected to generate) gross income. Other than to the extent relevant to the definitions of “holding business” and “intellectual property business”, income is not generally a relevant consideration in itself when determining whether an Entity is conducting relevant activity during any specific financial period. However, explanatory note 6.4 of the Rules confirms that an Entity which carries on a relevant activity, but which has no gross income from such activity in a specific financial period will not be expected to meet the ES requirements in respect of that relevant activity and financial period but will still be required to satisfy its notification and reporting requirements (i.e., the reporting expected will be akin to a “nil report”). Rule 20 confirms that gross income for these purposes means all income from whatever source derived, including revenues from sales of inventory and

properties, services, royalties, interest, premiums, dividends and any other amounts.

- **Investment fund business exemption** - Explanatory note 2.10 confirms that investment fund business has been expressly excluded from the list of relevant activities under the ES Act. For an Entity that is an investment fund to be identified as conducting a relevant activity, it shall be conducting a separate and distinct business activity in its own right. Otherwise, an investment fund (will be reporting that it is not conducting a relevant activity for the related financial period. In our experience, the vast majority of investment funds do not have any principal business other than operating as an investment fund and so will not be subject to any ES requirements. This wording reflects underlying amendments to the ES Act and the consistent industry view since the ES Act was first enacted.
- **Tax residence outside the BVI** - Following requirements of the COCG and FHTP, Part 4 of the Rules (which deals with the tax “non-resident” exemption) has been significantly amended. Entities considering a non-residence claim involving Guernsey, Jersey or the Isle of Man (the **Crown Dependencies**) or any jurisdiction that does not have a corporate income tax system are recommended to review these changes and may need to seek professional advice. A special mechanism, requiring additional evidence, for Entities claiming non-residence in any of the Crown Dependencies has been introduced under Rule 5A. Under Rule 5, an Entity cannot be regarded for tax purposes in a jurisdiction that does not have a corporate income tax system – the examples given are Anguilla, Bahamas, Bahrain, Barbados, Bermuda, the Cayman Islands, the Turks and Caicos Islands and the United Arab Emirates. Explanatory note 4.5A also confirms that withholding taxes are not to be considered when making a determination of tax residence. The application of these provisions can be complex and we generally recommend that Entities considering making a tax non-residence claim seek appropriate legal and tax advice.
- **Relevant activity definitions and guidance** - Part 5 of the Rules contains various helpful worked examples and further guidance regarding the nine relevant activity definitions.
- **Guidance regarding FPs for limited partnerships** - Specific financial periods for limited partnerships (**LPs**) without legal personality have been introduced, together with guidance on how to apply to modify the default FPs applicable to such LPs. These are set out in Part 10 of the Rules.
- **Reporting requirements** - The amended Rules reflect the new requirements for FPs commencing on or after 1 January 2022, which are set out in detail in Part 12 of the Rules. Entities considering their reporting obligations for prior FPs should generally refer to version 2 of the Rules (of 10 February 2020) or seek appropriate advice if they are uncertain. In particular, Entities should note the obligations to identify and report details in respect of any “immediate parent” (broadly any entity holding directly 25% or more of the ownership or voting interests in the Entity) and “ultimate parent” of the Entity, as defined in the BOSS Act. Entities and their RAs are advised to prepare for reporting earlier than usual in 2023, as they may need more time to prepare reports or to seek advice on the new requirements.
- **Special guidance for LPs** - Part 16 of the Rules introduces guidance for LPs in order to meet the requirements of the ESA and the BOSSs Act, as LPs have particular legal characteristics quite different to companies. LPs are recommended to consider the Part 16 Guidance and to seek further advice if they remain uncertain. In our experience, most LPs we encounter in practice are investment funds – and if the Entity is an investment fund, it is very unlikely to be carrying on any relevant activity.

How can I classify my Entity?

Harneys team of expert BVI ES lawyers can be contacted by email at bvieconomicssubstance@harneys.com (billing rates apply).

Harneys’ online classification solution is being updated to reflect the changes and allows Entities to obtain formal legal advice from Harneys on their classification and key obligations under the ES Act for a low, fixed fee. For more information, please [click here](#).

Please contact ecsolutions@harneys.com to be notified once the solution is back online.

Where can I find further guidance?

Harneys has published a client guide to assist directors and operators of BVI companies and limited partnerships, which is being updated to reflect version 3 of the ITA Rules and is available via [this link](#).

A copy of version 3 of the Rules is available via [this link](#).

If you have any queries regarding any aspect of the BVI ES regime or your Entity, please let your usual Harneys contact know or alternatively contact the authors.



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