

British Virgin Islands economic substance – ITA investigation and enforcement powers

The BVI International Tax Authority (**ITA**) is responsible for monitoring entities' compliance with the economic substance (**ES**) compliance and reporting requirements. The ITA is now investigating entities and taking further action, where appropriate. This guide summarises the key points to consider, including various legislative changes made in 2022 to increase the ITA's enforcement powers, and addresses some frequently-asked questions.

Background

The BVI introduced economic substance requirements in 2019 to fulfil the BVI's international commitments to the European Union (**EU**) Code of Conduct Group for Business Taxation (**COCG**) and the Organisation for Economic Co-operation and Development (**OECD**)'s Forum on Harmful Tax Practices.

The Economic Substance (Companies and Limited Partnerships) Act (the **ES Act**) and the Beneficial Ownership Secure Search System Act (the **BOSS Act**) set out the ES compliance and reporting requirements, respectively. Further guidance appears in ES rules and explanatory notes (the **Rules**) published by the ITA.

Broadly, the first compliance "financial periods" under the ES Act commenced in 2019 for all companies and limited partnerships with legal personality registered in the BVI and by 1 January 2022 (at the latest) for limited partnerships without legal personality registered in the BVI. As a result, all companies and limited partnerships (including foreign entities) registered in the BVI (**Entities**) are subject to certain ongoing obligations in connection with the ES regime. The extent and nature of those obligations varies widely depending on the activities and tax status of the relevant Entity.

The ES Act and BOSS Act created various new civil and criminal penalties for non-compliance as well as a spontaneous information exchange regime, which are summarised in Parts 13 and 14 of the Rules and discussed below.

The administrative mechanism for imposing those penalties was introduced via amendments to the International Tax Authority Act (the **ITA Act**) and the International Tax Authority (Administrative Penalties) Regulations (the **Regulations**), which came into force in June 2022.

From 2022, the ITA will be reviewed periodically by the EU COCG and the FHTP to ensure that it is monitoring Entities and taking investigation and enforcement action, where appropriate.

What are the key obligations?

The ES compliance and reporting requirements are summarised in our previous client guides, which are available [via this link](#).

Broadly, every Entity must:

- identify on a continuing basis whether it carries on any "relevant activity" for the purposes of the ES Act (and, if so, which ones);
- if it does carry on any relevant activity and cannot claim exemption under Part 4 of the Rules due its tax status, comply with the applicable ES requirements under the ES Act; and
- identify and report to the ITA via its registered agent (**RA**) certain prescribed ES information under the BOSS Act within

six months of the end of each financial period – and “nil returns” are required even if an Entity has carried on no relevant activity during a financial period.

The scope of the prescribed ES information has been increased for financial periods of an Entity commencing on or after 1 January 2022. Entities should ensure that they are referring to the BOSS Act as amended. As at the date of publication of this guide, Part 12 of the Rules had not yet been updated to reflect the new requirements – we understand that this was due to delays caused by the EU in approving publication of the ITA’s revised guidance.

The ES reporting regime is separate from the beneficial ownership (**BO**) reporting regime under the BOSS Act (which broadly requires an Entity to report its BO information to its RA within 15 days of any change), although in certain circumstances an Entity’s BO and ES information may be exchanged by the ITA with overseas tax and other competent authorities.

Failure to identify or report the prescribed BO or ES information without reasonable excuse, or the intentional provision of false information, is an offence carrying significant penalties. In limited circumstances, offences committed by an Entity may also be committed by any director, officer or senior manager of the Entity who consented to or connived in the offence or failed to exercise all reasonable diligence to avoid the commission of the offence.

How should my Entity monitor and demonstrate compliance?

The ITA has previously indicated that it expects to see robust written evidence to show how an Entity has classified itself under the ES Act, which may include minutes or written resolutions.

Following amendments in 2022, the ITA Act requires an Entity to establish and maintain adequate systems and controls to ensure compliance with the requirements and obligations under the ES Act and the BOSS Act, as well as the Mutual Legal Assistance (Tax Matters) Act (the **MLAT Act**), which implements the US Foreign Account Tax Compliance Act (**FATCA**), the OECD Common Reporting Standard (**CRS**) and Country-by-Country Reporting (**CbCR**).

As currently drafted, the ITA Act also requires Entities to establish and maintain a compliance procedures manual in this regard. However, the ITA has stated that, to assist with the implementation of this requirement, it intends to publish advance guidance on the mechanisms that will suffice to demonstrate and evidence compliance with this requirement and that Entities are expected to have their manuals established and implemented by the end of 2023. We expect to publish further guidance on this requirement in due course.

If the Entity carries on “relevant activity” and is not exempt due to its tax status, it will of course need to ensure compliance with the applicable ES requirements on a continuing basis. Whilst this may be fairly straightforward in the case of an entirely passive “pure equity holding entity”, this may require specialist advice in other cases – particularly in the case of any “intellectual property business”.

How will the ITA determine compliance?

The ITA generally has six years from the end of a financial period to determine that an Entity has not complied with the ES requirements.

The ITA will assess the ES report for the relevant financial period submitted via the Entity’s RA via the RA reporting portal and is also conducting risk-weighted “audits” to check the basis on which an Entity has classified itself for the purposes of the ES Act. Following an initial review, the ITA may determine that:

- the Entity was compliant (and we understand that the ITA will not usually notify the Entity of such fact);
- the Entity was non-compliant; or
- further information is required for the ITA to reach a determination.

The ITA has broad investigative powers under the ES Act and the ITA Act to obtain further information.

What information can the ITA request?

Under the ES Act, the ITA may serve notice on any person requiring the 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 the ES Act.

The ITA also has broad powers under the ITA Act to request that any person provides it with such information as it may require (and in such form as it requires), to undertake compliance inspections, to examine persons under oath and to obtain search warrants, if required.

In practice, we would expect the ITA to request information from an Entity, its director(s) or general partner(s) (as applicable) or its RA in the first instance.

However, this should not include information subject to legal professional privilege (for example, legal advice privilege).

What are the consequences of non-compliance?

Provided an Entity properly identifies and reports the prescribed ES information, the initial consequences of non-compliance with any applicable ES requirements are generally limited to civil penalties. The ITA must impose a penalty by notice if it determines non-compliance within the minimum and maximum amounts prescribed by the ES Act. The range of penalties increases on a second determination of non-compliance following the first notice and the penalties are also significantly higher in the case of a “high risk IP legal entity”.

However, in extreme cases, an Entity may be liquidated and dissolved for non-compliance by application to court. The ITA has stated that this is a last resort and that it will not make such an application without giving the relevant Entity a reasonable opportunity to state its case and to ensure that rights of third parties are protected but that it 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 ES requirements.

A determination of non-compliance under the ES Act is also one of various circumstances triggering spontaneous information exchange by the ITA with overseas tax and other competent authorities under Schedule 4 of the BOSS Act.

Broadly, under the ITA Act, the ITA can also take a wide range of enforcement action if:

- it is of the opinion that an Entity has:
 - contravened the ES Act or the BOSS Act – including by late filing, for example;
 - failed to comply with an ITA directive;
 - provided the ITA with any false, inaccurate or misleading information;
 - refused or failed to cooperate with an ITA compliance inspection; or
 - refused to take actions required to comply with an ITA compliance report; or
- an Entity fails to pay an administrative penalty imposed under the Regulations on or before the due date.

In addition to the powers outlined in the preceding section above, the ITA may also issue a warning letter or impose an administrative penalty under the Regulations. The ITA may also require a person to bear its costs and expenses incurred in conducting an investigation or taking enforcement action.

Can I appeal against the ITAs’ decision?

Yes, there is a procedure to appeal to court under the ES Act and the ITA Act. Broadly, the appeal must be filed with the court within 30 days of the penalty notice stating the ground(s) for appeal and notice of the appeal must be served on the ITA, which is entitled to appear and be heard at the appeal hearing.

The court has the power to confirm, vary or revoke an administrative penalty or decision. However, filing an appeal will not operate as a stay on the obligation to pay any penalty imposed by the ITA.

What should I be doing now?

The director(s) or general partner(s) of every Entity (as applicable) should therefore put in place appropriate mechanisms to ensure compliance with the relevant Entity’s obligations under the ES Act and the BOSS Act.

Every Entity should ensure that has previously considered its obligations under the ES Act and the BOSS Act and also determined whether it is subject to any obligations under FATCA, CRS or CbCR (i.e., as a “financial institution” or a member of a “multinational enterprise group”).

We generally recommend that an Entity maintains a written record of its compliance procedures as part of its general obligation to maintain records and underlying documentation under the MLAT Act and BVI company or limited partnership law (as applicable). Keeping such records for at least six years from the end of each financial period should be of real practical benefit in the event of an ITA investigation.

How can Harneys help?

Harneys is known as a market leader and “go-to” firm for BVI ES advice. For more complex structures that do not fall very simply into the “in-” or “out of scope” boxes, our legal team have been at the forefront of the development of the legislation in the BVI and are ideally placed to perform a full review of your Entities to determine and advise on all aspects of compliance with substance legislation and, where appropriate, what actions must be taken. Please contact the author or your usual Harneys contact if you wish to be connected with a lawyer.

Harneys have also developed an innovative online ES classification solution, which provides formal legal advice and a tailored PDF memo (plus template board resolution wording) via an online questionnaire for a low fixed fee. This can be used directly [via this link](#). This product was shortlisted for *Legal Week's* 2020 Innovation Award and is unique in providing robust legal advice on a reliance basis at this price point.

If your Entity has received a notice or request for information from the ITA in connection with its ES position and you would like legal advice, please click [this link](#) to contact Harneys’ team of specialist lawyers who will be delighted to assist you.

Harneys Fiduciary can also provide a wide-range of bespoke solutions to assist with ES compliance and reporting requirements.

[Click this link](#) to see further information regarding Harneys’ ES capabilities.



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