Legal guide

HARNEYS

Practical considerations for BVI economic substance (*ES*) reporting

All BVI companies and limited partnerships must report on their ES position annually (this includes foreign companies and limited partnerships registered in the BVI). The ES legislation was amended in July 2021 to bring limited partnerships without separate legal personality within the regime.

Entities must report whether or not they conducted any "relevant activity" during the financial period, and if so, they will either need to report specifics of their substance in the BVI or supply evidence of their tax status, if they are claiming exemption as a "non-resident" entity.

Reporting for entities with no relevant activity or entirely passive entities carrying on "holding business" as a "pure equity holding entity" should be straightforward. However, entities carrying on any other relevant activity – particularly intellectual property (***IP***) business – or claiming the tax "non-resident" exemption should ensure that they allow sufficient time to prepare their reports, as this can be quite complex and may require input from BVI counsel, accountants and tax advisors.

Entities have 6 months from the end of each ES "financial period" within which to arrange reporting via their registered agent (***RA***). This financial period is not necessarily the same as any tax or financial year of the entity (as discussed below). Only RAs can submit information using the BOSS(ES) system – the International Tax Authority (***ITA***)'s secured confidential database for ES information.

The vast majority of active BVI companies were incorporated prior to 2019, so this means first reports were required to be submitted to the ITA before 30 December 2020. In practice, Harneys and most other RAs impose deadlines to receive the information ahead of the actual deadline to allow sufficient time for processing the reporting. Although the first compliance and reporting deadlines were not extended, the ITA is very cognisant of the challenges posed by the COVID-19 pandemic. For our summary of the ITA's guidance for entities affected by this please click here.

Most users of BVI entities will be familiar with the different categories of relevant activity and have classified their entities. This guide addresses some frequently asked questions we encounter in practice. Please click here to read our general guide on the ES requirements.

If you have not yet classified your entity, click here to access useful classification resources or to use our industry-leading Economic Substance Classification Solution.

Failure to identify relevant activities or to report can result in offences carrying significant fines and penalties (and even personal liability, in limited circumstances).

Entities which carry on any relevant activity cannot qualify for exemption from reporting on their beneficial ownership as an "exempt person". This is potentially relevant to listed companies and their subsidiaries, as well as certain other types of entity.

Dates and deadlines

The ITA's rules and explanatory notes on ES (the ***Rules***) prescribe default financial periods determined by an entity's date of incorporation or formation (or in the case of continuations into the BVI, their date of registration in the BVI) as follows:

Incorporation date	Start of first ES financial period	End of first ES financial period
Entities registered before 1 January 2019	30 June 2019	29 June 2020
Entities registered from 1 January 2019 onwards	Date of incorporation	12 months from date of incorporation
Limited Partnerships without legal personality formed before 1 July 2021	1 January 2022	31 December 2022
Limited Partnerships without legal personality formed on or after 1 July 2021	Date of formation	12 months from date of formation

The ES financial period therefore does not have to align with an entity's financial year for tax, accounting or other purposes. It is also important to recognise that entities must be considering their own individual financial records, and not group consolidated accounts, as intra-group balances may also be relevant to the entity's classification and reporting status.

New entities can notify the ITA to shorten their first ES financial period within three months of incorporation. Entities can also apply to the ITA to shorten a financial period but such changes can only be made to subsequent financial periods, so it is not possible to "back-date" a change to previous financial periods.

Unless they have already been altered, the default reporting periods outlined above will apply for the first reporting cycle, and then the entity could file an application to bring the end of a subsequent financial period forward.

Under the ES regime, entities are required to report within six months of their financial period end but many registered agents have prescribed an internal deadline to allow sufficient processing time – Harneys Corporate Services Limited's deadline is two weeks before the ITA deadline.

Reporting

Nil reporting

Every relevant entity must report annually. Even if no relevant activity was carried on during a financial period, a nil return is required.

Exemption due to foreign tax status

If an entity carried on relevant activity during a financial period, it must either submit details demonstrating how it complied with the ES requirements during the period or claim and evidence a tax status qualifying it for exemption as a "non-resident" entity.

Such exemption is broader than the name suggests and includes entities tax resident outside the BVI as well as certain entities which are tax "transparent" or otherwise subject to tax on their income from relevant activities (for example, due to a taxable branch or permanent establishment), provided that the relevant jurisdiction does not appear on Annex I of the European Union's list of non-cooperative countries for tax purposes – often called the "EU tax blacklist".

Entities considering claiming exemption are recommended to consider the precise tests and implications with BVI counsel and their tax advisors if they are at all uncertain. These are set out in Part 4 of the Rules.

To claim such exemption, the entity must supply evidence of its tax status, covering the entire financial period, within the reporting deadline.

Under Rule 3, acceptable evidence includes:

- 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
- 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

“Non-resident” entities will be required to report details (entity name, entity number and jurisdiction) of any immediate parent and ultimate parent, where applicable.

An immediate parent means any entity(ies) that own(s) 25% or more of the ownership or voting interests in the relevant entity (and the immediate parent may be a corporate or a non-corporate entity, for example a partnership).

The ultimate parent means an entity which:

a) owns directly or indirectly a sufficient interest in the relevant entity that it is required to prepare consolidated financial statements under accounting principles generally applied in its jurisdiction of residence, or would be so required if its equity interest were traded on a public securities exchange in its jurisdiction of residence; and

b) there is no other entity that owns directly or indirectly an interest described in paragraph (a) above in the first mentioned entity.

A claim of non-residence will trigger the spontaneous exchange of information by the ITA with the competent authorities in the jurisdiction(s) of tax residence (as well as any EU member state in which a “beneficial owner” or “legal owner” of the entity resides, as defined for the purposes of the reporting legislation), which may lead to follow-up or investigation to ensure the claim is valid.

Provisional “non-resident” treatment

It may be difficult for entities to provide evidence within the reporting window as evidence needs to cover the entire ES financial period, which may not match the entity's fiscal period. If more time is need to supply the evidence required, it is possible to apply for provisional treatment as a “non-resident” under Rule 6.

Rule 6 applications must be made within 6 months of the ES financial period end and submitted via the RA onto BOSS(ES). Broadly, the entity must either:

- Demonstrate that it has established “non-resident” status for the previous financial period to the satisfaction of the ITA and certify that its tax status has not changed in the intervening period
- Supply within the reporting period the most recent available documentary evidence of its tax status which complies with the requirements of Rule 3 (see above) and certify that its tax status has not changed in the time since the period to which such evidence relates
- Evidence that it has been too recently been formed or established “non-resident” status to have any documentary evidence of such status which satisfies Rule 3 and produce some other evidence to demonstrate that it met the criteria to qualify as “non-resident” during the relevant financial period

If the entity’s application is accepted, it will be given a revised deadline by the ITA within which to provide Rule 3 evidence. This deadline is likely to be no later than the end of the next ES financial period. The proper evidence must then be uploaded to BOSS (ES) once available.

If the entity cannot produce Rule 3 evidence before the deadline the ITA may determine that it is not “non-resident” and require it to demonstrate that it had substance in BVI for that period. If the entity did not have adequate substance in the BVI, it will be subject to enforcement action.

We therefore recommend that clients seek advice from BVI counsel and their tax advisors if they are at all uncertain whether their entity qualifies for the exemption (or if they need to apply for treatment as provisionally exempt). In practice, clients may also want to submit other supporting information to the ITA in relation to their tax status where Rule 3 evidence cannot be provided or is unclear. This may include an opinion from a suitably qualified tax advisor, for example.

Relevant activity

Where relevant activity was conducted, and the entity is not treated as tax resident elsewhere, it will need to submit economic substance data, which the ITA will use to determine whether the entity had adequate substance in the BVI throughout the period.

The particulars required vary according to which relevant activities were conducted, with a reduced requirement for pure equity holding entities carrying on holding business and a more onerous test for companies which carry on IP business.

The table below summarises the reporting requirements for relevant activities other than IP business.

Reportable information	Holding business	Other relevant activities
Turnover	No	Yes
Direction and management	No	Yes
Employees	Yes	Yes
Premises	Yes	Yes
Outsourcing of core-income generating activities	No	Yes

The reporting and evidential requirements for IP business to demonstrate compliance are complex and, in practical terms, may be impossible for some entities to comply with. We recommend that entities with potential IP business seek legal advice, if they have not already done so.

Holding business – adequacy of BVI arrangements

Assuming an entity is entirely passive and does not have any employees (including individuals managed as if an employee but employed by someone else) it will likely wish to report zero employees globally (and in the BVI). The Rules state that the registered office address can be used as the BVI premises for holding business.

Intellectual property

Where IP business was conducted, unless it is claiming the “non-resident” exemption then the entity must report on whether any special equipment required for the business is located in the BVI and also confirm if it is a “high risk IP legal entity” and whether it is seeking to rebut the various presumptions of non-compliance as set out in ESA, in which case supporting evidence must be uploaded.

Correcting errors in reports

Entities should take care when preparing their reports and ensure that the person preparing their reports is properly authorised to do so and has the necessary knowledge and information.

If a mistake is made when reporting it is important that it be corrected as soon as possible. The provision of false or misleading information may result in the commission of criminal offences and significant fines and penalties.

The first step would be to establish if the RA has reported information supplied to the ITA yet. If not, then the RA should be able to assist with correcting the report relatively simply.

If the reporting has been filed with the ITA, the RA will need to initiate a correction process with the ITA.

If you have any questions in relation to ES or an entity’s compliance or reporting obligations our experts are happy to help.

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