HARNEYS

BVI economic substance – International Tax Authority investigations and enforcement powers

As the dust settles on the first economic substance (***ES***) reporting cycle in the BVI, Joshua Mangeot considers the International Tax Authority (***ITA***)'s investigation and enforcement powers under the Economic Substance (Companies and Limited Partnerships) Act 2018 (the ***ES Act***) and related provisions of the Beneficial Ownership Secure Search System Act 2017 (the ***BOSS Act***).

Given the extremely short deadlines set by the European Union and Organisation for Economic Co-operation and Development, as well as uncertainty resulting from new and untested concepts being imported into BVI law and ongoing disruption caused by the Covid-19 pandemic, it seems inevitable that some of the numerous companies registered in the BVI will have experienced challenges interpreting and complying with the new ES regime. Also, although a substantially complete draft was available in 2019, the ITA ES rules and explanatory notes (***Rules***) were only finalised on 9 October 2019 and then updated on 10 February 2020 to reflect revisions required by the EU.

With that in mind, it is likely that some BVI companies are now facing 2021 wondering whether full compliance has been achieved in time – and, if not, then what?

This guide deals in broad terms with the ITA's investigation and enforcement powers in relation to the ES regime and the spontaneous information exchange regime introduced via amendments to the BOSS Act, which implements EU and OECD requirements.

Our previous guides to the compliance and reporting requirements are available **here** and **here**, respectively.

A simplified regime applies to any company which is a "pure equity holding entity" or which qualifies for "non-resident" exemption due to its foreign tax status. Conversely, for companies carrying on other relevant activities (and particularly intellectual property business), the compliance and reporting requirements may be more burdensome and may very well require changes to pre-existing arrangements.

By way of reminder, the majority of BVI companies were incorporated prior to 2019 and had a six-month grace period within which to become compliant when the ES Act came into force on 1 January 2019.[1] Different timings apply to companies incorporated on or after 1 January 2019 or which elected or applied to alter the default financial periods under the ES Act.

The primary compliance and reporting requirements under the ES Act fall on the company itself. The role of the registered agent in relation to ES is broadly limited to taking "reasonable steps" to collect the prescribed ES reporting information and to upload it to the BVI's confidential "BOSS" database, which is maintained between registered agents and the BVI government.

What if I still need to classify my company?

There is a continuing obligation on every company to identify whether it carries on any of the nine "relevant activities". Merely receiving gross income may be relevant, as a company will be treated as carrying on a relevant activity during any financial period in which it receives income from that activity.

1 This guide focuses on BVI business companies incorporated under the BVI Business Companies Act 2004, as the most popular BVI corporate vehicle. However, similar considerations apply to (i) foreign companies registered in the BVI, (ii) BVI limited partnerships with legal personality and (ii) foreign limited partnerships with legal personality registered in the BVI.

Failure to identify relevant activity without "reasonable cause" is an offence punishable by a significant fine or imprisonment (or both).

By default, for pre-2019 incorporations, the first compliance "financial period" ran from 30 June 2019 to 29 June 2020. Such companies should therefore have taken steps to classify themselves prior to 30 June 2019.

We recommend that any company which has not previously considered ES should take advice on its position as soon as possible, as the potential consequences of non-compliance or failure to report are significant. Any changes to a company's activities and position under the ES Act should continue to be monitored by its board of directors.

For companies needing to classify themselves under the ES Act, our team of BVI specialists have developed an innovative automated online classification solution providing legal advice on a reliance basis for a low fixed fee. The solution and further information can be found **here**.

What if I have not completed my report within the deadline?

Every company must submit an ES report to the ITA via its registered agent within six months from the end of the financial period in question.[2] Failure to do so without reasonable cause is an offence punishable by a significant fine or imprisonment (or both).

By default, for pre-2019 incorporations, reports in respect of their first financial period had to be submitted to the ITA via the registered agent by 30 December 2020 at the latest.

A "nil return" is required even if a company did not carry on or receive income from any relevant activity during a specific financial period.

In practice, the complexity of reporting varies from being very simple to extremely complex depending on the company's precise activities and tax status (where relevant).

We recommend that any company which has not filed a report should liaise with its registered agent to do so as soon as possible (and may wish to take advice on its position), as the potential consequences of non-compliance or failure to report are significant.

What if my company has not complied with the ES requirements?

The ITA may determine that a company has not complied with the economic substance requirements during any financial period of the company ending on or after 31 December 2019. In addition to imposing civil penalties, the ITA may apply to strike off or liquidate the company. Where the ITA determines a company is in breach of the ES requirements, this is one of the circumstances which will trigger the spontaneous exchange of information with relevant overseas competent authorities (see below).

Where it determines non-compliance for a financial period, the ITA is first required to issue a notice to the company notifying it of the non-compliance and other specified information, including the reasons and what action the ITA considers should be taken to meet the ES requirements by a stated deadline. The minimum penalty on a first notice of non-compliance is US$5,000 and the maximum is US$20,000 (or US$50,000 in the case of a "high risk IP legal entity", as defined in the ES Act).

If the company fails to comply with the first notice within the deadline (or such longer period as the ITA may allow), the ITA must issue a second similar notice and impose another penalty. The minimum penalty on a second notice is US$10,000 and the maximum is US$200,000 (or US$400,000 in the case of a high risk IP legal entity).

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2 There are separate obligations regarding reporting changes to the prescribed beneficial ownership information under the BOSS Act. Broadly, such information (or any changes) must be notified to the registered agent within 15 days of the company identifying the relevant information. The beneficial ownership reporting regime is beyond the scope of this guide.

Broadly, the ITA may only apply for the striking off or liquidation of the legal entity following a second notice unless it determines that there is no realistic possibility of the company meeting the ES requirements.

Liquidation is an extreme sanction requiring a court order. The ITA has indicated it will give the relevant company a reasonable opportunity to state its case and to ensure that third party rights are protected but will not hesitate to resort to this sanction where it considers that a company has been guilty of clear, deliberate or egregious breaches.

We recommend that any company which is at all uncertain regarding its compliance position or which believes it may not have complied with the ES requirements take advice, as the potential consequences of non-compliance are significant and the potential risk exposure may increase if the position is allowed to persist.

What is the spontaneous information exchange regime?

In certain circumstances, including if it determines a company has not complied with the ES requirements, the ITA is required to procure the disclosure of all of the information held on the BOSS database under the BOSS Act to certain overseas competent authorities. These authorities may include those for each state in which a beneficial or legal owner resides. The information disclosed would, broadly, include all of the prescribed beneficial ownership and ES-related information that has been reported by the company to its registered agent.

Further guidance appears in Part 14 of the Rules and the OECD's guidance on the spontaneous exchange of information by no or only nominal tax jurisdictions.

What is the limitation period for an investigation?

The ITA may generally only determine non-compliance during the period of six years from the end of the relevant financial period. This limitation period does not apply if the ITA is unable to make a determination due to any deliberate misrepresentation, negligent or fraudulent action by the company or by any other person.

Can I appeal?

A company may appeal to court against a determination or the amount of any penalty imposed by the ITA. However, notice stating the grounds of appeal must be filed at court within 30 days of the ITA notice (and be served on the ITA, which is entitled to appear and be heard at the appeal).

What information could the ITA request (and from whom)?

Broadly, a company is obligated to provide any information reasonably required by the ITA to assist it in making a determination of compliance or non-compliance.

The ITA may also serve notice on any person (which would potentially include any person associated with the relevant company, such as its directors, officers, employees or registered agent) requiring that 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 exercise of the ITA's functions under the ES Act.

Failure to provide such information without "reasonable excuse" or the intentional provision of false information is an offence punishable by a significant fine or imprisonment (or both).

The ITA has indicated in public statements that it expects that companies will be able to produce robust written evidence of the basis for their classification under the ES Act.

We recommend that companies (and their directors and operators) ensure that their company is up-to-date regarding its record-keeping obligations under the BVI Business Companies Act 2004 (the ***BCA***). Broadly, the BCA requires that, if required to do so by the ITA, a company's registered agent shall request from the company records and underlying documentation in respect of the company. The company must then provide the requested information to the registered agent without delay. Breach of the BCA requirements may result in an offence punishable by a fine and could expose directors to personal liability if they have not complied with their duties to the company.

What about privileged information?

In the context of information requests, it is a well-established rule of common law that information subject to legal professional privilege is generally protected from disclosure. For example, legal advice privilege may apply to documents or

information containing confidential communications between a lawyer and their client for the purpose of obtaining or giving legal advice.

What if I am an operator of a company which has not complied with the requirements?

In limited circumstances, offences committed by a company may be committed by a person who is a director, general manager, secretary or other officer of the company. Broadly, the prosecution would have to prove either subjective intent or objective failure to exercise all reasonable diligence in the circumstances and the Attorney General would also have to approve the proceedings. Such proceedings are extremely uncommon in practice.

Although there is no specific duty to comply with all BVI legislation in the BCA, allowing a company to incur fines or penalties for non-compliance with BVI law requirements generally may constitute a breach of the director's duties. Generally, such duties are owed to the company (and so a claim should be brought by the company itself rather than the shareholders), but BVI law does allow derivative claims in some circumstances.

What is a reasonable cause or reasonable excuse?

These specific defences under the BOSS Act are not further defined. As far as we are aware, they have not yet been tested in this context before a BVI court but have been considered recently in other common law jurisdictions. The Rules indicate that, although this is a question for the court, the ITA anticipates that what amounts to reasonable excuse will depend on the facts and circumstances of the breach of the information request, including the identity of the infringer.

We recommend that any company or person who is subject to proceedings under the offences created under the ES Act, BOSS Act or BCA seek legal advice as soon as practicable.

What should I do if I receive an information request or notice under the ES Act?

We recommend that any person in receipt of an information request or notice under the ES Act or who is at all uncertain regarding their position or obligations take legal advice as soon as practicable.

Harneys is the leading BVI law firm for tax and regulatory investigations and information exchange requirements and our team of ES specialists will be happy to assist with any queries.

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