

ESA Solutions Limited

Economic Substance Requirements in the British Virgin Islands, a practical guide to effective solutions by ESA Solutions Limited.

The Economic Substance requirements were introduced in the British Virgin Islands via the Economic Substance (Companies and Limited Partnerships) Act, 2018 (the “**ESA**”) and amendments made to the Beneficial Ownership Secure Search System Act, 2017.

On 9th October 2019 The International Tax Authority (“**ITA**”) issued rules on how the economic substance requirements may be met, and the interpretation of expressions used in the ESA.

SCOPE

The ESA requires a “relevant entity” conducting “relevant activity” to file notifications and, unless exempt, to report to the ITA and maintain economic substance in the British Virgin Islands. A “relevant entity” which does not conduct “relevant activity” is required only to submit notifications. A “relevant entity” which receives no “relevant income” is not required to maintain economic substance.

What is a “relevant entity”?

All British Virgin Islands companies registered foreign companies, British Virgin Islands and foreign registered limited partnerships (except limited partnerships which do not have legal personality) are “legal entities” unless excluded as set out below.

An entity which is tax resident in another jurisdiction is also excluded from the definition of “legal entity” (so long as that other jurisdiction is not on the EU list of non-compliant jurisdictions). It is acknowledged that some jurisdictions (for example, the US) impose tax by reference to a criterion other than residence. What matters is whether the tax authority in the jurisdiction in question has accepted that the entity (or its participators in the case of a transparent entity) is chargeable to tax on its worldwide income.

What is a “relevant activity”?

Each of the following activities, which have been identified by the OECD as “geographically mobile” is a “relevant activity” as defined further in the ESA:

- (a) banking business;
- (b) distribution and service centre business;
- (c) financing and leasing business;
- (d) fund management business;
- (e) headquarters business;
- (f) holding business;
- (g) insurance business;
- (h) intellectual property business; and
- (i) shipping business.

A “relevant entity” that conducts more than one “relevant activity” is required to satisfy the ESA Test in relation to each relevant activity.

Please see the appended schedule for further details of the relevant activities (and the corresponding British Virgin Islands CIGA).

The ESA Test.

A relevant entity that conducts a relevant activity must satisfy the economic substance requirements (“**ESR**”) in relation to that relevant activity. A relevant entity satisfies the ESR in relation to a relevant activity if the relevant entity: (a) conducts British Virgin Islands core income generating activities (“British Virgin Islands CIGA”) in relation to that relevant activity; (b) is directed and managed in an appropriate manner in the British Virgin Islands in relation to that relevant activity; and (c) having regard to the level of relevant income derived from the relevant activity carried out in the British Virgin Islands: (i) has an adequate amount of operating expenditure incurred in the British Virgin Islands; (ii) has an adequate physical presence (including maintaining a place of business) in the British Virgin Islands; (iii) where the relevant activity is intellectual property business and requires the use of specific equipment, that equipment is located in the British Virgin Islands and (iv) has an adequate number of full-time employees or other personnel with appropriate qualifications and experience in the British Virgin Islands.

RELEVANT ACTIVITY

CORRESPONDING BRITISH VIRGIN ISLANDS CIGA

BANKING BUSINESS

Banking business has the meaning given by section 2(1) of the Banks and Trust Companies Act, 1990 where banking business means the business of receiving (other than from a bank or trust company) and holding on current, savings, deposit or similar account money that is repayable by cheque or order and is capable of being invested by way of advances to customers or otherwise, but does not include the receiving on savings, deposit or similar account money which is paid by one company to another at a time when (a) one is the subsidiary of the other; or (b) both are subsidiaries of another company.

CIGA in the context of banking business includes:

- i. raising funds, managing risk including credit, currency and interest risk;
- ii. taking hedging positions;
- iii. providing loans, credit or other financial services to customers;
- iv. managing regulatory capital; and
- v. preparing regulatory reports and returns

DISTRIBUTION AND SERVICE CENTER BUSINESS

Distribution and service centre business means the business of either or both of the following:

CIGA in respect of distribution and service centre business includes:

- 1 purchasing from foreign affiliates (as defined);

- i. transporting and storing goods;
- ii. managing stocks;

- i. component parts or materials for goods; or
 - ii. goods ready for sale, and
 - iii. reselling such component parts, materials or goods;
- 2 providing services to foreign affiliates in connection with the business but does not include any activity included in any other relevant activity except holding business.
- iii. taking orders; and
 - iv. providing consulting or other administrative services

FINANCE AND LEASING BUSINESS

Finance and leasing business means; the business of providing credit facilities of any kind for consideration.

For the purposes of the above, but without limiting its generality:

Consideration may include consideration by way of interest.

The provision of credit may be by way of instalments for which a separate charge is made and disclosed to the customer in connection with (a) the supply of goods by hire purchase, (b) leasing other than any lease granting an exclusive right to occupy land, or (c) conditional sale or credit sale.

Where an advance or credit repayable by a customer to a person is assigned to another person, that other person is deemed to be providing the credit facility for the purposes of the definition.

The CIGA in respect of finance and leasing business includes:

- i. agreeing funding terms;
- ii. identifying and acquiring assets to be leased (in the case of leasing);
- iii. setting the terms and duration of any financing or leasing;
- iv. monitoring and revising any agreements; and
- v. managing any risks.

FUND MANAGEMENT BUSINESS

Fund management business means the conduct of an activity that requires the legal entity to hold an investment business license pursuant to section 4 and category 3 of Schedule 3 of the Securities and Investment Business Act, 2010 ("SIBA").

Category 3 of Schedule 3 of SIBA encompasses the management of segregated portfolios, mutual funds, pension schemes, insurance product and other types of

CIGA in respect of fund management business includes:

- i. taking decisions on the holding and selling of investments;
- ii. calculating risks and reserves;
- iii. taking decisions on currency or interest fluctuations and hedging positions; and

investment.

We are qualified to advise on SIBA.

iv. preparing relevant regulatory or other reports for government authorities and investors

HEADQAURTERS BUSINESS

Headquarters business means the business of providing any of the following services to an entity in the same group:

- i. the provision of senior management;
- ii. the assumption or control of material risk for activities carried out by any of these entities in the same group; or
- iii. the provision of substantive advice in connection with the assumption or control of risk referred to in paragraph ii, but does not include banking business, financing and leasing business, fund management business, intellectual property business, holding company business or insurance business.

The CIGA in respect of headquarters business includes:

- i. taking relevant management decisions;
- ii. incurring expenditures on behalf of affiliates; and
- iii. co-ordinating group activities

HOLDING BUSINESS

Holding business means the business of being a pure equity holding entity. A “pure equity holding entity” means a legal entity that only holds equity participations in other entities and only earns dividends and capital gains.

THERE ARE NO CIGA REQUIRMENTS

According to the ES Code, the definition of pure equity holding entity is deliberately framed in narrow terms. A legal entity will only fall within the definition if it holds nothing but equity participations, yielding dividends or capital gains. The ownership of any other form of investment (such as an interest bearing bond) will take the legal entity outside this definition.

Equity participation obviously includes shares in a company but is wide enough to encompass other forms of investment in an entity which give the investor the right to participate in the profits of the entity. The word “dividends” will be construed broadly to encompass any payments made to an investor in respect of an equity participation.

INSURANCE BUSINESS

Insurance business has the meaning specified in section 3(1) of the Insurance Act, 2008 where insurance business means the business of undertaking liability under a contract of insurance to indemnify or compensate a person in respect of loss or damage, including the liability to pay damages or compensation contingent upon the happening of a specified event, and includes life insurance business and reinsurance business.

CIGA in respect of insurance business includes:

- i. predicting and calculating risk;
- ii. insuring or re-insuring against risk; and
- iii. providing insurance business services to clients

INTELLECTUAL PROPERTY BUSINESS

Intellectual property business means the business of holding intellectual property assets.

CIGA in respect of intellectual property business includes:

An “intellectual property asset” means any intellectual property right in intangible assets, including but not limited to copyright, patents, trade marks, brand, and technical know-how, from which identifiable income accrues to the business (such income being separately identifiable from any income generated from any tangible asset in which the right subsists).

- i. where the business concerns intellectual property assets such as patents, research and development; and
- ii. where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.

“Income” in respect of an intellectual property asset is defined in the ESA as including (i) royalties; (ii) capital gains and other income from the sale of an intellectual property asset; (iii) income from a franchise agreement; and (iii) income from licensing the intangible asset.

If the relevant activity is a high risk intellectual property business, other core income generating activities relevant to the business and the intellectual property assets is required, which may include: (i) taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the intangible asset generating income; (ii) taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the intangible asset; (iii) carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of income from third parties

According to the ESA, the relevant activity consists of holding an intellectual property asset from which identifiable income accrues, so if no identifiable income accrues there is no intellectual property asset.

The definition does not therefore apply to a business which owns intellectual property merely as an adjunct to its business. Most businesses will own some form of intellectual property but this does not earn specific amounts of revenue – it simply contributes to or protects the general profitability of the business.

The relevant activity is focusing on businesses which make money from licensing or otherwise

exploiting intellectual property rights.

SHIPPING BUSINESS

The term “shipping business” means any of the following activities involving the operation of a ship anywhere in the world other than solely within British Virgin Islands waters:

- i. the business of transporting, by sea, persons, animals, goods or mail;
- ii. the renting or chartering of ships for the purpose described in paragraph i;
- iii. the sale of travel tickets or equivalent, and ancillary services connected with the operation of a ship;
- iv. the use, maintenance or rental of containers, including trailers and other vehicles or equipment for the transport of containers, used for the transport of anything by sea;
- v. the management of the crew of a ship.

CIGA in respect of shipping business includes:

- i. managing the crew (including hiring, paying and overseeing crew members);
- ii. hauling and maintaining ships;
- iii. overseeing and tracking deliveries;
- iv. determining what goods to order and when to deliver them; and
- v. organising and overseeing voyages.

HOLDING BUSINESS REDUCED ESA TEST FOR PURE EQUITY HOLDING COMPANIES

A relevant entity that is only carrying on a relevant activity that is the business of a pure equity holding company is subject to a reduced ESA Test which is satisfied if the relevant entity confirms that it has complied with all applicable filing requirements under the BVI Business Companies Act, 2004 or the Limited Partnership Act, 2017; and has adequate human resources and adequate premises in the British Virgin Islands for holding and managing equity participations in other entities. ESR confirms that a pure equity holding company may engage its registered office service provider to satisfy these reduced substance requirements in the British Virgin Islands.

ESR FOR HIGH RISK INTELLECTUAL PROPERTY BUSINESS

ESR provides a rebuttable presumption that a relevant entity carrying on “high risk intellectual property business” is presumed not to have met the ESR for a financial period.

If there is BVI CIGA relevant to the business and the intellectual assets being carried out in the British Virgin Islands, unless the relevant entity can demonstrate to the ITA that there was a high degree of control over the development, exploitation, maintenance, protection and enhancement of the intangible asset, exercised by an adequate number of full-time employees with the necessary qualifications that permanently reside and perform their activities within the British Islands, and provides sufficient specified information to the ITA in relation to that financial year to rebut this presumption.

ESA Solutions Limited are experts in IP, with adequate and appropriately qualified and experienced professionals in the field of intellectual property, creating, registering, licensing, protecting, selling and creating security over IP rights. We are the leading firm who possess this expertise.

ESA Solutions Limited are probably the best placed firm to advise on the meaning of “high risk intellectual property business” and the evidential threshold.

We have the personnel the premises and the systems in place in order be able to provide and demonstrate a high degree of control over the development, exploitation, maintenance, protection and enhancement of the intellectual property asset, exercised by suitably qualified employees of the legal entity who are physically present and perform their functions within the British Virgin Islands and who are on long-term contracts.

We can ensure the relevant entity can provide sufficient specified information to the ITA to rebut the presumption that it is not conducting CIGA.

BRITISH VIRGIN ISLANDS CIGA

British Virgin Islands CIGA means the activities that are of central importance to a legal entity in terms of generating relevant income and which, if conducted, must be conducted in the British Virgin Islands. The examples of CIGA are not mandatory or exhaustive, so a “legal entity” need not perform every element of CIGA listed for the “relevant activity”.

Examples of British Virgin Islands CIGA are not mandatory or exhaustive, so a “relevant entity” need not perform every element of British Virgin Islands CIGA listed for the “relevant activity”. The assessment of substance in the British Virgin Islands will include consideration of what elements of British Virgin Islands CIGA the “relevant entity” is undertaking in the British Virgin Islands.

DIRECTED AND MANAGED

A relevant entity is directed and managed in an appropriate manner in the British Virgin Islands in relation to a relevant activity if:

- (a) its board of directors, as a whole, has appropriate knowledge and expertise to discharge its duties;
- (b) meetings of the board of directors are held in the British Virgin Islands, with a quorum of directors’ present in the British Virgin Islands, at adequate frequencies given the level of decision making required;
- (c) minutes of the above meetings record the making of strategic decisions of the relevant entity at the meeting; and
- (d) the minutes of all meetings of the board of directors and appropriate records of the relevant entity are kept in the British Virgin Islands.

In order to satisfy the ESR and the British Virgin Islands substance regime requirements the directors will need to have necessary knowledge and experience in each of the relevant activities

Relevant income means all of an entity’s gross income from its relevant activities and recorded in its books and records under applicable accounting standards. A relevant entity that carries on a relevant activity, but which has no relevant income is not obliged to meet the requirements of the

ESR. The relevant entity will still, however, be required to satisfy its notification and reporting obligations under the ESA (albeit the report filed will be a 'nil' return).

APPROPRATE AND ADEQUATE?

The ESRS are intended to assist relevant entities carrying on relevant activities to understand how to comply with the substance regime in the British Virgin Island.

Crucially and for self-interested reasons the British Virgin Islands ESRs do not define "adequate" and "appropriate". The OECD requirements are clear in that they require the directors in additions to hold relevant qualifications they also need to demonstrate appropriate experience in the Relevant Activity.

It is important to ensure appropriate directors and employees are providing substance. Difficulties will be encountered in the future where adequacy of the substance will be challenged because the employees and directors do not possess adequate and appropriate experience and qualifications in the relevant activities.

The ESR does not prescribe a minimum number of full-time employees for a particular level of relevant income either generally or for or any particular type of relevant activity because that would be arbitrary and would prove uneconomical in many cases.

What is adequate or appropriate for each relevant entity will be dependent on the particular facts of the relevant entity and its business activity. A relevant entity will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.

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What we are certain will be looked at is not only persons who have adequate or relevant qualifications, but the directors will need to demonstrate adequate and appropriate experience in the Relevant Activity. This cannot be overlooked when putting in place a robust Economic Substance Solution.

ESA Solutions Limited have unrivalled, professionally qualified directors who have an abundance of adequate and appropriate experience and qualifications in each of the Relevant Activities.

[Links to our director's bios are We can provide copies of our bios are attached.]

OUTSOURCING

A legal entity may satisfy the ESR by outsourcing the conduct of its British Virgin Islands CIGA to another person in the British Virgin Islands provided that the legal entity is able to monitor and control the carrying out of the British Virgin Islands CIGA.

Timing

A legal entity which carries on a relevant activity during any financial period must comply with the ES Requirements in relation to that activity. For a company or limited partnership incorporated or formed on or after 1 January 2019, a financial period shall be such period of not more than one

year from the date of incorporation or formation. For a legal entity in existence prior to 1 January 2019, such period must commence no later than 30 June 2019.

Reporting obligation

The ES Law amends the British Virgin Islands Beneficial Ownership Secure Search System Act, 2017 (“**BOSS Act**”) to add to the existing requirements such that a legal entity and its registered agent have obligations in respect of reporting prescribed information in relation to a legal entity’s economic substance. It has also been expanded to include limited partnerships with legal personality, which were hitherto not subject to the BOSS Act. The legal entity must notify its registered agent of prescribed information including information regarding the legal entity and its ownership, which must be provided within 15 days of being identified. The legal entity must also identify which, if any relevant activities it carries on and notify its registered agent of such activities within a period to be fixed by regulators following the end of its financial period. The registered agent must take reasonable steps to collect (and, in the case of prescribed information regarding the legal entity and its ownership, to identify) and enter particulars of the prescribed information on the RA database.

Determination of whether the ESA Requirements are satisfied

The ITA shall have the power, in accordance with the ESA and ESR, to decide as to whether a Relevant Entity satisfies the ES Requirements for any financial year. The ITA will not only review information filed under the BOSS Act but also has the power under the ES Law to issue notices for information. These notices may be issued to any person, whether they are legal entities self-reporting under the BOSS Act. There are penalties for supplying false information or failing to supply any information.

Failure to satisfy the ES Requirements

If the ITA determines that a legal entity has failed to satisfy the ES Requirements for a financial year it shall issue a notice to the legal entity notifying the legal entity of such determination, giving the reasons, directing any action to be taken to satisfy the ES Requirements and advising of the legal entity’s right to appeal.

The ITA shall impose a penalty of minimum US\$5,000 to maximum US\$20,000 (or maximum US\$50,000 in the case of a high risk IP legal entity) on a first determination of non-compliance and a second penalty of US\$10,000 to maximum US\$200,000 (or maximum US\$400,000 in the case of a high risk IP legal entity) on a second determination of non-compliance. Following failure after two consecutive years the ITA may recommend to the Financial Services Commission that the Relevant Entity be struck off the register. If at any time following the service of a first determination the ITA decides there is no realistic possibility of the legal entity meeting the ESR, it may require the FSC to strike the legal entity off the register.

Further developments and next steps

International standards are continuing to develop, and it is anticipated that the ESA and ESR shall continue to evolve and be subject clarification.

Further rules and regulations can be anticipated. Issues surrounding adequacy and appropriateness test, especially having regard to relevant experience and expertise need to be monitored carefully.

There are relatively few appropriately qualified and experienced professional’s who can provide true substance. We at ESA Solutions Limited can provide the solution.

Contacts

ESA Solutions Limited can offer legal, regulatory and accountancy advice and guidance in connection with all aspects of the economic substance regime as it continues to evolve.

The principals of ESA Solutions Limited are committed to providing economic substance solutions that will enable all clients that are impacted by the regime to satisfy the necessary requirements for substance in the British Virgin Islands

For further information please speak with your Substance expert below or the any of the following persons;