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OUTCOME OF PROCEEDINGS

From: General Secretariat of the Council
To: Delegations

Subject: The EU list of non-cooperative jurisdictions for tax purposes

- British Virgin Islands: final legislation and assessment under criterion 2.2

A/ FINAL LEGISLATION:

The Economic Substance (Companies and Limited Partnerships) Act, 2018 was approved by the House of Assembly on 19 December and came into force on 1 January 2019.

https://eservices.gov.vg/gazette/sites/eservices.gov.vg.gazette/files/newattachments/Act%20No%2012%20--%20Economic%20Substance%20%28Companies%20and%20Limited%20Partnerships%29%20Act%202018-%20Revised%2017%2012%202018%20%28clean%29%20%281%29_0.pdf

A Guidance Note No. 1 by the Internal Tax Authority was also published in December 2018, which incorporates an explanatory memorandum of the Act. See [Annex 2](#).

On 26 January 2019, the BVI have sent a letter to the Chair of the Code of Conduct presenting some amendments that were recently passed in the legislation to ensure consistency with the EU requirements. No issues were identified as they mostly consisted in clarifications, stronger wording in line with Member States' expectations and some typological errors. See [Annex 3](#).

B/ FINAL ASSESSMENT:

The dialogue with the BVI on the introduction of substance requirements was constant and constructive with several conference calls and meetings on which the Commission Services reported regularly to Member States. The BVI shared draft legislation and sought feedback from the Code of Conduct Group. The following assessment only highlights the remaining issues identified and still pending at the beginning of 2019 following such feedback.

1 – Identification of the relevant activities and included entities

1.1 – On relevant activities

a) Geographical limitation for relevant activities to be in scope

It was reported to the BVI that there should be no limitation, in Section 5 on the scope of substance requirements, for relevant activities as to where included entities carry out those activities (in or from within the BVI).

The BVI have revised their drafting that no longer limits economic substance requirements to relevant activities carried out in the BVI.

Conclusion:

This issue is settled.

b) Need for detail on direction and management in the BVI

It was reported to the BVI that there was a need to clarify Section 8 of the Act on evidencing of direction and management in the BVI.

In the Guidance No. 1, para. 22, the ITA provides clarification on evidencing of management and direction in the BVI for entities carrying out relevant activities other than pure equity holding activity. There must be an adequate number of board meetings held in the BVI with a quorum of directors physically present in the BVI including adequate expertise to direct the relevant activity. The decisions of the board regarding the relevant activity must be minuted and minutes of those decisions must be kept in the BVI.

Conclusion:

This issue is settled.

1.2 – On included entities

The Commission services asked the BVI for further clarification on the partnerships included in the legislation on substance.

The Act introduces substance requirements for companies (including foreign companies registered in the BVI) and limited partnerships (including foreign limited partnerships registered in the BVI) carrying on relevant activities.

The BVI have not provided a note on other partnerships existing in their legislation. However, from publicly available information, it appears that there would be only general partnerships and limited partnerships (including local and international partnerships).

The Act provides that partnerships will not be included in the scope of substance requirements if the partners opted that the partnership does not have legal personality. This is equivalent to what other jurisdictions have chosen and should be monitored for Member States to decide in the coming months whether those entities should also be added to the scope of substance requirements.

Conclusion:

This issue is clarified and the risk of BEPS should be limited. It however needs to be monitored, in the coming months, whether it is considered necessary to include all partnerships in the scope of substance requirements.

2 - Imposition of substance requirements

2.1 – Income threshold

The final Act does not exclude entities based on income threshold.

Conclusion:

This issue is settled.

2.2 – Tax residence

In Section 2 of the Act, the BVI exclude from the scope of substance requirements companies that are tax residents in another jurisdiction, which is not on Annex I of the EU list of non-cooperative jurisdictions for tax purposes.

The Guidance No.1 provides that if an entity considers it is tax resident outside the BVI in a jurisdiction that is not on Annex I, it has to claim that exemption by proving to the satisfaction of the ITA that it is tax resident in the jurisdiction it claims to be. It is further mentioned that such a legal entity will need to consider how it will be able to meet this evidential requirement.

The Schedule to the Act modifies the reporting requirements¹ to mention that amongst the information to be reported to the Authority, entities claiming to be tax resident in another jurisdiction should file (i) information on the jurisdiction in which they are tax resident and (ii) evidence to support that tax residence.

In the Act nor in the Guidance, there is no specific requirement as to what type of evidencing will be accepted by the ITA.

In addition, it is provided that all information stored in the database for a legal entity claiming to be tax resident in another jurisdiction will be exchanged with the jurisdiction of the beneficial owner, parent entity, in which the entity is registered or within which the entity claims to be tax resident.

Although the evidencing of tax residence is not detailed, this issue relates to the evaluation of the efficient enforcement of the substance legislation, which should be monitored in the coming years.

Conclusion:

This issue is settled subject to future monitoring of the enforcement of the substance legislation.

¹ Beneficial ownership secure search system Act 2017 (the « BOSS Act »)

2.3 – Specific CIGAs for IP assets

It was reported to the BVI that there should be a direct link between the type of IP assets and the main CIGAs that should be carried out in the BVI.

The BVI have redrafted Section 7 of the Act to make a direct link between patents and the main CIGA that should be R&D. For non-trade intangible assets such as brand, trademark and customer data, the main CIGAs should be marketing, branding and distribution.

Conclusion:

This issue is settled.

2.4 – CIGAs in or from within the jurisdiction

It was reported to the BVI that it should be clarified that CIGAs should be carried out in the BVI.

The final legislation does not refer anymore to the wording “from within”. However, no clear link between the CIGAs and the BVI was made instead. The wording of Section 8(c) provides that:

“(...) a legal entity complies with the economic substance requirements if:

(...) (c) the legal entity conducts core income generating activity”.

However, the Guidance No.1 para. 9 clarifies that an entity carrying on one or more relevant activities “*will have to carry out the core income generating activities which relate to the activity within the BVI*”.

Section 8 read in conjunction with the Guidance makes a geographical link between CIGAs that have to be performed and the BVI.

Conclusion:

This issue is settled.

2.5 – Outsourcing safeguards

In a previous drafting of their legislation, the BVI had proposed the following safeguards:

- Outsourcing of CIGAs can only take place in the BVI;
- Only the part of the activities of the service provider that is attributable to generating income for the relevant entity shall be taken into account for substance requirements;
- The entity must be able to monitor and control the activity of the service provider.

The BVI were asked to ensure that when taking into account the part of the activities of the service provider linked to the generation of income for the primary entity, it should be clearly ensured that (i) there will be no double counting of resources of service providers and (ii) the information filed on outsourcing will be part of the spontaneous exchange of information.

The new wording of Section 8(d) provides that:

“in the case of income generating activity carried out for the relevant legal entity by another entity,

- (i) no core income generating activity is carried on outside the Virgin Islands;*
- (ii) only that part of the activities of that other entity which are solely attributable to generating income for the relevant legal entity and not for any other legal entity shall be taken into account when considering if the relevant legal entity meets the economic substance requirements;*
- (iii) the relevant legal entity is able to monitor and control the carrying out of that activity by the other entity”.*

This wording should allow to make sure there will be no double counting of the resources of the service providers amongst several legal entities. In addition, the Schedule to the Act provides that the entity will have to file information on the name of the entity, which carries out an activity on its behalf together with the details of the resources deployed by that entity in carrying out the activity on its behalf. This information will be part of the information exchanged with the relevant Member States.

Moreover, the Guidance No1 para. 19 to 21 provides additional interpretation on outsourcing. It is clarified that the ITA will ensure that the safeguards are complied with because outsourcing constitutes a potential source of abuse. The Guidance further specifies that “*abuse can occur where the expenditure, employees and premises of the contractor are counted towards the economic substance of more than one legal entity as regards any relevant activity*”. Substance of the service provider can only be used to support substance of the relevant entity to the extent that the expenditure, employees and premises of the contractor have actually been used for that purpose. It is specifically mentioned that “*where the contractor does work for more than one legal entity records must be kept to ensure that its work can be attributed to each of the legal entities in question. Legal entities need to bear in mind the need to produce this evidence when agreeing terms with any outsourcing contractor*”.

The requirements in the Act together with the clarification in the Guidance provides for an appropriate framework of safeguards as expected by Member States.

Conclusion:

This issue is settled.

2.6 – Other CIGA issues

a) Presumption of non-compliance in high-risk IP scenarios

In a previous drafting of the Act, in high-risk IP scenarios, the presumption of non-compliance is only applicable when an entity does not carry out R&D, marketing, branding or distribution activities.

It was reported that in high-risk scenarios, the presumption should apply from the beginning, whatever activities are carried out by the entity.

Section 9 of the final Act introduces a presumption of non-compliance in high-risk scenarios in all cases, whether or not R&D, marketing, branding or distribution activities are carried out by the entity.

Conclusion:

This issue is settled.

b) Holding companies

In a previous drafting, the BVI had included specific requirements for pure equity holding companies but suppressed reference to other holding companies that may carry on relevant activities and should fulfil substance requirements.

It was reported to the BVI that such entities should be covered by the substance requirements.

New Section 9 provides that minimum substance requirements are only applicable to pure equity holding entity “*which carries on no relevant activity other than holding equity participations in other entities and earning dividends and capital gains*”. Under Section 5, a legal entity that carries on one or more relevant activity should comply with economic substance requirements.

This should properly cover the holding with various activities.

Conclusion:

This issue is settled.

2.7 – Date of application of the legislation

The previous wording of the Act created confusion as to the date from when entities will have to comply with substance requirements based on the end of financial years.

Reference is now made in the Act to financial years starting on or after 1 January 2019 for new entities and to financial years starting no later than 30 June 2019 for other entities. This clarifies the date of application of the substance requirements.

Conclusion:

This issue is settled.

3 – Enforcement and sanctions

The sanctions framework was considered as not being dissuasive enough as the level of sanctions starts quite low and only states a maximum amount (no minimum or fixed amount) and the striking off is never considered as being mandatory for the authorities. The deadline for the implementation of recommendations in the written notices was furthermore still not specified.

The Guidance clarifies that in clear cases, the ITA may move straight from determination of non-compliance to striking-off the entity.

Conclusion:

This issue is settled and the evaluation of the efficient enforcement of the substance legislation is subject to monitoring in the upcoming years.

Conclusion

Leaving aside the issue of collective investment funds, the BVI have implemented their commitment under criterion 2.2.

ANNEX 1: assessment by COCG experts in 2017

ANNEX 2: Guidance note

ANNEX 3: Economic Substance (Companies and Limited Partnerships) (Amendment) Act, 2019

ASSESSMENT BY COCG EXPERTS IN 2017

	1a	1b	2a	2b	3	4	5
British Virgin Islands	X	?	?	?	V	X	X
<p><i>Criterion 2.2: "The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction"</i></p> <p>In light of the assessment made under all Code criteria applied by analogy, the tax system of BVI should be considered as harmful from a Code of Conduct point of view.</p> <p>However, we should consider further the nature of substance we expect to see in an offshore financial centre, and ensure that the BVI is attracting profits that reflect the real economic activity undertaken there.</p>						Overall: V	

Explanation

Absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero:

In this respect, where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero", then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2 has been met.

Relevant questions (Q 1.2)

The British Virgin Islands (BVI) operates a zero tax rate which applies to both domestic and foreign companies incorporated or registered in the BVI. The BVI therefore meets the

requirement to be assessed under criterion 2.2.

Criterion 1:

“whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

The BVI operates a zero tax rate which applies to both domestic and foreign companies incorporated or registered in the BVI. The law does not segregate between resident vs non-resident shareholders. We therefore propose a cross (X – not harmful) for criterion 1.a.

The BVI did not answer on the respective questions in the questionnaire. In our view, a jurisdiction should not benefit of such a denial of cooperation. Basing in the information available (beneficial ownership information for law enforcement only and denial of cooperation), we propose a question mark (“?”) for criterion 1.b

One expert provided the following dissenting opinion:

The information we requested in order to ascertain whether there is de facto ring fencing is not available for to be shared with us. In accordance with international standards, the BVI does have access to beneficial ownership information, but this is for law enforcement purposes. We would therefore propose a question mark (“?”) for criterion 1.b.

Criterion 2:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

Relevant questions (Q 2.1, Q 2.2, Q 2.3, Q 1.1, Q 1.2, Q 1.5, Q 1.8,)

Please see analysis above with regards criterion 1.

Criterion 3:

“whether advantages are granted even without any real economic activity and substantial economic presence within the jurisdiction offering such tax advantages”

Relevant questions (Q 1.1, Q 1.7, Q 1.9, Q 2.4, Q 2.5, Q 2.6, Q 2.7, Q 2.8)

On incorporation, BVI company law requires an entity to appoint a director and for that director to issue share capital. The entity may not carry on business until these steps have been taken. We understand that the majority of the 500,000+ directors registered in the BVI are individuals, but a proportion are themselves legal persons (13%).

All companies registered in the BVI are required to maintain accounting records with supporting underlying documentation in a form that is sufficient to show and explain the company’s transactions.

For a company to establish and carry out business activity in the BVI it must secure a trade license which specifies the type of business/profession it engages in, and it must have a physical address. In the past 5 years, 195 trading licenses have been denied by the Department of Trade and Consumer Affairs. Trading licenses are renewed every year, and government departments conduct inspections of license holders to ensure compliance.

Companies that are licensed and regulated by the Financial Services Commission do not have to apply for a trading license, but they are required to file audited accounts. They also have to comply with the BVI’s AML regime, and the FSC carries out period inspections to licensed entities to monitor AML compliance.

Statistics:

Companies in 2016: 416,784

Employees in 2015: 19,982

Population: 30,000

GDP: USD\$900m (in 2014)

Government tax revenue: USD\$302m, of which USD\$211 from the financial services sector. Government revenues are generated through various means including fees imposed on the financial services sector (including companies), payroll tax on all individual incomes in the BVI, work permit fees that are levied on individuals and companies (which are calculated by reference to salary levels), social security contributions, national health insurance contributions, customs duties, property tax and stamp duty on real estate purchases and leases, landholding fees for non-residents and tax income from the tourism sector.

Assessment:

*The conditions attached to the advantages at stake (e.g. requirements for incorporation or operations) do not include any express requirement for real economic activity or substantial economic presence. This alone justifies a conclusion on the lack of substance. In accordance with the Code of Conduct Criteria a lack of substance can arise from legal or de facto circumstances. Those criteria have to be applied by analogy. In case of a preferential regime, the Code of Conduct asks **for legal and de facto** requirements for substance. Therefore it is **reasonable** to ask a jurisdiction not raising a CIT, to have a de jure requirement for substance as part of their company law.*

In addition the data concerning employees and number of companies submitted by BVI strongly support the lack of substance in practice. If you divide the number of employees, which is 19,982 (as of 2015, no more recent data available), by the number of companies, which is 416,784 (as of 2016), there are on average only 0.05 employees per company. They give evidence that it is highly questionable whether there is an adequate de facto link between profits and underlying substance.

In addition there are no investigations on the carrying out of real economic activities in BVI. That fact also supports the view that there is no adequate link between profits and underlying substance. Even if the FSC can inspect licensed businesses, and these entities file audited financial statements, due to a lack of any requirements for economic substance those investigations are not within the scope of Criterion 3.

On the remark that EU MS do not have substance requirements in their legislations either, this is not completely true: CFC rule in the ATAD1 Directive (art. 7 para. 2, lett. a, last sentence) lays down the possibility to apply a substance test to exempt from taxation the

controlled foreign company income which EU MS should provide for when implementing ATAD. At least in EU, MS do apply a sort of substance requirement.

We would therefore propose a tick (“V”) for criterion 3.

Addendum by one expert only:

If you divide the number of employees, which is 19,982 (as of 2015, no more recent data available), by the number of companies, which is 416,784 (as of 2016), there are on average only 0.05 employees per company. From our perspective, these disproportionate figures strongly highlight the questions arising in respect of substance.

One expert of Panel III would propose a question mark (“?”) for Criterion 3, in accordance with the guidelines agreed at the Code of Conduct Group in July.

There are 19,982 people employed through BVI companies. Divided by the number of legal entities, this suggests limited substance in the BVI. However, the population of the BVI is 30,000, and we question the ability for the BVI to mandate any more substance from such a population size.

The Financial Services industry is a significant part of the BVI’s economy (Financial Services generate 63.8% of government revenue). We question whether the number of employees is the appropriate test of substance given for the BVI given this. Rather, we wonder if the fact financial services are regulated and monitored by the Financial Services Commission is more relevant. As previously mentioned, the FSC can inspect licensed businesses, and these entities file audited financial statements.

*Finally, we question whether it is **reasonable** to ask a jurisdiction to have a de jure requirement for substance as part of their company law. We are unaware of any other Member State who would require such substance on incorporation, when companies naturally don’t have economic substance, as they are not yet created.*

Criterion 4:

“whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD”

Relevant questions (Q 2.9, Q 2.10, Q 2.11, Q 2.12)

BVI operates a zero rate of corporate income tax to companies incorporated or registered in the BVI. Applying transfer pricing rules according to OECD guidelines is therefore not relevant. The BVI is currently drafting legislation that will ensure it confirms to the standards set out through the OECD initiative – this includes the adoption of CBCR rules.

The BVI also exchanges information with other jurisdictions to allow other jurisdictions to establish the extent and type of activity the BVI entity is engaged in. This includes:

- *Ownership information (both beneficial and legal);*
- *Banking information, and;*
- *Accounting information with supporting documents such as invoices, receipts and contracts.*

We would therefore propose a cross (“X” – not harmful) for criterion 4.

Criterion 5:

“whether the features of the tax system lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way”

Relevant questions (Q 2.13, Q 2.14, Q 2.15, Q 2.16)

All the elements of the legal system which are relevant for benefitting from the advantages at stake (including rules for the granting of tax residence or the setting up of companies) appear to be clearly set by the law and the practice does not appear to involve any administrative discretion. We would therefore propose a cross (“X” – not harmful) for criterion 5.

INTERNATIONAL TAX AUTHORITY

**ECONOMIC SUBSTANCE (COMPANIES AND LIMITED PARTNERSHIPS) ACT,
2018**

GUIDANCE NOTE No. 1

DECEMBER 2018

Introduction

1. The Economic Substance (Companies and Limited Partnerships) Act, 2018 (“the Act”) will come into force on 1 January 2019.
2. The Act introduces substantive economic substance requirements, and also amends the Beneficial Ownership Secure Search System Act (“the BOSS Act”) so as to impose reporting requirements and the obligation to pass information to competent authorities in other jurisdictions in appropriate cases. Both the Act and the BOSS Act envisage that their terms may be amplified by the making of regulations, although no regulations have been made as at the date of this Note. This Note refers to the Act, the amended BOSS Act and any regulations which may hereafter be made as “the legislation”.
3. A summary of the terms of the Act and the amended BOSS Act is set out in the Annex to this Guidance Note. Expressions defined in the legislation bear the same meaning in this Note. The expression “legal entity” refers to a company and a limited partnership with legal personality.

The status of this guidance

4. The International Tax Authority (ITA) is charged with enforcing the economic substance requirements. In that capacity it must interpret the legislation, monitor compliance with the legislation and take enforcement measures against legal entities which do not comply with it. The ITA proposes to issue guidance from time to time to facilitate compliance with the requirements of the Act. Legal entities will be entitled to rely on this guidance when seeking to comply with their obligations under the legislation.
5. The Act also envisages that the ITA may issue “rules” on how the economic substance requirements may be met, and on the meaning of expressions used in the Act and in any regulations made under it (see section 17(3)). Rules will be issued in due course. This guidance is not intended to constitute rules for this purpose.
6. This guidance should be read in conjunction with the Act. Further guidance will be issued in due course.
7. This guidance is intended for legal entities incorporated or formed under the law of the BVI. Note that the legislation also applies to foreign companies and limited partnerships

which do business in the BVI and which carry on relevant activities there. Those entities are not within the scope of this guidance.

Practical steps which legal entities must take in the light of the legislation.

New legal entities

8. The Act applies with immediate effect to all legal entities incorporated or formed on or after 1 January 2019. Such a legal entity needs to consider first whether it is proposing to carry out one or more relevant activities. If so, it needs to consider whether it will be tax resident outside the BVI. If it is tax resident outside the BVI (in a jurisdiction which is not on Annex I to the EU list of non-cooperative jurisdictions) it will be exempt from the economic substance requirements, but in order to claim that exemption it will have to prove to the satisfaction of the ITA that it is tax resident in the jurisdiction it claims to be. Such a legal entity will need to consider how it will be able to meet this evidential requirement.
9. A legal entity which is proposing to carry on one or more relevant activities, and which is not proposing to claim the non-resident exemption, must then consider how it is going to meet the economic substance requirements. For all activities other than the activity of a pure equity holding company the entity will need to demonstrate that the relevant activity is controlled and managed from within BVI. Further guidance on this topic is provided below. It will also have to carry out the core income generating activities which relate to the activity within BVI. There are strict limits on outsourcing such activities. Further guidance on this topic is also provided below.
10. It is essential that the legal entity documents its activities, and the basis on which the relevant activity is managed and directed from the BVI, so that it will be able to demonstrate compliance to the ITA in due course.
11. In addition, the legal entity must satisfy the economic substance requirements, in that they must show adequate expenditure and employees in the BVI which are devoted to the relevant activity. The legal entity must also have appropriate physical offices or premises in the BVI. Again record keeping will be essential in order to demonstrate compliance.

12. Further guidance will be supplied on how to assess the amount of expenditure and number of employees for this purpose.
13. The requirements of the legislation have to be complied with by reference to financial periods, as defined in section 4 of the Act. So, for example, if a newly formed legal entity chooses a one-year financial period from the date of its incorporation it will have to submit a return following the first anniversary of its incorporation or foundation.
14. Note that all legal entities will have to submit a return at the end of each financial period, whether or not they carry on a relevant activity, although legal entities which do not carry on a relevant activity will merely have to state that they do not do so. However, any legal entity which files a return stating it does not carry on a relevant activity may nonetheless be subject to investigation by the ITA to check the accuracy of its return.
15. It is possible that a legal entity will only start a relevant activity part way through a financial period. That is especially likely to be true for new legal entities, which will typically have a period of minimal activity between date of incorporation or formation and commencing to do business. In those circumstances the economic substance requirements will only apply for that part of the financial period during which the relevant activity is being conducted.
16. It should be noted that there are especially strict additional requirements for legal entities carrying on intellectual property business.
17. The business of a pure equity holding company is subject to a less rigorous regime. There is, in particular, no obligation to carry out core income generating activities in the BVI and no obligation that the relevant activity is directed and managed from the BVI. The company must, however, have economic substance, as required by section 8(2). Attention is drawn to the narrow definition of a "pure equity holding company". Other forms of holding company will have to comply with any requirements attaching to other types of relevant activity which it undertakes.

Existing legal entities

18. The guidance for new legal entities given above applies equally to existing legal entities, save that they only need to comply with the legislation with effect from 30 June 2019, so their first financial period will begin on that date.

Outsourcing

19. Sometimes a legal entity will outsource part of its business to a third party contractor. The ITA will be concerned to ensure that section 9(1)(d) of the Act is complied with in these circumstances, because outsourcing constitutes a potential source of abuse of the legislation.
20. Abuse can occur where the expenditure, employees and premises of the contractor are counted towards the economic substance of more than one legal entity as regards any relevant activity. The legislation therefore requires that the expenditure, employees and premises of the contractor can only be used to support the economic substance of the legal entity whose relevant activity has been outsourced to the extent that the expenditure, employees and premises of the contractor have actually been used for that purpose. So where the contractor does work for more than one legal entity records must be kept to ensure that its work can be attributed to each of the legal entities in question. Legal entities need to bear in mind the need to produce this evidence when agreeing terms with any outsourcing contractor. They must also ensure that they are able to meet their obligation to monitor and control the outsourced activities.
21. Core income generating activity can only be outsourced to another legal entity which carries on the activity in the BVI.

Management and direction

22. For relevant activities other than holding activity the relevant activity must be directed and managed from the BVI. That means that there must be an adequate number of board meetings held in the BVI, having regard to the nature of the relevant activity, and its importance in the overall business of the legal entity. For a board meeting to be held in the BVI there must be a quorum of directors physically present in the BVI. The directors of the legal entity attending such meetings must include among their number adequate

expertise to direct the relevant activity. Decisions of the Board regarding the relevant activity must be minuted, and minutes of those decisions must be kept in the BVI.

Striking off

23. An important sanction which the ITA can impose on a legal entity in breach of the economic substance requirements is to procure the striking off of the legal entity. That sanction is available if the legal entity fails to comply with a first determination of non compliance made by the ITA, and also where at any time after a first determination has been made the ITA considers that there is no realistic possibility of the legal entity meeting the economic substance requirements. Legal entities must understand that striking off is a real sanction which the ITA will not hesitate to use where it considers that a legal entity has been guilty of clear or deliberate breaches of the economic substance requirements, even where the entity has only been determined to be in breach on a single occasion.
24. The ITA will not resort to the sanction of winding up without giving the legal entity in question a reasonable opportunity to state its case in opposition.
25. Where third party rights are involved (eg the customers of a bank or insurance company) the ITA's preferred approach would be to impose penalties and then secure compliance with the economic substance requirements, or if that does not appear possible to secure the orderly running down of the business. However, even in this context it may opt for striking off if the breaches of the legislation have been egregious or deliberate in nature.

Further information

26. The ITA will hold consultations with the international business and financial services sector to facilitate compliance with the requirements of the Act, and will issue further guidance as appropriate.
27. Questions on this guidance may be sent to:

Director

International Tax Authority

Road Town Tortola

28. Questions may be answered collectively via the ITA's website rather than on an individual basis. The ITA cannot provide legal advice.

ANNEX

**ECONOMIC SUBSTANCE (COMPANIES AND LIMITED PARTNERSHIPS) ACT,
2018: EXPLANATORY MEMORANDUM**

Introduction

1. The Economic Substance (Companies and Limited Partnerships) Act, 2018 ("the Act") will come into force on 1 January 2019¹.
2. The Act introduces substantive economic substance requirements, and also amends the Beneficial Ownership Secure Search System Act (BOSS Act) so as to impose reporting requirements and the obligation to pass information to competent authorities in other jurisdictions in appropriate cases².
3. The International Tax Authority (ITA) is charged with monitoring and enforcing compliance with the requirements of the Act.

The scope of the Act

4. The Act imposes economic substance requirements on all BVI companies and limited partnerships with legal personality (LPs)³ which are carrying on "relevant activities" unless they are resident for tax purposes in a jurisdiction outside the BVI which is not on Annex I to the EU list of non-cooperative jurisdictions⁴, and on all foreign companies and LPs doing business in the BVI⁵.

The timing of the introduction of economic substance requirements

¹ See section 1.

² See section 16 and the Schedule.

³ See section 5, and the definitions of "legal entity", "company" and "limited partnership" in section 2.

⁴ See the definition of "non-resident company" and "non-resident limited partnership" in section 2 and the exclusion of those types of entity from the definitions of "company and limited partnership" in that section.

⁵ See the definitions of "foreign company" and "foreign limited partnership" in section 2.

5. The Act differentiates between “new” companies and LPs respectively incorporated and formed on or after 1 January 2019, and companies and LPs which existed before that date⁶.
6. New companies and LPs must comply with economic substance requirements immediately and meet the reporting obligations in the Schedule within one year of the date of incorporation or formation respectively⁷.
7. Existing companies must comply with economic substance requirements by 30 June 2019 and meet reporting obligations within one year of that date⁸.

Relevant activities

8. The economic substance requirements apply to the following “relevant activities”: banking business; insurance business; fund management business; finance and leasing business; headquarters business; shipping business; holding business; intellectual property business; and distribution and service centre business⁹.

Economic substance requirements

9. Each company or LP which is not tax resident outside the BVI must, in relation to any relevant activity other than holding business, carry out defined core income generating activity (CIGA) in the BVI¹⁰.
10. Such a legal entity must also ensure that any relevant activity, other than holding business, is directed and managed in BVI, and demonstrate substance by reference to the adequacy of employees, expenditure and premises¹¹.
11. A pure equity holding entity¹² is required to meet statutory filing requirements and have adequate employees and premises¹³.

⁶ See section 4.

⁷ This is the consequence of the definition of financial period in sections 4(a) and (b).

⁸ This is the consequence of the definitions of financial period in sections 4(c) and (d).

⁹ As set out in section 6.

¹⁰ See section 7.

¹¹ See section 8(1).

¹² As defined in section 2.

¹³ See section 8(2). The wording of this section of the Act precludes the possibility of a holding business which also carries on any other form of relevant activity claiming to be a pure equity holding company.

12. Additional requirements are imposed on intellectual property business, including high-risk IP legal entities¹⁴.

Outsourcing

13. A company or LP may outsource CIGA subject to complying with the following requirements¹⁵:
 - a. Where a legal entity outsources CIGA to a service provider, the service provider must undertake the CIGA in BVI;
 - b. There must be no double counting if a service provider provides services to more than one legal entity. The legal entity remains responsible for ensuring accurate information is reported to the ITA and this will include details of the resources employed by its service provider(s), for example based on the use of timesheets;
 - c. The legal entity must be able to demonstrate that it has adequate supervision of the outsourced activities.

Obligations to provide information

14. All BVI registered and foreign companies and LPs¹⁶ must provide information to enable the ITA to monitor whether a legal entity is carrying on relevant activities and (if so) whether it is complying with the economic substance requirements¹⁷. These obligations are in addition to the obligation to report on beneficial ownership as required by existing section 10(3)(a) of the BOSS Act.
15. The information to be provided will be integrated into the existing Beneficial Ownership Secure Search (“BOSS”) system.

¹⁴ See section 9.
¹⁵ See section 8(1)(d).
¹⁶ As defined in section 2.
¹⁷ As set out in the Schedule.

16. Companies and LPs are required to submit information about their status and relevant activities on an annual basis by reference to financial periods of not less than one year¹⁸.
17. The information to be supplied comprises enhanced¹⁹ beneficial ownership information, evidence to support any claim to be non-resident²⁰ and the following information about any relevant activities carried on by a legal entity which is not non-resident:
- (i) turnover from the relevant activity.
 - (ii) amount of expenditure from the relevant activity incurred in the BVI.
 - (iii) the total number of employees engaged in the activity.
 - (iv) the number of employees engaged in the activity in the BVI.
 - (v) the address of any premises within the BVI used for any relevant activity.
 - (vi) the nature of any equipment in the BVI used in connection with the relevant activity.
 - (vii) the names of the persons responsible for the direction of the relevant activity, their relationship with the company and whether they are resident in the BVI²¹.
 - (viii) certain additional information for companies carrying on intellectual property business²².
 - (ix) information about outsourcing²³.
18. The information supplied pursuant to the BOSS Act is designed to enable the ITA to screen large numbers of company returns. Some of the returns may show companies which are clearly non-compliant with the economic substance requirements. Other

¹⁸ See section 4 for the definition of financial period. The new section 9(6A) of the BOSS Act inserted by paragraph (d)(ii) of the Schedule and the amendments to section 10 of the BOSS Act made by paragraph (e) of the Schedule require that the information there specified has to be supplied for each financial period.

¹⁹ See amended section 9(2) of the BOSS Act as inserted by paragraph (d)(i) of the Schedule and new sections 10(3)(e) and (f) of the BOSS Act as inserted by paragraph (e)(iii) of the Schedule.

²⁰ New section 10(3)(g) of the BOSS Act as inserted by paragraph (e) of the Schedule.

²¹ Requirements (i) to (vii) are imposed by new sections 10(3)(h) of the BOSS Act.

²² New section 10(3)(i)

²³ New section 10(3)(j)

returns may show companies which, at least on the face of the return, are compliant, or out of scope. Some returns will require further investigation. The ITA has a general power to require further information which is to be found in section 11.

Determination of non-compliance

19. The ITA has a duty to ensure compliance with economic substance requirements by virtue of section 4 of the International Tax Authority Act 2018.
20. The ITA may enforce compliance in respect of financial periods ending on or after 31 December 2019.
21. Where the ITA determines non-compliance, it must issue a notice under section 12(1) which must, *inter alia*, impose a penalty and state what actions the company must take to comply. Those actions may well include ceasing to carry on the relevant activity in question. A time limit must be set for compliance, which will depend on what is reasonable to allow in the circumstances.
22. If the entity does not comply with the requirements set out in the first notice within the time limit the ITA must issue a second notice imposing a further penalty. It may also recommend that the Financial Services Commission (FSC) strike off the entity for non-compliance.
23. If the ITA considers at any time after the service of the first determination that there is no realistic possibility of the entity meeting the economic substance requirements it may require the FSC to strike off the entity. Thus, in clear cases, the ITA may move straight from determination of non-compliance to striking off.

Penalties for non-compliance

24. The Act imposes penalties both for failure to provide required information²⁴ and operating in breach of economic substance requirements²⁵. The Act specifies both minimum and maximum penalties. As noted above, the penalties regime includes striking a company or LP off the relevant register²⁶.

²⁴ Section 11 and BOSS Act section 26.

²⁵ Section 12.

²⁶ Sections 12(7) and 12(8).

Disclosure of information

The ITA will automatically disclose all information on the BOSS database in respect of an entity to overseas competent authorities in the circumstances set out in new Schedule 4 of the BOSS Act.

The regulation of mutual funds in the British Virgin Islands

Action Plan

Introduction

1. The Government of the British Virgin Islands (BVI) is committed to the continued effective regulation of mutual funds including compliance with appropriate substance requirements.
2. The Economic Substance (Companies and Limited Partnerships) Act, 2018 has introduced substance requirements for fund managers. The Securities and Investment Business Act, 2010 (as amended), the Mutual Fund Regulations, 2010 (as amended), and the Securities and Investment Business (Incubator and Approved Funds) Regulations, 2015 (as amended) impose requirements at the level of the fund. In addition, all mutual funds are required to comply with the Anti-Money Laundering Regulations, 2008 including the requirement to appoint a Money Laundering Reporting Officer.
3. The Government of the BVI believes that the existing body of law for mutual funds already imposes requirements at fund level that are consistent with the requirements of the Code of Conduct Group. However, the Government is committed to keeping the regime under review and will specifically focus on the three actions identified in this Plan.
4. The process will be led by the Financial Services Commission (FSC) in close consultation with the International Tax Authority as the competent authority for the monitoring and enforcement of the Economic Substance (Companies and Limited Partnerships) Act, 2018.

Previous submissions

5. The Government of the BVI submitted a paper to the European Commission on 6 November 2018 which: identified the core legislation dealing with the regulation of mutual funds in BVI; explained the types of mutual funds permitted and the requirements they must meet; and identified that funds classified as Professional Funds and Private Funds account for almost 90 per cent of the mutual funds recognised in BVI.
6. A further paper was submitted on 9 December responding to the European Commission's request for clarification concerning the regulation of (a) Foreign Funds and (b) Incubator and Approved Funds. This paper stated that there are five Foreign Funds. The correct number is six such funds.
7. For convenience, this Action Plan repeats information provided in these earlier papers.

Types of mutual fund

8. There are six categories of mutual fund in BVI. They are (with the number of funds in each category shown in brackets):
 - a. Professional Funds (985): made available only to professional investors;

- b. Private Funds (339): must either have no more than 50 investors or only make a private invitation to subscribe for or purchase fund interests;
- c. Public Funds (46): retail product subject to a stringent regulatory regime;
- d. Foreign Funds (6): retail product subject to regulation in its home jurisdiction that provides an equivalent level of investor protection to the Public Funds regime. Designed to give retail investors in BVI access to a wider range of diversified investment opportunities whilst ensuring high standards of investor protection. Scotiabank offers all but one of the six Foreign Funds. The sixth fund is a savings plan to help cover the cost of tertiary education.
- e. Approved Funds (78): introduced three years ago for managers who want to establish a private offering to a small group of investors (maximum of 20 investors; fund's net asset may not exceed US\$100 million) on a long term basis;
- f. Incubator Funds (51): introduced three years ago for start-up managers wishing to develop a track record and test a fund's viability. Validity period of two years, after which the fund must convert to a Private, Professional or Approved Fund or alternatively wind down its operations. Maximum of 20 investors who must each subscribe US\$20,000. The Fund's overall net assets may not exceed US\$20 million.

Common requirements across all categories of funds

Authorisation/registration

- 9. All funds are required to be authorised or registered by the FSC and must submit a written application to the FSC.

Directors

- 10. All funds must have at least two directors, both of whom must be individuals in the case of Public Funds and Foreign Funds (in recognition of the retail nature of these products) and one of whom must be an individual in the case of all other categories of fund.

Authorised Representative

- 11. All funds must at all times have an Authorised Representative in BVI.
- 12. There are currently 55 Authorised Representatives who are primarily corporates (with premises, staff and operational expenditure in BVI) and three are individuals.
- 13. The regulatory regime requires all Authorised Representatives to have sufficient resources to effectively carry on their duties.

Action 1: The FSC will keep the resource requirements for Authorised Representatives under review to ensure that they remain appropriate.

Continuing reporting obligations

14. All funds are subject to continuing requirements to report information to the FSC. Incubator Funds, for example, must make semi-annual returns to the FSC giving information on: the number of investors in the fund; total investments in the fund; aggregate subscriptions; aggregate redemptions paid; NAV; and any significant investor complaint. Approved Funds must submit annual returns giving broadly similar information.

Functionaries

15. Professional Funds, Private Funds, Public Funds and Foreign Funds must (with certain very limited exceptions) have at all times a fund manager, fund administrator and a custodian.
16. Reflecting the nature of a private offering, an Approved Fund is required to appoint an administrator to ensure suitable oversight of its operations but is not required to appoint other functionaries.
17. There is no requirement for an Incubator Fund to appoint functionaries, but the Fund must clearly demonstrate how all functions (management, administration and custody) would be performed. Approval is not granted by the FSC until this is adequately explained.
18. In practice, the majority of funds have third party functionaries.

Action 2: The FSC will review the operation of Approved Funds and Incubator Funds and will, following appropriate consultation, make recommendations for any adjustments to the regime to be made by end-June 2019.

Accounts and audit

19. Professional Funds, Private Funds and Public Funds must appoint an auditor who must prepare financial statements each year that comply with internationally recognised and generally accepted accounting standards approved by the FSC. Financial statements must be submitted to the FSC.
20. Foreign Funds are also subject to audit in line with the requirements imposed on Public Funds.
21. Approved Funds and Incubator Funds are not required to have their accounts audited but, where necessary, such funds must ensure that the notes to the financial statement give a true and fair view of the matters to which they relate. Financial statements must be included in the body of information provided to the FSC on a regular basis (see paragraph 14 above).
22. An Incubator Fund wishing to convert to another category of fund is subject to audit by a suitably qualified person who is not connected to the Fund.

Action 3: The FSC will review the appropriateness of existing requirements for the preparation of financial statements for Approved Funds and Incubator

Funds and will, following appropriate consultation, make recommendations for any adjustments to the regime to be made by end-June 2019.

Conclusion

23. The Government of the BVI is ready to provide the extensive body of legislation applied to mutual funds should that be helpful to the European Commission and the Code of Conduct Group.
24. The Government also stands ready to address any questions that may arise.

31 December 2018