

# BVI Economic Substance: Updated Rules on Tax Residency

A recent change to the British Virgin Islands ("BVI") Rules on Economic Substance ("ES Rules")<sup>1</sup> serves as a reminder of the need to be familiar with the BVI International Tax Authority's ("ITA") detailed rules around tax residency when an entity that carries on a relevant activity under the BVI economic substance regime is claiming a non-BVI tax resident status as grounds for not establishing economic substance in BVI.

This industry update considers the relevant rules as updated in April 2024.

## Scope of the BVI Economic Substance Regime

The BVI economic substance regime applies to legal entities<sup>2</sup> which carry on a relevant activity during an economic substance financial period, excluding 'non-resident companies' and 'non-resident limited partnerships'. This update sets out the rules that apply to legal entities claiming to be resident for tax purposes outside the BVI under the economic substance regime, under the recently updated ES Rules.

<sup>1</sup> Version 4 of the ES Rules issued by the BVI ITA on 2 April 2024 is available: <https://bviita.vg/library/legislation/>

<sup>2</sup> 'Legal entities' are defined as BVI companies and registered foreign companies and BVI limited partnerships and registered foreign limited partnerships.

<sup>3</sup> As at the date of this update the EU Annex 1 List includes American Samoa, Anguilla, Antigua and Barbuda, Fiji, Guam, Palau, Panama, Russia, Samoa, Trinidad and Tobago, US

## How can a legal entity claim to be resident for tax purposes outside the BVI?

### *General Principles*

Non-resident companies and non-resident limited partnerships are defined in the BVI Economic Substance (Companies and Limited Partnerships) Act (As Revised) ("ES Act") as a company / limited partnership which is resident for tax purposes in a jurisdiction outside the BVI which is not on Annex I to the EU list of non-cooperative jurisdictions for tax purposes ("EU Annex I List")<sup>3</sup>.

A legal entity whose only sources of income from relevant activities are subject to tax in a jurisdiction outside the BVI will be regarded as resident for tax purposes in that jurisdiction. This is also intended to cater for a legal entity which, for example, is taxed on a branch or agency basis on all its activities in a jurisdiction outside the BVI, even if it is not necessarily tax resident in that jurisdiction.

A legal entity cannot be regarded as resident for tax purposes in a jurisdiction that does not have a

Virgin Islands and Vanuatu. The ES Rules note that the EU Annex I List is updated at least once every six months and any legal entity which has claimed or may claim to be tax resident under the laws of any other jurisdiction is encouraged to monitor any updates to the list and seek professional advice if it is uncertain of its position. The current EU Annex I List is available: <https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/>.

corporate income tax system. The current non-exhaustive list of such jurisdictions includes: Anguilla, Bahamas, Bahrain, Barbados, Bermuda, Cayman Islands and Turks and Caicos Islands. Withholding taxes are not considered when making a determination of tax residence.

Version 4 of the ES Rules sets out that a legal entity will not be regarded as resident for tax purposes in the United Arab Emirates ("UAE") for financial periods before 1 June 2023, as before that date the UAE did not have a corporate income tax. If such a claim is made related to financial periods before 1 June 2023, the claim will be rejected by the ITA. A legal entity claiming to be tax resident in the UAE must ensure that its claim only relates to financial periods beginning on or after 1 June 2023, when the UAE introduced a corporate income tax. All claims made concerning the UAE must be made in accordance with the requirements set out in the ES Rules and the legal entity must ensure that the evidence outlined in the ES Rules is submitted to support the claim.

For a transparent entity, tax residence in another jurisdiction must be demonstrated by reference to each of the participators or partners on whom the legal entity's profits are taxable. 'Transparent entity' means a legal entity in respect of which the entire profits and gains are treated under the law of another jurisdiction as attributable to and taxable on some or all of the direct or indirect participators or partners in the legal entity in question.

The ITA accepts that some jurisdictions charge 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 legal entity (or its participators in the case of a transparent entity) is liable to tax (to the extent that the jurisdiction charges tax on income) in that jurisdiction by reference to the relevant local criteria. This may also include situations where all of the legal entity's income from relevant activities is attributable to a branch or other permanent

establishment which is regarded as tax resident under the laws of a jurisdiction other than the BVI (provided that the jurisdiction does not appear on the EU Annex I List).

Any legal entity claiming to be a non-resident company or non-resident limited partnership, must make a claim to that effect and support its claim to the ITA. A legal entity must consider the jurisdiction in which it is claiming to be tax resident and pay close attention to the evidence required in each instance. The rules that apply and evidence that is required depend on whether the jurisdiction of tax residence being claimed is Guernsey, Jersey or the Isle of Man, or any other jurisdiction (that is not on the EU Annex I List).

All evidence and information provided to the ITA must be provided in English. For any official documentary evidence that is not in English, a certified English translation must be provided.

It is possible that a legal entity may be tax resident in a jurisdiction subsequently placed on the EU Annex I List. The ITA will consider allowing a reasonable time for a legal entity to adjust its business in these circumstances. Legal entities should be aware that exchange of information will take place between the BVI and the tax authority of any jurisdiction in which a legal entity claims to be tax resident, as well as with any EU member state where the legal entity has one or more beneficial or legal owners resident.

*Rules for Claims to be Resident for Tax Purposes in a Jurisdiction other than Guernsey, Jersey or the Isle of Man*

Evidence which the ITA will accept to support a claim includes:

- (a) certificates or letters issued by the competent tax authority of the other jurisdiction;

- (b) tax assessments, demands, or evidence of payment issued by the competent tax authority of the other jurisdiction;
- (c) tax returns submitted to the competent tax authority of the other jurisdiction; or
- (d) rulings issued by the competent tax authority of the other jurisdiction.

*Rules for Claims to be Resident for Tax Purposes in Guernsey, Jersey or the Isle of Man*

Entities claiming to be tax resident in Guernsey, Jersey or the Isle of Man can only make a claim if the legal entity is resident for corporate income tax purposes and subject to the relevant corporate income tax law and sufficient proof of this must be provided as follows:

- (a) tax assessments, demands, or evidence of payment issued by the competent tax authority of the other jurisdiction;
- (b) tax returns submitted to the competent tax authority of the other jurisdiction;
- (c) confirmation that the entity is required to submit a corporate income tax return to the competent tax authority of the jurisdiction.

A legal entity cannot claim to be tax resident in a jurisdiction such as Guernsey, Jersey or the Isle of Man where it is a transparent entity.

*Rules for Clients to be a Disregarded Entity for US Tax Purposes*

In the case of a disregarded entity for United States income tax purposes, a signed statement from an external tax advisor or 'C'-level officer stating that all of that legal entity's income has been included on the corporate tax return of the parent company in the US will be accepted. This evidence must include the name of the parent entity and evidence relating to the tax declaration made by the parent entity on its behalf.

*Further Evidence Permitted*

Where evidence of the types described above is submitted to the ITA and requires clarification, the ITA will accept a letter addressed to it from suitably qualified professional(s) (e.g. lawyer(s) or chartered accountant(s) qualified to practice in the relevant jurisdiction(s) in question) stating that, in the opinion of the professional in question, the legal entity is considered to be resident for tax purposes in that jurisdiction (or, in cases where deemed tax residence for transparent entities is claimed as described above), the basis on which it applies having regard to the precise requirements of the ES Rules.

**What economic substance financial period applies?**

Economic substance is assessed by reference to economic substance financial periods, which will normally be one year in length. Where it is claimed that a legal entity is tax resident in a jurisdiction outside the BVI, it will be necessary to demonstrate this non-residence throughout the economic substance financial period under consideration. The economic substance financial period may not be the same period as a legal entity's tax accounting period, although the economic substance financial period (or the accounting period) can be adjusted to bring about that result if convenient.

Some tax documents may relate to fiscal years, or years of assessment, which may be different again from the legal entity's tax accounting period. For a legal entity which is relying on the types of evidence specified above, and that evidence does not relate specifically to the legal entity's economic substance financial period, it will usually be necessary to produce further evidence which spans the entire economic substance financial period. However, where a legal entity changes its tax residence part way through an economic substance financial period (in a manner that would

otherwise enable it to qualify as non-resident), the ITA will only expect to see compliance with the applicable economic substance requirements for that part of the relevant economic substance financial period during which it did not qualify as non-resident.

### Can a legal entity be provisionally resident?

Yes. Where a legal entity is unable to provide evidence as described above in respect of any economic substance financial period within the reporting period (i.e. six months following the end of the legal entity's economic substance financial period), the legal entity may apply to be treated as provisionally resident in a jurisdiction outside the BVI, pending submission of the evidence required to establish that fact. The ITA will agree to an application only if one or more of the conditions set out in ES Rule 10 are met. A provisional treatment application must be made before the end of the reporting period.

Where an application is made, the ITA, if it agrees to the application, must specify a reasonable period within which the necessary evidence is to be submitted (the "provisional extension period"). During the provisional extension period, and during any period prior to the ITA taking a decision, the legal entity will be treated for the purpose of the economic substance legislation as if it were resident for tax purposes in a jurisdiction outside the BVI. If the ITA refuses the application for provisional treatment, or if the legal entity fails to supply the necessary evidence within the provisional extension period, the legal entity will, notwithstanding the provisional treatment allowed, be treated as not being non-resident in the BVI throughout the economic substance financial period in question.

The ES Rules set out detailed conditions for granting provisional treatment. The conditions for

granting provisional treatment as tax resident outside the BVI are:

- (a) The legal entity has established its tax residence in the jurisdiction in question for the previous economic substance financial period to the satisfaction of the ITA, and certifies that its tax residence has not changed in the intervening period, or
- (b) The legal entity supplies (within the reporting period) the most recent available documentary evidence of tax residence in that jurisdiction which complies with the requirements set out above, and certifies that its tax residence has not changed in the time since the period to which the documentary evidence relates, or
- (c) The legal entity evidences either that it has been too recently formed, or that it has too recently assumed tax residence in the jurisdiction in question, for there to be any documentary evidence of its tax residence which satisfies the requirements described above, and produces other evidence to demonstrate that it met the criteria for tax residence in that jurisdiction during the economic substance financial period in question. In each case the evidence in support of the application of the condition must be supplied within the reporting period of the economic substance financial period in question.

The ES Rules note that documentary evidence of tax residence will often not be available for an entire economic substance financial period until sometime after the economic substance financial period has ended, and outside the reporting period. The ITA accepts this and will be prepared to treat the entity as provisionally tax resident outside the BVI during a reasonable period, which the ITA will specify, following the end of the economic substance financial period in question, provided certain conditions are met. This 'reasonable period' set by the ITA for a legal entity to submit the evidence required typically would not extend

beyond two economic substance financial periods inclusive of the economic substance financial period for which the legal entity has applied for provisional treatment.

If the necessary documentary evidence is not provided during the specified period, or any extension which the ITA may permit, the legal entity will be treated as having failed to establish tax residence outside the BVI. The ITA will then require it to demonstrate economic substance in BVI in the usual way for that period. If the legal entity cannot do that, it will be subject to enforcement action.

A legal entity which establishes that it is impossible, for the reasons given in relation to provisional treatment described above, to produce documentary evidence of its tax residence must produce other evidence to demonstrate that it met the criteria for tax residence in that jurisdiction during the economic substance financial period in question. The nature of the evidence to be supplied will depend on the criteria for tax residence laid down by the law of the jurisdiction in question. That evidence must be provided within the information time limit for the economic substance financial period in question.

### **Can a legal entity continue to claim that it is non-resident when in liquidation?**

A non-resident legal entity that has entered liquidation may continue to claim that it is resident for tax purposes in a jurisdiction outside the BVI, provided that the legal entity will in any event remain subject to any applicable requirements in relation to claiming and evidencing such claim of tax residency.

### **Conclusion**

The updated ES Rules provide welcome further details for legal entities claiming to be resident for tax purposes outside the BVI under the BVI economic substance regime. Those legal entities

should review the impact of the recent changes to identify any action needed.

### **How the Maples Group Can Help**

Please contact us if you would like additional advice relating to your ongoing BVI economic substance regime compliance obligations. We would be pleased to assist.

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