

## British Virgin Islands Economic Substance Requirements – 'Relevant Activity' of 'Intellectual Property Business'

For general background on The Economic Substance (Companies and Limited Partnerships) Act, 2018 (the "Economic Substance Act"), the related draft International Tax Authority Economic Substance Code that was issued on 22 April 2019 (the "Guidance") and for the meaning of 'legal entity', please click [here](#).

This update assumes that an entity has already been determined to be a 'legal entity' under the Economic Substance Act and that the 'legal entity' is now considering whether it is carrying on one of the nine categories of geographically mobile 'relevant activities' - in particular, under the 'intellectual property business' category.

### What is 'Intellectual Property Business'?

'Intellectual property business' in the Economic Substance Act is defined to mean 'the business of holding intellectual property assets'.

'Intellectual property assets' 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).

The term 'income' in respect of an intellectual property asset is defined in the Economic Substance Act to include: (a) royalties; (b) capital gains and other income from the sale of an

intellectual property asset; (c) income from a franchise agreement; and (d) income from licensing the intangible asset.

### Economic Substance Test

If a 'legal entity' **only** carries on a 'relevant activity' that is an 'intellectual property business', it will be subject to the economic substance test set out in the Economic Substance Act. The economic substance test can be satisfied in relation to that 'intellectual property business' if the 'legal entity' ensures that:

- (a) the 'intellectual property business' is directed and managed in the British Virgin Islands;
- (b) having regard to the nature and scale of the 'intellectual property business':
  - (i) there are an adequate number of suitably qualified employees in relation to that activity who are physically present in the British Virgin Islands (whether or not employed by the relevant legal entity or by another entity and whether on temporary or long term contracts);
  - (ii) there is adequate expenditure incurred in the British Virgin Islands;
  - (iii) there are physical offices or

- premises as may be appropriate for the core income-generating activities (as described below in the context of 'intellectual property business');
- (iv) where the relevant activity is intellectual property business and requires the use of specific equipment, that equipment is located in the British Virgin Islands.
- (c) the legal entity conducts core income-generating activity in the British Virgin Islands as described below in the context of 'intellectual property business': and
  - (d) 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 British 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.
- (a) where the business concerns:
    - (i) intellectual property assets such as patents, research and development;
    - (ii) where the business concerns non-trade intangible assets such as brand, trademark and customer data, marketing, branding and distribution.
  - (b) in exceptional cases, except 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, which may include:
    - (i) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the 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 of the intangible asset;
    - (iii) carrying on the underlying trading activities through which the intangible assets are exploited and which lead to the generation of revenue from third parties.

### British Virgin Islands Core Income Generating Activities

The relevant British Virgin Islands core income generating activities in the context of 'intellectual property business' include:

### High Risk Intellectual Property Business

In addition, section 9(2)(b) of the Economic Substance Act provides that there is a presumption that a legal entity does not conduct core income generating activity if the legal entity is a high risk IP legal entity. A 'high risk IP legal

entity' is defined in the Economic Substance Act as 'a legal entity which carries on an intellectual property business and which:

- (a) acquired the intellectual property asset;
  - (i) from an affiliate; or
  - (ii) in consideration for funding research and development by another person situated in a country or territory other than the British Virgin Islands; and
- (b) licences the intellectual property asset to one or more affiliates or otherwise generates income from the asset in consequence of activities (such as facilitating sale agreements) performed by foreign affiliates.

This concept is discussed further below.

### **The Guidance on 'Intellectual Property Business'**

The Guidance contains some additional sector specific provisions in respect of 'intellectual property business' to state that 'the relevant activity consists merely of holding an intellectual property asset from which identifiable income accrues (if no identifiable income accrues there is no intellectual property asset at all)'.

The Guidance further provides 'that the definition of 'intellectual property business' does not therefore apply to a business which owns intellectual property merely as an adjunct to its business. Further, the Guidance states that 'most businesses will own some form of intellectual property – trademark protection, copyright in their advertising material, technical know-how relating to their processes, but this property, like premises or plant and machinery, 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. When read with the relevant core income generating activities (as described above) it is clear that what is being targeted are entities which receive income (as defined) from intellectual property rights which they have not developed themselves or, as the case may be, are not actively exploiting'.

Further, intellectual property business, in the form of 'high risk intellectual property business', has sector-specific guidance applicable to it included in the Guidance, which provides that 'income derived from intellectual property assets can pose a higher risk of artificial profit shifting than non-intellectual property assets. This higher risk is reflected in the presumptions of noncompliance with the economic substance requirements which apply in the two scenarios identified in section 9(2)(a) and (b) of the Economic Substance Act (as described below). Those presumptions are rebuttable, and are intended to serve the purpose of addressing the higher risk of artificial profit shifting, whilst not inadvertently prohibiting activities that constitute real economic activity.

Section 9(2)(a) of the Economic Substance Act provides that there is a presumption that a legal entity does not conduct core income generating activity if the activities being carried on from within the British Virgin Islands do not include any of the (core income generating) activities identified.

What is required to rebut this presumption under section 9(2)(a) is to evidence that the activities being carried on from within the British Virgin Islands include:

- (a) taking the strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the intangible asset generating income;
- (b) taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation of the intangible asset;
- (c) carrying on the underlying trading activities through which the intangible assets are exploited and which lead to the generation of revenue from third parties.

The Guidance provides that 'In determining whether the presumption (under section 9(2)(a) of the Economic Substance Act) has been rebutted (on the basis of the above-mentioned activities), the Information Tax Authority will need to be satisfied on the basis of the information provided by the entity that the activity taking place in the British Virgin Islands is more than local staff passively holding intangible assets whose creation and exploitation is a function of decisions made and activities performed outside of the jurisdiction. Equally, periodic decisions of non-resident board members will not suffice. Instead, the entity must employ local, permanent and qualified staff who make active and ongoing decisions in relation to the generation of income in the BVI'.

For 'high risk IP legal entities', section 9(2)(b) of the Economic Substance Act provides that 'there is a presumption that a legal entity does not conduct core income generating activity if the legal entity is a high risk IP legal entity'.

The Guidance clarifies that 'there is a high evidential threshold for rebutting this presumption' and further states that 'as set out in section 9(4) of the Economic Substance Act, the presumption in subsection (2)(b) may be rebutted where a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intellectual property asset is exercised by suitably qualified employees of the relevant legal entity who are physically present and perform their functions from within the British Virgin Islands and who are on long-term contracts. In determining whether the presumption has been rebutted, the Information Tax Authority will take into account the same factors which it takes into account when determining whether the presumption under section 9(2)(a) of the Economic Substance Act has been rebutted. In addition, the Information Tax Authority will need stronger evidence of the decision-making which is taking place in the British Virgin Islands'.

### **What to do if a Legal Entity is Carrying on the Relevant Activity of 'Intellectual Property Business' or 'High Risk Intellectual Property Business'**

It is worth noting that there are a range of consequences for breaches of the Economic Substance Act (including financial penalties and potential striking-off).

If you have any specific questions in relation to a 'legal entity' conducting 'intellectual property business', 'high risk intellectual property business' or this update, please speak to your usual Maples Group contact or:

## British Virgin Islands

**Richard May**  
+1 284 852 3027  
richard.may@maples.com

**Chris Newton**  
+1 284 852 3043  
chris.newton@maples.com

**Ruairi Bourke**  
+1 284 852 3038  
ruairi.bourke@maples.com

## Dubai

**Philip Ireland**  
+971 4 360 4073  
philip.ireland@maples.com

## Hong Kong

**Matt Roberts**  
+852 3690 7405  
matt.roberts@maples.com

**Richard Spooner**  
+852 2971 3046  
richard.spooner@maples.com

## London

**Matthew Gilbert**  
+44 7466 1608  
matthew.gilbert@maples.com

## Singapore

**Michael Gagie**  
+65 6922 8402  
michael.gagie@maples.com

**May 2019**  
© **MAPLES GROUP**

This update is intended to provide only general information for the clients and professional contacts of Maples Group. It does not purport to be comprehensive or to render legal advice.