

## Amendments to the Economic Substance regime in the British Virgin Islands

The British Virgin Islands (**BVI**) has introduced further changes to the economic substance (**ES**) regime by way of amendments to the Economic Substance (Companies and Limited Partnerships) Act, 2018 (the **Act**). The amendments are introduced by the Economic Substance (Companies and Limited Partnerships) (Amendment) Act, 2021 (the **Amendment Act**) which came into force on 29 June 2021.

### What are the key changes to the ES regime?

#### *Distribution and service centre business and limited partnerships without legal personality*

- Distribution and service centre business. Prior to the changes introduced by the Amendment Act, the provision of consulting or administrative services (**CA Services**) to foreign affiliates was not expressly included in the definition of “distribution and service centre business”. Nevertheless, the provision of CA Services to foreign affiliates was listed as one of the core income generating activities (**CIGAs**) relating to “distribution and service centre business” under the Act. As a matter of construction, some industry practitioners were of the view that any relevant entity providing CA Services would likely be providing “services to foreign affiliates in connection with the business” within the meaning of the previous definition. The Amendment Act now makes it clear that “distribution and service centre business” includes the provision of CA Services to foreign affiliates.
- Limited partnerships without legal personality. Initially, the definition of “limited partnership” under the Act excluded limited partnerships without legal personality. The Amendment Act removes that exclusion such that every limited partnership, with or without legal personality, is now subject to the ES regime.
- Financial periods for limited partnerships without legal personality. Following the introduction of the Amendment Act, there is now a six-month transition period for limited partnerships without legal personality which were formed prior to 1 July 2021 (**Pre-Existing LPs**). Limited partnerships without legal personality formed on or after 1 July 2021 (**New LPs**) will be immediately subject to the Act upon formation as is already the case with other relevant entities. The “financial period” for Pre-Existing LPs and New LPs is:
  - **Pre-Existing LPs**: such period of one year commencing on a date no later than 1 January 2022 as the Pre-existing LP shall notify to the International Tax Authority (**ITA**) and thereafter each successive period of one year running from the end of that period;
  - **New LPs**: such period of not more than one year from the date of formation as the New LP shall notify to the ITA and thereafter each successive period of one year running from the end of that period.

## Investment fund business

Prior to the introduction of the Amendment Act, only the Rules on Economic Substance in the Virgin Islands (the **Rules**) contained any express indication that the business of being an investment fund did not itself comprise a “relevant activity”. The ITA based its conclusion on the exhaustive list of “relevant activities” under the Act, which did not include investment fund business. The Amendment Act now expressly provides that investment fund business is not a “relevant activity”. Accordingly, an entity that only carries on investment fund business will not be required to comply with any of the ES requirements.

### *What is investment fund business?*

The Amendment Act introduces a definition of “investment fund” as “...an entity whose principal business is the issuing of investment interests to raise funds or pool investor funds with the aim of enabling a holder of such an investment interest to benefit from the profits or gains from the entity’s acquisition, holding, management or disposal of investments and includes any entity through which an investment fund directly or indirectly invests or operates (but not an entity that is itself the ultimate investment held), but does not include a person licenced under the Banks and Trust Companies Act, 1990 or the Insurance Act, 2008, or a person registered under the Cooperatives Societies Act 1979 or the Friendly Societies Act 1928.”

The Amendment Act then defines “investment fund business” as “the business of operating an investment fund”.

The definition of “investment fund” does not make a distinction as between redeemable or non-redeemable interests. As such, it likely includes both open-ended and closed-end investment funds.

Based on our interpretation of the Amendment Act, the following entities might meet the definition of “investment fund”:

- (i) Mutual funds recognised as such by the Financial Services Commission (including incubator and approved funds)
- (ii) Closed-end funds recognised under the private investment fund regime
- (iii) A master fund, being an entity through which an investment fund directly or indirectly invests

It is likely that that the ITA will provide guidance as to which entities or categories of entities might meet the definition of an “investment fund”. Until then, any relevant entity claiming not to be carrying on a “relevant activity” on the basis that it is an investment fund should consult with their BVI counsel to determine whether the entity is indeed carrying on the business of an investment fund in respect of any relevant financial period.

### *Core income generating activities and winding up*

- Core income generating activities (CIGAs). The Act sets out a list of CIGAs for each “relevant activity”. Following the introduction of the Amendment Act, CIGA now also encompasses “all the activities that are of central importance to the relevant entity in terms of generating relevant income and must be carried on in the Virgin Islands”. The ITA had already indicated in the Rules that the specified CIGAs for each “relevant activity” are not confined to those specified activities and that what constitutes the

CIGA of a particular activity requires a fact-sensitive analysis in each case. With the new gloss on the definition of CIGA, entities carrying on a relevant activity, other than holding business, might wish to conduct a more structured analysis to pinpoint all activities that generated relevant income for the entity for the financial period under consideration and then determine whether those activities were conducted in the BVI for that period as required by the Act.

- Winding up. Given the pending changes to the strike off regime, instead of the ITA seeking for the entity to be struck off under the Act, the ITA will now be seeking for the entity to be wound up in cases where it determines that this is an appropriate enforcement action for any breach of the Act.

### What should I be doing now?

Pre-Existing LPs should now be looking to undergo a classification exercise to determine whether the entity is within the scope of the ES requirements. Entities claiming to be conducting only investment fund business and which would accordingly not be required to comply with any of the ES requirements, should also seek legal advice to confirm their status.

If you need further information or any assistance with classification of your entity for the purposes of the Act, particularly in light of the introduction of the Amendment Act, please feel free to contact us.

### Contact Us

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