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## NEWSLETTER

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### COMMERCIAL UPDATE



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## Economic Substance Legislation in the British Virgin Islands, Cayman Islands and other Offshore Jurisdictions

On 1st January 2019, key offshore jurisdictions including the British Virgin Islands, Cayman Islands, Bermuda, Guernsey, Isle of Man and Jersey enacted new economic substance laws and regulations, which require entities to demonstrate that they have maintained adequate economic substance in the jurisdiction.

This reform was initiated by the European Union (EU) which has in recent years stepped up in bringing these offshore jurisdictions with low tax or preferential tax regimes in line with the EU's "fair taxation" principle that "a jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction".

### I. SCOPE OF APPLICATION

While the scope of the new economic substance laws and regulations vary in different offshore jurisdictions, in general, the scope is wide and encompasses all limited partnerships and companies of that jurisdiction which carry on any of the "relevant business activities". "Relevant business activities" are also broadly defined to include banking, insurance, fund management, finance and leasing, headquarters, shipping, holding, intellectual property, distribution and service centre businesses. It should be noted that while entities which do not carry on a relevant activity are generally not subject to the economic substance requirements, they may still be subject to other obligations, for example the reporting obligations under the relevant BVI economic substance laws and regulations.

### II. EXCEPTIONS

As mentioned above, if a company can demonstrate that they are a tax-resident in another jurisdiction, they may be exempted from the economic substance requirements under the new laws and regulations.

Further, pure investment holding company or passive equity holding company, which solely holds equity in other entities for dividends earnings and capital gains are exempted from the economic substance requirements or are subject to a reduced level of requirements. However, it should be noted that investment fund management business is distinguished from pure investment holding or passive equity holding business. Fund management is a relevant business activity and the entity carrying on such activity is subject to the economic substance requirements.

### III. THE REQUIREMENTS

#### 1. The Economic Substance Requirements

The new laws and regulations across the various offshore jurisdictions generally require entities which fall under the scope of the laws and regulations to conduct the relevant business activities within the jurisdiction.

In particular, the following main criteria shall be met to comply with the economic substance requirements:

- (i) the core income generating activities of the entity at issue shall be directed and managed in the offshore jurisdiction;
- (ii) the entity shall employ an adequate number of qualified employees who are physically present in the offshore jurisdiction;
- (iii) the entity shall incur an adequate expenditure in the offshore jurisdiction; and
- (iv) the entity shall maintain physical offices or premises as may be appropriate for the core income-generating activities.

#### 2. The Reporting Obligations

There are also requirements for entities to file their economic substance information annually with the applicable authority in the offshore jurisdiction for the authority to assess whether the entities comply with the economic substance requirements.

Further, while entities which are not tax resident of an offshore jurisdiction are generally exempted from the economic substance requirement of that jurisdiction, they are still required to notify the relevant authority details of the jurisdiction where they are tax resident.

#### 3. Timeline

A six-month transitional period is allowed for existing entities to fulfil the economic substance requirements. Given that the new laws and regulations were effective in the British Virgin Islands, Cayman Islands, Bermuda, Guernsey, Isle of Man and Jersey on the same day on 1st January 2019, entities which were in existence on 1st January 2019 shall demonstrate economic substance no later than 30th June 2019. Reporting obligations shall also be met within one year from that date, i.e. 30th June 2020.

On the other hand, new entities incorporated after 1st January 2019 are required to comply with the economic substance requirements immediately and meet the reporting obligations within one year from the date of incorporation.

### IV. WAYS FORWARD

In view of the new economic substance laws and regulations enacted, enterprises and individuals investing in such offshore jurisdictions are advised to promptly review if their offshore entities fall within the ambit of the new laws and regulations. If yes, further steps shall be taken to ascertain whether the economic substance requirements are met and if structural and/or operational changes in the entities are required.

Further, given that the EU will be reviewing the new economic substance laws and regulations enacted by the offshore jurisdictions to determine if the EU's "fair taxation" principles are met, further amendments to the relevant laws and regulations may be made. Investors are advised to closely monitor any further changes to the requirements.