

British Virgin Islands Economic Substance Requirements – 'Relevant Activity' of 'Distribution and Service Centre 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 'distribution and service centre business' category.

What is 'Distribution and Service Centre Business'?

'Distribution and service centre business' in the Economic Substance Act is defined to mean the business of either or both of the following:

- (a) purchasing from foreign affiliates;
 - (i) component parts or materials for goods; or
 - (ii) goods ready for sale; and
 - (iii) reselling such component parts, materials or goods;

- (b) providing services to foreign affiliates in connection with the business,

but does not include any activity included in any other relevant activity except holding business.

'Affiliate' is defined in section 2 of the Economic Substance Act as having the same meaning as an 'affiliated company' specified in regulation 2(2) of the BVI Business Companies Regulations, 2012, which in turn provides (at Regulation 2(2)) that a company is affiliated with another company if it is in the same group as the other company. In addition, references to a company include references to a limited partnership, and other expressions appropriate to companies are construed as including references to the corresponding persons, documents or organs, as the case may be, appropriate to limited partnerships.

Economic Substance Test

If a 'legal entity' **only** carries on a 'relevant activity' that is a 'distribution and service centre 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 'distribution and service centre business' if the 'legal entity' ensures that:

- (a) the 'distribution and service centre business' is directed and managed in the British Virgin Islands;

- (b) having regard to the nature and scale of the 'distribution and service centre 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 'distribution and service centre business'); and
- (c) the legal entity conducts core income-generating activity in the British Virgin Islands as described below in the context of 'distribution and service centre 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 that 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.

British Virgin Islands Core Income Generating Activities

The relevant British Virgin Islands core income generating activities in the context of 'distribution and service centre business' include:

- (a) transporting and storing goods;
- (b) managing stocks;
- (c) taking orders;
- (d) providing consulting or other administrative services.

The Guidance on 'Distribution and Service Centre Business'

The Guidance contains some additional sector specific provisions in respect of 'distribution and service centre business'. It provides that for an entity to carry on distribution and service centre business it must have a business which consists of purchasing assets from other entities in the same group, and / or a business providing services to entities in the same group. The affiliates in question must be 'foreign' – that is to say an affiliate which is an entity which is not a legal entity for the purposes of the legislation.

The Guidance provides that the purpose behind this category of relevant activity is to prevent the use of legal entities paying zero tax in the British

Virgin Islands from extracting profits from entities in other jurisdictions, which might be paying substantial tax on their profits.

The Guidance clarifies that the following do not constitute distribution and service centre business:

- (a) the business of purchasing and reselling assets from, or providing services to, entities in the same group both of which are located in the British Virgin Islands;
- (b) the business of purchasing and reselling assets from, or providing services to, entities that are not part of the same group as the entity carrying on the business, even if located outside the British Virgin Islands; or
- (c) occasional transactions within the description that do not form part of a business, but are undertaken ancillary to a different business.

Further, the Guidance provides that transactions that fall within any other type of relevant activity, as well as being capable of being distribution and service centre business, will be treated as falling within that other activity, and will not be treated as distribution and service centre business. Thus, for example, the provision, by way of business, of banking, insurance or shipping services to foreign affiliates will be treated as banking, insurance or shipping business, not distribution and service centre business. The exception to this rule is where the other type of relevant activity is holding company business.

What to do if a Legal Entity is Carrying on the 'Relevant Activity' of 'Distribution and Service Centre 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 'distribution and service centre 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
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