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Delegations will find attached the declassified version of the above document.

The text of this document is identical to the previous version.

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NOTE

From:	Commission Services
To:	Code of Conduct Group (Business Taxation)
Subject:	The EU list of non-cooperative jurisdictions for tax purposes – Progress Report - British Virgin Islands

Delegations will find attached a document by the Commission services.

ANNEX

PROGRESS REPORT - THE BRITISH VIRGIN ISLANDS

Code of conduct subgroup – 25 January 2019

Background

The Code of Conduct Group (the COCG) found that the British Virgin Islands' (the "BVI") tax system failed to meet listing criterion 2.2 because of a lack of substance requirements. The BVI were put on Annex II in March 2018[1] following their commitment to remedy the deficiencies identified.

This report assesses the overall implementation of the commitments undertaken by the BVI.

The dialogue with the BVI on the introduction of substance requirements was constant and constructive with several conference calls and meetings on which the Commission Services reported regularly to Member States. The BVI shared draft legislation and sought feedback from the COCG.

Assessment of the BVI implementation of commitment under criterion 2.2

This assessment is based on the Terms of Reference (the "TOR") agreed by the Code of Conduct Group in July 2017 which is the basis for the decision taken by Member States on the compliance of jurisdictions under criterion 2.2, as further clarified in the Scoping Paper (the "2.2 SP") agreed in June 2018.

The Economic Substance (Companies and Limited Partnerships) Act, 2018 was approved by the House of Assembly on 19 December and came into force on 1 January 2019.

A Guidance Note No. 1 by the Internal Tax Authority was also published in December 2018, which incorporates an explanatory memorandum of the Act.

The following assessment only highlights the remaining issues identified and still pending following the last progress reports presented to the COCG.

[1] The process was put on hold until February 2018 for jurisdictions that were affected by the hurricanes in 2017.

On 26 January, the BVI have sent a letter to the Chair of the Code of Conduct presenting some amendments that were recently passed in the legislation to ensure consistency with the EU requirements. We have checked these amendments and no issues were identified as they mostly consist in clarifications, stronger wording in line with Member States' expectations and some typological errors.

However, in the same document, the BVI are requesting an extended transitional period for entities that existed before 1 January 2019. This request is based on the "Approach to review of substantial activities requirements for no or only nominal tax jurisdictions" paper of the FHTP that was discussed at the January FHTP meeting. From the FHTP document, existing entities will be allowed a transition period until 30 June 2021. On the contrary, the Scoping paper only allows for a six-month transition period for existing entities.

The BVI emphasizes that a longer transitional period would reduce the risk that existing entities would mount legal challenges to enforcement action taken by the competent authority because they had not had a reasonable time to adjust their activities. If such challenges were successful, they could damage the credibility of the entire economic substance regime.

Suggested way forward

Based on the Scoping Paper, the Commission services consistently asked jurisdictions to implement in their legislation and can only suggest refusing this longer transitional period.

However, if Member States decide to align with the FHTP standard, this decision should be taken horizontally by Member States for all 2.2 jurisdictions that would need to be informed equally. Granting a specific jurisdiction a longer transitional period without allowing all jurisdiction to benefit from the same would alter the level playing field amongst 2.2 jurisdictions.

1 – Identification of the relevant activities and included entities

1.1 – On relevant activities

a) Geographical limitation for relevant activities to be in scope

Following the December meeting, the Commission services reported to the BVI that there should be no limitation, in Section 5 on the scope of substance requirements, for relevant activities as to where included entities carry out those activities (in or from within the BVI).

The BVI have revised their drafting that no longer limits economic substance requirements to relevant activities carried out in the BVI.

Suggested way forward

We suggest concluding that this issue is settled.

b) Need for detail on direction and management in the BVI

Following the December meeting, the Commission services reported that there was a need to clarify Section 8 of the Act on evidencing of direction and management in the BVI.

In the Guidance No. 1, para. 22, the ITA provides clarification on evidencing of management and direction in the BVI for entities carrying out relevant activities other than pure equity holding activity. There must be an adequate number of board meetings held in the BVI with a quorum of directors physically present in the BVI including adequate expertise to direct the relevant activity. The decisions of the board regarding the relevant activity must be minuted and minutes of those decisions must be kept in the BVI.

Suggested way forward

We suggest concluding that this issue is settled.

1.2 – On included entities

Following the December meeting, the Commission services asked the BVI for further clarification on the partnerships included in the legislation on substance.

The Act introduces substance requirements for companies (including foreign companies registered in the BVI) and limited partnerships (including foreign limited partnerships registered in the BVI) carrying on relevant activities.

The BVI have not provided a note on other partnerships existing in their legislation. However, from publicly available information, it appears that there would be only general partnerships and limited partnerships (including local and international partnerships).

The Act provides that partnerships will not be included in the scope of substance requirements if the partners opted that the partnership does not have legal personality. This is equivalent to what other jurisdictions have chosen and should be monitored for Member States to decide in the coming months whether those entities should also be added to the scope of substance requirements.

Suggested way forward

We suggest concluding that this issue is clarified and that the risk of BEPS should be limited. It however needs to be monitored whether, in the coming month, it is considered necessary to include all partnerships in the scope of substance requirements.

2 - Imposition of substance requirements

2.1 – Income threshold

The final Act does not exclude entities based on income threshold.

Suggested way forward

We suggest concluding that this issue is settled.

2.2 – Tax residence

In Section 2 of the Act, the BVI exclude from the scope of substance requirements companies that are tax residents in another jurisdiction, which is not on Annex I of the EU list of non-cooperative jurisdictions for tax purposes.

The Guidance No.1 provides that if an entity considers it is tax resident outside the BVI in a jurisdiction that is not on Annex I, it has to claim that exemption by proving to the satisfaction of the ITA that it is tax resident in the jurisdiction it claims to be. It is further mentioned that such a legal entity will need to consider how it will be able to meet this evidential requirement.

The Schedule to the Act modifies the reporting requirements[2] to mention that amongst the information to be reported to the Authority, entities claiming to be tax resident in another jurisdiction should file (i) information on the jurisdiction in which they are tax resident and (ii) evidence to support that tax residence.

In the Act nor in the Guidance, there is no specific requirement as to what type of evidencing will be accepted by the ITA.

In addition, it is provided that all information stored in the database for a legal entity claiming to be tax resident in another jurisdiction will be exchanged with the jurisdiction of the beneficial owner, parent entity, in which the entity is registered or within which the entity claims to be tax resident.

Although the evidencing of tax residence is not detailed, this issue relates to the evaluation of the efficient enforcement of the substance legislation, which should be monitored in the coming years.

Suggested way forward

We suggest concluding that this issue is settled subject to future monitoring of the enforcement of the substance legislation.

[2] Beneficial ownership secure search system Act 2017 (the « BOSS Act »)

2.3 – Specific CIGAs for IP assets

Following the December meeting, the Commission services reported to the BVI that there should be a direct link between the type of IP assets and the main CIGAs that should be carried out in the BVI.

The BVI have redrafted Section 7 of the Act to make a direct link between patents and the main CIGA that should be R&D. For non-trade intangible assets such as brand, trademark and customer data, the main CIGAs should be marketing, branding and distribution.

Suggested way forward

We suggest concluding that this issue is settled.

2.4 – CIGAs in or from within the jurisdiction

Following the December meeting, the Commission services reported that it should be clarified that CIGAs should be carried out in the BVI.

The final legislation does not refer anymore to the wording "from within". However, no clear link between the CIGAs and the BVI was made instead. The wording of Section 8(c) provides that:

"(...) a legal entity complies with the economic substance requirements if:

(...) (c) the legal entity conducts core income generating activity".

However, the Guidance No.1 para. 9 clarifies that an entity carrying on one or more relevant activities "*will have to carry out the core income generating activities which relate to the activity within the BVI*".

Section 8 read in conjunction with the Guidance makes a geographical link between CIGAs that have to be performed and the BVI.

Suggested way forward

We suggest concluding that this issue is settled.

2.5 – Outsourcing safeguards

In a previous drafting of their legislation, the BVI had proposed the following safeguards:

- Outsourcing of CIGAs can only take place in the BVI;
- Only the part of the activities of the service provider that is attributable to generating income for the relevant entity shall be taken into account for substance requirements;
- The entity must be able to monitor and control the activity of the service provider.

Following negative feedback after the December meeting, the Commission services asked the BVI to ensure that when taking into account the part of the activities of the service provider linked to the generation of income for the primary entity, it should be clearly ensured that (i) there will be no double counting of resources of service providers and (ii) the information filed on outsourcing will be part of the spontaneous exchange of information.

The new wording of Section 8(d) provides that:

"*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 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*".

In our view, this wording should allow to make sure there will be no double counting of the resources of the service providers amongst several legal entities. In addition, the Schedule to the Act provides that the entity will have to file information on the name of the entity, which carries out an activity on its behalf together with the details of the resources deployed by that entity in carrying out the activity on its behalf. This information will be part of the information exchanged with the relevant Member States.

Moreover, the Guidance No1 para. 19 to 21 provides additional interpretation on outsourcing. It is clarified that the ITA will ensure that the safeguards are complied with because outsourcing constitutes a potential source of abuse. The Guidance further specifies that "*abuse can occur where the expenditure, employees and premises of the contractor are counted towards the economic substance of more than one legal entity as regards any relevant activity*". Substance of the service provider can only be used to support substance of the relevant entity to the extent that the expenditure, employees and premises of the contractor have actually been used for that purpose. It is specifically mentioned that "where the contractor does work for more than one legal entity records must be kept to ensure that its work can be attributed to each of the legal entities in question. Legal entities need to bear in mind the need to produce this evidence when agreeing terms with any outsourcing contractor".

In our view, the requirements in the Act together with the clarification in the Guidance provides for an appropriate framework of safeguards as expected by Member States.

Suggested way forward

We suggest concluding that this issue is settled.

2.6 – <u>Other CIGA issues</u>

a) Presumption of non-compliance in high-risk IP scenarios

In a previous drafting of the Act, in high-risk IP scenarios, the presumption of non-compliance is only applicable when an entity does not carry out R&D, marketing, branding or distribution activities.

Following the December meeting, the Commission services reported that in high-risk scenarios, the presumption should apply from the beginning, whatever activities are carried out by the entity.

Section 9 of the final Act introduces a presumption of non-compliance in high-risk scenarios in all cases, whether or not R&D, marketing, branding or distribution activities are carried out by the entity.

Suggested way forward

We suggest concluding that this issue is settled.

b) Holding companies

In a previous drafting, the BVI had included specific requirements for pure equity holding companies but suppressed reference to other holding companies that may carry on relevant activities and should fulfil substance requirements.

Following the December meeting, the Commission services reported to the BVI that such entities should be covered by the substance requirements.

New Section 9 provides that minimum substance requirements are only applicable to pure equity holding entity "which carries on no relevant activity other than holding equity participations in other entities and earning dividends and capital gains". Under Section 5, a legal entity that carries on one or more relevant activity should comply with economic substance requirements.

In our view, this should properly cover the holding with various activities.

Suggested way forward

We suggest concluding that this issue is settled.

2.7 – <u>Date of application of the legislation</u>

The previous wording of the Act created confusion as to the date from when entities will have to comply with substance requirements based on the end of financial years.

Reference is now made in the Act to financial years starting on or after 1 January 2019 for new entities and to financial years starting no later than 30 June 2019 for other entities. In our view, that clarifies the date of application of the substance requirements.

Suggested way forward

We suggest concluding that this issue is settled.

3 – Enforcement and sanctions

Following the last COCG meeting, we have raised the issue of the sanctions framework not being dissuasive enough as the level of sanctions starts quite low and only states a maximum amount (no minimum or fixed amount) and the striking off is never considered as being mandatory for the authorities. The deadline for the implementation of recommendations in the written notices is still not specified.

The Guidance clarifies that in clear cases, the ITA may move straight from determination of non-compliance to striking-off the entity.

Suggested way forward

We suggest concluding that this issue is settled and that the evaluation of the efficient enforcement of the substance legislation is subject to monitoring in the upcoming years.

Conclusion

We propose to conclude that the BVI have implemented their commitment under criterion 2.2 and to remove them from Annex II.