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Offshore Jurisdictions Continue to Respond to International Pressures – June 2023

New BVI Accounting Requirements

Due to changes to the BVI Business Companies Act, BVI holding companies are subject to enhanced reporting requirements, as of this past January. This will include filing unaudited financial statements annually with their Registered Agent in the BVI.

Background

The OECD began initiatives in the late 1990s, addressing tax avoidance practices of multi-national companies and some wealthy families. Many of these practices are legal schemes, taking advantage of gaps created because different tax systems treat certain types of transactions differently. However, due to a lack of transparency and reporting it is very difficult for national tax authorities to figure out which are legal and which are not.

In 2013, a 15-point Action Plan was adopted by the OECD, intended to create greater transparency and a better alignment amongst domestic tax regimes, especially with respect to income-producing activity that is geographically mobile.

High in importance was identifying where entities actually conducted their income (wealth) producing activities → thus *Action 5*, or the new *economic substance* rules now applied by most offshore jurisdictions.

To enhance information sharing between tax authorities, the Common Reporting Standard (CRS) was introduced in mid-2014. By 2018 most “offshore” jurisdictions had signed up to CRS.

Another initiative is the so-called BEPS program where a greater attempt to match sales with declared taxable income across countries in which a company operates.

International pressures, led by the EU, for a flatter playing field have resulted in additional amendments in domestic tax regimes. Hong Kong recently made rather remarkable changes to how it taxes capital gains and has promised additional tinkering next year.

Those pressures have also led jurisdictions, such as BVI, to enhance transparency and income reporting.

Details

BVI-registered companies without meaningful operations in the BVI will be required to submit a balance sheet and profit and loss statement within nine months of their financial year-end. For a typical family-owned investment company with a December 31 year-end, this will mean the first filing is due Sept 30, 2024.

This information will not automatically be passed along to any BVI authority unless the Registered Agent is requested to provide it, and it will not be made public. However, if you fail to file the annual statements with your Registered Agent, the Agent is required to notify government authorities.

There have been enquiries about how to prepare a starting balance sheet when historical records are not adequate (as financial statements for many of these companies may be nothing more than periodic statements from private banks over the years).

The guidance from the regulations is a little vague and as far as we know, the format for the Annual Financial Return is still being developed.

The general commentary assessment is that this financial information does not necessarily need to conform to IFRS. Some firms are advising that for purposes of the starting balance sheet, owners assume that all retained profits have been flushed through as dividends. For pass-through entities, that may be helpful. It is not as straightforward for those companies holding investment assets that reflect realised and unrealised gains over the years.

However, most accounting firms tend to want to do things properly and are not going to produce weak statements, even if they do not have to provide an audit opinion.

Practical Impacts

Changes in reporting by Offshore Jurisdiction might be intended to demonstrate compliance with EU expectations without actually contributing much to international tax compliance and transparency. However, even this might be prophylactic in nature, as companies will not know if or when their records are going to be accessed by authorities in a tax dispute --- since authorities are aware those records are out there.

So, it would make sense, even if your tax planning is rather aggressive, to be thinking through now how you plan to produce these financial returns and convince yourself that you are prepared to stand behind them with documentary proof should you ever be called upon.

It also presents an opportunity to reassess why you even have these offshore holding companies. Some

families are responding by simplifying their holdings, by moving assets into a fewer number of companies.

If there were valid planning reasons to have the separate holding vehicles, then this may be an unfortunate development.

However, when asked why they are using an Offshore company to hold their investment account, some do not have a persuasive explanation. Some do not remember, other than a vague recollection that a financial advisor once recommended it.

There has been a risk that securities issued by U.S. companies and held personally could become subject to US estate tax. Unfortunately, the very high exemption limits available to U.S. families are not necessarily available to non-U.S. persons, which causes concerns.

The easy protection was a BVI company. They were once cheap to incorporate and maintain, because it was easier to open and maintain bank and custody accounts in the company's name.

Much has changed in the past 10 years. Banks are no longer eager to maintain inactive company bank accounts. Agent's fees have slowly increased along with responsibilities. Many custody banks are becoming less comfortable with offshore jurisdictions.

And now, you have the Economic Substance filings, which can be complicated, encouraging some to seek professional assistance. These Annual Financial Reports will almost certainly require professional assistance to prepare if you are not a well-staffed Family Office.

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