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US Virgin Islands: Trends & Developments
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US VIRGIN ISLANDS

Trends and Developments

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Overview

The United States Virgin Islands (USVI) offers unique opportunities for private wealth planning for US citizens and tax residents through its economic development programmes that focus in large part on providing tax incentives to family offices, investment managers and advisers, and businesses engaged in venture capital management and investments as well as investment banking and financial services. The USVI also provides significant benefits for non-US citizens who have substantial assets outside the USA but seek to obtain US citizenship. By becoming naturalised in the USVI, new US citizens can structure their holdings to avoid US estate and gift tax on any non-US situs assets, including the assets they held at the time of naturalisation. Finally, the USVI is the only US jurisdiction where foreign shareholders can set up exempt companies to hold their assets worldwide and obtain tax exemptions on all the income earned from investments (other than income from US sources) while obtaining the benefits of the US flag, US investment treaty network, and US banking system. This article will discuss each of the benefits in turn after providing a brief background on the USVI.

Background and Tax System Overview

The USVI is an unincorporated territory of the USA located approximately 1,100 miles southeast of Miami, Florida. Acquired from Denmark in 1917, the USVI is made up of the islands of St Croix, St John, St Thomas and Water Island, along with numerous uninhabited cays, with a total population of just over 90,000. The USVI uses US currency, and no exchange controls exist.

The USVI's prime natural resources include pristine beaches, crystal-clear seas, a mild year-round climate, the natural harbour on St Thomas, the Virgin Islands National Park on St John, and the rainforest on St Croix. These assets, combined with the investment security of a US jurisdiction and a variety of federal and local incentives, have cemented tourism as the major local economic activity.

Beyond tourism, the USVI is the location for a growing number of family office and investment-focused businesses owned by entrepreneurs who want to live and work in paradise. In 2020 the USVI completed a long-term economic strategy and action plan (Vision 2040) with goals that include diversifying the territory's economic base through growth in target industries, including professional/technological services, coastal/ocean resources, renewable energy, health, research & development, and a variety of other industries related to innovative small businesses and fast-growing technology-based firms.

The USVI also offers banks that are FDIC insured and the USVI is covered by the US' extensive network of bilateral investment treaties (but not tax treaties). The USVI has two federal judges and is part of the Third Circuit Court of Appeals. It has direct flights to many mainland cities and attracts many yachts seeking a secure, well-located home base.

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The Internal Revenue Code of 1986 (the Code) applies in the USVI under a "mirror" system whereby the "USVI" is effectively substituted for "United States" wherever the latter appears. The income tax provisions of the Code, the Treasury Regulations promulgated thereunder, and revenue rulings and revenue procedures issued by the Internal Revenue Service are generally applicable in the USVI, with certain limitations.

As a US territory, the USVI occupies a unique status: although it is part of the USA, it has been granted authority by the US Congress to enact special tax laws to encourage investment in business operations. The USVI offers many opportunities for investors who seek a politically stable, low-tax jurisdiction, legitimate protection of their assets from taxes, and an enticing location with excellent telecommunications.

Benefits for Family Offices, Investment Managers, Venture Capital Management, and Investment Banking and Similar Businesses

Overview of USVI economic incentive programmes

The infrastructure to support family offices and investment and consulting businesses in the USVI has largely been in place since 1986 through the Economic Development Authority (EDA) and its various investment programmes and their predecessors. The Economic Development Commission (EDC) programme, administered by the EDA's seven-member Board, offers exemptions and reductions to entities qualified as EDC beneficiaries, and reductions to direct and indirect owners of entities qualified as EDC beneficiaries if the owners are bona fide residents of the USVI.

Businesses can also qualify for tax incentives under the Research and Technology Park (RTPark) programme, which seeks to support the USVI's expanding technology and knowledge-based sectors to promote the growth, development and diversification of the USVI economy. In addition, the RTPark works to broaden the capabilities of the University of the Virgin Islands (UVI) by providing it with financial support and training opportunities for UVI students and creating a supportive research environment that combines the resources of UVI with those of the public sector and private industry. Oversight of the RTPark programme is vested in the seven-member RTPark Board of Directors (the Board), which is vested with the authority to review and approve or disapprove applications by potential beneficiaries, referred to under the RTPark programme as "Protected Cells".

The RTPark programme is ideal for applicants engaged in energy and research and system development, business process outsourcing, and financial technology, especially where technological resources are critical elements. By way of illustration, RTPark beneficiaries currently operate in such areas as data analytics, e-commerce, software development and licensing, technology-based management and business process services, internet advertising, telecommunications and information technology, and financial technology and medical device technology.

Tax benefits

Benefits under the EDC and RTPark programmes include a credit equal to 90% of the otherwise applicable income tax, which applies to the income from the benefitted business and to the USVI resident owners on their allocations or dividends. A USVI corporation pays an effective tax rate of approximately 23.1% on its eligible income, and with the 90% tax credit the effective rate is 2.31%. (Salaries and other forms of compensation such as guaranteed payments are fully taxable.)

Beneficiaries are also exempt from the territory's 5% tax on gross receipts, and from USVI property tax for the property occupied by the beneficiary for its approved business activities. No withholding tax is imposed on payments to US corporations or US-resident individuals. Beneficiary companies with foreign owners are exempt from withholding tax on interest payments and are subject to a reduced withholding tax rate of 4.4% on dividend payments overseas. Similarly, no income tax is withheld on interest paid to non-resident individuals, and the tax rate on dividends paid to non-resident individuals is 4%. A beneficiary's customs duties are reduced from 6% to 1% on raw materials and component parts imported from outside the USA. No local customs duties are imposed on US-made products.

EDC programme requirements

To qualify under the EDC programme, an applicant in a qualifying business must make a minimum capital investment of USD100,000 and meet certain employment requirements. A designated service business, such as financial or consulting firms serving clients outside the USVI, is required to employ five full-time employees, and the EDA has the authority to lower the five-employee minimum or permit a business to have several years to meet the five-employee minimum upon evidence of good cause.

80% of the beneficiary's employees must be USVI residents unless a waiver is granted. Beneficiaries must purchase goods and services locally when available, make certain contributions to scholarships and public education, and provide a plan for civic participation. Beneficiaries must also provide employee benefits and a management training programme.

The application process requires a detailed application including details of the beneficiary's ownership, financial information and a background check for beneficial owners with more than a 5% interest. Submission of the application is followed by the application's presentation at a public hearing before the EDC commissioners and a review by the EDC commissioners.

Upon approval by the EDC, benefits are available for initial periods of 20 years for investments on the islands of St Thomas and St John, and for 30 years on St Croix. Beneficiaries that make an additional investment in the beneficiary business in infrastructure, new construction, or refurbishment in an aggregate amount of not less than USD2,500,000 during the term of their existing certificates are entitled to 100% of existing benefits for an additional period of five years upon the expiration of their certificates. Beneficiaries that invest in infrastructure, new construction, or refurbishment in an aggregate amount of not less than USD 1,000,000 may be granted 100% of their existing benefits for an additional five years upon the expiration of their certificates. Also, prior to the expiration of a benefits term, a beneficiary may seek an extension of 100% of benefits for an additional ten years.

RTPark programme requirements

In most cases, an applicant, through a legal representative, negotiates the terms of its tenancy with RTPark's executive director. Negotiations include the amount of the one-time entry fee paid by the applicant (typically at least USD50,000 and up to USD100,000 depending on the size of the applicant), the applicant's obligation to pay annual management fees to the RTPark (typically between 2% and 4.5% of the applicant's gross income), the structuring of a charitable donation to UVI that can include scholarships, internships, faculty support, funds for specific programmes and in-kind contributions of time, and the percentage and characteristics of an of equity interest to be awarded to the RTPark. The payments are based on the applicant's projected revenues.

Once negotiations have been finalised, an agreement is entered into between the applicant and the RTPark providing the basis for the formal application that covers the applicant and its owners. After the application is submitted, the RTPark conducts a due diligence review. Each RTPark application requires a USD2,500 application fee.

Benefits under the RTPark programme are initially available for 15 years and can be renewed for an initial renewal period of ten years, followed by subsequent renewal periods of five years, subject to Board approval.

Legal requirements for tax incentives

The USVI can grant tax benefits on any USVI source income and on certain income that is effectively connected with a USVI business such as non-US source dividends, interest, and royalties. USVI source income includes fee income for services performed in the USVI. Capital gains derived by a USVI business may also be eligible if certain requirements are met.

Benefits for Persons who are Naturalised in the USVI

General rule

The Code imposes estate taxes on the value of estates of US citizen decedents and taxes on gifts, defined as the transfer for less than fair value. Persons who obtain their US citizenship by reasons of their birth or naturalisation in the USVI are treated for US estate and gift tax purposes as non-citizens not resident in the USA when they are resident in one of the possessions at the time a gift is made or are domiciled in one of the possessions at the time of death.

Specifically, Section 2209 of the Code provides that a person who acquires US citizenship solely by reason of (1) being a citizen of a US possession, or (2) birth or residence within such possession, is treated as a non-resident not a citizen of the USA if he or she resides in a possession at the time of death. Under Section 2501(c), a person meeting these requirements is treated as a non-resident for federal gift tax purposes if he or she resides in a possession at the time of making the gift.

Non-residents taxable on certain US situs assets

The gross estate of a decedent is determined in the same manner as the gross estate of a US citizen or resident, no matter where the property is located. However, only the part of the gross estate located in the USA (ie, the 50 states and the District of Colombia) is subject to the tax under Section 2103 of the Code.

Federal estate tax rates for non-resident non-citizens are the same as for citizens, but a special credit applies

The estate tax must first be computed, but only in respect of US situs assets, and then reduced by certain credits. For a non-resident non-citizen who resides in a US possession and was a US citizen because of birth, residence, or citizenship in the possession, Section 2102(c) of the Code provides that the taxpayer's estate qualifies for a credit that is the greater of USD13,000 or USD46,800 multiplied by the ratio that the value, at death, bears to the value of the decedent's gross estate.

For gifts made by non-residents, non-citizens, the federal gift tax applies to a transfer only if the property is situated in the USA, pursuant to Section 2511(a) of the Code. For such gifts, the USD16,000 annual exclusion (2022) provisions apply.

A person seeking a Green Card leading to US citizenship under the EB-5 Programme can invest in the USVI as an immigrant investor

The EB-5 Programme requires a USD800,000 investment for a Targeted Employment Area, which the USVI is. The US Senate approved a reauthorisation of the EB-5 Regional Centre Programme on 10 March 2022 as part of the FY 2022 Consolidated Appropriations Bill. President Biden signed the bill on 15 March 2022.

A single new commercial enterprise may be used for investor/employment-creation classification by more than one investor, provided each petitioning investor has invested the required amount, and each investment results in the creation of at least ten full-time positions for qualifying employees. An alien investor, however, must maintain more than a passive role in the new enterprise.

An enterprise can qualify as a single new commercial enterprise in one of four ways. First, an investor can create an original business. Second, an investor can purchase and structure an existing business. Third, an investor can expand an existing business, thereby substantially changing the net worth or number of employees in a business. Finally, an investor can invest in a troubled business, so that there is a 40% change in net worth or number of employees.

A holding company and its wholly owned subsidiaries can also constitute a new commercial enterprise if each subsidiary is engaged in a for-profit activity formed for the ongoing conduct of a lawful business. The enteprise can also receive EDC tax benefits.

Naturalisation in the USVI requires residency in the USVI

Even if a person has acquired their permanent resident Green Card status through a means other than as an immigrant investor in the USVI, the person can apply for naturalisation in the USVI. The IRS has not specifically ruled on how long a person must reside in a possession in order to acquire citizenship "solely by residence within a US possession." To become naturalised in the USVI a person who has already attained permanent resident alien status must meet all the usual requirements for naturalisation in the USA and must reside in the USVI for at least three months preceding the filing of the application for naturalisation. The usual requirements for naturalisation are that the permanent resident alien must:

- have continuous residence in the USA for at least five years preceding the application;
- be physically present in the USA for at least one half of the time of continuous residence;
- reside continuously within the USA from the date the application is filed until the date of admission to citizenship; and
- be a person of good moral character.

A person who meets the above requirements may file his or her naturalisation petition with one of the USCIS offices in the USVI and become naturalised there once the application is approved.

"Residence" for the purposes of these naturalisation rules means a person's dwelling place in fact, without regard to intent. The duration of residence in a particular location begins from the moment it is established at that location. "Continuous residence" as used above does not necessarily mean continuous physical presence. At the time of submitting the application, or later, the applicant may be required to submit evidence of residence in the USVI for the three-month period preceding the application.

USVI law exempts USVI residents from inheritance and gift taxes

A resident of the USVI is exempt from USVI inheritance tax pursuant to Secition 5, Chapter 1, Title 33, Virgin Islands Code. Specifically, Section 5 provides that "an inheritance is exempt from the payment of inheritance taxes if the decedent, when living, would have been considered a 'non-resident not a citizen of the United States' under 26 U.S.C. Section 2501(c), or if the decedent was a resident of the Virgin Islands... at the time of his death."

Similarly, a USVI resident is exempt from USVI gift tax under Section 31, Chapter 2, Title 33, Virgin Islands Code. Section 31 provides that a "person is exempt from the payment of gift taxes... if that person is considered a 'non-resident not a citizen of the United States' under 26 U.S.C. Section 2501(c), or if the person was a resident of the Virgin Islands at the time the gift was made."

USVI Exempt Companies Provide Tax Benefits on Global Operations

The USVI's Exempt Company programme has been in place for approximately 35 years. Exempt entities offer the benefits of other offshore jurisdictions' international business companies but with the added advantages of US flag protection, access to US courts, and the ability to obtain an "N" registration number from the US Federal Aviation Administration (FAA) for foreign-owned aircraft.

Qualification requirements

There are five requirements to establish and maintain a USVI exempt company. Specifically, the exempt company must:

- not engage in active conduct of a trade or business in the USA;
- not engage in active conduct of a trade or business in the USVI (with three exceptions);
- comply with the stock ownership requirements set out in Section 934(b)(3)(B) of the Code, ie, less than 10% of the total voting power and total value of the corporation's stock can be owned by one or more US individuals or corporations;
- comply with the stock ownership requirements set out in the Virgin Islands Code; ie, less than 10% of the total voting power or the total value of an exempt company's stock can be owned by one or more USVI persons; and
- elect to be an exempt company at the time of incorporation either in its articles or through a separate election filed with the USVI Office of the Lieutenant Governor.

Elaborating on these requirements, the company must not engage in the active conduct of a trade or business in the USA. However, a USVI exempt company can be actively engaged in a trade or business anywhere else in the world. By way of example, a USVI exempt company can be the perfect entity for owning a factory in a newly industrialised nation, providing the investors with access to US courts for dispute resolution and protection from expropriation under the USA's expansive network of Treaties of Friendship, Commerce, and Navigation and Bilateral Investment Treaties.

Second, except for an exempt international insurer, an exempt international banking facility, or an exempt mutual fund, a USVI exempt company cannot engage in the active conduct of a trade or business in the USVI. Moreover, an exempt company can maintain one or more accounts in a USVI bank to invest its proceeds from its international operations and receive tax-free USVI source interest income.

Third, a USVI exempt company cannot be owned by US persons beyond the limits set out above. However, it can be owned by individuals or companies from any other country in the world. The US Congress authorised the USVI to eliminate the income tax liability of certain USVI companies in Section 934(b)(3) of the Code. Under this authorisation less than 10% of the total voting power and total value of a USVI company's stock can be owned by residents of the USA to receive the income tax exemption, and its income from US sources or from conducting a US trade or business cannot receive the tax exemption.

Fourth, up to 100% of the voting power of a USVI exempt company can be owned by a USVI trust if the beneficial interest of the exempt company's stock is more than 90% foreign-owned. The trustees will not have a beneficial ownership interest in the exempt company.

Fifth, a company must elect to be an exempt company at the time of incorporation. This election can be made in the company's articles of incorporation or through a separate election in letter form filed with the Office of the Lieutenant Governor while the articles of incorporation are filed.

A foreign company can also establish an exempt branch in the USVI instead of a separately chartered USVI exempt company. An exempt branch receives the same benefits as a USVI exempt company and is exempt from the branch profits tax otherwise imposed under the Code.

An exempt company is exempt from tax on all income except for income derived from US sources and some income from USVI sources and is exempt on interest income received on deposits with banks or savings institutions located in the USVI or abroad, as well as on amounts held by an insurance company under an agreement to pay interest on the amounts. A USVI exempt company is also exempt from tax on dividends and interest received from another exempt company and on gains or losses from the sale, exchange, or other disposition of the stock of another exempt company.

Moreover, a USVI exempt company is exempt from all local USVI taxes. Shareholders of a USVI exempt company are not subject to any withholding tax, which is otherwise imposed at a 10% rate. Stock held by a non-resident alien individual in a USVI exempt company is not subject to federal estate tax or to USVI inheritance tax. Thus, an exempt company can be an important estate planning tool for foreign individuals, who can place their worldwide assets in an exempt company to obtain the benefits such an entity provides.

A USVI exempt company provides an investor with a tax-exempt entity that can be used to hold assets – similar to an international business company that can be established in other offshore jurisdictions – but with unique advantages over such offshore holding companies. Along with access to the USA's extensive network of Treaties of Friendship, Commerce, and Navigation and Bilateral Investment Treaties, as well as and access to the US court system for dispute resolution, no licensing requirements exist for a USVI exempt company except for exempt international insurers, exempt international banking facilities, and exempt mutual funds. A USVI exempt company must only file a short combined annual report and franchise tax report with the Office of the Lieutenant Governor's Division of Corporations and pay an annual franchise tax of USD1,000. A USVI exempt company's tax benefits are guaranteed under a 20-year contract between the exempt company and the USVI government.

In conclusion, a USVI exempt company offers investors many benefits of establishing a company under the US flag to hold assets and to engage in business around the world.

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Marjorie Rawls Roberts PC has decades of experience representing companies and individuals in business, securities, tax, trusts and estates, and real estate matters. The firm's clients are based in the USVI, the US mainland, other US territories and international locations. The firm also provides comprehensive estate planning services and advice regarding the requirements for bona fide USVI residency. Of particular note, the firm represents clients before the USVI Economic Development Authority, the University of the Virgin Islands Research and Technology Park, and other government agencies as they seek economic incentives.

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Marjorie 'Jorie' Roberts founded Marjorie Rawls Roberts PC in 1999 after working in both the public and private sectors. She serves as the managing partner of the firm, which focuses exclusively on business and tax legal matters, including tax controversy. Jorie holds law degrees from Harvard Law School, Cambridge University and New York University and previously worked for global law firm Gibson, Dunn & Crutcher, the US Treasury Department and the USVI Bureau of Internal Revenue, and as general counsel and vice president of Globalvest Management Company, a St Thomas-based hedge fund manager. She is admitted to practise law in the USVI, the State of California, the Third Circuit Court of Appeals, and before the US tax court. Jorie is also a solicitor in England and Wales and is licensed to practise law in the British Virgin Islands.

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