

MARSHALL ISLANDS ECONOMIC SUBSTANCE GUIDELINES PROVIDE CLARITY FOR SHIPPING

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ON OCTOBER 17, 2019, THE MARSHALL ISLANDS REGISTRAR OF CORPORATIONS PUBLISHED GUIDANCE AND FREQUENTLY ASKED QUESTIONS INTERPRETING THE MARSHALL ISLANDS ECONOMIC SUBSTANCE REGULATIONS.

The guidelines provide some clarity to the business community in interpreting the regulations, especially for shipping and pure holding companies. Marshall Islands entities and their affiliates should carefully review their structure and operations to determine whether and how the guidelines and economic substance regulations apply to them.

"The guidelines provide that a relevant entity is treated as satisfying the economic substance requirements by operating the ship in international traffic including crew management, ship maintenance, overseeing voyages and related activities."

ECONOMIC SUBSTANCE REGULATIONS

In 2018-19, the Marshall Islands promulgated regulations imposing "economic substance" requirements on certain "relevant entities" organized in the Marshall Islands, including Marshall Islands corporations, partnerships and limited liability companies that engage in "relevant activities" including the businesses of shipping, serving as a holding company or headquarters, financing and leasing. The regulations were enacted in response to the OECD's and EU's initiative to combat offshore "tax havens." In general, the regulations provide that a Marshall Islands entity that is not centrally managed or controlled in the Marshall Islands, is not tax resident in another jurisdiction, and that engages in a "relevant activity" must have specified levels of economic substance in the Marshall Islands. For a more detailed description of the economic substance regulations, see our June 2019 briefing, *Marshall Islands – Economic Substance Requirements for Shipping Companies*.

SHIPPING BUSINESS

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One of the relevant activities to which the economic substance regulations apply is the shipping business. The regulations define a shipping business to include most activities involving a Marshall Islands-flagged ship, including owning, financing, managing the crew, chartering the ship and other related services. The guidelines provide that a relevant entity is treated as satisfying the economic substance requirements by operating the ship in international traffic including crew management, ship maintenance, overseeing voyages and related activities. The relevant entity must also generally comply with its obligations under applicable Marshall Islands law and International Maritime Organisation (IMO) and International Labour Organisation regulations, including its customs and manning requirements, and must pay its financial obligations to the Marshall Islands.

As a result, Marshall Islands entities that own or charter a Marshall Islands-flagged ship and otherwise comply with applicable requirements generally will be treated as satisfying the economic substance requirements with respect to their shipping business, without any requirement to have management, employees or any other physical presence in the Marshall Islands.

The guidelines clarify that the ownership of a private yacht generally does not fall within the definition of “shipping business” and the relevant entity owning the yacht is not subject to the economic substance test with respect to its ownership of the yacht.

PURE EQUITY HOLDING COMPANIES

In general, a relevant entity that is a pure equity holding company (i.e., a company that only holds equity participations in other entities, only earns dividends and capital gains, and performs no commercial activity) may satisfy the economic substance test by complying with applicable Marshall Islands law and paying applicable fees. A pure holding company must still have “adequate” human resources and premises in the Marshall Islands for holding and managing participations in other entities, which is determined based on facts and circumstances. The guidelines provide that a pure equity holding company *may* be able to satisfy these reduced substance requirements by maintaining a registered agent in the Marshall Islands, and that a pure equity holding company is not required to be directed and managed in the Marshall Islands.

In general, a Marshall Islands holding company that owns a company engaged in a shipping business (e.g., a joint venture entity that owns a Marshall Islands special purpose vehicle, which in turn owns a ship) could possibly be treated as satisfying the economic substance requirements, either because it is a pure equity holding company, or because it is treated as conducting a shipping business indirectly through its subsidiary, although the guidelines do not clarify how holding companies within a shipping business are treated. The treatment of a Marshall Islands entity that may not be a “pure” equity holding company is less certain. For example, a Marshall Islands entity that guarantees a loan of its parent or subsidiary could be treated as performing a commercial activity, which would be outside the scope of being a pure equity holding company.

AGENTS

A relevant entity generally can satisfy the economic substance requirements through the actions of its agent in the Marshall Islands (including an affiliate), so long as the relevant entity is able to monitor and control its agent’s activities, and the agent’s activities cannot be counted multiple times for purposes of satisfying multiple parties’ economic substance requirements.

REPORTING REQUIREMENTS

"Relevant entities" (i.e., entities to which the economic substance regulations apply) will have reporting requirements, including:

- (a) business type;
- (b) amount and type of gross income;
- (c) amount and type of expenses and assets;
- (d) premises;
- (e) number of employees, including the number of full-time employees; and
- (f) evidence that it has conducted relevant core income-generating activities in the Marshall Islands (which, as noted above, is generally not required for a shipping business).

"A Marshall Islands entity that is tax resident outside the Marshall Islands is not required to have economic substance in the Marshall Islands."

Reporting for new and existing entities will begin in 2020. All reporting will be done through a dedicated, secure web portal which is in development. Precise reporting timelines have yet to be released and are subject to change.

OBJECTIVE EVIDENCE REQUIRED OF ENTITIES THAT ARE TAX RESIDENT OUTSIDE THE MARSHALL ISLANDS

A Marshall Islands entity that is tax resident outside the Marshall Islands is not required to have economic substance in the Marshall Islands. Any such entity will need to provide satisfactory evidence of its tax residence, such as a tax identification number, tax residence certificate, assessment or payment of a tax liability, or other proof that the entity is subject to the tax regime of another jurisdiction. A specific rule provides that an entity that is classified as a "disregarded entity" for United States income tax purposes (or other similarly treated entities in other jurisdictions) may produce as objective evidence a signed statement under penalty of perjury from an external tax advisor or "C" level officer (generally deemed to be a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Commercial Officer or an equivalent) stating that all of that entity's income has been included on the corporate tax return of the parent company. The guidelines do not mention, and therefore it is not clear, whether this rule could be expanded to other fiscally transparent entities, such as an entity classified as a partnership for US tax purposes, all of whose partners are taxable US corporations, or a disregarded entity that is owned by a US tax resident who is an individual.

ENTITIES DO NOT BECOME RESIDENT BY COMPLYING WITH REGULATIONS

The guidance clarifies that a non-resident entity does not become a resident entity by complying with the economic substance regulations, meaning it can remain an entity not subject to income tax in the Marshall Islands.

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