

BRIEFING

WHAT SHOULD SHIPPING DO ABOUT
ECONOMIC SUBSTANCE?

JUNE 2019

- TRADITIONAL "OFFSHORE" SHIPPING JURISDICTIONS HAVE INTRODUCED "ECONOMIC SUBSTANCE" RULES
- AN EU AND OECD INSPIRED INITIATIVE REQUIRING "ADEQUATE SUBSTANCE" IN THE PLACE OF INCORPORATION
- SLOW IMPLEMENTATION AND UNCERTAIN REQUIREMENTS
- A NUMBER OF EXEMPTIONS RELEVANT TO SHIP OWNING, OPERATING AND HOLDING COMPANIES
- ADVICE IS TO BE AWARE BUT TO WAIT AND SEE



What are the "economic substance rules"?

These are rules, pushed forward by the EU and the OECD, as part of the continued battle against "tax havens".

They seek to put pressure on zero tax jurisdictions by requiring companies incorporated in traditional "tax havens" to prove they have "adequate substance" in those jurisdictions to carry out the business they carry out.

"Adequate" is a deliberately vague term, capable of adapting itself to different fact patterns.

Which countries are affected/targeted?

The first wave of countries include Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Jersey, the Isle of Man and the Marshall Islands.

In each of these countries, the economic substance legislation is in force but there are still uncertainties as to what the rules really mean and quite how they will be implemented. The delay has been put down to interactions with the EU who are overseeing implementation and, understandably, wish to ensure that the rules create an almost "level playing field" (so that one jurisdiction does not use the rules to create for itself an opportunity to benefit at the expense of another simply by having more relaxed substance requirements). Some of the jurisdictions have not yet published guidance to assist in understanding the implications of the new legislation.

To date, we have not been made aware that Liberia or Panama, home to two of the three largest ship registries (the Marshall Islands Registry being the third), have been required to bring forward similar rules.

What happens if you do not comply?

Whilst quite what non-compliance looks like remains unclear, the position on consequences of non-compliance differs slightly in each jurisdiction. The various rules provide for a fine (USD\$10,000 or a small multiple of that) on the first occasion a company is considered non-compliant. That fine can then be increased if the position is not rectified in the following year. The ultimate sanction for continued non-compliance is that the company may be struck-off the local register (and, so, will, in essence, cease to exist, although the legal consequences of being struck off are more complicated than that).

How enthusiastically the different states seek to enforce their own rules, impose penalties and ultimately strike off companies, remains to be seen. However, we expect the EU and the OECD will seek to monitor enforcement and there may be a degree of policing between the states themselves to ensure the playing field remains as level as designed. However, following the success of the various global tax initiatives brought in under the "BEPS" banner, we might expect these rules to eventually have a real and meaningful impact.

What does the future look like?

The OECD has recently announced that it is looking into a project which effectively seeks to ensure that profits are taxed at a minimum rate somewhere. To follow the branding success of "BEPS", the new initiative has its own catchy name – "GloBE" ("global anti-base erosion"). If implemented, a globally applicable minimum tax rate would clearly be a significant issue for international groups even if they have met the substance requirements to allow them to retain subsidiaries "based" in zero-tax jurisdictions.

What should I do today?

Awareness and continued monitoring are appropriate.

The relevant legislation for each jurisdiction is fairly detailed and, on review, some groups may be able to feel more relaxed than others as there are various exemptions and some groups may find themselves outside of the scope of the rules. Shipping groups with IP assets held in any of the affected jurisdictions may need to think about more immediate steps, but others may be well advised to be aware that the rules exist, will develop and may or may not require action in the future. There is unlikely to be a requirement to make wholesale changes to group structures at this stage.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this briefing, please speak with a member of our team below. Richard and Daniel are Partners in our international Tax group, both with a focus on the shipping industry. Steven is a Corporate Partner in our New York office who is qualified in the Marshall Islands.



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