

Marshall Islands

Economic Substance in the Marshall Islands

The Marshall Islands, following the lead of other offshore jurisdictions such as Bermuda, the British Virgin Islands and the Cayman Islands, has introduced an economic substance regime effective 1 January 2019 in response to the work of the OECD and the European Union on fair taxation. The legislation has since been twice amended and supplemented by guidelines which were last updated in January 2020.

The guidelines provide some clarity to the international business community in interpreting the regulations, especially for shipping and pure holding companies, with further clarification provided on the launch of the reporting portal on 1 July 2020. We have provided an updated overview below.

The Economic Substance Regulations

The Marshall Islands Economic Substance Regulations, 2018 (the **ES Regulations**) mandate that all *relevant entities* carrying out a *relevant activity* in the Marshall Islands must satisfy reporting requirements regarding their actual level of economic substance in the jurisdiction.

The ES Regulations are issued by the Registrar of Non-resident Domestic Corporations (the **Registrar**) which is the body responsible for non-resident entities pursuant to the authority granted under the Business Corporation Act, and the Marshall Islands Revised Code (MIRC).

The ES Regulations have effect for financial periods starting on or after 1 January 2019, where financial period means the period for which financial statements have been prepared or the period of which an entity has used for accounting purposes to formulate annual finance reports.

Step 1: Classification of a *relevant entity*

The ES Regulations cover *relevant entities* with further reporting requirements on those which derive income from a *relevant activity* within the Marshall Islands.

A *relevant entity* is defined as any of the below:

- (a) non-resident domestic corporations, partnerships and limited liability companies (LLCs), including non-resident domestic entities (**NRDEs**) which are tax resident in the Marshall Islands;

Economic Substance in the Marshall Islands

(b) foreign corporations, partnerships, limited partnerships and limited liability companies, including foreign maritime entities (FMEs) which are centrally managed and controlled in the Marshall Islands.

Exclusions under the ES Regulations

Any NRDE or FME will be considered a non-relevant entity, and out of scope of the ES Regulations, if the entity can provide objective evidence to the Registrar that it is tax resident in a jurisdiction outside of the Marshall Islands.

The following may be considered as sufficient evidence of tax residency:

- Tax identification number (TIN)
- Tax residence certificate
- Tax assessment or tax payment proofs

Step 2: What is a *relevant activity*?

Relevant activities under the ES Regulations are:

- Banking business*
- Distribution and service centre business
- Finance and leasing business
- Fund management business
- Headquarters business
- Holding company business
- Insurance business*
- Intellectual property business
- Shipping business

* Whilst the above *relevant activities* correspond to relevant activities covered in other jurisdictions' economic substance legislation, it should be noted that pursuant to the Business Corporations Act, the Revised Partnership Act, the Limited Partnership Act, and the Limited Liability Company Act, every non-resident domestic corporation, partnership, limited partnership and LLC is prohibited from carrying on the business of banking, and the business of granting policies of insurance or assuming insurance risks.

Step 3: The Economic Substance Test

A *relevant entity* conducting any of the above *relevant activities* will be required to satisfy a three-part economic substance test (the **Substance Test**) by: i) being directed and managed in the Marshall Islands in relation to that relevant activity; ii) having an adequate number of employees, an adequate physical presence, and adequate expenditure in the Marshall Islands; and iii) by carrying out core income generating activities (CIGA) in the Marshall Islands.

Test	Requirements
i) Directed and managed	<ul style="list-style-type: none">• Hold board meetings with adequate frequency in the Marshall Islands• Have a quorum of persons physically present at such board meetings

Economic Substance in the Marshall Islands

	<ul style="list-style-type: none"> • Minute the meetings to record all relevant decisions taken; keep those meeting minutes and records within the Marshall Islands (with the Registered Agent) • Ensure the governing body of the entity to have the necessary knowledge and expertise to discharge their duties
ii) Adequate employees and presence	<ul style="list-style-type: none"> • Have an adequate number of qualified employees in the jurisdiction • Incur adequate expenditure with the level of activity • Have adequate physical presence in the jurisdiction
iii) CIGA - core income generating activities	In order to satisfy this test, the entity must prove its CIGA are being undertaken in the Marshall Islands. See some specific examples below.
The determination of what is 'adequate' will be based on the level of the relevant activity carried out in the Marshall Islands.	

Pure equity holding company

A *relevant entity* that is **only** carrying on the *relevant activity* that is the business of a pure equity holding company is subject to a reduced ES Test which may be satisfied if it confirms that:

- (a) it has complied with all applicable filing requirements under the Business Corporations Act, Revised Partnership, Limited Partnership Act, or Limited Liability Companies Act, including the payment of all fees; and
- (b) it has adequate human resources and adequate premises in the Marshall Islands for holding and managing equity participations in other entities.

As above, 'adequate' will be determined based on the circumstances of each pure equity holding company. However, a pure equity holding company may be able to satisfy these reduced substance requirements by maintaining a registered agent in the Marshall Islands in accordance with the Associations Law. A pure equity holding company is not required to be directed and managed in the Marshall Islands.

Shipping business

The ES Regulations define the shipping business as:

the operation of ships in international traffic for income from the transport of passengers or cargo and includes any of the following activities where the relevant activity is directly connected with, or ancillary to, such operation:

- i. the rental on a charter basis of a ship;
- ii. the sale of tickets or similar documents and the provision of services connected with the sale of tickets or similar documents, either for the enterprise itself or any other enterprise;
- iii. the use, maintenance, or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise; or
- iv. the management of the crew of a ship;

Economic Substance in the Marshall Islands

- v. the registration of a ship;
- vi. the recording of a financial instrument or lien in relation to a ship;
- vii. the ownership of a ship;
- viii. the financing of a ship;
- ix. the obtaining of statutory certificates for a ship;
- x. the surveying of a ship; or
- xi. the provision of services related to the foregoing.

In determining economic substance in the context of shipping business, the Registrar recognises that significant CIGA within shipping are performed in transit outside of the Marshall Islands, and that the value creation attributable to the CIGA that occur from a fixed location is more limited than for other types of regimes for mobile business income. This means that a *relevant entity* engaged in shipping business may satisfy the economic substance test by the operation of the vessel in international traffic including the management of the crew aboard the vessel, maintenance of the vessel, and overseeing voyages and activities related thereto.

The determination will further consider whether the relevant entity handles all obligations under the Marshall Islands Associations Law and Maritime Act 1990, including compliance with applicable International Maritime Organisation and International Labour Organisation regulations, customs, and manning requirements and whether all financial obligations to the Marshall Islands have been fulfilled.

The guidelines further note that private yachts lie outside of scope of 'shipping business', and therefore the ownership, operation or management of a private yacht is not considered a relevant activity under the ES Regulations and thus the relevant entity would not be subject to the economic substance test in respect of ownership of a private yacht in itself.

Notification and reporting

Timing

Starting from 1 July 2020, **all** NRDEs and FMEs as in-scope entities under the ES Regulations are required to prepare and file an annual **Economic Substance Declaration** to the Registrar within 12 months of the anniversary date of the entity. For newly formed entities, the reporting period will open on their first anniversary date.

Reporting requirements

The entity must confirm whether it is a relevant entity in the first instance, and where applicable continue to provide information on any income derived from a relevant activity. The information will include:

- Business type
- Amount and type of gross income
- Amount and type of expenses and assets
- Business premises
- Number of employees inclusive of those working full-time
- Relevant proof of CIGAs carried out within the Marshall Islands

All required reportable information is in respect of the corresponding financial period. Additional documentation may be required by the Registrar, depending on the relevant activity conducted.

Economic Substance in the Marshall Islands

Penalties for non-compliance

Non-compliance or failure to meet the economic substance requirements in the Marshall Island can result in certain penalties:

- A relevant entity that fails to comply with the reporting requirements or to meet the economic substance test for a financial period as required shall be fined up to USD50,000, or lead to a revocation and dissolution.
- If for the next financial period, the in-scope entity still does not pass the economic substance test, as determined by the Registrar, then the financial penalty can be added up to USD100,000, or lead to a revocation and dissolution.

Under the ES Regulations, the Registrar will deliver a notice to the entity for the determination, clarification of reasons why the entity has not satisfied the economic substance requirements, and applicable penalties together with other relevant information.

Next steps for Marshall Islands entities

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.

Marbury has been liaising with clients about the implementation of the economic substance requirements and will contact affected clients shortly to initiate the reporting process.

For further information on any aspect of this updaters please contact your usual Marbury adviser.

Disclaimer

This guide provides an overview of economic substance in the Marshall Islands and should not be read as legal advice. For more information please contact Marbury or info@marburys.com.