# REPUBLIC OF THE MARSHALL ISLANDS ECONOMIC SUBSTANCE REGULATIONS WEBINAR

## SPEAKERS

**Ryan Gibson**
*Deputy General Counsel*
*(International Registries, Inc. (IRI) Reston)*

**Damien Magee**
*Partner*
*(AMLR Cayman Limited)*

**Alison Wilson**
*Senior International Counsel, Head of Office*
*(IRI Long Beach)*

## MODERATOR

**Diego Ramírez**
*General Manager*
*(IRI Ft. Lauderdale)*

# Marshall Islands Economic Substance Regulations and Reporting

13 November 2024

By **Damien Magee**

dmagee@amrlcayman.com

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# Disclaimer

*This presentation is intended for general guidance only and is not, nor should it be used for, a substitute for specific legal advice on any particular transaction or set of circumstances. This presentation has been prepared on the basis of the law and practice as of 12 November 2024.*

# What is Economic Substance Reporting

- The RMI's Economic Substance Regulations, 2018 (as amended, the "**Regulations**") have been introduced as a result of commitments made by the RMI to the European Union (the "**EU**") in response to the Organisation for Economic Co-operation and Development's (the "**OECD**") Inclusive Framework on Base Erosion and Profit Shifting (or "**BEPS**").
- Economic substance reporting is not unique to the RMI and as common in various jurisdictions.

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# Why does any of this impact me?

- The Regulations create an obligation on non-resident domestic entities (such as Corporations, LLCs, LPs) and foreign registered entities (such as FMEs) to file Economic Substance Reports (or "**ESRs**").
- The ESR may be filed to declare that the entity is a "non-relevant entity" because its business is centrally managed and controlled outside the Republic and it is tax resident outside the Republic (to be discussed further).
- ESRs must be filed for each financial period; so in respect of each financial year.
- The ESR deadline is 12 months from the entity's anniversary date. Please check your annual invoice, as it will have details on the ESR deadline.
- Please remember that each entity must file an ESR, even if they did not engage in a "relevant activity".
- If an entity does not file its ESR by the relevant date, the Registrar of Corporations and Registered Agent will cease to provide services until the entity has remedied its deficiency and penalties of up to USD10,000 can be applied.

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# Is my entity a "relevant" or a "non-relevant" entity?

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- Please note that independent tax advice should be sought on this issue.
- Please also note that regardless of the conclusion reached, an ESR must still be filed with the Registrar.
- Section 2 of the Regulations defines a relevant entity as "*a corporation, partnership, limited partnership, or limited liability company, other than a resident domestic corporation, partnership, limited partnership, or limited liability company, that is incorporated or formed under the Business Corporations Act, Revised Partnership Act, Limited Partnership Act, or Limited Liability Company Act, unless its business is centrally managed and controlled outside the Republic and it is tax resident outside the Republic*" [there is a similar definition for foreign entities]
- So, if an entity is managed and controlled outside of the RMI (<u>most entities are</u>) and tax resident outside the RMI (<u>**again, most entities are**</u>) with a few exceptions, then the entity is not a "relevant entity" and this should be declared in the ESR by providing evidence of tax residency.
- The above scenario is what Section 8, paragraph 4 of the Regulations addresses when it refers to "non-relevant entities". If, for example, the yacht owning entity is declared for US tax purposes (the "ticking the box" approach"), then it is a "non-relevant entity" and evidence of tax residency elsewhere should be provided to the Registrar (a TIN and EIN or similar).

# How do I determine if the entity is engaged in "relevant activities"

- Regardless of the activity, an ESR must be filed with the Registrar.
- We do not anticipate seeing large numbers of "dormant" entities that do not engage in any economic activity. When asked if the entity had any business activity during the period, the default position is "yes", unless the entity is truly dormant.
- Section 3 of the Regulations provides that relevant activities (which are defined in Section 2) are as follows;
  - distribution and service center business;
  - financing and leasing business;
  - fund management business;
  - headquarters business;
  - holding company business;
  - intellectual property business;
  - shipping business;
  - banking business; or
  - insurance business.

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# What is a “shipping business”

- Section 2 of the Regulations provides that "shipping business" means 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; iv. the management of the crew of a ship; 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.

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# What if the entity owns a yacht?

- Whilst the definition of “shipping business” in broad, it must be kept in mind that the focus is on a “business”.
- A “private yacht” means “*any yacht not for hire, not engaged in trade or commerce, and used solely for private use, pleasure or recreational purposes by its owner*” (§112 of the RMI Maritime Act).
- A private yacht, even if engaged in limited charters, should not deemed to be a “shipping business” and thus would not undertake the relevant activity of a shipping business. This is as the purpose of the charter is not to engage in trade or commence a business, but merely to reduce the operating losses of the private yacht owner.
- The same analysis would apply for a private yacht taking part in the YET scheme. The chartering is designed to reduce operating losses via limited chartering.
- A “commercial yacht” however is “*a yacht engaged in trade, commerce or on charter for hire*” (§112 of the RMI Maritime Act) and so would appear to be a shipping business.
- There is a clear distinction to be made between private and commercial yachts.

# What is a “holding company business”?

- Section 2 of the Regulations provides that “holding company business" means the business of a "*pure equity holding company*“, which means “*a company that only holds equity participations in other entities, only earns dividends and capital gains, and performs no commercial activity*.”
- If it is a pure equity holding company, Section 4 of the Regulations provides that “*A pure equity holding company is subject to a reduced economic substance test which is satisfied if the relevant entity confirms that it: (a) complies with its statutory obligations under the Business Corporations Act, Revised Partnership Act, Limited Partnership Act, or Limited Liability Companies Act, as appropriate; and (b) has adequate human resources and premises in the Republic for holding and managing equity participations in other entities*.”
- Please keep in mind this is a narrow concept. If the entity holds title to a yacht, it would not be deemed to be a pure equity holding company. We do not anticipate seeing large numbers of pure equity holding companies.

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# What are the economic substance requirements?

- Section 4 of the Regulations addresses the requirements for economic substance; the "economic substance test".
- *"A relevant entity has economic substance in the Republic in relation to a relevant activity if the relevant entity:*

  *(a) is directed and managed in the Republic in relation to that relevant activity;*

  *(b) having regard to the level of relevant activity carried out in the Republic:*

    *i. has an adequate number of qualified employees in the Republic (whether or not employed by the relevant entity or by another entity and whether on temporary or long-term contracts);*

    *ii. has an adequate physical presence in the Republic; and*

    *iii. has an adequate amount of expenditure incurred in the Republic; and*

  *(c) it carries out core income-generating activity in relation to that relevant activity in the Republic as set forth in Section 5 of these Regulations."*

# What if the entity is engaged in “shipping business”?

- If the entity is engaged in a shipping business then it must satisfy the economic substance test.
- Section 5 of the Regulations addresses that and what constitutes “core income generating activity”, or “CIGA”, which relates to “*activities of central importance to a relevant entity in terms of generating income*”.
- At Section 5(g) of the Regulations, footnote 3 provides that “*The determination of economic substance in the context of shipping business recognizes that significant core income generating activities within shipping are performed in transit outside of the Republic, and that the value creation attributable to the core income-generating activities that occur from a fixed location is more limited than for other types of regimes for mobile business income. The determination further considers whether the relevant entity handles all obligations under the Associations Law and Maritime Act 1990, including compliance with applicable International Maritime Organisation regulations, customs, and manning requirements.*

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# Penalties

- If an entity fails to file its ESR by the required date, the Registrar will suspend "*all corporate services for that entity*". This could have rather wide ranging consequences.
- Section 6 of the Regulations provides that if an entity fails to file an ESR or provide the required information for the Registrar to make a determination, then a penalty of USD10,000 can be levied and/or the entity can be dissolved or revoked.
- Section 7 of the Regulations addresses the penalties for failing to satisfy the economic substance test. For a first offence, a penalty of up to USD50,000 can be levied and/or the entity can be dissolved or revoked. If the noncompliance continues into the following financial period, then a penalty of up to USD100,000 can be levied and/or the entity can be dissolved or revoked.
- The penalties, which have teeth and can be have real financial consequences or may result in annulment of the entity, can be avoided by filing the required information within the necessary time period.
- Please file your ESRs with accurate information and in a timely basis. If a request from the Registrar is made, please also respond to same in a timely basis with the requested information and documentation.

# How to file an ESR

- The Registrar has invested in a microsite to assist in providing access to information and documentation, as well as filing ESRs.
- The microsite can be located at: https://www.register-iri.com/corporate/esr/
- There is a user guide, there are frequently asked questions and there are guidance notes.
- There is also a link to the Regulations themselves. Economic-Substance-Regulations-2018-courtesy-copy-published-by-the-Registrar-of-Corporations-through-29-August-2019-amendments.pdf

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13 November 2024

# OVERVIEW

- Abbreviations and Acronyms
- European Union Listing Update
- Economic Substance Regulations Portal Updates:
  - Uploading Evidence of Tax Residency
  - Rejection of Certain Tax Jurisdictions
  - New Common Reporting Standard Questions
- Audits and Compliance Actions
- Questions?

# ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| **%** | Percent |
| **CRS** | Common Reporting Standard |
| **e.g.** | For Example |
| **ESR** | Economic Substance Regulations, 2018 |
| **Etc.** | et cetera |
| **EU** | European Union |
| **FHTP** | Forum on Harmful Tax Practices |
| **i.e.** | that is |
| **OECD** | Organisation for Economic Co-operation and Development |
| **RMI** | Republic of the Marshall Islands |
| **RFI** | Reporting Financial Institutions |
| **SEOI** | Spontaneous Exchange of Information |
| **US** | United States |
| **USD** | US Dollars |

# EU LISTING UPDATE

# EU LISTING UPDATE

- RMI undergoes continual monitoring from the EU to assess enforcement by the Registrar of Corporations and compliance by RMI entities.
- RMI remains **Whitelisted** as of the last assessment on 8 October 2024.
- List updated every February and October. Next update – February 2025.
- Current lists:
  - **Blacklist**:
    American Samoa, Anguilla, Fiji, Guam, Palau, Panama, Russia, Samoa, Trinidad and Tobago, the US Virgin Islands, and Vanuatu.
  - **Greylist**: Antigua and Barbuda, Belize, British Virgin Islands, Costa Rica, Curacao, Eswatini, Seychelles, Türkiye, and Vietnam.

# ESR PORTAL UPDATES – UPLOADING EVIDENCE OF TAX RESIDENCY

# ESR PORTAL UPDATES – UPLOADING EVIDENCE OF TAX RESIDENCY

**RMI Portal Changes:**

- Entities claiming tax residency in an EU Member State that has opted-in to receive SEOI from the RMI will be required to upload evidence of tax residency.
  - Opt-in countries are **Austria, Belgium, Czech Republic, Germany, Ireland, Luxembourg, Netherlands, Slovak Republic, Spain, and Sweden**.
- Entities claiming tax residency in **Guernsey, Jersey, or Isle of Man** must upload documentation showing:
  - tax residency in Guernsey, Jersey, or Isle of Man; and
  - payment of corporate tax in Guernsey, Jersey, or Isle of Man.

**Reason for Changes:**

- OECD FHTP 2022 Guidance enforced by the EU which states:

> "Currently, there are three no or only nominal tax jurisdictions that have corporate income tax systems, which are Guernsey, Isle of Man, and Jersey… Hence, entities can only be a tax resident and subject to a corporate income tax system in one of these three no or only nominal tax jurisdictions."

# ESR PORTAL UPDATES – UPLOADING EVIDENCE OF TAX RESIDENCY (continued)

- If Austria, Belgium, Czech Republic, Germany, Ireland, Luxembourg, Netherlands, Slovak Republic, Spain, and Sweden are selected:

For the relevant financial period, does the entity declare it was tax resident or subject to a tax regime (such as a tonnage tax regime) in a country outside of the Marshall Islands? ◉ Yes ○ No

* Country of tax residency or where the entity is subject to a tax regime: AUSTRIA

* Upload the documentation selected below to confirm tax residency. Choose File No file chosen

(Please upload all documentation in a single pdf file)

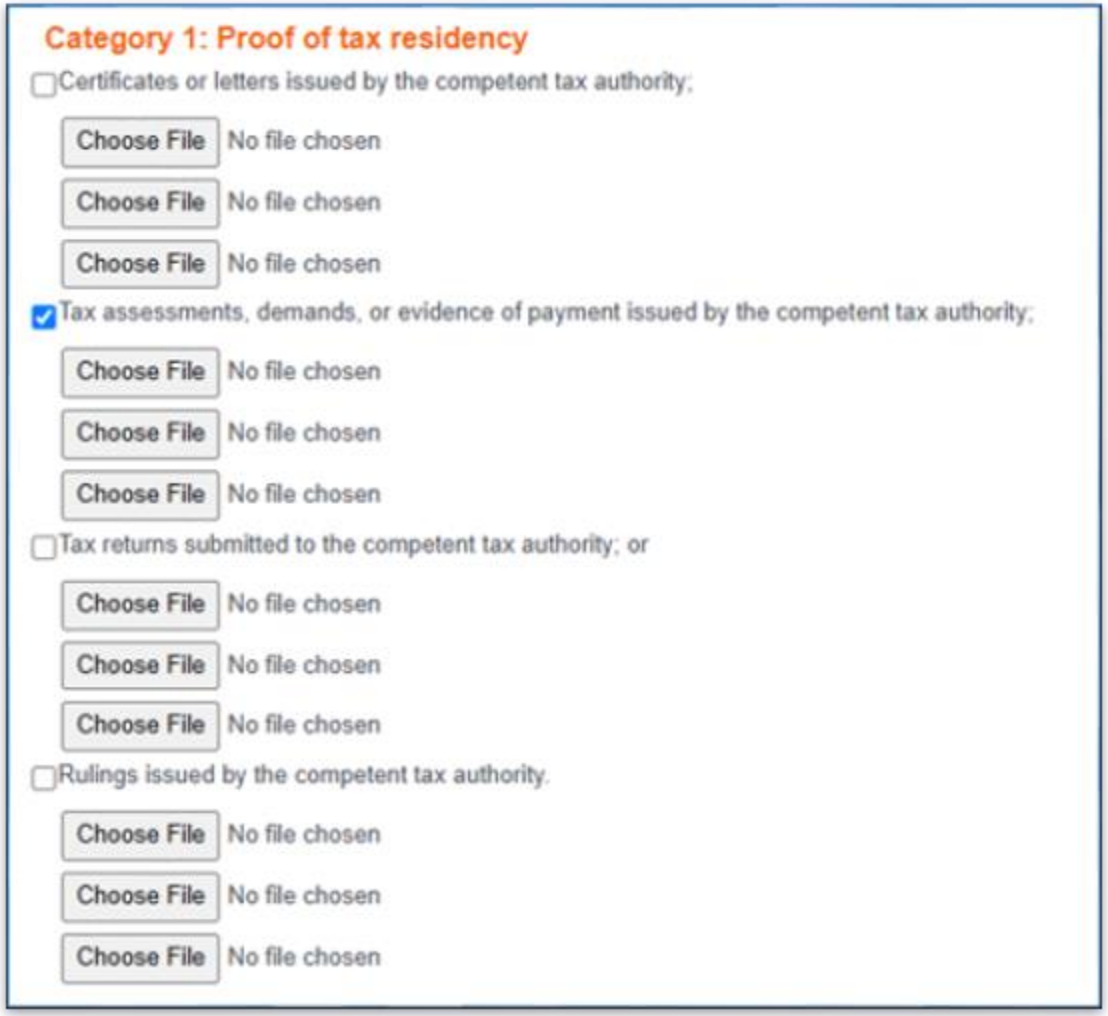
Please mark all objective evidence the entity can provide to substantiate the above:

- ☐ tax identification number (or equivalent)
- ☐ tax certificate
- ☐ evidence of assessment or payment of tax liability
- ☐ other proof the entity is subject to a tax regime outside of the Marshall Islands or is a disregarded entity for US tax purposes (such as an affidavit from a 'C' level officer or a tax advisor)

Continue

# ESR PORTAL UPDATES – UPLOADING EVIDENCE OF TAX RESIDENCY (continued)

- If Guernsey, Jersey, or Isle of Man is selected (Category 1):



Category 1: Proof of tax residency

- [ ] Certificates or letters issued by the competent tax authority;

Choose File No file chosen

Choose File No file chosen

Choose File No file chosen

- [x] Tax assessments, demands, or evidence of payment issued by the competent tax authority;

Choose File No file chosen

Choose File No file chosen

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- [ ] Tax returns submitted to the competent tax authority; or

Choose File No file chosen

Choose File No file chosen

Choose File No file chosen

- [ ] Rulings issued by the competent tax authority.

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Choose File No file chosen

Choose File No file chosen

# ESR PORTAL UPDATES – UPLOADING EVIDENCE OF TAX RESIDENCY (continued)

- If Guernsey, Jersey, or Isle of Man is selected (Category 2):

**Category 2: Proof the entity is subject to the jurisdiction's corporate income tax system:**

- [ ] Tax assessments, demands, or evidence of payment issued by the competent tax authority;

  Choose File No file chosen

  Choose File No file chosen

  Choose File No file chosen

- [x] Tax returns submitted to the competent tax authority; or

  Choose File No file chosen

  Choose File No file chosen

  Choose File No file chosen

- [x] Confirmation that the entity is required to submit a corporate income tax return to the competent tax authority.

  Choose File No file chosen

  Choose File No file chosen

  Choose File No file chosen

- **Note:** If one document includes both Category 1 and Category 2 information, this would be sufficient.

# ESR PORTAL UPDATES – REJECTION OF CERTAIN TAX JURISDICTIONS

# ESR PORTAL UPDATES – REJECTION OF CERTAIN TAX JURISDICTIONS

**RMI Portal Changes:**

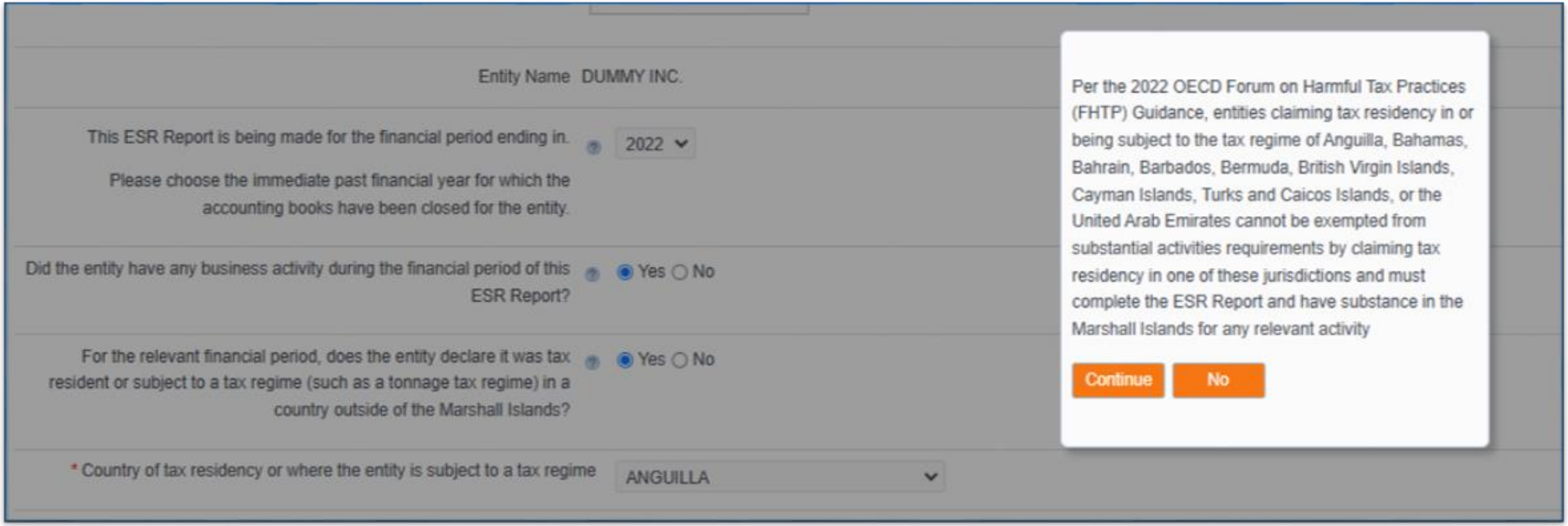
- Claims of tax residency in **Anguilla, Bahamas, Bahrain, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Turks and Caicos Islands, and the United Arab Emirates** will be automatically rejected.
- Entities claiming tax residency in the above jurisdictions must meet the economic substance requirements in the RMI for any income from a relevant activity.

**Reason for Changes:**

- OECD FHTP 2022 Guidance enforced by the EU which states:

> "Most of the no or only nominal tax jurisdictions do not have a concept of corporate tax residence, which means entities cannot be residents for tax purposes there... If another no or only nominal tax jurisdiction introduces a (partial) corporate income tax system, the FHTP could consider if the approach also applies to that jurisdiction and update its guidance, as appropriate"

# ESR PORTAL UPDATES – REJECTION OF CERTAIN TAX JURISDICTIONS (continued)



# ESR PORTAL UPDATES – NEW CRS QUESTIONS

# ESR PORTAL UPDATES – NEW CRS QUESTIONS

- The CRS is a global standard that requires countries to collect information from their domestic RFIs on financial accounts held by people / entities resident in a foreign country and to exchange that information annually.

- Three questions related to the CRS have been added to the ESR portal for the purpose of identifying potential RFIs that may have CRS reporting obligations in the RMI.

- If "*holding company business*" is selected, one new question:

  **"Is the entity managed by another entity that is a Financial Institution?"**

- A "**Financial Institution**" is a Depository Institution (e.g., commercial bank), a Custodial Institution (e.g., custodian bank), a Specified Insurance Company (e.g., life insurance company), or an Investment Entity (e.g., asset management company or private equity fund).

# ESR PORTAL UPDATES – NEW CRS QUESTIONS (continued)

| | |
|---|---|
| Did the entity have income from carrying on one of the below relevant activities for the previous financial period? | ○ entity had no income from a relevant activity<br>○ distribution and service center business<br>○ financing and leasing business<br>○ fund management business<br>○ headquarters business<br>◉ holding company business<br>○ intellectual property business<br>○ shipping business related to a Marshall Islands-registered vessel<br>○ banking business<br>○ insurance business |
| Is the entity compliant with all filing and statutory requirements under the Associations Law? | ◉ Yes ○ No |
| Does the entity maintain a registered agent in the Marshall Islands? | ◉ Yes ○ No |
| Is the entity managed by another entity that is a Financial Institution? | ○ Yes ○ No **NEW** |

# ESR PORTAL UPDATES – NEW CRS QUESTIONS (continued)

- If "*entity had no income from a relevant activity*" is selected, two new questions:

**"Is the entity a Custodial Institution?"**

**"Is the entity an Investment Entity?"**

- A "**Custodial Institution**" is an entity that holds financial assets for the account of others as a substantial portion of its business (i.e., 20% or more of its gross income over the last three years). Examples include custodian banks, brokers, and central securities depositories.

- An "**Investment Entity**" is an entity that either:
  - *Type A* – primarily conducts business investment activities or operations for or on behalf of a customer (for example, an asset management company); or
  - *Type B* – derives its gross income from investing, reinvesting, or trading in financial assets <u>and</u> is managed by a Financial Institution (for example, a private equity or venture capital fund).

# ESR PORTAL UPDATES – NEW CRS QUESTIONS (continued)

Did the entity have income from carrying on one of the below relevant activities for the previous financial period?

- (●) entity had no income from a relevant activity
- ( ) distribution and service center business
- ( ) financing and leasing business
- ( ) fund management business
- ( ) headquarters business
- ( ) holding company business
- ( ) intellectual property business
- ( ) shipping business related to a Marshall Islands-registered vessel
- ( ) banking business
- ( ) insurance business

Is the entity a Custodial Institution? ( ) Yes ( ) No

Is the entity an Investment Entity? ( ) Yes ( ) No

NEW

# AUDITS AND COMPLIANCE ACTIONS

# AUDITS AND COMPLIANCE ACTIONS

**Audits**

- Entities are selected at random or based upon a risk-based analysis after a review of the entity's ESR Report.
- The ESR auditor will send a letter to the reporting individual seeking documentation to verify the ESR Report.
- Relevant documentation could include tax certificates, financial statements / accounting records, ship certificates of registry, evidence of payment of tonnage tax, etc.

**Compliance Actions**

- Both monetary fines and/or annulment of the entity will be imposed if the entity fails to:
  - file the ESR Report within the three-month grace period after the reporting deadline; or
  - respond to an audit by the deadline stated in the audit letter; or
  - meet the substance requirements, where applicable.

# QUESTIONS?

# CONTACTS

Ryan Gibson
legal@register-iri.com

Damien Magee
dmagee@amrlcayman.com

Alison Wilson
legal@register-iri.com


THANK YOU