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Obscure legal concepts or terms in a loan document explained in plain English

February 2020

Marshall Islands Economic Substance Regulations

What is it?

The Marshall Islands, among various other jurisdictions, promulgated economic substance regulations (“ESR”) that generally came into effect during 2019. Generally, the ESR requires certain legal persons (i.e., a “relevant entity” under the ESR) conducting certain activities in the Marshall Islands have sufficient economic substance in the Marshall Islands.

Why is it here? Is it just the Marshall Islands?

Generally, the ESR responds to anti-tax avoidance initiatives by The Organization for Economic Cooperation and Development (OECD) and the European Union. ESR is not limited to the Marshall Islands. In fact, various jurisdictions, including, for example, the Cayman Islands and Bermuda, have passed similar rules.

Who is affected?

Most Marshall Islands-formed vessel-owning companies are expected to be considered “relevant entities” and, thus, subject to the ESR. A “relevant entity” for Marshall Islands purposes is a “non-resident” Marshall Islands entity, including a corporation, limited liability company or limited partnership. “Non-resident” Marshall Islands entities are typically used by shipping companies. Relevant activities specifically include the “shipping business” which is broadly defined to include owning, operating, chartering or managing a vessel as well as the use, maintenance and rental of shipping containers.

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Who should shipowners and vessel operators be aware of?

In the context of the shipping business, the regulations recognize that the shipping business is inherently mobile and that most of the core income generating activities are performed in transit outside of the Marshall Islands. Therefore, the level of value creation attributable to a fixed location is “more limited” than other types of activities. As a result, the economic substance required in the Marshall Islands under the ESR for companies engaged in the shipping business may be less than for certain other businesses and may be satisfied by continuing to conduct business in the ordinary course without having management, employees or any other physical presence in the Marshall Islands.

In addition, pure equity holding companies are subject to reduced economic substance requirements. It is indicated that a pure equity holding company may be able to satisfy such requirements by maintaining a registered agent in the Marshall Islands.

How do I demonstrate compliance with the ESR?

Relevant entities that do not have income from a relevant activity are required to submit an Economic Substance Declaration to the Registrar. A relevant entity that does derive income from relevant activities (e.g., a ship-owning company) must report to the Registrar about its business type, the amount and type of income and expenses, its premises, employees and operations and evidence that it has conducted core income-generating activities in the Marshall Islands. Reporting will be made through a web portal.

The Marshall Islands is expected to release the details of its reporting regime for economic substance in 2020. Organizations with Marshall Islands entities in their structure should pay attention to any potential requirements and deadlines that may apply to them..

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Questions?

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