REPUBLIC OF THE MARSHALL ISLANDS
CONFIDENTIAL
C.M. 210 (2019)

FOR ACTION
Minister of Finance, Banking and Postal Services

FOR INFORMATION
All Ministers

SUBJECT: Proposed Amendments to the Economic Substance Regulations, 2018, as amended, promulgated pursuant to Section 129.5 of the Business Corporation Act.

At its meeting on August 29, 2019, the Cabinet:

1. **rescinded** Cabinet Minute 197 2019; and
2. **approved** the attached proposed amendments to the Economic Substance Regulations, 2018 promulgated pursuant to Section 129.5 of the Business Corporations Act; and
3. **authorized** the Registrar of Corporations to transmit said regulations to the EU Code of Conduct Group.

Hilda C. Heine, Ed. D
President

Earlie Carter Bing
Clerk of the Cabinet

[Reference – C.P. 8261 (2019)]
Signed by the President on August 29, 2019.

REPUBLIC OF THE MARSHALL ISLANDS
ECONOMIC SUBSTANCE REGULATIONS, 2018

The Registrar of Corporations responsible for non-resident domestic entities promulgates the following regulations (the "Regulations") pursuant to the authority granted under § 129.5(2) of the Business Corporations Act, Part I of Title 52 of the Marshall Islands Revised Code ("MIRC").

Section 1. Short Title and Effect

(1) *Short title.* These Regulations may be cited as the "Economic Substance Regulations, 2018."

(2) *Force and effect.* These Regulations come into force on 1 January 2019 and have effect for financial periods commencing on or after 1 January 2019.

Section 2. Definitions

For purposes of these Regulations, the terms defined in the Associations Law, Title 52 of the MIRC, shall have the meanings set forth therein. In addition, for purposes of these Regulations, unless the context otherwise requires:

(a) "**banking business**" has the meaning set forth in § 102 of the Banking Act 1987, Chapter 1 of Title 17 of the MIRC;

(b) "**competent authority**" means, for each respective jurisdiction, an authority designated in or for the purposes of an "agreement" within the meaning of §502 of the Automatic Exchange of Financial Account Information Act 2016, Chapter 5 of Title 48 of the MIRC;

(c) "**distribution and service center business**" means the business of either or both of the following:

i. purchasing from an entity in the same Group component parts or materials for goods, or goods ready for sale, and reselling such component parts, materials, or goods outside the Republic; or

ii. providing services to an entity in the same Group in connection with the business outside the Republic;

but does not include any activity included in any other relevant activity except "holding company business";

(d) "**finance and leasing business**" means the business of providing credit facilities for any kind of consideration to another person but does not include any activity

falling within the definition of "banking business," "fund management business," or "insurance business";

(e) "**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;

(f) "**fund management business**" means the business of exercising any managerial function in relation to an investment or in relation to the assets underlying an investment when carried out for an investment fund pursuant to a license issued under the laws of the Republic;

(g) "**Group**" has the meaning set forth in §602 of the Country-by-Country Reporting Act, 2018, Chapter 6 of Title 48 of the MIRC;

(h) "**headquarters business**" means the business of providing any of the following services to an entity in the same Group:

i. the provision of senior management;

ii. the assumption or control of material risk for activities carried out by any of those entities in the same Group; or

iii. the provision of substantive advice in connection with the assumption or control of risk referred to in paragraph (ii);

but does not include any activity falling within the definition of "banking business," "distribution and service center business", "financing and leasing business," "fund management business," "IP business," "insurance business," or "shipping business";

(i) "**high risk intellectual property (IP) business**" means an IP business carried on by:

i. an entity that:

1. did not create the IP in an IP asset that it holds for the purposes of its business;

2. acquired the IP asset:

a. from an entity in the same Group; or

b. in consideration for funding research and development by another person situated in a country or territory other than the Republic; and

3. licenses the IP asset to one or more entities in the same Group or otherwise generates income from the asset in consequence of

activities (such as facilitating sale agreements) performed by entities in the same Group; or

ii. an entity that does not carry out the core income-generating activities specified in Section 5(f)(i) or (ii) of these Regulations in the Republic;

(j) "**holding company business**" means the business of a pure equity holding company;

(k) "**insurance business**" means the business of granting policies of insurance or assuming insurance risks;

(l) "**investment fund**" means an entity whose principal business is the issuing of investment interests to raise funds or pool investor funds with the aim of enabling a holder of such an investment interest to benefit from the profits or gains from the entity's acquisition, holding, management or disposal of investments and includes any entity through which an investment fund directly or indirectly invests or operates;

(m) "**investment interest**" means a share, limited liability company interest, partnership interest, or other right that carries an entitlement to participate in the profits or gains of the entity;

(n) "**IP assets**" means any intellectual property right in intangible assets, including copyright, patents, trademarks, brand, and technical know-how;

(o) "**IP business**" means the business of holding, exploiting or receiving income from IP assets;

(p) "**pure equity holding company**" means a company that only holds equity participations in other entities, only earns dividends and capital gains, and performs no commercial activity;

(q) "**Registrar**" means the Registrar of Corporations responsible for non-resident domestic entities as provided for in § 4 of the Business Corporations Act;

(r) "**relevant activity**" has the meaning set forth in Section 3 of these Regulations;

(s) "**relevant entity**" means:

i. 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; or

ii. a corporation, partnership, limited partnership, limited liability company, or other entity incorporated or formed outside of the Republic (a "foreign entity") registered under the under the Business Corporations Act, Revised Partnership Act, Limited Partnership Act, or Limited Liability Company Act, including a foreign maritime entity, whose business is centrally managed and controlled in the Republic, unless the foreign entity is tax resident outside the Republic;

(t) "**ship**" means a vessel registered in the Republic pursuant the Maritime Act 1990, Title 47 of the MIRC;

(u) "**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; or

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.

Section 3. Relevant Activities

For purposes of these Regulations, the following are relevant activities:

(a) distribution and service center business;

(b) financing and leasing business;

(c) fund management business;

(d) headquarters business;

(e) holding company business;

(f) intellectual property business;

(g) shipping business;

(h) banking business[1]; and

(i) insurance business[2].

Section 4. Economic Substance Requirement

(1) *Requirement.* A relevant entity must, for each financial period in which it derives income from a relevant activity, have economic substance in the Republic in relation to that relevant activity.

(2) *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.

(3) *Directed and managed test.* The test in paragraph (2)(a) is met if:

(a) the relevant entity's governing body meets in the Republic at an adequate frequency given the level of decision-making required of the body;

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[1] Pursuant to § 3(5) of the Business Corporations Act, § 77(1) of the Revised Partnership Act, § 5(1) of the Limited Partnership Act, and § 6(1) of the Limited Liability Company Act, every non-resident domestic corporation, partnership, limited partnership, and limited liability company is prohibited from carrying on the business of banking.

[2] Pursuant to § 3(5) of the Business Corporations Act, § 77(1) of the Revised Partnership Act, § 5(1) of the Limited Partnership Act, and § 6(1) of the Limited Liability Company Act, every non-resident domestic corporation, partnership, limited partnership, and limited liability company is prohibited from carrying on the business of granting policies of insurance or assuming insurance risks.

(b) at meetings described in sub-paragraph (a), there is a quorum physically present in the Republic;

(c) the minutes of meetings described in sub-paragraph (a) record the making of strategic decisions of the relevant entity at the meeting;

(d) the governing body of the relevant entity, as a whole, has appropriate knowledge and expertise to discharge its duties as a governing body; and

(e) the minutes of all governing body meetings and appropriate records of the relevant entity are kept in the Republic.

(4) A relevant entity satisfies the test in paragraph (2)(c) in relation to a relevant activity if its core income-generating activities in relation to that relevant activity are conducted by any other person only if:

(a) the relevant entity is able to monitor and control from the Republic the carrying out of the core income-generating activity by the other person;

(b) the core income-generating activity is carried out in the Republic; and

(c) the economic substance of the other person will not be counted multiple times by multiple relevant entities when evidencing their own substance in the Republic.

(5) *Pure equity holding companies.* 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.

(6) *High risk IP business.* In relation to a high risk IP business, the test in paragraph (2)(c) is presumed not to be met during a fiscal period unless the relevant entity provides sufficient evidence to rebut this presumption as provided in Section 6 of these Regulations.

(7) *Guidance.* The Registrar may issue guidance on how the economic substance test may be met.

(8) *Assessment.* The Registrar may determine that a relevant entity has not met the economic substance test during any financial period of the entity starting on or after 1 January 2019.

Section 5. Core Income-Generating Activities

For purposes of these Regulations, "core income-generating activities" means activities of central importance to a relevant entity in terms of generating income and that are being carried out in the Republic including:

(a) in relation to distribution and service center business:

i. transporting and storing goods, components, and materials;

ii. managing stocks;

iii. taking orders; or

iv. providing consulting or other administrative services;

(b) in relation to finance and leasing business:

i. agreeing funding terms;

ii. identifying and acquiring assets to be leased (in the case of leasing);

iii. setting the terms and duration of any financing or leasing;

iv. monitoring and revising any agreements; or

v. managing any risks;

(c) in relation to fund management business:

i. taking decisions on the holding and selling of investments;

ii. calculating risk and reserves;

iii. taking decisions on currency or interest fluctuations and hedging positions; or

iv. preparing relevant regulatory or other reports for government authorities and investors;

(d) in relation to headquarters business:

i. taking relevant management decisions;

ii. incurring expenditures on behalf of Group entities; or

iii. coordinating Group activities;

(e) in relation to holding company business, all activities related to that business;

(f) in relation to IP business:

i. where the intellectual property asset is a:

1. patent or an asset similar to a patent, research and development; or

2. non-trade intangible (including a trademark), branding, marketing and distribution

ii. in exceptional cases, except if the relevant activity is a high risk intellectual property business, other core income-generating activities relevant to the business and the intellectual property assets, which may include:

1. taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the intangible asset generating income;

2. taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the intangible asset; or

3. carrying on the underlying trading activities through which the intangible assets are exploited leading to the generation of income from third parties;

(g) in relation to shipping business[3]:

i. managing crew (including hiring, paying and overseeing crew members);

ii. overhauling and maintaining ships;

iii. overseeing and tracking deliveries;

iv. determining what goods to order and when to deliver them; or

v. organizing, and overseeing voyages;

(h) in relation to banking business:

i. raising funds;

ii. managing risk including credit, currency and interest risk;

iii. taking hedging positions;

iv. providing loans, credit or other financial services to customers;

v. managing regulatory capital; or

vi. preparing regulatory reports and returns; and

[3] 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.

(i) in relation to insurance business:

i. predicting and calculating risk;

ii. insuring or reinsuring against risk; or

iii. providing client services.

Section 6. Requirement to Provide Information

(1) *Generally.* A relevant entity must provide any reports, returns, or other information reasonably required by the Registrar in order to assist the Registrar in making a determination under Section 4(8) of these Regulations. These reports, returns, or other information must be provided in such form, at such times, and in respect of such financial periods as the Registrar may require. The Registrar may serve notice on any person requiring the person to provide, in a form approved by the Registrar and within the period specified in the notice and at such place as is specified in the notice, such documents and information as the Registrar may reasonably require for the purpose of facilitating the Registrar's exercise of functions under these Regulations.

At a minimum, each relevant entity must prepare and file the following information for the relevant financial period:

(a) business type (to identify the type of mobile activity);

(b) amount and type (e.g. rents, royalties, dividends, sales, services) 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) information showing that it has conducted relevant core income-generating activities in the Republic.

(2) *High risk IP business.* The presumption specified in Section 4(6) of these Regulations applies unless the relevant entity:

(a) evidences that, in addition or alternatively to research and development, branding, and distribution activities, a high degree of control over the development, exploitation, maintenance, enhancement, and protection of the intangible asset is, and historically has been, exercised by full time highly skilled employees that permanently reside and perform their core activities within the Republic; and

(b) supports these evidences through the provision of additional information, including detailed business plans which allow to clearly ascertain the commercial rationale of holding IP assets in the Republic; employee information including

level of experience, type of contracts, qualifications, and duration of employment; and concrete evidence that decision-making is taking place within the Republic.

(3) *Penalties.* A person who, having been required under this Section 6 to provide or make available to the Registrar any information that is in that person's possession or under that person's control:

(a) without lawful excuse fails so to do, within the time specified by the Registrar; or

(b) knowingly or willfully alters, destroys, mutilates, defaces, hides, or removes any such information;

commits an offence and is liable to a fine of $10,000, revocation of its formation documents and dissolution, or both.

Section 7. Failure to Satisfy the Economic Substance Test

(1) *Notice.* If the Registrar determines that a relevant entity has not met the economic substance test as required under Section 4 of these Regulations for a financial period, the Registrar shall issue a notice to the relevant entity stating the reasons for its determination, any applicable penalties, and such other information as may be determined by the Registrar.

(2) *Penalties.*

(a) A relevant entity that has not met the economic substance test as required under Section 4 of these Regulations for a financial period shall be liable to a fine not exceeding $50,000 for each relevant such financial period, revocation of its formation documents and dissolution, or both.

(b) If, for the financial period following a financial period in which a penalty, other than revocation of its formation documents, was imposed under subsection (a), the Registrar determines that a relevant entity has not met the economic substance test, the relevant entity shall be liable for a fine not exceeding $100,000, revocation of its formation documents and dissolution, or both.

Section 8. Exchange of Information to Competent Authorities

(1) *General.* In addition to other penalties prescribed by Section 7 of these Regulations, if the Registrar determines that a relevant entity has not met the economic substance test as required under Section 4 of these Regulations for a financial period, the Registrar ~~shall obtain objective evidence of tax residence outside of the Republic[4] from each non-relevant entity~~

[4] ~~The Registrar may regard an entity as tax resident outside the Republic if the entity is subject to the tax regime of another jurisdiction by reason of its domicile, residence, or any other criteria of a similar nature. The Registrar will require any entity claiming to be tax resident outside the Republic to produce satisfactory evidence to substantiate the same, such as a tax identification number, tax residence certificate, assessment or payment of a tax liability, or other proof the entity is subject to the tax regime of another jurisdiction.~~

~~and~~ shall provide the information provided under Section 6 of these Regulations relating to that relevant entity for that financial period to:

(a) the competent authority of the European Union Member State in which the parent company, ultimate parent company, and ultimate beneficial owner of the relevant entity resides; and

(b) if the relevant entity is organized outside the Republic, the competent authority of the jurisdiction in which the relevant entity is organized.

(2) *High risk IP business.* For a relevant entity that is carrying on a high risk IP business, regardless of whether the Registrar has made a determination under Section 4(8) of these Regulations, the Registrar shall provide the information provided under Section 6 of these Regulations relating to that relevant entity for each financial period to:

(a) the competent authority of the European Union Member State in which the parent company, ultimate parent company, and ultimate beneficial owner of the relevant entity resides; and

(b) if the relevant entity is incorporated outside the Republic, the competent authority of the relevant jurisdiction in which the relevant entity is incorporated.

(3) *International agreements.* Any exchange of information pursuant to this section must be in accordance with international standards and the international instruments to which the Republic is a party.

(4) *Non-relevant entities.* In the event an entity is not deemed to be a relevant entity because its business is centrally managed and controlled outside the Republic and it is tax resident outside the Republic, the Registrar shall obtain objective evidence of tax residence outside of the Republic[4] from each non-relevant entity and shall provide any relevant information or evidence provided to the Registrar which relates to the entity to:

(a) the competent authority of the European Union Member State in which the parent company, ultimate parent company, and ultimate beneficial owner of the entity resides; and

(b) the competent authority of the European Union Member State in which the entity claims to be tax resident.

[4] The Registrar may regard an entity as tax resident outside the Republic if the entity is subject to the tax regime of another jurisdiction by reason of its domicile, residence, or any other criteria of a similar nature. The Registrar will require any entity claiming to be tax resident outside the Republic to produce satisfactory evidence to substantiate the same, such as a tax identification number, tax residence certificate, assessment or payment of a tax liability, or other proof the entity is subject to the tax regime of another jurisdiction.

Section 9. False or Misleading Information

(1) *Prohibition.* A person shall not knowingly or willfully supply false or misleading information to the Registrar under these Regulations.

(2) *Penalty.* A person who contravenes subsection (1) shall be liable to a fine not exceeding $50,000, revocation of its formation documents and dissolution, or both.

Section 10. Right of Appeal

A person upon whom a penalty is imposed pursuant to these Regulations may:

(a) appeal on the ground that liability to that penalty does not arise; or

(b) appeal its amount.

Section 11. Confidentiality

Except in so far as may be necessary under these Regulations, the Registrar and any person acting on behalf of the Registrar shall preserve and aid in preserving confidentiality with regard to all matters relating to information or documents relating to a relevant entity that may come to the Registrar's knowledge pursuant to these Regulations.

Section 12. Reserved Power to Alter or Repeal

All provisions of these Regulations may be altered from time to time or repealed by the Registrar pursuant to the authority granted under § 129.5(2) of the Business Corporations Act.

REPUBLIC OF THE MARSHALL ISLANDS
CONFIDENTIAL
C.M. 197 (2019)

FOR ACTION
Minister of Finance, Banking and Postal Services

FOR INFORMATION
All Ministers

SUBJECT: Proposed Amendments to the Economic Substance Regulations, 2018, as amended, promulgated pursuant to Section 129.5 of the Business Corporation Act.

At its meeting on August 15, 2019, the Cabinet:

1. **approved** in principle, the proposed amendments to Section 8(1) of the Economic Substance Regulations, 2018 promulgated pursuant to Section 129.5 of the Business Corporations Act, pending and subject to the comments of the Banking Commissioner and clarification of the Attorney General's Office regarding the Administrative Procedures Act.

Wilbur Heine
Acting President

Earlie Carter Bing
Clerk of the Cabinet

[Reference – C.P. 82371 (2019)]
Signed by the Acting President on August 15, 2019.