

ECONOMIC
SUBSTANCE:

IMPACT ON TAX STRUCTURES

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ECONOMIC SUBSTANCE: HOW DID WE GET HERE?

- Incorporating in jurisdictions with a 0% tax rate
- Panama papers
- OECD and the EU Code of Conduct Group “blacklist”



WHAT IS ECONOMIC SUBSTANCE?

Entities incorporated in specific jurisdictions with these laws must have:

1. “Adequate” employees and expenditures located in that jurisdiction;
2. “Appropriate” physical offices or premises; and
3. In some situations, be directed and managed in that jurisdiction

If an entity engages in a “relevant activity” it must have “economic substance.”



WHAT ARE THE RELEVANT ACTIVITIES?

- Banking business
- Distribution and service center business
- Fund management business
- Financing and leasing business
- Headquarters business
- Insurance business
- Shipping business
- **Holding business**
- **Intellectual property business**

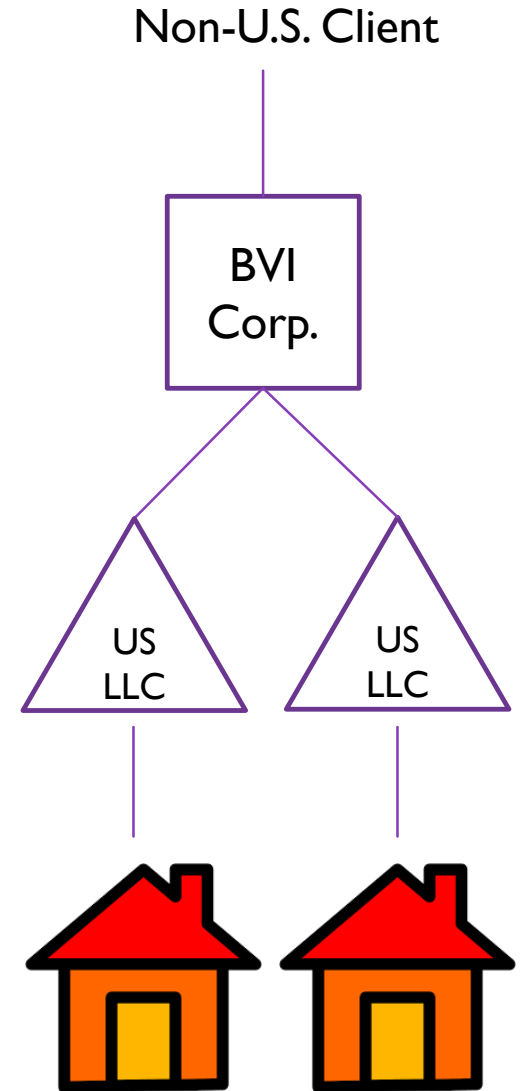


HOLDING BUSINESS

- Defined as “the business of being a pure equity holding entity”, which is a “legal entity that **only** holds equity participations in other entities **and only** earns dividends and capital gains.”
- Should be read literally

A TRAP FOR THE UNWARY

- In the U.S., single-member limited liability companies are considered disregarded for tax purposes. The BVI Corp. is the taxpayer.
- However, under BVI Economic Substance laws, the U.S. LLC is not disregarded, the LLC interests are considered equity participations.





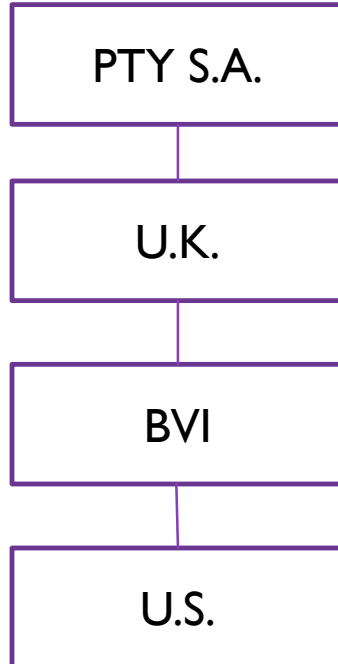
SHIPPING BUSINESS

- The business of overhauling and maintaining ships, overseeing and tracking deliveries, and organizing overseas voyages would qualify as “shipping business.”
- Pleasure yachts acquired and used by owners, or employing a crew to manage the vessel, would not constitute “shipping business.”

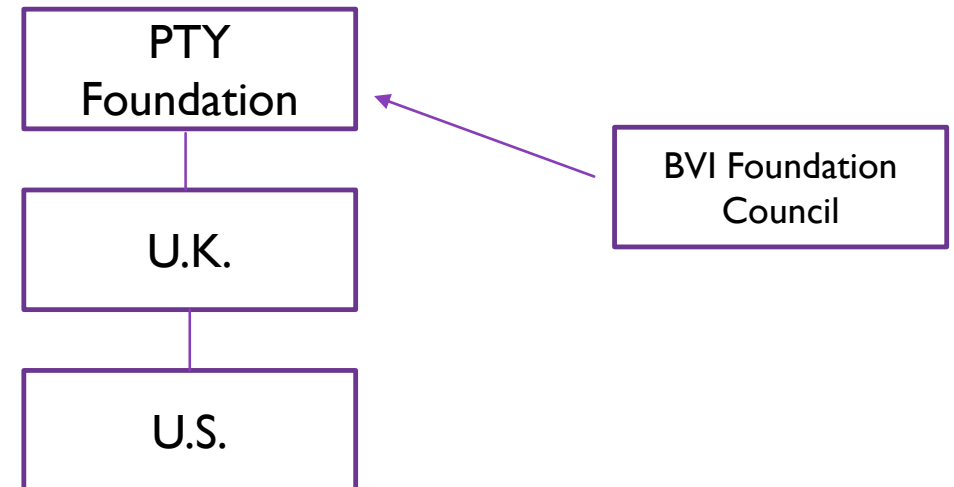
HEADQUARTERS BUSINESS

- Business of providing for the same “group”:
 - Senior Management
 - Control; or
 - Substantive control
- What is a “group” for this purpose?

1)

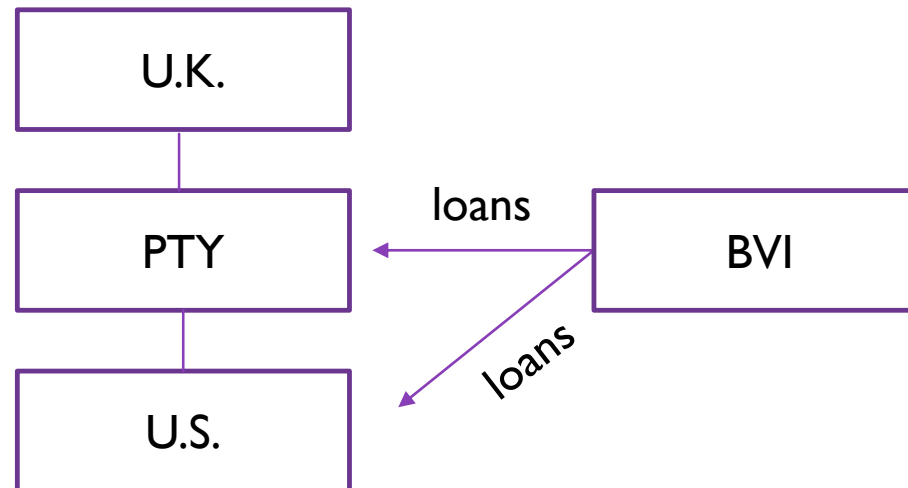


2)



FINANCING AND LEASING BUSINESS

- “Business of providing credit facilities of any kind for consideration, such as interest.”
 - Related (or unrelated) party loans (what if non-interest bearing?)
 - Fees for guarantees





INTELLECTUAL PROPERTY BUSINESS

- In addition to offices, employees and management, entities in ES compliant jurisdictions which own IP have a rebuttable presumption of noncompliance, a higher standard.
- Penalties are significantly higher for IP business entities as well.

PENALTIES

Jurisdiction	BVI	Cayman Islands	Bermuda	The Bahamas
1 st Offense	\$5K-\$20K	\$12.2K	\$7.5K-\$50K	\$10K
2 nd Offense	\$10K-\$200K	\$122K	\$25K-\$100K	\$150K
3 rd Offense	Struck off	Struck off	\$50K-\$250K Struck off	Struck off



REPORTING

- Even if an entity does not engage in a “relevant activity” and therefore does not need to have “economic substance” in its particular jurisdiction, it must still make a report.
- Annual reporting to registered agent (who is also eligible to be fined by the government).
- Likely to be an online submission but this will depend on registered agent and jurisdictional requirements (not yet released)
- Financial period



IMPACT

- Increased tax transparency
- Communication between blocker jurisdictions and tax homes
- Potential blacklisting of certain jurisdictions who do not abide by ES requirements
- Prosperity in the Caribbean region affected
- Reorganization of structures