

# Presentation on Economic Substance Regulations (ESR)

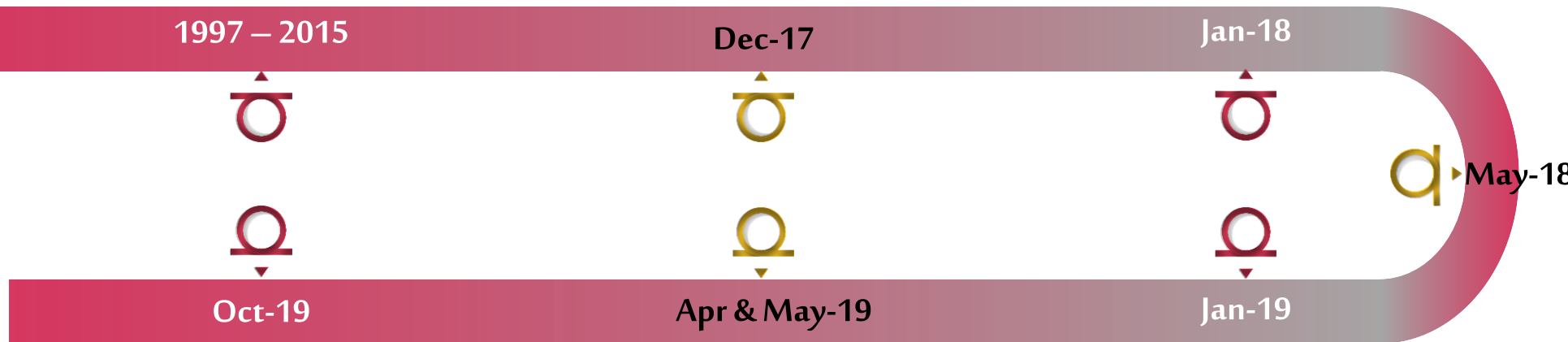
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# ESR Implementation in UAE – CONTEXT

- EU Adopted **Code of Conduct** to curb harmful tax competition
- OECD's **Report on Harmful Tax Competition**
- OECD's **BEPS Action Report** with 15 Action Points ([Annexure 1](#))

- EU released **1st List of Blacklisted Countries**, along with 3 listing criteria ([Annexure 2](#))
- **UAE was added to the EU's Black List of No tax Jurisdiction Countries**

- UAE was moved to **Grey List** based on commitments towards tax reforms



- UAE was removed from EU's Black List

- UAE **implemented ESR** (Action 5)
- UAE **ratified** Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (Action 6)
- UAE **Implemented CbCR** (Action 13)
- Mutual Agreement Procedure (Action 14)

- UAE **missed the deadline** of Dec-18 for applying BEPS minimum actions
- UAE **added back to the EU's Black List**

- UAE **joined** OECD BEPS Inclusive Framework
- **Committed** to implement Minimum Actions (5, 6, 13 & 14)
- UAE **will be subject to** (and assist with) peer reviews focusing on monitoring the implementation of the BEPS Action Points

## Other Tax Heavens That Implemented ESR?



BVI



Cayman Islands



Guernsey



The Isle of Man



Mauritius



Bermuda Bahamas



Bahrain



Jersey

A brief comparison of ESR in few major countries is provide in [Annexure 3](#)

## What is ESR?

- Economic Substance is a “tax principle” stating that a transaction must have a **substantial purpose** and an **economic effect**, other than reduction of tax liability and tax effect, in order to be considered valid
- Regulations requiring companies to **demonstrate actual economic activities** to achieve the economic interest, is **ESR**

### High Tax Jurisdictions

- R & D
- Manufacturing
- Shared Support Services

**Tax Deductible High  
Cost / expense**

**Low Margins**

**Tax on Low Margins**

Royalty, Interest, Dividend,  
Dist. Profits, Services Fees &  
Management Fees etc.

Payments

### Low Tax Jurisdictions

- IPs
- Investment / Finance
- Sales & Distribution
- Management Services

**Low Costs**

**High Margins**

**Tax @ 0%**

# When ESR was implemented in UAE & Due Dates for Compliance?

## When?



**30-Apr-2019:**

Resolution of the Cabinet of Ministers No. (31) for 2019 concerning ESR

**11-Sep-2019:**

Ministerial Decision no. 215 of 2019, Guidance on Applicability and Compliance to ESR

## Compliance Due Dates

1. Filing of Notification to declare Relevant Activities in 2019

Due Date	Relevant Authority
31-May-20	DAFZA
12-Jun-20	DIFC
30-Jun-20	SAIF, AFZ, ADGM, DMCC, RAKICC, HFZ, DWTCA, DACC, RAKEZ & MOE

2. Submission of ESR Report to prove Economic Substance in UAE for all Relevant Activities in 2019

Due Date
12 Months from the end of FY (FY started in 2019)

## Applicability of ESR

The Regulations applies to all entities in UAE including mainland, free zone and offshore entities, engaged in “Relevant Activity” (Article 3 read with Article 1 of ESR)



### Exemptions

1. Licensees that are directly or indirectly at least 51% owned by the Federal or an Emirate Government, or a UAE Government body or authority
2. Entities not engaged in any relevant activity

### Note:

1. ESR is an annual compliance i.e. annual assessment of relevant activity and passing economic substance tests
2. ESR compliance to be ensured for all trade licenses separately
3. Applicable in Branches and Partnerships as well



## Relevant Activity



### Banking –

Raising funds, managing risks, providing loans, etc.



### Insurance –

insuring or re-insuring, risk calculation



### Fund Management

Investment decisions



### Financing & Leasing



**Holding Company (only dividend & Capital Gain), if deriving income other than dividends and capital gains** activities associated with the type of income generated



### Distribution & Service Centre



### Intellectual Property -

Branding, marketing and distribution



### Headquarter-

Management, coordinating group activities



### Shipping (Marine) –

Managing crew and ship maintenance

To determine “Relevant Activity”, “substance over form” approach is used to look beyond the activities listed in commercial license  
Further details on relevant activities are provided in [Annexure 4 - 9](#)



## Few Examples of Relevant Activity

#	Example	Possible Relevant Activity
1	JK Bank in UAE offers savings account, current accounts, loans, Credit & Debit Cards to its individual as well as corporate customer in UAE	Banking
2	If a foreign bank have branch in UAE provides support service for the UAE loans, directly distributed by foreign bank, for this facility UAE branch charge monitoring fees and arranging fees to the foreign bank	Service Centre
3	ABC Life Insurance (UAE) provides life, health and car insurance in and from the UAE, and is regulated as an Insurer by the UAE Insurance Authority	Insurance Business (Life, Health & Car all verticals are covered but not the Insurance Agents / Brokers)
4	RSQ Is the fund registered with SCA in UAE. It has appointed PQR LLC as Investment Manager who looks after day to day business, investment and disinvestments decision. POR LLC takes all the discretionary decision.	RSQ – Fund – Not Applicable PQR – Applicable as Investment Fund Management Business
5	STU LLC (UAE) lends AED 1,000,000 to its subsidiary, VWX LLC (UAE) and XYZ Ltd. (India), at a 10% interest rate per annum.	Lease Finance (Both loans VWX and XYZ)
6	Gift Trade Co is an Wholesaler for Gift products and normally gives 30 days of the credit period to its customer. i. If customer does not pay within the credit period, Interest is charged on Late payment. ii. Extended credit period of 180 days is provided	i. No ii. Yes – Lease Finance
7	MNQ LLC has given loan to RST India without any consideration towards interest or any other charges, however, as per the loan agreement after 3 years the loan will be converted into equivalent value of equity shares of RST India	MNQ – Lease Finance

## Few Examples of Relevant Activity

#	Example	Possible Relevant Activity
7	MNO LLC (UAE) is part of a multinational group with subsidiaries around the world. Each of the <b>Senior Management team based in the UAE</b> has responsibility for a different region, and regularly <b>spend time at the subsidiaries</b> with the local management teams <b>providing strategic direction</b> and <b>helping manage material risks</b> . In addition, MNO LLC supports the group in <b>managing risk through the procurement of external advice centrally</b> , and the associated <b>costs are shared</b> amongst the group.	Headquarter Business
8	XYZ Co LLC purchases goods from a Group Company based in India and then resells throughout Middle East.	Distribution Centre
9	GST FZCO is JAFZA based entity and is a Trader of Food and vegetable, it purchases Fruits and Vegetables from India from unrelated person and resells to Lebanon	NO (Unrelated Person)
10	ABC LLC's is a <b>licensed Holding Company</b> , holding shares in four subsidiary companies, and ABC LLC is itself held by the regional holding company of the group headquartered in France. The <b>only</b> income earned by ABC LLC are annual dividends from its subsidiaries.	Holding Company
11	Next Year, ABC LLC started earning Management Fees from its subsidiary for providing directions on key decisions and managing material risks	Holding Company (Ceases) Headquarter Business
12	Charter LLC owns a ship and charters it on a bareboat basis to Cargo LLC that uses and operates the ship to carry cargo from the UAE to other countries.	Charter LLC - NO Cargo LLC – Shipping Business

## Key Concepts

**Substance over Form**

([Annexure 10](#))

**Adequate and  
Appropriate**

**CIGA**

([Annexure 11](#))

**Economic Substance  
Tests** ([Annexure 12](#))

**BEPS**

([Annexure 13](#))

**Self-Assessment &  
Self Reporting**

**Passive Activities**

**Connected Persons**  
([Annexure 14](#))

**Outsourcing  
Activities** ([Annexure 15](#))

### Note:

1. The ESR provisions are drafted based on prescribed International Standards & Concepts
2. The nature of compliance involves subjectivity & judgemental calls needs to be taken on multiple aspects
3. For right judgements, it is important to consider international views on the concepts and provisions of the law

## Way Forward for UAE Entities

In order to comply with the provisions of ESR, the suggested strategy for implementation is as follows:

1. **Identify** the trade licenses and respective due date for compliance
2. **Examine** relevant activities for 2019 and 2020
3. **File** Notification as per due date
4. **List** CIGA for Relevant Activities
5. **Assess** the place of management of CIGA
6. **Perform** economic substance tests and gather proof / evidences in relation to the tests 2019 & 2020
7. **Take corrective actions** to ensure economic substance in UAE 2020
8. **Submit** Economic Substance Report as per due date

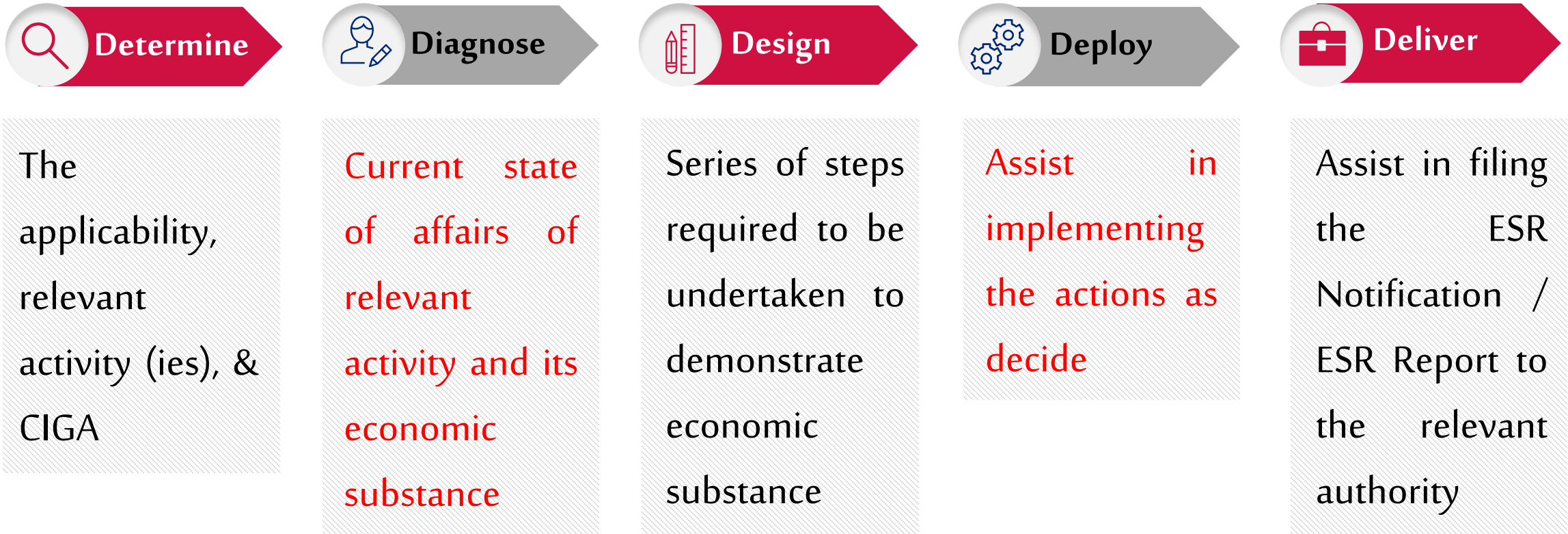
## Contents of ESR Notification

**The Licensee is supposed to provide the Regulatory Authority the relevant information annually within the time determined by the Authority, the information required is as follows:**

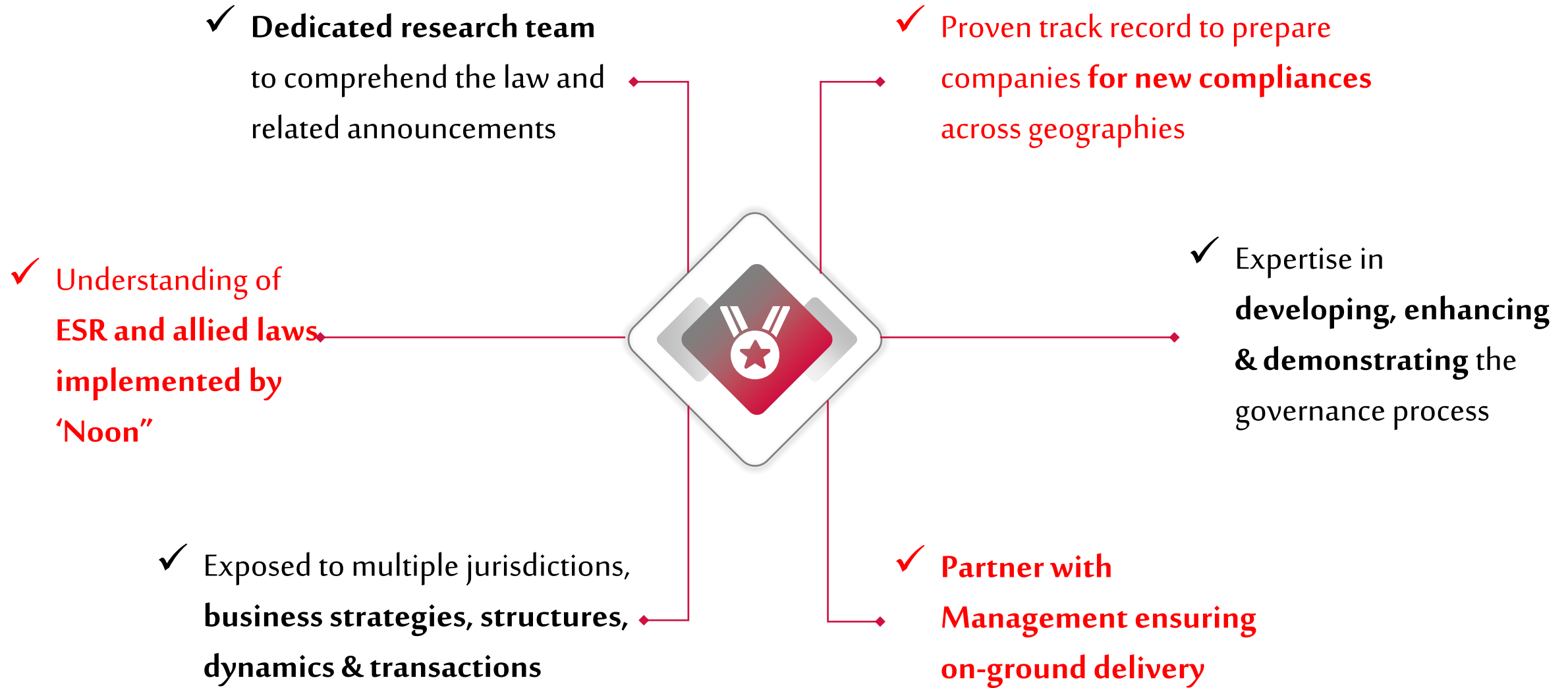
- |  |   |
|--|---|
| <ol style="list-style-type: none"><li>1. Whether or not it carries Relevant Activity</li><li>2. Did the Licensee earn income from the Relevant Activity during the Reportable Period?</li><li>3. Whether or not all or any part of the Licensee's gross income in relation to a Relevant Activity is subject to Tax in a jurisdiction outside UAE and;</li><li>4. Licensee Details like Name, License No, Address, Financial Year</li><li>5. Reportable Period details</li></ol> | <ol style="list-style-type: none"><li>6. If the Relevant activity includes High Risk IP business, the licensee needs to provide additional information like details relating to your<ul style="list-style-type: none"><li>• direct parent company,</li><li>• ultimate parent company,</li><li>• and ultimate beneficial owner(s) (as applicable)</li></ul></li><li>6. Declaration if 51% of Share Capital is held by Federal Government or Emirate Government or any Government body</li><li>7. Details of Designated person, Name contact details and email Id</li></ol> |
|--|---|

## How Nimai-RAMA can help?

Nimai-RAMA has framed a 5D's approach for assisting its clients to comply ESR in UAE.



## Why Nimai-RAMA?





## Why Act Now?

### 1. Monetary Penalties

**Non-compliance  
to the provisions  
of ESR and  
Inability to prove  
Economic  
Substance in UAE**

### 2. Limited Time for Corrective Actions

Limited corrective actions can be taken for relevant activities of 2019, but still 6 months to assess and take corrective actions for 2020

### 3. High Penalties for 2020

Monetary Penalties for 2019 are low as compared to penalties 2020 onwards:

**2019** – AED 10,000  
to AED 50,000

**2020** – AED 50,000  
to AED 300,000

## IF Licensee Fails To Meet The ES?

### Article 9, Cabinet Resolution No. 31

1. The Regulatory Authority, if they determined on the ES Test, shall provide the information provided under Article 8 relating to that Licensee for that period to the Competent Authority ("MoF").
2. The Competent Authority shall share the information of the licensee to the Foreign Competent Authority
6. Competent Authority will provide the information to-
  - the Foreign Competent Authority of the parent company, the ultimate parent company, and the Ultimate Beneficial Owner of the Licensee
  - If the Licensee is incorporated outside the State, the Foreign Competent Authority of the country or territory in which the Licensee is incorporated.

## INTRODUCTION

- Team Nimai - RAMA has wide experience in the field of **Risk Management & Business Advisory, Indirect Taxes, ERP Implementations, Management Assurance and Corporate Finance** across varied industries for reputed corporates within India and Overseas.
  - NIMAI was started in **early 2009**, with the Vision “**To be the Financial Consultant of choice by virtue of its superior service quality**”.
  - NIMAI is headquartered at Dubai-UAE with branch offices across UAE and Bangladesh, India and Africa.
- 
- RAMA has an edge of a blended resource pool of CA, MBA, ERP consultants & Subject Matter Experts, which enables to provide comprehensive services beyond the traditional way of auditing & consulting.
  - Expertise in Business Advisory, Indirect Taxes and ERP empowers RAMA to contribute in successful transition to new Business, Tax, and Economic regimes like GST in India and VAT in UAE.
  - **RAMA's IT arm** is a Microsoft Certified partner for implementing and managing Microsoft Dynamics products like AX, Navision, D365 and CRM.
  - Also, partners with Eresource ERP, SAB Infotech, Kockpit BI (Business Intelligence) Tool, Dynamics Mobile and IRIS for GST filings.

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**Our Reach:** GCC | New York | Singapore | London | Hong Kong | Europe

## Annexure-1

### List of the BEPS Action Plans

Action Plan	UAE
Action Plan 1	Addressing the tax challenges of the digital economy
Action Plan 2	Neutralize the effects of Hybrid Mismatch arrangements
Action Plan 3	Strengthen Controlled Foreign Company (CFC) Rules
Action Plan 4	Limit base erosion through interest deductions and other financial payments
Action Plan 5	Counter harmful tax practices-
Action Plan 6	Preventive treaty abuse
Action Plan 7	Prevent the artificial avoidance of Permanent Establishment (PE) status
Action Plans 8-10	Transfer Pricing Outcomes in line with Value Creation/ Intangibles/ Risk and Capital and other high-risk transactions
Action Plan 11	Measuring and monitoring BEPS
Action Plan 12	Disclosure of aggressive tax planning arrangements
Action Plan 13	Re-examine transfer pricing documentation
Action Plan 14	Making dispute resolution more effective
Action Plan 15	Developing a multilateral instrument



## Annexure-2

### Transparency

The law shall enable and ensure absolute transparency along with promoting increased certainty and predictability.

Action Plans 11, 12, 13 & 14 are towards this direction

### Coherence

Domestic tax laws are coherent as tax deductible of person constitutes income of the recipient. However, international coherence in corporate income tax is lacking. Action plan with a new set of standards designed to avoid double non-taxation.

Action plans 2, 3, 4 & 5 are towards this direction

### Substance

"Substance' warrants reporting and full disclosures of the effects and benefits of international standards.





Action plans 6, 7, 8, 9 & 10 are towards this direction

**Industry specification** - Action Plan I address the tax challenges of digital economy;

**Execution** - Action Plan 15 addresses development of multilateral instrument for amending bilateral treaties.



## Annexure-3

	UAE	Cayman	BVI	Bahrain
				
<b>Regulation</b>	CABINET OF MINISTERS RESOLUTION No. 31 of 2019	THE INTERNATIONAL TAX CO-OPERATION (ECONOMIC SUBSTANCE) LAW, 2018	ECONOMIC SUBSTANCE (COMPANIES AND LIMITED PARTNERSHIPS) ACT, 2018	MOICT Ministerial Order No. (106) of 2018
<b>Date of implementation</b>	30 <sup>th</sup> April 2019	17 <sup>th</sup> Dec-2018 (Revised on 07 <sup>th</sup> Jan 2020)	19 <sup>th</sup> -Dec-2019	27 <sup>th</sup> Dec 2018
<b>No of Articles in Law</b>	19	16	17	11
<b>Difference in Defn of Distribution Goods relevant Activity</b>	It is defined as Purchasing and importing of Goods from for Foreign Connected person in UAE and then reselling it outside UAE	It is defined as Purchasing Goods from same Group and then reselling it Outside the Island. It is similar to UAE definition.	It is defined as Purchasing goods from Foreign Affiliates and then reselling. <b>It has not used word "Reselling outside state"</b>	It is defined as Generating income from purchasing of Goods from group members and reselling the same. <b>It has not included word "reselling outside Bahrain"</b>
<b>Audit of books</b>	No such requirement of Audit of Books	No such requirement of Audit of Books	No such requirement of Audit of Books	Required for appointment of External Auditor and Audit of Books
<b>Relevant Activity No</b>	9	9	9	11
<b>Due date of Notification</b>	To be filed by 30th June 2020. Each Regulatory Authority is given the due dates	30th June 2020		30th June 2020





### Investment Fund Management

- It includes providing Discretionary Investment Fund Management services include making investment, divestment and risk related decisions on behalf of a domestic or foreign “Investment Funds”.
- The Investment Fund itself is not considered an Investment Fund Management Business, unless it is a self-managed fund (the Investment Manager and the Investment Fund are part of the same entity).

### CIGA for Investment Fund Management

- a) taking decisions on the holding and selling of investments
- b) calculating risk and reserves
- c) taking decisions on currency or interest fluctuations and hedging positions.
- d) preparing reports to investors or any government authority with functions relating to the supervision or regulation of such business



### Lease Finance Business

- Any company which offers credit or financing for any kind of consideration, such as loans, hire purchase agreements, long term credit plans, and finance leases in relation to assets other than land. This includes intra - group financing. The scope does not extend to cases where credit is offered and there is no expectation of consideration from the credit when providing it.
- Consideration will include interest, origination & processing fees, gains upon conversion of a loan into the share capital of the debtor, and late payment penalties. However, granting of security in favor of the lender would not constitute consideration.

### CIGA For Lease Finance Business

- a) agreeing funding terms, identifying and acquiring assets to be leased (in the case of leasing).
- b) setting the terms and duration of any financing or leasing.
- c) monitoring and revising any agreements & managing any risks



### Headquarter Business

A Licensee is regarded as carrying on a Headquarters Business if the Licensee provides services to foreign group companies, and through the provision of such services:

- The Licensee takes on the responsibility for the overall success of the group; or
- The Licensee is responsible for an important aspect of the overall group's performance.

Whether or not an entity is deemed to be a company headquarters will depend on the services it provides to other entities within the group.

### CIGA for Headquarter Business

- a) taking relevant management decisions.
- b) incurring operating expenditures on behalf of group entities.
- c) coordinating group activities.



### Intellectual Property

A business which is licensed in the UAE to hold, exploit or receive income from intellectual property assets. An IP assets has been defined as intellectual property right in intangible assets including, but not limited to, copyright, trademarks, patents, brand and technical know how, are within scope of the Economic Substance Rules.

### CIGA for IP Business

- a) taking strategic decisions and managing (as well as bearing) the principal risks related to development,
- b) Managing and bearing the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the intangible asset
- c) carrying on the ancillary trading activities through which the intangible assets are exploited leading to the generation of income from third parties



### Holding Company

A company will be regarded as a holding company if its sole function is to acquire and hold equities, and the equities in question are controlling stakes in other companies and it does not carry and other commercial activity.

If a company carries on any other relevant activity (irrespective of profit), then it would not fall within the definition of a holding company.

### Reduced Compliance for Pure Holding Company

- a) Complies with the requirement to submit any documents, records or information to the relevant Regulatory Authority in accordance with the law applicable to the Licensee in the State.
- b) Has adequate employees and premises for holding and managing the Holding Company Business



### Distribution & Service Center

- A Licensee is considered engaged in a “Distribution Business” if it purchases raw materials or finished products from a foreign group company and distributes those raw materials or finished goods.
- A Licensee is considered engaged in a “Service Centre Business” if it provides consulting, administrative or other services to a foreign group company, and those services are in connection with the foreign group company’s business outside the UAE.

### CIGA for Distribution & Service Centre

- a) transporting and storing component parts, materials or goods ready for sale.
- b) managing inventories.
- c) taking orders.
- d) providing consulting or other administrative services.



### Substance Over Form

1. The sentence “Substance Over Form” is commonly used in the regulation
2. UAE businesses are expected to use a ‘substance over form’ approach to determine whether or not they undertake a Relevant Activity and, as a result, are within the scope of the Regulations. This determination would require the UAE business to not only consider the activities stated under their commercial licence or registration certificate but also to assess the activities carried out during a financial period.
3. Thus it is important to assess the actual activity of the Licensee.
4. E.g.: A Entity has Trading Activity mentioned in the Trade license issued by the relevant Authority, but if the Entity has given a Loan with consideration to any of the Entity in UAE or Outside UAE, he will be classified as doing Lease-Finance Business even though he is in Trading Activity as per Document.
5. Thus assessment of the relevant activity should be done considering the overall and holistic approach as the law being newly implemented across geographies.





### What is CIGAs- BASICS

1. CIGAs are the key essential and valuable activities that generate the income of the company,
2. CIGAs that generate the income must be performed in the UAE.
3. Where the CIGAs involves making relevant decisions, then the majority of those making the decisions must be present in the UAE when the decision is made, otherwise the decision will not be considered to made in the UAE.
4. Activities undertaken outside the UAE must not be core income generating activities.
5. The taking of decisions outside the UAE would generally indicate performance of CIGAs outside the UAE.
6. Isolated decisions may be taken outside the UAE if it can be evidenced that the decisions taken and the CIGAs undertaken in the UAE are of a quality and quantity
7. CIGAs listed in the Regulations for each Relevant Activity are not an exhaustive list of all CIGAs in respect of each Relevant Activity.



## Annexure-12

### Economic Substance Test

Applicable when Relevant Activities are performed

Appropriately directed and managed in the UAE

- At least 1 quorate board meeting per year
- Minutes signed and kept in UAE
- Directors in UAE have necessary knowledge and expertise
- Key (strategic) decisions taken in UAE

CIGA are conducted in the UAE

- List included in the Regulations
- Principle is that the activities should show genuine activity in the UAE

Employees in UAE

- Adequate number of qualified employees who are physically present in the UAE (or adequate expenditure on outsourcing)

OPEX in UAE

- Adequate operating expenditure in the UAE (or adequate expenditure on outsourcing)

Physical assets in UAE

- Adequate physical assets in the UAE (or adequate expenditure on outsourcing)

Control and monitoring of outsourcing

- Third party service providers permitted, providing that the entity has sufficient control over the third party

Reduced test for Holding activities

Additional requirements for "High Risk IP" related activities



## Annexure-13

### Some Important Definitions in ESR

#### BEPS

1. BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity or to erode tax bases through deductible payments such as interest or royalties.
2. Although some of the schemes used are illegal, most are not. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level.
3. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.. Developing countries' higher reliance on corporate income tax means they suffer from BEPS disproportionately.
4. BEPS practices cost countries USD 100-240 billion in lost revenue annually.
5. Considering this OECD Members along with G20 Members and around 135 Countries and jurisdictions across Globe have adopted Inclusive Framework on BEPS which provided 15 Action points to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.
6. UAE Implemented ESR as per the mandatory Action point 5 being part of BEPS Inclusive Frame Work



## Annexure-14.1

### Connected Person

Law has defined Connected person a **natural or juridical person** who is related to **one or more natural or juridical person(s)** through **direct or indirect ownership or control, or common control**.

But the legislation has not provided any % or shareholding or any other guidance on what will be considered as Ownership or Control. Thus we may be require to look at international legislation or law to under stand it

**Determining Controlling Persons of Entity** - The CRS (OECD's Common Reporting Standard) provides that the term "Controlling Person" must be interpreted in a manner consistent with Recommendation 10 and the Interpretative Note on Recommendation 10 of the Financial Action Task Force (FATF) Recommendations (Section VIII(D)(6) and associated Commentary).

The Interpretative Note on Recommendation 10 states that for legal entity, summarises that controlling ownership interest depends on the ownership structure of the company. It may be based on a threshold, e.g. any person owning more than a certain percentage of the company (**e.g. 25%**) can be considered as Connected Person.

**Anti-Money Laundering and Combating the Financing of Terrorism and Illegal Organisations** - Guidelines for Financial Institutions by Central Bank provides the definition of "**Beneficial Owner**" i.e. Natural person who owns or exercises effective ultimate control, directly or indirectly, over a customer or the natural person on whose behalf a transaction is being conducted or, the natural person who exercises effective ultimate control over a legal person or Legal Arrangement.



## Annexure-14.2

### Connected Person

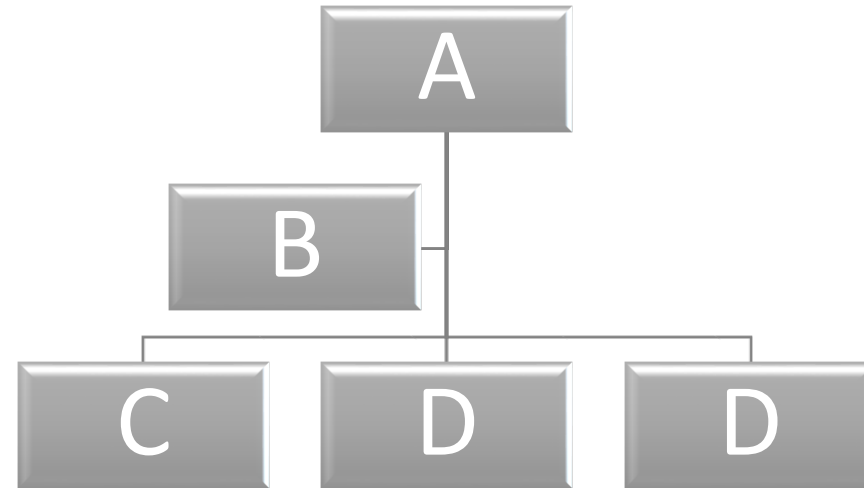
The Economic Substance law in **British Virgin Island** has also defined group as

**“group”**, in relation to a company (the “first company”), means the first company and any other company that is

- (a) a parent of the first company;
- (b) a subsidiary of the first company;
- (c) a subsidiary of a parent of the first company; or
- (d) a parent of a subsidiary of the first company

**Thus it is important to**

- Identify, beneficial owner (Natural person) of entities
- Identify, direct & indirect ownership of 25% or more
- Review the profile and control (example board, director, manager etc.) structure



## Annexure-15

### Outsourcing Arrangement

#### Who can you outsource to-

Third Party Service Providers and related companies

#### What can be outsourced

A Licensee can outsource any or all its CIGAs so long as the outsourced activities are performed in the UAE

A Licensee can outsource any or all non CIGA's activity outside UAE. For e.g. IT and HR activities

#### Licensee must demonstrate when outsourcing-

- Adequate supervision of the outsourced activity
- The outsourced activity must be conducted in the UAE
- The outsourcing provider has adequate substance in the UAE

