



10 LEAVES

# **ECONOMIC SUBSTANCE REGULATIONS IN UAE**



# KEYNOTES

- 🌱 Background
- 🌱 Who is covered under ESR
- 🌱 Relevant Activities
- 🌱 Economic Substance Test
- 🌱 Administrative Penalties
- 🌱 Way Forward
- 🌱 Q & A

# BACKGROUND

- UAE's commitment as a member of the OECD Inclusive Framework.
- Assessment of the UAE's tax framework by the European Union ("EU") Code of Conduct Group on Business Taxation.



- To ensure that UAE entities UAE undertaking certain activities report actual profits that are commensurate with the economic activity undertaken within the UAE.
- Major Step for UAE to be removed from the EU's Blacklist

Example – ABC UAE having \$ 5 Million turnover:

- |   |   |
|---|---|
| <ul style="list-style-type: none"><li>• No staff</li><li>• Virtual Office</li></ul> | <ul style="list-style-type: none"><li>• Not directed or managed in UAE,</li><li>• No core income generation activity in UAE</li></ul> |
|---|---|

# LICENSEE AND EXEMPT ENTITIES

## **Licensee:**

- Natural or judicial person who is licensed by the competent authority to carry out relevant activity.
- The law applies to UAE onshore, free zone companies, branches, and offshore companies in UAE.
- A License includes commercial license, certificate of incorporation or other form of permit.

## **Application:**

The ESR law is applicable to all the free zone companies, onshore and offshore and financial free zone companies.

## **Exempt Entities:**

- The entities who are directly or indirectly owned 51% or more by the UAE Government. This includes the Federal Government, the Government of any Emirate of the UAE or any governmental authority or body.
- Licensee that do not carry out relevant activity **during financial year**

# RELEVANT ACTIVITIES

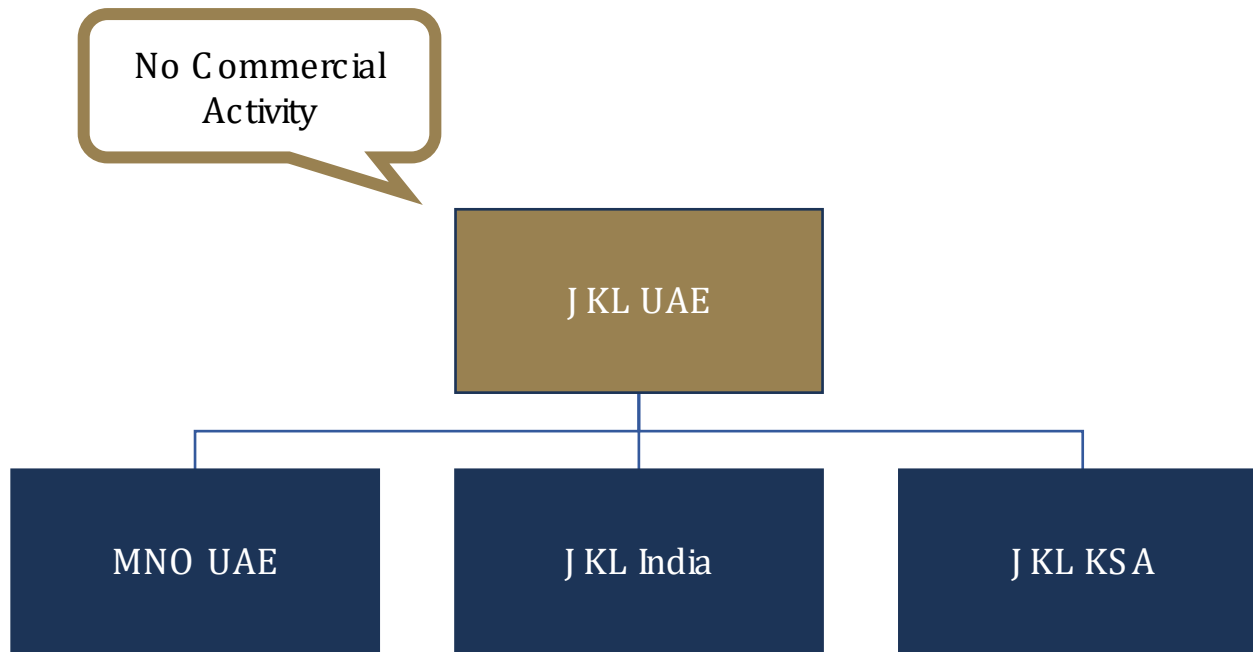
- 👉 **Holding Company**
- 👉 **Headquartered Business**
- 👉 Banking Business
- 👉 Insurance Business
- 👉 Shipping Business
- 👉 Lease-finance Business
- 👉 **Intellectual Property Asset**
- 👉 Investment Fund Management
- 👉 Distribution & Service Centre

# EXPLANATION OF RELEVANT ACTIVITIES

**Holding Company** - A holding company is defined as a business that

- ☛ Is a Holding Company in accordance with the law applicable to the Licensee carrying out such activity.
- ☛ Has as its primary function the acquisition and holding of shares or equitable interests in other companies.
- ☛ does not carry on any other commercial activity.

# HOLDING COMPANY – CASE STUDY



## Important Consideration

- Which activities would be covered under holding company business?
- What if J KL UAE carries out any other commercial activity in addition to holding equity interest ?
- How to meet the (reduced) substance test if the regulations are applicable ?

# REDUCED ECONOMIC SUBSTANCE TEST

## Requires:

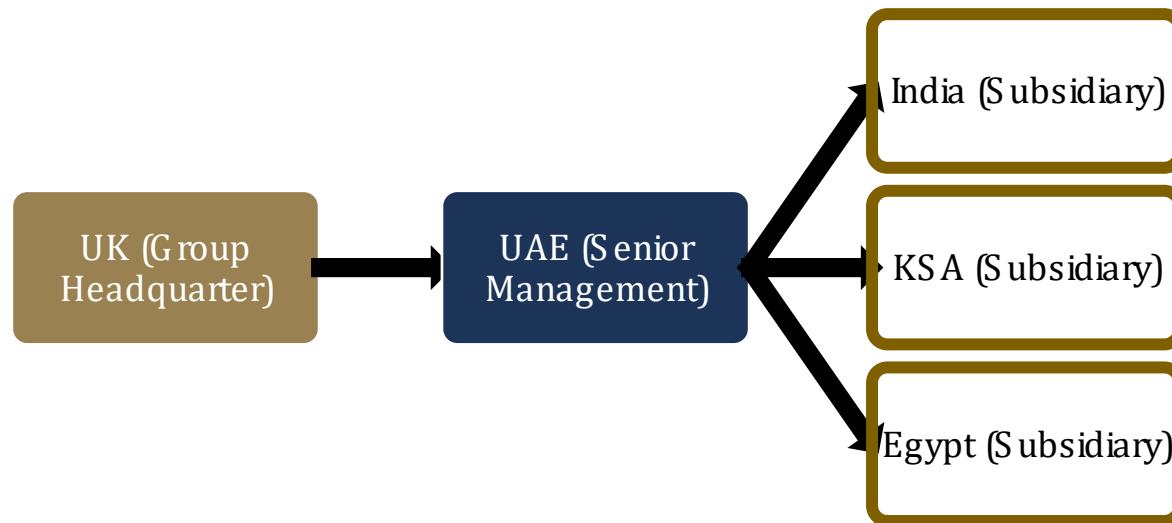
- ☞ All ADGM and DIFC companies must file a notification with the registration authority irrespective of whether relevant activity is carried out or not.
  - ☞ **ADGM Companies - before June 30th, 2020**
  - ☞ **DIFC Companies - before June 12th, 2020**
- ☞ Compliance with existing reporting/compliance requirements by submitting necessary documents, records or information to the Regulatory Authority.
- ☞ Core Income Generating Activity (CIGA) must be undertaken in the UAE.
- ☞ Adequate number of employees and physical assets (e.g. premises):
  - ☞ May be satisfied through a Corporate Service Provider or related company
  - ☞ directors can be counted as 'equivalent full-time employees'
  - ☞ registered offices or flexi-desks can be counted as 'premises'
- ☞ **Does Not Require:**
  - ☞ being 'directed and managed' in the UAE (subject to regulatory /policy framework)
  - ☞ adequate expenditure' being incurred in the UAE



# HEADQUARTERED BUSINESS

## Requires:

- Make management decisions on the substantive functions and significant risks for group companies, Incurring operating expenditures on behalf of group entities



## Important Consideration

- What activities performed would be covered under Headquarter business?
- Does entity need to be the “ultimate parent” to be considered a headquarter business?
- What if UAE entity is taking key decisions for another UAE Group entity?

# INTELLECTUAL PROPERTY BUSINESS

A UAE business is regarded as carrying on an Intellectual Property Business if it holds, exploits, or receives gross income from “Intellectual Property Assets”.

## High Risk IP Licensee

A licensee is considered high risk IP if either of the following conditions are met –

### COLUMN A

- ☛ Licensee did not create IP Asset .
- ☛ IP asset was acquired either from (1) connected person; or (2) as a consideration from any person outside UAE for funding R&D done by him.
- ☛ IP asset is further licensed to connected person or otherwise generates income from the asset in consequence of activities performed by Foreign Connected Person

### COLUMN B

- Does not carry out research and development or branding, marketing and distribution as part of its UAE Core Income-Generating Activity

# EXAMPLES

- ABC LTD holds a brand, the rights for which are licensed to others in return for a royalty. ABC LTD is within the scope of an Intellectual Property Business.
- Sofitech has developed a unique IT software platform for accepting, processing and tracking online orders that it holds and uses within its own business of online marketing. Sofitech also licences the IP software platform to others to use within their online marketing businesses. The users pay Sofitech a licence fee in order to use the IT software platform. Sofitech is within the scope of an Intellectual Property Business.

## High Risk IP Business Example:

- Pharma LLC, a UAE resident company earns gross income from licensing its patent for a new medicine to its group companies located in Egypt and KSA.
- Pharma LLC did not create the patent, the rights were acquired from a group company (R&D Co in the UK). Pharma LLC is within the scope of a high risk Intellectual Property Business.

# ECONOMIC SUBSTANCE TEST

## ESR Report Submission:

- Directed and managed in UAE. The board meetings must be held in the UAE as well – with written ‘minutes’ taken as evidence.
- Information related to adequate number of qualified employees in UAE, physical premises, office expenses or adequate outsourcing expenditure incurred for a third-party service provider.
- Core Income Generating Activity (CIGA) needs to be conducted in UAE.

# ADMINISTRATIVE PENALTIES

OFFENSES	PENALTIES
Failure to file a notification or failure to provide inaccurate information	AED 10,000 – AED 50,000
Failure to meet Economic Substance Test (First Year)	AED 10,000 – AED 50,000 Information exchange with foreign competent authority of the parent company, ultimate parent company and UBO
Failure to meet Economic Substance Test (Subsequent Year)	AED 100,000 – AED 300,000 Information exchange as above License may be cancelled or suspended

# WAY FORWARD

## Step 1

Examining if ESR is applicable to your entity and filing a notification with the registration authority.



## Step 2

Assistance in preparing and filing ESR Reports.

# STEP 1

Examining applicability of the Regulations and assistance in filing of notification:

- 🌱 Wide understanding of group's business operations and objectives
- 🌱 Examining relevant documents such as License and other incorporation documents, financial statements etc.
- 🌱 Analyzing and identifying the applicability of “Relevant activity”.

# STEP 2

Assistance in preparing and filing ESR Reports:

Broad analysis of operations, which will include:

- ✎ Understanding shareholding structure of the group.
- ✎ Analyzing key profit aspects of the group's operations
- ✎ Examining terms of key contracts of the local entity
- ✎ Analyzing financial statements
- ✎ Analyzing employee related information.
- ✎ Analyzing and reconciling the operations with Core Income Generating Activity ( CIGA's ), as provided under the regulations
- ✎ Assistance with respect to filing of the prescribed form by statutory due date with relevant authority



# FEES ESTIMATES

LEVEL	SCOPE OF WORK	PROPOSED FEE*
Level 1	Notification and Examining applicability of ESR	USD 500
Level 2	Preparing ESR Reports	To be mutually decided post completion of Level 1

Note

(\*) Proposed fees exclude VAT & Disbursement Fees

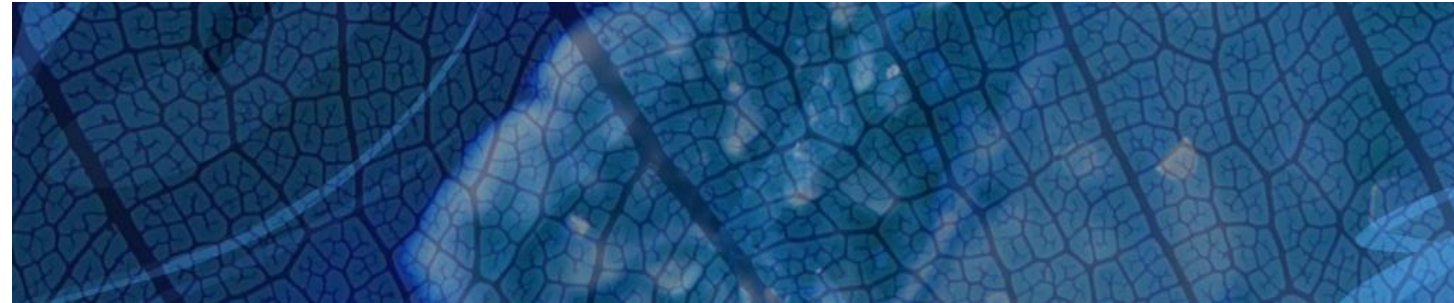


# Q & A



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[esr@10leaves.ae](mailto:esr@10leaves.ae)



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14<sup>th</sup> Floor, Al Khatem Tower Wework Hub 71, ADGM Square, Al Maryah Island, Abu Dhabi, U.A.E.

**[www.10leaves.ae](http://www.10leaves.ae)**

