

Transactions created without 'economic substance' and lack transparency on ultimate beneficiary have raised global concern as they veil the real purpose of the transactions and facilitate money laundering and tax avoidance from home country. International cooperation organizations, like Organization for Economic Co-operation and Development (OECD) under its BEPS Project, and European Union (EU), under its Code of Conduct Group are annually assessing zero or low tax jurisdictions and recommending introduction of regulations of economic substance.

Doctrine of 'economic substance' is applied to disentangle economic substance and tax avoidance by applying certain test to unravel real nature of transaction.

UAE Government has recently issued the Resolutions by Cabinet of Ministers No. (31) of 2019 concerning Economic Substance. Executive Regulations are expected to be issued shortly.

The framework of this Resolution is based on four major tenets:

### 1. Relevant activities (RA) & Core Income Generating Activity (CIGA):

The Resolution prescribes its applicability to the "licensee" carrying out the **Relevant Activities (RA)**. Under these **RA**, it also specifies activities that are considered **Core Income Generating Activity (CIGA)** that must be carried out by the Licensee in the UAE.

**Licensee** is defined as a natural or juridical person licensed by the competent licensing authority/ authorities in the State to carry out a Relevant Activity (RA) in the State, including a Free Zone and a Financial Free Zone.

**Relevant Activities** are activities that are specified in Article 4 of the Resolution as

- Banking | Insurance | Investment funds management | Lease Finance | Shipping
- Intellectual Property | Distribution & Services Centres | Holding company business | Head Quarter business.

**Core Income Generating Activities (CIGA)** are specified in Article 5 of the Regulation and must be carried out by the Licensee in UAE in relation to respective RA. The Regulation termed them as "State Core Income Generating Activity". They are detailed in Annexure 1.

### 2. Economic Substance Test:

The Resolution sets out criteria to meet **Economic Substance Test (EST)** in relation to **RA** stated above:

- Licensee conducts **CIGA** or in relation to its CIGA is directed and managed, in UAE.
- Licensee employs "adequate" number of employees | incurs "adequate" expenditures | has "adequate" size of physical assets
- Licensee should be able to monitor and control the activity, if its **CIGA** is outsourced.
- Where a Licensee is directed and managed in UAE, Licensee's board should meet with adequate frequency in UAE | should have quorum physically present and record the strategic decisions taken at the meeting | maintain the minutes | directors to have necessary knowledge and expertise
- This 'adequacy' may be specified later in Regulations.

### 3. Obligations:

The Resolution sets out obligations of the Licensee:

**A Licensee shall annually notify to Authority of the following:**

- Whether or not it is carrying on a RA
- Listing its RA and CIGA
- Declare whether it meets EST within 12 months of end of its financial year
- Whether its income in relation to its RA is taxed outside UAE

**Also other related information in relation to RA including:**

- Type | income | operating expenses | assets | location | employees

#### 4. Expected content of Economic Substance Report:

- Owner Information
- Management & control situated in UAE
- Relevant activity carried out & income generated from such RA
- Business premises details & assets employed to conduct the RA
- Employee information (no and payroll details) of employees involved in RA
- Intellectual property information
- Declaration

#### 5. Penalties:

The Resolution sets out range of offences and penalty for non-compliance and failure to meet EST and providing incorrect or inaccurate information. **The penalty ranges from AED 10,000/- to AED 300,000/-, depending on nature of non-compliance and failure to rectify could result into suspension, revocation or non-renewal of license.**

The Resolution specifically provide for exchange of information between UAE Competent and Foreign Competent Authority on regular basis, if a Licensee has not met the Economic Substance Test for a Financial Year, in pursuant to an international agreement, treaty or arrangement to which UAE is a party.

Going ahead, corporate businesses, banking and financial companies, family businesses, and overseas businesses having place of business in UAE engaged in any relevant activities need to reassess as to how the economic substance laws impact their current and envisaged UAE operations.

#### Annexure 1: RA and CIGA under respective RA

Business / RA	Core Income Generating Activity
<b>Banking</b>	➤ Raising funds, managing risk including credit, currency and interest risk   Taking hedging positions   Providing loans, credit or other financial services   Managing capital and preparing reports for /to investors or Authority.
<b>Insurance</b>	➤ Predicting and calculating risk   Insuring or re-insuring against risk and providing Insurance Business services   Underwriting insurance and reinsurance.
<b>Investment fund Management</b>	➤ Taking decisions on the holding and selling of investments   calculating risk and reserves   Taking decisions on currency or interest fluctuations and hedging positions   Preparing reports for / to investors or any Authority
<b>Lease-Finance</b>	➤ Negotiating funding terms   identifying and acquiring assets to be leased   Setting the terms and duration of any financing or leasing   Monitoring and revising any agreements   Managing related risks.
<b>Head Quarters Business</b>	<ul style="list-style-type: none"> <li>➤ Businesses of provision of services to Foreign Connected Person including providing senior management   Advising substantially on or actually assuming the control or risk of activities carried out by or assets owned by such Foreign Connected Person.</li> <li>➤ Foreign Connected Person is the one who is not resident or deem resident in UAE.</li> <li>➤ Taking relevant management decisions   Incurring operating expenditures on behalf of group entities   Coordinating group activities</li> </ul>
<b>Shipping</b>	➤ Managing crew (including hiring, paying and overseeing crew members)   Overhauling and maintaining ships   Overseeing and tracking shipping   Determining what goods to order and when to deliver them, organising and overseeing voyages
<b>Holding Company Businesses</b>	<ul style="list-style-type: none"> <li>➤ Its primary function is the acquisition and holding of shares or equitable interests in other companies; and does not carry any other commercial activity.</li> <li>➤ CIGA includes all activities related to that business   and for the other businesses that derives income from other sources other than dividends and capital gains from its equity interest, those activities that are related to such income generated.</li> </ul>

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Business / RA	Core Income Generating Activity
<b>Intellectual Property (IP) Business</b>	<ul style="list-style-type: none"> <li>➤ It is a business which holds, exploits, or receives income from IP Assets.</li> <li>➤ IP Assets means any IP right in intangible assets, including but not limited to copyright, patents, trademarks, brand, technical know-how and also include non-trade intangible (including a trademark), brand, marketing and distribution.</li> <li>➤ A separate set of activities are also provided for High Risk IP Licensee.</li> </ul>
<b>Distribution and Services Centers</b>	<ul style="list-style-type: none"> <li>➤ Encompasses the businesses of importing from and providing related services to Foreign Connected Person.</li> <li>➤ CIGA include purchasing, transporting and storing component parts, materials or goods ready for sale   Managing inventories   Taking orders   Providing consulting or other administrative services.</li> </ul>

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The firm is registered in UAE Ministry of Economy & Commerce having offices in Dubai and Sharjah. The firm excels in offering accounting, audit services and host of consulting services.

The fact that firm is enlisted on the panel of approved auditors of many local and international banks as well as free zones authorities' in UAE has made Kothari Auditors and Accountants a reputed audit firm in UAE.

### Our Services:

- Audit
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- System Designing & Implementation
- Computerization of Systems
- Management of Consultancy
- Project Reports & Feasibility Studies
- Cost Audit & Cost Analysis
- Business Restructuring
- Valuation Of Business
- Value Added Tax (VAT)



Global Business Services (GBS), an associate of Kothari Auditors & Accountants, was established to offer company Incorporation services in various onshore and offshore jurisdiction around the world.

GBS is dedicated to provide advisory on corporate formation, legal structuring, double tax avoidance treaties and assistance for formation of companies in various jurisdictions.

Our team of professionals include experts in the international business structuring, tax consultants, finance & laws.

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- Company Formation (Offshore & Onshore) in UAE
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- Company Management and Administration
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- Branch Registration of Foreign Corporations
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- Trusteeship and provision of Foundation Councils
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- Accounting
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