

Economic Substance Regulation (ESR)

Topic - Relevant Activity - Distribution & Service Centre Business

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Venue: ICAI Dubai Chapter – Webinar Zoom Platform

Speaker

CA. Manu Palerichal, FCA, CMA

CEO & Partner

emirates  chartered accountants group

UAE | BAHRAIN | UK | INDIA *More than figures.....*



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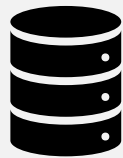
● **Distribution and Service Centres Businesses - Definition**

● **Regulatory Authorities**

● **State Core Income Generating Activities**

● **20 Practical Scenarios**

● **Q&A**

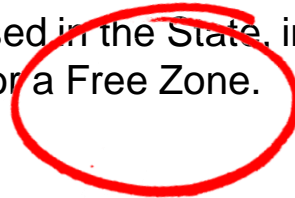


Distribution & Service Centre Business

Distribution & Service Center Business – Regulatory Authority

Cabinet of Ministers Resolution No. 31 – 2019 Article 4 (9)

Distribution and Service Centres Businesses as licensed in the State, including Distribution and Service Centres Businesses licensed in a Free Zone or a Free Zone.



Regulatory Authority

01

Ministry Of Economy

02

The competent authority in Free Zone

03

The competent authority in Financial Free Zone



Distribution & Service Centre Business

Cabinet of Ministers Resolution No. 31
– 2019 - Article 1 Definitions

A Licensee is considered engaged in a “Distribution & Service Centre Business” if it:

(a)

- Purchases goods (component parts or materials for goods; or goods ready for sale) from a **Foreign Connected Person & Importing & Storing** in the State and **Reselling** such goods **outside the state**.

(b) providing services to **Foreign Connected Persons** in connection with a business **outside the State**



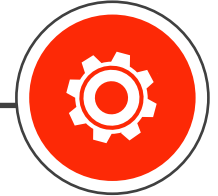
Foreign Connected Person (FCP)

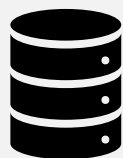


Connected Person: a natural or juridical person who is **related** to one or more natural or juridical person(s) through ***direct or indirect ownership or control, or common control.***



Foreign Connected Person: a **Connected Person** that is ***not resident or deemed as resident in the State.***





Core Income Generating Activities of a Distribution & Service Centre Business

SCIGA - Distribution & Service Center Business

Distribution Business

Transporting and storing goods, components and materials or goods ready for sale' -

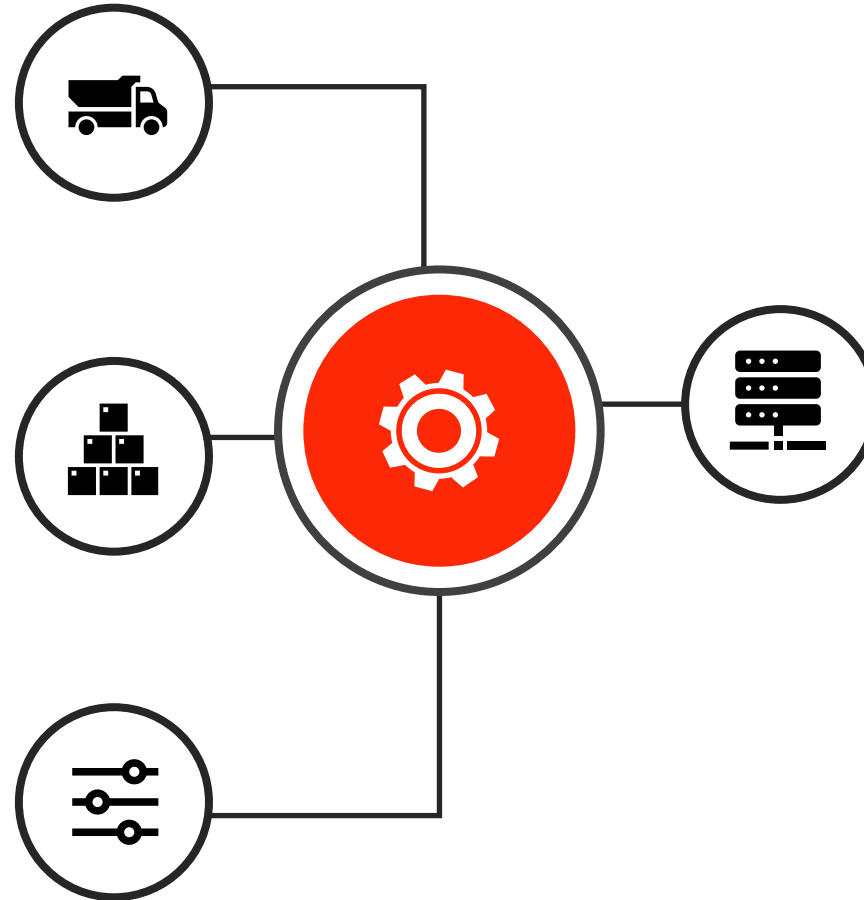
This CIGA refers to the movement and storage of raw materials or finished products and managing the risks associated with this.

Managing inventories' -

This CIGA could include considering minimum acceptable inventory levels, managing frequency of stock take, whether using storage space effectively, perishability of inventory and ensuring security procedures are in place.

Taking orders' -

This CIGA refers to the provision of the order processing element of the entire fulfilment process, whether that is manual or electronic



Service Center Business

Providing consulting or other administrative services' -

This CIGA covers the provision of any type of service to the Licensee's foreign group companies.

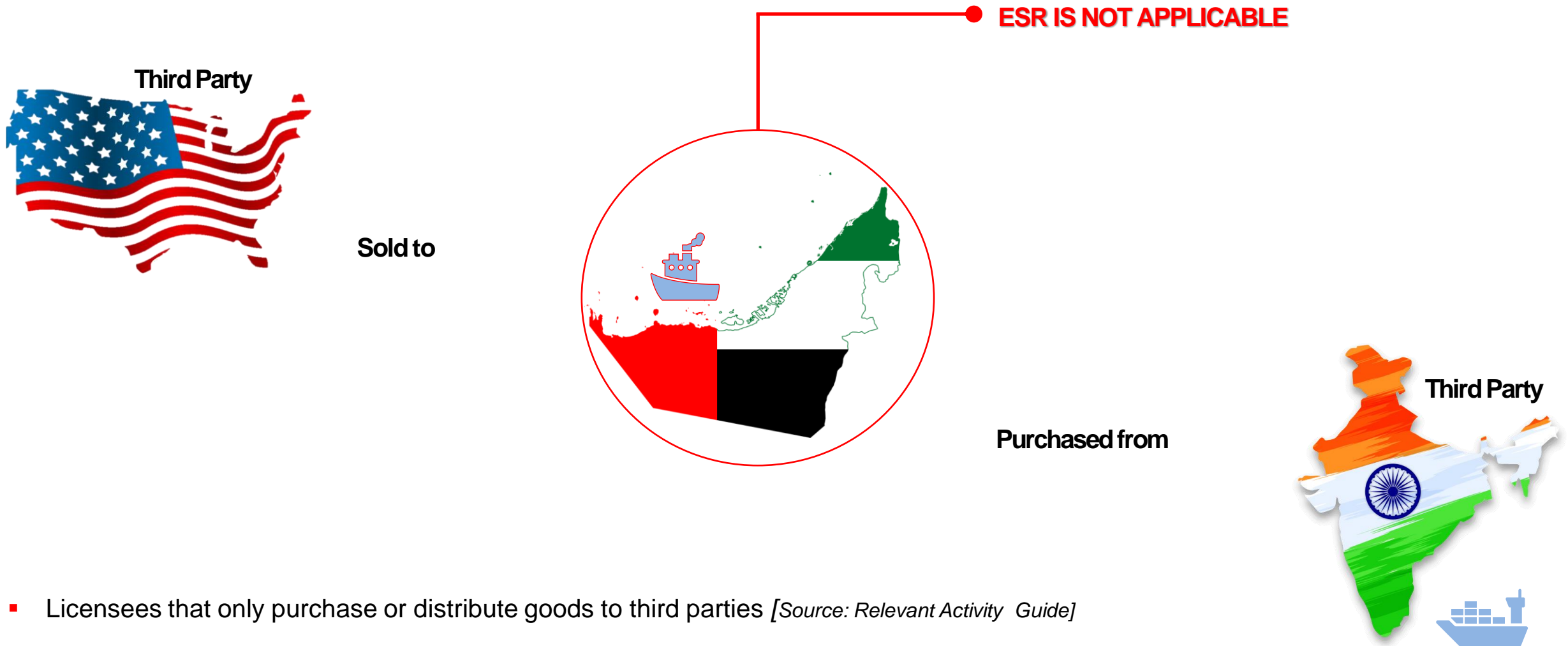


Practical Scenarios -



Part 1 - Distribution Centre Business

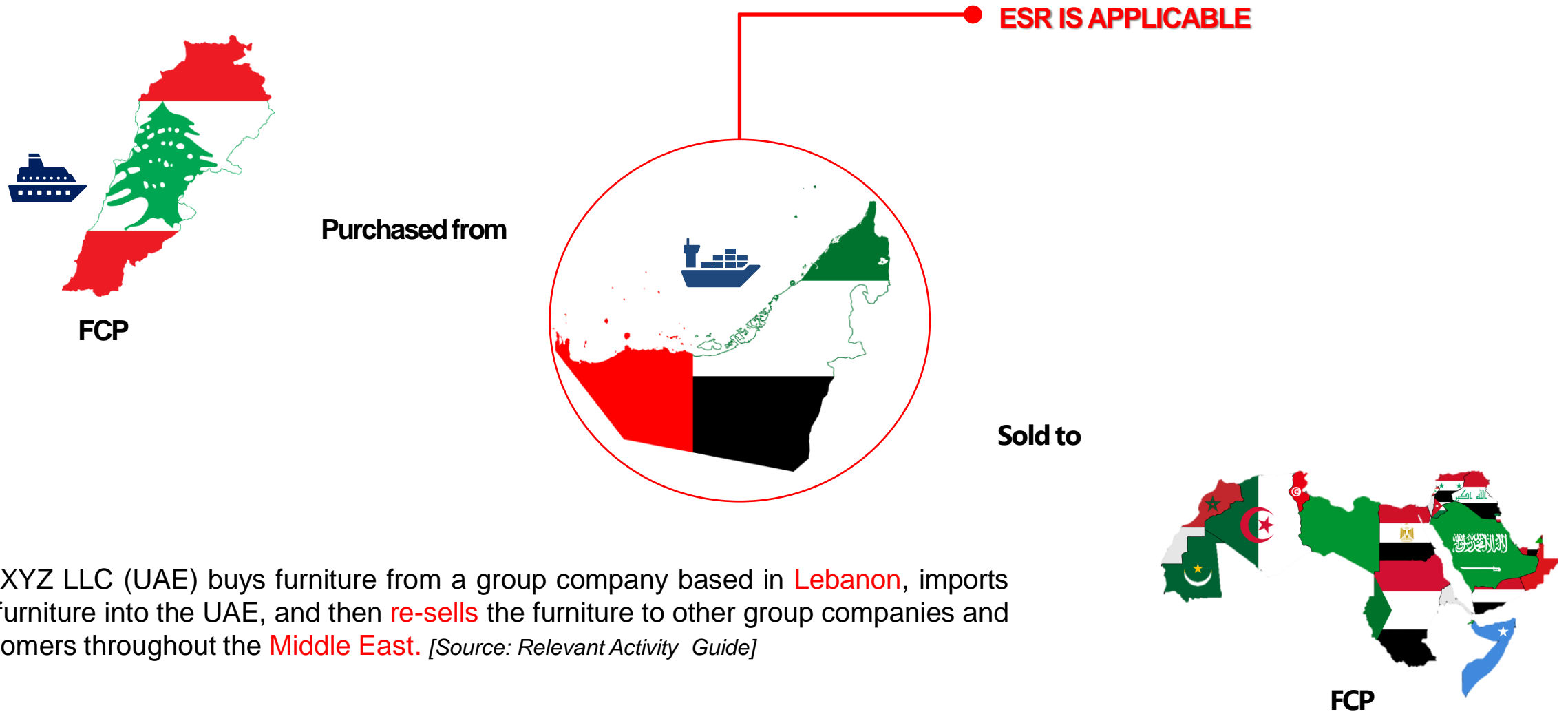
Scenario 1




- Licensees that only purchase or distribute goods to third parties [Source: Relevant Activity Guide]
- The licensee is considered as **NOT** carrying on a Distribution and Service Centre Business



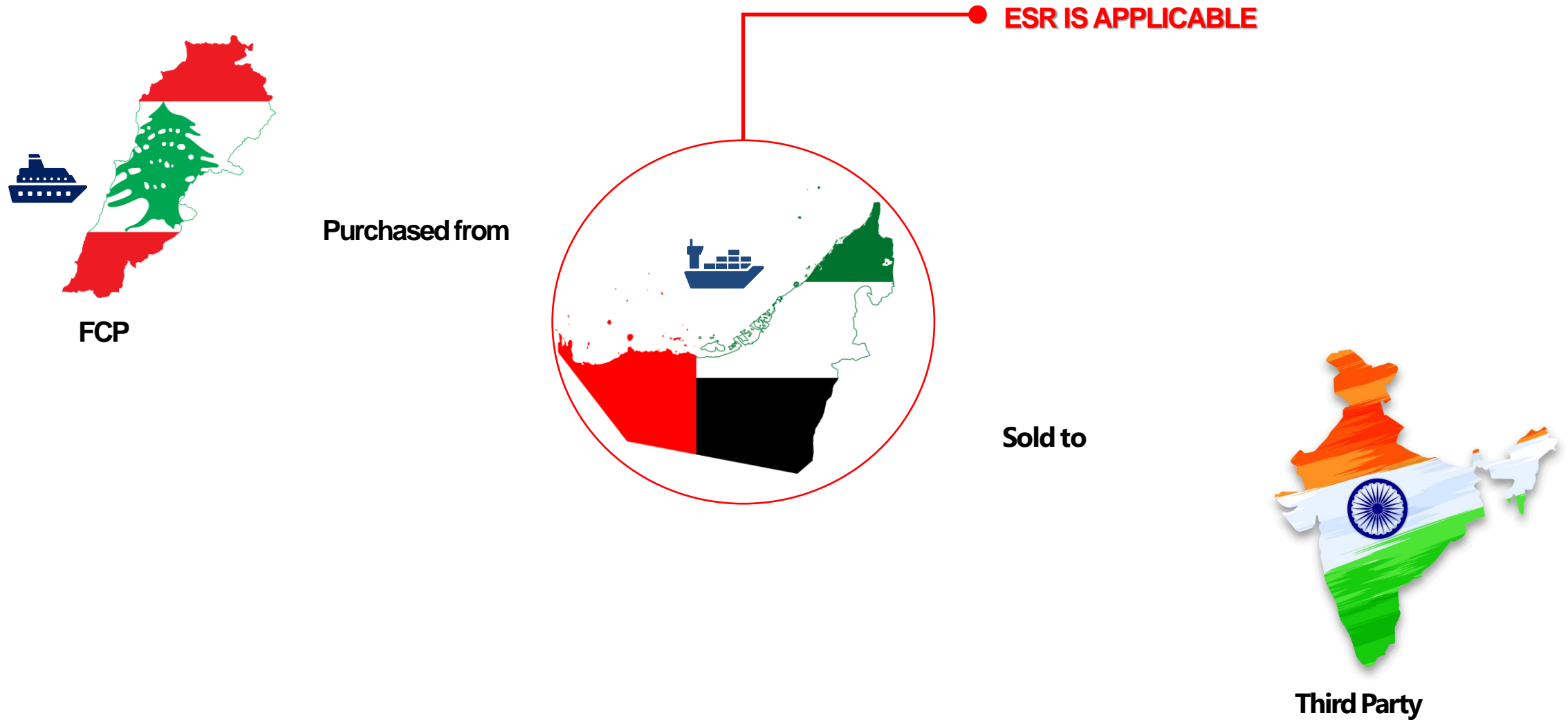
Scenario 2



- Eg: XYZ LLC (UAE) buys furniture from a group company based in **Lebanon**, imports the furniture into the UAE, and then **re-sells** the furniture to other group companies and customers throughout the **Middle East**. [Source: *Relevant Activity Guide*]
- XYZ LLC is considered as carrying on a Distribution and Service Centre Business



Scenario 3

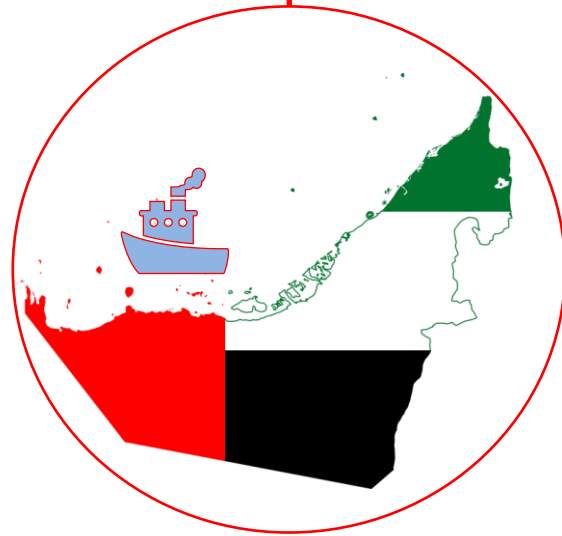


Scenario 4

FCP



Sold to



● ESR IS NOT APPLICABLE

Purchased from

Third Party

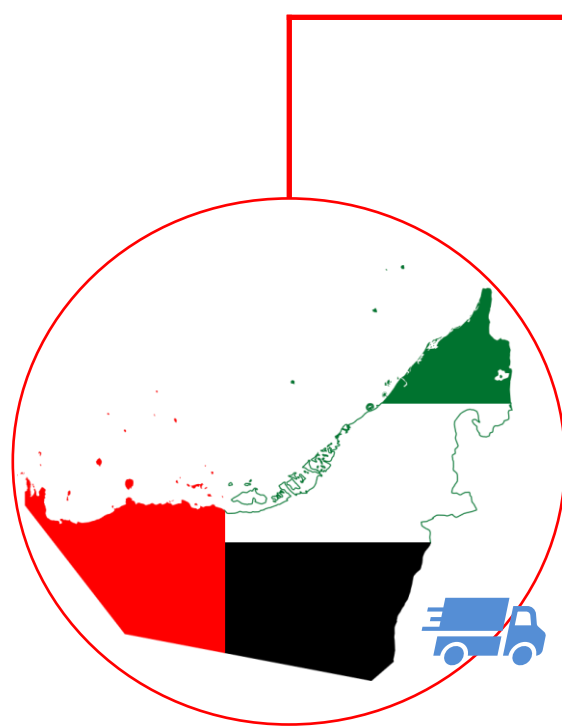




Scenario 5



Purchased from



Sold to



Scenario 6

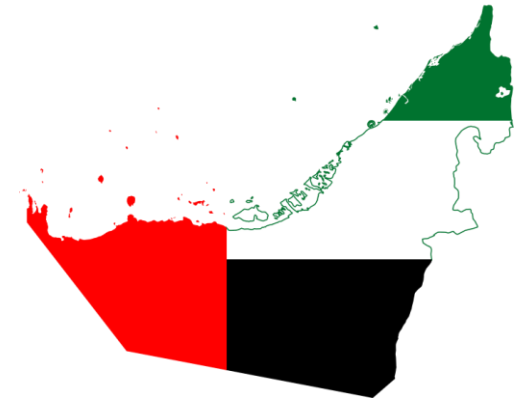


Purchased from



ESR APPLICABILITY?
[Let us interpret the Law]

Sold to



Third Party/CP

Bahrain

D&SC - The definition covers companies that generate income from the following:
a) Purchasing raw materials and finished products from other group members and **reselling these**; or
b) Providing services to other entities of the same group,

BVI

D&SC means the business of either or both of the following
(a) purchasing from foreign affiliates
(i) component parts or materials for goods; or
(ii) goods ready for sale; and
(iii) **reselling** such component parts, materials or goods;
(b) providing services to foreign affiliates in connection with the business,

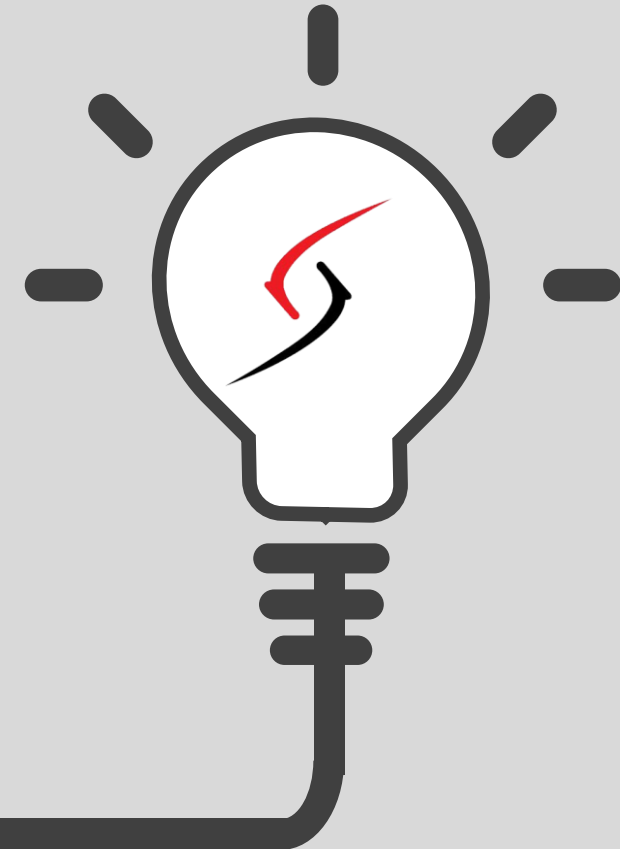
Cayman Islands

D&SC means the business of either or both of the following - (a) purchasing from an entity in the same Group - (i) component parts or materials for goods; or (ii) goods ready for sale, and **reselling** such component parts, materials or goods **outside the Islands**; (b) providing services to an entity in the same Group in connection with the business outside the Islands,

BEPS Action 5

D&SC provide preferential tax treatment to entities whose main or only activity is to purchase raw materials and finished products from other group members and **re-sell them for a small percentage of profits**. Service centre regimes provide preferential tax treatment to entities whose main or only activity is to provide services to other entities of the same group.

Distribution & Service Centre Business in other Jurisdictions



A Licensee is considered engaged in a “Distribution Business” if it:

- ✓ Purchases goods (component parts or materials for goods; or goods ready for sale) from a **Foreign Connected Person** and
- ✓ **Importing & Storing** in the State and
- ✓ **Reselling** such goods **outside the state**

Cabinet of Ministers Resolution No. 31 - 2019



Relevant Activities Guide - MoF

A Licensee is considered engaged in a “Distribution Business” if the Licensee

- ✓ purchases raw materials or finished products from a **foreign group company**, and
- ✓ **distributes** those raw materials or finished goods.



Scenario 7

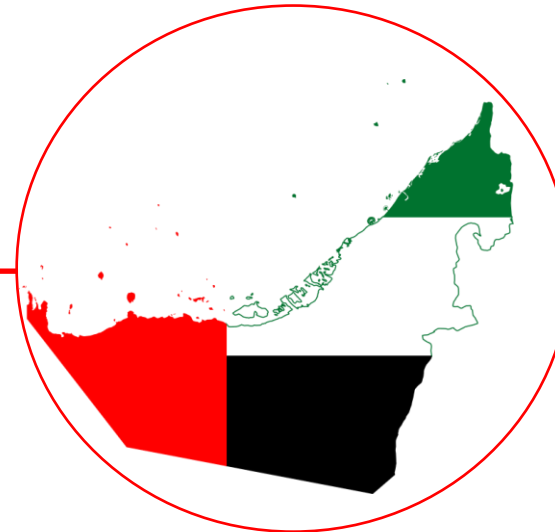


Sold to



Third Party/FCP

ESR APPLICABILITY?
[Let us interpret the Law]



Third Port Shipment

An example from Bahrain Law



XYZ W.L.L is a **distribution** company based in the Kingdom of Bahrain, **responsible for the distribution** of raw materials purchased from group entities in Asia, to other group entities based in Europe.



XYZ W.L.L contract transportation of goods to another non-resident company HAH Ltd. Goods are then stored in a UK warehouse by a third party company STO Ltd, who liaise directly with HAH Ltd over deliveries. The **board of XYZ W.L.L do not oversee** the activities of HAH Ltd nor STO Ltd.



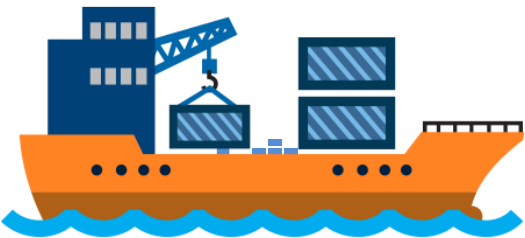
As the board and employees of XYZ W.L.L do not undertake the relevant CIGA at all, XYZ WLL will **not satisfy** the substance requirements.

Scenario 8



Third Party

Purchased from

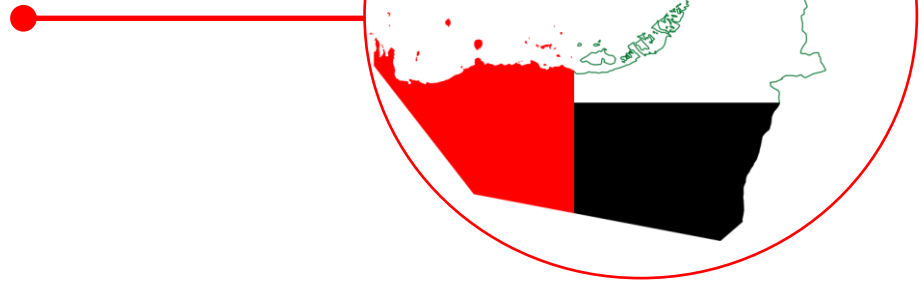


Sold to



FCP

ESR IS APPLICABLE ?





Part 2

Service Centre Business

Service Center Business

A Licensee is considered engaged in a “Service Centre Business” if it:

- Provides consulting, administrative or other services to a **Foreign Connected Person**; and
- Those services are in connection with the foreign group company’s **business outside the UAE**.

Scenario 9



Given To



ESR IS NOT APPLICABLE

✓ Licensees that are engaged in the business of providing services to third parties

Scenario 10



ESR IS NOT APPLICABLE

Given To



✓ Licensees that are engaged in the business of providing services within UAE



Scenario 11



ESR IS APPLICABLE

Given To



- ✓ Eg: The main business activity of TUV LLC (a company established in the Ajman Free Zone) is to provide HR and administrative support services to a group company based in USA, which are recharged at cost. Despite TUV LLC not charging a mark-up on the relevant costs, TUV LLC is considered as engaged in a Distribution and Service Centre Business.

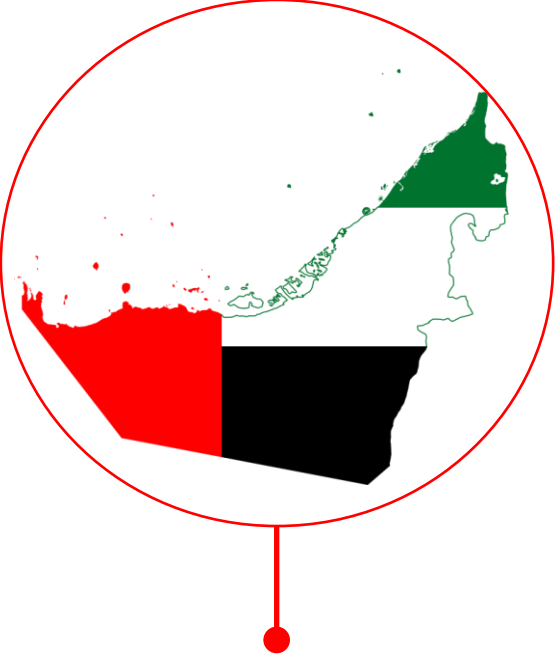
[Source: Relevant Activity Guide]



Scenario 12



Received from from

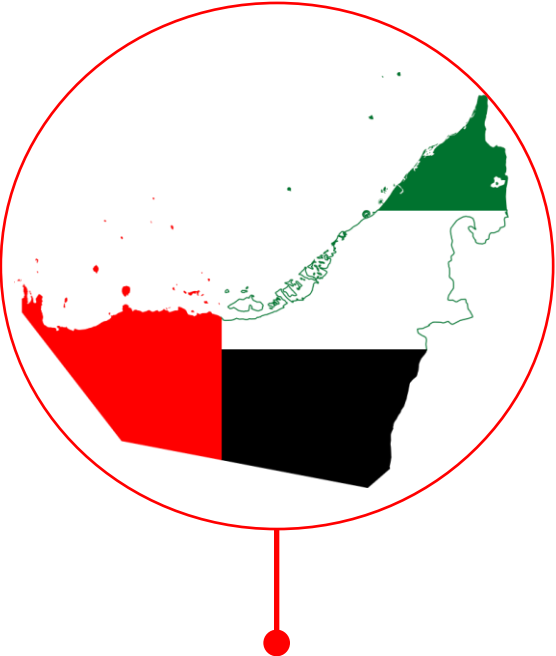


ESR IS NOT APPLICABLE

Scenario 13



Received from from



ESR IS NOT APPLICABLE



Transactions not in the ordinary course of business



Transactions not in the ordinary course of its business (e.g. a one-off transaction)

An entity that undertakes a transaction that falls within the scope of a “Distribution and Service Centre Business” would not be required to demonstrate economic substance in the UAE if it can evidence that the transaction was not in the ordinary course of its business (e.g. a one-off transaction) and the transaction is recharged to the relevant foreign group company at cost or less.



Scenario 14



HIG LLC, the KSA subsidiary of ABC LLC (a company established in the United Kingdom), requires specialist IT support with the implementation of a new accounting system which will be used by HIG LLC in the provision of services to KSA based clients. QRS LLC (a subsidiary of HIG LLC established in the Abu Dhabi General Markets Financial Free Zone) provides audit and accountancy services to third party customers in the UAE, and agrees to second one of its IT support staff to HIG LLC for three months. QRS LLC recharges HIG LLC the relevant salary costs incurred.



[Source: *Relevant Activity Guide*]

QRS Provides IT support to HIG LLC



It is not a Relevant Activity – reason

- ✓ QRS LLC is not in the business of providing IT services to foreign group companies,
- ✓ It does not offer/solicit such services or maintain employees to provide such services to other group companies &
- ✓ It does not earn a margin on the costs recharged to HIG LLC.



Not a Distribution or Service Center Business

HIG LLC, the KSA subsidiary of ABC LLC (a company established in the United Kingdom), requires specialist IT support with the implementation of a new accounting system which will be used by HIG LLC in the provision of services to KSA based clients. QRS LLC (a subsidiary of HIG LLC established in the Abu Dhabi General Markets Financial Free Zone) provides audit and accountancy services to third party customers in the UAE, and agrees to second one of its IT support staff to HIG LLC for three months. QRS LLC **recharges HIG LLC the relevant salary costs incurred.**

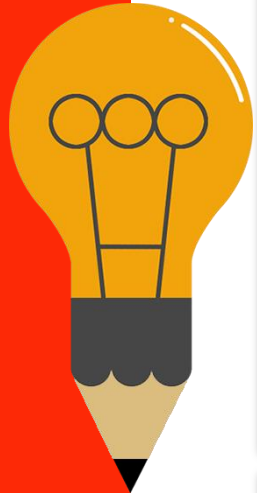
It is not a Relevant Activity – reason

- ✓ QRS LLC is not in the business of providing IT services to foreign group companies,
- ✓ It does not offer/solicit such services or maintain employees to provide such services to other group companies &
- ✓ it does not earn a margin on the costs recharged to HIG LLC.

HAH W.L.L is the service entity for an audit and accountancy partnership where its main activity is to provide services to customers in the Kingdom of Bahrain. HAH W.L.L employs the staff and owns the premises used for the business of the partnership. Another group company based in the UK requires **specialist IT skills**, which sit within HAH W.L.L and requests those skills for a period of 3 months, agreeing **to reimburse costs.**

It is not a Relevant Activity; because:

- ✓ HAH W.L.L is not in the business of providing those services to other group companies,
- ✓ it doesn't offer/solicit such services / It doesn't maintain employees to provide such services



Part 3

**Licensee engaged in
more than one Activity**

Scenario 15



Licensees' main activity is

- ✓ **Banking**
- ✓ **Insurance**
- ✓ **Investment Fund Management**
- ✓ **Lease-Finance**
- ✓ **Shipping, or**
- ✓ **Headquarter Business**

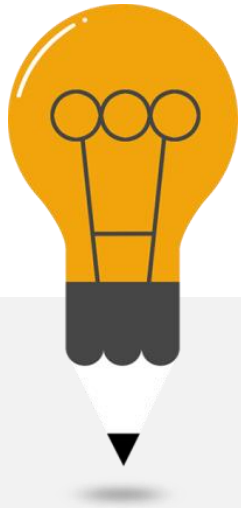
And purchase goods from/ provide services to foreign group companies as a **normal part of their business** operations.

To prevent duplicate reporting, such Licensees are not also considered engaged in a Distribution and Service Centre Business.

Scenario 15



Scenario 16



“

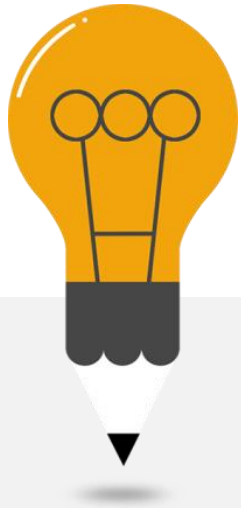
Licensees' main activity is Holding Company Business
And purchase goods from/ provide services to foreign
group company

”

•
**Such Licensees are considered engaged in a Distribution
and Service Centre Business, not holding company.**



Scenario 17



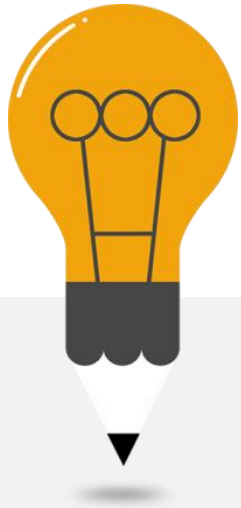
“

Licensees' main activity is Holding Company
Business
And purchase goods from/ provide services to
third parties

”

**Such Licensees are considered NOT engaged in any Relevant
Activities**

Scenario 19



“

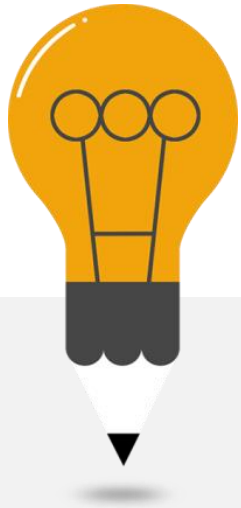
Licensee is into trading activity (buying from Foreign Group) & lend money to Connected persons/Third Party with interest.

”

•
Such Licensee is considered as engaged in both Relevant Activities



Scenario 20



“

Licensee is into trading activity (buying from Foreign Group) & and earn income from Royalty

”

•
Such Licensee is considered as engaged in both Relevant Activities





Speaker

CA. Manu Palerichal, FCA, CMA

CEO & Partner

emirates  chartered accountants group

UAE | BAHRAIN | UK | INDIA

More than figures.....

Economic Substance Regulation UAE (ESR UAE)

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Contact us:

CA. Dhara Rohit, ACA.
Att. Manager, Audit & Assurance
Mob: +971- 56 5956836
Email: dhara@emiratesca.com

CA. Manu Palerichal, FCA, CMA
CEO & Partner
+971 – 50 528 28727
manu@emiratesca.com

