



Economic Substance Regulations: Shipping & Insurance

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Presentation Outline

DISCUSSION POINTS

- What is Economic Substance
- Requirement of Economic Substance
- ESR Scope
- Relevant activities and CIGAs
- Outsourcing
- Notifications and Returns with Authorities
- Board Meetings
- Non-compliance with ESR
- Current situation of ESR in UAE
- Our service preposition

ESR Update -Covid-19

COVID – 19 Industry Advisory Notification: Cabinet of Ministers Resolution No. 31 of 2019 Concerning Economic Substance Regulations (“ESR”) The UAE Ministry of Finance (“UAE MoF”) recognises that businesses around the world and in the UAE may need to adjust their operating procedures to address disruptions caused by COVID-19. In particular, it is recognised that the outbreak of COVID-19 may affect the mobility of individuals, either as a result of travel restrictions or due to individuals being subject to self-isolation or quarantine requirements.

*It means board requirements will be eased-out for the year 2020.



Economic Substance

REQUIREMENT

1

ESR bring specific requirements for businesses to demonstrate actual economic activity

2

To ensure that profit are taxed where economic activities are generating the profits are performed and where value is created.


3

To Prevent the harmful tax practice of profit shifting from high-tax jurisdiction to low tax regimes.

ESR Scope

- The economic substance regulations apply to **all companies** that are established in the UAE* and which have income from a relevant sector in any accounting period commencing on or after 1 January 2019.
- Income for the purposes of the economic substance requirement is **gross income**

*except entity in which Minimum 51% direct or indirect investment of Govt. authorities)



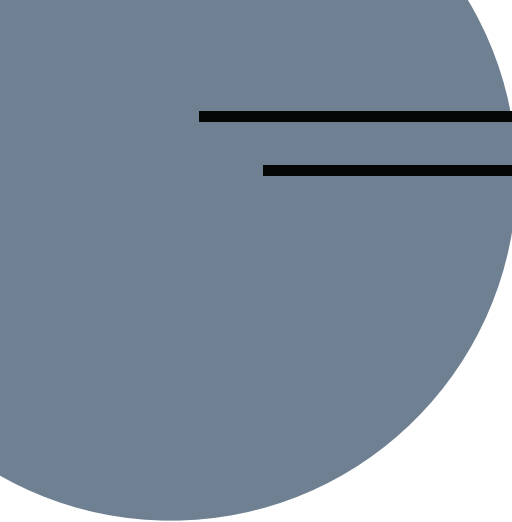
Adequate Substance

All companies with activities and income in a relevant sector in an accounting period will be required to demonstrate that they have adequate substance in the UAE.

The adequate substance requirements, will generally require that a company:

- is directed and managed in the UAE;
- has an adequate number of (qualified) employees proportionate to the level of activity carried on in the UAE;
- has adequate expenditure proportionate to the level of activity carried on in the UAE;
- has an adequate physical presence in the UAE; and
- conducts core income-generating activity ('CIGAs') in the UAE





1

CIGAs are the key essential and valuable activities that generate the income of the company, it must perform the CIGAs that generate the income it has in UAE

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



What is CIGAs

BASICS

CIGAs

Key Considerations

1

Substance over form approach must be taken i.e. assess all activities carried out during a financial period and not only those stated in the Commercial license.

2

Not necessary that a business should actively engaged in conducting the relevant activities. Passive receipt of income would also be considered as carrying Relevant Activities

3

Business can undertake more than one Relevant Activities during the same financial period, unless it is ancillary to the main Relevant Activity.

4

Ancillary Relevant Activity can be consolidated under the main Relevant Activity to prevent duplication. Consolidated reporting is permitted for Banking, Lease-financing, Headquarter and distribution and Service business.

Do you KNOW Factors behind ESR?

1. Ring Fencing

- A preferential regime will be considered to be **ring-fenced** only where it excludes resident taxpayers from the benefits of the regime or where the enterprise qualifying for the regime does not have access to the domestic market. Though there exist various considerations in this regard.
- This plays an important role with respect to Shipping. Tonnage/Corporate tax on shipping varies based on the country flag under which it sails (i.e. registered-in) on the domestic and international income because most of the income in shipping is attributed to the offshore activities.

DEFINITION:

Insurance Business means the business of accepting risks by effecting or carrying out contracts of insurance, in both the **life** and **non-life** sectors, including contracts of **reinsurance and captive insurance** arrangements.

Insurance Businesses as licensed in the **State**, including Insurance Businesses licensed in a **Free Zone or a Financial Free Zone**

RELEVANT ACTIVITY:

**INSURANCE
COMPANY**

Insurance **brokers, agents, and other UAE businesses providing insurance related services** that do not involve assuming all or some of the insured risk **do not fall within the definition of Insurance Business**, although they may conduct activities that fall into another Relevant Activity category

How insurance business can lead to Ring-Fencing?

BEPS through interest in the banking and insurance sectors -

- The use of interest is one of the simplest profit-shifting techniques available in international tax planning. The BEPS report Limiting Base Erosion Involving Interest Deductions and Other Financial Payments includes a common approach to tackling BEPS involving interest and payments economically equivalent to interest.
- The BEPS Report recommends that countries consider introducing a group ratio rule which allows an entity in a highly leveraged group to deduct net interest expense in excess of the amount permitted under the fixed ratio rule, based on a relevant financial ratio of its worldwide group.

CIGAs: Insurance Business

1. PREDICTING & CALCULATING RISK

It include the determination of the quantification and likelihood of the insured event occurring and the likely costs and ensuring that the premiums charged are commensurate with the risks accepted.

2. INSURING/REINSURING AGAINST RISK

This includes insuring policyholders against specific risks and providing reinsurance to primary insurers.

3. UNDERWRITING INSURANCE & REINSURANCE

This refers to the evaluation and analysis of the risks of an insurance policy and establishing the pricing for accepted insurable risks.

Example

INSURANCE RELEVANT ACTIVITY

1

First Life LLC (UAE) regulated as an Insurer by the UAE Insurance Authority provides life, health and car insurance in and from the UAE.

First Life LLC clearly undertakes an Insurance Business and is subject to the substance requirements.

2

ABC LLC (UAE) is an insurance intermediary that assists and represents consumers in the placement and purchase of insurance and provides services to insurance companies to facilitate and complement the insurance placement process.

ABC LLC not undertake an Insurance Business and is not subject to the Regulations .

What is flagship of convenience

Under international law, every merchant ship must be registered with a country, known as its flag state.

It seems natural that companies and cruise line would register their ships in their home country however this is not the case.

Using a business practice known as **flagship of convenience** ship operator register their vessels to countries without nationality or residency requirements.



Flagship of Convenience

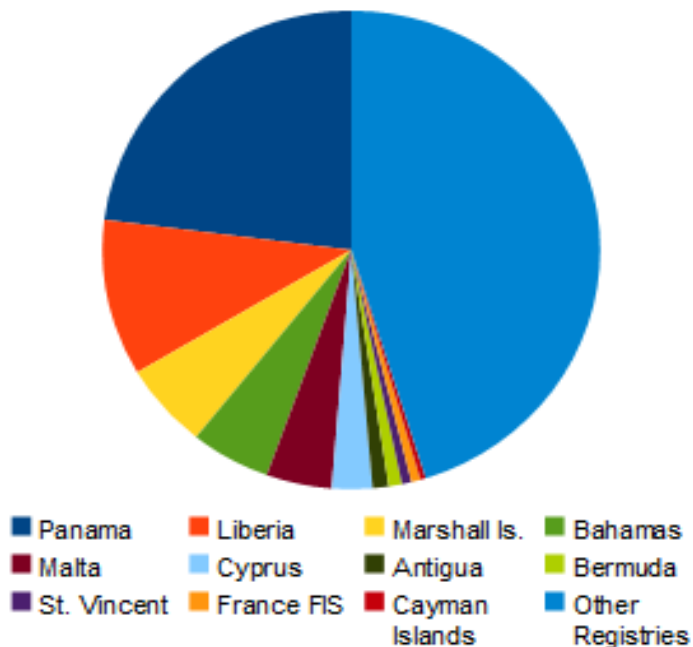


Flagship of convenience started to appear in the 1920 when American ship owners registered their ships to Panama due to increasing regulations and labor cost in their home country.

Benefits of flagship of convenience:

- Saving in registration cost of the ship.
- Low income tax or no tax on shipping business income,
- Lower overhead and administration cost
- Easy registration process and
- Less marine regulation and govt. requirements.

Top 11 FOCs
As Percentage of World Fleet in DWT



As seen from the diagram, Panama a small nation of just 4 Million has the largest shipping fleet in the world greater than those of the US and china combined.

In 2019 almost three quarters of the world 's fleet was registered under a flag of country other than its own.

Panama, Liberia and Marshall island flags accounting for almost 40% of the entire world fleet as calculated by tonnage while the population of together three countries are less than 7 million.

2. Corporate Taxation in shipping industry

The shipping industry has made significant technological advances but tax framework for shipping business have not always kept up with the rapid face of change.

There is a broad spectrum of taxation approaches. Countries such as Singapore and Cyprus take a very liberal approach; in these countries, various offshore vessels can generally be covered by their beneficial shipping taxation regime.

For instance, Singapore offers an outright tax exemption to income (**application required for non-Singapore flagged vessels**) derived from the operation of various **vessels outside the limits of the port of Singapore** regardless of the characteristics of the vessel in question.

In contrast, countries such as Denmark, Ireland, Italy and France take a more restrictive approach to the applicability of their **tax regimes to offshore vessels**. In these countries' vessels are required, either by law or by generally accepted common practice, to exercise transportation of goods or passengers. That creates a more restrictive environment and impacts the ability of offshore market players situated in these countries to compete over the long term.

Key shipping Countries with shipping tax liberal approach

Very Liberal Approach	Fairly Liberal Approach	Fairly Restrictive Approach	Vary restrictive Approach
Singapore	Germany	Denmark	Finland
Hong Kong	UK	France	USA
Cyprus	Greece	India	
UAE	Norway	Italy	



3. Separation of shipping income from its CIGA's



many countries including UAE exclude vessels related to the oil & gas industry from their shipping taxation regime.

In UAE, Wind form construction vessels, accommodation and support vessels (e.g. flotels crew transfer vessels) are not subject to taxation.

No tax on salaries and benefits of crew on board of Cypriot flagged vessel in Cyprus

DEFINITION:

Business who operate one or more ships in **international traffic**, for the transport of either passengers, cargo or both.

RELEVANT ACTIVITY**Shipping
Business**

The definition of a “ship” for purposes of the Regulations does not include:

- vessels used for fishing;
- vessels that are “small” (i.e. tonnage does not exceed ten tonnes); and
- leisure vessels (e.g. cruise ships and private yachts).

CIGAs

Shipping business

Managing, hiring, paying and overseeing crew members

Substance over form approach must be taken i.e. It include the sourcing, recruitment, selection, deployment, scheduling, training, and on-going management and associated administration of the crew

Overhauling and maintaining ships

It include responsibility and making decision in respect of, the lifting of vessels from the water for and the general maintenance of ships.

Overseeing and tracking shipping

It includes management and oversight of the logistical aspects of the international transportation of cargo and passengers by ship, including ship movements.


Taking Decision related to operation of the business

This includes managing the logistical aspects of the operation of ships, organizing and overseeing voyages.



BUSINESS NOT CONSIDERED AS CARRYING SHIPPING BUSINESS

Although such Business should consider whether it undertakes another Relevant Activity



The chartering of ship on bareboat basis (i.e. the entity chartering the ship without operating the ship)

Selling tickets for international travel by travel agencies and international shipping agencies

Entities engaged in transporting of goods by sea without operating the relevant ships.



Example : Shipping Business

1

ABC LLC owns and operate the ship in international traffic to carry passengers from the UAE to other Middle East countries.

BC LLC is within the scope of a Shipping Business because it operates a ship in international traffic for the transport of passengers.

2

ABC LLC doesn't operate the ship, but it manages the crew of XYZ LLC's ship as part of its crew management business.

Mere provision of crew and ship management services is not considered as "operating a ship" for purposes of the Regulations. ABC LLC is not considered to carry on shipping business as it does not operate the ship.

3

ABC LLC owns a ship and charters it on a bareboat basis to XYZ LLC that uses and operates the ship to carry cargo from the UAE to other countries.

ABC LLC is not considered to carry on shipping business as it doesn't operate the ship. On the other hand XYZ LLC is considered to carry on shipping business because it operate the ship

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



Outsourcing Arrangement

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
- No double counting





Board Meeting

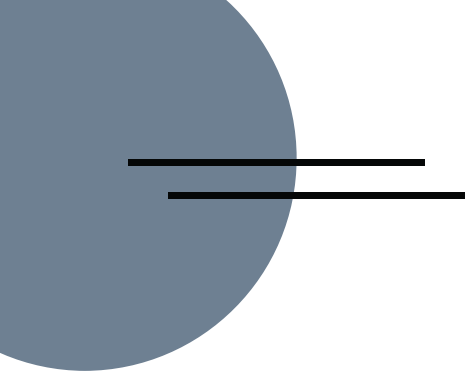




Board Meeting

Licensees must demonstrate that they are directed and managed in the UAE in relation to the Relevant Activity during the relevant financial year by:

- Holding board meetings in the UAE, at which decisions are made (the actual number of board meetings required will depend on the Relevant Activities undertaken and decision making taken);
- Quorum met with directors physically present in the UAE;
- Directors / board members have necessary knowledge and expertise;
- Meetings are properly minuted, signed by the directors/members present and kept in UAE;
- The manager/member of branches and entities with one (1) board member, must be in the UAE when making key decisions



Requirement to file ESR notification and return.



Requirement to file Notification under ESR

- All Licensee need to notify their respective competent authorities that they undertake a Relevant Activity.
- Notifications will be file by the licensee in the way prescribed by respective authorities
- Notifications will be file with the respective authorities , before the deadline communicated by the authorities.

Requirement to file Return under ESR

- All Licensees that are not exempt and undertake a Relevant Activity which they earn income from during a relevant Financial Year are required to:
- Meet economic substance requirements; and
- File economic substance return with the respective authorities on an annual basis

Return is due within 12 months after the relevant financial year end



Free Zone's Entities

Regulatory authority of the free zone where the business is carried out.



Other UAE Business

Ministry of Finance



Respective
Authorities for
ESR

Responsibility of Regulatory Authorities



Determining time and form for the notifications and reports



Requesting additional information if needed



Assessing whether the economic substance test has been met by Licensees



Entering businesses premises and examining business documents when appropriate



Imposing penalties



Issuing a resolution setting out the procedures for an appeal against administrative penalties

Current Situation of ESR in UAE



ESR in UAE

A Licensee must submit a notification and a report to the Regulatory Authority. The notification has effect from 1 January 2020; however, the exact time and form is yet to be determined by the respective Regulatory Authorities.

Some of the Free zone authorities has updated the timeline to file the ESR notification:

- DAFZA deadline is 31st May 2020
- Dubai South is 7th June 2020
- RAK Economic Zone – Last date to file notification is 30th June 2020.
- DIFC – Last date to file the notification is 12th June 2020.
- RAK ICC, Ajman Free zone (AFZ), Sharjah free zone (SAIF), Hamriyah free zone (HFZA), ADGM and DMCC – Last date of notification is 30th June 2020.

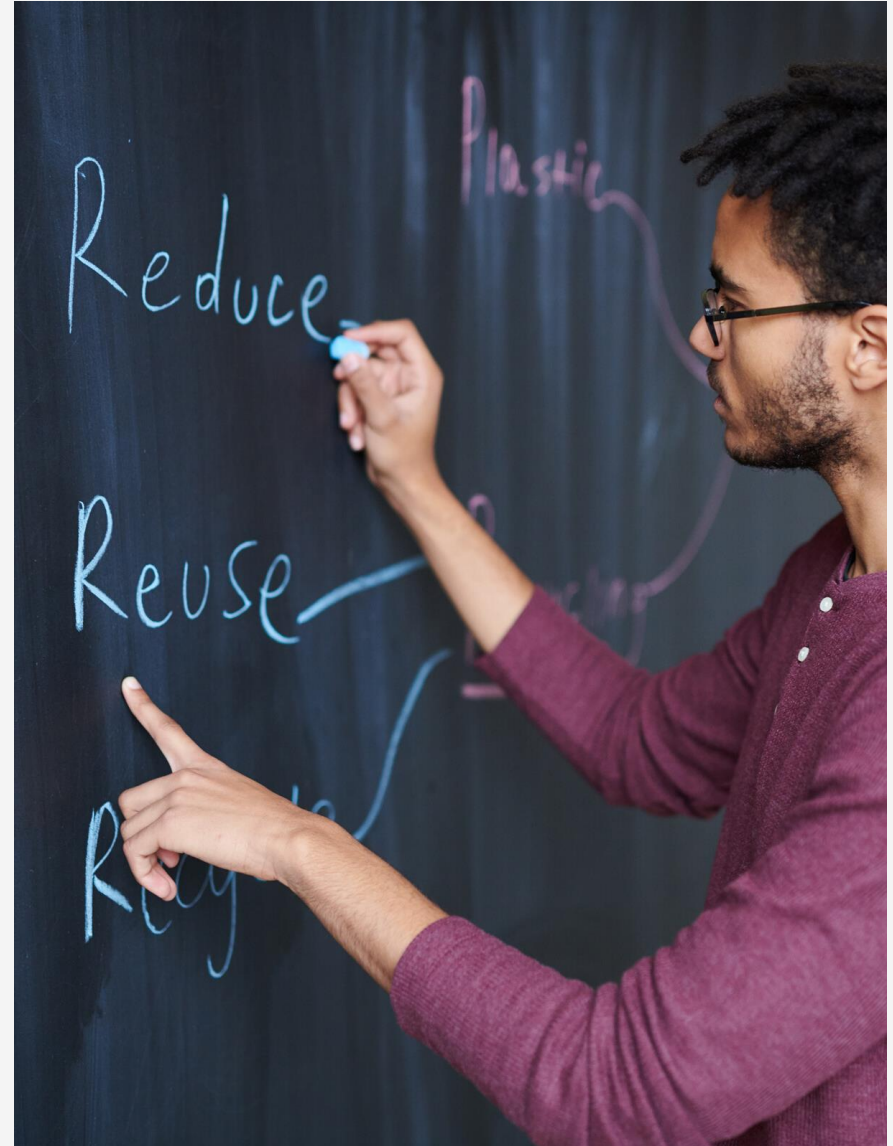
Further guidance is now expected from the respective Regulatory Authorities regarding the time, form and manner for the notifications and reports.

Non-Compliance

What if a company in a relevant sector does not meet the economic substance requirement in an accounting period?

it will be subject to

PENAL PROVISIONS.



Consequences of non-compliance

Penalties for failure to:

Notify	Provide accurate or complete information	Demonstrate sufficient economic substance in the UAE for the relevant Financial Year
<ul style="list-style-type: none">○ Penalty of AED10,000 to AED50,000	<ul style="list-style-type: none">○ Penalty of AED10,000 – AED50,000; and○ Deemed failure to demonstrate economic substance in the UAE	<p>First year of failure</p> <ul style="list-style-type: none">○ Penalty of AED10,000 – AED50,000; and○ Information exchange with foreign competent authority of:<ul style="list-style-type: none">• parent company;• ultimate parent company; and• ultimate beneficial owner <p>Second consecutive year of failure</p> <ul style="list-style-type: none">○ Information exchange (see above); and○ Penalty of AED100,000 – AED300,000; and○ Commercial licence could be: suspended, withdrawn or not renewed



Preliminary Assessment

Identify whether your business is within the scope of the regulations.



Core Assessment

If within the scope of the Regulations, check whether your business pass the Economic Substance Test.



Default Assessment

Identify the non-compliant elements if criteria of Regulations are not met



Rectification Procedure

Suggestions to correct the weaknesses in order to pass the Economic Substance Test.



Submission of reports

Filing the notification, returns and reports to the Relevant Regulatory Authority.

How We Can Assist you for Implementation of ESR

IMPACT ASSESSMENT

1. CIGA
2. Manpower
3. Decision Making
4. Asset Base

LEVEL OF SCRUTINY

Identify significant / normal areas for detailed scrutiny to document substance.

HOW CHARTERED HOUSE ADD VALUE TO COMPLIANCE

DESIGN

CIGA matrix design
Adequacy Chart
Substance Checklist

REPORT-SELF ASSESSMENT

Provide document checklist in line with law for each of identified areas for review.



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Thank you!

WE LOOK FORWARD TO WORK WITH YOU.