



Economic Substance Regulations – Recent updates

Following the issuance of the Economic Substance Regulations ('ESR') and the guidance by both, the United Arab Emirates (UAE) and Kingdom of Bahrain (Bahrain), implemented with effect from 1 January 2019, this alert sets out the recent developments as regards notification timelines announced by some of the regulatory authorities in the UAE and other key updates for jurisdictions where ESR is implemented (you can refer our previous alerts on the [UAE ESR](#) and [additional guidance](#) issued earlier).

As a background, entities that are governed by the UAE ESR were required to submit a notification to their Regulatory Authority (defined under [Cabinet Decision No \(58\) of 2019](#)) from 1 January 2020 onwards. The exact dates to submit the ESR notification was not specified by the ESR as the regulations left this to the determination of the relevant Regulatory Authority. In Bahrain, the Ministry of Industry, Commerce and Tourism ('MOICT') and the Central Bank of Bahrain ('CBB') require its licensees undertaking Relevant Activities to submit their ESR return by 31 March 2020.

United Arab Emirates

The deadline for submission of the notification was prescribed by some of the regulatory authorities i.e. Dubai International Financial Centre and Abu Dhabi Global Market as 31 March 2020 in their outreach sessions held earlier in the year. However, there have been certain changes in the timeline which are discussed below. Note that the due date to submit the ESR return is still within 12 months from the end of financial year, as set out in the ESR regulations.

Dubai International Financial Centre ('DIFC') – Notification due date of 31 March 2020 postponed

On 17 March 2020, DIFC updated its licensees through a communication released on its official website ([link](#)). The communication postpones the 31 March 2020 notification deadline, provides a brief overview of the regulations and seeks to provide clarity through release of ten FAQs on ESR applicability, compliance requirements, expected due dates, penalties etc. Following are the important clarifications discussed in the communication issued by DIFC:

1. **ALL** DIFC licensees (irrespective of whether they undertake a relevant activity or not) will be required to submit an annual notification on the DIFC client portal within the proposed due date likely to fall in **Quarter 2 of 2020**.

2. In addition to the annual notification, the ESR require licensees that carry on a relevant activity from which they derive income (and if they are not exempt) to submit an annual return (separate from the notification) within 12 months after their financial year end i.e. **31 December 2020**, for financial year ended on 31 December 2019.
3. The UAE Ministry of Finance will be issuing a **Relevant Activities Guide** which would assist all licensees in determining whether their business conducts a Relevant Activity and falls within the scope of the ESR.
4. It has been emphasized that once the Relevant Activities Guide has been issued, the **Registrar** at DIFC will make the requisite notifications available on the DIFC Portal and issue a communication to all DIFC licensees about the notification process and deadlines involved.

Abu Dhabi Global Market ('ADGM') – Notification due date of 31 March 2020 postponed

On 3 February 2020, ADGM had updated its members that all existing licensees must submit a notification by 31 March 2020. Licensees will have to submit the notification online through 'Lodge a General Document' service accessible at (www.registration.adgm.com). The notification template will be available soon, along with further guidance on reporting procedures. However, we have received feedback from ADGM that given the current situation in light of COVID – 19, the due date of 31 March 2020 is no longer applicable. It is expected that ADGM will communicate another due date for submission of ESR notification to all its licensees in due course.

RAK International Corporate Centre ('RAK ICC') – First notification due by 30 June 2020

Pursuant to being notified as a 'Regulatory Authority' ([see our alert on the role of a Regulatory Authority](#)) and issuance of guidance on economic substance regulations ([see our alert](#)) in October 2019, RAK ICC has now released a [step-by step guide](#) on how licensees within its free zone can submit their economic substance notification. Some of the key takeaways from the new guide are:

1. **ALL** licensees (irrespective of whether they undertake a relevant activity or not) would need to submit their notification through the **Registered Agent Portal** by **30 June 2020**.
2. The notification form will be available on the Registered Agent Portal from **29 March 2020**.
3. RAK ICC will provide agents that represent a large number of licensees with an excel spreadsheet to facilitate bulk filing, upon request. Agents can request for this spreadsheet by emailing RAK ICC at esr@rakicc.com.
4. Failure by an entity to comply with the Economic Substance Regulations will result in administrative penalties (AED 10,000 to AED 300,000), spontaneous exchange of information with the relevant Foreign Competent Authority and potential suspension, revocation or non-renewal of registration.
5. Following details are required in the notification on the portal¹:
 - Company name;
 - Financial year end;
 - Reportable period (start date and end date);
 - Type of Relevant Activity(ies) carried on by the entity;
 - Whether the entity earned income from the Relevant Activity during the reportable period;
 - Whether the income earned from the Relevant Activity is subject to tax outside the UAE;
 - Whether the share capital of the entity is at least 51% directly or indirectly owned by the UAE Federal or Emirate level government / authority / body; and
 - Whether the entity was a tax resident outside the UAE.

If the entity is classified as a 'High-Risk Intellectual Property' business under the UAE Economic Substance Regulations, then the agent must provide additional information in respect of the

¹ Refer the guide for details

licensee's parent company, ultimate parent company and ultimate beneficial owner (name and country) in the notification.

Ministry of Economy – Notification timeline awaited

The Ministry of Economy has not yet issued guidance on the implementation of ESR in the mainland (UAE). We have received a feedback from the Ministry of Economy that the competent department at the Ministry of Economy is currently in the **final stages** to publish all the requirements on the Ministry's official website regarding the ESR.

Ajman Free Zone – First notification due by 30 June 2020

Similar to RAK ICC, Ajman Free Zone authorities have also informed its licensees through email that ESR notification should be submitted by 30 June 2020.

Kingdom of Bahrain

Pursuant to the issuance of Ministerial Order No. 106 of 2018 by the MOICT and a directive concerning economic substance requirements by the CBB in 2018, both authorities published additional guidance, templates for the Economic Substance Returns and their filing mechanism this year.

The licensees are required to meet tests linked to state core income generating activities, direction and management, 'adequate' people, assets, premises and expenditure. The Economic Substance Returns require licensees to explain to the authority how they meet the tests and (importantly) upload relevant documents to substantiate their claim (e.g. minutes of board meetings and meeting agendas to meet direction and management tests).

MOICT requires its licensees undertaking Relevant Activities to submit their Economic Substance Return online via the Ministry's Sijilat portal by 31 March 2020. However, this functionality is yet to be activated on the Sijilat portal. Considering the current circumstances, it is possible that the due date for filing the Economic Substance Return in Bahrain is extended beyond 31 March 2020. However, since there is no formal communication from the MOICT yet, it is recommended that in-scope licensees keep the draft return ready for filing, if required, by 31 March 2020. We also understand that the MOICT is accepting physical copy filing of the returns in some cases.

The CBB requires its licensees to provide details in an excel template ([published on their website](#)) and send the same via email to aeoi@cbb.gov.bh by 31 March 2020 to meet their reporting obligation.

Other Countries update

The **Jersey** authorities have recently announced that where companies' operating practices have to be adjusted to compensate for the COVID-19 virus outbreak, the authority will not determine under Article 6, Taxation (Companies- Economic Substance) (Jersey) Law 2019, that a company has failed the economic substance test for financial year ended 31 December 2020. For example, if a company would normally hold directors' meetings in Jersey but, to avoid travel or because individuals are self-isolating, these meetings are temporarily held virtually to allow those individuals or alternatives to attend, then the authority would not regard this as failing to meet the economic substance test.

The **Guernsey** and **Bermuda** authorities have also announced similar relaxations in light of the COVID -19 virus outbreak.

All entities in **Cayman Islands** are required to make a notification to confirm, whether or not they conduct a 'relevant activity', the nature of activity (if applicable), details of exemption available (if any) along with contact person details. This notification is required to be submitted online, via the General Registry System's Corporate Administration Platform **by 31 March 2020** for the year 2019. Entities undertaking

a relevant activity also need to file a detailed return ('Nil' return where there is no income from a relevant activity) by 31 December 2020 (for financial year ending on 31 December 2019). The format and procedure for filing ESR return is still awaited.

Open issues

From a regional perspective, while the authorities in UAE and Bahrain have made an attempt to provide necessary clarifications through additional guidance and FAQs, however, there are certain open issues discussed below which would need more clarity:

For United Arab Emirates

1. It has been specified that an entity is considered engaged in a "Holding Company business", if it holds equitable interest(s) in juridical person(s). However, the percentage of holding through which control can be exercised has not been clarified. For instance, it is not clear if an entity holding 10% of equity shares of a company and earning dividend income (without exercising control as a majority shareholder or through voting rights) would also be categorised as a Holding Company.
2. If a Holding Company earns interest income from depositing dividends in the bank, will the entity still be classified as carrying on the Holding Company business (since the FAQ states that an entity is considered as a Holding Company if it only earns dividend and capital gain from its equity interest(s)). This also needs to be seen through further clarifications / guidance in the near future.
3. "Renting of assets" and "Intra group financing" are qualified to be covered under "Lease Finance business". However, the regulatory authority designated for such businesses (as per Cabinet decision No. (58) of 2019) is the Central Bank for mainland companies. It is not clear whether mainland companies (which are not licensed by the Central Bank) earning property rentals or interest on inter-company loans will be able to submit notifications and reports to the Central Bank, as the Ministry of Economy (as a Regulatory Authority for mainland companies) does not regulate such activities.
4. It is not clear whether the recharges towards staff or services to foreign related parties (at cost or along with a mark-up) constitute an income/consideration for "Service centre business".

For Kingdom of Bahrain

1. The UAE ESR guidance clarifies that to qualify as a pure holding company, the entity should not hold other form of assets (bonds, government securities, interest in real property). However, there is no clarity under the Bahrain ESR on this point.
2. FAQ 12 of the MOICT guidance answers the question as to whether a subsidiary of a passive holding entity that makes interest bearing loans to related entities would be treated as carrying on a core income generating activity. It is mentioned that the provision of loans is an example of a banking and financing core income generating activity and accordingly where such loans are provided for a commercial gain, the entity would be deemed to be performing a relevant activity (i.e. banking business). As such entities may not be licensed by the CBB and banking/ financing business is not a relevant activity under the MOICT, it is not clear how such a company would file the ESR return.
3. As per MOICT guidelines on ESR, local service and distribution centre appears to be covered which is different from the UAE ESR which explicitly mentions import from a foreign connected person and service to foreign related parties. The MOICT should provide more clarity as the intent is to cover transaction with foreign related parties.

Relief measures for impact of COVID – 19

Given the current situation around COVID – 19 and like Jersey, it would be helpful, if the authorities in the UAE and Bahrain were to issue relaxation on dispensing with the requirement to hold physical board meetings for the year 2020 until the situation improves.

Contact us

While this alert summarises the recent developments on the ESR, if you would like to understand the specific implications of the ESR to your business and undertaking requisite compliances, please feel free to get in touch with us.

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