



Economic Substance in the UAE

The United Arab Emirates (UAE) has issued the **Cabinet of Ministers Resolution No. 31 of 2019**, concerning economic substance regulations in the UAE (ESL Regulations), in order to remove the UAE from the European Union's blacklist of non-compliant tax jurisdictions.

Who needs to comply with UAE ESL?

The ESL Regulations shall apply to any UAE entity, including foundations, whether incorporated on the mainland or in a Free Zone. Every UAE establishment should consider the following three questions:

1. Does the UAE entity carry out of a Relevant Activity?
2. Is the entity generating income from the Relevant Activity?
3. If the answer to (1) and (2) is yes, is the entity able to meet the Economic Substance Requirements?

Further, in **Cabinet of Ministers Resolution No. 57/2020**, exempted licensees are outlined as a new category of licensee under the ESR and are currently defined as:

- (i) investment funds,
- (ii) licensees which are tax resident in another jurisdiction,
- (iii) licensees which carry on business only in the state by residents and are:
 - a. not part of an MNE group, being a group that includes two or more enterprises the tax residence for which is in different jurisdictions, or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction; and
 - b. only carry out business in the state; and
- (iv) branches of foreign entities which (relevant) income is subject to tax in a jurisdiction outside the UAE.

The Minister of Finance also retains the discretion to add further types of exempted licensees to the above.

In order to enjoy their exempt status for ESR purposes, exempted licensees must file a notification accordingly, and will be required to submit a report proving the qualifications for exemption.

1. What is a Relevant Activity?

Relevant activities are:

- Banking business;
- Finance and leasing business;
- Fund management business;

- Headquarters business;
- Holding company business;
- Insurance business;
- Intellectual property holding business;
- Shipping business; and
- Distribution and service centre business.

2. How is it determined whether income is generated from a Relevant Activity? And is this income to be considered Core-Income Generating Activity as per the ESL Regulations?

If no income is generated from A Relevant Activity, the entity falls outside of the scope of the ESL Regulations.

However, if income is generated, the entity will need to comply with the ESL Regulations, which require entities to conduct Core-Income Generating Activities (CIGA) in the UAE (with the exception of the Activity of Holding company business). However, the definition of CIGA varies according to each of the above Relevant Activities, elaborated in Article 5 of the ESL Regulations (as attached). Therefore, if you are unsure, we urge you to seek advice accordingly.

3. What are the Economic Substance Requirements?

If a UAE entity conducts a Relevant Activity, it must:

- Carry out CIGA in the UAE;
- be shown to be directed and managed in the UAE;
- Have adequate employees and premises in the UAE;
- Have adequate operating expenditure in the UAE;
- Have adequate physical assets or outsourcing in the UAE; and
- In the case of any outsourcing, show that this is sufficiently monitored.

For the Activity of Holding Business, there are reduced substance requirements, namely to:

- Have adequate employees and premises in the UAE, wherein a flexi-desk or registered agent shall suffice; and
- Comply with the requirement to submit any documents, records or information to the relevant Regulatory Authority in accordance with the laws.

Adequacy, with regard to all the above requirements, shall be assessed on a case-by-case basis. Outsourcing of any of the above requirements is also possible.

Additionally, A minimum of one board meeting (or equivalent for branches) is required to be held annually in the UAE for each relevant entity.

When are the compliance and filing deadlines?

The reporting requirements shall be set by the relevant Regulatory Authorities for each of the Relevant Activities, and the first round of reporting should have been due on or after 1

January 2020. Most UAE Companies should already be in compliance with the ESL Regulations. Further details and guidance with respect to the time, form and method of submission for the notifications and reports are expected to be released by the respective Regulatory Authorities.

Please note that **ALL UAE ENTITIES**, irrespective of whether they will need to comply with the ESL Regulations, will need to report annually to the relevant authorities whether or not they fall within the scope of the ESL Regulations, and to submit supporting documents accordingly should the relevant Regulatory Authorities request these.

Further, once notifications have been submitted, each entity should file an economic substance report within 6 months of the notification. The Ministry of Finance will launch a portal to facilitate the electronic filing of the notifications, reports and other relevant information. However, it has not yet been clarified when portal will be accessible.

What are the penalties for non-compliance?

Penalties for non-compliance with the ESL Regulations include fines of up to AED 50,000, exchange of information with international tax authorities, and striking off the entities as a last resort.

Please do not hesitate to contact us should you have any queries or require any guidance relating to the above.

Trench & Associates 2020 ©