

## ALYIANT2YOU: Regulatory Brief

### UAE ECONOMIC SUBSTANCE REGULATIONS

- **Background:** The United Arab Emirates (“UAE”) Cabinet of Ministers Resolution No. 57 of 2020 Concerning Economic Substance Regulations (the “**Amended ESR**”) was issued in 10 August 2020. The Amended ESR repealed and replaced the earlier Cabinet of Ministers Resolution No. 31 of 2019 Concerning Economic Substance Regulations (the “**Repealed ESR**”) and Cabinet of Ministers Resolution No. 58 of 2019 (regarding the concerned Regulatory Authorities). Following the Amended ESR, Ministerial Decision No. 100 for the year 2020 on the issuance of directives for the implementation of the provisions of the Cabinet Decision No. 57 of 2020 (i.e. the Amended ESR) was issued on 19 August 2020 (the “**Guidance**”). The Guidance repeals and supersedes Ministerial Decision No. (215) for the year 2019 on directives for the implementation of the provisions of the Repealed ESR (the “**Repealed Guidance**”). Accordingly, the Amended ESR read with the Guidance, make several important changes to the Repealed ESR and Repealed Guidance. The thrust of the Amended ESR read with the Guidance continues to be to determine and set out the criteria for confirming that a Licensee that is carrying on an activity in the UAE has economic substance. This article briefly sets out some of the features of the Amended ESR and the Guidance.
- **First reportable Financial Year:** Under the Guidance, all Licensees and Exempted Licensees are subject to the Amended ESR from the earlier of: (i) their Financial Year commencing on 1 January 2019, or (ii) the date on which they commence carrying out a Relevant Activity (for a Financial Year commencing after 1 January 2019).
- **Filing of Notifications and Economic Substance Reports:** In terms of the Amended ESR and the Guidance, every Licensee and Exempted Licensee is required to submit a ‘Notification’ and where applicable, every Licensee is required to submit an ‘Economic Substance Report’. Amongst other requirements, the Notification and Economic Substance Report are to be filed electronically on the UAE Ministry of Finance Portal launched with respect to the same. In present context, notwithstanding the previous submission of a Notification to a Regulatory Authority by the earlier date of 30<sup>th</sup> June 2020, a Notification is required to be re-submitted on the UAE Ministry of Finance Portal by a filing deadline of no later than **31 December 2020**. Further, the filing deadline for an Economic Substance Report for a Financial Year commencing on or after 1 January 2019 and ending on or before 31 December 2019, is also no later than **31 December 2020**.
- **Who needs to submit a Notification:** Pursuant to the Amended ESR and the Guidance, a Licensee and an Exempted Licensee is required to submit a ‘Notification’ annually in accordance with the Amended ESR and Guidance. The time frames for compliance with the requirements to submit a Notification are different from the time frames to submit an Economic Substance Report. The Notification is required to be submitted within six months from the end of the Financial Year of the Licensee or Exempted Licensee.
- **Who needs to submit an Economic Substance Report:** In terms of the Amended ESR and the Guidance, every Licensee is required to meet the applicable Economic Substance Test requirements and submit an Economic Substance Report containing the requisite information and documentation under the Amended ESR within twelve months from the end of the relevant Financial Year commencing on or after 1 January 2019.
- **Who is a Licensee:** A Licensee is defined by the Amended ESR to mean any of the following entities: (a) a juridical person (incorporated inside or outside the UAE); or (b) an Unincorporated Partnership, registered in the UAE, including a Free Zone and a Financial Free Zone and carries on a Relevant Activity. The term Licensee is elaborated upon in the Guidance.
- **Who is an Exempted Licensee:** An Exempted Licensee is defined by the Amended ESR to mean any of the following: (a) a Licensee that is an Investment Fund; (b) a Licensee that is a tax resident in a jurisdiction other than the UAE; (c) a Licensee that is wholly owned by one or more residents in the UAE and meets the following two conditions: (i) it is not part of a MNE Group; and (ii) it only carries out business in the UAE; (d) a Licensee that is a branch of a foreign entity the Relevant Income of which is subject to tax in a jurisdiction other than the UAE; and (e) any other Licensee as determined pursuant to a decision of the Minister of Finance. The term Exempted Licensee is elaborated upon in the Guidance.
- **What is a Relevant Activity:** A Relevant Activity is specified in the Amended ESR to cover the following activities: (i) **Banking Business**; (ii) **Insurance Business**; (iii) **Investment Fund Management Business**; (iv) **Lease-Finance Business**; (v) **Headquarters Business**; (vi) **Shipping Business**; (vii) **Holding Company Business**; (viii) **Intellectual Property Business**; and (ix) **Distribution and Service Centre Business**. The Amended ESR and Guidance cover in detail what each activity entails in order to fall within the ambit of a Relevant Activity.
- **What is the Economic Substance Test:** In terms of the Amended ESR, without prejudice to certain specified provisions thereof, a Licensee that is not an Exempted Licensee is required to satisfy the following criteria set forth in the Amended ESR and the Guidance to meet the **Economic Substance Test** in relation to any **Relevant Activity** carried on by it: (a) the Licensee conducts the necessary Core Income-Generating Activity in the UAE: the Amended ESR identifies a non-exclusive list of activities that are considered as being of central importance to a Licensee for generating income from a Relevant Activity; (b) the Relevant Activity is directed and managed in the UAE; (c) having regard to the level of Relevant Activity: (i) there is an adequate number of qualified full-time employees in relation to the Relevant Activity who are physically present in the UAE (whether or not employed by the Licensee or by another entity and whether on temporary or long-term contracts); (d) there is adequate operating expenditure incurred by the Licensee in the UAE; and (e) there are adequate physical assets in the UAE. A Licensee may outsource a Core Income-Generating Activity to an Outsourcing Provider on certain conditions prescribed by the Amended ESR being met. The Amended ESR and Guidance elaborate on the above matters for and in connection with meeting the Economic Substance Test, including with respect to what is “adequate”.
- **Holding Company Business:** The Amended ESR read with the Guidance provides for reduced substance requirements for a Holding Company Business under specified conditions.
- **Where there is no Relevant Income:** Under the Amended ESR and the Guidance, a Licensee is not required to meet the Economic Substance Test in a Financial Year in which it has no Relevant Income. The description of what is “Relevant Income” is contained in the Amended ESR and the Guidance.
- **High Risk IP Licensees:** In terms of the Amended ESR and the Guidance, a “High Risk IP Licensee” (as defined in the Amended ESR) is subject to increased economic substance requirements.
- **Evidencing Status as an Exempted Licensee:** In terms of the Guidance, any entity which claims to be an Exempted Licensee, must submit along with the Notification, sufficient evidence substantiating its status as an Exempted Licensee for each Financial Year in which it claims to be an Exempted Licensee. Under the Amended ESR, an Exempted Licensee that fails to meet the reporting requirements prescribed by the Amended ESR is: (a) required to meet the Economic Substance Test in relation to any Relevant Activity carried on by it for each Financial Year in which such failure occurs; and (b) be subject to all the provisions of the Amended ESR as are applicable to a Licensee.
- **Penalties and other matters:** In addition to the matters considered above, the Amended ESR and Guidance provides for various other matters, including provisions for offences and penalties for failure to provide a Notification; offences and penalties for failure to submit an Economic Substance Report and for failure to meet the Economic Substance Test; offences and penalties for providing inaccurate information; matters pertaining to and connected with the assessment of whether the Economic Substance Test is met; retention of information and records; provision of information; and exchange of information provisions. Please note that unless otherwise defined herein, any of the above defined terms identified by the capitalization of the initial letter of a word or a phrase, are defined in the Amended ESR and the Guidance and which are necessary to consider with respect to determining the impact of the same on a Licensee/Exempted Licensee under the Amended ESR and Guidance.
- **How we can assist businesses with respect to the Amended ESR:** Our Compliance and Risk Management services are able to assist businesses in the financial services and non-financial services sectors: (i) to carry out a review and analysis on the applicability of the Amended ESR to a business and if the Amended ESR is applicable, to then identify the matters required for compliance with the Amended ESR and Guidance; and (ii) to assist businesses with the completion of applicable Notification and Economic Substance Report submissions. Please contact Alyiant Consultancy Limited at [aly@alyiantconsultancy.com](mailto:aly@alyiantconsultancy.com) for further details.

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