



Introduction

In respect of Cabinet of Ministers Resolution no. 31 of 2019 Concerning Economic Substance Regulations

The full legislation can be found here:

https://www.mof.gov.ae/en/lawsAndPolitics/CabinetResolutions/Documents/Cabinet%20of%20Ministers%20Resolution%20No%20%2031%20of%202019%20Concerning%20Economic%20Substance_English.pdf

Guidance from the Ministry of Finance can be found here:

<https://www.mof.gov.ae/en/lawsAndPolitics/CabinetResolutions/Documents/Ministerial%20decision%20no.%20215%20for%20the%20year%202019.pdf>

N.b. All entities in the UAE need to consider how they are affected, whether they are registered in the Mainland, in a Freezone or with an International Corporate Centre.

Next Steps

The legislation came into effect on 30 April 2019 and all companies are required to provide the information within 12 months of the Financial Year End.

As the vast majority of RAK ICC companies have a financial year ending on 31 December the information will be required by 31 December 2020 but e.g. if the Financial Year End of the Company is 31 May then the filing would be required by 31 May 2020 in respect of the Year Ended 31 May 2019.

RAK ICC will be establishing the requirements for sending the appropriate Notification by 01 January 2020 and RAK ICC will be asking all companies to confirm whether they are undertaking a Relevant Activity. If the answer is “No” then no further action is likely to be required.

RAK ICC will ask all companies that conduct Relevant Activities to demonstrate how they satisfy the economic substance.

This will include providing information on the “core income generating activities” in the UAE;

The extent to which the company is “directed and managed” in the UAE; and

with reference to the level of activities performed in the UAE:

- confirmation that the company has adequate number of qualified full-time employees in the UAE
- Incurs an adequate amount of operating expenditure in the UAE
- Have adequate physical assets in the UAE.

If a Relevant Entity carries out more than one Relevant Activity, the economic substance requirements must be met for each of the Relevant Activities.

Holding Companies

Please note that a Relevant Entity that only undertakes a Holding Company Business will be subject to less stringent economic substance requirements.

A company will not be considered to be a Holding Company for the purposes of Economic Substance Requirements if it derives any income from sources other than dividends and capital gains. A company which owns other forms of assets (e.g. bonds, government securities, interest in real property), even if it owns equity participations, will not be treated as carrying on holding business.

Additional requirements apply if a Relevant Entity carries out “high risk IP related activities”.

Outsourcing

The legislation and guidance provides details on the requirements for outsourcing arrangements. In particular please note that “double counting” is not permitted and RAK ICC will be required to validate that there are adequate and appropriate resources available to meet the outsource agreement.

Legal Notice:

Please note: This guidance is not intended to be definitive legal advice and should not be relied upon as such. The interpretation of legislation is a matter on which RAK ICC cannot advise and entities/individuals need to form their own independent view on compliance with legislation. Independent legal advice is advised where there is any uncertainty.

Flow Chart

RAK ICC has devised a flow chart to help determine whether a company falls under the Economic Substance Requirements, and references the following annexures.

Annexure 1- Economic Substance Rules Relevant Activities

Under the Resolution, the economic substance requirements apply to all companies in the UAE companies that generate income by carrying out the following Relevant Activities, whether onshore or in the Free Zones, including the Financial Free Zones:

1. Banking;
2. Insurance services;
3. Finance leasing;
4. Headquarter activities related to (i) conducting management decisions; (ii) incurring operational expenditures on behalf of group entities; and (iii) coordinating group activities;
5. Shipping;
6. Intellectual property services;
7. Holding company activities; and
8. Distribution and service centre activities.

Banking

A company regulated by The Banking Supervision shall be treated as carrying on “banking business”. N.b. RAK ICC Regulations do not allow for Banking Business to be conducted by a RAK ICC company.

Insurance

Insurance business is defined as a resident company undertaking insurance business within the meaning of the Insurance Business carried on by a licensee. N.b. RAK ICC Regulations do not allow for Insurance Business to be conducted by a RAK ICC company.

Financing and leasing

The provision of credit facilities of any kind for consideration to any person — includes hire purchase, finance leasing, and conditional/credit sale

Headquartering

Provides non-resident inter group companies:

- a) Provision of senior management;
- b) Control of material risk for activities carried out by, or assets owned by, intra group persons
- c) Substantive advice in relation to the assumption or control of risk for such activities or assets.

Shipping

The operation of ships in international traffic for income from the transport of passengers or cargo, including the following activities: a) the renting or chartering of ships; b) the sale of travel tickets (or equivalent) and ancillary services connected with the operation of a ship; c) the use, maintenance, or rental of containers (including trailers and other vehicles or equipment for the transport of containers) used for the transport of anything by sea; d) the management of the crew of a ship.

Intellectual Property and High Risk IP

A resident company with income from intellectual property assets is an IP Company — High-risk IP company.

Holding Company

Has the primary function of the acquisition and holding of shares or equitable interest in other companies and does not carry on any other commercial activity.

Distribution and Service Centres - for group activities

Sole or main activity is:

- a) To purchase raw materials and finished products from other members of the same group which are non-resident and to re-sell them for a small percentage of profits.
- b) The provision of services to other members of the same group, which are non-resident.

Annexure 2- Substance Requirements not applicable

If the company does not have an income from operating in a relevant activity as stated in Annexure #1, the substance requirements are not applicable but the registered agent must submit a declaration to RAKICC confirming that the company does not have an income from operating in a relevant activity.

Annexure 3- Pure Equity Holding Company

A “pure equity holding company” has generally been defined to mean a company that only holds equity participation in other entities and only earns dividends and capital gains.

Annexure 4- High Risk IP Company

High-risk intellectual property business' means an intellectual property business carried on by: (a) an entity that: (i) did not create the intellectual property in an intellectual property asset that it holds for the purposes of its business; (ii) acquired the intellectual property asset.

Such a company will be considered a high risk company unless the relevant entity can demonstrate that there was a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intangible asset, exercised by an adequate number of full-time employees with the necessary qualifications that permanently reside and perform their activities within the UAE, and provides sufficient information to the Authority in relation to that financial year to rebut this presumption.

Annexure 5- Substance Requirement

Where an entity is undertaking Relevant Activities, the following requirements apply to meet the economic substance test:

- The entity conducts core income-generating activity (CIGA) in the UAE
- The entity must be directed and managed in the UAE in relation to CIGA
- The entity’s activities must be carried out with adequate local “economic substance” with regard to the level of relevant activity in the UAE
- Economic substance consists of:
 - Full-time employees: adequate number of suitably qualified employees in relation to that activity who are physically present in the UAE.
 - Expenditure: adequate expenditure incurred in the UAE
 - Premises: physical offices or premises as may be appropriate for the core income-generating activities.

Annexure 6- What happens if an entity does not meet the economic substance requirements?

A company would commit an offence and be liable to an administrative penalty of between AED 10k and 50k if it either fails to provide required information or knowingly provides inaccurate information

A similar penalty would be applied for failure to meet the Economic Substance Test. This increases to between AED 50k and 300k in the subsequent year(s)

RAK ICC will advise the company of the measure(s) it believes would be necessary to meet the test.

Failure to comply may lead to administrative action including suspension or strike-off of the company.