



UAE issues economic substance regulations effective 30 April 2019, impacting relevant entities in the UAE.

Summary

The recent introduction (on 30 April 2019) by the UAE Cabinet, of economic substance regulations has increased compliance requirements (annual requirement) for UAE entities which carry out certain ‘relevant activities’ in the country. Entities will need to report compliance with the regulations (linked to state core income generating activities, direction and management, people, assets, premises and expenditure tests, in the UAE) on an annual basis, and where they are unable to demonstrate economic substance, they would be subject to penalties (and even revocation of the license, if non-compliance is repeated), and therefore, would need to evaluate the need to fulfil substance requirements, and/or consider restructuring of operations. Though the regulations are effective 30 April 2019, additional guidance and regulations are expected in due course. We have outlined below details of the regulation and its impact on UAE entities.

Introduction

The Council of the European Union had adopted a revised EU list of non-cooperative jurisdictions for tax purposes on [15 May 2019](#), which increased the number of jurisdictions to 12: American Samoa, Belize, Dominica, Fiji, Guam, Marshall Islands, Oman, Samoa, Trinidad and Tobago, **UAE**, US Virgin Islands and Vanuatu.

As per the report published, jurisdictions like Marshall Islands, **UAE** and Vanuatu were identified as jurisdictions that facilitate offshore structures and arrangements aimed at attracting profits without real economic substance.

On **30 April 2019**, the UAE issued the [Cabinet of Ministers Resolution No. 31 of 2019 concerning economic substance regulations](#), with an aim to address the findings issued by the



Council of the European Union, and possible exclusion from the EU list of non-cooperative jurisdictions for tax purposes. The regulations were published on **20 June 2019** in public domain.

Other jurisdictions including British Virgin Islands, Mauritius, Jersey, Guernsey, Isle of Man, Seychelles, Bahamas, Bermuda and Cayman Islands have also introduced economic substance rules which are similar to the regulations published by the UAE Ministry of Finance.

Entities considered in-scope for economic substance test

The regulations apply to a license holder that carries out a “*Relevant Activity*”, established in the Mainland UAE or the various free zones (onshore) as a representative office, branch or a commercial enterprise. Exceptions from the regulations apply to a commercial enterprise in which the government (emirate or federal) has an ownership stake (however, clarity is required in relation to joint ventures or listed companies where the government has an ownership). The activities considered as a “*Relevant Activity*” are as follows:

- Banking
- Insurance
- Investment fund management
- Lease finance
- Headquarters
- Shipping
- Holding company
- Intellectual property
- Distribution and service centers

Economic substance test requirements

In order to meet the economic substance test requirements, a UAE entity undertaking a relevant activity must:

- undertake state core income generating activity in the UAE (Article 5 sets out the activity criteria for each of the Relevant Activities);
- be directed and managed in the UAE (which includes requirement for board meetings in UAE, and for a quorum of directors to be physically present in the UAE during these meetings);
- have ‘adequate’ number of qualified full-time employees physically present in the UAE;
- have ‘adequate’ operating expenditure in relation to the relevant activity; and
- have ‘adequate’ physical assets in the UAE.

The licensee may outsource the people, expenditure and physical assets criteria of the relevant activity to third party service providers as long as the licensee can demonstrate adequate supervision of the outsourced activity and that the outsourced activity is carried out in the UAE.

While there are additional requirements for high risk intellectual property businesses, the requirements for Holding companies are limited to submission of relevant documents to the



regulated authority and having adequate employees and premises for such holding function. The Competent Authority (being the Ministry of Finance) will issue additional guidance on the substance requirements, including the meaning of “adequate” in the context of people, expenditure and physical assets test.

The Regulatory Authority (which will be the relevant authority that issues the licences to UAE entity) has a period of 6 years after the end of the relevant financial year to determine if the economic substance test is met or not (for deliberate misinterpretation there is no time period, and for High Risk IP licensee the default determination must be that the economic substance is NOT met unless the licensee proves otherwise).

Information to be submitted by a UAE entity

While every licensee has to annually notify the regulatory authority of its financial year end and whether or not it is carrying on a relevant activity (time, form and manner of notification is yet to be prescribed by the regulatory authority), a UAE entity undertaking a relevant activity must submit a report to the regulatory authority within **12 months after the last day of the end of the financial year** (*this would imply that information would need to be submitted by 30 June 2020 for an entity with financial year ending 30 June 2019*). The report should include the following information:

- the type of Relevant Activity conducted by it.
- the amount and type of relevant income in respect of the Relevant Activity.
- the amount and type of operating expenses and assets in respect of the Relevant Activity.
- the location of the place of business and, if applicable, plant, property or equipment used for the Relevant Activity of the licensee in the state.
- the number of full-time employees with qualifications and the number of personnel who are responsible for carrying on the licensee’s Relevant Activity.
- information showing the State Core Income-Generating Activity in respect of the Relevant Activity that has been conducted.
- a declaration as to whether or not the Licensee satisfies the economic substance test.

There is additional information required to be submitted for high risk intellectual property businesses (namely information on exercising high degree of control on DEMPE¹ functions through qualified full-time employees residing in the UAE, business plan on IP ownership, certain employee information and evidence of decision making taking place in the UAE).

The regulatory authority will share the information submitted by the Licensee with the Competent Authority who will (in the event the licensee has not met the requirements) share such information with the Foreign Competent Authority of the country in which the parent company or Ultimate Beneficial Owner of the licensee resides.

¹ Development, exploitation, maintenance, enhancement and protection



Penalties

An amount of administrative penalty between AED 10,000 and AED 50,000 shall be imposed for failure to meet the economic substance test.

If repeated the next year, an amount of administrative penalty between AED 50,000 and AED 300,000 shall be imposed for failure to meet the economic substance test. Failure to provide any information or providing inaccurate information also attracts a separate penalty between AED 10,000 and 50,000.

The regulatory authority may also impose suspension, revocation or non-renewal of the licence of a licensee in case of repeated non-compliance.

A Licensee has the right to appeal against the conclusions drawn by the regulatory authority regarding absence of economic substance and the consequential levy of penalty. Appeal filing procedures would be issued subsequently.

Next steps

While the regulations should not impact UAE headquartered businesses and others with genuine operations in the UAE, there will be reporting and compliance requirements to manage. Nevertheless, all UAE entities should consider the following actions in order to prepare for the upcoming requirements:

- Analyse the group structure to identify entities in the UAE and other jurisdictions (like BVI and Cayman Islands) which require compliance with their local economic substance regulations;
- Determine if the UAE / relevant overseas entities undertake any Relevant Activities;
- Perform a gap assessment to determine the current level of compliance with the requirements;
- Determine remedial options which could include taking steps to inject additional substance or restructure the entity(ies) / business / operations / holdings.
- Maintain a compliance tracker for the respective in-scope UAE entities.

If you would like our assistance in understanding the specific implications of the same to your business, please feel free to get in touch with us.

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