

23<sup>rd</sup> June 2020

## Economic Substance Regulations in the UAE - UPDATE

The UAE Government has released the Resolution of the Cabinet of Ministers No. (31) of 2019 concerning Economic Substance Regulations (“ESR”) with effect from 30 April 2019 and furthermore, on 11 September 2019, the UAE Ministry of Finance issued Ministerial Decision No. 215 of 2019 containing further guidance on how the ESR may be met. MENA LEGAL informed about the introduction of the ESR in our respective previous newsletter.

The ESR’s administrative responsibility has been delegated to the respective Regulatory Authorities, i.e. the different onshore and free zone authorities (listed in Cabinet Resolution No (58) of 2019). If a Licensee is carrying out a Relevant Activity it is required to notify and submit the report to its respective Regulatory Authority. The UAE Ministry of Finance issued a guidance (Ministerial Decision No. 215 of 2019) helping to identify a Relevant Activity as per the ESR.

It was also clarified that UAE businesses are expected to use a “substance over form” approach to determine whether or not they undertake a Relevant Activity and, as a result, are within the scope of the ESR. This determination would require the UAE business to not only consider the activities stated under their commercial licence or registration certificate but also to assess the actual activities carried out during a financial period.

The deadline to submit the notification have been set differently by the respective regulatory authorities. However, Licensees are required to submit their notification latest by 30 June 2020. Many of the Regulatory Authorities require their companies to file notifications irrespective of whether or not they carry on a Relevant Activity.

As per the template provided by the UAE Ministry of Finance, at least (i) the type of Relevant Activity conducted by the Licensee (if any), (ii) whether income is earned from this activity and if this income has been subject to tax outside the UAE, and (iii) whether the Licensee is a tax resident outside the UAE, and if so where, should be declared in the notification.

Penalties ranging from AED 10,000 to AED 300,000 shall be imposed for non-compliance with the ESR.

### Short description of the Relevant Activities as per the Relevant Activities Guide issued by the UAE Ministry of Finance:

**Banking Business** means the business of accepting deposits of money which may be withdrawn, or that are repayable on demand or after a fixed period, or after notice, by cheque or otherwise, and the use of such deposits, either in whole or in part, in:

- A. the making or giving of loans, advances, overdrafts, guarantees or similar facilities;  
or
  - B. the making of investments,
- for the account and at the risk of the Licensee.

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**Insurance Business** means the business of accepting risks by effecting or carrying out contracts of insurance, in both the life and non-life sectors, including contracts of reinsurance and captive insurance arrangements.

The definition of an **Investment Fund Management Business** encompasses Licensees that provide discretionary investment management services in relation to domestic or foreign Investment Funds.

The definition of a **Lease-Finance Business** encompasses Licensees that offer credit or financing for any kind of consideration, and includes intra-group financing. Offering credit or financing includes making loans to related or unrelated parties, entering into finance leases in relation to assets other than land, and providing credit in the form of hire purchase agreements, long term credit plans, and other types of financing arrangements.

A Licensee is regarded as carrying on a **Headquarters Business** if the Licensee provides services to foreign group companies, and through the provision of such services:

- A. The Licensee takes on the responsibility for the overall success of the group; or
- B. The Licensee is responsible for an important aspect of the overall group's performance.

In order for a UAE business to be seen as having "taken on the responsibility for the overall or an important aspect of the overall group's success or performance", the services provided by the entity must involve (i) the provision of senior management; (ii) the assumption or control of material risk for activities carried out by foreign group companies; or (iii) substantive advice in relation to the assumption or control of such risks.

To undertake a **Shipping Business**, a Licensee must operate one or more ships in international traffic, for the transport of either passengers, cargo or both.

A **Holding Company Business** is defined as a business that (a) is a Holding Company in accordance with the law applicable to the Licensee carrying out such activity, (b) has as its primary function the acquisition and holding of shares or equitable interests in other companies, (c) does not carry on any other commercial activity. Equity interests include shares in a company and interests in an incorporated partnership, as well as any other instrument which gives the Licensee a beneficial ownership interest in a company.

A UAE business is regarded as carrying on an **Intellectual Property Business** if it holds, exploits, or receives gross income from "Intellectual Property Assets". An Intellectual Property Asset is defined as any intellectual property right in intangible assets, such as copyrights, patents, trademarks, brands, and technical know-how, from which the Licensee earns separately identifiable income in the form of royalties, license fees, franchise fees, capital gains and any other income from the sale or exploitation of the Intellectual Property Asset.

A **Distribution and Service Centre Business** refers to two distinct activities that are covered under one Relevant Activity heading. A Licensee is considered engaged in a Distribution Business if the Licensee purchases raw materials or finished products from a foreign group company, and distributes those raw materials or finished goods. A Licensee is considered engaged in a Service Centre Business if it provides consulting, administrative or other services to a foreign group company, and those services are in connection with the foreign group company's business outside the UAE. Licensees that only purchase goods from or distribute goods to third parties are not considered engaged in a Distribution Business. Likewise, Licensees that are engaged in the business of providing services to third parties are not considered as carrying on a Service Centre Business.

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Its members and individual experts have in-depth experience in matters of legal, tax, business consulting, accounting, property consulting, project finance and recruitment services, mainly with a focus on the markets of Europe, the Middle East, North Africa and beyond.

With over 30 years of personal and professional experience our members provide comprehensive and competent advice related to the business environment in various parts of the world, but also provide advice to regional entrepreneurs with respect to opportunities and legal matters in Europe, the Middle East, North America and Asia. With member offices in Germany, Italy, France, the Netherlands, USA, United Kingdom, Switzerland the United Arab Emirates, Egypt, Jordan and Saudi Arabia, along with associated partners in various other countries, our members are positioned to offer hands-on support and on-the-ground services on a regional basis.

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