

THE NEW UAE ECONOMIC SUBSTANCE REGULATIONS

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UAE Corporate Alert

By: Zaid Abu-Shattal, Kulsum Rehman, Farah Al-Nabulsi

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EXTENSION ANNOUNCED

The Ministry of Finance (MoF) announced on 31 December 2020 the extension of the deadline for submitting the ESR's notifications and reports. All companies in the UAE that were engaged in any of the ESR's relevant activities during the 2019 financial year must submit an ESR notification, and possibly a report. The submissions' deadline has now been extended from 31 December 2020 to 31 January 2021. We understand that the MOF will not be extending the submission deadline any further. Failing to meet the deadline will subject the companies, that fall within the scope of the ESR, to certain administrative penalties.

Submissions are made electronically via the [MOF portal](#). [Click here](#) for the official announcement by Emirates News Agency (WAM).

BACKGROUND

The European Union (EU) has a blacklist of countries that do not meet the EU's criteria on tax transparency, fair taxation, and the implementation of measures to counteract base erosion of profit shifting (BEPS). The EU's efforts to combat tax evasion go beyond the jurisdiction of the EU.

The UAE Government introduced Economic Substance Regulations in 2019 as a response to being blacklisted by the EU for tax purposes following an assessment of the UAE's tax framework by the EU Code of Conduct Group on Business Taxation. In late 2019, the EU removed the UAE from the blacklist.

Some of the main objectives of the previous Economic Substance Regulations and the current Regulations (defined below) are to ensure that UAE entities demonstrate an adequate economic presence in the UAE relative to the activities that they undertake and report actual profits that are commensurate with the economic activities undertaken within the UAE.

This article provides a high-level overview on the Regulations and, where appropriate, mentions the most important differences compared to the previous Economic Substance Regulations.

THE REGULATIONS

The UAE Cabinet of Ministers issued Cabinet Resolution No. 57 of 2020 Concerning Economic Substance Requirements on 10 August 2020, which provides an amended set of Economic Substance Regulations (the Resolution). The Resolution repeals and supersedes Ministerial Decision No. 215 of 2019 on the Issuance of

Directives for the Implementation of the Provisions of Cabinet of Ministers Resolution No. 31 of 2019 concerning Economic Substance Requirements.

Ministerial Decision No. 100 of 2020 on the Issuance of Directives for the Implementation of the Provisions of the Economic Substance Requirements was issued on 19 August 2020 (the Decision) and acts as the new “Relevant Activity Guide” (further discussed below). The Decision also repeals and replaces Cabinet of Ministers Resolution No. 31 of 2019 and Cabinet of Ministers Resolution No. 58 of 2019.

The Resolution and the Decision are referred to together as the “Regulations”.

SCOPE OF REGULATIONS

The Regulations apply to (i) any legal person (incorporated in or outside the UAE); or (ii) unincorporated partnership, registered in the UAE (a Licensee) that carries out one or more “Relevant Activity” (defined below). A Licensee also includes those entities registered in any of the UAE's free zones (including the financial free zones i.e., Abu Dhabi Global Market (ADGM) and Dubai International Financial Centre (DIFC)).

Natural persons, sole proprietors, trusts, and foundations do not fall within the scope of the Regulations (although they were considered Licensees under the previous Economic Substance Regulations).

The Relevant Activities include:

1. Banking Business
2. Insurance Business
3. Investment Fund Management Business
4. Lease Finance Business
5. Headquarters Business
6. Shipping Business
7. Holding Company Business
8. Intellectual Property Business
9. Distribution and Service Centre Business

A Licensee that carries out one or more Relevant Activity and derives Relevant Income (defined below) is required to maintain and demonstrate an adequate “economic presence” in the UAE relative to the activities it undertakes (the Economic Substance Test).

Schedule 1 of the Decision provides further information on each Relevant Activity together with guidance on how an entity can assess if it undertakes one or more Relevant Activity. The Decision provides 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 Regulations. This means that businesses in the UAE should look beyond what is stated on their license to the actual activities that they are undertaking.

The Regulations apply to financial years starting on or after 1 January 2019.

ECONOMIC SUBSTANCE TEST

A Licensee must satisfy the criteria below in relation to the Relevant Activity in order to meet the Economic Substance Test:

- The Licensee conducts the necessary Core Income-Generating Activity (defined below) in the UAE;
- The Relevant Activity is directed and managed in the UAE—this is satisfied if the following conditions are met:
 - The Licensee's board of directors meet in the UAE at an adequate frequency and there is a quorum of directors physically present in the UAE;
 - The board meetings are recorded in written minutes noting the making of strategic decisions in relation to the Relevant Activity and are signed by the directors attending such meetings;
 - The minutes of all board meetings and the records relating to the Licensee are kept in the UAE; and
 - The directors have the necessary knowledge and expertise to discharge the duties of the board; and
- Having regard to the Relevant Activity:
 - There is an adequate number of qualified full-time employees who are physically present in the UAE;
 - There is adequate operating expenditure incurred by the Licensee in the UAE; and
 - There are adequate physical assets in the UAE.

A Licensee whose activity is restricted to carrying out a Holding Company Business meets the Economic Substance Test if the Licensee (a) complies with the requirement to submit any documents and information to the relevant Regulatory Authority (defined below); and (b) has adequate employees and premises for holding and managing the Holding Company Business.

A Licensee is not required to meet the Economic Substance Test in a financial year in which it generates no “Relevant Income.” Relevant Income means gross income from any source, including revenue from sales of inventory and property, services, interest etc., recorded in an entity's books and records under the relevant accounting standards, whether or not earned in the UAE or abroad and irrespective of whether the entity derived a profit or loss from its activities.

Core Income-Generating Activities are activities that are of central importance to a Licensee for generating income from a Relevant Activity. Further details and guidance on Core Income-Generating Activities can be found in Article 3 of the Resolution and Schedule 1 of the Decision.

EXEMPTIONS

The Regulations have amended the exemption categories provided under the previous Economic Substance Regulations. “Exempted Licensees” now include:

10. An investment fund;
11. A Licensee that is not a UAE tax resident;

12. A Licensee that is wholly-owned by UAE residents and (a) is not part of a multinational enterprise group, and (b) is only carrying out business in the UAE; and
13. A branch of a foreign company registered in the UAE that carries out a Relevant Activity but the Relevant Income of such branch is subject to tax in a jurisdiction outside the UAE.

Any entity which claims to be an Exempted Licensee is required to submit to the relevant Regulatory Authority sufficient evidence substantiating its status as an Exempted Licensee for each financial year in which it claims to be an Exempted Licensee.

ECONOMIC SUBSTANCE NOTIFICATION AND ECONOMIC SUBSTANCE REPORT

All Licensees and Exempted Licensees are required to submit an Economic Substance Notification to their respective Regulatory Authority setting out the following for each relevant financial year (the Notification):

14. The nature of the Relevant Activity being carried out;
15. Whether Relevant Income was generated;
16. The date of commencement and end of their financial year; and
17. Any other information as may be requested by the Regulatory Authority.

A Notification submitted by any entity which claims to be an Exempted Licensee is required to submit to the relevant Regulatory Authority sufficient evidence substantiating its status as an Exempted Licensee for each financial year in which it claims to be an Exempted Licensee.

The Notification must be submitted within six months from the end of the Licensee's or Exempted Licensee's financial year. The Notification must be submitted electronically on the UAE Ministry of Finance's online portal. Licensee or Exempted Licensees that have already submitted a Notification directly to their Regulatory Authority are required to re-submit a Notification on the UAE Ministry of Finance's online portal.

Licensees that carry out a Relevant Activity and generate Relevant Income must submit, in addition to submitting a Notification, an Economic Substance Report in relation to the requirements and conditions that the Regulations have set to meet the Economic Substance Test (the Report). The Report must be submitted no later than 12 months after the last day of each financial year. The Report must include the information required by the Regulations, which include without limitation, the type of Relevant Activity that was undertaken, the amount of the Relevant Income earned and the Core Income-Generating Activity in respect of the Relevant Activity.

REGULATORY AUTHORITIES AND THE NATIONAL ASSESSING AUTHORITY

The role and functions of the Regulatory Authorities with regards to their respective jurisdictions (i.e., the Department of Economic Development for onshore entities, the DIFC Registrar of Companies for DIFC entities and the ADGM Registration Authority for ADGM entities) include without limitation (i) collecting Notifications and Reports from Licensees and Exempted Licensees (as applicable); (ii) collecting all relevant information as required to be submitted by such entities; (iii) reviewing Notifications, Reports and any information provided for accuracy and completeness; and (iv) reporting information to the UAE Federal Tax Authority (which is the appointed National Assessing Authority).

Failure by a Licensee or Exempted Licensee to submit a Notification, Report and/or information required under the Regulations to the relevant Regulatory Authority will be notified by such Regulatory Authority to the National Assessing Authority.

The National Assessing Authority's functions include without limitation: (i) undertaking assessments to determine whether a Licensee has met the Economic Substance Test; (ii) imposing administrative penalties where applicable; and (iii) hearing and deciding on appeals.

Both the Regulatory Authority and the National Assessing Authority have discretion to request additional information, documents, and records as may be required in their performance of their duties under the Regulations.

DEADLINES AND NEXT STEPS

As mentioned, Notifications (and, if applicable, Reports) that have already been submitted to a Regulatory Authority under the previous Economic Substance Regulations must be re-submitted.

Pursuant to a notice published by the UAE Ministry of Finance, the filing deadline for Notifications that are due before the Ministry of Finance online portal was available will be extended to 31 December 2020. For example, in respect of a Licensee with a 31 March 2020 financial year end, which under the Decision would be required to file by 30 September (i.e., before the Ministry of Finance's online portal became available), this Licensee would be required to file by no later than 31 December 2020.

The filing deadline for Reports for a financial year commencing on or after 1 January 2019 and ending on or before 31 December 2019 is 31 December 2020.

Companies should consult with their internal business department, legal advisors, accountants, and financial advisors to determine if they fall within the scope of the Regulations.

FAILURE TO COMPLY

The National Assessing Authority is responsible for determining whether a Licensee has adequately complied with the Regulations.

Failure to comply with the Regulations can result in penalties, suspension, revocation or non-renewal of a Licensee's license or permit.

Failure to submit a Notification by the set deadline may result in a penalty of AED 20,000 being imposed.

A penalty of AED 50,000 may be imposed for failure to submit a Report by the relevant deadline or for failure to meet the Economic Substance Test for the relevant financial year.

Providing inaccurate information to a Regulatory Authority or the National Assessing Authority may result in another penalty of AED 50,000.

RESOURCES

We include below links to some helpful resources:

- [Cabinet Resolution No. 57 of 2020 Concerning Economic Substance Requirements](#)

- [Ministerial Decision No. 100 of 2020 on the Issuance of Directives for the Implementation of the Provisions of the Economic Substance Requirements](#)
- [UAE Ministry of Finance Economic Substance Notification Template](#)
- [UAE Ministry of Finance Economic Substance Report Template](#)
- [UAE Ministry of Finance Economic Substance Notification Guidance](#)
- [UAE Ministry of Finance Economic Substance Report Guidance](#)

How We Can Help

Our lawyers are available to advise on all legal aspects of the new Economic Substance Regulations. Please feel free to get in touch with your usual K&L Gates contact or anyone listed below.

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KEY CONTACTS



ZAID ABU-SHATTAL
SENIOR ASSOCIATE

DUBAI
+971.4.427.2791
ZAID.ABU-SHATTAL@KLGATES.COM



FARAH AL-NABULSI
PARTNER

DUBAI
+971.4.427.2703
FARAH.AL-NABULSI@KLGATES.COM



KULSUM REHMAN
PARALEGAL

DUBAI
+971.4.427.2758
KULSUM.REHMAN@KLGATES.COM

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