

UAE Government had published Economic Substance Regulations in 2019 & implemented same wef financial year commencing on or after 1st January 2019.

Said regulations have been amended (effectively repealing old regulations) recently by way of Cabinet of Ministers Resolution No. 57 of 2020 & Ministerial Decision no. 100 of 2020.

We highlight below key changes brought about by above amendments to the earlier issued regulation and summarise the important provisions of Economic Substance Regulation that would thus be applicable.

The framework of this Resolution is based on four major tenets:

1. **Relevant activities (RA) & Core Income Generating Activity (CIGA):**

The Resolution prescribes its applicability to the “licensee” carrying out the **Relevant Activities (RA)**. Under these **RA**, it also specifies activities that are considered **Core Income Generating Activity (CIGA)** that must be carried out by the Licensee in the UAE.

Licensee is defined as a **juridical person & unincorporated partnerships registered / licensed** by the competent licensing authority/ authorities **in the State to carry out a Relevant Activity (RA)** in the State, **including a Free Zone and a Financial Free Zone.** (So regulations would no longer be applicable to natural persons thus effectively removing unincorporated entities like sole proprietorships etc. out of the purview of the ESR)

Exemption: Companies in which UAE Govt owned 51% or more were exempted but said automatic exemption has now been removed and following exempted categories have been added:

- Investment Fund
- Entity which is tax resident outside UAE
- Entity wholly owned by UAE residents, which is not part of Multi National Group & all activities are carried out in UAE and
- Branch of foreign entity whose relevant income is subject to tax outside UAE

Also in case of UAE entities with branches in UAE, only Parent Company need to report as composite notification / report.

Relevant Activities are activities that are specified in Article 4 of the Resolution as

- Banking | Insurance | Investment funds management | Lease Finance | Shipping
- Intellectual Property | Distribution & Services Centres | Holding company business | Head Quarter business.

Core Income Generating Activities (CIGA) are specified in Article 5 of the Regulation and must be carried out by the Licensee in UAE in relation to respective RA. The Regulation termed them as “**State Core Income Generating Activity**”. They are detailed in Annexure 1.

2. **Economic Substance Test:**

The Resolution sets out criteria to meet **Economic Substance Test (EST)** in relation to **RA** stated above:

- Licensee conducts **CIGA** or in relation to its CIGA is directed and managed, in UAE.
- Licensee employs “adequate” number of employees | incurs “adequate” expenditures | has “adequate” size of physical assets
- Licensee should be able to monitor and control the activity, if its **CIGA** is outsourced.
- Where a Licensee is directed and managed in UAE, Licensee’s board should meet with adequate frequency in UAE | should have quorum physically present and record the strategic decisions taken at the meeting | maintain the minutes | directors to have necessary knowledge and expertise
- This ‘adequacy’ not defined & would depend on business operations on case to case basis.

3. Obligations:

The Resolution sets out obligations of the Licensee:

A Licensee shall annually notify to Authority of the following:

- Whether or not it is carrying on a RA
- Listing its RA and CIGA **(by way of Economic Substance Notification)**
- Declare whether it meets EST within 12 months of end of its financial year
- Whether its income in relation to its RA is taxed outside UAE **(by way of Economic Substance Filing)**

Also other related information in relation to RA including:

- Type | income | operating expenses | assets | location | employees



4. Expected content of Economic Substance Report:

- Owner Information, Management & control situated in UAE
- Relevant activity carried out & income generated from such RA
- Business premises details, employees & assets employed to conduct the RA
- Intellectual property information
- **Financial statements in respect of RA & CIGA**
- Declaration



5. Penalties:

The Resolution sets out range of offences and penalty for non-compliance and failure to meet EST and providing incorrect or inaccurate information. **The penalty would be AED 20,000/- for failure to file notification, AED 50,000/- for failure to provide inaccurate information and from AED 50,000/- to AED 400,000/- for non filing of Economic Substance Report or failure to meet Economic Substance Test and could also result into suspension, revocation or non-renewal of license.**

6. Other Matters:

Connected Person is defined as an entity that is part of same group (two or more entities related through ownership or control such that they are required to prepare consolidated financial statements for reporting purpose under applicable accounting standards)

National Assessing Authority: Federal Tax Authority has been designated as National Assessing Authority which will be responsible to carrying out assessment of ESR Notifications, Test & Compliances.

Competent Authority: Ministry of Finance has been designated as the Competent Authority for enforcing this regulation.

Regulatory Authority: Respective licensing authorities have been designated as the Regulatory Authority.

Annexure 1: Relevant Activities & Core Income Generating Activities

Business / RA	Core Income Generating Activity
Banking	➤ Raising funds, managing risk including credit, currency and interest risk Taking hedging positions Providing loans, credit or other financial services Managing capital and preparing reports for / to investors or Authority.
Insurance	➤ Predicting and calculating risk Insuring or re-insuring against risk and providing Insurance Business services Underwriting insurance and reinsurance.
Investment fund Management	➤ Taking decisions on the holding and selling of investments calculating risk and reserves Taking decisions on currency or interest fluctuations and hedging positions Preparing reports for / to investors or any Authority

Lease-Finance	<ul style="list-style-type: none"> ➤ Negotiating funding terms identifying and acquiring assets to be leased Setting the terms and duration of any financing or leasing Monitoring and revising any agreements Managing related risks.
Head Quarters Business	<ul style="list-style-type: none"> ➤ Businesses of provision of services to Foreign Connected Person including providing senior management Advising substantially on or actually assuming the control or risk of activities carried out by or assets owned by such Foreign Connected Person. ➤ Foreign Connected Person is the one who is not resident or deem resident in UAE. ➤ Taking relevant management decisions Incurring operating expenditures on behalf of group entities Coordinating group activities
Shipping	<ul style="list-style-type: none"> ➤ Managing crew (including hiring, paying and overseeing crew members) Overhauling and maintaining ships Overseeing and tracking shipping Determining what goods to order and when to deliver them, organising and overseeing voyages
Holding Company Businesses	<ul style="list-style-type: none"> ➤ Its sole function is the acquisition and holding of shares or equitable interests in other companies; and does not hold other assets or carry any other commercial activity. ➤ CIGA includes all activities related to that business and for the other businesses that derives income from other sources other than dividends and capital gains from its equity interest, those activities that are related to such income generated.
Intellectual Property (IP) Business	<ul style="list-style-type: none"> ➤ It is a business which holds, exploits, or receives income from IP Assets. ➤ IP Assets means any IP right in intangible assets, including but not limited to copyright, patents, trademarks, brand, technical know-how and also include non-trade intangible (including a trademark), brand, marketing and distribution. ➤ A separate set of activities are also provided for High Risk IP Licensee.
Distribution and Services Centers	<ul style="list-style-type: none"> ➤ Encompasses the businesses of importing from and providing related services to Foreign Connected Person. ➤ CIGA include purchasing, transporting and storing component parts, materials or goods ready for sale Managing inventories Taking orders Providing consulting or other administrative services.

Annexure 2: Deadlines for filing ESR Notification:

Notification to be filed with Ministry of Finance within 6 months of the end of the financial year of the licensee or exempted licensee (via portal). **So all entities who have submitted earlier for period ended 31st Dec 2019 will need to re-submit Notification on Ministry of Finance Portal once it is live.**

Whilst every effort has been made to ensure that the details contained herein are correct and up-to-date, it does not constitute legal, tax or other professional advice. We do not accept any responsibility, legal or otherwise, for any errors or omissions. This publication has been prepared and issued on the basis of publicly available information, internally developed data and other sources believed to be reliable.

Our Expertise

Kothari Auditors and Accountants is a professionally managed accounting, auditing, management and financial consulting firm established in October 1992.

The firm is registered in UAE Ministry of Economy & Commerce having offices in Dubai and Sharjah. The firm excels in offering accounting, audit services and host of consulting services.

GBS DMCC, an associate of Kothari Auditors & Accountants, was established to offer company Incorporation services in various onshore and offshore jurisdiction around the world.

GBS is dedicated to provide advisory on corporate formation, legal structuring, double tax avoidance treaties and assistance for formation of companies in various jurisdictions.



Kothari Auditors and Accountants

502 Business Center, Khalid Bin Al Waleed Road,
Opp. Burjuman Center, Bank Street, Post Box 51504, Dubai (UAE)
Tel: +971-4-3526330 | info@kaa.ae
www.kothariauditors.com

Global Business Services DMCC

Office No 12A-06, 13th Floor, HDS Tower, Plot No F2
Jumeirah Lakes Tower, Post Box 309074 Dubai (UAE)
Tel: +971-4-4471804 | info@gbsei.com
www.gbsei.com