

UAE: Synopsis of Economic Substance Regulations issued

Corporate Overview



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On 30 April 2019, the UAE Cabinet issued the Cabinet of Ministers Resolution No.31 of 2019 concerning economic substance regulations in the “state” (State will include all UAE entities including financial Freezone and Freezone established in UAE), requiring all in-scope UAE entities (“Relevant Entities”) that carry on certain activities (“Relevant Activities”) to have demonstrable economic substance in the UAE from 30 April 2019.

The Regulations apply to all UAE onshore and free zone companies that carry on a "Relevant Activity".

Steps to Identify whether economic substance regulations are applicable to your company.

STEP 1: Are you performing at least one of the “relevant activities” inside “State”?

- Banking.
- Insurance
- Investment fund management business
- Lease finance
- Shipping
- Distribution and Service Centre
- Headquarters
- Holding Company
- Intellectual Property Business

STEP 2: If the activities are falling under the “relevant activities”, then you will be required to meet the following economic substance test.

Requirement 1: State core income generating activity that must be conducted

Sr.no	Relevant activity	Core income generating activity
1.	Banking	1. (i) Raising funds (ii) Managing risk including credit, currency and interest risk
		1. Taking hedging position
		1. (i) Providing loans (ii) Providing credits (iii) Other financial services to customers
		1. (i) Managing capital (ii) Preparing reports to investors or any government authority functions relating to the supervision or regulation of such businesses
2.	Insurance Business	1. Predicting and calculating risk
		1. (i) Insuring or reinsuring against risk (ii) Providing insurance business services to its clients
		1. Underwriting insurance and reinsurance
3.	Investment fund management business	1. Taking decisions on holding and selling of investments
		1. Calculating risk and reserve
		1. Taking decision on currency or interest fluctuations and hedging positions
		1. Preparing reports to investors or any government authority functions relating to the supervision or regulation of such businesses

STEP 2: If the activities are falling under the “relevant activities”, then you will be required to meet the following economic substance test.

Requirement 1: State core income generating activity that must be conducted

Sr.no	Relevant activity	Core income generating activity
4.	Lease Business	1. Agreeing funding terms
		1. Identifying and acquiring assets to be leased
		1. Setting the terms or duration of any financing or leasing
		1. Monitoring or revising any agreements
		1. Managing any risk
5.	Shipping	1. Managing crew including hiring, paying and overseeing crew members
		1. Overhauling and Maintenance of ships
		1. Overseeing and tracking shipping
		1. (i) Determining what goods to order and when to deliver them (ii) Organising and overseeing voyages
6.	Distribution and service centre business	1. Transporting component parts, material or goods ready for sale
		1. Storing component parts, material or goods ready for sale
		1. Managing inventories
		1. Taking orders
		1. Providing consulting or other administrative services
7.	Headquarters	1. Taking relevant management decisions
		1. Incurring operating expenditure on behalf of group entities
		1. Co-ordinating group activities

STEP 2: If the activities are falling under the “relevant activities”, then you will be required to meet the following economic substance test.

Requirement 1: State core income generating activity that must be conducted

Sr.no	Relevant activity	Core income generating activity
8	IP address	<p>1. Any income in the nature of</p> <ul style="list-style-type: none">(i) Royalties(ii) Income from franchising agreement(iii) Income from licensing of intangible asset(iv) Income derived from capital gains from Intellectual Property assets <p>Intellectual Property assets includes copyrights, patents, trademark, Brand, technical know-how etc.</p>
9	Holding Company	Holding company having licensee to carry on any activity related to its primary function of acquiring and holding of shares or equitable interest in other companies and do not carry out any other commercial activity.

Requirement 2. Director and Manager in the state (Place of effective management)

1. Board of directors meeting takes place in the state at a regular interval for decision making required at that level
2. Quorum of the directors should be met by physical presence.
3. Minutes of the BOD meetings are recorded and signed by the attending directors and to be kept in the state
4. Minutes should record the making of strategic decisions
5. The directors should have necessary knowledge and expertise to discharge the duties of the board.
6. In case of Branch or rep office of foreign companies in the state if managed and operated by a single manager, such manager should be physically present in the state.

Requirement 3:

1. **Full time employee:** Adequate number of qualified full-time employees physically present in the state.
2. **Third party entity:** It can be in house or outsourced, if outsourced then the third party should have presence in the state.

Requirement 4: Adequate operating expenditure incurred in the state.

Requirement 5: Adequate physical asset in the state.

Requirement 6: In case of state core income generating activity carried out for the relevant licensee by another entity it should be able to monitor and control the carrying out of that activity.

Step 3: Reporting requirements

Entities in the state will be required to report whether they are a relevant entity or not. Relevant entity that is carrying on a relevant activity is required to satisfy the Economic Substance Test shall, no later than twelve (12) months after the last day of the end of each Financial Year of the Licensee, prepare and submit to the Regulatory Authority a report which shall be submitted by the Regulatory Authority to the Ministry of Finance.

Existing entities (entity with an existing trade licence in the UAE on the effective date of the Regulations, being 30 April 2019)	Comply with the Regulations from 30 April 2019, with the first return due in 2020.
New entities (entity that receives a trade licence on or after the effective date of the Regulations, being 30 April 2019)	Comply with the Regulations upon receiving its trade licence, with the first return due in 2020 (or later)

Further guidance will be issued in future with regards to set up of the “Regulatory authority” and the process of reporting.

Penalties:

Failure to meet Economic Substance Test:

1. First time penalty of not less than dirhams ten thousand (AED 10,000) and not exceeding dirhams fifty thousand (AED 50,000)
2. Second time penalty of not less than dirhams fifty thousand (AED 50,000) and not exceeding dirhams three hundred thousand (AED 300,000)

Failure to provide information or for inaccurate information

Penalty of not less than dirhams ten thousand (AED 10,000) and not exceeding dirhams fifty thousand (AED 50,000)

Takeaway:

The Regulations should have limited impact on UAE-headquartered businesses and foreign multinationals that have genuine commercial operations and management in the UAE (aside from complying with additional disclosure requirements going forward).

For multinationals that undertake Relevant Activities in the UAE but are managed remotely will have to reassess their governance structure and operating model in light of the UAE economic substance requirements, and any necessary adjustments should be made to ensure compliance with the Regulations.

This note has been prepared for general guidance on matters of interest only and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice.

THANK YOU

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