

ECONOMIC SUBSTANCE REGULATIONS OF UAE

The UAE Cabinet on 30th April 2019 passed Cabinet of Ministers Resolution No. 31 of 2019 concerning Economic Substance Regulations (ESR). This is expected to increase the compliance requirements of companies operating in UAE.

BACKGROUND

Arising out of the initiatives by European Union Code of Conduct Group and the global standard set by OECD Forum on Harmful Tax Practices, companies conducting businesses are required to have adequate economic substance in the country where an economic activity is generated. This is with a view to ensure that shifting of profits to low or no tax jurisdictions is not resorted to by the companies. Many offshore countries such as Jersey, Guernsey, Isle of Man, BVI, Cayman, Bermuda and Bahamas have announced their economic substance regulations as commitments made to the EU. However, till last year UAE had not passed such regulations.

UAE's ECONOMIC SUBSTANCE REGULATIONS

The UAE Cabinet in line with the other countries has come out with its Economic Substance Regulations (ESR) by way of Cabinet of Ministers Resolution No. 31 of 2019.

The Legislation which came into effect on 30th April 2019 requires all companies licensed in UAE to maintain adequate economic substance in the UAE in respect of the relevant activities and provide the relevant information to the concerned Regulatory Authority within 12 months of their Financial Year End.

Cabinet Resolution No. 58 of 2019 (4th September 2019) defines the Regulatory Authority in respect of each of the Relevant Activity. Further guidance for implementation of the ESR is provided by the Cabinet Decision No. 215 of the year 2019 (11th September 2019).

Full text of the above Resolutions and the guidance on implementation is available on MOF website (www.mof.gov.ae).

RELEVANT STATE ACTIVITIES AS PER ESR

Under the Resolution, the economic substance requirements apply to all companies licensed in the UAE (except those in which the government has a direct or indirect holding of 51% or more) that generate income by carrying out the following Relevant Activities, whether onshore or in the Free Zones including the Free Zones offshore:

- Banking
- Insurance services
- Lease – Finance
- Investment Fund Management
- Headquarters
- Shipping
- Intellectual Property
- Holding Company
- Distribution and Service Centers

KEY REQUIREMENTS OF ECONOMIC SUBSTANCE TESTS

In order for a Licensee to demonstrate that its relevant activity in the UAE has adequate substance, it must meet the following:

- The entity conducts core income generating activity (CIGA) in the UAE
- The entity must be directed and managed in the UAE in relation to CIGA
- The entity's activities must be carried out with adequate local "economic substance" with regard to the level of relevant activity in the UAE.

Economic substance consists of:

- a) Full time employees: adequate number of suitably qualified employees in relation to that activity who are physically present in the UAE
- b) Expenditure: adequate expenditure incurred in the UAE
- c) Premises: physical offices or premises as may be appropriate for the core income generating activities

Note: The activities may be outsourced to third parties, registered in the UAE, if carried out by their employees from premises in UAE.



REPORTING REQUIREMENTS:

An annual reporting is required to be done by the licensee to the regulatory Authority, to cover:

- Date of its financial year end
- It has carried out the relevant activity
- Value of its income and expenses

Note: Reporting is required to be done within 12 months of the company's financial year end eg. in case of financial year ending on 31 December, the information will be required by 31 December 2020.

FAILURE TO MEET THE ECONOMIC SUBSTANCE REQUIREMENTS

A company would commit an offence and be liable to an administrative penalty of between AED 10,000 and 50,000 if it either fails to provide required information or knowingly provides inaccurate information

A similar penalty would be applied for failure to meet the Economic Substance Test. This increases to between AED 50,000 and 300,000 in the subsequent year(s).

To evaluate how these could affect your business and for professional assistance to comply with the regulations, do not hesitate to contact us.

Disclaimer:

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