



ECONOMIC SUBSTANCE REGULATIONS

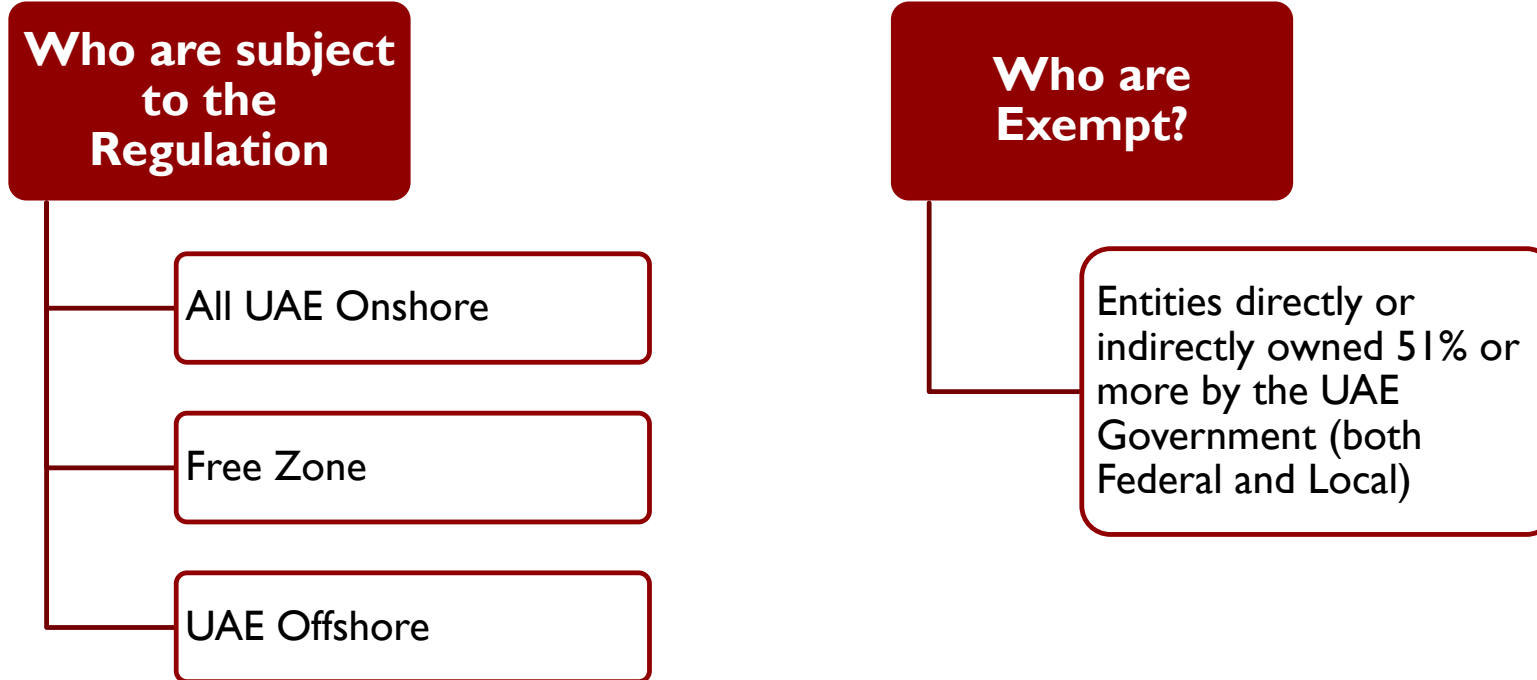




Economic Substance Regulations

An Introduction - ESR

- Introduced w.e.f. 30th April 2019
- Following categories of Companies that carries on *Relevant Activities*



“Relevant Activities” as per Article 4

Banking Business

Lease-Finance Business

Holding Company
Business

Insurance Business

Headquarters Business

Intellectual Property
Business

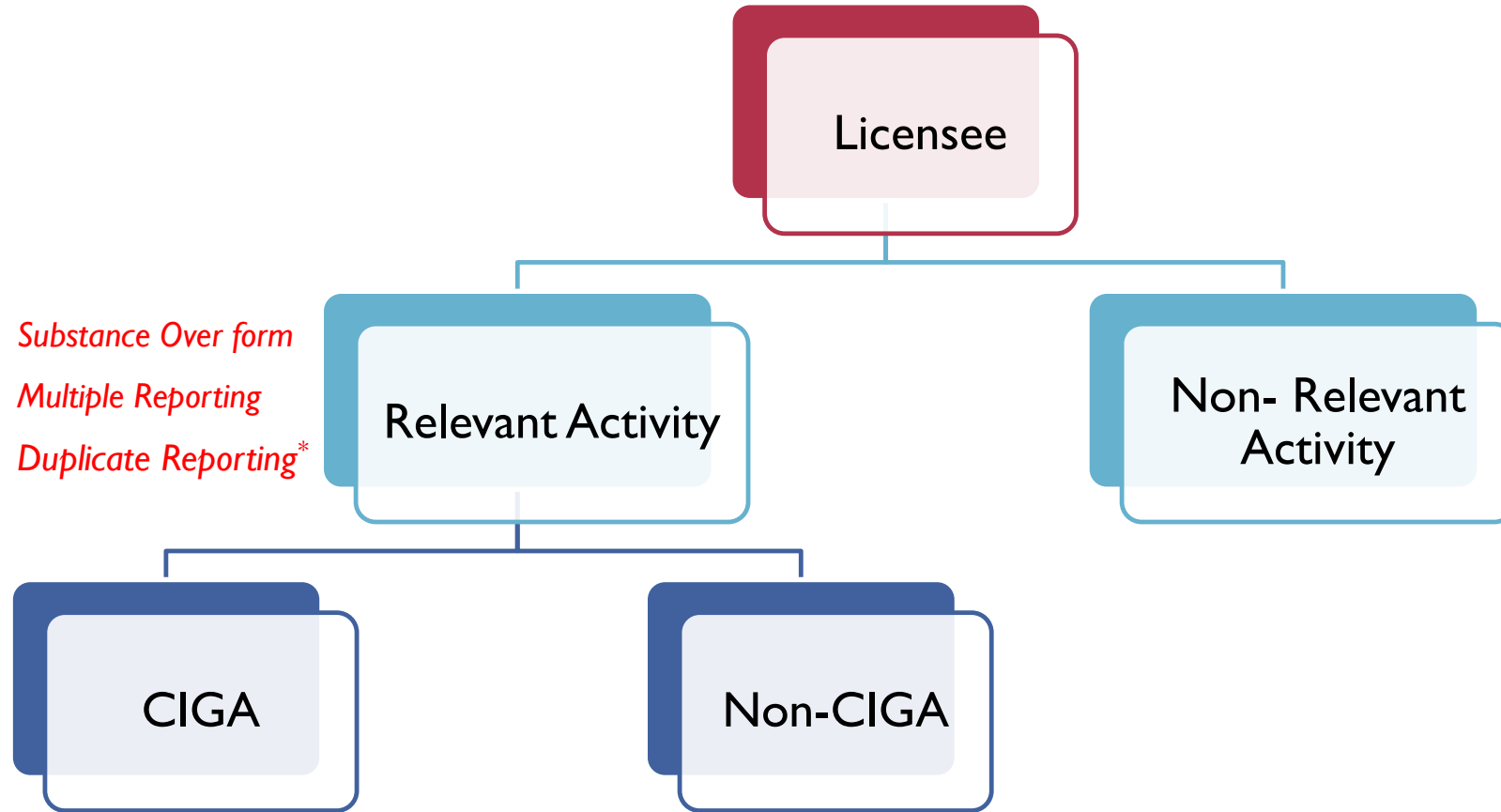
Investment Fund
Management Business

Shipping Business

Distribution and Service
Centre Business

Note: It is not required that a UAE business is actively engaged in any of the above business categories for it to be considered as carrying on a Relevant Activity. Even a passive receipt of Income under one of the Relevant Activity, then is said to carry on the Relevant Activity.....**NO THRESHOLD**

Economic Substance Regulations - briefly (Cont'd.)



** Licensees are required to demonstrate ES in respect of each Relevant Activity (RA), unless the other RAs are ancillary to a main RA*

Requirement to meet ES Test

As per ESR Regulations, Clause 2 of Article 6

A licensee meets the EST in relation to relevant activity in the following cases;

(1) if the Licensee conducts Core Income-Generating Activity (CIGA) within the UAE &

(2) if the *Licensee and its relevant activity are being directed and managed* in the UAE.

(3) having regard to the level of Relevant Activity, the licenses has an

- adequate number of qualified full-time employees **or** adequate level of expenditure on outsourcing to 3rd Party service providers*
- adequate operating expenditure incurred by it in the UAE.
- adequate physical assets in the UAE;

* Such 3rd Party service provider's activities, employees, expenditure and premises are in the UAE and are adequate.

Requirement to meet ES Test

(Cont'd.)

The test for 'directed and managed in the UAE' is satisfied if the below conditions are met:

- a) the Licensee's BOD meets in the UAE at an adequate frequency as needed for decision-making. Adequacy depends on the level of relevant activity ... However at least one meeting shall be held in UAE in a FY. Additionally, meeting requirements as per MOA/AOA shall also be met.
- b) there is a quorum of directors physically present in the UAE. ... Quorum as per MOA/AOA
- c) minutes of BOD meeting is recorded and signed by the directors attending the meetings.
- d) minutes of BOD meetings shall record the strategic decisions at the meeting.
- e) the BOD have the necessary knowledge and expertise to discharge the duties of the board.
- f) the minutes of all BOD meetings and the records of the Licensee are kept in the UAE.

Note:

In the case of branch/ representative offices of foreign companies (where no BOD exists but managed by Manager or CEO or GM). Such Manager/CEO/GM shall be physically present in the UAE when taking key decision relating to the management and operation of these entities and all above requirements shall apply.

Requirement to meet ES Test

(Con'td.)

- h) A Licensee may elect to outsource a Relevant Activity to 3rd party service providers, provided that:
- i. the Licensee is able to demonstrate adequate supervision of the outsourced activity.
 - ii. the outsourced activity must be conducted in the UAE.
 - iii. the economic substance of service providers will not be counted multiple times by multiple Licensees when evidencing their own substance in the UAE.

Note:

Outsourcing must not be used to circumvent ES Test.

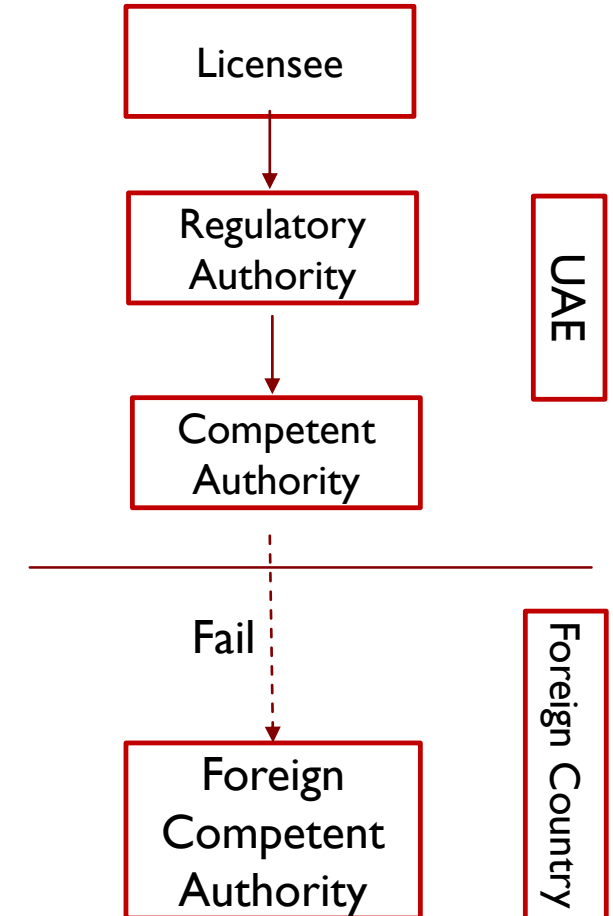
Who is the Regulatory Authority/ Competent Authority in UAE?

Relevant Activity	Regulatory Authority	Competent Authority
Investment Fund Management Business	<ul style="list-style-type: none"> - Securities and Commodity Authority (SCA) - Relevant authority in the FZ/FFZ 	Ministry Of Finance
Holding Company Business	<ul style="list-style-type: none"> - Ministry Of Economy (MOE) - Relevant authority in the FZ/FFZ 	

What happens if Economic Substance Test is failed for a FY?

Reporting

1. The Regulatory Authority, if they determine on the ES Test, shall provide the information provided under Article 8 relating to that Licensee for that period to the Competent Authority.
2. The Competent Authority shall share information of the licensee to the Foreign Competent Authority, if
 - the licensee fails to meet the ES Test for a specific Financial Year
3. Competent Authority shall in turn, pursuant to an international agreement, treaty or similar international arrangement, provide the information relating to such Licensee to –
 - the Foreign Competent Authority of the country or territory in which resides the parent company, the ultimate parent company, and the Ultimate Beneficial Owner of the Licensee.
 - If the Licensee is incorporated outside the State, the Foreign Competent Authority of the country or territory in which the Licensee is incorporated.



Holding Company Business

A Holding Company Business is defined under Article I of the ESR 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

Narrow definition to fit into Holding company business

Licensee whose activity is restricted to carrying out a Holding Company Business that derives its income **only** from:

- Dividends and
- Capital gains

Benefits of falling under above Definition - Reduced ESR Compliance

ESR is met if the following conditions are satisfied:

- Complies with the requirement to submit any documents, records or information to the relevant Regulatory Authority in accordance with the law applicable to the Licensee in UAE
- Has adequate employees and premises for holding and managing the Holding Company Business.

Special Points for consideration

A UAE business that does not meet the narrow definition of a Holding Company Business because it either:

- A. Carries on another activity; and/or
- B. Owns other forms of investments or assets (Interest bearing instruments)

may be required to meet the **Full** ES requirements depending on the coverage of other activities within the Relevant activities in ESR

CIGAs & Non-CIGA

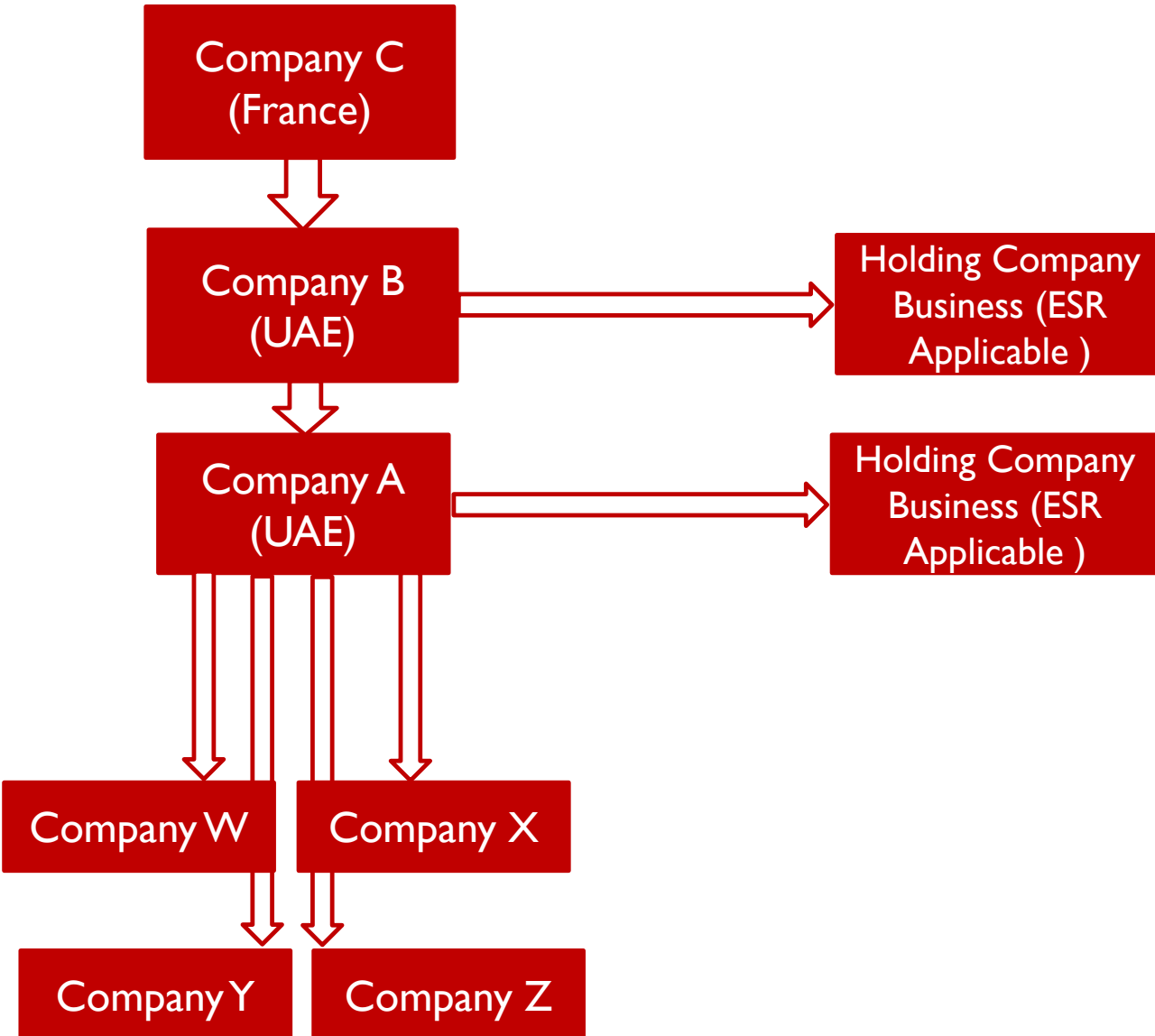
Relevant Activity	CIGAs (Indicative & not exhaustive)	Non-CIGAs
Holding Company Business	<ul style="list-style-type: none">• All activities related to that business; and in respect of Holding Company Business that derives income from other sources other than dividends and capital gains from its equity interest,• The CIGA shall be those activities associated with the income generated.	Support and other back office functions

Holding Company Business (Cont'd.)

Scenario I

Activity	Income from Activity	In Scope?	Under which RA?	Required to meet ES Requirements (if within scope)
Holding equity interests <u>only</u>	Income from equity (e.g. only dividends and capital gains)	Yes	Holding Company Business	Reduced substance requirements

Holding Company Business - Example



Scenario I

Example :

- Company A's only activity is the holding of shares in four subsidiary companies (Company W,X,Y,Z)
- Company B's only activity is the holding of shares in Company A
- The only gross income earned by Company A/ B are annual dividends from its subsidiaries.
- **Company A & B undertakes a Holding Company Business** irrespective of its own shares being held by another holding company in the group.

Reduced ESR Compliance to Companies A & B

ESR is met if the following conditions are satisfied:

- Complies with the requirement to submit any documents, records or information to the relevant Regulatory Authority in accordance with the law applicable to the Licensee in UAE
- Has adequate employees and premises for holding and managing the Holding Company Business.

Holding Company Business (Cont'd.)

Scenario II

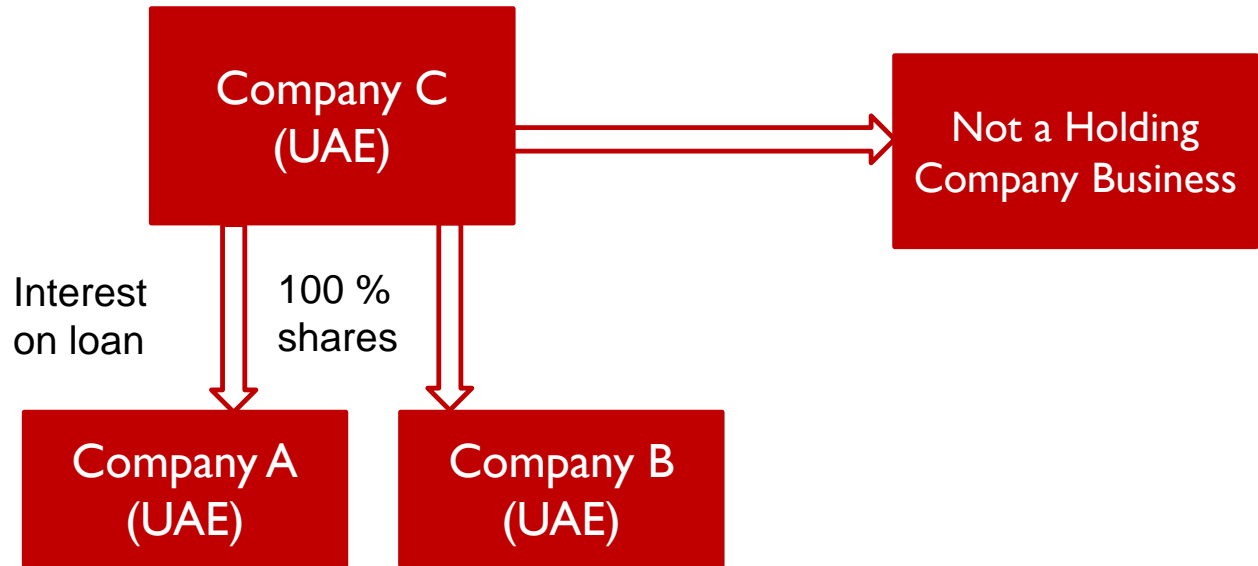
Activity	Income from Activity	In Scope?	Under which RA?	Required to meet ES Requirements (if within scope)
Holding equity interests <u>and</u> undertaking another Relevant Activity	Income from equity interests And Income from other Relevant Activity	Yes	Business of the Relevant Activity, but not a Holding Company Business	Yes. (increased substance requirements apply to a respective RA other than Holding Co.)

Holding Company Business - Example

Scenario II

Example :

- Company C holds 100% of the shares in two subsidiary companies and has provided an interest bearing shareholder loan to Company A.
- Company C earns annual dividends and interest income.
- **Company C will be considered as engaged in a Lease-Finance Business only, and NOT also considered as carrying on a Holding Company Business.**

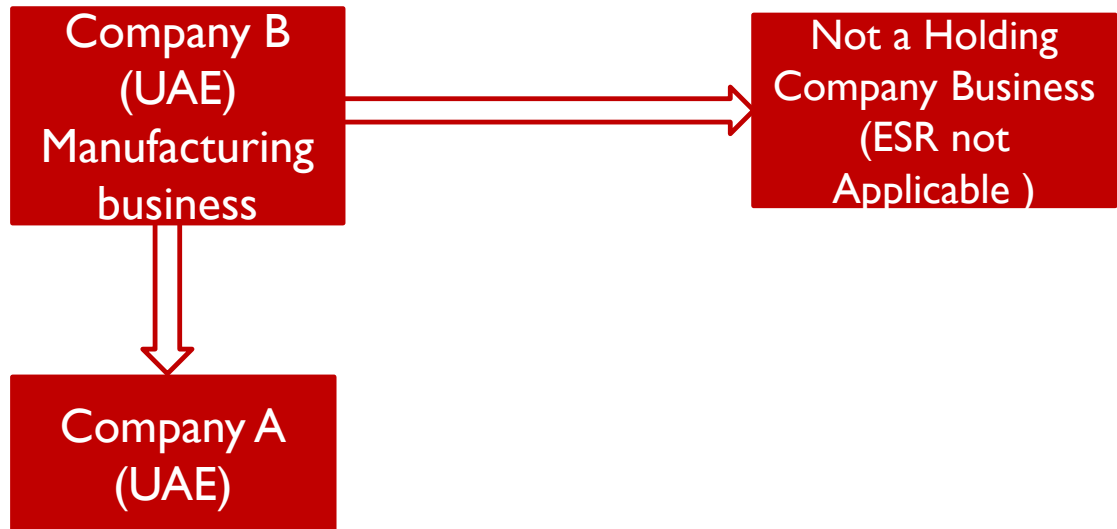


Holding Company Business (Cont'd.)

Scenario III

Activity	Income from Activity	In Scope?	Under which RA?	Required to meet ES Requirements (if within scope)
Holding equity interests and undertaking another activity that is <u>not</u> Relevant Activity	Income from equity interests and Income from Non-Relevant Activity	No	N/A	N/A

Holding Company Business - Example

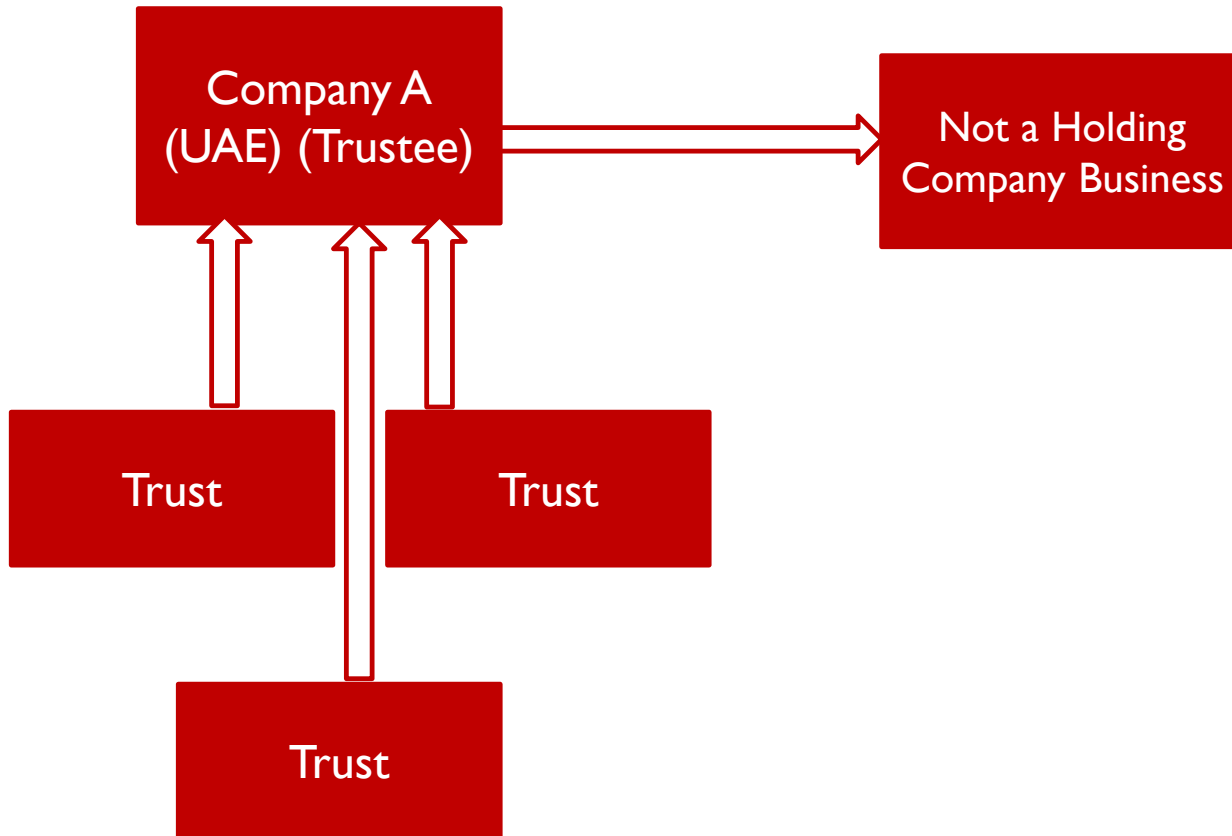


Scenario III

Example :

- Company B holding the shares of Company A and is also into manufacturing business by procuring and selling manufactured goods locally.
- **Company B is earning not only dividend income, hence is not considered a Holding Company Business.**
- The manufacturing business does not meet the definition of any of the other Relevant Activities and hence **Company B would not be covered under ESR**

Holding Company Business - Example



Example :

- Company A acts as trustee to a number of unconnected trusts, holding assets in its capacity as trustee.
- As Company A is in the business of providing trustee services and is not the beneficial owner of the assets, **Company A will not be considered a Holding Company Business.**

Investment Fund Management Business

“Investment Fund Management Business” encompasses Licensees that provide discretionary investment management services in relation to domestic or foreign “Investment Funds”

Discretionary Investment Fund Management services include making investment, divestment and risk related decisions on behalf of an Investment Fund.

CIGAs & Non-CIGAs

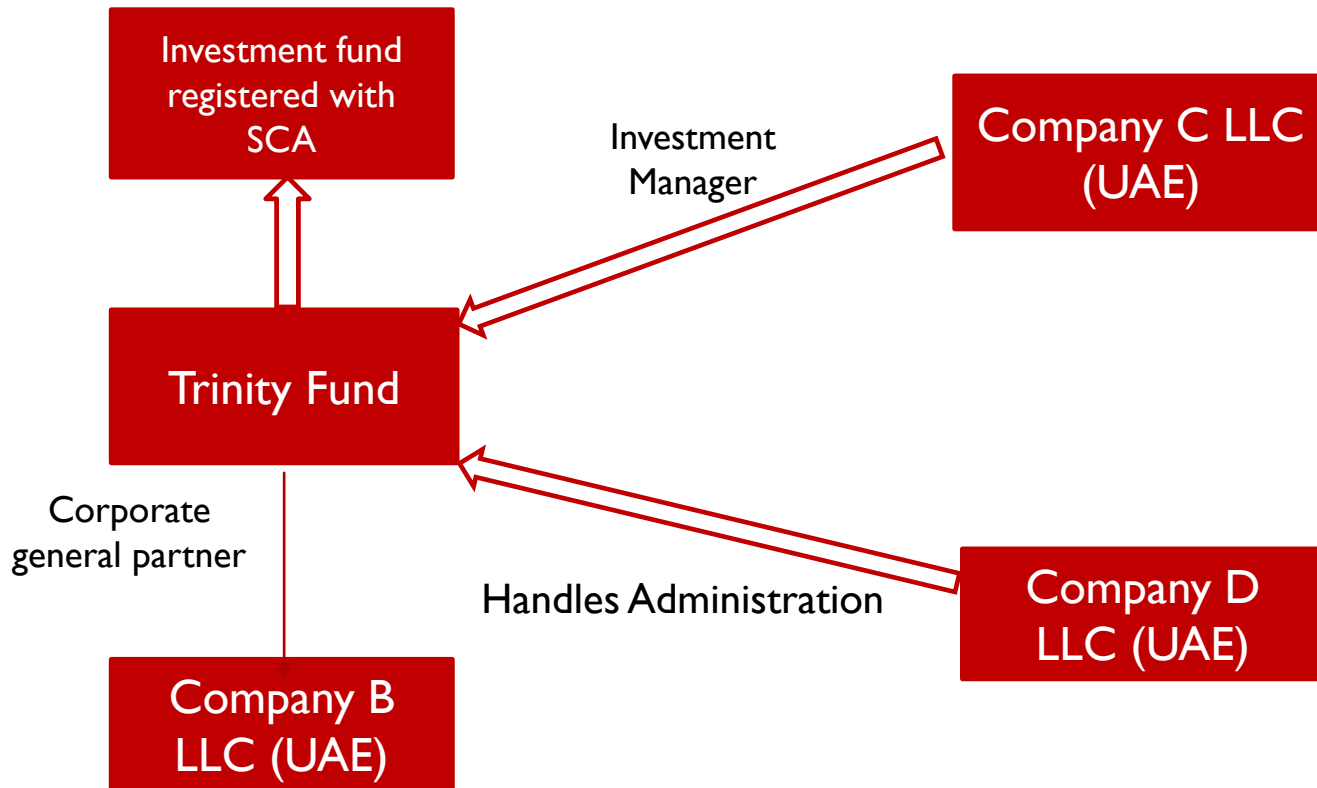
Relevant Activity	CIGAs (Indicative & not exhaustive)	Non-CIGAs
Investment Fund Management Business	<ul style="list-style-type: none"> • Taking decisions on the holding and selling of investments. • Calculating risk and reserves. • Taking decisions on currency or interest fluctuations and hedging positions. • Preparing reports to investors or any government authority with functions relating to the supervision or regulation of such business. 	Support and other back office functions

Investment Fund Management Business

Special Points for consideration

- Licensees engaged in the following activities are **not** considered to be carrying on Investment fund management (IFM) business:
 - Fund administration,
 - Custodian,
 - Investment advisory
 - Other Investment Fund related services
- The Investment Fund itself is not considered as an IFM Business, unless it is a **self-managed fund** (the Investment Manager and the Investment Fund are part of the same entity).
- Where an Investment Fund is structured as a partnership and has both a corporate General Partner and an Investment Fund Manager,
*only the **Investment Fund Manager** would be subject to the Regulations if the General Partner does not undertake business activities separate from its role as General Partner of the Investment Fund.*
- A licensee that is merely implementing decisions of another entity with respect to the holding and selling of investments without independent evaluation before taking steps or decisions to effect the investment or divestment decisions taken, does not perform the CIGA

Investment Fund Management Business



Example :

Company B has appointed Company C as the investment manager for Trinity Fund, and has delegated to Company C the day-to-day investment and divestment decision making responsibilities. The administration of the Investment Fund is handled by a third-party administrator established in the UAE, Company D.

Trinity Fund itself is not considered to undertake an Investment Fund Management Business

Company B on the basis that its activities are limited to being the General Partner of the Trinity Fund is not considered to undertake an Investment Fund Management Business

Company C, as the investment manager of the Company A, is considered as carrying on an **Investment Fund Management Business**

Company D does not provide discretionary investment management services and is therefore not considered an Investment Fund Management Business.

How CAs can assist?

Carry out an **Impact Assessment on Entity's compliance with ESR** and perform the following tasks:

- Assess what **Relevant Activities** have been/ likely to be performed during the financial period
- Assess amount and **type of income earned from the Relevant Activity** during the financial period; (Going forward **Audited Accounts** plays an important role, **Directors report** should comment on various compliances etc.,)
- Conduct board meetings with a quorum of directors' present in the UAE; document minutes of these meetings; **Entire Secretarial tasks** can be outsourced w.r.t. ongoing compliance requirements of ESR.
- Analyse **all the expenses** incurred;
- Analyse and document **key UAE based assets** (including premises) which is connected to the Relevant Activity;
- Maintain relevant documents such as **agreements and financial records** supporting the assets and expenses;
- Analyse **roles and responsibilities of employees** towards the Relevant Activity;
- Examine relevant **outsourcing agreements**;
- **Any other aspects** that may help Licensee to demonstrate sufficient Economic Substance in the UAE for a relevant financial period.
- Assistance in **Filing Economic Substance Notification/ Annual report** with Regulatory authority



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