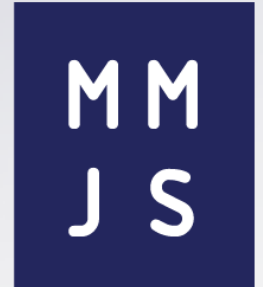




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# Economic Substance Regulations



# Background

# Background

- ▶ An **unfavorable status** of the United Arab Emirates (UAE) before the European Union (EU)
- ▶ Pro-active measures to address EU concerns around **shifting of profits** aimed at the following key factors:
  - ▶ No or nominal taxes;
  - ▶ Lack of transparency and exchange of information; and
  - ▶ Lack of substance requirements
- ▶ Consequent to commitments, **Economic Substance Regulations (Regulations)** vide Cabinet of Ministers Resolution No 31 of 2019 were released with effect from 30 April 2019



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***Economic Substance rules bring specific requirements for UAE businesses to demonstrate actual economic activity in UAE***

***Can form a basis to support that incorporation/ investment in UAE was not driven solely to benefit from a privileged tax regime***



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The background of the slide features a chessboard with several pawns. The pawns are in shades of blue and white. The chessboard is set against a light blue background that is split diagonally from the top-left to the bottom-right. The top-left portion is a slightly darker shade of blue, while the bottom-right portion is a lighter shade. The pawns are arranged in a way that suggests a strategic game in progress.

# **Economic Substance (ES) Law in a nutshell**

# Structure of ES Law



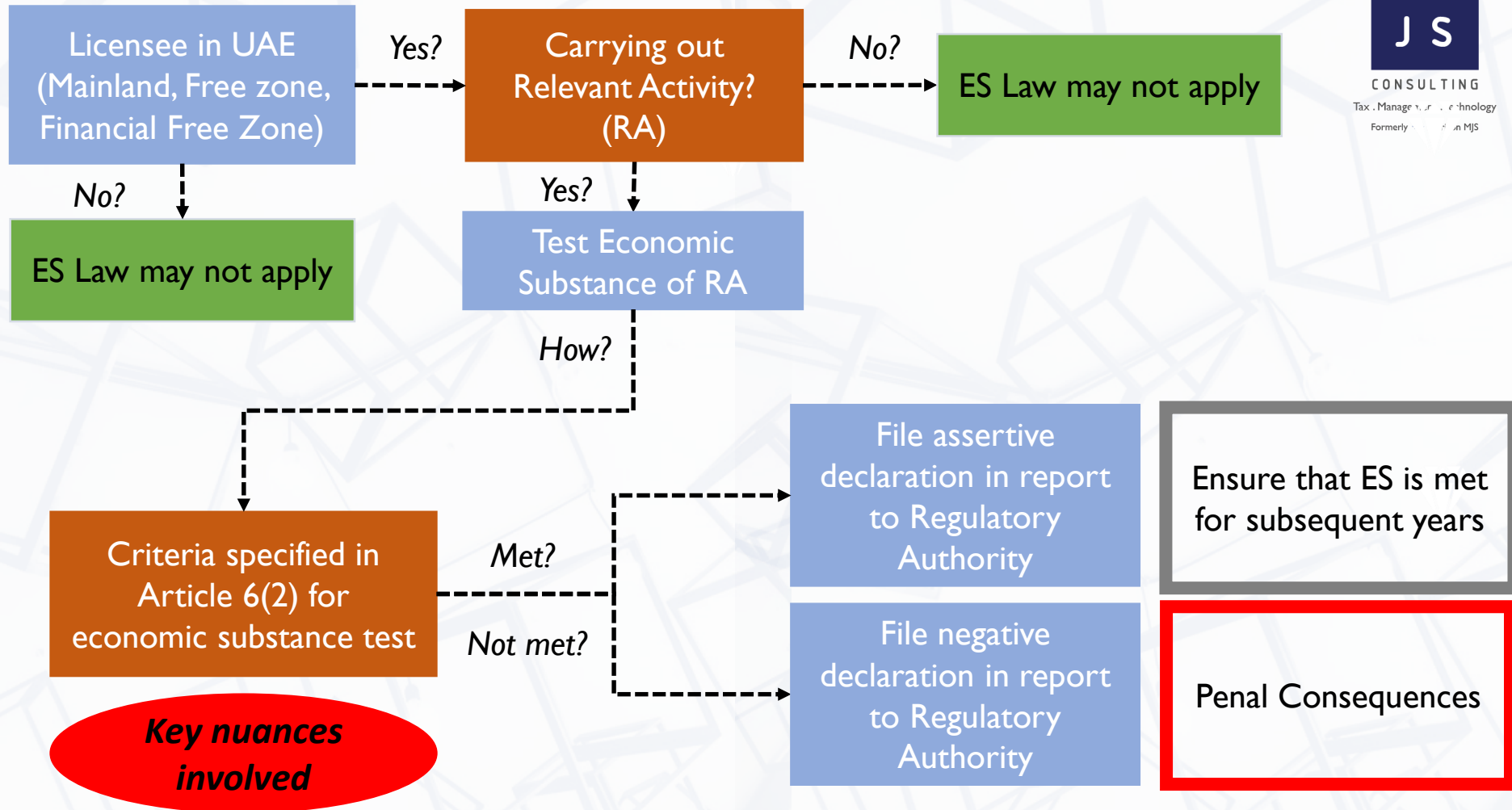
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Article	Provision
1	Definitions
2	Objective of the Resolution
3	Scope of application of the Resolution
4	Meaning of Relevant Activities and Regulatory Authority
5	Core Income Generating Activities in UAE per Relevant Activity
6	Criteria to meet Economic Substance test
7	Powers of Regulatory Authority to assess in respect of Economic Substance
8	Reporting requirements
9	Exchange of information with competent authorities
10 to 14	Penalties and appeals
15	Power of Regulatory Authority to enforce Economic Substance
16 to 19	Miscellaneous and administrative



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# ES Law in a nutshell



**ES Law does not apply to UAE Companies owned directly/ indirectly by any UAE Government or Government body**



# Relevant Activities

The economic substance regulations applies to **covered UAE licensees engaged in RA**



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- ▶ **Banking** – Raising funds, managing risks, providing loans, etc
  - ▶ **Insurance** – insuring or re-insuring, risk calculation
  - ▶ **Fund Management** – investment decisions
  - ▶ **Financing & Leasing**
  - ▶ **Holding Company (deriving income other than dividends and capital gains)** – Activities associated with the type of income generated
  - ▶ **Distribution & Service Centre**
  - ▶ **Intellectual Property** – Branding, marketing and distribution
  - ▶ **Headquarter** – Management, coordinating group activities
  - ▶ **Shipping (Marine)** – Managing crew and ship maintenance
- \*Foreign Connected Person**



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# Distribution & Service Centre

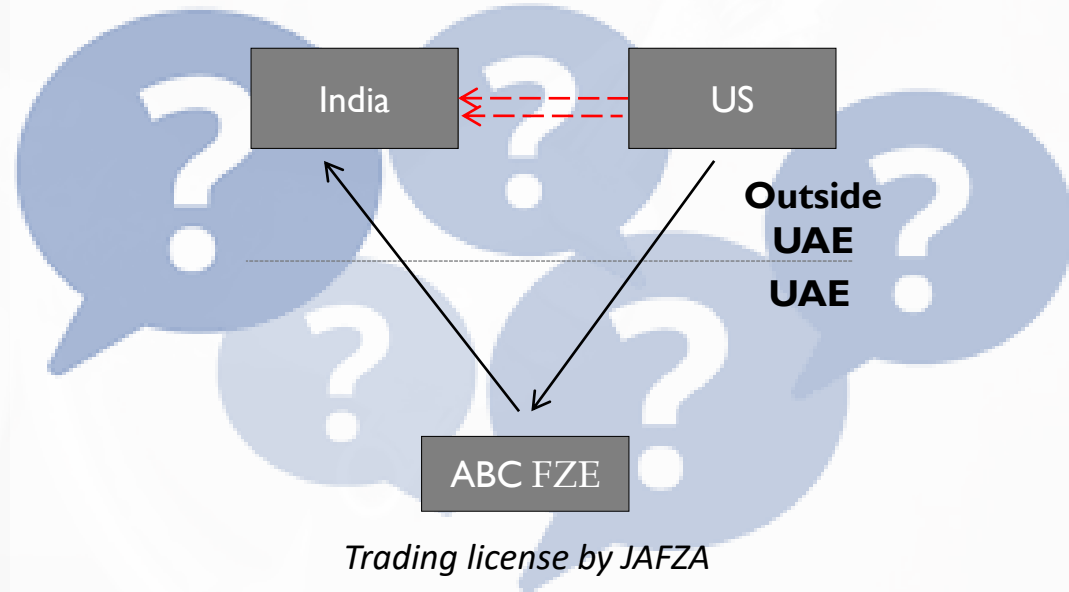


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- (a) Purchasing from a **Foreign Connected Person** and **importing and storing in UAE**
- (b) Providing services to **Foreign Connected Persons** in connection with a business outside UAE

## D&SC Core Income-Generating Activities:

- ▶ Transporting and storing component parts, materials or goods ready for sale
- ▶ Managing inventories
- ▶ Taking orders
- ▶ Providing consulting or other administrative services



---> Movement of Goods  
—> Invoicing

## Foreign Connected Person:

Connected Person that is **not a resident** or deemed as resident in UAE



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# Economic Substance Test criteria



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## Areas to check for Economic Substance Test:

- ▶ **Management:** Companies in UAE must be “adequately” managed and directed from the UAE;
- ▶ **Income:** Income generating activity related to the RA should be undertaken in the UAE; and
- ▶ **Other administrative aspects:**
  - ▶ Adequate number of qualified employees
  - ▶ Adequate physical assets
  - ▶ Annual expenditure in the UAE



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# Compliance

- ▶ Report whether the UAE company satisfies the Economic Substance Test must be submitted with the assigned Regulatory Authority
- ▶ No later than 12 months after the end of each financial year
- ▶ Regulatory Authority will then submit a report to the competent authority i.e. the UAE Ministry of Finance



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# Penal Consequences and right to appeal



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- ▶ Failure to meet economic substance in UAE:
  - ▶ Financial year 1 - AED 10,000 - 50,000
  - ▶ Subsequent financial years AED 50,000 - 3,00,000
- ▶ Administrative penalty of AED 10,000 - 50,000 for failure to provide information or furnishing inaccurate information

*All covered UAE businesses have the **right to appeal** against liability for administrative penal consequences and the amount of penalty – **To be detailed in a resolution to be released by the UAE Government***



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# Key contents of the ES Report



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- ▶ **Value and type** of income and operating expenses related to each RA;
- ▶ **Location of the business** and **physical assets** deployed to conduct the RA;
- ▶ Number of **employees**, their qualifications and the number of people responsible for conducting the Relevant Activity;
- ▶ Evidence that **decision making** takes place within UAE;
- ▶ **Ownership** related details;
- ▶ Special information with regard to **intellectual property**; and
- ▶ **Declaration stating that the corporate has met the economic substance requirements.**



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# Powers of Regulatory Authorities

- ▶ Authorities given the power to initiate audits 6 years from the end of the FY in which the report is filed – details and records to be maintained over the said period
- ▶ Authorities given the Power to Enter Business Premises and Examine Business Documents – requirements of prior notice for entering not mentioned – surprise checks may require ongoing compliance
- ▶ Regulatory Authority may suspend, revoke, or refuse the renewal of the License – could lead to major business disruption



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# Points to Ponder

## Economic Substance Test determining factors:

- ▶ **Outsourcing** of RA: Level of controls and supervision of outsourced activity needs to be checked
- ▶ Branches, representative offices which **do not have a board** must ensure that manager/director is physically present in the UAE during decisions concerning administration or operation
- ▶ Companies which carry out **intellectual property** related activities are subject to additional obligations
- ▶ **Holding companies** are subject to less extensive requirements and may satisfy the economic substance requirements if they fulfil the requirements for the submission of data and information to the competent authority, and if they have **sufficient staff and premises to carry out the work of a holding company**



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# Way Forward

# Way forward.....

## Businesses in UAE should:

- ▶ **Check for RA:** Assess whether the business is engaged in any relevant activity. If so, conduct an analysis whether it meets or will reasonably meet economic substance criteria for a financial year and subsequent financial years;
- ▶ **Impact assessment:** Identify gaps and conduct impact assessment of the Regulations on its business;
- ▶ **Decision making:** Take remedial measures either through process changes or business restructuring; and
- ▶ **Compliance:** Understand the reporting requirements and ensure compliance

**Note:** *Cabinet Decision to the Economic Substance Regulation will lay down other important rules and procedures*



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For information that may be substantial when taking decisions, please contact any of the below person or visit [www.mmjs.co](http://www.mmjs.co) or contact our office directly.



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