

UAE issues guidance on economic substance rules

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration [here](#).

Also available is our [EY Global Tax Alert Library](#) on ey.com.

Executive summary

On 11 September 2019, the United Arab Emirates (UAE) issued Ministerial Decision No. 215 of 2019 containing guidance for businesses on compliance with the Economic Substance Regulations (ESR), enacted in April. Businesses in the UAE should review the ESR and associated guidance to determine whether they are subject to the ESR requirements and the related notification and reporting requirements.

Detailed discussion

Background

On 30 April 2019, the UAE enacted the ESR in Resolution No. 31 of 2019.¹ Any natural or juridical person licensed by a competent licensing authority in the UAE (licensee) that carries out any relevant activity is subject to the ESR. Relevant activities are banking, insurance, investment fund management, shipping, lease-finance, distribution and service centers, headquarters and intellectual property (IP) activities.

Companies engaged in relevant activities in the UAE must satisfy three tests to comply with the ESR: (i) be directed and managed in the UAE for the specific activity; (ii) perform core income generating activity (CIGA) in the UAE for the specific activity; and (iii) have an adequate level of qualified employees, premises and annual operating expenditures.

Licensees must notify the Regulatory Authority of whether they are carrying out a relevant activity. If they are, the notification should include whether the gross income in relation to the relevant activity is subject to tax in a jurisdiction other than the UAE and the date of the end of its financial year. The time and form for this notification is yet to be specified by the Regulatory Authority.

In addition to the notification, licensees carrying out a relevant activity are required to submit a report to the Regulatory Authority including the type of relevant activity conducted, amount and type of income, operating expenses, assets, and employee information. This report must be submitted no later than 12 months after the last day of the end of each financial year commencing on or after 1 January 2019, in the form approved by the Regulatory Authority (also yet to be specified).

Non-compliance may result in administrative penalties for failure to meet the economic substance test (up to AED50,000 in the first financial period, and up to AED300,000 in subsequent financial periods), administrative penalties for failure to provide information (up to AED50,000), spontaneous exchange of information, and potentially deregistration.

On 11 September 2019, the UAE Ministry of Finance issued Ministerial Decision No. 215 of 2019 (guidance) containing further information on how the ESR may be met. Some of the key clarifications are highlighted below.

Definition of a license

A license includes a commercial license, certificate of incorporation, or other form of permit required to be procured before carrying out an activity in the UAE.

Companies must derive income to be subject to the ESR

Only companies deriving income from the relevant activities in the UAE must meet the requirements in the ESR.

Exempt companies

The ESR determines that commercial companies in which the Government of the State, or the Government of any Emirate of the State, or any governmental authority or body of any of the same has any direct or indirect ownership in its share capital shall be exempted from the ESR. The guidance clarifies that 51% ownership is required for this exemption to apply.

Submission of information notification

The Guidance clarifies that the licensee shall, with effect from 1 January 2020, submit the notification to the Relevant Authorities. The specific deadline, form and manner in which the notification must be submitted is yet to be determined by the Regulatory Authority. Further guidance is expected.

“Directed and managed” test

An adequate number of board meetings must be held and attended in the UAE to meet requirements in the ESR. The adequate number depends on the level of the relevant activity being carried out by the licensee. The guidance clarifies that it is expected that at least one meeting should be held in the UAE per financial year. These meetings must be recorded in written minutes, signed by attendees physically present in the UAE and kept in the country. If the licensee is managed by an individual (i.e., general manager or CEO), these requirements apply to such individual.

Meaning of “adequate” and “appropriate”

The UAE guidance states that what is adequate or appropriate for each licensee depends on the nature and level of the relevant activities. The guidance indicates that the ESR is not intended to impose requirements that businesses engage more employees or incur more expenditures than what is needed. Instead, a licensee should maintain sufficient records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.

Additional clarification on outsourcing activities

The guidance clarifies that a licensee may outsource CIGA to a related party in the UAE. Moreover, the licensee must be able to demonstrate that outsourcing to third-party or related-party service providers is not being done to circumvent compliance with the ESR. In addition, the guidance states that the resources of a third-party service provider in the UAE will be taken into consideration to

determine the adequacy of a licensee's resources, but there must be no double counting if the service is provided to more than one licensee carrying out a relevant activity in the UAE.

Sector-specific guidance

The guideline outlines information on holding companies, headquarter and high-risk IP businesses. The key clarifications are:

- ▶ Companies whose activities are limited to holding equity participation are not required to carry out CIGA in the UAE.
- ▶ Holding companies that undertake a relevant activity other than solely receiving income from equity interests (i.e., dividends and capital gains) do not benefit from the reduced ESR. The licensee must meet the full substance requirements associated with the relevant activities it carries out.
- ▶ An entity carrying out headquarter activities is tested based on the activities it performs, and not on its position within the group structure.

Further guidance expected

The determination of whether the economic substance requirements are met is made by the Regulatory Authorities, who are expected to adopt a "strict yet pragmatic approach" to the application of the rules.

To determine if the licensee meets the requirements of the ESR, various factors may be considered in the decision, such as the CIGA being carried out and the adequate level of employees or other resources, taking into consideration the fluctuation of resources needed during the course of a financial year, the timesheets and hours spent by employees to conduct the CIGA, and the average revenue per employee.

Further guidance is expected to determine the Regulatory Authority to which the notifications and reports should be submitted. Those authorities will determine the form and manner of these reports.

Endnote

1. See EY Global Tax Alert, [UAE enacts economic substance rules](#), dated 24 June 2019 for more information.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Middle East (Dubai Branch), Dubai

- ▶ Rajan Parmar rajan.parmar@ae.ey.com
- ▶ Mark Bennett mark.bennett@ae.ey.com
- ▶ Chris Lord chris.lord@ae.ey.com
- ▶ Guy Taylor guy.taylor@ae.ey.com
- ▶ Adil Rao adil.rao@ae.ey.com

Ernst & Young LLP (United States), Middle East Tax Desk, New York

- ▶ Asmaa Ali asmaa.ali1@ey.com

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2019 EYGM Limited.
All Rights Reserved.

EYG no. 001191-19Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com