

## UAE ECONOMIC SUBSTANCE REGULATION UPDATE: GUIDANCE RELEASED

On 12 September 2019, the UAE Ministry of Finance released a guidance document (the “Guidance”) regarding the Economic Substance Regulations (“ESR”) introduced earlier this year.

While the Guidance does not confirm who the Regulatory Authorities are, nor does it set a minimum standard for what is “adequate” or “appropriate” substance; it clarifies certain key aspects of the scope and application of the regulations, notably that:

- ESR apply to Licensees with **financial years commencing on or after 1 January 2019**
- The **earliest notification filing date is 1 January 2020**
- Only Licensees that do generate an income from a Relevant Activity over the assessed period are subject to ESR.
- **Holdings do benefit from reduced economic substance requirements**, but only if they own strictly equity interests.
- A **minimum of one board meeting** (or equivalent for branches) is required to be held **annually** in the UAE.
- All economic substance requirements – including CIGAs – can be outsourced to both third party and related companies.

Additional guidance are expected to be issued in due course.

All UAE entities will need to assess – qualitatively and quantitatively – whether and which of their activities fall within the scope of ESR, and how to ensure they meet economic substance requirements in respect to each Relevant Activity.

### Key take-aways

#### *In scope / out-of-scope*

The Guidance clarifies that a **“license” is to be interpreted broadly**, including all of commercial license, certificate of incorporation, or other form of permit required to be procured prior to the Licensee being able to carry out a “Relevant Activity”.

In practice, **any juridical person(s) established under UAE law** (e.g. LLC, branches, even rep offices) and any natural person registered to carry out a licensed business (e.g. as a partnership or sole proprietorship) **is considered a “Licensee” and therefore within the scope of ESR** (although not necessarily subject to the Economic Substance Test).

#### *No income? No problem!*

Similarly to regulations issued by other jurisdictions (e.g. Jersey, Guernsey), for ESR to apply a Licensee needs to “derive income” from undertaking a Relevant Activity.

In years **where no income is generated** from a Relevant Activity, there is **no requirement to meet the Economic Substance Test**.

#### *Welcome “on board”*

To demonstrate that a Licensee is “directed and controlled” in the UAE, **at least one board meeting** must be held in the jurisdiction **per financial year, with members physically attending**. Written board meeting minutes documenting all relevant decisions taken must be signed by attendees and kept in the UAE.

#### *A pragmatic approach*

Similarly to the approach adopted by other jurisdictions that have introduced ESR, the Guidance acknowledges that what is “adequate” and “appropriate” will depend on the nature and level of activities carried out by the Licensee, as well as the level of income earned.

When assessing whether a Licensee has met the Economic Substance Test, the Regulatory Authority shall therefore take a pragmatic approach: e.g. consider various forms of documentary evidence (e.g. time sheets, sector statistics) and take into account that directors may also perform some of the Core Income Generating Activities (“CIGAs”) in addition to performing their fiduciary duties as directors, which therefore may reduce or even eliminate the Licensee’s need for (extra) full-time employees or an outsourcing arrangement.

#### *CIGAs clarified*

The Guidance clarifies that the CIGAs listed in the Regulations for each Relevant Activity are meant as examples of core activities a Licensee may undertake in relation to a Relevant Activity, and do therefore not constitute an exhaustive or definitive list.

Rather than focusing on the CIGAs listed in the Regulations, a Licensee should consider what activities matter within the context of its Relevant Activity(ies).

#### *Broad scope for outsourcing*

Acknowledging the reality that many groups have centralised their resources and business infrastructure in one (or a few) company/ies in the UAE, the Guidance confirms that all substance requirements including CIGAs can be outsourced to both third-party service providers and related companies.

However, the burden of proof to demonstrate that the outsourcing arrangement is not done for the purpose of circumventing ESR is placed on the Licensee.

#### *Annual notification and reporting*

Reporting obligations extend widely. **Each year, all Licensees are required to notify the Regulatory Authority of:**

- **Whether or not it is carrying on a Relevant Activity;**
- In the event it is carrying on a Relevant Activity, **whether or not all or any part of its gross income in relation to the Relevant Activity is subject to tax in a jurisdiction outside of the UAE;**
- The **end of its financial year.**

Should the Licensee be required to pass the Economic Substance Test (based on its notification), additional information is to be reported to the Regulatory Authority (e.g. type of Relevant Activity being conducted, amount of income being generated; number of full-time employees with qualifications).

No deadline has yet been set for the first notification, due after 1 January 2020. The prescribed form for both the notification and the annual economic substance return will be determined by the Regulatory Authorities.

**Reporting is individual, even in the case of a group of companies** or a business with several entities registered in the UAE.

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### First Sector-specific guidance

The Guidance includes sector-specific comments. Particularly topical for the UAE is the clarification that a **“diversified” holding company — owning investments other than equity interests (e.g. real estate, bonds) — does not benefit from reduced economic substance requirements.**

#### Time for action!

ESR took effect on 30 April 2019. There are a number of actions which relevant Licensees must be undertaking to ensure compliance – from clarifying their entity classification, to the structuring of contractual and delegation arrangements, the review and organization of their internal governance, their employment and premises arrangements and the capturing of relevant business information which will be required for the preparation and filing of reporting information to the Regulatory Authority.

**Even entities not deploying a Relevant Activity should implement proper corporate governance mechanisms in order to avoid any risk of failing the Economic Substance Test.**

**If you operate a business in the UAE or hold shares in a UAE structure, we highly recommend that you take an active role in auditing your corporate arrangements with the view to bring in the necessary level of corporate substance.**

### Who we are

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### Who will assist you



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