

# inBrief



## New Economic Substance Regulations in the UAE

By Greg Mayew | 7 July 2019

A previous [inBrief dated 30 April 2019](#) discussed a law recently enacted in the BVI, the Economic Substance (Companies and Limited Partnerships) Act, 2018, which introduced economic substance requirements in the BVI. This article will discuss a similar measure recently promulgated in the UAE.

UAE Cabinet Resolution 31 of 2019 Concerning Economic Substance Regulations (the **UAE Economic Substance Regulations** or the **Regulations**) was published in the Official Gazette on 30 April 2019 and came into effect the same day.

### Background

The European Union's Code of Conduct Group (a group responsible for EU's taxation policy) maintains a blacklist of non-cooperative jurisdictions for tax purposes. In order to avoid being placed on such blacklist (or to attempt to get removed from the blacklist), jurisdictions such as the BVI, the Isle of Man, and the Cayman Islands, among others, have introduced legislation requiring entities established in such jurisdictions to demonstrate economic substance in their respective jurisdictions. The UAE was added to the blacklist in March of 2019, and the UAE Economic Substance Regulations were apparently promulgated in response to this development.

### Relevant Activities

The UAE Economic Substance Regulations apply to any Licensee, which is defined to mean any natural or juridical person licensed by the competent licensing authorities in the UAE to carry out a Relevant Activity in the UAE, including in free zones and financial free zones. The Regulations identify nine Relevant Activities:

- Banking Businesses
- Insurance Businesses
- Investment Fund Management
- Lease-Finance Businesses

### The Author



**Greg Mayew**  
Partner  
gmayew@afриди-angell.com  
Tel: +971 2 610 1010

Greg Mayew joined Afridi & Angell in 2004 and is the partner in charge of the Abu Dhabi office. He is involved in the firm's corporate and commercial, capital markets, construction, project finance, and banking practices. Greg holds a JD from the University of Minnesota Law School, a master's degree from the Massachusetts Institute of Technology and a BA from the University of Denver. He is a member of the New York State Bar. Prior to joining Afridi & Angell, Greg was an associate at the London and New York offices of a leading firm.

- Headquarters Businesses
- Shipping Businesses
- Holding Company Businesses
- Intellectual Property Businesses
- Distribution and Service Center Businesses

**Economic Substance Test**

Under the Regulations, a Licensee engaged in a Regulated Activity must meet an Economic Substance Test in relation to each Relevant Activity carried on by such Licensee. This includes but is not limited to demonstrating that its State Core Income-Generating Activities are carried out in the UAE. The activities that constitute State Core Income-Generating Activities vary for each of the nine Relevant Activities.<sup>1</sup>

Under Article 6(2) of the Regulations, a Licensee meets the Economic Substance Test if it satisfies the following criteria:

- (a) *If the Licensee conducts State Core Income-Generating Activity in the State.*
- (b) *If the Licensee is directed and managed in the State in relation to that activity.*
- (c) *Having regard to the level of Relevant Activity, if there is an adequate<sup>2</sup> number of qualified full-time employees in relation to that activity who are physically present in the State (whether or not employed by the Licensee or by another entity and whether on temporary or long-term contracts), or adequate level of expenditure on outsourcing to third party service providers, whose activities, employees, expenditure, and premises are in the State, and these activities, employees, expenditures and premises are adequate for carrying out the Relevant Activity being outsourced.*
- (d) *If there is adequate operating expenditure incurred by it in the State, or adequate level of expenditure on outsourcing to third party service providers whose activities, employees, expenditure and premises are in the State, and these activities, employees, expenditures and premises are adequate for carrying out the Relevant Activity being outsourced.*
- (e) *If there are adequate physical assets in the State or adequate level of expenditure on outsourcing to third party service providers in the State, for the activities of the Licensee.*
- (f) *In the case of State Core Income-Generating Activity carried out for the relevant Licensee by another entity, if it is able to monitor and control the carrying out of that activity by the other entity.*

Under Article 6(4), a Holding Company that derives its income from dividends and capital gains only is subject to a less stringent Economic Substance Test whereby such test is satisfied if the Licensee complies with all requirements to submit documents, records and information to the Regulatory Authority and has adequate employees and premises for holding and managing a Holding Company Business.

**Regulatory Authority & Competent Authority**

The Regulations stipulate that a Regulatory Authority will be delegated to regulate Relevant Activities in accordance with the Regulations. Such Regulatory Authority has not yet been identified. The Regulations stipulate that the Regulatory Authority will be appointed by the Cabinet pursuant to a further resolution.

<sup>1</sup> The definition of State Core Income-Generating Activities for each of the nine Relevant Activities is set out in Article 5 of the Regulations.

<sup>2</sup> The Regulations stipulate that the Guidance to be issued by the Competent Authority may include guidance regarding the meaning of “adequate”.

The Regulations designate the UAE Ministry of Finance as the Competent Authority. The role of the Competent Authority is different from that of the Regulatory Authority. The Regulations stipulate that the Competent Authority shall issue guidance on how the Economic Substance Test may be met. The Competent Authority is also responsible for determining the form of certain reports to be filed by a Licensee pursuant to the Regulations. Each Licensee will report to the Regulatory Authority who in turn will share certain information with the Competent Authority.

### **Reporting Requirements**

A Licensee engaged in a Regulated Activity has two periodic reporting requirements under the Regulations. Under Article 8(1) of the Regulations, a Licensee shall notify the Regulatory Authority annually of the following:

- (a) *Whether or not it is carrying on a Relevant Activity.*
- (b) *If the Licensee is carrying on a Relevant Activity, whether or not all or any part of the Licensee's gross income in relation to the Relevant Activity is subject to tax in a jurisdiction outside of the State; in all cases such Licensee shall provide the Regulatory Authority with all information and documentation required to be submitted by it pursuant to this Resolution or any further guidance or decision issued pursuant to this Resolution.*
- (c) *The date of the end of its Financial Year.*

Under Article 8(2) of the Regulations, the foregoing annual filing shall be made at the time specified by the Regulatory Authority and in the manner approved by the Regulatory Authority. As noted above, the Regulatory Authority has not yet been identified, so the filing deadline is currently unknown.

Article 8(3) of the Regulations states that: “A Licensee that is carrying on a Relevant Activity and is required to satisfy the Economic Substance Test shall, no later than twelve (12) months after the last day of the end of each Financial Year of the Licensee, prepare and submit to the Regulatory Authority a report which report shall be submitted by the Regulatory Authority to the Competent Authority.” Article 8(4) stipulates that such report shall be in the form approved by the Competent Authority and shall include the following information with respect to the Licensee:

- (a) *The type of Relevant Activity conducted by it.*
- (b) *The amount and type of relevant income in respect of the Relevant Activity.*
- (c) *The amount and type of operating expenses and assets in respect of the Relevant Activity.*
- (d) *The location of the place of business and, if applicable, plant, property or equipment used for the Relevant Activity of the Licensee in the State.*
- (e) *The number of full-time employees with qualifications and the number of personnel who are responsible for carrying on the Licensee's Relevant Activity.*
- (f) *Information showing the State Core Income-Generating Activity in respect of the Relevant Activity that has been conducted.*
- (g) *A declaration as to whether or not the Licensee satisfies the Economic Substance Test.*
- (h) *In the case of a Relevant Activity being an Intellectual Property Business, a declaration as to whether or not it is a high risk intellectual property business. If the Licensee declares that it is a high risk intellectual property business, the Licensee shall provide the information under paragraph (i) to refute a determination made by the Regulatory Authority under Clause 3 of Article 7 of this Resolution.*

- (i) *In the case of a Licensee that is carrying on a high risk intellectual property business, the following additional information must be provided:*
- i. *Information demonstrating that the Licensee does and historically has exercised a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intellectual property assets by an adequate number of full-time employees, with the necessary qualifications, who permanently reside and perform their activities in the State.*
  - ii. *Business plan showing the reasons for holding the ownership in the Intellectual Property Asset in the State.*
  - iii. *Employee information, including level of experience, type of contracts, qualifications and duration of employment with the Licensee.*
  - iv. *Evidence that decision making is taking place within the State.*
- (j) *Where a Relevant Activity is outsourced by a Licensee, the Licensee must demonstrate the following:*
- i. *The Relevant Activity that is outsourced is a Core Income-Generating Activity being carried out in the State.*
  - ii. *The Licensee has adequate supervision of the Relevant Activity outsourced.*
  - iii. *The Licensee shall submit to the Regulatory Authority a report containing information in relation to the level of resources employed by the third party service provider to which the Relevant Activity is being outsourced, demonstrating that the service provider's activities, employees, operating expenditures and premises in the State are adequate in relation to the level of the outsourced Relevant Activity.*

The Regulatory Authority may require a Licensee to provide such additional information, documents or other records as shall be reasonably required in order to make a determination as to whether the Economic Substance Test has been met.

### **Penalties**

Failing to meet the Economic Substance Test carries an administrative penalty of a fine between AED 10,000 and AED 50,000 in any Financial Year. Failing to meet the Economic Substance Test again the following Financial Year carries a fine of not less than AED 50,000 and not more than AED 300,000.

Failure to provide information required under Article 8 of the Regulations (*i.e.*, the reporting requirements discussed above), or providing inaccurate information, carries a fine between AED 10,000 and AED 50,000.

### **Implications**

Historically, jurisdictions such as BVI and the Cayman Islands have been major destinations for shelf companies (companies with little or no physical or economic presence in the jurisdiction of incorporation). The UAE has not been a major hub for shelf companies because, with limited exceptions (such as Jebel Ali offshore companies), businesses in the UAE are required to have physical offices and licenses to do business locally. Moreover, the UAE authorities have historically cooperated willingly with foreign official investigations into tax evasion, money laundering, and other offenses, and furthermore have implemented significant domestic measures. To us, it therefore appears that the European Union's pressure on the UAE to implement economic substance legislation was misdirected. In any event, it will not have the same impact in the UAE as it will in countries that have been major hubs for offshore shelf companies.

Nonetheless, for Licensees that were originally established in the UAE to hold assets in other jurisdictions without a significant economic presence in the UAE, the Economic Substance Regulations will have significant ramifications. Compliance with the Regulations may require substantial restructuring of business operations.

## Next Steps

All businesses licensed in the UAE should carry out an assessment to determine if they are subject to the Economic Substance Regulations and businesses that are subject to such Regulations should begin taking steps to ensure compliance. The timetable for compliance is currently unknown given that the Regulatory Authority has not yet been appointed but it would be prudent to start taking steps to comply as soon as possible. ■

### **Afridi & Angell**

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