

Overhaul of the UAE Economic Substance Regulations

By enacting so-called Economic Substance Regulations ("ESR") in April 2019, the United Arab Emirates ("UAE") introduced new legal obligations for companies licensed in the UAE. Such regulations generally serve to combat tax avoidance by ensuring that the income earned by a company in a state is consistent with the volume of business carried out in such state and the operational infrastructure maintained therein. After less than a year and a half, the ESR have now been overhauled. We have summarised the key takeaways below:

Which regulations have been enacted?

The UAE Cabinet adopted Cabinet Resolution No. 57 of 2020 on Economic Substance Requirements in August 2020. Subsequently, the Ministry of Finance issued Ministerial Decision No. 100 of 2020, which stipulates implementing regulations (together "Overhauled ESR").

The Overhauled ESR repeal and replace the previously issued provisions with retroactive effect from 01.01.2019.

What are the main changes under the Overhauled ESR?

The Overhauled ESR contain a number of amendments. We have compiled a selection of the most important changes for you:

Scope of Application

The Overhauled ESR limit the scope of their application by containing a new definition of the term Licensee. Licensee is now defined as "an entity that is a juridical person (incorporated inside or outside the State) or an Unincorporated Partnership, registered in the State, including a Free Zone and a Financial Free Zone and carries on a Relevant Activity".

Consequently, amongst others, natural persons and sole proprietorships no longer fall within the scope of the Overhauled ESR.

Exempt Licensee

The Overhauled ESR have introduced the category Exempt Licensee, which includes, inter alia, investment funds and branches of foreign entities whose relevant income is taxable in a foreign jurisdiction.

An Exempt Licensee is not automatically exempt from the requirement to pass the Economic Substance Test. Rather, exemption is granted upon submission of an ESR notification to the competent Regulatory Authority which must be accompanied by sufficient evidence to substantiate the status as Exempt Licensee. If evidence is not provided at all or is insufficient, an Exempt Licensee will have to pass the Economic Substance Test as well.

Relevant Activities

The Overhauled ESR include new definitions of some Relevant Activities, amongst others, Distribution and Service Centre

Business as well as Holding Company Business. Further, the terms Foreign Connected Person and High Risk IP Licensee have been redefined.

ESR Notification

The Overhauled ESR set a new deadline for the submission of the ESR notification. It has to be submitted electronically within six months from the end of the financial year of a Licensee or Exempt Licensee via an online portal of the Ministry of Finance yet to be launched.

Further, the Overhauled ESR provide for an obligation to resubmit ESR notifications that have already been handed in. Companies that have already submitted an ESR notification to the competent Regulatory Authority will have to resubmit their notifications through the aforementioned online portal. However, a deadline for resubmission has not been announced yet.

ESR Report

A Licensee who engages in a Relevant Activity and generates income therefrom during a financial year remains being required to pass the Economic Substance Test. In order to provide evidence that the Economic Substance Test has indeed been passed, an Economic Substance Report must be submitted within 12 months from the end of a financial year. The same applies to an Exempt Licensee who has not or not sufficiently fulfilled its obligation to submit an ESR notification.

The Overhauled ESR, however, now additionally oblige the Licensee to submit the annual financial statements together with the Economic Substance Report to the competent Regulatory Authority.

Penalties

Under the Overhauled ESR, penalties for non-compliance have been amended.

Failure to comply with the notification obligation may result in a fine of AED 20,000 (previously AED 10,000 to AED 50,000).

A fine of AED 50,000 can be imposed for failing to pass the Economic Substance Test for the first time or for failing to comply with the reporting obligation (previously AED 10,000 to



AED 50,000). Failure to pass the Economic Substance Test again in the immediately following financial year is subject to a fine of AED 400,000 (previously AED 50,000 to AED 300,000).

Reporting inaccurate information may result in a fine of AED 50,000 (previously AED 10,000 to AED 50,000).

Competent Authorities

The Federal Tax Authority has now been appointed as the National Assessing Authority. It is, inter alia, responsible for determining whether a Licensee has met the Economic Substance Test and for imposing penalties.

The Overhauled ESR further list the government bodies appointed as Regulatory Authorities. Apart from other functions, the Regulatory Authorities monitor compliance with the notification and reporting requirements and forward ESR notifications and reports collected from Licensees and Exempt Licensees to the National Assessing Authority.

Where can you find official guidance on the Overhauled ESR?

The Ministry of Finance has published a catalogue of 46 questions and answers on the Overhauled ESR along with other related resources on its website:

<https://www.mof.gov.ae/en/strategicpartnerships/pages/esr.aspx>

What should you do now?

Following the enactment of the Overhauled ESR, we recommend taking the following measures:

- Even if you have already assessed your position under the previous ESR, you now need to take action and reassess whether your findings based on the previous ESR are still accurate.
- If you have not yet done so, familiarise yourself with the Overhauled ESR and the respective guidance provided by the Ministry of Finance as soon as possible. Pay special

attention to the new category Exempt Licensee and the newly-introduced definitions for some of the Relevant Activities, such as Distribution and Service Centre Business.

- If your business falls within the scope of the Overhauled ESR, adapt your business operations quickly to the current legal situation to meet the requirements of the Economic Substance Test, if and when necessary.
- If and when necessary, resubmit the ESR notification in due form and time via the portal of the Ministry of Finance once it is available.
- Submit, if and when necessary, the Economic Substance Report in due form and time together with the annual financial statements.
- Should you need assistance in dealing with the Overhauled ESR, seek expert advice in a timely manner to avoid any violation of the new rules and imposition of penalties.

Do you have questions? – We would be glad to answer them!

From our office located in the heart of Dubai, our team of German attorneys has been advising small and medium-sized companies, corporations and individuals on the laws of the United Arab Emirates for more than 15 years. Our areas of expertise include corporate law (in particular business set-up), commercial agency law, employment law as well as tenancy and real estate law. We would be happy to attend to your questions as well. Contact us!

ANDERS LEGAL CONSULTANCY
Sama Tower, Office 806
Sheikh Zayed Road
PO Box 333 558, Dubai, UAE

Telephone: +971 4 327 5888
Telefax: +971 4 327 5999
eMail: info@anders.ae
Web: www.anders.ae

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