

Economic substance test requirements

Entities, which conduct relevant activities (*as defined in Economic substance regulations*) and earn income from the relevant activity during the reportable period, need to meet the economic substance test and also to demonstrate the same by filing Economic substance report within 12 months after financial year-end.

Economic substance test

1. Directed and managed test

The entity will need to be directed and managed in UAE with regards to the relevant activity:

- Adequate number of board meetings to be held and attended in UAE
- Regarding the number of board meetings, consideration should be given to the prescribed meeting requirements as stipulated in the constitutional documents of the entity. However, at least 1 meeting must be held in a financial year in UAE
- Meetings are to be recorded in written minutes and signed by attendees and such minutes kept in UAE
- Quorum to be met for the meetings and attendees physically present in UAE. Quorum may be set out in the constitutional documents of the entity
- Directors should have the necessary knowledge and expertise to discharge their duties
- If the entity is managed by an individual (General manager or CEO) rather than a board, then above requirements will apply to such individual

Covid-19 Industry advisory notification

UAE Ministry of finance (MOF) issued notification on 28th May 2020. This advisory provides relaxation of certain measures related to meeting requirements prescribed under the UAE Economic substance regulations ("ESR") for the period affected by Covid-19.

These considerations would only apply with respect to those substance requirements that are directly affected by COVID-19 measures (e.g. travel restrictions, self-isolation situations or quarantine requirements).

Entities should consider the possibility of appointing alternate directors in the UAE who can attend meetings in the UAE to address the short-term practical difficulty.

MOF also mentioned that these relaxations are only applicable to the periods affected by Covid-19 (as a temporary relief) and entities should maintain adequate records to demonstrate adjustments made to their normal operating procedures in response to Covid-19.

2. Core Income Generating activities ("CIGA") test

The entity will need to demonstrate that the relevant CIGA has been undertaken in UAE, having regard to the level of relevant income derived from the relevant activity. The CIGAs vary depending on the relevant activity. ESR has identified a list of activities that are considered as "core activities" but this is not an exhaustive list.

The general principle is that the activities which form the CIGA, are regarded to be the most important activities that an entity carrying out a relevant activity is expected to be carrying on in UAE.

Relevant activity	Example of CIGAs
Banking business	Raising funds; managing risks; taking hedge positions; providing loans, credit or other financial services to customers; managing capital and preparing reports to investors
Insurance business	Predicting and calculating risk; insuring or re-insuring against risk and providing Insurance Business services to clients; Underwriting insurance and reinsurance
Fund management business	Taking decisions on the holding and selling of investments; calculating risk and reserves taking decisions on currency or interest fluctuations and hedging positions; preparing reports to investors or any government authority
Lease-finance business	Agreeing funding terms; identifying and acquiring assets to be leased (in the case of leasing); setting the terms and duration of any financing or leasing; monitoring and revising any agreements; managing any risks
Headquarters business	Taking relevant management decisions; incurring operating expenditures on behalf of group entities; coordinating group activities.
Shipping business	Managing crew; overhauling and maintaining ships; overseeing and tracking shipping; determining what goods to order and when to deliver them; organising and overseeing voyages
Holding company business	All activities related to the business that derives income from dividends and capital gains from the equity interest
Intellectual property business	Taking strategic decisions and managing the principal risks related to (i) development and subsequent exploitation of the intangible asset generating income (ii) acquisition by third parties and subsequent exploitation and protection of the intangible asset (iii) carrying on the ancillary trading activities through which the intangible assets are exploited leading to the generation of income from third parties.
Distribution and Service Centre Business	Transporting and storing component parts, materials or goods ready for sale; managing inventories; taking orders; providing consulting or other administrative services

Note:

ESR in UAE allows that CIGAs can be outsourced to a corporate service provider in the UAE, subject to proper supervision by the entity. This means that an entity can use UAE based (i) employees and (ii) physical assets (including premises) of third parties or related entities to satisfy the Economic Substance Test. However, an entity cannot outsource "directed and managed", as the entity is required to demonstrate oversight and control of its relevant activity in UAE.

3. Adequacy test

- a) Adequate employees
 - Entity will need to have an adequate number of qualified employees in UAE
 - Employees who perform the CIGAs of an entity would in principle need to be resident in UAE. However, non-resident employees or other persons would count towards the economic substance in UAE (i) the relevant activities are performed while the individual is physically present in the UAE, and under the direction of the entity and (ii) the entity bears the relevant costs of the non-resident individual.
- b) Adequate operating expenditure
 - Entity will need to incur adequate expenditure in UAE
- c) Adequate physical presence and assets
 - Entity will need to have adequate premises and assets in UAE
 - Premises can include offices or other forms of business premises depending upon the nature of the relevant activity such as warehouse or facilities from which the relevant activity is being conducted

Economic substance Annual report

UAE MOF has not yet issued the format/detailed requirements of the annual report.

However, it is expected that at least following information will need to be provided in the annual report:

1. Type of relevant activity that the entity is engaged in;
2. Value and type of income related to that relevant activity;
3. Value and type of operating expenses and assets of the relevant activity;
4. Location of the place of business and if applicable, plant, property or equipment used for the relevant activity;
5. Number of full-time employees, including their qualifications and the number of those responsible for the exercise of the relevant activity;
6. Information showing the CIGA in respect of the relevant activity;
7. Declaration of whether the entity has met the requirements of the economic substance test.
8. Additional information must be provided for those entities carrying out a high-risk intellectual property business or outsourcing their relevant activity.

It is also expected that supporting documents might need to be provided to the authority for the above-required information such as minutes of meetings, qualifications evidence of employees, details of the expenses, assets and other accounting records and documents etc.

If you would like to discuss any ESR matters, please drop us an email at info@premier-brains.com or call us at + 971 4 3542959.

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