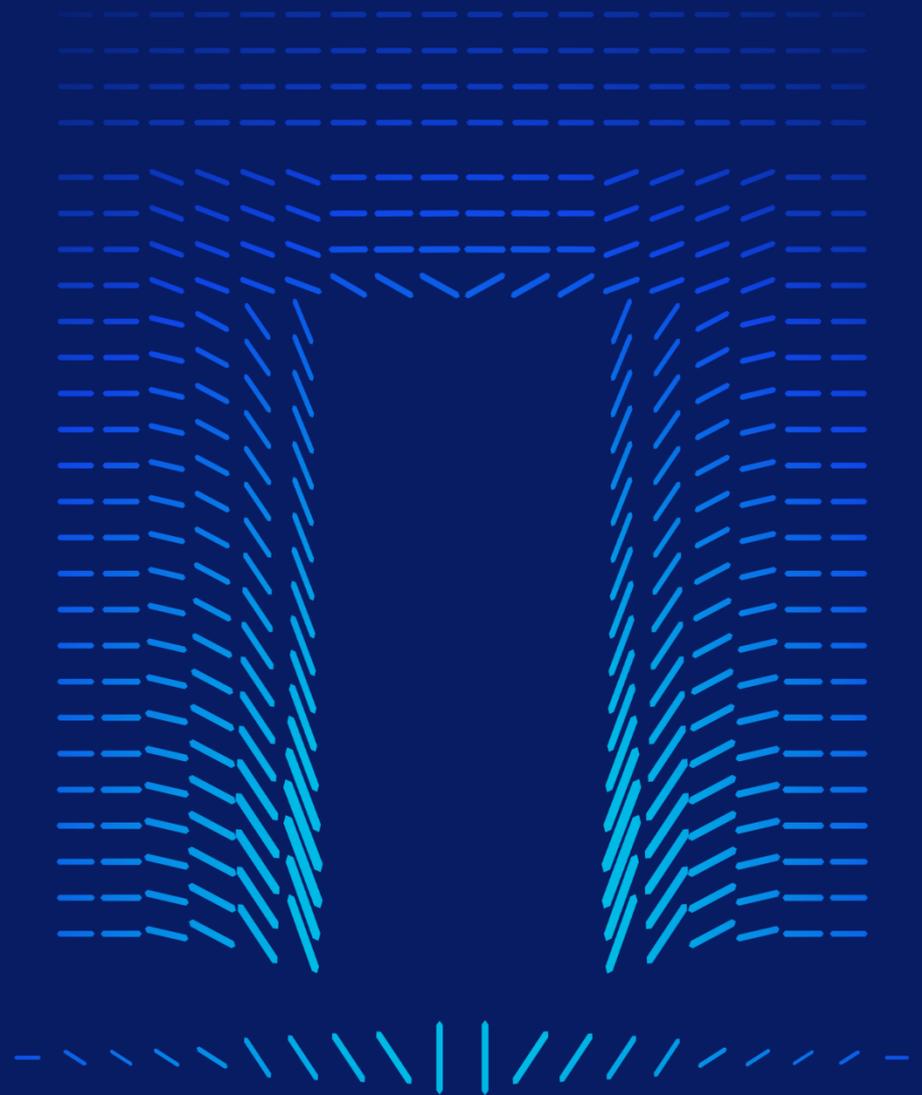




Dubai International
Financial Centre

UAE Economic Substance Regulations

17 December 2019

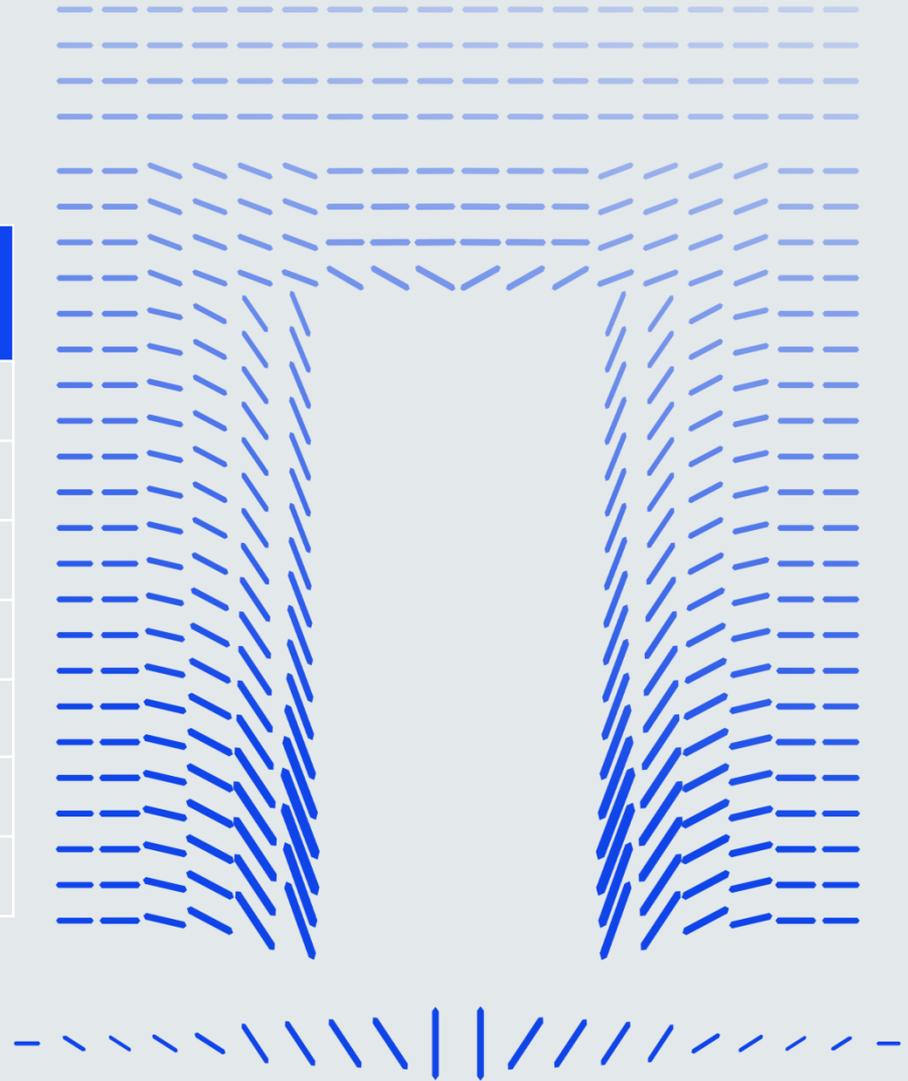




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Agenda

- 01 Welcome & Introduction
- 02 Background to the Regulations
- 03 Who is subject to the Regulations?
- 04 Meeting substance requirements
- 05 What do DIFC Licensees need to do?
- 06 Consequences of non-compliance
- 07 Q&A





01

Welcome & Introduction



02

Background to the Regulations



Background

Global Context

1. Organisation for Economic Development and Cooperation (OECD) standards to counter risks of base erosion and profit shifting in jurisdictions where there is a nominal or no tax regime
 - As a member of the OECD Inclusive Framework, the UAE is committed to ensuring that the UAE's legal and commercial framework is in line with global standards and is subject to review by the OECD to ensure that these standards are implemented
 - 12 jurisdictions (including the UAE) were required to introduce economic substance requirements in their domestic legislation
 - Jurisdictions that fail to apply substantial activities requirements will be categorized as 'harmful' tax jurisdictions
2. European Union Code of Conduct Group Standard
 - Criterion 2.2 - Substantial Activities Requirements
 - EU generates list of "tax haven" countries, which includes countries seen to have tax regimes that attract profits without real economic activity



Background

UAE Context

- On 27 June 2018 the UAE signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“BEPS”), which came into force on 1 September 2019.
- UAE has passed the following Federal Legislation to implement the convention which **applies across the UAE** in every jurisdiction, including all Free Zones and Financial Free Zone (such as the DIFC):
 - [UAE Cabinet of Ministers Resolution No. 31 Of 2019](#) Concerning Economic Substance Regulations, issued on 30 April 2019;
 - [Ministerial Decision No. 215 for the year 2019](#) providing guidance on Cabinet Decision No. 31 of 2019, issued on 11 September 2019; and
 - [UAE Cabinet of Ministers Resolution No. 58 of 2019](#) identifying the relevant Regulatory Authorities responsible for supervision and enforcement of the Regulations, issued on 4 September 2019.



03

Who is subject to the Regulations?



Who is currently in scope

Who do the Regulations Apply to:

- A “**Licensee**” under the Regulations is a **natural** or **juridical (legal) person** licensed by the competent licensing authority/authorities in the State to carry out a Relevant Activity in the UAE, including a Free Zone (including an offshore free zone) and a Financial Free Zone (eg DIFC)
- **DIFC Licensee**: Is a Licensee located in the DIFC.
- The Regulations **apply** to DIFC Licensees:
 - that **earn income** from 1 or more **Relevant Activities**
 - for financial years commencing **on or after 1 January 2019**

A DIFC Licensee can be a:

- | | |
|--------------------------------|--|
| ✓ Private Company (Ltd) | ✓ Foundation |
| ✓ Public Company (Plc) | ✓ Non-Profit Incorporated Organisation |
| ✓ Partnerships (LLP, LP & GP,) | ✓ DIFC branches of a UAE or foreign company or partnership |



Who is exempt?

Who is currently exempt from demonstrating substance?

- DIFC Licensees that are directly or indirectly owned 51% or more by the UAE government (Federal or Emirate level)
- DIFC Licensees that carry out a Relevant Activity but do not earn income from it

Who is outside the scope of the Regulations?

- DIFC Licensees that do not conduct a Relevant Activity



What are the Relevant Activities?

Banking Business	Insurance Business	Fund Management Business	Today's session will focus on: <ul style="list-style-type: none">● Holding Company Business● Headquarter Business● Distribution and Service Business <p>Note: To determine whether a Relevant Activity is taking place, a <u>substance over form</u> approach is required</p> <p>This means looking beyond what is stated on the commercial licence to what activity is actually being undertaken</p>
Financing or Leasing Business	Headquarters Business	Shipping Business	
Holding Company Business	Intellectual property ("IP") holding or exploitation	Distribution and Service Business	



What are the Relevant Activities?

Spotlight on Holding Company Business:

Holding Company Business

- Reduced economic substance requirements
- Only applicable to entities that:
 - hold **equity interests** (eg shares) in other entities;
 - earn income from **dividends or capital gains**; and
 - do **not** carry out any other **commercial activity**
- Example: An entity that also holds real estate or other assets **is not** a Holding Company Business, and is either:
 - outside the scope of the Regulations; or
 - within the scope of the Regulations, and subject to regular economic substance requirements, if it carries out another Relevant Activity (e.g. HQ)



What are the Relevant Activities?

Spotlight on Headquarter Business:

Headquarter Business

- Provision of “headquarter services” to Foreign Connected Persons (a person / entity based outside the UAE that is related due to common ownership or control)
- A Headquarter Business must be responsible for the management, material risks, activities and/or assets of the Foreign Connected Person(s)
- Headquarter services could include, but are not limited to:
 - taking relevant management decisions;
 - incurring operating expenditure on behalf of group entities; or
 - coordinating group activities



What are the Relevant Activities?

Spotlight on Distribution & Service Business

Distribution and Service Business

Two distinct activities, covered under one “Relevant Activity”

Distribution Business

Requires **all** of the following conditions to be met:

1. Purchase of goods from a Foreign Connected Person;
2. Import of goods into the UAE; **and**
3. Distribution of goods outside the UAE

Service Business

Broad scope (e.g. consulting or administrative services), but requires Services to be provided:

1. to a Foreign Connected Person; and
2. in connection with their business outside the UAE



04

Meeting economic substance requirements



Meeting economic substance requirements

Demonstrating substance

A DIFC Licensee (aside from those carrying out a “Holding Company” Business and those carrying out a “High Risk IP” Business) need to demonstrate **all 3 of the following conditions**:

1. Adequate employees, physical assets & expenditure in the UAE

- No definition of “adequate”
- Businesses vary in size, and the Regulations are not intended to impose requirements on businesses to hire more employees than actually required

2. Core Income Generating Activities (“CIGAs”) are undertaken in the UAE

- The CIGAs are the primary functions that underpin the Relevant Activity
- Lists in Article 5 of the Regulations are examples only

3. Directed and managed in the UAE

- Relevant Activity must be “directed and managed” in the UAE, e.g. through holding and minuting board meetings in the UAE, having a UAE based manager and/or directors, etc.



Employees, assets & expenditure

Demonstrating substance – employees, physical assets & expenditure

Demonstrate the following for **each Relevant Activity** that income is earned from that:

A. DIFC Licensee has adequate:

1. numbers of qualified full time (or equivalent) **employees** physically present in the UAE (whether employed by it or another entity);
2. **operating expenditure** in the UAE; and
3. **physical presence** in the UAE:

OR

B. DIFC Licensee has outsourced its CIGA:

- to a related entity or third party provider that has adequate activities, employees, expenditure and premises in the UAE; **and**
- the DIFC Licensee is able to:
 - **supervise and control** the carrying out of the CIGA; and
 - show that the **outsourcing** was **not to circumvent** compliance with Regulations;
- Substance of outsourced entity cannot be **counted multiple times** by multiple entities



Directed & Managed

Demonstrating substance – directed & managed

DIFC Licensees must demonstrate that they are **directed and managed in the UAE** in relation to the Relevant Activity during the relevant financial year by:

1. holding **board meetings** in the UAE, at which decisions are made (the actual number of board meetings required will depend on the Relevant Activities undertaken and decision making taken);
2. **quorum** met with **directors** physically **present** in the **UAE**;
3. Directors / board members have **necessary knowledge and expertise**;
4. meetings are properly **minuted, signed** by the directors/members present and kept in UAE;
5. the manager/member of **branches** and entities with one **(1) board member**, must be in the **UAE** when making **key decisions**



Outsourcing arrangements

Who can you outsource to?

Third Party Service Providers and related companies

What can be outsourced?

Core Income Generating Activities (defined in Article 5 of Regulations)

What does this mean?

Employees & physical assets (incl premises)

Can be outsourced

Directed and managed in UAE

Cannot be outsourced

What must DIFC Licensees demonstrate when outsourcing?

- Adequate supervision of the outsourced activity
- The outsourced activity must be conducted in the UAE
- The outsourcing provider has adequate substance in the UAE
- No double counting



Licensees should have agreements in place to demonstrate “oversight”



Holding Company Business: Reduced substance requirement

Holding Company Business - Reduced substance requirements

1. **Comply with existing DIFC reporting / compliance requirements** under DIFC Laws and Regulations applicable to the DIFC Licensee; **and**
2. **Have adequate employees and physical assets (e.g. premises)**
 - This could be satisfied through a corporate service provider or related company
 - Directors can be counted as “equivalent full time employees”
 - registered offices / co-working space (Fintech) / Small Offices / Business Centre counted as premises

Not required to:

- be “ **directed and managed** ” in the UAE (but must meet relevant DIFC legislation such as Company Law and Regulations, Operating Law, Prescribed Company Regulations etc.); **OR**
- Have **adequate expenditure** in the **UAE**



High Risk IP Business: Conditions

Condition A or B must be met to be considered a High Risk IP Business

Condition A - all of the following needs to be met by the DIFC Licensee:

1. The DIFC Licensee did not create the IP asset which it holds for the purposes of its business;
2. Acquired the IP asset either from:
 - a Connected Person; or
 - in consideration for funding research and development by another person situated outside the UAE; and
3. Licences the IP asset to one or more Connected Persons or otherwise generates income from the asset in consequence of activities performed by Foreign Connected Persons

OR

Condition B

Does not carry out research and development, or branding, marketing and distribution as part of its UAE Core Income-Generating Activity



High Risk IP Business: Increased substance requirement

High risk IP

Presumed to not meet economic substance test, unless the DIFC Licensee meets the increased substance requirements which require it to demonstrate (and submit proof) that the Licensee does and historically has:

- exercised a **high degree of control over developing the IP**
- **adequate full-time employees** with the necessary qualifications that permanently reside and perform their activities in the UAE - relevant employee information (e.g. experience, contracts, qualifications etc.) would need to be provided
- a **business plan** showing the reasons for holding the IP in the UAE
- its **decision making** takes place in the UAE



Licensees should submit proof to rebut presumption



05

What do DIFC Licensees need to do?



What do DIFC Licensees need to do?

Requirements under the Regulations

ALL DIFC entities are required to:

- **Notify** the DIFC Registrar of Companies (RoC) that they undertake a Relevant Activity

Only DIFC Licensees that are not exempt and **undertake a Relevant Activity** which they earn **income** from during a relevant Financial Year are required to:

- **Meet** economic substance requirements; and
- **File** economic substance **return** with the RoC on an annual basis



Notification to the RoC

Notification: Applies to all DIFC entities

- Requirement to notify applies to all DIFC entities (regardless of whether they conduct a Relevant Activity)
- Notification must be filed with the RoC on the DIFC Client Portal during Quarter 2 2020, by the deadline communicated by the ROC



Illustrative timeline for notification, demonstration of economic substance and return filing

Example #1:

An existing company with 1 January - 31 December financial year





Illustrative timeline for notification, demonstration of economic substance and return filing

Example #2:

An existing company with 1 April - 31 March financial year





File economic substance return with the RoC

Who does not need to file a return?

- Entities that do not undertake a Relevant Activity
- Exempt persons: $\geq 51\%$ UAE Government Owned (@ Federal or Emirate level)
- DIFC Licensees that undertake a Relevant Activity but do not derive income from it

Return declaration

- Required for DIFC Licensees that undertake a Relevant Activity which income is derived from
- Return is due within 12 months after the relevant financial year end



06

Consequences of non-compliance



Consequences of non-compliance

Penalties for failure to:

<i>Notify</i>	<i>Provide accurate or complete information</i>	<i>Demonstrate sufficient economic substance in the UAE for the relevant Financial Year</i>
<ul style="list-style-type: none">● Penalty of AED10,000 - AED50,000	<ul style="list-style-type: none">● Penalty of AED10,000 - AED50,000; and● Deemed failure to demonstrate economic substance in the UAE	<p><i>First year of failure</i></p> <ul style="list-style-type: none">● Penalty of AED10,000 - AED50,000; and● Information exchange with foreign competent authority of:<ol style="list-style-type: none">1. parent company;2. ultimate parent company; and3. ultimate beneficial owner <p><i>Second <u>consecutive</u> year of failure</i></p> <ul style="list-style-type: none">● Information exchange (see above); and● Penalty of AED100,000 - AED300,000; and● Commercial licence could be: suspended, withdrawn or not renewed



07

Q&A



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Thank You
