

Client Alert: New Economic Substance Regulations - Updated Reporting Guidelines

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Companies should be aware of the recent update to the Economic Substance Regulations. They must submit their Economic Substance Notifications and Reports through the Ministry of Finance portal by no later than 31 December 2020.

Background

In response to being blacklisted by the European Union in December 2017, the UAE passed Cabinet Resolution No. 31 of 2019 concerning Economic Substance. The Ministry of Finance issued Ministerial Decision No. 215 of 2019 as further guidance on the new economic substance regulations.

The purpose of the regulations was to prescribe minimal levels of “economic presence” for UAE entities. The economic substance regulations required that UAE mainland and free zone companies carrying on “Relevant Activities” demonstrate the existence of significant economic substance by meeting certain criteria.

All UAE companies were required to file an economic substance notification clarifying whether or not they were undertaking a “Relevant Activity”. If so, such entities were required to submit an annual report within 12 months of the end of their financial year.

Earlier this year, the UAE Cabinet of Ministers issued Cabinet Resolution No. 57 of 2020 and the Ministry of Finance issued Ministerial Decision No. 100 of 2020 (the “**New Regulations**”), replacing the existing economic substance regulations. The relevant changes in the regulations are highlighted below.

New Definition of Licensees

The New Regulations define a “Licensee” as any legal person (established inside or outside the UAE) or partnership undertaking a “Relevant Activity”. This means that individuals, sole proprietors, trusts and foundations are no longer covered by the New Regulations.

Exemptions

Under the New Regulations the following Licensees are now exempt from the economic substance obligations:

- investment funds;
- companies that are tax resident outside the UAE;
- wholly UAE resident-owned businesses which are not part of a multinational group and only do business in the UAE;

- a branch of a foreign entity which is subject to tax on all its relevant income in a foreign jurisdiction; and
- any Licensee granted the status of an “Exempt Licensee” by decision of the Ministry of Finance.

Exempt companies must file an economic substance notification evidencing their exempt status.

Updated Relevant Activities Guide

The New Regulations also include an updated Relevant Activities Guide that can be found on the Ministry of Finance website: <https://www.mof.gov.ae/en/strategicpartnerships/pages/esr.aspx>.

The updates have given clearer guidance in relation to “Distribution and Service Centre” business activities. The economic substance requirements for a Distribution and Service Centre Business are applicable to UAE entities whose main activity is distribution and/or service center operations.

- A UAE entity is considered as engaged in a Distribution Business if it:
 - purchases goods from a “Foreign Connected Person”; and
 - distributes those goods.
- A UAE entity is considered as engaged in a Service Centre Business if it provides services to a Foreign Connected Person.

A Foreign Connected Person is any entity which is part of the same group of companies but is not tax resident in the UAE.

This means that UAE entities that only purchase goods from third parties, or only provide services to third parties, are not subject to the New Regulations (as a Distribution and Service Centre Business).

Notification Submission Guidelines

The New Regulations require all economic substance notifications and reports to be submitted electronically through the Ministry of Finance portal.

Importantly, companies which submitted a notification to a UAE regulatory authority before the Ministry of Finance portal went live must re-submit their notification through the portal by 31 December 2020.

Other Changes

The New Regulations provide that government entities are no longer exempt from economic substance requirements.

Under the New Regulations, branches of a UAE parent entity no longer need to file separate Economic Substance Notifications. A submission by the parent entity is now sufficient.

The UAE Federal Tax Authority has now been appointed as the regulatory body for monitoring compliance and imposing administrative penalties.

Concluding Remarks

The online portal was not available until the start of December 2020. Given that the deadline for submissions is 31 December 2020, companies should submit their economic substance notifications on the abovementioned Ministry of Finance website.

Fines for non-compliance have been increased and currently range from AED 20,000 to AED 50,000. **Therefore, we encourage companies to urgently re-evaluate their position under the New Regulations.**

The templates containing filing requirements and deadlines for submission of the notifications and reports can also be found on the aforementioned Ministry of Finance website.

If you would like more information about this topic, please contact us.

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