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## Key Amendments to Economic Substance Rules

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## **Alert on key amendments to Economic Substance Regulations and revised template for ESR notification resubmission and ESR return**

- The Ministry of Finance (MoF) has issued Resolution No:57 of 2020 (**“Resolution”**) and Ministerial Decision No:100 of 2020 (**“Ministerial Decision”**) on Economic Substance Regulations which is applicable retrospectively from the financial year commencing on or after January 01, 2019.
- This resolution repeals and replaces the (i) Cabinet of Ministers Resolution No. 31 of 2019 (ii) Ministerial Decision No. 215 of 2019 effectively combining the most updated ESR related provisions into one single document.
- On 3<sup>rd</sup> November 2020, MoF has announced 31 December 2020, as the deadline for resubmission of ESR notification and ESR return and the portal for filing the notification and the returns are expected to go live in the first week of December.



# 1. Key Aspects in the new regulation

Sr No		As per previous ESR & R/A Guide	As per new ESR & R/A Guide
1	Definition of Licensee	<p>Definition of Licensee as per old guidance was as below:</p> <p>“Natural” or “Juridical” person licensed by the competent licensing authority/ authorities in the UAE to carry out a Relevant Activity in the UAE, including a Free Zone and a Financial Free Zone</p>	<p>Definition of Licensee as per new guidance is as below:</p> <p>“Natural” person has been excluded; “Juridical” person is defined as a person (incorporated inside or outside the UAE); or Unincorporated Partnership; registered in the UAE, including a Free Zone and a Financial Free Zone and carries on a Relevant Activity</p>
2	Definition of Connected Person	<p>Old Definition:</p> <p>Connected person is “A natural or juridical person who is related to one or more natural or juridical person(s) through direct or indirect ownership or control, or common control”</p>	<p>New Definition:</p> <p>Connected person is defined as “An entity that is a part of the same Group as the Licensee or Exempted Licensee”</p>
3	Definition of MNE Group	No definition provided	<p>MNE Group is defined as - any group that includes:</p> <ul style="list-style-type: none"> <li>a. Two or more entities the tax resident of which is in different jurisdictions or</li> <li>b. An entity that is resident for tax purposes in one jurisdiction and is subject to tax, with respect to activities carried out through branch/ permanent establishment (‘PE’), in another jurisdiction</li> </ul>
4	Exempted Licensee	<p>The earlier regulations exempted licensees which are directly or indirectly at least 51% owned by the Federal or an Emirate Government, or a UAE Government Body or Authority. Such licensees were only required to file notification with respective Regulatory Authorities</p>	<p>Exempted Licensee comprises the below:</p> <ul style="list-style-type: none"> <li>a. Investment Fund and its underlying SPVs / investment holding entities;</li> <li>b. Entity that is tax resident in a jurisdiction other than the UAE;</li> <li>c. Entity wholly owned by UAE residents and meeting following conditions: (i) Entity is not part of a MNE Group; and (ii) all of entity’s activities are only carried out in the UAE;</li> <li>d. Licensee that is a branch of foreign entity the Relevant Income of which is subject to tax in a jurisdiction other than the UAE</li> </ul>



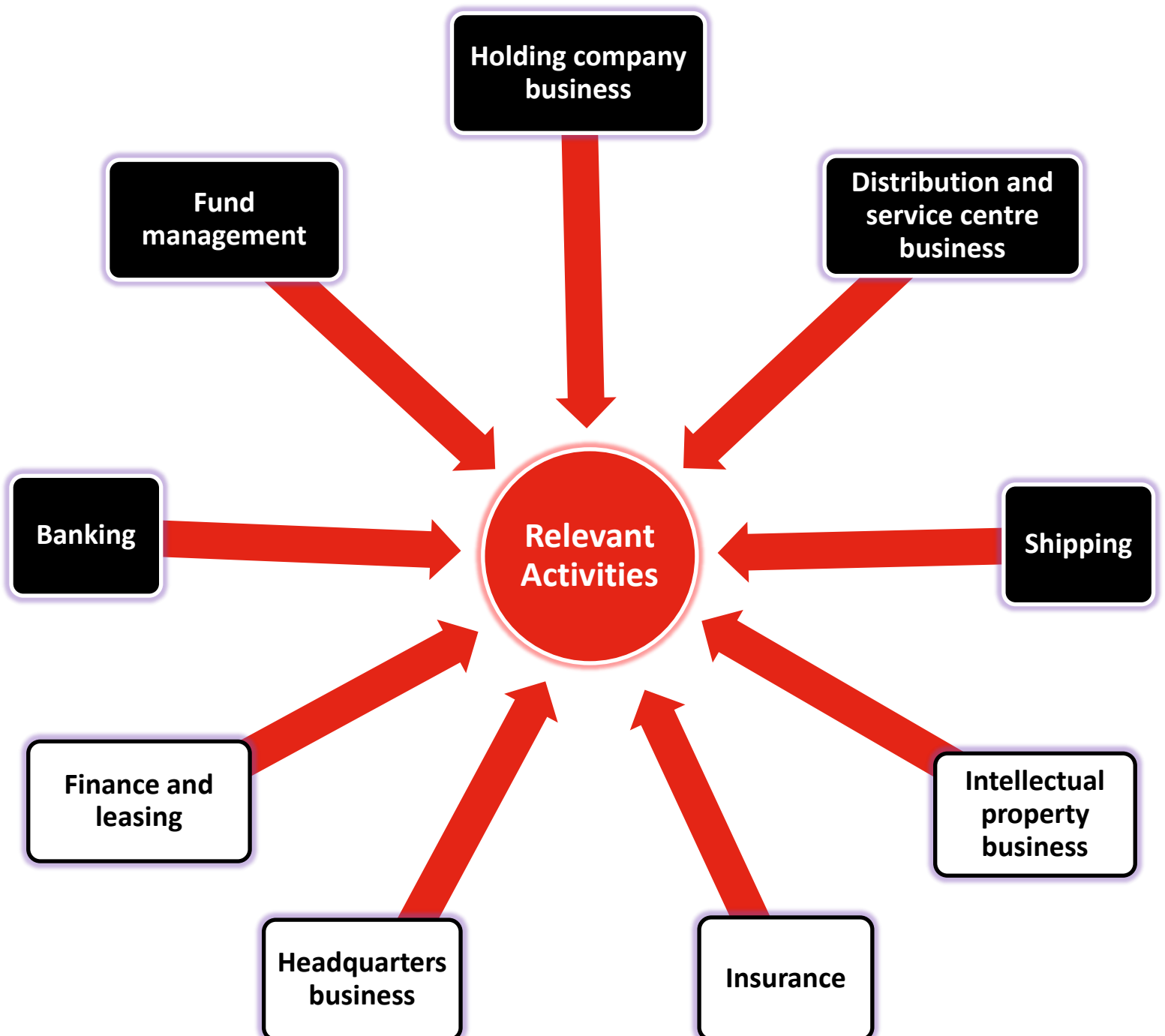
# 1. Key Aspects in the new regulation (contd...)

Sr No		As per previous ESR & R/A Guide	As per new ESR & R/A Guide
5	Appointment of Federal Tax Authority (FTA) as the National Assessing Authority for ESR	No information provided	<p>FTA is appointed as the 'National Assessing Authority' with following functions:</p> <ul style="list-style-type: none"> <li>a. Undertake assessments to determine whether a Licensee or Exempted Licensee has met the Economic Substance Test;</li> <li>b. Impose administrative penalties; Hear and decide on appeals;</li> <li>c. Carry out reporting requirements;</li> <li>d. Exercise any other powers or functions as required to implement ESR Resolution</li> </ul>
6	Board Meetings	The only guidance available was there should be a minimum of 1 board meeting per financial year	<p>As per the new guidance below are the additional clarifications:</p> <ul style="list-style-type: none"> <li>a. There is no minimum number of board meetings prescribed.</li> <li>b. It is only mentioned that the minutes of board meetings must record all strategic decisions taken in relation to Relevant Activity being undertaken by the entity.</li> <li>c. Board members not required to be UAE residents but are required to be physically present in the UAE when taking the decisions</li> </ul>
7	Retention of Information and Records	No information provided	<p>Clarifications provided as below:</p> <ul style="list-style-type: none"> <li>a. Each licensee and exempted licensee must retain all relevant documents, records and information required by licensee to meet ESR requirements for a period of 6 years from end of relevant financial year.</li> <li>b. All documents must be kept in English</li> </ul>

## 2. Relevant activities

### 2.1 Types of Relevant activities

The substance requirements apply to licensees carrying out and deriving incomes from any one of the Relevant Activities:





## 2. Relevant activities

### 2.2 Key amendments in the relevant activities

Sr No	Type of Relevant Activity	As per previous ESR & R/A Guide	As per new ESR & R/A Guide
1	Distribution and Service Centre Business	<p>Old definition was:</p> <ul style="list-style-type: none"> <li>a. Purchasing from a Foreign Connected Person and importing and storing in the State: component parts or materials for goods; or goods ready for sale, and reselling such component parts, materials or goods outside the State.</li> <li>b. Providing services to Foreign Connected Persons in connection with a business outside the State</li> </ul>	<p>New definition which has widened the scope of distribution and service centre business activity:</p> <ul style="list-style-type: none"> <li>a. Purchasing from Foreign Connected Person component parts or materials for goods; or goods ready for sale, and reselling such component parts, materials or goods; or</li> <li>b. Providing services to Foreign Connected Persons</li> </ul>
2	Holding Company Business	<p>A Holding Company Business is defined under Article 1 of the regulations as a business that:</p> <ul style="list-style-type: none"> <li>a. Is a Holding Company in accordance with the law applicable to the licensee carrying out such activity;</li> <li>b. has as its primary function the acquisition and holding of shares or equitable interests in other companies;</li> <li>c. does not carry on any other commercial activity</li> </ul>	<p>New Definition of Holding Company business activity is:</p> <ul style="list-style-type: none"> <li>a. A company whose sole function is acquisition and holding of shares or equitable interests in other companies;</li> <li>b. only earns dividends and capital gains from its equitable interests.</li> </ul> <p>Caveat provided:</p> <p>Real estate assets owned by the licensee that are solely used for purposes of its Holding Company Business will not prevent such licensee from being considered as carrying on a Holding Company Business</p>

## 2. Relevant activities

### 2.2 Key amendments in the relevant activities (Contd...)

Sr No	Type of Relevant Activity	As per previous ESR & R/A Guide	As per new ESR & R/A Guide
3	High Risk Intellectual Property ('IP') Business	<p>Old Definition of High Risk IP Business was as mentioned below:</p> <p>A Licensee was carrying on Intellectual Property Business if any of the following two conditions (a or b) was applicable:</p> <p><b>a.</b> the Licensee:</p> <ul style="list-style-type: none"> <li>i. did not create the intellectual property in an intellectual property asset which it holds for the purposes of its business.</li> <li>ii. acquired the intellectual property asset either from:               <ul style="list-style-type: none"> <li>(a) a Connected Person; or</li> <li>(b) in consideration for funding research and development by another person situated in a country other than this State.</li> </ul> </li> <li>iii. Licences the intellectual property asset to one or more Connected Persons or otherwise generates income from the asset in consequence of activities performed by Foreign Connected Persons.</li> </ul> <p><b>b.</b> the Licensee does not carry out research and development, or branding, marketing and distribution as part of its State Core Income Generating Activity.</p>	<p>As per the new guidance the Definition of High risk IP business is simplified as below:</p> <p>High Risk IP Business Licensee is a Licensee which carries on an Intellectual Property Business and Licensee:</p> <ul style="list-style-type: none"> <li><b>a.</b> did not create intellectual property in an Intellectual Property Asset which it holds for purpose of its business;</li> <li><b>b.</b> acquired Intellectual Property Asset either from:           <ul style="list-style-type: none"> <li>i. Connected Person; or</li> <li>ii. in consideration for funding research and development by another person situated in a country other than the UAE; and</li> </ul> </li> <li><b>c.</b> licenses or has sold Intellectual property Asset to one or more Connected Persons, or otherwise earns separately identifiable income from Foreign connected Person in respect of use or exploitation of Intellectual Property Asset.</li> </ul>



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## 3. Submission of revised ESR Notification

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The MoF has released the revised template for ESR notification which has to be submitted by all the Licensees (including Exempt Licensees). The revised ES notification template requires certain additional details based on the amendment to the resolution.

Key aspects of the templates are as follows:

- Name of the licensee
- License number
- Licensing authority
- Primary/ Main Regulatory Authority
- Registered office address
- Legal form of the company
- Details about the relevant activity carried out by the licensee
- Whether income earned from the relevant activity or not during the reportable period and if it is subject to tax outside UAE.
- Details of designated contact person

**Additional details to be provided in the new template are as follows:**

- Whether the licensee is registered for VAT in the UAE?
- If a licensee has multiple branches, details of the relevant activities (if any) carried out by the branches needs to be furnished in the ES notification filed by the main licensee. Hence the branches of the UAE entities need not file the ES notification separately.
- If the licensee claims exemption, then the licensee must specify the conditions under which the exemption is being claimed and furnish the documentary evidence to support the same.
- Details of the parent company, ultimate parent company and ultimate beneficial owners of the licensee must be furnished to the authority in the notification.



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## 4. The Economic Substance Test

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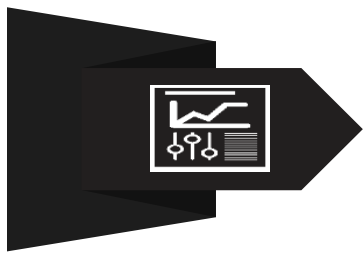
### 4.1 Requirements to meet the Economic Substance Test

All the licensees to whom the ESR is applicable must comply with the ESR requirements and will have to furnish the necessary details to the authority to substantiate the same. The company meets the economic substance test if they:



Conduct core income generating activities (or “CIGA”) in the country

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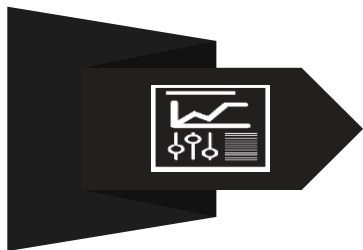
Have premises and adequate level of expenditure in the country

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Are directed and managed in the UAE in relation to that activity

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Have adequate no. of qualified full-time employees, physically present in the UAE



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## 4. The Economic Substance Test

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### 4.2 Key Contents of ESR Return template

The MoF has issued the template for submission of ESR return. The licensees to whom ESR is applicable will have to furnish the details in the ESR return to the relevant authority to substantiate whether the entity meet's the economic substance test. The critical information sought in the ESR return form is mentioned below:

- ✓ A unique ESR registration number will be allotted by MoF for ESR to the licensees.
- ✓ If the licensee is part of a multinational group?
- ✓ Detailed information about each of the relevant activities must be furnished viz. income earned, Core Income Generating activities (CIGA) performed in the UAE for each relevant activity, expenses incurred, accounting profit/loss from each relevant activity, no of full-time employees for each relevant activity.
- ✓ Confirmation as to whether the financial statements are audited or not.
- ✓ Currency used for financial information included in the report.
- ✓ Any deviation from the information filed in the notification must be specifically identified and provided in the return along with the reasons for the same.
- ✓ Details of the number of the board meetings held, whether it was held in UAE or outside UAE, quorum present, whether the minutes of the meeting are maintained, whether the minutes are signed are required to be provided.
- ✓ It is required to give specific declarations for the adequacy of the employees, operating expenditure, net book value of tangible assets.
- ✓ Details of the outsourced services providers where the CIGA is outsourced.
- ✓ Like ES notification, the report also requires details with respect to parent company, ultimate parent company and ultimate beneficial ownership of the licensee.
- ✓ The licensee may also attach additional documents to substantiate the economic substance viz. audited financial statements etc.

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## 5. Consequences for failure to comply with ESR

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The penal provisions for failure to comply with the ESR requirements is amended as below:

- Failure to submit the ESR notification: AED 20,000
- Failure to submit the Economic Substance Report : AED 50,000
- Failure to meet the Economic Substance Test : AED 50,000
- Failure to meet the Economic Substance Test (in consecutive financial period): AED 400,000
- Providing inaccurate information to the Regulatory Authority or National Assessing Authority: AED 50,000





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## 6. Timelines for filing ESR Notification and Return

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On 3<sup>rd</sup> November 2020, MoF has published on its website the timelines and manner for resubmission of Economic Substance Notification and filing of Economic Substance Return which are summarised below:

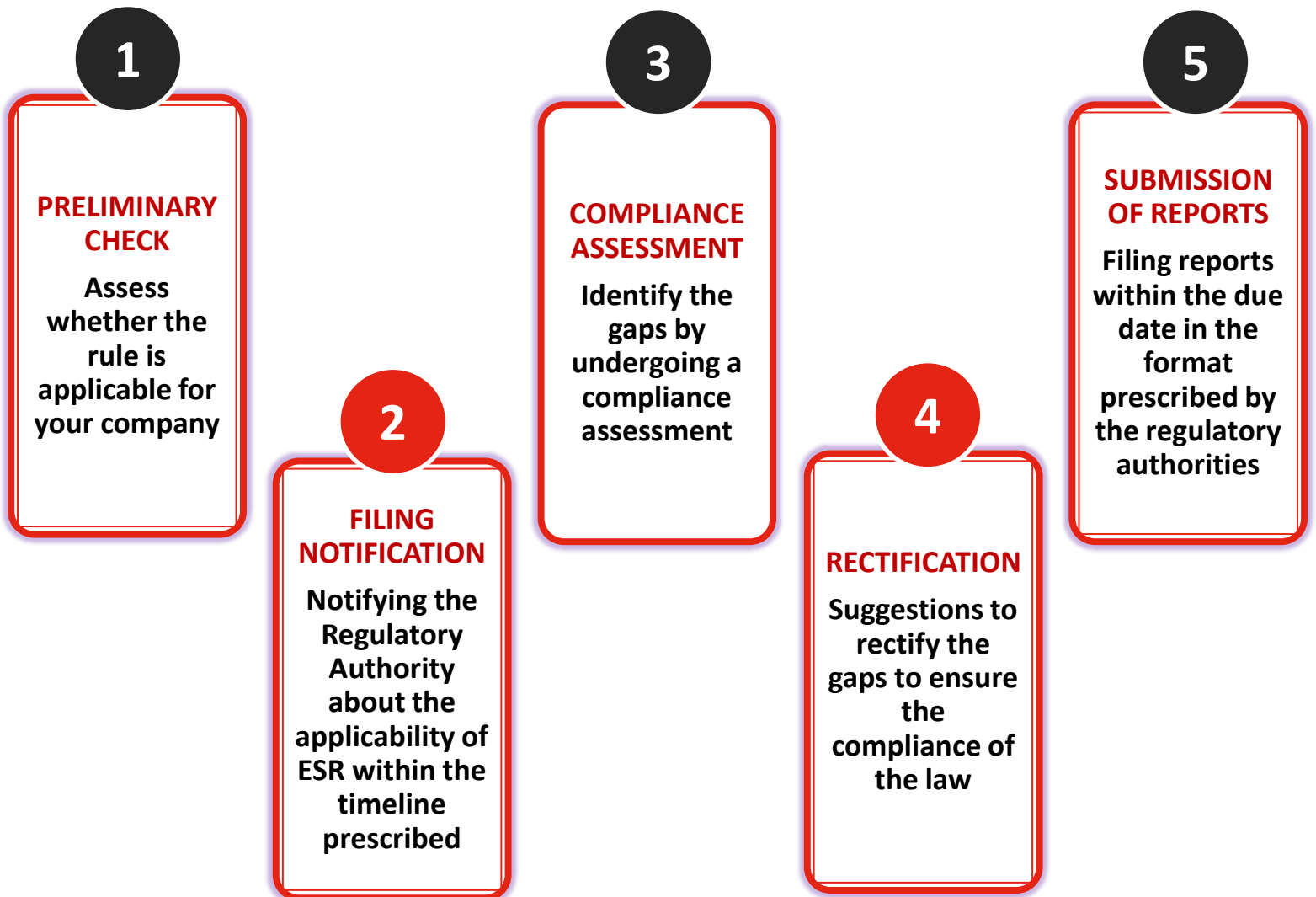
- Economic Substance notification and Economic Substance Return has to be filed through the online portal of Ministry of Finance which is expected to go live in the first week of December 2020.
- All Licensees' and Exempted Licensee's must submit the ESR notification within six months from the end of the financial year. Notifications that fell due before the MoF Portal was available has been **postponed to December 31, 2020**; and Licensees that already submitted the Notification directly to their Regulatory Authorities must review according to the new resolution and submit/re-submit **through the MoF Portal by 31st December 2020**;
- The filing deadline for Economic Substance Reports for a Financial Year commencing on or after 1 January 2019 and ending on or before 31 December 2019 shall be **31 December 2020**.

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## How Ethics Plus can assist

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