



ECONOMIC SUBSTANCE REGULATIONS REGULATIONS 100/2020



MINISTERIAL DECISION NO. 100 FOR THE YEAR 2020
ON THE ISSUANCE OF DIRECTIVES FOR THE IMPLEMENTATION OF THE PROVISIONS OF THE CABINET
DECISION NO 57 OF 2020
CONCERNING ECONOMIC SUBSTANCE REQUIREMENTS

The Minister of Finance:

After perusal of:

- The Constitution;
- Federal Law No (1) of 1972 Concerning the Competencies of Ministries and the Powers of Ministers, as amended;
- Federal Law No (18) of 1981 Concerning the Organization of Commercial Agencies, as amended;
- Federal Law No (26) of 1981 Concerning the Maritime Law, as amended;
- Federal Law No (5) of 1985 on the Issuance of the Civil Transactions Code, as amended;
- Federal Law No (3) of 1987 on the Issuance of the Penal Code, as amended;
- Federal Law No (10) of 1992 on the Issuance of the Law of Evidence in Civil and Commercial Transactions, as amended;
- Federal Law No (11) of 1992 on the Issuance of the Civil Procedures Code, as amended;
- Federal Law No (37) of 1992 Concerning Trademarks, as amended;
- Federal Law No (4) of 2000 Concerning the Emirates Securities and Commodities Authority and Market, as amended;
- Federal Law No (7) of 2002 Concerning Copyrights and Neighbouring Rights, as amended;
- Federal Law No (17) of 2002 Concerning the Organization and Protection of Industrial Property Rights for Patents and Industrial Designs, as amended;
- Federal Law No (8) of 2004 Concerning Financial Free Zones, as amended;
- Federal Law No (6) of 2007, on the Establishment of the Insurance Authority and Organization of its Activities, as amended;
- Federal Decree-Law No (26) of 2019 on Public Financial Management;
- Federal Law No (2) of 2015 Concerning Commercial Companies, as amended;
- Federal Law No (8) of 2015 Concerning the Federal Customs Authority;
- Federal Decree-Law No (13) of 2016 Concerning the Federal Tax Authority;
- Federal Law No (14) of 2016 Concerning Violations and Administrative Sanctions in the Federal Government;
- Federal Law No (19) of 2016 Combating of Commercial Fraud;

- Federal Law No (7) of 2017 Concerning Tax Procedures;
- Federal Decree-Law No (14) of 2018 Concerning the Central Bank and the Regulation of Financial Institutions and Activities;
- Federal Law No (8) of 2018 on Finance Lease;
- Federal Decree Law No (48) of 2018 Approving the Multilateral Administrative Agreement for the Automatic Exchange of Information,
- Federal Decree Law No (54) of 2018 Approving the Convention on Mutual Administrative Assistance in Tax Matters; and
- Cabinet of Ministers Resolution No 57 of 2020 concerning Economic Substance Requirements;
- Ministerial Decision No (215) of 2019 on the Issuance of Directives for the Implementation of the Provisions of Cabinet Decision No (31) of 2019 concerning Economic Substance Requirements.

Article 1 : DEFINED TERMS

Unless the context otherwise requires, words or expressions defined in Cabinet of Ministers Resolution No. 57 of 2020 Concerning Economic Substance Regulations (“**ESR Regulations**”) shall have the same meaning in this Decision.

Article 2 : OVERVIEW OF DECISION

2.1 Introduction

This Decision is issued pursuant to Article 20 of the ESR Regulations and hereby repeals and supersedes Ministerial Decision No. 215 of 2019 on the issuance of Directives for the Implementation of the Provisions of Cabinet Decision No. 31 of 2019 concerning Economic Substance Requirements.

This Decision is intended to provide further guidance and direction to entities carrying out one or more Relevant Activities. An entity subject to the ESR Regulations shall have regard to this Decision for the purposes of ensuring compliance with the ESR Regulations.

It may be necessary, from time to time, to revise or expand on this Decision.

2.2 Background

On 30 April 2019, the Cabinet of Ministers of the United Arab Emirates (“**UAE**”) issued Cabinet Resolution No. 31 of 2019 Concerning Economic Substance Regulations (“**Resolution 31**”). On 10 August 2020 amendments were introduced to Resolution 31 by the Cabinet of Ministers by way of Cabinet of Ministers Resolution No. 57 of 2020 which repealed and replaced Resolution 31.

The ESR Regulations are issued pursuant to the global standard set by the Organisation for Economic Co-operation and Development (“OECD”) Forum on Harmful Tax Practices, which requires entities undertaking geographically mobile business activities to have substantial activities in a jurisdiction.

In addition to the work of the OECD, the European Union Code of Conduct Group (“EU COCG”) also adopted a resolution on a code of conduct for business taxation which aims to curb harmful tax practices.

The Cabinet of Ministers enacted the ESR Regulations taking into account the relevant standards developed by the OECD and the EU COCG.

Article 3 : LICENSEES REQUIRED TO MEET THE ECONOMIC SUBSTANCE TEST

3.1 Definition of a Licensee

Article (1) of the ESR Regulations defines a Licensee as:

“an entity that is:

- i. a juridical person (incorporated inside or outside the State); or*
- ii. an Unincorporated Partnership;*

registered in the State, including a Free Zone and a Financial Free Zone and carries on a Relevant Activity.”

A juridical person is a corporate legal entity with separate legal personality from its owners.

An Unincorporated Partnership is defined under the ESR Regulations to include those forms of partnerships that may operate in the UAE without having separate legal personality and are thereby identified separately under the ESR Regulations.

Branches registered in the UAE are regarded to be an extension of their “parent” or “head office” and therefore are not considered to have separate legal personality.

Similarly, a branch of a foreign entity registered in the UAE that carries out a Relevant Activity, is required to comply with the ESR Regulations, unless the Relevant Income of such branch is subject to tax in a jurisdiction outside the UAE.

Where a UAE entity carries on a Relevant Activity through a branch registered outside the UAE, the UAE entity is not required to consolidate the activities and income of the branch for purposes of the ESR Regulations, provided that the Relevant Income of the branch is subject to tax in the foreign jurisdiction where the branch is located. In this context, a branch can include a permanent establishment or any other form of taxable presence for corporate income tax purposes which is not a separate legal entity.

3.2 Exempted Licensees

What are Exempted Licensees

The ESR Regulations exclude certain forms of entities from the requirement to meet the Economic Substance Test.

For the purpose of the ESR Regulations, an Exempted Licensee includes any of the following entities registered in the UAE and which carry out a Relevant Activity:

- (a) an Investment Fund;
- (b) an entity that is tax resident in a jurisdiction other than the UAE;
- (c) an entity wholly owned by UAE residents and meets the following conditions:
 - (i) the entity is not part of a MNE Group;
 - (ii) all of the entity's activities are only carried out in the UAE;
- (d) a Licensee that is a branch of a foreign entity the Relevant Income of which is subject to tax in a jurisdiction other than the State.

(a) Investment Funds

The ESR Regulations define an Investment Fund as *“an entity whose principal business is the issuing of investment interests to raise funds or pool investor funds with the aim of enabling a holder of such an investment interest to benefit from the profits or gains from the entity's acquisition, holding, management or disposal of investments and includes any entity through which an investment fund directly or indirectly invests (but does not include an entity or entities in which the fund invests).”*

The above definition would include the Investment Fund itself and any entity through which the fund directly and indirectly invests, but not the entity or entities in which the fund ultimately invests.

For the avoidance of doubt, the words “through which an investment fund directly or indirectly invests” refers to any UAE entity whose sole function is to facilitate the investment made by the Investment Fund.

The exemption for Investment Funds is distinct from the Investment Fund Management Business as regulated under ESR Regulations (see Section 2.3 of Schedule 1). The Investment Fund itself is not considered an Investment Fund Management Business, unless it is a self-managed fund (the Investment Manager and the Investment Fund are part of the same entity).

- (b) tax resident in a jurisdiction other than the State

An entity is not required to meet the Economic Substance Test if such entity is tax resident in a jurisdiction outside the UAE. In order for such entity to avail this exemption, the entity must be subject to corporate tax on all of its income from a Relevant Activity by virtue of being a tax resident in a jurisdiction other than the UAE.

It should be noted that an entity that pays withholding tax in a foreign jurisdiction will not be considered as tax resident in a foreign jurisdiction other than the UAE solely on that basis.

- (c) an entity wholly owned by UAE residents

An entity that is ultimately wholly and beneficially owned (directly or indirectly) by UAE residents is exempt from the Economic Substance Test only where such entity is: (i) not part of a MNE Group; (ii) all of its activities are exclusively carried out in the UAE and (iii) the UAE resident owners of the entity reside in the UAE. The entity must therefore not be engaged in any form of business outside the UAE.

In this context, "UAE residents" means UAE citizens and individuals holding a valid UAE residency permit, who reside in the UAE.

- (d) a UAE branch of a foreign entity the Relevant Income of which is subject to tax in a jurisdiction other than the State;

An entity is not required to meet the Economic Substance Test if such entity is a branch of a foreign entity and its Relevant Income is subject to corporate tax in the jurisdiction where such foreign entity is tax resident.

Evidencing status as an Exempted Licensee

Any entity which claims to be an Exempted Licensee must submit to the relevant Regulatory Authority, along with a Notification, sufficient evidence substantiating its status as an Exempted Licensee for each Financial Year in which it claims to be an Exempted Licensee.

A Licensee that claims to be exempt on the basis of being a tax resident in a foreign jurisdiction is required to submit one of the following documents along with its Notification in respect of each relevant Financial Year:

- (a) Letter or certificate issued by the competent authority of the foreign jurisdiction in which the entity claims to be a tax resident stating that the entity is considered to be resident for corporate income tax purposes in that jurisdiction; or

- (b) An assessment to corporate income tax on the entity, a corporate income tax demand, evidence of payment of corporate income tax, or any other document, issued by the competent authority of the foreign jurisdiction in which the entity claims to be a tax resident.

Where an entity fails to provide sufficient evidence to substantiate its status as an Exempted Licensee, the entity will be regarded as a Licensee for the purposes of the ESR Regulations and shall be subject to the requirements of the ESR Regulations as applicable to a Licensee, including the requirement to meet the Economic Substance Test.

3.3 First reportable Financial Year

All Licensees and Exempted Licensees are subject to the ESR Regulations from the earlier of: (i) their financial year commencing on 1 January 2019, or (ii) the date on which they commence carrying out a Relevant Activity (for a Financial Year commencing after 1 January 2019).

3.4 Relevant Activity

Article 3 of the ESR Regulations identifies any of the following activities to be a Relevant Activity:

- (i) Banking Business
- (ii) Insurance Business
- (iii) Investment Fund Management Business
- (iv) Shipping Business
- (v) Lease-Finance Business
- (vi) Distribution & Service Centre Business
- (vii) Headquarters Business
- (viii) Intellectual Property Business
- (ix) Holding Company Business

Entities are expected to use a 'substance over form' approach to determine whether or not they undertake a Relevant Activity and as a result will be considered Licensees for the purposes of the ESR Regulations, irrespective of whether such Relevant Activity is included in the trade licence or permit of the entity.

A Licensee can undertake more than one Relevant Activity during the same financial period. This would require the Licensee to demonstrate economic substance in respect of each Relevant Activity (see Schedule 1 for circumstances in which ancillary Relevant Activities may be consolidated under the main Relevant Activity to prevent duplicate reporting).

If a Licensee carries out a Relevant Activity, then the Licensee must review the requirements applicable to such activity under the ESR Regulations. By way of example, the ESR Regulations set out reduced substance requirements for holding companies that do not carry out any other Relevant Activity and solely hold equity participations in other entities (6-5, ESR Regulations). Conversely, a Licensee that derives

income from Intellectual Property Assets that is considered as high risk (High Risk IP Licensee) must comply with increased reporting requirements and higher evidentiary threshold of the Economic Substance Test.

An entity is not required to be actively engaged in any of the above business categories for it to be considered as carrying on a Relevant Activity. Any form of passive income from a Relevant Activity would bring the entity within scope of the ESR Regulations.

3.5 Relevant Income

A Licensee must satisfy the Economic Substance Test having regard to the level of Relevant Income derived from any Relevant Activity.

For the purposes of the ESR Regulations, “Relevant Income” means all of that entity’s gross income from a Relevant Activity as recorded in its books and records under applicable accounting standards, whether earned in the UAE or outside the UAE and irrespective of whether the entity has derived a profit or loss from its activities.

For the purposes of “Relevant Income”, gross income means all income from whatever source derived, including revenues from sales of inventory and properties, services, royalties, interest, premiums, dividends and any other amounts, and without deducting any type of costs or expenditure. In the context of income from sales or services, gross income means gross revenues from sales or services without deducting the cost of goods sold or the cost of services.

For the avoidance of doubt, gross income does not mean taxable or accounting income or profit.

3.6 Liquidation or otherwise ceasing to carry on Relevant Activities

A Licensee and an Exempted Licensee shall be subject to the ESR Regulations as long as such entity continues to exist.

Where an entity carries out a Relevant Activity during the course of a liquidation or winding up process, the entity, its liquidators (or equivalent) must ensure that the entity continues to satisfy all its obligations under the ESR Regulations.

If an entity is in liquidation or being wound up, it must continue to satisfy the Economic Substance Test for any period during which it carries on a Relevant Activity and derives Relevant Income. This would include full adherence to complete the Notification and reporting requirements prescribed under the ESR Regulations.

Article 4 : THE ECONOMIC SUBSTANCE TEST

4.1 Overview

Any Licensee that (i) carries out a Relevant Activity and (ii) derives Relevant Income from a Relevant Activity during a Financial Year is required to demonstrate sufficient economic substance in the UAE proportionate to the nature of the Relevant Activity and the amount of Relevant Income derived by it. .

For the avoidance of doubt, a Licensee is not required to meet the Economic Substance Test (and file an Economic Substance Report) in a Financial Year in which it has no Relevant Income. However, the Licensee remains subject to the Notification requirement (Article 8, ESR Regulations).

4.2 Key Requirements of Economic Substance Test

In order for a Licensee to demonstrate that it has adequate substance in the UAE in a given Financial Year, it must meet the following:

- (a) The Licensee conducts Core Income-Generating Activities (“CIGA”) in the UAE.

The CIGAs are those activities that are of central importance to the Licensee for the generation of the gross income earned from its Relevant Activity.

The CIGAs listed in Clause 2 of Article 3 of the ESR Regulations are examples of activities commonly associated with each Relevant Activity, but are not an exhaustive list of all CIGAs associated with a particular Relevant Activity.

A Licensee is not required to perform all of the CIGAs listed in the ESR Regulations for a particular Relevant Activity. However, it must perform any of the CIGAs that generate Relevant Income in the UAE.

For the avoidance of doubt, activities that are not CIGAs can be undertaken outside the UAE (refer to section 4.3.2 **Outsourcing activities other than CIGAs**).

- (b) The Relevant Activity is directed and managed in the UAE;

The ‘directed and managed’ test aims to ensure that a Relevant Activity is directed and managed in the UAE and requires that, *inter alia*, there are an adequate number of board meetings held and attended in the UAE.

A determination as to whether an adequate number of board meetings are held and attended in the UAE will be dependent on the level of Relevant Activity being carried out by a Licensee.

Consideration must also be given to more onerous requirements in respect of board meetings prescribed under the applicable law regulating the Licensee or as may be stipulated in the constitutional documents of the Licensee.

The 'directed and managed' test further requires that: (i) meetings are recorded in written minutes and that such minutes are kept in the UAE; (ii) quorum for such meetings is met and those attendees are physically present in the UAE; and (iii) directors have the necessary knowledge and expertise to discharge their duties and are not merely giving effect to decisions being taken outside the UAE.

The minutes of the board meetings must record all the strategic decisions taken in relation to Relevant Activities and must be signed by directors physically present in the UAE.

Quorum shall be determined in accordance with the law applicable to the Licensee setting out quorum requirements or as may be set out in the constitutional documents of the Licensee (or both).

For the avoidance of doubt, and for the purposes of the ESR Regulations, the 'directed and managed' requirement does not prescribe that board members (or equivalent) be resident in the UAE. Rather, the board members (or equivalent) are required to be physically present in the UAE when taking strategic decisions.

In the event that the Licensee is managed by its shareholders/owners/partners, an individual manager (e.g. general manager or CEO), or more than one manager, the above requirements will apply to such persons to the fullest extent possible.

- (a) having regard to the level of Relevant Income earned from a Relevant Activity, (i) has an adequate number of qualified full-time (or equivalent) employees in relation to the activity who are physically present in the UAE (whether or not employed by the Licensee or by another entity and whether on temporary or long-term contracts), (ii) incurs adequate operating expenditure by it in the UAE, and (iii) has adequate physical assets (e.g. premises) in the UAE.

What is adequate or appropriate for each Licensee will depend on the nature and level of Relevant Activity being carried out by such Licensee. A Licensee will have to ensure that it maintains sufficient records to demonstrate the adequacy and appropriateness of the resources and assets utilised and expenditure incurred. The National Assessing Authority shall review such records and other supporting documentation submitted in assessing whether a Licensee has demonstrated the adequacy and appropriateness of resources and assets utilised and expenditures incurred.

It is acknowledged that businesses vary in size and therefore the employees, expenditures and physical assets which are adequate or appropriate for a large or medium sized business may not

be adequate or appropriate for a small business. It is not the intention of the ESR Regulations to impose requirements on businesses in respect of the level of employees engaged, expenditures incurred or physical assets used provided the Licensee is engaged in genuine business activity and carries out CIGAs in the UAE with the employees, expenditures and physical assets it has and meets the requirements of any existing legislation regulating a Relevant Activity.

The requirement for adequate employees is aimed at ensuring that there is a sufficient number of suitably qualified employees carrying out the Relevant Activity.

The requirement for adequate physical assets is intended to ensure that a Licensee has procured appropriate physical assets to carry out a Relevant Activity in the UAE. Physical assets can include offices or other forms of business premises (such as warehouses or facilities from which the Relevant Activity is being conducted) depending on the nature of the Relevant Activity. Such premises may be owned or leased by the Licensee, provided that the Licensee is able to evidence the right to use the premises for the purposes of carrying out the Relevant Activity (e.g. lease agreement).

4.3 Outsourcing

A Licensee may, under paragraph 2 of Article 6 of the ESR Regulations, conduct all or part of its CIGAs for a Relevant Activity through an Outsourcing Provider. For the purposes of the ESR Regulations, an Outsourcing Provider may include third parties or related parties.

The substance (e.g. employees and physical assets) of the Outsourcing Provider in the UAE will be taken into account when determining the substance of the Licensee for the purpose of the Economic Substance Test.

Where an outsourcing arrangement is used, the following conditions must be met:

1. The Outsourcing Provider to whom all or part of the Licensee's CIGAs is outsourced must have, at all times in the UAE, levels of:

- i. employees;
- ii. expenditures; and
- iii. physical assets (e.g. premises),

which are, individually and in the aggregate, adequate in relation to the CIGAs being undertaken.

The ESR Regulations prohibit double counting by Licensees when utilising Outsourcing Providers to carry out a CIGA. Therefore, where an Outsourcing Provider is providing services to one or more Licensee, the time spent by employees and the use of assets of the Outsourcing Provider cannot be counted for more than one Licensee at any given time (for example, if an employee of an Outsourcing Provider spends an hour performing CIGAs for a Licensee, the same employee cannot spend the same hour performing CIGA for a different Licensee).

The obligation is on the Licensee to ensure that no such double counting occurs.

2. The Licensee must at all times be able to demonstrate its ability to supervise in the UAE the carrying out of the CIGAs by the Outsourcing Provider.

3. The Licensee's CIGAs that are outsourced must be undertaken in the UAE.

4. Where all or part of a CIGA is outsourced, the Licensee remains responsible for ensuring accurate information is reported to the Regulatory Authority, and this will include precise details of the level of resources employed by the Outsourcing Provider, for example based on the use of timesheets.

Licensees should consider service agreements it enters into for the purposes of outsourcing to ensure that such agreements meet the requirements of the ESR Regulations and include mechanisms for sharing of information relating to the employees, expenditures and physical assets of the Outsourcing Provider (as applicable) for the purposes of compliance with the ESR Regulations (Article 6-2, ESR Regulations).

4.3.1 Outsourcing must not be used to circumvent the Economic Substance Test

A Licensee must not use outsourcing with the objective of circumventing compliance with the Economic Substance Test.

4.3.2 Outsourcing activities other than CIGAs

A Licensee may outsource activities which are not CIGAs to outside the UAE. This can include, for example, outsourcing of back office functions, IT, payroll, legal services, or other expert professional advice or specialist services provided.

4.4 Notification Filings

Every Licensee and Exempted Licensee is required to submit a Notification to their respective Regulatory Authorities setting out the following for each relevant Financial Year:

- i. the nature of the Relevant Activity being carried out;
- ii. whether it generates Relevant Income;

- iii. the date of the end of its Financial Year;
- iv. any other information as may be requested by the Regulatory Authority.

A Notification submitted by an Exempted Licensee must be accompanied by sufficient evidence to substantiate the Exempted Licensee's status for each category in which it claims to be exempt. Failure to provide sufficient evidence to this effect will result in the Exempted Licensee not being able to avail itself of the exemption and having to comply with the full requirements of the ESR Regulations, including meeting the Economic Substance Test.

The time frames for compliance with the requirement to submit a Notification are different from the time frames to submit an Economic Substance Report (see below). The Notification must be submitted within six months from the end of the Financial Year of the Licensee or Exempted Licensee.

The Notification must be submitted electronically on the Ministry of Finance Portal (see 6.7 below). Licensees that have already submitted a Notification directly to their Regulatory Authorities are required to re-submit a Notification in accordance with the provisions of the ESR Regulations on the Ministry of Finance Portal once available.

4.5 Economic Substance Report

Every Licensee shall be required to meet the applicable Economic Substance Test requirements and submit an Economic Substance Report containing the requisite information and documentation prescribed under the ESR Regulations within twelve (12) months from the end of the relevant Financial Year.

The National Assessing Authority is subject to a six (6) year limitation period calculated from the end of the relevant Financial Year during which it must issue its decision in respect of whether a Licensee has met the Economic Substance Test.

This six (6) year limitation period shall not apply if the National Assessing Authority is not able to make a determination during this period due to gross negligence, fraud, or deliberate misrepresentation by the Licensee or any other person representing the Licensee.

4.6 Retention of Information and Records

The ESR Regulations prescribe for a minimum information retention period whereby each Licensee and Exempted Licensee must retain for a period of six (6) years from the end of its Financial Year all relevant documents, records and information required by the Licensee to meet their obligations under the ESR Regulations.

Any records and supporting documents required to be submitted to a Regulatory Authority and the National Assessing Authority by a Licensee or an Exempted Licensee pursuant to the ESR Regulations must be provided in English.

ARTICLE 5 SECTOR-SPECIFIC GUIDANCE

Please see attached 'Schedule 1 – Relevant Activities Guide' for additional guidance and illustrative examples on the application of the ESR Regulations for each Relevant Activity.

ARTICLE 6 REGULATORY AUTHORITIES AND NATIONAL ASSESSING AUTHORITY

In order to implement the provisions of the ESR Regulations, the UAE Cabinet of Ministers appointed various authorities that are empowered to oversee the implementation, monitoring and enforcement of the ESR Regulations in respect of each Relevant Activity.

Pursuant to the ESR Regulations, certain authorities are appointed in the capacity of "Regulatory Authorities" and the Federal Tax Authority has been appointed as the "National Assessing Authority".

6.1 Functions of Regulatory Authorities under the ESR Regulations

The functions of the Regulatory Authorities are set out under Article 4 of the ESR Regulations. These functions include, *inter alia*, the following: (i) collecting Notifications and Economic Substance Reports from Licensees and Exempted Licensees (as applicable); (ii) collecting all relevant information as required to be submitted by such entities; (iii) reviewing Notifications, Economic Substance Reports and any information attached thereto for accuracy and completeness; (iv) reporting information to the National Assessing Authority and/or Competent Authority; and (v) carry out any other functions for the purposes of implementing the provisions of the ESR Regulations.

Where a Licensee or Exempted Licensee fails to submit any information required under the ESR Regulations to the Regulatory Authority, such Regulatory Authority will notify the National Assessing Authority of such failure.

In respect of Notifications and information submitted by Exempted Licensees, the Regulatory Authority shall review all such information submitted by such Exempted Licensee for the purposes of confirming that such Exempted Licensee has sufficiently evidenced its status as an Exempted Licensee and shall notify the National Assessing Authority of its determination.

6.2 Obtaining Records, Documentation and Information from Licensees and Exempted Licensees

The Regulatory Authority shall collect, receive, review, hold, store and disseminate (as required) all documentation, records and information that any Licensee [or Exempted Licensee] is required to submit to the Regulatory Authority from time to time under the ESR Regulations.

The Regulatory Authority shall ensure that the submission of required documentation, records and information by any Licensee [or any Exempted Licensee] under the jurisdiction of the Regulatory Authority and shall follow-up with any Licensee [or Exempted Licensee] in the event of any delay or failure in the submission of required documentation, records and information, and/or in the event that documentation, records and information are discovered to be incorrect or incomplete. For these purposes the Regulatory Authority may:

- (a) serve a notice on a Licensee [or an Exempted Licensee] requiring further documentation or information; and/or
- (b) enter a Licensee's (or an Exempted Licensee's) premises in order to obtain necessary documentation or information.

6.3 Functions of National Assessing Authority under the ESR Regulations

Pursuant to Article 5 of the ESR Regulations, the National Assessing Authority is appointed to undertake, *inter alia*, the following functions:

- (a) undertake assessments to determine whether a Licensee has met the Economic Substance Test;
- (b) impose administrative penalties, applicable;
- (c) hear and decide on appeals;
- (d) exchange information to the Competent Authority pursuant to Article 10 of the ESR Regulations; and
- (e) carry out any other functions for the purposes of implementing the provisions of the ESR Regulations.

6.4 Determination of whether Economic Substance Test is Met

The National Assessing Authority shall, in accordance with the ESR Regulations and this Decision, make a determination under Article 7 of the ESR Regulations as to whether a Licensee meets the Economic Substance Test for any Financial Year in respect of each Relevant Activity carried out by the Licensee. In doing so, each Regulatory Authority shall adopt a strict yet pragmatic approach.

The National Assessing Authority will consider the information submitted by a Licensee under the ESR Regulations and any other information available to the National Assessing Authority to determine

whether or not a Licensee has met the Economic Substance Test with respect to each Relevant Activity in the UAE.

For the purpose of its determination of whether a Licensee has met the Economic Substance Test, the Regulatory Authority shall consider the following:

- (a) CIGAs being carried out in the UAE.
- (b) A CIGA for any particular Licensee may fluctuate during the course of a Financial Year and from one Financial Year to the next, with the result that what is an adequate level of employees and other resources may not be constant.
- (c) The National Assessing Authority may consider timesheets or other evidence of relevance when assessing whether a Licensee has an adequate number of full-time employees or other personnel in the UAE with appropriate qualifications, and may consider the hours spent by different employees and other personnel with appropriate qualifications to conduct CIGAs and relevant comparable statistics for the business sector, such as the average revenue per employee.
- (d) The directors of a Licensee may sometimes perform CIGAs in addition to performing their fiduciary duties as directors of the Licensee, and thereby reduce or even eliminate the Licensee's need for full-time employees or an outsourcing arrangement. In these cases, the National Assessing Authority may consider evidence of the CIGA performed by the directors in the UAE.
- (e) The National Assessing Authority will consider CIGAs outsourced to an Outsourcing Provider.
- (f) Any other relevant factors.

6.5 Apply Penalties and Hear Appeals

If the National Assessing Authority determines that a Licensee or an Exempted Licensee has failed to comply with applicable provisions of the ESR Regulations, the National Assessing Authority may impose various administrative penalties as set out under Articles 13, 14 and 15 of the ESR Regulations.

A Licensee may appeal a decision of the National Assessing Authority on the following grounds:

- (i) It did not commit a violation;
- (ii) The penalty imposed is not proportionate to the violation;

- (iii) The administrative penalty imposed exceeds the limit prescribed.

There is, in general, a six (6) year limitation period which applies to administrative penalties.

6.6 Sharing of Information and Reporting Requirements

The collection and submission of information that will enable the Regulatory Authority and the National Assessing Authority to monitor whether an entity is carrying on a Relevant Activity and whether it is complying with the ESR Regulations is an integral aspect to the monitoring and enforcement of the provisions of the ESR Regulations.

Information is generally collected from a Licensee in two ways, as follows:

- (1) By way of self-reporting and information submitted by a Licensee; and
- (2) Pursuant to specific information requests made by a Regulatory Authority or the National Assessing Authority.

The National Assessing Authority and the Regulatory Authorities may also coordinate with any ministry or administrative body in the UAE to procure any information within their possession relating to a Licensee or an Exempted Licensee that they may require for the purposes of implementing the ESR Regulations.

Each Regulatory Authority shall supply copies of all information received pursuant to the ESR Regulations to the Ministry of Finance, as the Competent Authority under the ESR Regulations, if so requested by the Ministry of Finance.

The National Assessing Authority will notify the Competent Authority of each Licensee that fails to satisfy the Economic Substance Test in relation to any Relevant Activity. In the case of a High Risk IP Licensee, the Regulatory Authority is required to submit all information obtained in relation to such Licensee to the Competent Authority irrespective of whether the National Assessing Authority has made a determination as to whether such High Risk IP Licensee has met the Economic Substance Test or not.

The Regulatory Authority will also immediately submit to the Competent Authority any information in relation to any of the following Exempted Licensees:

- (a) an entity tax resident in a jurisdiction other than the UAE
- (b) a branch of a foreign entity subject to tax in a jurisdiction other than the UAE

6.7 Filing Database

The Ministry of Finance will launch a portal (“**Portal**”) to facilitate the electronic filing of Notifications, Economic Substance Reports and all other relevant information and documents. Information on the Portal, including the rules and procedures for use of the Portal shall be published on the Ministry of Finance website.

ARTICLE 7 REPORTING AND FILING REQUIREMENTS

Each Licensee and Exempted Licensee must report directly to the Regulatory Authority designated to oversee each Relevant Activity that such Licensee and Exempted Licensee carries out, in the jurisdiction in which such Licensee or Exempted Licensee is registered. By way of example, a Licensee or Exempted Licensee that carries out a Distribution and Service Centre Business mainland in one of seven emirates of the UAE shall report annually to the Ministry of Economy in respect of such business. Conversely, an entity that carries out the same activity in one of the UAE Free Zones or Financial Free Zones, will report directly to the responsible authority within that Free Zone or Financial Free Zone.

Branches registered in the UAE are regarded to be an extension of their “parent” or “head office” and therefore are not considered to have separate legal personality. As such, a “parent” or “head office” registered in the UAE must file as a single Licensee, reporting the Relevant Activities of itself and all its branches in one composite Notification and / or Economic Substance Report.

ARTICLE 8 EXCHANGE OF INFORMATION WITH FOREIGN AUTHORITIES

The Competent Authority will spontaneously exchange information with relevant Foreign Competent Authorities under the ESR Regulations pursuant to an international agreement, treaty or similar arrangement to which the UAE is a party in the following circumstances:

- (c) where a Licensee fails to satisfy the Economic Substance Test;
- (d) where a Licensee is a High Risk IP Licensee;
- (e) where an entity claims to be tax resident in a jurisdiction outside the UAE; and
- (f) where a branch of a foreign entity claims to be subject to tax in a jurisdiction outside the UAE.

Every Licensee that is carrying out a Relevant Activity must identify the jurisdiction in which the Parent Company, Ultimate Parent Company and Ultimate Beneficial Owner claim to be tax resident.

An Exempted Licensee that is either: (i) tax resident in a jurisdiction other than the UAE; or (ii) a UAE branch of a foreign company of which all the income of the UAE branch is subject to tax in a jurisdiction other than the UAE, must in addition to identifying the foregoing, also identify the jurisdiction in which

such Exempted Licensee claims to be (i) tax resident or (ii) the jurisdiction of the foreign company of the UAE branch (as relevant).

Obaid Humaid Al Tayer
Minister of State for Financial Affairs

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**Schedule 1
Relevant Activities Guide**

1. Assessment of whether an entity is undertaking a Relevant Activity

The ESR Regulations apply to companies, partnerships, and other business forms registered in the UAE, including a Free Zone and Financial Free Zone, that carry out any Relevant Activity.

UAE businesses are expected to use a ‘substance over form’ approach to determine whether or not they undertake a Relevant Activity and, as a result, are within the scope of the ESR Regulations. This determination would require the UAE business to look beyond what is stated on their commercial licence to the activities actually undertaken during a financial period.

It is not required that a UAE business is actively engaged in any of the relevant business categories for it to be considered as carrying on a Relevant Activity. For example, the passive receipt of income under a finance lease would be considered as carrying on a Lease-Finance Business.

Licensees can undertake more than one Relevant Activity during the same financial period. This would require the Licensee to demonstrate economic substance in respect of each Relevant Activity, unless the other Relevant Activities are ancillary to a main Relevant Activity. In this case, the Licensee can consolidate the ancillary Relevant Activities under the main Relevant Activity to prevent duplicate reporting. The following sections discuss instances of where consolidated reporting may be permitted.

- Section 2.1: Banking Business;
- Section 2.4: Lease-Financing Business;
- Section 2.5: Headquarters Business; and
- Section 2.9: Distribution and Service Centre Business.

A Licensee is subject to the Economic Substance Test set forth in the ESR Regulations from the date on which the Licensee commences the Relevant Activity, or for financial years commencing, on or after, 1 January 2019, where the Licensee was in existence before the effective date of the ESR Regulations.

2. Relevant Activities and Core Income-Generating Activities

Whether or not a UAE business undertakes a Relevant Activity determines whether the entity is a “Licensee” that is within the scope of the ESR Regulations¹.

The next determination that would need to be made is whether the Licensee earned any gross income from its Relevant Activity(ies) during the relevant financial period. Only for those financial periods in

¹Although a business may determine that it does not carry on a Relevant Activity and is therefore not within scope of the ESR Regulations, the Regulatory Authority in that jurisdiction may request information from the business to demonstrate that position.

which any gross income was earned from a Relevant Activity would the Licensee need to demonstrate economic substance under the ESR Regulations, and file an ESR Report.

For the purposes of the ESR Regulations, “gross income” means all income from whatever source derived and in whatever form realised, including revenues from sales of inventory and properties, services, royalties, interest, premiums, dividends and any other amounts, and without deducting any type of costs or expenditure. In the context of income from sales or services, gross income means gross revenues from sales or services without deducting the cost of goods sold or the cost of services.

One of the requirements to demonstrate economic substance is that a Licensee needs to undertake the CIGAs in relation to its Relevant Activity (or Relevant Activities) in the UAE. The CIGAs are those activities that are of central importance to the Licensee for the generation of the gross income earned from its Relevant Activity.

It is clarified that the CIGAs listed in the ESR Regulations for each Relevant Activity are neither exhaustive nor mandatory. The CIGAs are meant as examples of core activities a Licensee may undertake in relation to a Relevant Activity, and it is not necessary for a Licensee to perform all of the CIGAs listed in the ESR Regulations. A Licensee should therefore consider the activities that generate the gross income it earns, and ensure that those CIGAs are performed in the UAE.

Where the CIGA involves making relevant decisions, then the majority of the persons making the decisions must be present in the UAE when the decision is made, in order for a decision to be considered as being made in the UAE.

The following sections discuss the intended scope of each Relevant Activity and their corresponding CIGAs, and give examples of scenarios where a Licensee may, or may not be, subject to the ESR Regulations, based on its activities.

The examples in this Relevant Activities Guide are meant as general guidance in the context of the specific Relevant Activity being discussed in the respective section. UAE businesses should consider whether the activities described under any of the examples could constitute another Relevant Activity.

2.1. Banking Business

“Banking Business” means the business of accepting deposits of money which may be withdrawn, or that are repayable on demand or after a fixed period, or after notice, by cheque or otherwise, and the use of such deposits, either in whole or in part, in:

- A. the making or giving of loans, advances, overdrafts, guarantees or similar facilities; or
- B. the making of investments,

for the account and at the risk of the Licensee.

Licensees undertaking a Banking Business in the UAE would generally be licensed as a “Commercial Bank”, or an equivalent licensing category that allows for the acceptance of deposits, by either the Central Bank (for a Licensee established in “onshore” UAE), the Dubai Financial Services Authority (“DFSA”) (for a Licensee established in the Dubai International Financial Centre (“DIFC”)), or the Financial Services Regulatory Authority (“FSRA”) (for a Licensee established in the Abu Dhabi Global Market (“ADGM”)). A Licensee that is part of a banking group and only provides advisory, arranging and other services to clients of the banking group would generally not be considered to conduct a Banking Business (although such Licensee should consider whether it undertakes another Relevant Activity).

UAE businesses engaged in exchanging foreign currency and remitting money, and financial intermediaries in the sale and purchase of domestic and foreign stocks and bonds, currencies and commodities and money market transactions, are not considered a Banking Business for purposes of the ESR Regulations.

Licensees engaged in a Banking Business may also provide services, or perform lease or financing activities as a normal part of their business operations. To prevent duplicate reporting, such Licensees are not also considered engaged in a separate Headquarter Business, Distribution and Service Centre Business or Lease-Finance Business and will not need to separately demonstrate economic substance in respect of such ancillary Relevant Activities.

Core Income-Generating Activities of a Banking Business

The ESR Regulations mention the following CIGAs for a Banking Business:

- ‘Raising funds, managing risk including credit, currency and interest risk’ – In addition to accepting deposits from the public, raising funds also includes raising capital, issuing bonds or going to the money markets. A Banking Business’ risk management activities would be aimed at ensuring the capital base of the Licensee is not eroded and to control the cost of funds. The key functions and related decision-making in respect of these activities are expected to be performed in the UAE.
- ‘Taking hedging positions’ – Where the Licensee mitigates risks by taking opposing or offsetting positions, the Licensee must be able to demonstrate that the related activities and decisions making take place in the UAE.
- ‘Providing loans, credit or other financial services to customers’ – A Banking Business would be expected to lend or otherwise invest its customer deposits and other available funds. The term “customer” is not limited to individuals, but also includes corporations and other financial institutions.
- ‘Managing capital and preparing reports to investors or any government authority with functions relating to the supervision or regulation of such business’ - The banking sector is highly

regulated, and involves various reporting to regulators and investors. The Licensee is expected to perform and oversee its reporting related functions and activities in the UAE.

Examples:

1. ABC Bank (UK) offers current accounts, savings accounts, loans, credit cards, and other products and services to individual and corporate customers through a number of branches in the UAE. ABC Bank clearly undertakes a Banking Business in the UAE and is subject to the ESR Regulations.
2. PQR is a UAE branch of the Investment Banking division of the STV Banking Group. The activities of PQR include underwriting new debt and equity securities, facilitating and advising buyers and sellers on mergers and acquisitions, and marketing financial products. Whilst permitted under its UAE investment banking license to accept deposits whose maturities are at least two years, PQR's funding is limited to borrowings from its head office and from other banks. PQR would not be considered as carrying on a Banking Business and be subject to the ESR Regulations on this basis.
3. MNO is the UAE branch of the JKL Banking Group that provides retail and corporate banking services globally. The activities of MNO are limited to providing UAE and regional clients with assistance and advice regarding the JKL Banking Group's products and services, including assistance in the process of opening accounts with JKL Banking Group entities that are based outside of the UAE. MNO LLC is not considered to undertake a Banking Business by virtue of being in the same corporate group, and assistance in the opening of bank accounts would not be considered as conducting deposit taking activities. MNO may, however, be considered as undertaking a "Distribution and Service Centre Business" and be within the scope of the ESR Regulations on this basis.

2.2. Insurance Business

Insurance Business means the business of accepting risks by effecting or carrying out contracts of insurance, in both the life and non-life sectors, including contracts of reinsurance and captive insurance arrangements.

A UAE business that carries on an Insurance Business would be regulated by either the UAE Securities & Commodities Authority (for a Licensee established 'onshore'), the DFSA (for a Licensee established in the DIFC), or the FSRA (for a Licensee established in ADGM).

To prevent duplicate reporting, Licensees providing captive insurance services are not also considered engaged in a Distribution and Service Centre Business.

Insurance brokers, agents, and other UAE businesses providing insurance related services that do not involve assuming all or some of the insured risk do not fall within the definition of Insurance Business, although they may conduct activities that fall into another Relevant Activity category.

Core Income-Generating Activities of an Insurance Business

The ESR Regulations mention the following CIGAs for an Insurance Business:

- ‘Predicting and calculating risk’ – This CIGA involves the determination of the quantification and likelihood of the insured event occurring and the likely costs, and ensuring that the premiums charged are commensurate with the risks underwritten.
- ‘Insuring or re-insuring against risk and providing Insurance Business services to clients’ – This CIGA includes insuring policyholders against specific risks and providing reinsurance to primary insurers.
- ‘Underwriting insurance and reinsurance’ – This CIGA refers to the evaluation and analysis of the risks of an insurance policy, and establishing the pricing for insurable risks.

Examples:

1. First Life LLC (UAE) provides life, health and car insurance in and from the UAE, and is regulated as an Insurer by the UAE Securities & Commodities Authority . First Life LLC clearly undertakes an Insurance Business and is subject to the substance requirements.
2. IntermediaryCo LLC (UAE) is an insurance intermediary that assists and represents consumers in the placement and purchase of insurance, and provides services to insurance companies to facilitate and complement the insurance placement process. IntermediaryCo is regulated as an insurance broker, but is not required to be regulated as an Insurer. IntermediaryCo does not undertake an Insurance Business and is not subject to the ESR Regulations on this basis.

2.3. Investment Fund Management Business

The definition of an Investment Fund Management Business encompasses Licensees that provide discretionary investment management services in relation to domestic or foreign “Investment Funds”.

Discretionary Investment Fund Management services include making investment, divestment and risk related decisions on behalf of an Investment Fund. UAE businesses providing fund administration, custodian, investment advisory, and other Investment Fund related services are not considered engaged in an Investment Fund Management Business.

The Investment Fund itself is not considered an Investment Fund Management Business, unless it is a self-managed fund (the Investment Manager and the Investment Fund are part of the same entity).

Where an Investment Fund is structured as a partnership and has both a corporate General Partner and an Investment Fund Manager, only the Investment Fund Manager would be subject to the ESR Regulations if the General Partner does not undertake business activities separate from its role as General Partner of the Investment Fund.

Core Income-Generating Activities of an Investment Fund Management Business

The ESR Regulations mention the following CIGAs for an Investment Fund Management Business:

- 'Taking decisions on the holding and selling of investments' – This CIGA involves the independent consideration, deliberation and making of investment and divestment decisions. A licensee that is merely implementing decisions of another entity with respect to the holding and selling of investments without independent evaluation before taking steps or decisions to effect the investment or divestment decisions taken, does not perform the CIGA.

It is a commercial reality that the directors or members of an investment committee may not all be based in the UAE or be physically present in the UAE when investment and divestment decisions are taken. However, for this CIGA to be seen as taking place in the UAE, the majority of those making the decisions should be physically present in the UAE when the decisions are made.

- 'Calculating risk and reserves' – Managing an Investment Fund involves identifying, measuring, monitoring and controlling risks attributable to the Investment Fund's operations and investments. This CIGA refers to activities in respect of risks for the Investment Fund as a whole, as opposed to isolated risk calculations for one area of applicable risk that does not take into account all relevant risks applicable to the Investment Fund and the reserves required on a holistic basis.
- 'Taking decisions on currency or interest fluctuations and hedging positions' – This CIGA refers to the activities required to determine if the Investment Fund is exposed to, or if it is in the best interests of the Investment Fund to enter into, hedging arrangements against currency or interest fluctuations, and taking relevant decisions regarding those determinations. As with the other CIGAs, the Investment Fund Manager is expected to perform this activity on a holistic basis, taking into account the Investment Fund's overall position. Isolated decisions involving specific investments are not sufficient to meet the CIGA requirement.
- 'Preparing reports to investors or any government authority with functions relating to the supervision or regulation of such business' – This CIGA does not require the Licensee to perform the administrative task of compiling the various routine annual or quarterly reports. However,

the Licensee is expected to oversee this work from the UAE and to ensure the necessary systems and processes are in place, including the contractual arrangement with any third party administrator. The Licensee is also expected to have the ultimate responsibility for the reporting, and to have the necessary understanding and knowledge to accurately convey the position of the Investment Fund(s) at any time.

Example:

Trinity Fund is an Investment Fund registered with the SCA. The fund is structured as a limited partnership with Trinity LLC (UAE) as its corporate General Partner. Trinity LLC has appointed Morpheus LLC (UAE) as the investment manager for the Trinity Fund, and has delegated to Morpheus LLC the day-to-day investment and divestment decision making responsibilities. The administration of the Investment Fund is handled by a third-party administrator established in the UAE, Neo LLC.

Trinity Fund itself is not considered to undertake an Investment Fund Management Business.

Trinity LLC, on the basis that its activities are limited to being the General Partner of the Trinity Fund, with all discretionary investment management activities being delegated to Morpheus LLC, is not considered to undertake an Investment Fund Management Business.

Morpheus LLC, as the investment manager of the Trinity Fund, is considered as carrying on an Investment Fund Management Business.

Neo LLC does not provide discretionary investment management services and is therefore not considered an Investment Fund Management Business.

2.4. Lease-Finance Business

The definition of a Lease-Finance Business encompasses Licensees that offer credit or financing for any kind of consideration, and includes financing to Connected Persons (e.g. intra-group financing).

Offering credit or financing includes making loans to related or unrelated parties, entering into finance leases in relation to assets other than land, and providing credit in the form of hire purchase agreements, long term credit plans, and other types of financing arrangements (including cash pool arrangements).

Besides interest, consideration for the purpose of a Lease-Finance Business would also include origination and processing fees, gains upon conversion of a loan into the share capital of the debtor, and late payment penalties. However, granting of security in favour of the lender would not constitute consideration.

The investment in bonds or similar securities or debt instruments that are traded on a regulated exchange would also not be considered a Lease-Finance Business.

Licensees that are mainly engaged in Banking, Insurance, Headquarters and Investment Fund Management Business may also perform lease or financing activities as a normal part of their business operations. To prevent duplicate reporting, such Licensees are not also considered engaged in a Lease-Finance Business and will not need to separately demonstrate economic substance in respect of any ancillary Lease-Finance activities.

Core Income-Generating Activities of a Lease-Finance Business

The ESR Regulations mention the following CIGAs for a Lease-Finance Business:

- 'Agreeing funding terms' – This CIGA relates to the funding of the Licensee itself, and includes agreeing the type of funding (e.g. equity, preference shares, debt, etc.), the quantum of funding, the currency, the rates of interest payable, the security given (if any), and any covenants.
- 'Identifying and acquiring assets to be leased (in the case of leasing)' – This CIGA refers to the activity of identifying and verifying suitable assets to purchase and then rent to a hirer or lessee for an agreed period, including negotiating the acquisition and the terms of the supply of the assets to be leased or hired.
- 'Setting the terms and duration of any financing or leasing' – The Licensee is expected to have the authority (within certain parameters, where applicable) and undertake the negotiation of the amount of financing or leasing to be provided, the financial and other terms and conditions, and the relevant legal agreements to be entered into.

- ‘Monitoring and revising any agreements’ - This CIGA could include obtaining data about a borrower or lessee (or the group to which they belong), testing compliance against covenants, extending the duration or the changing of other terms of the financing provided, and ensuring all relevant information is fed into the decision making process and any amended financing terms.
- ‘Managing any risks’ – This CIGA refers to activities in relation to debt collection, monitoring and maintaining the conditions of the underlying leased assets (in the case of leasing), entering into swap and hedging arrangements, and developing and implementing strategies to reduce or spread risks.

Examples:

1. STU LLC (UAE) lends AED 1,000,000 to its subsidiary, VWX LLC, at a 10% interest rate per annum. In respect of the interest bearing shareholder loan made by STU LLC, it is considered engaged in a Lease-Finance Business (specifically, financing).
2. STU LLC subsequently assigns the AED 1,000,000 loan to YZ LLC (UAE), another group company.

After the transfer, YZ LLC will be considered as carrying on a Lease-Finance Business.

If the AED 1,000,000 loan was the only loan advanced by STU LLC, and STU LLC does not obtain an interest bearing loan receivable from YZ LLC in exchange for the transfer, STU LLC would cease to carry on a Lease-Finance Business once the transfer is effected.

3. TradeCo LLC (UAE) sells office supplies and allows its customers a 45-day payment term on invoices. If customers do not pay within 45 days, TradeCo charges late payment interest.

This trade-credit arrangement is not a Lease-Finance Business, as the credit is not offered with the intention of generating interest, but rather to facilitate the trading business of TradeCo.

4. TreasuryCo LLC (UAE) is part of the JMR group and acts as the central treasury center for the group. TreasuryCo enters into external borrowing arrangements and on lends the borrowed funds to group companies at the same interest rate it is being charged by the external funders.

Despite TreasuryCo not applying a mark-up on the interest it is being charged, it offers financing to group companies for consideration, and is thus considered to carry on a Lease-Finance Business.

2.5. Headquarters Business

A Licensee is regarded as carrying on a Headquarters Business if the Licensee provides services to foreign group companies, and through the provision of such services:

- A. The Licensee takes on the responsibility for the overall success of the group; or
- B. The Licensee is responsible for an important aspect of the overall group's performance.

In order for a UAE business to be seen as having "taken on the responsibility for the overall or an important aspect of the overall group's success or performance", the services provided by the entity must involve:

- the provision of senior management;
- the assumption or control of material risk for activities carried out by foreign group companies; or
- substantive advice in relation to the assumption or control of such risks.

A Licensee's position in a group's corporate structure is not relevant for determining whether it is engaged in a Headquarters Business. The Licensee does not need to be the direct or ultimate parent of a group company for it to be considered a Headquarters Business; whether an entity carries on a Headquarters Business is entirely dependent on the nature of the services it provides to foreign group companies.

Licensees that are mainly engaged in Banking, Insurance, Investment Fund Management, Lease-Finance, Shipping or Distribution and Service Centre Businesses, it may be a normal part of their activities to provide headquarters services. To prevent duplicate reporting, such Licensees are not also considered engaged in a Headquarters Business, and will not need to separately demonstrate economic substance in respect of such activities.

Core Income-Generating Activities of a Headquarters Business

The ESR Regulations mention the following CIGAs for a Headquarters Business:

- 'Taking relevant management decisions' – This CIGA refers to making decisions on the substantive functions and significant risks for group companies, such as decisions on material acquisitions and purchases, the group companies' sales and marketing strategy, product development, business process standardization, etc. For a decision to be seen as being made in the UAE, the majority of those making the decision should be physically present in the UAE.
- 'Incurring operating expenditures on behalf of group entities' – This CIGA could include engaging specialist advice or procuring technology on behalf of the group as a whole, or purchasing significant assets or specific services for or on behalf of group companies.

- ‘Coordinating group activities’ – This CIGA refers to ensuring that activities such as marketing, HR, IT, finance, tax etc. are coordinated and organised in a way that produces the best outcome for the group as a whole as opposed to individual group companies.

Examples:

1. PLC LLC (UAE) is part of a multinational group with subsidiaries around the world. Each of the senior management team based in the UAE has responsibility for a different region, and regularly spend time at the subsidiaries with the local management teams providing strategic direction and helping manage material risks. In addition, PLC LLC supports the group in managing risk through the procurement of external advice centrally, and the associated costs are shared amongst the group.

PLC LLC’s activities are within the scope of a Headquarter Business.

2. FGH LLC (UAE) is part of a UK headquartered group and has subsidiaries in the Kingdom of Saudi Arabia (“KSA”). Whilst the senior management of FGH LLC have regular contact with the management of the KSA subsidiaries on the performance of their business and to share insights from the group, and FGH LLC (in its capacity as shareholder) has certain rights and influence in respect of the management and operations of the KSA subsidiaries, the KSA subsidiaries follow the strategic direction and manage risks in line with the corporate policy set by the headquarters based in the UK.

FGH LLC is not considered to be providing ‘headquarters services’ because the strategic direction for the group is set by the headquarters in the UK and not by FGH LLC, and FGH LLC is not responsible for the performance of the subsidiaries in KSA.

2.6. Shipping Business

To undertake a Shipping Business, a Licensee must operate one or more ships in international traffic, for the transport of either passengers, cargo or both.

The definition of a “ship” for purposes of the ESR Regulations does not include:

- vessels used for fishing;
- vessels that are “small” (i.e. tonnage does not exceed ten tonnes); and
- leisure vessels (e.g. cruise ships and private yachts).

Further, the following activities will be considered a Shipping Business only where they are undertaken by a Licensee in connection with the business of operating a ship, or ships, in international traffic:

- the rental on a charter basis of ships
- the sale of tickets or similar documents
- the use, maintenance or rental of containers
- the management of the crew of ships.

The chartering of ships on a bareboat basis does not fall within the scope of a Shipping Business because the entity which charters the ship does not operate the ship. This activity may however fall within the scope of a Lease-Finance Business (depending on the terms of the bareboat charter arrangement).

Travel agencies and international shipping agencies will not be treated as carrying on a Shipping Business merely on the basis of selling tickets to passengers for international travel by ship. Entities that arrange for their own or other businesses’ goods to be transported overseas by sea are also not considered engaged in a Shipping Business, unless they themselves operate the relevant ships.

Core Income-Generating Activities of a Shipping Business

The ESR Regulations mention the following CIGAs for a Shipping Business:

- ‘Managing crew (including hiring, paying and overseeing crew members)’ – This CIGA could include the sourcing, recruitment, selection, deployment, scheduling, training, and on-going management of the crew deployed on the vessels, including the associated administration (payroll, insurance, tax and social security withholding) and logistics (travel arrangements, temporary accommodation etc.).
- ‘Overhauling and maintaining ships’ – This CIGA involves having responsibility for, and the related decision making in respect of, the lifting of vessels from the water for maintenance and the general maintenance of ships.

- ‘Overseeing and tracking shipping’ - This CIGA refers to the management and oversight of the logistical aspects of the international transportation of cargo and passengers by ship, including overseeing and managing ship movements.
- ‘Determining what goods to order and when to deliver them, organising and overseeing voyages’ – This CIGA involves activities to determine how a ship is to be utilised, the types of cargo acceptable and the scheduling of the delivery of such cargos, managing the logistical aspects of the operation of ships, determining which routes to use, and ensuring necessary contingency arrangements are in place.

Examples:

1. Water LLC owns a passenger ship and its business is to operate that ship in international traffic to carry passengers from the UAE to other Middle East countries. Water LLC is within the scope of a Shipping Business because it operates a ship in international traffic for the transport of passengers.

SailorCorp LLC provides and manages the crew of Fourth Fleet LLC’s ship as part of its crew management business, but SailorCorp LLC does not operate the ship. SailorCorp LLC is not related to Fourth Fleet LLC.

SailorCorp LLC is not considered to carry on a Shipping Business because it does not operate the ships where its crew is being deployed. The mere provision of crew and ship management services is not considered as “operating a ship” for purposes of the ESR Regulations.

Because SailorCorp LLC is not related to Fourth Fleet LLC, SailorCorp LLC would also not be within the scope of the ESR Regulations as a “Distribution and Service Centre Business”.

2. Charter LLC owns a ship and charters it on a bareboat basis to Cargo LLC that uses and operates the ship to carry cargo from the UAE to other countries.

Charter LLC does not operate the ship it has chartered to Cargo LLC, or any other ship, and is therefore not considered engaged in a Shipping Business.

Cargo LLC, on the other hand, is considered as carrying on a Shipping Business because it operates the ship it has chartered for the international transportation of cargo. It is not relevant that Cargo LLC is not the owner of the ship.

2.7. Holding Company Business

A Holding Company Business is defined under Article 1 of the ESR Regulations as a business that:

- Has as its sole function the acquisition and holding of shares or equitable interests in other companies; and
- Only earns dividends and capital gains from its equitable interests.

A Licensee will be regarded as carrying on a Holding Company Business only if it meets the two conditions listed above.

Equity interests include shares in a company and interests in an incorporated partnership, as well as any other instrument which gives the Licensee a beneficial ownership interest in a company.

The term “dividends” should also be interpreted widely to mean any distribution of profits to the holder of shares or equitable interest in another company or incorporated partnership.

A Licensee whose activities are limited to being engaged in a Holding Company Business would only be required to meet the reduced economic substance requirements under Article 6.5 of the ESR Regulations.

A UAE business that does not meet the narrow definition of a Holding Company Business because it either;

- (i) carries on another activity; and/or
- (ii) owns other forms of investments or assets (e.g. interest-bearing loans)

may be required to meet the (full or increased) economic substance requirements under Article 6.1 of the ESR Regulations if the other activity or asset brings the UAE business within the scope of a different Relevant Activity category (e.g. Lease-Finance), and the Licensee derives gross income from such other Relevant Activity.

The following table provides examples of how a UAE business may assess its obligations under the ESR Regulations in the above circumstances.

#	Asset / activity	Income from asset / activity	In scope of the ESR Regulations	Required to meet the economic substance requirements (if within scope of the ESR Regulations)
1	Holding immovable assets (e.g. real estate)	Income from the immovable assets (e.g. rent)	No	N/A
2	Holding movable assets	Income from movable assets, e.g.: a) finance lease income b) income from the sale of movable assets)	a) Yes - Lease-Finance Business b) No	a) Yes b) No
3	Holding Intellectual Property Assets	Income from intellectual property (<i>refer to Section 2.8 for an example in respect of embedded intellectual property</i>)	Yes - Intellectual Property Business (if the gross income from the Intellectual Property Asset is separately identifiable)	Yes (increased substance requirements apply to a High-Risk IP Licensee)
4	Holding equity interests only	Income from equity (e.g. only dividends and capital gains)	Yes - Holding Company Business	Reduced substance requirements
5	Holding equity interests and undertaking another activity that is not Relevant Activity	Income from equity interests and non-Relevant Activities	No	N/A
6	Holding equity interests and undertaking another Relevant Activity	Income from equity interests and the other Relevant Activity	Yes - Business of the Relevant Activity, but not a Holding Company Business	Yes (increased substance requirements apply to a High-Risk IP Licensee)

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.

Core Income-Generating Activities of a Holding Company Business

The CIGAs of a Holding Company Business are all activities related to acquiring and holding shares or equitable interests in other companies, provided such activities do not constitute another “Relevant Activity”.

Examples:

1. ABC LLC’s only activity is the holding of shares in four subsidiary companies, and ABC LLC is itself held by the regional holding company of the group headquartered in France. The only gross income earned by ABC LLC are annual dividends from its subsidiaries.

ABC LLC undertakes a Holding Company Business irrespective of its own shares being held by another holding company in the group.

2. DEF LLC manufactures food products, and holds the shares in another company (GHI LLC) which operates a restaurant.

Despite DEF LLC holding the shares of GHI LLC and earning dividend income, DEF LLC is not considered a Holding Company Business because its business is food production.

Because the manufacturing of food products and the operation of restaurants does not meet the definition of any of the other Relevant Activities, neither DEF LLC nor GHI LLC are subject to the ESR Regulations.

3. GHI LLC holds 100% of the shares in two subsidiary companies, and has provided an interest bearing shareholder loan to one of these companies. GHI LLC earns annual dividends and interest income.

GHI LLC will be considered as engaged in a Lease-Finance Business only, and not also considered as carrying on a Holding Company Business.

4. Trustee LLC acts as trustee to a number of unconnected trusts, holding assets in its capacity as trustee. As Trustee LLC is in the business of providing trustee services and is not the beneficial owner of the assets, Trustee LLC will not be considered a Holding Company Business.

2.8. Intellectual Property Business

A UAE business is regarded as carrying on an Intellectual Property Business if it holds, exploits, or receives gross income from “Intellectual Property Assets”.

An “Intellectual Property Asset” is defined as any intellectual property right in intangible assets, such as copyrights, patents, trademarks, brands, and technical know-how, from which the Licensee earns separately identifiable income in the form of royalties, license fees, franchise fees, capital gains and any other income from the sale or exploitation of the Intellectual Property Asset.

Most UAE businesses will own some form of Intellectual Property Asset (e.g. their trademark, technical know-how relating to their processes, copyright in their works etc.), but not earn separately identifiable income from such assets. Instead, the Intellectual Property Assets contribute to or protect the value of the good or services these UAE businesses provide. The ownership of such Intellectual Property Asset would not be considered as carrying on an Intellectual Property Business as the Intellectual Property Asset is merely auxiliary to the main business of the UAE business.

If there is any indication that a Licensee has manipulated its gross income to avoid being subject to the economic substance requirements as an Intellectual Property Business, for example by disguising royalties as part of sales income, the Regulatory Authority shall take the necessary action to ensure compliance with the ESR Regulations.

Core Income-Generating Activities of an Intellectual Property Business

The ESR Regulations set out certain CIGAs for an Intellectual Property Business. Which CIGA needs to be undertaken in the UAE will depend on the nature of the asset being exploited and how that asset is being used to generate gross income for the Licensee.

Patents and similar assets (e.g. that share the same features of a patent including copyrighted software, technical know-how and other similar novel, useful and protected assets): ‘Research and development’.

This CIGA includes planning and documentation of new products, processes or services, prototyping, demonstrating, piloting, testing and validation of new or improved technologies, addressing known scientific or technological obstacles, applying research findings or other knowledge for producing or introducing new or improved materials, devices, products, processes, systems, technologies or services, etc.

Marketing intangibles (an intangible that relates to marketing activities, aids in the commercial exploitation of a product or service, and/or has an important promotional value for the product

concerned such as trademarks, brands, customer lists and relationships): 'Branding, marketing and distribution'.

Marketing and branding includes advertising, seeking endorsements, artistic design, developing consumer awareness and developing customer loyalty.

Distribution includes distribution of the marketing intangible through various mediums such as on demand services, business to business sectors, integration into IT systems, creating dealership networks and distribution channels and maintaining relationships to aid in the distribution of the marketing intangible.

In exceptional circumstances, a Licensee that owns a marketing intangible, patent or similar asset (and is not considered a High Risk IP Licensee - see next section) and that does not undertake any of the relevant CIGAs mentioned above, may be able to consider any of the following activities as CIGAs for Economic Substance purposes:

1. taking strategic decisions and managing (as well as bearing) the principal risks related to development and subsequent exploitation of the Intellectual Property Asset;
2. taking the strategic decisions and managing (as well as bearing) the principal risks relating to acquisition by third parties and subsequent exploitation and protection of the Intellectual Property Asset;
3. carrying on the ancillary trading activities through which the Intellectual Property Assets are exploited leading to the generation of revenue from third parties.

In demonstrating economic substance in the UAE for an Intellectual Property Business, periodic decisions made by non-resident directors would not be sufficient to satisfy the Economic Substance Test. Therefore, it would require more than local staff passively holding intangible assets whose creation and exploitation is a function of decisions made and activities performed outside of the jurisdiction.

Examples:

1. LicenseCo holds a brand, the rights for which are licensed to others in return for a royalty. LicenseCo is within the scope of an Intellectual Property Business.
2. ChocolateCo has a trademarked range of chocolates, which it manufactures and sells to unrelated third parties.

ChocolateCo is not an Intellectual Property Business as its gross income is derived from the sale of finished goods to third parties, not the exploitation of an Intellectual Property Asset (i.e. the value of the trademark is intrinsically linked to the value of the chocolates and is not separately distinguishable, making the use of the trademark incidental).

3. SoftwareCo has developed a unique IT software platform for accepting, processing and tracking online orders that it holds and uses within its own business of online marketing. SoftwareCo also licences the IP software platform to others to use within their online marketing businesses. The users pay SoftwareCo a licence fee in order to use the IT software platform. SoftwareCo is within the scope of an Intellectual Property Business.

High Risk IP Licensee

Where a Licensee is carrying on an Intellectual Property Business, it will also have to consider if it is a High Risk IP Licensee.

A High Risk IP Licensee is defined under Article 1 of the ESR Regulations as a Licensee which carries on an Intellectual Property Business, and meets all of the following three requirements:

1. The Licensee did not create the Intellectual Property Asset which it holds for the purpose of its business, and
2. The Licensee acquired the IP Asset from either;
 - a. A Connected Person; or
 - b. In consideration for funding research and development by another person situated in a foreign jurisdiction; and
3. The Licensee licenses or has sold the IP Asset to one or more group companies, or otherwise earns separately identifiable gross income (e.g. royalties, licence fees) from a foreign group company in respect of the use or exploitation of the IP asset.

Any High Risk IP Licensee, is by default, deemed to have failed the Economic Substance Test, unless such entity is able to adduce sufficient evidence to refute this determination.

A High Risk IP Licensee must provide sufficient evidence supporting that it has, and has historically had, a high degree of control over the development, enhancement, maintenance, protection and exploitation (the so-called “DEMPE functions”) of the Intellectual Property Asset.

Such entity is further required to have an adequate number of full-time employees, with the necessary qualifications, who permanently reside and perform their activities in the UAE, and would need to provide the following information:

- A business plan showing the reasons for holding the ownership in the Intellectual Property Asset in the UAE;
- Employee information, including;
 - level of experience;

- type of contracts;
 - qualifications; and
 - duration of employment of the Licensee;
- The above information would have to prove that in the UAE there is more than local staff passively holding intangible assets whose creation and exploitation is a function of decisions made and activities performed outside of the jurisdiction. As such, the business would need to evidence that decision making is taking place in the UAE (note: periodic decisions made by non-resident directors or board of members would not be sufficient).

Example:

1. PharmaCorp LLC, a UAE resident company earns gross income from licensing its patent for a new medicine to its group companies located in Egypt and KSA.

PharmaCorp did not create the patent, the rights were acquired from a group company (R&D Co in the UK).

PharmaCorp is a High Risk IP Licensee and would (i) be subject to the exchange of information provisions of Article 9.3, and (ii) be required to provide additional information to evidence its economic substance in the UAE.

2.9. Distribution and Service Centre Business

A “Distribution and Service Centre” Business refers to two distinct activities that are covered under one “Relevant Activity” heading.

A Licensee is considered engaged in a “Distribution Business” if it:

- A. Purchases raw materials or finished products from a foreign group company; and
- B. Distributes those raw materials or finished goods

A Licensee is considered engaged in a “Service Centre Business” if it provides consulting, administrative or other services to a foreign group company.

Licensees that only purchase or distribute goods to third parties, are not considered engaged in a Distribution Business. Likewise, Licensees that are engaged in the business of providing services to third parties are not considered as carrying on a “Service Centre Business”.

An entity that undertakes a transaction that falls within the scope of a “Distribution and Service Centre Business” would not be required to demonstrate economic substance in the UAE if it can evidence that the transaction was not in the ordinary course of its business (e.g. a one-off transaction) and the transaction is recharged to the relevant foreign group company at cost or less.

Licensees that are mainly engaged in Banking, Insurance, Investment Fund Management, Lease-Finance, Shipping, Intellectual Property or Headquarter Business may also purchase goods from, and/or provide services to foreign group companies as a normal part of their business operations. To prevent duplicate reporting, such Licensees are not also considered engaged in a Distribution and Service Centre Business.

Core Income-Generating Activities of a Distribution and Service Centre Business

The ESR Regulations mention the following CIGAs for a Distribution and Service Centre Business.

The following CIGAs generally apply in relation to a “Distribution Business”:

- ‘Transporting and storing goods, components and materials or goods ready for sale’ - This CIGA refers to the movement and storage of raw materials or finished products and managing the risks associated with this.
- ‘Managing inventories’ - This CIGA could include considering minimum acceptable inventory levels, managing frequency of stocktake, whether using storage space effectively, perishability of inventory and ensuring security procedures are in place.

- 'Taking orders'- This CIGA refers to the provision of the order processing element of the entire fulfilment process, whether that is manual or electronic.

The following CIGAs generally apply in relation to a "Service Centre Business":

- 'Providing consulting or other administrative services'- This CIGA covers the provision of any type of service to the Licensee's foreign group companies.

Examples:

1. XYZ LLC (UAE) buys furniture from a group company based in Lebanon, imports the furniture into the UAE, and then re-sells the furniture to other group companies and customers throughout the Middle East. XYZ LLC is considered as carrying on a Distribution and Service Centre Business.
2. The main business activity of TUV LLC (a company established in the Ajman Free Zone) is to provide HR and administrative support services to a group company based in Kuwait, which are recharged at cost. Despite TUV LLC not charging a mark-up on the relevant costs, TUV LLC is considered as engaged in a Distribution and Service Centre Business.
3. HIG LLC, the KSA subsidiary of ABC LLC (a company established in the United Kingdom), requires specialist IT support with the implementation of a new accounting system which will be used by HIG LLC in the provision of services to KSA based clients. QRS LLC (a subsidiary of HIG LLC established in the Abu Dhabi General Markets Financial Free Zone) provides audit and accountancy services to third party customers in the UAE, and agrees to second one of its IT support staff to HIG LLC for three months. QRS LLC recharges HIG LLC the relevant salary costs incurred.

As QRS LLC is not in the business of providing IT services to foreign group companies, nor does it offer/solicit such services or maintain employees to provide such services to other group companies, and because it does not earn a margin on the costs recharged to HIG LLC, QRS LLC is not considered as carrying on a Distribution and Service Centre Business.

3. Professional advice

If a business is unable to determine whether it conducts a Relevant Activity, it should seek professional advice.