

Ministerial Decision No. 215 for the Year 2019 on the issuance of directives for the implementation of the provisions of the Cabinet Decision No. (31) of 2019 concerning Economic Substance Requirements

22 September 2019

On 11 September 2019, the Ministry of Finance issued Ministerial Decision No. 215 for the year 2019 (hereafter: "**the Guidance**") to provide guidance on how to comply with the economic substance requirements decreed by Cabinet of Ministers Resolution No. 31 of 2019 (hereafter: "**ESR**").

This article provides some practical insights on the key points of the Guidance.

Scope of the ESR

All natural or juridical persons licensed by the competent licensing authority in the

UAE to carry out a Relevant Activity in the State, including a Free Zone and a Financial Free Zone, are within the scope of ESR.

Licensee

The Guidance clarified the definition of a Licensee. Following the Guidance, a Licensee is considered licensed if it holds a License from the relevant licensing authority from which a licensing approval is required to carry out a relevant Activity.

A license shall include a commercial license, certificate of incorporation, or other form of permit required to be procured prior to the carrying out of the Relevant Activity by the Licensee.

Companies exempt from ESR

It is clarified that the entities exempt from ESR requirements include companies in which the Federal Government, the Government of any Emirate of the UAE or any government authority or body of any of them has at least 51% direct or indirect ownership in its shareholding.

Timing of reporting

The Guidance clarifies the dates on which the notification and ESR report should be submitted to the Regulatory Authority.

As of 1 January 2020, Licensees shall submit a notification to the Regulatory Authority containing the following information:

- a. whether or not it carries or not a Relevant Activity;
- b. whether or not all or any part of the relevant entity's gross income in relation to the relevant activity is subject to tax in a jurisdiction outside the UAE, and
- c. the date of the end of its Financial Year ("FY");

If the Licensee is required to submit an ESR report, this ESR report shall be submitted to the Regulatory Authority within 12 months of the end of each FY of the Licensee commencing on or after 1 January 2019.

Each Regulatory Authority should provide the form of the reports and the mechanism for submitting such forms to the Licensees.

At this stage the procedures for the notification and ESR report for each Regulatory Authority are not clarified yet.

Key Requirements of the ESR Test

The Guidance clarifies the meaning of some wordings of the Resolution on the ESR Test:

A. *State Core Generating Activities ("CIGA")*

The list of CIGA provided in Article 5 of the ESR is not exhaustive. The general principle is that the activities forming part of CIGA are regarded as the most important activities that a Licensee must carry out in the UAE in relation to the Relevant Activity.

B. *What is meant by "directed and managed"?*

The Licensee is directed and managed in the UAE in relation to the Relevant Activity if it is expected that there are an adequate number of board meetings held and attended in the UAE.

The meaning of "adequate number" will depend on the level of the Relevant Activity of the Licensee. However, there must be at least one board meeting held in the UAE in a FY. Furthermore, consideration must also be given to meeting requirements prescribed in the applicable law regulating the Licensee or constitutional documents.

C. *What is meant by "adequate" and "appropriate"?*

The Guidance did not prescribe a minimum number of employees or

amount of expenditures for a level of relevant income either generally or for any type of Relevant Activity.

What is adequate or appropriate for each relevant entity will depend on the particular facts, including the nature and level of Relevant Activity being carried out by the Licensee.

A Licensee will have to ensure that it maintains and retains appropriate records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.

D. What is meant by “adequate premises”?

Depending on the nature of the Relevant Activity, adequate premises may include offices or other forms of business premises, owned or leased by the Licensee. This may include warehouses or facilities from which the Relevant Activity is conducted.

E. Additional requirements for outsourced CIGA

The Guidance provides some anti-avoidance rules when a Relevant Activity of a Licensee is outsourced to a third-party services provider:

- There must no double counting if the services of the third-party

provider are provided to more than one Licensee carrying out a Relevant Activity in the UAE;

- A Licensee must demonstrate that the Relevant Activity is not outsourced to a third-party service provider to circumvent the ESR.
- The Licensee shall remain responsible for ensuring that accurate information is reported to the Relevant Authority. Such report shall contain precise details of the level of resources employed by the third-party service providers.

Determination of whether ES Test is Met

Each Regulatory Authority is expected to adopt a pragmatic approach in carrying out the ES Test.

For purposes of determining whether a Licensee has met the ES Test, the Regulatory Authority may consider the following:

- ✓ What is “adequate” number of employees may not be constant as the CIGA may fluctuate within the course of the FY and from one FY to the next;
- ✓ Timesheets or other evidence may be considered for determining adequate number of full-time or other employees with appropriate

qualifications in the UAE, taking into account the hours spent by different employees, including relevant comparable statistics for the relevant business sector, such as the average revenue per employee;

- ✓ The directors may sometimes perform CIGA in addition to performing their fiduciary duties as directors of the License, thereby reducing or eliminating the need for full-time employees or outsourcing agreements. CIGA performed by directors may be considered as evidence for meeting the ES Test.

Key takeaway

The Ministerial Decision provides some clarification on several items introduced in the ESR. However, the Guidance for the most part reiterates the provisions of the ESR.

It is noteworthy that the Guidance does not contain a one-size-fits-all criteria on how to meet the ESR Test. Critical judgment must therefore be exercised by Licensees in the determination of the same as what is “adequate” and “appropriate” will depend on the nature and level of the Relevant Activity being carried out by the Licensee.

Also, it seems that the requirements of the ESR Test may be applied to the interpretation of the Regulatory Authority

and it may differ per Regulatory Authority. It should be noted that the forms and procedures of the reporting requirements are not published yet by the Regulatory Authorities. We expect that the Regulatory Authorities in the UAE will publish this information in the next months.

We refer to our previously issued newsletter on the ESR [here](#).

How Crowe can help

- Impact assessment of the ESR and the Guidance based on each entity’s specific facts and circumstances, including the identification of Relevant Activities and CIGA.
- Assistance in assessing “adequate” and “appropriate” levels of employees, premises, and expenditure in the UAE.
- Assistance in the notification and reporting obligations of the relevant entity.

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