

The logo for Intuit Management Consulting (IMC) features the lowercase letters 'imc' in a bold, dark blue sans-serif font. A small grey dot is positioned above the 'i'. The logo is centered within a white circle that has a thick blue border. This circle is set against a background of a city skyline with several tall skyscrapers under a clear blue sky. The water of a bay or sea is visible in the foreground.

Economic Substance Explained

INTRODUCTION TO ECONOMIC SUBSTANCE

ECONOMIC SUBSTANCE LEGISLATION CAME INTO EFFECT
IN THE UNITED ARAB EMIRATES ON 1 JANUARY 2019.

Economic Substance



Introduction

The Economic Substance legislation is the corner stone of optimizing income streams from economic activities. This localized financial activity encourages offshore jurisdiction in low tax regimes. The law is applicable to certain licensed financial activities in each jurisdiction and is not a blanket legislation. The relevant entities are bound to adhere to strict regulations that enunciate working conditions like recruiting adequate skilled employees to ensure that 'core income generating activities' are smooth. The revenue and margins are a part of the exercise.

The jurisdiction in UAE is strategized in two layers. The two stages are key to establish the impact on the company by the legislations are:

- The company should be in the purview of the new legislation. This signifies that the licensee is engaged in a relevant revenue grossing activity.
- The business entity should meet the substance requirements.

This document aims to act as a manual to designate the new substance laws in the UAE and demonstrate how IMC can enhance the customer delight by handling requirements and concerns in this domain.

Our team is happy to assist you in understanding how the new substance legislations impact your business.



Which Entities Are To Be Affected?

The legal entities in the UAE are the ones that are licensed to conduct business in the UAE. It should be noted that there cannot be any government holding in the entity's shareholding pattern and the entity should be engaged in relevant activity.

It should be noted that a Company in which there is more than 51% direct or indirect government ownership would not be considered under this Regulation.

An entity is a licensee if it is

1. Licensed to carry out business in UAE
2. Conducts Relevant Activity
3. Is not a commercial company with government holding in its share capital



State Core Income Generating Activity

State Core Income Generating Activities Are To Be Pursued In The Jurisdiction To Demonstrate Substance.
SOME EXAMPLES INCLUDE:

RELEVANT ACTIVITY	EXAMPLES OF CORE INCOME GENERATING ACTIVITY
Banking business	<ol style="list-style-type: none">1. Initiating infusion of funds, managing risk, managing credit, currency as well as the interest risk2. Taking suitable hedging positions3. Issuing loans, providing credit and a multitude of other financial services.4. Managing the capital and preparing returns and reports , issuing the same to the investors or to the local authorities
Distribution and the service centre business	<ol style="list-style-type: none">1. Transportation and storage of goods, multiple components and materials2. Stock Management3. Order management4. Consulting services and other administrative services
Financing and leasing business	<ol style="list-style-type: none">1. Negotiating and optimizing funding terms and conditions2. Identifying and acquiring assets that are to be leased3. Finalizing the terms of leasing and financing4. Managing and revising the financing terms or leasing agreements. Risk Management of the afore mentioned agreements.
Fund management activity	<ol style="list-style-type: none">1. Decision making on purchase and sale of investment instruments.2. Calculation of risks and reserves .3. Comprehending currency volatility and aligning hedging positions.4. Reports or returns created and provided to investors and local authorities when mandated.



State Core Income Generating Activity

RELEVANT ACTIVITY

EXAMPLES OF CORE INCOME GENERATING ACTIVITY

Headquarters business

1. Making relevant management decisions
2. Making decisive expenses as deemed necessary by all entities in the group.
3. Coordinating and managing the activities of the group.

Holding company business

1. Companies that hold equities in totality need to adhere to compliance with all relevant requirements under the jurisdictional law under which incorporation was initiated.
2. Compliance is required for all holding companies to be able to conduct all relevant activities.

Insurance business

1. Risk calculation and prediction.
2. Issuance of insurance and reinsurance of risk.
3. Local authorities and investors are provided with reports or returns as required.

Intellectual property business

- A. In the case where intellectual property asset is considered a
 1. Patent or a similar asset, conduit for research and development
 2. Branding, marketing and distribution along with trademarking. Non-trade or intangible assets are inclusive.
- B. In exceptional cases, unless the relevant business activity is a potentially high risk intellectual property entity, the multiple different core income generating activities that are relevant to business and intellectual property assets are inclusive of
 1. Strategic decision making, managing, and bearing) the major risks related to development and consequent exploitation of the purported intangible asset generation.
 2. Carrying on the basic trade activities by which the intangible assets are used to generate income from third parties.

Shipping business

1. Managing crew by means of hiring, overseeing and paying crew members
2. Overhauling and maintenance of ships
3. Tracking deliveries and general management including overseeing operations.
4. Order management, deliveries, organizing and overseeing voyages as a whole

Measurement And Reporting Substance

Establishing that an entity is the licensee to carry out relevant activity described by economic substance act regulations, and duly notified to the relevant authority

The Company must pass the 'Economic Substance Test', and based on which file and Annual Return

Whether the
relevant activity
is subject to tax in
a separate
jurisdiction

Whether the
entity is
conducting
relevant activity

At the end of
the financial
year

The Relevant Authority needs
to be notified about the
following details:

Measurement And Reporting Substance



It is fully managed and
duly directed in the
jurisdiction

There exists physical
office that is
operational.

An entity carrying out a relevant activity will generally meet the substance requirements if these conditions are in place:

Core Income
generation Activities
are carried out in the
valid jurisdiction

There are suitably qualified
employees in the requisite
number required for the
activity in hand in the
jurisdiction

There are further detailed criteria especially around the Core Income Generating Activities. They are accompanied by the and rules governing outsourcing. 'High-risk IP companies' are bound by special regulations. Please contact your usual IMC executive to discuss how these regulations impact your business entities. Once the substance is established, the business entity is bound to file an economic substance report every year with the relevant authority in its jurisdiction.

Adequate operating
expenditure is maintained
in accordance to the
relevant activity.

Penalties For Non-compliance

Non-compliance with the Regulations may lead to administrative fines and sanctions which include:



A fine of up to AED 50,000 for failing to meet an economic substance test



A fine of up to AED 300,000 for failing to meet an economic substance test in respect of a financial year after an initial notice of failure



Sharing of information regarding the non-compliance with tax authorities in the foreign states where the affected companies are incorporated or in which their parent company, ultimate parent or ultimate beneficial owner are resident; and,



Suspension, revocation or non-renewal of a licence.

HOW CAN IMC HELP?



IS THE BUSINESS ENTITY IN QUESTION WITHIN SCOPE OF THE NEW LAW?

The experts at IMC can provide the requisite professional non-legal advice to help clients identify the relevant entities to conduct relevant activities.



IMC is a leading cross border advisory firm specializing in the AMEA (Asia, Middle East, Africa) region established in 1979.

The firm has extensive knowledge and experience in gathering and reporting company data in the UAE. Additionally the robust networking in the region and deep experience in dealing with new regulations across regions covered by the group, IMC is uniquely placed to help it's clients understand and respond to this new legislation.

Substance determination is divided into three stages, and the outcome of each stage determines the subsequent reaction.

IMC applies the following approach to dealing with necessary substance requirements.



HOW CAN IMC HELP?



Does the business entity meet the necessary substance requirements?

IMC experts perform a substance test on the entities in scope that includes a request to garner additional information from the clients. The substance requirements may differ depending on the nature of relevant activity performed by the entity. The examination includes a gap-analysis to gauge the requirements for adequate control, personnel, operational facilities and expenditure.



How can the business entity enhance its substance?

Solutions may be straightforward for standard structures including additional corporate services or Company Secretarial activities. More complex structures require the development and implementation of customized solutions that include consideration of functions that IMC can facilitate adequately.



Submissions of notifications and reports

In scope entities are required to file a notification with the relevant authority. IMC can ably assist in the requisite preparation and submission of the notification and report in the format that is required by the relevant tax authority.





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Thank you