

UAE ECONOMIC SUBSTANCE REGULATION



QUALIFICATION AND ASSET / ACTIVITY

QUALIFICATION	PROVISIONS FROM THE RELEVANT ACTIVITY GUIDE	M/HQ COMMENTS
General	<p>Although a business may determine that it does not carry on a Relevant Activity and is therefore not within scope of the Regulations, the Regulatory Authority in that jurisdiction may request information from the business to demonstrate that position.</p>	<p>While the ESR does not require companies not deploying a Relevant Activity to submit a notification, it grants powers to the relevant Regulatory Authority to formulate ESR-related compliance duties [possibly going above and beyond the ESR] applicable to all establishments under their purview.</p> <p>E.g. the DIFC requires all companies registered in the zone to submit a notification regardless of the fact that they are or not conducting a Relevant Activity.</p>
Lease-Finance Business	<p>The definition of a Lease-Finance Business encompasses Licensees that offer credit or financing for any kind of consideration, and includes intra-group financing.</p> <p>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.</p> <p>When there is no expectation of consideration from the credit at the time it is provided, the UAE business will not be considered as carrying on a Lease-Finance Business.</p>	<p>The definition of what is deemed 'income' in a Lease-Finance Business has been extended: i.e. origination and processing fees, gains upon conversion of a loan into the debtor's share capital, and late payment penalties.</p> <p>Where no income/consideration is expected, the Lease-Finance activity is not qualified.</p>
Headquarter Business	<p>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:</p> <ol style="list-style-type: none"> The Licensee takes on the responsibility for the overall success of the group; or The Licensee is responsible for an important aspect of the overall group's performance. <p>For 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.</p>	<p>It is very common for entities providing services intra-group to be deemed to be undertaking both Distribution and Service Centre Business and Headquarter Business. In such a case, the entity will only be required to demonstrate economic substance in respect to its core activity of Distribution and Service Centre Business.</p>
Shipping Business	<p>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.</p> <p>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).</p> <p>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.</p>	<p>This Relevant Activity Guidance made clear that an entity will not be undertaking Shipping Business unless it operates the ship(s) in international traffic.</p>
Holding Company Business	<p>Clarification has been given to: (i) entities solely holding shares/equity interests; (ii) entities holding (i) plus deploying other non-Relevant Activity; (iii) entities holding (i) plus deploying other Relevant Activity; and (iv) entity solely holding properties.</p>	<p>It has been clarified that an entity holding a property and generating income from the property's rentals is not in scope of the ESR.</p> <p>It has also been clarified that the income from the sale of movable assets being held by an entity shall not qualify the entity as conducting a Relevant Activity.</p> <p>Should an entity hold shares/equity interests in other entities and at the same time conduct an activity that is not deemed as Relevant Activity, the entity will not fall within scope of ESR regardless of the fact that the entity generates income from dividends and the other non-Relevant Activity. To the contrary, should an entity hold shares/equity interests in other entities and at the same time conducts an activity that is deemed as Relevant Activity, the entity will fall within scope of ESR only due to the other Relevant Activity being conducted and not due to its participation in the shareholding of other entities.</p>
Distribution and Service Centre Business	<p>Licensees engaged in Banking, Insurance, Investment Fund Management, Lease-Finance, Shipping, or Headquarter Business may also purchase goods for, 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.</p> <p>Clarification has also been given in relation to certain types of provision of services to group companies.</p>	<p>An entity will not have to submit duplicate reporting if the entity is already engaged in Banking, Insurance, Investment Fund Management, Lease-Finance, Shipping, or Headquarter Business.</p> <p>It has also been clarified that if an entity provides support services to a group company based abroad, which are recharged at costs (i.e. no mark-up), this entity will be deemed as Distribution and Service Centre Business and therefore will fall within scope of ESR.</p> <p>The treatment of work-forces being seconded by entities from the same group has also been clarified. An entity will not fall within scope of ESR if it second its staff to its group company, provided that the entity seconding the staff is not engaged in the provision of secondment services and it is not earning a margin in the costs being recharged to the group company to whom the staff have been seconded.</p>

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

#	Asset/ activity	Income from asset / activity	In scope of the Regulations	Required to meet the economic substance requirements (if within scope of the 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)