



UAE ECONOMIC SUBSTANCE LAW BRIEFING

On 30th April 2019 the United Arab Emirates (UAE) issued the Cabinet of Ministers Resolution No. 31 of 2019 concerning economic substance regulations in the UAE (the “New Law”).

The New Law creates the basis for the UAE to meet the requirements of the European Union Code of Conduct Group (Business Taxation) (COCG) in respect of economic substance, and specially to ensure that the jurisdiction does “not facilitate structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction” and “avoids that profits registered in a jurisdiction are not commensurate with economic activities and substantial economic presence”. The introduction of the New Law follows the decision of the European Union (EU) to include the UAE on a list of non-cooperative jurisdictions for tax purposes.

The UAE has been firmly committed to its long-standing policy of meeting the highest international standards on taxation, including the OECD’s requirements. The introduction of the New Law is a strong sign that the country is keen to continuously update its domestic legislative framework in this regard.

1. What is the New Law about?

The New Law has been designed to address concerns that companies could be used to artificially attract profits that are not commensurate with economic activities and substantial economic presence in the UAE.

The New Law requires certain companies, including those incorporated in the UAE mainland or Free Zones (the “licensees” or the “companies”), to demonstrate that they have effective substance in the country by satisfying an “economic substance” test in relation to any income-generating “relevant activity”¹. The licensees meet this economic substance test if they:

- Conduct **core income generating activities** (or “**CIGA**”) in the country;
- Are **directed and managed in the UAE** in relation to that activity;
- Have **adequate number of qualified full-time employees** in relation to that activity who are **physically present in the UAE**;
- Have **premises and adequate level of expenditure in the country**.

2. What is the scope of the New Law?

The substance requirements apply to licensees carrying out and deriving incomes from one of the activities listed below (the “**Relevant activities**”):

- Banking business
- Finance and leasing business
- Fund management business
- **Headquarters business**
- **Holding company business**
- Insurance business
- **Intellectual property holding business**
- Shipping business
- **Distribution and service centre business.**

A licensee is **not required to pass the economic substance test if it does not generate income** in relation to a Relevant activity that it carries.

3. What does it mean in practice?

Reporting

Starting from 2020, every licensee will have to notify the Regulatory Authority on a yearly basis stating:

- whether or not it carries out a Relevant activity;
- whether or not all or any part of the company’s gross income in relation to a Relevant activity is subject to tax in a jurisdiction outside of the UAE; and
- the date of the end of its Financial Year.

Existing entities must comply with the New Law from 30 April 2019, with the first return due in 2020. New entities must comply with the New Law upon receiving its license, with the first return due in 2020 or later.

Directed and managed in the UAE

The New Law contains specific requirements on how a company has to be “directed and managed” in the UAE. e.g. number of board meetings being held and attended in the country, composition and competence of the board of directors, record of the minutes of all board meetings.

The number of meetings required will depend on the activities and the amount of decision-making required by the board of directors. The meetings must take place in the UAE with a quorum of knowledgeable directors physically present in the country and its minutes shall record the making of strategic decisions of the licensee and be signed by the directors attending the meeting. There should be at least one meeting held in the country each year even for companies with minimal activities.

In the event that the company is managed by an individual (general manager or CEO) rather than a board, the above requirements will apply to such individual, i.e. the decisions made by this individual must be properly documented and the individual must be physically present in the country when taking key decisions relating to the management and operation of the licensee.

Adequate employees, expenditure, physical assets

What is adequate for each licensee will be dependent on the particular facts of the company and its business activity. A company will have to ensure it maintains and retains appropriate records to demonstrate the adequacy of the resources utilized and expenditure.

1. Entities that are directly or indirectly owned by the UAE government (both federal and local) are excluded from the New Law.



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States core income generating activities

Another requirement necessary to meet the economic substance test is for the UAE company to have its CIGA in the UAE.

To demonstrate substance, the company will not have to perform all of the listed CIGA but only the ones that are relevant in its situation.

Sanctions

If the company registered in the UAE does not provide required information or submit inaccurate information to the regulatory authority knowing that it is inaccurate, it will be sanctioned by an administrative fine not less than AED 10,000 but not exceeding AED 50,000 in the first year, increased to an amount not less than AED 50,000 but not exceeding AED 300,000 in the subsequent year, and ultimately, deregistration in case of continuous non-compliance.

Exchange of information

Besides the fines, the Law stipulates that the tax authorities may exchange information on the non-compliant UAE-registered companies with the tax authorities in the State where their holding companies and UBOs are resident.

How can we help you?

Understanding the New Law and its implications is paramount to ensure you make the right decisions for your company. Is your entity in the scope of the new legislation? If so, is it conducting one or more of the listed relevant activities?

M/HQ can support you in assessing the impact of the new legislation on your business – providing preliminary assessments of your company’s current compliance obligations, and where required, help you to define a strategy and implement a bespoke plan of action.

Ensuring that your company complies with its administrative and statutory responsibilities can be cumbersome. Outsourcing this function – see our fact sheet “[Corporate Secretarial Services – Available Packages](#)” – to M/HQ enables you comply with your obligations and to focus on what you do best – manage your operation and grow your business.

We are happy to discuss your company’s specific needs in depth in light of the new economic substance law, helping you find the most cost and time effective solution to meet your administrative and statutory compliance responsibilities.

Who we are

M/HQ is a multi-service platform catering to a broad spectrum of clients, from individual entrepreneurs, family run SMEs to multinational corporations.

Our one-stop-shop offering is unique in the Middle East: a holistic and cross-disciplinary combination of a market-leading corporate services firm with a law firm’s specialist structuring expertise all on one single platform.

We have a substantial track-record delivering creative and results-oriented advice and support on a wide range of UAE structuring and re-structuring issues. Headquartered in the UAE, we are an entrepreneurial firm for entrepreneurial clients.

Who will assist you



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Presumably, a group would then run the greater risk of attribution of the UAE-allocated profits to the foreign jurisdictions although whether this would be included in or additional to the country-by-country reporting regime remains to be seen.

For all core requirements introduced by the law, **outsourcing is permitted** providing this outsourcing is not used to circumvent the economic substance test.

The company may satisfy the economic substance test if it retains a UAE-based service provider and outsources all or part of the requirements to it – e.g. occupy non-executive functions and/or coordinate the handling of meetings, maintenance of records, undertaking all or part of CIGA.

4. Our recommendation

Even companies not deploying a “relevant activity” implement proper corporate governance mechanisms in order to avoid any risk of failing the economic substance test.

If you own a business in the UAE, we highly recommend that you take an active role in auditing your corporate arrangements with the view to bring in the necessary level of corporate substance.