



SUBSTANCE REQUIREMENTS IN THE UAE

1. What exactly does “substance” mean?

The terms “tax substance” or “economic substance” refer to the requirement for an entity to have an actual economic presence in the jurisdiction where it is established to qualify for the benefit(s) of a tax treaty.

Substance attached to structures has become a key theme in regulatory tax circles at all levels – domestic (anti-avoidance provisions), regional (EU’s aggressive tax planning and harmful tax competition) and global (OECD’s base erosion and profit shifting, or BEPS). While the concept of substance has yet to be formally implemented in any treaty, it stands behind related concepts of residence and beneficial ownership, and in practice constitutes the safeguard tool of choice of governments wishing to prevent treaty shopping.

It is therefore paramount for UAE companies involved in international operations to be aware of the notion of “economic substance”, to prevent and counter the risk of a potential challenge over tax residency.

2. How can a UAE company evidence sufficient substance to foreign tax authorities?

The level of substance required from a UAE entity will vary depending – among others – on the nature of the company’s activities (i.e. substance requirements for a non-operational holding company are lower than for an operational financing or trading company) and the jurisdiction(s) involved (e.g. several EU member countries have implemented anti-abuse rules requiring a higher level of economic and physical substance).

In this context, key issues to be considered when setting up an entity in the UAE with the aim of it being considered as UAE tax residence from a foreign tax perspective notably consist of the following:

- To maintain a permanent, dedicated and identifiable office in the jurisdiction;
- To employ qualified personnel working physically in the company’s local premises;
- To have a dedicated telephone, fax, internet lines, as well as a website and e-mail address(es);
- To make use of local providers (e.g. bank(s), accounting firm, audit firm, law firm, IT firm, marketing firm);
- To be effectively managed in the UAE – e.g. board meetings should be held regularly and minutes of meeting duly documented, and all key decisions should be taken in the jurisdiction;
- To document the operations at the company’s local premises (e.g. books of accounts, minutes’ books, banks accounts, commercial contracts).

3. Do offshore companies meet substance requirements? What about free zone companies?

The primary difference between free zone companies and offshore companies is that offshore companies are not permitted to have an office in the UAE, making it difficult to satisfy the substance criteria. Free zone companies on the other hand have the ability to own or lease physical premises with the necessary infrastructure to carry out operations, thus meeting the substance test.

4. What are the consequences of a lack of economical substance?

Foreign tax authorities may consider UAE companies lacking substance as merely being setup to take advantage of tax treaty benefits or for shifting profits to the UAE – where such profits will not be subject to tax.

This may lead the same authorities to deny tax treaty benefits to the UAE entity and tax the entity’s income in their respective jurisdiction. In some instances, the overseas tax authorities may go as far as to consider the UAE company as a tax resident of the foreign country, e.g. because of the effective control and management being conducted in that jurisdiction.

5. Does a tax residency certificate suffice for obtaining treaty benefits?

In principle, a company becomes a UAE resident company by its incorporation under UAE corporate law. To obtain a tax residence certificate (“TRC”) the UAE entity will additionally need to meet minimal substance criteria (See our factsheet “UAE Tax residence certificate” for more information in this respect).

When faced with a valid TRC, foreign tax authorities will generally presume that the UAE entity is a fiscal residency of the UAE. But this presumption can be challenged based on a lack of substance. In this respect, the notion of seat of effective management goes beyond the form, and aims at exploring whether a UAE company is actually managed and controlled in and from UAE.

Conclusion

The notions of “tax substance” or “economic substance” are fundamentally subjective. Many countries have their own substance requirements and one should be fully aware of those requirements before determining appropriate tax substance solutions.

Satisfying the criteria add item 2 above is a good start but may not be enough to be considered as a bona fide UAE tax resident by overseas tax authorities.

Careful planning and sophisticated tax advice is therefore paramount in order to determine the extent of enhancing the substance of a UAE company.

Who we are

We are a multi-services platform catering to a broad spectrum of clients – from individual entrepreneurs and local SMEs to wealthy international families, to established blue-chip companies and multinationals. Our one-stop-shop offering is unique in the Middle East: a holistic and cross-disciplinary combination of a market-leading corporate services firm, a law firm’s specialist expertise and a regulatory & compliance services practice, all through one single platform.

We have broad experience with substantial track-record delivering creative and results-oriented tax advice on a wide range of domestic and cross-border issues, including direct and indirect tax matters, tax structuring and restructuring, private equity and venture capital.

Headquartered in the UAE, we are an entrepreneurial firm for entrepreneurial clients.

Who will assist you



Rima Chodhri
Senior Relationship Manager
✉ chodhri@m-hq.com



Matthieu Daguerre
Partner
✉ daguerre@m-hq.com