

New UAE Economic Substance Regulations Issued

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On 30 April 2019, the UAE Cabinet issued the Cabinet of Ministers Resolution No. 31 of 2019 concerning Economic Substance Regulations in the UAE (“Regulations”).

Why has the UAE issued the Regulations?

The implementation of the Regulations is a result of the recent initiatives conducted by the Organisation for Economic Co-operation and Development (“OECD”) and the EU Code of Conduct Group (“COCG”) in respect of certain low or zero rate corporate income tax regimes. In recent years, the EU has focused more directly on the tax policies of jurisdictions with zero or nominal corporation tax, and whether such jurisdictions require investors to have sufficient economic substance before benefitting from preferential tax regimes on geographically mobile resources. One outcome of these initiatives has been the publication of the EU list of non-cooperative tax jurisdictions, which, as at the date of this note, includes the UAE.

Consequently, the governments of many “tax havens” including the Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Mauritius and Seychelles introduced, at the commencement of 2019, economic substance rules based on the guidance and requirements issued by the OECD and COGC. Such rules (which are to be mirrored by the Regulations) are designed to ensure that companies operating in a low or zero corporate tax jurisdiction have a substantial purpose for their incorporation in that jurisdiction other than tax reduction. In order to align with international standards, the UAE has now enacted the Regulations.

Who is subject to the Regulations?

Any UAE entity that undertakes “Relevant Activities” which consist of any of the following businesses licensed in the UAE (including onshore mainland and/or free trade zones):

- Banking
- Insurance
- Investment fund management
- Lease finance
- Headquarters

- Shipping
- Holding company
- Intellectual property
- Distribution and service centres

UAE entities that are directly or indirectly owned by the UAE government (both federal and local) are specifically excluded from the Regulations. On this basis, UAE sovereign investment funds and other UAE government controlled and/or related entities would not be required to meet the UAE economic substance requirements.

Importantly, the Regulations extend to not just entities incorporated in the UAE, but those “licensed” which would therefore include branches and representative offices as well as standalone subsidiaries.

What are the economic substance requirements under the Regulations?

Where a UAE entity is undertaking Relevant Activities, the following requirements apply:

- the entity must conduct its core income generating activities (“CIGA”) in the UAE, i.e. undertakes its key business activities in relation to Relevant Activities in the UAE;
- the entity must be directed and managed in the UAE, i.e. holding board meetings and/or passing board resolutions on a periodic basis in the UAE; and
- the entity’s activities must be carried out with adequate local “economic substance” with regard to the level of relevant activity in the UAE, and such economic substance consists of:
 - adequate number of full-time employees;
 - adequate amount of operational expenditure; and
 - adequate level of physical assets.

It is noteworthy that holding companies, whose main activity is restricted to solely possessing shares or other assets, are subject to a reduced level of economic substance requirements.

What are the reporting requirements under the Regulations?

A UAE entity undertaking Relevant Activities will be required to submit a compliance report on an annual basis to the relevant authority issuing its commercial licence, and such report should include the following information:

- type of CIGA conducted;
- amount and type of income arising from the CIGA;

- amount and type of operating expenses to conduct the CIGA;
- location of place of business and type of physical assets required, e.g. plant, property or equipment;
- number of full-time employees responsible for carrying out the CIGA; and
- a declaration of compliance with the economic substance test under the Regulations.

Existing UAE entities undertaking Relevant Activities must comply with the Regulations from 30 April 2019 with the first compliance report due in 2020. New UAE entities undertaking Relevant Activities must comply with the Regulations upon the issuance of its commercial licence with the first compliance report due in 2020 or the year following incorporation.

What are the penalties for non-compliance?

An administrative fine of a minimum of AED 10,000 and a maximum of AED 50,000 shall be imposed on an UAE entity undertaking Relevant Activities when the economic substance test is not met, or if no information or inaccurate information is provided to the regulatory authority. Further, an administrative fine of a minimum of AED 50,000 and a maximum of AED 300,000 shall be imposed in the subsequent year for recurring non-compliance. Ultimately, regulatory authorities may suspend, revoke or deny renewal of the commercial licence of the offending entity.

What are the practical implications?

Aside from complying with additional economic substance reporting requirements going forward, the Regulations should have a relatively limited impact on UAE-headquartered businesses and foreign companies that have genuine commercial operations, assets and management in the UAE. For companies that undertake Relevant Activities in the UAE, but are managed remotely, it would be prudent to review their governance structure and operating model, and make any necessary adjustments to the same so as to ensure compliance with the Regulations.