



Economic substance in the UAE: Compliance, Governance and Risk Management alert

1. BACKGROUND

On April 30, 2019, the United Arab Emirates has promulgated the regulations on economic substance which will apply to UAE onshore, Free Zone and offshore companies that operate and generate income from the **relevant activities** (including **banking, investment fund management, holding company, headquarters business, intellectual property, insurance and lease-finance, shipping, distribution and services centre**) to comply with EU's requirements to be removed from the list of non-cooperative tax nations. The Regulations were followed by a guidance issued under Ministerial Decision 215 of 2019, which adds some clarity to the effect and interpretation of the Regulations.

Therefore company operating in any relevant activities must satisfy the below **economic substance requirements** of the Regulations (including but not limited to) demonstrating that it:

- conducts its **core income-generating activities** (CIGA) in the UAE. The relevant CIGAs for each of the Relevant Activities is set out within the Regulations;
- is **managed and directed** in the UAE with regards to its CIGA;
- possesses an adequate number of **qualified full-time employees** in relation to its activity and who are physically present in the UAE, or that sufficient expenditure is incurred in out-sourcing to third parties in the UAE whose activities, employees, expenditure and premises are adequate for carrying out the Relevant Activity being outsourced in the UAE;
- incurs adequate **operating expenditure** in the UAE or that adequate expenditure is incurred in out-sourcing to third parties in the UAE who meet the economic substance requirements of the UAE; and
- has adequate **physical assets** or levels of expenditure on outsourcing to third parties in relation to the CIGA in the UAE.



2. REPORTING REQUIREMENTS

Companies or persons within the UAE holding a trade licence, certificate of incorporation or other form of permit required in order to carry out a Relevant Activity (a Licensee) would need to submit a **notification to the regulatory authority** (as delegated pursuant to Cabinet Resolution No.58 of 2019) which contains the following information:

- whether the Licensee carries out a Relevant Activity;
- whether or not all or any part of the Licensee's gross income in relation to a Relevant Activity is subject to tax in a jurisdiction outside of the UAE; and,
- the date of its end of its financial year.

If the Licensee carries out a Relevant Activity and is required to satisfy the economic substance test, it would be required to submit a report to the Regulatory Authority in accordance with the requirements of the Regulations.

If the Relevant Activity is an IP business, additional information would be required as per the Regulations, failing which it would be determined that the economic substance test has not been met during the relevant financial year.

It is understood that each Regulatory Authority shall set out the form of reports to be filed and mechanisms for submitting such forms to it.

3. NON-COMPLIANCE

Non-compliance with the Regulations may lead to 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.



4. IS YOUR COMPANY SECURED?

Companies need to determine as to whether they fall within the scope of the Regulation by way of **an economic substance diagnostic check**, and then to assess and implement the potential options for ensuring that they meet the economic substance requirements.

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