



# Tax Newsletter

Economic substance requirements in the UAE for onshore, Free Zone and offshore companies: Compliance, Governance and Risk Management alert

January 2020

## TABLE OF CONTENTS

1. Who is subject to the Regulations? Who are the relevant entities?
2. What are the economic substance requirements?
3. What are the reporting requirements?
4. What are the deadlines for reporting and compliance?
5. Non-Compliance Risks and penalties?
6. Is your company compliant?
7. The Outcome

## Economic substance requirements in the UAE for onshore, Free Zone and offshore companies: Compliance, Governance and Risk Management alert

*By Mohammed Rahali – Tax Partner Wincore Advisory Group*

### IN BRIEF

On April 30, 2019, the United Arab Emirates has promulgated the regulations on economic substance -the Cabinet of Ministers Resolution No.31 of 2019, requiring all in-scope UAE entities (“**Relevant Entities**”) that carry on specific activities (“**Relevant Activities**”) to have verifiable economic substance in the UAE from 30 April 2019.

**“The new UAE substance law is applicable to any UAE Natural or Legal Person conducting Relevant Activity(ies) in the UAE”**

## 1. WHO IS SUBJECT TO THE REGULATIONS? WHO ARE THE RELEVANT ENTITIES?

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 - companies or persons within the UAE holding a trade licence, certificate of incorporation or other form of permit required in order to carry out an Activity (a Licensee) - that operate and generate income from relevant activities (to comply with EU's requirements to be removed from the list of non-cooperative tax nations) which include the following:

- banking
- investment fund management
- holding company
- headquarters business
- intellectual property
- insurance and lease-finance
- shipping
- distribution and services centre

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.

## 2. WHAT ARE THE ECONOMIC SUBSTANCE REQUIREMENTS?

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;
- With the reference to the level of activities performed in UAE:
- 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 amount of **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.

A Holding Company Business will be subject to less stringent economic substance requirements than a “high risk IP related activities” company.

The economic substance requirements must be met for each of the Relevant Activities undertaken by a company.

### 3. WHAT ARE THE REPORTING REQUIREMENTS ?

A Relevant Entity would need to submit on annual basis a **notification** on its Relevant Activities **to the regulatory authority** (as delegated pursuant to Cabinet Resolution No.58 of 2019- being the authority that issued the trade licence to the Relevant Entity) 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.

### 4. WHAT ARE THE DEADLINES FOR REPORTING AND COMPLIANCE?

|                                       |   |
|---------------------------------------|---|
| ENTITIES EXISTING ON 30 APRIL 2019    | Must comply with the Regulations from 30 April 2019, with the first return due in 2020                          |
| ENTITIES EXISTING SINCE 30 APRIL 2019 | Must comply with the Regulations upon receiving its trade licence, with the first return due in 2020 (or later) |

### 5. NON-COMPLIANCE RISKS AND PENALTIES?

Non-compliance with the Regulations may lead to fines and sanctions which include:

- an administrative fine of up to AED 50,000 for failing to meet an economic substance test;
- an administrative 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.

## 5. IS YOUR COMPANY COMPLIANT?

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.

### The Outcome

These regulations place UAE in line with other jurisdictions that have recently issued economic substance legislation (e.g. Mauritius, BVI, Cayman Islands, Bermuda,) - to address the risk of shifting profits derived from certain easily movable activities to “no or nominal tax jurisdictions” without respective local economic activities- in order to meet the EU’s requirements and be removed from the EU list of non-cooperative jurisdictions for tax purposes (the EU blacklist).

The Regulations should have only an additional disclosure requirement impact on UAE headquartered activities and foreign multinationals undertaking genuine operations with a management in the UAE.

For the others that are remotely managed and are not fulfilling the economic substance requirements, the governance structure and operating model must be reassessed and made compliant.

#### 4. HOW CAN WE ASSIST YOU?

While awaiting final legislation in the UAE and guidance on key terms, international groups having presence in the UAE or other 0%/low tax jurisdiction (such as BVI, Cayman Island, Mauritius, Seychelles, etc) should review their group structure to determine the actions to be taken in light of these new substance requirements.

Our experienced tax team can help you to understand the impact (if any) of the new economic substance requirements and the measures that your businesses will need to take to ensure compliance in the UAE but also abroad.

In the near future, we will be issuing additional updates on the status of the implementation of new substance requirements in the UAE. In the meantime, Get in touch with us – for any questions about these developments and their implications for your business.



Mohammed Rahali  
Wincore Advisory Group  
Tax Services Partner  
T: +971 (0) 55 138 95 91  
T: +971 (0) 42 212 6 02  
[m.rahali@wincoreadvisory.com](mailto:m.rahali@wincoreadvisory.com)

Maricar Caluracan  
Wincore Advisory Group  
Tax Services Officer  
T : +971 (0) 58 105 15 53  
T: +971 (0) 42 212 6 02  
[m.caluracan@wincoreadvisory.com](mailto:m.caluracan@wincoreadvisory.com)

---

#### ABOUT WINCORE ADVISORY GROUP

Wincore Advisory Group is a multi-disciplinary aggregate of tax planning, corporate services, corporate finance and wealth structuring advisory services provider. Our group was founded by prior executives and directors of major banks, trust, CSP and law firms to provide unmatched on-the-ground competences in the Middle East, Africa, US and Europe.

Under a private and independent ownership, our goal and commitment is to provide high quality pragmatic, confidential, flexible and efficient solutions to address our clientele's specific needs in the fast-moving international business and tax law environment.

Our corporate, finance and tax structuring team comprises multidisciplinary experts who have gained significant experience in the GCC, Africa and Europe in large and reputable international firms and financial institutions.

To keep pace with the changing international marketplace, we also continuously work to strengthen our international networks to deliver seamless and first-class services.