



UAE Economic Substance Regulation and its impact on foreign multinational companies' UAE presence

In response to being on the EU List of non-cooperative tax jurisdictions and the implementation of BEPS Action 5 which was one of the four minimum standards for signatory countries of the BEPS Inclusion Framework, the UAE has issued the Resolution of the Cabinet of Ministers No. (31) for 2019 concerning Economic Substance Regulations (the "Regulation") on 31 April 2019. This article is going to outline the potential impacts of the Regulation on foreign multinational companies ("MNC") having a presence in the UAE.

Scope of the Regulation

The Regulation is applicable to all UAE businesses ("Licensee") conducting relevant activities and these activities are banking, insurance, investment fund management, lease-finance, headquarters, shipping, holding company, intellectual property, distribution and service center businesses. As a global business hub, it is to be expected that MNCs have a presence in the UAE in the form of either subsidiary(ies) or branch office(s) acting as regional headquarter, holding vehicle(s) and/or distribution and service centers in order to deal with their affiliated entities outside the UAE ("Foreign Connected Person"). The Regulation further defines these three types of businesses as follows:

<p>Headquarters Business</p>	<p>the business of providing any of the following services to one or more Foreign Connected Person by the Licensee.</p> <ul style="list-style-type: none"> • the provision of senior management. • the assumption or control of material risk for activities carried out by, or assets owned by, any Foreign Connected Person and the provision of substantive advice related thereof.
<p>Holding Company Business</p>	<p>a business that is:</p> <ul style="list-style-type: none"> • a Holding Company in accordance with the law applicable to the Licensee carrying out such activity in the UAE. • has as its primary function the acquisition and holding of shares or equitable interests in other companies. • does not carry on any other commercial activity.
<p>Distribution and Service Centre Business</p>	<p>any of the following businesses:</p> <ul style="list-style-type: none"> • purchasing from a Foreign Connected Person and importing and storing in the State: component parts or materials for goods; or goods ready for sale, and reselling such component parts, materials or goods outside the State. • providing services to Foreign Connected Persons in connection with a business outside the State.

In relation to the above stated types of businesses, the Regulation further defines the activities carried out in the UAE by the Licensee (“Core Income Generating Activity”, i.e. CIGA). Where a CIGA is conducted, this will be one of the tests to determine whether the business has sufficient economic substance in the UAE. The following table illustrates these CIGA:

Headquarters Business	<ul style="list-style-type: none"> • taking relevant management decisions. • incurring operating expenditures on behalf of group entities. • coordinating group activities.
Holding Company Business	all activities related to that business; and in respect of Holding Company Business that derives income from other sources other than dividends and capital gains from its equity interest, the CIGA shall be those activities associated with the income generated.
Distribution and Service Centre Business	<ul style="list-style-type: none"> • transporting and storing component parts, materials or goods ready for sale. • managing inventories. • taking orders. • providing consulting or other administrative services.

MNCs and their economic substance requirements

While establishing their presence to conduct a CIGA in the UAE, MNCs need to consider other aspects so that their UAE entity can also take advantage of the available tax benefits. These factors are, among others, the management of the UAE entity, including how strategic decisions are made, the qualification of the management team, adequate qualified full-time employees, physical assets and operational expenditure. Although there are possibilities to outsource the latter requirements, MNCs must ensure that the outsourced activities are controlled and take place in the UAE. Apart from tax benefits, the ability to meet the UAE economic substance requirements may minimize the risk of dispute with and/or penalties from the tax authority in the home country of the MNC.

Non-compliance with the economic substance requirements

From the UAE perspective, the following penalties are applicable for businesses which are subject to the Regulation but fail the economic substance test or do not provide correct information to the authority:

Failure to meet the Economic Substance Test	First time: AED 10,000 – AED 50,000 Subsequent Financial Year: AED 50,000 – AED 300,000, possibility of the company license non-renewal
Failure to provide information or inaccurate information	AED 10,000 – AED 50,000

How can Crowe support MNCs?

Whilst awaiting further clarification from the UAE government, MNCs need to start analyzing the economic substance of their UAE presence. Crowe Tax team can support further in:

- Gap analysis of the MNC’s existing presence in the UAE and assessment of the impact on the overall international tax structure, in cooperation with Crowe Global Tax team
- Implementation of economic substance requirements for the MNC’s existing or future presence in the UAE
- Notification and reporting obligations of the MNC’s UAE presence which is subject to the Regulation

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