



Client Alert

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UAE issues Guidance on Economic Substance and drops off EU blacklist

The removal from the EU blacklist should give multinationals more comfort that their UAE establishments (including companies, branches and representative offices) can take advantage of the relevant double tax treaty in place, and further increase trust in the market and growth in investments in the UAE. Furthermore, other jurisdictions may follow suit and remove the UAE from their domestic list of tax havens or list of non-cooperative tax jurisdictions which should make it easier and more efficient for companies established in those countries to do business in the UAE.

On 10 October 2019, the European Union (**EU**) agreed to remove the United Arab Emirates (**UAE**) from their list of non-cooperative tax jurisdictions (the **EU blacklist**).

This followed from the introduction of the Economic Substance Regulations (Cabinet Resolution No. 31 of 2019 or **ESR**) in the UAE in March 2019, and more recently, the specific Guidance on the ESR (Ministerial Decision No. 215 of 2019 or the **Guidance**) published by the UAE Ministry of Finance in September 2019.

As reported in our [previous alert](#), companies carrying out relevant activities in the UAE are required to meet the minimal substance requirements and to conduct annual compliance reporting. Set out





below are some of the specific guidelines under the newly issued Guidance on the interpretation of and compliance with the ESR.

Relevant Activities

Under the ESR, the relevant activities carried out by companies to generate income in the UAE, whether onshore or in the free zones including financial free zones, include:

- Banking;
- Insurance;
- Investment fund management;
- Leasing and finance;
- Headquarters;
- Shipping;
- Intellectual property;
- Holding company business; and
- Distribution and service centers.

Guidance: If a company carries out a relevant activity, it should review the requirements applicable to such activity under the ESR. If it carries out more than one relevant activity, it should satisfy the Economic Substance Test for each activity.

Economic Substance Test

Companies in the UAE that carry out any of the above relevant activities must meet the substance and reporting requirements for each activity, in particular:

- Carry out the Core Income-Generating Activity (**CIGA**) in the UAE;
- Be directed and managed in the UAE;
- Have an adequate level of qualified full-time employees, operational expenditure and physical assets present in the UAE to conduct the CIGA; and



- Prepare and submit a compliance report to the regulatory authority which should include specific information¹ in relation to compliance with the Economic Substance Test.

Guidance: The meaning of "adequate" may vary from business to business. The ESR is not intended to impose requirements on companies to engage more employees or incur more expenses than are actually required to carry out a relevant activity. What is "adequate" depends on the nature and level of the relevant activity carried out by a company in the UAE.

This requirement may also be met if there is an adequate level of expenditure incurred on outsourcing employees and physical assets to third party service providers in the UAE. A third party service provider to whom part of a relevant activity is outsourced must have at all times adequate levels of i) activities, ii) employees, iii) expenditures and iv) premises in the UAE.

With regard to reporting, although the ESR does not prescribe a set period for the retention of records, it is advisable that a company keeps records and any relevant information evidencing compliance with the ESR for a period of six years after the end of each financial year. In assessing whether a company has met the Economic Substance Test, the regulatory authority can make its determination within that six-year period.

Sector-Specific Guidance

Holding companies: The ESR sets out reduced substance requirements for holding companies that do not carry out any other relevant activity and solely hold equity participation in other entities.

Intellectual property: A company that generates income from intellectual property assets that are considered "high risk" have additional reporting requirements.

¹ Specific information for compliance reporting include: type of CIGA conducted; amount and type of income arising from the CIGA; amount and type of operating expenses and assets to conduct the CIGA; location of place of business and, if applicable, plant, property or equipment; number of full-time employees with qualifications and staff responsible for carrying out the CIGA; and a declaration of compliance with the Economic Substance test.



Headquarter business: Determining whether a company carries out such activity depends on the services provided to other companies in the group and not on its position in the group.

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