

Client Alert: Landmark Reforms for UAE Business – Relaxation of Foreign Ownership Restrictions; Introduction of Economic Substance Regulations and Tax Reporting Requirements

By Jochen Murach and Stephen Hodgson

The UAE Government has recently passed two new pieces of legislation which will mark a watershed for businesses operating in the UAE and which will significantly change the UAE's business environment over the coming years.

Firstly, on 2 July 2019, the UAE Cabinet announced that onshore companies licensed in 122 specific activities in 13 distinct business sectors will be eligible for up to 100% foreign ownership.

Secondly, in a move to promote the global framework for tax compliance, the UAE Cabinet published two Resolutions dealing with economic substance requirements and annual compliance and tax reporting for multinational groups of companies. The Resolutions apply to both onshore UAE entities and free zone incorporated companies, including entities in the Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM) financial free zones.

Foreign Ownership

Prior to these ground-breaking changes, any company established in the UAE (other than those in the UAE's numerous free zones) was required to have at least 51% of its share capital held by a UAE national shareholder.

In September 2017, the UAE Cabinet promulgated the Foreign Direct Investment Law (Federal Decree Law No. 18) which provided a framework for the relaxation of the majority shareholder requirement in specific licensed activities and business sectors to be detailed in supplementary legislation setting out a "positive list" of such activities and sectors.

On 2 July 2019, the UAE Cabinet announced in an official press release that a Resolution had been passed approving the "positive list" of 13 business sectors in the UAE now eligible for up to 100% foreign ownership.

The Business Sectors

Publication of the Cabinet Resolution is still awaited but the business sectors referred to in the official press release include the following:

- Renewable energy
- Space
- Agriculture
- Manufacturing
- Transport and Storage
- Hospitality and Food Services
- Information and Communications
- Professional, Scientific and Technical Services
- Administrative and Support Services
- Healthcare
- Arts and Entertainment
- Construction
- Education

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Some Activities but Not All

When published, the Resolution will detail which activities within the above sectors will qualify for the new regime of up to 100% foreign ownership.

It is already clear, however, that not all activities will be subject to the foreign ownership relaxation. Those mentioned in the official press release appear to be restricted to activities focused on research, e-commerce, biotech and renewables.

In addition, individual UAE Emirates will retain the ultimate authority to determine which activities are subject to liberalised foreign ownership. Whilst it is not anticipated that individual Emirates will take widely divergent positions from the “positive list,” certain Emirates could reduce the maximum foreign ownership requirements to meet specific economic development prerogatives.

Implications for Business

The changes will be particularly relevant for new businesses establishing in the UAE but there are also likely to be wide ranging implications for existing businesses established under the previous framework.

Many foreign investors with minority shareholdings will have negotiated provisions enabling them to require a transfer of the UAE national majority shareholding on a change in legislation. The new legislation is likely to see these arrangements tested in practice. Contentious issues concerning the robustness of such provisions are likely to arise, as well as questions of valuation.

Where current arrangements do not provide for the kind of protective provisions outlined above, foreign investors are likely to be very much at the mercy of the local majority shareholder in any commercial negotiations on buy-out terms.

Foreign companies which have established branches in the UAE rather than minority owned LLCs may wish to replace the branch with an LLC structure in which they hold a majority, if not the entirety, of the LLC’s shares.

Decisions on these and other related matters will only be possible once the details of the Cabinet Resolution and the “positive list” become known.

Economic Substance Requirements and Tax Reporting

On 30 April 2019, the UAE Cabinet issued two Resolutions introducing legislation on economic substance requirements and tax reporting. These Resolutions have only recently been published and are as follows:

- Federal Cabinet Resolution No.31 of 2019 regarding the requirements of actual economic activities, and
- Federal Cabinet Resolution No.32 of 2019 regarding the organization of reports submitted by multinational companies.

Resolution No. 31 requires that UAE entities carrying on specific categories of licensed activities in the UAE satisfy prescribed economic substance criteria and report annually on compliance. The Resolution applies to onshore UAE entities and free zone incorporated companies, including those incorporated in the financial free zones of the DIFC and ADGM and is of immediate effect.

Resolution No. 32 is focused on multinational groups of companies and requires an entity established in the UAE which is a member of such a group to issue a detailed report of financial and other information if certain criteria are met. In practice, this will not require reporting by any UAE entity which is subject to Resolution No. 32 until 2020 at the earliest.

Economic Substance-Federal Cabinet Resolution No.31

UAE companies carrying on specific categories of licensed activities must demonstrate the existence of substantive economic activity by meeting specific criteria.

All UAE companies (onshore and free zone companies) will be required to file an annual notice stating whether they undertake relevant activities. If so, the entity must submit an annual report within 12 months of the end of its financial year. In practice, reporting will not be required until 2020 at the earliest.

Non-compliance will result in fines ranging from AED 10,000 to AED 50,000 for a first-time breach and between AED 50,000 to AED 300,000 thereafter.

Licensed Activities Subject to Cabinet Resolution No. 31

Any UAE company carrying on any of the following activities will be subject to Resolution No. 31:

- Banking
- Insurance
- Investment fund management
- Finance leasing
- Headquarters
- Shipping
- Holding company
- Intellectual property
- Distribution and service centres

Substantive Economic Activity Criteria

In order to meet the economic substance test, a company must demonstrate:

- *Core Income*- it generates core income from its activities in the UAE; these “core income generating activities” (CIGA) are specific to each licence category and non-exhaustive lists are included in the Resolution.
- *Direction and Management*- is undertaken from within the UAE; board meetings are held within the UAE; meetings are UAE member quorate; and minutes of the meetings are maintained within the UAE.
- *Adequate Employees*- the business has an appropriate number of full-time employees in the UAE.
- *Adequate Operating Expenditure*- the business incurs adequate operational expenditure in the UAE.
- *Adequate Assets*- the business has adequate tangible assets in the UAE.

Entities which conduct “high risk intellectual property” activities will be subject to higher standards and more detailed reporting requirements.

Entities which undertake “equity holding company business” are subject to less stringent economic substance requirements.

Entities which outsource administrative activities may still meet the economic substance test if their service providers are within the UAE.

Tax Reporting-Federal Cabinet Resolution No. 32

Resolution No. 32 requires an entity established in the UAE to issue a detailed tax report of financial and other information if:

- *Multinational group parent*-it is a parent of a multinational group; or
- *Multinational group affiliate*- it is an affiliate of a multinational group and the parent of the group is not required to file a tax report in its jurisdiction of tax residency *or* such jurisdiction does not share or repeatedly fails to share tax information with the UAE authorities.

Multinational Group

The concept of a “multinational group” is central to the ambit of Resolution No. 32. A multinational group is one:

- in which:
 - at least two of the companies are tax resident in different jurisdictions, *or*
 - one entity has permanent establishments in at least one other jurisdiction, and
- which generates consolidated revenues of at least AED 3.15 billion per annum.

The AED 3.15 billion revenue threshold is determined by reference to the group’s consolidated accounts and, by definition therefore, the requirements of Resolution No.32 will apply in practice only to large international businesses.

The Tax Report

Tax reports must be submitted within 12 months after the end of a multinational group’s financial year beginning on 1 January 2019. In practice, reporting will not be required until 2020 at the earliest.

The contents of any tax report will need to include the following for each country in which the multinational group operates:

- Revenue
- Profit and loss before tax
- Income tax paid
- Declared capital
- Accrued profits
- Number of employees
- Non-cash or cash equivalent assets.

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