Bloomberg Tax

International Tax News®

NUMBER 0 FEBRUARY 26, 2018

INSIGHT: Foreign Direct Investment Opportunities for Multinational Enterprises in the UAE

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The commitment of the United Arab Emirates (UAE) to adopting the BEPS minimum standards in 2019 has solidified its position as a major regional hub for investment. The Organization for Economic Co-operation and Development (OECD) released a preferential regimes report on July 23, 2019 confirming that the UAE is in line with international tax standards (with one technical point being addressed at present).

This article details the Action 5 and Action 13 regulations introduced in the UAE in June/July 2019 as part of the BEPS Inclusive Framework commitment and considers how the regulations can be applied in designing an efficient international structure for investment into and out of the region.

The UAE and BEPS The UAE joined the OECD BEPS Inclusive Framework in May 2018 and signed the multilateral instrument (MLI) in June 2018 through which Actions 6 and 14 will be implemented.

As mentioned above, Action 5 and Action 13 regulations have now been introduced in the UAE (Action 13 in the UAE has taken the form of Country-by-Country Reporting without documentation requirements unless/until a corporate income tax is implemented alongside the regulations at some point).

Note that the UAE has 75 double tax agreements (DTAs) despite there being no corporate income tax at present; it is interesting to see how many DTAs the UAE has in place to facilitate international trade.

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Despite the plethora of new regulations, multinational enterprises (MNEs) could view this as an opportunity to continue to invest in and centralize substance in the UAE and other attractive locations in the Middle East whilst ensuring they are compliant with international standards.

Core Income Generating Activities (the Bare Minimum) The Action 5 regulations in the UAE have adopted the OECD recommendations and approach taken by other locations (for instance Jersey).

These regulations will require MNEs operating in the UAE to demonstrate that certain core income generating activities (CIGA) are performed in the UAE (certain level of knowledge and expertise, meetings and minutes, employees, expenditure and assets). The regulations bring legitimacy to the UAE as a regional hub in which MNEs can build significant substance to support the level of profitability.

Economic Substance and Transfer Pricing Design As a general transfer pricing rule, the level of economic substance in a jurisdiction will determine the level of taxable profits in that jurisdiction. Therefore, the UAE's new regulations will facilitate the use of the UAE as a regional and/or global hub for investment into other jurisdictions. The OECD terms this ‘‘Business Restructurings’’ and there are a number of MNEs that have already implemented or are looking at the UAE as a center for investment (see international rankings below).

The OECD Transfer Pricing Guidelines define Business Restructurings for the purposes of transfer pricing as ‘‘cross-border reorganization of the commercial or financial relations between associated enterprises. . .Relationships with third parties (e.g. suppliers, subcontractors, customers) may be a reason for the restructuring or be affected by it.''

Chapter IX of the OECD Transfer Pricing Guidelines confirms that there must be:

- valid business reasons in place for any restructuring that will result in an allocation of profits to a lower tax jurisdiction; and

- the arrangement must be arm's length at the level of each individual taxpayer (i.e. not just the MNE as a whole that may have obtained a cash tax advantage from a restructuring).

Chapter IX also confirms that ''MNEs are free to organize their business operations as they see fit. Tax administrations do not have the right to dictate to an MNE how to design its structure or where to locate its business operations.''

Recent Rankings for the UAE Against Other Investment Hubs At the heart of Action 5 is the concept of economic and commercial substance. Despite the blacklisting of the UAE by the EU in March 2019, this investment center continues to outperform Switzerland, Luxembourg and Singapore in independent research studies that look at foreign direct investment:

- The United Nations Conference on Trade and Development (UNCTAD) report on World Investment for 2017–18 confirmed that more than 25% of the world's 500 largest companies have the UAE as the regional base of their operations in MENA. The UAE is ranked 30th (globally) in terms of the quantum of foreign direct investment (FDI) inflows (rising five positions from 2016–17 and continuing to move up this prestigious list). The UAE has also moved above Luxembourg and is closing in on the U.K. when the comparison is honed down to global financial centers attracting FDI.

- The World Bank 2018–19 ''Ease of Doing Business'' study witnessed the UAE climb 10 places from the previous year to rank 11th out of 190 business hubs (ahead of Switzerland). The World Bank study confirmed that ''The UAE has become a global hub for innovation, entrepreneurship and investment.''

- The UAE was also ranked number five in the recent IMD World Competitiveness Ranking (Singapore, Switzerland and Hong Kong were also in the top five alongside the U.S.).

Planning Points The positive economic environment for business in the UAE and the implementation of the BEPS minimum standards this year (with discussions around a 5% corporation tax rate being introduced at some point) has helped to put some daylight between the UAE and other no or only nominal (''Noon'') tax jurisdictions.

Despite a favorable rating in the OECD preferential regimes report, many Noons (e.g. BVI, Jersey, Cayman, Barbados) will struggle to support a high level of profits due to a lack of economic substance and the Country-by-Country Reporting tables under Action 13 will make this apparent to all stakeholders.

As set out above, the UAE is a major investment hub and businesses operating in the UAE will only face the challenge of having to demonstrate substance if challenged and this can be managed as part of Action 13 global transfer pricing documentation and Action 5 local substance reviews.

MNEs with operations in the Middle East (or looking to expand in the Middle East) should consider the UAE as a regional hub alongside commercial strategies for growth. The potential benefits are likely to be significant.

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