



UAE Economic Substance

A complete guide to compliance

October 2021

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Introduction

Introduction

The United Arab Emirates (UAE) Economic Substance (ES) Regulations (ESR), which took effect from 1 January 2019, have been implemented in response to the Organization for Economic Co-operation and Development's global initiative of curbing harmful tax practices.

The purpose of the ESR is to prevent businesses (typically multinational corporations) from artificially shifting profits to jurisdictions that impose little or no income tax (such as the UAE) without having substantial activities in that jurisdiction in order to take advantage of their tax laws.

Accordingly, the ESR impose an obligation on all entities that carry on geographically mobile business activities to annually submit a comprehensive report to the authorities demonstrating that they have substance and legitimate operations in the UAE.

Failing to report or not being able to demonstrate that an in-scope entity has substance in the UAE would result in sanctions, such as financial penalties and license revocation. It is therefore important that entities operating in the UAE are aware of the impact the ESR has on them in order to avoid any unnecessary burdens and to ensure business as usual is maintained.

Given the importance of the ESR, we are delighted to present to you the first of its kind ES guide with a view to support you in complying with the ESR.

In particular, this guide includes:

- a compilation of all the relevant laws, regulations, and Frequently Asked Questions (FAQs) in one document;
- detailed instructions / a step-by-step manual as to how to perform a Relevant Activity (RA) assessment and complete the notification and report;
- guiding questions in order to determine whether the ES tests are met; and
- additional practical commentary from Deloitte practitioners dealing with the ESR on a day-to-day basis.

In preparing our manual, we have addressed those areas which we understand are important to the ESR and necessary for completing filings accurately. We believe that our manual will serve you as an informative and practical guide to effectively navigating the ESR requirements in a way that would align with the needs of your organization.

We are confident that this manual will provide you with comprehensive and valuable guidance to comply with the ESR, making an impact that matters to your business.

In case you have any questions or suggestions as to how to improve the manual in an updated version, please feel free to reach out to the contacts below.

Yours faithfully,

Alex Law
Partner
alexlaw@deloitte.com

Jan Roderick van Abbe
Director
jvanabbe@deloitte.com

Editors

Alex Law
Jan Roderick van Abbe
Tanisha Rayan
Noor Atef

Contributors

Maria Cristina Hernandez
Max Brummans
Tim Donkin
Karim Ousta
Chiara Furfari

Legislation

Legislation

This section details the ESR in accordance with the Cabinet of Ministers Resolution No. 57 of 2020 and Ministerial Decision No. 100 of 2020, our comments on the practical application of the ESR, as well as comparative inputs based on the ES legislation in other jurisdictions.

1. Licensee

1.1 Definition of a Licensee

The ESR applies to all UAE entities that meet the definition of a Licensee. This includes entities registered onshore, in free zones, financial free zones, and offshore free zones. Entities that are not classified as Licensees are out of scope for ESR purposes and are not subject to the compliance requirements.

Article 1 of the ESR defines a Licensee as:

“an entity that is:

- i. a juridical person (incorporated inside or outside the State); or*
- ii. an unincorporated Partnership;*

registered in the UAE, including a Free Zone and a Financial Free Zone and carries on a Relevant Activity.”

The ESR further defines a juridical person to be a corporate legal entity that has a separate legal personality from its owners, and an unincorporated partnership to mean a:

- i. limited partnership (which is not a juridical person); or
- ii. general partnership, that is registered in the UAE, including in a free zone or a financial free zone.

The FAQs released by the Ministry of Finance (MoF) provide helpful guidance on the application of the ESR.



MoF FAQ: What is a Licensee?

A Licensee is a juridical person or an unincorporated partnership that is registered in the UAE and that undertakes a RA. By way of example, a Licensee can be:

- A limited liability company
- A private shareholding company
- A public shareholding company
- A joint venture company
- A partnership (e.g., a limited liability partnership, a limited partnership, a general partnership, etc.)



The following persons are not considered "Licensees" under the Regulations:

- A natural person
- A sole proprietorship
- A trust
- A foundation

MoF FAQ: What if a Licensee does not undertake a RA during a financial period?

If a Licensee does not undertake a RA during a financial period, it does not need to meet the ES test.

The Licensee would not be required to submit a notification or submit an ES report for the relevant financial period.



If an entity does not undertake any RA, it would not be considered as a Licensee for the purposes of the ESR and thereby not be required to comply with the ESR. These entities would not be required to submit any notification or report to the MoF. It is, however, worth noting that entities will need to evaluate their position on an annual basis.

1.2 Treatment of branches

There is also detailed guidance available with respect to the treatment of branches.

- **UAE branch of a UAE entity**

Branches registered in the UAE are considered to be an extension of their head office and therefore are not considered to have a separate legal personality.

There is no requirement to submit standalone filings for the head office and branches. Rather, a consolidated notification and report can be submitted by the head office disclosing the RA of itself and its branches.

- **UAE branch of a foreign entity**

A branch of a foreign entity registered in the UAE that carries out an RA would be required to comply with the ESR, unless the Relevant Income of the branch is subject to tax in a jurisdiction outside the UAE (refer to 1.3.1.4 below). Relevant Income, under the ESR, refers to income earned from the RA.

- **Foreign branch of a UAE entity**

Where a UAE entity carries out an RA through a branch registered outside the UAE, the UAE entity would not be required to consolidate the activities and income of the branch for purposes of the ESR, to the extent that the Relevant Income of the branch is subject to tax in the foreign jurisdiction where the branch is located. In this context, a branch can include a permanent establishment or any other form of taxable presence for corporate income tax purposes which is not a separate legal entity.



Unlike for UAE branches of foreign companies, Licensees that generate relevant income through foreign branches do not need to submit any notification or claim an exemption, to the extent that the Relevant Income is subject to tax outside the UAE.

It is recommended that supporting documentation is put in place and kept readily available if requested by the authorities.

Step 4: Determine satisfaction of the ES tests

If a Licensee has not earned income from an RA or has claimed exemption from the ESR in the reportable period, steps 4 and 5 would not apply.

However, where a Licensee has earned income from the RA and has not claimed exemption, it would need to satisfy the ES tests and submit a report.

4.1 ES tests

Set out below are guiding questions to help determine whether the Licensee has satisfied the three ES tests. Please see Section 4 – ‘ES tests’ of the ‘Legislation’ section in this manual for detailed guidance.

- CIGA test:** The below CIGA are indicative only and are not limited. As such, it is not mandatory for Licensees to satisfy only the CIGA listed below. Every business is different, and Licensees should consider those activities which are core to their business (whilst using the below CIGA as a base). Further, the ESR do not clarify the level of CIGA required to demonstrate substance. Therefore, Licensees would have to assess internally what are the key activities driving the specific CIGA and carefully document this position.

Licensees need only consider the CIGA relevant to the RA(s) they have carried out and not all RAs.

- Directed and Managed test:** Licensees should satisfy the Directed and Managed test for any RAs, with the exception of Holding Company Business (see Section 4.2 of the ‘Legislation’ section).
- Adequate test:** Licensees should satisfy the Adequate test for any RAs with the exception of Holding Company Business (see Section 4.2 of the ‘Legislation’ section of the manual).

No.	Questions	Deloitte Comments
1.	CIGA test (<i>lists provided below are for general guidance and are not exhaustive</i>)	
A. Banking Business		
A.1	Is the entity raising funds, managing risk including credit, currency, and interest risk?	The CIGA noted are indicative / examples only. Please consider any further specific CIGA which are relevant to the RA and the Licensee.
A.2	Is the entity taking hedging positions?	To the extent that a Licensee carried out a Banking Business in the reportable period and satisfied any of these CIGA in the UAE, it would be considered to have met the CIGA test with respect to the Banking Business RA.
A.3	Is the entity providing loans, credit, or other financial services to customers?	
A.4	Is the entity managing capital and preparing reports to investors or any government authority with functions relating to the supervision or regulation of such business?	
B. Insurance Business		
B.1	Is the entity predicting and calculating risk?	The CIGA noted are indicative / examples only. Please consider any further specific CIGA which are relevant to the RA and the Licensee.
B.2	Is the entity insuring or reinsuring against risk and providing Insurance Business services to clients?	To the extent that a Licensee carried out an Insurance Business in the reportable period and satisfied any of these CIGA in the UAE, it would be considered to have met the CIGA test with respect to the Insurance Business RA.
B.3	Is the entity underwriting insurance and reinsurance?	

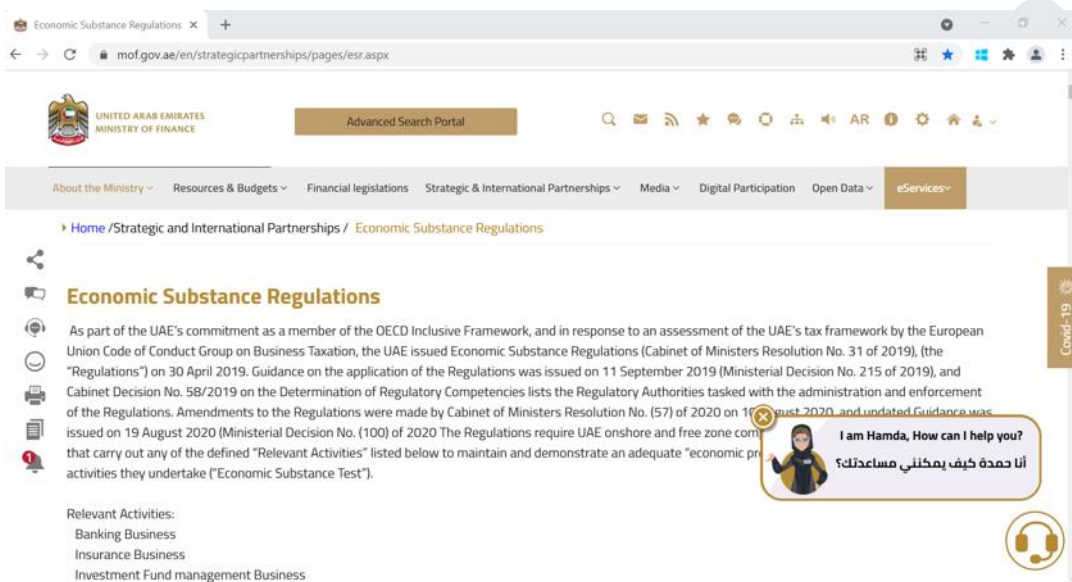
Guide to filing

Guide to filing

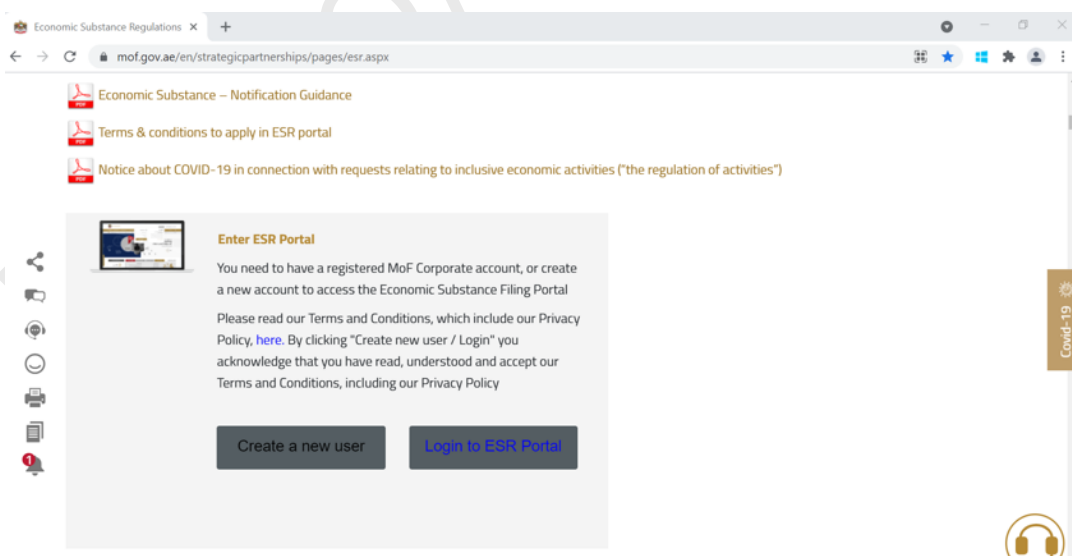
This section will support you in understanding the MoF portal and submitting the ES notification and report as accurately as possible and in accordance with the provisions of the ESR.

1. Logging onto the portal

1. Access the MoF's ESR page at <https://www.mof.gov.ae/en/strategicpartnerships/pages/esr.aspx>



2. Scroll down past the attachments to the 'Enter ESR portal' section and click on either 'Create a new user' or 'Login to ESR portal', depending on whether you are a first-time or existing user.





We are aware that the UAE authorities are reviewing and checking if the financial data that Licensees are filing within the ES report is consistent with the information provided in the financial statements. We have seen instances in which the authorities have requested Licensees to confirm where there has been a mismatch of information.

Accordingly, it is expected that most of the financial information should remain consistent between both. However, in cases where this is not possible, it is recommended that Licensees keep supporting documentation outlining the reasoning behind any discrepancies, for a period of up to six years, in case requested by the authorities.

5. Additional documentation (optional field)

You can select 10 files.



It is not mandatory to attach any additional documents when submitting the report, and this is at the Licensee's discretion.

Whilst it is recommended that supporting documentation and calculations for the disclosures made in the report are maintained, Licensees may consider not submitting these upfront unless requested by the authorities.

6. Additional information (optional field)

⁶ Any additional information to support a Licensee's declaration that they have met the ES test for the Relevant Period.



It is not mandatory to complete this field when submitting the report, and this is at the Licensee's discretion.

Licensees can make use of this field to provide clarity on any disclosures in the report which are unclear for the purposes of the regulatory authority's consideration. Comments regarding the Directed and Managed test can be included in this field. Please refer to our comments under section 4.1.2 in the 'Legislation' section of the manual.

When completing this field, we suggest that the wording is kept brief, concise and with the acknowledgement that further details can be provided upon request.

7. I confirm that the information provided in the Economic Substance Report is complete and accurate, and acknowledge that there are sanctions for providing inaccurate information as per Article 15 of the Economic Substance Regulations

⁷ Providing incorrect or false information in the ES report is subject to a penalty of AED 50,000. Knowingly providing incorrect or false information can result in the Licensee being deemed to have failed the ES test for the relevant Financial Year.



The portal allows Licensees to select any of the following options:

- Yes
- No

Appendix D: Relevant Activities summary table

Relevant Activity (pursuant to Article 3.1 of Cabinet Resolution No. 57 of 2020)	Core Income Generating Activities (non-exhaustive) (Article 3.2 of Cabinet Resolution No. 57 of 2020)	Regulatory Authority (pursuant to Article 4 of Cabinet Resolution No. 57 of 2020)
Banking Business	<ul style="list-style-type: none"> a. Raising funds, managing risk including credit, currency and interest risk. b. Taking hedging positions. c. Providing loans, credit or other financial services to customers. d. Managing capital and preparing reports to investors or any government authority with functions relating to the supervision or regulation of such business. 	<ul style="list-style-type: none"> 1. UAE Central Bank. 2. The competent authority in the Financial Free Zone for the Banking Businesses.
Insurance Business	<ul style="list-style-type: none"> a. Predicting and calculating risk. b. Insuring or re-insuring against risk and providing Insurance Business services to clients. c. Underwriting insurance and reinsurance. 	<ul style="list-style-type: none"> 1. Insurance Authority 2. The competent authority in the Free Zone and Financial Free Zone for the Insurance Business
Investment Fund Management Business	<ul style="list-style-type: none"> a. Taking decisions on the holding and selling of investments. b. Calculating risk and reserves. c. Taking decisions on currency or interest fluctuations and hedging positions. d. Preparing reports to investors or any government authority with functions relating to the supervision or regulation of such business. 	<ul style="list-style-type: none"> 1. Securities and Commodities Authority 2. The competent authority in the Free Zone and Financial Free Zone for the Investment Fund Management Business
Lease-Finance Business	<ul style="list-style-type: none"> a. Agreeing funding terms. b. Identifying and acquiring assets to be leased (in the case of leasing). c. Setting the terms and duration of any financing or leasing. d. Monitoring and revising any agreements. e. Managing any risks. 	<ul style="list-style-type: none"> 1. UAE Central Bank 2. The competent authority in the Free Zone and Financial Free Zone for the Lease-Finance Business
Headquarter Business	<ul style="list-style-type: none"> a. Taking relevant management decisions. b. Incurring operating expenditures on behalf of group entities. c. Coordinating group activities. 	<ul style="list-style-type: none"> 1. Ministry of Economy 2. The competent authority in the Free Zone and Financial Free Zone for the Headquarter Business



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