

# United Arab Emirates: UAE Federal Corporate Tax and UAE Economic Substance Regulations

June 2023



## In brief

According to the Cabinet Decision No. 55 of 2023 issued on 30 May 2023 (in effect on 1 June 2023), businesses registered and operating in one (or more) UAE free zones will be required to maintain adequate substance (amongst other conditions) to meet the “Qualifying Free Zone Person” definition.

## In detail

### UAE Economic Substance Regulations (ESR)

#### Background

The UAE issued economic substance regulations (Regulations) in April 2019, repealed by Cabinet Resolution No.57 of 2020 in August 2020, which introduced a requirement for UAE entities to maintain an adequate “economic presence” in the UAE relative to the activities they undertake.

#### Scope of application

The Regulations introduced a requirement for certain juridical persons (i.e. persons with separate legal personality, including branches) and unincorporated partnerships that carry on a 'Relevant Activity' (RA) in the UAE (UAE Licensees) to maintain adequate 'economic presence' in the UAE, relative to the activities they undertake.

The Regulations apply to financial periods commencing on, or after, 1 January 2019 and include all UAE jurisdictions, including UAE Free Zones.

#### Compliance and administrative requirements

UAE Licensees are subject to comply with two potential filing requirements, being:

- Economic Substance (**ES**) Notification.
- ES Annual report (applicable only to UAE Licensees that undertake RA(s), generate 'relevant income' from those 'relevant activities' and do not meet the exemption requirements provided by the Regulations).

The Notification and Substance Report should be submitted electronically via the Ministry of Finance (**MoF**) online portal within 6 and 12 months of the financial year end of the UAE Licensee, respectively. These filings must be made on an annual basis, if applicable.

Further, UAE Licensees that are subject to comply with the ES Annual report are also required to satisfy the applicable economic substance test (**ES Test**).



The introduction of the UAE Corporate Tax Law will require UAE businesses registered and operating in one (or more) UAE free zones to maintain adequate substance.





## Compliance and administrative requirements (cont'd)

An UAE Licensee that meet any of the following conditions can claim an exemption from demonstrating substance in the UAE:

1. An investment fund;
2. A branch of a foreign entity the relevant income of which is subject to tax in a jurisdiction other than the UAE;
3. An entity that is tax resident in a jurisdiction other than the UAE; and
4. An entity that is wholly owned by one or more residents in the UAE and meets the following two conditions:
  - a. It is not part of an MNE Group, and
  - b. It only carries out business in the UAE.

Acceptance of an exemption claim is at the discretion of the authorities, furthermore, an exemption claim must be claimed for in each financial period, if applicable.

## UAE Corporate Tax and ESR interaction with respect to UAE free zones

In general, Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses (**UAE Corporate Tax Law**) outlines the application of a 0% (zero percent) rate on “Qualifying Free Zone Persons” income according to the following conditions:

- a) 0% (zero percent) on “*Qualifying Income*”, and
- b) 9% (nine percent) on income subject to the UAE Corporate Tax Law that, in turn, is not deemed as “*Qualifying Income*”.

“*Qualifying Free Zone Person*”, according to the UAE Corporate Tax Law, is defined as a Free Zone juridical person that meets all of the following requirements:

1. Maintains adequate substance,
2. Derives “*Qualifying Income*”,
3. Has not elected to be subject to Corporate Tax,
4. Complies with transfer pricing requirements,
5. Non-qualifying Revenue does not exceed the “de-minimis requirements”
6. Prepares audited financial statements, **and**
7. Other conditions prescribed by the UAE Minister.

Among other requirements and exclusions, Cabinet Decision No. 55/2023 requires “*Qualifying Free Zone Persons*” to maintain adequate substance in a Free Zone according to the following conditions:

1. Core income-generating activities (**CIGAs**) shall be undertaken in a Free Zone,
2. Maintain adequate assets, adequate number of qualified employees, and incur an adequate amount of operating expenditures with respect to the level of the CIGAs undertaken in a Free Zone.





## UAE Corporate Tax and ESR interaction with respect to UAE free zones (cont'd)

“Qualifying Free Zone Persons” may opt to outsource their CIGAs to a Related or third party provided the following two requirements are met:

1. The related or third party is a Free Zone person, and
2. The Qualifying Free Zone Person has adequate supervision of the outsourced activity.

### *Consequences of non-compliance*

From an UAE Corporate Tax perspective, a “Qualifying Free Zone Person” shall cease to be considered as such (i.e. the 0% (zero percent) on “Qualifying Income” would no longer be applicable) from the beginning of that tax period and for the subsequent four Tax Periods if the “Qualifying Free Zone Person” fails to meet the ‘adequate substance’ condition and the other conditions discussed above.

### *Key considerations for UAE Licensees located in Free Zones*

Assessing adequate economic substance should adopt a ‘substance over form’ approach and consider the following elements per RA:

1. CIGAs should be carried out in the Free Zone - this implies, but is not limited to, an adequate mapping of the CIGAs and documentary evidence supporting the CIGAs carrying within the Free Zone;
2. The UAE Licensee should be directed and managed in the UAE - this represents, but not necessarily is limited to, the following aspects:
  - a. Directors should have the necessary knowledge and expertise to discharge their duties,
  - b. An adequate number of board meetings should be held and attended in the UAE,
  - c. A quorum of directors should physically attend board meetings in the UAE and Board meetings should be physically conducted in the UAE, and
  - d. Board meeting minutes should be recorded in writing, signed by the attending directors, and kept on file in the UAE; and
3. Adequate number of qualified employees, assets and operating expenditures in the UAE - The Regulations do not provide a “minimum” standard for what is considered “adequate” or “appropriate” as the businesses may vary in size and nature and, therefore, the UAE Licensee is encouraged to conduct an exhaustive operational/human capital/ financial review to determine the adequacy of these elements.

Related or third parties, acting as an outsourcing provider under the Regulations, should consider the above suggestions per RA and UAE Licensee it accepted to outsource the activities from. In addition, an outsourcing provider should ensure no double counting and a service level agreement with the UAE Licensee(s) it accepted to outsource the activities from, including, but not limited to, the responsibilities and activities of the parties; compensation; supervision; location of the outsourcing services; etc.






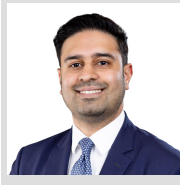

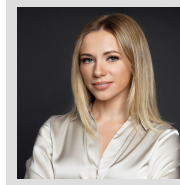
# The takeaway

Cabinet Decision No. 55 of 2023 issued on 30 May 2023 (in effect on 1 June 2023) outlines the requirements for Qualifying Free Zone Persons (as defined by the UAE Corporate Tax Law) and the economic substance requirements for businesses registered and operating in one (or more) UAE free zones. UAE businesses should assess the impact of Cabinet Decision No. 55 of 2023 (including the Ministerial Decision No. 139 of 2023) and take note of the economic substance requirements that need to be met.

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## Let's talk

If you have not yet considered the impact of the UAE CT and ESR on your business, we would be happy to assist you with these matters:

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