



Economic substance regulations in the UAE

**Overview and actions for
UAE businesses**

—
May 2020

Recap on ESR

The UAE Government introduced Economic Substance Regulations (“ESR”), effective from 1 January 2019, in response to European Commission concerns which resulted in the UAE being added to the European Union list of non-cooperative tax jurisdictions (the so called “black list”).

The ESR effectively impose a legal requirement for UAE entities (including branches of local and foreign companies) that carry out any of nine relevant activities to maintain economic substance in the UAE specific to each relevant activity. There are also annual regulatory filing requirements (that include Notification and reporting) that need to be met in order to comply with the regulations, as well as penalties for non-compliance.

The first requirement is to submit a notification to the Regulatory Authority (*most due dates are in May and June 2020*) on whether the company is engaged in any relevant activity as stipulated by the ESR. This may, depending on the outcome, entail further requirements:



to meet the economic substance (ES) tests and



to file an ES Return (*by 31 December 2020 for FY 19*). For an overview of the ESR process in a nutshell, kindly refer to the next page

The function of monitoring and regulating ESR compliance has been delegated to free zone authorities and various mainland licensing authorities.

Notification requirement

Some free zones have already announced the deadline for the first ES Notification (e.g. DAFZA - 31 May 2020; DIFC – 12 June 2020, ADGM – 30 June 2020, DMCC – 30 June 2020). It is expected that ES Notification across the UAE would need to be filed **not later than 30 June 2020**.

Non-compliance with the obligation to file an ES Notification by the stipulated deadlines, or providing incorrect or false information in the ES Notification, is subject to **penalties ranging from AED 10,000 to AED 50,000**.

Further, providing incorrect or false information or incorrectly claiming an exemption from the Economic Substance Regulations may result in the licensee being deemed to have **failed the Economic Substance Tests for the relevant financial period, which will be reported to the Ministry of Finance and shared with foreign tax authorities**.

What action should be taken?

As the deadline is rapidly approaching, we recommend completing an ESR assessment as soon as practicable in order to be ready to have **an accurate position for filing ES Notification**.

As a starting point, it will be critical to undertake the assessment of actual business activities before the notification deadline to determine:

- If UAE entities are engaged in any Relevant Activity, and if so, which entities are in or out of scope of ESR and which activities should be reported in the ES Notification;
- For those entities which are engaged in a Relevant Activity – to conduct gap assessment to see if they complied with Economic Substance Tests. Depending upon the extent of gaps, consider remedial actions, as this will be reported in the Economic Substance Return, due by 31 December 2020 (for the year ended 31 December 2019).

The entity classification and gap assessment would need to be performed / validated on an annual basis.



How we can help:

We can support you in



1. performing an assessment of business activities and operations in the UAE to determine which entities will be within the scope of ESR, and to what extent;



2. completing and filing an accurate ES Notification with the regulatory authority;



3. undertaking a detailed assessment in relation to meeting applicable ES Tests based on our knowledge of available MOF guidance and similar regulations implemented in comparable international tax jurisdictions, as well as OECD guidance;

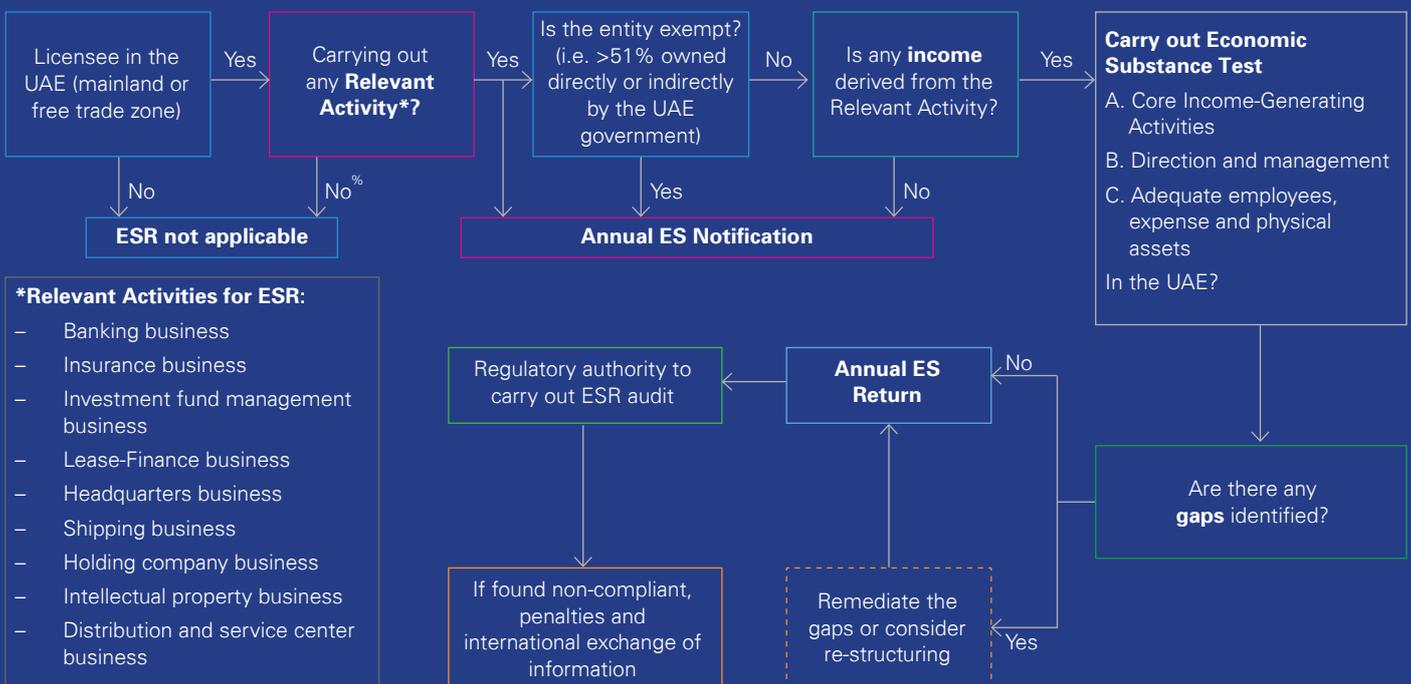


4. developing remediation action plan in case of any gaps identified;



5. preparing an accurate ES Return demonstrating how the entity met ES Tests for the relevant financial period.

UAE Economic Substance Regulations – in a nutshell



30 April 2019: ESR effective date (covers FYs from 1 January 2019)

1 May to 30 June 2020: Various deadlines for ES Notification to be filed for FY#2019

By December 2020: Submission of an ES Return for FY# 2019

By December 2025: Regulatory Authority has **6 years** for ESR audit for FY#2019

Failure to comply =
 \$ Financial penalties (AED 10,000 to AED 300,000)
 X Suspension, withdrawal, non-renewal of trade license
 > Exchange of information with foreign authorities

% Although the Regulations state that only a Licensee carrying out a Relevant Activity is required to file a notification, regulatory authorities have been empowered to mandate filing of notification by all licensees irrespective of whether they carry out a Relevant Activity or not.

FY here refers to the period January to December

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