

Economic Substance Regulations

Updated Guidance Note (October 2020)

Background

The Economic Substance Regulations (“ESR”) ([Cabinet Resolution No. 57 of 2020](#)) aim to ensure that businesses, which perform so-called geographically mobile activities have economic substance in the jurisdiction where its income is being reported. This means that businesses will need to demonstrate that the income generated (and profits reported) in the UAE adequately correspond with the economic activities actually undertaken in the UAE (“**Economic Substance**”).

The first year of reporting under the ESR is 2019 and all UAE based companies, branches and other commercial license holders (together referred to as “**Licensees**”), including those in the Media Zone, must report under these regulations.

Relevant Activities

Under the ESR, all Licensees are obliged to self-assess whether or not they performed any Relevant Activities in the previous financial year. The Relevant Activities under the ESR are:

- Banking Business
- Investment Fund Management Business
- Headquarters Business
- Holding Company Business
- Distribution and Service Centre Business
- Insurance Business
- Lease – Finance Business
- Shipping Business
- Intellectual Property Business

More detailed information on the types of Relevant Activities is provided in the Guidance to the ESR ([Ministerial Decision No.100 of 2020](#)) and the UAE Ministry of Finance’s Relevant Activities Guide, which may be found in Schedule 1 of the Guidance to the ESR.

Economic Substance Notification

The first step under the ESR is for all Licensees to self-assess and self-report whether or not Relevant Activities were performed during the financial year which precedes the Notification due date. As the appointed Regulatory Authority of Licensees established in the Media Zone under the ESR, **all Licensees that are carrying out a Relevant Activity under the ESR must submit an Economic Substance Notification in relation to the previous financial year on or before the applicable deadline (details to be provided by the UAE Ministry of Finance)** in relation to the preceding financial year, started on or after 1 January 2019. For example, for Licensees with their financial year starting 1 January 2019, the first reportable period under the ESR will be 1 January 2019 – 31 December 2019.

Licensees are expected to use a ‘substance over form’ approach in determining whether or not they undertake a Relevant Activity. This means Licensees should not limit themselves to the activities stated under their business license but all activities actually performed in the UAE should also be considered.

Economic Substance Report

The second step under the ESR for Licensees performing one or more Relevant Activities, is to file an Economic Substance Report (“**Report**”), as a means of demonstrating that the Licensee’s Core Income Generating Activities (“**CIGA’s**”) are conducted in the UAE. The CIGA’s are those activities that are of central importance to the Licensee for the generation of the gross income earned from its Relevant Activities, and these are further explained per Relevant Activity in the Relevant Activities Guide. In the Report, Licensees must provide information on the level of their Economic Substance in the UAE, considering items such as having adequate (i) number of employees, (ii) operational expenses, (iii) physical office space, and (iv) evidence that the Licensee is directed and managed in the UAE, among others. Please note that High Risk IP Businesses (as defined in the Relevant Activities Guide) must meet increased substance and reporting requirements. A Licensee must self-declare in the Report whether it satisfies these Economic Substance tests.

Exempted Licensees

Companies, which fall under one of the Exempted Licensee categories highlighted below will be exempt from submitting the Report, but must still file the Notification.

Under the ESR, the Exempted Licensee categories are as follows:

- a Licensee that is an Investment Fund (as defined under the ESR);
- a Licensee that is tax resident in a jurisdiction other than the UAE;
- a Licensee that is wholly owned by one or more residents in the UAE and meets the following two conditions:
 - it is not part of an MNE Group (as defined under the ESR); and
 - it only carries out business in the UAE.
- A Licensee that is a branch of a foreign entity the Relevant Income of which is subject to tax in a jurisdiction other than the UAE; and
- any other Licensee as determined pursuant to a decision of the UAE Ministry of Finance.

Sanctions for non-reporting, late reporting or inaccurate reporting

Both the Notification and subsequent Report must be filed accurately and within the applicable deadline, in order to avoid penalties. Licensees not meeting the Economic Substance tests may also see their information exchanged by the UAE Ministry of Finance with the tax authorities of jurisdictions of the Licensees' direct parent company, ultimate parent company and/or ultimate beneficial owner. Licensees qualifying as High Risk IP Businesses will have their information automatically exchanged with those tax authorities, regardless of whether the Economic Substance tests are met. More information on penalties can also be found under question 45 of the Ministry of Finance's [Frequently Asked Questions](#) on ESR.

Please note that MZA will not be able to assist Licensees with their self-assessment for the Economic Substance Notification or provide advice on the Relevant Activities. We recommend that Licensees obtain independent advice if they are unclear on any of the above requirements.