

Updates on Economic Substance Reporting in the UAE – Reporting Deadlines and MoF COVID-19 Clarification

Legal Briefing (31 May 2020)

In April 2019, the UAE published its first Economic Substance Regulations (ESR) with Cabinet Decision No. 31 of 2019. With the Introduction of ESR all companies incorporated in the UAE are required to assess their business models and operations against the ESR and (re)structure their organizational accordingly in order to achieve compliance. Depending on the governing authority (e.g. mainland or respective free zone authorities) various filing deadlines are fast approaching in May and June 2020. This legal briefing provides an overview of the ESR and updates on the current implementation of Economic Substance Reporting (Reporting) and applicable deadlines in the UAE and its free zones.

I. What is “Economic Substance”?

The economic substance doctrine means that a business has to prove that its transactions have a substantial purpose aside from reduction of tax liabilities and an economic effect aside from the tax effect in order to be considered valid.

Economic Substance Reporting requirements are one of the Base erosion and profit shifting (BEPS) measures propagated by the Organisation for Economic Co-operation and Development (OECD). BEPS Measures are aimed at preventing the use of shell companies in countries with low or non-existing corporate taxes in order for companies to shift their profits to such shell companies.

II. UAE’s Economic Substance Regulations

In April 2019, the UAE published its first ESR which have then been constantly updated by subsequent decisions and guidelines to form the following framework:

- Cabinet of **Ministers Resolution No. 31 of 2019** concerning Economic Substance Regulations (ESR);
- **Ministerial Decision No. 215 of 2019** on the Issuance of Directives for the Implementation of the Provisions of the Cabinet Decision No. 31 of 2019 concerning Economic Substance Requirements (IR);
- **Cabinet Resolution No. 58 of 2019** Determining the Regulatory Authorities Concerned with the Business mentioned in Cabinet Resolution No. 31 of 2019 Concerning Economic Substance Regulations; and
- The **UAE Economic Substance Regulations – Relevant Activities Guide (Guide)**¹.

1. Scope of Application

Pursuant to Art. 3 of the ESR, the ESR and its IR are applicable to any natural or legal person licensed by an authority in the UAE carrying out a so-called “**Relevant Activity**”. This means that any company licensed in the UAE, regardless of its legal form or place of incorporation, potentially falls under the scope of the ESR. It should be noted that Art. 3.1 of the ESR explicitly

¹ It should be noted that the Guide is technically not a legal document and only provides practical guidance and clarifications to the ESR and IR.

includes companies incorporated in free zones and financial free zones into the scope of the ESR.

In accordance with Article 4 of the ESR, the number of Relevant Activities is set at 9, and include **banking, insurance, investment fund management, headquarters, holding company, lease & finance, shipping, intellectual property and distribution & service centers**. These Relevant Activities are further defined by Art. 5 of the ESR by stating so called core income-generating activities (**CIGA**) for each of the Relevant Activities. As the list of CIGA for each Relevant Activity is quite short and general, the UAE Ministry of Finance issued the Guide which explain the CIGA with respective examples.

When assessing whether a company is carrying out a Relevant Activity, the UAE Ministry of Finance has advised to look beyond the license and its licensed activities and to use a “substance over form” approach. This means that activities mentioned on the license will be considered as a mere indication. The factually carried out activities by the respective company will be decisive when assessing whether or not a Relevant Activity is being carried out.

2. Economic Substance Test

If it has been established that a company is carrying out one or more Relevant Activities, a so-called “**Economic Substance Test**” itself must be carried out. It should be noted that the Economic Substance Test has to be carried out in relation to each determined Relevant Activity for each financial year, starting from the financial year 2019. The purpose of the Economic Substance Test is to establish that the company in question has sufficient *substance* in the UAE in order to actually carry out the respective Relevant Activities.

In accordance with Art. 6 para. 2 of the ESR the following criteria have to be satisfied in relation to the respective Relevant Activity:

- company carries out CIGA in the UAE;
- company is directed and managed in the UAE;
- company has an adequate number of qualified full-time employees who are physically present in the UAE;
- adequate operating expenditure incurred in the UAE;
- adequate physical assets in the UAE.

It is up to the concerned authority’s sole discretion to decide whether an Economic Substance Test has been passed by a company or not.

Due to COVID-19 and its impact on business life (i.e. travel restrictions, decreases in personnel, revenues and assets), the **Ministry of Finance recently issued a clarification** on this topic. The competent authorities shall take into considerations the **impact of COVID-19** when determining whether a company has been able to show economic substance in the UAE. This especially applies to the criteria “directed and managed in the UAE” as managers and directors have not been able to travel to the UAE to attend meetings. It should be noted that this “easement” will only apply for the reporting for the financial year 2020 and more specifically to the period of COVID-19. It will not be applicable for the financial year 2019 which is now due for reporting.

3. Reporting Requirements

The Economic Substance declaration has to be filed with the concerned authority within a timeframe stipulated by the concerned authority and in a form prescribed by the concerned authority.² It should be noted that a declaration has to be filed every year by all companies,

² For an overview of various deadlines in the UAE, please refer to section III. below.

regardless of whether Relevant Activities have been carried out or not. Group companies cannot file one Economic Substance Report for both. This means that an Economic Substance Report has to be prepared and submitted for each entity, separately. Furthermore, every company is obliged to self-assess and self-declare the Economic Substance Test to the competent authority within the given timeframe.

The concerned authorities for receiving and evaluating the Economic Substance Forms have been identified under Cabinet Resolution No. 58 of 2019. For companies located in a free zone, the respective free zone authority will be the competent authority to prescribe the form of the submission as well as to determine whether a company has passed the Economic Substance Test. For all companies holding a license in the UAE mainland, the UAE Ministry of Economy will be the competent authority.

Exceptions for the above-mentioned authorities have been made for companies conducting banking, insurance, investment and lease-finance business. These companies have to report to such authorities by which they have been licensed and/or received a third-party approval (UAE Central Bank, UAE Insurance Authority, UAE Securities and Commodities Authority).

Although it is up to the competent authority to decide on the form of the Economic Substance Report, Art. 8 of the ESR sets out the minimum requirements for the information to be provided by the companies.

It is up to the sole discretion of the competent authority to decide whether or not companies pass the Economic Substance Test based on the provided information (Art. 7 ESR). The competent authority may also ask for additional information and/or documents in order to decide whether or not an Economic Substance Test has been passed. In the

event of a negative decision, companies have the right to appeal to the competent authority.

4. Fines and Penalties

If the competent authority decides that the Economic Substance Test has not been passed, it will forward the matter to the UAE Ministry of Finance which will then in turn provide forward the case the competent foreign authority of the country in which the parent company or the ultimate beneficial owners (whichever is applicable) are located.

In addition to forwarding the relevant information to foreign authorities, the concerned authority may impose a fine between AED 10,000 and AED 50,000 for failing the Economic Substance Test. This fine increases to AED 50,000 – AED 300,000 in case of a repeated failure to pass the test in the subsequent period. Moreover, the concerned authority can suspend, revoke or refuse to renew companies' licenses.

III. ESR Deadlines

For UAE mainland entities the deadline for submission of Economic Substance Reports to the UAE Ministry of Economy has not been announced yet.

UAE free zone authorities have published different deadlines as well as separate reporting guidelines:

Dubai Airport Free Zone

Deadline: **May 31, 2020**

Form of Submission: Via online portal

Dubai Multi Commodities Center

Deadline: **June 30, 2020**

Form of Submission: Via online portal

DIFC

Deadline: **June 12, 2020**

Form of Submission: Via online portal

Dubai South

Deadline: **June 7, 2020**

Form of Submission: By email

Dubai Silicon Oasis

Deadline: **May 25, 2020**

Form of Submission: By email

Dubai World Trade Center

Deadline: **June 30, 2020**

Form of Submission: By email

RAKEZ

Deadline: **June 30, 2020**

Form of Submission: Via a special link

RAKICC

Deadline: **June 30, 2020**

Form of Submission: Via online portal

ADGM

Deadline: **June 30, 2020**

Form of Submission: By email

SAIF-Zone

Deadline: **June 30, 2020**

Form of Submission: By email

Ajman Free Zone

Deadline: **June 30, 2020**

Form of submission: By email

Fujairah Free Zone Authority

Deadline: **May 31, 2020**

Form of Submission: By email

Other free zones are yet to announce their procedures for filing the declaration as well as the deadline. Furthermore, it should be noted that the UAE Ministry of

Economy – being the competent authority for all companies incorporated in UAE mainland – has neither announced the reporting procedures nor any deadline yet.

IV. Summary

Although the requirement of filing an Economic Substance Report has been introduced in mid-2019, it seems like this new obligation has not been vigorously pursued – not only by companies but also by the competent authorities. Due to COVID-19 and its impact on the economies around the world, this requirement took a back seat and became even more forgotten.

However, with various deadlines approaching, companies should ensure compliance with ESR and follow the respective guidelines for filing Economic Substance Reports.

SCHLÜTER GRAF provides comprehensive advice on ESR and Economic Substance Reporting. For more information, please contact your usual contact person at SCHLÜTER GRAF or send an email to dubai@schlueter-graf.com.

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