



K P I
Insights for enduring growth

ECONOMIC SUBSTANCE REGULATIONS

Notifications & Compliance



- 1. Background**
- 2. Economic Substance Regulation**
- 3. Applicability of the ESR**
- 4. Economic Substance Test**
- 5. Reporting Requirements & Deadline**
- 6. Penalties for Non-Compliance**
- 7. How We Can Help You**
- 8. Contact Us**

1. Background

The Organization of Economic Cooperation and Development (“OECD”) is an inter-governmental economic development body set up in 1961 to stimulate economic progress and world trade. OECD currently has 36 member countries. Under the OECD inclusive framework on Base Erosion and Profit Shifting (“BEPS”), over 135 countries are implementing 15 Actions to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment. UAE is a signatory to the OECD Inclusive Framework and has committed to implementing 4 BEPS minimum standards including Country by Country reporting and Harmful tax practices (Economic Substance Regulation).

2. Economic Substance Regulation

The UAE has introduced Economic Substance Regulations (“ESR”) by way of a Cabinet Resolution No. 31 of 2019 on 30 April 2019. The introduction of the ESR is a milestone for the UAE to align with the OECD BEPS directives.

According to the ESR, a licensee needs to demonstrate the actual economic activity in the UAE and that the business presence in the UAE is not driven entirely to benefits from the prevailing tax regime.

3. Applicability of the ESR

The UAE ESR applies to all licensees in the UAE (mainland, free zones and offshore companies) that carry on a Relevant Activity. The following are considered as Relevant Activities under the ESR:

- ✓ Banking Business
- ✓ Insurance Business
- ✓ Investment Fund Management business
- ✓ Lease Finance business
- ✓ Headquarter business
- ✓ Shipping business
- ✓ Holding Company business
- ✓ Intellectual Property business
- ✓ Distribution and Service Centers business

A UAE Government company (Federal or Emirates) and a company in which the UAE government (Federal or Emirates) owns at least 51% directly or indirectly are outside the scope of ESR.

4. Economic Substance Test

The regulation imposes the licensee that undertakes relevant activity/ies need to demonstrate economic substance under the three broad tests.

1. Core Income Generating Activity Test
2. Direct and Managed Test
3. Adequate Test

5. Reporting requirements and Deadlines

All existing licensees must submit the notification in the prescribed format to the respective competent authority(ies) before the notified deadline of 30 June 2020. All licensees falling under Dubai Development Authority are required to submit the notification on or before 25 June 2020.

The annual ESR return must be submitted on or before 31 December 2020 or as per licensees' respective year ending. It should be noted that both notification and annual return are an annual compliance requirement and needs to be submitted to the authority(ies) annually going forward.

A new licensee must comply with the Regulations upon receiving its business license with the first return due in 2020 or later.

6. Penalties for non-compliance

The UAE ESR outlines administrative penalties for non-compliance and are summarized below:

Administrative Offences	Penalties in AED
Failure to meet economic substance test for the first financial year	10,000 subject to a maximum of 50,000
Failure to meet economic substance test for the subsequent financial year	50,000 subject to a maximum of 300,000
Failure to provide information or adequate information	10,000 subject to a maximum of 50,000

7. How we can help you

All UAE licensee must assess whether their activities fall under the ambit of Relevant Activities and be prepared to comply with the ESR. Our competent and experienced team can assist you with:

- Conduct the Economic Substance Test
- Prepare / review the notification
- Prepare / review the ESR return (as and when it is due for submission)

8. Contact Us

Should you require any additional information or assistance in complying with the ESR, please feel free to contact:



Mahesh Shetty, ACA

Partner – Advisory & Assurance

mahesh@kpi.co

KPI Business Advisors & Consultants

+971 4 455 10 10

admin@kpi.co

Suite 301, Building-2, Bay Square, Business Bay, Dubai, U.A.E

Level 35, Al Maqam Tower, ADGM Square, Al Maryah Island, Abu Dhabi, UAE

406 Suprabat, Kapikad, Mangalore, India

www.kpi.co



KPI
Insights for enduring growth