

Economic Substance Regulations in the UAE



Background

In April 2019, the United Arab Emirates (UAE) introduced a requirement for certain mainland and free zone legal entities to maintain and demonstrate an adequate “economic presence” in the UAE.

The initial economic substance requirements released in Cabinet of Ministers Resolution No. 31 of 2019 were later repealed and replaced in August 2020 by the Cabinet of Ministers Resolution No. 57 of 2020 (the Regulations).

The Regulations were introduced to ensure that UAE entities report actual profits which correspond with their level of economic activity within the UAE and more broadly, as part of the UAE’s commitment to global initiatives to counter harmful tax practices.

The Regulations prepared in consultation with the Organisation for Economic Cooperation & Development (OECD) and the European Union are in line with economic substance rules introduced at around the same time in similar ‘no or only nominal’ tax jurisdictions (e.g., the British Virgin Islands, Cayman Islands, Jersey, etc.).

Entities should determine on an annual basis whether their activities may fall within the scope of the Regulations, which apply to financial years commencing on or after 1 January 2019, and comply with the applicable requirements. Failure to comply with the Regulations may result in significant financial and non-financial penalties.

Who needs to comply?

Entities in scope

The Regulations apply to all UAE onshore and free zone companies and certain other business forms that conduct certain activities (Relevant Activities) during a financial year (referred to as Licensees).

Natural persons, sole proprietorships, trusts and foundations fall outside the scope of the Regulations.

Relevant activities

- The Regulations provide for the following nine Relevant Activities:
1. Banking Business
 2. Insurance Business
 3. Investment Fund Management Business
 4. Lease-Finance Business
 5. Headquarters Business
 6. Shipping Business
 7. Holding Company Business
 8. Intellectual property Business
 9. Distribution and Service Center Business

The Relevant Activity definitions as set out in the Regulations can be very broad in scope. Therefore, entities are expected to follow a ‘substance over form’ approach to determine whether they undertake a Relevant Activity.

Exemptions - - - - -

The Regulations provide that certain entities which conduct a Relevant Activity may be considered exempt from the requirement to demonstrate substance in the UAE:

- Investment Funds
- Entities tax resident in a jurisdiction other than the UAE
- Entities wholly owned by UAE residents, which are not part of a multinational group and only conducts business in the UAE
- Branches of foreign entities
- Any other entity as determined by the Ministry of Finance

Exemptions are not automatic and should be claimed annually by an entity at the time of filing the notification. Certain conditions should be met, and sufficient supporting evidence must be provided to claim an exemption.

Requirement to demonstrate substance in the UAE

Entities earning income from a Relevant Activity during a financial year are required to demonstrate that:

1. The entity conducts all necessary core income generating activities in the UAE;
2. The entity and Relevant Activity are directed and managed in the UAE; and
3. The entity has an adequate number of qualified employees, expenditure and premises in the UAE in relation to the Relevant Activity conducted.

The requirements for entities conducting a Holding Company Business are reduced and those for High Risk Intellectual Property entities are increased. The above requirements do not apply to entities which have successfully claimed an exemption from the requirements for the period (see above).

Filing obligations

The Regulations require entities that conduct one or more of nine Relevant Activities to comply with annual filing requirements, as follows:

- A notification must be submitted within six months from the end of the financial year declaring that the entity undertakes a Relevant Activity, irrespective of whether the entity is exempt from the Regulations or income was earned from a Relevant Activity.
- A report detailing certain business information must be submitted within twelve months from the end of the financial year, but only if income was earned in the period from a Relevant Activity and the entity is not exempt.

Fact pattern of entity	Filing requirements
Not conducting a Relevant Activity	No filing requirements
Conducting a Relevant Activity and not earning income	Notification only
Conducting a Relevant Activity and earning income	Notification and report
Conducting a relevant activity, earning income, and exempted	Notification only

Non-compliance with the Regulations

Failure to comply with the Regulations may result in the following significant financial and non-financial penalties.

Description on non-compliance	Financial penalties
Failure to submit notification	AED 20,000 (c. USD 5.4K)
Failure to submit report	AED 50,000 (c. USD 13.6K)
Failure to provide accurate or complete information	AED 50,000 (c. USD 13.6K)
Deemed failure to demonstrate substance in the UAE for the relevant financial year: <ul style="list-style-type: none">• First failure• Second consecutive instance of failure• Admin measures: Exchange of information with foreign authorities, suspension / withdrawal / non-renewal of trade license	AED 50,000 (c. USD 13.6K) AED 400,000 (c. USD 109K) -

How can Deloitte help?

Impact Assessment

- Assess whether an entity is conducting any of the nine Relevant Activities in a period and therefore, within the scope of the Regulations.
- Consider whether an entity could benefit from any of the exemptions provided by the Regulations.

Compliance Review

- Support with assessing whether an entity has an adequate level of economic substance in the UAE in relation to the Relevant Activity conducted.
- Support addressing any potential areas of non-compliance and risk mitigation strategies.

Filing support

Support with the preparation and review of annual economic substance notifications and reports.

Inquiries and appeals

- Support with responding to questions or requests for additional information received from the authorities.
- Support with navigating the appeals process.

Internal procedures and governance

Support with establishing or reviewing internal governance procedures to comply with the Regulations.

Resources

- Deloitte [webinar recordings](#) and repository of [client alerts](#) with updates on the Regulations.
- Deloitte [UAE Economic Substance Manual](#) which includes comprehensive guidance developed to help businesses manage compliance with the Regulations.

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