



# SHARJAH MEDIA CITY (Shams)

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## UAE Economic Substance Regulations

### Frequently Asked Questions (FAQs)

# Economic Substance Frequently Asked Questions (‘FAQs’)

مدينة الشارقة للإعلام  
Sharjah Media City



29<sup>th</sup> June 2020

## To all Sharjah Media City (Shams) member entities

Further to our correspondence dated 15<sup>th</sup> June 2020 in relation to the introduction of Economic Substance Regulations (‘ESR’ or ‘the Regulations’) in the UAE, the Sharjah Media City Free Zone Authority (‘Shams Free Zone Authority’) is pleased to release this document which aims to provide answers to the ESR-related questions which are frequently asked by Shams member entities.

**Please be advised that this document has been prepared for general informational purposes only and may not be exhaustive or applicable to the specific facts and circumstances of a Shams member entity. Furthermore, the responses provided to these FAQs neither purport to address all matters relevant to ESR nor constitute a sufficient basis for Shams member entities to determine whether they are compliant with the Regulations. We would like to reiterate that ensuring full compliance with ESR is the responsibility of each and every Shams licensee.**

**For any uncertainty on how to apply ESR, we strongly recommend consulting a professional advisor.**

## FREQUENTLY ASKED QUESTIONS

### 1. What is ESR? What are its purposes?

Economic Substance Regulations (‘ESR’, or the ‘Regulations’), have been introduced by the UAE Government by way of Cabinet of Minister’s Resolution No. 31 of 2019 issued by the Ministry of Finance (‘MoF’). These Regulations are applicable with effect from 30 April 2019 to all UAE based licensees, with reportable period beginning on or after 1 January 2019.

The purpose behind the introduction of ESR in the UAE is two fold:

- i. To demonstrate the UAE government’s commitment as a member of the Organisation for Economic Co-Operation and Development (‘OECD’)’s Inclusive Framework; and
- ii. In response to European Commission’s (‘EU’) review of the UAE tax framework which resulted in the UAE being added to the European Union list of non-cooperative tax jurisdictions (the ‘EU blacklist’).

ESR was introduced as a legal requirement for all UAE entities to locally maintain ‘economic substance’ in line with the level and type of activity they undertake in terms of business in the UAE. This is to ensure that UAE entities that undertake certain business activities in the UAE do not artificially attract profits that are not commensurate with the level of economic activity undertaken in the UAE.

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## 2. Who needs to submit an ES notification by 30<sup>th</sup> June 2020 in Shams?

Broadly speaking, all Licensees of whatever legal form established in Sharjah Media City Free Zone (Shams) regardless of whether or not they have carried out a Relevant Activity during the Relevant reportable period, are required to file the ES notification form.

With respect to the 30<sup>th</sup> June 2020 deadline, taking into consideration that ESR apply to financial years starting on or after 1 January 2019, only those Shams licensees with a financial year that commences on or after 1<sup>st</sup> January 2019 and ends on 31<sup>st</sup> December 2019 will be required to file ES notification no later than 30<sup>th</sup> June 2020, irrespective of when the Licensee was incorporated.

For example, a Shams licensee that was incorporated after ESR were enacted (e.g. 1<sup>st</sup> May 2019) that has set a 31<sup>st</sup> December 2019 financial year end would be required to file a Notification by 30<sup>th</sup> June 2020.

## 3. What is the difference between the ES notification and ES return?

### **ES notification**

An ES notification is a simple notification form that needs to be completed by every Shams licensee irrespective of whether the Licensee qualifies for an exemption under the Regulations, undertakes a Relevant Activity or has earned income from the Relevant Activity during the relevant financial period.

This purpose of the ES notification is to provide Shams Free Zone Authority (being the Regulatory Authority for entities operating within Shams Free Zone) with certain initial information on the licensee and its activities in the UAE, and is a prerequisite to filing an ES return for the Reportable Period (where required).

The ES notifications for the financial period 2019 are to be filed on or before 30<sup>th</sup> June 2020 by e-mailing a copy of the duly filled ES notification form (in Excel Macro-enabled workbook format) to [esrnotification@shams.ae](mailto:esrnotification@shams.ae).

Please note that in the absence of a financial year end / accounting reference period (e.g. where the Licensee is not required to have a financial year end / accounting reference period), the anniversary of the Licensee's incorporation date should be used

[Please click here](#) to download a copy of the ES notification form and the user guide.

### **ES return**

An ES return is a detailed report which is required to be filed only by licensees that earn income from a Relevant Activity during the relevant financial period, and that are not exempt<sup>1</sup> from the Regulations. ES returns must be filed within 12 months from the end of the relevant financial period.

The format for the ES return is yet to be prescribed by Shams Free Zone Authority. We will release a detailed guidance with respect to ES returns in due course.

<sup>1</sup> Please note that Shams licensees in which the Federal Government or the Government of any Emirate of the UAE, or any governmental authority or body of any of them which has at least 51% direct or indirect ownership in its shareholding, are exempt from the Regulations.

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## 4. Can a single ES Notification be filed for multiple Licensees?

No. Shams Free Zone Authority does not allow filing a single/consolidated ES notification form covering two (2) or more licensees.

Therefore, each Shams licensee must file the ES notification form on a standalone basis.

## 5. What is a reportable period?

A Reportable Period is the financial period to which the Notification relates to that commenced on or after 1st January 2019.

The end of the Reportable Period should correspond to the financial year end of the Licensee, and the period that financial statements (if any) are prepared.

## 6. How do I identify my Company Financial year end?

The financial year end or accounting reference period is the date on which the Licensee's financial year ends (and to which the Licensee's financial accounts are prepared).

In the absence of a financial year end / accounting reference period (e.g. where the Licensee is not required to have a financial year end / accounting reference period), the anniversary of the Licensee's incorporation date should be used.

## 7. Am I obliged to submit ES Notification file even if my company was incorporated during 2020?

No. A Shams licensee is obligated to submit a ES notification by 30<sup>th</sup> June 2020 only if the entity was incorporated prior to or during 2019.

However, entities incorporated during 2020 will be obligated to file the ES notification during 2021 as notification filing is an annual compliance obligation.

## 8. When is the deadline for filing the ES notification form for Licensees with a financial year end other than 31st December 2019?

The deadline for the submission of the ES notification form for Shams licensees with a different financial year end other than 31st December 2019 (e.g. 31st March 2020, 30th June 2020, etc.) will be communicated by the Shams Free Zone Authority in due course.

Having said the above, in case a Shams licensee with a reportable period ending after 31st December 2019 (e.g. 31st March 2020) does not submit the ES notification form by 30th June 2020, no administrative penalties be imposed by the Shams Free Zone Authority.

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**9. What if a Shams Licensee has a long first accounting period which started in 2018 and ended during 2019 (e.g. from 1st June 2018 to 31st December 2019) - is such Licensee required to file a Notification for the said accounting period by 30th June 2020?**

No. In the specific example provided above, the Shams licensee's first reportable period will be 1st January 2020 to 31st December 2020 and the first Notification would be due in 2021, the deadline for which will be announced by the Shams Free Zone Authority in due course.

**10. What is the reportable period for Shams licensees that do not have a financial year end / accounting reference period (e.g. a Shams licensee that is wholly owned by an individual and the entity does not prepare financial statements)?**

In the absence of a financial year end / accounting reference period (e.g. where the Shams licensee is not required to have a financial year end / accounting reference period), the anniversary of the Shams licensee's incorporation date should be used.

**Examples:**

**a. A Shams licensee that does not have financial year end and has a 'license formation date' of 1st November 2019 will have its first reportable period as follows:**

Start Date: 1st November 2019

End Date: 30th October 2020

In this specific example, the Shams licensee will not be required to file the ES Notification form by 30th June 2020.

**b. A Shams licensee that does not have financial year end and has a 'license formation date' of 1st January 2019 will have its first reportable period as follows:**

Start Date: 1st January 2019

End Date: 31st December 2019

In this specific example, the Shams licensee will be required to file the ES Notification form by 30th June 2020.

**c. A Shams licensee that does not have financial year end and has a 'license formation date' of 2nd January 2019 will have its first reportable period as follows:**

Start Date: 2nd January 2019

End Date: 1st January 2020

In this specific example, the Shams licensee will not be required to file the ES Notification form by 30th June 2020.

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***d. A Shams licensee that does not have financial year end and has a 'license formation date' of 20th December 2018 will have its first reportable period as follows:***

Start Date: 20th December 2019

End Date: 19th December 2020

In this specific example, the Shams licensee will not be required to file the ES Notification form by 30th June 2020.

## **11. What if a Licensee does not undertake a Relevant Activity during a financial period?**

Under ESR, only those Licensees which carry on a Relevant Activity during the reportable period are required to submit a Notification.

However, Shams Free Zone Authority requires that all entities operating within the Shams Free Zone (with a financial year that commences on or after 1<sup>st</sup> January 2019 and ends on 31<sup>st</sup> December 2019) to submit the ES notification form on or before 30<sup>th</sup> June 2020, regardless of whether or not they have carried out a Relevant Activity during the reportable period.

Subsequently, such Licensees which do not undertake any relevant activity during the relevant reportable period will not be required to meet the economic substance test as per the Regulations and therefore, are not mandated to submit the ES return for such reportable period.

## **12. What if a Licensee undertakes a Relevant Activity, but does not earn any income from that activity during a financial period?**

If a Licensee undertakes a Relevant Activity, but does not earn any income from that activity during a financial period, it will be required to file a notification with Shams stating that it carries out a Relevant Activity in the UAE for the financial period and that it does not earn income from such Relevant Activity.

Subsequently, such Licensee will not be required to meet the economic substance test as per the Regulations and therefore, will not be required to submit the ES return for such reportable period.

## **13. How do I identify that my company falls under a relevant activity or not?**

In order to identify whether the entity falls under a relevant activity, a thorough assessment of the activities and operations of the entity would have to be undertaken in order to conclude whether any of the activities undertaken by the entity during the reportable period would be deemed as a relevant activity, and whether it undertakes relevant activity(ies) in order to be subject to substance requirements.

For further information with respect to each type of relevant activity, please read the Relevant Activities Guide issued by the MoF ([please click here](#)).

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## **14. What If I fail to submit ES Notification Form as per the given timeline?**

In accordance with Article 11 of the Cabinet Decision No 31 of 2019, failure to submit the ES notification may result in a penalty of AED 10,000 to AED 50,000.

## **15. What happens if the information provided in the ES Notification is incorrect?**

In accordance with Article 11 of the Cabinet Decision No 31 of 2019, failure to provide accurate or complete information may result in a penalty of AED 10,000 to AED 50,000.

The Shams licensee will also be automatically considered to have failed demonstrating economic substance in the UAE.

## **16. Are Shams licensees that have been dissolved or liquidated prior to the deadline for submission of the Notification required to file a Notification?**

No. For example, a Shams licensee that is already dissolved/liquidated as of 29th June 2020 will not be required to file the Notification.

All other Shams licensees are required to submit the ES notification form, including those that are currently in the process of dissolution or liquidation.

## **17. If the activity of a Shams licensee has changed during a Reportable Period - which activity should be reported in the Notification?**

The Licensee must report all Relevant Activities undertaken during the Reportable Period.

## **18. Are financial statements required to be submitted along with the ES notification form?**

No. Shams licensees are not required to submit a copy of its financial statements at the time of filing the ES notification form.

## **19. If all the income from the Relevant Activity is earned from outside UAE, is the Licensee exempt from the Regulations?**

No. Please note that the exemption from the Regulations only applies to Shams licensees in which the Federal Government or the Government of any Emirate of the UAE, or any governmental authority or body of any of them which has at least 51% direct or indirect ownership in its shareholding.

Shams licensees that do not carry out any Relevant Activity, or carry out a Relevant Activity but do not earn income from such activity are neither required to meet the economic substance test nor mandated to submit the ES return.

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## **20. Do employees who perform Core Income Generating Activities (‘CIGAs’) need to be residents in the UAE?**

A Shams licensee that is required to meet the economic substance test must be able to demonstrate that it has an adequate number of qualified-full time (or equivalent) employees (in relation to the Relevant Activity that the Shams licensee conducts) who are physically present in the UAE (whether or not employed by the Shams licensee or by another entity, and whether on temporary or long-term contracts).

Having said the above, employees who perform the CIGAs of a Shams licensee would in principle, need to be resident in the UAE. Non-resident employees or other persons would count towards the economic substance of a Shams licensee in the UAE only if all the following conditions are satisfied:

- i. the relevant activities are performed while the individual is physically present in the UAE, and under the direction of the Shams licensee; and
- ii. the Shams licensee bears the relevant costs of the non-resident individual.

However, please note that for the periods affected by the COVID-19 pandemic, Shams Free Zone Authority will take into consideration the impact of COVID-19 on usual operations of Shams Licensees when making a determination of whether or not a Licensee has demonstrated sufficient economic substance in the UAE, specifically with respect to the impact of travel restrictions, self-isolation and/or other quarantine measures on Shams’ licensees ability to meet the requirements of the directed and managed test under Article 6.2(b) of the Regulations.

Further, for the periods affected by the COVID-19 pandemic, Shams licensees shall retain the requisite records to demonstrate adjustments made to their normal operating procedures in response to COVID-19.

## **21. Do the directors of the Licensee need to be resident in the UAE?**

No, directors only need to be physically present in the UAE to attend relevant board meetings of the Licensee.

With respect to periods affected by COVID-19 pandemic, Shams licensees should give consideration to the ability to appoint alternate directors in the UAE who can physically attend meetings in the UAE and thereby address any short-term practical difficulties arising from COVID-19 related measures.

## **22. Will a Shams licensee be considered to have failed the economic substance test if the licensee is a tax resident outside the UAE?**

No. The ability of a Shams licensee to satisfy the economic substance test is broadly, subject to meeting the following requirements:

- Is the entity directed and managed in the UAE
- Are Core Income Generating Activities (‘CIGAs’) undertaken in the UAE?
- Does it have adequate substance (i.e. Qualified employees, expenditures, operations and functions, and physical presence in the UAE)

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## **23. Do the regulations only apply to UAE entities that are part of a foreign multinational group?**

No. All UAE onshore and free zone companies (including offshore companies), branches, partnerships and other UAE business forms (referred to as ‘Licensees’) are covered by the Regulations.

For ESR purposes, a ‘licensee’ is defined as a natural or juridical person licensed by the competent authority/authorities in the UAE to carry out a Relevant Activity in the UAE, including a free zone (such as Shams) and a financial free zone.

Accordingly, all entities operating within Shams Free Zone are required to assess their obligations under the ESR.

## **24. My company in Shams Free Zone is in trading business, do I still need to file the notification and file the report as well?**

The determination of whether or not a Shams licensee is carrying out a relevant activity under the Regulations is not dependent on the activities shown on the license. All Shams licensees are expected to adopt a ‘substance over form’ approach to determine whether or not they undertake a relevant activity, which means looking beyond what is stated on the commercial license, trade license or permit and making an assessment based on the activities actually undertaken during the reportable period. A trading business will also need to consider whether its actual activities and operating model falls within the scope of Relevant Activities as per the ESR.

In this specific question, a Shams licensee that is engaged in trading business will be required to file the ES notification by 30<sup>th</sup> June 2020 if such licensee has a financial year that commences on or after 1<sup>st</sup> January 2019 and which ends on 31<sup>st</sup> December 2019. In case the trading entity in this specific example has no financial year end / accounting reference period, it will be required to file the ES notification if it has a ‘license formation date’ of 1<sup>st</sup> January 2019 (which means that the licensee’s first reportable period is from 1<sup>st</sup> January 2019 to 31<sup>st</sup> December 2019).

As answered in the previous questions, an ES return is required to be filed (within 12 months from the end of the relevant financial period) only by Licensees that earn income from a Relevant Activity during the relevant financial period and that are not exempt from the Regulations.

## **25. I bought 100% shares of an existing company during 2020 and it seems to have carried out a relevant activity in 2019. Do I still need to file the ES notification and ES report knowing that a different shareholder owned the company during 2019?**

Yes, as change in shareholding is not a factor in determining whether or not a Shams licensee is exempt from the Regulations under the previous ownership.

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## 26. Will a Shams licensee that did not pass the economic substance test be penalized?

Yes. Shams licensees who failed to demonstrate sufficient economic substance in the UAE for a relevant financial year will be subject to the following administrative penalties:

- **First offence** – Penalty of AED 10,000 to AED 50,000. Furthermore, Shams Free Zone Authority may disclose the licensee’s information with the foreign competent authority
- **Second consecutive year of offence** – Penalty of AED 100,000 to AED 300,000. Shams Free Zone Authority may also disclose the licensee’s information with the foreign competent authority. Furthermore, the licensee’s license may be suspended, revoked or not renewed.

## 27. Should a Shams licensee consider “net accounting profit” to determine whether or not it earned income from a Relevant Activity?

No. Income from a Relevant Activity means the gross income earned from that activity as recorded in the books and records for the Reportable Period prepared under applicable accounting standards, including income that is generated outside of the UAE, and without deducting any type of costs or expenditure.

In the context of income from sales or services, gross income means gross revenues from sales or services without deducting the cost of goods sold or the cost of services.

## 28. How can the income earned from a Relevant Activity be subject to tax outside the UAE?

Income from a Relevant Activity is considered to be subject to tax outside the UAE where:

- The Shams licensee has a taxable presence / permanent establishment in a foreign country and it reports all or part of the income from the Relevant Activity in the corporate income tax return filed in that foreign country; or
- The Shams licensee is a UAE branch of a foreign juridical person and all the income of the UAE branch is reported in the foreign juridical person’s corporate income tax return, even if the foreign jurisdiction exempts branch profits from corporate income tax.

## 29. In what cases can a Licensee be tax resident outside the UAE?

A UAE Juridical person (e.g. a LLC or PJSC) is considered tax resident outside the UAE if another country treats the UAE entity as a local company under its corporate income tax legislation (usually on the basis of a central management and control type test) and the income of the UAE entity is subject to corporate income tax in the foreign country because of its tax residence therein.



## Sources and Links:

### □ UAE Ministry of Finance:

#### ▪ Cabinet Resolution No. (31) of 2019:

[https://www.mof.gov.ae/en/lawsAndPolitics/CabinetResolutions/Documents/Cabinet%20of%20Ministers%20Resolution%20No%20%2031%20of%202019%20Concerning%20Economic%20Substance\\_English.pdf](https://www.mof.gov.ae/en/lawsAndPolitics/CabinetResolutions/Documents/Cabinet%20of%20Ministers%20Resolution%20No%20%2031%20of%202019%20Concerning%20Economic%20Substance_English.pdf)

#### ▪ Cabinet Resolution No. (7) of 2020:

[https://www.mof.gov.ae/en/lawsAndPolitics/CabinetResolutions/Documents/Cabinet\\_Resolution\\_7\\_2020.pdf](https://www.mof.gov.ae/en/lawsAndPolitics/CabinetResolutions/Documents/Cabinet_Resolution_7_2020.pdf)

#### ▪ Cabinet Decision No. (58) of 2019:

<https://www.mof.gov.ae/en/lawsAndPolitics/CabinetResolutions/Documents/Cabinet%2BResolution%2BNumber%2B58%2Bof%2B2019.pdf>

#### ▪ Ministerial Decision No. (215) of 2019:

<https://www.mof.gov.ae/ar/StrategicPartnerships/Documents/Ministerial%2Bdecision%2Bno.%2B215%2Bfor%2Bthe%2Byear%2B2019.pdf>

#### ▪ UAE Economic Substance Flowchart:

[https://www.mof.gov.ae/en/StrategicPartnerships/Documents/Economic-Substance-UAE-Economic-Substance-Flowchart%20\(1\).pdf](https://www.mof.gov.ae/en/StrategicPartnerships/Documents/Economic-Substance-UAE-Economic-Substance-Flowchart%20(1).pdf)

#### ▪ Frequently Asked Questions:

<https://www.mof.gov.ae/en/StrategicPartnerships/Pages/ESR.aspx>

#### ▪ Relevant Activities Guide:

[https://www.mof.gov.ae/ar/StrategicPartnerships/Documents/Relevant%2BActivities%2BGuide%2B\\_April%2B2020.pdf](https://www.mof.gov.ae/ar/StrategicPartnerships/Documents/Relevant%2BActivities%2BGuide%2B_April%2B2020.pdf)

#### ▪ Covid-19 Industry Advisory Notification:

<https://www.mof.gov.ae/ar/StrategicPartnerships/Documents/COVID-19%2B-%2BEnglish.pdf>