

Free Zone Businesses Under Customs Audit Lens



Background

Over the past two decades, Free Zones in Dubai have become a hub for businesses seeking middle east expansion, freehold ownership and long-term tax incentives.

With over 20 free zones classified as fenced (e.g., JAFZA, DAFZA) or unfenced (e.g., DMCC, DIFC), these areas offer significant trade advantages. A key benefit is customs duty suspension on imports for businesses engaged in manufacturing or distribution. However, this privilege comes with a caveat—customs audits.

Why Free Zone Businesses Are Subject to Customs Audits

Dubai Customs monitors free zone businesses to ensure goods imported under duty suspension are either re-exported or imported into UAE mainland on payment of applicable duty. Any discrepancies in inventory records, misclassification of goods, or undeclared movement can trigger an audit, leading to duty assessments and penalties.

Customs Target Audit Procedure

Dubai Customs employ risk-based engine in their internal system to select free zone businesses for target audit. The audit period typically spans from the date of establishment till the date of audit commencement. For example, if a Company started operations in year 2000 and has received audit notice in 2025, the target audit shall be for inventory records of upto 25 years.

For Trading Businesses, customs authorities expect inventory reconciliation of HS code wise quantities, and weights of imported goods against exports, import into mainland, and available inventory records. Given the long audit period, reconciliation of each historic inbound transaction data with outbound could be challenging and require careful handholding.

For Manufacturing & Assembly Businesses, audit submissions become more complex due to HS code changes between raw materials and finished products. Businesses have to justify material consumption, wastage, and production outputs as part of audit reconciliation, valuation if sold to customers in UAE mainland. In certain cases, businesses are required to get customs tariff approval on the entire manufacturing process.

Areas Under Customs Focus

In the audit, Customs authorities typically focus on:

- Mismatch in Inward & Outward Movements
- Under Valuation for Imports into UAE Mainland
- Variances in Quantity & Weight Mismatches
- Unauthorized movement of Goods Without Customs Declaration
- Physical Inventory Stock Verification
- Internal Consumption & Wastage

Outcome of a Customs Target Audit

The outcome of a customs audit largely depends on the extent of compliance, the accuracy of customs records, and the ability of the business to explain and reconcile its inbound and outbound transactions. Based on the findings, businesses may face one or more of the following outcomes:

- Reconciliation & Clearance (No Financial Impact)
- Minor errors in terms of Documentation Gaps & Corrective Action
- Additional Duty Adjustments
- Penalties & Legal Consequences
 - Customs Duty on CIF Value: 5% duty on improperly declared goods.
 - Penalties: Ranging from 10% to 200% of the CIF value based on type of goods and the severity of non-compliance.
 - Red flag in Customs Records: Legal case is registered in Customs records and any subsequent violations could attract higher percentage penalties

Statute of Limitation for Free Zone Customs Audits

The concept of statutory limitation under the GCC Common Customs Law establishes the period during which customs authorities can assess and pursue claims for duty payments or violations.

While the GCC Common Customs Law provides a 5-year limitation for general customs claims and a 15-year period for smuggling or fraudulent cases, free zone businesses face a different reality.

Customs authorities often interpret the limitation period differently for free zone entities, arguing that it only starts once goods are officially declared out of the free zone, either through export or import into the mainland. Since goods that remain within the free zone have not been formally declared outward, the authorities assume they are still available in the business's stock. As a result, even if goods were brought in beyond the 5-year or 15-year statutory period, they are still considered part of the company's inventory for customs purposes, meaning the statute of limitation does not trigger, and the business remains subject to audit from its date of establishment.

Voluntary Disclosure System (VDS)

Recently in June 2024, Dubai Customs introduced Voluntary Disclosure System (VDS) which allows businesses to disclose errors or omissions in customs declarations before they are detected by authorities, enabling them to correct mistakes and settle any outstanding customs duties without facing severe penalties. Following are the benefits under VDS:

- Partial or full waiver of penalties if disclosures are made before a customs audit is initiated
- Avoidance of severe legal consequences that may arise from non-disclosure of errors
- Transparency and trust with customs authorities, reducing future scrutiny

Self-Assessment & Customs Clearance Certificate

Rather than waiting for a target audit, Dubai Customs encourages businesses to conduct self-assessments, prepare audit-ready reconciliations, file VDS submissions where necessary, and then request a Clearance Certificate (commonly known as Customs NOC Audit).

The Customs NOC Audit is a compliance tool where businesses can voluntarily approach Dubai Customs for a review of their records. This helps in identifying and addressing potential discrepancies, avoiding surprises and officially getting clearance certificate from Dubai Customs.

This approach is particularly beneficial as it mitigates risks associated with extended audit periods, spanning 10-20 years. Given the challenges of archiving and retrieving historic data, businesses can safeguard themselves by undertaking a clearance review.

Conclusion

With increased scrutiny on free zone businesses, using tools such as self-assessments, VDS and clearance review, businesses can mitigate risks, address discrepancies in advance.

For more information on how Dhruva Consultants can support, feel free to reach out to our team.



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