



UAE Introduces Federal Corporate Tax

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On 9 December 2022, the UAE released the Corporate Tax (CT) Law through Federal Decree No 47 of 2022 (CT law). This follows an earlier announcement in January 2022, wherein the UAE had announced its intention to introduce CT on business activities, effective financial years on or after 1 June 2023. A public consultation document (PCD) was also issued in May 2022 setting out the proposed framework and policy decisions of the UAE CT law, and inviting comments from stakeholders for consideration by the Government. In addition to the CT law, the Ministry of Finance has also published supplemental FAQs to aid the understanding of UAE CT.

The UAE CT is applicable to businesses from financial years commencing on or after 1 June 2023, i.e. for businesses operating on a calendar year (Jan-Dec), UAE CT will apply from 1 January 2024. With a headline tax rate of 9%, the CT law introduces tax liability and annual compliance requirements (including transfer pricing requirements) for taxable persons in the UAE. A number of reliefs and exemptions are also provided for in the CT law, related either to the categories of exempt persons, or nature of income that will be exempt from CT (qualifying dividends and capital gains, business restructuring reliefs etc), including Qualifying Free Zone persons that will be subject to 0% tax.

In addition to payment of the tax liability in consonance with the tax computation provisions, a taxable person will need to register with the Federal Tax Authority ('Authority') and on an annual basis submit tax returns, pay tax liability and prepare necessary documents (financial statements, tax returns, transfer pricing related documents, etc.). Any non-compliance is expected to attract applicable penalties.

We have outlined key highlights of the UAE CT and next steps for businesses.

Key Highlights – Federal Decree Law No 47 of 2022 Issued on 9 December 2022

I) A Taxable Person (resident or a non-resident person carrying on business and having a Permanent Establishment or nexus in the UAE) will be subject to tax at the following rates:

Taxpayer	Applicable CT Rate
Individuals and juridical persons	0% for taxable income up to the specified threshold (expected to be AED 375,000, to be confirmed in a Cabinet Decision) 9% for taxable income exceeding specified threshold
Qualifying Free Zone Persons (see further information below)	0% on qualifying income (to be specified in a Cabinet Decision) 9% on taxable income that does not meet the qualifying income definition

In addition to 0% rate for businesses with taxable income up to AED 375,000, “small businesses” with revenue below a certain threshold and meeting other prescribed conditions can elect to be treated as not having taxable income, and be subject to simplified compliance obligations. Details of the revenue threshold and other conditions are yet to be prescribed.

It is critical to note that all UAE tax residents (juridical person or natural persons carrying on a business that is to be specified in cabinet decision) are subject to tax in the UAE. Additionally, non-UAE tax residents are subject to tax in the UAE if they have a PE (refer below) in the UAE or any nexus to the UAE (to be specified). UAE sourced income of non-UAE tax residents is subject to tax in the UAE at 0%.

The law has also specified that BEPS Pillar 2 provisions on Global Minimum Tax are expected to make way into UAE CT provisions (which should amongst other things, prescribe a higher CT rate – likely 15% – for large multinational businesses with annual turnover exceeding a certain threshold), however until such date the UAE CT rates discussed in the table above will prevail.

II) Resident and Non-Resident persons

A Resident person is a:

- Natural person carrying out a business or business activity in the UAE;
- Juridical person:
 - Incorporated or established or recognized under the legislation of the UAE including a Free Zone Person; or

- Recognised under the legislation of a foreign jurisdiction that is effectively managed and controlled in the UAE;

- Any person that may be specified in a Cabinet decision.

Non-Resident person is a person who is not a resident person in the UAE and has:

- A permanent establishment in the UAE; or
- Derives UAE sourced income; or
- A nexus in the UAE that will be specified in a Cabinet decision.

III) Qualifying Free Zone Person

A Qualifying Free Zone Person should meet the following conditions to benefit from the 0% CT rate – a) maintain adequate substance in the UAE (possibly linked to Economic Substance Regulations but could possibly now apply to all entities in free zone seeking to claim exemption regardless of whether they undertake a Relevant Activity; b) derives Qualifying Income (as to be specified in a Cabinet decision); c) has not elected to be subject to CT; d) complies with transfer pricing provisions (as applicable); and e) is a part of a Free Zone that has been listed in a Cabinet Decision as a Free Zone for UAE CT. Free Zone Persons need to file tax returns even if they entirely benefit from 0% CT rate. Helpfully, and in contrast to the PCD which seemed to suggest that the FZ exemption is “all or nothing”, only non qualifying income will be taxable at 9%.

IV) Exempt Persons

Certain persons, i.e., government and government-controlled entities, extractive businesses, non-extractive

natural resource businesses, qualifying public benefit entities, public or private pension and social security funds, qualifying investment funds are exempt from UAE CT, either automatically or by way of an application to the authority. Certain exempt categories of exempt persons may also need to register for CT, and may also be required to submit some form of declaration to the FTA.

While extractive and non-extractive natural resource businesses that are currently subject to Emirate level taxation are eligible for exemption, branches of foreign banks that are also subject to tax under relevant Emirate level decrees are still subject to UAE CT, and have not been listed in the exempt categories of persons.

V) Permanent Establishment (PE)

A non-resident person will create a PE in the UAE where:

- It has a fixed or permanent place of business (Fixed Place PE),
- A person has and habitually exercises to conduct a business on behalf of the non-resident (Agency PE),
- There is any other form of nexus in the UAE, to be specified in the Cabinet decision
- There is a Construction PE – projects lasting more than 6 months.

While there is exemption from PE for activities of preparatory and auxiliary nature, the CT law takes into account the Action Plan 7 of the OECD's BEPS Project on anti-fragmentation where non-resident or its related party carries out activity in the UAE through another PE in the UAE and on combined basis the otherwise auxiliary activities form a cohesive business operation of non-resident in the UAE.

The CT law also provides an exemption from PE provisions applying to UAE Investment Managers when acting on behalf of non-resident investors (subject to conditions) on the basis that such UAE investment managers are considered to be independent agents.

In the endeavour to continue supporting the remote working rules in the UAE, the CT law clarifies that a natural person working in the UAE will not create a PE if

- The presence is temporary or due to an exceptional situation; or
- His/her activities are non core income generating **and** the non-resident does not derive state sourced income from UAE.

VI) Transfer Pricing

Transactions between related parties or payments made to connected persons (owner, director, related

party of owner or director) should be at arm's length and applies to both domestic and cross-border related party transactions. Corresponding adjustments would be made by the FTA (either automatically or pursuant to an application) to the taxpayer and its related parties for transactions which are subjected to transfer pricing adjustments.

A taxable person is required to file a disclosure form with annual tax return capturing details of transactions undertaken with related or connected parties and maintain local and master file which may be required to be submitted to the authority on request.

VII) Calculating Taxable Income

Taxable Income shall be the accounting income as per the financial statements for that period adjusted primarily for:

- Unrealised gains or loss on an accrual or realization basis, subject to an election;
- Exempt Income and reliefs;
- Expenditure not incurred for business purposes;
- Interest expense over and above 30% of EBIDTA;
- Related Party Transactions;
- 50% entertainment expenditure;
- Other non-deductible expenditure (eg - donations, grants or gifts to specified entities, fines and penalties, bribes, dividends, corporate tax, recoverable input VAT).

VIII) Exempt Income

Dividend and profit distribution from a UAE tax resident to be exempt from UAE CT. Dividend and profit distributions from a non-UAE tax resident (or gains from participation in UAE or non UAE juridical person) to be exempt if Participation Exemption conditions are met, i.e. a) minimum shareholding threshold of 5% is met (may be lower if the cost of acquisition that may be prescribed meet thresholds); b) 12 months ownership criteria (either prior to receipt of income or an intention to hold shares can be demonstrated); c) the participation is subject to CT of at least 9% in its jurisdiction; d) Not more than 50% of the assets of participation consist of ownership interests or entitlements that would not have qualified for an exemption if held by directly by Taxable Person. In cases of indirect ownerships (where SPV is interposed), similar conditions as above will apply.

The CT law also provides for a Foreign PE exemption whereby, a resident person can make an election to not take into account the income and associated expenditure

of its foreign PEs in determining its taxable income. Such foreign PE exemption only applies in respect of a foreign PE that is subject to CT or similar tax at a rate not less than 9%.

Income earned by non-resident airline and shipping companies will also be exempt provided reciprocal exemption is available to UAE airlines/shipping companies in the non-resident jurisdiction.

IX) Tax Group

A UAE parent company can apply to form a tax group with one or more other resident persons (including deemed residents), if the following conditions are met: a) Resident persons are juridical persons; b) UAE parent company owns at least 95% of the share capital, voting rights and entitlement to the profits and net assets of the subsidiary, either directly or indirectly through one or more subsidiaries; c) No entity proposing to be a part of the group is an exempt person or a Qualifying Free Zone Person; d) All entities proposed be in the group have the same financial year and prepare financial statements using same accounting standards.

A tax group is treated as a single taxable person. The UAE parent company should prepare the financial results, assets, and liabilities of each subsidiary, eliminating transactions between the tax group entities. Note that the Tax Group for UAE CT purposes may be different from VAT groups due to differing thresholds.

X) Reliefs

Transfers within a qualifying group: No gain or loss shall arise from the transfer of one or more assets or liabilities between two taxable persons that are members of the same qualifying group. To avoid claw back of relief, a minimum holding period of two years post-date of transfer is applicable.

Qualifying group: Taxable persons shall be treated as members of the same qualifying group where:

- Taxable persons are a juridical resident persons or non-resident persons having a PE in the UAE;
- Either taxable person has direct or indirect ownership of at least 75% in the other taxable person or a third person holds a direct or indirect ownership interest of at least 75% in each of the taxable persons;
- None of the persons are an exempt person or a qualifying free zone person;
- Financial year of the taxable persons ends on the same date; and

- Taxable persons prepare their financial statements using the same accounting standards.

Business restructuring relief: No gain or loss to arise in a qualifying business (transfer of business in exchange for shares/ ownership) exercise between two taxable persons. Similar holding period condition of two years as qualifying group transfers applies to avoid claw back. For business restructurings where relief is obtained, the cost basis of assets will not be stepped up, and their period of holding will not be reset.

Interest deduction and carry forward relief: A taxable person's net interest expenditure, including any carried forward interest expenditure, shall be deductible upto 30% of EBITDA excluding exempt income. The interest expenditure that is disallowed can be carried forward and deducted in subsequent 10 years (subject again to the 30% EBITDA cap). A de minimus amount may be specified by the Minister of Finance upto which the interest may be deducted without the 30% EBITDA cap.

Also, no deduction shall be allowed for interest expenditure incurred on a loan obtained from a related party for following purposes

- A dividend or profit distribution to a related party;
- A redemption, repurchase, reduction or return of share capital to a Related Party
- A capital contribution to a Related Party.
- The acquisition of an ownership interest in a Person who is or becomes a Related Party following the acquisition.

However, this restriction will not apply if the main purpose of the loan for carrying out above transactions is not to gain a corporate tax advantage, which shall be deemed NOT to arise if the related party is subject to effective rate of 9% tax.

XI) Tax Loss

A tax loss can be carried indefinitely. Up to 75% of taxable income of a subsequent year can be offset against the tax loss of prior years. Loss incurred prior to the date of commencement of UAE CT, loss on account of an exempt income cannot be carried forward and utilised in the subsequent period. Tax loss of one entity can be transferred to another entity subject to certain conditions which primarily revolve around ownership (75% direct, indirect or common for loss transfers, 50% same shareholder criteria), none of the persons is an exempt person or qualifying free zone person, and entities have the same tax year.

XII) Withholding Tax and Foreign Tax Credit

Income of a non-resident sourced from the UAE will be subject to a 0% withholding tax rate. A taxable person can claim foreign tax credits (i.e. taxes paid in foreign jurisdictions) up to the amount of UAE CT due on the relevant income in the UAE. Any unutilised foreign tax credit cannot be carried forward or backward, or claimed as a tax refund from the FTA.

XIII) Anti-Avoidance Rules

The CT law contains General anti-avoidance rules under which any transaction or arrangement will be counteracted or adjusted if it is reasonably concluded that:

- The transaction or arrangement is not for a valid commercial or other non-fiscal reason which reflects economic reality; and
- The main purpose or one of the main purposes of the transaction is to obtain corporate tax advantage.

There are other articles in the CT law which contain anti-avoidance rules within those specific articles.

XIV) Transitional Rules

The opening balance sheet for UAE CT shall be the closing balance sheet prepared for financial reporting purposes under accounting standards applied in the UAE on the last day of the financial year that ends immediately before the first tax period commences. The general-anti abuse rule shall apply to transactions or arrangements entered into on or after the date the CT law is published in the Official Gazette.

XV) Compliance and Administration

The following key provisions are set out in the CT law on compliance:

- A taxable person shall register with the authority and file a tax return within 9 months from the end of the relevant tax period. The parent company of a tax group shall file a tax return on behalf of all the tax group entities however, the parent company and each

subsidiary shall be jointly and severally liable for the UAE CT payable by the tax group.

- Taxable persons are not required to pay any advance tax, and the tax liability shall be paid within 9 months from the end of the tax year.
- The taxable person is required to maintain all records and documents supporting the information provided in the tax return or filed with the tax authority for 7 years following the end of the tax year.
- Non-compliance will attract penalties as per the tax procedures law.

What Businesses Should Do

Business Groups should carry out or re-visit the impact assessment of UAE CT law on their business operations:

- Review existing group structures and entities to determine tax profile and potential effective cash tax cost for the group/ entities
- Analyse the:
 - Applicability of the UAE CT to its entities
 - Potential exemptions available
 - Tax grouping options and benefits
 - Intra-group transactions to ensure transfer pricing compliance
 - Documents/updates required to the ERP system
- Inform stakeholders of the impact and potential business restructuring;
- Review M&A transactions (including tax models) to factor appropriate effective tax cost and implications of the proposed UAE CT;
- Establish a tax governance framework to facilitate efficient administration and compliance.

At FTI Consulting, our team of tax and transfer pricing experts can help business groups in assessing the impact of the CT law, and assist in preparing for the documentary and structural changes to the businesses to be in compliance with the new regime

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