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Trading of Qualifying Commodities

Corporate Tax Implications

TRADING OF COMMODITIES AND TAX CONSEQUENCES

This guide provides an in-depth and comprehensive analysis of the tax implications for income derived from the trading of commodities in the UAE. Moving beyond a simple overview, this document is designed to equip you with the practical knowledge needed to navigate the nuances of the UAE's Corporate Tax Law in the real world.

We will delve into every critical area of this topic, using **case studies and real-life examples** to illustrate key concepts. The purpose of this guide is to provide a complete understanding, ensuring you can confidently apply the knowledge you acquire.

Specifically, this guide will cover:

- **Who is the Trader?** - A detailed breakdown of the tax consequences for both Free Zone and Mainland companies engaged in commodity trading. We will explore how their legal status and location fundamentally alter their tax obligations.
- **What is a "Qualifying Commodity"?** - A meticulous examination of the Federal Tax Authority's (FTA) criteria. We will provide practical examples of what constitutes a "raw form" commodity and the types of "Recognized Commodities Exchange Markets" that are valid under the law.
- **How Should it be Traded?** - An analysis of the trading activities themselves, including physical trading, off-market transactions, and associated derivative trading. We will clarify the specific conditions that must be met to ensure the activity qualifies for the 0% tax rate.
- **Who is the Receiver?** - A crucial look at the counterparty. We will explain why, in the context of qualifying commodities, the identity of the customer (be it a Free Zone company, a Mainland entity, or an international client) does not affect the taxability of the income.
- **What are the Tax Consequences?** - A clear-cut summary of the tax rates and the conditions a Free Zone company must meet to qualify for the 0% tax rate. We will also examine the risks of non-compliance, such as failing the "de minimis" test and the resulting tax liabilities.

AN OVERVIEW OF CORPORATE TAX CONSEQUENCES

Corporate Tax in the UAE

For any business operating in the Mainland UAE, corporate tax is straightforward:

- Taxable income up to AED 375,000 is taxed at a **0% rate**.
- Taxable income that exceeds AED 375,000 is taxed at the standard **9% rate**.

This applies to all their business activities, including trading commodities. If a Mainland company trades commodities, all the income it generates from this activity will be subject to these standard tax rates.

The Free Zone Twist: The General Rule

Free Zones were created to offer businesses attractive incentives, and corporate tax is a big part of that. However, the tax benefits for Free Zone companies are not automatic. To get the benefit of a 0% tax rate on their income, a Free Zone company must become a **Qualifying Free Zone Person (QFZP)** and earn **Qualifying Income**.

The general rule for what counts as "Qualifying Income" for a QFZP is:

- Income from transactions with other Free Zone companies.
- Income from certain "Qualifying Activities" (which we'll get to).

Income from transactions with customers in the Mainland UAE or abroad is usually considered "non-qualifying income" (unless its from qualifying activity) and is subject to the standard 9% tax rate.

This is the standard state of things. If you're a Free Zone company, your business with the Mainland is typically taxed.

3. The Special Exception: Trading Qualifying Commodities

Here is where the rule changes for the better. The trading of **Qualifying Commodities** is considered a **Qualifying Activity**. This is a special, high-value exception that allows a QFZP to earn income from this activity and have it treated as "qualifying income" for tax purposes, regardless of who the customer is.

This means:

- A QFZP trading qualifying commodities with another Free Zone company? **0% Corporate Tax.**
- A QFZP trading qualifying commodities with a company in the Mainland UAE? **0% Corporate Tax.**
- A QFZP trading qualifying commodities with a customer outside the UAE? **0% Corporate Tax.**

This is a huge benefit for commodity traders, as it allows them to use the Free Zone as a global hub without worrying about their income from international or Mainland transactions being taxed.

WHAT IS TRADING?

The Definition of "Trading" for This Purpose

Under the UAE Corporate Tax Law, the activity of "Trading of Qualifying Commodities" is clearly defined in Ministerial Decision No. 265 of 2023. It specifies that this activity means:

"the physical trading activities of Qualifying Commodities and associated derivative trading used to hedge against risks involved in such activities."

This definition gives us a very clear picture of what a Free Zone company should be doing to be considered a trader for the purpose of the 0% tax rate. Let's break down the key components:

1. "Physical Trading Activities"

This refers to the direct buying and selling of the qualifying commodities. A trader's primary role is to acquire these commodities (e.g., purchasing a shipment of crude oil) and then sell them on to another party. The company's profit is derived from the margin between the purchase price and the selling price.

- **What it includes:**
  - Buying and selling raw commodities.
  - The logistics involved in the transfer of ownership, such as arranging for transportation, storage, and handling. These activities are considered part of the core trading function.
- **What it excludes:**
  - **Significant processing or manufacturing.** This is the crucial distinction you raised. If the company takes the raw commodity and performs a significant alteration that changes its fundamental nature or creates a new product, that is no longer "trading." For example, buying raw cocoa beans and then manufacturing chocolate is considered a processing/manufacturing activity, not a trading activity.
  - **Distribution as a standalone activity.** While a trader performs distribution-like functions as part of its core business, a separate activity that is solely focused on distributing goods that are not the company's own (e.g., acting as a distributor for a third-party manufacturer) might fall under a different "qualifying activity" (such as distribution from a designated zone), but it wouldn't be considered "trading" in this context.

2. "Associated Derivative Trading"

The law also explicitly includes derivative trading in the definition of a "qualifying activity," but with an important condition: it must be used **"to hedge against risks involved in such activities."**

- **What it includes:** Using financial instruments like futures, options, and swaps to manage the price volatility or other risks associated with the physical commodities the company is trading.
- **What it excludes:** Speculative trading of derivatives that is not directly linked to the physical trading of the company's own commodities. For example, a company that trades physical crude oil can use futures contracts to hedge against price drops. However, a company that only trades on a commodities exchange for speculative purposes, without any underlying physical commodity transactions, would not be considered a "trader" for this specific tax benefit.

How to Distinguish "Trading" from "Processing" or "Distribution"

The key lies in the **degree of transformation** and the **intent of the business**.

- **Trading:** The business's main purpose is to buy and sell the raw commodity for a profit. The commodity remains in its raw form (or with minimal, non-transformative processing like cleaning or sorting). The profit comes from market fluctuations and arbitrage.
- **Processing/Manufacturing:** The business's main purpose is to transform a raw material into a new product. The profit comes from the value added through the manufacturing process.
- **Distribution:** While a free zone distributor can also get a 0% tax rate under certain conditions, its activity is more focused on logistics and selling to a reseller, not to the final consumer. The trading of qualifying commodities is a broader activity that isn't limited to a designated zone and doesn't have the same restrictions on who the end customer can be.

QUALIFYING AND NON-QUALIFYING COMMODITIES

QUALIFYING COMMODITIES:

To be a "qualifying commodity" and unlock the 0% tax benefit, a commodity must meet a strict set of conditions. These are not just general guidelines but specific requirements set out in the Ministerial Decisions.

Here are the conditions a commodity must satisfy to be treated as a qualifying commodity:

1. The Commodity Type

I. Metals

This category generally includes both precious and industrial metals in their raw, tradable forms. The key here is that they are typically traded as bars, ingots, or ore, not as finished products.

- **Precious Metals:**
  - **Gold:** Bullion bars and coins, gold ore, and raw doré bars.
  - **Silver:** Silver bars, ingots, and granules.
  - **Platinum:** Platinum bars and ingots.
  - **Palladium:** Palladium bars and ingots.
- **Industrial Metals:**
  - **Copper:** Copper cathodes, wire rods, and concentrates.
  - **Aluminum:** Aluminum ingots, billets, and scrap.
  - **Zinc:** Zinc ingots and slabs.
  - **Nickel:** Nickel cathodes, briquettes, and pellets.
  - **Lead:** Lead ingots and billets.
  - **Tin:** Tin ingots.

II. Minerals

This category covers non-metallic substances that are mined or extracted from the earth. Like metals, they must be in their raw, unprocessed state.

- **Coal:** Thermal coal, coking coal.
- **Iron Ore:** Iron ore pellets and fines.
- **Lithium:** Raw lithium carbonate or hydroxide.
- **Potash:** Raw potash.
- **Uranium:** Uranium ore.
- **Industrial Minerals:** Such as salt, gypsum, and limestone, as long as they are traded on a recognized exchange.

III. Energy

This is a critical category in the UAE, covering the raw materials that generate power.

- **Crude Oil:** This is the most prominent example. The various grades of crude oil, such as Brent Crude or WTI, are the quintessential qualifying commodities in this category.
- **Natural Gas:** Liquefied natural gas (LNG) and compressed natural gas (CNG) are traded on various exchanges.
- **Heating Oil:** A fuel oil product that is traded on a recognized exchange.
- **Gasoline:** Unfinished gasoline products, not the final refined product at the pump.
- **Propane and Butane:** As raw liquid commodities, these are also traded on exchanges.

IV. Agricultural Commodities

This category includes a wide range of raw products that are grown or harvested. The key is that they are in their whole, unprocessed form, not as finished food products.

- **Grains:**
  - **Wheat:** Raw wheat kernels.
  - **Corn:** Raw corn kernels.
  - **Rice:** Unprocessed rice paddy.
  - **Soybeans:** Raw soybeans.
- **Softs:**
  - **Coffee:** Green coffee beans (before roasting).
  - **Cocoa:** Raw cocoa beans (before processing into cocoa powder or chocolate).
  - **Sugar:** Raw sugar.
  - **Cotton:** Raw ginned cotton.
- **Livestock:** This category can also include livestock products like live cattle, frozen beef, and lean hogs, as they are traded on recognized exchanges in their raw state.

2. The "Raw Form" Condition

This is arguably the most critical and nuanced condition. The commodity must be in its **raw, unprocessed state**.

- **What is considered "raw form"?**
  - This refers to the commodity in its natural state, just as it was extracted, harvested, or mined.
  - However, the law acknowledges that some minimal processing is often required to meet the standards for trading on a commodities exchange. This can include activities like **cleaning, sorting, grading, and minor refining**. For example, gold bars with a specific purity level (like 99.4%) are considered to be in "raw form" for this purpose because this is the form in which they are traded on an exchange. Similarly, crude oil is a qualifying commodity, but the process of refining it into jet fuel would disqualify it.
- **What is NOT considered "raw form"?**

- Any significant transformation of the commodity into a new product. If the processing changes the fundamental nature of the commodity, it is no longer considered "raw." For instance, turning cocoa beans into chocolate is a manufacturing process, not trading of a raw commodity. Similarly, processing raw cotton into yarn or fabric would not qualify.

3. The "Recognized Commodities Exchange Market" Condition

The commodity must be of a type that is **traded on a Recognized Commodities Exchange Market**. This condition serves to validate the commodity's raw form and its nature as a globally traded item.

- **What is a "Recognized Commodities Exchange Market"?**
  - **Within the UAE:** This includes any exchange market that is licensed and regulated by the relevant competent authority in the UAE, such as the Securities and Commodities Authority (SCA) or a financial services regulator in a free zone (like the DFSA in the DIFC). Examples include the Dubai Gold & Commodities Exchange (DGCX) and the Dubai Mercantile Exchange (DME).
  - **Outside the UAE:** This includes any reputable international exchange that is recognized as being of "equal standing" to the UAE's regulated exchanges. Examples include the London Metal Exchange (LME) and the Chicago Board of Trade (CBOT).
- **Important Caveat:** The key here is that the **type of commodity** is traded on a recognized exchange. The Free Zone company does not have to perform the actual transaction on the exchange itself. The trading activity can occur off-market, as long as the commodity being traded is one that is standardized and traded on a recognized exchange.

In summary, for a commodity to be a "qualifying commodity," it must be a **metal, mineral, energy, or agricultural product** that is in its **raw, minimally processed form** and is of a type that is **traded on a recognized commodities exchange market**.

Determining a Qualifying Commodity Using HSN Codes:

The Harmonized System (HS) or Harmonized System Nomenclature (HSN) code provides a globally recognized and systematic way to classify traded goods. For a Free Zone company, these codes serve as a critical tool for verifying whether a commodity meets the criteria to be considered a "qualifying commodity" under the UAE's Corporate Tax Law.

This section outlines how to use HSN codes to help determine if a commodity qualifies for the 0% corporate tax rate, specifically by verifying its type, raw form, and alignment with recognized exchange markets.

To use HSN codes to determine if a commodity is qualifying, you would follow these steps:

1. **Identify the Commodity's HSN Code:** You can find this through official customs portals (like Dubai Customs), trade and logistics websites, or by consulting with a customs broker. The code will tell you the general category and subcategory of your product.
2. **Verify it's a "Qualifying Type":** Check if the HSN code falls within the chapters that correspond to metals, minerals, energy, or agricultural products.
    - **Metals:** Generally Chapters 71-81.
    - **Minerals:** Chapters 25-26.
    - **Energy:** Chapter 27.
    - **Agricultural:** Chapters 1-24.
3. **Confirm the "Raw Form":** This is where you need to be careful. You must check that the specific HSN code and its description correspond to a raw or minimally processed version of the commodity. A refined or manufactured version, even if derived from a qualifying commodity, will have a different HSN code and would likely disqualify it.
4. **Cross-Reference with Exchange Listings:** While there isn't a master list of HSN codes from the FTA, you can use the HSN code to find a standardized description of the product. You then cross-reference this with the product specifications of a recognized commodities exchange (like the DGCX, LME, or CME Group). If the product described by the HSN code is the same as the product traded on the exchange, you have strong evidence that it is a qualifying commodity.

NON-QUALIFYING COMMODITIES

For income from a commodity transaction to be non-qualifying, one or more of these conditions must be met:

- The commodity is a **processed or manufactured** product.
- The commodity is **not traded on a recognized exchange**.
- The commodity **does not fall into one of the four specified categories**.
- The business activity is not true **"trading"** (e.g., it's brokering without taking title).
- The company's **QFZP status is lost** due to exceeding the "de minimis" threshold or failing the substance test.

In all these scenarios, the income generated from that transaction or activity will be subject to the standard 9% corporate tax rate (Non-qualifying Income) in the UAE.

ANCILLARY ACTIVITIES FOR TRADING OF QUALIFYING COMMODITIES

While the primary activity of a Free Zone Person (QFZP) must be the physical buying and selling of Qualifying Commodities, the business of trading involves numerous essential supporting tasks. Under the UAE Corporate Tax Law, an activity is considered **ancillary** to a Qualifying Activity if it meets two key conditions:

1. It is **necessary for the performance of the main activity**.
2. It serves **no independent function** but makes a minor contribution to the main activity and is so closely related to it that it should not be regarded as a separate activity.

The law explicitly recognizes that activities ancillary to the trading of qualifying commodities will also be treated as a qualifying activity and will therefore be subject to the 0% corporate tax rate. This is a crucial provision that provides clarity and flexibility for commodity traders.

Here are detailed examples of ancillary activities that are typically considered part of the trading of qualifying commodities:

1. Warehousing and Storage

What it entails: This refers to the physical storage of the qualifying commodities. In the context of trading, a QFZP buys a large quantity of a commodity and needs a place to store it before it is sold to a customer. This can include:

- **Renting or operating a dedicated warehouse:** The company might lease a facility to hold its inventory of commodities.
- **Storage in a customs-bonded facility:** Holding commodities in a designated zone or customs-controlled area is a common practice in international trade and is considered a part of the storage function.
- **Inventory management:** The related administrative tasks of tracking stock levels, organizing the warehouse, and managing the inflow and outflow of goods are all part of this ancillary activity.

Why it is ancillary: Warehousing is a necessary and closely related function to the main activity of trading. Without it, a company cannot physically manage its inventory to fulfill contracts and make a profit. It is not an independent service but an integral part of the buy-and-sell cycle.

2. Delivering

What it entails: This refers to the physical movement of the qualifying commodities to the customer. A trader's responsibility often extends to ensuring the goods are transported from their point of storage to the point of delivery specified in the sales contract. This can include:

- **Arranging for transportation:** Engaging a third-party logistics provider to move the commodity.
- **Operating an in-house fleet:** Using the company's own vehicles or vessels to deliver the goods.
- **Last-mile delivery:** Even if the final delivery happens outside the free zone or in another country, it is still considered part of the main trading activity and remains ancillary.

Why it is ancillary: Delivery is the final step in a successful trade. A trader's income is derived from the sale of the commodity, and the delivery is a non-independent, essential component of completing that sale.

Key Distinction: It is important to note that these activities are ancillary **to the trading of a qualifying commodity**. They are not stand-alone logistics services for which the QFZP would receive separate payment. The income is from the sale of the commodity, not from providing warehousing or delivery services to an external party for a separate fee. If a QFZP were to, for example, charge a third-party company a fee for storing their goods, that income would be from a separate logistics service and would be subject to its own set of rules for qualifying activities.

Case Study 1: The Qualifying Commodity Trader

Company: Al Falah Metals FZCO is a Qualifying Free Zone Person (QFZP) based in the Jebel Ali Free Zone (JAFZA). The company's sole business is trading gold.

Business Model:

- **Procurement:** Al Falah sources raw gold in the form of doré bars (a semi-pure alloy of gold and silver) from various mining operations in Africa. The doré bars are shipped directly to the UAE.
- **Ancillary Activities:** Upon arrival, the doré bars are stored in a secure, third-party vault facility in a Designated Zone. The company engages in minimal, non-transformative processing, such as having the bars assayed to determine their exact purity. The company uses this information to get the bars certified for trading on the Dubai Gold & Commodities Exchange (DGCX).
- **Sales:** The company sells the certified gold bars to two primary customers:
    - **Customer A:** A local jewelry manufacturer based in Mainland Dubai. The manufacturer will melt the gold and use it to create finished jewelry products.
    - **Customer B:** An investment fund based in Switzerland, which buys the gold bars for its portfolio. The gold bars are not physically shipped to Switzerland but are held in a vault on behalf of the fund.
- **Financials:** Al Falah's revenue is solely from the sale of the gold bars. All of its operational costs, including storage, logistics, and minimal assaying fees, are directly tied to these transactions. The company meets the adequate substance requirements, has no other sources of income, and maintains audited financial statements.

Analysis:

1. **Is the commodity "qualifying"?** Yes. Gold is a metal, and the doré bars, even after minimal assaying, are considered to be in their raw form. Critically, gold bars are a product traded on a recognized exchange (DGCX). The HSN code for the raw gold confirms its classification.
2. **Is the company a QFZP?** Yes. The company meets all the necessary conditions, including adequate substance and no non-qualifying income.
3. **Is the activity "trading"?** Yes. The company is engaged in the physical buying and selling of the commodity.
4. **Tax Consequence:** The income from both Customer A and Customer B is treated as **Qualifying Income**. Therefore, all income from these sales will be subject to a **0% Corporate Tax rate**.

Case Study 2: The Non-Qualifying Commodity Processor

Company: Global Metals Processing FZE is a Free Zone Person in the Ras Al Khaimah Economic Zone (RAKEZ). Its business involves the treatment and processing of scrap metal.

Business Model:

- **Procurement:** The company imports large quantities of mixed metal scrap (e.g., old car parts, appliances) from international suppliers.
- **Processing:** The company operates a small manufacturing facility within its Free Zone premises. Here, the scrap metal is melted down, separated by metal type (steel, aluminum, etc.), purified, and then cast into new, uniform ingots and sheets. This is a significant transformation of the raw material into a new product.
- **Sales:** The company sells these new metal ingots and sheets to various construction and fabrication companies in Mainland UAE and abroad. These customers use the ingots and sheets to manufacture finished products like building materials and machinery.
- **Financials:** All of the company's revenue is from the sale of these processed metal products. It has adequate substance and maintains audited financials. The company also offers a separate consulting service to other companies on scrap metal recycling, which constitutes 15% of its total revenue.

Analysis:

1. **Is the commodity "qualifying"?** No. While the initial raw material was a metal, the company's activity involves a significant transformation. The final products (uniform ingots and sheets) are a result of a processing and manufacturing activity, not the trading of a raw commodity. The HSN code for the finished ingots and sheets would be different from that of raw scrap metal.
2. **Is the company a QFZP?** Even if the company's manufacturing activity were a qualifying activity (which it can be under the law), the consulting revenue alone (15% of total revenue) exceeds the "de minimis" threshold of 5%. This means the company is not a QFZP.
3. **Is the activity "trading"?** No. The core activity here is processing and manufacturing. The company is adding significant value to a raw material, which is fundamentally different from a pure trading model.
4. **Tax Consequence:** Because the company is not a QFZP (due to exceeding the de minimis threshold) and the core activity is not the "trading of qualifying commodities" in its raw form, Therefore, all income from these sales will be subject to a **0% Corporate Tax rate**.

Case study 3: Trading of Qualifying Commodities

Company Name: Emirates Gold

Business Activity: Emirates Gold Bullion FZE is a Free Zone Person operating in the Dubai Multi Commodities Centre (DMCC). Its core business is the physical trading of gold, a Qualifying Commodity. The company buys and sells gold bullion and bars to a variety of clients.

- The company negotiates a purchase of 1,000 kilograms of gold bullion from an international refinery at a price of AED 250,000 per kilogram. The total cost is AED 250,000,000.
- It then finds a buyer, a major bank on the mainland, who agrees to purchase the 1,000 kilograms at a slightly higher price of AED 251,500 per kilogram.
- The total sales revenue amounts to AED 251,500,000, resulting in a gross profit of AED 1,500,000 from the core trade.

Ancillary Activities and Revenue Streams: To facilitate the transaction, Emirates Gold Bullion FZE provides two additional services:

1. Secure Vault Storage: As part of the sale, the company stores the gold in its secure, DMCC-approved vault for a short period before the bank arranges its own pick-up. It charges a storage fee of AED 500 per kilogram, generating an additional AED 500,000 in revenue.
2. Assay and Certification Services: The bank requires a final assay and certification to verify the purity of the gold. Emirates Gold Bullion FZE provides this service for an additional fee, using its in-house experts and equipment. This service generates an additional AED 150,000 in revenue.

Analysis of Revenue Streams

The analysis clearly identifies each revenue stream and determines its qualifying status.

- Core Qualifying Activity: The AED 251,500,000 from the trading of gold is revenue from a Qualifying Activity. This income stream is subject to the 0% Corporate Tax rate.
- Secure Vault Storage: The AED 500,000 from secure storage is considered Qualifying Income. It is directly linked to the core trading activity, as secure storage is often a necessary service to complete a precious metals transaction.
- Assay and Certification Services: The AED 150,000 from assay and certification is also considered Qualifying Income. Similar to storage, this service is directly related to the core activity of trading gold and adds value to the main transaction

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