FINHIVE

ASSURANCE
ADVISORY
TAX

Corporate Tax for Unincorporated Partnership

OVERVIEW OF UNINCORPORATED PARTNERSHIPS' TAX CONSEQUENCES

An Unincorporated Partnership is treated as a **"tax-transparent" entity**. This is a core concept under the UAE CT Law. It means the partnership itself is not considered a Taxable Person and is not subject to tax. Instead, the tax consequences flow directly to the partners, who are individually responsible for paying Corporate Tax on their share of the profits.

The partnership's role is to calculate its net income, and its partners will then include their portion of this income in their own taxable income calculations.

WHO CAN BE A PARTNER IN UNINCORPORATED PARTNERSHIP?

Based on the Corporate Tax Law, a partner in a partnership can be either an **individual** (a natural person) or a **legal entity** (a juridical person).

- **Individuals and Legal Entities:** A partnership can be formed by any combination of these. This includes a partnership between multiple individuals, multiple companies, or a mix of both. The partners can be residents and non-residents, as well as UAE and foreign-incorporated companies.
- **Partnerships as Partners:** A partnership itself **cannot** be a partner in another partnership. This is because an unincorporated partnership does not have its own separate legal identity (it is not a juridical person), which is a requirement to become a partner in another partnership.
- **Tax Groups:** A Tax Group, which is a collection of companies treated as one taxable entity, also **cannot** be a partner. A Tax Group is a construct of the Corporate Tax Law, not a legal person. However, the individual companies that make up the Tax Group can individually be partners in a partnership.

LIABILITY OF THE UNINCORPORATED PARTNERSHIP AND ITS PARTNERS FOR CORPORATE TAX

The partnership itself is **not a Taxable Person** and has no tax liability. The tax liability falls on the partners.

- **Partnership's Role:** The partnership is required to register for Corporate Tax and fulfill certain filing obligations. However, it does not pay the tax.
- **Partners' Role:** Each partner **is individually responsible for paying Corporate Tax** on their distributive share of the partnership's income. They must include this income in their own tax calculations based on their tax status.

PARTNERSHIP DEED/AGREEMENT

The **Partnership Deed or Agreement** is the single most important document. It outlines the terms of the partnership, including how profits and losses will be shared among the partners. This document serves as the primary evidence for determining each partner's **distributive share**, on which their tax is calculated.

DISTRIBUTIVE SHARE OF PARTNERS

A partner's distributive share is their portion of the partnership's income, which is determined by the partnership deed.

- If a partner is a **company** (juridical person), their distributive share is subject to the standard 9% UAE Corporate Tax rate.
- If a partner is an **individual** (natural person), their distributive share is subject to Corporate Tax only if it is derived from a business or business activity they carry on in their capacity as a partner.

CAPITAL CONTRIBUTIONS BY PARTNERS

Capital contributions that a partner makes to the partnership are considered an investment. They are **not tax-deductible** for the partnership when calculating its income.

PAYMENT TO PARTNERS

Any payments made by the partnership to a partner, such as a salary, bonus, or other form of compensation, are treated as part of the partner's distributive share. These payments are **not deductible** as an expense for the partnership. This is done to ensure that the income is taxed only once, at the partner level.

DISSOLUTION OF PARTNERSHIP

Upon the dissolution of an Unincorporated Partnership, the partners may receive assets and income from the liquidation. The **income or gain** arising from the dissolution and distribution of assets is considered part of the partners' taxable income and will be treated in accordance with their respective tax status. The partnership itself, being a tax-transparent entity, is not subject to tax on the dissolution.

UNINCORPORATED PARTNERSHIPS: THE "FISCALLY TRANSPARENT" MODEL

The term **"fiscally transparent"** is a core concept in the UAE Corporate Tax Law and is used to describe how Unincorporated Partnerships are treated for tax purposes. This model means the partnership is not a separate taxable entity. Instead, its financial life is "seen through" directly to its partners.

WHAT DOES "FISCALLY TRANSPARENT" MEAN?

In simple terms, "fiscally transparent" means the partnership itself does not pay Corporate Tax. The income and expenses of the partnership are not taxed at the entity level. The tax consequences are passed directly to the partners as if the income was earned by them personally.

- **No Entity-Level Tax:** The partnership is not considered a "Taxable Person" under the law. It does not file a tax return to pay tax.
- **Income Flows to Partners:** The income generated by the partnership is treated as if it were the partners' income from the very beginning.

WHY THIS MODEL IS USED

The main objective of the fiscally transparent model is to avoid **double taxation**.

- **Avoiding Double Taxation:** Without this model, the partnership's income would be taxed once at the partnership level and then a second time when the remaining profits are distributed to the partners. The fiscally transparent approach ensures the income is taxed only once, at the partner level.
- **Simplifying Tax for Partners:** It streamlines the process for partners by allowing them to simply include their share of the partnership's income in their own tax returns.

THE ROLE OF THE PARTNERSHIP IN A FISCALLY TRANSPARENT MODEL

Even though a partnership is fiscally transparent, it is not invisible to the tax authority. It still has important responsibilities:

- **Financial Accounting:** The partnership must accurately calculate its total income, deduct its expenses, and determine its net profit.
- **Information Reporting:** The partnership is required to **register for Corporate Tax** and file an **Information Return**. This report provides the FTA with a clear breakdown of the partnership's income and how it was distributed among the partners. This allows the FTA to verify that each partner is correctly reporting and paying tax on their share.

NATURAL PERSONS AND JURIDICIAL PERSONS AS PARTNERS

IF NATURAL PERSON WAS THE PARTNER

The fundamental principle is that the partnership's income is not taxed at the partnership level. Instead, the tax liability is passed directly to the partners. For a natural person, their distributive share of the partnership's income is subject to CT **only if** that income is considered to be from a "business or business activity" they carry on as a partner. This means not all income a natural person receives from a partnership is taxable.

Corporate Tax for Natural Person Partners

- **Turnover Threshold:** A natural person who is a partner is only subject to Corporate Tax if their **total turnover** from all their business activities (including their share from the partnership) exceeds AED 1 million in a calendar year. If they are under this threshold, they have no tax liability and are not required to register.
- **Excluded Income:** Certain types of income are **disregarded** when calculating this AED 1 million threshold, regardless of how much is earned. This includes:
    - Wages or salaries
    - Personal investment income
    - Real estate investment income (if not done under a license)
- **Small Business Relief:** If a natural person's total revenue from all their businesses (including their share from the partnership) is below AED 3 million, they may be eligible for Small Business Relief. This relief is assessed individually for each partner, not at the partnership level.

IF JURIDICAL PERSON WAS THE PARTNER

- **Resident Juridical Person:** A company or other resident legal entity that is a partner is subject to Corporate Tax on its distributive share of the partnership's income, along with any other business income. It's taxed at the standard rates (0% up to AED 375,000, 9% on income above that).
- **Non-Resident Juridical Person:** A non-resident company is only subject to UAE Corporate Tax if it has a **Permanent Establishment** in the UAE, derives **State Sourced Income**, or has a similar **nexus**. If the partnership constitutes a Permanent Establishment, the non-resident partner will be taxed on their share. If not, their share is treated as State Sourced Income and may be subject to a different tax regime.

FISCALLY OPAQUE UNINCORPORATED PARTNERSHIPS

An unincorporated partnership can apply to the Federal Tax Authority (FTA) to be treated as a **Taxable Person** in its own right, making it **fiscally opaque**. This means the partnership is subject to Corporate Tax on its profits, not the individual partners.

- **Tax Liability:** The partnership will file its own tax returns and pay Corporate Tax on its **Taxable Income**.
- **Partners' Liability:** The partners are still **jointly and severally liable** for the tax payable by the partnership. This means if the partnership fails to pay, the FTA can pursue any of the partners for the full amount.

Key Takeaway for Tax Planning

The most significant tax planning opportunity for unincorporated partnerships is the choice of tax treatment.

- **Default (Fiscally Transparent):** This model is often beneficial for **natural person partners** whose share of the partnership's turnover, combined with their other business income, remains below the AED 1 million threshold. It allows them to operate without a Corporate Tax liability.
- **Electing to be a Taxable Person:** The partners can apply to the Federal Tax Authority (FTA) to have the partnership itself treated as a taxable entity. This can be beneficial for managing complex tax liabilities, especially for partnerships with many partners or those involving juridical persons. This centralizes the tax payment and compliance at the partnership level, simplifying the process for the partners. Once this election is made and approved, it is generally **irrevocable**.

Computation of 1M Threshold and Interaction with Small Business Relief Example

An unincorporated partnership has a total annual revenue of **AED 2.5 million**.

- **Partner A** (a natural person) has a **40% share** in the partnership.
- **Partner B** (a company) has a **60% share**.

For the purpose of the AED 1 million threshold:

- **Partner A's revenue share** is AED 2.5 million x 40% = **AED 1 million**.

- In this specific case, since Partner A's share is exactly AED 1 million, they **must register** for Corporate Tax. But the Partner can claim Small business relief for the taxable income

If the partnership's revenue had been AED 2.4 million, Partner A's share would be AED 960,000, which is below the threshold. In that scenario, Partner A would **not** be required to register, assuming they have no other business revenue.

Example: A Fiscally Transparent Partnership with Strategic Tax Planning for a Foreign Partner

The Setup:

- **Partnership:** Unincorporated partnership G&H Advisory, a mainland-based financial consulting firm.
- **Partner 1 (Natural Person):** Mr. G, a UAE-resident, with a 40% distributive share. His only other income is from a separate, unlicensed real estate business in the UAE, with a revenue of AED 800,000.
- **Partner 2 (Juridical Person):** Company H, a non-resident juridical person incorporated in a foreign country with a tax rate of **20%**. It has a 60% distributive share.
- **Financials:** In its first tax period, the partnership's revenue is AED 5 million, with deductible expenses of AED 2 million. This results in a net profit of AED 3 million.

Analysis of the Two Corporate Tax Scenarios

The partners of G&H Advisory have a choice that will have significant tax consequences: operate under the default fiscally transparent model or elect to be a fiscally opaque taxable entity.

Scenario 1: Fiscally Opaque (Electing to be a Taxable Person)

This is the most strategic choice for Company H. The partnership itself becomes the taxable entity.

- **Partnership Tax Liability:** The partnership files a Corporate Tax return on its **full net profit of AED 3 million**.
  - Tax on the first AED 375,000: AED 0 (0% rate)
  - Tax on the remaining AED 2.625 million: AED 236,250 (9% rate)
  - **Total UAE Tax paid by the partnership: AED 236,250.**
- **Consequences for Company H (Foreign Partner):** When Company H receives its profit distribution, it is considered to have received income that has already been taxed at the source. The foreign jurisdiction will generally **not impose a second layer of tax** on this income. This is a crucial benefit for Company H, as it allows them to satisfy their tax obligation at the lower UAE rate of 9% rather than at their home country's higher 20% rate.

Scenario 2: Fiscally Transparent (The Default Position)

In this model, the partnership is not taxed. Instead, the tax liability is passed on to the partners individually.

- **Consequences for Company H (Foreign Partner):** Company H's distributive share of the net profit is AED 1.8 million. This income is subject to UAE Corporate Tax, assuming the partnership's activities create a Permanent Establishment (PE) for Company H.
    - UAE tax on AED 1.8 million: AED 128,250 (calculated at 9% on the portion above AED 375,000).
- **Foreign Tax Credit Analysis:** Company H will also have to report this income in its home country. Its home country will calculate tax on this AED 1.8 million at its 20% rate, which equals AED 360,000.
    - To prevent double taxation, Company H can claim a foreign tax credit for the tax it paid in the UAE. However, the credit will only be for **AED 128,250**.
    - Company H would still need to pay an additional tax of **AED 231,750** (AED 360,000 - AED 128,250) to its home country.
- **The Disadvantage:** Under the transparent model, the UAE tax is just a prepayment of a portion of the higher foreign tax. The final effective tax rate on this income would still be **20%**, making it a less favorable option for Company H.

Conclusion: Strategic Takeaways

- **Opaque is the Strategic Choice:** The fiscally opaque model is a powerful tax planning tool for the partnership with a foreign partner in a higher-tax jurisdiction. It allows the partnership to pay the tax in the UAE at the lower 9% rate. This payment is then generally considered to satisfy the foreign partner's tax obligation in their home country, effectively allowing them to benefit from the UAE's lower tax rate.
- **Risk of Double Taxation:** The fiscally transparent model creates a significant risk of a higher overall tax burden for a foreign partner. The UAE tax would not eliminate their foreign tax liability but only partially offset it through a foreign tax credit, leading to a higher effective tax rate.
- **Mr. G's SBR:** The choice between models also impacts Mr. G. If they opt for the opaque model, the partnership's AED 5 million revenue **exceeds the SBR threshold**, making the partnership ineligible for the relief. However, Mr. G may still prefer this route if the benefits for Company H are part of a larger business strategy.

DETERMINING TAXABLE INCOME – FISCALLY OPAQUE/TRANSPARENT

Whether a partnership is fiscally transparent or opaque, its net profit is the starting point for calculating Taxable Income.

- **Financial Statements:** All partnerships must prepare standalone financial statements. If the partnership's revenue exceeds AED 50 million, these financial statements must be **audited**.
- **Fiscally Opaque:** The partnership will calculate its own Taxable Income based on its financial statements and make all necessary adjustments (e.g., for non-deductible expenses). It then pays tax on this amount.
- **Fiscally Transparent:** The partnership calculates its net profit as a whole, but the partners then take their **distributive share** of that profit. Each partner must then add their share to their other business income to determine their personal Taxable Income. They are responsible for their own tax payments.
-

INVESTMENT INCOME

Fiscally Transparent Unincorporated Partnership

In this default model, the partnership's investment income is directly attributed to each partner based on their distributive share.

- **For Juridical Person Partners:**
  - **UAE Dividends & Distributions:** Income from dividends or profit distributions from a UAE-resident juridical person is **exempt** from Corporate Tax without any conditions.
  - **Foreign Dividends & Capital Gains:** Income from dividends, distributions, or gains from the sale of shares in a foreign company is also **exempt**, provided the investment qualifies as a **"Participating Interest."** This generally requires a minimum 5% ownership stake and a 12-month holding period (or intent to hold).
- **For Natural Person Partners:**
  - **Personal Investment Income:** Dividends and capital gains received by a natural person from investments are considered **"Personal Investment income."** This type of income is **not subject to Corporate Tax**, as long as the investment activity is not conducted through a license or considered a commercial business. This means the individual partner does not need to consider the participation exemption rules, as the income is already outside the scope of Corporate Tax.

Fiscally Opaque Unincorporated Partnership

If the partnership elects to be a taxable entity, all investment income is dealt with at the **partnership level**.

- **Tax Liability:** The partnership itself is treated as a resident juridical person and is responsible for determining its own Taxable Income. The partners are not taxed on their distributive share of the partnership's income.
- **Exemptions:** The partnership is eligible for the same exemptions as any other company.
  - **UAE Dividends & Distributions:** Dividends and profit distributions from a UAE-resident juridical person are **exempt** from Corporate Tax.
  - **Foreign Investment Income:** Income from foreign dividends, distributions, or capital gains is **exempt** if the partnership's investment qualifies as a **"Participating Interest."**

Tax Planning Perspective

The choice of tax structure has a direct impact on the tax treatment of investment income.

- **Natural Person Partners:** The transparent model is generally simplest for natural persons, as their personal investment income is not subject to Corporate Tax.
- **Juridical Person Partners:** The decision is more strategic. A **fiscally opaque** structure can be highly beneficial for a partnership with a **foreign corporate partner**. If the partnership's investments generate exempt income (e.g., qualifying dividends from a foreign company), the partnership will not pay tax in the UAE. This can be more favorable than a transparent structure where the foreign partner might have to deal with complex foreign tax credit rules.

Fiscally Transparent: Taxed at the Partner Level

In this model, the partnership's investment income is a pass-through. The income is attributed to each partner, and their individual tax status and circumstances are used to determine if the income is taxable or exempt.

- **Example 1: A Partnership with a Corporate Partner** Partnership A (transparent) holds shares in a foreign company that pays a dividend. Partnership A's profit-sharing agreement attributes 70% of this income to its partner, Company B (a UAE-resident juridical person).

- **Tax Treatment:** The dividend income is not taxed at the partnership level. Instead, the AED 700,000 dividend is attributed to Company B.
- **Exemption Test:** Company B will then test if this investment qualifies for the **Participation Exemption**. If Company B has held a 5% or greater ownership stake in the foreign company for at least 12 months, the AED 700,000 dividend is **fully exempt** from Corporate Tax in its hands.

- **Example 2: A Partnership with a Natural Person Partner** Partnership C (transparent) invests in a foreign stock. The capital gain from the sale of this stock is attributed to Mr. D, a UAE-resident natural person who is a partner.
  - **Tax Treatment:** The income is not taxed at the partnership level. It is attributed to Mr. D.
  - **Exemption Test:** The income will be treated as **personal investment income**. As long as Mr. D did not conduct this activity under a commercial license, this income is **outside the scope of Corporate Tax** for him. The participation exemption rules for juridical persons do not apply here because the income is inherently non-taxable for the individual.

Fiscally Opaque: Taxed at the Partnership Level

In this model, the partnership is treated as a separate legal entity for tax purposes. It is the one that is subject to Corporate Tax, not the partners.

- **Example: A Partnership with Both Partner Types** Partnership E (opaque) has a juridical partner and a natural person partner. The partnership's investments generate AED 1 million in dividends from a UAE-resident company and a AED 500,000 capital gain from the sale of shares in a foreign company.
  - **Tax Treatment:** The partnership, not the partners, is the taxable person. It will file a Corporate Tax return on its investment income.
  - **Exemption Test:**
    - **UAE Dividends:** The AED 1 million in dividends from the UAE company is **exempt** from Corporate Tax in the partnership's hands.
    - **Foreign Capital Gains:** The partnership will test if its investment in the foreign company qualifies for the **Participation Exemption**. If the conditions are met, the AED 500,000 capital gain is also **exempt** at the partnership level.
- **Result:** After the partnership has paid its tax (which would be zero in this case), it can distribute the remaining cash to the partners. The partners generally won't

have to pay Corporate Tax on these distributions because the income has already been dealt with by the partnership.

In summary, the key difference is the point of taxation. A transparent structure passes the tax burden to the individual partners, who then apply their specific tax rules. An opaque structure keeps the tax burden at the partnership level, where it is treated like any other company and can claim corporate-level exemptions.

PROFITS AND TRANSFER OF PARTNER'S DISTRIBUTIVE SHARE

Fiscally Transparent: Taxed at the Partner Level

In this model, the partnership is not a Taxable Person. Instead, its income and expenses "pass through" directly to the partners. The partners are individually responsible for reporting their share of the partnership's income.

- **Share of Profits:** A partner's distributive share of the partnership's profits is considered their business income. They must include this income in their personal CT calculation to determine if they meet the tax thresholds (e.g., the AED 1 million revenue threshold for natural persons).
- **Transfer of Share:** The gain or loss from selling a partner's share is treated as **Business income** and is subject to CT in their hands. This is because the law considers the partners to be directly conducting the business of the partnership, and the partnership does not have a separate legal personality.

Fiscally Opaque: Taxed at the Partnership Level

Here, the partners have applied to the Federal Tax Authority (FTA) to treat the partnership as a separate Taxable Person.

- **Share of Profits:** Any income the partners receive from the partnership (e.g., as a distribution) is **not considered taxable income** for them. This is because the income has already been taxed at the partnership level. The partnership determines its Taxable Income and pays the CT.
- **Transfer of Share:** The gain or loss from the sale of a partner's share can be **exempt** from CT. This is a significant distinction. The FTA will apply the **Participation Exemption** rules to this transaction, even though the partnership isn't a juridical person. If the transfer meets the conditions (e.g., the partner's share in the partnership is at least 5% and held for 12 months), the gain on the sale of the interest can be exempt from CT.

Tax Planning Perspective

The choice of tax structure creates very different outcomes for partners, especially when they exit the partnership.

- **Transparent Model:** Provides **no exemption** on the gain from selling a partnership share. The gain is treated as business income and is fully taxable, subject to the partner's individual tax status. This can be a major disadvantage for partners with valuable, long-term holdings.
- **Opaque Model:** Offers a potential **tax-free exit**. By applying the Participation Exemption to the transfer of a partnership share, the gain from a sale can be completely exempt from CT. This makes the opaque model an excellent strategic choice for partners looking to build and eventually sell a valuable business without incurring a significant tax liability on the capital gain.

DEDUCTIBLE EXPENSES

The general rule is that any expense incurred **wholly and exclusively** for business purposes is deductible from a partnership's taxable income. If an expense serves multiple purposes, only the portion directly attributable to the business can be deducted.

- **Fiscally Transparent:** In this model, the partners are the taxable persons. Therefore, each partner will take their **distributive share of the partnership's expenses** when calculating their individual taxable income. They may also deduct any expenses they incurred directly for the partnership's business.
- **Fiscally Opaque:** In this case, the partnership is the taxable person. It will deduct all of its eligible expenses when calculating its own taxable income. The partners do not deduct any partnership-related expenses on their personal tax returns.

NON-DEDUCTIBLE EXPENDITURES

Certain payments are specifically disallowed as deductions, regardless of the partnership's tax treatment. These typically involve amounts that are considered a return on investment rather than a legitimate business expense.

- **Dividends and Profit Distributions:** Any dividends or profit distributions paid by the partnership to its partners are **not deductible**.
- **Amounts Withdrawn by a Partner:** This is a crucial point. Any money or assets a partner takes from the business, outside of a formal, deductible expense like a salary for services rendered, is considered a withdrawal. These withdrawals are **not deductible** for tax purposes.

TAX PLANNING PERSPECTIVE

The non-deductibility of payments to partners is a key consideration.

- **Transparent Model:** For a fiscally transparent partnership, payments to partners are treated as **amounts withdrawn from the business**. This means they are not deductible from the partners' taxable income, as the full profit has already been attributed to them.
- **Opaque Model:** For a fiscally opaque partnership, payments to partners (or on their behalf) are considered **profit distributions** to the owners. This is why they are not deductible from the partnership's taxable income.
- **Conclusion:** The principle is the same in both scenarios: you cannot deduct payments to partners that are simply a share of the profits. This prevents

partnerships from reducing their taxable income by paying out profits to partners disguised as expenses.

INTEREST DEDUCTION

General Interest Deduction Limitation Rule (GIDLR)

This rule prevents businesses from excessively reducing their taxable income through debt. It limits the deductible **Net Interest Expenditure** (interest expense minus interest income) to the greater of AED 12 million or 30% of adjusted EBITDA.

- **Fiscally Transparent Partnerships:** The GIDLR is tested at the **partner level**.
  - **Natural Person Partner:** The rule **does not apply** to natural persons, as they are specifically excluded. This is a significant benefit for individuals in a transparent partnership.
  - **Juridical Person Partner:** The rule **does apply**. The 30% limitation is based on the juridical person's **own adjusted EBITDA**, not the partnership's.
- **Fiscally Opaque Partnerships:** The GIDLR is tested at the **partnership level**.
  - **Partnership as the Taxable Person:** The rule applies to the partnership itself, regardless of whether its partners are individuals or companies. The 30% limitation is calculated based on the partnership's **adjusted EBITDA**.
- **Unutilised Interest:** Any interest expense disallowed under this rule can be carried forward for up to 10 years. In an opaque partnership, this carried-forward amount belongs to the partnership and **cannot** be allocated to partners who leave.

Specific Interest Deduction Limitation Rule (SIDLR)

This rule disallows interest deductions on loans from a related party if the loan's main purpose is to fund specific transactions, such as a dividend distribution or a capital contribution. This prevents tax base erosion.

- **Fiscally Transparent Partnerships:** The SIDLR is tested at the **partner level**. If a partner receives a loan from a related party for a restricted purpose, the deductibility of that interest is assessed based on the partner's circumstances.
- **Fiscally Opaque Partnerships:** The SIDLR is tested at the **partnership level**. The partnership's interest deduction is restricted if it obtains a loan from a related party for a restricted purpose.

Interest on Capital Contributions

This type of interest is **never deductible** for tax purposes. It is treated as a profit distribution, not an expense. The tax consequences differ based on the partnership's status.

- **Fiscally Transparent:** The partnership itself isn't a taxable person, so there's no deduction to claim. For the partners, the interest received is considered an **allocation of income**, not a deductible business expense. They must include this interest as taxable income when calculating their individual CT liability.
- **Fiscally Opaque:** The interest is treated as a **profit distribution** or similar benefit paid to an owner. Therefore, it is **not deductible** for the partnership. For the partners, the interest they receive is **excluded from their taxable income** because the underlying income has already been subject to tax at the partnership level.

Interest on Loans from Partners

This is a very different scenario from capital contributions. A partner lending money to the partnership is treated as a separate transaction from their equity investment.

- **Fiscally Transparent:** The interest expense is deductible at the **partner level**. If a partner receives a loan from another partner, and the loan is used **wholly and exclusively** for the partnership's business and is at **arm's length**, the interest can be deducted. The partner receiving the interest must include it as taxable income.
- **Fiscally Opaque:** Tx`he interest expense is deductible at the **partnership level**. The partnership can deduct the interest on a loan from a partner, provided the loan was for business purposes and the interest rate is at **arm's length**. The partner who receives the interest must report it as taxable income.

Tax Planning Perspective

The tax treatment of interest creates clear planning opportunities.

- **Capital Contributions:** The most significant difference is in the **opaque model**, which allows a partner to receive interest on their capital contribution tax-free, as the income was already taxed at the partnership level. In contrast, in the **transparent model**, this interest is taxed in the partner's hands.
- **Loans from Partners:** In both models, a partner can get a tax deduction for interest paid on a loan from another partner, as long as it's a genuine, arm's-

length transaction for business purposes. This provides a clear tax advantage over contributing capital.

- **Conclusion:** Partners who wish to provide additional funds to the partnership should strongly consider structuring the transaction as a **loan** instead of a capital contribution to gain a tax-deductible expense.

SALARY

Fiscally Transparent Partnership

In this default model, the partnership is not a taxable entity. All income and expenses "pass through" to the partners, who are individually responsible for paying Corporate Tax.

- **Salary Treatment:** A salary paid to a partner is not deductible from the partnership's income. It is treated as an **amount withdrawn** from the business.
- **Tax Impact:** The partner must include their **full distributive share of the partnership's profits** (calculated *before* the salary is paid) in their own taxable income. The salary amount they receive is then added back to this total, effectively making them pay tax on both their profit share and their salary.
- **Who Benefits:** This model benefits partners who, in their individual capacity, fall below the AED 1 million revenue threshold for being a taxable person. By not being a taxable person themselves, they can receive both their share of profits and a salary without incurring any Corporate Tax.

Fiscally Opaque Partnership

Here, the partners have elected for the partnership to be treated as a separate taxable entity. The partnership itself is responsible for filing a return and paying Corporate Tax.

- **Salary Treatment:** The salary paid to a partner is treated as a **profit distribution** to an owner and is not a deductible expense for the partnership.
- **Tax Impact:** The partnership calculates its full Taxable Income (without deducting the partner's salary) and pays Corporate Tax. The partners, in turn, are **not taxed** on the salary they receive from the partnership. This prevents the same income from being taxed twice.
- **Who Benefits:** This model primarily benefits partners who are **taxable persons themselves**, particularly those in higher-tax jurisdictions. It allows

the salary and profits to be taxed only once at the lower UAE tax rate, as the income is already dealt with at the partnership level. This can be more efficient for tax compliance than a transparent model.

SERVICE PROVIDED BY THE PARTNERS

Fiscally Transparent: Taxed at the Partner Level

In this model, the partnership is not the taxable person. The tax treatment of the service payment is handled by the partners themselves.

- **For the Partner as a Service Provider:** The partner receives a payment for services (e.g., rent, legal work) separate from their profit share. This payment is **taxable income** for the partner.
    - **Natural Person:** If the natural person's total revenue from all business activities (including this service income) exceeds AED 1 million, they will be subject to Corporate Tax.
    - **Juridical Person:** This income is generally part of their total taxable income.
- **For the Partnership's Tax Calculation:** The payment for services is **deductible** from the partnership's income, but this deduction is effectively passed through to the partners. The deduction is applied to the partners' taxable income in proportion to their distributive share.

Fiscally Opaque: Taxed at the Partnership Level

Here, the partnership is the taxable person, and it directly handles the tax treatment of the service payment.

- **For the Partnership:** The payment for services to a partner is a **tax-deductible expense** for the partnership, provided it is **wholly and exclusively** for the business and meets the **arm's length** standard. This means the payment must be what the partnership would have paid an unrelated third party for the same service.
- **For the Partner as a Service Provider:** The partner must include the payment they receive for services in their own taxable income. It is considered an independent business activity, separate from their ownership of the partnership.

REIMBURSEMENTS OF EXPENDITURE

Reimbursements are treated differently from payments for services. A reimbursement is when a partner pays for a partnership expense from their own funds and is then paid back by the partnership.

- **Transparent Partnership:** The partner who incurred the expense can deduct it from their taxable income to the extent they are reimbursed.
- **Opaque Partnership:** The partnership can deduct the reimbursement as a business expense. If the partner is not reimbursed, they **cannot** claim the expense as a deduction against any other taxable business, as it was not incurred for that business.

Tax Planning Perspective

The main difference is where the deduction is applied.

- **Benefit of Opaque:** For a partner with a valuable service or asset (like renting a property to the partnership), the opaque model offers a clear tax benefit. The **partnership** receives the tax deduction, which directly reduces its own taxable income. The partner receives the income, which is taxed at their personal level. This is straightforward and prevents any confusion regarding income allocation.
- **Transparent Model's Complexity:** In a transparent model, the deduction is fragmented and must be allocated to the partners. This can be complex and less direct than the opaque model's approach, where the deduction is claimed at a single, centralized entity.

TAX LOSS RELIEF AND CARRY-FORWARD

Tax losses can be carried forward to offset up to **75%** of a taxable person's future taxable income. However, they cannot be carried back to previous years. The ability to carry forward losses is subject to certain limitations.

- **Fiscally Transparent:** Tax losses are calculated and carried forward at the **partner level**.
  - **Limitation:** A partner's tax loss can only be offset against their **own future taxable income** from the partnership or other business activities.
  - **Exit of Partner:** If a partner leaves a fiscally transparent partnership, any unutilised tax losses they had accumulated are not lost. They remain with the **individual partner** and can be carried forward to offset their future taxable income from other business activities.
- **Fiscally Opaque:** The partnership is the taxable person, and tax losses are calculated and carried forward at the **partnership level**.
  - **Limitation:** The partnership can use its tax losses to offset its own future taxable income. The loss is tied to the partnership and **cannot be allocated or transferred to the partners**.
  - **Change in Ownership:** An opaque partnership can still carry forward its tax losses even if there is a change of more than 50% in ownership, as long as it continues to conduct the **same or a similar business**. This provides continuity and stability for the business.

FOREIGN TAX CREDIT (FTC)

A foreign tax credit is available to prevent double taxation on income earned from abroad that has already been subject to a foreign tax.

- **Fiscally Transparent:** The foreign tax credit is allocated among the partners in proportion to their **distributive share**.
  - **Calculation:** Each partner individually calculates their FTC. The credit is the **lower of** two amounts:
    1. The actual foreign tax paid (based on their share).
    2. The amount of UAE Corporate Tax that would be due on that same foreign income.
  - **Example:** As in the example provided, if Company A has a 40% share of a partnership's foreign income that was taxed at AED 200,000, Company A's share of the foreign tax is AED 80,000. However, the UAE CT due on that income for Company A is AED 58,500. The Foreign Tax Credit for Company A is the lower of the two, which is AED 58,500.
- **Fiscally Opaque:** The foreign tax credit is claimed at the **partnership level**.
  - **Calculation:** The partnership itself will calculate the credit based on its total foreign income and the total foreign tax paid.
  - **Benefit:** This simplifies the process for partners, as they do not need to calculate individual tax credits on their returns. The partnership handles the entire process, and the partners receive distributions from an entity that has already accounted for its tax liability.

CONSEQUENCES OF CHANGING STATUS

When the partners of a fiscally transparent Unincorporated Partnership decide to apply to the Federal Tax Authority (FTA) to be treated as a Taxable Person (fiscally opaque), it triggers a number of important Corporate Tax consequences, including eligibility for business restructuring relief and new rules for managing tax losses and accounting.

- **Deemed Transfer:** For Corporate Tax purposes, the change in status is treated as if each partner has **transferred** their portion of the partnership's assets and liabilities to the new, fiscally opaque partnership. However, this is just a tax treatment and does not require a legal transfer.
- **Business Restructuring Relief:** This deemed transfer can be covered under **Business Restructuring Relief**, allowing the transfer to be made on a "no gain or loss" basis. This relief prevents the partners from being taxed on any appreciation in the value of the partnership's assets at the time of the change in status.
- **Irrevocability:** Once approved, the application is generally **irrevocable**, meaning the partnership will remain a taxable person until it is dissolved or liquidated. This ensures stability in the tax status. However, the FTA can approve a revocation in exceptional circumstances.
- **Procedural Requirements:** The partnership, now a taxable person, is required to notify the FTA within **20 business days** of any partner joining or leaving the partnership. This is a crucial procedural step to maintain compliance.
- **Tax Losses:** Any tax losses incurred by the partnership after it becomes fiscally opaque can **only be used by the partnership** to offset its own future taxable income. These losses cannot be allocated to the partners, even if they leave.
    - **Continuity of Business:** An opaque partnership can still carry forward its tax losses even if there is a change of more than 50% in ownership, as long as it continues to conduct the **same or a similar business**.

IMPACT OF DIFFERENT ACCOUNTING METHODS

The change in a partnership's tax status can create complexities if partners use different accounting methods. The core principle is that partners must consistently apply their respective accounting methods for transactions that occurred when the partnership was fiscally transparent.

- **Accrual Basis vs. Cash Basis:** A partner who uses the **Accrual Basis** of accounting will recognize their share of partnership income in the period it is earned, even if the cash is not received. A partner using the **Cash Basis** will only recognize income when it is actually received.
- **Preventing Non-Taxation:** When a partnership changes from transparent to opaque, any income or expense that was accrued but not yet received/paid while the partnership was transparent must still be accounted for by the individual partner who used the cash basis.
    - **Example:** If a transparent partnership earns AED 10 million in December 2024 but receives the cash in January 2025, a partner using the Accrual Basis will recognize their share in their 2024 taxable income. A partner using the Cash Basis, however, will recognize their share of the income in their 2025 taxable income, even though the partnership is now opaque. This prevents that income from escaping taxation.

CORPORATE TAX REGISTRATION & RETURNS

Fiscally Transparent Partnerships

In this default model, the partnership itself isn't a taxable person, so it doesn't file a tax return. Compliance obligations fall on the individual partners.

- **Partners' Registration:**
  - **Juridical Partners:** A juridical person is already a taxable person and must comply with their own registration requirements. They don't need an additional registration for the partnership.
  - **Natural Person Partners:** A natural person must register for Corporate Tax only if their total revenue from all business activities in the UAE exceeds **AED 1 million** within a Gregorian calendar year.
- **Partnership's Registration:** The partners must appoint an authorized partner to register the partnership with the FTA. This registration results in a **Tax Registration Number (TRN)** for the partnership, but it is **inactive**. The purpose of this inactive TRN is solely for compliance and identification, not for tax payment.
- **Tax Returns:** The partnership does **not** file a tax return. Instead, each partner must file their **individual tax return** for their distributive share of the partnership's income. The authorized partner, however, must submit an **annual declaration** on behalf of all partners, providing details on the partnership's financials and each partner's distributive share.

Fiscally Opaque Partnerships

When partners elect to treat the partnership as a taxable person, the compliance obligations shift to the partnership as a single entity.

- **Partnership's Registration:** The inactive TRN becomes **active**. The partnership is now a taxable person and is responsible for all its tax obligations.
- **Partners' Deregistration:** If the partners do not have any other business activities, they can **deregister** from Corporate Tax, as their income from the partnership is now taxed at the partnership level.
- **Tax Returns:** The partnership files its **own tax return** by the standard deadline, like any other taxable person. The partners are not required to file a return for their share of the partnership's income.

TAX PERIODS AND FINANCIAL STATEMENTS

Fiscally Transparent Partnerships

The tax period and financial statement requirements are based on each partner's individual status.

- **Tax Period:** Each partner uses their **own tax period** to report their share of the partnership's income. This can lead to a situation where partners have different tax periods, requiring careful allocation of income and expenses. For example, a partner on a Gregorian calendar year will report their share of the partnership's income earned within that period, while a partner on a different financial year will report their share based on their own year-end.
- **Financial Statements:** The partnership must maintain financial statements, and the FTA can request them from the authorized partner. Audited financial statements are required if an **individual partner's revenue** from all business activities exceeds **AED 50 million**.

Fiscally Opaque Partnerships

The partnership is treated as a single entity for tax and compliance purposes.

- **Tax Period:** The partnership's tax period is the period for which it prepares its financial statements (e.g., its 12-month financial year).
- **Financial Statements:** The FTA can request financial statements directly from the partnership. The partnership is required to prepare **audited financial statements** if its total revenue (not the individual partners' revenue) exceeds **AED 50 million**. This centralizes the audit obligation, simplifying compliance for partners.

ASSURANCE
ADVISORY
TAX

FINHIVE Consulting LLC - FZ
4010, The Citadel Tower
Business Bay - Dubai - UAE

letstalk@fin-hive.com
04 552 7971 | 058 100 7397
www.fin-hive.com