ASSURANCE
ADVISORY
TAX

Qualifying Freezone Person Guide

Corporate Tax

What is a Free Zone (from a CT perspective)?

Under the Corporate Tax Law (Federal Decree-Law No. 47 of 2022), a Free Zone is defined as a specific geographical area that has been designated as such by a Cabinet decision. A "Free Zone Person" (FZP) is a company or branch registered in one of these recognized zones.

Crucially, all freezone entities are now considered "taxable persons." This means they are not automatically exempt. They must register for Corporate Tax with the Federal Tax Authority (FTA), obtain a Corporate Tax Registration Number (CTRN), and file an annual tax return. The question is no longer "are we exempt from tax?", but rather, "can we qualify for the 0% tax rate on our income?

The tax benefits are now a reward for meeting a specific set of criteria, not an inherent right of a free zone license.

This is the central reason for the distinction between a "Free Zone Person" (FZP) and a "Qualifying Free Zone Person" (QFZP).

- **FZP:** A company simply registered in a free zone. It is a taxable person with compliance obligations.
- **QFZP:** An FZP that meets all the conditions to benefit from the 0% CT rate on its "Qualifying Income."

The CT regime has therefore created a clear pathway and this will be discussed in this guide later in detail.

LIST OF FREEZONES IN UAE

Designated Zones
Abu Dhabi
Free Trade Zone of Khalifa Port
Abu Dhabi Airport Free Zone
Khalifa Industrial Zone
Al Ain International Airport Free Zone
Al Butain International Airport Free Zone
Dubai
Jebel Ali Free Zone (North & South)
Dubai Cars and Automotive Zone (DUCAMZ)
Dubai Textile City
Free Zone Area in Al Quoz
DAFZA Industrial Park Free Zone - Al Qusais
Dubai Aviation City
Dubai Airport Free Zone
International Humanitarian City – Jebel Ali
Dubai Commercial City
Dubai Logistics City
Dubai Carpet Free Zone
Sharjah
Hamriyah Free Zone
Sharjah Airport International Free Zone Ajman
Ajman Free Zone
Umm Al Quwain Free Trade Zone in Ahmed Bin Rashid Port
Umm Al Quwain Free Trade Zone on Sheikh Mohammed Bin Zayed Road
RAK
RAK Port Free Zone
RAK Maritime City Free Zone
RAK Airport Free Zone
Al Hamra Industrial Zone —Free Zone
Al Ghail Industrial Zone — Free Zone
Al Hulaila Industrial Zone — Free Zone
Fujairah
Fujairah Free Zone
FOIZ (Fujairah Oil Industry Zone)

Other Free Zones
International Free Zone Authority (IFZA)
Dubai Multi Commodities Centre (DMCC)
Dubai Silicon Oasis (DSO)
Dubai International Financial Centre (DIFC)
Dubai South Free Zone (formerly known as Dubai World Central)
Ras Al Khaimah Economic Zone (RAKEZ)
Ras Al Khaimah Free Trade Zone (RAK FT Z)
Abu Dhabi Global Market (ADGM)
Dubai World Trade Centre (DWTC) Free Zone
Dubai Healthcare City (DHCC)
Dubai Design District (d3)
International Media Production Zone (IMPZ)
Dubai Studio City
Dubai Internet City (DIC)
Dubai Knowledge Park
Dubai Science Park
Dubai Techno Park
Energy and Environmental Park (Enpark)
Twofour54
Masdar City Free Zone
Sharjah Media City
Sharjah Publishing City Free Zone (SPCFZ)
Ajman Media City Free Zone (AMCFZ)
Dubai International Academic City (DIAC)
Dubai Auto Zone
Dubai Maritime City
Dubai Gold and Diamond Park
Dubai Flower Centre
Dubai Carpet Free Zone
Khalife Industrial Zone Abu Dhabi Group (KEZAD)
Dubai Media City
Dubai Production City
Meydan Free Zone

Sharjah Research, Technology and Innovation Park (SRTIP).
RAK International Corporate Centre (RAK ICC).
Fujairah Creative City.
Dubai Biotechnology and Research Park (DuBiotech)
Dubai Industrial City (DIC):
Dubai Outsource City
Dubai Wholesale City
Expo City Dubai Free Zone
DUQE Free Zone
Jumeirah Lakes Towers Free Zone
U.S.A. Regional Trade Center (USARTC) Free Zone
Sharjah Communication Technologies Free Zone (COMTECH)
Ras Al Khaimah Media Free Zone
Ras Al Khaimah Investment Authority
Industrial City of Abu Dhabi (ICAD)

THE PRACTICAL FOUR-STEP MODEL FOR FREE ZONE CORPORATE CLIENTS

This guide is designed to provide a clear, step-by-step roadmap for dealing with free zone clients under the new UAE Corporate Tax (CT) regime. Rather than being a rigid tax manual, this is a practical workflow designed for immediate application. We've structured this process into a four-step model that simplifies the entire assessment, ensuring nothing is missed.

---

1. Know Your Client

The first and most critical step is to understand the client's fundamental tax status. Before we can analyze their income or activities, we must determine if they qualify for any tax benefits at all. This involves a comprehensive check to see if the free zone company meets all the criteria to be considered a Qualifying Free Zone Person (QFZP). This foundational check is the gateway to the 0% tax rate.

---

2. Know Your Client's Customers

Once the client's QFZP status is confirmed, the next step is to understand their revenue streams by analyzing who their customers are. The tax treatment of a free zone company's income is heavily dependent on the location and type of its customers. This step involves segmenting all customers into key categories, such as other free zone entities, mainland UAE companies, or international clients, to create a clear picture of the client's revenue landscape.

---

3. Know Your Client's Business Activity

With the customer information in hand, this step involves linking the revenue streams to the specific business activities that generate them. We will classify each of the client's activities to determine if whether they fall under the official list of "Qualifying Activities" or “Excluded Activities” as defined by the tax law. This is the stage where we distinguish between income that is eligible for the 0% tax rate and income that will be subject to the standard 9% rate.

---

4. Know Your Client's Tax Rate

The final step is to bring all the information together to calculate the client's final tax liability. This will lead to a final tax blueprint that clearly outlines what income is taxed at 0%, what is taxed at 9%, and what actions are needed to ensure full compliance. This step provides the ultimate answer to the client's tax question.

1) KNOW YOUR CLIENT

This first step is the non-negotiable starting point for every free zone client. The purpose is not just to collect data, but to critically evaluate whether the client can be a Qualifying Free Zone Person (QFZP) for the tax period. If they are not, the rest of our analysis on qualifying income becomes irrelevant, and a different tax strategy must be adopted.

The QFZP status is a gateway. If the gate is closed, the client's entire taxable income will be subject to the standard 9% tax rate.

To be a QFZP, the client must satisfy all six of the following criteria throughout the entire tax period. We will assess each one with a practical, investigative approach.

Checklists:

1. Is the Client a **"Recognized"** Free Zone Person?
2. Does the Client Maintain **"Adequate Substance"**?
3. Is the Client Deriving **"Qualifying Income"**?
4. Has the Client Made an **"Election"** to be Taxed at 9%?
5. Does the Client Comply with **"Arm's Length Principle"** & Maintain **"Transfer Pricing Documents"?**
6. Does the Client Maintain **"Audited Financial Statements"**?
7. Is the **"De Minimis"** Threshold Met?

1. Is the Client in a "Recognized" Free Zone?

What it means: The company must be incorporated or registered in a free zone that has been officially recognized by a Cabinet Decision for Corporate Tax purposes.

Practical Perspective: This is a foundational, non-negotiable check. While all major and commercially active free zones (e.g., JAFZA, DMCC, RAKEZ, DIFC, ADGM, etc.) are recognized, it is a crucial first verification step. The government wants to ensure that the 0% tax rate is tied to a legitimate, officially designated economic area.

What to do: Ask for a copy of the client's trade license. If the free zone is one of the well-known hubs, you can proceed with confidence. For any free zone that is unfamiliar or newly established, you should verify its status by checking the official list from the FTA or by contacting the Free Zone Authority directly.

2. Does the Client Maintain "Adequate Substance"?

- **What it means:** This is the most crucial and subjective criterion. The company must have a genuine, physical presence and conduct its Core Income-Generating Activities (CIGA) within the free zone. "Adequate" is always proportional to the business's scale and nature. The government is looking to avoid "brass plate" or shell companies.
- **Practical Application:** We must act like a tax auditor. We will ask probing questions to build a clear picture of their operations:
  - **Physical Assets:** Do they have a dedicated office, warehouse, or workshop? Is it a "flexi-desk" used only for mail, or is it a fully-equipped workplace?
  - **Human Resources:** How many full-time employees are on the company's visa and payroll? Are they qualified and capable of performing the business's CIGA? For a consulting firm, this means qualified consultants. For a logistics firm, it means warehouse staff and drivers. A high-revenue company with only one employee on a flexi-desk is a significant red flag.
  - **Management & Control:** Where are the key strategic decisions made? Who signs the contracts? Ideally, a significant portion of the company's management and decision-making should be based in the free zone.
  - **Operating Expenses:** Is the company incurring an adequate amount of operating expenses *in the free zone* that aligns with the scale of its activities? This includes rent, salaries, utilities, and other costs.
- **Perspective & Suggestions:**
  - **The "Outsourcing" Caveat:** A company can outsource its CIGA, but only to a third party within the UAE. However, the client must still maintain **adequate supervision** over the outsourced activity. We must see a clear outsourcing agreement and evidence of their oversight.
  - **Proportionality is Key:** What is "adequate" for a holding company (which may only need a few senior managers) is very different from what's needed for a manufacturing company. We must assess this on a case-by-case basis.

3. Is the Client Deriving "Qualifying Income"?

The client's business must primarily generate income that qualifies for the 0% tax rate. The definition of "Qualifying Income" depends entirely on the client's customers and activities. We will apply a clear, two-part rule:

The Rule for Free Zone Income (Freezone Clients)

Every income derived from a transaction with another Free Zone Person is **"Qualifying Income",** provided it is not from an **"Excluded Activity".**

- What it means: When a free zone company sells goods or provides services to another free zone company, that income is automatically eligible for the 0% tax rate. You don't need to check if the activity itself is on the "Qualifying Activities" list. The transaction's location and the customer's status are what matter.
- The Crucial Caveat: The only exception is if the income comes from an "Excluded Activity." These activities are never qualifying, regardless of who the customer is. Examples include residential property rental and certain banking and insurance services.

The Rule for Non-Free Zone Income (Mainland & International Clients)

Every income derived from a transaction with a non-Free Zone Person (i.e., a mainland or international client) must be from **a "Qualifying Activity"** to be considered "**Qualifying Income".**

- What it means: For any income coming from a mainland or international client, the client's business activity must be on the official list of "Qualifying Activities" as defined in Ministerial Decision No. 265 of 2023. If the activity is not on this list, the income will be taxed at 9%.
- Example 1 (Qualifying): A free zone company in Jebel Ali manufactures goods and exports them to a customer in Germany. "Manufacturing" is a Qualifying Activity. Therefore, the income from this transaction is Qualifying Income and subject to 0% tax (assuming all other QFZP conditions are met).
- Example 2 (Non-Qualifying): A free zone company provides Finance consulting services to a client in mainland. The activity of providing " finance consulting services" is not on the official list of Qualifying Activities. Therefore, the income from this international client would be considered non-qualifying and subject to the 9% tax rate.

4. Has the Client Made an "Election" to be Taxed at 9%?

- **What it means:** A free zone entity can voluntarily choose to be subject to the standard 9% tax rate. This is an irreversible decision.
- **Practical Application:** This is a simple confirmation check. We will ask the client directly if they have made this election. If they haven't, this condition is met. This election is often made for strategic reasons, such as to be part of a mainland tax group, so it is a crucial question to ask upfront.

5. Does the Client Comply with "Arm's Length Principle" & Maintain “Transfer Pricing Documents”?

- **What it means:** Any transactions with related parties (e.g., a parent company, a sister company) must be conducted at "arm's length," meaning the price must be the same as if the transaction were between unrelated parties. For businesses that meet specific revenue thresholds, this also requires maintaining Transfer Pricing (TP) documentation.
- **Practical Application:** We will ask if the client has any related-party transactions. If so, we will advise them to have formal agreements that justify the pricing. For larger companies, we will review their TP documentation (Master File, Local File) to ensure it is compliant. Failing this check is a major compliance risk that can lead to the loss of QFZP status.

6. Does the Client Maintain "Audited Financial Statements"?

- **What it means:** The client must have its financial statements audited by a qualified auditor and ensure they are compliant with a recognized accounting standard (such as IFRS).
- **Practical Application:** This is a mandatory requirement for all free zone entities seeking QFZP status, regardless of their revenue. We will request the client's audited financial statements for the tax period. This provides a formal, verifiable record of their financial position and activities, which is essential for a thorough tax assessment.

7. Is the "De Minimis" Threshold Met?

- What it means: The "De Minimis" rule provides a small margin of error for a Free Zone Person (FZP). It allows a company to have a limited amount of non-qualifying revenue without losing its QFZP status. This is a crucial safety net for businesses that have some unavoidable transactions with non-free zone clients. If a company's non-qualifying revenue exceeds this threshold, even by one dirham, it will fail the test with severe consequences.

How it is Computed: A Step-by-Step Guide:

The De Minimis test is a simple but precise calculation. To perform it, we must first correctly identify the two key components: Total Revenue and Non-Qualifying Revenue.

1. Calculate **Total Revenue** for the De Minimis Test:
    - Start with the company's total revenue from its financial statements.
    - Crucially, exclude any revenue from the company's Domestic or Foreign Permanent Establishments (PEs). This is a key point often missed. Income from a mainland branch (a Domestic PE) is already subject to the 9% tax rate and is therefore not part of the De Minimis calculation.
2. Identify **Non-Qualifying Revenue:**
    - This is the sum of all income streams that do not meet the criteria for "Qualifying Income." This includes revenue from:
        - All Excluded Activities, regardless of the customer (e.g., residential property rental, banking activities).
        - All activities with a Non-Free Zone Person (i.e., mainland or international clients) that are not on the official "Qualifying Activities" list (e.g., general consulting, as discussed earlier).

When the De Minimis Limit Fails (and QFZP Status is Lost):

A company will fail the De Minimis test, thereby losing its Qualifying Free Zone Person (QFZP) status, if **either** of the following conditions is met:

1. The company's **Non-Qualifying Revenue is greater than AED 5,000,000.**
2. The company's **Non-Qualifying Revenue is more than 5% of its total revenue**

THE DE MINIMIS RULE: COMPUTATION AND APPLICATION

Step 1: Identifying Relevant Revenue Streams

The provided article introduces a vital step: certain revenue streams must be **completely excluded from both the numerator (Non-Qualifying Revenue) and the denominator (Total Revenue)** before the De Minimis calculation is performed.

Revenues to Exclude from Calculation

The following income streams are ignored for the purpose of the De Minimis test:

- **Immovable Property Transactions:**
  - Revenue from commercial property in a Free Zone where the other party is a Non-Free Zone Person (e.g., a mainland tenant).
  - Revenue from any non-commercial (e.g., residential) property, regardless of the customer's location.
- **Permanent Establishment Revenue:** Any revenue attributable to a Domestic Permanent Establishment (DPE) or a Foreign Permanent Establishment (FPE).
- **Non-Qualifying Intellectual Property (IP) Revenue:** Income from the ownership or exploitation of IP assets that are not considered "Qualifying Intellectual Property" (e.g., royalties from a trademark).

Step 2: Performing the Calculation

Once the excluded revenues are removed, we can proceed with the two-part calculation.

1. **Calculate the Adjusted De Minimis Threshold:**
   - Determine the **Adjusted Total Revenue** (Total Revenue - Excluded Revenues).
   - Calculate the 5% threshold: Adjusted Total Revenue x 5%.
   - The De Minimis threshold is the lower of this 5% figure or **AED 5 million**.
2. **Calculate the Adjusted Non-Qualifying Revenue:**
   - Determine the **Adjusted Non-Qualifying Revenue** (Non-Qualifying Revenue - Excluded Revenues).
3. **Perform the Test:** Compare the **Adjusted Non-Qualifying Revenue** to the **Adjusted De Minimis Threshold**.

Case Study : De Minimis Threshold

Let's apply these rules to a hypothetical Free Zone company, "Alpha Services," with the following financial data for a tax period.

Revenue Stream	Amount (AED)	Customer	Activity Type	Comment
A. Qualifying Services	12,000,000	Free Zone Person	Qualifying	Core qualifying activity.
B. Logistics Services	3,000,000	Non-Free Zone Person	Qualifying	Qualifying activity with a mainland client.
C. Commercial Property Rental	1,000,000	Non-Free Zone Person	Excluded Activity	Commercial property in Free Zone, mainland tenant.
D. Trademark Royalty	700,000	Non-Free Zone Person	Excluded IP	Non-qualifying IP asset.
E. Residential Property Rental	200,000	Non-Free Zone Person	Excluded Activity	Non-commercial property.
F. Mainland Branch Sales	500,000	Non-Free Zone Person	Excluded Activity	Attributable to a DPE.
G. General Consultancy	200,000	Non-Free Zone Person	Excluded Activity	Non-qualifying activity with a mainland client.
Total Revenue	**17,600,000**			

1. Identify and Exclude Revenues

Based on the provided article, we must first remove the following revenues from our calculation:

- **C.** Commercial Property Rental (AED 1,000,000)
- **D.** Trademark Royalty (AED 700,000)
- **E.** Residential Property Rental (AED 200,000)
- **F.** Mainland Branch Sales (AED 500,000)

2. Calculate the Adjusted Values

- **Adjusted Total Revenue:** 17,600,000 - (1,000,000 + 700,000 + 200,000 + 500,000) = **AED 15,200,000**
- **Adjusted Non-Qualifying Revenue:** The only remaining non-qualifying revenue is from **G. General Consultancy** (AED 200,000). 200,000

3. Perform the De Minimis Test

- **Threshold 1 (5% of Adjusted Total Revenue):** 15,200,000 x 5% = **AED 760,000**
- **Threshold 2: AED 5,000,000**
- **Adjusted De Minimis Threshold:** The lower of the two is **AED 760,000**.
- **Test:** Compare the **Adjusted Non-Qualifying Revenue** (AED 200,000) to the **Adjusted De Minimis Threshold** (AED 760,000).

Conclusion: Since AED 200,000 is **less than** AED 760,000, "Alpha Services" **PASSES** the De Minimis test for this tax period.

WHAT HAPPENS IF A COMPANY FAILS TO BE A QUALIFYING FREE ZONE PERSON?

This is the ultimate risk for any Free Zone Person seeking the 0% tax rate. Failure to meet the criteria is not a minor setback; it triggers a significant and long-lasting change in the company's tax status.

Here are the direct consequences of failing to meet the QFZP conditions:

- **The Five-Year "Cooling-Off" Period:** This is the most severe consequence. A company that fails to meet the QFZP conditions will be disqualified from regaining QFZP status for the tax period of the failure and for the subsequent four tax periods. This is a non-negotiable, five-year waiting period before the company can reapply.
- **All Income Becomes Taxable at the Standard Rates (0% & 9%):** Once the QFZP status is lost, the company is treated as a standard mainland entity for tax purposes. As a result, its entire taxable income for the year is subject to the standard tax rates:
    - **0%** on the portion of taxable income up to AED 375,000.
    - **9%** on the portion of taxable income that exceeds AED 375,000. This completely nullifies the benefit of the 0% rate on qualifying income, as the company's entire profit is now subject to the standard progressive rates.
- **Loss of QFZP Status for the Entire Tax Period:** The company will lose its QFZP status from the very beginning of the tax period in which the failure occurred. This means that even if a breach happened on the last day of the financial year, the entire year's income is impacted.

COMPREHENSIVE STRATEGIC PLANNING FOR QFZP STATUS: A DEEP DIVE INTO SOLUTIONS

1. Solutions for Failing the "Adequate Substance" Test

If a company is failing this test (e.g., operating with only a flexi-desk and a single employee while generating significant revenue), the solution must involve a fundamental change in operations.

- **Approach 1: The "Operational Scale-Up"**
    - What it is: This is the most direct solution. The company commits to building genuine, verifiable substance within the free zone.
    - How to do it:
        - Physical Presence: Secure a proper, physical office space with a formal tenancy contract. This moves the company beyond a flexi-desk and demonstrates a real commitment to the free zone.
        - Human Resources: Increase the number of full-time, qualified employees on the company's visa and payroll. The number and expertise of these employees must be commensurate with the company's revenue and the complexity of its core income-generating activities (CIGA).
        - Management & Control: Ensure that the company's leadership and decision-makers are physically present and operate from the free zone. This can be documented through meeting minutes, a physical presence of directors, and the execution of contracts from the free zone office.
    - Best for: Companies whose business model can support the cost of a full physical and human presence and who want to maintain the benefits of the free zone in a fully compliant manner.

- **Approach 2: The "Strategic Outsourcing"**
  - What it is: This approach allows a free zone company to meet the substance test by outsourcing certain CIGA to a compliant third party.
  - How to do it:
    - Outsource within a Free Zone: The outsourced activity must be performed by another entity located in a UAE free zone.
    - Maintain Supervision: The most critical part of this approach is that the outsourcing free zone company must maintain adequate supervision and control over the outsourced activity. You must be able to prove, through contracts, reporting, and management oversight, that you are directing the work, not just passing it off.
  - Best for: Companies with a lean business model that still need to demonstrate substance, but can prove active management and control over their outsourced operations

2. Solutions for Exceeding the "De Minimis" Threshold

This issue is often a result of a business model that unintentionally generates non-qualifying revenue. The solution here is to actively manage and segregate revenue streams.

- **Approach 1: The "Split-Entity" Strategy**
  - What it is: This is the most widely used and recommended tax planning approach. The company's operations are divided between two distinct legal entities.
  - How to do it:
    - Free Zone Entity: This company handles only the Qualifying Income streams. This includes transactions with other free zone companies and any qualifying activities with international clients. The goal is to keep its non-qualifying revenue at zero, thereby ensuring it passes the De Minimis test with no risk.
    - Mainland Entity: A new mainland company is established to handle all the Non-Qualifying Revenue. This includes business with mainland clients and all services that are not on the official "Qualifying Activities" list. This income is then taxed at the standard 9% rate.

- **Approach 2: The "Proactive Revenue Management"**
  - What it is: For a company with a small amount of non-qualifying revenue, this approach involves careful management and oversight to ensure the De Minimis threshold is not breached.
  - How to do it:
    - Continuous Monitoring: Actively track non-qualifying income throughout the year and compare it against the rolling threshold (the lower of 5% of total revenue or AED 5 million).
    - Strategic Invoicing: As the company approaches the threshold, it can strategically manage its invoicing. For example, it might defer a mainland project invoice until the start of the next tax period to avoid a breach in the current year.
  - Best for: Companies with a minor amount of non-qualifying revenue that can be easily managed and controlled. This is a short-term tactical solution, not a long-term strategic one.
- **Approach 3: The "Ancillary Activities" Rule**
  - What it is: In some cases, a company's non-qualifying revenue might be considered "ancillary" to a qualifying activity.
  - How to do it:
    - Demonstrate Dependency: The company must be able to prove that the non-qualifying activity is a minor and directly related part of a larger qualifying activity. For example, a free zone logistics company's main revenue is from qualifying activities, but it also earns a small amount of money from an administrative service for a mainland company. If this administrative service is directly and indispensably linked to the logistics service, it may be considered ancillary.
  - Best for: Very specific cases where a minor non-qualifying activity is a logical and inseparable part of a qualifying one. This requires strong documentation and is subject to FTA interpretation.

2. KNOW YOUR CLIENT'S CUSTOMERS

This is the most critical analysis for a Qualifying Free Zone Person (QFZP). A company's revenue is not automatically qualifying simply because it is generated from within a free zone. The tax treatment of that income—whether it's taxed at 0% or 9%—depends almost entirely on who the customer is and the nature of the service or goods provided.

The purpose of this step is to meticulously classify the client's customers to segregate their revenue streams. This segregation is the foundation for determining Qualifying Income and for managing the De Minimis threshold.

Customer Classification: The Four Key Categories and Their Tax Implications

From a Corporate Tax perspective, a QFZP's customers must be categorized based on both their location and their legal status.

1. Free Zone Legal Persons

- **Who they are:** Any company, branch, or entity that is registered and operates within a recognized UAE free zone.
- **Tax Treatment:** Income derived from a transaction with a Free Zone Legal Person is considered Qualifying Income (Except the income derived from "Excluded Activity") and is subject to the 0% Corporate Tax rate.

2. Foreign Persons

- **Who they are:** Any company or entity that is incorporated or operates outside the UAE.
- **Tax Treatment:** Income from a Foreign Person is generally considered Qualifying Income and is subject to the 0% Corporate Tax rate, provided it relates to a "Qualifying Activity" and is not an "Excluded Activity."

3. Mainland Legal Persons

- **Who they are:** Any company or entity that is registered and operates in mainland UAE. This also includes any domestic branches of the QFZP itself (Domestic Permanent Establishments).
- **Tax Treatment:** Income from a Mainland Legal Person is generally considered Non-Qualifying Income and is subject to the standard 9% tax rate.
- **The Critical Exception:** Income from a Mainland Legal Person can be considered Qualifying Income if it is in respect of a specific, pre-defined "Qualifying Activity" (e.g., certain logistics services, ownership of IP, or headquarters services).

4. Natural Persons (Individuals)

- **Who they are:** Any individual, such as a freelancer, a sole proprietor, or a private consumer, whether they are a resident of a free zone, mainland UAE, or a foreign country.
- **Tax Treatment:** Income from transactions with natural persons is explicitly listed as an **"**Excluded Activity" in most cases. This means it is automatically considered Non-Qualifying Income and is subject to the standard 9% tax rate.
- **Important Conditions:** There are very limited exceptions, such as for specific, regulated "Qualifying Activities" like certain types of fund, wealth, and investment management services. However, for most free zone companies, any income from an individual is a direct hit to the non-qualifying revenue bucket and will impact the De Minimis threshold.

Practical Application and Best Practices

To effectively manage this step, we must:

1. **Obtain a Full Customer List:** Request a complete list of all customers, including their legal name, country, and city of registration. We must also distinguish between entities (legal persons) and individuals (natural persons).
2. **Verify Legal Status:** For all customers, we will verify their legal status. For UAE-based customers, this means checking their trade license to confirm if they are a free zone or mainland legal person. For all customers, we must identify if they are an individual.
3. **Segregate Revenue:** Using the client's financial data, we will create separate reports for each of the four customer categories. This allows us to see exactly how much revenue is qualifying and how much is non-qualifying, and to track the impact of natural person transactions on the De Minimis threshold.

3. KNOW YOUR CLIENT'S BUSINESS ACTIVITY

This step is the final piece of the puzzle. It takes the customer segmentation you've already completed and pairs it with the specific services or goods the client provides. The outcome of this analysis is the definitive classification of every dirham of the company's revenue.

QUALIFYING ACTIVITIES

When a QFZP transacts with a non-Free Zone or Foreign person, the income is only considered **Qualifying Income** if the activity falls squarely on this list. If the activity is not on the list, the income is automatically **Non-Qualifying Revenue**. This are the qualifying activities as of now:

1. Manufacturing and Processing of Goods or Materials

- **What it means:** This is the most straightforward qualifying activity. It covers any business that physically creates a new product or transforms raw materials into a finished good. It includes a full-fledged factory as well as activities like assembly, packaging, or converting materials into a different form.
- **Real-life examples:**
  - A free zone company imports plastic pellets and manufactures plastic containers for a client in Saudi Arabia.
  - An electronics company in JAFZA imports computer components and assembles them into finished laptops for a distributor in mainland UAE.
  - A firm imports raw fabric and processes it into finished clothing, which is then sold to a foreign retailer.
- **Key takeaway:** The focus here is on the physical transformation of a tangible item.

Real-life example: *RAK Ceramics is an excellent example. Operating from their facilities in Ras Al Khaimah, they import raw materials like clay and feldspar. These are processed and manufactured into finished ceramic products like tiles and sanitary ware. The income from selling these products to distributors, both in mainland UAE and internationally, would be treated as qualifying income. Another example is a company in JAFZA that assembles computer components imported from different countries into finished laptops.*

2. Trading of Qualifying Commodities

- **What it means:** This activity allows a company to trade specific raw commodities (e.g., metals, minerals, energy, agriculture) that are traded on a recognized global exchange. This includes the physical trading of the commodities and any associated derivative trading used for hedging risks.
- **Real-life example:** A DMCC-based company buys and sells gold and silver bullion on the Dubai Gold & Commodities Exchange (DGCX). Its income from these trades with international clients would be qualifying.
- **Key takeaway:** The commodity must be in a "raw form" and traded on a regulated exchange.

Real-life example: *A company like Emirates Gold DMCC, a well-known name in the precious metals sector, or a regional branch of a major international trading house like Trafigura, would be a prime example. These firms, registered in DMCC, buy and sell physical gold bullion with international clients and use the Dubai Gold & Commodities Exchange (DGCX) to hedge their price risk. The income from these trades is considered qualifying.*

3. Holding of Shares and Other Securities for Investment Purposes

- **What it means:** This is for free zone companies that act as holding entities. The income from holding shares, bonds, and other financial securities is qualifying, provided they are held for long-term investment, not for short-term, speculative trading. The law provides a helpful rule: if the shares are held for an uninterrupted period of at least 12 months, they are presumed to be for investment purposes.
- **Real-life example:** A free zone holding company owns a 100% stake in a subsidiary located in another country. The dividends and capital gains received from this investment would be considered qualifying income.
- **Key takeaway:** This is not for day-to-day traders. The intention to hold for the long term is critical and must be documented.

Real-life example: *Many international private equity firms or regional family offices establish holding companies in the DIFC or ADGM. For instance, a holding company might acquire a controlling stake in a logistics firm or a technology company located outside the UAE. The dividends and any capital gains realized from selling this stake after a minimum of 12 months would be qualifying income. This is distinct from the activities of a day trader.*

4. Ownership, Management, and Operation of Ships

- **What it means:** This covers businesses involved in international shipping and maritime logistics. The company can own the ships, manage them for other owners, or operate them for the international transportation of goods, passengers, or livestock.
- **Real-life example:** A company registered in a free zone owns a fleet of cargo ships. It leases these ships to a foreign shipping line to transport goods between ports outside the UAE. The lease income and management fees would be qualifying.
- **Key takeaway:** The activity must be related to international, not domestic, shipping.

Real-life example: *Global shipping giants like Maersk or MSC have a significant presence in JAFZA. Their free zone entities often own or manage a fleet of container ships. The income from leasing these ships on a long-term basis to other foreign shipping lines for international voyages would be qualifying. The same applies to a company that manages the operational aspects (crew, maintenance) of a fleet on behalf of other owners*.

5. Reinsurance Services

- **What it means:** This activity involves an insurance company transferring a portion of its risk to another company, known as a reinsurer. In simpler terms, it is "insurance for insurance companies." Free zone companies licensed to provide reinsurance can earn qualifying income from other free zone companies, foreign entities, and even insurance companies in mainland UAE.
- **Real-life example:** A multinational reinsurance provider like a branch of **Munich Re** or **Swiss Re** operates out of the **DIFC** or **ADGM**. An insurance company in Dubai writes a large-scale policy for a new skyscraper. To manage its exposure to this single, high-value risk, it cedes a portion of the policy to the free zone reinsurer. The premium received by the reinsurer for taking on this risk would be considered qualifying income.
- **Key takeaway:** This is a highly specialized business that is exclusively regulated by authorities like the **DFSA** or **FSRA**.

Real-life example: *Many of the world's largest reinsurance firms have a presence in the DIFC. A firm like Swiss Re or Munich Re might have a subsidiary in the DIFC that provides reinsurance services to insurance companies across the Middle East and Africa. For example, a local insurance company in Bahrain might "cede" a portion of its risk for a major industrial project to the DIFC-based reinsurer. The premiums received by the reinsurer for taking on this risk would be qualifying income.*

6. Fund Management Services

- **What it means:** This involves the professional management of investment funds. A free zone company acting as a fund manager would be responsible for making investment decisions on behalf of its clients, who are the investors in the fund. This can include activities like portfolio management, risk management, and the day-to-day operation of the fund.

- **Real-life example:** A company in the **DIFC** or **ADGM**, such as a regional branch of a major asset manager like **BlackRock** or a specialist boutique firm, establishes and manages an investment fund. This fund could be a private equity fund or a public mutual fund, with investors from various countries. The fees charged to these investors for managing the fund would be qualifying income.

- **Key takeaway:** The services must be subject to regulatory oversight by the relevant UAE authority to qualify for the tax benefit.

Real-life example: A global asset manager like **BlackRock** or **Franklin Templeton** has a presence in the **DIFC**. Their DIFC entity provides fund management services for various investment funds. They are responsible for making investment decisions, managing the portfolio, and reporting to investors. The fees they charge for these management services would be qualifying income.

7. Wealth & Investment Management Services

- **What it means:** This activity covers a range of services provided to high-net-worth individuals, families, or institutions to help them manage and grow their assets. It includes offering discretionary and non-discretionary investment advice, portfolio management, and comprehensive financial planning.

- **Real-life example:** A private bank or a specialized wealth management firm in DIFC or ADGM manages the assets of a wealthy family from Saudi Arabia. The firm provides expert advice on where to invest their capital, manages their portfolio of stocks and bonds, and provides regular reporting. The fees earned for these advisory and management services would be considered qualifying income.

- **Key takeaway:** Similar to fund management, this activity is only a qualifying activity if it is conducted under the strict regulatory oversight of the DFSA or FSRA.

Real-life example: *Reputable private banks and wealth management firms like Credit Suisse (now part of UBS) or Lombard Odier operate in the DIFC or ADGM. They provide highly personalized services to wealthy families from across the GCC, managing their investment portfolios, offering financial advice, and assisting with succession planning. The fees earned for these bespoke services are qualifying income.*

8. Headquarter Services to Related Parties

- **What it means:** This is for a company that acts as the regional or global headquarters for a multinational group. It provides specific, high-value services to its related parties (group companies), such as strategic management, business planning, risk management, and administrative oversight.
- **Real-life example:** A free zone company acts as the MENA headquarters for a European multinational. It provides administrative, senior management, and procurement services to its subsidiary companies in other countries. The fees charged for these services would be qualifying.
- **Key takeaway:** The services must be for "Related Parties" and cannot be for non-related, third-party companies.

Real-life example: *A multinational corporation like Siemens or Procter & Gamble often has a regional headquarters in a free zone like DAFZA or JAFZA. This hub provides strategic management, administrative, and procurement services to its subsidiaries in countries like Saudi Arabia, Egypt, and Jordan. The fees charged to these related parties for these services are qualifying income.*

9. Treasury and Financing Services to Related Parties

- **What it means:** This covers a free zone company that acts as the in-house bank for its multinational group. It manages cash, provides financing, or handles treasury functions for its related parties.
- **Real-life example:** A free zone company collects payments from various subsidiaries of a multinational group and provides them with intercompany loans. The interest income from these loans would be qualifying.
- **Key takeaway:** Similar to headquarters services, this activity must be provided exclusively to "Related Parties."

Real-life example: *A large multinational company like Unilever or PepsiCo might establish a treasury center in a free zone. This center would manage the group's regional cash flow, centralizing collections and payments. It could also provide intercompany loans to subsidiaries to fund new projects or operations in other countries. The interest income from these loans would be qualifying*.

10. Logistics Services

- **What it means:** This covers the movement and storage of goods on behalf of another person without taking ownership of the goods. This includes cargo handling, warehousing, container storage, customs brokerage, and order management.
- **Real-life example:** A free zone company operates a warehouse in JAFZA. It stores goods for a mainland distributor and handles the packing, inventory management, and shipping of those goods as per the distributor's instructions. The fee for this service would be qualifying.
- **Key takeaway:** The company must not take title to the goods. If it takes ownership, the activity falls under "Distribution" and has different rules.

Real-life example: *A global logistics giant like DHL or FedEx has a massive presence in JAFZA. A mainland UAE-based company, such as a major retailer, might use DHL's JAFZA warehouse to store its imported goods. The DHL entity would handle all the logistics: receiving, storing, packing, and arranging onward delivery, all while the ownership of the goods remains with the retailer. The fees for these services are qualifying income.*

11. Distribution of Goods or Materials in or from a Designated Zone

- **What it means:** This activity involves a company that takes ownership of goods and distributes them. It is qualifying only if the goods are distributed from a "Designated Zone" (a specific type of free zone with customs fences).
- **Real-life example:** A company in JAFZA (a Designated Zone) buys electronics from a manufacturer and resells them to a distributor in Saudi Arabia or to a retailer in mainland UAE. The income from this resale is qualifying.
- **Key takeaway:** The goods must enter or leave a Designated Zone, and the company must take title (ownership) of the goods.

Real-life example: *An electronics distributor, for example, a subsidiary of a company like Aptec Ingram Micro, operating from a "Designated Zone" like JAFZA, would be a perfect example. They import a container of computers, take ownership of them at their JAFZA warehouse, and then sell and distribute them to resellers in Saudi Arabia and Qatar. The income from the resale of these goods is qualifying because the entire distribution chain originates from the Designated Zone.*

12. Financing and Leasing of Aircraft

- **What it means:** This activity is for free zone companies involved in the aviation finance and leasing sector. It includes providing financing for the acquisition of aircraft, as well as entering into operating or finance leases for aircraft, aircraft engines, and other major replaceable components. This is a crucial activity in the global aviation industry, which relies heavily on leasing for fleet management.
- **Real-life example:** A company registered in a free zone specializing in aviation, such as a subsidiary of a global aircraft lessor like **AerCap** or **Avolon**, provides a long-term lease for an Airbus or Boeing aircraft to a foreign airline. The income from the lease payments for the aircraft, engines, and other components would be considered qualifying income.
- **Key takeaway:** This activity is distinct because it specifically relates to aviation assets. The income from financing and leasing aircraft is a qualifying activity, which is an important distinction from other general finance and leasing activities that may be excluded. This highlights the UAE's strategic push to become a hub for the global aviation industry.

***Real-life example:** A global aviation services company like Dubai Aerospace Enterprise (DAE) is a prime example. Its core business of aircraft leasing is a qualifying activity. The company would purchase an aircraft and provide a long-term lease for it to a foreign airline. The income from the monthly lease payments would be the qualifying income.*

13. Ancillary Activities

- **What it means:** This is a crucial catch-all category. An activity that is not on the official list can still be considered a qualifying activity if it is directly and indispensably related to a main qualifying activity and makes a minor contribution to it.

- **Real-life example:** An IT support team for a manufacturing company. The IT support service itself is not a qualifying activity, but because it is essential for the factory to run, it is considered ancillary.

- **Key takeaway:** The activity cannot be a standalone business; it must be a necessary support function for a main qualifying activity.

***Real-life example:** For our RAK Ceramics example, the company's in-house R&D department, which develops new tile designs and materials, would be an ancillary activity. While R&D is not a qualifying activity on its own, it is essential for the core manufacturing business. Similarly, the marketing team for a JAFZA-based manufacturing company is an ancillary activity, as their work is necessary to sell the products produced by the qualifying activity.*

Case study 1: Detailed Real Life Example for Ancillary Activities

Company Name: Al- Futtaim

Business Activity: Al-Futtaim Logistics is a major and well-established Free Zone Person operating in the UAE. Its primary and core activity is providing logistics and supply chain solutions, which is a Qualifying Activity under the UAE Corporate Tax Law. The company has a wide range of clients and does not have any transactions with natural persons.

Relevant Tax Period: In the relevant tax period, Al-Futtaim Logistics had a total revenue of AED 8,500,000, broken down as follows:

- AED 8,200,000 from core logistics and shipping services: This revenue was generated from its main business of transporting, storing, and managing the supply chain for various clients, including both Free Zone Persons and Non-Free Zone Persons. This is revenue from a Qualifying Activity.
- AED 250,000 from customs brokerage services: To streamline the shipping process for its clients, the company also offers in-house customs clearance and brokerage services. This involves handling the necessary paperwork and liaising with customs authorities on behalf of the clients. This service is a supplementary offering that is directly connected to its primary logistics service.
- AED 50,000 from the sale of packaging materials: The company maintains a stock of specialized packaging and crating materials. When a client needs their goods to be packaged or re-packaged for transport, Al-Futtaim Logistics sells these materials to them at an additional charge. This is also a service that directly supports the main logistics function.

Analysis:

- Total Revenue: The total revenue of Al-Futtaim Logistics is AED 8,500,000.
- Qualifying Activity Revenue: The revenue from its core logistics and shipping services (AED 8,200,000) is derived from a Qualifying Activity.
- Ancillary Activity Revenue: The combined revenue from customs brokerage (AED 250,000) and the sale of packaging materials (AED 50,000) totals AED 300,000.
- Minor Contribution Test: The revenue from the ancillary activities (AED 300,000) is considered a "minor contribution" as it is less than 5% of the total revenue of AED 8,500,000 (300,000 / 8,500,000 = ~3.53%).

Case study 2: Detailed Real Life Example for Manufacturing and Ancillary Activity

Company Name: Emirates Cable FZE

Business Activity: Emirates Cable FZE is a Free Zone Person operating in JAFZA, engaged in the manufacturing of specialized fiber optic cables. This is a Qualifying Activity. The company does not deal with end customers directly. Instead, it sells its products to a large distributor.

The Transaction Chain:

1. Emirates Cable FZE (a Free Zone Person) manufactures and sells the fiber optic cables to Etisalat FZE (a Free Zone Person). Etisalat FZE is a major distributor that services a wide range of customers across the UAE.
2. The sales agreement between Emirates Cable FZE and Etisalat FZE specifies that due to the technical nature of the cables, Emirates Cable FZE is responsible for any necessary installation support and post-sale technical assistance required by Etisalat FZE's end customers.
3. These services are performed by employees of Emirates Cable FZE at the premises of the end customers (e.g., a data center in a Non-Free Zone), even though the sale was made to another Free Zone company.

Analysis:

- Core Qualifying Activity: The primary revenue for Emirates Cable FZE comes from the manufacturing and sale of the fiber optic cables. This is a clear Qualifying Activity.
- The Intermediary: The sale is made to another Free Zone Person, Etisalat FZE. This is a common and legitimate business practice. The income derived from this transaction is considered Qualifying Income.
- The Ancillary Services: The installation support and technical assistance are activities performed for the benefit of the end user, who is a non-Free Zone person, even though the contract for these services is tied to the sale to Etisalat FZE.
- Minor Contribution Test: The revenue generated from these post-sale services is typically a small fraction of the total revenue from the manufacturing and sale of the cables. This revenue is so closely tied to the main manufacturing activity that it cannot function independently. The customer is buying a complete solution, not just a bare cable.

Case study 3: Detailed Real Life Example for Processing and Ancillary Activities

Company Name: Strata Manufacturing PJSC (an existing company in Al Ain)

Business Activity: Strata Manufacturing is a Free Zone Person engaged in the manufacturing of advanced composite aircraft parts for global aviation giants. This is a highly technical Qualifying Activity under the UAE Corporate Tax Law. The company has invested heavily in cutting-edge machinery and highly skilled engineers.

Relevant Tax Period: In the relevant tax period, Strata Manufacturing's total revenue was AED 25,000,000, which came from three sources:

- AED 23,800,000 from core manufacturing: This revenue is generated from the sale of composite parts to its customers (e.g., Airbus or Boeing). This is its core Qualifying Activity.
- AED 900,000 from the sale of waste materials: The manufacturing process of composite parts generates a significant amount of high-grade carbon fiber offcuts and other scrap materials. Strata has a process to collect and package this waste, which it then sells to a specialized company that recycles it into non-aerospace products (e.g., sporting goods). This generates an additional revenue stream.
- AED 300,000 from renting out machinery: To maximize the use of its expensive machinery, Strata decides to rent out some of its CNC (Computer Numerical Control) machining equipment to a smaller company in the industrial sector during off-peak hours. The rental agreement includes the use of the machine but not the specialized operators.

Analysis:

The analysis distinguishes between the two non-core revenue streams based on their relationship to the main Qualifying Activity.

- Sale of Waste Materials (Qualifying Ancillary Activity): The revenue of AED 900,000 from selling carbon fiber offcuts is considered closely related to the core activity of manufacturing aircraft parts. The waste is a direct, unavoidable by-product of the primary manufacturing process. The sale of this material is a form of efficient resource management directly linked to the core business. Since this revenue makes a minor contribution to the total revenue (900,000 / 25,000,000 = 3.6%), it is classified as ancillary (So by Qualifying Income)
- Renting out Machinery (Non-Qualifying Activity): The revenue of AED 300,000 from renting out machinery is not closely related to the core manufacturing activity. While the company is using its own assets, the act of renting out equipment is a separate business function—a form of asset leasing. It is not necessary for the performance of the core activity and does not directly support the manufacturing process. Therefore it is a non-qualifying income

Case study 4: Detailed Real Life Example for Logistics, Holding of Shares and Ancillary Activities

Company Name: DP World Logistics FZE

Business Activity: DP World Logistics FZE is a Free Zone Person operating within Jebel Ali Free Zone (JAFZA). Its core business is logistics services, including warehousing, freight forwarding, and packaging solutions, which is a Qualifying Activity. The company's main operations generated AED 10,000,000 in the relevant tax period.

Additional Income Streams: In the same period, DP World Logistics also had two other income streams:

- Renting Unused Warehouse Space: The company had a large, unused section of its warehouse. It rented this space to another Free Zone Person (a furniture distributor) for AED 700,000.
- Dividends from a Company: The company owns a 4% stake in a another company located on the mainland UAE. This investee company is a marketing and sales firm for logistics software. DP World Logistics received AED 100,000 in dividends from this investee.

Analysis of the Revenue Streams

This example shows how different types of income are treated under the corporate tax law.

- Core Business Revenue: The AED 10,000,000 from logistics services is Qualifying Income because it's derived from a Qualifying Activity. This income is subject to the 0% corporate tax rate.
- Rental Income: The income from renting out factory space is not ancillary because it isn't a by-product of the core timber processing and isn't necessary for the main business to function. However, it is considered Qualifying Income because the rental of a commercial property in a Free Zone to another Free Zone Person is a specifically listed Qualifying Activity in the law.
- Dividend Income: This income is not ancillary as it's a passive investment return completely separate from the day-to-day business operations. However, the holding of shares and other securities for investment purposes is a specifically listed Qualifying Activity. The income from these dividends is therefore considered Qualifying Income and is eligible for the 0% Corporate Tax rate, provided the company meets the investment condition. This condition generally requires the company to have held the stake for an uninterrupted period of at least 12 months, demonstrating a long-term investment intention.

Case study 5: Detailed Real Life Example for 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

Case study 6: Detailed Real Life Example for Holding Investment

Company Name: Al Falah Investments FZE

Business Activity: Al Falah Investments FZE is a Free Zone Person operating in the Abu Dhabi Global Market (ADGM). Its sole business activity is the holding of a diversified portfolio of shares and other securities for investment purposes. This is a Qualifying Activity for a Free Zone Person. The company's goal is to generate long-term capital gains and stable dividend income.

Revenue Streams in the Relevant Tax Period:

1. AED 1,000,000 in Dividends: This dividend was received from a public company where Al Falah Investments has a small stake. On the date the dividend was received, the shares had been held for only 8 months. However, the company has documented and demonstrable intent to hold the shares for a period of more than 12 months as part of its long-term investment strategy.
2. AED 1,500,000 in Dividends: This dividend was received from a private company where Al Falah Investments holds a membership interest that it has owned for over 2 years.
3. AED 2,500,000 in Capital Gains: The company sold a portion of its shareholding in a multinational corporation. These shares were held for 18 months prior to the sale.
4. AED 250,000 in Interest Income: This income was generated from corporate bonds the company has held in its portfolio for a period of 15 months.

Analysis of Revenue Streams

The key point of this example revolves around the AED 1,000,000 dividend received from shares held for a short period. While the law generally requires an uninterrupted 12-month holding period for an investment to be considered a Qualifying Activity, an exception is made for cases where the company can clearly demonstrate a genuine intention to hold the shares long-term. Since Al Falah Investments FZE has documented proof of its intent to hold the shares for more than 12 months, this dividend is also treated as Qualifying Income.

The other income streams (dividends, capital gains, and interest totaling AED 4,250,000) are straightforward. Since the underlying assets were all held for more than 12 months, they satisfy the core requirement for a Qualifying Activity without needing any special consideration. All this income is considered Qualifying Income.

Case study 7: Detailed Real Life Example for Holding Investment

Company Name: Innovate Ventures FZE

Business Activity: Innovate Ventures FZE is a Free Zone Person engaged in holding shares for investment purposes. Innovate Ventures acquires 100% of the shares of a small, mainland-based tech startup, 'CodeSpark LLC', for AED 10,000,000.

The Agreement & Indemnity: The acquisition is focused on CodeSpark's proprietary software, which is crucial for its business. As part of the Share Purchase Agreement, Innovate Ventures FZE requires an indemnity from the previous owner. The indemnity clause states that if any undisclosed intellectual property (IP) infringement claims are made against CodeSpark within three years, the seller will compensate Innovate Ventures for any associated legal costs and damages, up to a maximum of AED 1,000,000.

The Claim: 18 months after the acquisition, a competitor files a lawsuit against CodeSpark LLC, alleging that a core component of its software infringes on their patent. This liability was unknown at the time of the sale. Innovate Ventures FZE and CodeSpark spend AED 750,000 in legal fees and settlement costs to resolve the claim.

The Indemnity Payment: In accordance with the agreement, the original seller of CodeSpark honors the indemnity clause and pays AED 750,000 to Innovate Ventures FZE to cover these costs.

Tax Treatment

The AED 750,000 received by Innovate Ventures FZE is not considered a new, separate revenue stream. Instead, it's an adjustment to the original purchase price of the shares.

Qualifying Activity: The core activity of Innovate Ventures is the "Holding of shares and other securities for investment purposes," which is a Qualifying Activity for a Free Zone Person

Case study 7: Detailed Real Life Example for Holding Investment

Company Name: DP World Marine FZE

Business Activity: DP World Marine FZE is a Free Zone Person operating in Jebel Ali Free Zone (Jafza). Its core business is the ownership, management, and operation of a fleet of cargo vessels used in international transportation. This is a Qualifying Activity under UAE Corporate Tax law. During the relevant tax period, in addition to its freight charges, the company earned income from various related services.

Additional Revenue Streams:

- Demurrage Charges: A customer kept a vessel at a port longer than the agreed-upon time, incurring demurrage fees. DP World Marine FZE charged the customer a total of AED 1,100,000 for the extended port stay.
- Standby Charges: A vessel was instructed to wait at sea before being allowed to berth and unload its cargo. The company charged the customer a total of AED 400,000 for this standby period.
- War Risk Insurance Premium: To transport cargo through a high-risk area, the company purchased additional war risk insurance and charged the customer an extra AED 300,000 to cover the premium.
- Heating Charges: For a cargo that required a specific temperature, the company charged AED 50,000 to cover the cost of running the vessel's heating system.

Analysis:

All these revenue streams, totaling AED 1,850,000, are directly and intrinsically linked to the core business of operating the ships. Demurrage and standby charges compensate the company for delays and unutilized time, which are part of the operational risks. The additional insurance premium and heating charges are necessary costs incurred to fulfill the specific requirements of a transport contract. Since these activities are closely related to the main qualifying activity of ship operations, they are considered ancillary.

Case study 8: Detailed Real Life Example for Reinsurance Activity

Company Name: Falcon Re FZE

Business Activity: Falcon Re FZE is a Free Zone Company operating in the Dubai International Financial Centre (DIFC). Its core business is providing reinsurance services to direct insurers, which is a Qualifying Activity. It has a contract with a mainland-based property insurance firm (Company M) to cover a portion of the risk on their portfolio of commercial building policies.

Under this contract, Falcon Re FZE accepts a 15% share of the liability for all fire and flood claims in exchange for 15% of the premiums paid by policyholders.

Additional Revenue Streams: Falcon Re FZE also provides several other services to direct insurance companies.

- Risk Modelling Services: The company has developed sophisticated risk models to analyze the likelihood and potential severity of catastrophic events like floods and fires in specific geographical areas. It licenses this model and offers consulting on how to use it to other insurance firms for a fee.
- Subrogation and Recovery Services: When a claim is paid out, Falcon Re FZE assists the primary insurer in seeking reimbursement from the liable third party (e.g., a negligent contractor). The company charges a fee for these subrogation and recovery services.

Revenue for the Relevant Tax Period:

- Premiums of AED 1,500,000: Company M issued new policies with a total premium of AED 10,000,000. Falcon Re FZE received AED 1,500,000 as its 15% share.
- Income from Investments of AED 250,000: Falcon Re FZE invests a portion of the premiums received in a portfolio of government bonds and other low-risk assets to ensure liquidity.
- Income from Risk Modelling Services of AED 50,000: The company earned a fee by licensing its risk model and providing consulting to another insurance firm.
- Income from Subrogation Services of AED 25,000: The company earned a fee for assisting with the recovery of costs from a third party.

Analysis of Revenue Streams

The total revenue for Falcon Re FZE is AED 1,825,000. All of these income streams are directly related to its core business.

- Qualifying Activity: The AED 1,500,000 from premiums and the AED 250,000 from investment income are directly related to the core business of providing reinsurance. Investment of premiums is a fundamental part of a reinsurer's operations. This combined income of AED 1,750,000 is treated as being derived from a Qualifying Activity.

- Ancillary Activities: The revenues from risk modelling (AED 50,000) and subrogation services (AED 25,000) are not considered separate, non-qualifying business lines. They are closely related to the main activity of reinsurance and underwriting. These services are natural extensions of a reinsurer's expertise.

Case study 9: Detailed Real Life Example for Fund Management

Company Name: Capital Growth FZE

Business Activity: Capital Growth FZE is a regulated investment manager operating as a Free Zone Person in the Abu Dhabi Global Market (ADGM). Its core business is the management of a private equity fund that invests in early-stage tech companies. This is a Qualifying Activity

Fund Performance: During the relevant tax period, the fund had a total of AED 500,000,000 in assets under management (AUM). The fund's investments grew significantly, resulting in a total return of AED 125,000,000. The fund's income from investments, consisting of capital gains and dividends, belongs entirely to its investors.

Income from Fund Management Services: Capital Growth FZE received the following income for its services:

1. Investment Management Fee: The company charges an annual management fee of 2% of the total assets under management. This generated AED 10,000,000 (AED 500,000,000 x 2%).
2. Performance Fees: The company charges a "carried interest" or performance fee of 20% on any returns that exceed a "hurdle rate" of 8% per annum. The fund's actual return was 25% (AED 125,000,000 / AED 500,000,000), which is 17% over the hurdle rate. This resulted in a performance fee of AED 17,000,000 (AED 500,000,000 x 17% x 20%).

Analysis of Revenue Streams

The total revenue for Capital Growth FZE from its fund management services is AED 27,000,000 (AED 10,000,000 from management fees + AED 17,000,000 from performance fees).

It is crucial to note that the AED 125,000,000 investment return from the fund's assets does not belong to Capital Growth FZE; it belongs to the fund's investors. The company's qualifying income is solely the revenue it earns from providing its management services.

Both the investment management fee and the performance fee are direct compensation for the core service of fund management. They are explicitly covered as part of the qualifying activity.

Case study 10: Detailed Real Life Example for Fund Management (Delegation)

Company Name: Zenith Capital FZE

Business Activity: Zenith Capital FZE is a Free Zone Person and a regulated investment management company in the Dubai International Financial Centre (DIFC). It manages a large, diversified hedge fund with total assets under management (AUM) of AED 250,000,000. This fund management service is a Qualifying Activity.

The Delegation: The hedge fund includes a significant portfolio of complex derivatives and foreign exchange instruments, valued at AED 50,000,000. Zenith Capital FZE has strong investment expertise but lacks the specialized, quantitative analysis skills required for advanced risk management in this specific, high-frequency derivatives market. To mitigate risk and maximize returns, Zenith Capital FZE decides to delegate the day-to-day risk management and quantitative modeling for this portion of the fund to Alpha Analytics FZE, another Free Zone Person.

The Fee Structure: Alpha Analytics FZE charges a fee of 0.5% of the assets it manages for risk management services.

- Delegated Fee: 0.5% of AED 50,000,000 = AED 250,000

Analysis:

The AED 250,000 in revenue received by Alpha Analytics FZE is directly for providing services that are a crucial component of Zenith Capital FZE's fund management qualifying activity. The UAE Corporate Tax law recognizes that a Free Zone Person may need to delegate parts of a qualifying activity to other specialized Free Zone Persons to maintain competitiveness and expertise.

Case study 11: Detailed Real Life Example for Freezone to Freezone Transaction

Company Name: Quantum Tech FZE

Business Activity: Quantum Tech FZE is a Free Zone Person in the Dubai Media City Free Zone. Its core business is providing advanced IT and software development services, which is generally not a listed Qualifying Activity.

The Transaction: Quantum Tech FZE is engaged by Digital Marketing FZE, another Free Zone Person, which provides digital advertising and marketing services. Digital Marketing FZE is considered a Qualifying Free Zone Person because its services are provided to international clients and other Free Zone Persons.

Digital Marketing FZE is launching a new, complex AI-powered advertising platform. To build this platform, it requires a highly specialized team of software developers and data scientists. Quantum Tech FZE provides these services to Digital Marketing FZE.

The Fee Structure:

- Platform Development: Quantum Tech FZE charges a project fee of AED 250,000 for the initial development and launch of the AI platform.
- Ongoing Support: After the launch, Quantum Tech FZE provides continuous technical support and updates for a monthly retainer of AED 15,000, which amounts to AED 180,000 annually.

Total Revenue for Quantum Tech FZE: The total revenue for Quantum Tech FZE from this engagement is AED 430,000 (AED 250,000 + AED 180,000).

Analysis

The services provided by Quantum Tech FZE (software development) are not explicitly listed as a "Qualifying Activity" in the law. However, the income can still be treated as Qualifying Income because of a special provision:

- Transaction between Free Zone Persons: Both Company Q (Quantum Tech FZE) and Company Y (Digital Marketing FZE) are Free Zone Persons.
- Beneficial Recipient: Digital Marketing FZE is the beneficial recipient of the legal services. This means Digital Marketing FZE is the end user of the services and does not simply act as a pass-through entity to a client on the mainland.
- Qualifying Status: Assuming both companies meet all the other requirements to be a Qualifying Free Zone Person, the revenue from this transaction is considered Qualifying Income.

EXCLUDED ACTIVITIES

The concept of "Excluded Activities" is designed to ensure that the Free Zone tax regime is not misused for activities that are primarily domestic, speculative, or a part of the core regulated financial sector (which is taxed separately). If a Qualifying Free Zone Person (QFZP) generates any income from these activities, that income is immediately considered non-qualifying and is subject to the 9% corporate tax rate.

Important Note on Exclusions: It is critical to understand that any income derived from an excluded activity is considered non-qualifying, regardless of the customer. This means that a transaction with a Free Zone Person, a Mainland Person, or a foreign entity will still be non-qualifying if the activity itself is on the excluded list. The rule that income from Free Zone clients is always qualifying is only true as long as the underlying activity is **not** an excluded activity.

1. Transactions with Natural Persons

- **What it means:** This excluded activity applies when a Qualifying Free Zone Person (QFZP) earns income from direct transactions with an individual. The core principle behind this exclusion is that the Free Zone Corporate Tax regime is primarily designed to promote B2B (business-to-business) activities and international trade. It is not intended to provide a 0% tax rate for activities that directly serve the local consumer market in the UAE.
- **Description:** Any income a free zone company generates by providing goods or services directly to an individual is generally non-qualifying and is subject to the standard 9% tax rate. This includes a wide range of activities, from direct sales to consulting services. The crucial factor is the recipient of the goods or services; if it's a person rather than a registered company or legal entity, the income is at risk of being treated as non-qualifying.

The law includes a vital set of exceptions. These are four specific qualifying activities where income from a natural person is still considered qualifying and can benefit from the 0% tax rate. This is a critical point that requires careful attention, as it carves out specific business models that are deemed acceptable even in a consumer-facing context.

- **Real-life UAE Free Zone Company Example:**
  - **Excluded Example:** An e-commerce company in Dubai CommerCity or DMCC sells goods like electronics or apparel directly to individual customers across the UAE via its website. The income from these sales is revenue from a transaction with a natural person and is therefore non-qualifying. This income would be subject to the 9% tax rate.

  - **Qualifying Example:** A free zone company in Jebel Ali Free Zone (JAFZA) manufactures specialized equipment and sells it to a mainland distributor (a juridical person). The distributor then sells the equipment to a skilled tradesperson (a natural person) who uses it for their work. In this case, the free zone company's income is still qualifying because its direct transaction was with a non-free zone juridical person (the distributor), not the natural person.

The Four Exempted Activities with Natural Persons

The following four activities are explicitly exempt from the "transactions with a natural person" exclusion. This means that a QFZP can earn qualifying income from these activities even when the client is an individual.

I. **Ownership, Management, and Operation of Ships**

- **Description:** This exception allows a free zone shipping company to earn qualifying income from services provided to a natural person. This is relevant in the context of leisure or private maritime services.
- **Real-life example:** A company in **JAFZA** that owns a fleet of luxury yachts leases one of them to a high-net-worth individual for a private international cruise. The income from this lease is qualifying. This exception is vital for the UAE's maritime and tourism sectors, allowing free zone companies to engage in these high-value activities with individuals without losing their 0% tax status.

II. **Fund Management Services**

- **Description:** This exception allows free zone fund managers to manage funds for individuals and have that income treated as qualifying.
- **Real-life example:** A branch of an international asset management firm like **BlackRock** or **Franklin Templeton** in the **DIFC** or **ADGM** manages an investment fund. A high-net-worth individual from another country invests in this fund. The management fees charged to this individual for managing their portion of the fund would be considered qualifying income. This exception is crucial for the UAE's financial free zones, which are key hubs for wealth and asset management.

III. **Wealth & Investment Management Services**

- **Description:** This exception is for highly personalized financial and investment services provided to individuals.
- **Real-life example:** A private bank or wealth management firm in the **DIFC** or **ADGM** has a high-net-worth client from a neighboring GCC country. The firm provides bespoke services, including financial planning, portfolio management, and investment advice tailored to that individual's needs. The fees earned for

these personalized advisory services are qualifying income, despite the client being a natural person.

IV. Financing and Leasing of Aircraft

- **Description:** This exception allows a free zone company to lease aircraft to individuals and have the income treated as qualifying.
- **Real-life example:** A specialized aircraft leasing company in a free zone (e.g., **Dubai South**) leases a private jet to a high-net-worth individual for a long-term contract. The income from the lease payments is qualifying. This is a crucial exception that supports the private and corporate aviation sectors, which are a significant part of the UAE's economy.

Case study : Detailed Real Life Example for Ownership and Management of Ships

Company Name: Gulf Express Ferries FZE

Business Activity: Gulf Express Ferries FZE is a Free Zone Person in Ras Al Khaimah Economic Zone (RAKEZ). Its business is the ownership, management, and operation of a fleet of high-speed passenger ferries. This is a Qualifying Activity under the UAE Corporate Tax Law.

The Itinerary: The ferries offer round-trip services for passengers, connecting ports in the UAE with international destinations. A typical route would be a round-trip from Ras Al Khaimah to Bandar Abbas (Iran) and back, allowing passengers to enjoy a multi-day trip with dining and entertainment options on board.

Analysis: This business model demonstrates how a leisure-focused activity can still qualify for the 0% corporate tax rate.

- Ownership, Management, and Operation of Ships: The core activity of owning and operating the ferry fleet is a explicitly Qualifying Activity.
- Transit through Non-UAE Ports: The round-trip itinerary includes a foreign port (Bandar Abbas), which is a key factor. This means the service is not considered "local transportation" or "recreational purposes" that are confined to UAE territorial waters.
- Exclusion for Floating Hotels/Restaurants: The ships are in constant motion and are not moored in a fixed location. Therefore, they do not fall under the exclusion for "floating hotels or restaurants" which refers to vessels that are permanently stationed at a single port.
- Transactions with Natural Persons: Although the company's customers are individuals (natural persons), this does not automatically exclude the activity. The law specifies that for this particular qualifying activity, transactions with natural persons are not an excluded activity.

2. Banking Activities

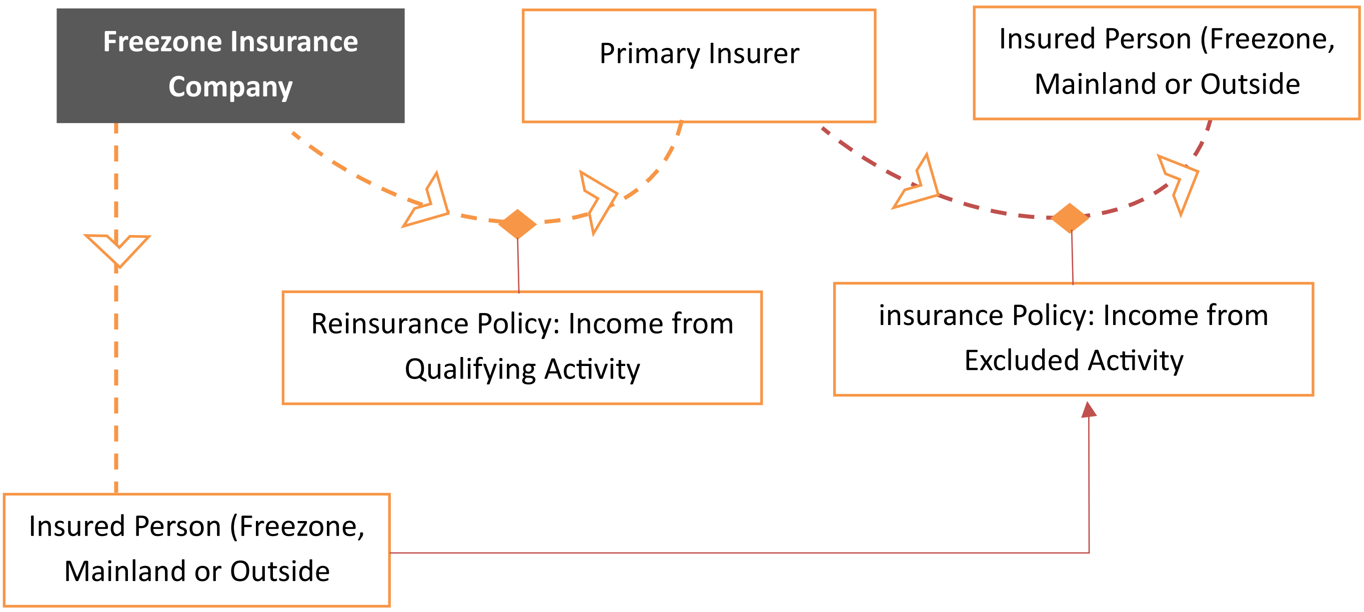
- **What it means:** This excluded activity applies to core banking functions that are subject to regulatory oversight by the competent authority in the UAE. The intention is to ensure that the highly regulated banking sector, which serves both individuals and businesses across the country, is taxed consistently under the standard 9% rate.
- **Description:** The exclusion covers activities that are typically performed by licensed banks. This includes a bank's primary revenue streams, such as interest income from loans, fees from maintaining customer accounts, and income from providing credit facilities. These services are often provided to a wide range of clients, from large corporations to small businesses and individuals, both within and outside the free zone.
- **Real-life UAE Free Zone Company Example:**
    - **Excluded Example:** A global bank like **Standard Chartered** or **HSBC** has a free zone branch in the **DIFC**. This branch is licensed and regulated by the **DFSA**. The branch's income from providing corporate loans to a mainland construction company, managing bank accounts for clients, or offering a range of financial products is all considered banking income. Because this is an excluded activity, this income is subject to the 9% tax rate. The same would apply even if the loan was given to another free zone company.
    - **Qualifying Example:** A free zone company providing **treasury and financing services to related parties** (which is a qualifying activity) is not considered a banking activity, as it is a specialized inter-company service, not a public banking service. The interest income from these inter-company loans would be qualifying.

3. Insurance Activities (with exceptions)

- **What it means:** This exclusion applies to insurance activities that are subject to regulatory oversight by the relevant authority (e.g., the Central Bank of the UAE or the DFSA/FSRA in financial free zones). The aim is to tax the broader insurance sector at the standard 9% rate.
- **Description:** This category covers the income from a company's direct insurance operations, such as underwriting policies for life, health, property, or motor insurance. The income from these premiums is considered non-qualifying. The law makes a specific and important carve-out for reinsurance, recognizing its specialized nature and international scope.
- **Real-life UAE Free Zone Company Example:**
    - **Excluded Example:** A free zone company in Dubai International Financial Centre (DIFC) is licensed by the DFSA to sell property and casualty insurance to businesses across the UAE. The premiums it collects from these policies and any profits from its underwriting activities would be non-qualifying income, subject to the 9% tax rate.
    - **Qualifying Example:** As a contrast, a multinational reinsurance provider like a branch of Swiss Re or Munich Re operates out of the DIFC. This company's sole business is to provide reinsurance to other insurance companies, helping them to manage their large risks. The premium income received from these insurance companies is explicitly defined as a qualifying activity and would therefore be subject to the 0% tax rate.

4. Finance and Leasing Activities (with exceptions)

- **What it means:** This is a broad exclusion for most general finance and leasing activities that are subject to regulatory oversight, with a few important exceptions. The exclusion is designed to prevent a company from gaining a tax advantage on common financing or leasing arrangements that are not part of the specifically targeted qualifying activities.
- **Description:** This includes income from providing credit, loans, or leasing arrangements for a wide variety of assets. The key is that the activity is not one of the specific exceptions. A company that provides a loan to a non-related party or leases general equipment would likely fall under this exclusion.
- **Real-life UAE Free Zone Company Example:**
  - **Excluded Example:** A free zone company has a license to provide general equipment leasing. It leases a fleet of vehicles to a mainland company for its business operations. The income from these lease payments would be classified as an excluded activity and would be taxed at 9%.
  - **Qualifying Example:** A company in a free zone that provides a long-term lease for an **aircraft** to a foreign airline. This is a specific qualifying activity, and the income would be 0%. Another example is a free zone company that provides **inter-company loans to its related parties**. This is a treasury and financing service to related parties, which is a qualifying activity, and the interest income is subject to the 0% rate.



5. Ownership or Exploitation of Intellectual Property (IP) Assets

- **What it means:** This is one of the most technical and nuanced exclusions. The general rule is that income from owning or "exploiting" any intellectual property asset is considered non-qualifying and is subject to the 9% corporate tax rate. The term "exploitation" is used broadly to cover any way in which a company generates income from its IP, such as through licensing, royalties, or the sale of the IP itself.
- **Description:** This rule is in place to align the UAE's tax system with international anti-avoidance measures. It prevents multinational corporations from simply setting up a free zone entity as a holding company for their valuable IP (e.g., trademarks) and then shifting profits to this entity through royalty payments to get a 0% tax rate.

The law makes a clear and important distinction between **"Qualifying Intellectual Property" (QIP)** and all other IP.

- **Non-Qualifying IP (Excluded):** The most significant exclusion is for **marketing-related IP assets**. This includes:
    - Trademarks
    - Brand names
    - Customer lists and relationships
    - Any other intangible assets that primarily relate to marketing activities.
- **Qualifying Intellectual Property (QIP):** To be considered qualifying, the IP must be "innovation-driven." This includes:
    - **Patents:** Granted under UAE law or a foreign jurisdiction.
    - **Copyrighted Software:** This is a specific and key inclusion, as it is also considered a form of innovation-driven IP.
    - **Functionally Equivalent Rights:** Any other legal right that is similar to a patent, such as utility models, orphan drug designations, and extensions of patent protection.

The "Nexus Approach" and its Computation

Even if a free zone company owns Qualifying Intellectual Property (QIP), the entire income from that IP may not be qualifying. The law applies the **"nexus approach,"** which is a formula-based method to ensure that the tax benefit is directly linked to the actual research and development (R&D) activities that took place within the free zone or were legitimately outsourced.

The qualifying income from QIP is calculated using the following formula:

Qualifying IP Income = (Qualifying Expenditures / Overall Expenditures) x Overall IP Income

To apply this formula, you need to understand the three components:

1. **Overall IP Income:** This is the total revenue a company earns from its IP, such as all subscription fees, royalties, or license fees.
2. **Qualifying Expenditures:** These are the expenditures incurred by the free zone company on R&D activities conducted within the free zone, or legitimately outsourced to a non-related party, that are directly related to the creation, invention, or significant development of the QIP.
3. **Overall Expenditures:** This includes the Qualifying Expenditures, plus any costs to acquire the IP or any other R&D expenditures (e.g., those outsourced to a related party that cannot be categorized as Qualifying Expenditures). The law also allows for a 30% "uplift" to be added to the Qualifying Expenditures, which may boost the Qualifying Income.

Nexus Formula Based Computation Example:

Let's assume a free zone company developed a patent-protected product.

- **Overall IP Income:** The company earns a total of AED 10 million in royalties from licensing the patent.
- **Qualifying R&D Expenditures:** The company's in-house team in the free zone spent AED 2 million on R&D for the patent.
- **Acquisition/Other R&D Costs:** The company also spent AED 3 million to acquire a portion of the technology from an external, related-party company.
- **Overall Expenditures:** The total expenditures are AED 2 million (Qualifying) + AED 3 million (Acquisition) = AED 5 million.

Computation:

- **Qualifying IP Income** = ($2,000,000 / $5,000,000) x $10,000,000
- **Qualifying IP Income** = (0.4) x $10,000,000 = **AED 4 million**

In this example, only AED 4 million of the total AED 10 million IP income would be considered qualifying and taxed at 0%. The remaining AED 6 million would be taxed at the standard 9% corporate tax rate.

Real-life UAE Free Zone Company Example:

- **Non-Qualifying Example (Trademarks):** A free zone company in Jebel Ali Free Zone (JAFZA) is the owner of a well-known brand name and its associated trademark for a popular consumer product. It licenses this trademark to its group companies in Saudi Arabia and Egypt for a royalty fee. This royalty income is from a marketing-related IP asset and is therefore an excluded activity. The income will be subject to the 9% corporate tax rate. This is the most common and important scenario for the exclusion.
- **Qualifying Example (Taxmen AI App):** A free zone company called **"Taxmen"** is in a tech-focused free zone like **Dubai Silicon Oasis (DSO)**. It has a team of engineers working in its DSO office who developed a new AI tax application. The company owns the copyright to this software. It then licenses this copyrighted software to a large number of individual and corporate subscribers for a monthly subscription fee. The company has adequate substance in its DSO office, and all the R&D for the AI app happened in the free zone. The income from these subscription fees is from a Qualifying Intellectual Property (QIP) and is therefore considered qualifying income and taxed at 0%.

Key Takeaway:

The rule is not a blanket exclusion for all IP. It is a targeted exclusion of marketing-related IP (primarily trademarks). Income from innovation-related IP like patents and copyrighted software can be qualifying, but only if the company has sufficient substance and has a direct link between its R&D activities and the income generated, as determined by the nexus formula.

6. Ownership or Exploitation of Immovable Property

- **What it means:** This is a key excluded activity that states that income from any real estate-related business is generally non-qualifying. This is a very specific and targeted exclusion. The intent is to prevent free zone companies from using the tax relief for income from property ownership, a business activity which is deeply tied to the physical location of the asset and the local economy.
- **Description:** The rule is designed to be a clear line in the sand. **All real estate income is non-qualifying and subject to the 9% corporate tax rate**, with one and only one exception. This applies to income from:
  - **Residential Property:** Income from owning, renting, or selling any residential property, regardless of its location (in a free zone or mainland), is non-qualifying.
  - **Commercial Property (Mainland):** Income from owning, renting, or selling a commercial property located anywhere in the mainland UAE is non-qualifying.
  - **Commercial Property (Free Zone - with non-free zone client):** Income from renting a commercial property in a free zone to a company in the mainland UAE is non-qualifying.

The only circumstance under which real estate income can be qualifying is when all three of the following conditions are met:

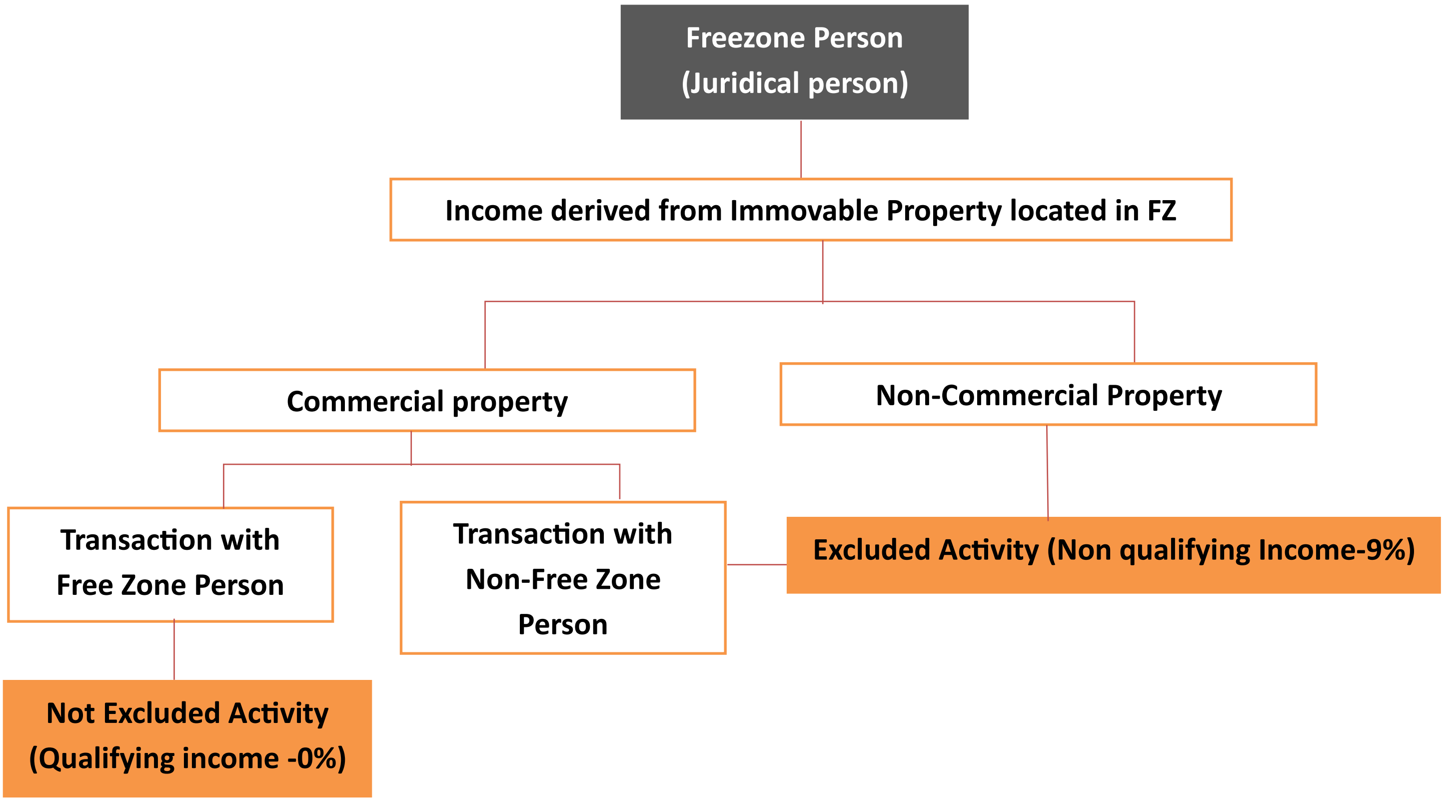
1. The property is **commercial**.
2. The property is located **within a free zone**.
3. The transaction (e.g., leasing) is with **another Free Zone Person**.

This single exception is crucial and serves to support the internal real estate ecosystem of the free zones themselves.

- **Real-life UAE Free Zone Company Example:**
  - **Non-Qualifying Example 1:** A free zone company in **DMCC** owns a portfolio of apartments in Jumeirah Lake Towers (JLT) and rents them out. Since these are residential properties, the rental income is an excluded activity and is taxed at 9%.
  - **Non-Qualifying Example 2:** A free zone company in **Dubai Media City** owns an office building in mainland Business Bay. The rental income it receives from a tenant is non-qualifying and is taxed at 9%.
  - **Non-Qualifying Example 3:** A free zone company in **Jebel Ali Free Zone (JAFZA)** owns a commercial warehouse in JAFZA. It leases this warehouse to a logistics company that has its main license in mainland

Dubai. The rental income is non-qualifying because the transaction is with a non-free zone client.

- **Qualifying Example:** A free zone company in the **DIFC** owns a commercial office tower also located in the DIFC. It leases office space in this tower to a law firm that is also a Free Zone Person registered in the DIFC. This rental income meets all three conditions of the exception and is therefore considered qualifying income, subject to the 0% corporate tax rate.



7. Ancillary Activities to Excluded Activities

- **What it means:** This is a logical and important extension of the other excluded activities. Any activity that is directly and indispensably related to an excluded activity and makes a minor contribution to it is also considered excluded.
- **Description:** This rule prevents a company from using the "ancillary activities" loophole to gain a tax advantage on support functions for a non-qualifying business. If a company's main business is an excluded activity, all its internal support functions are also considered part of that excluded activity.
- **Real-life UAE Free Zone Company Example:**
    - **Excluded Example:** A free zone company that is primarily engaged in excluded banking activities has a small, in-house IT team that develops and maintains the bank's internal software. The income (or cost-center allocation) for this IT team's work would also be considered excluded because it is an ancillary activity to the core excluded banking business.

Conclusion: The Process of Income Segregation

Based on our analysis of a client's business activities and customer base, our duty is to now accurately segregate the company's income into **Qualifying Income** (taxable at 0%) and **Non-Qualifying Income** (taxable at 9%). This is a critical step in determining the tax liability of any Free Zone company. The key is to move from a theoretical understanding of the rules to a practical, accounting-based approach that a business can implement to ensure compliance.

4. KNOW YOUR CLIENT'S TAX RATE

Having successfully identified and classified all of the client's business activities and their corresponding customer types, we now move to the final and most critical step. This phase is where we translate our conceptual understanding of the tax rules into a practical financial computation.

This step is designed to achieve the following:

- **Segregate Income and Expenses:** Meticulously divide the company's total income and expenditures into Qualifying (0% tax) and Non-Qualifying (9% tax) categories.
- **Apply the De Minimis Test:** Use the segregated financial data to perform the vital De Minimis test, which will be the ultimate determinant of the company's tax status.
- **Determine the Final Tax Rate:** Based on the outcome of the test, we will be able to confirm the final Corporate Tax rate applicable to the company's income for the entire tax period.

The following guide provides a detailed, step-by-step approach to performing this segregation and computation with the accuracy required for full compliance.

PRACTICAL GUIDE TO FREE ZONE INCOME SEGREGATION

Revenue & Activity Identification

- **Review Financial Statements:** Get a copy of the company's full Income Statement (or Profit & Loss).
- **Identify All Revenue Streams:** List every single line item of revenue, no matter how small.
- **Categorize Activities:** For each revenue stream, identify the corresponding business activity and its customer. Use the list of Qualifying and Excluded Activities as your primary reference.

Segregation of Income & Expenditures

This phase is the core of the segregation process. We will create two distinct financial statements: one for Qualifying Income and one for Non-Qualifying Income.

Revenue Segregation Table:

This phase is the core of the segregation process. We will create two distinct financial statements: one for Qualifying Income and one for Non-Qualifying Income.

Revenue Stream	Total Revenue	Customer Type	Activity Type	Income Category	Qualifying Income	Non-Qualifying Income
Sales of Goods	15,000,000	Other FZ Person	Qualifying	Qualifying	15,000,000	-
Logistics Services	3,000,000	Non-FZ Person (Mainland)	Qualifying	Qualifying	3,000,000	-
IP Royalties (Trademark)	500,000	Non-FZ Person (Foreign)	Excluded	Non-Qualifying	-	500,000
Interest from Savings Account	50,000	N/A	Other Passive Income	Non-Qualifying	-	50,000
Total Revenue	**18,550,000**				**18,000,000**	**550,000**

Cost & Expenditure Segregation:

This step requires a meticulous review of all costs to determine if they are directly linked to a specific income stream or if they are indirect costs that need to be apportioned.

Expense Category	Total Expenditure (D)	Directly Allocated to Qualifying (E)	Directly Allocated to Non-Qualifying (F)	To be Apportioned (G)
Cost of Goods Sold	8,000,000	8,000,000	-	-
Direct Employee Salaries	2,500,000	1,500,000	1,000,000	-
Shared Office Rent & Utilities	1,000,000	-	-	1,000,000
Management Salaries	500,000	-	-	500,000
Total Expenditures	**12,000,000**	**9,500,000**	**1,000,000**	**1,500,000**

Apportionment of Indirect Costs

We will use the Revenue Basis for apportionment as it is often the most practical and defensible method.

- **Total Revenue:** AED 18,550,000
- **Non-Qualifying Revenue:** AED 550,000
- **Apportionment Ratio (Non-Qualifying):** 550,000 / 18,550,000 = **2.96%**
- **Apportioned Non-Qualifying Costs:** 1,500,000 (Indirect Costs) x 2.96% = **AED 44,400**
- **Apportioned Qualifying Costs:** 1,500,000 - 44,400 = **AED 1,455,600**

Final Segregated Income Statement

Financial Metric	Qualifying Income (0% Tax)	Non-Qualifying Income (9% Tax)
Total Revenue	18,000,000	550,000
Less: Direct Costs	(9,500,000)	(1,000,000)
Less: Apportioned Costs	(1,455,600)	(44,400)
Taxable Income	**7,044,400**	**(494,400)**

The De Minimis Test

This is the most critical checkpoint. Passing this test is the only way to retain the 0% tax benefit for Qualifying Income.

1. **Calculate Total Revenue:** AED 18,550,000
2. **Calculate Non-Qualifying Revenue:** AED 550,000
3. **Determine De Minimis Thresholds:**
   - **Threshold 1:** 5% of Total Revenue = 18,550,000 x 5% = **AED 927,500**
   - **Threshold 2: AED 5,000,000**
4. **Compare:** The De Minimis threshold is the lower of the two values, which is **AED 927,500**.
5. **Result:** The company's Non-Qualifying Revenue of **AED 550,000** is now **less than** the threshold of **AED 927,500**.

Conclusion: The company **PASSES** the De Minimis test for this tax period. It retains its "Qualifying Free Zone Person" status.

Final Tax Computation & Reporting

Since the company passed the De Minimis test, it can apply the 0% tax rate to its Qualifying Income and the 9% rate to its Non-Qualifying Income.

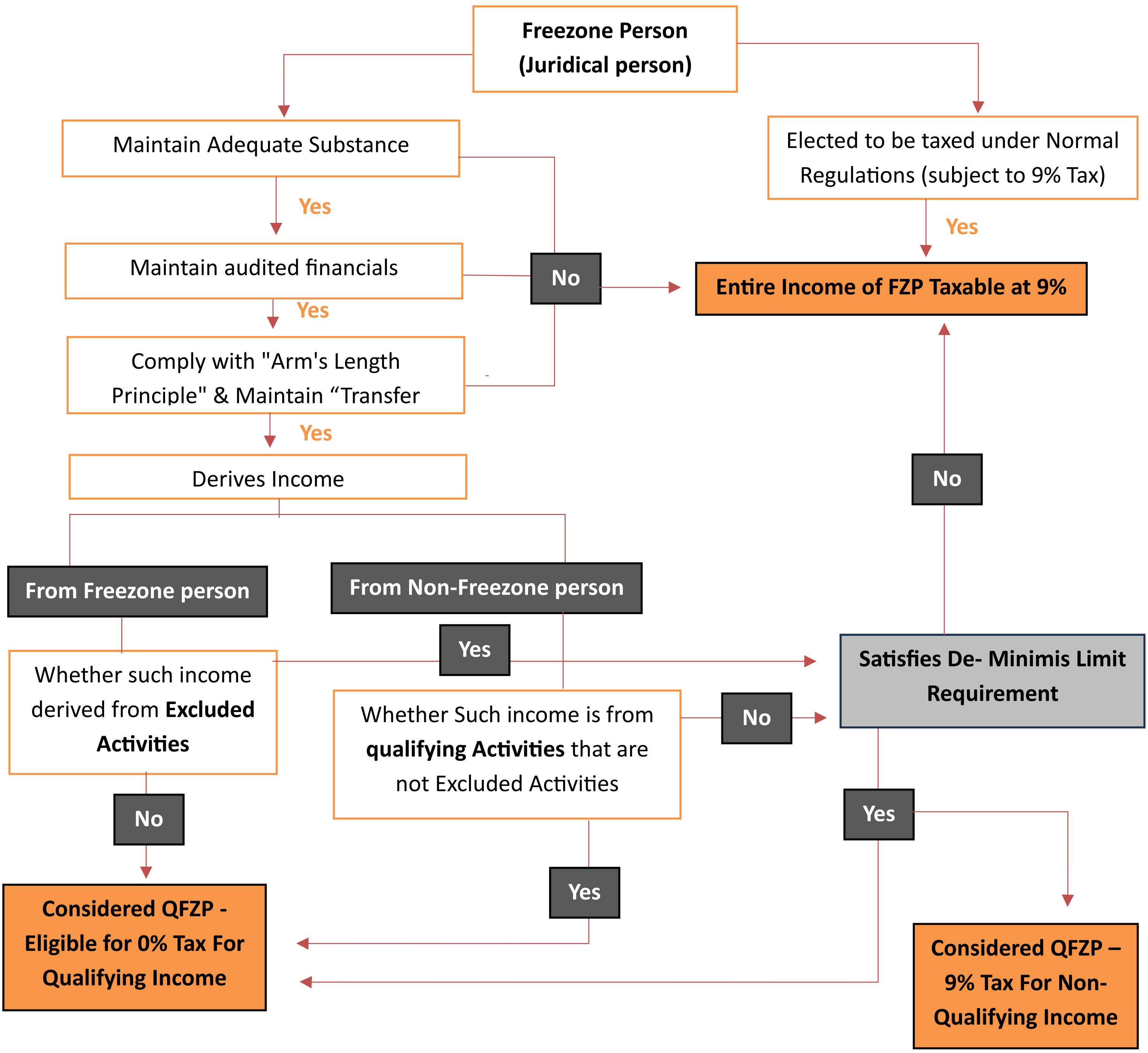
1. **Tax on Qualifying Income:** 7,044,400 x 0% = **AED 0**
2. **Tax on Non-Qualifying Income:** The company has a loss in this category, so no tax is payable. The loss of AED 494,400 can be carried forward to offset future taxable income in a subsequent tax period.
3. **Total Corporate Tax Payable: AED 0**

Important Note: This updated example demonstrates the crucial impact of correctly classifying each income stream. The company's tax liability changed from AED 555,750 to AED 0 simply by correctly applying the rules. This highlights the absolute necessity of meticulous and accurate segregation.

The Two Streams of Tax Treatment

- **No Offset Between Streams:** A crucial rule to understand is that you cannot use a loss from one stream to offset a gain in the other. The loss from your client's non-qualifying income cannot be used to reduce the taxable qualifying income, which is already subject to a 0% tax rate. The two streams are ring-fenced from each other.
- **Carry Forward for the Non-Qualifying Stream:** The loss generated from the non-qualifying activities (the 9% tax stream) can be carried forward to offset future taxable gains from the same non-qualifying stream**.** This is exactly what here the client in our example can do. The loss can be carried forward indefinitely, but it must be used to offset future taxable income within that same stream.

SUMMARY


Freezone Person (Juridical person)
Maintain Adequate Substance
Yes
Maintain audited financials
Yes
Comply with "Arm's Length Principle" & Maintain "Transfer
Yes
Derives Income
No
Elected to be taxed under Normal Regulations (subject to 9% Tax)
Yes
Entire Income of FZP Taxable at 9%
No
From Freezone person
From Non-Freezone person
Yes
Whether such income derived from Excluded Activities
No
Considered QFZP - Eligible for 0% Tax For Qualifying Income
Whether Such income is from qualifying Activities that are not Excluded Activities
No
Yes
Satisfies De- Minimis Limit Requirement
Yes
Considered QFZP – 9% Tax For Non-Qualifying Income

FINHIVE
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