



# Contents

	<i>Page No.</i>
<b>Publishing Printing &amp; Text Permit</b>	<i>I-5</i>
<b>Acknowledgement</b>	<i>I-7</i>
<b>Preface</b>	<i>I-9</i>
<b>Disclaimer</b>	<i>I-11</i>
<b>Chapter 1</b>	
<b>Introduction</b>	
<b>1.1</b>	Overview .....
<b>1.2</b>	Regulatory Environment in UAE.....
<b>1.3</b>	Legal Structure of Entities.....
<b>1.4</b>	Federal Structure of the UAE.....
<b>1.4-1</b>	Legislative Powers .....
<b>1.4-2</b>	Judiciary Powers .....
<b>1.5</b>	Tax landscape in the UAE.....
<b>1.5-1</b>	Value Added Tax (VAT).....
<b>1.5-2</b>	Corporate Income Tax .....
<b>1.5-3</b>	Federal Corporate Tax .....
<b>1.6</b>	Impact of UAE Corporate Tax .....
<b>1.7</b>	Overview of UAE CT Law.....
<b>1.7-1</b>	Important Definitions .....
<b>1.7-2</b>	Applicability .....
<b>1.7-3</b>	Entities exempt from CT .....
<b>1.7-4</b>	Taxable Base.....
<b>1.7-5</b>	Incomes exempt from tax .....
<b>1.7-6</b>	Threshold and Tax rates .....
<b>1.7-7</b>	Computation of Taxable income.....
<b>1.7-8</b>	Non-deductible expenses.....

---

Page No.

<b>1.7-9</b>	Adjustment for losses.....	11
<b>1.7-10</b>	Nexus Rules .....	11
<b>1.7-11</b>	Transfer Pricing Regulation .....	12
<b>1.7-12</b>	General Anti-Abuse Rules .....	12
<b>1.7-13</b>	Compliance and Administration.....	12

## Chapter 2

### Imposition of Corporate Tax and Applicable Rates

<b>2.1</b>	Introduction .....	14
<b>2.2</b>	Article 2: Imposition of Corporate Tax .....	14
<b>2.2-1</b>	Levy of Corporate Tax .....	14
<b>2.2-2</b>	Tax Procedures Law.....	14
<b>2.3</b>	Article 3: Corporate Tax Rate .....	15
<b>2.3-1</b>	Tax Rates for Persons other than Free Zone Person.....	15
<b>2.3-2</b>	Tax Rates for Qualifying Free Zone Person ..	15
<b>2.3-3</b>	Tax Rate for Multinational Enterprises (MNE).....	16
<b>2.3-4</b>	Consequences if an entity is artificially separated .....	16

## Chapter 3

### Exempt Persons

<b>3.1</b>	Introduction .....	17
<b>3.2</b>	Article 4: Exempt person .....	17
<b>3.2-1</b>	List of exempt entities.....	18
<b>3.2-2</b>	Government Entities .....	19
<b>3.2-3</b>	Government Controlled Entities.....	19
<b>3.2-4</b>	Entities engaged in the extraction of natural resources and related non-extractive activities .....	19
<b>3.2-5</b>	Charities .....	20
<b>3.2-6</b>	Specified Funds .....	20
<b>3.2-7</b>	Juridical Persons .....	21
<b>3.2-8</b>	Any other specified person .....	22

	Page No.
<b>3.2-9</b>	Mandatory to register for specified exempt persons ..... 22
<b>3.2-10</b>	Effective date of exemption..... 22
<b>3.2-11</b>	Withdrawal of exemption ..... 23
<b>3.2-12</b>	Immunity against the withdrawal of exemption..... 23
<b>3.3</b>	Article 5: Government Entity ..... 24
<b>3.3-1</b>	Overview..... 25
<b>3.3-2</b>	Meaning of Government entities ..... 25
<b>3.3-3</b>	Tax on income from commercial activities by Government entities ..... 26
<b>3.3-4</b>	Application for a single taxable entity ..... 26
<b>3.3-5</b>	Procedure to recognise a single taxable entity..... 27
<b>3.3-6</b>	Intimation for change in the business activities ..... 27
<b>3.3-7</b>	Withdrawal of the status ..... 27
<b>3.3-8</b>	Consolidation of financial results ..... 28
<b>3.4</b>	Article 6: Government-Controlled Entity..... 28
<b>3.4-1</b>	Overview..... 28
<b>3.4-2</b>	Meaning of government-controlled entities .. 29
<b>3.4-3</b>	Exemption for mandated activities..... 29
<b>3.4-4</b>	Separate books of account for non-mandated activities ..... 29
<b>3.5</b>	Article 7: Extractive Business..... 30
<b>3.5-1</b>	Overview..... 31
<b>3.5-2</b>	Meaning of extractive business..... 31
<b>3.5-3</b>	Meaning of business activities ..... 31
<b>3.5-4</b>	Exemption for income from extractive business ..... 31
<b>3.5-5</b>	Conditions to claim the exemption for income from extractive business ..... 32
<b>3.5-6</b>	Exemption for incidental or ancillary income ..... 32
<b>3.5-7</b>	No exemption for income from other business activities ..... 33
<b>3.5-8</b>	Computation of income from other business activities ..... 33



Page No.

<b>3.6</b>	Article 8: Non-Extractive Natural Resource Business.....	34
<b>3.6-1</b>	Overview.....	35
<b>3.6-2</b>	Meaning of non-extractive natural resource business .....	35
<b>3.6-3</b>	Exemption for income from non-extractive business .....	35
<b>3.6-4</b>	Conditions to claim the exemption for income from non-extractive business.....	36
<b>3.6-5</b>	Exemption for incidental or ancillary income .....	36
<b>3.6-6</b>	No exemption for income from other business activities .....	36
<b>3.6-7</b>	Computation of income from other business activities .....	37
<b>3.7</b>	Article 9: Qualifying Public Benefit Entity .....	37
<b>3.7-1</b>	Overview.....	38
<b>3.7-2</b>	Exemption to Qualifying Public Benefit Entity .....	38
<b>3.7-3</b>	Conditions to claim the exemption by Qualifying Public Benefit Entity .....	39
<b>3.7-4</b>	List of Qualifying Public Benefit Entity .....	40
<b>3.7-5</b>	Furnishing of information by Qualifying Public Benefit Entity .....	40
<b>3.7-6</b>	Registration of Qualifying Public Benefit Entity .....	40
<b>3.7-7</b>	Application to claim exemption .....	40
<b>3.8</b>	Article 10: Qualifying Investment Fund.....	41
<b>3.8-1</b>	Meaning of Investment Fund .....	41
<b>3.8-2</b>	Exemption to Investment Fund .....	41
<b>3.8-3</b>	Condition for Qualifying Investment Funds .....	42
<b>3.8-4</b>	Key Highlights of CT Guide on Investment Manager .....	42

## Chapter 4

### Taxable Person and Corporate Tax Base

<b>4.1</b>	Introduction .....	45
<b>4.2</b>	Article 11: Taxable Person .....	45

	Page No.
<b>4.2-1</b>	Overview.....46
<b>4.2-2</b>	Basis of tax.....47
<b>4.2-3</b>	Tax Residency.....47
<b>4.2-4</b>	Taxable Persons.....49
<b>4.2-5</b>	Comprehensive Example.....52
<b>4.3</b>	Article 12: Corporate Tax Base.....53
<b>4.3-1</b>	Overview.....54
<b>4.3-2</b>	Taxable income of a juridical resident person.....54
<b>4.3-3</b>	Taxable income of a natural person.....54
<b>4.3-4</b>	Taxable income of a non-resident person.....55
<b>4.3-5</b>	Overview.....56
<b>4.4</b>	Article 13: State-Sourced Income ..57
<b>4.4-1</b>	Overview.....57
<b>4.4-2</b>	General rules for State-Sourced Income ..59
<b>4.4-3</b>	Special rules for State-Sourced Income.....60
<b>4.4-4</b>	Comprehensive Example.....62
<b>4.5</b>	Article 14: Permanent Establishment ..63
<b>4.5-1</b>	Overview.....65
<b>4.5-2</b>	Fixed Place Permanent Establishment.....66
<b>4.5-3</b>	Places constitute Fixed Place PE ..68
<b>4.5-4</b>	Dependent Agent Permanent Establishment ..70
<b>4.5-5</b>	Preparatory or Auxiliary Activities do not constitute PE ..72
<b>4.5-6</b>	Anti-fragmentation rules.....73
<b>4.5-7</b>	Stay in UAE due to exceptional situations may not constitute a PE ..74
<b>4.5-8</b>	Other Permanent Establishments.....75
<b>4.5-9</b>	Comprehensive Example.....75
<b>4.6</b>	Article 15: Investment Manager Exemption ..76
<b>4.6-1</b>	Investment Manager not to be treated as dependent agent PE.....77
<b>4.7</b>	Article 16: Partners in an Unincorporated Partnership ..78
<b>4.7-1</b>	Overview.....80
<b>4.7-2</b>	Status of unincorporated partnership ..80
<b>4.7-3</b>	Taxation of unincorporated partnership as a pass-through entity.....80



Page No.

<b>4.7-4</b>	Taxation of unincorporated partnership as a taxable unit. ....	83
<b>4.7-5</b>	Foreign Partnership. ....	84
<b>4.8</b>	Article 17: Family Foundation .....	85
<b>4.8-1</b>	Overview.....	86
<b>4.8-2</b>	Foundation <i>v.</i> Trusts .....	87
<b>4.8-3</b>	Taxation of family foundation as an independent juridical person .....	87
<b>4.8-4</b>	Taxation of family foundation as a pass-through entity.....	87
<b>4.8-5</b>	Taxation of beneficiaries if family foundation treated as a pass-through entity .....	88

## Chapter 5

### Free Zone Person

<b>5.1</b>	Introduction .....	90
<b>5.2</b>	Article 18: Qualifying Free Zone Person .....	90
<b>5.2-1</b>	Overview.....	91
<b>5.2-2</b>	Taxation of Free Zone Persons .....	91
<b>5.2-3</b>	Condition to qualify as Free Zone Person ..	92
<b>5.2-4</b>	<i>De Minimis</i> Requirement.....	94
<b>5.2-5</b>	Qualifying Income.....	94
<b>5.2-6</b>	Non-Qualifying Revenue.....	95
<b>5.2-7</b>	Qualifying Activities.....	95
<b>5.2-8</b>	Excluded Activities.....	97
<b>5.2-9</b>	Implications of cessation of status as a Qualifying Free Zone Person. ....	100
<b>5.2-10</b>	Exemption Period .....	100
<b>5.2-11</b>	Cost-benefit Analysis .....	100
<b>5.2-12</b>	Income Derived from Qualifying Intellectual Property .....	101
<b>5.2-13</b>	Corporate Tax Guide on Free Zone Person.....	102

Page No.

**Chapter 6****Calculating Taxable Income**

<b>6.1</b>	Introduction .....	109
<b>6.2</b>	Article 20: General Rules for Determining Taxable Income.....	109
<b>6.2-1</b>	Determination of taxable income.....	111
<b>6.2-2</b>	Method of Accounting.....	111
<b>6.2-3</b>	Adjustment from the standalone profit .....	112
<b>6.2-4</b>	Option to tax ‘gains or loss’ on a realisation basis .....	114
<b>6.2-5</b>	Accounting Standards <i>v.</i> The CT Law.....	115
<b>6.2-6</b>	Comprehensive Example.....	115
<b>6.3</b>	Article 21: Small Business Relief.....	116
<b>6.3-1</b>	Overview.....	117
<b>6.3-2</b>	Threshold limit for small businesses relief. .	117
<b>6.3-3</b>	Eligible person .....	117
<b>6.3-4</b>	Treatment of tax losses .....	118
<b>6.3-5</b>	Limitation on deduction for net interest . .	118
<b>6.3-6</b>	Consequences of artificial separation of business .....	118
<b>6.3-7</b>	Certain provisions shall not apply .....	119
<b>6.3-8</b>	Illustration .....	119
<b>6.3-9</b>	Comprehensive Example.....	119

**Chapter 7****Exempt Income**

<b>7.1</b>	Introduction .....	121
<b>7.2</b>	Article 22: Exempt Income.....	121
<b>7.2-1</b>	Overview.....	122
<b>7.2-2</b>	Exemption for dividend and profit distribution.....	122
<b>7.2-3</b>	Taxability of income from participating interest .....	123

Page No.

<b>7.2-4</b>	Taxability of income from international transportation operation .....	123
<b>7.3</b>	Article 23: Participating Exemption .....	123
<b>7.3-1</b>	Income eligible for exemption .....	125
<b>7.3-2</b>	Conditions to claim exemption for dividend .....	126
<b>7.3-3</b>	Conditions to establish 'Participation Interest'.....	126
<b>7.3-4</b>	Eligible income .....	133
<b>7.3-5</b>	Restrictions on the participation exemption .....	135
<b>7.4</b>	Article 24: Foreign Permanent Establishment Exemption.....	137
<b>7.4-1</b>	Overview.....	138
<b>7.4-2</b>	Taxability of foreign subsidiary or foreign branch. ....	138
<b>7.4-3</b>	Options available for taxability of foreign branch profits.....	139
<b>7.4-4</b>	Condition to avail exemption in respect of foreign PE .....	139
<b>7.4-5</b>	Computation of income and expenditure of foreign PE .....	139
<b>7.4-6</b>	Allowability of the foreign tax credit .....	139
<b>7.4-7</b>	Comprehensive Example .....	140
<b>7.5</b>	Article 25: Non-Resident Person Operating Aircraft or Ships in International Transportation .....	141
<b>7.5-1</b>	Overview.....	141
<b>7.5-2</b>	Eligible Person.....	141
<b>7.5-3</b>	Eligible income .....	142
<b>7.5-4</b>	Reciprocity.....	142

## Chapter 8

### Reliefs

<b>8.1</b>	Introduction .....	143
<b>8.2</b>	Article 26: Transfers within a Qualifying Group.....	143
<b>8.2-1</b>	Overview.....	144

Page No.

<b>8.2-2</b>	Conditions to be treated as a member of the Qualifying Group.....	145
<b>8.2-3</b>	Withdrawal of relief.....	149
<b>8.2-4</b>	Illustration .....	150
<b>8.2-5</b>	Key Highlights of CT Guide on Qualifying Group Relief.....	150
<b>8.3</b>	Article 27: Business Restructuring Relief .....	151
<b>8.3-1</b>	Overview.....	153
<b>8.3-2</b>	Transactions not subject to UAE CT Law ..	153
<b>8.3-3</b>	Conditions for tax-neutral business restructuring .....	154
<b>8.3-4</b>	Conditions for relief.....	156
<b>8.3-5</b>	Relief to be allowed .....	157
<b>8.3-6</b>	Implications for breach of conditions .....	158
<b>8.3-7</b>	General Rules for determining taxable income .....	160
<b>8.3-8</b>	Key Highlights of Guide on Business Restructuring Relief.....	161

## Chapter 9

### Deductions

<b>9.1</b>	Introduction .....	163
<b>9.2</b>	Article 28: Deductible Expenditure .....	164
<b>9.2-1</b>	Overview.....	164
<b>9.2-2</b>	Allowable Expenditure .....	164
<b>9.2-3</b>	Expenditures not allowed as a deduction...	166
<b>9.2-4</b>	Expenditure for more than one purpose ..	167
<b>9.3</b>	Article 29: Interest Expenditure.....	167
<b>9.3-1</b>	Overview.....	167
<b>9.3-2</b>	Deductibility of an interest expenditure....	167
<b>9.4</b>	Article 30: General Interest Deduction Limitation Rule .....	168
<b>9.4-1</b>	Limit on deduction for interest expenditure.....	168
<b>9.4-2</b>	<i>De Minimis</i> Net Interest Expenditure.....	169
<b>9.4-3</b>	Computation of EBITDA.....	169



	Page No.
<b>9.4-4</b>	Computation of net interest expenditure . . . . . 170
<b>9.4-5</b>	Inclusions in Interest. . . . . 170
<b>9.4-6</b>	Carry forward of interest. . . . . 171
<b>9.4-7</b>	Carry forward of interest in Tax Groups . . . . . 172
<b>9.4-8</b>	Non-applicability of Interest capping rules . 173
<b>9.5</b>	Article 31: Specific Interest Deduction Limitation Rule . . . . . 175
<b>9.5-1</b>	Taxability of Interest on borrowed funds . . . . . 175
<b>9.6</b>	Article 32: Entertainment Expenditure . . . . . 176
<b>9.6-1</b>	Deduction for entertainment expenditure . . . . . 176
<b>9.7</b>	Article 33: Non-deductible Expenditure . . . . . 177
<b>9.7-1</b>	Overview. . . . . 177
<b>9.7-2</b>	Non-deductible expenditure . . . . . 177

## Chapter 10

### Transactions with Related Parties and Connected Persons

<b>10.1</b>	Introduction . . . . . 180
<b>10.2</b>	Article 34: Arm's Length Principle . . . . . 180
<b>10.2-1</b>	Overview. . . . . 182
<b>10.2-2</b>	Overview of arm's length principle . . . . . 182
<b>10.2-3</b>	International transfer pricing regulations . 183
<b>10.2-4</b>	Comparability analysis . . . . . 183
<b>10.2-5</b>	Transfer Pricing Methods . . . . . 184
<b>10.2-6</b>	Selection of most appropriate method. . . . . 191
<b>10.2-7</b>	Corresponding adjustment . . . . . 193
<b>10.3</b>	Article 35: Related Parties and Control . . . . . 194
<b>10.3-1</b>	Overview. . . . . 195
<b>10.3-2</b>	Related Parties (Two natural persons) . . . . . 195
<b>10.3-3</b>	Related Parties (Natural and Juridical persons) . . . . . 195
<b>10.3-4</b>	Related Parties (Two or more juridical persons) . . . . . 197
<b>10.3-5</b>	Related Parties (Person and its PE or foreign PE) . . . . . 198

Page No.

<b>10.3-6</b>	Related Parties (Partners in unincorporated partnership) .....	199
<b>10.3-7</b>	Related Parties (Trustee, founder, settlor or beneficiary of a trust).....	199
<b>10.4</b>	Article 36: Payments to Connected Persons .....	199
<b>10.4-1</b>	Overview.....	200
<b>10.4-2</b>	General rule of deduction .....	200
<b>10.4-3</b>	Deductibility of payment made to connected persons .....	201
<b>10.4-4</b>	Connected Persons.....	201
<b>10.4-5</b>	Persons to whom this provisions shall not apply .....	203
<b>10.4-6</b>	Adjustments in the value of transactions between related persons .....	203

## Chapter 11

### Tax Loss Provisions

<b>11.1</b>	Introduction .....	205
<b>11.2</b>	Article 37: Tax Loss Relief .....	205
<b>11.2-1</b>	Overview.....	206
<b>11.2-2</b>	Set-off of business loss .....	206
<b>11.2-3</b>	When is set-off not allowed? .....	207
<b>11.2-4</b>	Mandatory to set-off the losses .....	208
<b>11.3</b>	Article 38: Transfer of tax loss .....	208
<b>11.3-1</b>	Overview.....	208
<b>11.3-2</b>	Conditions to transfer tax loss .....	209
<b>11.3-3</b>	How much losses can be transferred? .....	212
<b>11.3-4</b>	Adjustment after transfer of losses .....	212
<b>11.3-5</b>	Transfer of Unutilised Tax Losses in Business Restructuring .....	212
<b>11.3-6</b>	Comprehensive illustration .....	213
<b>11.4</b>	Article 39: Limitation of carry forward of loss .....	213
<b>11.4-1</b>	Overview.....	214
<b>11.4-2</b>	Minimum holding of interest .....	214
<b>11.4-3</b>	Change of ownership interest .....	215

---

*Page No.*

<b>11.4-4</b>	Relaxation for Listed Company .....	215
<b>11.4-5</b>	Comprehensive illustration .....	216

## Chapter 12

### Tax Group Provisions

<b>12.1</b>	Introduction .....	218
<b>12.2</b>	Article 40: Tax Group .....	218
<b>12.2-1</b>	Overview.....	220
<b>12.2-2</b>	Conditions to form a tax group.....	220
<b>12.2-3</b>	Reporting to FTA .....	224
<b>12.2-4</b>	Compliance.....	224
<b>12.2-5</b>	Liability of the companies forming a tax group.....	224
<b>12.2-6</b>	Addition in a tax group .....	224
<b>12.2-7</b>	Leaving a tax group .....	224
<b>12.2-8</b>	Complying Conditions.....	225
<b>12.2-9</b>	Replacement of a parent company.....	225
<b>12.2-10</b>	Illustrations .....	225
<b>12.3</b>	Article 41: Date of Formation and Cessation of a Tax Group .....	225
<b>12.3-1</b>	Overview.....	226
<b>12.4</b>	Article 42: Taxable Income of a Tax Group .....	227
<b>12.4-1</b>	Overview.....	228
<b>12.4-2</b>	Computation of taxable income of the tax group.....	228
<b>12.4-3</b>	Consequences of exiting from the tax group.....	230
<b>12.4-4</b>	Offsetting the unutilised tax loss.....	230
<b>12.4-5</b>	Limit to offset the loss.....	233
<b>12.4-6</b>	Sequence of set off.....	233
<b>12.4-7</b>	Treatment of unutilised losses on change in tax group constitution.....	234
<b>12.4-8</b>	Calculation of the direct or indirect ownership interest .....	235

Page No.

<b>12.4-9</b>	Business Restructuring and Tax Group . . . . .	235
<b>12.4-10</b>	Cost-benefit analysis . . . . .	236
<b>12.4-11</b>	Comprehensive Illustrations . . . . .	236

## Chapter 13

### Calculation of Corporate Tax Payable

<b>13.1</b>	Introduction . . . . .	238
<b>13.2</b>	Article 43: Currency . . . . .	238
<b>13.2-1</b>	Computation of income in local currency . .	238
<b>13.3</b>	Article 44: Calculation and Settlement of Corporate Tax . . . . .	239
<b>13.3-1</b>	Overview . . . . .	240
<b>13.3-2</b>	Self Assessment System. . . . .	240
<b>13.3-3</b>	Illustration . . . . .	240
<b>13.4</b>	Article 45: Withholding Tax . . . . .	241
<b>13.4-1</b>	Overview . . . . .	241
<b>13.4-2</b>	Rate of withholding tax . . . . .	241
<b>13.4-3</b>	Obligation to withhold the Tax . . . . .	241
<b>13.5</b>	Article 46: Withholding tax credits . . . . .	242
<b>13.5-1</b>	Withholding tax credit and refund . . . . .	242
<b>13.5-2</b>	Illustrations . . . . .	242
<b>13.6</b>	Article 47: Foreign tax credits . . . . .	243
<b>13.6-1</b>	Double taxation under the UAE CT Law . .	243
<b>13.6-2</b>	Avoidance of double taxation Internationally . . . . .	243
<b>13.6-3</b>	Method adopted by UAE CT Law . . . . .	243
<b>13.6-4</b>	Set-off of foreign tax credit . . . . .	243
<b>13.6-5</b>	Illustrations . . . . .	244
<b>13.6-6</b>	Foreign taxes for which Foreign Tax Credit is available . . . . .	246
<b>13.6-7</b>	When will foreign tax be considered as "paid"? . . . . .	247
<b>13.6-8</b>	Who can claim Foreign Tax Credit? . . . . .	248

Page No.

<b>13.6-9</b>	How to calculate the Foreign Tax Credit? . . . . .	249
<b>13.6-10</b>	Unutilised Foreign Tax Credit . . . . .	251
<b>13.6-11</b>	Scenarios where no Foreign Tax Credit is allowed . . . . .	251
<b>13.6-12</b>	Timing mismatches . . . . .	252
<b>13.6-13</b>	Maintenance of records . . . . .	255
<b>13.6-14</b>	Impact of Double Taxation Agreements . . . . .	255

## Chapter 14

### Payment and Refund of Corporate Tax

<b>14.1</b>	Introduction . . . . .	256
<b>14.2</b>	Article 48: Corporate Tax Payment . . . . .	256
<b>14.2-1</b>	Timeline to settle the CT payment . . . . .	256
<b>14.2-2</b>	Illustration . . . . .	257
<b>14.2-3</b>	Specification of type and tax period . . . . .	257
<b>14.3</b>	Article 49: Corporate Tax Refund. . . . .	257
<b>14.3-1</b>	Cases of corporate tax refund . . . . .	257
<b>14.3-2</b>	Application of refund. . . . .	258
<b>14.3-3</b>	Set-off of refund against tax payable . . . . .	258
<b>14.3-4</b>	When can a refund be denied? . . . . .	258
<b>14.3-5</b>	Intimation by the FTA to the taxpayer . . . . .	258

## Chapter 15

### Anti-Abuse Rules

<b>15.1</b>	Introduction . . . . .	259
<b>15.2</b>	Article 50 : General Anti-Abuse Rule . . . . .	259
<b>15.2-1</b>	Overview . . . . .	261
<b>15.2-2</b>	BEPS Action Plan 6 . . . . .	261
<b>15.2-3</b>	GAAR v. BEPS . . . . .	262
<b>15.2-4</b>	Conditions for applicability of GAAR . . . . .	263
<b>15.2-5</b>	Relief where tax advantage is consistent with UAE CT Law . . . . .	263

	Page No.
<b>15.2-6</b> Consequences of applying GAAR .....	264
<b>15.2-7</b> How to invoke GAAR?.....	264
<b>15.2-8</b> GAAR will not apply if business purpose is <i>bona fide</i> .....	265
<b>15.2-9</b> Applicability of various Ministerial Decisions .....	266
<b>15.2-10</b> Comprehensive Example.....	266

## Chapter 16

### Tax Registration and De-Registration

<b>16.1</b> Introduction .....	267
<b>16.2</b> Article 51: Tax registration .....	267
<b>16.2-1</b> Obtaining Tax Registration .....	267
<b>16.2-2</b> Tax Registration for Exempt Person.....	268
<b>16.2-3</b> Exemption from the registration requirement .....	268
<b>16.2-4</b> Timelines for registration .....	269
<b>16.3</b> Article 52: De-registration .....	269
<b>16.3-1</b> Overview.....	270
<b>16.3-2</b> Application to the FTA for de-registration ..	270
<b>16.3-3</b> Time Limit for filing of application .....	270
<b>16.3-4</b> Approval of de-registration .....	270
<b>16.3-5</b> De-registration without application .....	270

## Chapter 17

### Tax Returns and Clarifications

<b>17.1</b> Introduction .....	271
<b>17.2</b> Article 53: Tax Returns .....	272
<b>17.2-1</b> Overview.....	272
<b>17.2-2</b> Information to be submitted in the tax return .....	273
<b>17.2-3</b> Due date to submit the tax return.....	273
<b>17.2-4</b> Information to be disclosed in the tax return .....	273

*Page No.*

<b>17.2-5</b>	List of exempt persons required to file a declaration .....	273
<b>17.2-6</b>	Unincorporated Partnership Firms .....	274
<b>17.2-7</b>	Filing of declaration .....	275
<b>17.2-8</b>	Tax return of Tax Group .....	275
<b>17.3</b>	Article 54: Financial Statements .....	275
<b>17.3-1</b>	Overview.....	275
<b>17.3-2</b>	Maintenance of Financial Statements .....	276
<b>17.3-3</b>	Submission of Financial Statement .....	276
<b>17.3-4</b>	Persons required to prepare and maintain Audited Financial Statements .....	276
<b>17.3-5</b>	Reporting requirement for unincorporated partnerships .....	276
<b>17.4</b>	Article 55: Transfer Pricing Documentation .....	276
<b>17.4-1</b>	Overview.....	277
<b>17.4-2</b>	Documents to be maintained .....	277
<b>17.4-3</b>	Disclosure requirements for related parties internationally .....	278
<b>17.5</b>	Article 56: Record Keeping.....	279
<b>17.5-1</b>	Maintenance of Records under UAE CT Law .....	280
<b>17.5-2</b>	Time period .....	280
<b>17.5-3</b>	Tax Procedure.....	280
<b>17.6</b>	Article 57: Tax Period .....	283
<b>17.6-1</b>	Tax Period.....	283
<b>17.7</b>	Article 58: Change of Tax Period .....	283
<b>17.7-1</b>	Request to FTA.....	284
<b>17.7-2</b>	Application to FTA.....	284
<b>17.8</b>	Article 59: Clarifications .....	284
<b>17.8-1</b>	Ideal Tax System .....	285
<b>17.8-2</b>	Advance Pricing Agreement .....	285
<b>17.8-3</b>	Process of obtaining an APA .....	285
<b>17.8-4</b>	Validity of APA .....	285
<b>17.8-5</b>	Types of APA.....	285
<b>17.9</b>	Illustration.....	286

## Chapter 18

### Violations and Penalties

<b>18.1</b>	Introduction .....	287
<b>18.2</b>	Article 60 : Assessment of Corporate Tax and Penalties .....	287
<b>18.2-1</b>	Overview.....	287
<b>18.2-2</b>	Assessment by the FTA .....	288
<b>18.2-3</b>	Issue of Tax assessment.....	288
<b>18.2-4</b>	Issue of Estimated Tax Assessment .....	288
<b>18.2-5</b>	Issue of Administrative Penalties Asse-ssment.....	289
<b>18.2-6</b>	Penalty and Prosecution .....	291
<b>18.2-7</b>	Judgment by the Court .....	292
<b>18.2-8</b>	Review and Reconsideration of decision ..	293
<b>18.2-9</b>	Dispute Resolution Committee.....	293
<b>18.2-10</b>	Procedures of Appeal before Courts.....	294
<b>18.2-11</b>	Inadmissible Appeal.....	294

## Chapter 19

### Transitional Rules

<b>19.1</b>	Introduction .....	296
<b>19.2</b>	Article 61: Transitional Rules .....	296
<b>19.2-1</b>	Adjustments in respect of the closing balance sheet .....	296
<b>19.2-2</b>	Any other prescribed conditions.....	297

## Chapter 20

### Closing Provisions

<b>20.1</b>	Introduction .....	300
<b>20.2</b>	Article 62: Delegation of Power .....	300
<b>20.2-1</b>	Overview.....	300
<b>20.3</b>	Article 63: Administrative Policies and Procedures ..	301
<b>20.3-1</b>	Overview.....	301

Page No.

<b>20.4</b>	Article 64: Cooperating with the Authority . . . . .	301
<b>20.4-1</b>	Overview . . . . .	301
<b>20.5</b>	Article 65: Revenue Sharing . . . . .	301
<b>20.5-1</b>	Overview . . . . .	302
<b>20.6</b>	Article 66: International Agreements . . . . .	302
<b>20.6-1</b>	Overview of DTAA . . . . .	302
<b>20.6-2</b>	International Agreements and UAE CT Law . . . . .	302
<b>20.6-3</b>	List of Double Taxation Avoidance Agreements (DTAA) the UAE has signed with other countries . . . . .	303
<b>20.7</b>	Article 67: Implementing Decisions . . . . .	307
<b>20.7-1</b>	Overview . . . . .	308
<b>20.8</b>	Article 68: Cancellation of Conflicting Provisions . . . . .	308
<b>20.8-1</b>	Overview . . . . .	308
<b>20.9</b>	Article 69: Application of this Decree-Law to Tax Periods . . . . .	308
<b>20.9-1</b>	Overview . . . . .	308
<b>20.9-2</b>	Illustration . . . . .	309
<b>20.10</b>	Article 70: Publication and Application of this Decree-Law . . . . .	309
<b>20.10-1</b>	Overview . . . . .	309

## APPENDIX

Federal Decree-Law No. 47 of 2022 - Issued 3 October 2022 (Effective 15 days after publishing in the Official Gazette) . . . . .	313
Federal Decree-Law No. 60 of 2023-Amending Certain Provisions of the Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses . . . . .	356
Federal Tax Authority Decision No. 3 of 2024 regarding The Timeline specified for Registration of Taxable Persons for Corporate Tax for the purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses and its amendments . . . . .	358
Federal Tax Authority Decision No. 5 of 2023 regarding Conditions for Change in Tax Period for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses . . . . .	362

## Page No.

Federal Tax Authority Decision No. 6 of 2023 regarding Tax Deregistration Timeline for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	364
Federal Tax Authority Decision No. 7 of 2023 regarding Provisions of Exemption from Corporate Tax for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	366
Federal Tax Authority Decision No. 11 of 2023 regarding Requirements of Submitting a Declaration for Exempt Persons for purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	368
Federal Tax Authority Decision No. 12 of 2023 regarding Conditions for Forming the Tax Group by Subsidiaries of a Government Entity for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	370
Federal Tax Authority Decision No. 13 of 2023 regarding Determination of Conditions for Conversion of Amounts Quantified in a Currency other than the United Arab Emirates Dirham for the Purposes of the Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	372
Federal Tax Authority Decision No. 16 of 2023 regarding Determining the Requirements for the Registration of the Unincorporated Partnership and Determining the Distributive Shares of Partners in an Unincorporated Partnership for the purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses and its amendments .....	374
Ministerial Decision No. 27 of 2023 on Implementation of Certain Provisions of Cabinet Decision No. 85 of 2022 on Determination of Tax Residency .....	376
Cabinet Decision No. 37 of 2023 Regarding the Qualifying Public Benefit Entities for the Purposes of Federal Decree- Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	379
Ministerial Decision No. 43 of 2023 Concerning Exception from Tax Registration for the Purpose of Federal Decree- Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	416

---

*Page No.*

Cabinet Resolution No. 44 of 2020 organising reports submitted by multinational companies .....	418
Cabinet Decision No. 49 of 2023 on Specifying the Categories of Businesses or Business Activities Conducted by a Resident or Non-Resident Natural Person that are Subject to Corporate Tax.....	426
Cabinet Decision No. 55 of 2023 on Determining Qualifying Income for the Qualifying Free Zone Person for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses.....	428
Cabinet Decision No. 56 of 2023 on Determination of a Non-Resident Person's Nexus in the State for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	432
Ministerial Decision No. 68 of 2023 on the Treatment of all Businesses and Business Activities Conducted by a Government Entity as a Single Taxable Person .....	434
Ministerial Decision No. 73 of 2023 on Small Business Relief for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	438
Cabinet Decision No. 74 of 2023 on the Executive Regulation of Federal Decree-Law No. 28 of 2022 on Tax Procedures .....	440
Cabinet Decision No. 75 of 2023 on the Administrative Penalties for Violations Related to the Application of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	458
Cabinet Decision No. 81 of 2023 on Conditions for Qualifying Investment Funds for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	463
Ministerial Decision No. 82 of 2023 on the Determination of Categories of Taxable Persons Required to Prepare and Maintain Audited Financial Statements for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	467
Ministerial Decision No. 83 of 2023 on the Determination of the Conditions under which the Presence of a Natural Person in the State would not Create a Permanent Establishment for a Non-Resident Person for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	468

	Page No.
Determination of Tax Residency Cabinet Decision No. 85 of 2022 - Issued 2 Sept. 2022 (Effective 1 Mar. 2023) .....	470
Ministerial Decision No. 97 of 2023 Requirements for Maintaining Transfer Pricing Documentation for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	473
Cabinet Decision No. 100 of 2023 on Determining Qualifying Income for the Qualifying Free Zone Person for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses.....	475
Ministerial Decision No. 105 of 2023 on the Determination of the Conditions under which a Person may Continue to be Deemed as an Exempt Person, or Cease to be Deemed as an Exempt Person from a Different Date for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	480
Ministerial Decision No. 114 of 2023 on the Accounting Standards and Methods for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	482
Ministerial Decision No. 115 of 2023 on Private Pension Funds and Private Social Security Funds for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	484
Ministerial Decision No. 116 of 2023 on the Participation Exemption for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	487
Ministerial Decision No. 120 of 2023 on the Adjustments Under the Transitional Rules for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	494
Ministerial Decision No. 125 of 2023 on Tax Group for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	499
Ministerial Decision No. 126 of 2023 on the General Interest Deduction Limitation Rule for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	504
Ministerial Decision No. 127 of 2023 on Unincorporated Partnership, Foreign Partnership and Family Foundation for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	510



Page No.

Ministerial Decision No. 132 of 2023 on Transfers Within a Qualifying Group for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	512
Ministerial Decision No. 133 of 2023 on Business Restructuring Relief for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	516
Ministerial Decision No. 134 of 2023 on the General Rules for Determining Taxable Income for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	520
Ministerial Decision No. 139 of 2023 Regarding Qualifying Activities and Excluded Activities for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	526
Ministerial Decision No. 265 of 2023 Regarding Qualifying Activities and Excluded Activities for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses .....	529



## CHAPTER

# 1

# Introduction

### 1.1 Overview

The United Arab Emirates (UAE or Emirates), an elective monarchy formed from a federation of seven emirates, issued the *Federal Decree-Law No. 47 of 2022* on the Taxation of Corporations and Businesses. The Emirates introduced the tax laws for the first time, and various cabinet decisions are also being issued to prescribe the rules. It is important to understand these typical aspects of the law as one would need to refer to all relevant material to understand and apply the context in which the law prescribes it. Intending to simplify the same, here is our attempt to put all relevant material together to enable readers to apply the law with clarity.

The Federal Tax Authority of the UAE (FTA) issued the Federal Decree in the Arabic version, followed by an English Translated version. The readers should be aware of the fact that the Arabic version of the law is binding and will prevail over the English Translated version of the law. Thus, in our humble opinion, one should not apply the interpretation principles as applied to English language laws in an international context. It would be appropriate to refer to the Arabic version and the overall context of the provision and then apply the interpretation rules more cautiously.

Wherever required, reliance has been placed on OECD and other commentaries to explain certain provisions of the UAE Corporate Tax Law ('CT Law'). However, one should not blindly follow the same, as these commentaries may only have persuasive value, not precedence value.

With this as the backdrop, we will now turn first to the overview of the regulatory environment in UAE and then some salient features of the law and finally, followed by a brief overview of various segments of the book.

### 1.2 Regulatory Environment in UAE

The UAE is formed from a federation of seven emirates: Abu Dhabi (the capital), Ajman, Dubai, Fujairah, Ras Al Khaimah, Sharjah and Umm Al Quwain. Formed in 1971, each Emirate is governed by a ruler, and the rulers form the Federal Supreme Council. The members of the Federal Supreme Council elect a President and Vice President from among their members. Traditionally, the ruler of Abu Dhabi serves as President, while the ruler of Dubai is Vice-President and Prime Minister.

The UAE is strategically located in the Arabian Peninsula, overlooking approaches to the Strait of Hormuz, which is a vital transit point for world oil. It shares borders with Saudi Arabia and Oman. The UAE has extensive oil and gas reserves.



Foreign investors can carry out any activities in the UAE only after obtaining registration and license from the relevant authorities in the UAE. Such business licenses will reflect the business activities that the corporate entity is permitted to conduct. The corporate entity will need to select the activities it wishes to conduct from a list of activities available in each jurisdiction. The entity may not conduct business activities other than the ones it has been licensed for. In general, a foreign investor can establish a suitable business presence in either the UAE mainland or in one of the Free Zones (also commonly known as 'Onshore').

Each Emirate has its onshore licensing authority, the Department of Economic Development, which licenses and regulates companies incorporated in that Emirate.

### 1.3 Legal Structure of Entities

The legal forms for the UAE mainland are governed by the Federal Law No. 32 of 2021 regarding the Commercial Companies, issued on 20th September 2021 (CCL), which came into force in January 2022 and replaced in its entirety, Federal Decree-Law No. 2 of 2015 on Commercial Companies Law (old Companies Law). In terms of the legal forms, UAE Company Law provides the regulations governing the operations of foreign businesses. The Federal Law provides for six categories of business organisation: Limited Liability Company, Branches, Partnership, Joint Venture Company, Public Shareholding Company and Private Shareholding Company. The most commonly used business forms in the UAE mainland are the Limited Liability Company (LLC) or a branch of a foreign company.

There are approximately 45 free zones in the UAE, and each Emirate in the UAE has one or more free zones, which are regulated by an independent free zone authority and governed by different sets of companies' regulations and rules. Some free zones are economic (such as the Jebel Ali Free Zone) or financial zones (Dubai International Financial Center (DIFC) and Abu Dhabi Global Market (ADGM)), while some are dedicated to a certain sector/industry or are general free zones.

### 1.4 Federal Structure of the UAE

The UAE has a federal system of Government which is composed of three branches:

- ◆ Legislative: A Federal Supreme Council (FSC) and the advisory Federal National Council (FNC).
- ◆ Executive: The President, who is also commander-in-chief of the military, the Prime Minister and the Council of Ministers.
- ◆ Judicial: The Supreme Court and lower federal courts.

#### 1.4-1 Legislative Powers

The Constitution provides a certain distribution of legislative powers between the Federation and the individual Emirates. According to the Constitution, certain

matters are vested exclusively with the Federation as regards their enactment and implementation, while others are left to the individual Emirates to implement. The highest constitutional authority in the UAE is the FSC. The council consists of the rulers from the seven emirates and has both legislative and executive powers. The FSC elects a cabinet that is headed by the Prime Minister. The Cabinet is responsible for managing all internal and foreign affairs.

### **1.4-2 Judiciary Powers**

The UAE has a federal court system. The UAE's judicial system is derived from the civil law system and Islamic Sharia law. Islam is the state religion according to the Constitution and the principal source of law, but the legal system has changed and modernised more recently. Sharia laws are mainly enforced in criminal matters. For the personal matters Sharia laws are applied to Muslims and are optional for others. Commercial disputes are usually solved by civil courts.

UAE is essentially a civil law jurisdiction heavily influenced by French, Roman, Egyptian and Islamic law. Common law principles, such as adopting previous court judgments as legal precedents, are generally not recognised.

Under the Constitution, each Emirate can establish its own judiciary or merge with the federal court system. As a result, there is a combination of federal and local (or Emirate) courts in the UAE with parallel jurisdictions, depending on which system the individual Emirate has opted for. The judicial systems of most of the Emirates – except for Dubai, Ras Al-Khaimah and Abu Dhabi, which have retained their own distinct and autonomous local judicial systems – have merged into the UAE Federal Judicial Authority.

In terms of judicial hierarchy, the UAE federal system is divided into courts of first instance (trial court), courts of appeal and court of cassation (Supreme Court). The UAE Federal Supreme Court, situated in Abu Dhabi, is the highest court in the federal judicial system. All court proceedings are conducted in Arabic, and parties must be represented by qualified local advocates with special licences.

In addition, with a view to offering flexibility and being recognised as a leading financial centre, UAE has also adopted a Common law judiciary for its two financial free zones *viz.* Dubai International Financial Centre (DIFC) and Abu Dhabi Global Markets (ADGM). Thus, for the companies established in these financial free zones, common law is the governing law, and they have also established Courts which follow and uphold common law principles as far as civil or commercial disputes within these companies are concerned. Further, these legal systems have also given the flexibility to other Corporates to choose to be governed by Arbitration and dispute resolution mechanisms offered by such common law courts. Further, these Courts are granted equal status as Courts of first instance, and orders issued by such common law courts can also request for execution orders to be issued by the UAE Federal courts.

However, tax disputes will always follow the hierarchy prescribed and will not be governed or adjudicated by the common law courts as per the current regulations.



## 1.5 Tax landscape in the UAE

The tax landscape in the UAE has witnessed a paradigm shift in recent years. In the past few years, the UAE has brought forth significant tax reforms to streamline its tax system and align it with international best practices while diversifying its state revenue.

### 1.5-1 Value Added Tax (VAT)

The introduction of Value Added Tax (VAT) had been under discussion in the GCC for more than a decade before the UAE established the Federal Tax Authority (FTA) in 2016 to administer, collect and enforce Federal taxes, which currently comprise Excise Tax and VAT.

In line with the GCC agreements, UAE introduced its first two taxes at the Federal level: Excise Tax at the rate of 100 per cent on energy drinks and tobacco products; and 50 per cent on carbonated drinks from 1st October 2017 (expanded to e-smoking devices and liquids at the rate of 100 per cent and sweetened drinks at the rate of 50 per cent from 1st December 2019) and VAT at the standard rate of five per cent with effect from 1st January 2018.

### 1.5-2 Corporate Income Tax

The UAE Federation does not impose a federal corporate income tax in the Emirates. Each Emirate has issued local tax decrees. However, in practice, the Emirate-level income-tax decrees have been enforced for upstream oil and gas activities and branches of foreign banks till now. Oil and gas exploration and production companies are taxed at progressive rates of up to 55% under the applicable Emirate-level income tax decree. However, in practice, different rates may be agreed upon with the relevant authority under specific Government concession agreements. Branches of foreign banks are taxed at rates according to the banking tax decree of the Emirate in which they operate, generally at a flat rate of 20%. Free zone entities are typically offered tax holidays and exemptions for terms of between 15 to 50 years.

Many of the changes in the UAE were driven by the Organisation for Economic Co-operation and Development's ('OECD'), and Base Erosion Profit Shifting ('BEPS') projects, which seek to tackle international tax avoidance and address gaps in existing tax rules that allow the profits of multinational companies to be artificially shifted from high tax jurisdictions to low or no tax environments where little or no economic activity takes place. The OECD developed a 15-point BEPS Action Plan in partnership with the G20 countries in 2013. The UAE became an inclusive member in May 2018, together with more than 135 other countries, committing to the implementation of four minimum BEPS standards, namely, Countering Harmful Practices (Action 5), Countering Treaty Abuse (Action 6), Transfer Pricing Documentation and Country-by-Country Reporting (Action 13) and Improving Dispute Resolution Mechanisms (Action 14). In line with its commitment, the UAE introduced Economic Substance Regulations (ESR) and Country-by-Country Reporting (CbCR) regulations in April 2019.

In October 2021, the UAE joined over 130 members of the BEPS Inclusive Framework in agreement on a landmark deal to address the tax challenges arising from the digitalisation of the economy. BEPS 2.0, through a two-pillar solution, aims to address gaps in current laws that allow large corporations to earn significant revenue in foreign markets without paying income tax there. The new rules ensure that large Multinational Enterprises (MNEs) pay a fair share of tax wherever they operate.

### **1.5-3 Federal Corporate Tax**

As a historical development, on 31st January 2022, the Ministry of Finance (MoF) of UAE announced the introduction of the Federal Corporate Tax (CT) regime for financial years starting on or after 1st June 2023 with a headline rate of 9%. The introduction of CT follows from the international pressure to implement a global corporate minimum tax under the BEPS project coupled with UAE's commitment to meet international tax transparency and fairness standards.

On 28th April 2022, the Ministry of Finance (MoF) provided an excellent opportunity for businesses, inviting the public to provide feedback on the design and implementation of the CT regime and to analyse its impact through the issue of a Public Consultation Document (PCD), providing broad contours of the upcoming CT regime. Thereafter, the UAE published the Federal Decree-Law No. (47) of 2022 on the Taxation of Corporations and Businesses (hereinafter referred to as the 'UAE CT Law' or 'CT Law') on 9th December 2022.

### **1.6 Impact of UAE Corporate Tax**

Given the UAE's position as a leading global centre for investment and businesses with minimum taxation, announcement of CT Law will change how businesses operate in the country. The introduction of CT will definitely impact the tax and compliance costs of most businesses. The tax rate of 9% remains highly competitive compared to other jurisdictions.

Overall, the UAE authority is inclined to keep the UAE CT laws and regulations simple with minimum procedure and compliance for the taxpayers. However, in line with international best practices, it has adopted various distinctive features in CT law, making it unique.

### **1.7 Overview of UAE CT Law**

In a landmark announcement, the MoF announced on 31st January 2022 that the UAE would introduce a Federal Corporate Tax regime (a type of direct tax) effective on or after 1st June 2023. The 9% tax rate in the UAE CT Law is one of the most competitive rates globally, and even in the Middle East region, it is the lowest rate, not counting Bahrain, which has not introduced a CT regime yet. At the outset, the new tax regime would certainly require a change in the mindset of the tax and finance department of any business. In the ensuing discussions, we have outlined the key features and overview of UAE CT law.



### **1.7-1 Important Definitions**

#### **1.7-1a State**

State means ‘United Arab Emirates’.

#### **1.7-1b United Arab Emirates**

The United Arab Emirates is an elective monarchy formed from a federation of seven emirates comprising of:

- ◆ Abu Dhabi (the capital)
- ◆ Ajman
- ◆ Dubai
- ◆ Fujairah
- ◆ Ras Al Khaimah
- ◆ Sharjah
- ◆ Umm Al Quwain

Each Emirate is governed by a ruler, and collectively, the rulers form the Federal Supreme Council. The members of the Federal Supreme Council elect a President and Vice President from among their members.

#### **1.7-1c Federal Government**

The Government of the UAE is referred to as the ‘Federal Government’. The federal Government is the national Government of the UAE, a unitary federation of seven self-governing emirates.

#### **1.7-1d Local Government**

Local Government means any of the governments of the Member Emirates of the Federation.

#### **1.7-1e Minister and Ministry**

Ministry of Finance and Minister of Finance are referred as ‘Ministry’ and ‘Minister’ respectively across the CT Law.

#### **1.7-1f Tax Procedure Law**

Federal Decree-Law No. 7 of 2017 and Federal Decree-Law No. 28 of 2022 are the laws that govern tax procedures, which are referred to as ‘Tax Procedures Law’.

#### **1.7-1g Government Entity**

‘Government Entity’ includes the Federal Government, Local Governments, ministries, Government departments, Government agencies, authorities and public institutions of the Federal Government or Local Governments.



### **1.7-1h Government-Controlled Entity**

'Government Controlled Entity' refers to any juridical person wholly owned and controlled, directly or indirectly, by a Government Entity, as specified in a decision issued by the Cabinet at the suggestion of the Minister.

### **1.7-1-i Authority**

Authority means 'Federal Tax Authority', the Governing authority responsible for the administration, collection and enforcement of federal taxes.

### **1.7-1j Licensing Authority**

The competent authority concerned with licensing or authorising a business or business activity in UAE is known as Licensing Authority.

### **1.7-1k Financial Year**

Financial Year is a Gregorian Calendar Year, or the 12 month period for which the taxable person prepares financial statements. Article 57 provides flexibility for the selection of the Financial Year, and different taxable persons can have different Financial Years.

### **1.7-1-l Corporate tax**

The tax imposed under the Federal Decree-Law No. 47 of 2022 on the juridical person and business income is referred to as 'Corporate Tax'.

### **1.7-1m Corporate tax Payable**

The corporate tax that has or will become due for payment to the FTA in respect of one or more tax periods is referred to as 'Corporate Tax Payable'.

### **1.7-1n Taxable Person**

A person who is subject to CT in the UAE is referred to as a 'Taxable Person'. A taxable person can be either a resident person or a non-resident person.

### **1.7-1-o Taxable Income**

The income subjected to Corporate Tax under the CT Law is referred to as Taxable income.

### **1.7-1-p Exempt Income**

Any income which is exempted from the CT is referred to as 'Exempt Income'.

### **1.7-1-q Tax Loss**

'Tax Loss' means any negative taxable income as calculated for a given Tax Period.



### **1.7-1r Tax Period**

The period for which the taxable person is required to file a tax return is referred to as Tax Period.

### **1.7-1s Tax Return**

A taxable person shall be required to file information with the FTA for CT Law purposes in the prescribed form and manner. Such a prescribed form is referred to as a tax return.

### **1.7-1t Withholding Tax**

'Withholding Tax' means the corporate tax withheld from State Sourced Income in accordance with the CT Law.

### **1.7-1u Tax Registration**

The procedure under which a person registers for corporate tax purposes with the FTA is referred to as 'Tax Registration'.

### **1.7-1v Tax Registration Number**

A unique number issued by the FTA to each person registered for corporate tax purposes is known as 'Tax Registration Number'.

### **1.7-1w Tax Deregistration**

A procedure under which a person is deregistered for corporate tax purposes with the FTA is referred to as 'Tax Deregistration'.

### **1.7-1x Top-up Tax**

The top-up tax imposed on Multinational Enterprises in accordance with this Decree-Law and the rules and controls to be determined by the Cabinet under Article (3) of this Decree-Law for the purposes of the pillar two rules issued by the Organization for Economic Cooperation and Development.

### **1.7-1y Multinational Enterprise**

An entity and/or one or more of its member entities located in the State or in a foreign jurisdiction, as specified in a decision to be issued by the Cabinet at the suggestion of the Minister.

## **1.7-2 Applicability**

The UAE CT regime will be effective for financial periods starting on or after 1st June 2023. The UAE CT will be implemented at a Federal level, uniformly across all the Emirates, which shall apply to all UAE companies and other legal entities conducting business and commercial activities, with certain exceptions.

The CT will apply to the following taxable persons:

- (a) A resident person, who can be a:

- ◆ Legal person incorporated or otherwise established in the UAE, including a Free Zone Person;
  - ◆ Foreign entities effectively managed and controlled in the UAE;
  - ◆ Natural persons (individuals) who conduct a Business or Business Activity in the UAE as specified in a Ministerial & Cabinet Decisions.
- (b) A non-resident person, who is not a resident person, and it either:
- ◆ Has a Permanent Establishment (PE) in the UAE;
  - ◆ Derives the UAE - Sourced income that is not attributable to a PE; or
  - ◆ Has a nexus in the UAE.

### ***1.7-3 Entities exempt from CT***

Certain types of businesses or organisations are exempt from Corporate tax, which are as follows:

- (a) Government Entities
- (b) Government-Controlled Entities
- (c) Extractive Business
- (d) Non-Extractive Natural Resource Businesses
- (e) Qualifying Public Benefit Entities
- (f) Public or Private Pension Funds
- (g) Social Security Funds
- (h) Qualifying Investment Funds

### ***1.7-4 Taxable Base***

A resident person is subject to CT on the following income:

- (a) A Juridical person will be subject to CT on its taxable income derived from the UAE or from outside UAE. In other words, the worldwide income shall be taxable in the hands of a resident juridical person.
- (b) In the case of an Individual, the scope of CT will be limited to the income from specified business or business activity derived from the UAE or outside the UAE but which is conducted from UAE.

A non-resident person is subject to CT on the following income:

- (a) Income attributable to UAE PE;
- (b) UAE sourced income; and
- (c) Income attributable to nexus in the UAE.

### ***1.7-5 Incomes exempt from tax***

The following income and related expenditure shall not be taken into account in determining taxable income:

- (a) Dividends and other profit distributions received from the incorporated or resident legal persons.



- (b) Dividends and other profit distributions received from a Participating Interest (5% or more ownership interest) in a foreign juridical person.
- (c) Certain other income (e.g., capital gains, foreign exchange gains/losses and impairment gains or losses) from a Participating Interest.
- (d) Income from a foreign branch or PE where an election is made to claim the "Foreign PE" exemption.
- (e) Income derived by a Non-Resident Person from operating aircraft or ships in international transportation that meets certain conditions.

### ***1.7-6 Threshold and Tax rates***

The rate of corporate tax at 9% is one of the lowest corporate tax rates in the world. To support small businesses and start-ups, no corporate tax will have to be paid for profits up to a threshold of AED 375,000 and any income exceeding this amount will be taxed at the rate of 9%. Entities in free zones meeting all necessary requirements can benefit from 0% CT on their qualifying income, and other non-qualifying income will be taxable at 9%. A separate decision will be issued in due course for Multinational enterprises to ensure that they are subject to effective tax rate of 15% in line with Pillar Two Rules.

### ***1.7-7 Computation of Taxable income***

The UAE CT shall be calculated in the following manner:

<i>Determination of CT payable</i>	<i>Amount (in AED)</i>
Accounting net profit (or loss) as stated in the financial statement	xxx
<i>Add/Less: Adjustments</i>	xxx
<b>Final taxable income</b>	<b>xxx</b>
Tax on final taxable income up to AED 375,000	<i>nil</i>
Tax at 9% on final taxable income in excess of AED 375,000	xxx
<i>Less: Foreign Tax Credit</i>	xxx
<b>Final CT payable</b>	<b>xxx</b>

The UAE CT will be levied on adjusted accounting net profit earned by taxable persons. CT law provides for a handful of adjustments for expense deductions.

In line with the OECD's BEPS Action 4, it has introduced thin capitalisation rules wherein interest expenditure will be deductible up to 30% of the taxable person's accounting earnings before deduction of interest, tax, depreciation and amortisation (EBITDA).

Further, the following expenses will be allowed as a deduction up to the limits as prescribed below:

- (a) Expenses incurred to entertain customers, shareholders, suppliers, and other business partners will be allowed as a deduction up to 50% of the expenses.
- (b) If a loan is availed from a related party, no interest deduction is allowed if such a loan is utilised for specified transactions like dividend payments, capital contributions, etc.

### **1.7-8 Non-deductible expenses**

Following are the expenses that will not be deductible for tax purposes:

- (a) Donations, grants or gifts made to an entity that is not a Qualifying Public Benefit Entity.
- (b) Fines and penalties, other than amounts awarded as compensation for damages or breach of contract.
- (c) Bribes or other illicit payments.
- (d) Dividends, profit distributions or benefits of a similar nature paid to an owner of the taxable person.
- (e) Amounts withdrawn from the business by a natural person who is a taxable person.
- (f) Corporate tax imposed on a taxable person under this decree-law.
- (g) Input Value Added Tax incurred by a Taxable Person that is recoverable under Federal Decree-Law No. (8) of 2017.
- (h) Tax on income imposed on the taxable person outside the State.
- (i) Such other expenditure as specified in a decision issued by the Cabinet at the suggestion of the Minister.

### **1.7-9 Adjustment for losses**

While businesses will be allowed to offset losses of one period as against taxable income of a future period and the maximum loss which can be set off has been capped to 75% of the taxable income, losses shall be allowed to be carried forward for an indefinite period subject to certain conditions. This will bring a huge relief to taxpayers, specifically for new businesses and start-ups.

Also, CT law has adopted a unique provision for the transfer of losses. Group companies (having a common ownership interest of atleast 75% or more) will be allowed to transfer losses from one group company to another profitable group company subject to certain conditions.

Restructuring or Re-organising within a group (e.g. merger) will be considered tax neutral on fulfilment of certain conditions. Such relief will be 'clawed back' if conditions are violated.

### **1.7-10 Nexus Rules**

The concept of PE has been adopted in the CT law, while it is generally applied through double taxation avoidance agreements. The PE definition in the CT Law is relatively standard and includes the usual "fixed place of business" in the UAE and "dependent agents". It also includes anti-fragmentation provisions where the non-resident or its related party carries out activity in the UAE through another PE in the UAE, and on a combined basis, the otherwise preparatory or auxiliary activities form a cohesive business operation of non-resident in the UAE.



A non-resident will also be subject to tax in UAE if they have a ‘nexus’ in the UAE. Although the word ‘nexus’ has limited meaning, the CT law widens the scope of taxation for non-residents considering the challenges of evolving business models in the wake of digitalisation and globalisation. Application of Nexus concept has been at the moment kept limited to a foreign company owning immovable property in UAE and thus that company will be subject to taxation under CT law in relation to income earned from such property.

### ***1.7-11 Transfer Pricing Regulation***

The intercompany transactions, both domestic and cross-border, will have to be conducted on an arm’s length basis and supported by robust documentation in line with OECD transfer pricing guidelines. The scope of transfer pricing regime is wide enough to include remuneration and other benefits given to owners and key managerial personnel (along with their relatives).

The arm’s length price will usually be determined using one of a set number of internationally recognised methods as follows:

- (a) The Comparable Uncontrolled Price method (CUP)
- (b) The Resale Price Method (RPM)
- (c) The Cost-Plus Method (CPM)
- (d) The Transactional Net Margin Method (TNMM)
- (e) The transactional Profit Split Method (TPSM)

A taxable person may use any other method if none of the above can be reasonably applied. UAE has set a high threshold of revenue in excess of AED 200 million to maintain a local file and master file for the transfer pricing documentation.

### ***1.7-12 General Anti-Abuse Rules***

The UAE CT Law includes General Anti-Abuse Rules (GAAR) and mandates the principal purpose test for the transactions where any transaction should not be conducted with only tax advantage as a primary motive. Interestingly, the GAAR provisions have been made applicable even for the transition period until the law becomes effective.

### ***1.7-13 Compliance and Administration***

Any person subject to CT will need to register with FTA and obtain a Tax Registration number. This is to be obtained separately from existing VAT registration. A Person with a Tax Registration Number shall file a Tax Deregistration application with the authority where there is a cessation of its Business or Business Activity

A taxable person with revenue exceeding AED 50,000,000 (fifty million dirhams) during the relevant tax period and Qualifying Free Zone Person will be required to prepare and maintain Audited Financial Statements.

Taxpayers will have to file CT returns and settle CT liability within 9 months from the end of the relevant tax period.



Taxable person (including Exempt Person) shall maintain all records and documents for a period of (7) seven years.

The FTA will be responsible for the administration, collection and enforcement of UAE CT.

The law does not define its dispute procedure system but refers to the *Tax Procedures Law*.

# Imposition of Corporate Tax and Applicable Rates

## 2.1 Introduction

Chapter 2 of the CT Law deals with the imposition of the Corporate Tax and provides the applicable rate of CT. Chapter 2 collectively creates a charge on the taxable income. This Chapter comprises the following two articles:

- (a) Article 2 – Imposition of Corporate Tax
- (b) Article 3 – Corporate Tax Rate

## 2.2 Article 2: Imposition of Corporate Tax

Article 2 reads as follows:

*“Corporate Tax shall be imposed on Taxable Income, at the rates determined under this Decree-Law, and payable to the Authority under this Decree-Law and the Tax Procedures Law.”*

### 2.2-1 Levy of corporate tax

The tax imposed under the *Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses* (“Corporate Tax Law or the CT Law or the UAE CT Law”) on the juridical person and business income is referred to as “Corporate Tax”.

Article 2 of the UAE CT Law levies the corporate tax on the taxable Income of a taxable person. The Corporate tax is payable to the Federal Tax Authority (“FTA or Authority”) in accordance with the procedures laid down under the Tax Procedures Law.

‘Federal Tax Authority’, means the Government authority responsible for the administration, collection and enforcement of federal taxes.

*See Chapter 6 for “Taxable Income” and Chapter 4 for “Taxable Persons”*

### 2.2-2 Tax Procedures Law

*Federal Decree-Law No. 7 of 2017* and *Federal Decree-Law No. 28 of 2022* are the laws that govern Tax procedures, which are referred to as “Tax Procedures Law”.

While the CT Law creates a charge on the taxable income and levies the corporate tax, the Tax Procedures Law deals with the procedural aspects like administration,

collection and enforcement of the Tax Laws and the administrative penalties. The Tax Procedures Law deals with procedural aspects of administrative penalties, review of assessment, objection and appeal, refund and tax collection, the statutory limitation for assessment, etc.

## 2.3 Article 3: Corporate Tax Rate

Article 3 reads as follows:

- "1. Corporate Tax shall be imposed on the Taxable Income at the following rates:*
- (a) 0% (zero per cent) on the portion of the Taxable Income not exceeding the amount specified in a decision issued by the Cabinet at the suggestion of the Minister.*
- (b) 9% (nine per cent) on Taxable Income that exceeds the amount specified in a decision issued by the Cabinet at the suggestion of the Minister.*
- 2. Corporate Tax shall be imposed on a Qualifying Free Zone Person at the following rates:*
- (a) 0% (zero per cent) on Qualifying Income.*
- (b) 9% (nine per cent) on Taxable Income that is not Qualifying Income under Article 18 of this Decree-Law and any decision issued by the Cabinet at the suggestion of the Minister in respect thereof."*
- \*[3. Without prejudice to the provisions of Clauses (1) and (2) of this Article, the Cabinet at the suggestion of the Minister shall issue a decision regulating all cases, provisions, conditions, rules, controls procedures for imposing the Top-up Tax on Multinational Enterprises and the exemptions therefrom, so that the total percentage of the effective tax imposed on them is (15%) fifteen per cent.]*

### 2.3-1 Tax Rates for Persons other than Free Zone Person

Cabinet of the Ministers *vide* its Decision No. 116 of 2022, dated 30 December 2022, prescribed the threshold of AED 3,75,000 to charge the corporate tax. The taxable income of a taxable person exceeding AED 3,75,000 shall be subject to a 9% corporate tax rate in the relevant tax period. If the taxable income of the taxable person is below AED 3,75,000, then no corporate tax shall be payable.

Tax Rates for Person other than Free Zone Person	Rate
Taxable income up to AED 3,75,000	0%
Taxable income exceeding AED 3,75,000	9%

### 2.3-2 Tax Rates for Qualifying Free Zone Person

A Free Zone Person that meets the conditions of Article 18 (*see Chapter 5*) of the CT Law and is subject to CT under Article 3(2) is recognized as Qualifying Free Zone

\*Inserted by Federal Decree-Law No. 60 of 2023, with effect from a date yet to be Notified.



Person. As per Article 18, a Free Zone person, who maintains adequate substance in a state, derives Qualifying income, has not elected to be subject to Corporate Tax, and complies with arm's length principles is a Qualifying Free Zone Person.

The Qualifying Income of a Qualifying Free Zone Person shall be exempt from the CT Law. However, any income other than the Qualifying Income shall attract Corporate tax at 9%. It appears that the basic threshold of AED 3,75,000 is unlikely to be applied to non-qualifying income of the Qualifying Free Zone Person. Hence, entire non-qualifying income is likely to attract corporate tax at the rate 9%. The scope of Qualifying income has been laid down in separate cabinet and ministerial decision dealing with this subject.

<i>Tax Rates for Qualifying Free Zone Person</i>	<i>Rate</i>
Qualifying Income	0%
Non-qualifying income	9%

### **2.3-3 Tax Rate for Multinational Enterprises (MNE)**

UAE has issued Federal Decree Law No. 60 of 2023 to facilitate the introduction of Pillar Two. As per the decision, a separate decision shall be issued in due course outlining the mechanism, terms, conditions, rules, and procedures for imposing a top-up tax on MNE (an entity or a group of entities with presence in more than one country) so that the total percentage of the effective rate imposed on them is fifteen per cent (15%) in line with Pillar Two Rules.

### **2.3-4 Consequences if an entity is artificially separated**

Where it is established to the FTA that one or more persons have artificially separated their business or business activity and the taxable income across their entire business or business activity was subject to corporate tax at 0% in the tax period on an amount exceeding 3,75,000 AED, this would be considered an arrangement to obtain a benefit in relation to Corporate Tax under Clause 1 of Article 50 (General Anti-Abuse Rule) of the CT Law, *i.e.* to obtain a Corporate Tax advantage.

To verify whether two or more persons have artificially separated their business or business activity, the FTA shall consider the commercial purpose of the transaction and substance of the business or business activity by taking into account all the relevant facts and circumstances, without limitation of their financial, economic and regulatory ties.

*See Chapter 15 for Anti-Abuse Rules.*



## CHAPTER

# 3

# Exempt Persons

## 3.1 Introduction

Chapter 3 of the CT Law covers the list of entities exempt from the corporate tax. This Chapter comprises the following articles:

- (a) Article 4 – Exempt Person
- (b) Article 5 – Government Entity
- (c) Article 6 – Government Controlled Entity
- (d) Article 7 – Extractive Business
- (e) Article 8 – Non-Extractive Natural Resource Business
- (f) Article 9 – Qualifying Public Benefit Entity
- (g) Article 10 – Qualifying Investment Fund

Article 4 provides the list of persons exempt from the corporate tax, which includes Government entities, government-controlled entities, qualifying public benefit entities, qualifying investment funds, etc. Articles 5 and 6 define conditions for the exemption of Government entities and government-controlled entities. Articles 7 to 10 prescribe the conditions subject to which the extractive business, non-extractive natural resource business, qualifying public benefit entity or qualifying investment fund would be entitled to claim the exemption.

## 3.2 Article 4: Exempt person

Article 4 reads as follows:

- "1. The following Persons shall be exempt from Corporate Tax:*
- (a) A Government Entity.*
  - (b) A Government Controlled Entity.*
  - (c) A Person engaged in an Extractive Business, that meets the conditions of Article 7 of this Decree-Law.*
  - (d) A Person engaged in a Non-Extractive Natural Resource Business, that meets the conditions of Article 8 of this Decree-Law.*
  - (e) A Qualifying Public Benefit Entity under Article 9 of this Decree-Law.*
  - (f) A Qualifying Investment Fund under Article 10 of this Decree-Law.*
  - (g) A public pension or social security fund, or a private pension or social security fund that is subject to regulatory oversight of the competent authority in the State and that meets any other conditions that may be prescribed by the Minister.*

- (h) A juridical person incorporated in the State that is wholly owned and controlled by an Exempt Person specified in paragraphs (a), (b), (f) and (g) of Clause 1 of this Article and conducts any of the following:
1. Undertakes part or whole of the activity of the Exempt Person.
  2. Is engaged exclusively in holding assets or investing funds for the benefit of the Exempt Person.
  3. Only carries out activities that are ancillary to those carried out by the Exempt Person.
- (i) Any other Person as may be determined in a decision issued by the Cabinet at the suggestion of the Minister.
2. A Person under paragraphs (a), (b), (c) and (d) of Clause 1 of this Article that is a Taxable Person insofar as it relates to any Business or Business Activity under Article 5, 6, 7 or 8 of this Decree-Law, respectively, shall be treated as an Exempt Person for the purposes of Articles 26, 27, 38 and 40 of this Decree-Law.
  3. Persons specified in paragraphs (f), (g), (h) and (i) of Clause 1 of this Article, as applicable, are required to apply to the authority to be exempt from Corporate Tax in the form and manner and within the timeline prescribed by the authority in this regard.
  4. The exemption from Corporate tax under paragraphs (f), (g), (h) and (i) of Clause 1 of this Article, as applicable, shall be effective from the beginning of the Tax Period specified in the application, or any other date determined by the authority.
  5. In the event that the Exempt Person failed to meet any of the conditions under the relevant provisions of this Decree-Law at any particular time during a Tax Period, such person shall cease to be an Exempt Person for the purposes of this Decree-Law from the beginning of that Tax Period.
  6. For the purposes of Clause 5 of this Article, the Minister may prescribe the conditions under which a Person may continue to be an Exempt Person, or cease to be an Exempt Person from a different date, in any of the following instances:
    - (a) Failure to meet the conditions is the result of the liquidation or termination of the person.
    - (b) Failure to meet the conditions is of a temporary nature and will be promptly rectified, and appropriate procedures are in place to monitor the compliance with the relevant conditions of this Decree-Law.
    - (c) Any other instances as may be prescribed by the Minister."

### **3.2-1 List of exempt entities**

The following persons are exempt from the corporate tax:

- (a) Government Entities (see **Para 3.2-2**);
- (b) Government Controlled Entities (see **Para 3.2-3**);

- (c) Entities engaged in the extraction of natural resources and related non-extractive activities (*see Para 3.2-4*);
- (d) Charities (*see Para 3.2-5*);
- (e) Specified Funds (*see Para 3.2-6*);
- (f) Juridical Persons (*see Para 3.2-7*); and
- (g) Any other specified person (*see Para 3.2-8*).

### ***3.2-2 Government Entities***

The following Government entities are exempt from the corporate tax:

- (a) *The Federal Government Entity*: The Federal Government of the UAE, ministries, Government agencies, authorities, and public institutions of the Federal Government; and
- (b) *Local Governments Entity*: The Local Governments, ministries, Government departments, Government agencies, authorities, and public institutions of the Local Governments;
- (c) Juridical persons wholly owned and controlled by the above entities.

The federal Government is the national Government of the UAE, and the local Government means any of the governments of the Member Emirates of the Federation.

### ***3.2-3 Government Controlled Entities***

The following entities are exempt from the corporate tax:

- (a) Wholly Government-owned entities that carry mandated activity and are listed in a Cabinet Decision; and
- (b) Juridical persons wholly owned and controlled by the above entities.

'Government Controlled Entity' refers to any juridical person wholly owned and controlled by a Government Entity, directly or indirectly, as specified in a decision issued by the Cabinet at the suggestion of the Minister.

Ministry of Finance and Minister of Finance are referred to as 'Ministry' and 'Minister' respectively across the CT Law. The Ministry of Finance is the Ministry of the Federal Government of the UAE.

### ***3.2-4 Entities engaged in the extraction of natural resources and related non-extractive activities***

Entities engaged in extracting UAE natural resources and related non-extractive activities subject to Emirate-level taxation are not chargeable to corporate tax.

'Natural Resources' means water, oil, gas, coal, naturally formed minerals, and other non-renewable, non-living natural resources that may be extracted from the territory comprising land, territorial sea and airspace above it of the seven Emirates.



### **3.2-5 Charities**

Charities and other public benefit organizations that are listed in a Cabinet Decision shall be exempt from corporate tax.

### **3.2-6 Specified Funds**

The following specified funds are exempt from corporate tax:

- (a) Investment Funds; and
- (b) Public or Private Pension or Social Security Funds;
- (c) Juridical persons wholly owned and controlled by the above entities.

The private pension funds or private social security funds would be eligible to claim the exemption only if such funds are subject to regulatory oversight of competent UAE authorities. A private pension fund or social security funds, which are not regulated by the UAE authorities, shall be liable to pay corporate tax in UAE.

In this reference, the Ministry of Finance has issued *Ministerial Decision No. 115 of 2023* on Private Pension Funds and Private Social Security Funds.

#### ***3.2-6a What is Private Pension Fund?***

For a private pension fund to be exempt from Corporate Tax, the following conditions must be fulfilled:

- (a) The fund comprises a pool of assets which have been assigned by law or contract as Pension Plan assets or the acquisition of these assets has been financed by or with the use of contributions to a Pension Plan for the exclusive purpose of financing the Pension Plan benefits;
- (b) The fund provides Pension Plan Members or Beneficiaries with rights, contractual claims, or entitlements against its assets or earnings;
- (c) The income generated by the fund is exclusively derived from the prescribed sources.
- (d) The fund must have an Auditor.

#### ***3.2-6b What is Private Social Security Fund?***

A private social security fund is exempt from Corporate Tax if the following conditions are fulfilled:

- (a) The fund comprises a pool of assets that are legally assigned or contracted as fund assets, or the acquisition of these assets is financed by contributions to the fund with the sole purpose of financing the End of Service Benefit.
- (b) The income generated by the fund is exclusively derived from the prescribed sources.
- (c) The fund must have an Auditor.

### **3.2-6c Specified Sources of Income**

A private pension fund and a private social security fund must earn their income from any of the following sources to claim exemption:

- (a) Income from investments, or deposits, held by the fund specifically for fulfilling its obligations. The investments or deposits should not constitute a separate business operated by the fund;
- (b) Commissions charged by the fund for underwriting purposes;
- (c) Rebate of charges paid by the fund to individuals involved in managing the fund's assets that are not considered as compensation for services provided by the fund;
- (d) Any other income derived in accordance with a defined investment policy that benefits the Pension Plan Members or beneficiaries of the End of Service Benefit, depending on the applicable circumstances.

### **3.2-6d Who can make contributions to a Private Pension Fund?**

Employers who are Taxable Persons can deduct the full value of contributions made to a private pension fund for their employees who are Pension Plan Members. The maximum deductible amount for each Pension Plan Member's contributions is limited to 15% of the total deductible remuneration of that Member for Corporate Tax purposes in the relevant Tax Period.

### **3.2-6e Audit of Funds**

The Auditor of a private pension fund or private social security fund is required to annually confirm the fund's compliance with the provisions of the Corporate Tax Law when the fund has applied for exemption from Corporate Tax.

If an exemption has been granted, the Auditor must report to the Authority any breaches of the conditions specified in the Decision that they become aware of during the audit of the fund's annual report.

### **3.2-6f Withdrawal of exemption**

The Authority has the right to withdraw the exemption from a private pension fund or private social security fund under the following circumstances:

- (a) If the Auditor confirms that the fund no longer meets the specified conditions;
- (b) If the Auditor fails to satisfy the conditions specified in para 3.2-6e;
- (c) If the Authority determines that the fund no longer meets the conditions specified in the Decision.

### **3.2-7 Juridical Persons**

A juridical person incorporated in UAE and wholly owned and controlled by the Government entity, government-controlled entity, exempt public or private pen-



sion funds or social security funds and qualifying investment fund, would be exempt from corporate tax if such person:

- (a) Undertakes part or whole of the activity of the exempt person;
- (b) Is engaged exclusively in holding assets or investing funds for the benefit of the exempt person; or
- (c) Only carries out activities that are ancillary to those carried out by the exempt person.

It should be noted that the Arabic version of the CT Law seems to suggest that the juridical entity does not need to be controlled by the Government but only needs to be a subsidiary to be exempted from CT.

### **3.2-8 Any other specified person**

Any other person decided by the Cabinet at the suggestion of the Minister shall be exempt from the corporate tax.

### **3.2-9 Mandatory to register for specified exempt persons**

The *Federal Tax Authority Decision No. 7 of 2023, dated 7-4-2023* (effective from 1-6-2023), requires the mandatory registration for the following exempt persons:

- (a) A qualifying investment fund;
- (b) Public Pension funds and Social Security funds;
- (c) Private Pension funds and Social Security funds;
- (d) A juridical person;
- (e) Any other person, as decided by the Cabinet.

The above exempt persons shall be required to apply for registration to the FTA and obtain a tax registration number as of 1st June 2024. On approval of the tax registration application, the above exempt persons may be entitled to submit an application for exemption within a period of 60 business days from the end of the tax period in which the person meets the conditions for exemption. On approval of the application, the exemption benefit shall be available to the applicant entity.

### **3.2-10 Effective date of exemption**

The persons whose exemption application has been accepted by the Federal Tax Authority (FTA) shall enjoy the exemption from the start of the tax period specified in the application. Further, such exempt persons shall be required to submit an annual declaration confirming the fulfilment of the exemption conditions.

The 'Tax Period' is the period for which the taxable person is required to file a tax return.

The effective date of exemption shall be different in the circumstances specified below.



### ***3.2-10a Acquisition of the applicant***

If the applicant is acquired during a tax period by one or more of the following and the conditions for exemption were not met at the beginning of the tax period specified in the registration form:

- (a) Government entity;
- (b) Government Controlled entity;
- (c) Qualifying Investment Fund;
- (d) Public Pension Funds and Social Security Funds;
- (e) Private Pension Funds and Social Security Funds that are subject to regulatory oversight of competent UAE authorities.

In such a situation, the Federal Tax Authority (FTA) shall determine another date from which the exemption shall be granted to ensure that the date of exemption starts after the fulfilment of all remaining tax obligations.

### ***3.2-10b Incorrect tax period is mentioned***

If the tax period specified in the registration form is incorrect, and the FTA receives sufficient supporting information that the conditions have been met within the later tax period, the exemption shall be effective after the date of fulfilment of the conditions.

### ***3.2-10c In any other situation***

The effective date of exemption in any other instance specified by a decision issued by the Cabinet shall be in accordance with the period specified in the decision.

### ***3.2-11 Withdrawal of exemption***

A person specified above shall cease to be deemed as an exempt person if it fails to meet the conditions to be exempt under the relevant provisions of the Corporate Tax Law. *Ministerial Decision No. 105 of 2023* addresses situations where a person ceases to be considered an exempt person from a different date. Where it can be reasonably concluded that the main purpose or one of the main purposes of this cessation is to obtain a Corporate Tax advantage that contradicts the intentions of the CT law, the person will no longer be deemed an exempt person starting from the day they fail to meet the conditions for exemption.

### ***3.2-12 Immunity against the withdrawal of exemption***

The UAE MOF has issued *Ministerial Decision No. 105 of 2023* (Decision), which establishes the conditions under which a person can be considered an exempt person or cease to be deemed as an exempt person.





### **3.2-12a In case of liquidation or termination**

According to the Decision, persons undergoing liquidation or termination procedures can continue to be regarded as exempt persons from the start of these procedures until their completion. To maintain the exempt status, the person must submit a notification to the FTA within 20 business days of the commencement of the procedures. However, the person shall cease to be deemed as an Exempt Person on the day following the date of the completion of the liquidation or termination procedure.

### **3.2-12b Failure to meet the conditions is of a temporary nature**

In cases where a person fails to meet the conditions for exemption due to unforeseen circumstances beyond his control, he can still be deemed exempt if certain conditions are met. These include submitting an application with the FTA within 20 business days of failing to meet the conditions, with a reasonable expectation of rectifying the failure within 20 business days from the submission of the application.

Furthermore, upon request of the FTA, person must provide evidence demonstrating the implementation of appropriate procedures to monitor compliance with the relevant conditions.

The FTA will review the application and make a decision within 20 business days of its submission. If the failure to meet the conditions is beyond the person's reasonable control, the timeframe for rectification may be extended by an additional 20 business days.

## **3.3 Article 5: Government Entity**

Article 5 reads as follows:

- “*1. A Government Entity shall be exempt from Corporate Tax and the provisions of this Decree-Law shall not apply to it.*
- 2. Notwithstanding Clause 1 of this Article, a Government Entity shall be subject to the provisions of this Decree-Law if it conducts a Business or Business Activity under a Licence issued by a Licensing Authority.*
- 3. Any Business or Business Activity conducted by a Government Entity under a Licence issued by a Licensing Authority shall be treated as an independent Business, and the Government Entity shall keep financial statements for this business separately from the Government Entity's other activities.*
- 4. The Government Entity shall calculate the taxable Income for its Business or Business Activity specified in Clause 2 of this Article independently for each Tax Period, in accordance with the provisions of this Decree-Law.*
- 5. Transactions between the Business or Business Activity specified under Clause 2 of this Article and the other activities of the Government Entity shall be considered Related Party transactions subject to the provisions of Article 34 of this Decree-Law.*

6. A Government Entity may apply to the authority for all its Businesses and Business Activities to be treated as a single Taxable Person for the purposes of this Decree-Law subject to meeting the conditions to be prescribed by the Minister."

### **3.3-1 Overview**

Article 5 of the CT Law provides as under:

- (a) All the Government entities have been kept outside the preview of the CT regime. Generally, activities of the Government would typically be non-commercial in nature. However, the Government has to engage in some commercial activities depending upon strategic or economic requirements.
- (b) Such commercial activities may be conducted by the Government either by themselves or in association with third parties.
- (c) Any commercial business activity carried out directly by the Government under a trade license will fall within the scope of the UAE CT regime.
- (d) Any Government agency which undertakes such kind of business activities shall have to maintain separate sets of books of account in respect of the commercial activities.
- (e) The taxable income of the commercial activities shall be calculated independently for each tax period in accordance with the computational provisions.
- (f) All the transactions between the non-business activities and business activities commercial in nature shall be considered as related party transactions and have to adhere to the arm's length principle as per Article 34.
- (g) The Government entities shall apply for treating all the businesses as a single taxable person under the UAE CT regime.

### **3.3-2 Meaning of Government entities**

'Government entities' are defined as:

- (a) The Federal Government;
- (b) The Local Governments;
- (c) The Ministries;
- (d) The Government departments;
- (e) The Government agencies;
- (f) The authorities; and
- (g) The public institutions of the Federal Government or Local Governments.

Accordingly, the Government of UAE, any of the governments of the Member Emirates of the Federation, their ministries, the Government department and agencies, authorities and public institutions would be kept outside the purview of the Corporate Tax regime.



### **3.3-3 Tax on income from commercial activities by Government entities**

The relaxation to the Government entities is not a blanket exemption. If the above Government entities undertake any commercial activities under a license issued by licensing authorities, the income arising from the business or business activities conducted by the Government entities shall be subjected to corporate tax in UAE. In such a scenario, the Government entities shall maintain separate books of account for commercial activities. The transactions between the commercial and non-commercial wings of the Government shall also be subjected to the arm's length principle under the transfer pricing regulations.

### **3.3-4 Application for a single taxable entity**

To simplify the process of claiming an exemption for Government related functions, all business or business activity shall be brought together under a single license for Federal and Local Governments, respectively, as a single taxable person. This move is likely to segregate business functions under one umbrella and, as a result, reduce the compliance burden to maintain and segregate separate books, allocate common expenses and also adhere to the arm's length principle on internal transactions.

The Government entities shall apply for treating all the businesses as a single taxable person under the UAE CT regime. The Cabinet, *vide* its *Decision No. 68 of 2023, dated 29-3-2023*, has prescribed conditions to file an application to FTA and the conditions subject to which the Government entities can treat all businesses and business activities a single taxable person.

The Cabinet Decision has prescribed criteria for treating all business and business activities as a single taxable person in relation to the following category of Government entities:

- (a) Federal Government; and
- (b) Local Government.

#### ***3.3-4a Conditions for the Federal Government's business activities***

The businesses and business activities conducted by the Federal Government Entities shall be treated as a single taxable person subject to meeting all of the following conditions:

- (a) The application to be treated as a single taxable person shall include all businesses and business activities conducted by the Federal Government Entities;
- (b) The businesses and business activities of the Federal Government Entities shall be conducted under a Licence issued by a Licensing Authority; and
- (c) The application to the FTA to be treated as a single taxable person shall only be made by the Representative Federal Government Entity.

#### ***3.3-4b Conditions for the Local Government's business activities***

The businesses and business activities conducted by the Local Government

Entities shall be treated as a single taxable person subject to meeting all of the following conditions:

- (a) The application to be treated as a single taxable person shall include all businesses and business activities conducted by the Local Government Entities;
- (b) The businesses and business activities of the Local Government Entities shall be conducted under a Licence issued by a Licensing Authority;
- (c) The businesses and business activities of the Local Government Entities shall be conducted within the same Emirate for which the licence has been issued; and
- (d) The application to the FTA to be treated as a Single Taxable Person shall only be made by the Representative Local Government Entity.

### ***3.3-5 Procedure to recognise a single taxable entity***

After making an application to be treated as a Single Taxable Person, the FTA shall be notified of the appointment of the Representative Federal/Local Government Entity that is mandated to comply with all prescribed obligations.

In case of substitution of the Representative Federal/Local Government Entity, an application shall be made to the FTA to replace the Representative without discontinuation of the treatment as a Single Taxable Person.

The status as a Single Taxable Person shall start from the beginning of the tax period specified in the application submitted to the FTA, or from the beginning of any other Tax Period approved by the FTA.

At every time any new businesses or business activities conducted by the Federal/Local Government Entity added, which meets the criteria of a Single Taxable Person, it shall be directly treated as part of the Single Taxable Person, and the Representative Federal/Local Government Entity shall notify the authority within 20 business days from the establishment of such new business entities.

### ***3.3-6 Intimation for change in the business activities***

The Representative Federal/Local Government Entity shall notify the authority within 20 business days from the occurrence of any of the following circumstances:

- (a) Any business or business activity is no longer conducted by the Federal/Local Government Entity;
- (b) Any business or business activity is no longer conducted under a Licence issued by a Licensing Authority.

### ***3.3-7 Withdrawal of the status***

The status of a Single Taxable Person shall cease in any of the following circumstances:

- (a) Approval by the FTA for an application made by the Representative Federal/Local Government Entity to cease the treatment as a Single Taxable Person.



In such a scenario, status as a Single Taxable Person shall end from the beginning of the tax period specified in the application submitted to the FTA or from the beginning of any other Tax Period determined by the FTA.

- (b) Failure to meet the conditions as specified under this Article. The status as a Single Taxable Person shall end from the beginning of the Tax Period in which the specified conditions are no longer met.

### **3.3-8 Consolidation of financial results**

For tax compliances, respective representatives shall consolidate the financial results of all business activities attributable to the single taxable person for the relevant tax period, eliminating transactions between the business activities of the Government Entities within the same single taxable person.

## **3.4 Article 6: Government-Controlled Entity**

Article 6 reads as follows:

- “1. A Government Controlled Entity shall be exempt from Corporate Tax and the provisions of this Decree-Law shall not apply to it.
2. Notwithstanding Clause 1 of this Article, a Government Controlled Entity shall be subject to the provisions of this Decree-Law if it conducts a Business or Business Activity that is not its Mandated Activities.
3. Any Business or Business Activity conducted by a Government Controlled Entity that is not its Mandated Activity shall be treated as an independent Business, and the Government Controlled Entity shall keep financial statements for this business separately from its Mandated Activity.
4. The Government Controlled Entity shall calculate the Taxable Income for its Business or Business Activity that is not its Mandated Activity independently for each Tax Period, in accordance with the provisions of this Decree-Law.
5. Transactions between the Business or Business Activity specified in Clause 2 of this Article and the Mandated Activity of the Government Controlled Entity shall be considered Related Party transactions subject to the provisions of Article 34 of this Decree-Law.”

### **3.4-1 Overview**

Article 6 of the CT Law provides as under:

- (a) The Government-controlled entities are exempt from corporate tax levy;
- (b) The Government-controlled entities would be liable to pay corporate tax on the income arising from the business or business activities conducted by them if such business or business activities are not mandated activities;
- (c) Non-mandated business activities shall be considered an independent business, and a separate financial statement shall be prepared for the non-mandated activities;

- (d) The transactions between mandated and non-mandated business activities shall be considered as related party transactions, and transfer pricing provisions shall apply to such transactions.

### ***3.4-2 Meaning of government-controlled entities***

The Government often does not directly get involved in civic activities but appoint some agencies, department or third party to conduct essential or mandated activities. To grant such agencies, departments or third parties statutory enforceability or delegation of power and responsibilities, the legislatures pass a statute which creates and regulates a separate body for undertaking such mandated activities. For example, Few Free Zone Authorities, utility companies in UAE (e.g. DMCC – Dubai Multi Commodities Centre established in the free zone, DEWA – Dubai Electricity & Water Authority and Toll operators operating in the Free Zone) are government-controlled entities.

'Government-controlled entities' are defined under Article 1 as any juridical person wholly owned and controlled by a Government Entity, directly or indirectly, as specified in a decision issued by the Cabinet at the suggestion of the Minister. Thus, the ownership and control of the entities should be 'wholly' owned by the Government entities. Partial ownership and control would not suffice. Further, the ownership and control could be direct or indirect. Thus, the step-down wholly owned subsidiary of the Government entity would also qualify as a government-controlled entity. The Ministerial Decision identifying such Government controlled entities is still awaited.

### ***3.4-3 Exemption for mandated activities***

Wholly Government-owned UAE companies that carry out a sovereign or mandated activity are primarily an extension of the Government only, with the relevant activity segregated from those of the Government just for management and accountability purposes. Accordingly, these entities are kept outside the scope of UAE CT insofar as their sovereign or mandated activities are concerned. However, if it conducts any business activities, it will fall within the ambit of the UAE CT Regime and relevant provisions of the CT Law shall apply to such entity.

Any activity conducted by a Government Controlled Entity in accordance with the legal instrument establishing or regulating the entity that is specified in a decision issued by the Cabinet at the suggestion of the Minister would be considered a 'mandated activity'.

### ***3.4-4 Separate books of account for non-mandated activities***

The government-controlled entities shall maintain separate books of account for the non-mandated activities. The transactions between the mandated activities and non-mandated activities shall also be subjected to the arm's length principle under the transfer pricing regulations.

### 3.5 Article 7: Extractive Business

Article 7 reads as follows:

- "1. A Person shall be exempt from Corporate tax and the provisions of this Decree-Law shall not apply to its Extractive Business where all of the following conditions are met:
  - (a) The person directly or indirectly holds or has an interest in a right, concession or Licence issued by a Local Government to undertake its Extractive Business.
  - (b) The person is effectively subject to tax under the applicable legislation of an Emirate in accordance with the provisions of Clause 6 of this Article.
  - (c) The person has made a notification to the Ministry in the form and manner agreed with the Local Government.
2. If a Person that meets the conditions of Clause 1 of this Article derives income from both an Extractive Business and any other Business that is within the scope of this Decree-Law, the following shall apply:
  - (a) The income derived from the Extractive Business shall be calculated and taxed according to the applicable legislation of the Emirate.
  - (b) The income derived from the other business shall be subject to the provisions of this Decree-Law, unless that other business meets the conditions to be exempt from Corporate Tax under Article 8 of this Decree-Law.
3. For the purposes of Clause 2 of this Article, a Person shall not be considered to derive income from any other Business where such other business is ancillary or incidental to that Person's Extractive Business and the Revenue of such other Business in a Tax Period does not exceed 5% (five per cent) of the total Revenue of that Person in the same Tax Period.
4. For the purposes of calculating the Taxable Income of the person's other Business, the following shall apply:
  - (a) The other business shall be treated as an independent Business, and financial statements shall be kept for this business separately from the Extractive Business.
  - (b) Any common expenditure shared between the Extractive Business and the other Business of the Person shall be apportioned in proportion to their revenue in the Tax Period, unless such expenditure is taken into account in different proportions for the purposes of calculating the tax payable by the person under the applicable legislation of the relevant Emirate in respect of its Extractive Business, in which case the expenditure will be apportioned in the latter proportion.
  - (c) The person shall calculate the Taxable Income for its other business independently for each Tax Period in accordance with the provisions of this Decree-Law.
5. Transactions between the Extractive Business and the other Business of the same Person shall be considered Related Party transactions subject to the provisions of Article 34 of this Decree-Law, unless such other business is exempt from Corporate Tax under Article 8 of this Decree-Law.

6. A Person shall be considered effectively subject to tax under the applicable legislation of the Emirate for the purposes of this Article if the Local Government imposes a tax on income or profits, a royalty or revenue tax, or any other form of tax, charge or levy in respect of such Person's Extractive Business.
7. The exemption under this Article shall not apply to contractors, subcontractors, suppliers or any other Person used or contemplated to be used in any part of the performance of the Extractive Business that does not in its own right meet the conditions to be exempt from Corporate Tax under this Article or Article 8 of this Decree-Law."

### **3.5-1 Overview**

Article 7 of the CT Law provides as under:

- (a) The profits generated from extractive business are exempt from corporate tax;
- (b) If a taxable person derives income from extractive business and other business, the corporate tax shall be levied on the profits generated from other business;
- (c) The transactions between extractive and other businesses shall be subjected to the arm's length principle;
- (d) Exemption shall not be available to contractors, sub-contractors, suppliers or any other person used in any part of the performance of the extractive business.

### **3.5-2 Meaning of extractive business**

The business or business activity of exploring, extracting, removing, or otherwise producing and exploiting the natural resources of UAE or any interest therein as determined by the Minister is referred to as 'Extractive Business'.

Natural Resources means water, oil, gas, coal, naturally formed minerals, and other non-renewable, non-living natural resources that may be extracted from the UAE's territory comprising land, territorial sea and airspace above it.

### **3.5-3 Meaning of business activities**

Business activity means any transaction or activity, or series of transactions or series of activities conducted by a person in the course of its business.

These activities can include identifying market opportunities, doing research and development of products or services, marketing and advertising, selling and distribution of products or services, financing activities, customer relationship management, etc.

### **3.5-4 Exemption for income from extractive business**

Traditionally, the economy of the UAE is largely dependent upon the extractive

business, including oil, natural gas, and deposits of sand and rocks. The production and exploitation of these natural resources make up a significant part of the exchequer. The extraction and exploitation of natural resources are often done by companies that are wholly or partially privately owned under long-term concession agreements entered into with the respective Emirate Government.

The extractive business activities like extraction of oil and gas businesses are subject to tax in the Emirates by respective local governments. To avoid double taxation on the same income, the corporate tax regime grants exemption in respect of profits arising from extractive business, including activities of exploring, extracting, removing, or otherwise producing and exploiting the natural resources (*viz.* water, oil, gas, coal, naturally formed minerals, and other non-renewable, non-living natural resources) in UAE. Such extractive business may be conducted on the lands, territorial sea and airspace above it.

However, the exemption shall not apply to the following persons engaged in the extractive business but do not meet the specified conditions in their own right:

- (a) Contractors;
- (b) Sub-contractors;
- (c) Suppliers; or
- (d) Any other person.

### **3.5-5 Conditions to claim the exemption for income from extractive business**

The corporate law provides exemptions subject to the fulfilment of all of the following conditions:

- (a) The taxable person directly or indirectly holds or has an interest in a right, concession, or license issued by a local Government to undertake the extractive business;
- (b) The taxable person is subject to tax under the applicable legislation of the Emirate in respect of such business; and
- (c) The person has notified the Ministry in the agreed form and manner.

Thus, any person who directly or indirectly holds the right or license to undertake extractive business issued by the local Government and the local Government imposes a tax on income or profits, a royalty or revenue tax, or any other form of tax, charge or levy in respect of such person's extractive business, it would be entitled to claim exemption from CT Law. The taxable person shall notify the Ministry about the exemption claimed in the prescribed form and manner.

### **3.5-6 Exemption for incidental or ancillary income**

The benefit of the exemption would be extended to the income incidental or ancillary to the extractive business. The income from incidental or ancillary activities would continue to enjoy the exemption if the gross income of such other business in a tax period does not exceed 5% of the total gross income.

For example, X Ltd. is engaged in the extractive nature of business activities. It also undertakes the activities ancillary to the main business. The income statement prepared for the tax period is as under:

<i>Particulars</i>	<i>Extractive business</i>	<i>Incidental business</i>	<i>Total</i>
Gross income	50,000	2,000	52,000
Net income (Profit)	8,600	400	9,000
% of Gross income		3.84%	

In the above case, the income earned from the ancillary activities of 400 AED shall be exempt as gross income from ancillary activities (2,000 AED) does not exceed 5% of the total combined gross income from extractive business and incidental business activities.

### ***3.5-7 No exemption for income from other business activities***

The exemption to an eligible entity would be restricted only to the profits derived from the extractive business. If an entity deriving income from the eligible extractive business is also engaged in other business activities, the exemption from the corporate tax would be restricted to the profits derived from the extractive business.

The taxable person shall compute income from the extractive and other businesses separately. The profits from the extractive business shall continue to suffer the tax or levy imposed by the respective local government, whereas the income from other businesses shall be subjected to corporate tax.

### ***3.5-8 Computation of income from other business activities***

While calculating the taxable income from other businesses, the following points shall be taken into consideration:

- (a) Income derived from the other business shall be treated as an independent business activity, and financial statements for the same shall be prepared separately;
- (b) Any common expenditure incurred for the extractive and other business shall be apportioned in proportion to their revenue in the tax period unless a different basis for the allocation is specifically provided under the relevant legislation;
- (c) The taxable income derived from the other business shall be calculated independently;
- (d) The transactions between the extractive and other businesses shall be treated as a related party transaction and shall be subjected to the arm's length principle.

A detailed guide has been issued to assist with actual application and overall process.



### 3.6 Article 8: Non-Extractive Natural Resource Business

Article 8 reads as follows:

- "1. A Person shall be exempt from Corporate tax and the provisions of this Decree-Law shall not apply to its Non-Extractive Natural Resource Business where all of the following conditions are met:*
- (a) The person directly or indirectly holds or has an interest in a right, concession or Licence issued by a Local Government to undertake its Non-Extractive Natural Resource Business in the State.*
  - (b) The person's income from its Non-Extractive Natural Resource Business is derived solely from Persons that undertake a Business or Business Activity.*
  - (c) The person is effectively subject to tax under the applicable legislation of an Emirate in accordance with the provisions of Clause 6 of this Article.*
  - (d) The person has made a notification to the Ministry in the form and manner agreed with the Local Government.*
- 2. If a Person that meets the conditions of Clause 1 of this Article derives income from both a Non-Extractive Natural Resource Business and any other Business that is within the scope of this Decree-Law, the following shall apply:*
- (a) The income derived from the Non-Extractive Natural Resource Business shall be calculated and taxed according to the applicable legislation of the Emirate.*
  - (b) The income derived from the other business shall be subject to this Decree-Law, unless that other business meets the conditions to be exempt from Corporate Tax under Article 7 of this Decree-Law.*
- 3. For the purposes of Clause 2 of this Article, a Person shall not be considered to derive income from any other Business where such other business is ancillary or incidental to that Person's Non-Extractive Natural Resource Business and the Revenue of such other Business in a Tax Period does not exceed 5% (five per cent) of the total Revenue of that Person in the same Tax Period.*
- 4. For the purposes of calculating the Taxable Income of the person's other Business, the following shall apply:*
- (a) The other business shall be treated as an independent Business, and financial statements shall be kept for this business separately from the Non-Extractive Natural Resource Business.*
  - (b) Any common expenditure shared between the Non-Extractive Natural Resource Business and other Business of the Person shall be apportioned in proportion to their revenue in a Tax Period, unless such expenditure is taken into account in a different proportion for the purposes of calculating the tax payable by the person under the applicable legislation of the relevant Emirate in respect of its Non-Extractive Natural Resource Business, in which case the expenditure will be apportioned in the latter proportion.*

- (c) *The person shall calculate the Taxable Income for the other business independently for each Tax Period in accordance with the provisions of this Decree-Law.*
5. *Transactions between the Non-Extractive Natural Resource Business and any other Business of the same Person shall be considered Related Party transactions subject to the provisions of Article 34 of this Decree-Law, unless such other business is exempt from Corporate Tax under Article 7 of this Decree-Law.*
6. *A Person shall be considered effectively subject to tax under the applicable legislation of the Emirate, for the purposes of this Article if the Local Government imposes a tax on income or profits, a royalty or revenue tax, or any other form of tax, charge or levy in respect of such Person's Non-Extractive Natural Resource Business.*
7. *The exemption under this Article shall not apply to contractors, subcontractors, suppliers or any other Person used or contemplated to be used in any part of the performance of the Non-Extractive Natural Resource Business that does not in its own right meets the conditions to be exempt from Corporate Tax under this Article or Article 7 of this Decree-Law."*

### **3.6-1 Overview**

Article 8 of the CT Law provides as under:

- (a) The profits generated from non-extractive natural resource business are exempt from corporate tax;
- (b) If a taxable person derives income from a non-extractive natural resource business and any other business, the corporate tax shall be levied on the profits generated from the other business;
- (c) The transactions between non-extractive natural resource business and any other business shall be subjected to the arm's length principle;
- (d) Exemption shall not be available to contractors, sub-contractors, suppliers, or any other person used in any part of the performance of the non-extractive natural resource business.

### **3.6-2 Meaning of non-extractive natural resource business**

Non-Extractive Natural Resource Business means the business or business activity of separating, treating, refining, processing, storing, transporting, marketing or distributing the natural resources of UAE.

### **3.6-3 Exemption for income from non-extractive business**

The non-extractive natural resource business activities are granted exemption from the corporate tax. Accordingly, the business activity of separating, treating, refining, processing, storing, transporting, marketing, or distributing the natural resources (*viz.* water, oil, gas, coal, naturally formed minerals, and other non-renewable, non-living natural resources) would be exempt from the corporate tax.



It is important to note that the scope of the exemption is restricted to non-renewable natural resources. Hence, the entities involved in business activities relating to renewable natural resources shall be subject to corporate tax. Further, the ‘non-extractive natural resource business’ covers the entire supply chain post-extraction activities till its further distribution to other persons engaged in business (e.g. distributors, manufacturers, etc.).

However, the exemption shall not apply to the following persons engaged in the non-extractive natural resource business but do not meet the specified conditions in their own right:

- (a) Contractors;
- (b) Sub-contractors;
- (c) Suppliers; or
- (d) Any other person.

#### **3.6-4 Conditions to claim the exemption for income from non-extractive business**

The corporate law provides exemptions subject to the fulfilment of all of the following conditions:

- (a) The taxable person directly or indirectly holds or has an interest in a right, concession, or license issued by a local Government to undertake non-extractive natural resource business;
- (b) The taxable person derives income from non-extractive natural resource business from other persons engaged in business activities;
- (c) The taxable person is subject to tax under the applicable legislation of the Emirate in respect of such business; and
- (d) The taxable person has notified the Ministry in the agreed form and manner.

Thus, any person who directly or indirectly holds the right or license to undertake a non-extractive natural resource business issued by the local Government and the local Government imposes a tax on income or profits, a royalty or revenue tax, or any other form of tax in respect of such person’s non-extractive natural resource business, it would be entitled to claim exemption. The taxable person shall notify the Ministry about the exemption claimed in the prescribed form and manner.

#### **3.6-5 Exemption for incidental or ancillary income**

The exemption would be extended to the income incidental or ancillary to the non-extractive natural resource business. The income from incidental or ancillary activities would continue to enjoy the exemption if the gross income of such other business in a tax period does not exceed 5% of the total gross income.

#### **3.6-6 No exemption for income from other business activities**

The exemption would be restricted only to the profits derived from the non-ex-

tractive natural resource business. If a taxable person deriving income from the eligible non-extractive natural resource business is also engaged in other business activities, the exemption from the corporate tax would be restricted to the profits derived from the non-extractive natural resource business.

The taxable person shall compute income from the eligible and other businesses separately. The profits from the eligible business shall continue to suffer the tax or levy imposed by the respective local government, whereas the income from other businesses shall be subjected to corporate tax.

### ***3.6-7 Computation of income from other business activities***

While calculating the taxable income from other businesses, the following points shall be taken into consideration:

- (a) Income derived from the other business shall be treated as an independent business activity, and the financial statements for the same shall be prepared separately;
- (b) Any common expenditure incurred for the non-extractive natural resource and other business shall be apportioned in proportion to their revenue in the tax period unless a different basis for the allocation is specifically provided under the relevant legislation;
- (c) The taxable income derived from the other business shall be calculated independently;
- (d) The transactions between the non-extractive natural resource business and other businesses shall be treated as a related party transaction and shall be subjected to the arm's length principle.

A detailed guide has been issued to assist with actual application and overall process.

## ***3.7 Article 9: Qualifying Public Benefit Entity***

Article 9 reads as follows:

- "1. A *Qualifying Public Benefit Entity* shall be exempt from Corporate Tax where all of the following conditions are met:
  - (a) *It is established and operated for any of the following:*
    - 1. *Exclusively for religious, charitable, scientific, artistic, cultural, athletic, educational, healthcare, environmental, humanitarian, animal protection or other similar purposes.*
    - 2. *As a professional entity, chamber of commerce, or a similar entity operated exclusively for the promotion of social welfare or public benefit.*
  - (b) *It does not conduct a Business or Business Activity, except for such activities that directly relate to or are aimed at fulfilling the purpose for which the entity was established.*
  - (c) *Its income or assets are used exclusively in the furtherance of the purpose for which it was established, or for the payment of any associated necessary and reasonable expenditure incurred.*

- (d) *No part of its income or assets is payable to, or otherwise available, for the personal benefit of any shareholder, member, trustee, founder or settlor that is not itself a Qualifying Public Benefit Entity, Government Entity or Government Controlled Entity.*
- (e) *Any other conditions as may be prescribed in a decision issued by the Cabinet at the suggestion of the Minister.*
2. *The exemption under Clause 1 of this Article shall be effective from the beginning of the Tax Period in which the Qualifying Public Benefit Entity is listed in the Cabinet decision issued at the suggestion of the Minister or any other date determined by the Minister.*
3. *For the purposes of monitoring the continued compliance by a Qualifying Public Benefit Entity with the conditions of Clause 1 of this Article, the authority may request any relevant information or records from the Qualifying Public Benefit Entity within the timeline specified by the authority.”*

### **3.7-1 Overview**

Article 9 of the CT Law provides as under:

- (a) The income earned by qualifying public benefit entity is exempt from the corporate tax;
- (b) Such exemption would be available to the entities exclusively engaged in religious, charitable, cultural, educational, and other similar activities. Further, the income of the professional entities or chambers of commerce operating for the promotion of social welfare or public benefit is also exempt;
- (c) The exemption shall be effective from the beginning of the tax period in which the entity is listed in the Cabinet decision, or any other date as suggested.

### **3.7-2 Exemption to Qualifying Public Benefit Entity**

The Government of UAE actively promotes corporate social responsibility, volunteering activities and community service and is the home of many philanthropic and public benefit organisations. These organisations play an important role by taking a shared responsibility with the Government for the promotion of social or public welfare or communal or group interests.

Each Emirate in the UAE has set up Cultural Development Authority (CDA). All organisations with a non-profit motive objective are registered with such authority and obtain the necessary approval and license to carry out such cultural activities. Similarly, the Chamber of Commerce also issue license to organisations for the growth of trade and industries.

To support these organisations established for carrying out social, cultural, religious, charitable or other public benefit activities, the exemption is granted from the corporate tax. The public benefit entities shall apply to the authorities for exemption. If the application is approved, the entity will be listed in a cabinet decision to be issued at the request of the Minister of Finance.

Only those public benefit entities shall be entitled to exemption from corporate tax which are listed by the Cabinet. Whether an organisation qualifies for a corporate tax exemption is at the discretion of the Ministry of Finance. However, no exemption will be available to entities that undertake commercial activities that are not directly related to their stated purpose or whose income and donations are or may be used for the personal gain of persons associated with the organisation (e.g., the founders and fiduciaries).

### ***3.7-3 Conditions to claim the exemption by Qualifying Public Benefit Entity***

The public benefit entity may qualify for an exemption from the corporate tax if all of the following conditions are satisfied.

#### ***3.7-3a Engaged in the prescribed objectives***

The exemption shall be available to the entity if it is:

- (a) A chamber of commerce or any similar organisation established to promote social welfare or for the betterment of the public benefit at large.
- (b) Established and operated exclusively for any of the following activities:
  - ◆ Religious;
  - ◆ Charitable;
  - ◆ Scientific;
  - ◆ Artistic;
  - ◆ Cultural;
  - ◆ Athletic;
  - ◆ Educational;
  - ◆ Healthcare;
  - ◆ Environmental;
  - ◆ Humanitarian;
  - ◆ Animal protection; or
  - ◆ Other similar purposes.

#### ***3.7-3b Fulfils the prescribed conditions***

The exemption shall be available to the entity if it is:

- (a) Not engaged in a business or business activity. However, it can conduct such activities that directly relate to or are aimed at fulfilling the purpose for which the entity is established.
- (b) The income and the assets of the entity should be exclusively used in the furtherance of the purpose for which it is established or for the payment of any associated necessary and reasonable expenditure incurred.
- (c) No part of its income or assets should be utilised for the personal benefit of the shareholder, member, trustee, founder or settlor.



- (d) The Cabinet may prescribe further conditions for eligibility of an entity to claim exemption.

### **3.7-4 List of Qualifying Public Benefit Entity**

The Cabinet has issued *Decision No. 37 of 2023, dated 7-4-2023*, wherein the list of 521 Federal and Emirate level Qualifying Public Benefit Entities have been prescribed along with compliance requirements.

The Government Entity may file an application to the Ministry to suggest an amendment to the list of prescribed Qualifying Public Benefit Entities in the prescribed form and manner. The suggestion may cover the addition or deletion of entities. The Government Entity shall provide any data, information and documentation as may be requested to process the application. The Cabinet, at the suggestion of the Minister, can add/delete the Qualifying Public Benefit Entity from the list.

### **3.7-5 Furnishing of information by Qualifying Public Benefit Entity**

A Qualifying Public Benefit Entity shall be required to provide all relevant documents, data and information to the Ministry and the FTA to verify compliance with prescribed conditions. The Government Entities shall cooperate with the Ministry and the FTA to supply all data, information and documentation related to a Qualifying Public Benefit Entity and its activities. The Ministry and the FTA may also exchange other data, information, and documents with each other in respect of any Qualifying Public Benefit Entity and its activities.

### **3.7-6 Registration of Qualifying Public Benefit Entity**

As per Federal Tax Authority *Decision No. 7 of 2023, dated 7th April 2023* (effective from 1st June 2023), the Qualifying Public Benefit Entity shall be required to apply for tax registration and obtain a tax registration number as of 1st October 2023. The FTA may request the Qualifying Public Benefit Entity to file an annual declaration confirming that it fulfils the exemption conditions.

### **3.7-7 Application to claim exemption**

The entity shall have to make an application to the Ministry of Finance or its governing body in the prescribed manner to claim exemption from the corporate tax. The exemption would be available from the beginning of the tax period in which the Cabinet approves the application or any other date determined by the Minister.

To prevent abuse of the exemption, the authority may request relevant information to monitor the continued compliance status of the public benefit entity. The public benefit entity should maintain proper accounts and necessary documents to prove the genuineness of the activities.

## 3.8 Article 10: Qualifying Investment Fund

Article 10 reads as follows:

- “1. An investment fund may apply to the Authority to be exempt from Corporate Tax as a Qualifying Investment Fund where all of the following conditions are met:
  - (a) The investment fund or the investment fund's manager is subject to the regulatory oversight of a competent authority in the State, or a foreign competent authority recognised for the purposes of this Article.
  - (b) Interests in the investment fund are traded on a Recognised Stock Exchange, or are marketed and made available sufficiently widely to investors.
  - (c) The main or principal purpose of the investment fund is not to avoid Corporate Tax.
  - (d) Any other conditions as may be prescribed in a decision issued by Cabinet at the suggestion of the Minister.
2. For the purposes of monitoring the continued compliance by a Qualifying Investment Fund with the conditions of Clause 1 of this Article, the Authority may request any relevant information or records within the timeline prescribed by the Authority.”

### 3.8-1 Meaning of Investment Fund

The ‘Investment funds’ are the structures that issue investment interests to raise funds or pool investor funds, or establish a joint investment fund with the aim of enabling the holder of such an investment interest to benefit from the profits or gains from the entity’s acquisition, holding, management or disposal of investments. Generally, the interest in the investment funds is represented in ‘Units’ issued by the investment funds.

### 3.8-2 Exemption to Investment Fund

#### ***3.8-2a Incorporated as a limited partnership***

The ‘Investment funds’ are commonly organised as limited partnerships (as opposed to corporate entities) to ensure tax neutrality for their investors. This tax neutrality follows from the fact that most countries treat limited partnerships as transparent ('flow through') for domestic and international tax purposes, which puts investors in the fund in a similar tax position as if they had invested directly in the underlying assets of the fund.

#### ***3.8-2b Incorporated as a corporate entity***

The investment funds that are structured as corporate entities can apply to the FTA to be exempt subject to meeting the following requirements:

- (a) The investment fund should be incorporated in UAE.
- (b) It should be registered and regulated by the competent authority of the UAE.



- (c) Interests in the investment fund are traded on a Recognised Stock Exchange in UAE or a foreign country or are marketed and made available sufficiently widely to investors.
- (d) It should satisfy the 'Principal Purpose Test' ('PPT') that its main or principal purpose is not to avoid UAE corporate tax.
- (e) Any other conditions as may be prescribed by a Cabinet Decision.

### ***3.8-3 Condition for Qualifying Investment Funds***

MOF has issued Cabinet Decision No. 81 of 2023 to specify the following additional conditions for Qualifying Investment Funds to claim exemption from CT:

**1. An Investment Fund excluding a Real Estate Investment Trust (REIT)** shall meet all of the following conditions to apply to the FTA to be exempt from Corporate Tax as a Qualifying Investment Fund:

- ◆ The main business activities of the investment fund must be related to investment business. Any other business activities conducted by the fund should be ancillary or incidental to the investment business.
- ◆ A single investor and its related parties do not own the following:
  - More than 30% of the ownership interest in an investment fund with less than 10 investors.
  - More than 50% of the ownership interest in an investment fund with 10 or more investors.
- ◆ The investment fund is managed or advised by an Investment Manager that has a minimum of 3 investment professionals.
- ◆ The investors shall not have control over the day-to-day management of the investment fund.

**2. Real Estate Investment Trust (REIT)** shall meet all of the following conditions to apply to the FTA to be exempt from Corporate Tax as a Qualifying Investment Fund:

- ◆ The value of real estate assets (excluding land) managed or owned by the REIT must exceed AED 100,000,000.
- ◆ At least 20% of the share capital of the REIT is floated on a recognized stock exchange.
- ◆ It is directly wholly owned by 2 or more institutional investors provided that at least 2 of those institutional investors are not Related Parties.
- ◆ REIT has an average Real Estate Asset Percentage of at least 70% during the relevant Gregorian calendar year, or the relevant 12 for which the financial statements are prepared.

### ***3.8-4 Key Highlights of CT Guide on Investment Manager***

On the 6th of May 2024, the UAE Federal Tax Authority (FTA) published a Corporate Tax (CT) General Guide (CTGIFM1), which provides essential information

regarding the applicability of UAE Corporate Tax to investment funds, investors, and investment managers.

### **Here are the key takeaways from this guide:**

#### **1. Allocation of income**

Qualifying Investment Funds (including qualifying REITs) (that are not structured as tax-transparent Unincorporated Partnerships) may be exempt from CT, provided certain conditions are met. This exemption aims to balance direct investments and investments through collective funds by avoiding extra taxes and compliance. Instead, each investor in QIFs will include their proportional part of the QIF net income available for distribution (as reflected in the financial statements of the QIF) in their own income statement, provided the investor is a Taxable Person.

QIFs (including qualifying REITs) shall allocate the amount reflected as net income available for distribution in their financial statements as Exempt Income, Interest Income, Income from Immovable Property, and Other Income.

Each of these different categories shall then be included in the investor's income, according to their proportional share in the QIF. The investors will then be subject to UAE CT depending on whether they are UAE Resident Persons or Non-Resident Persons (in cases where the Non-Resident Person has UAE sourced income, a UAE PE or UAE nexus).

It is worth noting that net income from Immovable Property in the UAE can create a UAE nexus for an investor that is a Non-Resident juridical person, therefore bringing the Non-Resident investor within the scope of UAE CT.

#### **2. Time apportionment of income**

The net income and expenditure for a particular financial year of the QIF (including a qualifying REIT) will be the amount reflected in the financial statements of the QIF as at its year end. If the financial year of the QIF differs from the Tax Period of an investor, the investor must include the net income available for distribution in the Tax Period in which the year end of the QIF occurs.

#### **3. Application of other CT provisions**

QIFs (including qualifying REITs) that are exempt from UAE CT cannot form part of a Qualifying Group (for the purposes of the Qualifying Group Relief), are not entitled to benefit from the Business Restructuring Relief, are not entitled to benefit from the provisions for the transfer of Tax Losses and cannot form part of a UAE CT Tax Group.

#### **4. QIF and REIT registration**

An investment fund should apply for the UAE CT exemption after it has been registered with the Federal Tax Authority ("FTA") and obtained a Tax Registration Number ("TRN"). If it meets the relevant QIF (or REIT conditions, where applicable), it may make an application to the FTA, specifying for which Tax Period the QIF intends to be an Exempt Person. The FTA will then notify the QIF of its decision.

#### **5. Transfer Pricing ("TP") requirements for investment managers**

The Guide clarifies that for the investment manager exemption to apply, all invest-



ment management and brokerage fees received from non-resident persons should be performed on an arm's length basis. This re-emphasizes the UAE TP rules that all related party transactions with resident and non-resident persons are required to be performed on an arm's length basis.

While the guide focuses on the income the investment manager should receive, sub-contracted services should also be assessed from a transfer pricing perspective.

The guide further clarifies that if in prior years it is found that a non-arm's length fee was received by the investment managers, a "true-up" adjustment may be applied to ensure consistency with the arm's length standards.

Finally, all the above analysis should be documented from a UAE TP perspective within the Local File on a contemporaneous basis and maintained on file.



## CHAPTER

# 4

# Taxable Person and Corporate Tax Base

### 4.1 Introduction

Chapter 4 deals with two critical aspects - 'Who' shall be subject to corporate tax and 'Which income' shall be taxed in the UAE.

This Chapter comprises the following articles:

- (a) Article 11 – Taxable Person
- (b) Article 12 – Corporate Tax Base
- (c) Article 13 – State Sourced Income
- (d) Article 14 – Permanent Establishment
- (e) Article 15 – Investment Manager Exemption
- (f) Article 16 – Partners in an Unincorporated Partnership
- (g) Article 17 – Family Foundation

Article 11 lays down criteria regarding the persons who shall be subject to corporate tax in the UAE, and Article 12 creates the tax base under the Corporate Tax law. Article 13 and Article 14 define crucial criteria for the taxation of non-residents. The concept of the permanent establishment has been borrowed from the international tax trends and model conventions issued by multinational forums like Organization for Economic Cooperation and Development ('OECD') and United Nations ('UN'). Article 15 accords certain exemptions to investment managers in relation to permanent establishment criteria. Article 16 deals with the taxability of partners in an unincorporated partnership, whereas Article 17 deals with the family foundation established for the benefit of natural persons, a public benefit entity or both.

### 4.2 Article 11: Taxable Person

Article 11 reads as follows:

- “1. *Corporate Tax shall be imposed on a Taxable Person at the rates determined under this Decree-Law.*
2. *For the purposes of this Decree-Law, a Taxable Person shall be either a Resident Person or a Non-Resident Person.*

3. A Resident Person is any of the following Persons:
  - (a) A juridical person that is incorporated or otherwise established or recognised under the applicable legislation of the State, including a Free Zone Person.
  - (b) A juridical person that is incorporated or otherwise established or recognised under the applicable legislation of a foreign jurisdiction that is effectively managed and controlled in the State.
  - (c) A natural person who conducts a Business or Business Activity in the State.
  - (d) Any other Person as may be determined in a decision issued by the Cabinet at the suggestion of the Minister.
4. A Non-Resident Person is a Person who is not considered a Resident Person under Clause 3 of this Article and that either:
  - (a) Has a Permanent Establishment in the State as under Article 14 of this Decree-Law.
  - (b) Derives State Sourced Income as under Article 13 of this Decree-Law.
  - (c) Has a nexus in the State as specified in a decision issued by the Cabinet at the suggestion of the Minister.
5. A branch in the State of a Person referred to in Clause 3 of this Article, shall be treated as one and the same Taxable Person.
6. The Cabinet shall, upon a suggestion of the Minister and in coordination with the relevant competent authorities, issue a decision specifying the categories of Business or Business Activity conducted by a resident or non-resident natural person that are subject to Corporate Tax under this Decree-Law.”

#### **4.2-1 Overview**

Article 11 of the CT Law provides as under:

- (a) Corporate tax is leviable on taxable income of the ‘taxable persons’ at the ‘specified rates’;
- (b) Taxable person can be a natural person or a juridical person;
- (c) Such taxable person can be resident or non-resident;
- (d) Following persons shall be regarded as resident ‘Taxable Person’ of the UAE for taxation purposes:
  - ◆ A juridical person incorporated or established or recognised under the UAE laws, including a Free Zone Person;
  - ◆ A juridical person incorporated or established or recognised under foreign laws of a country but effectively managed and controlled in the UAE;
  - ◆ A natural person who conducts a business or business activity in the UAE; and
  - ◆ Any other person determined by Cabinet after consultation with the Minister.

(e) A non-resident person shall be subjected to CT Law if:

- ◆ It has a permanent establishment in the UAE;
- ◆ It derives state-sourced income from the UAE; or
- ◆ It has satisfied the prescribed nexus test;

(f) A branch and the head office are to be regarded as one and the same taxable person.

#### ***4.2-2 Basis of tax***

Every country has a sovereign right to tax income. However, such taxing rights can be exercised where the country has sufficient nexus with the income. Countries can decide the ‘nexus’ to exercise their taxing rights. Such nexus may depend upon the source of income, residency of the taxpayer or other similar criteria like citizenship, domicile, etc. These nexus principles are as under:

- ◆ ‘Source’ – Where has the income accrued or arisen?
- ◆ ‘Residence’ – Whether the taxpayer is a resident or non-resident of the country?
- ◆ ‘Citizenship’ – Whether the taxpayer is a citizen of the country?
- ◆ ‘Domicile’ – Whether the taxpayer has a domicile based out of the country?

Countries can adopt a combination of the above criteria. For example, India follows taxation based on source as well as residency tests. Accordingly, the income accrued or arising shall be taxed in India irrespective of the residential status of the taxpayer. At the same time, all the income of the resident taxpayer is subjected to Indian taxes irrespective of whether such income has arisen or accrued in India or outside India. In addition to source and residency criteria, the United States of America follows citizenship criteria. Accordingly, the income of the USA citizens is subjected to tax in the USA, irrespective of whether they are tax residents of the USA or not and whether the income has arisen or accrued in the USA. The UAE corporate tax law follows residency as well as source-based taxation.

#### ***4.2-3 Tax Residency***

Under the CT law, no specific criteria are prescribed for determining residency. An independent Cabinet Decision lays down criteria to be applied by FTA for the issuance of a Tax Residency certificate. Thus, this may be used as a reference under CT law as well.

The *Cabinet Decision No. 85 of 2022* contains the criteria to determine ‘Tax Residency’. It provides as under:

##### ***4.2-3a Juridical person incorporated in the UAE***

A juridical person incorporated, formed or recognised in accordance with the legislation in force in the UAE shall be a tax resident of the UAE. However, it does not include the branch registered by a foreign juridical person in the UAE.



#### 4.2-3b Natural Person

A natural person shall be recognised as a resident of the UAE if any of the following conditions are met:

- (a) If the usual or primary place of residence and the centre of his financial and personal interests are in the UAE;
- (b) If he meets the conditions and criteria determined by a decision from the Minister;
- (c) If he has been physically present in the State for a period of 183 days or more, within the relevant 12 consecutive months; or
- (d) If he has been physically present in the State for a period of 90 days or more, within the relevant 12 twelve consecutive months, and he is the UAE national, holds a valid Residence Permit in the UAE or holds the nationality of any member state of the Gulf Cooperation Council, and meets any of the following:
  - ◆ He has a Permanent Place of Residence in the UAE; or
  - ◆ He carries on employment or business in the UAE.

##### *Meaning of usual or primary place of residence*

The usual or primary place of residence shall be the residence wherein the natural person usually stays. While determining the usual or primary place of residence, various social and personal factors, along with the number of days of stay, can be taken into consideration.

##### *Meaning of centre of financial interests*

The centre of financial interests of a natural person refers to the economic activities being conducted by the natural person. In contrast, the centre of personal interest refers to the family and social factors which are relevant to the natural person.

##### *Test of the period of stay*

Generally, the tax residency is determined based on the number of days of physical presence, and the Tax Residency Guidelines provides the criteria of 183 days in relevant 12 consecutive months. The limit of 183 days is curtailed to 90 days for the UAE national who holds a valid residence permit in the UAE or holds the nationality of GCC. Further, such the UAE or GCC nationals should have a permanent place of residence in the UAE or should be carrying employment or business in the UAE.

##### *Tax Residency Certificate*

The tax resident of the UAE may apply for Tax Residency Certificate (TRC) to the FTA. The application shall be submitted in the prescribed form and manner. If the authority is satisfied that the applicant meets the residency criteria, the FTA may approve the application and issue the Tax Residency Certificate. The tax residency certificate shall be relevant to claim the benefits of international agreements.

## **4.2-4 Taxable Persons**

### ***4.2-4a Juridical person***

A juridical person shall be recognised as a ‘taxable person’ in the UAE if it is:

- (a) Incorporated, formed or recognised under the UAE laws;
- (b) Based out of Free Zone (referred as ‘Free Zone Person’);
- (c) Incorporated, established, or recognised under foreign laws but effectively controlled and managed from the UAE.

### ***4.2-4b Foreign Juridical person***

A juridical person that is incorporated or otherwise established or recognised under the applicable legislation of a foreign jurisdiction shall be a tax resident of the UAE if it is effectively managed and controlled in the UAE.

Whether effective control and management are situated in the UAE or not requires a critical examination of facts regarding who essentially takes key decisions regarding the business of the juridical person. The situs of the brain and head of the juridical person may be regarded as the place of effective control and management.

To determine whether a foreign juridical person is effectively managed or controlled from UAE, an Explanatory guide to CT provides the guidance.

Whether a juridical person is effectively managed and controlled in the UAE needs to be determined with regard to the specific circumstances of the juridical entity and its activities, with a key factor being where key management and commercial decisions concerned with broader strategic and policy matters necessary for the conduct of the company’s business as a whole are regularly and predominantly made and given. This will ordinarily be where a company’s board of directors (or any equivalent body for other types of juridical persons) make these decisions. However, depending on the specific circumstances, other factors, such as where the controlling shareholders make decisions, the location of another person or body to which the board has delegated its decision-making functions, or the location where the directors or executive management of the juridical person reside may also need to be considered. It also further elaborates that a mere residency of the board of directors is not the only factor in determining effective control and management.

### ***4.2-4c Natural person***

A natural person, *i.e.* an individual, shall be a ‘Taxable person’ in the UAE only if he carries business or business activities in the UAE on an ongoing and independent basis. Generally, natural persons are allowed to conduct only professional activities in the UAE. The natural persons have to incorporate entities like LLCs, etc., to undertake business activities such as industrial, commercial, agricultural, service or excavation activities or any other activity related to the use of tangible or intangible properties.



Thus, a natural person shall be regarded as a taxable person in the UAE if he undertakes business activities in the UAE. Such activities should be ongoing activities, and one-time activities shall not constitute 'business' activities. Further, such business activities should be undertaken on an independent basis. If the person conducts activities in the capacity of an employee, such activities shall not qualify as 'independent activities'. Accordingly, an individual working in the capacity of an employee may not be regarded as a taxable person in the UAE.

Accordingly, an individual shall qualify as a taxable person of the UAE if:

- (a) The individual carries out independent business activities;
- (b) Such business activities should be conducted on a regular basis;
- (c) Such business activities are undertaken in the UAE;
- (d) Turnover or gross amount of income derived from Businesses or Business Activities exceeds AED 1,000,000 within a Gregorian calendar year (specified in *Cabinet Decision No. 49 of 2023*).

◆ **Meaning of Business**

'Business' means any activity conducted regularly, on an ongoing and independent basis by any person and in any location, such as industrial, commercial, agricultural, vocational, professional, service or excavation activities or any other activity related to the use of tangible or intangible properties. 'Business Activity' is defined in the CT Law as any transaction or activity, or series of transactions or series of activities conducted by a Person in the course of its Business.

The business should be undertaken on a systematic and regular basis. It means any economic activity, whether continuous or short-term, conducted by any person. It is implied that a business is conducted with a profit motive and that there is the existence of some system and organisation to the activity conducted. However, a business or business activity for the UAE CT purposes does not lose its identity simply because it does not make a profit.

A business can be undertaken under various ownership structures, such as a sole proprietorship, partnership, corporation, or limited liability company.

In the UAE, a business can be conducted by a Natural Person or a Juridical Person. The expression 'Business' is wide to cover professional and vocational activities.

◆ **What does not constitute income from business?**

The following are not considered income from a Business or Business Activity conducted by a resident or non-resident natural person, irrespective of the amount of amount of income derived:

- (a) *Wages*: Any wages or salaries paid to employees in consideration of their services under an employment contract, whether in cash or kind. This includes all allowances, bonuses and benefits paid to the employees as per the employment contract or the applicable legislation.

- (b) *Personal investment income*: Any income from investment activity carried out by the natural person on their personal account (not conducted through a Licence or requiring a Licence from a Licensing Authority in the UAE), and which is not considered as a commercial business in accordance with the *Federal Decree-law No. 50 of 2022*.
- (c) *Real estate investment income*: Any income from activity conducted by the natural person in relation to the sale, leasing, sub-leasing, and renting of land or real estate in the UAE (not conducted through a Licence or requiring a Licence from a Licensing Authority in the UAE).
  - ◆ Tax Registration of Natural persons

Natural persons conducting a Business or Business Activity with a turnover exceeding AED 1 million are required to register for Corporate Tax.

#### **4.2-4d Non-resident person**

A person shall be a non-resident of the UAE if he is considered not to be a 'Resident' of the UAE he shall be taxable in the UAE if he satisfies any of the ensuing criteria:

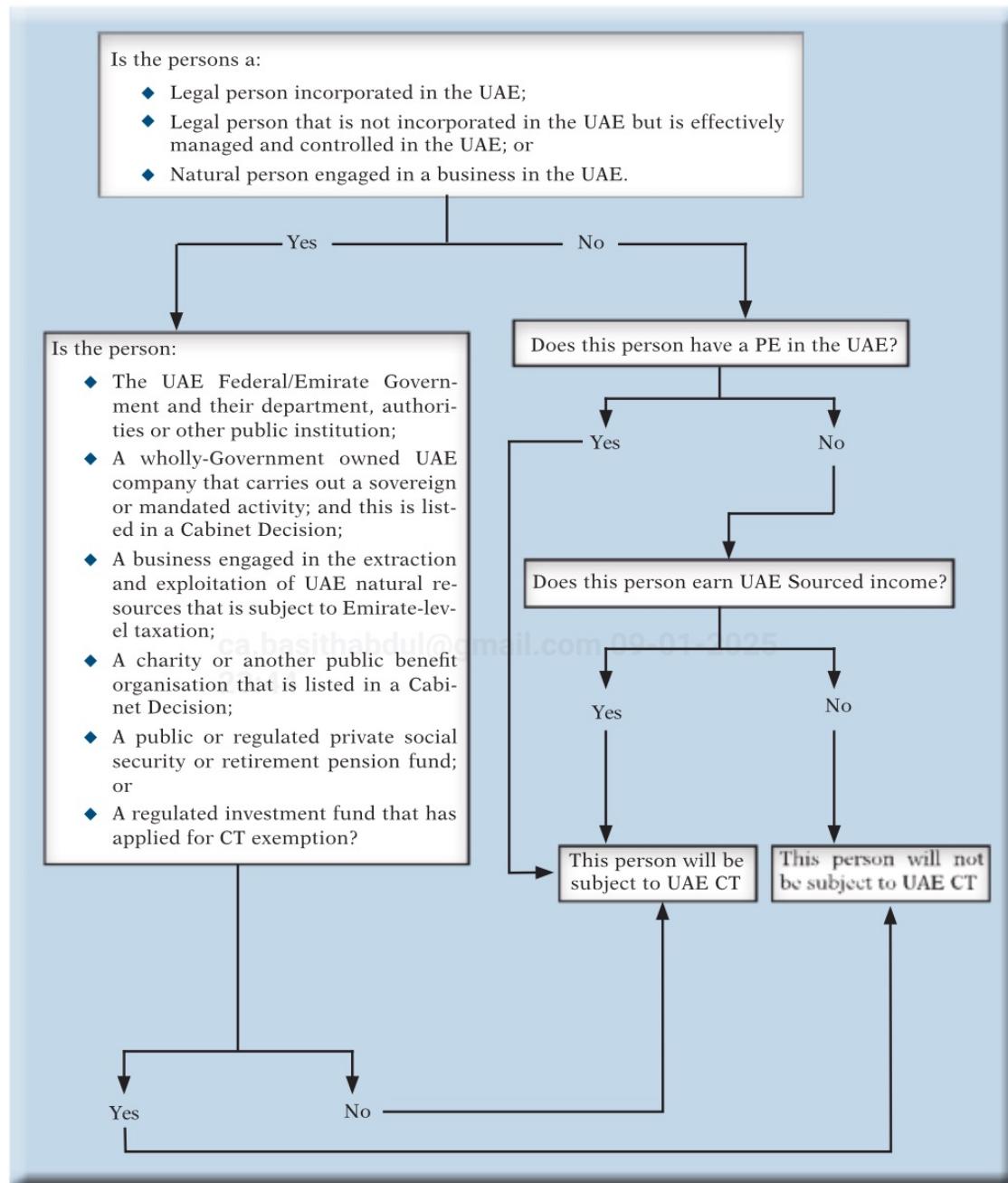
- (a) Such person has a 'Permanent Establishment' in the UAE;
- (b) Such person derives 'State Sourced Income'; or
- (c) Such person has a nexus in the UAE as specified by the Cabinet after consultation with the Minister.

The Cabinet is empowered to issue, upon a suggestion of the Minister and in co-ordination with the relevant competent authorities, a decision specifying the categories of business or business activity conducted by a resident or non-resident natural person that are subject to corporate tax. The natural person (an individual) would be subjected to corporate tax only if the income relates to such business or business activities.

#### **4.2-4e Other Persons**

In addition to the above, the CT law grants powers to Cabinet to declare any 'Other Criteria' to consider any person as a taxable person of the UAE after consultation with the Minister.

## 4.2-4f Overview



## 4.2-5 Comprehensive Example

ABC Ltd. is a multinational company, and it is headquartered in the UK. ABC Ltd. has established a subsidiary, XYZ FZCO, in the UAE and has a marketing branch PQR in the UAE.

### (a) Status of entities

- ◆ XYZ FZCO is a juridical person incorporated and recognized under UAE laws. It satisfies the criteria of a resident person as it is incorporated and

established under the applicable legislation of the UAE. It is subject to corporate tax in the UAE.

- ◆ ABC Ltd., which is incorporated and based in the UK, is a non-resident person from the UAE CT law perspective. Further, it is not controlled and managed from the UAE. Thus, ABC Ltd. will be regarded as a Non-resident person.
- ◆ ABC Ltd. has established a branch office PQR in the UAE, which constitutes a permanent establishment. This presence in the UAE through a branch office makes ABC Ltd. liable to corporate tax in the country in relation to profits attributable to such branch.

(b) *State-Sourced Income*

If ABC Ltd. generates income from activities conducted within the UAE, such income would be considered state-sourced income. This income would also be subject to corporate tax in the UAE.

(c) *Tax Residency Certificate*

XYZ FZCO can apply for a Tax Residency Certificate from the FTA to establish its tax residency status in the UAE. This certificate can be used to claim benefits under international agreements.

(d) *Conclusion*

XYZ FZCO, as a resident person incorporated in the UAE, is subject to corporate tax. The branch office of ABC Ltd. may also be subject to corporate tax if it meets specific conditions outlined in the law.

### 4.3 Article 12: Corporate Tax Base

Article 12 reads as follows:

- “1. A Resident Person, which is a juridical person, is subject to Corporate tax on its Taxable Income derived from the State or from outside the State, in accordance with the provisions of this Decree-Law.
2. The Taxable Income of a Resident Person, which is a natural person, is the income derived from the State or from outside the State insofar as it relates to the Business or Business Activity conducted by the natural person in the State as set out in Clause 6 of Article 11 of this Decree-Law.
3. A Non-Resident Person is subject to Corporate Tax on the following:
  - (a) The Taxable Income that is attributable to the Permanent Establishment of the Non-Resident Person in the State.
  - (b) State Sourced income that is not attributable to a Permanent Establishment of the Non-Resident Person in the State.
  - (c) The Taxable Income that is attributable to the nexus of the Non-Resident Person in the State as determined in a decision issued by the Cabinet pursuant to paragraph (c) of Clause 4 of Article 11 of this Decree-Law.”



### **4.3-1 Overview**

Article 12 of the CT Law provides as under:

- (a) The taxable income of a person shall be determined based on provisions of Article 12.
- (b) The taxable income shall depend upon the residential status of the taxable person.
- (c) A juridical resident person shall be subjected to tax in respect of income arising from the UAE or outside the UAE.
- (d) Natural person (an individual) shall be liable to pay corporate tax in the UAE in respect of the income derived from the UAE or outside the UAE, so far as it relates to business or business activities conducted in the UAE.
- (e) Non-resident persons would pay corporate taxes in the UAE in respect of:
  - ◆ Taxable income attributable to the Permanent Establishment of the non-resident person in the State;
  - ◆ State-sourced income even if not attributable to a Permanent Establishment;
  - ◆ The Taxable Income that satisfies the nexus test as determined in a decision issued by the Cabinet.

### **4.3-2 Taxable income of a juridical resident person**

All income of the juridical resident person shall be taxable in the UAE, whether it arises in or outside the UAE. The place of the receipt of such income would not be relevant. For example, income earned by a juridical resident person outside the UAE would be taxable under the UAE corporate law, even if such income has accrued outside the UAE.

<i>Place of receipt</i>	<i>Place of Accrual</i>	
	<i>Within UAE</i>	<i>Outside UAE</i>
Within UAE	Taxable	Taxable
Outside UAE	Taxable	Taxable

### **4.3-3 Taxable income of a natural person**

The taxability of a natural person (individual person) would depend upon the nature of income. If the income relates to business or business activities conducted in the UAE, the income arising in or outside the UAE would be taxable in the UAE.

Whether the income relates to the business or business activities conducted in the UAE may depend on the nature of business/business activities in the UAE and the nature of income arising outside the UAE.

For example, Mr. A is a tax resident of the UAE for the tax year 2023-24. The taxpayer, engaged in professional services, has set up a head office in the UAE. The

brand name of the profession is registered in the UAE. He provides services to Indian tax residents through online media from its head office in UAE and earns more than AED 1 million in fees. Would he be liable to pay tax in the UAE regarding the income arising from services provided to Indian residents from the head office in the UAE? It may be argued that the business is set up in the UAE, and the income relates to the business activities conducted in the UAE. Hence, the income of the natural person would be taxable under the CT Law.

A fact-based exercise is relevant to determine the taxable nexus of business activities conducted outside the UAE. Pertinent to note that the place of receipt of such income, within UAE or outside, would not determine taxability under corporate tax law.

#### ***4.3-4 Taxable income of a non-resident person***

Unlike resident persons, non-resident persons (juridical or natural persons) are liable to pay taxes in the UAE in respect of limited income. The taxability would depend upon the following tests.

##### ***4.3-4a Whether the income is attributable to the permanent establishment in UAE?***

The non-resident would be liable to pay taxes in respect of the income 'attributable' to the 'permanent establishment' in the UAE. A fact-based exercise would be required to determine whether the income 'attributes' to the permanent establishment in the UAE. The nature of income and the activities conducted by the permanent establishment would be relevant to determine the nexus of the income and permanent establishment. The detailed analysis of the concept of 'Permanent Establishment' can be referred to in Article 14 (*see Para 4.5*).

##### ***4.3-4b Whether the income is 'State Sourced income' not attributable to a permanent establishment in UAE?***

'State Sourced Income' of a non-resident would be subjected to the UAE corporate tax law, even if such income is not attributable to the permanent establishment. Refer to Article 13 for a detailed analysis and scope of 'State Sourced Income' (*see Para 4.4*).

##### ***4.3-4c Taxable income that satisfies the nexus test***

The taxable income of the non-resident shall suffer tax liability in the UAE if the income meets the nexus test as declared by the Cabinet.

As per the *Cabinet Decision No. 56 of 2023, dated 30 May 2023* prescribing the factors for the determination of a Non-Resident Person's Nexus in the State. A Non-Resident Juridical Person will be considered to have a connection or nexus in the State if it generates incomes from any Immovable Property within that State.

The Taxable Income that is attributable to the Immovable Property in the State shall include income derived from the right in sale, disposal, assignment, direct

use, letting, including sub-letting and any other form of exploitation of Immovable Property.

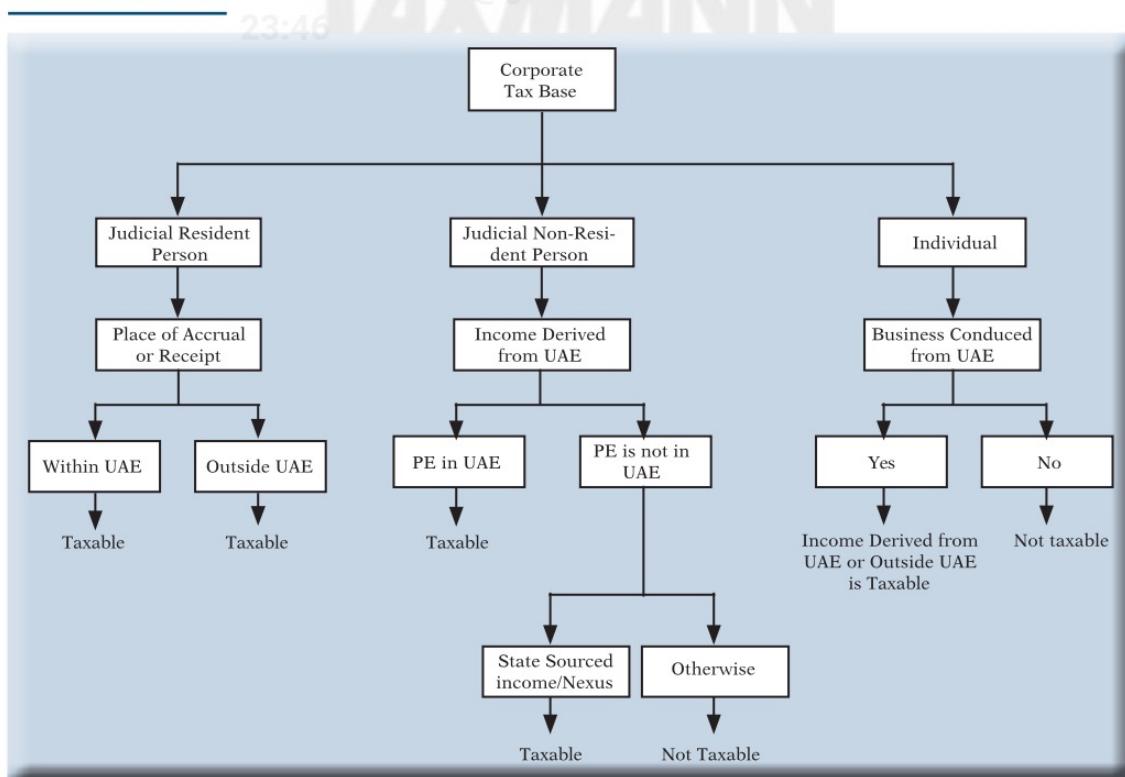
An 'immovable property' means any of the following:

- (a) Any area of land over which rights, interests, or services can be created;
- (b) Any building, structure or engineering work attached to the land permanently or attached to the seabed;
- (c) Any fixture or equipment that makes up a permanent part of the land or is permanently attached to the building, structure or engineering work or attached to the seabed.

Thus as per this guideline, any foreign company or a non-resident person owning real estate in UAE and earning income there from will be considered to have nexus in UAE and thus required to register and comply with UAE CT law.

The Decision also provides that if a Non-Resident Person artificially transfers or otherwise disposes of its right in rem in any immovable property in the state to another person and that transfer or disposal is not for a valid commercial or other non-fiscal reason, which reflects economic reality, this would be considered an arrangement to obtain a Corporate Tax advantage under Article 50(1) of the Corporate Tax Law.

#### **4.3-5 Overview**



## 4.4 Article 13: State-Sourced Income

Article 13 reads as follows:

- 1. Income shall be considered State Sourced Income in any of the following instances:*
  - (a) *Where it is derived from a Resident Person.*
  - (b) *Where it is derived from a Non-Resident Person and the income received has been paid or accrued in connection with, and attributable to, a Permanent Establishment of that Non-Resident Person in the State.*
  - (c) *Where it is otherwise accrued in or derived from activities performed, assets located, capital invested, rights used, or services performed or benefited from in the State.*
- 2. Subject to any conditions and limitations that the Minister may determine, State Sourced Income shall include, without limitation:*
  - (a) *Income from the sale of goods in the State.*
  - (b) *Income from the provision of services that are rendered or utilised or benefited from in the State.*
  - (c) *Income from a contract insofar as it has been wholly or partly performed or benefited from in the State.*
  - (d) *Income from movable or immovable property in the State.*
  - (e) *Income from the disposal of shares or capital of a Resident Person.*
  - (f) *Income from the use or right to use in the State, or the grant of permission to use in the State, any intellectual or intangible property.*
  - (g) *Interest that meets any of the following conditions:*
    1. *The loan is secured by movable or immovable property located in the State.*
    2. *The borrower is a Resident Person.*
    3. *The borrower is a Government Entity.*
  - (h) *Insurance or reinsurance premiums in any of the following instances:*
    1. *The insured asset is located in the State.*
    2. *The insured person is a Resident Person.*
    3. *The insured activity is conducted in the State."*

### 4.4-1 Overview

Under the source rule of taxation, income arising from the source jurisdiction is taxable irrespective of whether it is earned by a resident or non-resident person. All the 'State Sourced income' of the non-resident taxpayer would be taxable in the UAE. However, the taxpayer may refer to the treaty provisions to avail relief from double taxation.



Article 13 spells out the scope of the income, which shall be regarded as having a source in and arising from the UAE. For different streams of income, different criteria have been provided. Sub-clauses (a) and (b) of Clause 1 of Article 13 emphasise the payer of the income, whereas the sub-clause (c) of Clause 1 of Article 13 focuses on the situs of the assets or place of activities. Clause 1 of Article 13 provides general rules, whereas Clause 2 of Article 13 deals with specific rules.

The following incomes shall be considered ‘State Sourced Income’:

- (a) The income derived from a Resident person;
- (b) The income derived from a non-resident person and such income has been paid or accrued in connection with, and attributable to, a Permanent Establishment of that Non-Resident Person in the State;
- (c) The income accrued or derived from the following sources situated in the UAE:
  - ◆ activities performed;
  - ◆ assets located;
  - ◆ capital invested;
  - ◆ rights used; or
  - ◆ services performed or benefited from.

In respect of following ‘State Sourced income’, the Minister shall decide the conditions and limitations:

- (a) Income from the sale of goods in UAE;
- (b) Income from the provision of services rendered or utilised or benefited from in the UAE;
- (c) Income from a contract insofar as it has been wholly or partly performed or benefited from in UAE;
- (d) Income from movable or immovable property in the UAE;
- (e) Income from the disposal of shares or capital of a resident person;
- (f) Income from the use or right to use in the State, or the grant of permission to use in the State, any intellectual or intangible property;
- (g) Interest income received:
  - ◆ In respect of the loan secured by movable or immovable property located in UAE;
  - ◆ From the borrower, who is a Resident Person;
  - ◆ From the borrower, who is a Government Entity.
- (h) Insurance or reinsurance premiums received:
  - ◆ In respect of insured assets located in the State;
  - ◆ From a resident-insured person; or
  - ◆ In respect of insured activity conducted in the UAE

#### ***4.4-2 General rules for State-Sourced Income***

A resident taxable juridical person is liable to pay corporate tax in respect of its worldwide income, including the income sourced from UAE. In contrast, the resident natural person is liable to pay corporate tax on income derived from or outside the UAE, so far as it relates to business or business activities conducted in the UAE. However, the non-resident shall be taxed in respect of its state-sourced income derived from the UAE. Article 13 of the CT Law defines and expands the scope of the taxable income of non-resident persons.

##### ***4.4-2a Taxability of income derived from resident***

Where the income is derived from the resident person, such income would be regarded as 'State Sourced income' and hence, would be taxable under the Corporate Law. For example, a LLC is a tax resident of the UAE. It pays 1,00,000 Dirham to B, a German Company, for the services rendered outside UAE. Since the income is 'derived from' a resident person, such income would be subjected to corporate tax in the UAE. Hence, whenever any income is derived from any person having a connection with UAE, the recipient needs to exercise caution regarding the residential status of the payer.

##### ***4.4-2b Taxability of Income derived from non-resident***

Relation between the income and the permanent establishment of the non-resident in the UAE can create 'State sourced income' in UAE. Such relation may rise on 'payment' by a permanent establishment or on 'accrual' in connection with or attributable to the permanent establishment. Accordingly, if the income is derived from a non-resident person and such income has been paid or accrued in connection with, and attributable to, a Permanent Establishment of such a non-resident person in the UAE, then it would be regarded as 'State Sourced income' of the UAE.

For example, C LLC is a USA-based company with a permanent establishment in the UAE. The head office of C LLC, USA has availed advertisement services from D Co., an Indian company, in connection with the UAE business. The consideration is paid by the USA head office. However, since the income is derived from a non-resident and accrued in connection with/attribution to permanent establishment, such amount would be considered as 'State Sourced Income'.

##### ***4.4-2c Taxability of Income based on the situs of the asset***

Depending upon the situs of property, capital assets, rights, activities performed, services performed or benefited from, the income can be regarded as 'State Sourced Income'. Accordingly, capital gains arising from the transfer of capital assets situated in the UAE, consideration attributable to the services or activities performed in the UAE, royalty in respect of trademark registered in the UAE, interest/dividend income on the capital investment in the UAE company, etc. shall be characterised as 'State Sourced Income'. Similarly, the consideration for services



performed outside the UAE may be regarded as 'State Sourced Income' if such services are utilised in the UAE.

For example, A LLC is a USA-resident marketing company. It provides market outlook services for specified countries and regions of particular industries. B LLC is a tax resident of the USA engaged in the sales of luxury items. B LLC has set up an office in UAE, constituting its fixed place permanent establishment in UAE. The UAE branch office wants to understand the industry outlook in UAE. A LLC conducts a survey through electronic means without visiting UAE. While no activities are performed in the UAE, the report would be utilised for the UAE business. In such cases, the UAE tax authorities may take the view that since the services are utilised in the UAE, the consideration paid to A LLC, USA would be regarded as 'State Sourced Income'.

For example, ABC Ltd. is a tax resident of Singapore, and it wants to explore investment opportunities in the UAE. Subject to the laws in force, ABC Ltd. invests in shares of a UAE-based company. Subsequently, it disinvests and realises the capital gain income. Since the capital gain arises from the transfer of capital assets situated in the UAE, the income would be 'State Sourced Income' in the UAE.

For example, X LLC is a tax resident of the USA with a fixed place permanent establishment in the UAE. It has acquired trademarks and intellectual properties registered in the UAE. X LLC gives rights to use the trademark in particular geographical markets, e.g. Asia, Europe and African Continent, for royalty consideration. Since the royalty income arises from capital assets/properties registered in the UAE, the royalty income shall be regarded as 'State Sourced income' in UAE.

#### **4.4-3 Special rules for State-Sourced Income**

Clause 2 of Article 13 deals with specific rules for different streams of income. Taxation of such streams is subject to further limitations and conditions to be decided by the Minister.

##### ***4.4-3a Income from the sale of goods***

Income from the onshore sale of goods in the UAE would be regarded as 'State sourced income'. A view may be explored that the offshore sale of goods does not satisfy this criterion. Further, the attribution of profits arising from the sale of goods may create practical challenges.

For example, A LLC is engaged in sales of electronic products. It does in-house manufacturing of a few products and sells a few other products on a trading basis. It has undertaken two types of transactions:

- (a) Manufacturing of goods outside the UAE and sale in the UAE;
- (b) Purchase of goods outside the UAE and sale in the UAE.

The taxability of the profits arising from such sales may vary depending upon the manufacturing and trading activities. Further, in the case of manufacturing activities, the key value addition activity, *i.e.* manufacturing, is undertaken outside the UAE. Hence, limited profits may be attributable to the UAE on a reasonable basis.

Whereas in the case of trading of goods, the profits attributable to UAE may be a higher proportion.

#### **4.4-3b Income from the provision of services**

The income arising from the provision of services will be considered as 'State Sourced Income' if such services are either rendered or utilised in the UAE. Thus, the place of provision or the place where the services are utilised is relevant to determine the taxability of income in the UAE.

#### **4.4-3c Income from a contract**

Income attributable to a contract wholly or partly performed or utilised or benefited from in the UAE would be considered as sourced in the UAE. The place of execution of the contract amongst the parties may not be a relevant factor. This clause may have wide ramifications. The contract may be executed outside the UAE, and it could be partly or wholly executed or performed in the UAE. Whether the test of 'benefited from' requires direct benefit or even indirect or remote benefit is sufficient to create taxing rights is an ambiguous aspect. A clarification or limitations on the scope of the provision can bring certainty.

#### **4.4-3d Income from movable or immovable property in the UAE**

Any income arising from movable or immovable property in the UAE would be regarded as sourced from the UAE. This clause may cover rental income from letting out of the movable or immovable property. This clause will have relevance in respect of movable property only. Nexus due to Immovable property specifically covered in Article 12 (See **Para 4.3-4c**).

#### **4.4-3e Income from disposal of shares or capital of a resident person**

Capital gain arising from the transfer of shares or capital of a resident person is income sourced in the UAE. Such gain may arise on the transfer of shares of the UAE resident company or capital of other entities, e.g. a company tax resident of the UAE.

#### **4.4-3f Income from the use or right to use intellectual or intangible property**

Income arising from the use or right to use any intellectual or intangible property, e.g. trademark, know-how, copyright, franchisee rights, etc., in the UAE is income sourced in UAE.

#### **4.4-3g Interest income**

Interest income is sourced in the UAE if it is receivable:

- (a) In respect of a loan secured by movable or immovable property situated in the UAE; or
- (b) From a resident borrower or Government entity.



#### **4.4-3h Insurance or reinsurance premiums**

The source of the Insurance/reinsurance premium would depend upon the situs of the insured asset or activities or the residential status of the insured person. Accordingly, if the insured asset/activity is located in UAE or the insured person is a UAE resident, the premium is sourced in UAE.

#### **4.4-4 Comprehensive Example**

XYZ Corporation, a multinational company and a tax resident of the UK, operates in multiple countries, including the UAE. Let's examine the following income streams and determine whether they fall under State Sourced Income under Article 13:

*(a) Income derived from a Resident person*

XYZ Corporation receives from A LLC, a UAE resident company, 5,00,000 AED for marketing services. Since the income is derived from a resident person (A LLC), it falls under State Sourced Income and is subject to corporate tax in the UAE.

*(b) Income derived from a PE in UAE*

ABC Corporation has a PE in the UAE. It pays income to its head office located in the United States. The income received from the UAE PE is a State Sourced Income because it is derived by a non-resident person (the head office) and is connected to the PE. Therefore, this income is taxable in the UAE.

*(c) Income from the sale of goods in the UAE*

XYZ Corporation generates revenue from the sale of products within the UAE. This income is a State Sourced Income since it arises from the sale of goods within the country.

*(d) Income from the provision of services rendered or utilised in the UAE*

XYZ Corporation provides consulting services to a UAE-based client and receives payment for such services. Since the services are rendered or utilised within the UAE, the income falls under State Sourced Income and is taxable in the UAE.

*(e) Income from a contract performed or benefited from in the UAE*

XYZ Corporation enters into a contract with a UAE company to develop and implement a software system. The contract involves both parties performing their obligations in the UAE. As a result, the income derived from this contract is considered State Sourced Income and subject to taxation in the UAE.

*(f) Income from movable property in the UAE*

XYZ Corporation owns construction equipment in the UAE and earns rental income from leasing it to a local business. The rental income qualifies as State Sourced Income as it arises from the ownership of movable property located in the UAE.

(g) *Income from the disposal of shares or capital of a resident person*

XYZ Corporation sells its shares in a UAE-based company and realizes a capital gain. This capital gain is considered State Sourced Income since it arises from the disposal of shares in a resident person (the UAE-based company).

(h) *Income from the use or right to use intellectual or intangible property*

XYZ Corporation licenses its patented technology to a UAE company for a royalty. The royalty income derived from the use of intellectual property in the UAE falls under State Sourced Income and is subject to taxation in the UAE.

(i) *Interest income meeting specific conditions*

XYZ Corporation receives interest income from a loan it provided to a UAE resident person. Since the borrower is a resident person, the interest income is considered State Sourced Income and taxable in the UAE.

(j) *Insurance or reinsurance premiums based on specific conditions*

PQR Corporation, an insurance company, collects premiums for insuring assets located in the UAE. Since the insured assets are in the UAE, the insurance premiums qualify as State Sourced Income and are subject to taxation in the UAE.

In summary, Article 13 of the UAE Corporate Tax Law classifies various income streams as State Sourced Income. The taxability of income depends on whether it is derived from a resident person, a non-resident person with a PE in the UAE, or activities, assets, capital, rights, or services in the UAE. It would be pertinent to note that since withholding tax is at 0% at the moment, non-residents earning merely state-sourced income (without having either a PE or nexus in UAE) may not be exposed to CT law till such time the rate is kept at 0%.

## 4.5 Article 14: Permanent Establishment

Article 14 reads as follows:

- "1. A Non-Resident Person has a Permanent Establishment in the State in any of the following instances:
  - (a) Where it has a fixed or permanent place in the State through which the Business of the Non-Resident Person, or any part thereof, is conducted.
  - (b) Where a Person has and habitually exercises an authority to conduct a Business or Business Activity in the State on behalf of the Non-Resident Person.
  - (c) Where it has any other form of nexus in the State as specified in a decision issued by the Cabinet at the suggestion of the Minister.
2. For the purposes of paragraph (a) of Clause 1 of this Article, a fixed or permanent place in the State includes:
  - (a) A place of management where management and commercial decisions that are necessary for the conduct of the business are, in substance, made.

- (b) A branch.
  - (c) An office.
  - (d) A factory.
  - (e) A workshop.
  - (f) Land, buildings and other real property.
  - (g) An installation or structure for the exploration of renewable or non-renewable natural resources.
  - (h) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources, including vessels and structures used for the extraction of such resources.
  - (i) A building site, a construction project, or place of assembly or installation, or supervisory activities in connection therewith, but only if such site, project or activities, whether separately or together with other sites, projects or activities, last more than (6) six months, including connected activities that are conducted at the site or project by one or more Related Parties of the Non-Resident Person.
3. Notwithstanding Clauses 1 and 2 of this Article, a fixed or permanent place in the State shall not be considered a Permanent Establishment of a Non-Resident Person if it is used solely for any of the following purposes:
- (a) Storing, displaying or delivering of goods or merchandise belonging to that person.
  - (b) Keeping a stock of goods or merchandise belonging to that person for the sole purpose of processing by another Person.
  - (c) Purchasing goods or merchandise or collecting information for the Non-Resident Person.
  - (d) Conducting any other activity of a preparatory or auxiliary nature for the Non-Resident Person.
  - (e) Conducting any combination of activities mentioned in paragraphs (a), (b), (c) and (d) of Clause 3 of this Article, provided that the overall activity is of a preparatory or auxiliary nature.
4. Clause 3 of this Article shall not apply to a fixed or permanent place in the State that is used or maintained by a Non-Resident Person if the same Non-Resident Person or its Related Party carries on a Business or Business Activity at the same place or at another place in the State where all of the following conditions are met:
- (a) Where the same place or the other place constitutes a Permanent Establishment of the Non-Resident Person or its Related Party.
  - (b) The overall activity resulting from the combination of the activities carried out by the Non-Resident Person and its Related Party at the same place or at the two places is not of a preparatory or auxiliary nature and together would form a cohesive Business operation, had the activities not been fragmented.

5. For the purposes of paragraph (b) of Clause 1 of this Article, a Person shall be considered as having and habitually exercising an authority to conduct a Business or Business Activity in the State on behalf of a Non-Resident Person if any of the following conditions are met:
  - (a) The person habitually concludes contracts on behalf of the Non-Resident Person.
  - (b) The person habitually negotiates contracts that are concluded by the Non-Resident Person without the need for material modification by the Non-Resident Person.
6. The provisions of Paragraph (b) of Clause 1 of this Article shall not apply where the person conducts a Business or Business Activity in the State as an independent agent and acts for the Non-Resident Person in the ordinary course of that Business or Business Activity, unless the person acts exclusively or almost exclusively on behalf of the Non-Resident Person, or where that person cannot be considered legally or economically independent from the Non-Resident Person.
7. For the purposes of Clause 3 of this Article, the Minister may prescribe the conditions under which the mere presence of a natural person in the State does not create a Permanent Establishment for a Non-Resident Person in any of the following instances:
  - (a) Where such presence is a consequence of a temporary and exceptional situation.
  - (b) Where the natural person is employed by the Non-Resident Person, and all of the following conditions are met:
    1. The activities being conducted in the State by the natural person are not part of the core income-generating activities of the Non-Resident Person or its Related Parties.
    2. The Non-Resident Person does not derive State Sourced Income."

#### **4.5-1 Overview**

The concept of 'Permanent Establishment' is an important principle of international tax law. Generally, the term 'Permanent Establishment' is defined under the OECD and UN model convention and the international agreements entered between two contracting states to avoid double taxation. Unlike other countries, the UAE CT Law specifically defines the term 'Permanent Establishment' in domestic law. The main purpose of the 'Permanent Establishment' concept is to determine whether a company has established sufficient presence in a foreign country to warrant the taxation of the business profits of the company in the source country. Generally, a country only has the right to tax the business profits of a foreign company if that company has a Permanent Establishment in that country.

The Permanent Establishment concept under the UAE CT regime has been designed based on the OECD Model Tax Convention. Article 5 of the OECD Model Tax Convention sets out internationally recognised principles for determining a



Permanent Establishment, which will form the basis for determining a Permanent Establishment under the UAE CT regime. UAE's double tax treaties are also generally based on the OECD Model Tax Conventions.

While assessing whether they have a Permanent Establishment in the UAE, the outcome should typically be aligned with the position where there is a double tax treaty in place between the country of the foreign company and the UAE.

The concept of 'Permanent establishment' has been developed and evolved over a period of time. The classical form of 'Fixed Permanent Establishment' is restricted to the physical place of conducting business activities like a factory, office, branch, etc. Then, installation PE, construction PE, dependent agent PE, service PE, etc., have evolved. The OECD and UN commentary may be referred to as directory guidance to understand the concept of 'Permanent Establishment'.

Article 14 of the CT Law provides as under:

- (a) Fixed or permanent place of business and dependent agent shall constitute 'Permanent establishment' in UAE;
- (b) Fixed permanent establishment shall include branch, offices, factory, land, building, construction site, etc.;
- (c) A person having authority to conduct business or business activity on behalf of the non-resident person shall constitute a 'Dependent Agent Permanent Establishment'; and
- (d) Exemption has been granted in respect of preparatory or auxiliary activities.

#### ***4.5-2 Fixed Place Permanent Establishment***

'Fixed place PE' refers to a fixed or permanent place through which the business of the non-resident person, or any part thereof, is conducted. The definition of 'Fixed Place PE' refers to the following important criteria:

- (a) Existence of a 'place of business', *i.e.* a facility such as premises or, in certain instances, machinery or equipment;
- (b) The place of business must be 'fixed', *i.e.* it must be established at a distinct place with a certain degree of permanence;
- (c) The enterprise carries on the business of through such a fixed place of business.

#### ***4.5-2a Place of Business Test***

The term 'place of business' covers any premises, facilities or installations used for carrying on the business of the enterprise, whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise, and it simply has a certain amount of space at its 'disposal'. A place of business may be constituted by a certain permanently used area in a customs depot (*e.g.*, area for the storage of dutiable goods).

### *Disposal Test*

The fixed place of business should be available at the 'disposal' of the taxable person. 'Disposal test' does not refer to the legal right of the premises, rather it will depend on that non-resident having the effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there.

For example, A Ltd. is a company incorporated in India. It wants to exploit the UAE market. It sends goods to the UAE and stores them at a warehouse in the UAE for a temporary period. It pays the rental for the use of the storage facility. It does not have the storage space available at its disposal. Hence, the storage facility cannot be considered to be a 'Fixed Place PE' in UAE. However, B Ltd. pays rent for a room in the warehouse. The rental charges are payable irrespective of whether any goods are stored there during the period or not. B Ltd. is free to visit the premises and use it for business activities. The place is available at the disposal of B Ltd. against the rental consideration. If any business activities are carried out from such premises, such premises shall constitute fixed place PE.

Whilst no formal legal right to use a particular place is required, mere presence at a particular location does not necessarily mean that location is at the disposal. The 'Disposal test' depends upon effective power to use the location as well as the extent of the presence of the taxable person at that location and the activities that it performs there.

For example, a co-sharing office taken on rent shall constitute a fixed place of business. The taxable person can access the place anytime and conduct business activities using the space.

If a taxable person's presence at a location is intermittent or incidental, the location cannot be considered a place of business of the enterprise (e.g. employees have access to the premises of related parties which they often visit but without working from these premises for an extended period of time). Where an enterprise does not have a right to be present at a location or does not use that location itself, that location is not available at the disposal of the enterprise.

For example, a plant owned and used exclusively by a supplier or contract manufacturer is not at the disposal of the taxable person receiving goods produced at that plant merely because all these goods will be used in the business of that taxable person. While this is generally considered relevant internationally to apply the PE test, under UAE CT – as per the explanatory guide, the fixed place, even though not being at the disposal of a foreign person, could still constitute a PE if other criteria are met.

As per Explanatory Guide on CT Law, a fixed or permanent place implies the existence of a physical location in the UAE with some degree of permanency. The Corporate Tax Law does not prescribe any minimum requirements in terms of the size or nature of the physical location, nor is there a specific time limit for a fixed place to constitute a Permanent Establishment other than under Clause (2)(i) of Article 14. It is also not required that the fixed place is owned or used exclusively by the Non-Resident Person or is at the disposal of the Non-Resident Person for an extended period of time.



### *Instances from OECD Model Commentary*

The OECD Model Commentary illustrates instances of 'Permanent Establishment' as under:

Scenario	Whether a Permanent Establishment exists?
A salesman visits a major customer to take orders and meets the purchasing director on a regular basis.	The customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute PE.
An employee of a company is allowed to use an office in the headquarters of another group company for a long period of time in order to ensure that the latter company complies with its obligations under contracts concluded with the former company.	The employee is carrying on activities related to the business of the former company and the office is at his disposal at the headquarters of another company will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a 'fixed place of business'.

### **4.5-2b Permanent Nature Test**

The place of business must be fixed, and it should have a certain degree of permanency. A purely temporary place of business shall not constitute a permanent establishment. However, depending on the nature of the business, a permanent establishment may exist only for a very short period of time.

### **4.5-2c Business Activity Test**

There should be a link between the place and the business activities. Merely an owned office may not constitute a 'Fixed place PE' of the non-resident unless any business activities are carried out through such office premises.

Permanent establishment begins to exist as soon as the taxable person commences to carry on its business through a fixed place of business. Generally, the period of time during which the fixed place of business itself is being set up should not be counted. The permanent establishment ceases to exist with the disposal of the fixed place of business or with the cessation of any activity through it. A temporary interruption of operations, however, cannot be regarded as a closure.

### **4.5-3 Places constitute Fixed Place PE**

Article 14(2) contains a list of places which shall qualify as permanent establishments, such as:

- (a) A place of management where management and commercial decisions that are necessary for the conduct of the business are, in substance, made (commonly referred to as a 'Place of effective management');
- (b) A Branch;
- (c) An office;

- (d) A factory;
- (e) A workshop;
- (f) Land, buildings and other real property;
- (g) An installation or structure for the exploration of renewable or non-renewable natural resources;
- (h) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources, including vessels and structures used for the extraction of such resources; and
- (i) A building site, a construction project, or place of assembly or installation, or supervisory activities in connection therewith, but only if such site, project or activities, whether separately or together with other sites, projects or activities, last more than (6) six months, including connected activities that are conducted at the site or project by one or more related parties of the non-resident person.

This is an inclusive list of permanent establishments. Each place of business has to satisfy the conditions prescribed in Article 14(1) to qualify as a permanent establishment (*See Para 4.5-2*).

#### **4.5-3a Place of effective management**

The place where management and commercial decisions necessary for the conduct of the business are in substance made is considered a Fixed Place PE. Internationally there is reference only to Place of Management – while UAE CT mentions Place of effective management. As per the explanatory guide to UAE CT law, it means day-to-day conduct and not necessarily strategic decision-making or holding board meetings.

As per Explanatory Guide to CT, a place of management in the UAE is where decisions necessary for the day-to-day conduct of the foreign entity's Business are (in substance) made, which may constitute a Permanent Establishment.

For the purposes of Clause 2(a) of Article 14 of CT Law, a distinction should be made between the board or equivalent senior management of an entity, which takes the strategic decisions, and the day-to-day management, which takes the implementing decisions. To determine whether a place of management exists for the purposes of this Article, one would need to look at where the day-to-day operational management and decisions relating to the execution of decisions given by the board of directors (or equivalent governing body) are carried out.

#### **4.5-3b Business Premises**

Branch, offices, factories, workshops, land, buildings and other real estate property are also examples of fixed-place permanent establishments.

#### **4.5-3c Installation or Construction PE**

Generally, in the extraction and mining business, the land is owned by the Government. The licensee is given the right to explore and extract the resources. An

installation or structure for the exploration of renewable or non-renewable natural resources shall create a PE. Similarly, a mine, oil or gas well, quarry, or any other place of extraction of natural resources, including vessels and structures used for the extraction of resources, shall constitute PE.

A building site, a construction project, a place of assembly or installation, or connected supervisory activities shall create a PE if such site, project or activities last more than six months. The term 'A building site, a construction project, or place of assembly or installation' includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation of buildings, roads, bridges or canals, the laying of pipe-lines and excavating and dredging. Additionally, the term "installation project" also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors. On-site planning and supervision of the erection of a building are also covered.

The threshold of 'six months' has been subjected to mischief and tax avoidance. MNCs divide the activities at the site amongst related parties and group entities so that the time spent by each entity on the site does not exceed 'six months'. A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, e.g. if it installs a planning office for the construction.

The Explanatory guide to CT Law provides that while considering the threshold of 'six months', the duration of all sites, projects, and activities should be taken into consideration. Further, the duration of connected activities conducted at the site or project by one or more related parties of the non-resident person shall be added. The term 'Related party' can be interpreted in the manner prescribed in Article 35 (See **Para 10.3**).

#### ***4.5-4 Dependent Agent Permanent Establishment***

Fixed Place PE requires a fixed place of business through which the business activities are carried out. To avoid fixed permanent establishment, the MNCs appoint a dependent agent in the source country through which the business is run. The dependent agent exercises the authority to conduct business activities in the source country on behalf of the non-resident person. Such an agent is mainly or solely dependent upon the non-resident person.

As per Clause (1)(b) of Article 14, the dependent agent of a non-resident shall constitute a permanent establishment in the UAE. If a person in the UAE has and habitually exercised an authority to conduct business activities in the UAE on behalf of the non-resident, then such person shall be considered as a permanent establishment.

#### ***4.5-4a Conditions to create Dependent Agent PE***

While applying the test of 'Dependent Agent Permanent Establishment', all of the following conditions should be satisfied:

- (a) The person acts in the UAE on behalf of a non-resident person;



## *Taxable Person and Corporate Tax Base*

- (b) In doing so, that person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the non-resident person; and
- (c) These contracts are either in the name of the non-resident person or for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident person or that the non-resident person has the right to use or for the provision of services by that non-resident person.

### *Meaning of 'habitually exercising the authority'*

A person shall be considered as having and habitually exercising the authority to conduct business activities in the UAE on behalf of a non-resident person if any of the following conditions are met:

- (a) Such person habitually concludes contracts on behalf of the non-resident person; or
- (b) Such person habitually negotiates contracts that the non-resident person concludes without material modifications.

The phrase 'concludes contracts' focuses on situations where, under the relevant law governing contracts, a contract is considered to have been concluded by a person.

### *Meaning of 'habitually negotiates contract'*

The phrase 'habitually negotiates contracts that are concluded by the non-resident person without the need for material modification by the non-resident person' is aimed at situations where the conclusion of a contract directly results from the actions that the agent performs in the UAE on behalf of the non-resident even though, under the relevant law, the contract is not concluded by that person in the UAE.

It is not necessary for the agent to conclude the contract on behalf of the non-resident person. However, if the agent habitually negotiates contracts and such contracts are concluded by the non-resident person without the need for material modification, then such person shall be considered as having and habitually exercising authority to conduct business activities on behalf of the non-resident person.

For example, the agent solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods belonging to the non-resident are delivered and where the non-resident routinely approves such transactions. The agent shall be considered a dependent agent PE. It does not apply, however, where the agent merely promotes and markets goods or services of a non-resident in a way that does not directly result in the conclusion of contracts.

The requirement that an agent must 'habitually' conclude contracts or negotiate the contracts that are routinely concluded without material modification by the non-resident reflects the underlying principle that the presence of a non-resident should be 'Permanent' and more than merely transitory. The extent and frequency of activity necessary to conclude that the agent is 'habitually' concluding contracts or negotiating the contracts will depend on the nature of the contracts and the business of the principal.



#### ***4.5-4b Independent agent shall not create a PE***

The 'dependent agent permanent establishment' shall exclude the independent agents. Accordingly, the persons who conduct business activity in the UAE as independent agents and act for the non-resident person in the ordinary course of that business activities shall not be regarded as dependent agents.

For example, a broker-dealer in the financial sector performs a variety of market intermediation activities as an agent for non-resident persons and sometimes on its own account, the broker-dealer will be considered to be acting in the ordinary course of its business as an agent when it performs these various market intermediation activities.

However, if the agent acts exclusively or almost exclusively on behalf of the non-resident person, or where that agent cannot be considered legally or economically independent from the non-resident person, such agent shall be considered as 'dependent agent' of the non-resident, leading to the creation of dependent agent permanent establishment.

It may be noted that the subsidiary or group company of the non-resident in the UAE cannot automatically create a dependent agent permanent establishment of the non-resident person. The existence of the permanent establishment depends upon the nature of the transactions between the non-resident and the subsidiary or group company.

#### ***4.5-5 Preparatory or Auxiliary Activities do not constitute PE***

If a fixed place of business is used solely for the following purposes, such place of business shall not create a permanent establishment in the UAE:

- (a) Storage, display or delivery of goods or merchandise belonging to the non-resident person;
- (b) Stock keeping of goods or merchandise belonging to the non-resident person for the sole purpose of processing by another person;
- (c) Purchase of goods or merchandise or collecting information for the non-resident person;
- (d) Conducting any other activity of a preparatory or auxiliary nature for the non-resident person; and
- (e) Conducting any combination of the above activities so that the overall activity is of a preparatory or auxiliary nature.

#### ***4.5-5a Warehousing facilities***

The CT Law excludes a fixed place of business in the UAE used by the non-resident for storage, display or delivery of goods or merchandise. It is important to note that no direct selling operations should be performed from such a place.

For example, an Indian company directly sells goods or merchandise from India. However, it keeps warehousing arrangements in the UAE to facilitate fast delivery



of goods. Such a warehouse in the UAE will not constitute a fixed place PE in the UAE.

#### **4.5-5b Use of place for job work**

In a few cases, the non-resident avails job work services from service providers of another country. The non-resident sends and stores the goods in the State of the job work service provider. The storage place used for keeping goods or merchandise of a non-resident person for the sole purpose of processing by another person shall not constitute a permanent establishment.

#### **4.5-5c Use of place for procurement**

If the non-resident uses a fixed place of business solely for the purpose of procurement of goods or merchandise and no sales operations are carried out through such place, then such a fixed place shall not create a permanent establishment. Similarly, the place of business used for collecting information shall not qualify as a permanent establishment.

#### **4.5-5d Any other place used for similar purposes**

The place of business used for conducting any other activities or combination of the above activities, which are of a preparatory or auxiliary nature, shall not create a permanent establishment. Important to note that the place of business should not be used for providing services to any other person. Place of business used for own purpose of non-resident person for above purposes shall be excluded from the scope of permanent establishment.

### **4.5-6 Anti-fragmentation rules**

The above exclusions are created to avoid the creation of a permanent establishment. The non-resident person sub-divides activities amongst a different place of business so that the individual place of business does not give rise to the permanent establishment. In line with OECD's BEPS Action Plans, the CT Law provides for the anti-fragmentation rule, which provides that the relief in respect of preparatory or auxiliary services shall be denied if the same non-resident person or its related party carry on business activities at the same place or at another place in the UAE, if the same place or the other place constitutes a permanent establishment of the non-resident person or its related party and the overall activity resulting from the combination of the activities carried out by the non-resident person and its related party at the same place or at the two places is not of a preparatory or auxiliary nature and together would form a cohesive business operation, had the activities not been fragmented.

First, the test of permanent establishment is to be applied for each place of business separately. If any of the place of business of a non-resident or its related party in the UAE constitutes permanent establishment and the overall activity resulting from the combination of the activities carried out by the non-resident or its



related party across the different places of business form cohesive business operation nature and are not of preparatory or auxiliary nature, then each place of business contributing to the overall business activities shall constitute a permanent establishment. The fragmentation of activities across the locations shall be ignored.

#### **4.5-7 Stay in UAE due to exceptional situations may not constitute a PE**

Whether an employee working from his home situated in UAE can create a permanent establishment of a foreign employer? Can the tax authorities contend that an employee's home is available at the disposal and business is being carried out through his home? Post-Covid, the instances of work-from-home/remote locations have significantly increased, and hence, it raises questions regarding the creation of permanent establishments.

The Minister has prescribed the conditions under which the mere presence of an individual in UAE does not create a permanent establishment for a non-resident person if such presence is a consequence of a temporary and exceptional situation or the natural person is employed by the non-resident person.

##### **4.5-7a Conditions to met**

In this reference, the Ministry of Finance has issued *Ministerial Decision No. 83 of 2023 dated 10 April 2023 (effective from 25 April 2023)* on the determination of the conditions under which the presence of a natural person in the UAE would not create a permanent establishment for a non-resident person. These conditions are as follows:

- (a) The presence of the natural person in the UAE is a result of exceptional circumstances of a public or private nature;
- (b) The natural person or non-resident person cannot reasonably predict the exceptional circumstances;
- (c) The natural person did not have any intention to remain in the UAE when the exceptional circumstances end;
- (d) The non-resident person does not have a Permanent Establishment in the UAE before the occurrence of the exceptional circumstances;
- (e) The non-resident person did not consider that the natural person is creating a Permanent Establishment or deriving income in the UAE as per the tax legislation applicable in other jurisdictions.

On satisfaction of the above conditions, the presence of the natural person shall be regarded as temporary and exceptional circumstances, and such presence shall not create a permanent establishment of the non-resident in the UAE.

However, if an individual is employed by the non-resident person and the activities being conducted in the UAE by the individual are part of the core income-generating activities of the non-resident person or its related parties or such non-resident person derives State Sourced income, then the relaxation shall not be granted.

#### **4.5-7b Circumstances considered Exceptional**

Exceptional Circumstances mean a situation or an event which is beyond the control of the natural person and occurred while he was already in the UAE, which he could not predict or prevent and which prevented him from leaving the UAE he originally planned. These exceptional circumstances can be public or private in nature.

The exceptional circumstances of a public nature include:

- (a) Adoption of public health measures by the competent authorities in the UAE or in the jurisdiction of the original workplace or by the World Health Organization;
- (b) Travel restrictions are imposed by the competent authorities in the UAE or in the jurisdiction of the original workplace;
- (c) Legal sanctions are imposed on the natural person preventing them from leaving the UAE;
- (d) War or occurrence of terrorist attacks;
- (e) Occurrence of natural disasters;
- (f) Any other circumstances similar to those provided above as prescribed by the Authority.

The exceptional circumstances of a private nature include:

- (a) Occurrence of an emergency health condition which affects the natural person or their relatives up to the fourth degree, including by way of adoption or guardianship;
- (b) Any other circumstances similar to those provided above as prescribed by the Authority.

#### **4.5-8 Other Permanent Establishments**

Clause (1)(c) of Article 14 refers to any other form or nexus in the UAE which shall create a permanent establishment. The Cabinet, at the suggestion of the Minister, can specify any other form of nexus in the UAE which shall create a permanent establishment.

#### **4.5-9 Comprehensive Example**

ABC Construction Ltd., an Indian company, is undertaking a construction project in the UAE. We'll examine the various aspects of permanent establishment (PE) based on the provisions of Article 14 of the UAE Corporate Tax Law.

##### **(a) Fixed Place Permanent Establishment**

ABC Construction Ltd. establishes a branch office in Dubai to carry out its construction project. The branch office has a physical location where management and commercial decisions necessary for the project are made. This branch office constitutes a fixed place PE under Article 14(1)(a) of the CT Law.

Additionally, ABC Construction Ltd. sets up a construction site in Abu Dhabi, UAE. The construction site, involving assembly and installation activities, lasts for more than six months and includes connected supervisory activities. This construction site also qualifies as a fixed place PE under Article 14(2)(i) of the CT Law.

(b) *Dependent Agent Permanent Establishment:*

ABC Construction Ltd. engages a local construction project manager, Mr. Ahmed, as a consultant, who has the authority to negotiate and conclude contracts on behalf of the company. Mr. Ahmed habitually exercises this authority and plays a crucial role in obtaining new projects. As a result, Mr. Ahmed constitutes a dependent agent PE under Article 14(1)(b) of the CT Law.

(c) *Exemptions for preparatory or auxiliary activities*

ABC Construction Ltd. has rented a warehouse in Sharjah, UAE, where it stores construction materials and equipment for the project. This warehouse is used for storing goods belonging to ABC Construction Ltd., but it belongs to another third party that provides storage services and efficient retrieval when required. Thus, such an arrangement is considered a preparatory or auxiliary activity. Therefore, the warehouse does not constitute a permanent establishment under Article 14(3)(a) of the CT Law.

(d) *Exceptions to Exemption for Preparatory or Auxiliary Activities*

ABC Construction Ltd. has a separate construction project office in Sharjah, UAE, in addition to the warehouse, where project-related activities are conducted for more than six months and involve connected activities by related parties. The combined activities would not be considered preparatory or auxiliary activities. In such a case, the office in Sharjah and the warehouse would form a cohesive business operation, and both places could qualify as a fixed place PE under Article 14(4)(b) of the CT Law.

## 4.6 Article 15: Investment Manager Exemption

Article 15 reads as follows:

- "1. For the purposes of Clause 6 of Article 14 of this Decree-Law, an Investment Manager shall be considered an independent agent when acting on behalf of a Non-Resident Person, where all of the following conditions are met:
  - (a) The Investment Manager is engaged in the business of providing investment management or brokerage services.
  - (b) The Investment Manager is subject to the regulatory oversight of the competent authority in the State.
  - (c) The transactions are carried out in the ordinary course of the Investment Manager's Business.
  - (d) The Investment Manager acts in relation to the transactions in an independent capacity.

- (e) *The Investment Manager transacts on an arm's length basis with the Non-Resident Person and receives due compensation for the provision of services.*
  - (f) *The Investment Manager is not the Non-Resident Person's representative in the state in relation to any other income or transaction that is subject to Corporate Tax for the same Tax Period.*
  - (g) *Any such other conditions as may be prescribed in a decision issued by the Cabinet at the suggestion of the Minister.*
2. *For the purposes of Clause 1 of this Article, "transactions" means any of the following:*
- (a) *Transactions in commodities, real property, bonds, shares, derivatives or securities of any other description.*
  - (b) *Transactions of buying or selling any foreign currency or placement of funds at interest.*
  - (c) *Such other transactions permissible to be carried out by the Investment Manager on behalf of a Non-Resident Person under the applicable legislation of the State."*

#### **4.6-1 Investment Manager not to be treated as dependent agent PE**

As per Article 14 of the CT Law, the dependent agent of a non-resident person shall create Permanent Establishment, and the income attributable to such a permanent establishment shall be taxed in the UAE. Generally, the brokers and investment managers act as an agent to fulfil the financial requirement of the investors and hence, may create dependent agent permanent establishment in UAE.

Considering the UAE's position as a leading investment and wealth management centre, the UAE CT regime allows regulated UAE investment managers to provide discretionary investment management services to foreign customers without triggering a UAE permanent establishment for the foreign investor or the foreign investment fund. This exemption shall be subject to conditions comparable to similar regimes in leading financial centres.

#### **4.6-1a Conditions to be fulfilled**

An Investment Manager will not be treated as a dependent agent PE of a non-resident client if the following conditions are fulfilled:

- (a) The investment manager should be engaged in the business of providing investment management or brokerage services. The investment services may cover different investment avenues, *viz.* commodities, real property, bonds, shares, derivatives, or securities of any other description, including foreign exchange or debt arrangements.
- (b) The relief shall be available to the regulated investment managers. The investment manager should be regulated by and registered with the competent authority in the UAE.
- (c) The transactions should be carried out in the ordinary course of the investment manager's business. Further, it has to act in an independent capacity



in relation to the transactions. The investment manager should be legally or economically independent from the non-resident person. The investment manager should not derive significant revenue/profits from the non-resident to the extent it can affect its independence.

- (d) The transactions with the non-residents shall satisfy the test of arm's length basis. The investment manager shall receive due compensation commensurate with the provision of services.
- (e) The investment manager should not act as a representative of the non-resident in relation to any other taxable income or transaction for the same tax period.
- (f) The Cabinet, at the suggestion of the Minister, may prescribe additional conditions subject to which the relief shall be available from the scope of the permanent establishment.

The benefit of the relief shall be available in respect of all the transactions, including transactions in commodities, real property, bonds, shares, derivatives or securities of any other description or transactions of buying or selling any foreign currency or placement of funds at interest. Further, any other such transactions permissible to be carried out by the investment manager on behalf of a non-resident person under the applicable legislation of UAE shall be eligible to claim a benefit of the relief.

ca.basithabdu@gmail.com 10-01-2025

## 4.7 Article 16: Partners in an Unincorporated Partnership

Article 16 reads as follows:

- “1. Unless an application is made under Clause 8 of this Article, and subject to any conditions the Minister may prescribe, an Unincorporated Partnership shall not be considered a Taxable Person in its own right, and Persons conducting a Business as an Unincorporated Partnership shall be treated as individual Taxable Persons for the purposes of this Decree-Law.
- 2. Where Clause 1 of this Article applies, a Person who is a partner in an Unincorporated Partnership shall be treated as:
  - (a) Conducting the Business of the Unincorporated Partnership.
  - (b) Having a status, intention, and purpose of the Unincorporated Partnership.
  - (c) Holding assets that the Unincorporated Partnership holds.
  - (d) Being party to any arrangement to which the Unincorporated Partnership is a party.
- 3. For the purposes of Clause 1 of this Article, the assets, liabilities, income and expenditure of the Unincorporated Partnership shall be allocated to each partner in proportion to their distributive share in that Unincorporated Partnership, or in the manner prescribed by the authority where the distributive share of a partner cannot be identified.

4. *The Taxable Income of a partner in an Unincorporated Partnership shall take into account the following:*
  - (a) *Expenditure incurred directly by the partner in conducting the Business of the Unincorporated Partnership.*
  - (b) *Interest expenditure incurred by the partner in relation to contributions made to the capital account of the Unincorporated Partnership.*
5. *Interest paid by an Unincorporated Partnership to a partner on their capital account shall be treated as an allocation of income to the partner and is therefore not a deductible expenditure for calculating the Taxable Income of the partner in the Unincorporated Partnership.*
6. *For the purposes of calculating and settling the Corporate Tax Payable of a partner in an Unincorporated Partnership under Chapter Thirteen of this Decree-Law, any foreign tax incurred by the Unincorporated Partnership shall be allocated as a Foreign Tax Credit to each partner in proportion to their distributive share in the Unincorporated Partnership.*
7. *A Foreign Partnership shall be treated as an Unincorporated Partnership for the purposes of this Decree-Law where all of the following conditions are met:*
  - (a) *The Foreign Partnership is not subject to tax under the laws of the foreign jurisdiction.*
  - (b) *Each partner in the Foreign Partnership is individually subject to tax with regards to their distributive share of any income of the Foreign Partnership as and when the income is received by or accrued to the Foreign Partnership.*
  - (c) *Any other conditions as may be prescribed by the Minister.*
8. *The partners in an Unincorporated Partnership can make an application to the authority for the Unincorporated Partnership to be treated as a Taxable Person.*
9. *Where an application under Clause 8 of this Article is approved:*
  - (a) *The provisions of Clauses 1 to 6 of this Article shall no longer apply to the partners in the Unincorporated Partnership in respect of the business conducted by the Unincorporated Partnership.*
  - (b) *Each partner in the Unincorporated Partnership shall remain jointly and severally liable for the Corporate Tax Payable by the Unincorporated Partnership for those Tax Periods when they are partners in the Unincorporated Partnership.*
  - (c) *One partner in the Unincorporated Partnership shall be appointed as the partner responsible for any obligations and proceedings in relation to this Decree-Law on behalf of the Unincorporated Partnership.*
10. *Where the application under Clause 8 of this Article is approved, the Unincorporated Partnership shall be treated as a Taxable Person effective from the commencement of the Tax Period in which the application is made, or from the commencement of a future Tax Period, or any other date determined by the authority."*



#### **4.7-1 Overview**

Businesses use different ownership structures to undertake business activities. Such structures may include proprietorships, companies, etc. Sometimes, two or more independent parties come together and contribute their capital, knowledge, skill, experience, etc., to form an association for undertaking business activities.

Such a relationship established by contract between two or more persons, such as a partnership or trust or any other similar association of persons, in accordance with the applicable legislation of the UAE, is regarded as an ‘unincorporated partnership’. Such joint ventures and associations of persons are not incorporated; hence, they do not enjoy separate legal existence. In essence, such joint ventures and associations of persons are not partnership firms which are popular business structures in certain jurisdictions like India.

The CT Law accords pass-through status to unincorporated partnerships. An unincorporated partnership shall not be considered a taxable person in its own right, and persons conducting business as an unincorporated partnership shall be treated as individual taxable persons. This means that the partnerships will not be taxpayers in their own right, but their income will instead ‘flow through’ and be taxed in the hands of the partners or members only. This flow-through treatment is widely recognised and accepted internationally. It also ensures tax neutrality for investors in collective investment funds often structured as limited partnerships. However, such an unincorporated partnership shall also have the option to file an application with the FTA to treat the unincorporated partnership as a ‘taxable person’.

#### **4.7-2 Status of unincorporated partnership**

The unincorporated partnership is a pass-through entity under the CT Law. The income and expenditure of the unincorporated partnership shall be allocated to the partners proportionate to their ownership interest. However, the unincorporated partnership may exercise an option by filling an application to FTA to be treated as a taxable unit. The *Ministerial Decision No. 127 of 2023, dated 24 May 2023*, provides that the Unincorporated Partnership shall not be considered a taxable person in its own right, provided it is not a juridical person.

#### **4.7-3 Taxation of unincorporated partnership as a pass-through entity**

When the unincorporated partnership is granted transparent status, the partners shall be treated as conducting the business of the unincorporated partnership. The partners of the unincorporated partnership shall step into the shoes of the unincorporated partnership. The partners shall carry the same status, intention, and purpose of the unincorporated partnership. The assets held by the unincorporated partnership shall be considered as assets held by the partners. Further, the partners shall be considered a party to the arrangements or agreements in which the unincorporated partnership has entered into.

#### 4.7-3a Computation of taxable income

The assets, liabilities, income and expenditure of the unincorporated partnership shall be allocated to each partner in proportion to their share in that unincorporated partnership. However, if the share of partners is unidentified, the allocation shall be done in accordance with the manner prescribed by the FTA.

While computing the taxable income in the hands of the partner of the unincorporated partnership, the partner shall take into consideration the allocable proportionate expenditure incurred by the unincorporated partnership. Further, it would be allowed to deduct expenditures incurred directly by the partner in conducting the business of the unincorporated partnership and interest expenditures incurred by the partner in relation to contributions made to the capital account of the unincorporated partnership.

*Illustration*

Particulars	Amount in AED
Gross income of the unincorporated partnership	1,00,000
Expenditure incurred by the unincorporated partnership	45,000
Share of Mr. A in the unincorporated partnership	50%
Interest expenditure on funds borrowed by Mr. A to make capital contribution in the unincorporated partnership	20,000

Calculate the taxable income of Mr. A from the unincorporated partnership.

The income and expenditure proportionate to the ownership interest of Mr. A shall be taxed in the hands of Mr. A.

Particulars	Total	Allocable to Mr. A (50% share)
Gross income of the unincorporated partnership	1,00,000	50,000
Expenditure incurred by the unincorporated partnership	45,000	(22,500)
Net income of the unincorporated partnership	-	27,500
Interest on borrowing for capital contribution to the unincorporated partnership	-	(20,000)
<b>Net taxable income</b>	<b>-</b>	<b>7,500</b>

#### 4.7-3b No deduction for interest paid to the partners

While computing the income of the unincorporated partnership, the interest paid/payable to the partners of the unincorporated partnership shall not be allowed. The interest paid/payable to the partners shall be considered an allocation of profits and hence, shall not be a deductible expenditure for calculating the taxable income of the partner in the unincorporated partnership.



#### **4.7-3c Distribution of foreign tax credit**

If the unincorporated partnership derives income from foreign sources and the taxes are paid on such foreign income, the resultant foreign tax credit shall also be distributed amongst the partners proportionate to their ownership interest.

Illustration

Particulars	Amount in AED
Gross income of the unincorporated partnership from the UAE	1,00,000
Expenditure incurred by the unincorporated partnership in UAE (including interest paid to partner Mr. B AED 5,000)	45,000
Gross income of the unincorporated partnership from India	3,00,000
Expenditure incurred in India	2,50,000
Share of Mr. B in the unincorporated partnership	10%
Eligible foreign tax credit calculated as per Article 47	5,000

Calculate the taxable income of Mr. B from the unincorporated partnership.

Particulars	Total	Allocable to Mr. B (10% share)
Gross income of the unincorporated partnership from UAE	1,00,000	10,000
Expenditure incurred by the unincorporated partnership, excluding interest paid to Mr. B on capital contribution	(40,000)	(4,000)
Gross income of the unincorporated partnership from India	3,00,000	30,000
Expenditure incurred in India	(2,50,000)	(25,000)
Net taxable income from the unincorporated partnership	-	11,000
Corporate tax at 9% (assuming the other income is more than 3,75,000 AED and the income from the unincorporated partnership is subject to tax)	-	9,900
Foreign tax credit	5,000	(500)
Net tax payable	-	9,400

#### **4.7-3d Exclusion of income taxed in the hands of unincorporated partnership**

The *Ministerial Decision No. 134 of 2023* provides for other adjustments to be made to the accounting income to determine the taxable income of a partner in an unincorporated partnership.

Where the unincorporated partnership is treated as a taxable person, any income or loss arising to such unincorporated partnership shall be excluded from the taxable income of the partners. The adjustment ensures that partners are not subject to double taxation by excluding the income or loss already recognized at the partnership level from their individual Taxable Income. This treatment recognizes the pass-through nature of an Unincorporated Partnership, where the partnership's profits or losses flow to the partners, who are individually responsible for reporting and paying taxes on their respective shares.

The loss or gains arising on transfer, sale or disposal of the interest of the taxable person in an unincorporated partnership or part thereof shall be excluded from the taxable income of the partner on the satisfaction of conditions to Participation Exemption (*See Para 7.3*).

#### ***4.7-4 Taxation of unincorporated partnership as a taxable unit***

The partners in an unincorporated partnership can make an application to the FTA to tax the unincorporated partnership as a taxable person. On approval of the application, the unincorporated partnership shall be taxed on its own, and no taxable income shall arise to the partner. The unincorporated partnership shall constitute a taxable person effective from the commencement of the tax period in which the application is made or from the commencement of a future tax period or any other date determined by the FTA.

##### ***4.7-4a Conditions subsequent to approval of application***

Where an application for the unincorporated partnership to be treated as a taxable person in its own right is approved, the following shall apply:

- (a) The application shall be deemed irrevocable, except under exceptional circumstances and pursuant to the approval by the Authority;
- (b) The unincorporated partnership shall notify the Authority within 20 business days from the occurrence of any of the following circumstances:
  - ◆ Any partner joining the unincorporated partnership;
  - ◆ Any partner leaving the unincorporated partnership.

##### ***4.7-4b Liabilities of partners shall be joint, and several***

Even if the partnership is recognised as a taxable unit, the partners shall continue to be liable for the corporate tax liability of the unincorporated partnership. Each partner in the unincorporated partnership shall remain jointly and severally liable for the corporate tax payable by the unincorporated partnership for the tax periods when they are partners in the unincorporated partnership. The FTA can collect the tax from any one or more or all of the partners at its own option. The tax liability shall not be extended to the period during which the person was not a partner of the unincorporated partnership.



The partners shall designate one partner amongst themselves, who shall be responsible for any obligations and proceedings in relation to the CT Law on behalf of the unincorporated partnership. In case of any non-compliance, such designated partner shall be responsible.

#### ***4.7-5 Foreign Partnership***

A relationship established by contract between two persons or more, such as a partnership or trust or any other similar association of persons, in accordance with laws of a foreign jurisdiction shall be considered a foreign partnership. E.g. Joint Venture agreement executed amongst two UK residents in the UK or an Indian partnership firm, etc.

Investing in and through unincorporated partnerships in a cross-border context can create difficulties and unintended tax consequences where one country treats the partnership as a transparent entity, and the other country taxes the partnership as if it were a company. To align the tax treatment of partnerships in a cross-border context, the treatment of foreign unincorporated partnerships in the UAE CT Law would generally follow the tax treatment of the partnership in the respective foreign jurisdiction.

Such foreign partnership shall be treated as an unincorporated partnership for the purposes of the CT Law if the tax law applicable in foreign jurisdiction also accords the transparent status to such foreign partnership. Thus, if the foreign partnership is not a taxable unit under the laws of the foreign jurisdiction, each partner in the foreign partnership shall be individually subject to tax under the CT Law with regard to their distributive share of income as and when the income is received by or accrued to the foreign partnership.

Certain jurisdictions allow the limited liability corporations an option to tax as taxable units on their own or the partners/owners to be taxed in respect of their proportionate interest. If the foreign partnership opts to select pass-through status, and each partner/owner is taxed towards the proportionate income, the foreign partnership shall be regarded as an unincorporated partnership for the purpose of the CT Law. Further, the Minister may prescribe additional conditions to treat a foreign partnership as an unincorporated partnership for the purpose of the CT Law.

If the foreign partnership is considered as an unincorporated partnership under the CT Law, it may exercise the option to be treated as a pass-through entity or can be taxed on its own similar to the unincorporated partnership of UAE.

Further in this regard, as per the *Ministerial Decision No. 127 of 2023, dated 24 May 2023*, the following conditions have been prescribed for a foreign partnership to be treated as an unincorporated partnership:

- (a) The Foreign Partnership submits an annual declaration to the Authority to confirm meeting the following conditions as prescribed under Article 16(7) (a)/(b) of the Corporate Tax Law, in the form and manner and within the timeline prescribed by the Authority:

- ◆ The foreign partnership is not subject to tax under the laws of the foreign jurisdiction;
  - ◆ Each partner in the foreign partnership is individually subject to tax with regard to their distributive share of any income of the foreign partnership as and when the income is received by or accrued to the foreign partnership. This condition shall be deemed to be satisfied if the partners are subject to tax on their share of income from the foreign partnership in the jurisdiction where the partner holds tax residency.;
- (b) Adequate arrangements exist for cooperation between the State and the jurisdiction under whose applicable laws the foreign partnership was established for the purpose of sharing tax information of the partners in the foreign partnership.

The *Ministerial Decision No. 133 of 2023* has provided relief to Unincorporated Partnership in Business Restructuring (*see Para 8.3*). It provides that if an application has been made by an unincorporated partnership to be treated as a taxable person, there is no requirement to consider any gain or loss in determining taxable income. This applies regardless of whether the partners in the unincorporated partnership receive shares or ownership interests or if all partners in the unincorporated partnership are taxable persons. Therefore, even if there are transfers of shares or ownership interests within the unincorporated partnership, those transfers do not affect the calculation of taxable income in this particular scenario.

By exempting the consideration of gains or losses in determining Taxable Income, this provision simplifies the tax treatment for Unincorporated Partnerships that have elected to be treated as Taxable Persons. It provides a streamlined approach that avoids the need for complicated calculations related to gain or loss recognition within the partnership structure.

## 4.8 Article 17: Family Foundation

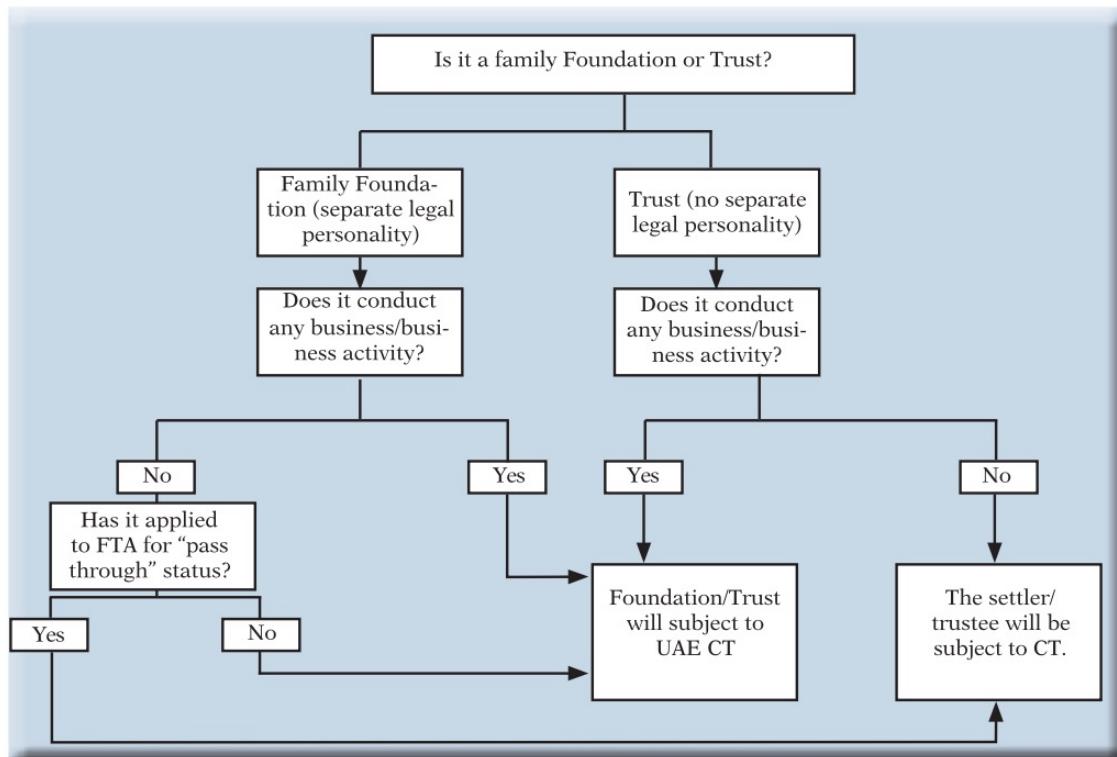
Article 17 reads as follows:

- "1. A Family Foundation can make an application to the authority to be treated as an Unincorporated Partnership for the purposes of this Decree-Law where all of the following conditions are met:
- (a) The Family Foundation was established for the benefit of identified or identifiable natural persons, or for the benefit of a public benefit entity, or both.
  - (b) The principal activity of the Family Foundation is to receive, hold, invest, disburse, or otherwise manage assets or funds associated with savings or investment.
  - (c) The Family Foundation does not conduct any activity that would have constituted a Business or Business Activity under Clause 6 of Article 11 of this Decree-Law had the activity been undertaken, or its assets been held, directly by its founder, settlor, or any of its beneficiaries.

- (d) The main or principal purpose of the Family Foundation is not the avoidance of Corporate Tax.
- (e) Any other conditions as may be prescribed by the Minister.
2. Where the application under Clause 1 of this Article is approved, the Family Foundation shall be treated as an Unincorporated Partnership effective from the commencement of the Tax Period in which the application is made, or from the commencement of a future Tax Period, or any other date determined by the authority.
  3. For the purposes of monitoring the continued compliance by a Family Foundation with the conditions of Clause 1 of this Article, the authority may request any relevant information or records from the Family Foundation within the timeline specified by the authority."

#### **4.8-1 Overview**

Generally, High Net-Worth Individuals ('HNIs') set up family trusts/foundations to hold the assets of the family for succession purposes. The family trust/foundation holds the assets for the benefit of the family members. The constitutional deed of the family foundation lays down the conditions regarding the use of the income for the benefit of the family members. Article 17 of the CT Law deals with the taxation of family foundations. It provides that the family foundation shall be taxed similarly to an unincorporated partnership on the satisfaction of prescribed conditions.



#### **4.8-2 Foundation v. Trusts**

Under the Civil Law, the concept of 'Foundation' is recognised, as compared to 'Trusts' recognised under the Common Law system. The Foundations have separate legal existence of their own; hence, they can be taxed independently. However, the Trusts are regarded as mere arrangements or contractual obligations with no independent existence. Such trusts are generally regarded as pass-through and transparent for taxation purposes.

#### **4.8-3 Taxation of family foundation as an independent juridical person**

Foundations and certain types of trusts are independent juridical persons with separate legal personalities and would *prima facie* be subject to UAE CT in their own right. However, these foundations can apply to be treated as transparent 'Unincorporated Partnerships' for UAE CT purposes, resulting in the founder/settlor and the beneficiaries of the trust being seen as owners of the assets held by the trust. This would prevent the income of the foundation or trust from attracting UAE CT.

Other types of trusts (for example, trusts established in DIFC or ADGM<sup>1</sup>) are the contractual relationship between two or more persons (e.g., the beneficiary, settlor, and trustee) and do not have separate legal personalities. These types of trusts will, by default, be treated as transparent vehicles for UAE CT purposes.

#### **4.8-4 Taxation of family foundation as a pass-through entity**

A family foundation can make an application to FTA to be treated as an unincorporated partnership if the conditions given below are satisfied.

The family foundation shall be treated as an unincorporated partnership effective from the commencement of the tax period in which the application is made or from the commencement of a future tax period or any other date determined by the FTA. The FTA may request any relevant information or records from the Family Foundation within the specified timeline to monitor continuous compliance with the prescribed conditions.

#### **4.8-4a Purpose**

The family foundation should be set up and established for the benefit of identified or identifiable natural persons, or for the benefit of a public benefit entity, or both. Only natural persons or public benefit entities can be beneficiaries in the family foundation, and any other person, *viz.* company, cannot be added as a beneficiary.

The beneficiary can be identified or identifiable. For example, would-be grandsons or daughters-in-law can be made beneficiaries in such a foundation.

---

1. 'DIFC' stands for Dubai International Financial Centre and 'ADGM' stands for Abu Dhabi Global Market.



#### **4.8-4b Principal Activity**

The principal activity of the family foundation should be to receive, hold, invest, disburse, or otherwise manage assets or funds associated with savings or investments. The family foundation may receive the assets from the founder or settlor. It may continue to hold it as per the direction of the founder/settlor specified in the constitution deed. The funds may be invested or managed by the family foundation. Any proceeds or income from the investment or sale of the investment may be disbursed to the beneficiaries.

#### **4.8-4c Business activity**

The family foundation does not conduct any activity that would have constituted a business activity under the CT Law had the activity been undertaken or its assets been held directly by its founder, settlor, or any of its beneficiaries. The family foundation merely invests the funds rather than utilising the same for the purpose of business activities.

#### **4.8-4d Main or Principal Purpose**

The main or principal purpose of the family foundation is not to avoid corporate tax but to set up for the benefit of the natural person or public benefit entity. If the main or principal purpose of the family foundation is to avoid corporate tax, then the benefit of the unincorporated partnership shall be denied.

#### **4.8-4e Any other condition**

The Minister may prescribe any other conditions, subject to which the family foundation shall be taxed, similar to unincorporated partnerships.

In this regard, *Ministerial Decision No. 127 of 2023* provides that the family foundation shall be taxed similarly to unincorporated partnerships if the following conditions are satisfied:

- (a) One or more of the beneficiaries are public benefit entities;
- (b) Such beneficiaries are not deriving income that would be deemed as taxable income in the event they had derived it in their own right; and
- (c) Where the condition specified in point (b) is not met, the deemed taxable income is distributed to the relevant beneficiaries within 6 months from the end of the relevant tax period.

#### **4.8-5 Taxation of beneficiaries if family foundation treated as a pass-through entity**

On satisfaction of the above conditions, the FTA may approve the application of the family foundation, and it may be treated as an unincorporated partnership. Accordingly, it shall be regarded as a pass-through entity, and the beneficiaries shall be taxed in respect of the income of the unincorporated partnership proportionate to their ownership interest.

While the intention under CT law is to accord pass-through status to a foundation, treating them similarly to an unincorporated partnership may pose some challenges. Creating a foundation aims to accumulate wealth and not distribute it immediately, like in an unincorporated partnership. Further, a foundation needs a mechanism as to who would do compliance – as founder or council members or beneficiaries. Most of the time, individual shares of beneficiaries may not be determined immediately. There needs to be a certainty that the distribution of capital by the foundation shall not be subject to CT. These aspects, if clarified, will make this taxation of foundation a lot more certain.



## CHAPTER

# 5

# Free Zone Person

### 5.1 Introduction

UAE is one of the attractive investment destinations for foreign investors, largely due to its favourable geographical location, progressive business regulations, and diverse talent pool.

Free Zones are an integral part of the UAE economy. They are very important for achieving the country's goal of encouraging foreign direct investment and enhancing the ease of doing business. When the CT regime was announced on 31st January 2022, the UAE Ministry of Finance confirmed its commitment towards the tax incentives available to Free Zones. The Ministry of Finance announced that they would honour the tax incentives available to entities in the Free Zones. While the Free Zones entities would be within the scope of CT Law, required to register under the said regime and file tax returns, they would be eligible for a 0% CT rate subject to the fulfilment of prescribed conditions. The conditions mainly include the 'Substance' requirement along with compliance with the arm's length principles.

Chapter 5 of the CT Law deals with the taxation of Free Zone Person. This Chapter comprises the following articles:

- (a) Article 18: Qualifying Free Zone Person
- (b) Article 19: Election to be subject to Corporate Tax

Article 18 contains conditions subject to which the Free Zone Person shall benefit from 0% tax rate from applicability of Corporate Tax. Article 19 grants the Free Zone Person an option to pay corporate rate tax under the CT Law.

On 3rd November 2023, UAE Ministry of Finance (MoF) released Cabinet Decision No. 100 of 2023 on Determining Qualifying Income, and Ministerial Decision No. 265 of 2023 on Qualifying Activities and Excluded Activities. Both Decisions are retroactively effective from 1st June 2023, and replace previous Decisions *i.e.* Cabinet Decision No. 55 of 2023 and Ministerial Decision No. 139 of 2023 in the context of Free Zone Persons.

### 5.2 Article 18: Qualifying Free Zone Person

Article 18 reads as follows:

*"1. A Qualifying Free Zone Person is a Free Zone Person that meets all of the following conditions:*

- (a) Maintains adequate substance in the State.*

- (b) Derives Qualifying Income as specified in a decision issued by the Cabinet at the suggestion of the Minister.
- (c) Has not elected to be subject to Corporate Tax under Article 19 of this Decree-Law.
- (d) Complies with Articles 34 and 55 of this Decree-Law.
- (e) Meets any other conditions as may be prescribed by the Minister.
  - 1. A Qualifying Free Zone Person that fails to meet any of the conditions under Clause (1) of this Article at any particular time during a Tax Period shall cease to be a Qualifying Free Zone Person from the beginning of that Tax Period.
  - 2. Notwithstanding Clause (2) of this Article, the Minister may prescribe the conditions or circumstances under which a Person may continue to be a Qualifying Free Zone Person, or cease to be a Qualifying Free Zone Person from a different date.
  - 3. The application of paragraph (a) of Clause (2) of Article 3 of this Decree-Law to a Qualifying Free Zone Person shall apply for the remainder of the tax incentive period stipulated in the applicable legislation of the Free Zone in which the Qualifying Free Zone Person is registered, which period may be extended in accordance with any conditions as may be determined in a decision issued by the Cabinet at the suggestion of the Minister, but any one period shall not exceed (50) fifty years."

### **5.2-1 Overview**

Article 18 of the CT Law provides as under:

- (a) Qualifying Free Zone Person shall be eligible to claim relief from the applicability of the corporate tax;
- (b) If the Free Zone Person fails to meet any of the prescribed conditions, it shall be ineligible to claim the benefit of exemption from the beginning of the relevant tax period;
- (c) The benefit shall be available for the remainder of the tax incentive period stipulated in the applicable legislation of the Free Zone in which the Qualifying Free Zone Person is registered.

A branch of a foreign company registered with a free zone in UAE could opt to be treated as a free zone person. Similarly, as per the explanatory guide to CT, a branch of a mainland company can also opt to be treated independently as a free zone person.

### **5.2-2 Taxation of Free Zone Persons**

Article 3 of the CT Law levies the corporate tax on the taxable income of the taxable person. Accordingly, the qualifying income of the Qualifying Free Zone Person shall be subjected to 0% CT, whereas non-qualifying income shall attract CT



at a regular rate of 9%. Accordingly, the qualifying income of the Qualifying Free Zone Person shall be subjected to 0% CT, whereas non-qualifying income shall attract CT at a regular rate of 9%.

<i>Income of Qualifying Free Zone Person</i>	<i>Tax Rate</i>
Qualifying Income	0%
Non-qualifying income	9%

### ***5.2-3 Condition to qualify as Free Zone Person***

Article 18 prescribes conditions subject to which the Free Zone Person shall qualify as a 'Qualifying Free Zone Person'.

#### ***5.2-3a Adequate substance***

The Free Zone Person shall qualify only if it has adequate substance in the Free Zone or Designated zone. *Cabinet Decision No. 100* prescribes what would be considered from a 'adequate substance' perspective. The following four specific aspects need to be evaluated:

##### *(a) Core income-generating activity*

Free Zone Person must undertake core income-generating activities in Free Zone or Designated zone depending on the activity to be conducted. Core income-generating activity means activities which consist of significant functions that contribute substantially to the business value for each activity and are not predominantly support activities.

##### *(b) Employees*

Free Zone Person should employ an adequate number of full-time qualified and experienced personnel who are physically present in the Free Zone to provide the specified services. The profile of the employees, *viz.*, number of employees, their experience, education, and qualification, can be relevant to examine the substance of the activities.

##### *(c) Assets*

Few commercial activities like manufacturing and provision of services require high-end technological plants and machinery, computers, or other equipment. To establish the substance, the taxable person should employ adequate physical assets in the Free Zone Area depending upon the nature and level of business activities.

##### *(d) Operating expenditure*

To demonstrate substance, Free Zone Person should incur an adequate amount of operating expenditure corresponding to the business activities for the relevant period. *Examples of operating expenditures*, payroll, sales commissions, administrative expenses, transportation and travel costs, amortisation and depreciation and rent.

(e) *Adequate Supervision*

A Free Zone Person can outsource its core income generating activities to another person in a Free Zone or Designated Zone depending on where such activities are required to be conducted, provided the Qualifying Free Zone Person has adequate supervision of the outsourced activity. Free Zone Persons can outsource core income-generating activities related to Qualifying Intellectual Property to any person within the UAE or to non-related parties outside the UAE provided they maintain adequate supervision of the outsourced activity.

*For example*, Z FZE is engaged in distribution activities in Free Zone. It out-sources distribution activities to 'X FZE' (Third Party) without any adequate supervision or assets to undertake manufacturing activities. As the test of 'adequate supervision of outsourced activity' is missing, it falls short of the 'Substance Test'. Consequently, 'Z FZE' will not be able to avail Free Zone benefit of 0%.

### **5.2-3b Specified qualifying income**

The Free Zone Person should be earning a specified qualifying income.

### **5.2-3c Arm's Length Pricing and Transfer Pricing Provisions**

Free Zone persons would be required to adhere to the arm's length principle and maintain adequate transfer pricing documentation providing disclosure of transactions with related parties and connected persons.

### **5.2-3d Not subjected to Corporate Tax**

Free Zone Person has the option to pay corporate tax on its taxable income under normal provisions. The Free Zone Person should not elect to be subjected to corporate tax to remain a 'Qualifying Free Zone Person'.

### **5.2-3e Other conditions as may be prescribed**

As per *Ministerial Decision No. 265*, a Qualifying Free Zone Person must meet the following two conditions:

- (a) Its non-qualifying Revenue does not exceed the *de minimis* requirements;
- (b) It prepares audited financial statements in accordance with IFRS.

Subject to fulfilment of all the above conditions, the Qualifying income of the Qualifying Free Zone Person shall be subjected to 0% Corporate Tax.

The *Cabinet Decision No. 100 of 2023* was issued on determining Qualifying Income for the Qualifying Free Zone Person. The Ministry of Finance issued the *Ministerial Decision No. 265 of 2023* regarding Qualifying Activities and Excluded Activities for the Purposes of the CT Law. Both Decisions should be read in conjunction to obtain a full understanding of the rules.



### **5.2-4 De Minimis Requirement**

The *de minimis requirements* shall be considered satisfied where the non-qualifying Revenue derived by the Qualifying Free Zone Person in a Tax Period does not exceed the lower of the following:

- (a) 5% of the total Revenue of the Qualifying Free Zone Person in that Tax Period; or
- (b) 5 Millions AED.

The following Revenue shall not be included in the calculation of non-qualifying Revenue and Total Revenue:

- (a) Revenue attributable to immovable property located in a Free Zone derived from the transactions with Non-Free Zone Persons in respect of Commercial Property and transactions with any person in respect of immovable property that is not a Commercial Property;
- (b) Revenue attributable to a Domestic Permanent Establishment or a Foreign Permanent Establishment of the Qualifying Free Zone Person.
- (c) Revenue derived from the ownership or exploitation of intellectual property except for revenue related to Qualifying income from ownership or exploitation of Qualifying Intellectual Property.

For the purposes of this Article, a Qualifying Free Zone Person and its Domestic Permanent Establishment or Foreign Permanent Establishment shall be treated as if the establishment was a separate and independent Person that is a Related Party of the Qualifying Free Zone Person.

### **5.2-5 Qualifying Income**

Qualifying Free Zone Person deriving the following categories of income will be considered as having "Qualifying Income" for the purpose of availing benefit under the Corporate Tax Law.

#### ***5.2-5a Income derived from other free zone persons***

Income derived from transactions with other Free Zones Persons shall be considered qualifying income if such free zones person is a beneficial recipient of the relevant goods or services and such income is not derived from Excluded Activities.

A beneficial recipient is a person who has the right to use and enjoy the service or the goods and does not have a contractual or legal obligation to supply such goods or services to another person.

"Good" shall mean tangible or intangible property that has economic value in dealing, including movable and immovable property.

#### ***5.2-5b Income derived from non-free zone persons***

Income derived from transactions with Non-Free Zone Person shall be considered qualifying income only in respect of Qualifying Activities that are not Excluded Activities.

### **5.2-5c Income Derived from Qualifying Intellectual Property**

Income derived from the ownership or exploitation of Qualifying Intellectual Property in a relevant tax period shall be considered qualifying income. Qualifying Intellectual Property has been defined in Cabinet Decision No. 100 of 2023, as patents, copyrighted software and any right functionally equivalent to a patent but does not include any marketing related intellectual property assets, such as trademarks. The methodology for calculating Income derived from qualifying Intellectual property is defined under para 5.2-13.

### **5.2-5d Any other Income that fulfils the *de minimis* requirement**

Any other income derived by qualifying free zones person in a relevant tax period shall be considered qualifying income if it fulfils the *de minimis* requirement (*see Para 5.2-4*).

### **5.2-6 Non-Qualifying Revenue**

The following income will be considered as non-qualifying Revenue:

- (a) Income earned from excluded activities;
- (b) Income earned from activities other than "Qualifying activities" if it is earned from a Non-Free Zone Person.
- (c) Transactions with a Free Zone Person where such Free Zone Person is not the Beneficial recipient of the relevant services or Goods.

Further, in the following cases, a Free Zone Person will be subject to corporate tax at the rate of 9% without availing basic exemption limit of AED 375,000:

- (a) Income attributable to Domestic or Foreign Permanent Establishment (branches in Mainland or in a foreign country) of the Qualifying Free Zone Person;
- (b) Income earned from a Non-Free Zone person in respect of commercial property situated in a Free Zone.
- (c) Income earned from any person in respect of immovable property that is not a Commercial property situated in a Free Zone.

### **5.2-7 Qualifying Activities**

A list of qualifying activities shall be as under:

Sr. No.	Goods	Services	Others
1	Manufacturing of goods or materials	Ownership, management & operation of Ships	Holding of shares and other securities for investment purpose if it is held for uninterrupted 12 months period

Sr. No.	Goods	Services	Others
2	Processing of goods or materials	Reinsurance services, if subject to regulatory oversight	
3	Distribution of goods or materials in or from a "Designated Zones"*	Fund management services, if subject to regulatory oversight	
4	Trading of Qualifying Commodities	Wealth and investment management services, if subject to regulatory oversight	
5		Headquarter services to Related Parties.	
6		Treasury and financing services to Related Parties	
7		Financing and leasing of Aircraft, including engines and rotatable components	
8		Logistics services	
Any activities ancillary to all listed activities which serve no independent function but are necessary for the performance of the main Qualifying Activity.			

\*The list of Designated Zones as per VAT law is given below-

Dubai	Abu Dhabi	Ras Al Khaimah	Others
Jebel Ali FZ (North-South)	Free Trade Zone of Khalifa Port	RAK Port FZ	Sharjah
Dubai Cars and Automotive Zone.	Abu Dhabi Airport FZ	RAK Maritime City FZ	Hamriyah FZ
DAFZA Industrial Park FZ - Al Qusais	Khalifa Industrial Zone	Al Hamra Industrial Zone - FZ	Sharjah Airport International FZ
Dubai Aviation City	Al Ain International Airport FZ	Al Ghail Industrial Zone-FZ	Fujairah
Dubai Airport FZ	Al Butain International Airport FZ	Al Hulaila Industrial Zone - FZ	Fujairah FZ

<i>Dubai</i>	<i>Abu Dhabi</i>	<i>Ras Al Khaimah</i>	<i>Others</i>
International Humanitarian City- Jebel Ali			Fujairah Oil Industry Zone
Dubai Commer City			Umm Al Quwain
			Umm Al Quwain Free Trade Zone in Ahmed Bin Rashid Port
			Umm Al Quwain Free Trade Zone on Sheikh Mohammed Bin Zayed Road
			Ajman
			Ajman FZ

### ***5.2-8 Excluded Activities***

A list of excluded activities is as follows:

- (a) Any Transaction with Natural Persons (other than Services as covered in above points 1,3,4,7 in the Qualified Activities);
- (b) Banking activities, if subject to regulatory oversight;
- (c) Insurance activities, if subject to regulatory oversight;
- (d) Finance and leasing activities, if subject to regulatory oversight (other than services as covered in above points 1, 6 & 7 in the Qualified Activities);
- (e) Ownership or exploitation of immovable property, other than Commercial Property located in a free zone where the transaction in respect of such Commercial Property is conducted with other Free Zones Persons;
- (f) Any activities ancillary to the activities listed above.

All the activities which are mentioned above are further explained as under:

- 1. The manufacturing process** involves the production, improvement, or assembly of products and materials, from raw materials or components.
- 2. Processing goods or materials** encompasses activities such as preparation, treatment, transformation, or conversion, of goods or materials into another form of product or material intended for commercial or industrial use or sale.
- 3. Income derived from the Trading of Qualified Commodities** shall be considered qualifying income where income is derived from physical trading of metals, minerals, energy and agricultural commodities in raw form that



are traded on a recognized commodities exchange, as well as the associated derivative trading used to hedge against, the risk of such trading activities.

- 4. The holding of shares and securities** for investment purposes includes:
  - a. Ownership of shares in the share capital of another entity or other equitable interests conferring profit and liquidation entitlements, whether as a legal or beneficial owner.
  - b. Possession of negotiable or non-negotiable financial instruments, including derivatives, financial commodities, and other tradable or convertible investment instruments, excluding those issued in securitization of non-financial asset receivables.

Note: For shares and securities to be considered as a held for investment, an interrupted period of at least 12 months is required.

- 5. Ownership, management and operation of Ships** includes the ownership, management and operation of Ships used in the international transportation of passengers, goods or livestock, towing activities and the provision of general assistance to Ships at sea, dredging activities at sea, and leasing and chartering of Ships on a bareboat basis used in the international transportation of passengers, goods or livestock. This activity shall not include Ships used for local transportation or leisure or recreational purposes, or as floating hotels, restaurants or casinos.
- 6. Fund management services** includes the activities of portfolio management, risk management, discretionary and non-discretionary fund management services and other services relating to the day-to-day management and operation of an investment fund by a fund manager that is appointed by the fund or its investors, including those activities that are delegated by an investment fund or its fund manager to an investment advisor or sub-advisor, that are subject to the regulatory oversight of the Competent Authority in the State.
- 7. Wealth and investment management services** includes the activities of providing discretionary and non-discretionary investment management and advisory services, portfolio management and wealth and investment advisory services, that are subject to the regulatory oversight of the Competent Authority in the State.
- 8. Headquarter services to Related Parties** includes the administering, overseeing and managing of Business Activities of Related Parties, including the provision of senior and general management, captive insurance services, administrative services, procurement services, business planning and development, risk management, coordination of group activities, and in general incurring expenditures on behalf of Related Parties and providing other support services to Related Parties.

9. **Treasury and financing services to Related Parties** includes the provision of cash and liquidity management, financing, debt management, and financial risk management and related advisory services to Related Parties, including centralised payment and collection activities for or on behalf of Related Parties.
10. **Financing and leasing of Aircraft** includes the financing, leasing and securitisation of the financing and leasing of Aircraft, Aircraft engines or rotatable components, granting the right to use Aircraft, Aircraft engines or rotatable components in exchange for rental or other consideration pursuant to a finance lease, operating lease or other arrangement and related advisory and agency services for the procurement, sale or leasing of Aircraft, Aircraft engines or rotatable components undertaken by the Qualifying Free Zone Person.
11. **Distribution of goods or materials in or from a Designated Zone**, includes the buying and selling of goods, materials, component parts or any other items that are tangible or movable and may include the importation, storage, inventory management, handling, transportation and exportation of those goods or materials to a customer that resells such goods or materials, or parts thereof or processes or alters such goods or materials or parts thereof for the purposes of sale or resale, provided such activities are conducted in or from a Designated Zone and the goods or materials entering the State are imported through the Designated Zone.
12. **Logistics services** includes the storage and transportation of goods or materials on behalf of another Person without taking title to the good or material of that other Person, including cargo handling, warehousing, container storage, transport agency services, customs brokerage services, order and inventory management, freight forwarding and brokerage services, document preparation, packing and unpacking and other related services.
13. **Banking activities** means the regulated financial activities specified under Article 65 of Federal Decree-Law No. 14 of 2018.
14. **Insurance activities** means insurance operations that are regulated under Federal Law No. 6 of 2007.
15. **Finance and leasing activities** means the provision of credit or financing for any kind of consideration, and the letting or otherwise granting the right to use an asset in exchange for rental or other consideration pursuant to a finance lease, operating lease or other arrangement, that are subject to the regulatory oversight of the Competent Authority in the State.
16. **An activity shall be considered ancillary** where it is necessary for the performance of the main activity or where it makes a minor contribution to it and is so closely related to the main activity that it should not be regarded as a separate activity.



### **5.2-9 Implications of cessation of status as a Qualifying Free Zone Person**

A Qualifying Free Zone Person who fails to meet any of the above conditions at any time during a tax period shall lose the exemption. Such Free Zone Person shall cease to be a Qualifying Free Zone Person from the beginning of that tax period and shall be taxed at a rate of 9% on the taxable income.

As per *Cabinet Decision 100 read with Ministerial Decision 265*, a Qualifying Free Zone person will cease to qualify for the status of free zone for a period of 4 years and will be treated ordinary taxable person and corporate tax at the rate of 9% will apply to all of his income after applying threshold limit of AED 375,000 in case of the following:

- (a) Non-Qualifying Revenue earned during the relevant tax period exceeds the *de minimis requirement*, which is lower of AED 5 million or 5% of the Total Revenue;
- (b) Fails to prepare and maintain audited financial statements for the purpose of the Corporate Tax Law; and
- (c) Fails to meet any of the conditions set out in Article 18(1).

### **5.2-10 Exemption Period**

A Qualifying Free Zone Person shall be eligible for the exemption for the remainder of the tax incentive period stipulated in the applicable legislation of the Free Zone in which the Qualifying Free Zone Person is registered. However, such period may be extended in accordance with any conditions as determined by the Cabinet at the suggestion of the Minister. However, such a period shall not exceed fifty years.

### **5.2-11 Cost-benefit Analysis**

A Free Zone person has the option to elect to be taxed as per the normal provisions. Free Zone companies, especially ones that are part of large groups, would have to carefully evaluate the pros and cons of opting out of the exemption, as it is a one-time option.

Further, the cost-benefit analysis should be done on other factors like the Qualifying Free Zone persons would be required to adhere to the arm's length principle and maintain adequate transfer pricing documentation providing disclosure of transactions with related parties and connected persons. The Qualifying Free Zone persons cannot be part of tax groups (*See Para 12.2*) and are also not eligible for tax relief on intra-group transfers and restructuring. Also, the transfer of tax loss (*See Para 11.3*) to or from a Free Zone person is not permissible. Since the Qualifying income of the Qualifying Free Zone Person is not subject to corporate tax in the UAE, the foreign tax credit (*See Para 13.6*) shall lapse.

As per Federal Decree-Law No. 60 of 2023 issued, Qualifying Free Zone Entities that are part of a large multinational group are anticipated to be subject to an

effective tax rate of 15% once the Pillar Two rules are embedded into the UAE CT regime.

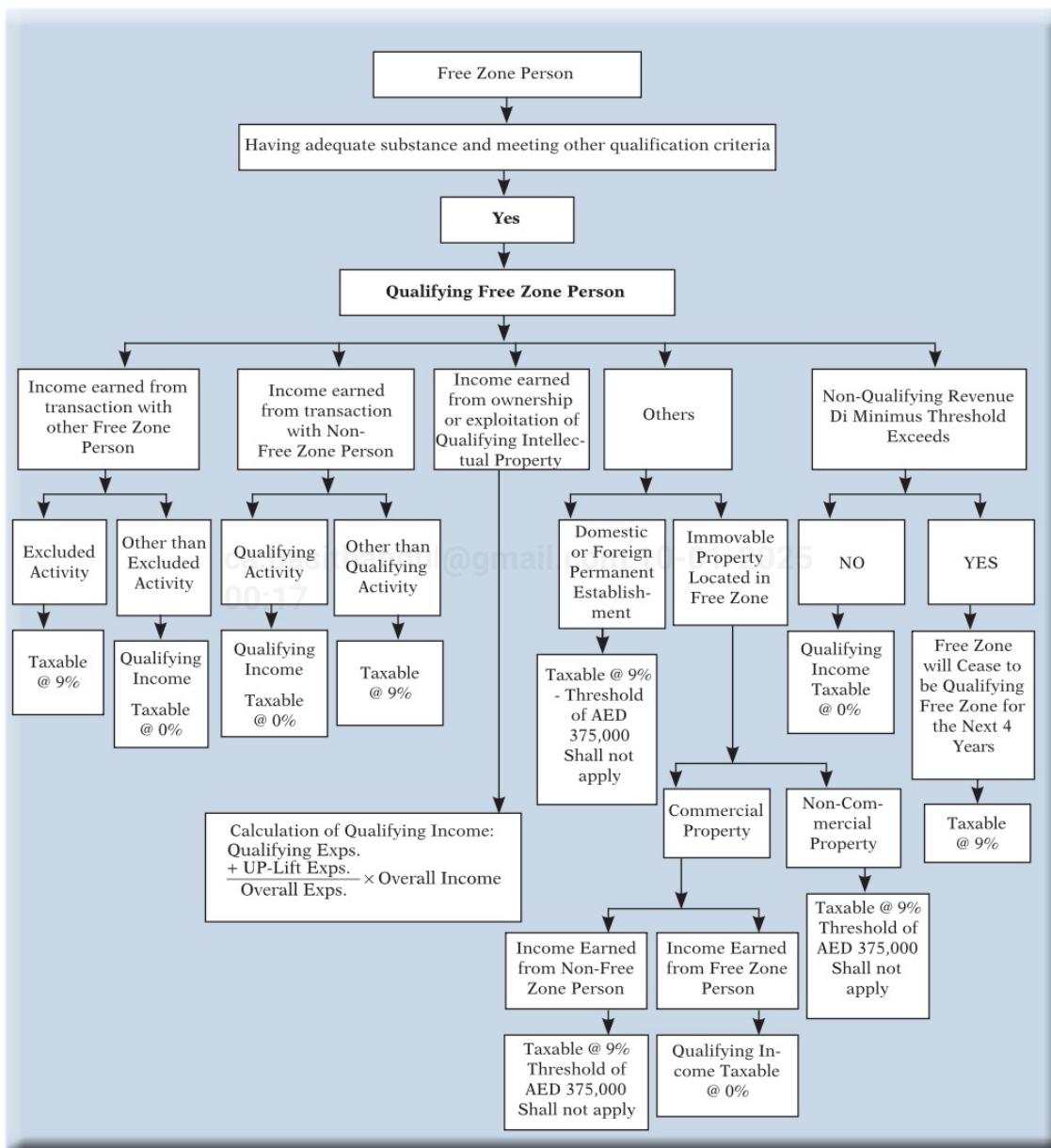
### ***5.2-12 Income Derived from Qualifying Intellectual Property***

Qualifying Income derived from the ownership or exploitation of Qualifying Intellectual Property (Such as patents, copyrighted software and any right functionally equivalent to a patent but does not include marketing related intellectual property assets, such as trademarks) shall be calculated as under:

$$\text{Qualifying Income} = \frac{\text{Qualifying Expenditures} + \text{Up-lift Expenditures}}{\text{Overall Expenditures}} \times \text{Overall Income}$$

- a. 'Qualifying Expenditures' means expenditures incurred to fund research and development activities, conducted either by the Qualifying Free Zone Person or outsourced to any Person in the State or any Person outside the State that is not a Related Party, directly connected with the creation, invention or significant development of the Qualifying Intellectual Property.
- b. 'Overall Expenditures' means total expenditures incurred to fund research and development activities, conducted either by the Qualifying Free Zone Person or outsourced to any Person, directly connected with the creation, invention or significant development of the Qualifying Intellectual Property, including acquisition costs of the Qualifying Intellectual Property.
- c. 'Overall Income' means royalties or any other income derived from Qualifying Intellectual Property as determined according to the provisions of the Corporate Tax Law, including embedded intellectual property income derived from the sale of products and the use of processes directly related to the Qualifying Intellectual Property as determined in accordance with the arm's length principle under Article 34 of the Corporate Tax Law.
- d. 'Uplift Expenditures" means the Qualifying Expenditure increased by 30% (thirty per cent), subject to the application of Clause (3) of this Article.
- e. The Up-lift Expenditures shall be applicable only to the extent that Qualifying Expenditures, after being up-lifted is less than or equal to Overall Expenditures.
- f. For the purposes of determining what income from Qualifying Intellectual Property is to be considered Qualifying Income, the Qualifying Free Zone Person must maintain all records, books and documents that prove the following and make them available to the Authority:
  - a. Ownership and the right to exploit the Qualifying Intellectual Property
  - b. Qualifying Expenditures and Overall Expenditures incurred
  - c. Overall Income derived from the Qualifying Intellectual Property.
  - d. The link between Qualifying Expenditures and Overall Income derived from Qualifying Intellectual Property.

There has been a significant change, at first all intellectual property income was part of Excluded activities. Now genuine research expense to develop and register Patents will get the benefit of 0% tax rate. It specifically excludes trade related IP and hence eligible free zone companies that can take the benefit will be limited.



### 5.2-13 Corporate Tax Guide on Free Zone Person

A corporate tax guide has been issued on Free Zone Person by the FTA. This guide offers comprehensive guidance and clarity on various technical aspects for entities conducting business in a Free Zone in the UAE. It is designed to be read alongside the relevant articles of the UAE Corporate Tax Law, implementing decisions, and other guidance published by the FTA.

**Below are some of the key highlights from the CT guide for Free Zone entities:**

<b>Confirmation from Free Zone Authority:</b>	Every Free Zone person should <b>check with their respective Free Zone Authority</b> to confirm if they operate in a Free Zone or Designated Zone to avail the benefit of CT @ 0%. There is no separate list of Free Zones/Designated Zones issued for CT purposes.
<b>Election:</b>	<ul style="list-style-type: none"> <li>(i) A Free Zone Person will be <b>deemed to be a Qualifying Free Zone Person (QFZP)</b> unless they fail to meet one of the QFZP conditions or elect to be subject to tax.</li> <li>(ii) A QFZP that elects to be subject to standard CT (<i>i.e.</i> 9%), or fails to meet the QFZP criteria for a specific Tax Period, <b>will lose its QFZP status</b> starting from the beginning of the Tax Period in which it elects to pay CT or fails to meet the criteria, as well as for the following four Tax Periods. After this period, <b>a new election can be made</b> if the entity wishes to continue not being treated as a QFZP unless it no longer meets the criteria of QFZP in a particular tax period.</li> <li>(iii) The said election can be made at any point during the Tax Period in question or in the subsequent Tax Return after the Tax Period ends. This election <b>cannot be made after the tax return filing deadline</b> for the concerned tax period.</li> </ul>
<b>Allocation of expenses:</b>	If a Free Zone Person generates both Qualifying Income and Taxable Income (for example, income attributable to its Foreign Permanent Establishment or Domestic Permanent Establishment), it must <b>allocate expenses between the two</b> and also maintain sufficient documentation that the profits attributed are commensurate with the functions performed, assets used, and risks based on the arm's length principle.
<b>Transaction between free zone persons:</b>	In case of Qualifying Income derived from transactions between Free Zone Persons, the seller may obtain a <b>written statement or undertaking from the purchaser</b> affirming their role as a Beneficial Recipient and their intention to utilize the services or goods for their free zone business.
<b>No income during start up phase:</b>	A Free Zone Person who <b>hasn't earned any Qualifying Income</b> in a Tax Period because they haven't commenced revenue generation <b>won't lose eligibility as a QFZP</b> , as long as they do not derive any non-qualifying revenue and fulfil all other obligations outlined in the CT Law.
<b>Treatment of Tax losses:</b>	<ul style="list-style-type: none"> <li>(i) Tax Losses incurred by a QFZP on their Taxable Income can be carried forward to offset against future Taxable Income, except for income from intellectual property.</li> <li>(ii) <b>Losses related to Qualifying Income cannot be used to offset taxable income, transferred, or carried forward.</b> Further, QFZPs cannot transfer or receive Tax Losses from other Taxable Persons.</li> </ul>

<b>Outsourcing of core income generating activity:</b>	In case a Free Zone Person outsources a core income-generating activity to another entity within a Free Zone or Designated Zone, adequate supervision over the activity by the Free Zone Person is important where it should be capable of overseeing and controlling the activity adequately, and ensuring that the resources of the entity performing the activity are sufficient for the specific services rendered to the Free Zone Person, without any duplication of assets, employees, or expenses across multiple Free Zone Persons. <b>For distribution activity, core income generating activity must be outsourced within a designated zone.</b>
<b>Treatment of Mixed use property:</b>	In the case of a <b>hotel building in a Free Zone, revenue allocation between commercial and non-commercial units should be determined.</b> This allocation can be based on the records of the land registry department or alternative methods like rental or property value. The aim is to achieve a fair and reasonable arm's length allocation considering the specifics of each case. Generally, retail outlets and restaurants are classified as commercial units, while rooms, conference rooms, and banquet halls are considered non-commercial units.
<b>Ancillary activities:</b>	Qualifying Activities include ancillary activities, which are those necessary for the performance of the main activity or contributing minorly to the main Qualifying Activity and are closely related to it. <b>If an ancillary activity is conducted independently of the main Qualifying Activity, it will not be considered a Qualifying Activity.</b> Determining whether an activity is ancillary depends on the specifics of the main Qualifying Activity conducted by the Free Zone Person and will be assessed based on the particular facts and circumstances of the case.
<b>Income from Qualifying Intellectual Property:</b>	<p>(i) In order to benefit from the 0% rate on Qualifying income from Qualifying Intellectual property, a QFZP must be able to <b>demonstrate a nexus between Qualifying expenditure and income</b> from Qualifying Intellectual Property. In such cases, a QFZP must set up an appropriate tracking system in order to avail the benefit.</p> <p>(ii) While calculating the Qualifying income from Intellectual Property, the sum of Qualifying expenditure and Uplift expenditure shall be lower of the following—</p> <ul style="list-style-type: none"> <li>◆ 130% of Qualifying Expenditure</li> <li>◆ Overall Expenditures</li> </ul>
<b>Compliances:</b>	<p>(i) A QFZP is <b>not required to prepare separate Financial Statements</b> for its Qualifying Income and its other income and should have sufficient documentation to demonstrate the calculation of Qualifying Income.</p> <p>(ii) A QFZP is <b>not required to prepare separate Financial Statements for any of its branches.</b></p>

**Here are the main highlights from this CT guide regarding Qualifying activities:**

<b>1. Manufacturing of goods or materials:</b>	<p>(i) <b>Activities that might be considered ancillary</b> to the Qualifying Activity of manufacturing goods or materials, provided they naturally and integrally complement the main Qualifying Activity and meet the conditions for ancillary activities, <b>include post-sale activities and customer support</b>. Also, manufacturing does not include repairs.</p> <p>(ii) Intangible items like software, which can be sold independently of a physical asset, are not considered goods under the definition for this Qualifying Activity. Therefore, the creation of software, ERPs, automation tools, and similar items will not be classified as the manufacturing of goods or materials. However, Software embedded in hardware (<i>i.e.</i> it is inherently part of the hardware) generally would be considered as goods.</p> <p>(iii) Goods that are manufactured in the UAE do not need to pass through a Designated Zone, however, the distribution activity is required to be conducted in or from a Designated Zone in order to be a Qualifying Activity. However, <b>the question remains unresolved as to whether a manufacturer producing goods or materials within a free zone, which isn't designated as such, would have their distribution activities from that free zone considered as Qualifying activities.</b></p>
<b>2. Trading of Qualifying Commodities:</b>	<p>(i) Qualifying Commodities encompass metals, minerals, energy, and agricultural products traded in their raw form on a <b>Recognized Commodities Exchange Market</b>. Recognized Commodities Exchange Market means the following—</p> <ul style="list-style-type: none"> <li>◆ Markets that are established in the UAE and licensed and regulated by the relevant authorities (such as Central Bank of the UAE, the Dubai Financial Services Authority of the Dubai International Financial Centre (DFSA), the Financial Services Regulatory Authority of the Abu Dhabi Global Market (FSRA), or the Securities and Commodities Authority (SCA). For example, the Dubai Gold &amp; Commodities Exchange in the UAE) or</li> <li>◆ Markets are of equal standing if established outside the UAE (such as the Chicago Board of Trade, and the London Metal Exchange).</li> </ul> <p>(ii) The Qualifying Commodity needs to be in a form that is traded on a Recognised Commodities Exchange Market. Metals, minerals, energy, and agriculture commodities that are traded on a Recognised Commodities Exchange Market will be deemed to be in raw form when they meet the conditions to be traded on the said exchange (for example, gold being 99.4% purity in bullion form). <b>The trade itself does not need to be performed through an exchange.</b></p>

	<ul style="list-style-type: none"> <li>(iii) Raw form refers to commodities in their natural, unprocessed state, with no added value, traded on recognized commodities exchange markets before any processing or transformation.</li> <li>(iv) Under agricultural commodities it includes products like wheat, corn, and soybeans.</li> <li>(v) Under Energy commodities it includes crude oil and natural gas.</li> <li>(vi) Under Metals it includes items like gold, silver bars, and aluminum ingots.</li> <li>(vii) While many commodities are traded in their raw form, it is important to recognize that some degree of processing may be required to meet the trading standards or specifications necessary for trading on a Recognized Commodities Exchange Market.</li> <li>(viii) <b>The HSN code can help verify whether a commodity still retains its raw form.</b></li> </ul>
<b>3. Holding of shares and other securities for investment purposes:</b>	<ul style="list-style-type: none"> <li>(i) The active trading of shares and other securities would not constitute a Qualifying Activity.</li> <li>(ii) If the intention to hold can be demonstrated for an uninterrupted period of at least 12 months, Shares and other securities shall be deemed to be held for investment purposes and accordingly benefit shall be available.</li> <li>(iii) Income derived from <b>securities backed by receivables from non-financial asset is excluded from the Qualifying Activity</b>. However, <b>securities backed by receivables from a financial asset will be considered under Qualifying Activity</b>.</li> </ul>
<b>4. Ownership, management and operation of ships:</b>	<ul style="list-style-type: none"> <li>(i) Ships used for local transportation or leisure or recreational purposes, or as floating hotels, restaurants or casinos is not considered under Qualifying Activity.</li> <li>(ii) Business consisting solely of maintenance, fit-out or repairing ships will not be considered as a Qualifying Activity.</li> <li>(iii) It also does not include the leasing of shipping containers, unless that activity is ancillary to a shipping business.</li> </ul>
<b>5. Fund management services and Wealth and investment management services:</b>	<ul style="list-style-type: none"> <li>(i) Fund management services and Wealth and investment management services will be <b>considered as Qualifying Activities if they are subject to the regulatory oversight of the relevant Competent Authority in the UAE</b>. The following shall be considered as Competent Authority in the UAE:— <ul style="list-style-type: none"> <li>a. Central Bank of the United Arab Emirates</li> <li>b. The Dubai Financial Services Authority</li> </ul> </li> </ul>

	<p>c. The Financial Services Regulatory Authority of the Abu Dhabi Global Market or</p> <p>d. The Securities and Commodities Authority</p> <p>(ii) <b>Single Family Office and Multi Family Office would not be considered under Qualifying Activity of wealth and investment management services if it is not appropriately regulated by a relevant Competent Authority.</b></p>
<b>6. Treasury and financing services to related parties:</b>	<p>(i) Under this activity, the definition of Related Parties includes Domestic Permanent Establishments and self-investment. Income from investment of surplus funds such as Interest from bank deposits, will be treated under Qualifying Activity as it will be considered as Treasury and Financing services to oneself.</p> <p>(ii) The activity of Treasury and Financing is widely defined and includes cash pooling, cash management, risk management, investment management and financing.</p>
<b>7. Financing and leasing of Aircraft:</b>	<b>Sub-leasing of Aircraft</b> will fall within the scope of Qualifying activity.
<b>8. Distribution of goods or material in or from a Designated Zone</b>	<p>(i) A key feature of distribution activity is that the <b>distributor holds the title to the products which differentiates it from Logistics services.</b></p> <p>(ii) As per MD 265 of 2023, definition of "Distribution of goods or material in or from a Designated Zone" includes buying and selling of goods, materials, component parts or any other items that are tangible or movable. Accordingly, distribution of intangible products and services such as <b>licenses, software and financial products/ services will not be covered under distribution activity.</b> However, the guide has further clarified that if the product is embedded onto a hardware, income for which is not separately identifiable, they can still qualify for Distribution activity.</p> <p>(iii) The <b>concept of 'end-user' is now defined in the Guide.</b> End-user is the person who eventually uses the product for its intended purpose, whether they may be personal, commercial or industrial. Accordingly, if a distributor is engaged in selling goods to a customer who is end-user (<i>i.e.</i>, uses or consumes the product), then such activity will not be considered as a Qualifying activity. A QFZP has to conduct necessary due-diligence (obtain KYC, undertaking etc. from the customer) to demonstrate that the customer is not an end-user in order to fall within the scope of the Distribution as a Qualifying activity.</p>



	<p>(iv) Under Ministerial Decision No. 265 of 2023 on Free Zone, it was not clear whether High Seas Sales (Third port shipment) is covered under Qualifying activity-Distribution of goods or materials in or from a Designated Zones, as goods do not physically enter UAE. Now the new guide has <b>clarified that High Seas Sales (Third Port Shipment) if undertaken from Designated Zones shall be covered under Qualifying Activities.</b></p> <p>(v) There are <b>no limitations on the mode of distribution</b>. For goods that are procured from UAE itself and sold in UAE/outside, they do not need to pass through a Designated Zone. The <b>requirement of distributed goods to enter a Designated Zone only applies in case goods are imported into the UAE and then sold.</b></p>
<b>9. Logistics services:</b>	<p>(i) Logistics services do <b>not include the movement of people</b>.</p> <p>(ii) <b>Last-mile delivery services outside of the Free Zone in the UAE or in a foreign country will also be considered as a Qualifying Activity</b> provided QFZP performs most of its logistics services within a Free Zone for its customers in the UAE outside a Free Zone or foreign customers.</p>



## CHAPTER

# 6

# Calculating Taxable Income

## 6.1 Introduction

Chapter 6 of the CT Law deals with the rules and regulations for calculating taxable income. The provisions aim to reduce administrative complexity and compliance costs for UAE taxable persons by providing a clear computation mechanism. This Chapter comprises the following two articles:

- (a) Article 20: General Rules for Determining Taxable Income
- (b) Article 21: Small Business Relief

Article 20 contains general rules for the computation of taxable income. The computation of taxable income starts with profits from the standalone financial statement as adjusted in accordance with Article 20. Article 21 grants relief to taxable persons running small businesses and deriving revenue less than the prescribed threshold.

## 6.2 Article 20: General Rules for Determining Taxable Income

Article 20 reads as follows:

- “1. *The Taxable Income of each Taxable Person shall be determined separately, on the basis of adequate, standalone financial statements prepared for financial reporting purposes in accordance with accounting standards accepted in the State.*
2. *The Taxable Income for a Tax Period shall be the Accounting Income for that period, and to the extent applicable, adjusted for the following:*
  - (a) Any unrealised gain or loss under Clause 3 of this Article.
  - (b) Exempt Income as specified in Chapter Seven of this Decree-Law.
  - (c) Reliefs as specified in Chapter Eight of this Decree-Law.
  - (d) Deductions as specified in Chapter Nine of this Decree-Law.
  - (e) Transactions with Related Parties and Connected Persons as specified in Chapter Ten of this Decree-Law.
  - (f) Tax Loss relief as specified in Chapter Eleven of this Decree-Law.
  - (g) Any incentives or special reliefs for a Qualifying Business Activity as specified in a decision issued by the Cabinet at the suggestion of the Minister.

- (h) Any income or expenditure that has not otherwise been taken into account in determining the Taxable Income under the provisions of this Decree-Law as may be specified in a decision issued by the Cabinet at the suggestion of the Minister.
- (i) Any other adjustments as may be specified by the Minister.
3. For the purposes of calculating the Taxable Income for the relevant Tax Period, and subject to any conditions that the Minister may prescribe, a Taxable Person that prepares financial statements on an accrual basis may elect to take into account gains and losses on a realisation basis in relation to:
- All assets and liabilities that are subject to fair value or impairment accounting under the applicable accounting standards; or
  - All assets and liabilities held on capital account at the end of a Tax Period, whilst taking into account any unrealised gain or loss that arises in connection with assets and liabilities held on revenue account at the end of that period.
4. For the purposes of paragraph (b) of Clause 3 of this Article:
- "Assets held on capital account" refers to assets that the Person does not trade, assets that are eligible for depreciation, or assets treated under applicable accounting standards as property, plant and equipment, investment property, intangible assets, or other non-current assets.
  - "Liabilities held on capital account" refers to liabilities, the incurring of which does not give rise to deductible expenditure under Chapter Nine of this Decree-Law, or liabilities treated under applicable accounting standards as non-current liabilities.
  - "Assets and liabilities held on revenue account" refers to assets and liabilities other than those held on a capital account.
  - An "unrealised gain or loss" includes an unrealised foreign exchange gain or loss.
5. Notwithstanding Clauses 1 and 3 of this Article, the Minister may prescribe any of the following for the purposes of this Decree-Law:
- The circumstances and conditions under which a Person may prepare financial statements using the cash basis of accounting.
  - Any adjustments to the accounting standards to be applied for the purposes of determining the Taxable Income for a Tax Period.
  - A different basis for determining the Taxable Income of a Qualifying Business Activity.
6. Subject to any conditions prescribed under Clause 5 of this Article, a Taxable Person can make an application to the Authority to change its method of accounting from cash basis to accrual basis from the commencement of the Tax Period in which the application is made or from the commencement of a future Tax Period.
7. In the case of any conflict between the provisions of this Decree-Law and the applicable accounting standards, the provisions of this Decree-Law shall prevail to that extent."

### **6.2-1 Determination of taxable income**

Article 20 sets out the approach to determine the taxable income that will be subject to tax under the CT regime. To reduce complexity and compliance costs, the CT regime requires the use of the accounting net profit (or loss) as stated in the financial statements of a business as the starting point for determining their taxable income.

Taxable income for each taxable person shall be determined separately for each tax period. The standalone financial statement shall form the basis for the computation of taxable income. The standalone financial statement shall be prepared in accordance with accounting standards and frameworks generally accepted in the UAE. The financial statement may be prepared on an accrual or cash basis.

### **6.2-2 Method of Accounting**

The Ministry of Finance has issued a *Ministerial Decision No. 114 of 2023* on the Accounting Standards and Methods for Preparing the Financial Statements, which states as under.

#### ***6.2-2a Accounting Standard***

The Taxable Person shall prepare its Financial Statements as per the following Financial Reporting Standard based on its revenue:

<i>Revenue Limit</i>	<i>Financial Reporting Standards</i>
Exceeds AED 50 Million	International Financial Reporting Standards (IFRS)
Does not exceed AED 50 Million	International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs)

#### ***6.2-2b Cash Basis of Accounting***

The cash basis of accounting is a method of recording income and expenses when they are actually received or paid rather than when they are earned or incurred. A person can use the cash basis of accounting in any of the following instances:

- (a) Revenue does not exceed AED 3 million; or
- (b) In exceptional circumstances, if approval is obtained through an application to the Authority.

A taxable person may apply to the FTA to transition its accounting system from a cash basis to an accrual basis from the commencement of the tax period in which the application is made or the commencement of a future Tax Period.

#### ***6.2-2c Consolidated Financial Statement***

The preparation of consolidated Financial Statements of a Tax Group (See **Para 12.2**) shall mean preparing standalone financial statements for a tax group by aggregating the standalone financial statements of the parent company and its sub-

sidiaries and eliminating transactions between them as required by the Corporate Tax Law.

### ***6.2-3 Adjustment from the standalone profit***

The taxable income for a tax period shall be computed after making the following adjustments from the accounting income for that period:

<i>Particulars</i>	<i>Amount</i>
Profits/loss as per the standalone financial statement	xxx
<b>Add: Adjustments (Additions)</b>	
(a) Unrealised loss ( <i>see Para 6.2-3a</i> )	xxx
(b) Expenditure incurred for deriving exempt income ( <i>see Para 7.2</i> )	xxx
(c) Any expense not previously accounted for	xxx
(d) Transfer Pricing and Arm's Length Adjustment ( <i>see Para 10.2</i> )	xxx
(e) Expenditures which are not allowed as a deduction ( <i>see Para 9.7</i> )	xxx
(f) Any other addition the Minister may deem necessary	xxx
<b>Less: Adjustments (Reductions)</b>	
(a) Unrealised gain ( <i>see Para 6.2-3a</i> )	(xxx)
(b) Exempt Income ( <i>see Para 7.2</i> )	(xxx)
(c) Any income not previously accounted for	(xxx)
(d) Transfer Pricing and Arm's Length Adjustment ( <i>see Para 10.2</i> )	(xxx)
(e) Financial incentives or special treatment for a Qualifying Business activity	(xxx)
(f) Expenditures which are allowed as a deduction ( <i>see Chapter 9</i> )	(xxx)
(g) Any other reduction the Minister may deem necessary	(xxx)
<b>Less: Reliefs</b>	
(a) Relief in respect of 'Transfers within Qualifying Group' ( <i>see Para 8.2</i> )	(xxx)
(b) Business Restructuring relief ( <i>see Para 8.3</i> )	(xxx)
(c) Tax loss relief ( <i>see Para 11.2</i> )	(xxx)
Taxable Income	xxx

### ***6.2-3a Other adjustments, as suggested by Cabinet***

The Cabinet, at the suggestions of the Minister, may specify financial incentives or special treatment for Qualifying Business activity. The Cabinet may also specify any income or expenditure that has not otherwise been considered in the computation of taxable income, which may be adjusted in the computation of taxable income.

As per *Ministerial Decision No. 134 of 2023*, the Accounting Income shall be adjusted with the following while calculating the Taxable Income:

- (a) Include realised or unrealised gains and losses reported in the financial statements that would not be subsequently recognised in the statement of income;
- (b) Substitute the effect of the equity method of accounting, if applied, with the effect of the cost method of accounting as allowed under the accounting standards.
- (c) In case a Taxable Person that prepares financial statements on an accrual basis elects to take into account gains and losses on a realisation basis in relation to all assets and liabilities that are subject to fair value or impairment accounting and assets/liabilities held on capital account under the applicable accounting standards, the following adjustments shall be made:
  - ◆ Exclude depreciation, amortisation, or other change in the value of assets other than financial assets, to the extent adjustment amount related to a change in the net book value exceeding the original cost of the asset;
  - ◆ Exclude change in value, including amortisation of liability or a financial asset, except gain or loss arising upon realisation of liability or financial assets;
  - ◆ Upon realisation of the assets and liabilities, include the unrecognised gains or loss, excluding those that arose before the most recent acquisition of assets/liability by a mode other than not considered as transfer within a qualifying group or business restructuring relief.
- (d) No deduction of expenditure or loss shall be allowed in the computation of taxable income unless it is otherwise allowed under Article 28 to Article 33 of Chapter 9.

### **6.2-3b Deduction of capital expenditure**

Depreciation, amortisation, or other changes related to capital expenditures shall not be deductible if such expenditure would not have been deductible had it been classified as non-capital in nature. In other words, depreciation, amortisation, or any other capital expenditure-related deductions are not allowed if they would not have been deductible as regular expenses. These non-deductible capital expenditures shall be deducted in the computation of gains or losses arising upon the realisation of the respective asset or liability.

Classification of expenditure as capital expenditure or non-capital expenditure would depend upon treatment prescribed by the applicable accounting standards followed by the taxable person.

### **6.2-3c Conditions to elect the use of the realisation basis**

Taxable persons who prepare financial statements on an accrual basis of accounting shall have the option to recognise gains and losses on a realisation basis or accrual basis. The taxable person may follow the realisation basis of accounting as



a conservative and cautious approach. This option gives taxable persons flexibility in aligning their financial reporting with their business operations and preferences.

The taxable person shall elect to apply the realisation basis of accounting during the first tax period. The election, once exercised, cannot be changed later, except in exceptional circumstances. The requirement for an irrevocable election adds certainty to the tax reporting process while allowing for exceptional circumstances where a change may be warranted.

#### ***6.2-4 Option to tax 'gains or loss' on a realisation basis***

A taxable person may prepare the financial statement on an accrual basis wherein the unrealised gains/loss are considered in the computation of taxable income. However, such a taxable person may offer the following gains or losses on a realisation basis:

- (a) Gains or losses from assets or liabilities which are subject to fair value or impairment accounting under applicable accounting standards;
- (b) Gains or losses from assets or liabilities held on capital accounts, namely:
  - ◆ Assets the taxable person does not trade;
  - ◆ Assets eligible for depreciation;
  - ◆ Assets treated under applicable accounting standards as property, plant and equipment, investment property, intangible assets, or other non-current assets;
  - ◆ Liabilities which does not give rise to deductible expenditure; or
  - ◆ Liabilities treated under applicable accounting standards as non-current liabilities.
- (c) Gains or losses attributable to assets and liabilities that are kept on the revenue account at the end of the tax period.

As per *Ministerial Decision No. 134 of 2023*, the following transfers of assets or liabilities shall not be considered as a realisation of the assets or the liabilities:

- (a) Transfers between taxable persons who are members of the same qualifying group;
- (b) Transfers between a taxable person and any other person involving the transfer of an entire business or an independent part of the business that are exempt under Articles 26 and 27 of the CT Law.

The realisation of assets shall include sale, disposal, transfer, settlement, or complete worthlessness of an asset as per applicable accounting standards. The realisation of liability includes settlement, assignment, transfer, or forgiveness of liability as per the applicable accounting standards.

#### ***6.2-4a An illustrative list of unrealised gains or losses***

Whether a particular accounting item represents unrealised gains/loss to be offered

to tax on an accrual basis or on realisation will depend upon the accounting standards. Broadly, the following accounting items can be referred to as unrealised gain/loss:

- (a) Provision for expected credit loss;
- (b) Provision for slow-moving inventory;
- (c) Derivative financial instruments;
- (d) Impairment of property, plant and equipment;
- (e) Impairment of Investment Property;
- (f) Unrealised foreign exchange gain or loss;
- (g) Financial assets or liabilities carried forward at fair value through profit or loss (FVTPL) – forward exchange contracts not used for hedging;
- (h) Investment property fair value changes;
- (i) Adjustment for loss due to revaluation of property, plant and equipment;
- (j) Adjustment for loss on revaluation of intangible assets.

### ***6.2-5 Accounting Standards v. The CT Law***

In case of any conflict between the accounting standards and provisions of the CT Law, the provisions of the CT Law shall prevail. *For example*, interest expenditure is deducted while computing the taxable income. However, Articles 29 to 31 restricts the deductions of interest in a certain scenario. Since the CT Law provisions override the accounting standards, the deduction shall be restricted even if the interest is deducted in deriving profits in the standalone financial statement.

### ***6.2-6 Comprehensive Example***

Determine the taxable income for XYZ Ltd. based on the given information:

Particulars	Amount (in AED)
Accounting Net Profit	1,000,000
Unrealised loss on revaluation of Investment	50,000
Expenditure incurred for exempt income	20,000
Transfer Pricing and Arm's Length upward Adjustment	30,000
Expenditures not allowed as deductions	15,000
Unrealised gain on revaluation of fixed asset	40,000
Exemption Income	30,000
Financial incentives or special treatment	10,000
Expenditures allowed as deductions	5,000



*Solution*

Particulars	Amount (In AED)
Accounting Net Profit	1,000,000
<b>Additions</b>	
◆ Unrealised loss on revaluation of Investment	50,000
◆ Expenditure incurred for exempt income	20,000
◆ Transfer Pricing and Arm's Length Adjustment	30,000
◆ Expenditures not allowed as deductions	15,000
<b>Reductions</b>	
◆ Unrealised gain on revaluation of fixed asset	(40,000)
◆ Exempt Income	(30,000)
◆ Financial incentives or special treatment	(10,000)
◆ Expenditures allowed as deductions	(5,000)
Taxable Income	1,030,000

### 6.3 Article 21: Small Business Relief

Article 21 reads as follows:

- “1. A Taxable Person that is a Resident Person may elect to be treated as not having derived any Taxable Income for a Tax Period where:
  - (a) The Revenue of the Taxable Person for the relevant Tax Period and previous Tax Periods does not exceed a threshold to be set by the Minister; and
  - (b) The Taxable Person meets all other conditions prescribed by the Minister.
- 2. Where Clause 1 of this Article applies to a Taxable Person, the following provisions of this Decree-Law shall not apply:
  - (a) Exempt Income as specified in Chapter Seven of this Decree-Law.
  - (b) Reliefs as specified in Chapter Eight of this Decree-Law.
  - (c) Deductions as specified in Chapter Nine of this Decree-Law.
  - (d) Tax Loss relief as specified in Chapter Eleven of this Decree-Law.
  - (e) Article 55 of this Decree-Law.
- 3. The Authority may take the necessary measures to verify the compliance with the conditions of Clause 1 of this Article, and may request any relevant information or records from the Taxable Person within the timeline prescribed by the Authority.”

### **6.3-1 Overview**

While a certain level of complexity is unavoidable in the corporate tax regime for a diversified and innovative economy such as the UAE, the Ministry of Finance intends to keep the CT regime as simple as possible to minimise the compliance cost for business.

While larger businesses would generally incur a higher absolute cost in complying with their CT obligations, in many tax systems worldwide, the relative tax compliance burden is disproportionately higher for small and medium-sized businesses. In order to support start-ups and small businesses in the UAE and to manage the compliance burden on small taxpayers, the CT regime provides relief for small businesses in the form of simplified financial and tax reporting obligations.

The CT Law grants an option to the taxable persons running small businesses to elect treated as not deriving any taxable income for a tax period. The taxable persons shall be allowed the exemption if the revenue derived during a tax period and previous tax periods does not exceed the threshold prescribed by the Minister.

### **6.3-2 Threshold limit for small businesses relief**

The *Ministerial Decision No. 73 of 2023*, dated 3 April 2023, prescribed a revenue threshold of 3,000,000 AED for each tax period to avail the benefit of small business relief. The threshold shall apply to tax periods commencing on or after 1 June 2023 and shall continue to apply to subsequent tax periods that end on or before 31 December 2026. Hence, the gross revenue of the current as well as previous tax periods should be tested. A taxable person shall not be able to apply for the small business relief if its revenue in any relevant or previous tax period has exceeded 3,000,000 AED. The revenue shall be determined in accordance with the applicable accounting standards accepted in UAE.

### **6.3-3 Eligible person**

The exemption shall be available only to resident-taxable persons. Further, the resident person should not be a Qualifying Free Zone Person or the constituent company of a Multinational Enterprises Group as defined in *Cabinet Decision No. 44 of 2020* issued in respect of Country-by-Country Reporting.

#### ***6.3-3a Multinational Enterprises Group***

'Multinational Enterprises Group' means any group that includes two or more companies, the tax residence of which is located in different jurisdictions, or one single company having its tax residence in one country and being subject to tax with respect to the activity it carries out through a permanent entity located in another country and has a total consolidated group revenue equal to or more than AED 3,150,000,000 (UAE Dirhams Only Three Billion One Hundred and Fifty Million) during the fiscal year immediately preceding the reporting fiscal year as indicated in its consolidated financial statements for that preceding fiscal year.



### ***6.3-3b 'Constituent of Multinational Enterprises Group':***

A person shall be a 'Constituent of Multinational Enterprises Group' if such person falls in either of the following categories:

- (a) Any separate business unit of an MNE Group that is included in the Consolidated Financial Statements of the MNE Group for the purposes of preparing the financial reports or would be so included therein if equity interests therein were traded on a public securities exchange;
- (b) Any business unit excluded from the MNE Group's Consolidated Financial Statements solely on size or materiality grounds;
- (c) Any permanent establishment pertaining to any separate business unit of the MNE Group referred to above, provided that the said business unit prepares separate financial statements for such permanent establishment for the purposes of financial reporting, preparation, regulatory, tax reporting, or internal management control purposes.

### ***6.3-4 Treatment of tax losses***

When the taxable person elects for small business relief in respect of a tax period, any tax losses incurred in such tax period cannot be carried forward to any subsequent tax periods.

Any unutilised tax losses incurred in previous tax periods when small business relief was not applied may be carried forward to subsequent tax periods in which an election to apply the small business relief is not made.

### ***6.3-5 Limitation on deduction for net interest***

The taxable person opting for small business relief cannot carry forward the net interest expenditure incurred of such tax period to any subsequent tax periods.

Any net interest expenditure incurred in previous tax periods when small business relief was not applied can be carried forward to subsequent tax periods in which small business relief is not applied. It may be noted that the net interest expenditure can be carried forward upto 10 years.

(For the meaning of net interest expenditure, *see Para 9.4-4*)

### ***6.3-6 Consequences of artificial separation of business***

For the purposes of determining whether the business or business activity has been artificially separated, the FTA shall consider the commercial purpose of such an arrangement. The FTA shall also check whether the persons carry on substantially the same business or business activity by taking into account all relevant facts and circumstances, including but not limited to their financial, economic and organisational links.

Where the FTA establishes that one or more persons have artificially separated their business or business activity and the aggregate amount of revenue across the persons' entire business or business activity exceeds the threshold of 3,000,000

AED in any tax period, and such one or more persons have elected to apply the small business relief, such artificial separation shall be regarded as tax abusive arrangement attracting provisions of General Anti-Abuse Rules under Article 50 (*see Para 15.2*).

### ***6.3-7 Certain provisions shall not apply***

The following provisions of the UAE CT Law shall not apply to taxable persons electing for small business relief:

- (a) Exempt Income (*see Chapter 7*);
- (b) Reliefs (*see Chapter 8*);
- (c) Deductions (*see Chapter 9*);
- (d) Tax loss relief (*see Chapter 11*); and
- (e) Transfer Pricing compliance requirements (*see Para 10.2*).

### ***6.3-8 Illustration***

Whether the small business relief shall be available in the following case.

<b>Entity</b>		<b>Tax Period</b>		
		<i>1 June 2023 to 31 July 2024</i>	<i>1 June 2024 to 31 July 2025</i>	<i>1 June 2025 to 31 July 2026</i>
A	Revenue	2,950,000	1,750,000	1,950,000
LLC	Eligibility	Yes	Yes	Yes
B	Revenue	2,950,000	4,000,000 <sup>[Note 1]</sup>	1,000,000 <sup>[Note 2]</sup>
LLC	Eligibility	Yes	No	No
C	Revenue	3,050,000 <sup>[Note 1]</sup>	2,950,000	2,950,000
LLC	Eligibility	No	No	No

Note 1: Since the revenue of B LLC and C LLC in one of the tax periods exceeds 3,000,000 AED, small business relief shall not be available.

Note 2: Since the taxable person has received revenue during the previous tax period in excess of 3,000,000 AED, the small business relief shall not be available.

### ***6.3-9 Comprehensive Example***

ABC Company starts operations as a resident person in the UAE. Calculate its eligibility for small business relief based on the threshold limit and other conditions mentioned in this Article.

<b>Tax Period</b>	<b>Revenue (AED)</b>	<b>Eligible for Relief</b>
Tax Period 1	2,500,000	Yes
Tax Period 2	3,200,000	No

*Treatment of Tax Losses and Net Interest Expenditure*



Since ABC Company elected for small business relief in Tax Period 1, any tax losses incurred during that period cannot be carried forward to subsequent tax periods. However, any unutilised tax losses incurred in Tax Period 1 when small business relief was not applied can be carried forward to future tax periods where the relief is not elected. Similarly, the net interest expenditure incurred during the Tax Period 1, when small business relief was applied cannot be carried forward to future tax periods.

#### *Consequences of Artificial Separation of Business*

The Federal Tax Authority will assess whether ABC Company has artificially separated its business or business activity. Suppose the FTA determines that artificial separation has occurred and the aggregate revenue across the entire business or business activity exceeds the threshold of 3,000,000 AED in any tax period where small business relief is elected. In that case, the artificial separation will be considered a tax-abusive arrangement and subject to provisions of General Anti-Abuse Rules under Article 50.





## 7.1 Introduction

The CT Law imposes a tax on the taxable income of a taxable person. While computing the taxable income, certain streams of income are not taken as a part of taxable income. Such streams of 'Exempt income' are covered under Chapter VII (Exempt income) of the CT Law.

As per Chapter VII, the dividend income and profit distribution from the resident juridical persons shall not be taxable. Further, dividends and other profit distributions received from a participating interest in a juridical person or any other income from specified participating interest shall not be taxed in the hands of the taxable person. Certain income of a foreign permanent establishment and income derived by a non-resident person from operating aircraft or ships in international transportation shall not be subject to CT implications.

Chapter VII comprises the following Articles:

- (a) Article 22: Exempt Income
- (b) Article 23: Participation Exemption
- (c) Article 24: Foreign Permanent Establishment Exemption
- (d) Article 25: Non-Resident Person Operating Aircraft or Ships in International Transportation

Article 22 covers a list of the income which are excluded from the scope of the taxable income. It covers income-specified exemptions (irrespective of the status of the taxable income), such as dividend or profits distribution from juridical persons, and exemptions available to a taxable person basis its residential status, such as foreign permanent establishment exemption, international transportation in aircraft or shipping line, etc. Article 23 deals with exemption in respect of any income received from a juridical person in which the taxable person owns participation interest. Article 24 lists the criteria subject to which the income of the foreign permanent establishment shall be exempt from the corporate tax. Article 25 lists the conditions to grant exemptions to the non-resident person in respect of income earned by way of aircraft or shipping operations in international transportation.

## 7.2 Article 22: Exempt Income

Article 22 reads as follows:

*"The following income and related expenditure shall not be taken into account in determining the Taxable Income:*

1. *Dividends and other profit distributions received from a juridical person that is a Resident Person.*
2. *Dividends and other profit distributions received from a Participating Interest in a foreign juridical person as specified in Article 23 of this Decree-Law.*
3. *Any other income from a Participating Interest as specified in Article 23 of this Decree-Law.*
4. *Income of a Foreign Permanent Establishment that meets the condition of Article 24 of this Decree-Law.*
5. *Income derived by a Non-Resident Person from operating aircraft or ships in international transportation that meets the conditions of Article 25 of this Decree-Law.”*

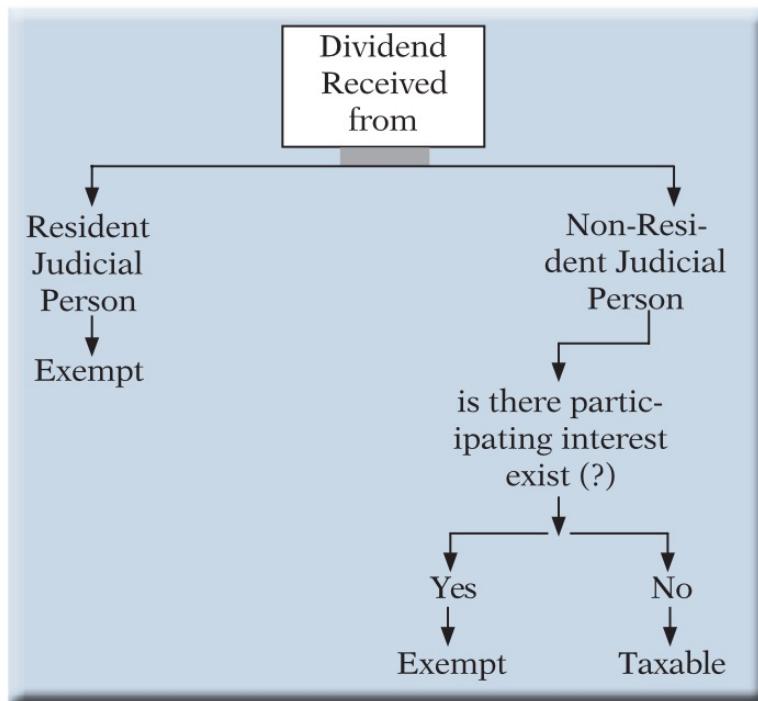
### **7.2-1 Overview**

The following stream of income shall be exempt from payment of the corporate tax:

- (a) Dividend or profit distribution received from a resident juridical person;
- (b) Dividend or profit distribution received from a foreign juridical person in which the recipient has participating interest;
- (c) Any income received from participating interest;
- (d) Income earned from a foreign permanent establishment; and
- (e) Income of a non-resident person operating aircraft or ships in international transportation.

### **7.2-2 Exemption for dividend and profit distribution**

The resident juridical person is liable to pay corporate tax on its worldwide income. To avoid double taxation of the profits earned and distributed by the resident judicial person, the CT Law provides an exemption in respect of dividends or profit distribution received from a resident juridical person. The dividend or profit distributed by the foreign juridical person shall be taxable in the hands of the recipient unless the recipient has participating interest in such a foreign juridical person. In the absence of participating interest, the dividend or distribution of profits from the foreign juridical person shall be taxable, even if such profits are sourced from UAE and already taxed under the Corporate Tax Law.



While the above income is exempt from the applicability of the corporate tax, any expenditure incurred or amount spent for earning/deriving such income shall be excluded from the calculation of taxable income. Any expenditure incurred for earning such income shall be non-deductible in the computation of taxable income. A common expenditure incurred for taxable and exempt income shall be allowed as a deduction in the computation of taxable income on a proportionate basis as per Article 28.

### ***7.2-3 Taxability of income from participating interest***

Any income arising from the participating interest shall be exempt from the CT. The income of a foreign permanent establishment of a resident person shall be exempt under Article 24 if such income meets the specified conditions. (See **Para 7.4**)

### ***7.2-4 Taxability of income from international transportation operation***

Income derived by a non-resident person from international transportation operation of aircraft or ships shall be excluded from the taxable income.

## **7.3 Article 23: Participating Exemption**

Article 23 reads as follows:

- “1. *Income from a Participating Interest shall be exempt from Corporate Tax, subject to the conditions of this Article.*

2. A *Participating Interest* means, a 5% (five per cent) or greater ownership interest in the shares or capital of a juridical person, referred to as a "Participation" for the purposes of this Chapter where all of the following conditions are met:
  - (a) *The Taxable Person has held, or has the intention to hold, the Participating Interest for an uninterrupted period of at least (12) twelve months.*
  - (b) *The participation is subject to Corporate Tax or any other tax imposed under the applicable legislation of the country or territory in which the juridical person is resident which is of a similar character to Corporate Tax at a rate not less than the rate specified in paragraph (b) of Clause 1 of Article 3 of this Decree-Law.*
  - (c) *The ownership interest in the participation entitles the Taxable Person to receive not less than 5% (five per cent) of the profits available for distribution by the participation, and not less than 5% (five per cent) of the liquidation proceeds on cessation of the participation.*
  - (d) *Not more than 50% (fifty per cent) of the direct and indirect assets of the participation consist of ownership interests or entitlements that would not have qualified for an exemption from Corporate Tax under this Article if held directly by the Taxable Person, subject to any conditions that may be prescribed under paragraph (e) of this Clause.*
  - (e) *Any other conditions as may be prescribed by the Minister.*
3. A *Participation* shall be treated as having met the condition under paragraph (b) of Clause 2 of this Article where all of the following conditions are met:
  - (a) *The principal objective and activity of the participation is the acquisition and holding of shares or equitable interests that meet the conditions of Clause 2 of this Article.*
  - (b) *The income of the participation derived during the relevant Tax Period or Tax Periods substantially consists of income from Participating Interests.*
4. A *Participation* in a Qualifying Free Zone Person or an Exempt Person shall be treated as having met the condition under paragraph (b) of Clause 2 of this Article, subject to any conditions that may be prescribed by the Minister.
5. Where the conditions of Clause 2 of this Article continue to be met, the following income shall not be taken into account in determining Taxable Income:
  - (a) *Dividends and other profit distributions received from a foreign Participation that is not a Resident Person under paragraph (b) of Clause 3 of Article 11 of this Decree-Law.*
  - (b) *Gains or losses on the transfer, sale, or other disposition of a Participating Interest (or part thereof) derived after expiry of the time period specified in paragraph (a) of Clause 2 or Clause 9 of this Article.*
  - (c) *Foreign exchange gains or losses in relation to a Participating Interest.*
  - (d) *Impairment gains or losses in relation to a Participating Interest.*
6. The exemption under this Article shall not apply to income derived by the Taxable Person from a Participating Interest insofar as:

- (a) *the participation can claim a deduction for the dividend or other distributions made to the Taxable Person under the applicable tax legislation;*
  - (b) *the Taxable Person has recognised a deductible impairment loss in respect of the Participating Interest prior to the Participating Interest meeting the conditions of Clause 2 of this Article;*
  - (c) *the Taxable Person or its Related Party who is subject to Corporate Tax under this Decree-Law has recognised a deductible impairment loss in respect of a loan receivable from the participation.*
7. *Where the impairment loss referred to in paragraph (c) of Clause 6 of this Article is reversed in a subsequent Tax Period, the associated income of the Taxable Person shall be exempt from Corporate Tax in that Tax Period up to the amount of income from the Participating Interest that was not exempted under paragraph (c) of Clause 6 of this Article.*
8. *The exemption under this Article does not apply to a loss realised on the liquidation of a Participation.*
9. *The exemption under this Article shall not apply for a period of (2) two years where a Participation was acquired in exchange for the transfer of an ownership interest that did not meet the conditions of Clause 2 of this Article or a transfer that was exempted under Article 26 or 27 of this Decree-Law.*
10. *Where a Taxable Person fails to hold a 5% (five per cent) or greater ownership interest in the participation for an uninterrupted period of at least (12) twelve months, any income previously not taken into account under this Article shall be included in the calculation of the Taxable Income in the Tax Period in which the ownership interest in the participation falls below 5% (five per cent).*
11. *The Minister may prescribe that an ownership interest in the shares or capital of a juridical person meets the minimum ownership requirement under Clause 2 of this Article where the acquisition cost of that ownership interest exceeds a threshold specified by the Minister.”*

### **7.3-1 Income eligible for exemption**

The following income received from a juridical person in which the recipient has a participating interest would be exempt from the CT Law:

- (a) Dividends and other profit distributions received from a non-resident foreign participation;
- (b) Gains or losses on the transfer, sale, or other disposition of a Participating Interest (or part thereof) derived after a specified period;
- (c) Foreign exchange gains or losses in relation to a Participating Interest;
- (d) Impairment gains or losses in relation to a Participating Interest.

The exemption does not apply to a loss realised on the liquidation of a Participation.



In line with many other countries and leading international financial centres, a UAE corporate shareholder will generally be exempt from corporate tax on dividends received and capital gains earned from the sale of shares of a subsidiary company.

### ***7.3-2 Conditions to claim exemption for dividend***

As per *Ministerial Decision 116 of 2023*, the exemption shall be available in respect of dividend received in the form of any payments or distributions declared or paid on or in respect of shares or other rights participating in the profits of the issuer of such shares or rights.

Dividend does not include a return on capital or a return on debt claims, whether such payments or distributions are in cash, securities, or other properties, and whether payable out of profits or retained earnings or from any account or legal reserve or capital reserve or revenue.

Dividend will include any payment or benefit which in substance or effect constitutes a distribution of profits made in connection with the acquisition or redemption or cancellation of shares or termination of other ownership interests or rights or any transaction or arrangement with a Related Party or Connected Person which does not comply with arm's length principle under Article 34. (See **Para 10.2**)

### ***7.3-3 Conditions to establish 'Participation Interest'***

When a person holds 5% or more ownership interest in the shares or capital of a juridical person and satisfies the following conditions, such interest is referred to as a 'Participation Interest'.

#### ***7.3-3a Ownership Interest through specified securities or rights***

As per *Ministerial Decision 116 of 2023*, the 'Ownership interest' shall include various instruments such as:

- (a) *Ordinary shares* (give the owner, on a share-by-share basis, equal entitlement to voting rights, profits, and liquidation proceeds);
- (b) *Preferred shares* (give the owner priority entitlement to profits and liquidation proceeds ahead of owners of Ordinary Shares);
- (c) *Redeemable shares* (the juridical person issuing this instrument has agreed to redeem or buy back from the owner of this instrument at a future date or after a specific event, for a predetermined amount or with reference to a predetermined amount);
- (d) *Membership and partner interests* (the equity interests owned by a member or a partner in the juridical person, which entitles the member or the partner to a share of the profits, determined with reference to the member's or the partner's capital contribution, and which may be transferred to others);
- (e) Other securities and rights entitling the owner to receive profits and liquidation proceeds.



The above instruments should be classified as '*equity interest*' under the accounting standards applied by the taxable person holding such ownership interest.

The taxable person shall be considered as holding an ownership interest if such a taxable person controls the ownership interest and has the right to economic benefits from such ownership interest under the applicable accounting standards.

Islamic financial instruments shall be treated as ownership interests if such instruments are classified as equity interest under the accounting standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions.

Income from a debt instrument issued by a participation shall be treated as income from a participating interest and would be exempt if such debt instrument is classified as '*equity interest*' under the taxable person's accounting standards.

### **7.3-3b Minimum ownership of 5%**

A person should hold 5% or more ownership interest in the shares or capital of a juridical person. For the purpose of testing the participation threshold of 5% ownership interest or minimum ownership requirement, different types of ownership interests in the same juridical person held by the taxable person or held by other members of a qualifying group shall be aggregated.

Where a Taxable Person exchanges an ownership interest in a juridical person held by the Taxable Person for an ownership interest in another juridical person, the new ownership interests shall be treated as the same continuous ownership interest if the original ownership interest has been exchanged for another ownership interest in pursuance of eligible business restructuring transactions. The ownership interest in both the juridical persons should satisfy other criteria of participation interest.

### **7.3-3c Minimum ownership for a continuous period**

The person should hold 5% or more ownership interest for an uninterrupted period of at least 12 months. The participation exemption would be available even if the taxable person has just acquired 5% or more ownership interest and intends to hold for an uninterrupted period of 12 months. As per *Ministerial Decision No. 116 of 2023*, the percentage of ownership shall be determined with reference to the total paid-up capital or equity interest contributions to the participation.

There can be a situation where after strategic investment, the ownership interest does not cross 5% as is required under the conditions to qualify as participation despite a huge investment. Similarly, a 5% or more threshold for investment in a listed company may require huge and substantial investment and can be burdensome.

As per *Ministerial Decision No. 116 of 2023*, a taxable person shall be considered to have a participating interest if the aggregated acquisition cost of ownership interests in a juridical person is equivalent to AED 4,000,000 or more. In calculating the aggregated cost of ownership interests, the following amounts shall be aggregated:





- (a) The value of the equity interest or capital contribution made or consideration paid in cash or kind for ownership interests in the participation by the Taxable Person;
- (b) The value of any subsequent equity interest and capital contributions made to the participation as reduced by the value of any equity interest or capital repayments made by the participation to the Taxable Person;
- (c) Expenditure incurred by the Taxable Person in relation to the acquisition or transfer of ownership interests in the participation that can be capitalised as part of the acquisition cost of the ownership interest in the participation.

The value of equity interest or capital contribution, consideration paid, or payment of equity interest shall be determined at the time that the contribution or repayment was made or the consideration was paid by applying a foreign currency conversion rate, without taking into account any subsequent value adjustments made under the applicable Accounting Standards.

In determining the acquisition cost in respect of an ownership interest in a foreign Participation, the exchange rate at the acquisition/formation date of the relevant ownership interest shall be used.

Where an ownership interest is partly sold, transferred, or otherwise disposed of, the aggregated acquisition cost shall be reduced in proportion to the average acquisition cost attributable to the part of the ownership interest that is sold, transferred, or otherwise disposed of.

The income previously not considered in the computation of taxable income for the fulfilment of minimum acquisition cost criteria shall be included in the Taxable Income if the minimum acquisition cost threshold is not met for a continuous period of 12 months.

### **7.3-3d Subject to tax**

The juridical person should be subject to corporate tax or similar income tax in its residence foreign jurisdiction. The corporate tax applicable to such juridical persons should not be lower than the corporate tax rate of 9%.

As per *Ministerial Decision 116 of 2023*, the participation exemption would be available if taxes in a foreign jurisdiction is applied on a similar basis to corporate tax. Taxes imposed under the applicable legislation of the foreign country in which the participation is resident for tax purposes shall not be considered a tax which is of a similar nature to Corporate Tax, if the tax applies only to selected activities or the tax paid is refunded at the time of distribution of the relevant profits or income or the tax is only due in the event of a distribution of profits or income.

Some of the instances which shall be considered as taxes imposed on a similar basis are differences in reductions and reliefs, lower tax rates applicable to certain brackets of income, targeted incentives or exemptions of a temporary nature or application of alternative taxes on income or profits.

If the participation can demonstrate to the FTA either it is subject to a tax on income or profits at an effective rate in the relevant Tax Period of not less than 9%

or if it recalculated its accounting net profits according to the basis provided for in the Corporate Tax Law, and the tax levied on such profits, then this would result in an effective tax rate of not less than 9%.

Further, the condition shall stand satisfied if the participation is a resident of foreign country, and it is subject to a tax charged in respect of income, equity or net worth, or a combination of any or all of these in that other country or foreign territory. The tax levied should result in an effective tax rate of not less than 9% on the accounting profits of the participation calculated in accordance with the Accounting Standards in the relevant Tax Period. The above conditions should be satisfied in the year of income or gain.

*Exception to the condition of 'Subject to tax'*

Like UAE, other countries may also contain similar provisions granting exemption in respect of passive income received from participation interest. As a result of such an exemption, the applicable corporate tax payable might be lower than 9%. The CT Law envisages such a scenario and relaxes the 'Subject to tax' condition if the following conditions are satisfied:

- (a) The principal objective and activity of the investee juridical person is the acquisition and holding of shares or equitable interests;
- (b) Such shares or equitable interest satisfy all qualifying conditions for a participation exemption; and
- (c) The income of the investee juridical person derived during the relevant tax period substantially consists of income from participating interests.

As per the *Ministerial Decision No. 116 of 2023*, for participation to qualify as a holding company, including being directed and managed in another country or foreign territory, complying with relevant laws and regulations, having adequate personnel and premises, and limiting activities to those related to share acquisition and holding, the following conditions are to be satisfied:

- (a) Participation is being directed and managed in the relevant other country or foreign territory;
- (b) The participation complies with the requirement to submit any documents, records or information to the relevant authority under the laws and regulations applicable to such participation in the relevant other country or foreign territory;
- (c) The participation has adequate personnel and premises for the acquisition and holding of the shares or equitable interests in the relevant other country or foreign territory;
- (d) Having regard to the level of activity carried on by the participation and the extent to which those activities are performed on behalf or for the benefit of the participation by another Person in that other country or foreign territory; and
- (e) The participation does not conduct any other activities other than those that are incidental or ancillary to the acquisition and holding of shares or equitable interests.



The average income during the relevant and preceding Tax Period consisted of 50% or more of dividends, capital gains and other income from Participating Interests. If the above conditions are satisfied, then irrespective of the taxes applicable in the foreign jurisdiction, the 'Subject to tax' condition shall be deemed to be satisfied. Similarly, Qualifying Free Zone or those eligible for a 0% corporate tax rate under the CT Law or exempt persons shall be considered to have met 'subject to tax' conditions.

### ***7.3-3e No deduction for acquisition cost or cost of disposal***

*Ministerial Decision No. 116 of 2023* states the allowability of expenditure in relation to the acquisition and disposal of a Participating Interest. It provides that no deduction shall be allowed of the expenditure related to the acquisition, sale, transfer, or disposal of an entire participating interest or part of it, except for interest expenditure subject to certain conditions. These expenditures include professional fees, due diligence costs, litigation costs, commissions and brokerage fees, stamp duty, registration duties and other irrecoverable taxes, appraisal and valuation costs, refinancing costs, etc.

Interest expenditure incurred in relation to the acquisition and subsequent holding of a Participating Interest shall be deductible, subject to Chapter Nine of the Corporate Tax Law. The expenditure disallowed under this Article shall be capitalised as part of the acquisition cost of the Participating Interest.

### ***7.3-3f Interest in profit distribution***

The taxable person should be entitled to 5% or more in profits available for distribution by the juridical person. The ownership interest in the juridical person should represent entitlement equivalent to 5% or more profit distribution interest.

In foreign jurisdictions, the business may be set up in the form of a partnership firm or any other form, wherein such structures do not issue share capital certificates. Further, such entities do not pay dividends from the profits; the owners are entitled to receive profit distribution in proportion to their ownership interest. In such a situation, the taxable person should be entitled to receive 5% or more from the profits of such juridical person.

### ***7.3-3g Interest in liquidation***

The taxable person should be entitled to 5% or more of the liquidation proceeds on cessation of the juridical person. On cessation of the juridical person, the taxable person should be entitled to receive at least 5% of the liquidation proceeds.

### ***7.3-3h Exemption qualification of direct or indirect assets***

The juridical person may be holding direct or indirect assets. Such assets may consist of ownership interest or entitlements in other entities, e.g. shares in other



companies. If such assets were directly held by the taxable person and it would not have been entitled to 'Participation exemption' representing not more than 50% of the direct and indirect assets, then the participation exemption would be available.

If the value of 'disqualified' ownership interest or entitlement contributes 50% or more in the direct and indirect assets of the investee juridical person, then the exemption would be denied. In other words, if the ownership interest or entitlement directly held by the taxable person cannot avail of the participation benefit, then any income received from a new entity created just for the purpose of holding such 'disqualified' ownership interest or entitlement would not be eligible for the exemption benefit.

As per *Ministerial Decision No. 116 of 2023*, the condition of 50% or more direct and indirect eligible assets should be satisfied throughout the tax period either basis on the consolidated balance sheet of the participation and the accounting asset value reflected therein or market value valuation of direct and indirect ownership interest and other assets of the participation.

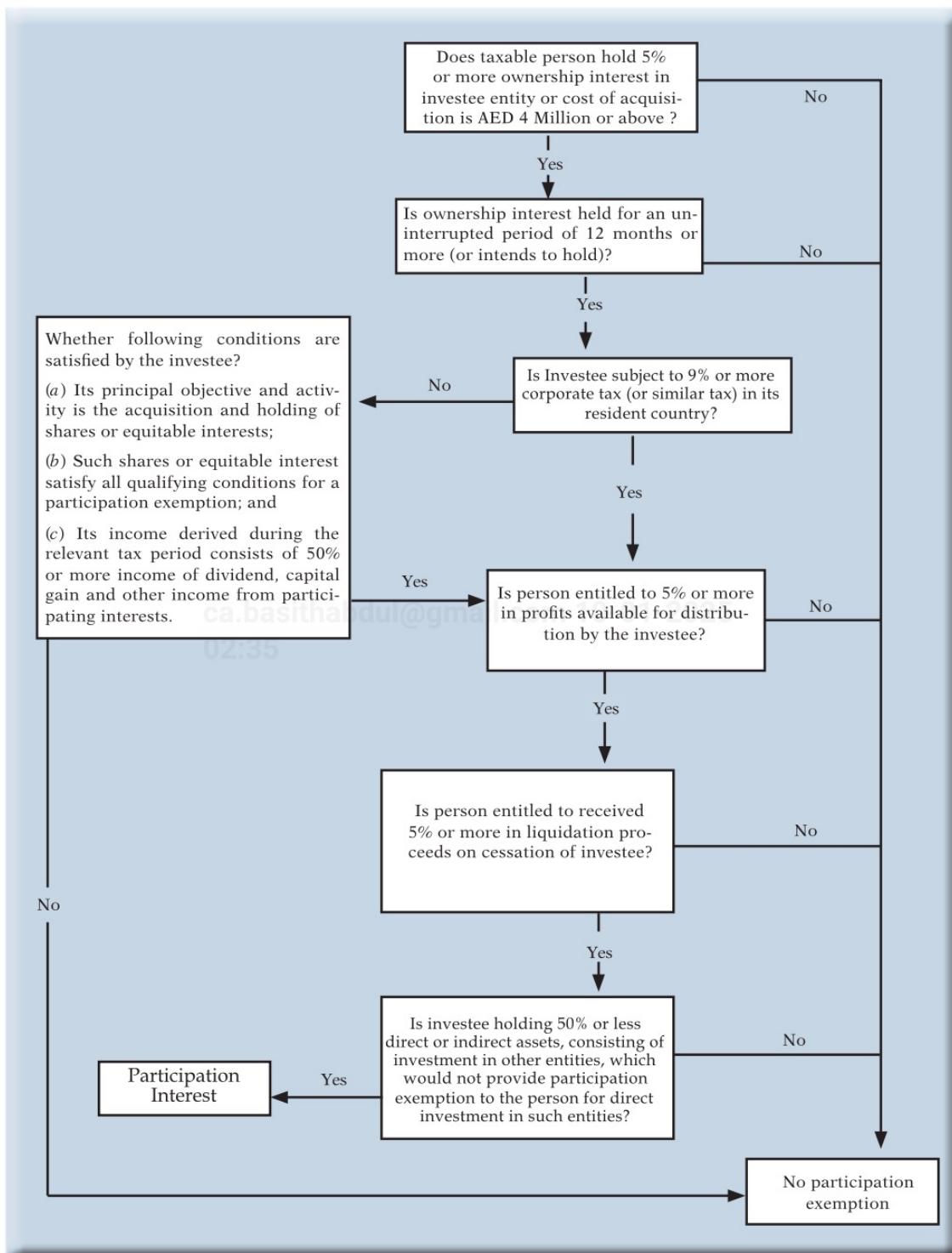
*For example*, A LLC, a resident taxable person of the UAE, owns 100% shares in a company incorporated in the British Virgin Islands. No corporate tax is applicable to the BVI company. The BVI Company holds a 60% ownership interest in a South Africa-based company, which is subject to payment of tax at 15%. Since the direct subsidiary is not subject to tax, participation exemption shall not be available to A LLC in respect of the ownership interest in BVI and the South Africa-based company.

*For example*, B LLC, a resident taxable person of the UAE, owns 100% shares in a company incorporated in South Africa, which is subjected to tax at the rate of 15%. The South African company holds a 90% ownership interest in a company incorporated in the British Virgin Islands, along with 10% owned by B LLC, which is not subjected to tax in its residence jurisdiction. B LLC shall be entitled to claim participation exemption in respect of eligible income received from the South African company. However, the eligible income received from the British Virgin Islands shall not be eligible for relief.

### 7.3-3-i Other conditions

The Minister may prescribe any other conditions, subject to which the participation exemption shall be allowed.

### 7.3-3j Overview



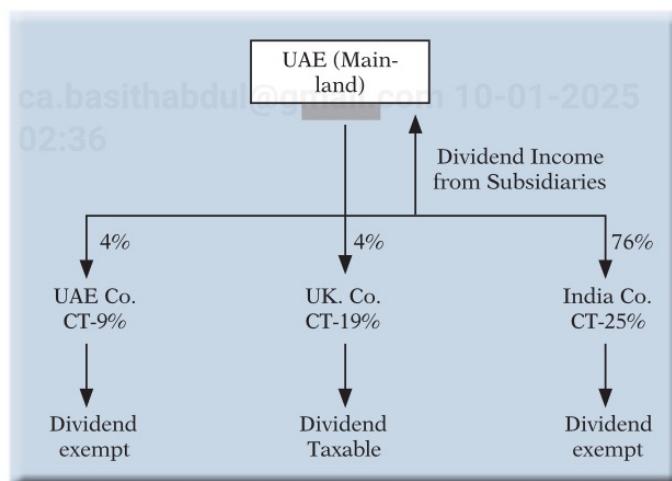
### **7.3-4 Eligible income**

The participation exemption shall be available in respect of the following income.

#### ***7.3-4a Dividend and other profit distributions***

Dividends or any other profit distributions received from a foreign non-resident participation shall be exempt from the corporate tax. The dividend or any other profit distribution received from the resident shall be exempt under Article 22 of the CT Law.

*For example*, A UAE-based company holds 4% shareholding in another UAE company and a UK-based company. It also holds 76% shareholding in an Indian company. These companies pay 9%, 19% and 25% corporate tax rates in their resident countries, UAE, UK and India, respectively. The dividend received from the UAE-based company shall be exempt from tax under Article 22. The dividend from the Indian company shall be exempt from tax under Article 23, being a dividend received from a non-resident foreign participation. The dividend from the UK-based company shall be taxable because the condition of 5% or more participating interest is not satisfied.



#### ***7.3-4b Gains or losses from the transfer of a participating interest***

Any capital gain arising from the transfer, sale or other disposals of participating interest or part thereof shall be exempt if such gains or losses are derived after 12 months of holding the ownership interest. The participation exemption is available only in respect of the gains arising from shares presenting participation interest. Capital gains arising from any other asset class shall not be eligible to claim participation relief.

The time limit of 12 months shall be extended to 2 years in the following circumstances:

- (a) The participation has been acquired in exchange for the transfer of an ownership interest, and the original ownership interest did not meet the qualifying conditions; or



- (b) The participation has been acquired under an exempt transaction under Article 26 (Transfers within a Qualifying Group) or Article 27 (Business Restructuring Relief).

The CT Law puts a reasonable restriction on the time limit for availing of the exemption benefit. Generally, the capital gain arising on the transfer of participation interest held for more than 12 months is exempt. However, if such participation interest is acquired in exchange for ownership interest which did not qualify for participation exemption or acquired under 'Transfers within a Qualifying Group' or 'Business Restructuring Relief' which was exempt under the CT Law, then the time limit of 12 months shall be extended to 2 years. If the participation interest is sold within a period of 2 years, then the exemption in respect of the capital gains shall be denied and shall attract the corporate tax liability under normal provisions.

#### ***7.3-4c Foreign exchange gains or losses in relation to a participating interest***

Any foreign exchange gains arising in relation to participating interest shall be excluded from the taxable income. Similarly, any loss arising on foreign exchange fluctuations in relation to participating interest shall be ignored while computing the taxable income.

#### ***7.3-4d Loss due to liquidation of participation***

As per Ministerial Decision No. 116 of 2023, a Participation shall be considered liquidated if it ceases to have legal existence. Liquidation loss shall be calculated as the difference between the acquisition cost of the Participating Interest, adjusted for any part disposals and the fair value of the liquidation proceeds received by the Taxable Person.

The provisions for exemption for transfer within the qualifying group and business restructuring relief shall not apply where assets or liabilities are transferred to the Taxable Person as a result of the liquidation.

The liquidation loss shall be adjusted for the following amount in the relevant Tax Period and the preceding Tax Period:

- (a) Tax losses transferred by the participation to the Taxable Person;
- (b) Exempt dividends or other profit distributions received by the Taxable Person from the participation;
- (c) Income or gains on the transfer of assets or liabilities between the Taxable Person and the participation not taken into account under transfer within the qualifying group and business restructuring relief.

#### ***7.3-4e Impairment gains or losses in relation to a participating interest***

An impairment loss arises when the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount. The difference between the carrying amount and the recoverable amount is recognised as an impairment loss. In subsequent years, if there is any indication that an impairment loss recognised in prior periods for an asset may no longer exist or may have decreased, the impairment loss recognised in the prior period shall be reversed.

Any gains or losses accounted in the profit and loss statement in relation to participating interest shall be ignored while computing the participating interest.

### ***7.3-5 Restrictions on the participation exemption***

The CT Law provides certain scenarios in which the participation exemption shall not be allowed.

As per *Ministerial Decision No. 116 of 2023*, any income derived from a Participation shall be exempt in so far it is received by a Taxable Person in his capacity as owner of an ownership interest or ownership interests in the participation. But the income derived from other capacities or indirectly from ownership interests in participation shall not be exempt.

#### ***7.3-5a Juridical entity can claim a deduction for dividend***

The exemption shall not be allowed to the extent the juridical entity can claim a deduction for the dividend or other distributions made to the taxable person under the applicable tax legislation. The restriction is not based on the actual deduction claimed by a juridical entity. The exemption may be denied to the extent the juridical entity can claim a deduction. Despite the ineligibility of dividends or other profit distributions for the exemption, other income like capital gains, impairment gains or foreign fluctuations shall continue to enjoy the exemption.

One has to understand the applicable tax legislation of foreign jurisdiction to identify if the exemption is available for the dividend to the juridical entity.

*For example*, Company X, a UAE-based juridical entity, holds a 30% ownership interest in Company Y, a foreign company. Both companies are subject to their respective tax legislation. In a given tax year, Company Y declares a dividend of 1 million AED to its shareholders, including Company X. The applicable tax legislation in the foreign jurisdiction allows a deduction for dividends received by a juridical entity when calculating taxable income.

Under the CT Law, dividends received by a juridical entity may be exempt from corporate tax liability. However, the exemption shall not be allowed to the extent the juridical entity can claim a deduction for the dividend under the applicable tax legislation.

In this case, Company X, being a juridical entity, is eligible for the dividend exemption under the CT Law. However, since the applicable tax legislation of the foreign jurisdiction allows a deduction for dividends received by a juridical entity, Company Y is entitled to claim a deduction for the 1 million AED dividend when calculating its taxable income.

As a result, the exemption for the full amount of the dividend received by Company X would be denied to the extent that Company Y can claim a deduction for the dividend under the foreign tax legislation. The portion of the dividend for which Company Y claims a deduction would be subject to corporate tax liability in the UAE.

It's important to note that while dividends or other profit distributions may be ineligible for the exemption due to the ability to claim deductions, other types of



income such as capital gains, impairment gains, or foreign fluctuations may continue to enjoy the exemption, subject to the relevant provisions of the CT Law and the applicable tax legislation in foreign jurisdictions.

### 7.3-5b Impairment loss

Where a taxable person has recognised deductible impairment loss in respect of the Participating Interest before fulfilling the conditions of participating interest under the CT Law, any reversal of such impairment loss after satisfaction of conditions of participating interest shall not be eligible to claim participation exemption.

*For example*, a UAE-based company, Company X holds a 50% participating interest in Company Y, a foreign company. Both companies are subject to their respective tax legislation.

In a previous tax year, Company X recognised a deductible impairment loss of 2 million AED in respect of its participating interest in Company Y. At that time, Company X had not fulfilled the conditions required for claiming participation exemption under the CT Law.

In the subsequent tax year, Company X fulfils the conditions of participating interest under the CT Law, allowing it to potentially claim participation exemption for future gains or income related to its participating interest in Company Y.

During the same subsequent tax year, there is a positive change in the financial position of Company Y, resulting in the reversal of the impairment loss previously recognised by Company X. The reversal of the impairment loss amounts to 1.5 million AED.

However, according to the CT Law, any reversal of impairment loss after satisfying the conditions of participating interest shall not be eligible for the participation exemption. Therefore, even though Company X has fulfilled the conditions required for claiming participation exemption, it would not be able to claim an exemption for the reversal of the impairment loss of 1.5 million AED.

As a result, Company X would need to recognise the reversal of the impairment loss as taxable income in the UAE and include it in its taxable income calculation.

### 7.3-5c Restrictions for certain acquisitions

No exemption shall be allowed for a period of 2 years in respect of income arising from participation interest acquired:

- (a) In exchange for ownership interest which did not qualify for 'Participation exemption';
- (b) Through Transfers within a Qualifying Group or Business Restructuring Relief, which were exempt under the CT Law.

The dividend income or any other profits distribution shall also be taxed under normal provisions of the CT Law.

### 7.3-5d Failure to hold participation interest

The participation exemption is available in respect of income arising from 5% or more ownership interest held for an uninterrupted period of at least 12 months. The benefit of participation exemption would be available even if the taxable person has just acquired 5% or more ownership interest with an intention to hold for an uninterrupted period of 12 months. If the taxable person fails to hold 5% or more ownership interest for a continuous period of 12 months, then all the income which was not taken into account previously shall be taxable in the tax period in which the ownership interest in the participation entity falls below 5%.

*For example,* On January 1, 2024 Company X, a UAE-based company, acquired a 6% ownership interest in Company Y, a foreign company, intending to hold it for an uninterrupted period of at least 12 months. Both companies are subject to their respective tax legislation. During this tax year, Company X earns an income of 1 million AED from its ownership interest in Company Y. Since Company X holds a 5% or more ownership interest for the entire tax year, the income is eligible for the participation exemption. Therefore, the 1 million AED income is not taxable.

In the next tax period of 2025, Company X earns an additional income of 500,000 AED from its ownership interest in Company Y. However, Company X fails to hold a 5% or more ownership interest in Company Y for a continuous period of 12 months. The ownership interest falls below 5% on July 1, 2025, before completing the 12-month uninterrupted period. As a result, all the income from the ownership interest in Company Y, which was not taken into account previously, becomes taxable in the tax year 2025. Therefore, the additional income of 500,000 AED earned in Tax Year 2025 becomes taxable.

## 7.4 Article 24: Foreign Permanent Establishment Exemption

Article 24 reads as follows:

- "1. A Resident Person can make an election to not take into account the income, and associated expenditure, of its Foreign Permanent Establishments in determining its Taxable Income.
2. Where Clause 1 of this Article applies, a Resident Person shall not take into account the following in determining its Taxable Income or Corporate Tax Payable for a Tax Period:
  - (a) Losses in any of its Foreign Permanent Establishments, calculated as if the relevant Foreign Permanent Establishments were a Resident Person under this Decree-Law;
  - (b) Positive income and associated expenditure in any of its Foreign Permanent Establishments, calculated as if the relevant Foreign Permanent Establishments were a Resident Person under this Decree-Law; and
  - (c) Any Foreign Tax Credit that would have been available under Article 47 of this Decree-Law had the election under Clause 1 of this Article not been made.

3. For the purposes of this Article, “income and associated expenditure” of a Taxable Person’s Foreign Permanent Establishments for a Tax Period is the aggregate of the income and associated expenditure in each of the relevant foreign jurisdictions.
4. In determining the income and associated expenditure of a Foreign Permanent Establishment, a Resident Person and each of its Foreign Permanent Establishments shall be treated as separate and independent Persons.
5. For the purposes of Clause 4 of this Article, a transfer of assets or liabilities between a Resident Person and its Foreign Permanent Establishment shall be treated as having taken place at Market Value at the date of the transfer for the purposes of determining the Taxable Income of that Resident Person.
6. The exemption under Clause 1 of this Article shall apply to all Foreign Permanent Establishments of the Resident Person that meet the condition specified in Clause 7 of this Article.
7. The exemption under Clause 1 of this Article shall only apply to a Foreign Permanent Establishment that is subject to Corporate Tax or a tax of a similar character under the applicable legislation of the relevant foreign jurisdiction at a rate not less than the rate specified in paragraph (b) of Clause 1 of Article 3 of this Decree-Law.”

#### **7.4-1 Overview**

Article 24 of the CT Law provides as follows:

- (a) A foreign permanent establishment refers to a place of business/foreign branch outside the UAE owned by a resident person.
- (b) A resident person can elect to be exempt from tax in respect of the profits of the foreign permanent establishments subject to the condition that the foreign PE is subject to a minimum 9% tax in the overseas jurisdiction.
- (c) If such an election is made, then losses, profit, or associated expenditure in any of the PE shall not be considered for determining the taxable income of the resident person.
- (d) The resident person cannot claim a foreign tax credit for taxes paid in the foreign country in respect of the foreign PE.

#### **7.4-2 Taxability of foreign subsidiary or foreign branch**

UAE businesses may structure their foreign operations either through a foreign subsidiary or through a foreign branch. A foreign branch would typically constitute a PE in the foreign country and be subject to corporate tax (or an equivalent tax) on its profits in that foreign country. The main difference between operating abroad through a foreign subsidiary or a foreign branch is that a subsidiary is a separate legal entity with its own books and records, and transactions between the UAE parent company and its foreign subsidiary would generally be clearly documented and recorded. On the other hand, a branch is not a separate legal entity but an extension of its parent company. No separate financial statements may need

to be prepared, and many of the transactions of the branch would be transactions of the parent company with itself, which complicates determining the 'standalone' financial results of the foreign branch.

#### ***7.4-3 Options available for taxability of foreign branch profits***

Recognising the potential complexities associated with attributing income and expenses to foreign branches, the UAE companies can either:

- (a) Claim a foreign tax credit for taxes paid in the foreign branch country; or
- (b) File an application to claim an exemption for foreign branch profits.

A resident person can exercise an option to not take into account the income, and associated expenditure, of its foreign PE in determining its taxable income. Where the option is exercised for exemption of foreign branch profits, losses in any of its foreign PE shall not be available for set off against the profits of the resident person. Positive income, expenditure and loss shall be calculated as if the relevant foreign PE were a resident person under the CT Law. Any Foreign Tax Credit ('FTC') available under Article 47 of the CT Law shall not be available. 'Income and associated expenditure' of a taxable person's foreign PE for a tax period is calculated as an aggregate of the income and associated expenditure in each relevant foreign jurisdiction.

#### ***7.4-4 Condition to avail exemption in respect of foreign PE***

The exemption benefit shall be available only for foreign PEs that are subject to corporate tax or a tax of a similar character under the applicable legislation of the relevant foreign jurisdiction at a rate not less than 9%. If the tax rate applicable to the foreign PE in a foreign jurisdiction is less than 9%, then the taxable income of the foreign PE shall be taxed in the UAE, and a foreign tax credit shall be available. The resident person shall not have the option to exclude the income of the foreign PE.

#### ***7.4-5 Computation of income and expenditure of foreign PE***

The income and associated expenditure of a foreign PE shall be calculated as if the resident person and each of its foreign PE are separate and independent persons. For the purposes of determining the taxable income of the resident person, the market value on the date of transfer shall be adopted for the purpose of calculating taxable income arising from the transfer of assets or liabilities between a resident person and its foreign PE. As per the Explanatory guide to CT, a taxable person will need to make a choice for all of the Foreign PE whether to be taxed or apply for the exemption together, and the choice cannot be made for each foreign PE individually in relation to this option.

#### ***7.4-6 Allowability of the foreign tax credit***

The quantum of the foreign tax credit is limited under Article 47 to the extent of the lower of the foreign tax credit or the corporate tax due on the relevant



income. If the resident person elects to be exempt from tax in respect of the profits of the foreign permanent establishments, it cannot claim a foreign tax credit for taxes paid in the foreign country in respect of the foreign PE. In other words, if it exercises the option not to tax the income of foreign PE, then the entire foreign tax credit shall lapse, and there shall not be any liability under the CT Law.

As per *Ministerial Decision No. 116 of 2023*, a deduction of foreign permanent establishment tax losses shall be allowed in cases where the Taxable Person can elect to apply the Foreign Permanent Establishment exemption or any income arising upon or following incorporation of the Foreign Permanent Establishment can benefit from Participation Exemption.

#### **7.4-7 Comprehensive Example**

XYZ Corporation is a resident company in the UAE that operates a foreign permanent establishment (PE) in Country A. The corporation is subject to the provisions outlined in Article 24 of the UAE Corporate Tax Law. Let's examine the tax treatment of XYZ Corporation's foreign PE profits and available options for taxability.

(a) *Nature of Foreign Permanent Establishment*

XYZ Corporation's foreign PE is a place of business or foreign branch located in Country A, which qualifies as a foreign permanent establishment as defined in Article 24(a) of the CT Law.

(b) *Exemption for Foreign Permanent Establishment Profits*

Under the provisions of Article 24(b), XYZ Corporation has the option to be exempt from tax in respect of the profits of its foreign PE, subject to certain conditions. One such condition is that the foreign PE must be subject to a minimum 9% tax in Country A. Let's assume that XYZ Corporation's foreign PE in Country A meets the minimum tax requirement and is subject to a 12% corporate tax rate in that jurisdiction.

(c) *Treatment of PE Losses and Expenditure*

As per Article 24(c) of the CT Law, if XYZ Corporation elects for the exemption of its foreign PE profits, any losses, profit, or associated expenditure incurred by the foreign PE will not be considered in determining the taxable income of XYZ Corporation in the UAE.

(d) *Foreign Tax Credit*

Since XYZ Corporation has elected for the exemption of its foreign PE profits, it cannot claim a foreign tax credit for taxes paid in Country A in respect of the foreign PE. Any taxes paid in Country A will not be offset against the corporation's tax liability in the UAE.

(e) *Conclusion*

XYZ Corporation's foreign PE in Country A earns a profit of 2 million AED and pays tax in Country A at the rate of 12%. In this scenario, since XYZ Corporation has elected for the exemption of its foreign PE profits, the taxable income of XYZ Corporation in the UAE will not include the profit of AED 2,000,000 derived from its foreign PE in Country A. Therefore, only the

income generated within the UAE will be subject to taxation. XYZ Corporation cannot claim the credit of the foreign tax paid in Country A.

## 7.5 Article 25: Non-Resident Person Operating Aircraft or Ships in International Transportation

Article 25 reads as follows:

*"Income derived by a Non-Resident Person from the operation of aircraft or ships in international transportation shall not be subject to Corporate Tax where all of the following conditions are met:*

1. *The Non-Resident Person is in the Business of any of the following:*
  - (a) *International transport of passengers, livestock, mail, parcels, merchandise or goods by air or by sea.*
  - (b) *Leasing or chartering aircrafts or ships used in international transportation.*
  - (c) *Leasing of equipment which are integral to the seaworthiness of ships or the airworthiness of aircrafts used in international transportation.*
2. *A Resident Person that performs any of the activities under Clause 1 of this Article would be exempt, or not be subject to tax that is of a similar character to Corporate Tax, under the applicable legislation of the country or territory in which the Non-Resident Person is resident."*

### 7.5-1 Overview

As per international practice, the income arising from the operation of aircraft or ships in international transportation of non-residents is taxable in the state of residence. The OECD model convention gives exclusive right to tax the income arising from 'International Shipping and Air Transport' activities in favour of the residence country. The source country does not have the right to tax the income from international shipping and air transport business.

Following the same principles, the CT Law provides for conditional exemption in respect of income derived by a non-resident person from the operation of aircraft or ships in international transportation. Accordingly, no corporate tax shall apply on fulfilment of the prescribed conditions.

### 7.5-2 Eligible Person

Any non-resident person engaged in any of the following businesses shall be eligible for exemption:

- (a) *International transport of passengers, livestock, mail, parcels, merchandise, or goods by air or by sea.*
- (b) *Leasing or chartering aircraft or ships used in international transportation.*
- (c) *Leasing of equipment which is integral to the seaworthiness of ships or the airworthiness of aircraft used in international transportation.*



### **7.5-3 Eligible income**

The exemption is available on transportation of goods, *viz.* livestock, mail, parcels, merchandise, etc., and passengers through aircraft or shipping.

Generally, in the air or shipping transportation business, the aircraft or ships are not owned by the transporter but owned by a third party and then provided on a leasing or chartering basis to the transporters. The persons who are engaged in the business of leasing or chartering aircraft or ships for international transportation shall enjoy the exemption benefit. However, such leased or chartered aircraft or ships should be utilised for international transportation. Similarly, any person engaged in leasing equipment which is integral to the seaworthiness of ships or airworthiness of aircraft used in international transportation is also subjected to exemption benefit.

### **7.5-4 Reciprocity**

The exemption would be available only if the resident country of such a non-resident person engaged in international transportation has granted a similar exemption to the resident of the UAE. In other words, if a resident person of UAE performs any similar activities in the country or territory in which the non-resident person is a resident and it is exempt or not subjected to tax under the applicable legislation of that country, then the exemption benefit would be available to the non-resident person in the UAE.

*For example*, A LLC is a resident of Spain, and B Ltd. is a resident of India. Spain levies a corporate tax on the non-resident in respect of income arising from international transportation. However, India grants exemption to non-residents engaged in the international shipping business. If A LLC and B Ltd. both are deriving income from the UAE, A LLC shall not enjoy the benefit of the exemption. However, since India, *i.e.* residence country of B Ltd., grants a similar exemption to the resident of UAE, B Ltd. shall enjoy the exemption.

Few countries may provide a reciprocal exemption to the UAE resident only in respect of shipping or air transport activities and not both. The exemption under the CT law shall be provided for the corresponding income only.

*For example*, Article 8 of the UAE-India treaty provides an exemption to the UAE residents in respect of income earned from international shipping business activities. However, no such exemption is available in respect of international air transport. Hence, in such a scenario, the exemption in respect of income arising to Indian residents from the operation of ships in international transportation shall be allowed. However, no exemption shall be available to Indian residents for income arising from the operation of aircraft in international transportation.

Pertinent to note that the income of the resident taxable person engaged in the international shipping and air transport business shall be subjected to corporate tax. No exemption shall be allowed to the income earned by a resident person.

# 8 Reliefs



## 8.1 Introduction

Businesses organise and reorganise their affairs to improve operational efficiencies, adapt to economic changes or achieve other business objectives. Such reorganisation activities involve mergers, acquisitions, demergers, and business restructuring. Such restructuring can be undertaken within the group or outside the group.

The organisation restructuring provides economies of scale, backward and forward integration, cost savings, and many more strategic benefits. Mergers and acquisitions provide inorganic growth, market penetration and competitive advantage. At the same time, the demerger route can be explored to divest the undertakings not fitting into the organisation.

In the absence of targeted tax rules, restructuring or reorganisation within a group could result in a tax liability arising on the realisation of gains from the transfer of assets or liabilities. This is considered undesirable because there is no change in the ultimate ownership of the business or assets being transferred.

Recognising the importance of allowing businesses to reorganise themselves without triggering an unnecessary tax charge, Chapter VIII of the UAE CT law allows relief or deferral of CT in respect of the transfer of assets or liabilities between the group members. In addition, the CT regime will allow certain corporate reorganisation transactions (*e.g.*, mergers) to be undertaken on a tax-neutral basis, such that no taxable gain or loss arises.

Chapter VIII comprises of following Articles:

- (a) Article 26: Transfers within a Qualifying Group
- (b) Article 27: Business Restructuring Relief

## 8.2 Article 26: Transfers within a Qualifying Group

Article 26 reads as follows:

- 1. No gain or loss needs to be taken into account in determining the Taxable Income in relation to the transfer of one or more assets or liabilities between two Taxable Persons that are members of the same Qualifying Group.*
- 2. Two Taxable Persons shall be treated as members of the same Qualifying Group where all of the following conditions are met:*
  - (a) The Taxable Persons are juridical persons that are Resident Persons, or Non-Resident Persons that have a Permanent Establishment in the State.*

- (b) Either Taxable Person has a direct or indirect ownership interest of at least 75% (seventy-five per cent) in the other Taxable Person, or a third Person has a direct or indirect ownership interest of at least 75% (seventy-five per cent) in each of the Taxable Persons.
- (c) None of the Persons are an Exempt Person.
- (d) None of the Persons are a Qualifying Free Zone Person.
- (e) The Financial Year of each of the Taxable Persons ends on the same date.
- (f) Both Taxable Persons prepare their financial statements using the same accounting standards.
3. For the purposes of this Decree-Law, where a Taxable Person applies Clause 1 of this Article:
- (a) the asset or liability shall be treated as being transferred at its net book value at the time of transfer so that neither a gain nor a loss arises; and
- (b) the value of any consideration paid or received against the transfer of the asset or liability shall equal the net book value of the transferred asset or liability.
4. The provision of Clause 1 of this Article shall not apply where, within (2) two years from the date of the transfer, any of the following occurs:
- (a) There is a subsequent transfer of the asset or liability outside of the Qualifying Group.
- (b) The Taxable Persons cease to be members of the same Qualifying Group.
5. Where Clause 4 of this Article applies, the transfer of the asset or liability shall be treated as having taken place at Market Value at the date of the transfer for the purposes of determining the Taxable Income of both Taxable Persons for the relevant Tax Period."

### **8.2-1 Overview**

Article 26 provides as under:

- (a) Gains or losses arising from the transfer of one or more assets or liabilities between two taxable persons of the same Qualifying Group at net book value shall not be taken into account in the calculation of taxable income.
- (b) Two taxable persons shall be treated as members of the same Qualifying Group if the prescribed conditions, including the 75% ownership criterion, is satisfied.
- (c) The relief shall be withdrawn in case of subsequent transfer of assets or liabilities outside the group or taxable person ceases to be a member of the same qualifying group.
- (d) Even the loss arising from the transfer of assets or liabilities within the group shall be ignored. The taxpayer cannot claim the loss arising from the transfer of assets or liabilities in the computation of its taxable income.

## ***8.2-2 Conditions to be treated as a member of the Qualifying Group***

The CT Law contains special relief in respect of the gains or losses arising from the transfer of assets or liabilities within the Qualifying Group. Any gain or loss arising from the transfer of assets or liabilities within the qualifying group shall be ignored in determining the taxable income.

Two taxable persons shall be treated as a member of the Qualifying Group if all of the following conditions are satisfied.

### ***8.2-2a Status of juridical person***

Only Juridical resident persons can constitute a Qualifying Group. The relief in respect of *transfer within a 'Qualifying Group'* shall not be available to natural persons viz. Individuals. Such a Juridical person should be a tax resident of the UAE. The benefit of the relief is further extended to a permanent establishment of non-resident juridical persons in the UAE.

Can the following Transferor and Transferee form a Qualifying Group, subject to the satisfaction of other conditions?

<i>Transferor</i>	<i>Transferee</i>	<i>Qualifying Group?</i>
Resident company	Resident company	Yes
Resident company	PE of a non-resident company in UAE	Yes
PE of a non-resident company in UAE	PE of a non-resident company in UAE	Yes

### ***8.2-2b Ownership criteria***

The taxable person should have an ownership interest in another taxable person directly or indirectly. The CT Law prescribes a 75% ownership interest threshold to constitute a Qualifying Group. Hence, a transfer of asset or liability by a parent company to a subsidiary company or *vice versa* shall be subjected to relief, subject to fulfilment of other conditions.

Further, the transfer of assets or liabilities to a commonly owned sister concern shall also be eligible for relief. Accordingly, if the ownership interest of both the taxable persons is commonly owned by a third person, to the extent of 75%, then the transfer of assets or liability shall be ignored in the computation of taxable income. Such common owners can be a resident or a non-resident. Further, it could be a juridical person or a natural person.

In this regard, the Ministry of Finance has issued *Ministerial Decision No. 132 of 2023* on transfers within a Qualifying Group.

#### *Meaning of Ownership Interest*

Ownership interests include various instruments such as ordinary shares, preferred shares, redeemable shares, membership and partner interests, and other securities or rights that entitle the owner to receive profits and liquidation proceeds.



An ownership interest is classified as such if it is considered an equity interest according to the Accounting Standards applied by the Taxable Person holding the ownership interest.

A Taxable Person is considered to hold an ownership interest if it controls it and has the right to the economic benefits produced by that interest, as determined by the Accounting Standards applied by the Taxable Person.

Islamic Financial Instruments or combinations of arrangements that form part of the same instrument are treated as ownership interests if they are classified as equity interests according to the Accounting Standards applied by the Taxable Person.

The percentage of ownership held through ownership interests is determined based on the total paid-up capital of the Taxable Person or the total equity interest contributions made to the Taxable Person, depending on the applicable circumstances.

#### *Election to apply transfers within a Qualifying Group*

To apply the provisions of Article 26 of the Corporate Tax Law to a transfer meeting the conditions of that Article, the Transferor must make an election. The election should be made in the prescribed form and manner as determined by the Authority, and both the Transferor and Transferee must maintain the specified records in the manner prescribed in Article 6 of this Decision.

The election should be made when submitting the Tax Return for the relevant Tax Period in which the transfer occurs and the Taxable Person chooses to apply Article 26 of the Corporate Tax Law.

Once made, the election is irrevocable and remains effective for calculating Taxable Income for the relevant Tax Period and all subsequent Tax Periods unless the Authority grants an exception based on the circumstances upon application by the Taxable Person.

When the election is made, Article 26 of the Corporate Tax Law applies to all transfers of assets and liabilities held on the capital account by the Transferor provided the conditions of Article 26 are met.

If Article 26(1) of the Corporate Tax Law applies, any adjustments to the Taxable Income of both the Transferor and the Transferee should be made according to the Ministerial Decision on the general rules for determining taxable income.

#### *Exchange of Assets and Liabilities*

Transfers involving the exchange of assets or liabilities are treated as two separate transfers for the purposes of applying Article 26 of the Corporate Tax Law.

If Article 26(1) applies, each individual transfer within the exchange will be subject to the provisions of Article 26 of the Corporate Tax Law and the Ministerial Decision on general rules for determining taxable income. This applies when at least one of the Taxable Persons involved in the transfer has chosen to apply Article 26 of the Corporate Tax Law.

### *Subsequent Transfer*

Where any gain or loss resulting from the application of Article 26(5) of the Corporate Tax Law is considered for calculating the Taxable Income of the Transferor, it is included in the Tax Return of the Transferor if there is a subsequent transfer of the asset or liability outside of the Qualifying Group or the Transferor or Transferee cease to be members of the same Qualifying Group.

However, if the Transferor has ceased to be a Taxable Person, any gain or loss that would have accrued to the Transferor under Article 26(1) is attributed to the Transferee.

If Article 26(2) applies, the Transferee takes into account any gain or loss for calculating its Taxable Income. It is included in the Tax Return of the Transferee if there is a subsequent transfer of the asset or liability outside of the Qualifying Group or the Taxable Persons cease to be members of the same Qualifying Group.

In the case of a subsequent transfer of part of the asset or liability outside of the Qualifying Group, Article 26(4)(a) of the Corporate Tax Law applies proportionately as required by the context.

When Article 26(5) of the Corporate Tax Law applies to a transfer, the Transferee makes necessary adjustments to its Taxable Income during the relevant Tax Period. This is done to reverse any depreciation, amortisation, or change in the value of an asset or liability that has been previously adjusted by the Transferee for this transfer, following the Ministerial Decision on general rules for determining taxable income.

The relevant provisions of the Ministerial Decision on general rules for determining taxable income no longer apply for the current and future Tax Periods regarding this transfer.

Further, according to *Ministerial Decision No. 134 of 2023*, dated 29 May 2023 on the General Rules for determining taxable income following other adjustments have been prescribed.

Certain adjustments are to be made in the calculation of the Taxable Income of the Transferee when there has been a transfer of assets or liabilities between Taxable Persons who are members of the same Qualifying Group, excluding Tax Groups under the Corporate Tax Law. This applies when Article 26(1) of the Corporate Tax Law applies.

The adjustments can be summarised as follows:

- ◆ In cases other than upon realisation, exclude any changes in value (such as depreciation, amortisation, or other changes) related to a gain or loss that arose to the Transferor and has not been recognised as a gain or loss under the application of Article 26(1) of the Corporate Tax Law. This adjustment aims to exclude any unrealised gains or losses from the calculation of the Transferee's Taxable Income.
- ◆ Upon realisation of an asset or liability, include any amount that has not been recognised for Corporate Tax purposes under the specific clause and article mentioned above, except for amounts that arose prior to the most recent

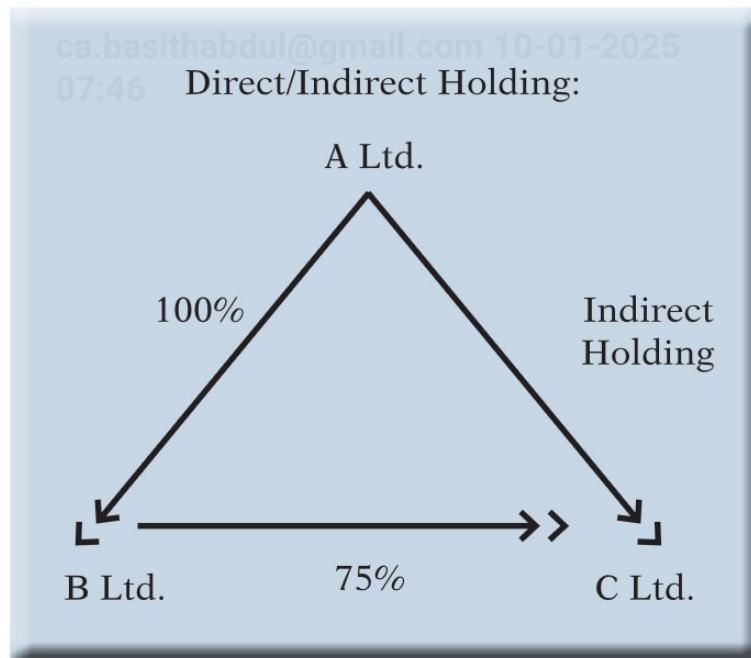


acquisition where Article 26(1) of the Corporate Tax Law did not apply. This adjustment ensures that any unrecognised gains or losses related to the transfer are included in the Transferee's Taxable Income upon realisation.

This provision focuses on the tax treatment of transfer of assets or liabilities within a Qualifying Group of Taxable Persons, excluding Tax Groups, as defined by the Corporate Tax Law. It addresses the adjustments to be made in the calculation of the Transferee's Taxable Income in situations where Article 26(1) of the Corporate Tax Law applies.

The adjustments aim to align the Taxable Income of the Transferee with the economic reality of the transfer. The first adjustment excludes any unrealised gains or losses that arose to the Transferor and have not been recognised under the applicable clause of the Corporate Tax Law. This ensures that the Transferee is not taxed on gains or losses that have not yet been realised.

The second adjustment focuses on the realisation of assets or liabilities. It includes any previously unrecognised gains or losses related to the transfer in the Transferee's Taxable Income upon realisation. However, it excludes any amounts that arose before the most recent acquisition where the specific clause of the Corporate Tax Law did not apply. This adjustment ensures that the Transferee appropriately accounts for any gains or losses realised from the transfer.



Here, A Ltd. directly holding 100% ownership in B Ltd. and Indirectly holds 75% ownership in C Ltd. through B Ltd.

### **8.2-2c None of the persons should be an exempt person**

None of the persons should be exempt from the CT Law. The CT Law does not permit to form Qualifying Group with an exempt person, and both persons should be subjected to tax under the CT Law.

### ***8.2-2d None of the persons should be a Qualifying Free Zone Person***

None of the taxable persons should be a Qualifying Free Zone person eligible for 0% corporate tax for qualifying income. Any gains or loss arising from the transfer of assets or liabilities by a taxable person to a Qualifying Free Zone Person shall be taken in the computation of taxable income. Further, any gain or loss arising from the transfer of assets or liabilities by a Qualifying Free Zone person shall be taxed as per the provisions of Chapter V.

### ***8.2-2e Financial Year of both taxable persons end on the same date***

The CT Law provides liberty to follow a flexible financial year depending upon the period for which the financial statements are prepared. Accordingly, the financial year of a taxable person can be the Gregorian calendar year or 12 months period for which the taxable person prepares the financial statements.

For availing relief in respect of transfers within Qualifying Group, the CT Law mandates that the financial year of both taxable persons should end on the same date. The Transferor and Transferee cannot follow two different financial years.

### ***8.2-2f Both taxable persons prepare financial statements using same accounting standards***

Consistency in applying the accounting standards for preparing financial statements is an important aspect of claiming relief. Both the taxable person should prepare their financial statements using the same accounting standards.

In case of transfer of assets or liabilities within a Qualifying Group, the asset or liability shall be treated as being transferred at its net book value, and the value of the consideration paid or received against the transfer shall equal the net book value of the transferred asset or liability.

### **8.2-3 Withdrawal of relief**

To prevent mischief and to ensure that the benefit is availed for genuine transfers within the Qualifying group, the CT Law provides an additional lock-in period of 2 years. The benefit shall be withdrawn if the Transferee further transfers such asset or liability outside of the Qualifying Group within a period of two years from the date of transfer. Further, the benefit shall be withdrawn if the taxable persons cease to be members of the same Qualifying Group within a period of 2 years. The lock-in period of 2 years shall be reckoned from the date of transfer.

In case of subsequent transfer or the taxable person ceases to be a member of the same Qualifying Group within a period of 2 years, the taxable income of both the taxable persons for the relevant tax period shall be computed taking the market value as on the date of transfer. The market value shall be derived at a price that could be agreed upon in an arm's-length free market transaction between the persons who are not related parties or connected persons in similar circumstances. Any gain or loss arising from such adjustment shall be taken in the computation of taxable income for the tax period in which the withdrawn conditions are triggered.



### **8.2-4 Illustration**

Mr. A, a resident of the USA, owns 80% ownership interest in two UAE entities, A LLC and B LLC, which are engaged in the business of dry fruit trading and food processing activities, respectively. Mr. A also owns 100% ownership interest in a USA-based C LLC, which is engaged in the manufacturing of FMCG products and has a factory in the UAE.

As a part of the restructuring, the following activities are envisaged:

- (a) Transfer machinery from C LLC's UAE factory to B LLC
- (b) Transfer assets from A LLC to B LLC

What shall be the tax implications if Mr. A sells 30% ownership interest in A LLC after 1 year?

The Qualifying Group can be formed between two taxable juridical persons who are UAE residents or permanent establishments of non-residents in the UAE. A LLC and B LLC are resident juridical persons, and C LLC is a juridical non-resident who has a permanent UAE establishment. Since Mr. A has more than 75% ownership interest in all three entities, all the entities shall constitute the Qualifying Group. Hence, the transfer of assets as a part of restructuring activities shall be eligible for relief.

However, if Mr. A sells 30% ownership interest after 1 year, the ownership interest shall fall below 75%, and A LLC shall cease to be a member of the Qualifying Group. The benefit shall stand withdrawn. In such case, the gain or loss arising based on the market value as of the date of transfer shall be adjusted in the computation of taxable income of A LLC and C LLC.

### **8.2-5 Key Highlights of CT Guide on Qualifying Group Relief**

FTA has published a Corporate Tax Guide on "Qualifying Group Relief" aiming to provide general guidance on the Relief available under the CT Law. The key highlights of the Guide are outlined below:—

#### ***8.2-5a Assets and liabilities eligible for Qualifying Group (QG) Relief***

1. QG Relief is applicable on transfers such as sale, exchange, relinquishment, sale, and lease back, etc.
2. QG Relief applies only to the transfer of assets or liabilities held on capital account and recorded on the balance sheet of the Transferor.
3. The transfer of assets or liabilities which are not held on capital account (for example, inventory transferred as part of regular Business operations) is not within the scope of QG Relief and hence, cannot benefit from the no gain or loss tax treatment.
4. A transfer of assets or liabilities which are not recognised in the Financial Statements of the Transferor (for example, a self-generated intellectual property, such as goodwill, brand or customer lists) would not fall within the scope of QG Relief.

5. Where assets or liabilities are transferred to a Taxable Person as a result of liquidation, dissolution or merger, QG Relief shall not apply.

### **8.2-5b Consideration for transfer under QG Relief**

1. QG Relief does not require any consideration to be paid. Where it is paid, it does not need to be in a specific form. Further, the consideration can be in cash or in kind.
2. Where the Transferee pays consideration in kind in the form of another asset or liability held on capital account, this constitutes an exchange transaction. An exchange of assets or liabilities between two members of the same QG shall be treated as two separate transfers for the purposes of QG Relief.

### **8.2-5c Compliance requirements**

1. The no gain or loss treatment within the QG is only available if the Transferor makes an election to FTA which means the QG relief is not automatic.
2. Transfer pricing rules are not applicable if the transferor has made an election for QG Relief in respect of transferred assets or liabilities that are held on the capital account.
3. Both the Transferor and the Transferee are required to maintain a record of the agreement to transfer the asset or liability and evidence of the value.
4. In case the conditions of QG are not met or the Transferor does not elect for the QG relief, the transfer will be taxable as per the normal provisions of the UAE CT Law according to arm's length pricing as outlined in the Transfer Pricing Rules.

## **8.3 Article 27: Business Restructuring Relief**

Article 27 reads as follows:

- 1. No gain or loss needs to be taken into account in determining Taxable Income in any of the following circumstances:*
  - (a) *A Taxable Person transfers its entire Business or an independent part of its Business to another Person who is a Taxable Person or will become a Taxable Person as a result of the transfer in exchange for shares or other ownership interests of the Taxable Person that is the Transferee.*
  - (b) *One or more Taxable Persons transfer their entire Business to another Person who is a Taxable Person or will become a Taxable Person as a result of the transfer in exchange for shares or other ownership interests of the Taxable Person that is the Transferee, and the Taxable Person or Taxable Persons that are the Transferor cease to exist as a result of the transfer.*
- 2. Clause 1 of this Article applies where all of the following conditions are met:*
  - (a) *The transfer is undertaken in accordance with, and meets all the conditions imposed by, the applicable legislation of the State.*

- (b) *The Taxable Persons are Resident Persons, or Non-Resident Persons that have a Permanent Establishment in the State.*
- (c) *None of the Persons are an Exempt Person.*
- (d) *None of the Persons are a Qualifying Free Zone Person.*
- (e) *The Financial Year of each of the Taxable Persons ends on the same date.*
- (f) *The Taxable Persons prepare their financial statements using the same accounting standards.*
- (g) *The transfer under Clause 1 of this Article is undertaken for valid commercial or other non-fiscal reasons which reflect economic reality.*
3. *For the purposes of this Decree-Law, where a Taxable Person applies Clause 1 of this Article, all of the following must be observed:*
- (a) *The assets and liabilities transferred shall be treated as being transferred at their net book value at the time of transfer so that neither a gain nor a loss arises.*
- (b) *The value of the shares or ownership interests received under paragraph (a) of Clause 1 of this Article shall not exceed the net book value of the assets transferred and liabilities assumed, less the value of any other form of consideration received.*
- (c) *The value of the shares or ownership interests received under paragraph (b) of Clause 1 of this Article shall not exceed the book value of the shares or ownership interests surrendered, less the value of any other form of consideration received.*
- (d) *Any unutilised Tax Losses incurred by the Taxable Person that is the Transferor prior to the Tax Period in which the transfer under Clause 1 of this Article completes may become carried forward Tax Losses of the Taxable Person that is the Transferee, subject to conditions to be prescribed by the Minister.*
4. *The provisions of this Article shall apply, as the context requires, where, in the case of a transfer under Clause 1 of this Article:*
- (a) *Shares or ownership interests are received by a Person other than the Taxable Person that is the Transferor;*
- (b) *Shares or ownership interests are issued or granted by a Person other than the Taxable Person that is the Transferee; or*
- (c) *No shares or ownership interests are received by the Taxable Person who is a partner in an Unincorporated Partnership that is treated as a Taxable Person under Clause 9 of Article 16 of this Decree-Law.*
5. *Where a Taxable Person transfers an independent part of its Business, paragraph (d) of Clause 3 of this Article shall apply only to those unutilised Tax Losses that can be reasonably attributed to the independent part of the Business being transferred.*
6. *The provision of Clause 1 of this Article shall not apply where, within (2) two years from the date of the transfer, any of the following occurs:*

- (a) *The shares or other ownership interests in the Taxable Person that is the Transferor or the Transferee are sold, transferred or otherwise disposed of, in whole or part, to a Person that is not a member of the Qualifying Group to which the relevant Taxable Persons belong.*
  - (b) *There is a subsequent transfer or disposal of the Business or the independent part of the Businesses transferred under Clause 1 of this Article.*
7. *Where Clause 6 of this Article applies, the transfer of the Business or the independent part of the Business shall be treated as having taken place at Market Value at the date of the transfer.”*

### **8.3-1 Overview**

Article 27 provides that:

- (a) No gains or loss arising from eligible business restructuring shall be taken into the computation of taxable income;
- (b) Any utilised tax loss of the business shall be carried forward to the Transferee to the extent reasonably attributable to the business subjected to transfer;
- (c) A lock-in period of two years has been prescribed to continue holding the ownership interest in the Transferee and the business transferred.

### **8.3-2 Transactions not subject to UAE CT Law**

To facilitate mergers, demergers, spin-offs and corporate restructuring transactions, the UAE CT Law provides relief from taxation of resultant gains. No gains or loss arising from the transfer of the whole business or independent parts of a business in exchange for shares or other ownership interests shall be taxable under the CT Law.

Accordingly, any gain or loss arising from the following transactions shall not be subject to taxation under the CT Law:

#### **8.3-2a Demerger**

The business restructuring relief shall be allowed on transferring the entire business or an independent part thereof by a taxable person to another person in exchange for shares or other ownership interest of the Transferee. The Transferee can be a taxable person or should become a taxable person as a result of the transfer. In common parlance, such a transaction may be referred to as ‘Demerger’.

In the case of demerger, the Transferor continues to survive. It transfers the business or any part thereof to another taxable person or any person who shall become a taxable person because of such transfer. The Transferor shall receive consideration in the form of shares or other ownership interest in the transferee entity for the transfer of the business. The Transferor can even transfer part of the business and continue to hold and run the remaining business.



### ***8.3-2b Merger or Amalgamation***

The business restructuring relief shall be allowed on transferring the entire business by one or more taxable persons to another person in exchange for shares or other ownership interest of the Transferee. As a result of such transfer, the Transferor ceases to exist. The Transferee should be a taxable person, or it will become a taxable person as a result of such transfer. In common parlance, such a transaction may be referred to as a 'Merger or Amalgamation'.

In case of merger or amalgamation, one or more taxable persons transfer their entire business to another taxable person or to any person who shall become a taxable person because of such transfer. After such business restructuring, the Transferor ceases to exist. The Transferor receives shares or other ownership interest of the Transferee and becomes an owner of the transferee entity.

Important to note that the consideration for transfer of business can be issued by the transferee entity or any other person. Hence, the transferee company or its parent company can issue consideration in the form of shares or ownership interest in the transferee company. Similarly, shares or ownership interests can be received by a transferor or any other person. Accordingly, the consideration in the form of shares or ownership interest can be received by the shareholders of the transferor entity as well. However, no shares or ownership interests shall be received by the partner in an unincorporated partnership treated as a taxable person.

### ***8.3-3 Conditions for tax-neutral business restructuring***

The CT Law lays down the following conditions for tax-neutral business restructuring.

#### ***8.3-3a Transfer in accordance with applicable legislation***

The transfer should be undertaken in accordance with the applicable legislation of the UAE. All the conditions prescribed under the legislation for the restructuring should be complied with, and any violation of the other legislation can lead to taxability under the CT Law.

#### ***8.3-3b Status of Transferor***

The relief shall be available to a resident taxable person or non-residents having a permanent establishment in the UAE.

Should transfer between the following Transferor and Transferee be eligible for relief under Article 27 subject to the satisfaction of other conditions?

<i>Transferor</i>	<i>Transferee</i>	<i>Is relief available?</i>
Resident company	Resident company	Yes
Resident company	PE of a non-resident company in UAE	Yes

<i>Transferor</i>	<i>Transferee</i>	<i>Is relief available?</i>
PE of a non-resident company in UAE	PE of a non-resident company in UAE	Yes
Resident individual running proprietorship business	Resident company	Yes
Resident company	Resident individual	No (Since the individual Transferee cannot issue shares or ownership interest)

### ***8.3-3c None of the persons should be an exempt person***

None of the persons should be exempt from the CT Law, and the CT Law does not allow business restructuring relief to exempt persons. Both persons should be subject to tax under the CT Law.

### ***8.3-3d None of the persons should be a Qualifying Free Zone Person***

None of the transferors or transferees should be a Qualifying Free Zone person eligible for 0% corporate tax for qualifying income. Any gains or loss arising from the transfer of business by a taxable person to a Qualifying Free Zone Person shall be taken in the computation of taxable income. Further, any gain or loss arising from the transfer of business by a Qualifying Free Zone person shall be taxed as per the provisions of Chapter V.

### ***8.3-3e Financial Year of both taxable persons end on the same date***

The CT Law provides liberty to follow a flexible financial year depending upon the period for which the financial statements are prepared. Accordingly, the Financial Year of a Taxable Person can be the Gregorian calendar year or 12 months period for which the Taxable Person prepares the financial statements.

For availing relief in respect of business restructuring, the CT Law mandates that the financial year of both transferor and transferee persons should end on the same date. The Transferor and Transferee cannot follow two different financial years.

### ***8.3-3f Both persons prepare their financial statements using the same accounting standards***

Consistency in applying the accounting standards for preparing financial statements is an important aspect of claiming relief. Both Transferor and Transferee should prepare their financial statements using the same accounting standards.



### **8.3-4 Conditions for relief**

#### ***8.3-4a Economic reality***

The transfer should be undertaken for valid commercial or other non-fiscal reasons which reflect economic reality. The transfer of business for availing tax benefits shall not be eligible for the relief, and the counterfactuals of the transaction would be relevant to test this condition.

#### ***8.3-4b Transfer at net book value***

The net book value of the assets and liabilities transferred should be taken as consideration for the transfer. Hence, no gains or loss arises from the transfer of assets and liabilities under business restructuring.

#### ***8.3-4c Value of shares or ownership interest received***

In the case of 'Demerger', the value of the shares or ownership interests received for the transfer of the business should not exceed the net book value of the assets transferred and liabilities assumed as reduced by the value of any other form of consideration received.

Similarly, the value of the shares or ownership interests received under 'Merger or Amalgamation' should not exceed the book value of the shares or ownership interests surrendered by the owners of the transferor entity as reduced by the value of any other form of consideration received.

#### ***8.3-4d Transfers in Exchange for Shares and Other Forms of Consideration***

The Ministry of Finance has issued *Ministerial Decision No. 133 of 2023* on Business Restructuring Relief. It provides that to meet the conditions of Article 27(1) of the Corporate Tax Law, a transfer must adhere to certain criteria. These criteria state that the Market Value of any additional forms of the consideration received, apart from shares or other ownership interests, should not exceed the *lower* of two values:

- ◆ The net book value of the assets and liabilities transferred.
- ◆ 10% of the nominal value of the ownership interests issued.

#### *Meaning of Ownership Interest*

Ownership interests include various instruments such as ordinary shares, preferred shares, redeemable shares, membership and partner interests, and other securities or rights that entitle the owner to receive profits and liquidation proceeds.

An ownership interest is classified as such if it is considered an equity interest according to the Accounting Standards applied by the Taxable Person holding the ownership interest.

A Taxable Person is considered to hold an ownership interest if it controls it and has the right to the economic benefits produced by that interest, as determined by the Accounting Standards applied by the Taxable Person.



### **8.3-4e Election to apply Business Restructuring Relief**

To apply the provisions of Article 27 of the Corporate Tax Law to a transfer meeting the conditions of that Article, the Transferor must make an election. The election should be made in the prescribed form and manner as determined by the Authority, and both the Transferor and Transferee must maintain the specified records.

If Article 27(1) of the Corporate Tax Law applies, any adjustments to the Taxable Income of both the Transferor and the Transferee should be made according to the Ministerial Decision on the general rules for determining taxable income.

### **8.3-4f Parties to the Transfer**

According to Article 27(4)(a) of the Corporate Tax Law, for the specified purpose, the shares or ownership interests must be received by a Person who has a direct or indirect ownership interest of at least 50% in the Transferor. This requirement ensures that the transfer occurs within a closely related group of entities where there is substantial control or influence over the Transferor by the recipient of the shares or ownership interests.

Likewise, Article 27(4)(b) states that for the specific purpose, the shares or ownership interests must be issued by a Person who has a direct or indirect ownership interest of at least 50% in the Transferee. This condition ensures that the Transferee is closely connected to the issuing entity and establishes a significant ownership link between them.

These provisions set requirements for the transfer of shares or ownership interests in relation to the Transferor and the Transferee. The conditions are based on the ownership structure and aim to ensure that there is a significant ownership connection between the relevant parties involved.

By setting these ownership threshold requirements, the provisions aim to limit the applicability of the specific purposes mentioned in Article 27(4) to transactions involving entities that have a substantial ownership connection. This helps prevent potential abuse or misuse of the provisions by ensuring that the transfer occurs within a related group of entities with a significant level of control or ownership influence.

It is important to understand that Business Restructuring relief in case of amalgamation, merger or demerger is available to the groups with a direct or indirect ownership interest of 50% or more. However, in case of transfer of one or more assets or liabilities, tax neutrality can be availed within the qualifying groups (common ownership of 75%).

### **8.3-5 Relief to be allowed**

If the business restructuring satisfies the above criteria, any gains or loss arising from such transaction shall not be taken into the computation of taxable income.

Subject to the fulfilment of certain conditions, any unutilised tax losses incurred by the Transferor prior to the tax period in which the business restructuring completes can be carried forward to the transferee taxable person. Where a taxable



person transfers an independent part of its business, the unutilised tax losses reasonably attributed to such an independent part of the business shall be transferred to the transferee taxable person. However, the CT Law does not prescribe any method of attribution for the transfer of losses to the transferee entity.

*For example*, Mr. A holds 100% shareholding in Company A. Company A runs two business segments: chemical manufacturing and the FMCG trading business. The balance of carried forward tax losses to date is 1,00,000 AED. As per the latest segmental financial statements, the chemical manufacturing business is profit generating segment, whereas the FMCG trading business is a loss-making business. Company A wants to spin off the chemical manufacturing business to Company B, against consideration in the form of shares of Company B.

On a reasonable basis, it could be argued that the hived-off business of chemical manufacturing activities does not incur losses. Hence, there is no tax loss attributable to chemical manufacturing activities, and hence, no loss should be carried forward to the Transferee.

### **8.3-6 Implications for breach of conditions**

If any of the following events occur within a period of 2 years from the date of the transfer, the relief shall stand withdrawn:

- (a) If the shares or other ownership interests in the Transferor or the Transferee are sold, transferred, or otherwise disposed of, in whole or part, to any person who is not a member of the Qualifying Group to which the relevant taxable persons belong.
- (b) Subsequent transfer or disposal of the business or the independent part of the businesses transferred during the business restructuring.

#### ***8.3-6a On disposal of ownership interest***

The shares or other ownership interest in the Transferor or Transferee should not be sold or otherwise disposed of to any person outside the Qualifying Group to which such person (Transferor or Transferee as the case may be) belongs. Hence, the transfer of shares or other ownership interest in the Transferor to any such non-group member person shall withdraw the benefit. Similarly, the transfer of shares or other ownership interest in the Transferee, in whole or part, to any other person outside the Qualifying Group shall revoke the relief. Whether the Transferee of such share or other ownership interest is part of the Qualifying Group shall be decided basis on the criteria as discussed above under Article 26.

*For example*, assume in the above illustration Mr. A wants to sell 30% stake in Company A to Company C. Company C is also 100% owned by Mr. A only. Hence, Company A and Company C are part of the same Qualifying Group. Since the shares or the ownership interest is sold to a person who is also part of the Qualifying group of the Transferor, the relief shall continue to apply. However, if Mr. A transfers shares in Company A to Company D, in which Mr. A does not hold interest, then as a result of the transfer to a non-group member entity, the relief shall be revoked. Similarly, any transfer of shares or ownership interest in the transferee company

to any other person outside the Qualifying Group within a period of 2 years from the date of transfer shall withdraw the relief. Thus, if Company B further sells or disposes off the Chemical business to another person outside the Qualifying Group, the relief shall be taken away.

If the lock-in period of 2 years is not satisfied and the conditions are violated, the gains or losses arising from the business restructuring transaction shall be taken in the computation of income. Such gains or losses shall be calculated at a market value of such business as on the date of the transfer.

Any gain or loss resulting from applying Article 27(7) of the Corporate Tax Law is considered for calculating the Taxable Income of the Transferor. It is included in the Transferor's Tax Return when:

- (a) Shares or ownership interests in the Transferor or Transferee are sold, transferred, or disposed of to a non-member of the Qualifying Group.
- (b) There is a subsequent transfer or disposal of the Business or the independent part of the Business that was transferred.

However, if the Transferor ceases to be a Taxable Person or is a natural person, any gain or loss that would have occurred to the Transferor is attributed to the Transferee. In this situation, the Transferee shall consider any gain or loss for calculating Taxable Income. It is included in the Transferee's Tax Return.

When Article 27(7) applies to a transfer:

- (a) The Transferee adjusts its Taxable Income during the relevant Tax Period to reverse any previous adjustments made for depreciation, amortisation, or changes in the value of assets or liabilities related to the transfer.
- (b) The relevant provisions of the Ministerial Decision on determining taxable income no longer apply to this transfer for the current and future Tax Periods.

It specifies that any gain or loss should be considered for Taxable Income calculations and reported by the Transferor in their Tax Return. This applies when there is a sale, transfer, or disposal of shares or ownership interests to a non-member of the Qualifying Group or when there is a subsequent transfer or disposal of the Business or its independent part that was originally transferred. However, there are exceptions. If the Transferor ceases to be a Taxable Person or is a natural person, any gain or loss that would have occurred to the Transferor is attributed to the Transferee, who will account for it in their Taxable Income calculations and report it in their Tax Return.

Additionally, the Transferee is required to make necessary adjustments to its Taxable Income for the relevant Tax Period when Article 27(7) applies. This includes reversing any previous adjustments made for depreciation, amortisation, or changes in the value of assets or liabilities related to the transfer. The Ministerial Decision on determining taxable income no longer applies to this specific transfer for the current and future Tax Periods.

Overall, these provisions ensure that gains or losses resulting from transfers are properly accounted for in the Taxable Income calculations of the Transferor and Transferee, depending on the circumstances and the nature of the transfer.



### **8.3-7 General Rules for determining taxable income**

The Ministry of Finance has issued *Ministerial Decision No. 134 of 2023* dated 29 May 2023 (effective from 30 May 2023) on the General Rules for determining taxable income, prescribing the other adjustments.

Certain adjustments are to be made in the calculation of the Taxable Income of the Transferee when there has been a transfer of assets or liabilities between a Taxable Person and another Person, constituting the transfer of an entire Business or an independent part of the Business under Article 27 of the Corporate Tax Law. These adjustments apply when Article 27(1) of the Corporate Tax Law is applicable.

The adjustments can be summarised as follows:

- (a) In cases other than upon realisation, exclude any changes in value (such as depreciation, amortisation, or other changes) related to a gain or loss that arose to the Transferor and has not been recognised as a gain or loss under the application of Article 27(1) of the Corporate Tax Law. This adjustment aims to exclude any unrealised gains or losses from the calculation of the Transferee's Taxable Income.
- (b) Upon realisation of an asset or liability, include any amount that has not been recognised for Corporate Tax purposes, except for amounts that arose prior to the most recent acquisition where Article 27(1) of the Corporate Tax Law did not apply. This adjustment ensures that any unrecognised gains or losses related to the transfer are included in the Transferee's Taxable Income upon realisation.

This provision focuses on the tax treatment of transfers of assets or liabilities between a Taxable Person and any other Person, where the transfer constitutes the transfer of an entire Business or an independent part of the Business as defined by Article 27 of the Corporate Tax Law. It addresses the adjustments to be made in the calculation of the Transferee's Taxable Income when Article 27(1) of the Corporate Tax Law applies.

The adjustments serve to align the Taxable Income of the Transferee with the economic consequences of the transfer. By excluding unrealised gains or losses related to the transfer, the first adjustment ensures that the Transferee is not taxed on gains or losses that have not yet been realised. This is consistent with the principle of taxing income when it is realised rather than based on unrealised fluctuations in value.

The second adjustment focuses on the realisation of assets or liabilities. It includes any previously unrecognised gains or losses related to the transfer in the Transferee's Taxable Income upon realisation. However, it excludes any amounts that arose before the most recent acquisition where the specific clause of the Corporate Tax Law did not apply. This adjustment ensures that the Transferee appropriately accounts for any gains or losses realised from the transfer while maintaining consistency in the tax treatment.



### **8.3-8 Key Highlights of Guide on Business Restructuring Relief**

The FTA has released a Guide concerning “Business Restructuring Relief” ('Relief'), with the aim of offering comprehensive direction on the Relief provisions outlined in the CT Law. This guide is crafted to furnish readers with a broad understanding of the Business Restructuring Relief. The key highlights of the Guide are outlined below:—

#### ***8.3-8a Consideration for transfer***

1. One of the conditions for Business Restructuring Relief on the transfer of a Business or an independent part of a Business is that the consideration for the transfer is to be received by the Transferor.
2. As an exception, a transfer will still be considered to meet the conditions for the Business Restructuring Relief if the consideration is received by a Person that has a direct or Indirect ownership interest of at least 50% in the Transferor. The shareholder of the Transferor who can receive the consideration for a transfer within the framework of Business Restructuring Relief can be a juridical person or a natural person and is not required to be a Taxable Person.

#### ***8.3-8b Conditions to qualify for BR Relief***

1. There is no condition in respect of the ownership of the transferor or the transferee. Thus, the relief covers business restructuring transactions where a business is transferred from one related party to another and also where the business restructuring is between third parties.

#### ***8.3-8c Consequences of electing for BR Relief***

1. **For the Transferor:** As the Transfer of assets and liabilities is at net book value, there will be no taxable gain or loss for the Transferor.
2. **For Transferee:**
  - ◆ **In cases other than realisation** - The Transferee shall exclude depreciation, amortisation or other change in the value of the transferred assets and liabilities to the extent that they relate to the gain or loss that arose to the Transferor and were not recognised as a result of the Business Restructuring Relief being applied.
  - ◆ **In cases upon realization** - The Transferee will need to include any amount that has not been recognised for CT purposes.

#### ***8.3-8d Transfer of Tax Losses***

1. Where a business or independent part of a business is transferred on a no gain or loss basis, any unutilised tax losses incurred by the Transferor in tax periods before the restructuring transaction, can be carried forward



and are considered as tax losses of the transferee, provided the transferee continues to conduct the same or a similar business or business activity as the Transferor conducted before the restructuring transaction.

ca.basithabdul@gmail.com 10-01-2025  
11:05 **TAXMANN**





## CHAPTER

# 9

# Deductions

### 9.1 Introduction

The computation of the taxable income begins with the profits computed as per the financial statement. The CT Law further provides for certain adjustments to the book profit basis on which the taxable income shall be derived. Chapter IX 'Deductions' of the CT law contains Articles dealing with the deductibility of certain expenditures. As a general principle, any revenue expenditure incurred wholly and exclusively for the purpose of business is a deductible expenditure. However, no deduction shall be allowed in respect of expenditure incurred for exempt income or personal purposes. The CT Law contains 'Thin Cap' provisions to restrict the deduction of interest expenditure to the extent of 30% EBITDA. Further, any interest payable on the loan obtained from related parties for restricted purposes shall not be allowed in the computation of income.

The CT Law allows the deduction of entertainment expenditure in the computation of income only to the extent of 50%. Further, no deduction shall be available in respect of the dividend paid, donations, gifts, bribes, fines, and penalties for violation of law, corporate tax, foreign tax, etc.

Chapter IX comprises of following Articles:

- (a) Article 28: Deductible Expenditure
- (b) Article 29: Interest Expenditure
- (c) Article 30: General Interest Deduction Limitation Rule
- (d) Article 31: Specific Interest Deduction Limitation Rule
- (e) Article 32: Entertainment Expenditure
- (f) Article 33: Non-deductible Expenditure

Article 28 provides conditions for claiming a deduction of expenditure. Generally, the revenue expenditure incurred wholly and exclusively for the purpose of business shall be allowed as a deduction in the computation of taxable income. Articles 29, 30 and 31 deal with interest deduction. No interest shall be allowed as a deduction in the computation of taxable income in excess of 30% of the EBITDA for the relevant tax period. Excess net interest expenditure shall be carried forward to subsequent 'ten' tax periods. No interest deduction shall be allowed in respect of a loan obtained, directly or indirectly, from a related party for specified purposes. Article 32 denies entertainment expenditure to the extent of 50% of the expenditure amount. Article 33 denies a deduction for the expenditures incurred for donation, fines, profit distribution, etc.



## 9.2 Article 28: Deductible Expenditure

Article 28 reads as follows:

- "1. *Expenditure incurred wholly and exclusively for the purposes of the Taxable Person's Business that is not capital in nature shall be deductible in the Tax Period in which it is incurred, subject to the provisions of this Decree-Law.*
2. *For the purposes of calculating the Taxable Income for a Tax Period, no deduction is allowed for the following:*
  - (a) *Expenditure not incurred for the purposes of the Taxable Person's Business.*
  - (b) *Expenditure incurred in deriving Exempt Income.*
  - (c) *Losses not connected with or arising out of the Taxable Person's Business.*
  - (d) *Such other expenditure as may be specified in a decision issued by the Cabinet at the suggestion of the Minister.*
3. *If expenditure is incurred for more than one purpose, a deduction shall be allowed for:*
  - (a) *Any identifiable part or proportion of the expenditure incurred wholly and exclusively for the purposes of deriving Taxable Income.*
  - (b) *An appropriate proportion of any unidentifiable part or proportion of the expenditure incurred for the purposes of deriving Taxable Income that has been determined on a fair and reasonable basis, having regard to the relevant facts and circumstances of the Taxable Person's Business."*

### 9.2-1 Overview

Article 28 provides as under:

- (a) Subject to provisions of Chapter IX, revenue expenditure incurred wholly and exclusively for the purpose of business shall be deductible in the computation of taxable income;
- (b) While calculating the taxable income, no deduction shall be allowed in respect of the following:
  - ◆ Expenditure incurred for any purpose other than the business purpose;
  - ◆ Expenditure incurred for deriving an exempt income; and
  - ◆ Losses not connected with the business.
- (c) If an expenditure is incurred for more than one purpose, then deduction shall be proportionately allowed only for those incurred for earning taxable income.

### 9.2-2 Allowable Expenditure

The taxable person shall start the computation of taxable income with reference to its book profits. Subject to the provisions of the CT Law, reliefs shall be taken into consideration. The taxable income of a taxable person shall be derived after deducting the allowable expenditure from the taxable income.

As a general principle, unless otherwise provided, an expenditure shall be allowed in the computation of taxable income if the following conditions are satisfied:

- (a) The taxable person has 'incurred' expenditure;
- (b) Such expenditure should have been incurred wholly and exclusively for the purpose of business;
- (c) Such expenditure should not be capital in nature.

### **9.2-2a Meaning of 'Incur'**

An amount of expenditure is allowed as a deduction in the Tax Period in which it is incurred. As per the Explanatory Guide, when a cost or expenditure is deemed to be incurred will depend on the basis of financial accounting a person follows. In broad terms, a Person recognises an expenditure on a cash basis when it is paid and recognised on an accruals basis when the obligation to pay arises (*i.e.* when it is irrevocably committed for payment).

*For example,* Company A, a taxable person, has availed consultancy services during the financial year 2024-25. It received an invoice worth 10,000 AED dated 31-03-2025, payable on or before 10-04-2025. Whether Company A shall be allowed a deduction of consultancy services in the computation of taxable income for the FY 2024-25? Since the taxable person has availed services and is liable to pay the fees of 10,000 AED, the expenditure shall be allowed in the computation of income. The fact that the payment is pending is not a relevant criterion in granting a deduction.

### **9.2-2b Meaning of 'Wholly' and 'Exclusively'**

All the expenditure should be incurred by a taxable person 'wholly and exclusively' for the purpose of business. The word 'wholly' refers to the quantum of expenditure, whereas 'exclusively' refers to the motive, objective, and purpose of the expenditure. It should be examined whether the expense has been incurred with the sole object of furthering the trade or business interest of the taxable person and not mixed with any other consideration. If the expense bears an element other than the trade or business interest of the taxable person, the expenditure is not 'wholly and exclusively' incurred for the purpose of business.

*For example,* A LLC pays an insurance premium for the life of its keyman managerial person Mr. X. In case of death or permanent disability of Mr. X, A LLC will receive 1,000,000 AED from the insurance company. Such insurance premium is paid to cover the probable loss arising to A LLC. Hence, the insurance premium shall be allowed as an expenditure incurred wholly and exclusively for the purpose of business.

*For example,* A LLC pays an insurance premium for the life of Ms. C, daughter of director Mr. X. In case of death or permanent disability of Ms. C, the insurance company shall pay 100,000 AED to the legal heir of Ms. C. In such case, the insurance premium is not paid wholly and exclusively for the purpose of the business. Hence, the deduction shall be denied.



*For example*, a business is paying an insurance expense of its proprietor and booking such payment as expenditure in its books of account. The expenditure is not wholly and exclusively for the purpose of the business.

### **9.2-3 Expenditures not allowed as a deduction**

#### ***9.2-3a Capital expenditure***

No deduction shall be allowed for an expenditure which is capital in nature. Where the object of making the payment is to acquire a capital asset or to bring into existence an asset or an advantage for the enduring benefit of a trade, then it may be regarded as a capital expenditure. The word 'capital' connotes permanency, and capital expenditure is, therefore, closely akin to the concept of securing something, tangible or intangible property, corporeal or incorporeal right so that they could be of a lasting or enduring benefit to the enterprises in the issue. On the other hand, revenue expenditure is operational in its perspective and solely intended for the furtherance of the enterprise. *For example*, the sum incurred to purchase plant and machinery, car, computer, etc., is a capital expenditure.

#### ***9.2-3b Personal expenditure***

No deduction shall be allowed in respect of expenditure incurred for any purpose other than business. Hence, any expenditure incurred for personal purposes shall not be allowed.

*For example*, Mr. A, a lawyer, suffers from cardiac conditions, and he undergoes surgery. The expenditure incurred for the cardiac surgery is an expenditure incurred for personal purposes, and hence, no deduction shall be allowed in the computation of taxable income.

#### ***9.2-3c Expenditure to earn exempt income***

The CT Law grants expenditure in reference to the taxable income only. No expenditure incurred for the purpose of earning and generating the exempt income can be allowed as a deduction in the computation of taxable income.

*For example*, dividends and other profit distributions received from a resident juridical person are exempt incomes. Any expenditure incurred to earn such income, like convenience fees, etc., shall not be allowed as a deduction.

#### ***9.2-3d Personal losses***

Only those losses connected with or arising out of the taxable person's business shall be allowed as a deduction in the computation of taxable income. Personal loss cannot be claimed as a deduction.

*For example*, Mr. A is running a restaurant business. He extends a personal loan to Mr. B to meet his household requirement. Mr. B could not repay the loan, and the amount is considered as bad debt. Since the loss is not connected with or arising out of Mr. A's business, no deduction shall be allowed in the computation of

income. Further, the Cabinet, at the suggestion of the Minister, can prescribe other non-deductible expenditures.

#### ***9.2-4 Expenditure for more than one purpose***

In case of expenditure incurred for more than one purpose, the deduction shall be allowed for any identifiable proportion of the expenditure incurred wholly and exclusively for the purposes of deriving taxable income. However, in other cases, an appropriate proportion of the expenditure determined on a fair and reasonable basis can be allowed as a deduction.

*For example*, Company A gives a car to its employees for business and personal purposes. The employees are expected to maintain a log regarding the use of car for business and personal purposes. Basis the same, the revenue expenditure for the use of cars shall be allowed in the computation of income.

### **9.3 Article 29: Interest Expenditure**

Article 29 reads as follows:

*"Notwithstanding paragraph (b) of Clause 2 of Article 28 of this Decree-Law, Interest expenditure shall be deductible in the Tax Period in which it is incurred, subject to the other provisions of Article 28 and Articles 30 and 31 of this Decree-Law."*

#### ***9.3-1 Overview***

Article 29 read with Article 30 provide as under:

- (a) No interest deduction shall be permissible in excess of 30% of the EBITDA for the relevant tax period;
- (b) The net interest expenditure in excess of 30% of the EBITDA shall be carried forward and deducted in the subsequent ten years;
- (c) No interest deduction shall be allowed in respect of a loan obtained, directly or indirectly, from a related party for specified purposes.

#### ***9.3-2 Deductibility of an interest expenditure***

Generally, companies rely on different funding sources to finance their business activities. Such funding can be raised through debt instruments or equity instruments, or quasi-debt/quasi-equity instruments. The debt instruments carry interest and repayment obligations. The interest expenditure is charged to profit and allowed as a deduction in the computation of taxable income.

The interest deduction would be allowed in the computation of income, even if such interest is paid to derive exempt income.

*For example*, the taxable person has borrowed funds and invested in the shares of a subsidiary resident company. The subsidiary company pays dividends which is exempt under Article 22(1) of the CT Law. The borrowed funds carry a coupon, and the taxable person pays the interest during the period. Even though the interest is



paid for deriving the exempt income, the interest shall be allowed as a deduction in the computation of the taxable income.

## 9.4 Article 30: General Interest Deduction Limitation Rule

Article 30 reads as follows:

- “1. A Taxable Person’s Net Interest Expenditure shall be deductible up to 30% (thirty per cent) of the Taxable Person’s accounting earnings before the deduction of interest, tax, depreciation and amortisation (EBITDA) for the relevant Tax Period, excluding any Exempt Income under Article 22 of this Decree-Law.
2. A Taxable Person’s Net Interest Expenditure for a Tax Period is the amount by which the Interest expenditure incurred during the Tax Period, including the amount of any Net Interest Expenditure carried forward under Clause 4 of this Article, exceeds the taxable Interest income derived during that same period.
3. The limitation under Clause 1 of this Article shall not apply where the Net Interest Expenditure of the Taxable Person for the relevant Tax Period does not exceed an amount specified by the Minister.
4. The amount of Net Interest Expenditure disallowed under Clause 1 of this Article may be carried forward and deducted in the subsequent (10) ten Tax Periods in the order in which the amount was incurred, subject to Clauses 1 and 2 of this Article.
5. Interest expenditure disallowed under any other provision of this Decree-Law shall be excluded from the calculation of Net Interest Expenditure under Clause 2 of this Article.
6. Clauses 1 to 5 of this Article shall not apply to the following Persons:
  - (a) A Bank.
  - (b) An Insurance Provider.
  - (c) A natural person undertaking a Business or Business Activity in the State.
  - (d) Any other Person as may be determined by the Minister.
7. The Minister may issue a decision to specify the application of Clauses 1 and 2 of this Article to a Taxable Person that is related to one or more Persons through ownership or control and there is an obligation on them under applicable accounting standards for their financial statements to be consolidated.”

### **9.4-1 Limit on deduction for interest expenditure**

The company may require funding for undertaking business activities. Since debt funding carries an interest obligation, which is an allowable expenditure in the computation of taxable income, the business groups may prefer a highly leveraged capital structure. To prevent such base erosion, the CT Law states that a taxable person’s Net Interest Expenditure shall be deductible up to 30% of the taxable per-

son's accounting earnings before the deduction of interest, tax, depreciation, and amortisation (EBITDA).

#### ***9.4-2 De Minimis Net Interest Expenditure***

The Cabinet has provided a safe harbour threshold or '*De Minimis Net Interest Expenditure*' *vide Ministerial Decision No. 126 of 2023*, dated 30 May 2023 to reduce the administrative burden. Where the net interest expense of the taxable person for the relevant tax period does not exceed such threshold, the expenditure shall be allowed without applying the limit based on the EBITDA rule. According to this Decision, the General Interest Deduction Limitation Rule shall not apply where the Net Interest Expenditure for the relevant Tax Period does not exceed AED 12 million. Hence, in case the Net Interest Expenditure exceeds the threshold of AED 12,000,000, the deduction on account of interest shall be limited to higher of:

- (a) AED 12,000,000 or
- (b) 30% of the EBITDA (*i.e.* accounting earnings before the deduction of interest, tax, depreciation and amortisation) for the relevant tax period.

In case the relevant Tax Period is more than or less than 12 months, the threshold of AED 12 million shall be adjusted in proportion to the length of the Tax Period.

#### ***9.4-3 Computation of EBITDA***

*Ministerial Decision No. 126 of 2023*, dated 30 May 2023 defines EBITDA shall be the greater of:

- (a) AED 0 (zero Dirham) or
- (b) Taxable Income calculated in accordance with Article 20 of the Corporate Tax Law, with the addition of Net Interest Expenditure, Depreciation and amortisation expenditure taken into account in determining the Taxable Income and any Interest income or expenditure relating to historical financial assets or liabilities held prior to 9 December 2022.

There are also certain inclusions/exclusions while calculating EBITDA for the General Interest Deduction Limitation Rule:

- (a) Interest income and Interest expenditure in relation to Qualifying Infrastructure Projects exempted under Article 14 of this Decision shall be excluded;
- (b) Any amount of income and expenditures attributable to the interest capitalised in accordance with the Accounting Standards shall be included proportionately in the year of amortisation of capitalised interest over the useful life of the related asset and not when the interest is incurred.

The deduction on account of Interest Expenditure under Article 29 of the Corporate Tax Law shall be applied only after the Accounting Income has been adjusted with the amount of deductions, relief, unrealised gain/loss, exempt incomes etc. in accordance with Article 20(2) of the Corporate Tax Law.



#### ***9.4-4 Computation of net interest expenditure***

The ‘Net interest expenditure’ is calculated as a difference between interest income and interest expenditure for the tax period. The net interest expenditure shall be further increased by the amount of net interest expenditure carried forward from previous years. While computing the net interest expenditure, interest expenditure disallowed under any other provision shall be excluded. All the interest paid to banks, financial institutions, related and unrelated lenders, and individual lenders shall be aggregated in the computation of net interest expenditure.

The net interest expenditure shall be calculated in the following manner:

Particulars	Amount
Total Interest expenditure for the current year	*****
Add: Interest expenditure carried forward from the earlier year	*****
Less: Interest income	(*****)
Less: Interest expenditure disallowed under any other provision	(*****)
Net interest expenditure	*****

#### ***9.4-5 Inclusions in Interest***

##### ***9.4-5a Interest component in instruments***

The Ministry of Finance issued *Ministerial Decision No. 126 of 2023* on 30 May 2023 in relation to General Interest Deduction Rule. The Decision lays down that the interest component in financial returns on Financial Assets and Liabilities shall be considered as interest expense or income for the General Interest Deduction Limitation Rule, regardless of its classification and treatment under the applicable Accounting Standards. This applies to the interest component on various instruments/arrangements such as:

- (a) Performing and non-performing debt instruments;
- (b) Collective Investment Schemes;
- (c) Collateralised asset-backed debt securities;
- (d) Agreements for the sale and subsequent repurchase of the same security at a future date at an agreed-upon price;
- (e) Stock lending arrangements;
- (f) Securitisations and similar transactions;
- (g) Lease or hire purchase arrangements; or
- (h) Factoring and similar accounts receivable purchase transactions.

#### **9.4-5b Interest in connection with raising finance**

The Decision also provides that amounts incurred in connection with raising finance shall be considered interest for the purposes of the General Interest Deduction Limitation Rule, such as:

- (a) Guarantee fees, Arrangement fees, Commitment fees and Other similar charges;
- (b) Interest component on forward contracts, futures contracts and options;
- (c) Interest rate and foreign exchange swap agreements or other financial derivative instruments used for hedging risks.

#### **9.4-5c Islamic Financial Instruments**

The interest equivalent component on Islamic Financial Instruments shall be treated as interest for the purposes of the General Interest Deduction Limitation Rule.

'*Islamic Financial Instruments*' are financial instruments that comply with Sharia principles and are economically equivalent to any instrument covered under the Financial Assets and Liabilities, or a combination thereof.

#### **9.4-5d Finance and Non-Finance Lease**

The finance element of finance and non-finance lease payments accounted for in accordance with the Accounting Standards shall be considered as interest for the purposes of the General Interest Deduction Limitation Rule. This applies to both expenditure incurred and income received in relation to the finance cost element. The total finance element in a lease agreement shall be determined in accordance with the Accounting Standards and in accordance with the accounting policy of the Taxable Person in the year in which the lease was entered into.

#### **9.4-5e Foreign Exchange Movements**

All foreign exchange gains and losses accruing from interest shall be considered as interest and shall be subject to General Interest Deduction Limitation Rule.

#### **9.4-5f Capitalised Interest**

Where an amount that is deemed to be Interest under this Decision is capitalised in the accounts of the Taxable Person in accordance with the Accounting Standards, income and expenditure attributable to the capitalised Interest amount shall be subject to the General Interest Deduction Limitation Rule.

#### **9.4-6 Carry forward of interest**

The net interest expenditure in excess of 30% of the EBITDA shall be carried forward and deducted in the subsequent ten tax periods in the order in which the amount was incurred.



For example, AB LLC earns an interest income of 1,000 AED and has an interest expenditure of 2,000 AED. Its EBITDA is 2,500 AED. The allowable interest expenditure shall be calculated as under:

Particulars	AED
Interest Expense	2,000
Less: Interest Income	(1,000)
Net Interest Expenditure(a)	1,000
30% of EBITDA ( $2,500 \times 30\%$ )(b)	750
Interest expenditure allowed [C = Lower of (a) and (b)]	750
Interest expenditure carried forward for 10 tax periods [(d) = (A) – (C)]	250

For example, M/s XY LLC carried forward net interest expenditure as under:

Tax Period	Amount
1	2,000
2	1,000
3	1,000
4	750
Total	4,750

In tax period 5, the company earned an EBITDA of 10,000 AED. Please suggest the set off of the net interest expenditure.

As per the general interest limitation rule, the net interest deduction shall be restricted to 30% of the EBITDA, i.e. 3,000 AED. The carried forward net interest expenditure can be used as a deduction in the computation of taxable income. The carried forward interest expenditure shall be utilised and set off in the order in which it was incurred, following the 'first in, first out' method. Accordingly, the carried forward net interest expense of the tax periods 1 and 2 shall be adjusted in year 5. The net interest expense for the tax periods 3 and 4 shall be carried forward to the next year.

#### ***9.4-7 Carry forward of interest in Tax Groups***

*Ministerial Decision No. 126 of 2023* on 30 May 2023 provides for special rules to be applied for the treatment of carried forward Net Interest Expenditure in case of the cessation of a Tax Group or a subsidiary joining or leaving a Tax Group.

##### ***9.4-7a Subsidiary joining Tax Group***

Where a Subsidiary joins an existing Tax Group, any carried forward Net Interest Expenditure of the subsidiary at the date the subsidiary becomes a member of the Tax Group may only be utilised against the Taxable Income of the Tax Group that is attributable to that subsidiary.

### **9.4-7b Subsidiary leaving Tax Group**

Where a subsidiary leaves a Tax Group, any carried forward Net Interest Expenditure of the Tax Group shall remain with the Tax Group, except the unutilised carried forward Net Interest Expenditure attributable to that subsidiary.

### **9.4-7c Cessation of Tax Group**

On cessation of a Tax Group, any carried forward Net Interest Expenditure of the Tax Group shall be allocated as follows:

- (a) Where the Parent Company continues to be a Taxable Person, any carried forward Net Interest Expenditure of the Tax Group shall remain with the Parent Company.
- (b) Where the Parent Company ceases to be a Taxable Person, any carried forward Net Interest Expenditure of the Tax Group shall not be available for offset against future Taxable Income of individual subsidiaries, except any unutilised pre-Grouping carried forward Net Interest Expenditure of such subsidiaries.

## **9.4-8 Non-applicability of Interest capping rules**

### **9.4-8a Exemption to certain businesses**

Interest capping rules will not apply to taxable persons being banks, insurance businesses or natural persons. The Cabinet may also prescribe other categories of taxable persons who shall not be subjected to the general interest deduction limitation rule.

Thus, Net Interest Expenditure and Income of a Bank or Insurance Provider within a tax group are excluded while calculating the total Net Interest Expenditure and EBITDA of the Tax Group for the purposes of the General Interest Deduction Limitation Rule.

### **9.4-8b Exemption for historical financial liabilities**

Contracts for debt instruments or other liabilities entered into before or after 9 December 2022 for which terms were agreed before 9 December 2022, solely to reduce the interest rate risk on those liabilities shall not be subject to the General Interest Deduction Limitation Rule. This exemption applies only to the Net Interest Expenditure attributable to the relevant debt instruments or other liabilities. Net Interest Expenditure attributable to debt instruments or other liabilities, in this case shall be the lower of:

- (a) Net Interest Expenditure that arises on the debt instrument or other liability in the Tax Period; or
- (b) Net Interest Expenditure that would have arisen on the debt instrument or other liability in the Tax Period in accordance with the terms of the debt instrument or other liability as they stood on 9 December 2022.



#### **9.4-8c Exemption to Exempt Person**

Interest capping rules will not apply to the Exempt Person. However, the following Exempt Persons shall be subject to the General Interest Deduction Limitation Rule in relation to their independent Business or Business Activity under Article 5, 6, 7 or 8 of the Corporate Tax Law:

- (a) A Government Entity;
- (b) A Government Controlled Entity;
- (c) A Person engaged in an Extractive Business; and
- (d) A Person engaged in a Non-Extractive Natural Resource Business.

#### **9.4-8d Qualifying Infrastructure Projects**

Net Interest Expenditure incurred by a resident Qualifying Infrastructure Project Person in relation to a Qualifying Infrastructure Project shall not be subject to the General Interest Deduction Limitation Rule provided the Qualifying Infrastructure Project Person, and the Qualifying Infrastructure Project satisfies the conditions prescribed below.

##### *Qualifying Infrastructure Project Person*

A Qualifying Infrastructure Project Person is a Resident Person that satisfies one of the following conditions in the relevant Tax Period:

- (a) It is responsible for the provision, maintenance or operation of a Qualifying Infrastructure Project;
- (b) It carries on any other activity that is ancillary to or facilitates the provision, maintenance or operation of a Qualifying Infrastructure Project.

##### *Qualifying Infrastructure Project*

A Qualifying Infrastructure Project is a project that satisfies all of the following conditions:

- (a) It is exclusively for the public benefit of the State;
- (b) It is exclusively for the purposes of providing transport, utilities, education, healthcare or any other service within the State as may be specified by the Minister;
- (c) Its assets may not be disposed of at the discretion of the relevant Qualifying Infrastructure Project Person;
- (d) The assets provided, operated or maintained by the project should last, or be expected to last, not less than 10 years, or another period as may be specified by the Minister;
- (e) All its assets must be situated in the State's Territory;
- (f) All its Interest income and Interest expenditure must arise in the State; and
- (g) It satisfies any other conditions that may be prescribed by the Minister.

## 9.5 Article 31: Specific Interest Deduction Limitation Rule

Article 31 reads as follows:

- “1. No deduction shall be allowed for Interest expenditure incurred on a loan obtained, directly or indirectly, from a Related Party in respect of any of the following transactions:
  - (a) A dividend or profit distribution to a Related Party.
  - (b) A redemption, repurchase, reduction or return of share capital to a Related Party.
  - (c) A capital contribution to a Related Party.
  - (d) The acquisition of an ownership interest in a Person who is or becomes a Related Party following the acquisition.
2. Clause 1 of this Article shall not apply where the Taxable Person can demonstrate that the main purpose of obtaining the loan and carrying out the transaction referred to under Clause 1 of this Article is not to gain a Corporate Tax advantage.
3. For the purposes of Clause 2 of this Article, no Corporate Tax advantage shall be deemed to arise where the Related Party is subject to Corporate Tax or a tax of a similar character under the applicable legislation of a foreign jurisdiction on the interest at a rate not less than the rate specified in paragraph (b) of Clause 1 of Article 3 of this Decree-Law.”

### 9.5-1 Taxability of Interest on borrowed funds

Generally, dividend and profit distribution are not recognised as expenditures for the purpose of business. Similarly, a capital contribution is a capital account activity, and no deduction shall be allowed in respect of such transaction in the computation of taxable income. Capital reduction, repurchase or redemption are not revenue expenditures for the purpose of claiming a deduction. Hence, where the borrowed funds are utilised for the above activities and paid to the related party, no deduction shall be allowed on the interest paid on such borrowed funds. Hence, if a taxable person avails a loan from a related party and utilises the funds for dividend or profit distribution or redemption, repurchase, reduction or return of share capital to a related party, no interest deduction shall be allowed. Further, interest expenditure incurred towards borrowed funds utilised for capital contribution to a related party or acquisition of ownership interest in a person who is or becomes a related party following such acquisition shall not be allowed in the computation of taxable income.

However, the restriction shall not be disallowed if the taxable person can demonstrate that obtaining the loan and carrying out the transaction is not to gain a corporate tax advantage. It shall be deemed that no corporate tax advantage arises if the related party lender to whom the interest is paid is subjected to corporate tax or tax of a similar character under the applicable legislation of a foreign jurisdiction, which is not less than the interest rate at a rate not less than the CT rate, i.e. 9%.



## 9.6 Article 32: Entertainment Expenditure

Article 32 reads as follows:

- “1. Subject to Article 28 of this Decree-Law, a Taxable Person shall be allowed to deduct 50% (fifty per cent) of any entertainment, amusement, or recreation expenditure incurred during a Tax Period.
2. Clause 1 of this Article applies to any expenditure incurred for the purposes of receiving and entertaining the Taxable Person’s customers, shareholders, suppliers or other business partners, including, but not limited to, expenditure in connection with any of the following:
  - (a) Meals.
  - (b) Accommodation.
  - (c) Transportation.
  - (d) Admission fees.
  - (e) Facilities and equipment used in connection with such entertainment, amusement or recreation.
  - (f) Such other expenditure as specified by the Minister.”

### 9.6-1 Deduction for entertainment expenditure

Entertainment expenses are revenue in nature. As per the general provision under Article 28 of the CT law, the entire entertainment expenses would have been allowed to arrive at the taxable profits. However, the entertainment expenditure involves elements of non-business and personal purposes. The CT Law presumes that entertainment expenses have been incurred for non-business use as well, and based on this assumption, the expenditure is restricted to the tune of 50%.

#### 9.6-1a Entertainment expenses for customers, suppliers and shareholders

Expenses incurred in relation to the entertainment of customers, shareholders, suppliers, and other business partners, such as meals, accommodation, transportation, admission fees, facilities and equipment used for entertainment and other specified expenses, shall be subjected to deduction to the extent of 50%. Any other expenditure may be decided by the Cabinet for which the deduction shall be restricted to 50% of the amount incurred.

The scope of the entertainment expenses is very wide, and it covers expenses incurred for other business partners who can be any party associated with the business, like distributors, investors, resellers, etc.

For example, AB LLC provides hotel accommodation to its suppliers that cost 25,000 AED to the company, along with the cost of meals of 7,000 AED. It will be considered as an entertainment expense of 32,000 AED. The deduction shall be restricted to only 50%, i.e. 16,000 AED.

### **9.6-1b Entertainment expenses for employees**

The explanatory guide to CT law mentions that this limitation does not apply to the expenses incurred for the employees' entertainment, and such expenses are deductible.

## **9.7 Article 33: Non-deductible Expenditure**

Article 33 reads as follows:

*"No deduction is allowed for:*

- 1. Donations, grants or gifts made to an entity that is not a Qualifying Public Benefit Entity.*
- 2. Fines and penalties, other than amounts awarded as compensation for damages or breach of contract.*
- 3. Bribes or other illicit payments.*
- 4. Dividends, profit distributions or benefits of a similar nature paid to an owner of the Taxable Person.*
- 5. Amounts withdrawn from the Business by a natural person who is a Taxable Person under paragraph (c) of Clause 3 of Article 11 of this Decree-Law or a partner in an Unincorporated Partnership.*
- 6. Corporate Tax imposed on a Taxable Person under this Decree-Law.*
- 7. Input Value Added Tax incurred by a Taxable Person that is recoverable under Federal Decree-Law No. (8) of 2017 referred to in the preamble and what replaces it.*
- 8. Tax on income imposed on the Taxable Person outside the State.*
- 9. Such other expenditure as specified in a decision issued by the Cabinet at the suggestion of the Minister."*

### **9.7-1 Overview**

Article 33 provides that the CT Law does not allow deduction in respect of expenditure incurred for specified transactions.

### **9.7-2 Non-deductible expenditure**

The CT Law provides deductions of revenue expenditures incurred for the purpose of the business. However, it does not provide deductions for the following expenses.

#### **9.7-2a Donations, grants, or gifts to a Non-Qualifying Public Benefit Entity**

Any donations, grants or gifts are not allowed as deduction in the computation of the taxable income. Such donations, grants or gifts are payments of personal nature and cannot be regarded as expenditures incurred for the purpose of business. However, donations, grants or gifts to the Qualifying Public Benefit Entity shall be deductible expenditures in the computation of taxable income.



### **9.7-2b Fines and penalties, other than compensation for damages or breach of contract**

Fines and penalties paid to the government for violation of the statute shall not be allowed as a deduction. However, any payment in the form of compensation for damages or breach of contract shall be allowed in the computation of income. Rather than the nomenclature, the nature of the transaction will be relevant.

*For example,* A LLC had entered into a supply contract with B LLC. As per the agreement, if A LLC fails to provide the contract quantity within a period of 1 month, it has to pay compensation of AED 10,000. A LLC could not match the target and failed to meet the timeline. The penalty/liquidated damages payable as per the agreement would be allowed as a deduction in the computation of the taxable income, as it represents compensation for damages or breach of contract.

*For example,* B LLC violated pollution control regulations and was subjected to a fine of 25,000 AED. The payment of the fine would not be allowed as a deduction.

### **9.7-2c Bribes or other illicit payments**

Bribe and illicit payments in violation of the law are discouraged. The payments in violation of the law cannot be permissible as a deduction in the computation of taxable income. The bribe and any payments to any government authorities or any other organisations in violation of the law shall be disallowed.

### **9.7-2d Dividends, profit distributions or similar benefits to an owner of the taxable person**

Dividends, profit distributions, or benefits of a similar nature paid to an owner of the taxable persons shall be an appropriation of profits and not charged to the profits. Appropriation of profits cannot be considered as expenditure incurred wholly and exclusively for the purpose of profits and gains.

The explanatory guide to CT clearly provides that if any payment is made to the owner or shareholder which is contingent on the financial performance of the business, then such payments will be treated as profit distributions and not allowed as deductions to the taxable person.

### **9.7-2e Amount withdrawn from the business by a natural person**

A natural person is a taxable person if he conducts a business or business activity in the State or is a partner in an Unincorporated Partnership. A natural person may withdraw the business funds for household purposes. Such withdrawal cannot be regarded as expenditure incurred for the purpose of the business and is not eligible for deduction. Similarly, the amount withdrawn from the business by a partner in an unincorporated partnership shall also be not allowed as a deduction.

### **9.7-2f Corporate tax imposed on a taxable person**

The corporate tax imposed on a taxable person cannot be allowed as a deduction in the computation of taxable income.