



Public Consultation  
Document for UAE CT

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# 1. Background

The UAE Ministry of Finance (“MoF”) has released a consultation paper (“draft”) to provide insight on the potential Corporate Tax (“CT”) regime in UAE which shall be applicable after 1st June 2023. This draft is released to seek stakeholder comments, before 19th May 2022 in order to incorporate the best industry practices. The purpose of introduction of CT is to enable UAE to achieve its strategic objectives and accelerate the development and transformation.

CT shall apply to businesses as well as natural persons undertaking a commercial license or equivalent permit, operating within seven emirates shall also include Free Zones (at a 0% tax rate).



# Taxable Person & Residential Status

UAE CT shall apply to the following persons:

- ❖ Individuals engaged in commercial activities in UAE
- ❖ Incorporated Legal Entities in UAE
- ❖ Foreign entities managed and controlled from UAE
- ❖ Foreign entities having permanent establishments or UAE sourced income
- ❖ Unlimited liability partnerships and unincorporated JVs will be flow through entities for UAE CT purposes and the income will be taxable in the hands of partners or members

The above mentioned are the taxable persons, there are certain entities which are exempt from the CT regime which include Federal and Emirate governments, their departments, and companies carrying out sovereign activities, companies engaged in the extraction of natural resources, charities, pension funds, investment funds (subject to conditions).

Residency is key to determine the levability of UAE CT on any person. Furthermore, UAE taxable persons (resident individuals and UAE companies) shall be taxed on worldwide income subject to the benefit of foreign tax credit and DTAA.

## W & S Takeaway:

- Individuals who are partners or members of unlimited liability partnerships and unincorporated JVs shall not be liable to be taxed on their flow through/pass through income if it is in the nature of dividend or capital gains, investment and rental income (however, commercial profit shall be chargeable to tax).
- Family Office – Foundation/Trust having a passive income shall also be treated at par with individuals and accordingly not liable to be taxed.

# Taxability of a Free Zone

UAE government reaffirmed that UAE CT will continue to honor the tax incentives currently being offered to Free Zones persons. Subject to the substance requirements of other conditions.

A Free Zone Entity (entities incorporated in Free Zones and Branches registered in Free Zones) shall continue to enjoy the benefit from a 0% CT rate on the following income:

- Income from businesses outside UAE/export to other countries
- Income from trading with other Free Zone entities
- Income from regulated financial services directed at foreign markets

Free Zone entities shall be permitted to carry the following mainland activities without forfeiting their 0% tax rate:

- Income from branch office in mainland (profits of the branch taxable at 9%)
- Earning passive income from mainland entities (interest, royalties, dividend)
- Transactions with the mainland companies (however, payments to Free Zone entities shall not be a deductible expense for mainland companies)
- Sale of goods to mainland businesses by entities in designated Free Zones

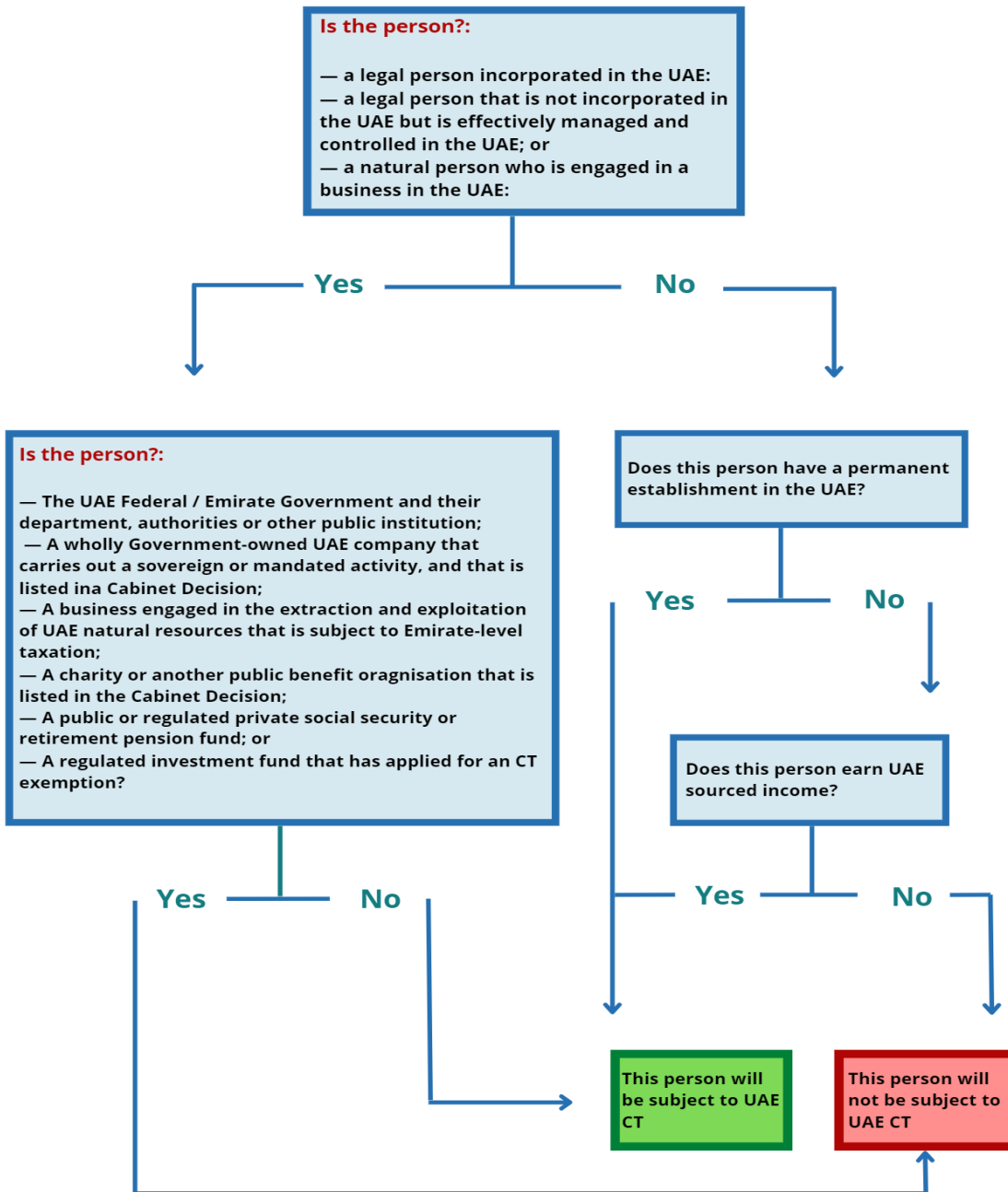
## Important Note

It is pertinent to note that any other income earned by a Free Zone entity while transacting with a mainland entity **shall disqualify the Free Zone entity from 0% tax rate** and such a Free Zone entity shall be liable to pay tax on the entire income of the Free Zone Entity.

## W & S Takeaway:

- Free Zone Entities are recommended to have separate books of accounts for the Free Zone operations and mainland branch.
- Clarification is also required as to whether the passive income, sale of goods exclusion shall also apply to inter group transactions.
- Assessment of corporate structure, business operating model, interaction between group companies etc. is required to understand the impact of proposed CT on businesses. Timely Restructuring may be considered to align your business and corporate structure with the proposed UAE CT regime in a tax efficient manner.

# Flowchart



# Computation of Taxable Income

The draft paper seeks the businesses to use acceptable accounting standards in the UAE for the computation of taxable income.

The computation of the tax shall primarily include accounting profit or loss, in cases where the entities do not have a financial accounting period, their default tax period shall be the Gregorian calendar year. *(i.e. from 1st January to 31st December)*

**It provides the accounting for the unrealized gains and losses under the common accounting practice which includes the following two elements:**

- A. Unrealized gains or losses on capital are not considered while calculating the taxable income.
- B. Unrealized gains or losses on revenue items will need to be considered when calculating taxable income.

It is pertinent to note that the aforementioned practices shall potentially trigger temporary differences from a balance sheet perspective as the accounting shall differ from the filings (Deferred tax assets/liabilities).

## W & S Takeaway:

The current law allows Free Zone entities to not maintain Books of Accounts and get their books of accounts audited; therefore it is imperative that the entities shall plan in advance and have an effective accounting system in place in line with the CT regime.

# Exempt Income

The CT regime also seeks to exempt UAE companies from the income from taxation of other entities. The draft also provides an exemption on the dividend and the capital gains subject to fulfilment of all the relevant conditions, a key criterion to apply for the shareholding is a minimum of 5% shareholding in the Company.

**UAE company having a foreign branch if it is subject to CT at a minimal rate of 9%, the MoF however has acknowledged the complexities involved in relation to the compliance issues and has proposed the following options:**

- A. Claim foreign tax credit for the taxes paid in foreign branch country
- B. Elect to claim an exemption on the foreign branch profits

The CT regime provides for the exemption for income earned by a non-resident from operating or leasing aircrafts or ships (and associated equipment) provided that the same benefit is extended to a UAE entity in the relevant foreign jurisdiction under the reciprocity principle.

## W & S Takeaway:

Individuals/Foundations/Trusts earning passive income like dividends, capital gains, rental income, etc. shall be exempted irrespective of their percentage of shareholding.

# Interest Capping

The MoF under the CT regime has proposed a cap on the net interest expenses to 30% of the earnings before income tax, depreciation, and amortization (“EBITDA”) in line with the OECD’s 2015 BEPS Action plan 4.

The interest limitation however shall not apply to banks, insurance businesses and certain other regulated financial services entities. The interest capping rules shall also not apply to businesses carried on by natural persons.

Further, related party interest will only be deductible if there is a valid commercial reason for obtaining the loan. A valid commercial reason will be considered to exist if the related party lender is subject to CT (or an equivalent tax) of at least 9% on the interest income earned.

## W & S Takeaway:

Interest Capping provision shall have a sizeable impact on the treasury functions of MNE’s and other group companies, and it is advised to assess and analyze the probable impact of the business and put in place necessary corrective actions which will be required.

# Restructuring Relief

In order to facilitate Mergers, Spinoffs, and other corporate restructuring transactions, the CT regime seeks to exempt or allow for the deferral of taxation where a whole business or independent parts of the business are transferred in exchange for shares or other ownership interests.

The CT regime further provides, any restructuring relief shall be “clawed back” within three years of restructuring if there is a subsequent transfer of the business to a third party. Any gain or loss that would have arisen upon the initial transfer would need to be calculated and included in the tax return for the tax period of the third-party disposal.



# Tax Group and Loss Relief

A UAE resident group may opt to enter into a tax group if the parent company holds at least 95% of the share and voting rights, after the approval from the Federal Tax Authority (“FTA”) (a notice should be signed by the parent and the subsidiary). The proposed CT regime allows groups to transfer losses between companies (similar to the tax system). To transfer the losses the companies must have 75% common ownership.

The transfer of losses essentially allows the losses to be transferred without a formal tax group in place. In this regard, it is important to properly administer and ensure the loss making business is compensated.

**It is pertinent to note that, no tax loss relief will be available in case of the following:**

- A. Losses incurred before the effective date of CT.
- B. Losses incurred before a person becomes a taxpayer for UAE CT purposes.
- C. Losses incurred from activities or assets which generate income that is exempt from UAE CT; or
- D. Losses incurred by a Free Zone Person that are not attributable to a PE in the mainland

# Intra Group Transfers

The intra group transfers relief can be availed by the UAE resident companies if there is a 75% common ownership, provided the assets and liabilities shall remain in the same group for a minimum of three years. The transfer of the assets and liabilities shall be at their net book value. In cases where the aforementioned conditions are not met, there will be an assessment made on the taxable gains that arose from the transfer.

# Transfer Pricing [TP]

The consultation document proposes the introduction of a TP regime in line with the internationally recognised “arm’s length” principle. The applicability of the proposed regulations would be for transactions between related parties and connected persons.

For the determination of related parties, rules have been suggested which include the following:

- Individuals related to the fourth degree of kinship.
- Individuals holding directly or indirectly more than 50% or greater share, or control in a legal entity.
- Two or more legal entities holding directly or indirectly more than 50% or greater share, or control in a legal entity.
- Branch or a Permanent Establishment (PE).
- Partners in an unincorporated partnership.
- Exempt and non-exempt business activities of the same person.

With respect to the inclusion of connected persons, the objective is to avoid excessive charges by owners of businesses or persons connected with them. These include:

- Individuals directly or indirectly owning the business.
- Directors or officers of the taxpayer.
- Individuals related to the owner.
- Partners in an unincorporated partnership or a related party of any of the above.

Taxpayers engaging in transactions with related parties and connected persons will be required to be in compliance with the arm’s length principle. They should adhere to the OECD TP guidelines. For determining the arm’s length price, the International TP methods are to be referred. A disclosure containing information regarding their transactions with related parties and connected persons is to be submitted by the taxpayers (on whom the TP provisions apply) as per the TP provisions. It is advised for taxpayers to prepare and maintain a master file and a local file if the transactions meet the prescribed thresholds as per the guidelines.

## W & S Takeaway:

- TP regulations are proposed to be in line with the international OECD guidelines which shall guide the taxpayers to adhere to the arm’s length prices.
- Clarification is required in respect of the applicability of TP transactions between exempt and non-exempt business activities for the same taxpayer.
- Requirement of transfer pricing audit as seen in other countries is not specified/referred in the public consultation document, however we shall have to wait for the introduction of the CT regime to gain clarification in this regard.

# Computation of CT Liability

## 1. CT Rate

The following rates for the computation of the CT will be considered:

- A rate of 0% up to AED 375,000 of taxable income and;
- A rate of 9% above AED 375,000
- The draft further provides that a different tax rate shall apply on large
- Multinational Entities (“MNEs”), however, does not specify the tax rate.

## 2. Withholding of tax

- A withholding tax rate of 0% is proposed to apply on all types of domestic and cross border payments.
- UAE businesses will not be required to deduct taxes while making payments, therefore will not have the liability for filing the returns on withholding tax returns.

## 3. Foreign Tax Credit

UAE residents are taxed on their worldwide income, therefore may be liable to be taxed in the source country as well as UAE. Thus, in accordance with the DTAA, the UAE CT regime will allow a credit for the tax paid in a foreign jurisdiction to avoid double taxation. This credit will be availed against the UAE CT liability on foreign sourced income (Which has not been otherwise exempted) as “Foreign Tax Credit”.

The maximum Foreign Tax Credit available will be the lower of:

- The amount of tax that paid in the foreign jurisdiction; or
- The UAE CT payable on the foreign sourced income.

Any unutilised Foreign Tax Credit will not be allowed to be carried forward or back to other tax periods, nor will the FTA refund any unutilised Foreign Tax Credit.

### W & S Takeaway:

- As UAE is a signatory to the BEPS Inclusive Framework. The OECD BEPS Pillar Two propositions have proposed a minimum of 15% Global Minimum Tax. However, there is no specific mention of the rate to be adopted for the large MNEs. It can be foreseen that the introduction of the CT may clarify as to how the Pillar Two proposition will be embedded in the CT regime.
- Withholding tax of 0% is a very welcomed move as it re-affirms the UAE government's commitment to maintain a business-friendly environment.

# Administration

## Registration & Deregistration

The UAE CT consultation draft highlights factors such as how businesses should register themselves with the authorities and obtain a Tax Registration Number (TRN). A business subject to CT must apply with the FTA to obtain a TRN within the prescribed time period.

A business can deregister themselves if they are no longer subjected to CT requirements upon submission of required documents and clearing past CT dues or penalties (If any).

## Filing, payment and refund

To minimize the administrative burden on taxpayers, a business will only need to prepare and file one tax return and other related supporting schedules with the FTA within nine (9) months of the end of the relevant Tax Period. There will be no requirement for a business to file a provisional CT return and make advance payments of CT.

The Payments to settle a taxpayer's CT liability for a Tax Period will need to be made within nine (9) months of the end of the relevant Tax Period. Where the taxpayer can demonstrate that a Tax refund is applicable, they shall make an application to the FTA



# Audit Requirement and Documentation

Businesses will be required to maintain records of documents which contain information relating to the CT returns as well as the documents filed with the FTA.

*\*Certain exempted persons will also be required to maintain records to allow the FTA to ascertain the person's exempt status*

Whether the financial statements of a business are required to be audited by an accredited audit firm is and will continue to be determined by applicable company laws and regulations.

However, the UAE CT regime will require a Free Zone Person to have audited financial statements if it wants to benefit from the 0% CT regime.

## W & S Takeaway:

- With the proposed ideas, the paradigm will be shifting from the previously followed methodology to a more systematic approach.
- Such approach will ensure that organizations will maintain proper records of documents (Past, Present and Future) and have an organized system in place for smoother functioning.

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