

Summary of Public Consultation Document issued for UAE Corporate Tax

On 31 January 2022, the UAE Ministry of Finance announced the introduction of Federal Corporate Tax (CT) in UAE w.e.f. 1 June 2023. While the UAE Federal Tax Authority (FTA) is finalizing the UAE CT regime, on 28 April 2022, it issued a public consultation document covering various aspects of the proposed law. The business community and other interested stakeholders are expected to provide their comments online at the prescribed link by 19 May 2022.

In this alert, we have captured certain key aspects of the document and possible impact areas:

Taxable Persons

- UAE CT will apply to UAE companies and other legal persons incorporated in the UAE as well as to a foreign legal entity having a Permanent Establishment (PE) in UAE.
- UAE CT will not apply to individuals unless he is engaged in business or commercial activity in the UAE, which requires him to obtain a commercial license or equivalent permit from the relevant competent Authority in the UAE.
- The following persons are exempted from UAE CT:
 - Federal and Emirate Governments and their authorities and other public institution;
 - Wholly-owned, Government-owned UAE companies that carry out the sovereign or mandated activity and that are listed in a cabinet decision;
 - Businesses engaged in the extraction and exploitation of UAE natural resources that are subject to Emirate level taxation;
 - Charities and other public benefit organizations that are listed in a Cabinet Decision;
 - Public and regulated private social security and retirement pension funds;
 - Investment funds, subject to meeting certain conditions.

Basis of Taxation

- UAE CT would be based on the residential status of the person in UAE.
- The following persons shall be considered as Residents of UAE for UAE CT:
 - A legal person that is incorporated in UAE;
 - Any natural person who is engaged in a business or commercial activity in the UAE, either in their own name or through an unincorporated partnership;
 - A foreign company, if it's effectively managed and controlled from the UAE.
- Tax residents would be liable for UAE CT on its worldwide income. Any income earned from a foreign jurisdiction on which taxes is paid in such jurisdiction will be allowed as a credit against UAE CT.
- Non-residents will be subject to UAE CT on taxable income from their PE in UAE and income which is sourced in the UAE.

The PE concept under the UAE CT regime has been designed on the basis of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention.

Free Zones

- While companies and branches registered in Free Zones will be within the scope of UAE CT and subject to tax return filing requirements, they would be liable for a 0% CT rate if it maintains adequate substance and complies with all regulatory requirements.
- Free Zone person that has a branch in mainland UAE will be taxed at a regular CT rate on its mainland source income while continuing to benefit from the 0% CT rate on its other income earned by Free Zone person.
- Where Free Zone Person does not have a Branch in mainland UAE and earns income from the mainland, then a 0% CT rate would apply only to 'passive' income (like interest, royalties, dividend, capital gains on shares of mainland UAE company, etc.).

- 0% CT will also apply to the transaction between Free Zone Person and their group company in mainland UAE. However, payments made to Free Zone Person by a mainland group company shall not be tax-deductible.
- A Free Zone Person earning any income other than the above-mentioned incomes from the mainland would lose the benefit and would be liable to be taxed at CT rates on the entire income.
- Free Zone person would have an irrevocable right to opt for a regular CT regime.
- Income earned by a Non-resident from operating or leasing aircrafts or ships (and associated equipment) used in international transportation, provided similar treatment is provided to a UAE business in the relevant foreign jurisdiction
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Calculation of taxable income

- Accounting net profit (or loss) as stated in financial statements would be considered as a starting point for determining taxable income.
 - Commonly, the International Financial Reporting Standard (IFRS) is used in UAE for preparing financial statements. However, consideration is given to allowing alternate financial reporting standards for drawing the financial statement.
 - Capital unrealized gains and losses will not be required to be included while computing taxable income, but Revenue item unrealized gains and losses will have to be considered while computing taxable income.
 - The following income shall be exempt from taxation:
 - Capital gain and dividend income received by UAE company from a foreign company, subject to certain conditions like UAE shareholder company must own at least 5% of the shares, and the foreign company is subject to CT (or an equivalent tax) at a rate of at least 9% in home country – Participation Exemption;
 - All domestic dividend income earned by UAE company (including dividend paid by Free Zone person);
 - UAE Company will have two options for taxing the income of foreign branches (i) claim a foreign tax credit for taxes paid in the foreign branch country, or (ii) elect to claim an exemption for their foreign branch profits. Income from Foreign Branches. An exemption for foreign branch profits shall not be available where the foreign branch is not subject to a sufficient level of tax in the foreign jurisdiction in which it is located;
 - Interest capping rule – It is proposed to cap the amount of interest expense to group companies to 30% of earnings before interest, tax, depreciation and amortization (EBITDA). Irrespective of the 30% cap, some fixed amount would be allowed as a deduction. Specific exemption from these provisions to banks, insurance, and certain regulated financial services entities and businesses carried out by natural persons.
 - Different interest capping thresholds may be allowed for the consolidated groups. In addition to meeting arm’s length test, interest payment between group companies would also be required to provide commercial justification for availing the loan.
 - Only 50% of the expenditure incurred to entertain customers, shareholders, suppliers, and other business partners shall be tax-deductible, as such expenses often include non-business and personal elements.
 - No deduction will be allowed for certain specific expenses such as administrative, penalties, recoverable VAT, or donations paid to an organization that is not an approved charity or public benefit organization.
 - Losses incurred would be allowed to be carried forward for an indefinite period and set off against future profits upto 75% of taxable income. If shareholding of 50% or more continues, then only tax losses are allowed to be carried forward indefinitely.
- ### Groups
- A UAE resident group of companies can elect to form a tax group and to be treated as a single taxable person if the parents hold directly or indirectly at least 95% of the share capital and voting rights of its subsidiary. **To form a tax group, neither the parent company nor any of the subsidiaries can be an exempt person or a Free zone person that claims exemption.**

- Losses would be allowed to be transferred and set off from one group company to another group company if 75% of the shares of both companies are commonly owned. Furthermore, no losses can be transferred from a company exempt from UAE CT or that benefits from a 0% Free Zone CT regime. Also, the total tax offset will not be able to exceed 75% of the taxable income of the company receiving the transferred losses in the relevant period.
- Group re-organization shall not be taxable under the UAE CT regime, subject to certain conditions.

Transfer Pricing

- Transfer Pricing Regulations shall be applicable for transactions between domestic as well as foreign-related parties and needs to be at arm's length price.
- Transfer Pricing regulations shall be in line with OECD Transfer Pricing Guidelines.
- Transfer Pricing Documentation Requirement shall include:
 - Disclosure containing information regarding transactions with related parties and connected persons;
 - Need to maintain Master and Local Files (with format and content as prescribed under OECD Base Erosion and Profit Shifting (BEPS) Action Plan 13), where arm's length value of transactions with the related party would exceed a certain threshold.

International Tax Development – UAE's approach for a response to international tax developments

- The introduction of CT regime in UAE will provide a basis for the UAE to execute its support of Global minimum effective tax rate as proposed under Pillar Two of BEPS 2.0. Though, UAE is currently working with other members of the Inclusive Framework to implement the Pillar two proposals.
- In line with the BEPS project, the UAE had introduced Country by Country Reporting (CbCR) requirements effective from the financial year starting on or after 1 January 2019. The introduction of the UAE CT regime will not impact the existing CbC reporting requirements and relevant regulations.

Administration

- A business subject to CT will need to register with the FTA and obtain a tax registration Number within a prescribed period. FTA will have the power to automatically register a business for CT if the person does not voluntarily do so.
- Where business is ceased to be subject to the CT (due to cessation or liquidation), it will need to apply for deregistration for FTA for CT purposes within three months from the date of cessation. Again, The FTA will have the power to deregister any person based on available information.
- The businesses will be liable to file the annual tax return within nine months from the end of the relevant tax period. It would be important to note that each taxable person can choose their tax period based on their annual period of financial reporting.
- UAE CT regime will be based on self-assessment principles. However, the FTA may review a CT return and issue an assessment within the timeframe prescribed in tax procedures law. A taxpayer may challenge an amended assessment issued by FTA by processes and procedures prescribed in the law.

Impact Areas – Our Comments

- At an overall level, the UAE authority is inclined to keep the UAE CT laws and regulations simple with minimum procedure and compliances with the taxpayers. However, on an overall basis, Free Zone Companies would have to re-look at the substance and licensing requirements for claiming the benefits, evaluate transactions with the mainland and its implications, etc. Furthermore, the businesses would also be required to look at their capital structure, considering transfer pricing provisions and interest limitation provisions.
- Keeping a financial profit and tax profit alignment is a good proposal. However, allowing reporting of financial statements as per any accounting standards may have disparity between the taxpayers carrying similar businesses.
- As per the proposed UAE CT regime, Investment fund managers located in UAE shall not be considered as PE for the foreign investor or the foreign investment fund. Also, the UAE CT is not applicable to a natural person. Accordingly, global investment funds may look at keeping their managers located in the UAE for wealth management of funds.
- Many aspects may require clarity, mainly on the computation of tax on foreign source income for credit, whether ESR compliance would be sufficient for substance, adjustment to income, etc.

We are sure that various stakeholders and interested parties will make various suggestions, and the law will evolve.



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