How Holding Companies Could Hold Ground under UAE Corporate Tax

The UAE has long been known for its business-friendly environment, characterized by a lack of corporate and personal tax. However, the UAE's Federal Tax Authority has brought a significant shift by introducing the UAE Corporate Tax (CT) law vide Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses (CT Law). The CT Law has far-reaching implications on the taxpayers, particularly for Holding Companies. In this article, we explore the key aspects of the newly introduced UAE CT law and its impact on Holding Companies.

Holding Company Business

In common parlance, a Holding Company has a primary business objective to hold controlling interests in the securities of various companies. The income of Holding Companies generally comprises of dividends, capital gains and interest income.

Definition under Company Law (Federal Decree-Law no. (32) of 2021)

"Article 268- Definition of the Holding Company

- A Holding Company is a Joint Stock Company or a Limited Liability Company that establishes subsidiaries inside the State or abroad or controls existing companies, by holding shares or membership interests enabling such Company to control the management of the subsidiary and have influence on the decisions thereof.
- The name of the Company followed by the expression "Holding Company" shall appear on all the papers, advertisements, and other documents issued by the Holding Company."

Definition under UAE Economic Substance Regulations (ESR)

"A business that:

- Has as its sole function the acquisition and holding of shares or equitable interest in other companies;
- Only earns dividends and capital gains from its equitable interests."

Tax Implications on Holding Companies

When a Holding Company is located in the Free Zone

A Holding Company located in the UAE Free Zone is likely to benefit from 0% tax rate relief available to Qualifying Free Zone Person (QFZP). In other words, the QFZP engaged in Holding Company business can enjoy 0% CT rate on its income.

A Free Zone company can become QFZP upon fulfillment of certain conditions; few notable ones are:

- Maintaining adequate substance in the Free Zone
- Compliance with UAE Transfer Pricing regulations
- Preparing audited financial statements
- Derives 'Qualifying Income'
- Non-qualifying Income is within de-minimis level (5% of total revenue or AED 5 million, whichever is lower).

In the above backdrop, the key question that arises is whether the income of a Holding Company business viz Dividend and Capital gain could qualify the definition of 'Qualifying Income'.

In this regard, it is pertinent to note that holding of shares and securities (held for an uninterrupted period of 12 months) is one of the 'Qualifying Activity' included in the definition of 'Qualifying Income.' Therefore, the income of QFZP engaged in Holding Company business is likely to be categorized as 'Qualifying Income' subjected to a 0% UAE CT rate.

When a Holding Company is located outside Free Zone, i.e., in the Mainland

UAE mainland companies engaged in Holding Company business could be subject to 9% UAE CT unless the income is covered under Article 22 of the Federal Decree no. 47 of 2022 (FD 47)

Article 22 of FD 47 specifies the types of income that would be exempt from the CT Law, which inter-alia include the following:

- Dividends and other profit distributions received from a domestic (resident) company.
- Dividends and other profit distributions received from a Participating Interest in a foreign company (subject to conditions specified by Article 23 of FD 47).
- Any other income from a Participating Interest as specified in Article 23 of FD 47.

Accordingly, based on the above reading of Article 22 of FD 47, the dividend income or any profit distribution received from a domestic company will be exempted in the hands of the Holding Company.

In case of investments made by the Holding Company in foreign companies, Article 23 of FD 47 read with Ministerial Decision 116 of 2023, stipulates the participation exemption under which the dividend and profits received from the participating interest in the foreign companies would be exempted subject to fulfillment of certain conditions prescribed therein.

In summary, the income of mainland company engaged in Holding Company business would be taxed under UAE CT as under:

Type of income	Participation exemption conditions	
	Satisfied	Not Satisfied
Dividend from domestic company	0%	0%
Capital gain on sale of shares of domestic company	0%	9%
Dividend from foreign company	0%	9%
Capital gain from the sale of share of foreign company	0%	9%
Foreign exchange or impairment gains	0%	9%

Participation exemption related condition

A Participating Interest is a significant, long-term ownership interest in a juridical person (the Participation) that suggests some degree of control or influence over the Participation.

In order to qualify an ownership interest as a participating interest, the following tests must be satisfied:

- **Minimum ownership test** – Ownership interest of at least 5% or more should be held in a Participation.
- **Minimum acquisition cost test** – Alternatively, the minimum ownership test can be satisfied if the acquisition cost of the ownership interest is more than or equal to AED 4 million.
- **Holding period test** – The Participating Interest must be held, or intended to be held, for an uninterrupted period of at least 12 months.
- **Subject to tax test** – The Participation must be subject to tax in its country of residence at a rate of 9% or more. QFZP, Exempt Persons and Holding Companies, subject to certain conditions, are treated as having met the subject to tax test.

- **Entitlement to profits and liquidation proceeds test** – The participating interest must entitle the holder to receive at least 5% of the profits and liquidation proceeds.
- **Asset test** – Not more than 50% of the direct and indirect assets of the Participation must consist of ownership interests that would not qualify for the participation exemption if those are directly held by the taxable person (holding company).

Further to point no. (d) above, the Holding Company, even though not subject to 9% CT, would be deemed to satisfy the subject to tax test if the below-mentioned conditions as prescribed by Ministerial Decision 116 of CT law are satisfied:

- The Participation should be directed and managed in the relevant other country or foreign territory.
- Comply with any requirement to submit documents or information as required in the relevant jurisdiction.
- Should have adequate personnel and premises (in substance) for the acquisition and holding of the shares or equitable interests in the relevant jurisdiction.
- Should not conduct any other activities other than any incidental or ancillary activity for holding of shares.
- The average income of the Holding Company should consist of 50% or more from Participating interests.

Substance test for UAE Free Zone Companies to avail 0% tax rate

As mentioned above, a UAE Free Zone company engaged in Holding Company business could enjoy 0% UAE CT on its income, subject to fulfillment of certain conditions. One such condition is to demonstrate adequate Economic Substance within the Free Zone.

This condition mainly implies that the company should conduct its core-income generating activities within the Free Zone. In order to test the maintenance of adequate substance, various criteria should be checked on a case-by-case basis. In essence, the company should be able to demonstrate the following:

- Core-income generating activities are being performed within the Free Zone
- Employs adequate staff and assets
- Incurs adequate operating expenditure
- Should be directed and managed within Free Zone

While the CT does not provide a detailed explanation of how to analyze the above criteria. However, regard should be made to the existing UAE ESR, which contains detailed guidance to test the substance.

According to the ESR Regulations, a Licensee carrying on a Holding Company Business has to satisfy a reduced Economic Substance Test, which entails the following conditions:

- Complies with the requirement to submit any documents or information as required by the relevant authority; and
- Has adequate employees and premises for holding and managing the Holding Company Business.

Transfer Pricing Impact

Transfer Pricing provisions incorporated in the UAE CT Law are applicable to transactions or arrangements between businesses in the UAE and the related parties, notwithstanding the related parties are established in the UAE mainland, a Free Zone, or in a foreign jurisdiction. Furthermore, for a Free Zone Holding Company, one of the conditions for being eligible for QFZP is to comply with the UAE transfer pricing provisions. For example, interest income earned by the Holding Company from loans given to its related parties would be required to adhere to arm's length principle as specified under Article 34 of CT Law. As mentioned above, compliance with transfer pricing provisions is one of the key conditions for QFZP to enjoy 0% CT on its income.

Conclusion

In conclusion, the impact of the UAE corporate tax law on Holding Companies can be multifaceted depending on the streams of income, type of investment, etc. Analyzing the aforementioned provisions and strategically adapting to the new tax landscape will be pivotal for Holding Companies in the UAE, which would require a thorough understanding of the implications and proactive planning.

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