R&D Tax Credit - A Significant Step Towards the UAE's Innovation Driven Tax Incentives under the Corporate Tax Framework

As the corporate tax landscape continues to evolve, new incentives are being introduced. The UAE recently introduced R&D Tax Credit regime[1], and last week it issued additional implementation guidance[2], bringing much-needed clarity on eligibility, calculation mechanics, compliance requirements, and anti-abuse provisions.

Important terms

Qualifying entity

- All entities engaged in Qualifying R&D Activities, including:
  - Foreign companies having a permanent establishment in the UAE
  - Free zone entities that are subject to Corporate Tax at 9% and/or Top-up Tax.
- The Following entities are excluded:
  - Entities not subject to Corporate Tax or Top-up Tax
  - Entities that have elected for Small Business Relief
  - Any other entity specified by the Minister is also excluded.

The qualifying entity must obtain pre-approval from **The Emirates Research and Development Council (the Council)** for any R&D Project for which the R&D Tax Credit is claimed.

Qualifying R&D activities

Activities carried out in the UAE as part of an R&D project, provided they are:

- Novel, in that it aims to produce new findings.
- Creative, involving original concepts or hypotheses.
- Outcomes are uncertain, or the means of achieving them are not known in advance.
- Systematic, following a plan and budget.
- Transferable or reproducible.

The key determinative factor shall be the criteria set out in the OECD Frascati Manual.

1 Cabinet Decision No. 215 of 2025

2 Ministerial Decision No. 24 of 2026

Note: The examples below are illustrative and provided by Nexdigm for guidance only; they are not part of the official notification.

Some common examples of such Qualifying R&D activities may be:

- designing an AI model for general or specific industry use
- building new systems driven by technology under a defined business plan and budgets
- developing substitutes for existing resources

It is important for businesses to document not only what is developed but also the technical uncertainties encountered and the creative solutions devised along the way.

Key Exclusions

- R&D activities in the fields of social sciences, humanities, and arts.
- R&D activities performed outside the UAE.

Qualifying R&D Expenditure

Specific categories of expenses incurred by a Qualifying Entity in the relevant tax year in respect of qualifying R&D activities are covered. These are:

Staff Costs - includes salaries, bonuses, allowances, medical insurance, pension contributions, end-of-service gratuity, benefits in kind, and training to R&D staff in relation to qualifying R&D activity.	• Must relate to UAE based R&D staff under the entity's control, direction and supervision. • 30% uplift allowed for overheads. • Cost of employees working partially on R&D to be reasonably attributed. • Externally provided worker included subject to conditions • Stock options excluded
Consumable Costs - consumable or transformable materials, including but not limited to water, fuel, and power, License fees, and other similar costs related to intangible assets not being capital in nature, Payments made to patients or subjects participating in a clinical trial for R&D	• Must be fully or partially consumed in R&D activities. • In case of partial usage, reasonable attribution to be made. • Materials disposed of in ordinary course of business for consideration to be excluded. • Materials or licenses, acquired from another member of the same Tax Group are excluded.

Sub-contracting Fees	• Sub-contractor must be UAE-based (foreign PE not allowed) and activities must be performed locally. • No further subcontracting allowed. • Related-party sub-contractors must maintain audited financials. • Subcontracting between members of the same Tax Group – expense to be disregarded
Cost Contribution Arrangement – cost and risk sharing for joint R&D activities that benefit each qualifying entity	• Must follow arm's length principles • Only expenses on activities carried in UAE qualifies.

Any of the above costs, if capitalized under the applicable accounting standards in respect of internally generated intangibles resulting from Qualifying R&D Activities, are also treated as qualifying R&D expense.

Other conditions for treating expenses as qualifying R&D expenses

- Expenses must be wholly and exclusively incurred for the purposes of carrying on Qualifying R&D Activities. If it is incurred for more than one purpose, only the identifiable part shall be considered for the claim of tax credit.
- At least AED 5,00,000 should be incurred on each R&D project, excluding any staff costs.
- Expenses should not directly or indirectly be funded by a Grant.
- Expenses should not be subject to any other incentive, credit, exemption, or relief under the Corporate Tax Law or any other legislation in the State.

R&D Tax Credit System

- The R&D Tax Credit is calculated using a progressive rate structure, but importantly, eligibility depends on meeting both expenditure and workforce thresholds:

Qualifying R&D Spend	Average R&D Staff (Total monthly R&D staff/Months with R&D activities)*	Credit Rate (to be applied to the respective portion of Qualifying R&D expense)
Up to AED 1 million (Mn)	≥ 2 staff	15%
AED 1 Mn – 2 Mn	≥ 6 staff	35%
AED 2 Mn – 5 Mn	≥ 14 staff	50%

**For subcontracted R&D and cost contribution arrangement, include all full-time staff of the entity and subcontractors/partners directly engaged in the qualifying activities.*

- R&D tax credit as computed above is to be reduced from the Corporate Tax and/or Top-up Tax liability of the Qualifying Entity, Tax Group, Domestic group (under Pillar Two regime), and shall be non-refundable.
- If either of the eligibility thresholds is not satisfied, the credit will be adjusted to the highest tier for which the criteria are met,
- In case of tax groups, the Qualifying R&D Expenditure and R&D Staff of all Qualifying Entities shall be aggregated for the purposes of the thresholds.

Carry-Forward and Transfer of R&D tax credits

- Unutilized R&D Tax Credit can be carried forward if ownership stays above 50%, and in case there is a change of more than 50% ownership, the qualifying entity conducts the same or similar business.
- Carry-forward of tax credits cannot be claimed by entities listed on a recognized stock exchange.
- Transfer is permitted if both qualifying entities have at least 75% common ownership. The transferee cannot carry forward or further transfer the tax credit.

Special Rules for Tax Groups

- Parent entity of the tax group is responsible for pre-approval, claim of R&D tax credit, and other compliance obligations for the qualifying entity in the tax group.
- Tax Credits of each qualifying entity of the tax group are pooled together and utilized against the group corporate tax liability / top-up tax liability.
- Any pre-grouping tax credit of a qualifying entity should be utilized first before utilizing the R&D tax credit of the tax group.
- If the tax group is also subject to top-up tax or is a domestic group for the purpose of the Pillar Two framework, R&D Tax credit shall be first utilized against the CT liability of the tax group before being utilizing for top-up tax liability.
- If a qualifying entity leaves a tax group, its R&D credit continues with the tax group, except for the pre-grouping tax credits
- Allocation mechanism for unutilized R&D tax credit is prescribed in case of cessation of the tax group.
- If claw-back provisions apply, each entity in the tax group shall have joint and several liability.

For qualifying entities that are constituent entities or part of a domestic group under the Pillar Two framework, any unutilized tax credit must be first utilized at the entity or tax group level before being used against the top-up tax liability of the domestic group.

Impact of a Business Restructuring on unutilized R&D tax credit

In the case of business restructurings, unutilized R&D tax credits can be transferred if business continuity conditions are met by the transferee for at least 2 years from the date of transfer. In the event of a violation, claw-back provisions to apply.

Anti-Abuse and Claw-Back Provisions

Credits may be clawed back if:

- Qualifying entity does not continuously meet the conditions.
- Business exits the tax regime within 5 years and opts for qualifying free zone person status, applies small business relief, or enters into liquidation.
- Arrangements lack economic substance. Businesses are artificially separated to maximize credit
- Tax groups do not meet the prescribed conditions
- In case of business restructuring, the same or similar business is not continued for at least 2 years.

If claw-back provisions apply, the R&D tax credit claimed must be repaid within the timelines prescribed by the FTA. An Unutilized tax credit cannot be further carried forward or refunded. No other reliefs or set offs are available for offset against the liability arising from claw-back. Additional penalty exposure shall arise.

Administration of R&D tax credit

Submission of R&D Tax Credit Claim

- Claims to be made along with the filing of the tax return or the top-up tax return,
- **Documents Required:**
    - Council pre-approval,
    - senior management declaration,
    - R&D expenditure breakdown,
    - audited financials,
    - any other Minister-specified documents.
- Late Claims: Only accepted in exceptional cases approved by the Authority.

Record-Keeping Requirements

Sufficient technical and financial documentation must be retained for 7 years. These include comprehensive written, visual or electronic records detailing the objectives, processes, methodologies, experiments, and findings associated with the Qualifying R&D Activities.

Our Comments

R&D tax credits will be available for all tax periods commencing on or after 1 January 2026. No timelines are prescribed for obtaining council approval. However, companies seeking such approval must immediately approach the council and submit the required documentation to obtain the mandatory pre-approval.

The R&D tax credit scheme aligns with substantial deductions/ exemptions offered by various other jurisdictions to promote the innovation and technology sectors. However, careful workforce planning and budgeting of expenses are essential.

About Nexdigm

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We provide integrated, digitally-driven solutions encompassing Business and Professional Services across industries, helping companies address challenges at all stages of their business lifecycle. Through our direct operations in the USA, Poland, the UAE, and India, we serve a diverse range of client base, spanning multinationals, listed companies, privately-owned companies, and family-owned businesses from over 50 countries. By combining strategic insight with hands-on execution, we help businesses not only develop and optimize strategies but also implement them effectively. Our collaborative approach ensures that we work alongside our clients as partners, translating plans into tangible outcomes that drive growth and efficiency.

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