Public Consultation Document – UAE CT

Overview

The announcement of the introduction of corporate tax (CT) in January 2022 was a significant development in the tax landscape of the UAE. As mentioned in the FAQs released by the Ministry of Finance (MoF), the UAE CT shall be applicable for financial years (FY) commencing on or after June 01, 2023.

In a run-up to the release of the final CT regulations, the MoF has invited comments from stakeholders on a public consultation document which details the broad contours of the UAE CT law. The consultation document is well thought and covers key legislative aspects of a robust corporate tax regime

In detail

Taxable persons

The following persons shall be subject to UAE corporate tax:

- Individuals carrying on business/ commercial activities in UAE
- UAE incorporated legal entities
- 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 / members

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) would be exempt from CT

Computation mechanism

For computing taxable income, accounting profit/loss would be the starting point. The default tax year would be the Gregorian calendar year. Expenses on account of interest payments have been limited to 30% of EBITDA and only 50% of entertainment expenses would be allowed as deduction

Taxability of Free zone entities

A 0% tax has been proposed for companies and branches registered in Free zones on the following incomes:

- Income from businesses outside UAE
- Income from trading with other Free zone entities
- Income from regulated financial services directed at foreign markets

Free zone entities would be permitted to carry on following activities in mainland without forfeiting their 0% tax rate:

- Having branch in mainland (profits of the branch taxable at 9%)
- Earning passive income from mainland entities (e.g., interest, royalties, dividends)
- Transactions with mainland group companies (however payments to Free zone entities will not be deductible for mainland companies)
- Sale of goods to mainland businesses by entities in designated Free zones

Any other income earned by a Free zone entity from mainland will disqualify Free zone entities from the 0% CT regime. Free zone entities will also have an irrevocable option to move to the regular tax regime.

Set-off and carry forward of losses

Entities will be allowed to utilise prior period losses (from the effective date onwards) to offset up to a maximum of 75% of the taxable income. Tax losses can be carried forward indefinitely. In case of change in ownership of more than 50% tax losses can be carried forward provided the same business is continued.

Exemptions

Dividends, capital gains earned from 'qualifying shareholdings" (UAE shareholder must own at least 5% of the shares in the subsidiary company) will be exempt from CT in the UAE.

Further, UAE CT will not be levied on a foreign investor's income from dividends, capital gains, interest, royalties, and other investment returns.

UAE companies can elect to claim an exemption for their foreign branch profits or claim a foreign tax credit of taxes paid in foreign jurisdiction.

Income earned by non-residents from operating or leasing aircraft or ships (and associated equipment) used in international transportation are subject to similar exemption available to UAE entities in overseas jurisdiction.

CT Group

The UAE CT regulations will allow group of companies to form a tax group and file a single tax return for the entire group, subject to the following conditions:

- Common parent company holding 95% of share capital in the group companies;
- Parent/subsidiary are not exempt persons or in Free zone availing benefit of 0% CT rate;
- All group members must use the same financial year

Further guidance and details on the tax grouping will be provided in the UAE CT law.

Transfer of losses

Inter-se transfer of losses from a loss-making company to a profit-making company is possible, subject to:

- common ownership of at least 75%;
- company transferring the loss is not an entity exempt from CT or a Free zone entity availing 0% CT;
- other conditions as may be detailed in the CT law.

Group relief on intra-group transfer of assets and liabilities

Transfer of assets and liabilities amongst UAE resident group companies with common ownership of at least 75% will not be subject to CT, provided such assets and liabilities are held for a minimum 3 years period from the date of transfer.

Gain / loss on such transfer shall be subject to CT in the hands of transferor in the year in which such conditions are not met.

Restructuring relief

CT exemptions/ tax deferral shall be available to facilitate merger, spinoff and restructuring of transactions where a business is transferred in exchange of shares or other ownership interests. Any such relief to be clawed back in case of subsequent transfer of business to third party within 3 years of restructuring.

Transfer Pricing (TP)

The consultation document proposes the introduction of a TP regime in line with the internationally recognized "arm's length" principle. The proposed TP regulations would be applicable for transactions between related parties and connected persons.

Rules have been suggested for the determination of related parties which include, 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 and exempt and non-exempt business activities of the same person.

With respect to the inclusion of connected persons, the underlying principle 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 undertaking transactions with related parties and connected persons would need to comply with the arm's length principle as set out in the OECD TP guidelines. The arm's length price should be determined using the internationally recognised TP methods.

Taxpayers to whom the TP provisions apply would be required to submit a disclosure containing information regarding their transactions with related parties and connected persons. Also, taxpayers would be required to prepare and maintain a master file and a local file if the transactions meet the prescribed thresholds.

Calculation of CT liability

- **CT rates**

As outlined in the announcement issued in January, the CT rates are as follows:

  - 0% for taxable income not exceeding AED 375,000
  - 9% for taxable income exceeding AED 375,000

However, the different rate for large multinationals (with consolidated turnover exceeding AED 3.15 billion) has not been prescribed.

- **Withholding tax**

Presently, a 0% withholding tax is proposed to apply to all types of domestic and cross-border payments. UAE businesses will not need to deduct taxes while making payments. Further, there will be no obligation to file withholding tax returns.

- **Foreign tax credits**

Since UAE resident companies will be subject to CT on their worldwide income, in order to avoid double taxation, a foreign tax credit will be allowed in UAE which will be the lower of:

  - Tax paid in the foreign country
  - UAE CT payable on foreign-sourced income

It should be noted that unutilized tax credits cannot be carried forward nor will the FTA refund such unutilized credits

International tax developments

As UAE is a signatory to the BEPS Inclusive Framework, the CT regime lays down the basis for UAE to embed the Global Minimum tax rate as per the OECD BEPS Pillar Two propositions.

While Pillar Two has proposed a 15% Global Minimum Tax, the UAE CT public consultation document has not specified the rate to be adopted for large multinationals in the UAE. The document mentions that work is ongoing and further announcements will clarify how the Pillar Two rules will form part of the UAE CT regime.

In line with the first BEPS project, UAE had introduced Country-by-Country Reporting (CbCR) requirements for financial years commencing on or after January 1, 2019. The CbCR obligations will remain unaffected with the introduction of UAE CT.

Administration

Businesses shall have to obtain a Tax Registration Number ('TRN'). Timeline to pay the CT and file the CT return is 9 months from the end of the relevant tax period.

The CT return may be subject to assessment by the Federal Tax Authority (FTA) and the assessment may be challenged by the taxpayer in the manner to be specified.

Taxpayer may apply to FTA for clarification in case of uncertainty with respect to the tax treatment of a proposed or existing transaction. Taxpayers shall have to maintain following documentation in support of CT return / tax status:

- Audited financial statements depending on the requirement of applicable regulations
- Records to support exempt tax status;
- Free zone entities wishing to avail 0% CT regime benefit shall have to mandatorily get the financial statements audited.

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