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HIGHLIGHTS

CORPORATE TAX

Federal Decree-Law No. 47 of 2022

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1. INTRODUCTION - FEDERAL CORPORATE TAX LAW

- UAE has formally introduced the Corporate Tax law vide Federal Decree-Law No. 47 of 2022 with the rate of taxation at 9%.
- We have highlighted and summarized some of the key aspects of Corporate Tax Law ('CT law').

I Basics

As expected, the CT law will take effect on or after 1 June 2023. A tax year is determined by the Gregorian calendar year (January to December) or any other 12-month period for which financial statements are prepared by the taxpayer. For most Taxpayers, the first year of Corporate Tax is expected to start in January 2024.

Corporate Tax ('CT') will be levied at the following rates:

- 0% if the taxable income does not exceed the threshold (this is yet to be prescribed but the updated FAQs still mention the threshold to be AED 375,000)
- 9% if the taxable income exceeds the thresholds.

2. APPLICABILITY

I To whom will the Corporate Tax apply?

CT will apply to resident persons, certain non-resident persons, and free zone persons. A resident person has been defined quite comprehensively and includes:

- A juridical person (including its branches in UAE) incorporated, established, or otherwise recognized in UAE.
- A foreign juridical person if it is effectively managed and controlled in UAE.
- A juridical person in a free zone including a branch of the non-resident person registered in a free zone (collectively termed as 'free zone person').
- A natural person who conducts specified business or business activity in UAE. Further guidance is awaited on the categories of business/business activity carried on by natural persons that will be subject to CT.

Non-residents are covered if they have a permanent establishment ('PE') in UAE, derive income from sources in UAE (other than PE income), or have a common ground of nexus in UAE. The CT law incorporates internationally accepted provisions of fixed place PE and Dependent Agent PE. Certain PE exemptions have been provided for an investment manager.

Unincorporated partnership firms would not be considered taxable person unless it elects to do so. Each partner of the partnership firm would be considered an individual taxable person. The assets, liabilities, income, and expenditures will be allocated in proportion to each partner's shares.

II Corporate Tax Base

Resident juridical persons would be subject to tax on their worldwide income. Resident natural persons would be subject to tax on the income that is related to business or business activity conducted in UAE.

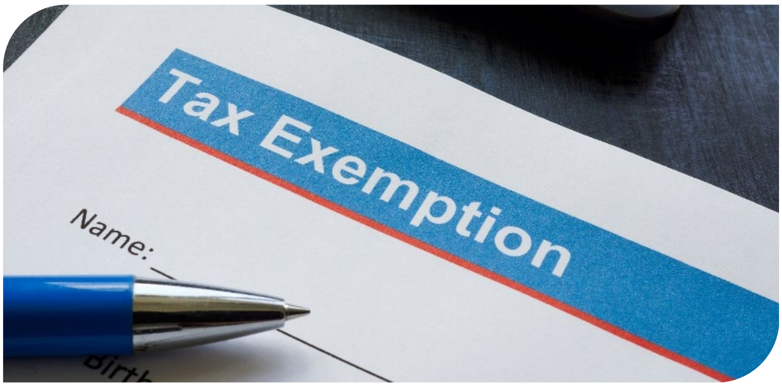
Non-resident persons would be subject to CT on the taxable income attributable to:

- PE of a non-resident in UAE
- state sourced income not attributable to a PE of the non-resident in UAE
- nexus of the non-resident in UAE.

III Exempted Persons

- Government and Government controlled entities unless they conduct a business under a license, are exempt from UAE CT.
- Persons engaged in certain extractive businesses (they will continue to be taxed at an Emirate level) and certain non-extractive natural resources businesses. Detailed conditions and rules have been prescribed for persons engaged in extractive and non-extractive businesses to determine the qualification for exemption and calculation of income exemption in the case of mixed business.
- Certain qualifying investment funds, pension or social security funds, charities, and public benefit organizations are exempt based on an application made by them in a prescribed manner to relevant authorities.

IV Exempt Incomes



- Dividends and other profit distributions received from a resident juridical person
- Foreign dividends and other profit distributions and capital gains from the sale of shares (domestic or foreign) would be exempt subject to the following key participation shareholding

conditions:

- The investee juridical person (whether foreign or domestic) is subject to CT of 9%.
- The taxpayer holds at least 5% interest in the ownership, right to profits, and right to liquidation proceeds of the investee juridical person.
- The taxpayer holds or intends to hold such interest for an uninterrupted period of 12 months.
- Foreign exchange gains or losses and impairment gains or losses in relation to participation shareholding.
- Income derived by a non-resident person from operating aircraft or ships in international transportation that meets the conditions.
- Income from Foreign PE subject to such an election being made by the resident person and such foreign PE being present where CT Rate is at least 9%.

V Small Business Relief

To provide relief to certain small taxpayers, resident taxable persons, who do not meet certain revenue thresholds (yet to be prescribed) and subject to certain other conditions, elect to be treated as not having derived any taxable income for the tax period.

VI Free Zone Persons

- A qualifying free zone person that maintains adequate substance in UAE and who derives qualifying income (meaning the term qualifying income is expected to be covered in the regulations), subject to certain conditions, would be subject to 0% tax. Non-qualifying income of the free zone person is to be

taxed at 9%.

- The beneficial rate is applicable for the remaining period of the tax incentive period stipulated in the relevant free zone law or such extended period, but one period shall not exceed 50 years.
- As anticipated, qualifying free zone persons can elect to be taxable at normal CT rates i.e., 0% or 9% on the entire income earned by the free zone person.

3. CALCULATION OF TAXABLE INCOME

Taxable income is to be calculated based on the financial statements prepared for each taxable person, in accordance with the accounting standards accepted in UAE. Taxable income shall be the adjusted accounting income.

I Deductible Expenses

Expenditure wholly and exclusively incurred for the purpose of business shall be tax deductible, in the year in which it is incurred. No deduction shall be allowed on expenses that are capital in nature or incurred for deriving exempt income. Further, losses not connected with the taxpayer's other businesses would also not be deductible.

Pro-rata basis deductions for expenses that are deployed across multiple taxable income streams.

II Specific Limitations

a. Interest Expenditure

Net interest expenditure shall be deductible only up to 30% of EBITDA (Earnings before Interest, Tax, Depreciation, and Amortization) for the applicable tax period. The 'Interest Expenditure' includes all the Interest expenses including the ones from prior years that were disallowed / not availed. This restriction shall not apply to banks, insurance providers, natural persons, and other persons as may be determined.

Interest on Related party loans with respect to Profit distributions, Acquisitions of capital/shares, or any indirect CT advantage of 'additional deductions' will not be permitted. This limitation will not apply where the taxpayer can demonstrate that the main purpose of obtaining the loan is not for obtaining a CT advantage. If the lender is a UAE/Non-UAE entity that is subject to CT @ 9%, No CT advantage will be deemed to have taken place.

b. Entertainment Expenditure

Entertainment, amusement, and recreational expenses will be deductible only up to 50%. Entertainment expenses include expenditures in connection with meals, accommodation, transportation, admission fees, etc. incurred in relation to the taxpayer's customers, shareholders, suppliers, or other business partners.

c. Other Limitations

No deduction shall be allowed on donations, grants, or gifts made to non-qualifying/non-approved charitable organizations, fines, penalties (excluding compensation for damages or breach of contract), bribes, other illicit payments, dividends or profit distribution or other benefits of similar nature to owners, withdrawals from business, CT paid, recoverable vat and any foreign taxes paid.

III Tax Losses

There is no limitation on the number of years the Tax losses are allowed to be carried forward and set off. However, tax losses can be set off up to 75% of the taxable income of the subsequent year in which such losses are set off.

Tax losses would not be eligible to be carried forward or set off when:

- Such losses have been incurred prior to the commencement of CT Law or before the taxpayer becomes a taxable person or from an asset/activity that is exempt.
- There is a change in shareholding of more than 50% other than when the same or similar business is carried out.

Tax losses can be transferred between resident juridical persons with a common shareholding of at least 75%, provided the common shareholding was prevalent in the entire tax period when such losses were incurred.

IV Group Transfers and Business Restructuring Relief

No Corporate Tax shall arise in cases of:

- Transfer of assets or liabilities between UAE resident legal entities that are 75% commonly owned, subject to certain conditions. The transferred assets and liabilities are to be recognized at new book value.
- A slump sale of mere Transfer of business or part of the business at net book value to another taxable person in exchange for shares or other ownership interest subject to certain conditions.

a. Tax Groups

UAE juridical persons will be able to form a tax group and file a single tax return and make a single tax payment. Tax Grouping will be allowed subject to the following key conditions:

- Parent entity holds 95% ownership, voting rights, and right to the assets and profit of the group entities
- None of the entities vouching for the Tax group is an exempt entity. (NA for Government entity, where the primary function is a non-exempt income)
- Neither the parent nor the subsidiary is a qualifying free zone
- All the entities follow the same financial year and prepare their financial statements using the same accounting standards

An application will have to be made to the FTA to form a Tax group by all the entities intending to form the Tax Groups. The CT liability can be a joint and several or can be restricted to one member. The CT law provides for multiple scenarios where the Tax group may cease to exist.

b. Taxable Income of a Tax Group

- Taxable income of the Tax Group shall be determined at a consolidated level, eliminating transactions between the members of the Tax Group.
- Any income in relation to a transfer of an asset or liability that was not into account in the income of the Tax Group, shall be considered if the transferor or transferee leaves the Tax Group within 2 years from the date of the transaction.
- Unutilized tax loss of a newly joining subsidiary to the Tax Group ('pre-group losses') can be carried forward and set off against the taxable income of the Tax Group. However, the existing tax loss of the Tax Group cannot be utilized for offsetting Taxable Income attributable to the new joining subsidiary.
- When a subsidiary leaves the Tax Group, tax losses shall remain with the Tax Group other than the unutilized pre-group losses.
- On cessation of a Tax Group, the tax losses shall be available to the parent if it is still a taxable person. Else, the tax losses will lapse other than the unutilized pre-group losses.

4. OECD GUIDANCE

Taxable income is to be calculated based on the financial statements prepared for each taxable person, in accordance with the accounting standards accepted in UAE. Taxable income shall be the adjusted accounting income.

I Transfer Pricing ('TP')

The Transfer pricing rules will apply to transactions between related parties and/or connected persons. The first and foremost criteria are that such transactions should be carried out at an arm's length basis.

In case related party transactions are not conducted on an arm's length basis, a tax adjustment will be affected by the FTA and a corresponding adjustment will be made for the other related parties.

Related parties shall also cover other connected persons viz, directors, shareholders, owners, and their related persons, etc.

II TP Compliance

In addition to the maintenance of the TP Master file and local files, Taxpayers on whom TP is applicable will be required to file a disclosure form along with the CT returns covering details of related party transactions.

III General Anti-Abuse Rules

CT law introduces general anti-abuse rules to curb tax avoidance. An arrangement or transaction entered into without a valid commercial reason may be disregarded and taxed. The determination of whether a transaction or arrangement is entered into to obtain a tax advantage will be based on a variety of factors.

5. OTHER TAXES

I Withholding Taxes

Withholding tax provisions have been legislated. For now, the rate is kept at 0% on certain transactions.

II Foreign Tax Credits

The number of foreign tax credits cannot exceed the amount of CT due. There is no carry-forward or carry-back allowed on the unutilized portion of foreign tax credits. To claim foreign tax credits, necessary documentation needs to be in place.

III Refunds

Taxpayers will have to file an application with the FTA for tax refunds in the following situations:

- The Withholding Tax Credit available to a Taxable Person exceeds the Taxable Person's Corporate Tax Payable.
- Where the Authority is otherwise satisfied that the Taxable Person has paid Corporate Tax in excess of the Taxable Person's Corporate Tax Payable.

6. ADMINISTRATION

I Tax Registration

Persons covered by the CT law are required to register and obtain a Tax Registration Number. The timelines and the process details are yet to be announced.

In case of cessation of business activities in the future, a tax deregistration application can be filed to discontinue the registration.

II Currency in use

All amounts must be quantified in AED. Any foreign currency must be converted as per the rate set by the Central Bank of UAE subject to conditions to be prescribed by the FTA.

III Tax Returns and Payments

The CT returns and tax payments must be filed within 9 months of the end of the tax period. Qualifying free zone persons have to not only obtain the registration but also file the return.

IV Record-keeping

All Taxable persons and exempt persons are required to retain documents that support the information to be provided in a Tax Return or in any other document to be filed with the Authority and they are also required to retain documents that enable the Taxable Person's Taxable Income to be readily ascertained by the Authority for a period of 7 years from the end of the relevant tax period.

V Clarifications

Like the VAT Law, the FTA provides for businesses to seek clarifications on proposed transactions and arrangements. Further clarity is awaited on the procedures covering this.

VI Assessments and Penalties

CT assessments shall be in accordance with the Tax Procedures Law and the decisions issued in the implementation of its provisions. The Tax Procedures Law shall also determine the relevant penalties and fines relevant to the implementation of this Decree-Law.

7. TRANSITIONAL CLOSING PROVISIONS

A taxable person's closing balance sheet for the prior year shall be considered the opening balance sheet for CT purposes, subject to transfer pricing considerations.

To the extent the terms of an international agreement that is in force in the State are inconsistent with the provisions of this Decree-Law, the terms of the international agreement shall prevail.

8. WAY FORWARD

Entities in the UAE need to carry out a detailed analysis of how the CT law will impact their profitability status as well as the more important Transition from a non-CT era to a CT Era.

Sun Management Group is always ready to help you to ensure that this massive change for UAE companies is done in the most cordial manner.

On this journey, to prepare your business and employees for corporate tax, take a breather and contact Sun, your corporate tax partner. Our expert tax team will assist you and guide you in a step-by-step process!

Our Corporate tax assistance varies from impact advisory to implementation support to Post implementation support including CT registration, advisory, representation, etc.

Please feel free to reach out to our team below.

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