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Ministry of Finance (MoF) consults stakeholders on proposed Corporate Tax law, Online Consult closes on **May 19, 2022**

Give us a call
+971 4 297 1814

Chat with us on WhatsApp
+971 5 050 34670

Send us an email
Corporatetax@agconsultancy.ae

Send us a fax
+971 4 287 1815

Write to Ardor Global Consultancy
Office Suite #810, Prime Tower,
Business Bay, Dubai, PO Box 86627,
United Arab Emirates

www.agconsultancy.ae

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On January 31, 2022, the UAE announced that it would introduce a Federal Corporate Tax (CT) on business profits that will be effective for financial years starting on or after 01 June 2023. Now, the Ministry of Finance (MoF) has placed a Public Consultation Document on UAE CT which is open for comments only until May 19, 2022.

The public consultation document is released in advance of relevant legislation being finalized and promulgated for inputs from interested stakeholders. MoF has stated that consulting with the business community and other interest parties as part of the implementation process, it has demonstrated its commitment to implementing a CT regime that is compatible with the UAE's business environment.

Rationale for introducing a Federal CT regime

1. Achieve its strategic objectives and accelerate its development and transformation.
2. CT regime that adheres to international standards, together with the UAE's extensive network of double tax treaties will ensure that UAE is preferred jurisdiction for business and investment
3. Introduction of CT regime will provide basis for the UAE to execute its support of the global minimum effective tax rate under" Pillar Two" of the OECD BEPS project.

Key Principles

The Ministry of Finance has been guided by a set of internationally accepted principles to ensure efficiency, fairness, transparency and predictability in the design and execution of the proposed UAE CT regime.

- Flexibility and alignment with modern business practice
  Tax laws must be aligned with the changing economic and social circumstances.
- Certainty and Simplicity
  Tax rules must be clear and simple, so the compliance costs are minimized
- Neutrality and equity
  Tax rules must be equitable towards different business sectors and address possible inequalities and arbitrage opportunities.
- Transparency
  Clear guidance and public communication

Who is subjected to CT?

Residency is the key determinant of whether the business profits will be subject to CT in the UAE. Following persons are subject to CT:

1. Is a person
   a. A legal person incorporated in the UAE.
   b. A legal person that is not incorporated in UAE but is effectively managed and controlled in the UAE.
   c. A natural person who is engaged in business in the UAE.

   (OR)
2. Is a Non-resident person who has permanent establishment in the UAE.

   (OR)
3. Is not any of the above, however, is a non-resident person who earns UAE sourced income.

Who is exempt from CT?

The following persons will be exempt from UAE CT:

1. The Federal and Emirate Governments and their departments, authorities and other public institutions.
2. Wholly Government-owned UAE companies that carry out a sovereign or mandated activity, and that are listed in a Cabinet Decision.

3. Businesses engaged in the extraction and exploitation of UAE natural resources that are subject to
4. Emirate-level taxation that are listed in a Cabinet Decision
   Charities and other public benefit organizations that are listed in a Cabinet Decision
5. Public and regulated private social security and retirement pension funds
6. Investment funds subject to conditions

Free Zones

Companies and branches that are registered in a free zone, maintain adequate substance, and comply with all regulatory requirements will be subject to 0% CT rate (which means they will be subjected to tax return filing requirements, but are not liable to pay CT), except where in cases where they are disqualified from 0% CT regime.

Following incomes earned by freezone entity is subject to 0% CT rate:

1. Income earned from business outside UAE
2. Income earned from transactions with business located in same free zone or any other free zones
3. Passive income such as interest, royalties, dividends, and capital gains which is earned by a free zone entity from mainland UAE
4. Income by freezone entity from their group companies located in mainland subject to condition that such transactions will not qualify as a deductible expense for mainland group company
5. Income from sale of goods by a free zone person located in Designated Zone for VAT purposes where the UAE mainland businesses is importer on record of those goods

However, to restrict businesses to gain unfair competitive advantage over businesses established in mainland UAE, if the free zone entity has any other mainland sourced income it will disqualify the free zone person from 0% CT regime in respect of all their income.

A free zone entity can establish a branch in the mainland UAE which will be taxed at regular CT rate on its mainland source income, while continuing with 0% rate on its other income

The UAE CT regime will require a free zone person to have audited financial statements if it wants to benefit from the 0% CT regime.

Taxable Income

UAE business proposes to use the accounting net profit (or loss) as stated in financial statements of a business as the starting point for determining their taxable income. However, the financial statements must be prepared using accounting standards and principles that are acceptable in the UAE.

Unrealized income or losses may be recorded for accounting purposes even though they are not yet realized. Depending on the nature of unrealized income or losses, these may be considered or excluded for computing the taxable income.

Where the unrealized income or losses is on capital items such unrealized gains or losses are not considered for calculating the taxable income, on the other hand where such unrealized gains or losses are on revenue items those considered for calculating the taxable income.

Exempt Income

Following incomes would be exempted from CT:
1. Domestic dividends earned from UAE companies including dividends paid by a free zone person that benefits from 0% CT regime.

2. Capital gains from sale of shares in the UAE and foreign companies will also be exempt from the UAE subject to certain conditions are met
3. Dividends paid by foreign companies will be exempt from CT provided that the UAE shareholder company must own atleast 5% of the shares and the foreign company is subject to CT (or an equivalent tax) rate of atleast 9% in the other country
4. Foreign branch profits will be exempted from UAE CT provided that the foreign branch is subject to sufficient level of tax in the foreign jurisdiction in which it is located. Alternatively, the foreign branch can elect to claim foreign tax credits for tax paid in the foreign branch country. The election to claim a branch profit exemption is proposed to apply to all foreign branches of the UAE company.
5. Income earned by a non-resident from operating or leasing aircrafts or ships used in international transportation provided that the same tax treatment is granted to UAE businesses in the relevant foreign jurisdiction under the reciprocity principle

Interest Capping Rules

The UAE CT regime will cap amount of net interest expense that can be deducted at to 30% of a business earnings before interest, depreciation and amortization (EBITDA).

Non-deductible Expense

Businesses will not be allowed to fully deduct the expenditure incurred towards entertaining customers, shareholders, suppliers and other business partners. Only 50% of the expenditures will be allowed as deductible expense.

Administrative penalties, recoverable VAT and donations paid to organisations that are not approved for charity or public benefit organisations will not be allowed as deductible expense.

Carry Forward and Offset of Business Losses

Tax losses can be carried forward indefinitely provided that the same shareholders hold at least 50% of the share capital since the start of the period of loss is incurred to the end of the period in which the loss is offset against the taxable income. However, if there is a change in ownership of more than 50%, tax losses may still be carried forward provided that the same or similar business is carried out by the new owners.

The condition does not apply to the businesses that are listed on the recognized stock exchange. Business will be able to offset a loss incurred in one period against the taxable income of future periods, up to maximum of 75% of the taxable income in each of those future periods.

Tax Groups

The UAE CT regime will allow full consolidation for tax purposes (tax grouping) for essentially wholly owned group of companies. For the period during which the entities are members of the tax group, the parent company and each subsidiary will be jointly and severally liable for the group's CT. However, this joint and several liability can be limited to one or more named members of the tax group, with approval from the FTA.

Transfer of losses is possible in cases where the group of companies do not meet the criteria to form a tax group or do not intend to form a tax group.

Following conditions must be adhered to by the entities to form a tax group for CT purposes:

1. UAE Resident companies can elect to form a tax group
2. Parent Company owns at least 95% of the share capital and voting rights in the subsidiaries (Direct ownership)
3. Subsidiary can also be part of tax group if it is owned indirectly by the parent company and other subsidiaries own at least 95% of its shares (Indirect ownership)
4. Neither the Parent Company nor any of the subsidiaries can be exempt person or a free zone person that benefits from 0% CT rate.
5. All group members must use same financial year
6. To determine the taxable income of the tax group, the Parent Company has to prepare consolidated financial statements as the Parent Company will be responsible for administration and payment on behalf of the tax group

Transfer of Losses

Transfer of losses would result in transfer of value from the loss company to the profitable company, therefore, one of the main criteria for availing group loss relief is that the UAE group companies are at least 75% commonly owned and no loss transfers will be allowed from companies that are exempt person or a free zone person that benefits from 0% CT rate.

Transfer of losses is possible in cases where the group of companies do not meet the criteria to form a tax group or do not intend to form a tax group.

Related Parties

All related party transactions will need to comply with the transfer pricing rules and the arm's length principle as per OECD transfer pricing guidelines.

For the UAE CT purposes, the following are considered as related parties:

1. Two or more individuals related to the fourth degree of kinship or affiliation, including by birth, marriage, adoption or guardianship
2. An individual and a legal entity where alone, or together with a related party, the individual directly or indirectly owns a 50% or greater share in, or controls, the legal entity
3. Two or more legal entities where one legal entity alone, or together with a related party, directly or indirectly owns a 50% or greater share in, or controls, the other legal entity
4. Two or more legal entities if a taxpayer alone, or with a related party, directly or indirectly owns a 50% share of each or controls them
5. A taxpayer and its branch or permanent establishment
6. Partners in the same unincorporated partnership
7. Exempt and non-exempt business activities of the same person

Connected Persons

Connected Persons are different from Related Parties. A person will be considered as 'connected' to a business that is within the scope of the UAE CT regime if:

1. An individual who directly or indirectly has an ownership interest in, or controls, the taxable person

2. A director or officer of the taxable person
3. An individual related to the owner, director or officer of the taxable person to the fourth degree of kinship or affiliation, including by birth, marriage, adoption or guardianship
4. Where the taxable person is a partner in an unincorporated partnership, any other partner in the same partnership
5. A Related Party of any of the above

Arm's Length Principle

All Related Party transactions and transactions with Connected Persons will need to comply with the arm's length principle. The arm's length price will need to be determined using one of a set number of internationally recognized transfer pricing methods, or a different method where the business can demonstrate that the specified methods cannot be reasonably applied to determine an arm's length result.

Where relevant, the business will be required to submit a disclosure containing information regarding their transactions with Related Parties and Connected Persons.

A business will also need to maintain a master and local file (with format and content consistent with the requirements prescribed under OECD BEPS Action 13) where the arm's length value of their Related Party transactions exceeds a certain threshold in the relevant tax period.

Illustration of Calculation of CT Payable

Determination of CT Payable	
Final taxable income	
Taxable Income (0-AED 375,000)	NIL
Taxable Income (>AED 375,000)	CT @ 9%
CT liability	XXXX
Less: Foreign Tax Credit	(XXXX)
Final CT Payable	XXXX

To avoid double taxation, the UAE CT regime will allow a credit for the tax paid in a foreign jurisdiction against the UAE CT liability on the foreign sourced income that has not been otherwise exempted. This is known as "Foreign Tax Credit".

However, the maximum foreign tax credit will be lower of:
1. The amount of tax paid in foreign tax jurisdiction
2. The UAE CT payable on the foreign sourced income

Any unutilized foreign tax credit will not be allowed to be carried forward to other tax period nor will FTA refund any unutilized foreign tax credit.

Withholding Tax

CT provisions propose 0% withholding tax on specified domestic and cross-border payments made by UAE businesses. UAE businesses will not be required to make any deductions from payments made, nor will there be an obligation to file withholding tax returns.

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Administrative Guidelines

A business subject to CT will need to register with the FTA and obtain a Tax Registration Number within a prescribed period.

The UAE CT regime will be based on a self-assessment principle. This means that a business is responsible for ensuring that the tax return and any supporting schedules submitted to the FTA are correct, complete and comply with the UAE CT law.

Business would need to prepare and file only one tax return for each tax period. There is no requirement for making advance payment of CT.

Each return and related supporting schedules will need to be submitted to FTA within 9 months of end of the relevant tax period.

The introduction of the UAE CT regime will not impact the existing CbC reporting requirements and relevant regulations.

Click here for submission of response to MoF: **Corporate Tax Submission Public Consultation**

Ardor Global Consultancy has a dedicated Corporate Tax team to support clients and organisations. If you want to know or hear more please contact us via our website or email us at **corporatetax@agconsultancy.ae** and we will get back to you.

This UAE CT Public consultation document should be a reminder that you need to start thinking seriously about how Corporate Tax will impact your business. Ardor Global Consultancy can conduct high level impact assessments, review systems and develop an implementation plan for you.

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