

UAE: Introduction of Federal Corporate Tax - Public Consultation

April 2022



The UAE launches a public consultation on corporate tax



On 28 April 2022, the UAE Ministry of Finance (MoF) issued a public consultation document that contains information on the proposed UAE corporate tax (CT) regime. The document is released for the purposes of obtaining input from interested parties.

The document does not represent the final legislation, and cannot be relied upon to make individual or commercial decisions.

The consultation period lasts for three weeks from 28 April 2022 until 19 May 2022.

The [consultation document](#) can be found on the [MoF website](#).

Further information is expected to be released by mid 2022.

In detail

The UAE MoF recognises the importance of consultation with the business community and interested stakeholders, and is launching this initiative ahead of the final legislation being released.

The document outlines the rationale for a federal CT regime and the key principles. There is important information on the proposed approach to:

- Taxable persons
- Basis of taxation
- Calculation of taxable income and CT liability
- Groups
- Withholding taxes
- Transfer pricing
- Administration

Information contained in this document serves solely as guidance and could be subject to change based on the feedback received.

We highlight below some of key aspects revealed in the consultation document and the intention / direction of the MoF.

Taxable persons

Based on the consultation document all **natural persons** will be subject to tax to the extent they are engaged in a business or commercial activity in the UAE. UAE CT will apply to all **UAE companies and legal persons** incorporated in the UAE. The definition of legal persons includes foreign legal persons with a **permanent establishment (PE)** in the UAE or that are **effectively managed and controlled** in the UAE, in line with international practice.

Limited and general partnerships will be treated as transparent for UAE CT purposes, meaning their income will flow through and be taxed in the hands of the partners or members only. This will also apply to **investment funds** where they are organised as limited partnerships. Where none of the partners have unlimited liability for the partnership's obligations or other partners' actions, the partnership will be subject to UAE CT in the same manner as a UAE company.

Exemptions

In addition to businesses engaged in the extraction and exploitation of UAE natural resources, the **UAE government and its wholly UAE entities** are exempt from UAE CT with respect to sovereign or mandated activities (i.e. activities that are non-commercial in nature).

Charities and Public Benefit Organisations can apply to the MoF to be exempt from UAE CT as long as they do not undertake any commercial activities per se.

Regulated investment funds and real estate investment trusts (REITs) can apply to the Federal Tax Authority (FTA) to be exempt from UAE CT subject to meeting certain requirements (listed in the document).



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Free Zone entities

The 0% CT rate applies to income earned from transactions with businesses located outside the UAE, in the same Free Zone, or any other Free Zone. Where a Free Zone entity earns any mainland sourced income that is not passive in nature (i.e interest, royalties, dividends, capital gains, etc), **all its income will be disqualified** from the 0% CT regime. As an exception, a 0% tax rate will apply on income earned by a Free Zone entity located in a designated zone for value added tax from the sale of goods to UAE mainland businesses that are importers of record of those goods.

Transactions between Free Zone entities and their group entities located in mainland UAE will be subject to **0% tax**, however the associated payments made by mainland entities **will not be deductible** for UAE CT purposes. This will not be applicable to transactions between UAE mainland entities and a UAE mainland branch of a Free Zone entity as the latter should be subject to UAE CT at the applicable rates.

A Free Zone entity can make an election to become subject to regular CT in the UAE. Such election is irrevocable.

Basis of taxation

The UAE CT system will be a **residence-based CT regime** that taxes the worldwide profits of UAE resident businesses, and only the UAE-sourced business income of non-residents. Where a business is resident for CT purposes would be determined based on the place of incorporation or the place of effective management and control of the business. For non-residents taxation will depend on whether they create a **PE in the UAE** (definition in line with Article 5 of the OECD Model Tax Convention) and whether they derive **UAE sourced income** (subject to withholding tax at 0%).

A Free Zone entity could create a **PE in mainland UAE** under the same principles.

Regulated UAE investment managers may provide discretionary investment management services to foreign customers **without triggering a PE** in the UAE for the investor or the foreign investment fund, subject to meeting certain conditions.

Calculation of taxable income and CT liability

Taxable income

UAE CT will be payable on the **accounting net profit (loss)** as stated in the financial statements, subject to certain adjustments. In addition to International Financial Reporting Standards (IFRS), consideration is being given to allow the use of **alternative financial reporting standards**.

Unrealised gains or losses

A distinction should be made as to whether these relate to **capital items or revenue items**, where the latter should be taken into account when calculating taxable income.

Participation exemption

Participation exemption will apply to dividends and capital gains earned by UAE entities.

- **Dividends earned from UAE companies** (including Free Zone companies) will be **exempt from UAE CT**.
- **Dividends earned from foreign companies** and **capital gains** earned from disposals in **UAE and foreign companies** will be exempt from UAE CT subject to a **5% ownership threshold** and where the **foreign company is taxed** at a rate of **at least 9%**.

Income of foreign branches

UAE companies can **either** claim a foreign tax credit for tax paid by their foreign branches in the foreign jurisdiction **or** elect to claim an exemption for their foreign branch profits. The election to claim an exemption **applies to all foreign branches** of the UAE company and is **irrevocable**. The exemption might not be available if the foreign branch is not subject to sufficient tax in the foreign jurisdiction.

Reciprocity principle

Income earned by a non-resident from operating or leasing aircraft or ships (and associated equipment) used in international transportation will be exempt from UAE CT provided the same tax treatment is granted to a UAE business in the relevant foreign jurisdiction.



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Expense deduction limitations

- Deductibility of **interest expense** is limited to **30% of EBITDA**. Businesses may be allowed a deduction **up to a safe harbor / de minimis amount irrespective of the** EBITDA limitation. These rules will not apply to financial services entities. **Related party interest** should be set at **arm's length** with a **valid commercial reason in order to be deductible**. This can be satisfied if the related party lender is subject to at least 9% tax on the interest income earned.
- **Payments made to Free Zone entities** from related UAE mainland entities will not be deductible.
- **Entertainment expenses** will be deductible up to 50%.
- **Penalties, recoverable VAT, and donations** (paid to an organisation that is not an approved charity or public benefit organisation) will not be deductible.

Tax losses

Tax losses can be carried forward **indefinitely** (with offset limited to up to 75% of each year's taxable income) provided no change in ownership of more than 50% occurs. If more than 50% ownership change takes place, tax losses can still be carried forward only if the same or similar business is carried out by the new owner. These conditions are not applicable to listed businesses.

Losses incurred before the effective date for CT or before a person becomes a tax payer in the UAE **will not be available** for future periods. Similarly, losses generated in relation to an exempt income and losses incurred by a Free Zone entity that are not attributable to a mainland PE will not be available for future periods.

Tax credits

Foreign tax credits are available subject to certain limitations. It will no be possible to carry forward or back any unutilised tax credits, or apply for a refund.

Groups

Tax groups

A UAE resident group of companies can elect to form a tax group if the parent company holds at least **95%** (direct and indirectly through other subsidiaries) of the share capital and voting rights of the subsidiaries. A UAE branch of the parent or of one of the subsidiaries can also be part of the tax group. To form a tax group, all entities (including the parent) should be **subject to CT** in the UAE and have the **same financial year**.

The parent company and each subsidiary will be jointly and severally liable for the group's CT for the period in which the entities are part of the same tax group. This can be limited to one or more named members if approved by the FTA.

Transfer of losses

Companies that do not meet the 95% common ownership requirement or that do not want to form a tax group can transfer tax losses to each other as long as they are at least **75% commonly owned**. No loss transfers will be allowed from exempt companies or those that benefit from a 0% Free Zone CT regime.

Group relief

- Transfer of assets and liabilities between UAE resident companies that are **at least 75% commonly owned**, can be undertaken **tax neutrally**, provided the assets / liabilities transferred remain within the same group for a **minimum of three years (clawback period)**. Where relief is claimed, the relevant assets / liabilities should be recognised at net book value.
- **Certain restructuring transactions** (e.g. mergers, spin offs, etc.) can also be undertaken **tax neutrally**. A **three years claw back period** will apply in case of a subsequent transfer to a third party.

Withholding taxes

Certain income streams as listed in the consultation document will be subject to a 0% withholding tax. There will be no obligation to make any deductions or file any associated withholding tax returns.



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Transfer pricing (TP)

The UAE introduces TP regulations, which means that qualifying Related Party transactions and transactions with Connected Persons (“intercompany transactions”) will need to comply with the applicable transfer pricing requirements, according to the arm’s length principle as set out in the [OECD Transfer Pricing Guidelines](#). The announcement further enlists a set of criteria for defining both concepts of “Related Parties” as well as “Connected Persons”.

Where the value of the related party transactions exceeds a threshold (to be specified) during the relevant tax period, qualifying businesses will also need to prepare a Local File and Master File (according to the format and content prescribed under OECD BEPS Action 13). Also, the arm’s length nature of the intercompany transactions will need to be supported using one of the internationally recognised TP methods, or a different method where the business can demonstrate that the specified methods cannot be reasonably applied.

Additionally, where conditions are met, businesses will be required to prepare and submit a TP disclosure form containing information regarding their intercompany transactions. It remains to be seen on whether the TP disclosure form would need to be submitted at the same time as the tax return (i.e. within nine (9) months of the end of the relevant tax period) or at a different deadline.

Administration

The intention is that there will be simplified reporting for small and medium businesses.

The CT return and payment will be due within **9 months** after the end of the relevant tax period. **One tax return** will need to be filed and **one CT payment** will need to be made. It is also possible to request for a **CT refund** from the FTA.

The period during which the **FTA can issue assessments** will be according to the Tax Procedures Law (within 5 years from the end of the relevant tax period, may extend to 15 years in case of tax evasion or non-tax registration). Similar treatment will apply for **challenges submitted by taxpayers**.

Clarifications requests regarding certain tax positions can be submitted by businesses to the FTA. Provided the facts and circumstances outlined in the clarification request continue to apply, such clarification would be binding on the FTA.

There is a requirement to maintain **financial and other records** by taxpayers. This will also apply to certain exempt persons.

Audited financial statements are not a requirement for UAE CT purposes except for Free Zone entities benefiting from a 0% CT regime.

There is **no requirement for UAE business to restate their balance sheet** upon entering into the UAE CT regime.

International tax developments

There are no details on how the Pillar 2 rules will be embedded into the UAE CT regime. Further information will be made available in due course.

Next steps

This consultation shows the UAE’s commitment to introduce UAE CT. This should be a reminder that businesses need to start thinking seriously about how CT will impact their business, and should consider responding to the consultation document. The consultation document is open until the 19th of May and responses should be submitted online.

Comments should focus around areas that may help reduce compliance cost and complexity and clarify uncertain tax treatments. Comments can also address other aspects not covered in the consultation document. Additional guidance on the consultation document can be found [here](#).

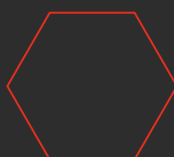
How we can help

If you need assistance in responding to this consultation document or If you have not yet considered the impact of the UAE CT on your business, we would be happy to assist you in responding, or assess your position and guide you as to what actions are required to make sure you are ready to comply with CT once it becomes effective.

Should you have any questions, we have a designated team who will be able to assist you. You can reach us by emailing CT.UAE@pwc.com or completing [this form](#).



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