



# M2K UAE Knowledge Series

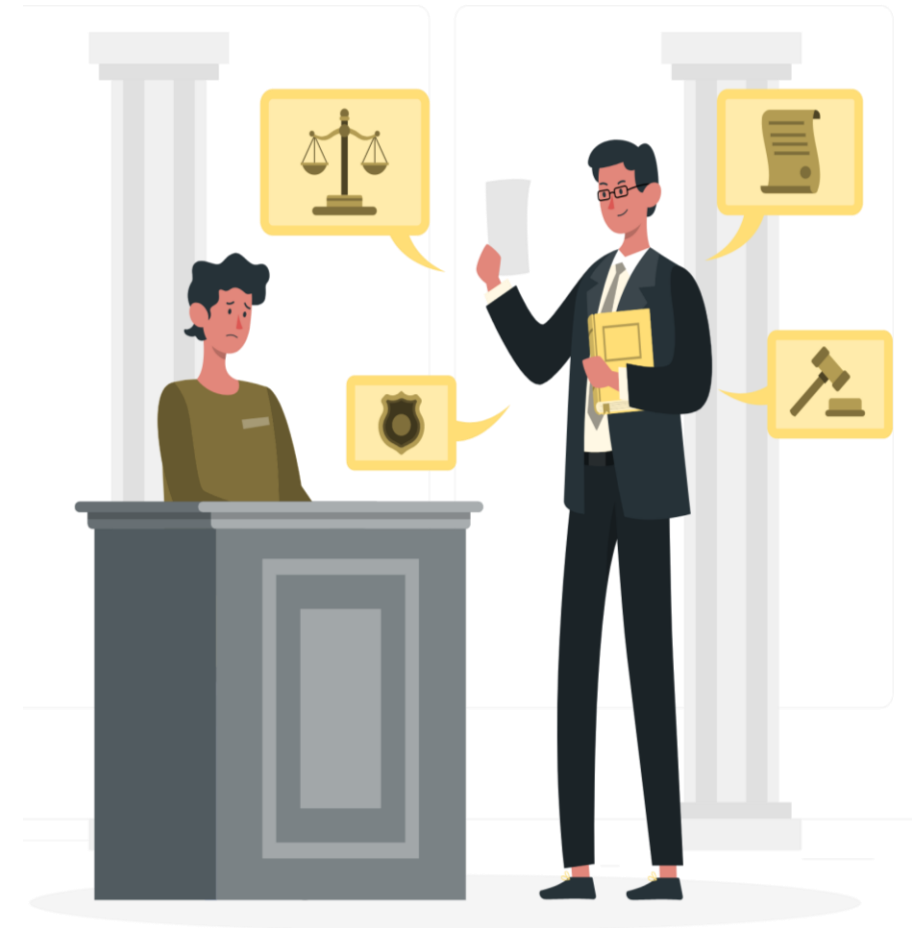
## Levy of Corporate Tax

*SERIES #01*

# Background

United Arab Emirates ('UAE') is one of the countries with significant oil and natural gas reserves. In the 21st century, the country has become less reliant on oil and gas and is economically focusing on tourism and business. The tax and regulatory developments in the country over the last few years till date are as follows:

- Implemented Value Added Tax ('VAT') w.e.f. 2018.
- During the same year, it joined the Inclusive Framework on Base Erosion and Profit Shifting ('BEPS').
- Enacted laws on Anti – Money Laundering and combating the financing of terrorism and illegal organizations.
- Introduced Country by country reporting ('CbCR') to the UAE headquartered Multinational Entity ('MNE') Groups with financial reporting years starting on or after 1<sup>st</sup> January 2019.
- Issued Economic Substance Regulations ('ESR') on 30 April 2019.
- Issued Cabinet Resolution regulating the Beneficial Owner Procedures on 28 Aug 2020.
- As a latest development, Corporate Tax law has been enacted.



# Introduction to Corporate Tax in UAE

- UAE has introduced Corporate Tax with the objective of UAE's development and transformation and honouring its international commitment for tax transparency and prevention of harmful tax practices.
- Corporate Tax is essentially a direct tax levied on the net income of the businesses, and hence would be levied in addition to the Excise Tax imposed on sale of certain commodities and Value Added Tax ('VAT') on the sale of goods or services. Business engaged in extraction of natural resources and certain non-extractive business, which are subject to Emirate level taxation will be outside the scope of Corporate Tax, subject to certain conditions.\*
- Corporate Tax is a federal tax and therefore is applicable across all Emirates (i.e., Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al Quwain, Ras Al Khaimah and Fujairah).
- Corporate Tax would be applicable to financial years starting on or after 1<sup>st</sup> June 2023. An option has been provided to the 'taxable persons' to choose any 12-month period for which financial statements are prepared as 'Tax Period'.

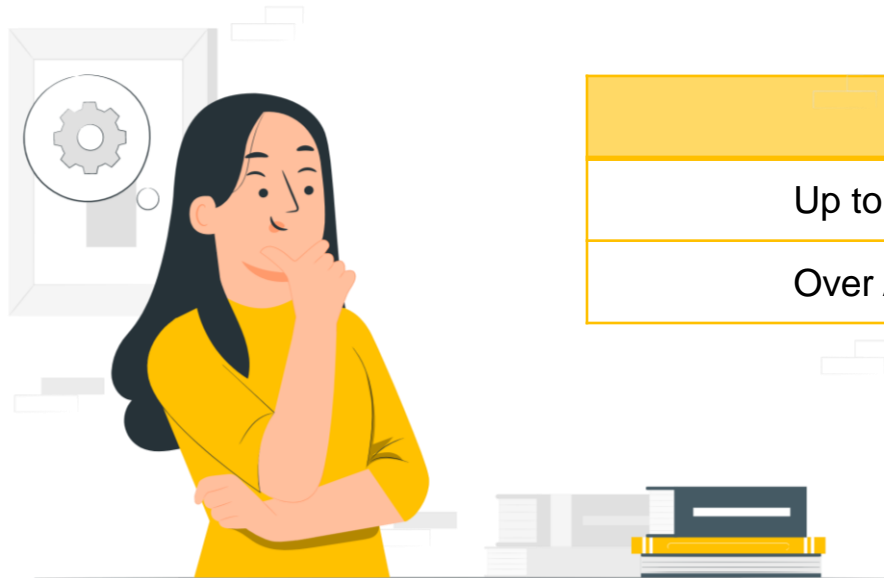
\* The same shall be dealt with in subsequent alerts of this Series.



The flexibility provided to choose any 12-month period as '**tax year**' would eliminate the need of preparation of separate financial statements for the purpose of corporate tax, where the businesses prepare financial year for a different 12-month period, based on the financial year of the foreign parent company etc., and promotes ease of compliance.

# Corporate Tax rate

The Corporate Tax rate (as applicable to those other than qualifying free zone persons) would be as follows:



Net Income	Tax Rate
Up to AED 375,000	0%
Over AED 375,000	9%

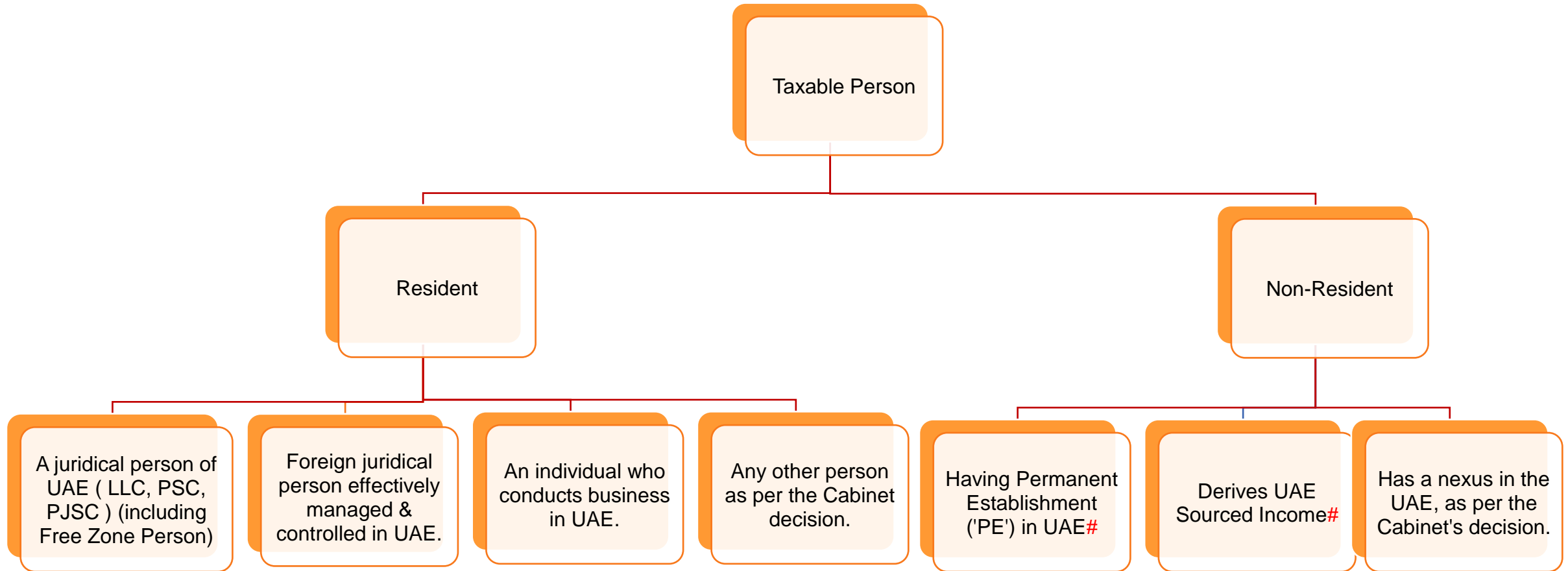
Small businesses earning income below the given threshold of **AED 375,000** would not be required to pay Corporate Tax in UAE.

Organization for Economic Cooperation and Development (OCED) has proposed **15% of Global Minimum Tax (GMT)** should be levied on MNEs with Consolidated Revenues of EUR 750 Million or more (Pillar II Solution), for addressing the BEPS issues.

At present, the **corporate tax @ 9%** levied by UAE is apparently **lower than GMT proposed @ 15%**. It would be interesting to watch the mechanics to be adopted by UAE (being a signatory to inclusive framework on BEPS) to implement GMT.

# 'Taxable person' upon whom corporate tax is imposed

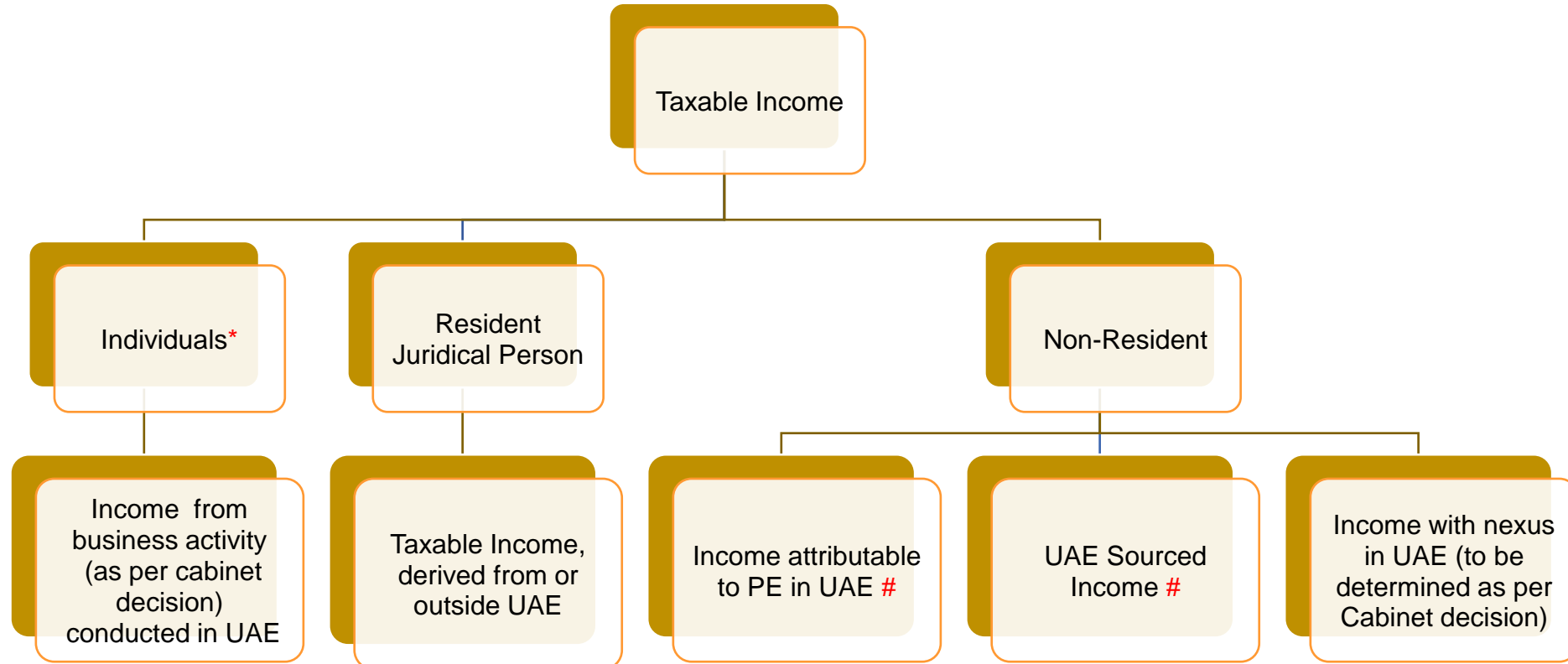
The 'taxable person' may be a resident or non-resident. The persons who are considered as 'taxable person' can be summarized as follows:



# The provisions of UAE Corporate Tax Laws in relation to PE and UAE (State) Sourced Income will be discussed in detail in subsequent alerts of this Series.

# 'Income' subject to Corporate Tax

The income which are included under the ambit of the 'taxable income' in respect of different types of persons can be depicted as below:



\* Individuals who conduct business in UAE are considered to be 'resident' for the purpose of UAE Corporate Tax Law.

# The provisions of UAE Corporate Tax Laws in relation to PE and UAE (State) Sourced Income will be discussed in detail in subsequent alerts of this Series.

# Taxation of Individuals

Only individuals who are engaged in business (including in the form of sole proprietorship or a civil company) as per cabinet decision to be issued will be subject to Corporate Tax. The income earned from foreign countries to the extent connected with the business activity conducted in UAE would also be within the scope of Corporate Tax.

Salary income and employment income from service relationship in the nature of the remuneration for the labour, where all or most of the income of the individual is derived from one customer **would not be subject** to Corporate Tax.

Income of self-employed persons (including freelancers) would be subject to corporate tax, only if the activity carried on by them would constitute taxable business as per cabinet decision\*. However, such income would be subject to basic exemption limit of AED 375,000 and small business relief, the provisions regarding which is to be spelt by way of a cabinet decision.

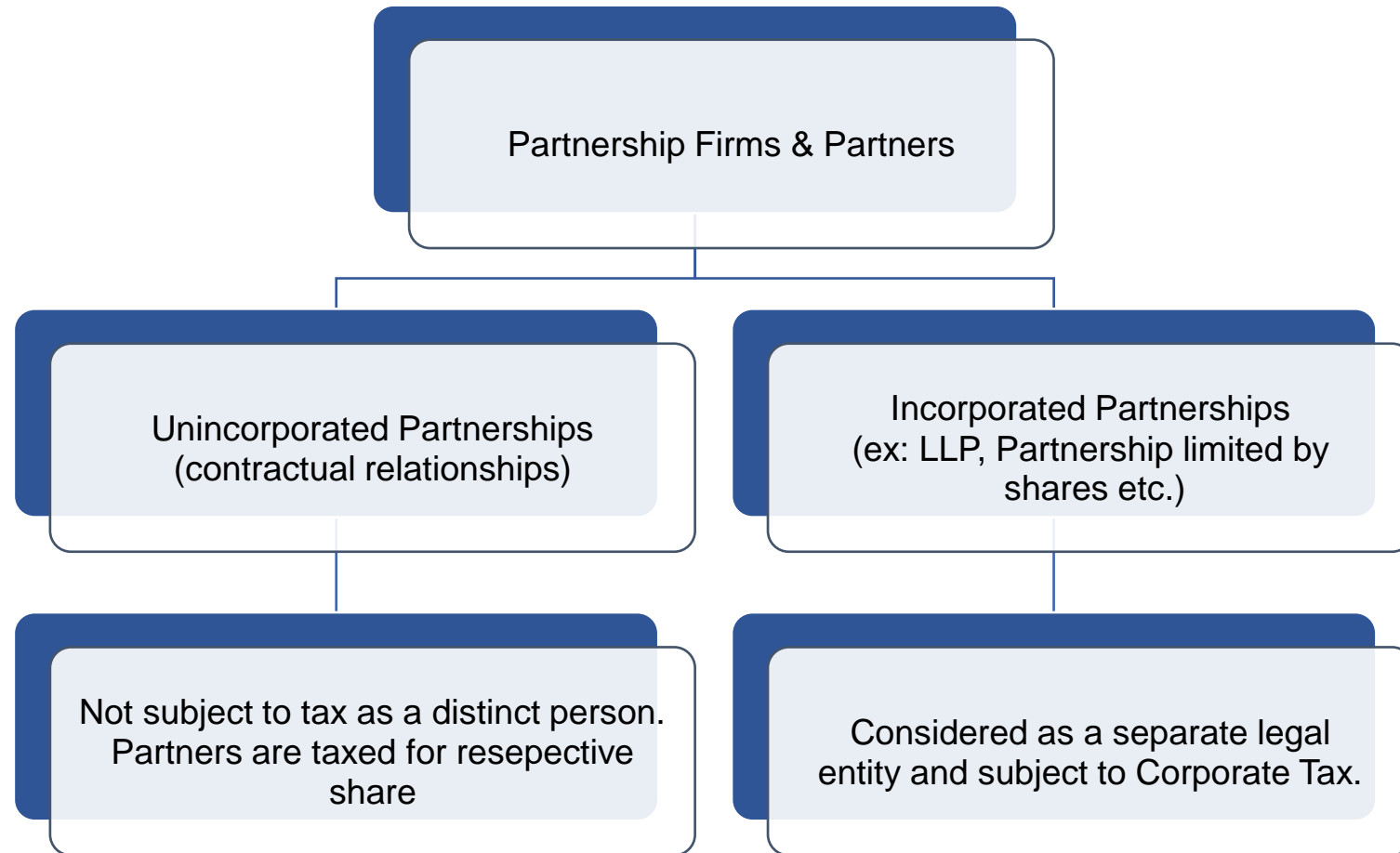
The below income earned by an individual in his/her personal capacity **would not be subject** to corporate tax:

- Interest and other personal investment and savings income,
- Dividend, capital gains and other income from owning shares and securities,
- Income from investment in UAE Property



*\*The cabinet decisions to be issued providing the details of the 'taxable business' and 'business activity' within the scope of Corporate Tax and the 'small business relief' are eagerly awaited, which should provide clarity and greater details on imposition of Corporate Tax on business or profession carried on by the individuals.*

# Partnership firms and partners (1/2)





# Partnership firms and partners (2/2)

## The following aspects are to be noted in case of taxation of an unincorporated partnership ('UP')

- The partners of a UP are treated to be conducting the business of the UP, holding the assets of the UP and party to any agreement entered into by the UP. The assets, liabilities, income, expenditure and foreign tax credit of the UP are allocated to each of the partners based on their respective distributive shares.
- Where the distributive shares of respective partners are not identifiable, the manner of allocation may be prescribed by the federal tax authority.
- Deduction would be available for the following in the hands of the partners of UP: i) Expenditure incurred directly by the partner for the purpose of the business of UP and ii) Interest expenditure incurred by the partner on the borrowing taken for capital contributed to the UP
- No deduction is allowed on interest paid on capital paid by the UP to a partner.
- Foreign partnerships that are not subject to tax under the laws of that country are treated as UP in UAE and all the tax consequences in the hands of the partners would follow accordingly.
- Alternatively, Partners of a UP can make an application to the Federal Tax Authorities to treat the UP as a taxable person. Any conditions may be prescribed for grant of the same.

The above tax provisions would need careful consideration in choosing an appropriate form of business in UAE.

*The option provided to the make an application that the UPs shall be treated as separate taxable person would help the partners who do not carry out any other business in their individual capacity to avoid assuming corporate tax compliance burden. On the other hand, can each of the partners of UP enjoy an basic exemption limit of AED 375,000 individually, when UP is treated as tax transparent entity?*

# Family Foundation



- A 'foundation' is a separate legal entity, where the assets are bestowed by the founder, a 'council' is appointed for management of its assets in accordance with its charter in support of a cause or a purpose, or for the benefit of the beneficiaries.
- Family foundation ('FF') is one of the common vehicles for holding and managing family wealth and succession planning. The Corporate Tax provisions in relation to 'family foundation' is as follows:
- Being a separate legal entity, 'foundation' is generally taxed as a separate person. However, an option is provided to family foundations, meeting the below conditions to make an application to be treated as a UP.
  - a) The beneficiaries or identified or identifiable natural persons or a public benefit entity
  - b) The principal activity is to receive, hold, invest, disburse or otherwise manage assets or funds associated with savings or investment
  - c) The FF is not engaged in any business or business activities
  - d) The main purpose of the FF is not avoidance of corporate tax
- Further, additional conditions may be imposed by Minister of Finance.

# Free Zone Persons (1/2)

Corporate Tax rate is imposed on a Qualifying Free Zone Person as below.

Income	Tax Rate
On qualifying income	0%
Taxable income that is not a qualifying income	9%

However, a qualifying free zone person may elect to be subject to Corporate Tax, i.e., without availing the benefit of Corporate Tax @ 0% on qualifying income.

It is to be noted that the basic exemption limit of AED 375,000 is not available for free zone person.

Consider the below examples in case of a qualifying free zone person:

Particulars	Scenario I	Scenario II
Qualifying Income	AED 200,000	AED 500,000
Taxable income, that is not qualifying income	AED 170,000	AED 170,000
<b>Total</b>	<b>AED 370,000</b>	<b>AED 670,000</b>
<b>Option I:</b> Considering 0% on qualifying income	AED 15,300 (AED 170,000 * 9%)	AED 15,300 (AED 170,000 * 9%)
<b>Option II:</b> Exercising option for normal tax provisions as provided in Article 19	AED 0 (Basic exemption limit of AED 375,000)	AED 26,550 ((AED 670,000 – 375,000) * 9%)

However, once a free zone person elects to opt for normal tax under Article 19, there same is applicable **from** the tax period in which such election is made or the following tax period. As such election is irreversible for subsequent years, the same should be made duly considering all the factors holistically including long-term interest.

# Free Zone Persons (2/2)



**A free zone person that meets the below conditions are considered as a qualifying free zone person.**

- a) Maintains adequate substance in the state
- b) Derives qualifying income (to be specified in a cabinet decision)
- c) Complies with transfer pricing provisions
- d) Has not opted to be subject to normal Corporate Tax Provisions.

Further, additional conditions may be imposed by Minister of Finance.

The Corporate Tax Compliances (i.e., registration, filing of return etc.) are applicable to the qualifying free zone persons as well.

It has been clarified that the qualifying free zone entities that are part of large multi-national group are anticipated to be subject to a different Corporate Tax rate, once Pillar II rules are embedded into UAE Corporate Tax regime.

*The cabinet decision prescribing what constitutes qualifying income is awaited, which would be crucial for the free zone persons to evaluate the corporate tax implications. In case where the free zone persons earns both qualifying income and other income, there could be common expenses incurred for earning both these income and how the same should be allocated to qualifying income stream and other income stream etc. would be one of the key aspects requiring clarity.*

# Stay tuned for more updates on UAE!

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# THANK YOU

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