



# Tax Alert

**United Arab Emirates  
Corporate Tax  
December 2022**

# The UAE announces the application of corporation tax

On 9 December 2022, the UAE Ministry of Finance (MoF) released the Federal Decree-Law No.47 of 2022 on the Taxation of Corporations and Businesses which will be effective for Tax Periods commencing on or after 1 June 2023. The introduction of the Federal Decree-Law represents another major evolution in the UAE tax landscape, following the introduction of Value Added Tax, Economic Substance Regulations, Country-by-Country Reporting requirements and the commitment to support the global minimum effective tax rate under Pillar Two of the OECD Base Erosion and Profit Shifting initiative.

## In brief

- The Corporate Tax (CT) regime will come into effect from 1 June 2023.
- The regime is applicable to UAE-based entities, foreign entities, and natural persons, which are carrying out business activities in the UAE.
- Residence is key: where a business was incorporated is far from the single factor determining whether it falls within the scope of the CT regime.
- The standard CT rate is 9%, with a rate of 0% applying to businesses with profits lower than a set threshold.
- Free Zone entities are in scope but may benefit from a 0% CT rate, subject to certain conditions being met.
- The scope of transfer pricing has been expanded and the pricing of related party transactions should be at arm's length.
- The Law elaborates in detail on corporate tax exemptions, deductions, and reliefs that are available to taxpayers, provided they do not gain an unfair tax advantage.

## Foreign taxpayers

- Entities effectively managed and controlled in the UAE.
- A Non-resident who has a Permanent Establishment (PE) in the UAE (e.g., branches).
- A Non-resident who derives UAE sourced income.
- A Non-resident who has a Nexus in the UAE (Definition to be determined)

Some other business structures, such as unincorporated partnerships, shall not be considered taxable businesses unless specific elections are made. Such structures would instead be taxed at the level of their partners who would become taxable individuals.

## Exempt Businesses

Certain businesses can be exempt from UAE CT, either automatically or by way of application, but only when such businesses meet specific conditions.

The list of exempt businesses includes government and government-controlled entities, certain businesses engaged in the extraction and processing of natural resources, public benefit entities (e.g., religious, educational, charitable entities) and certain qualifying investment funds.

Some of the exempt businesses discussed above could still be within the scope of UAE CT if, in addition to their exempted activity, they also conduct non-exempted business activities under their trade licenses.

Such business activities will be treated as independent, and entities will have to maintain financial statements for the business activities separately from the exempt activities. Transactions between the exempt business activities and taxable business activities will be considered related party transactions.

## In detail

### Scope of the UAE CT

UAE CT is potentially applicable to all UAE businesses, including the following:

#### Domestic taxpayers

- Entities incorporated, established or recognised under the applicable legislation in the UAE (e.g., LLC, PJSC and private shareholding companies) including those in Free Zones.
- Certain individuals who conduct business activities in the UAE



## Permanent Establishments

The main purpose of the PE concept is to determine if and when a company has established sufficient presence in a foreign country to warrant the direct taxation of the business profits of the company in that country.

The PE concept under the UAE CT regime will typically be determined by either the fixed place of business test (e.g., when a branch of a foreign entity is located in the UAE) or dependent agent test (e.g., when employees of a foreign entity conclude contracts in the UAE).

Apart from these two instances, the Tax Law also stipulates that “any other form of nexus” in the UAE, to be specified in a separate Cabinet Decision, may lead to the recognition of a PE in the UAE.

Certain types of activities (e.g., storing of goods, preparatory, auxiliary activities, etc.) will not be considered as creating a PE in the UAE. However, if a related party of such non-resident carries out business activities in the UAE, this may also trigger a PE in the UAE.

Investment managers shall be exempt from being recognised as a PE for non-residents, if a list of conditions is duly met.

## Free Zones

Companies and branches that are registered in a Free Zone (FZ) are in scope of UAE CT and subject to tax return filing requirements.

In keeping with the original intention and purpose, a Qualifying FZ business can benefit from a 0% CT rate if all conditions below are met:

- Maintains adequate substance in the UAE
- Derives Qualifying income (to be defined)
- Has not elected to be subject to CT
- Complies with Transfer Pricing rules

A Qualifying FZ business shall cease to benefit from the 0% CT if any of the above conditions are not met.

## Calculation of taxable income

### Income tax base

The starting point for calculating the taxable income of a business is the accounting net profit (or loss) as stated in the standalone financial statements, prepared according to the accounting principles and standards accepted in the UAE. This is then adjusted for tax purposes based on the following items.

### Unrealised gains and losses

Upon election by the taxpayer, unrealised gains and losses may not be taken into account for tax purposes in relation to either i) assets and liabilities that are subject to fair value or impairment accounting or ii) assets and liabilities held on capital account. These gains or losses would only become subject to tax once they are finally realised.

Depending on the election made, any unrealised gain or loss arising in connection with assets and liabilities held on revenue account at the end of the tax period, including unrealised foreign exchange gain or loss, would continue to be subject to tax.

### Interest deductibility rules

Interest expenditure is considered a legitimate cost of business and is therefore generally deductible for UAE CT purposes. However certain rules apply in order to avoid excessive amounts of interest being relieved for corporate tax where the profitability of a company is not in line with the debt. These rules have been introduced as follows:

### Deductibility cap

- The deductibility of net interest expense is capped at 30% of EBITDA (earnings before interest, tax, depreciation and amortisation) less exempt income.
- Any excess interest amount that is not deductible can be carried forward to be deducted in future tax periods where permitted, subject to a 10-year carry-forward cap.
- The above limitation should not apply where the net interest expenditure does not exceed a certain threshold, which is to be confirmed.

## Interest on Related Party debts

- Interest expenditure shall not be deductible if it is associated with a loan obtained from a related party in a number of circumstances, unless the taxpayer can demonstrate that the main purpose of obtaining the loan is not to obtain tax advantage.

## Exemptions from the interest capping rule

The interest capping rules does not apply to:

- Banks, Insurance Providers, taxable individuals carrying on business activities in the UAE.

## Non-deductible expenses

The law identifies certain expenses which shall be non-deductible for CT calculation purposes as follows:

- Non-Business-related expenditure.
- Expenditure associated with Exempt Income.
- 50% of entertainment expenditure related to customers, shareholders, suppliers and other business partners.
- Donations, grants or gifts paid to an entity that is not a Qualifying Public Benefit Entity.
- Fines and Penalties excluding compensations.
- Bribes or other illicit payments.
- Dividends, profit distributions or benefits of a similar nature paid to a business owner.
- Corporate tax, recoverable VAT or foreign income tax.

## Exempt income

The law also identifies certain income which shall be treated as non-taxable for CT calculation purposes as follows:

- Domestic dividends and profit distributions including those from Free Zone businesses.
- Dividends and other income from a Participating Interest (see next section).
- Income of a foreign Permanent Establishment that meets specific conditions.
- Income derived by a non-resident business from operating aircrafts or ships in international transportation that meets specific conditions.

## Participation exemption

A taxpayer's income as a result of a Participating Interest in an entity could be excluded from their taxable income where a number of conditions are met. To qualify as a Participating Interest, the taxpayer must own 5% or more of the entities shares or capital. Other conditions to be met include but are not limited to:

- The Participating Interest must be held or intended to be held for a period of at least 12 months.
- The Participation is subject to CT or similar tax of a rate not less than 9% where the Participation is not resident in UAE.
- The ownership interest in the entity entitles the Taxable Person to at least 5% of distributable profits and liquidation proceeds.

The income that could be exempted as a result of a Participating Interest includes:

- Dividends and profit distributions.
- Capital gains / losses from the disposal of the interest.
- Foreign exchange and impairment gains or losses in relation to the interest.

## Foreign Permanent Establishments exemption

A Taxable business that has a PE (e.g., a branch) in another jurisdiction can elect to exempt the PE's profits from UAE tax (provided the PE is subject to a CT of not less than 9% in the country of residence). Alternatively, where PE profits are not exempted, the business can claim a foreign tax credit for any corporate tax paid in the jurisdiction in which the PE is situated.

## Reliefs

### Transfer of assets and liabilities

Transfer of assets and liabilities could take place on a tax neutral basis between two Taxpayers within a Qualifying Group if the below conditions are met:

- The transfer is between two Taxpayers who are either tax resident in the UAE or a Non-Resident that has a PE in the UAE.

- Either Taxpayer has at least 75% ownership interest in the other, or both are commonly owned by at least 75% (directly or indirectly).
- None of the taxpayers are exempt or are a Free Zone business.
- The financial statements of both taxpayers are prepared using the same accounting standards and their financial years are the same.

### Business restructuring relief

Some business restructuring transactions could take place on a tax neutral basis where the transfer of a business is in exchange for shares or ownership interest in the Transferee.

The following conditions are just some of those that must be met in order that such restructuring relief applies:

- The transfer is between two taxpayers who are either tax resident in the UAE or a Non-Resident that has a PE in the UAE.
- None of the taxpayers are exempt or are a Free Zone business.
- The financial statements of both taxpayers are prepared using the same accounting standards and their financial years are the same.
- The transfer is undertaken for valid commercial or economic reasons.

### Tax losses

Tax losses incurred in a Tax Period could be carried forward indefinitely to offset against the Taxable Income of future Tax Periods', however the relief is capped at a maximum of 75% of the taxable income in the future period.

#### Transfer of Losses

The law allows up to 75% of the taxable income of a Taxable business to be offset by losses where:

- Both taxpayers are Tax Resident in UAE
- Either Taxpayer has at least 75% direct or indirect ownership interest in the other or both taxpayers are commonly owned by at least 75% (directly or indirectly).

- Such ownership threshold should last from the start of the Tax Period where the tax loss is incurred to the end of the Tax Period where the tax loss is utilized.
- Neither of the taxpayers are exempt or are a Free Zone Person.
- The financial statements of both taxpayers are prepared using the same accounting standards and their financial years are the same.

Tax losses may be forfeited if there is a change of ownership of more than 50% and the nature of the trade carried on by the new owners changes.

### Tax groups

The law allows full tax consolidation for groups of companies where all of these conditions are met:

- The Resident taxpayers are separate legal entities
- The Parent Company holds at least 95% of the voting rights of its subsidiaries
- The Parent Company is entitled to at least 95% of the Subsidiary's profits and net assets
- Neither the Parent Company or the Subsidiaries are exempt or a Free Zone business.
- The Parent Company and the Subsidiaries' financial statements are prepared using the same accounting standards and their financial years are the same.

#### Compliance for tax groups

- A notice signed by the Parent and all Subsidiaries will need to be submitted to the FTA and the parent company should consolidate the financial accounts of each subsidiary for the relevant tax period and eliminate any intra-group transactions.
- A single tax return will be submitted for the whole Tax Group.

Withholding tax

Withholding tax (WHT) will be set at a rate specified in a Cabinet Decision and is currently set at 0%. The Tax will be applied to State Sourced Income of a non-resident person where that income is not attributable to a taxable UAE permanent establishment of that non-resident taxpayer. Other categories of income subject to WHT may be introduced in future periods and any introduction of further categories will be specified in a Cabinet Decision.

Foreign Tax Credit

CT payable in the UAE can be reduced by an amount of Foreign Tax Credit during a tax period capped to a tax rate of 9%. Any unutilised foreign tax credit cannot be carried forward or carried back to other tax periods.

Calculation of CT liability

CT is calculated as follows:

- 0% on Taxable Income up to a certain threshold.
- 9% on Taxable income exceeding the same threshold.

The above threshold has been indicated to be AED 375,000, however this is to be confirmed in a Cabinet Decision.

CT is imposed on a Qualifying Free Zone business as follows:

- 0% on Qualifying Income
- 9% on Taxable income that is not Qualifying Income

Filing dates

Tax Returns must be filed with the FTA no later than nine months from the end of the relevant Tax Period.

- The CT shall be applicable to the fiscal years starting on or after 1 June 2023 (see examples below).

Financial year end	30 June	31 December	31 March
First tax period	1 July 2023 - 30 June 2024	1 January 2024 - 31 December 2024	1 April 2024 - 31 March 2025
Filing & payment due	31 March 2025	30 September 2025	31 December 2025

Payment

A taxpayers must settle the Corporate Tax Payable within nine months from the end of the relevant Tax Period.

Transfer Pricing

The Law consists of specific provisions for Transfer Pricing which provides guidance on the coverage as well as the application of the Arm’s Length Principle.

Under the provisions, all ‘Related Party’ transactions and transactions with ‘Connected Persons’ should be consistent with the Arm’s Length Principle.

Definition of Related party and Control.

The law defines a Related Party as follows:

- Two or more individuals related to the fourth degree of kinship or affiliation, including by birth, marriage, adoption or guardianship
- Natural person / Juridical person (alone or together with its Related Parties) that owns at least 50% ownership interest in the other Juridical Person.

- Natural person / Juridical person (alone or together with its Related Parties) directly or indirectly 'Controls' the other Juridical person.
- Any person (alone or together with its Related Parties) that owns at least 50% ownership interest in the other Juridical Person.
- A person and its permanent establishment or foreign permanent establishment
- Two or more Persons are partners in the same unincorporated partnership
- A person who is the trustee, founder, settlor or beneficiary of a trust or foundation (along with its related parties).

For the taxpayers, the definition of "Control" would include:

- Ability to exercise at least 50% of the voting rights
- Ability to determine at least 50% of the composition of the Board of Directors
- Ability to receive at least 50% of profits
- Ability to determine / exercise significant influence over the conduct of business and affairs

Based on the above definitions, it becomes key for taxpayers to evaluate critically if their actions can be deemed to be exercising control over the other Person.

## Definition of Connected Person

The law defines a Connected Person as follows:

- Owner of the taxable business
- Director or officer of the taxable business
- Where the taxpayer is a partner in an unincorporated partnership, any other partner in the same partnership
- A Related Party of any of the above

### Condition imposed for transactions with Connected Persons:

Any payments or benefits provided by a business to its Connected Person will be deductible only if the business can demonstrate that the payment or benefit:

- Corresponds with the market value of the service provided; and
- Incurred wholly and exclusively for the purposes of the taxpayer's business

*(not applicable to businesses whose shares are traded On the recognised stock exchange / subject to regulatory oversight of competent authority)*

The above mechanisms are aimed at checking if there is any erosion to the tax base as a result of any excessive payment made to a Connected Person.

## Coverage and applicability

Based on the Law, the below taxpayers are specifically carved-in to comply with the Arm's Length Principle:

- Taxpayer that has transactions with its Related Parties and Connected Persons
- Exempt and non-exempt business activity of the same taxpayer
- Qualifying Free zone business
- In case of tax losses, a member of the Tax Group before joining / leaving the Tax Group
- Opening balances as per balance sheet for the transition year to Corporate tax shall be in accordance with the arm's length principle.

## Arm's Length Principle

- Transfer Pricing methods to determine the Arm's Length Principle (ALP) are in line with the Transfer Pricing Guidelines prescribed by Organisation of Economic Commerce and Development (OECD). These are generally in line with the methodology prescribed by various other Tax Jurisdictions.
- Introduction to the concept of 'Arm's Length Range' to be adopted to achieve the arm's length results.
- Authority shall allow corresponding adjustment to the Taxable Income of the Related Party for adjustments made by it in the Taxable Income of the taxpayer (including mechanism for availing such benefit in case of a foreign competent authority).

## Anti-abuse rules

One of the major changes that was reflected in the Law is the anti-abuse provisions. These provisions are largely written in line with international practices and prescribe the denial of any tax advantage (e.g., tax deductions, exemptions, reliefs, etc.) if transactions do not have a commercial reason and their main purpose or one of the main purposes is to obtain a corporate tax advantage.

This means that any transaction entered into by a taxpayer in the scope of the CT regime on or after the date the Decree-Law is published in the Official Gazette should be carefully analysed from the anti-abuse rules perspective.

Following submission of the tax return, a taxable person must maintain all records and documents for a period of 7 years following the end of the tax period.

## Administration

### Registration

Any business subject to CT must register with the FTA and obtain a Tax Registration Number, except in very limited circumstances.

Where businesses are exempt from CT by way of being a qualifying public benefit entity, a qualifying investment fund, a public pension or a social security fund they may still be required to register for corporate tax and obtain a tax registration number.

### Documentation and filing requirements

All in scope businesses are required to maintain proper documentation which justifies and explains the information contained within the CT return to arrive at their taxable income. Further explanatory documentations may be requested by the FTA following submission of the tax return such as the financial statements used and any transfer pricing documentation:

- Certain businesses will be required to submit the information containing transactions with their Related Parties and Connected Persons along with their Corporate Tax return.
- If the transactions with Related Parties and Connected Persons crosses certain threshold, then such businesses shall be required to maintain Master File and Local File



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