

## inBrief

**Business Income Tax in the UAE in 2023**

By Shahram Safai, Mevan Bandara and Alex Vromans | 09 September 2022

Many are still of the belief that business income tax (also called corporate income tax (CT)) is only under discussion and its introduction uncertain. That is certainly not the case. The UAE federal government has announced the application of income tax for business activities as of 1 June 2023.

Although the law for CT has not yet been issued, we know that the Federal Tax Authority (FTA) (which also administers the VAT) is busy preparing for the introduction of CT. We also know that federal public prosecutors are being trained and prepared to prosecute tax crimes such as tax evasion.

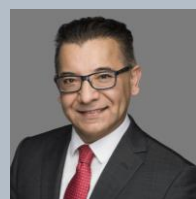
Also, we have a rough framework of what the CT law will encompass. In May 2022, the UAE Ministry of Finance issued a detailed public consultation document with respect to CT describing their proposals for the CT law and sought views from the public on any improvements/modification (which final version of CT law may be different but we do not anticipate much change).

**1. TAXABLE PERSONS****1.1 Natural persons**

CT will apply to natural persons engaged in a business or commercial activity in the UAE. This will include sole establishments or proprietorships, and individual partners in an unincorporated partnership that conducts business in the UAE. Whether an individual is engaged in a business that is subject to CT would generally depend on whether the activity requires the individual to obtain a commercial licence or equivalent permit from the relevant competent authority.

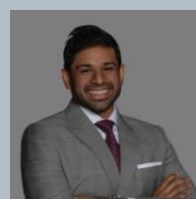
**1.2 Legal persons**

CT will apply to UAE companies and other legal persons incorporated in the UAE, as well as to foreign legal entities that have a permanent establishment in the UAE or that earn UAE sourced income. For the application of CT, legal persons incorporated in a foreign jurisdiction that are effectively managed and controlled in the UAE will be treated as if they were UAE incorporated entities.

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Limited and general partnerships and other unincorporated joint ventures and associations of persons will be treated as 'transparent' for CT purposes. Their income will instead 'flow through' and be taxed in the hands of the partners or members only.

### 1.3 Exempt persons

Certain persons will be exempt from CT, either automatically or by way of application. For examples, regulated investment funds and Real Estate Investment Trusts can apply to the FTA to be exempt from CT subject to meeting certain requirements.

### 1.4 Free Zones

Companies and branches that are registered in a Free Zone will be within the scope of the CT and subject to tax return filing requirements. The CT regime will however honour the tax incentives currently being offered to Free Zone Persons that maintain adequate substance and comply with all regulatory requirements. Therefore, it would be important to review the specific tax incentives offered in each Free Zone. A Free Zone Person that has a branch in mainland UAE will be taxed at the regular CT rate on its mainland sourced income, whilst continuing to benefit from the zero percent CT rate on its other income

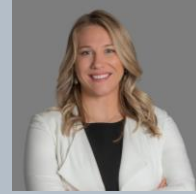
## 2. BASIS OF TAXATION

### 2.1 Residents

Residency is a key determining factor of whether business profits will be subject to CT in the UAE. A legal person that is incorporated in the UAE will automatically be considered a 'resident' person for CT purposes. Equally, any natural person who is engaged in a business or commercial activity in the UAE, either in their own name or through an unincorporated partnership, will also be considered a resident person for purposes of the CT regime. A foreign company may be treated as a resident person if it is effectively managed and controlled in the UAE. UAE resident persons will be taxable in the UAE on their worldwide income, which for a natural person will be limited to the income earned from their business activity carried out in the UAE. However, certain income earned from overseas will be exempt from CT. Where income earned from abroad is not exempt, income taxes paid in the foreign jurisdiction can be taken as a credit against the CT payable in the UAE.

### 2.2 Non-residents

Non-residents will be subject to CT on:



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- Taxable income from their Permanent Establishment (PE) in the UAE. 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 activity threshold that will trigger a PE for a foreign company in the UAE will be determined by the following two main tests:
  - (i) Fixed place of business test: a fixed place of business will include a place of management, a branch, an office (including a temporary field office or an employee's home office), a factory, a workshop, real property, and a building site where activities are carried out for a period exceeding six months.
  - (ii) Dependent agent test: the "dependent agent test" may be met where business travellers or UAE based persons act on behalf of the foreign company in the UAE and have, and habitually exercise, the authority to conclude contracts in the name of foreign company.
- Income which is sourced in the UAE.

Considering the UAE's position as a leading investment and wealth management centre, the CT regime will allow regulated UAE investment managers to provide discretionary investment management services to foreign customers without triggering a UAE PE for the foreign investor or the foreign investment fund.

UAE sourced income earned by a foreign person that does not have a PE in the UAE will be subject to withholding tax at a rate of zero percent.

### 3. CALCULATION OF TAXABLE INCOME

#### 3.1 Basis of calculating taxable income

The CT regime proposes to use the accounting net profit (or loss) as stated in the financial statements of a business as the starting point for determining their taxable income.

#### 3.2 Treatment of unrealised gains and losses

Unrealised gains or losses arise in instances where an asset or liability held by a business has changed in value but no transaction to generate a gain or loss has yet taken place. For example, when a business property increases in value, but the property is not sold, the gain would be unrealised. These gains or losses may be recorded for accounting purposes even though they are not yet realised. The CT will have specific rules to determine whether an unrealised gain or loss should be taken into account when calculating taxable income. These relate to whether the gain or loss is related to capital items or revenue items.

#### 3.3 Exempt income

UAE resident companies will be subject to CT on their worldwide income, including capital gains. However, to avoid instances of double taxation, the CT regime will exempt certain forms of income from taxation.

#### 3.4 Exemption for dividends and capital gains

A UAE corporate shareholder will generally be exempt from CT on dividends received and capital gains earned from the sale of shares of a subsidiary company. Also, the proposed CT regime will exempt all domestic dividends earned from UAE companies. Dividends paid by foreign companies, and capital gains from the sale of shares in both UAE and foreign companies will also be exempt from CT, provided certain conditions are met.

#### 3.5 Foreign branch profit exemption

A foreign branch would typically constitute a PE in the foreign country and be subject to CT (or an equivalent tax) on its profits in that foreign country. UAE companies can either (i) claim a foreign tax credit for taxes paid in the foreign branch country, or (ii) elect to claim an exemption for their foreign branch profits.

### 3.6 Expense deduction limitations

The calculation of taxable income will largely follow accounting rules, but the CT regime will disallow or restrict the deduction of certain specific expenses. This is to ensure that relief can only be obtained for expenses incurred for the purpose of generating taxable income, and to address possible situations of abuse or excessive deductions.

### 3.7 Interest capping rules

Interest and other similar financing costs are considered a cost of doing business and will accordingly be deductible for CT purposes. The proposed CT regime will cap the amount of net interest expense that can be deducted to 30 percent of a business' earnings before interest, tax, depreciation, and amortisation (EBITDA), as adjusted for CT purposes.

Businesses may be allowed to deduct up to a certain amount of net interest expenditure (safe harbour or de minimis amount) irrespective of the interest deductibility limit based on the EBITDA rule. The interest capping rules will not apply to banks, insurance businesses, and certain other regulated financial services entities. Additionally, the interest capping rules will also not apply to businesses carried on by natural persons.

### 3.8 Non-deductible expenses

Businesses will be allowed to deduct up to 50 percent of expenditure incurred to entertain customers, shareholders, suppliers and other business partners, to acknowledge that these types of expenses often also have non-business or personal element.

### 3.9 Losses

A fundamental principle behind the CT regime is that CT is meant to be paid on the total profit of a business over its entire life cycle, as opposed to a single financial period. A business will be able to offset a loss incurred in one period against the taxable income of future periods, up to a maximum of 75 percent of the taxable income in each of those future periods. Tax losses can be carried forward indefinitely provided the same shareholder(s) hold at least 50 percent of the share capital from the start of the period a loss is incurred to the end of the period in which a loss is offset against taxable income. If there is a change in ownership of more than 50 percent, tax losses may still be carried forward provided the same or similar business is carried on by the new owners. No tax loss relief will be available for the following losses:

- losses incurred before the effective date of CT;
- losses incurred before a person becomes a taxpayer for CT purposes;
- losses incurred from activities or assets which generate income that is exempt from CT; or
- losses incurred by a Free Zone Person that are not attributable to a PE in the mainland.

## 4. GROUPS

Large businesses often conduct their operations through a group of companies, which has a parent company and a number of subsidiaries. The CT regime will allow full consolidation for tax purposes (tax grouping) for essentially wholly-owned groups of companies, and the transfer of losses between group companies that are 75 percent or more commonly owned.

### 4.1 Tax groups

A UAE resident group of companies can elect to form a tax group and be treated as a single taxable person if the parent company holds at least 95 percent of the share capital and voting rights of its subsidiaries.

#### 4.2 Intra-group transfer of assets and liabilities

Intra-group transfer relief will be available for transfers of assets and liabilities between UAE resident companies that are at least 75 percent commonly owned, provided the assets and/or liabilities being transferred remain within the same group for a minimum of three years. Where intra-group relief is claimed, the relevant assets and liabilities will be treated as being transferred at their tax net book value, so that neither a gain nor a loss needs to be taken into account when calculating the taxable income of the transferor and the transferee company.

#### 4.3 Restructuring relief

To facilitate mergers, spin-offs and other corporate restructuring transactions, the CT regime will exempt or allow for a deferral of taxation where a whole business, or independent parts of a business, are transferred in exchange for shares or other ownership interests.

### 5. TRANSFER PRICING

This section sets out the proposed treatment under the CT regime of transactions between related parties. The CT regime will have transfer pricing rules to ensure that the price of a transaction is not influenced by the relationship between the parties involved. In order to achieve this outcome, the UAE will apply the internationally recognised “arm’s length” principle to transactions and arrangements between related parties and with connected persons.

#### 5.1 Arm’s length principle

All related party transactions and transactions with connected persons will need to comply with transfer pricing rules and the arm’s length principle as set out in the OECD Transfer Pricing Guidelines.

In order for a transaction or arrangement between related parties or with a connected person to meet the arm’s length standard, the results of the transaction or arrangement must be consistent with what the results would have been if they had been between parties that are not related to each other.

### 6. CALCULATION OF CT LIABILITY

#### 6.1 Applicable CT rates

CT will be charged on the annual taxable income of a business as follows:

- zero percent for taxable income not exceeding AED 375,000; and
- nine percent, for taxable income exceeding AED 375,000.

#### 6.2 Withholding tax

Given the position of the UAE as a global financial centre and an international business hub, a zero per cent withholding tax will apply on domestic and cross-border payments made by UAE businesses.

#### 6.3 Tax Credits

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

The maximum Foreign Tax Credit available will be the lesser of:

- the amount of tax that was paid in the foreign jurisdiction; or
- the CT payable on the foreign sourced income.

## 7. ADMINISTRATION

### 7.1 Registration and deregistration

A business subject to CT will need to register with the FTA and obtain a Tax Registration Number within a prescribed period. Where a business ceases to be subject to the CT (e.g., due to cessation or liquidation of the business), it will need to apply to the FTA to be deregistered for CT purposes within three months from the date of cessation.

### 7.2 Filing, payment and refund

A business will only need to prepare and file one tax return and other related supporting schedules with the FTA for each tax period. Each tax return and related supporting schedules will need to be submitted to the FTA within nine months of the end of the relevant Tax Period. Payments to settle a taxpayer's CT liability for a Tax Period will need to be made within nine months of the end of the relevant Tax Period. Where a taxpayer can demonstrate that a CT refund may be due, the taxpayer can apply to the FTA to request a refund.

### 7.3 Assessment

The FTA may review a CT return filed and may issue an assessment within the timeframe prescribed in the Tax Procedures Law. A taxpayer may challenge an amended assessment issued by the FTA via the processes and procedures outlined in the Tax Procedures Law. ■

## **Afridi & Angell**

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