

inBrief

**The Participation Exemption – Dividends and Capital Gains**

By Shahram Safai and Alex Vromans | 22 December 2023

Ownership of shares by companies usually results in tax being payable for dividends received or capital gains realised upon sale. However, in the UAE, the Corporate Tax law (Federal Decree No. 47 of 2022) ("CT Law") provides an exemption to Corporate Tax in a certain scenario referred to as the Participation Exemption.

Article 23 of the CT Law states:

"Participation Exemption"

1. *Income from a Participating Interest shall be exempt from Corporate Tax, subject to the conditions of this Article.*
2. *A Participating Interest means, a 5% (five percent) or greater ownership interest in the shares or capital of a juridical person, referred to as a "Participation" for the purposes of this Chapter where all of the following conditions are met:*
 - a.) *The Taxable Person has held, or has the intention to hold, the Participating Interest for an uninterrupted period of at least (12) twelve months.*
 - b.) *The Participation is subject to Corporate Tax or any other tax imposed under the applicable legislation of the country or territory in which the juridical person is resident which is of a similar character to Corporate Tax at a rate not less than the rate specified in paragraph (b) of Clause 1 of Article 3 of this Decree-Law.*
 - c.) *The ownership interest in the Participation entitles the Taxable Person to receive not less than 5% (five percent) of the profits available for distribution by the Participation, and not less than 5% (five percent) of the liquidation proceeds on cessation of the Participation.*
 - d.) *Not more than 50% (fifty percent) of the direct and indirect assets of the Participation consist of ownership interests or entitlements that would not have qualified for an exemption from Corporate Tax under this Article if held directly by the Taxable Person, subject to any conditions that may be prescribed under paragraph (e) of this Clause.*
 - e.) *Any other conditions as may be prescribed by the minister.*

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This Article provides that income from a Participating Interest, such as dividends and capital gains, is exempt from Corporate Tax. A Participating Interest is defined as a significant, long-term ownership interest in a juridical person (the Participation) that suggests some degree of control or influence over the Participation and that meets the conditions of this Article 23. With respect to dividends, Article 23 is usually used for dividends received by a UAE company (which is a Resident Person) from a foreign company. Dividends received from a UAE company (which is a Resident Person) are exempt from Corporate Tax with no further conditions (Article 22 (1) of the CT Law).

As an example, if a UAE Company owns a German Company (Participating Interest) and it receives dividends and later sells these shares and receives capital gains, then the dividend income and the capital gains income can be exempt from Corporate Tax if the following condition are met:

- a.) **the UAE company has held, or has the intention to hold, the Participating Interest for an uninterrupted period of at least (12) twelve months.** The UAE Company should hold the shares of the German Company (Participating Interest) for an uninterrupted period of 12 months.
- b.) **The Participation must be subject to Corporate Tax (or equivalent) of 9% or more.** This condition requires the Participation (ownership of shares by the UAE Company in UAE Company) to be subject to Corporate Tax or any other tax imposed under the applicable legislation of the country or territory in which the juridical person is resident which is of a similar character to Corporate Tax. In this case, it would be subject to Corporate Tax if it were not for this exemption and it would be subject to a similar or higher tax rate in Germany. Hence this test is satisfied.
- c.) **The ownership interest of the UAE Company in the Participation entitles the UAE Company to at least 5% of the profits and liquidation proceeds.** In this case, the UAE Company would be entitled to 100% of the profits and liquidation proceeds of the German Company as the 100% owner. The ownership interest must entitle the UAE Company to at least 5% of the Participation's profits available for distribution and at least 5% of the liquidation proceeds upon cessation of the Participation. As a result, this test is satisfied. Note that if the acquisition of the Participating Interest exceeds AED 4 million then this test is also satisfied (Ministerial Decision 116 of 2023).
- d.) **50% or less of the assets of the Participation consist of non-qualifying ownership interests.** An ownership interest in a Participation will be deemed a passive or portfolio investment that does not qualify for the Participation Exemption if 50% or more of the Participation's assets, on a consolidated basis, consist of ownership interests or entitlements that by themselves do not meet the conditions of this Article had they been held directly by the Taxable Person.

Assets that would not qualify for the Participation Exemption include, for example, ownership interests in foreign juridical persons that are not subject to a corporate income tax in the relevant foreign jurisdiction, unless such ownership interests meet the conditions of Clause 3, or any other conditions as may be prescribed by the Minister under Clause 2(e).

In this case, the assets of the UAE Company that are shares in the German Company would be subject to tax in the UAE. Hence, the shares in the German Company are qualifying ownership interests which should satisfy this condition.

- e.) **The Participation Interest must meet any other conditions as may be prescribed by the Minister.** As of the date of this memorandum, the other prescribed conditions are not relevant to these facts.

Based on the above, the following income (as specified under Article 23(5) of the CT Law) being capital gains and dividend income shall not be taken into account by the UAE Company in calculating its Taxable Income for Corporate Tax:

- *Dividends and other profit distributions received from a foreign Participation that is not a Resident Person under paragraph (b) of Clause 3 of Article 11 of this Decree-Law.*
- *Gains or losses on the transfer, sale, or other disposition of a Participating Interest (or part thereof).*
- *Foreign exchange or impairment gains or losses in relation to a Participating Interest.*

For the sake of illustrating the use of the Participation Exemption, the above analysis does not discuss the effects of any applicable double taxation treaty.

Please contact Shahram Safai (ssafai@afриди-angell.com) if you require advice with respect to Corporate Taxation in the UAE. ■

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