TAX ALERT

The United Arab Emirates to introduce corporate tax as from 01 June 2023

BACKGROUND

Corporate tax introduced in the UAE

The UAE Ministry of Finance has announced, on 31 January 2022, the introduction of a federal corporate tax which will be effective for financial years on or after 01 June 2023.

The UAE Corporate Tax regime has been designed to incorporate best practices globally and minimise the compliance burden for UAE businesses.

The corporate tax rates

The corporate tax rates will be as follows:

- 0% for taxable income up to AED 375,000;
- 9% for taxable income above AED 375,000; and
- a different tax rate for large multinationals that meet specific criteria set with reference to 'Pillar Two' of the OECD Base Erosion and Profit Shifting project[1]

The corporate tax payable will be calculated based on the accounting net profit reported in the financial statements, adjusted for credits and allowances (see below).

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[1] *A multinational corporation is a corporation that operates in its home country, as well as in other countries through a foreign subsidiary, branch or other form of presence / registration. Merely earning income from outside its home country without a foreign presence or registration would not make a business a multinational corporation*
In the context of the global minimum effective tax rate as proposed under 'Pillar Two' of the OECD Base Erosion and Profit Shifting project," large" refers to a multinational corporation that has consolidated global revenues in excess of EUR 750m (c. AED 3.15 bn)

Foreign Tax Credits

Foreign Taxes suffered on UAE taxable income will be allowed as a tax credit against the UAE tax liability.

Losses

The corporate tax regime will allow a business to use losses incurred (as from the UAE corporate tax implementation effective date) to offset taxable income in subsequent financial periods.

Tax losses from one group company[2] may be used to offset taxable income of another group company, provided certain conditions are met. Further information on the group loss utilisation rules will be provided in due course.

Exemptions

Capital gains and dividends earned from qualifying shareholdings, as well as Qualifying intra-group transactions and restructurings, will not be subject to corporate tax. Further clarification will be provided about "qualifying shareholdings" and "qualifying intra-group transactions".

Who will be subject to Corporate tax?

Corporate tax will apply to all UAE businesses and commercial activities alike, except for the extraction of natural resources, which will remain subject to Emirate level corporate taxation.

What about freezone companies?

Free zone businesses will be within the scope of corporate tax and will be required to register and file a tax return but will continue to benefit from the tax holidays (0% tax rate)[3] if they comply with all regulatory requirements and do not conduct business in mainland (non-freezone) UAE.

Administration

The Federal Tax Authority will be responsible for the administration, collection, and enforcement of corporate tax.

Our Commentary

The UAE has announced major upheavals in its tax framework which seem to have specific focus on balancing the necessity to comply with international standards with interests to remain a holding company location of choice for foreign direct investments. In particular, we note the following:

- Despite the introduction of a federal corporate tax, investment holding companies should still be able to achieve tax neutrality through the proposed regime such as dividend and capital gains exemptions, generous foreign tax credit and generous deductions and tax losses rules, to name a few;

- Most free zones in the UAE already provide tax incentives to companies. Free zone businesses which comply with regulatory requirements and do not conduct business with mainland UAE should, in principle, continue to benefit from a tax free status and should therefore not be affected by the new corporate tax rate (at least for the duration of their special tax status);

- the UAE already has a wide tax treaty network with over 100 countries, with a significant portion with the African continent. These treaties seek to eliminate double taxation and will play an even more crucial role in mitigating corporate tax for non-residents after the recently introduced changes to the tax framework;

[2] ***UAE group companies can form a tax group and file a single tax return for the entire group, and transfer tax losses to other members of the group.***

[3] ***Freezones in the UAE generally offer tax holidays of 15 to 50 years to incentivize businesses to register and operate within the freezone***

Our Commentary (Continued)

- businesses will not be required to pay corporate tax on profits below AED 375,000 per annum. The ability to protect the income of growing businesses will allow them to re-invest and continue their development, which will continue to create space for entrepreneurs and SME owners;

- businesses will only need to file one tax return each year and will not have to make advance tax payment (as is the case in many jurisdictions). This will further smooth the compliance burden; and

- other measures that the UAE has announced, such as loss utilisation, group relief in respect of losses and intragroup transactions and 0% tax for small businesses, demonstrate the intention to adopt a business-friendly ecosystem, rather than an aggressive one.

KEY TAKEAWAYS

From an international standpoint, the UEA's decision to gradually dismantle its free tax regime and introduce a corporate tax will be viewed positively by standard setting organisations such as the OECD and the EU. This move demonstrates the UEA's willingness to align itself with international standards including with BEPS initiatives and fight against unfair tax competition by creating a more level playing field. Moreover, due to the current trajectory and international stance to taxation, taxpayers seeking to pay zero tax worldwide will find it more difficult to find jurisdictions that enable them to do so.

However, it is important to note that conglomerates with an UAE presence and whose turnover exceed EUR 750m may be subject to the minimum tax rate of 15%in line with the Pillar Two OECD BEPS project

Whilst the new legislation is yet to be published, companies incorporated in the UAE (including in the freezones) will have to evaluate the impact that the new legislation will have on their businesses and take necessary steps to address any potential issues, challenges or inefficiencies.

This tax alert is issued jointly by DTOS UAE (member of the DTOS Group) and Prism Chambers

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