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UAE: MoF Consultation Paper on Corporate Income Tax

Legal Briefing (12 May 2022)

*After the announcement regarding the introduction of a federal corporate income tax in the UAE ("**CIT**") on 31 January 2022, the UAE Ministry of Finance ("**MoF**") recently published a public consultation paper on the CIT on its website with the possibility to submit comments until 19 May 2022. This legal briefing looks at the most important points included in the consultation paper and their potential practical impact.*

I. General

Commencing on 1 June 2023 taxable persons will be subject to a CIT of 9% on their taxable income. Although the MoF already compiled important information on the applicability of CIT on its website, certain topics remained open or unclear.

The MoF's consultation paper now addresses important points in more detail. However, due to the nature of the document, this information (as described herein) may be subject to further changes.

II. Details

CIT at a rate of 9% will be applicable on resident taxable persons on their taxable income.

1. Taxable Persons

a. General Rule

In general, CIT will be applicable to companies and other legal persons incorporated in the UAE as well as foreign companies with a permanent establishment ("**PE**") in the UAE or an income sourced in the UAE. This means that the following companies will be subject to CIT:

- limited liability companies
- joint stock companies
- free zone companies
- branches of foreign companies
- civil partnerships
- sole establishments
- limited liability partnerships
- partnerships limited by shares.

It should be noted that sole establishments and civil partnerships will not be taxed on a corporate level but rather on the partners' / members' level.

As a basic rule, it can be stated that any legal entity – irrespective of its legal form – holding a license or permit issued by any Department of Economic Development or any free zone authority for carrying out a commercial activity within the UAE or a free zone, will be subject to CIT.

b. Exemptions

The following legal persons will be exempted from CIT:

- governments and their departments and institutions on a federal and Emirate level
- wholly government owned companies (to be listed in a respective cabinet decision)
- charities and public benefit organisations (to be listed in a respective cabinet decision)
- companies engaged in the extraction and exploitation of UAE natural resources
- public and regulated private social security funds and pension funds
- investment funds.

c. Free Zone Companies

In general, free zone companies (including branches of foreign companies incorporated in a free zone) are subject to CIT. However, the MoF decided to honour existing tax incentives offered to free zone companies.

This means that subject to certain conditions, free zone companies will benefit from a CIT rate of 0% on the following transactions:

- transactions with businesses located outside the UAE
- transactions with businesses located in the same or another free zone
- passive income from UAE mainland business (e.g., interest, royalties, dividends, capital gains)
- transactions with group companies in UAE mainland.

Free zone companies will, however, be subject to the normal CIT rate of 9% on all transactions with UAE mainland businesses. The same applies to income generated by branches of free zone companies established in the UAE mainland.

Despite the above, free zone companies may elect to be subject to the normal CIT rate at any time. Once such an election has been made, it cannot be reversed.

Furthermore, it has to be noted that free zone companies wishing to benefit from the 0% CIT rate, have to prepare audited financial statements.

d. Residency and Permanent Establishment (PE)

In principle, only taxable persons resident in the UAE are subject to the UAE CIT. This means that any legal person incorporated in the UAE (and effectively holding a license issued in the UAE) is being considered as a resident in the UAE.

However, there are two main exemptions to this principle:

- foreign companies effectively managed and controlled in the UAE (i.e. key management and commercial decisions are made in the UAE);
- Permanent establishments.

The MoF will follow the internationally recognised principles for determining a PE as set out in Art. 5 of the OECD Model Tax Convention.

A PE can be established either through a fixed place of business (e.g., a branch, office, factory, workshop or property from which commercial activities are carried out for more than 6 months) or a dependent agent who is concluding contracts on behalf of the foreign company.

2. Taxable Income

The taxable income will be determined on the basis of the accounting net profit as stated in the financial statement and calculated in accordance with internationally recognized accounting standards.

Passive income such as dividends received from subsidiaries and capital gains from sales of shares in subsidiaries (subject to certain conditions) will be exempted from CIT and will not count toward taxable income

Profits from foreign branches (of UAE based companies) can be recognized in two forms:

- claiming tax credit if taxes have been paid in the host country; or
- claiming a tax exemption for foreign branch's profits.

A tax exemption for the profits of foreign branches can only be claimed for all branches of a UAE company (not only selected branches) and cannot be reversed.

3. Administration

The UAE Federal Tax Authority will be responsible for the administration, collection and enforcement of CIT. According to the consultation paper, a new registration for CIT will be required. This means that businesses will also receive another tax registration number for CIT. Whether or not the existing VAT portal will be extended, is unclear.

Each company has to prepare only one tax return. Submission and payment of CIT has to be done within 9 months following the end of the respective tax period (i.e., for businesses with the financial year ending on December 31, submission and payment deadline would be September 30).

III. Summary & Recommendations

The consultation paper published by MoF provides more detailed information on certain topics which have been mentioned on the MoF's website in an FAQ format.

Due to the nature of the consultation paper, it remains to be seen if the final corporate income tax law will adopt the principles laid down in the consultation paper without any further amendment or whether certain provisions will be amended completely.

In any case, as more light has been shed on free zone companies and the applicability of CIT on them, **companies are advised to re-evaluate their business models and set-ups in the UAE** and whether they remain profitable under the new CIT regime. Furthermore, free zone companies may have to implement additional accounting procedures and principles in order to benefit from the CIT exemption.

How can we help?

SCHLÜTER GRAF will continue to monitor the developments on CIT in the UAE. Our dedicated corporate, compliance and tax team can assess and develop tax compliance procedures. For more information, please contact your usual contact person at SCHLÜTER GRAF or send an email to tax@schlueter-graf.com.

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