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Dubai Team
Tax Practice
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UAE issues its Corporate Income Tax law

After more than 10 months of waiting, on 9 December 2022 the Federal Tax Authority ("**FTA**") published Federal Law Decree No. 47 of 2022 on the Taxation of Corporations and Businesses ("**CIT Law**"), which sets out the legislative basis for the UAE federal corporate income tax ("**CIT**").The issuance of the CIT Law follows the UAE Ministry of Finance's announcement on 31 January 2022, the release of the public consultation document summarising the proposed CIT system in April 2022, and Cabinet Decision No. 85 of October 2022 defining tax residency for federal tax purposes (in preparation for the introduction of income tax rules).

The CIT Law will be effective for financial years starting on or after **1 June 2023** and confirms the main points in the FAQs on the Ministry of Finance's website and the public consultation document of April 2022, as outlined below.

1) Scope and applicable rates[1]

The following CIT rates will apply:

- 0% on taxable income under a threshold to be specified by the Cabinet (AED 375,000 according to the FAQs);
- 0% on the overall qualifying income of free zone persons; and
- 9% in all other cases (standard rate).

The CIT does not specify how the above CIT rates will fit with the forthcoming OECD Pillar 2 rules (including the 15% global minimum tax for MNEs with revenues of EUR 750 m or more).

2) Exempt persons[2]

The following persons will be exempt from CIT:

- UAE local and federal government entities and government-controlled entities, and entities incorporated in the UAE controlled by an exempt juridical person if certain conditions are met;
- persons engaged in extractive businesses and non-extractive natural resources businesses, if certain conditions are met;
- qualifying public benefit entities;
- qualifying investment funds and entities incorporated in the UAE and controlled by the UAE government, if certain conditions are met;
- public or private pension or social security funds subject to regulatory oversight by the competent UAE authority and entities incorporated in the UAE and controlled by the UAE government, if certain conditions are met; and

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[1] Arts. 2–3 of the CIT Law.
[2] Arts. 4–10 of the CIT Law.

- any other persons indicated by the Cabinet at the suggestion of the Ministry of Finance.

3) Taxable persons and corporate tax base[3]

The following are taxable persons for CIT purposes:

- resident persons in relation to their worldwide income; and
- non-resident persons in relation to their taxable income attributable to a permanent establishment ("**PE**")[4] in the UAE or to UAE-sourced income not attributable to a PE in the UAE. Income earned by resident and non-resident persons with a PE in the UAE and from activities performed, assets located, capital invested, rights used, or services performed or benefitted from in the UAE is considered UAE-sourced income.

The following resident persons are subject to CIT:

- juridical persons incorporated in the UAE (including the free zones);
- juridical persons incorporated abroad but effectively managed and controlled in the UAE; and
- natural persons who conduct certain categories of businesses or business activities (to be defined by the Cabinet).

4) Free zone persons[5]

Free zone persons qualify for 0% CIT if they:

- maintain adequate substance in the UAE;
- earn qualifying income (to be specified by the Cabinet);
- have not elected to be subject to the standard CIT rate;
- comply with transfer pricing provisions and documentation requirements; and
- meet all other conditions imposed by the Ministry of Finance.

5) Calculating taxable income[6]

Taxable income will be calculated based on the taxable person's accounting net profits, which will be adjusted to take account of the following:

- Unrealised gain and losses.
- Exempt income. This includes the following:
  - Dividends from UAE resident juridical persons, dividends from qualifying participations in foreign juridical persons, and other income from qualifying participations in accordance with UAE participation exemption rules.
  - Income from foreign PEs that the taxable person elects not to take into account under the PE exemption regime.
  - Income earned by non-resident persons from operating aircrafts or ships in international transportation, if certain conditions are met.

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[3] Arts. 11–17 of the CIT Law.
[4] The definition of permanent establishment of non-resident persons is in line with the latest definition in the OECD Model Convention.
[5] Arts. 18–19 of the CIT Law.
[6] Arts. 20–39 of the CIT Law.

- Relief. This includes the following:
  - Gains or losses arising from the transfer of assets and liabilities between entities in the same qualifying group if certain conditions are met.
  - Gains or losses arising from certain types of business restructuring, if certain conditions are met.
- Deductions. A general interest deduction limitation applies based on the 'earnings stripping rule': net interest expenses are deductible up to 30% of EBITDA in a relevant period.
- Transactions with related parties and connected persons. Income and expenditures from intercompany transactions not in line with the arm's length principle will be disregarded for federal tax purposes (and thus aligned with the rules under the OECD's Transfer Pricing Guidelines).
- Tax losses. These can be used to reduce taxable income in a specific tax period by up to 75%. The Corporate Income Tax Law also envisages the possibility to transfer tax losses to other taxable persons if certain conditions are met. Tax losses can be carried forward only if change-of-control and vitality requirements are met.
- Any incentives or special relief for qualifying business activities specified by the Cabinet.
- Any other adjustments specified by the Ministry of Finance.

6) Participation exemption[7]

Under UAE participation exemption rules, a 100% exemption applies to dividends, capital gains or losses, forex gains or losses, and impairment gains or losses relating to participations of 5% or more in juridical persons if the following conditions are met:

- The holding period is at least 12 consecutive months.
- The juridical person in which the participation is held is subject to tax at a minimum tax rate of 9%.
- The ownership interest in the participation entitles the taxable person to a minimum of 5% of available profits.
- A maximum of 50% of the direct and indirect assets of the participation are ownership interests or entitlements that are not exempt from CIT under the participation exemption rules if they are held directly by the taxable person.

Expenses related to exempt income under the participation exemption rules will be non-deductible.

7) Tax groups[8]

The CIT Law introduces the option to form a tax group so that – if certain conditions are met – a parent UAE resident company and its UAE resident subsidiaries can be treated as a single taxable person. To calculate the tax group's taxable income, the parent company must consolidate the financial results, assets and liabilities of each subsidiary and exclude transactions between them.

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[7] Art. 23 of the CIT Law.
[8] Arts. 40–42 of the CIT Law.

8) Transfer pricing provisions[9]

The CIT Law embraces the arm's length principle and the basic concept enshrined in the OECD Transfer Pricing Guidelines (e.g., economically relevant characteristics and transfer pricing methods). With regard to the definition of related parties, the CIT Law seems to rely on the concepts of de jure control (50% or more of voting rights, and the ability to determine the composition of the board of directors or receive profits) and de facto control (the ability to determine or exercise significant influence over another person's business and affairs).

Moreover, the CIT Law introduces specific provisions regarding payments and benefits provided by a taxpayer to connected persons, i.e., the taxpayer's owner, directors and officers or a party related to them. Under these provisions, only payments and benefits corresponding to market value will be deductible for CIT purposes – and market value is to be determined in accordance with the arm's length principle.

The CIT Law also stipulates that taxpayers – above certain thresholds still to be identified – must draw up a masterfile and a local file and submit them to the FTA if so requested within 30 days.

Lastly, the CIT Law introduces the possibility to request a unilateral corresponding adjustment to taxable income in case of transfer pricing primary adjustments in foreign jurisdictions.

9) Other provisions[10]

- Certain categories of UAE-sourced income will be subject to 0% (or a different rate decided by the Cabinet) withholding tax.[11]
- The CIT Law sets out ordinary foreign tax credit ("**FTC**") rules whereby the FTC cannot exceed the amount of CIT due on relevant income, and the unutilised FTC cannot be carried forward or back.[12]
- The CIT Law introduces a general anti-avoidance provision[13] applicable to transactions and arrangements that lack business rationality and whose main purpose is to obtain a corporate tax advantage consistent with the intention or purpose of the CIT Law.
- CIT payments and returns must be made within nine months from the end of the relevant tax period.
- All taxable persons must register for CIT with the federal tax authority and obtain a tax registration number.
- International agreements will prevail if any inconsistencies arise between them and the CIT Law.

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[9] Arts. 26–34 of the CIT Law.
[10] Arts. 26–34 of the CIT Law.
[11] Art. 45 of the CIT Law.
[12] Art. 47 of the CIT Law.
[13] Art. 50 of the CIT Law.