Consultation on Corporate Tax by the UAE Ministry of Finance

May 2022

On April 28th, the UAE Ministry of Finance ("MoF") released a consultation paper to provide insight on the potential corporate tax ("CT") regime. As noted in the consultation, the information shared should not be considered final but this public consultation supports the UAE's commitment to transparency and recognizes the importance of input from respective stakeholders.

The timeframe of the consultation will be from 28 April 2022 till 19 May 2022, which indicates a short turnaround, but we highly encourage businesses to seize the opportunity and provide the MoF with valuable insight from a commercial perspective on the proposed CT law. The MoF has asked businesses to focus their feedback on recommendations that may help reduce compliance cost and complexity but also on topics not included in the consultation from a completeness perspective.

In this document we have summarized the key highlights and top five takeaways for businesses to prepare for the implementation of the CT.

Announcement:

As per the announcement on 31 January 2022, there have been no adjustments to the effective date of CT (i.e. for financial years starting on or after 1 June 2023) and the communicated CT rates of 0% up to AED 375,000 of taxable income and 9% above that threshold. The consultation has only indicated that the Base Erosion and Profits Shifting (BEPS) project is still under review and further announcements on how the BEPS 2.0, Pillar Two rules will be embedded into the UAE CT regime will be made in due course.

Our post announcement key highlights

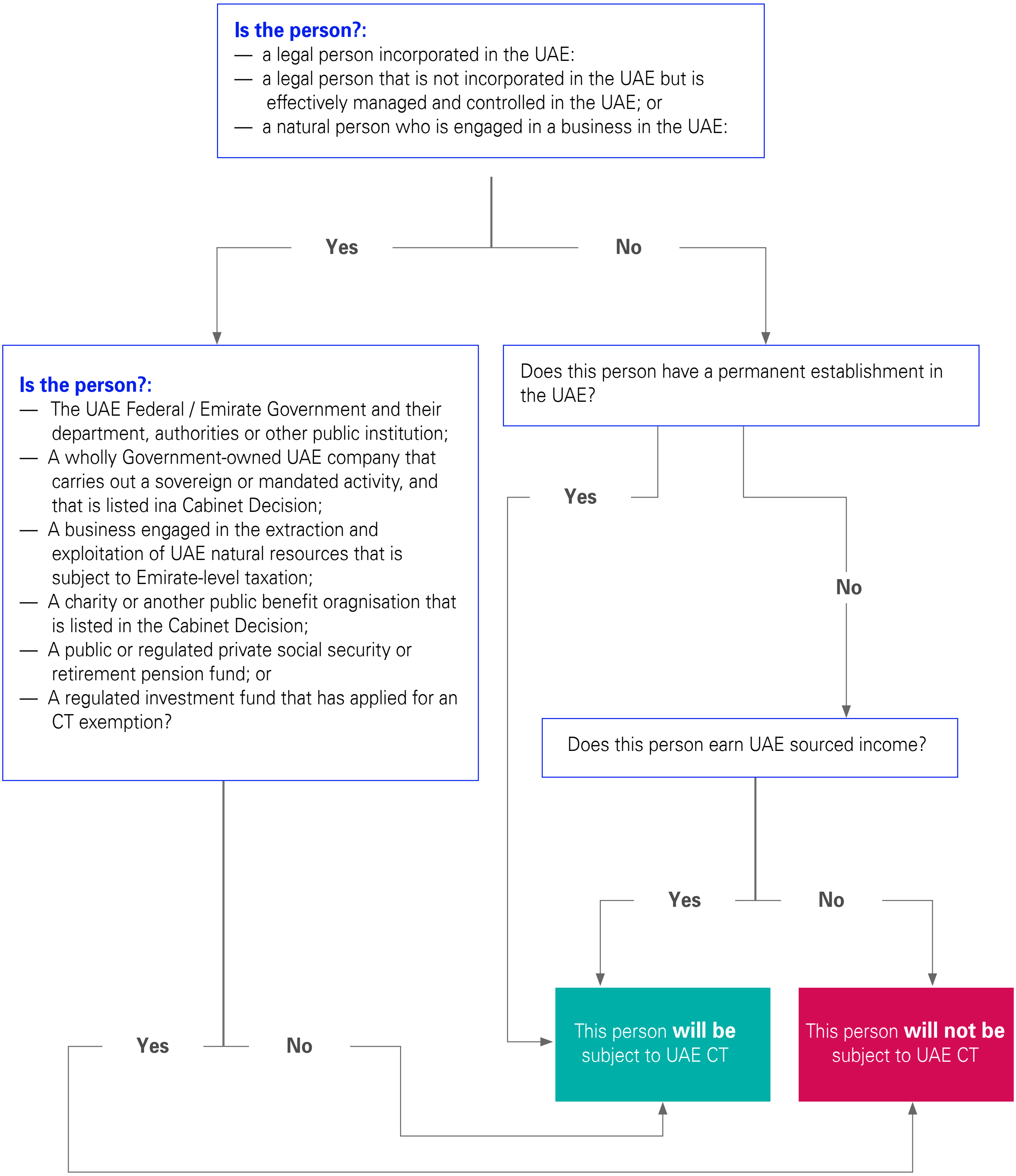
Scope of CT

Businesses or natural persons undertaking commercial activities that require a commercial license or equivalent permit, operating within the seven emirates will be subject to CT, including Free Zones (albeit at a 0% tax rate).

However, there are certain exceptions that will exempt entities from CT and are as follows:

- The federal and emirate governments and their departments, authorities and other public institutions;
- Wholly government-owned UAE companies that carry out a sovereign or mandated activity, and that are listed in a cabinet decision;
- Businesses engaged in the extraction and exploitation of UAE natural resources that are subject to Emirate-level taxation;
- Charities and other public benefit organizations that are listed in a cabinet decision;
- Public and regulated private social security and retirement pension funds; and
- Investment funds, subject to meeting the relevant conditions.

Flowchart (1): Who will be subject to UAE CT?



Free Zones Persons

Free Zones Persons will fall under the scope of the CT at a 0% rate and the UAE will continue to honor the tax incentive (note: Free Zones Persons will have to file a tax return).

There are some key exceptions to be considered which are as follows:

- Any branches of Free Zone Persons located on the mainland will be taxed at the regular CT rate on their mainland sourced income – other income will be subject to a zero CT rate.
- If mainland income is generated without a branch, the 0% is limited to 'passive income', including interest and royalties but also dividends and capital gains. Any other mainland sourced income will disqualify a Free Zone Person from the 0% CT regime in respect of all their income.
- Transactions with mainland related party group companies will be subject to a zero CT rate, but there will be no deduction for UAE mainland companies on costs incurred.

As regards the criteria for FZ exemption linked to "not doing business with mainland" as per MOF's FAQs, the consultation document seems to indicate that this means income earned from transactions with businesses located outside of UAE or in the same or another free zone.

Basis of calculating taxable income:

To achieve commitment from the MoF, the consultation paper requires businesses to use acceptable accounting standards in the UAE as the starting point for computing the taxable income. A key aspect is in terms of accounting for 'unrealized gains and losses' under common accounting practice.

There are two elements that have been provided which are as follows:

(1) Unrealized gains or losses on capital items are not taken into account when calculating taxable income

(2) Unrealized gains or losses on revenue items will need to be taken into account when calculating taxable income.

The above approach (movements on capital accounts) will potentially trigger temporary differences from a balance sheet perspective as accounting will deviate from the tax base (tax filing) position with a deferred tax position to be accounted for.

Exemptions:

The consultation paper has provided an exemption on dividends and capital gains. The exemption will have to be met by all relevant conditions, but the key criteria to apply the exemption is a minimum 5% shareholding in the company.

Another key exemption relates to foreign branches (if the foreign branch is subject to CT at a minimal rate of 9%). The MoF has acknowledged the complexities and compliance issues pertaining to branches. This has resulted in a proposed option for UAE taxpayers being:

(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

Interest capping rules

As seen in most jurisdictions, the MoF has proposed a cap on the net interest expense to 30% of the earning before income tax, depreciation and amortization ("EBITDA"), in accordance with the OECD's 2015 BEPS Action plan 4. The MoF has expressed that there will be a de minimis amount but has not shared the amount that will be deductible. The interest limitation will not apply to banks, insurance businesses, and certain other groups.

The consultation document is silent on the carry forward option of the net interest expense that will not be deductible that would give rise to a deferred tax asset (future benefit), subject to recognition criteria.

Losses

There is an indefinite loss carry forward period proposed but taxable profits will only be allowed to be offset at a maximum of 75% of prior year loss(es). The Businesses will therefore have to consider – from an accounting perspective – to what extent the deferred tax asset related to prior year losses can be recognized.

The consultation paper notes that if there is a change in ownership of more than 50%, tax losses may still be carried forward provided the same or similar business is carried on by the new owners.

It is important to note that any losses incurred before the effective date will not be available to be carried forward in the following situations:

- if a person was not liable to UAE tax;
- the losses relate to activities which generate income that is exempt from UAE CT; and
- the losses were generated by a Free Zone Person that are not attributable to a PE in the mainland.

The consultation paper does not provide any option for carry back.

Tax groups and loss relief

UAE resident group of companies can elect to enter a tax group if the parent company holds at least 95% capital share and voting rights, after approval from the FTA (a notice should be signed by the parent and subsidiaries).

The consultation paper allows groups to transfer losses between companies that are not in a tax group (similar to the UK tax system). To transfer, they must be 75% commonly owned. This allows losses to be transferred without a formal tax group in place. Important considerations should be made here in terms of administration and recharges to ensure the loss-making business is compensated (e.g. a tax sharing agreement to be formalized).

Intra-group transfer

There will be an intra-group transfer relief if there is a 75% commonly ownership (only UAE residents). The CT consultation paper requires the transfer to take place at their tax net book value and the transfer assets and liabilities must remain within the group for three years.

If the criteria are not continued to be met, there will be an assessment to be made on the taxable gain that arose from the initial transfer.

Transfer pricing

The UAE CT has proposed to introduce transfer pricing rules to align with international practice. This means that related parties will have to determine the 'arms length' principle on transactions and arrangements between related parties to ensure pricing is not influenced by the connected relationship.

Related party transactions will have to comply with the rules set out in the OECD Transfer pricing guidelines. The relevant transfer pricing documentation that will be required to be submitted, includes a Master and Local file as per the OECD 2015 BEPS Action plan 13.

Withholding tax

The consultation paper has continued to maintain the position of the UAE being an important financial hub resulting in a 0% withholding tax rate to be applied on domestic and cross-border payments.

Administration

An important change in the initial expectations relates to the timing of the tax return. The MoF has provided a nine month period for tax payers to submit and pay the amount of CT due. There will also be no requirement in terms of provisional CT or advance payments.

The consultation document is silent in terms of any extension possibilities, fines and penalties.

Transition rules:

The MoF does not intend for businesses to restate their balance sheet for CT purposes. However, for accounting purposes (e.g. IFRS) there most likely will be temporary differences that will arise on the balance sheet and should be assessed accordingly.

Our key takeaways for your consideration

1. Use the data shared to update or model any impact assessments on your group structure and assess the need for any changes.

2. Assess the interaction between businesses in a Free Zone and UAE mainland. How does this impact your business from a tax perspective with the current operating model?

3. Use the consultation document as an opportunity to provide valuable insight to your stakeholders and potential implications (accounting, compliance, tax function setup, etc.) that the consultation paper will have on the business.

4. Understand the accounting implications on unrealized gains and losses that many not be allowed in the tax computation creating temporary differences that will need to be accounted for.

5. Give your views to the MoF using this link: Corporate Tax Submission Public Consultation (mof.gov.ae) the UAE: Corporate Tax Submission Public Consultation (mof.gov.ae)

What's next?

Submission is due by 19 May 2022 and we encourage businesses to make the effort and, if possible, liaise with partners in their sector to discuss how the consultation paper will impact them.

We at KPMG are ready to support and guide you through this process as we understand the importance of providing the MoF with valuable insights that they can take onboard before the law is finalized and further communication with your stakeholders on the impact of the proposed CT law.

For further information and support on this process, please reach out to your KPMG contact

Contact us

Stuart Cioccarelli
Partner
Head of Tax
e: scioccarelli@kpmg.com

Wassim Chahine
Partner
Corporate Tax
e: wchahine@kpmg.com

Nilesh Ashar
Partner
International Tax
e: nashar1@kpmg.com

Shabana Begum
Partner
Tax
e: shabanabegum@kpmg.com

Follow us on:

@kpmg_lowergulf

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