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BORROWING COSTS AND HOW THEY COULD BE LOOKED AT

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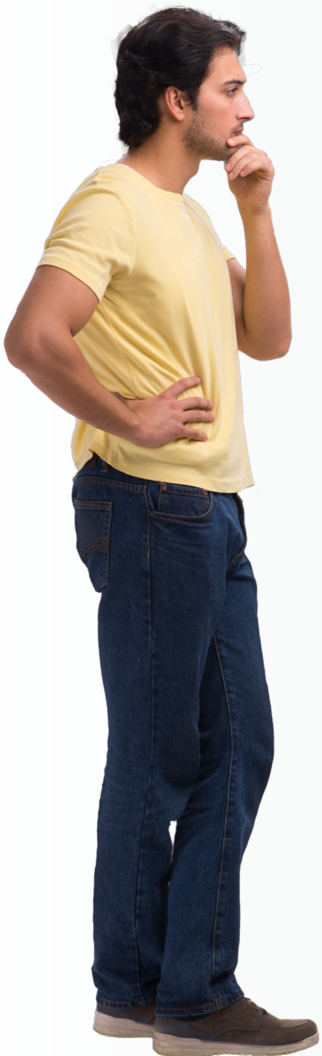

DEBT-EQUITY MIX

Debt and equity are two primary sources of financing.

The mix of debt and equity depends on factors such as industry risk, ability to raise funds and legal, commercial, and tax considerations.

Tax considerations do play a role in the choice of financing.

Debt financing costs are tax-deductible.

GROUP TAX SAVING USING DEBT FINANCING

UAE CO
(PARENT CO – TAX RATE 9%)

Debt **AED 100 million** given against interest payable @10%

Interest payment of **AED 10 million**, which is tax deductible in Saudi Arabia

SAUDI ARABIA CO
(SUBSIDIARY CO – TAX RATE 20%)

TAX SAVINGS

THERE IS A TAX SAVING TO THE GROUP @11% ON AED 10 MILLION.

TAX CONSIDERATIONS

TRANSFER PRICING

- Related party?
- Low or nil interest

CORPORATE TAX

- Interest deductible expense
- Deduction in high tax jursdiction and income in low tax jurisdiction

With the introduction of UAE corporate tax law and transfer pricing regulations, potential tax risks for these transactions need attention.

BORROWINGS FROM RELATED PARTIES

SOME POSITIVES

- Large corporates utilize shareholder and intra-group loans to **manage their liquidity requirements** and **facilitate cash transfers** between entities within the group.
- These loans are usually granted with **no security, minimal documentation** and **flexible terms**.

TRANSFER PRICING IMPLICATIONS

- The interest rate should be at arm's length and comparable with a third party / market scenario.
- Benchmarking analysis is to be undertaken based on principal, duration, market conditions, and the borrower's credit rating.
- A group policy may be designed for determining the interest rate for loans advanced within the group.

HIGHER INTEREST – TAX DEDUCTION

Interest payments are tax-deductible, while dividends are not.

Based on tax rates in a jurisdiction, a company can reduce its overall tax liability and increase its after-tax profits.

The OECD and the G20 nations adopted the BEPS Action Plan 4, limiting interest deductions and other financial payments.

Many countries have introduced either thin capitalisation rules or limitation of interest deduction rules.

UAE CT Law has general and specific interest deduction limitation rules (Articles 29 to 31).

UAE CORPORATE TAX LAW CONSIDERATIONS

GENERAL INTEREST DEDUCTION

Net interest expenditure deductible up to 30% of earnings before interest, tax, depreciation and amortization (EBITDA), excluding any exempt income **or** amount specified by Minister whichever is lower.

Net Interest expenditure = Total Interest expenses for the year + brought forward Interest expenditure – Taxable Interest Income.

Balance net interest expenditure would be carried forward and utilised in subsequent 10 years.

SPECIFIC INTEREST DEDUCTION

Related party debts used to finance exempt income, then interest is not deductible **unless**:

- The company shows that the main purpose of the loan was not to gain a tax advantage or
- If the interest income is taxed at a rate of at least 9% in the foreign country where it was earned.

POINTS TO CONSIDER

Where interest is capitalised as asset cost, since its not in the P&L account arguably no disallowance is warranted.

In a loss situation, the interest portion may have to be carried forward for 10 years separately.

NEXT STEPS

- Benchmarking and documentation for commercial expediency in related party interest payments from a transfer pricing perspective.
- Drafting debt agreements from a tax compliance perspective.
- In the case of international debt transactions, analysis of source country tax implications, treaty provisions and overall group tax cost impact.
- Formation of tax groups to absorb interest costs.

OUR TEAM

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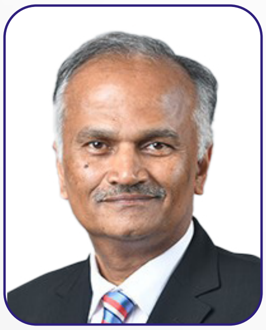

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