



## WTS Dhruva Tax Alert – Explanatory Guide on UAE Corporate Tax Law

### Overview

Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses ('CT Law') was signed on 03 October 2022 and published in the Official Gazette on 10 October 2022.

Along with the CT Law, a list of 158 Frequently Asked Questions ('FAQs') were released by the Ministry of Finance ('MoF'). Subsequently, MoF and Federal Tax Authority ('FTA') have issued multiple Decisions for implementation of various provisions of CT Law.

MoF has issued a detailed Explanatory Guide on CT Law on 12 May 2023. Explanatory Guide explains the meaning and intended effect of each Article of the CT Law and would act as an aid for interpreting the CT Law. Explanatory Guide is to be read in conjunction with the CT Law and Decisions issued by the MoF and FTA.

This alert summarizes the key clarifications provided in the Explanatory Guide.

### In detail

#### Definitions

#### **Government Entity and Government Controlled Entity**

Government Controlled Entity carrying out mandated activities is exempt from Corporate Tax ('CT'). While the Cabinet Decision on list of Government Control Entities and mandated activities is awaited, it appears from the Explanatory Guide that Government Controlled Entities undertaking activities which are extension of the primary function of the Government entities may only be eligible for exemption.

#### **Business or business activities**

Definition of the term 'Business' and 'Business Activities' is provided in CT Law. It is implied in the definition of Business that business activity is conducted with the intention of generating profits.

#### **Person**

Person means any natural person and juridical person.



It is clarified that branches of UAE or a non-UAE juridical person are extension of 'head office' and hence, they are not separate juridical persons.

### **Taxable Person**

CT Law defines Taxable Person as any person that is subject to tax under CT Law. It is clarified that even Exempt Persons would be considered as Taxable Person, if they engage in any business or business activities.

### **Licensing Authority**

Licensing Authority would include Authority providing business licenses for 'mainland' and for 'Free Zone' or 'Special Economic Zone'. Examples of Licensing Authorities are Economic Development in each Emirate, the Dubai International Financial Centre Authority, the Dubai Development Authority, Abu Dhabi Global Market, the Central Bank and the Securities and Commodities Authority.

### **Revenue**

'Revenue' refers to the gross amount of income or receipts derived during the Tax Period and recorded in Taxable Person's financial statements prepared as per applicable accounting standards.

Non-operating and passive income like royalties, interest, premiums, dividend and other similar amount are included within the meaning of revenue.

Value Added Tax is to be excluded while computing revenue.

### **Dhruva Observations**

CT Law provides revenue thresholds for determining applicability of provisions of audited financial statements, maintenance of TP documentation and small business relief. Taxpayers will have to analyse the meaning of revenue carefully while applying the above thresholds.

### **Free Zone Person**

CT Law defined Free Zone Person as a juridical person incorporated, established or otherwise registered in a Free Zone, including branch of a non-resident person registered in Free Zone. It is now clarified that a free

zone branch of a UAE Mainland would be covered within the meaning of Free Zone Person.

A foreign juridical person that transfers its place of incorporation to a Free Zone shall also qualify as Free Zone Person.

There may be instances where a foreign juridical person becomes resident in UAE due to application of Place of Effective Management ('PoEM') rule. It was unclear whether a foreign juridical person will qualify as a FZP if it has a PoEM in a free zone. It is clarified that in such cases, residential status of such foreign juridical person would be a mainland UAE resident, and not a FZ resident.

### **Dhruva Observations**

The clarifications on FZ branch of mainland entity and foreign juridical person having PoEM in FZ provides more certainty on interpretation of meaning of FZP.

Cabinet Decision on the meaning of Qualifying income is keenly awaited.

### **Dividend**

Apart from ordinary meaning of the word dividend, scope of the term includes any distribution of profit made or provided in connection with acquisition, redemption, termination, cancellation of shares or other ownership interest. In addition to the same, dividend also includes any transaction or arrangement with a related party or connected person which is not in accordance with arm's length pricing.

### **Dhruva Observations**

This expanded meaning of the term 'Dividend' would have significant implications under CT Law. In case any payment or distribution gets classified as a dividend, the same may have bearing on computation of Taxable Income of the payer (as the same may not be allowed as a deduction) as well as recipient (in case of overseas dividends not satisfying participation exemption conditions).

### **Market Value**

'Market Value' is defined in the CT Law to mean arm's length price in a free market transaction between

persons, who are not related parties or connected person.

Reference to the term 'Market Value' is provided in various Articles of CT Law viz. transfers within a qualifying group, business restructuring relief, transfer pricing and more.

### **Dhruva Observations**

Explanatory Guide provides for a deeming provision in case of transfer of assets to a related party or a connected person. In such case, consideration for transfer would be deemed to be the market value of assets, irrespective of actual transaction value. This will have significant impact on asset transfers between group companies (where benefit of Qualifying Groups and Restructuring Relief is not available).

### Qualifying Free Zone Person not eligible for basic exemption threshold

A Taxable Person is generally subject to Corporate Tax at following rates:

- Taxable income up to AED 375,000 - 0%
- Taxable income exceeding AED 375,000 - 9%

For Qualifying Free Zone Person, rate of tax is as under:

- 0% on qualifying income;
- 9% on non-qualifying income.

Explanatory Guide has clarified that a Qualifying Free Zone Person is not entitled to the benefit of basic exemption limit (0% tax on income up to AED 375,000) in case it earns non-qualifying income.

### **Dhruva Observations**

Explanatory Guide is in line with the provisions of CT Law and the confirmation of the above position, removes the ambiguity in interpretation which existed amongst taxpayers / tax professionals. However, a Free Zone Person opting for the 9% CT rate, should be eligible to take the benefit of the AED 375,000 threshold.

### Exempt Person

### **Government Entity and Government Controlled Entity**

Government entities and Government-controlled entities carrying out mandated activities are exempt

from CT, unless they undertake business activity. Following clarifications are now available:

- Juridical persons used by Government Entities for specific activities under outsourcing and other arrangements are not considered Government Entities.
- A Government Controlled Entity is a separate juridical person and not an unincorporated part or body of the Government.
- Not all activities listed in the legal instrument governing a Government Controlled Entity would automatically be considered as Mandated Activity. Cabinet Decision will be issued in this regard.
- The earnings of a Government Controlled Entity must ultimately be credited to the Government's account.
- The composition of the 'board of directors' should be considered to determine whether a Government Controlled Entity is "controlled" by the Government. The board would typically comprise government officials and other members appointed by the Government.

### **Extractive Business and Non-Extractive Natural Resources Business**

Person into extractive, non-extractive business and other non-exempt business, would have dual status under the CT Law.

A Person engaged only in extractive, non-extractive business is exempt from tax registration. However, if such Person is earning income from other business, it will have to obtain a tax registration number.

Such person would not be eligible for following reliefs:

- transfer of Losses within a group
- transfer of Assets within a group
- benefit of Qualifying Group
- benefit of Tax Group

One of the conditions for claiming exemption is that the person should be subject to tax in the respective Emirate. It has been clarified that the meaning of 'tax' should be interpreted widely, and to include all forms of tax, charge or levy payable on income, profits or revenues to the Local Government.

Businesses which are ancillary or incidental to extractive, non-extractive business are also exempt from CT. When evaluating whether a business is ancillary or incidental to a person's extractive, non-extractive business, several factors should be considered such as the relative size and value of the other business, as well as the duration and frequency of the activity.

In case of non-extractive business which are engaged in activities related to the distribution, processing, transport, sale, or storage of natural resources, necessary authorization should be obtained from the Licensing Authority of the relevant Emirate.

### **Qualifying Public Benefit Entity ('QPBE')**

A QPBE is exempt from CT Law if it is exclusively engaged in carrying out charitable, social, cultural, religious or other public benefit activities without a profit motive.

MoF *vide* Cabinet Decision No. 37 of 2023 specified a list of QPBEs which are exempt from CT Law. The said list is subject to modification from time to time.

Explanatory Guide has provided further clarification and guidance:

- Illustrative meaning of the term 'Humanitarian', 'Cultural' and 'Athlete' is provided.
- To classify any activity for public benefit, the benefit must be for and widely accessible to general public at large and it should not be restricted to few individuals.
- QPBE can engage in business or business activity directly related or aimed to fulfil its charitable purpose. Any surplus arising from such commercial activities would not preclude a QPBE from claiming status of exempt person, provided the surplus is used for the charitable purpose.

### **Dhruva Observations**

CT Law provides exemption to various categories of persons. The exemption is either automatic or subject to approval from FTA. Exempt persons will have to adhere to the prescribed conditions for availing exemption from CT Law throughout the relevant period, failure of which can have significant tax implications.

Exempt Persons will have to carefully analyse the impact of the above clarifications and additional guidance for claiming exemption status.

### **Taxable Person**

Only persons qualifying as a resident or as non-resident will be covered by the CT Law.

In case of any conflict with provision of tax treaties, tax treaty provisions would need to be considered.

Under the CT Law, Non-UAE juridical persons are deemed to be Resident for UAE CT purposes if they are effectively managed and controlled in the UAE. Critical factor would be the place where key management and commercial decisions concerned with broader strategic and policy matters necessary for the conduct of the person as a whole are regularly and predominantly made. Other factors include:

- Location of company's board of directors (or any equivalent body);
- Location of controlling shareholders;
- Location of any other Person or body to whose decision-making powers have been delegated by the board of directors;
- Place of residence of directors or executive management.

Regardless of tax residency, natural persons would be regarded as Resident for UAE CT, if he / she conducts Business or a Business Activity in the UAE.

Business or Business Activity conducted through a sole establishment / civil company (having unlimited liabilities) or unincorporated partnership would also be considered as that of the natural person (unlimited liability test to be looked at).

As per the Ministerial decision No. 49 of 2023, business activities of Natural persons will be covered by CT Law only if the turnover from the business activities exceed AED 1,000,000 in a calendar year.

In determining the turnover threshold of AED 1,000,000, the turnover from the following will not be considered:

- Wage
- Personal investment income
- Real estate investment income

## Dhruva Observations

It has specifically been clarified that tax residency is different from residency for UAE CT purposes. This requires careful consideration especially in a cross-border context.

While further guidance on effective management and control is awaited, a broad framework setting out the factors to be looked at while undertaking this evaluation has been provided.

Meaning of 'Nexus' is awaited. It would be important to understand and analyze the inter-play between state sourced income and nexus rule when introduced.

## Corporate Tax Base

Resident Juridical Persons will be taxable on their income derived from UAE and Non-UAE sources.

Resident Natural Persons will also be taxable on their UAE and non-UAE sourced income but only in so far as such income is derived from business activity in UAE.

In case of natural persons, non-UAE sourced income (income from foreign jurisdiction) would not be taxable if not connected or related to the Business or Business Activity conducted in the UAE.

'Derived' in the context of taxable income of residents to depend on the accounting method adopted by the Taxable Person – cash or accrual basis.

'Derived' in the context of withholding tax on state sourced income of non-residents, clarified to mean 'payment' or 'income that is otherwise made available'.

In case of natural persons, non-UAE sourced income (income from foreign jurisdiction) would not be taxable if not connected or related to the Business or Business Activity conducted in the UAE.

## Dhruva Observations

Clarity on the term 'Derived' in the context of Taxable Income is a welcome move as this would eliminate multiple interpretations.

While withholding tax is at 0% at the time of enactment of the CT Law, clarity on applicability at the time of payment (and not accrual) has been provided. Provision to be carefully followed as obligation to withhold taxes appears to be imminent.

## State Sourced Income

State Sourced Income clarified to be widely defined.

General rule that income from a UAE Resident Person or derived from activities performed, assets located, capital invested, rights used, or services performed or benefitted from / in the UAE would be considered State Sourced Income reiterated.

Detailed guidance on the indicative list of incomes specified to have their source in the UAE provided.

- Factors to be looked at include having some connection to the UAE / deductibility of payment in the hands of a UAE Resident Person while computing taxable income.

## Dhruva Observations

Source of income would be more relevant once withholding tax provisions are applicable.

## Permanent Establishment ('PE')

Guidance while assessing PE in the UAE may be drawn from the principles provided in the OECD Model Convention on Income and Capital.

### Fixed Place PE

Minimum requirements (exclusions) not provided for the following while evaluating for fixed place PE:

- Size or nature of the physical location;
- Duration of presence (time);
- Ownership, exclusive use or availability (disposal) of the fixed place

Depending on the nature of the Business of the Non-Resident Person, absence of employees and other forms of human involvement (i.e., Persons receiving instructions from the Non-Resident Person) would not preclude a fixed place from giving rise to a Permanent Establishment.

Preparatory or auxiliary activity exemption cannot be availed in respect of a fixed or permanent place in the UAE if its general purpose is identical to that of the Non-Resident Person.

While assessing a fixed place PE in the UAE, it has been clarified that day-to-day operational management and execution of decisions given by the board of

directors (or equivalent governing body) needs to be looked at. This has specifically been clarified to be different from the place where strategic decisions are made (this would need to be looked at while evaluating effective management and control for residency purposes).

### Agency PE

Agency PE could be created regardless of whether the contracts or other legal obligations in respect of core business operations are concluded in the name of the Non-Resident Person.

- Conclusion can happen in the name of agent / any representative representing the Non-Resident Person.
- Employees / Other Persons acting on behalf on the Non-Resident Person and habitually exercising authority to conclude contracts may also result in creation of a PE in the UAE.
- Authority to conclude contracts or other legal obligations clarified as not being restricted only to formal act of signing or concluding. Negotiating all elements and details of a contract in a manner binding the Non-Resident Person also covered despite signing of the contract outside the UAE, by the Non-Resident Person without material modification.
- Mere attendance or participation in the negotiation of a contract by a Person in the UAE may by itself not result in creation of a PE.
- In order to be independent, absence of legal and economic dependence to be demonstrated.

### Other clarifications

- Scope of PE could be extended by a Cabinet Decision. Any other economic or business link to the UAE could be covered here.
- Natural resources in the context of PE to be understood as per ordinary meaning as opposed to definitions provided in the CT Law with respect to Exempt Persons.
- Further clarity on anti-fragmentation rules provided.

### Dhruva Observations

Evaluation of PE is a complex fact specific exercise requiring careful consideration of the CT Law and

guidance provided under the OECD Model Tax Convention on Income and Capital.

Clear distinction to be made between strategic and operational decision making. Strategic decision making would result in residency while operational decision making would result in PE. Critical to bear in mind while assessing PE exposure.

Guidance and explanations along with scenarios have been provided in the Explanatory Guide which would aid in the assessment of potential PE exposure in the UAE. This is a welcome move by the MoF.

### Investment Manager Exemption

Detailed guidance on the each of the condition for availing Investment Manager exemption has been provided.

Indicators in assessment of independent capacity discussed.

Wide scope of assets covered under this exemption.

Transactions listed in the Explanatory Guide include transactions in commodities, real property, secured and unsecured debt obligations, warrants, foreign currency, futures, options, swaps and other derivatives or securities, carbon emission credits, crypto-assets and other permissible regulated investment transactions.

### Dhruva Observations

Exemption widely extended considering UAE's status as a leading holding company jurisdiction with suitable safeguards to prevent potential misuse.

### Partners in an Unincorporated Partnership

- Partnership not organised as Limited or general and formalised in a written agreement can also be treated as unincorporated partnership.
- Partnership formed through verbal agreement also covered.
- Conduct to be evaluated in order to ascertain classification as unincorporated partnership.
- It is clarified that the definition of unincorporated partnership has been intentionally kept broad to extend the tax treatment for wide variety of unincorporated relationships.



- It has been clarified that having separate legal personality does not automatically result in non-classification as unincorporated partnership.
- Important factor in determining whether arrangement or entity is an unincorporated partnership is presence of direct and unlimited liability of partners for the debts and other obligations.
- CT Law provided that in case of unincorporated partnership, business of the partnership would be treated as being conducted by the individual (natural person) partners. Every partner in unincorporated partnership would automatically become a Taxable Person.
- Explanatory Guide has clarified that the pass-through status of unincorporated partnership could result in different treatment for different partners.
- With respect to partners of foreign partnerships, it has been clarified that to avail unincorporated partnership status, the partners would need to be subject to tax in their country of tax residence (and not the country / territory of foreign partnership's formation) on the income accrued or received by the foreign partnership.

### **Dhruva Observations**

Much needed clarity has been provided with respect to unincorporated partnership.

It appears that the scope has consciously been kept wide recognising business and commercial realities.

Clarity with respect to foreign partnership eligibility is also welcome.

### **Family Foundation**

Clarified that pass-through status for Family Foundations has been brought in recognizing the different structures that may be used by natural persons to manage their personal wealth and investment for a number of reasons such as asset protection, succession planning and so on.

With respect to conditions, the following have been clarified:

- Beneficiaries of the foundation are not required to be individually named at the time of establishment of foundation. It is sufficient if the category of

beneficiaries is identified (for example children or grandchildren of the settlor)

- Public benefit entity referred to in the context of family foundations to be understood in its ordinary meaning (viz. not for profit organisation carrying out charitable, social, cultural, religious, educational or other public benefit activities) and not as QPBE of Article 9 (viz. listed in the Cabinet Decision)
- Trustee of a family foundation despite holding legal title to assets of family foundation would not be subject to tax on the income of family foundation because of beneficial ownership being with the beneficiaries.

### **Dhruva Observations**

It would be advisable to revisit current structures and underlying assets to ascertain eligibility to avail the status as family foundations for CT Law purposes.

### **Qualifying Free Zone Person**

Clarity is awaited with respect to Qualifying Free Zone Person. It has been stated that relevant decisions on this will be released.

### **Taxable Income**

The accounting net profit or loss before tax as stated in the financial statements is the starting point for computing taxable income for a tax period, subject to certain adjustments (unrealised gain / loss, exempt income, deductions, etc.) provided under the CT Law.

It is explained now that an election to be taxed on a realisation basis must specify whether the election is being made either in respect of all assets and liabilities or only in respect of assets and liabilities held on capital account. Additional conditions for the purposes of election will be specified in a Ministerial Decision.

### **Small Business Relief**

Resident Persons (start-ups and other small or micro businesses) will qualify for Small Business Relief if:

- Revenue for the relevant tax period does not exceed AED 3 million; and
- Resident Person is not a member of a multinational group required to prepare CbCR; or
- Qualifying Free Zone Person.

The threshold for Small Business Relief will continue to apply to tax periods that end on or before 31 December 2026.

### **Dhruva Observations**

Resident Persons availing Small Business Relief should continue to prepare financial statements and corporate tax returns during the relief period.

While transfer pricing documentation need not be maintained, the Resident Person claiming the relief would still need to conduct transactions with related parties and connected persons at arm's length.

### Participation Exemption

CT Law provides for participation exemption benefit on taxation of capital gains and foreign dividends. One of the conditions for participation is holding of minimum 5% ownership interest in the shares or capital of a juridical person. Explanatory Guide has provided that the term 'ownership interest' would generally mean a legal and beneficial ownership.

It is also clarified that a PE of a foreign juridical person situated in UAE can also avail the participation exemption.

### **Dhruva Observations**

Meaning of 'ownership interest' is clear now and should remove possibilities of multiple interpretations.

### Deductible Expenditure

Deduction of expenditure is allowed if it is 'incurred' wholly and exclusively for the 'purposes of Business or Profession'.

Any expenditure incurred for more than one purpose is required to be apportioned between business purpose (allowed as deduction) and other than business purpose (to be disallowed).

Explanatory Guide provides that an expenditure is considered as incurred under the following circumstances:

- a. If cash basis of accounting is followed - when expenditure is paid;
- b. If accrual basis of accounting is followed - when obligation to pay arises.

### **Dhruva Observations**

Apportionment of expenditure between business purpose and other than business purpose is a fact specific exercise and would require selection of appropriate allocation keys for apportionment.

### Interest Capping Rules

#### **General**

Deduction of interest expenditure is restricted up to 30% of earnings before the deduction of interest, tax, depreciation and amortisation (EBITDA).

Explanatory Guide provides that while the interest definition is very wide, it is meant to be compensation paid for use of money or for a debt obligation.

### **Dhruva Observations**

While it is not explicit whether interest expense recognised as per IFRS 16 (Leases) would fall within the meaning of interest expenditure, it appears that the intent is to cover conventional financing arrangements and lease financing charges may not fall within the ambit of interest expenditure.

#### **Specific**

Interest on loan borrowed from a related party for certain specified purposes shall be disallowed. This rule shall not apply if main purpose is not to take a CT advantage i.e., the lender is subject to corporate tax at 9% or more.

It is clarified that even if it is proved that main purpose is not to take a CT advantage, the loan transaction may still be subject to General Anti-Abuse Rule.

### Entertainment Expenditure

Entertainment Expenditure is allowed as a deduction only to the extent of 50%. This includes meals, accommodation, transportation, tickets for concerts, events, etc for customers, shareholders, suppliers or business partners.

It is clarified that entertainment expenditure incurred for staff is fully deductible.

### **Dhruva Observations**

Identification of entertainment expenditure is a fact specific exercise considering different nature of businesses. Necessary changes may be needed in the



ERP system and chart of accounts to identify such expenditure at source.

### Other Non-deductible Expenditure

Dividends, profit distributions or 'benefits of a similar nature' paid to an owner of the Taxable Person.

Following payments may fall within the ambit of dividend and be disallowed:

- issuance of bonus or non-cash entitlement to the direct or indirect owners.
- any compensation payable to direct or indirect owners, which is not fixed and determinable but is contingent on the financial performance of the Taxable Person.

### **Dhruva Observations**

Compensation / Salary payable to key executives are at times linked with the profits of the company. When such executives are also owners of the company, one may have to look at this provision carefully to avoid unintended outcomes.

### Transfer of Tax Loss

Transfer of tax losses between taxable resident juridical persons who have a minimum common ownership of 75% is permissible, subject to certain conditions. This is beneficial for those resident taxpayers where they are not 95% or more held by the same shareholders (and cannot be tax grouped) but are at least 75% commonly owned. It is also clarified that a single Taxable Person can transfer its tax loss to multiple Taxable Persons in a single tax period.

### Limitation on Tax Losses Carried Forward

In case of unlisted entities, tax losses can be carried forward only in case where there is either a continuity of ownership (minimum 50% common ownership) or continuity of 'same or similar business' (if ownership changes beyond 50%).

On facts, to determine whether two activities are 'similar' or not, would require an evaluation and comparison of all the commercial operations of the previous business with the new business.

This anti-abuse measure is to prevent the practice of reducing CT liability through acquiring entities with tax losses.

### Transfer Pricing

Chapter 10 ('Chapter') of the Explanatory Guide provides guidance on the following aspects of Transfer Pricing:

- Arm's Length Principle
- Related Parties and Control
- Payments to Connected Persons

### **Arm's length Principle**

The concept of 'Arm's Length Principle' is intended to be aligned with the OCED guidelines, with arm's length price corresponding to that being charged if the parties to the transaction had acted independent of their existing relationship.

While determining the arm's length price, the Taxpayers are allowed to use more than one TP method along with an option to select a method other than the five prescribed TP methods. Use of 'any other method' is possible only if the Taxpayer is able to demonstrate that none of the prescribed TP methods could be reasonably applied.

The Explanatory Guide emphasises that there is no hierarchy with respect to the application of a particular TP method and the Taxpayers must choose the most reliable method after considering five factors. It also specifies that use of arm's length range is preferred while determining arm's length price.

With respect to Transfer Pricing audit, it is provided that where an adjustment is deemed reasonable, FTA has the power to make a corresponding adjustment to the Taxable Income of the related party.

In cases where a Foreign Competent Authority makes an adjustment to a transaction or arrangement involving a Taxable Person, an application to the FTA can be made by such Taxable Person to make a corresponding adjustment.

### **Related Parties and Control**

'Related Party' includes natural as well as juridical person related to each other through ownership, control

or kinship including a permanent establishment (in UAE/ outside) of the Taxpayer.

Further the article defines 'Control' by way of the following parameter:

- Exercising 50% or more voting rights;
- Ability to appoint majority of directors of the other person;
- The entitlement to majority of profits of the other person;
- The ability to significantly influence the conduct of a business.

### Payment to connected persons

Any payment or benefit provided by a Taxable Person to a connected person shall be a deductible expenditure only if, and to the extent, such payment or benefit is at market value (market value to be determined by exercising one of the prescribed TP methods) and is incurred wholly and exclusively for business purposes.

The above provision is not applicable to:

- A Taxable Person whose shares are traded on a Recognized Stock Exchange
- A Taxable Person that is subject to the regulatory oversight of a competent authority
- Any other Person as may be determined in a Cabinet Decision

Further, the Article defines 'Connected person' to mean:

- Owner of the Taxable Person; or
- A director or officer of the Taxable Person; or
- A related party of the owner or director or officer of the Taxable Person.

In case of Taxable Person being a partner in Unincorporated partnerships, another partner in that unincorporated partnership will be considered connected alongwith its related party.

### Transfer Pricing documentation

Taxpayers are required to undertake the following compliance:

- TP Disclosure Form to be filed together with the Tax Return detailing transactions and arrangements with related parties and connected persons;

- Maintain a Master File and a Local File

### Master File and Local File

The MoF has issued an update with respect to maintaining of transfer pricing documentation *vide* Decision no. 97 of 2023 to the Federal Decree law No. 47 of 2022, which highlights the threshold for maintaining TP documentation.

Following Taxable Persons are required to maintain a master file and a local file:

- Having revenue of AED 200 million or more in the tax period; or
- Belonging to a multinational group with total consolidated revenue of AED 3.15 billion

The format of the Master File and Local File is yet to be prescribed by FTA. The Master File and Local File is required to be submitted with the Tax Authority within 30 days of such request by the Authority.

### TP Disclosure form

The TP Disclosure Form will be prescribed by the Authority.

### Clarifications

The Article throws light on the option of using Advance Pricing Agreement ('APA') as a means for Taxpayers to achieve certainty with respect to their Related Party Transactions.

However, the administrative requirements and procedure to opt for an APA will be prescribed by the Authority in due course.

### Dhruva Observations

The Explanatory Guide re-emphasises the details mentioned in the erstwhile Decree and combines the clarifications provided in the FAQ, to ensure that the Taxpayers obtain a better understanding with respect to the TP Regulations.

The fact that there is no hierarchy with respect to the use of TP method, provides the Taxpayer with flexibility to conduct a benchmarking analysis and choose a method that provides the most reliable results. This practice is also in line with the OCED guidelines.

Further, with the preference of range over an absolute value, it is to be noted that every result that will fall within the range realized in comparable uncontrolled transactions, would principally comply with the arm's length standard. Hence, it provides Taxpayer with a much broader value to set their Transfer Price and thereby limits the need to make economic adjustments for ensuring compliance with arm's length principle.

With respect to the Transfer Pricing documentation, while the Ministerial decision No. 97 has provided a threshold for Local file and Master file, the Taxpayers await guidelines with respect to TP disclosure form and its applicability.

### Tax Group

Jointly and severally is defined to mean that all of the members of the Tax Group together are liable to meet the CT liability of the Tax Group, and at the same time each individual member has a standalone obligation to meet the CT liability of the Tax Group.

### Taxable Income of a Tax Group

As per the CT Law, transactions between members of a Tax Group will generally not be considered when determining the Taxable Income of the Tax Group. However, where an asset or liability is transferred between members of a Tax Group, and either of these members leaves the Tax Group within two years, any taxable gain or loss arising on such transfer will be taxable for the Tax Group.

The Explanatory Guide clarifies that this is to prevent a direct sale of asset or liability being transformed into an indirect sale, i.e., through the sale of a Subsidiary owning the asset or liability that would be exempt under the Participation Exemption.

- For example, A Co and B Co are part of same tax group. A Co transfers land to B Co. Subsequently, shares of B Co are transferred to D Co and such transfer satisfies the conditions for participation exemption. As a result, the land will indirectly be transferred from A Co to D Co.
- If transfer between A Co and B Co is eliminated under the normal grouping provisions, such transfer will not be subject to tax. However, if such asset was directly transferred to D Co by A Co, gains

arising on such transfer would be taxable in the hands of A Co.

- To prevent such instances of tax avoidance, the condition of continuation of both the transferor and transferee has been added for a period of two years.

### **Dhruva Observations**

This is a specific anti-avoidance provision to prevent misuse of the relaxation provided to the Taxable Persons forming a tax group, to reduce the compliance burden.

### Currency

CT Law provides that any amount in a foreign currency must be converted, at the applicable exchange rate set by the Central Bank of the United Arab Emirates, to United Arab Emirates dirhams.

Guidance with respect to the timing of such conversions is provided. Translation of amounts denominated in foreign currency should be done at the time the relevant income is derived or expenditure incurred is taken into account for the purposes of the CT Law, subject to any conditions that may be prescribed by FTA.

Further, a reasonable and consistent approach is to be adopted throughout the entirety of the Tax Period by the Taxable Person.

### **Dhruva Observations**

The exchange rate is subject to frequent fluctuation and has a direct impact on the amount of the corporate tax liability.

### Foreign Tax Credit

Foreign Tax Credit to be available for foreign tax of a 'similar character' as Corporate Tax.

'Similar character' is defined as the amount imposed by, and payable to, a non-UAE government, where the payment is compulsory and enforceable by law. It is provided that the legislation imposing the tax, the title, method of collection of tax is not relevant in determining the nature of the tax paid.

Tax Collected at source, for example is calculated on different components to the tax base (having both an income and a non-income element). Where the intent is

to levy tax on income, regardless of the method of collection, the amount to be considered to be of a similar character to Corporate Tax, provided other conditions specified above are satisfied.

An illustrative list of items that are not considered to be of a similar character to Corporate Tax is provided:

- Consumption taxes such as Value Added Tax / Goods and Services Tax / Sales Tax;
- Customs duty / Excise Tax / other forms of import duties;
- Transaction taxes such as stamp tax and capital duty;
- Property taxes and wealth taxes calculated based on ownership of specified items or value of assets without regard to income; and
- Estate Tax / other forms of inheritance taxes and duties.

### Dhruva Observations

Guidance is provided on the nature of foreign taxes paid for which credit may be allowed subject to applicable Double Taxation Avoidance Agreements.

Illustrative list provides further clarity to businesses paying taxes in other jurisdictions, on the nature of taxes that will not be considered of similar nature as corporate tax.

### CT Payment and Refund

Timeline and due date for payment of CT is 9 months from the end of the relevant tax period or such other date as determined by the FTA.

It is now explained that the due date of tax payment coinciding with the due date of filing of tax returns is to ease the compliance burden of taxpayers by enabling them to pay CT and file return at the same time.

Failure to comply with the due dates to pay CT shall attract penalties upto twice the amount of CT.

Application for refund to the FTA can be made in case where withholding tax credit or CT paid exceeds the CT payable. It is now explained that the withholding tax credit will be refunded if it exceeds the CT that is due in the same tax period.

### General Anti-Abuse Rules (GAAR)

Applicable to any transaction or arrangement:

- which lacks commercial substance; and
- the main purpose or one of the main purposes of such transaction or arrangement is to obtain a CT advantage, otherwise not available.

It is now explained that GAAR also applies to transactions or arrangements where the person who entered into the transaction and the person who obtained the tax benefit are not the same.

FTA has the authority to treat the transaction or arrangement based on its economic reality by way of issuance of an assessment.

### Tax Registration and De-registration

All Taxable Persons are required to be registered for CT purposes. Certain categories of Exempt Persons (Government entity conducting non-business activity, Government controlled entity conducting non-mandated business activity, person engaged in an extractive business or a non-extractive natural resource business and non-resident without Permanent Establishment in UAE deriving only State sourced income) are excluded from the requirements of registration.

Timelines to apply for CT registration for the following categories of Exempt Persons:

Person	Timeline
Qualifying Public Benefit Entity	01 October 2023
Qualifying Investment Fund Public or Private or Social Security Fund UAE juridical person wholly owned and controlled by specified categories of Exempt Person	01 June 2024

Upon registration, unique Tax Registration Number will be issued by the FTA which would form part of the Person's identifying information.

De-registration is possible only when business or business activity has ceased to exist, all pending CT



dues / administrative penalties are paid and CT returns for all periods up to the date of cessation are filed.

Application for de-registration shall be made within three months from the date of cessation of business.

### **Dhruva Observations**

While the timeline for filing the de-registration application is notified, the form and manner for making such application is awaited.

### Tax returns and Clarifications

Tax returns to be filed within nine months from the end of relevant tax period containing the minimum information listed under the CT Law.

Certain categories of 'exempt persons' to submit a declaration rather than a full-scale tax return for verification of compliance with exemption conditions.

In case of an unincorporated partnership that has not applied to be treated as a Taxable Person, the authorised partner to file a declaration on behalf of all the partners.

Taxable Person might be requested by the FTA to submit financial statements used to determine taxable income for a tax period.

Taxable Person deriving revenue exceeding AED 50 million during the relevant tax period and a qualifying Free Zone are required to maintain audited financial statements.

Taxable Person to keep all documents and records (cash book, salary register, related records that support tax return) for a period of seven years after the end of the tax period.

Non-maintenance of record keeping would attract penalties upto twice the amount of CT.

Tax Period shall be the financial year ending on 31 December or such other period of 12 months as adopted by the Taxable Person in the preparation of financial statements.

Tax Period can be changed (liquidation, tax grouping, valid commercial / economic / legal reasons) by making an application to the FTA (before the lapse of 6 months from the end of the original tax period) provided tax

return for the tax period which needs to be changed is filed.

Tax Period can be either extended upto 18 months or shortened to be between 6 and 12 months.

Application for shortening a Tax Period cannot be filed for the prior or current Tax Period.

### **Dhruva Observations**

This is more relevant for Taxable Persons who follow different FYs but wish to form a tax group or avail benefits of tax relief on account of business restructuring or transfers within a Qualifying Group.

### FTA Clarification

FTA could be approached for a clarification regarding application of the CT Law or conclusion of APAs for a transaction or arrangement proposed or entered into by a person.

It is now explained that the person seeking clarification might not be a Taxable Person at the time the clarification is sought and such clarification may be sought pre or post the relevant transaction or arrangement has taken place.

### Violations and Penalties

FTA can undertake CT assessment of any person, not necessarily a Taxable Person, even in the absence of a tax return.

Failure to comply with the obligations under the CT Law, the Tax Procedures Law and other related legislations could attract penalties and fines.

### Transitional Rules

Balance sheet as on the last day of the financial year before the beginning of a tax period, shall be considered as the opening Balance sheet for CT purposes and should be prepared considering the arm's length principle as per the CT Law.

As GAAR provisions would apply to transactions or arrangements entered on or after 10 October 2022 (i.e., the date the CT Law was published in the Official Gazette) is to allow FTA to counter arrangements or transactions that would result in undue CT advantages, benefits, or CT relief in the future.

## Closing Provisions

Administrative policies, processes and procedures determined by the FTA including tax return format, type of information to be included in the tax return and the processes to be followed in filing tax returns.

Government authorities required to cooperate with the FTA include other ministries of the Federal Government and Government departments at the local Government level (the Department of Finance, Free Zone regulatory authorities,).

The terms of international agreement shall override the CT Law. It is now explained that 'international agreement' includes various agreements for the avoidance of double taxation entered into between the UAE and other countries and the multilateral instruments adopted by the UAE.

The provisions of the CT Law shall supersede other laws apart from international agreements.

## **Conclusion**

The CT law, various decisions and this Explanatory Guide provide clarity and direction for businesses to plan and implement next steps.



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