



FROM OUR GCC LEADER

The hospitality sector in the UAE has emerged as a cornerstone of the nation's non-oil economy, contributing significantly to its GDP and positioning the country as a premier global tourist destination. With a robust growth trajectory, the sector is anticipated to expand from \$7.37 billion in 2023 to \$9.46 billion by 2028.



The government's strategic emphasis on diversifying the economy beyond oil has led to substantial investments in world-class infrastructure, attracting international hotel chains and fostering homegrown brands. This dynamic growth is evidenced by the ongoing investment of approximately \$32 billion to add 48,000 more hotel rooms, bringing the total to 200,000 across the UAE.

Amidst this rapid expansion, the hospitality sector faces an increasingly complex tax environment. The introduction of federal taxes such as VAT in 2018 and corporate tax from June 2023, alongside emirate-level levies like municipality tax and tourism fees, has created a multifaceted tax framework that hospitality businesses must navigate. As these taxes continue to evolve, understanding their impact on the sector's operations becomes critical for stakeholders, from hotel operators to property owners and guests.

This report, prepared by Dhruva Consultants, offers the first comprehensive analysis of the tax implications—specifically VAT, corporate tax, and transfer pricing—on the hospitality sector in the UAE. Drawing upon our extensive experience working with renowned hotel chains in the region, we explore the unique challenges and opportunities these taxes present. The report delves into key areas such as VAT treatment of common hotel transactions, the introduction of corporate tax and its implications on financial planning, and the importance of robust transfer pricing documentation.

Readers will find this report invaluable in gaining a deeper understanding of the intricate tax landscape that shapes the UAE's hospitality sector. Whether you are a hotel operator, property owner, or involved in related industries, the insights provided will equip you with the knowledge necessary to navigate these challenges effectively and ensure compliance.

We would be glad to welcome your feedback on this report and happy to have a chat should you have any questions.

NIMISH GOEL



FROM OUR AUTHORS

As the authors of this guide, we have shared valuable insights into the UAE hospitality sector, covering the evolving tax landscape, including VAT, Corporate Tax (CT), and Transfer Pricing (TP) regulations. Drawing from our experience working with renowned hotel chains, we analyze the impact of taxes on the sector's operations, exploring prevalent business models, the multifaceted tax framework, and compliance requirements.



VAT

This guide offers an in-depth analysis of VAT implications. We explore the VAT treatment of everyday transactions like accommodation, F&B, and ancillary services. Additionally, we address challenges such as residential vs. serviced accommodation, intercompany recharges, and membership fee treatment.

~ Geet Shah, Associate Partner



Corporate Tax

With CT's introduction, we provide insights into its impact on the sector. This section examines CT implications on property deals, management contracts, brand royalties, shared costs, and employee benefits. We also discuss tax grouping benefits and compliance requirements.

~ Rakesh Jain, Partner



Transfer Pricing

Recognizing the importance of TP regulations, we dedicate a section to highlighting the significance of robust documentation for arm's length compliance. Topics include legal/economic ownership of intangibles, profit allocation, shared costs, and staff secondment implications.

~ Kapil Bhatnagar, Partner

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BUSINESS MODELS
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Resurgence of the Hospitality Industry

In the past few years, the UAE's hospitality sector has demonstrated remarkable recovery, bouncing back from the significant challenges posed by COVID-19. The pandemic initially triggered a significant downturn, with lower occupancy rates and high recurring costs. However, the UAE government's swift response, with health protocols and supportive economic measures, played a crucial role in stabilizing and reviving the sector.

The hospitality industry gained momentum with major international events, notably Expo 2020 Dubai and the Qatar FIFA World Cup 2022. The management of these events reinforced the UAE's status as a prime destination for MICE (Meetings, Incentives, Conferences, and Exhibitions) tourism, attracting visitors worldwide.

Several global hotel chains such as Marriott, Hilton, Hyatt, and Accor, alongside influential homegrown groups like Jumeirah Group and Emaar Hospitality, operate in the region. These entities collectively contribute to the region's hospitality sector.

Evolving Tax Regime

When VAT was introduced back in January 2018, businesses had to integrate VAT into their operations with limited guidance and clarity. Over the past six years, the Federal Tax Authority ('FTA') has published multiple public and private clarifications and sector-specific guides, to clarify tax positions and compliances to be followed and expected by businesses.

Implementing CT from the financial years starting from June 2023 brings another wave of change for the UAE hospitality sector. The CT impact would likely involve adjustments in hotel pricing, costing, and financial planning.

With these tax changes, this report aims to provide a broad overview of the impacts of VAT, CT, and TP on the ecosystem revolving around:



Property owners



Hotel operators



Restaurants



Digital aggregators



Guests

Disclaimer: This report should not be considered as an exhaustive compilation of tax implications in the hospitality industry and may not necessarily cover all transactions. This report should not be considered as an opinion or clarification, and can neither be defended in the Court of Law nor be considered as FTA's views on the hospitality industry. The contents of this report are based on the information available and on common practice

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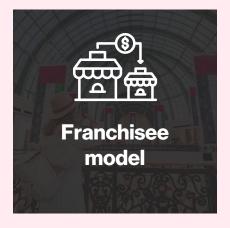


Hotels are complex establishments that rely on various resources and expertise to operate successfully.

Although they can exist as independent entities, they are often part of a broader ecosystem that includes owners, operators, brands, and other stakeholders. In general, the most common business models in the sector are:











Hoteliers under this business model include international hotel brands initially owned and operated by hotels. Due to the intensive capital requirements of ownership and the need for destination-specific expertise in hotel development, a strategic shift occurred. This involved separating real estate ownership from hotel operations to facilitate faster business growth.

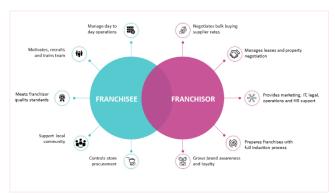
Local property owners invest and oversee hotel development; international hotel chains, on the other hand, bring operational expertise, focusing on day-to-day functions like brand management, revenue optimization, and guest experience enhancement. The collaboration ensures business growth for the local owners, with management companies earning fees based on revenue and profit percentages, creating a partnership.





Franchisee model

Under the franchise model, owners use the franchisor's brand and standards but manage operations independently, often at lower costs. Owners pay a franchise fee based on room and food revenue, gaining autonomy in decision-making while the franchisor oversees performance. This model provides flexibility, aiding operators to seek diverse expansion, and owners aim to boost ownership levels and accountability for profit and loss.



Boutique Hotels

Independent and boutique hotels stand alone, offering unique and personalized experiences. While enjoying operational freedom without management or franchisee fees, these hotels face the challenge of building brand recognition to attract guests in a competitive market.





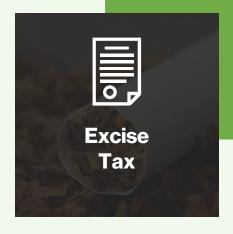
The hospitality sector in the UAE is subject to a multifaceted tax framework. In addition to federal-level direct and indirect taxes, there are also emirate-level taxes that apply to businesses in this space.

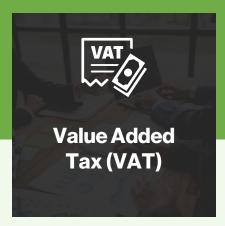
















Popularly known as municipality fees, this is an emirate-level tax applied to revenues of hotel rooms or apartments, food and beverage, and other provided services.

Objective

- Generate revenue for local infrastructure and tourism development.
- Maintain and improve quality standards in the hospitality industry

Tax Rate

A flat percentage tax ranging from 4-10%, applied to the majority of the services provided by the hotel. The rate of tax is subject to frequent changes in each emirate, depending on market dynamics.

Compliance

Hotel businesses are required to discharge tax and file returns on a monthly basis in most emirates.

Audit

Businesses are also subject to audit scrutiny by emirate-level authorities, who specifically focus on the reconciliation of revenue reported vis-à-vis the audited revenue in the financials.

Direct vs. Indirect Tax

Most hotels charge
municipality tax as a separate line
item in the invoice and pass on the cost to the
customers. There is still an ambiguity on
whether the levy is a direct tax on the hotels or
an indirect tax levy on the customer.

The above position could have material implications on how other taxes would apply on the invoice.



Popularly known as tourism dirham or tourism fees, this is also an emirate-level tax charged per room, per night of occupancy to the guests.

Objective

The objective of this levy is similar to municipality tax. Revenue generated from the levy is utilized to fund various initiatives that enhance the overall tourism experience in the emirate.

Tax Rate

A flat fee ranging from AED 7–20 per room per night in Dubai, and 4% on room rates in Abu Dhabi. The rate varies in each emirate. It can also vary depending on the hotel category (luxury, standard, etc.).



As in most countries, customs duty applies to the import and export of goods to and from the UAE mainland.

Tax Rate

The tax rate for customs duty in the UAE varies depending on the type of goods being imported or exported.

For hotel businesses, commonly imported items such as furniture, fixtures, equipment, and supplies are subject to customs duty. Rates can range from 0-5% in most cases, In certain cases, specific percentage rates based on the value and classification of the goods.

Compliance

Customs duty is generally applied to the importation of goods into the country and is to be discharged on import clearance.

There are no specific compliances in terms of filing of returns.

Audit

Businesses could be subject to audit scrutiny with regard to appropriate classification or arm's length valuation of goods imported. One also needs to assess the interplay with TP provisions that apply the arm's length principle for imports from related parties. Businesses are generally advised to maintain adequate records related to imports for these purposes.



Excise tax was introduced across the UAE in October 2017.

Objective

Excise tax is a federal tax levy applied on specific goods that are typically harmful to human health or the environment.

Tax Scope

The tax is levied on the importation, manufacturing, or stockpiling of goods such as:

- tobacco and tobacco products,
- carbonated drinks, and
- energy drinks.

The list was further expanded in December 2019 with the inclusion of:

- sweetened drinks.
- electronic smoking devices and liquids used in these electronic smoking devices.

Tax Rate

The tax rate ranges from 50% to 100%.

Compliance

Businesses are required to discharge tax and file excise returns monthly, on or before the 15th of the subsequent month.

Most hotel businesses are subject to excise tax, either as a "stockpiler" or "importer" of excise goods. In most cases as stockpilers, hotels were required to discharge a one-time excise tax on excess inventory of these goods over a 12-month

average held in stock on the date of excise tax implementation.

Audit

Hotel businesses could be subject to excise tax audit scrutiny.



Excise Tax Audit Assessment

Many hotels have been subject to an excise audit scrutiny by the FTA in the past two years.

Challenges faced by Hotels in audit typically include:

- Non-availability of excise inventory data
- Errors in stockpiler calculations
- 3. Reconciliation and documentation of audited inventory count to support excise tax calculations



Value Added Tax (VAT)

The UAE introduced VAT as part of a unified agreement signed by the GCC countries.

Objective

The levy generates a source of income that is utilized to provide high-quality public services.

Tax Rate

Supply of goods or services is subject to the standard rate of 5%, with a few exceptions.

Compliance

Businesses with a turnover below AED 150 million are generally required to pay and file returns on a quarterly basis, while those with a higher turnover are subject to monthly payment and filing of returns.

Audit

Similar to the excise tax, businesses could be subject to a VAT audit by the FTA to review the tax position adopted and VAT compliances undertaken for the preceding five years.



UAE has introduced a Corporate Tax regime for financial years commencing on or after 1 June 2023.

Objective

A competitive CT regime based on international best practices is expected to cement the UAE's position as a leading global hub for business and investment, and to accelerate the UAE's development and transformation to achieve its strategic objectives. Introducing a CT regime also reaffirms the UAE's commitment to meeting international standards for tax transparency and preventing harmful tax practices.

Tax Rate

The tax rate is 9% on taxable income exceeding AED 375,000.

A Qualifying Free Zone Person (QFZP) benefits from a 0% rate on their qualifying income, subject to conditions being satisfied.

Compliance

All businesses registered for UAE CT purposes are required to file the CT return and pay for any CT liabilities within nine months from the end of the relevant tax period.

Records

A taxable person is required to maintain all records and documents for a period of seven years following the end of the tax period to which they relate.



The Corporate Tax regime contains detailed TP regulations. As per the TP provisions, UAE businesses undertaking transactions with related parties and connected persons will be required to ensure arm's length pricing of their transactions, mirroring transactions between independent entities under similar circumstances.

Objective

To prevent artificial shifting of profits from group entities in higher tax jurisdictions to lower tax jurisdictions, and from high tax entities to low/no tax entities, resulting in an overall lower tax burden for those groups.

TP Adjustment

Tax administrations may perform a Transfer Pricing adjustment if a transaction is not found to be reflective of the market value or arm's length price. In such cases, the adjustment would be subject to tax, at the applicable Corporate Tax rate for the business.

Compliance

The TP provisions provide for the rules and documentation requirements for businesses that are in line with the Organization for Economic Cooperation and Development's ('OECD') Transfer Pricing Guidelines.

As per the UAE legislation, the TP documentation requirements for each Tax Period are as follows:

- TP disclosure form which covers details of the Controlled Transactions during a Tax Period.
 The details with regard to the threshold and applicability are awaited.
- The Master File, which provides a high-level overview of the Group's business and the allocation of income and economic activity within a Group. It only applies to a business with revenue exceeding AED 200 million in a financial year, or if such business is part of a larger MNE Group with consolidated revenue exceeding AED 3.15 billion, as set out in Ministerial Decision No. 97 of 2023.
- The Local File, which provides detailed information on operations of the local entity and analysis and testing of the outcomes of the Controlled Transactions against the Arm's Length Principle. It only applies to a business

- with revenue exceeding AED 200 million in a financial year, or if such business is part of a larger MNE Group with consolidated revenue exceeding AED 3.15 billion, as set out in Ministerial Decision No. 97 of 2023.
- A Country-by-Country Report which provides jurisdictional quantitative information about an MNE Group (above AED 3.15 billion), as well as an overview of the different activities conducted by affiliates of an MNE Group, as set out in Cabinet Resolution No. 44 of 2020.

Audit

The FTA may undertake an assessment under specific circumstances and conditions to be prescribed by the FTA.

Typical Hotel Accommodation Invoice Break-up

Invoice break-up	Abu Dhabi	Dubai	Sharjah	Ras-Al-Khaimah
Room Charges	1000	1000	1000	1000
Comicas alsouses	100	100	100	100
Services charges	(10%)	(10%)	(10%)	(10%)
	40	70	100	70
Municipality tax*	(4%)	(7%)	(10%)	(7%)
T	40	7-20	0	7-20
Tourism tax*	(4%)			
) / A T	55	55	55	55
VAT	(5%)	(5%)	(5%)	(5%)
Total	1,235	1,245	1,255	1,245

^{*}Note: rates may vary across emirates, depending on the prescribed range in the emirate and the classification of the hotel



Hotel and catering services, for VAT purposes, are taxed in the place where such services are actually performed.

In most cases, supplies made by hotels are subject to VAT at the standard rate. However, there may be a few exceptions applying to specific products or combinations thereof that must be thoroughly evaluated to ensure that the correct VAT treatment is adopted.



Common hotel transactions and the corresponding VAT considerations are discussed herein.



Hotel accommodation

The supply of hotel accommodation is subject to VAT at the standard rate of 5%. Hotels are among those that are expressly excluded in the VAT regulations from the definition of "Residential Buildings" for VAT purposes, and therefore cannot be classified as VAT exempt.



Serviced apartments

Serviced apartments likewise do not come under the definition of residential buildings for VAT purposes. In general, these types of apartments would be subject to the standard rate of VAT at 5%.

Advance booking

The receipt of payment is among the dates that could qualify as the date of supply which determines the point in time upon which VAT must be accounted for by the taxpayer. Where the hotel receives payment in advance of the booking date or issuance of tax invoice. VAT must be accounted for at such point. Furthermore, where the advance payment triggers the date of supply, the hotel must issue the tax invoice within 14 days of advance receipt.



Security deposits

Hotels shall evaluate whether security deposits constitute a consideration for a supply on which VAT must be accounted for. Non-refundable deposits are seen as part of the consideration received for the hotel accommodation and shall be subject to 5% VAT, while refundable deposits shall only be taxable on the portion that is actually charged to the guest at the time when the charges are made/deducted (except for cases where the charge is in the nature of compensation for damages to the hotel furniture/asset).



Special room arrangements

Most hotels offer options for early check-in and/or late check-out for additional fees. Such fees are an additional consideration for hotel accommodation services, and are subject to 5% VAT.



Complimentary rooms, meals, parking, others

Goods and services provided without charge to employees or other persons may be taxable as a deemed supply. Hotels shall therefore charge and report 5% VAT on the value of these complimentary benefits, unless any of the exceptions provided for in the VAT Regulations apply.

Complimentary services and goods provided as part of another charged package or service must also be analyzed on a case-to-case basis to determine the appropriate VAT treatment.

Restaurant and food services

Food and drinks provided within the hotel premises (restaurants, cafés and bars), as well as room service, are considered catering services subject to VAT at 5%. Hotels are required to display the prices as VAT-inclusive.



Tips

"Tips" given by guests gratuitously to the staff or added to a bill are generally outside the scope of VAT. Where the tip is imposed compulsorily on the guest as a service charge, this may be seen as additional consideration subject to 5% VAT.



No show/cancellation charges

If the hotel policy/contract allows the guest to cancel the booking by paying cancellation charges, such charges are considered the cessation of a right, constituting a supply subject to 5% VAT.



Provision of other services

Hotel facilities including spa, salon, parking, and laundry services.

Additional services provided by hotels are subject to 5% VAT in general.



Local sightseeing/ tour packages

Hotels are required to account for 5% VAT on the consideration received for local tour packages arranged and operated by the hotel. However, where a third party is involved (as is the usual case), the hotel must consider the agency provisions in determining the proper VAT reporting. Where the hotel is acting merely as a (disclosed) agent, the hotel shall only account for VAT on its service fees.



Local transportation

Airport and other local transfers that are provided by the hotel as an optional service to guests is a supply of passenger transport and classified as VAT exempt, provided that the main objective of the transport is not for pleasure or entertainment (e.g. sightseeing, enjoyment of catering); otherwise, 5% VAT will apply.

Additionally, hotels must also consider whether the transport forms a single supply with the provision of hotel accommodation, for example, as part of a package or promotion, which may alter the VAT treatment of the supply.



Telecommunications services

Charges for local telephone calls and other similar amenities offered by the hotel shall also be subject to 5% VAT.



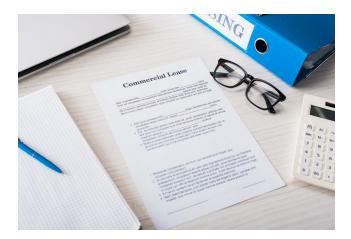
Foreign currency exchange

Financial services in terms of exchange of currency are exempt from VAT except, where the services are provided for an explicit fee, discount, commission, rebate, or similar. Gains realized by hotels from foreign currency exchange would normally be exempt from VAT. However, hotels in the industry generally discharge 5% VAT on foreign currency exchange gains as a conservative position.



Long-term residential accommodation

Accommodations qualifying as residential in nature (e.g. not serviced apartments) shall be exempt from VAT. However, the supply of residential accommodation for a period of six months or shorter to individuals who do not have an Emirates ID ('EID') shall be subject to standard rated VAT of 5%.



Commercial leasing of offices, stores, and restaurants

The rent charged to offices and other businesses in accordance with a commercial lease for space in the hotel premises is subject to 5% VAT.



Conferences

Exhibitors and conference service providers in the UAE can avail themselves of VAT refunds for services granted to international customers under specific conditions. These conditions include the right to attend or occupy a space, the absence of a recipient's establishment in the UAE, and a written declaration from the recipient. The VAT refund scheme applies to eligible suppliers registered for VAT, holding a valid trade license, and licensed by the FTA for the VAT Refund scheme. Suppliers still charge VAT but do not collect it from international customers, instead claiming the refund in the adjustment column of their VAT return.

Hotel management/brand License Fees

The VAT treatment of management and/or brand license fees charged to hotel owners in the UAE may vary. Depending on the circumstances of each case, these could be subject to VAT at 5% if the hotel manager/brand is in the UAE, or by the hotel owner under the reverse-charge mechanism ('RCM').



Recoveries from employees

Expenses incurred by the hotel for its employees, which are recharged (partially or in full) to those employees, could be considered taxable reimbursements subject to VAT at 5%, depending on the nature of expenses recharged.





Legal vs beneficial ownership of a hotel

There may be cases where a hotel property is owned by a person other than the person actually operating the hotel and making taxable supplies therefrom, as well as recognizing the land and building in their books; that is to say, the legal owner of the property is different from the beneficial owner.

The concept of legal and beneficial ownership is not explicitly discussed in the UAE VAT legislation. As such, a position may be taken that arrangements of such nature may result in a supply of a right to use the real estate from the legal owner to the beneficial owner, taxable at 5%. The valuation of such supply may also be governed by related-party valuation rules.

Leasing property in a personal capacity

In the UAE, landlords may not be required to hold a specific license to lease their properties. Because they don't have a license, these landlords may be under the impression that they are not subject to VAT. However, leasing commercial properties is a taxable service regardless of whether it is provided under a license or not. Therefore, landlords who are engaged in leasing their properties may still need to evaluate whether they meet the registration threshold or not, and must comply with applicable VAT obligations.

VAT posting on daily folio vs billing on checkout

The taxable event, according to the date-of-supply rules, is on the completion of a service. As there is not yet clarity on when hotel accommodation services are considered as completed—i.e., daily (since rates are charges per night) or at the end of the booking period, hotels appear to take differing views on the matter. While some hotels account for VAT on a daily basis, others may consider the point of completion as occurring at guest checkout. This becomes a concern when the booked period extends over two tax periods, which can result in a delay in tax reporting for those who are adopting the latter approach.

Hotels may opt to integrate the VAT reporting with their daily accounting revenue recognition to take a conservative stand; however, some may find this to be a challenge, since necessary adjustments and reconciliation may need to be undertaken manually.

VAT on membership fees and rental income

Hotels may offer facility access to paying "members" (e.g. gym memberships). Fees from this privilege form part of the hotel's other revenue, along with commercial rent from third parties occupying space within the premises. While income on these transactions may be recorded in the books on a monthly or periodic basis, the payments may not be received on the same schedule. Since the date-of-supply rules for accounting VAT liability do not necessarily follow the revenue recognition accounting principles, this often causes errors if the applicable VAT on such fees is reported in the VAT return as applying at the date of book entry instead of the date of receipt of payment (for example), as the date of book entry bears no relevance in determining the date of supply for VAT purposes. Hotels must therefore evaluate the relevant supply dates to determine when VAT must be accounted for in their return, and maintain the necessary reconciliations.



Intercompany recharges of shared resources

Larger hotel networks may have employees who oversee or perform functions for multiple establishments. Similarly, non-managerial employees may also be seconded to other entities, often temporarily, especially in cases of major events where more support staff are required than usual. With the employee visa issued under one entity, the salary costs would likely be recharged to the other entities. In such a case, a taxable supply of manpower services may occur. Hotels should evaluate their salary recharges to identify whether there is any VAT reporting obligation.

There may also be intercompany recharges for the transfer of inventory stock of one entity to be used by another. These charges could be taxable as consideration for a local supply of goods, and as such should be reviewed by hotels

Residential versus serviced accommodation

The classification of accommodation as residential or commercial (serviced apartment) may be more complex than it seems. This comes into play especially where the lease/rental of a property comes with other underlying arrangements, such as the provision of additional amenities and services, pricing structure, optional add-ons, manner of advertising the property, type of property as per Government records, etc.

Such factors can blur the lines between residential and commercial categorization, and it is crucial to assess the specifics of each transaction before drawing a conclusion, to ensure that the correct tax position is adopted.

Taxable amount, other taxes

In KSA, the ZATCA has explicitly clarified that VAT shall be charged on the full consideration received, including the municipality and other local taxes. However, in the UAE, it was previously communicated by local authorities through a circular that as per the FTA, VAT is to be charged on the amount exclusive of local taxes i.e. municipality fee and tourism fee. As no official clarification/guideline has been published directly by the FTA, it is yet to be determined whether FTA's view aligns with the circular or with the interpretations followed by other GCC countries.

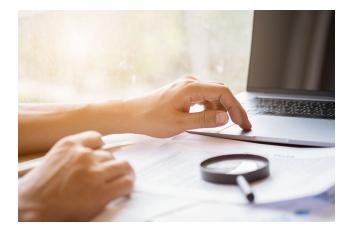
Registration dilemma - multiple licenses for business activities

Hotels often obtain separate licenses for each of their business activities, depending on the requirements of the relevant emirate. It must be clarified whether or not each license creates a separate legal identity for VAT purposes for which the supplies must be assessed individually for VAT registration purposes, or whether these should be consolidated under one VAT registration pertaining to the legal person holding each license.



Recoverability of Input VAT on staff accommodation and duty meals expenses

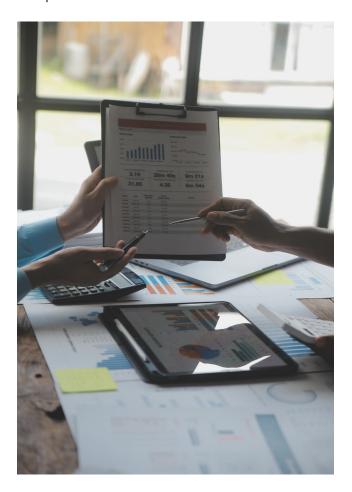
It is common for hotels to provide accommodation and meals to employees as part of their compensation package. Generally, input VAT on expenses incurred to provide these benefits would not be recoverable for taxpayers. However, the peculiar nature of the hotel business raises a question about whether these benefits can and should be considered essential to the employees' performance of their roles. If such a necessity is established, there may be grounds to support the recovery of input VAT by the employer (provided that all other conditions are satisfied).



Principal-agency transactions

Hotel investors collaborating with third-party entities such as event management companies entail certain tax reporting implications.

Specifically, these arrangements may require the careful examination of agency concepts against the details of the agreement between the parties, to determine proper VAT reporting and compliance.





Agency Principles

Under UAE VAT, a person who acts on behalf of another person in respect of a specific task may be considered an agent. Where this agency is disclosed to the customer, the transaction remains between the customer and the principal. In such cases, the principal should report in its VAT return the full value of the supplies, while the agent remains responsible solely for declaring VAT on its agency services provided to the principal.

However, any "agent" acting in their own name will be considered the principal and shall be required to declare VAT on the value of the supplies to the customer, as well as any agency fees earned.



Online Booking Platforms

Because customers are aware of the hotel establishment when making a booking, online booking platforms generally classify as "disclosed agents" and are normally required to account only for their hosting services to hotels, rather than the hotel accommodation supplies.





Property transactions



Management and third-party contracts



Hotels operating in Free Zone



Brand royalties and other intangibles



Shared costs and payment



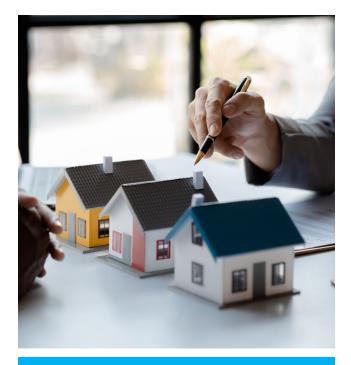
Employee benefits and free supplies



Restaurants and food delivery



Tax grouping option





Property transactions

When legal and beneficial owners of hotels are considered related parties or connected persons, it is essential to establish appropriate agreements and ensure arm's length payment terms.

Real estate investment income is not subject to CT when derived by natural persons, provided that these activities are not conducted through a license and do not require a license from a Licensing Authority.

Article 61 of the UAE CT Law outlines transitional rules for a taxable person's opening balance sheet, which includes assets like hotel properties, intangible assets, financial assets, and liabilities. This allows for the exclusion of pre-CT regime gains during eventual asset sales. The decision to exclude these gains must be made in the initial tax return and is generally irrevocable.

Regarding unrealized gains and losses, hotel operators must decide whether to tax all assets and liabilities upon realization, or only capital assets and liabilities. If no election is made, tax treatment of unrealized gains and losses will be aligned with accounting treatment. Depreciation and amortization deductions must align with accounting practices.



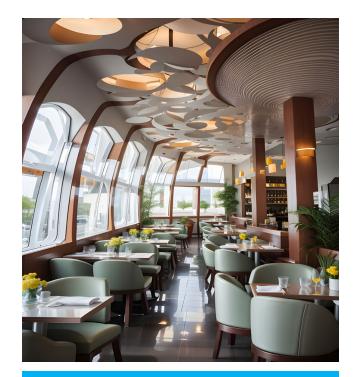
Management and third-party contracts

Under management agreement, hotel management companies bring operational expertise, focusing on day-to-day functions like brand management, revenue optimization, and guest experience enhancement against the specified fees. Beyond this, different third-party contracts encompass a range of services, including housekeeping, catering for events, security, landscaping, IT support, laundry, transportation, entertainment, maintenance and repairs, marketing, consulting, training, waste management, and energy solutions. Each agreement is tailored to meet the specific needs of the hotel

Management agreements and the third-party contracts should be backed up by signed agreements defining the nature of services provided and the pricing policy. Being operating expenses, the same shall be tax deductible. However, in case of any payment to non-resident, 0% withholding tax would be applicable.

In the case of management agreements, the businesses will first have to evaluate whether the property owners and the management companies fall under the definition of related parties or connected persons under the CT regime. If it is established that the property owners and the management companies are related parties, the transaction of management fees between the owners of the property and the management should conform to the TP rules and regulations. This would involve conducting a Functions, Asset, and Risk ('FAR') analysis and a detailed benchmarking analysis, to ensure that the management fee (or the 'Transfer price') is at arm's length.

Excess payments (if any) may not be allowable as a deduction while computing taxable income.





Hotels operating in Free Zone

QFZP can enjoy the benefit of a 0% tax rate for transactions with free-zone persons in respect of commercial property located in free zone. As per CT law, commercial property refers to an immovable property or part thereof used exclusively for a business or business activity, and not used as a place of residence or accommodation (including hotels, motels, bed and breakfast establishments, serviced apartments and the like). Generally, retail outlets and restaurants in a hotel are commercial units, but rooms, conference rooms and/or banquet halls are non-commercial units. Hence, in the case of a hotel building in a free zone, the revenue should be allocated between the commercial and noncommercial units. This could be based on records of the relevant land registry department or some alternate basis (for example, rental or property value) that results in an arm's length allocation that is reasonable based on the facts and circumstances of each case.

While rental income from restaurants and retail outlets in a free zone may qualify for a 0% tax benefit, the operational income from these businesses may not be eligible for the tax benefit, if it involves direct dealings with natural persons.



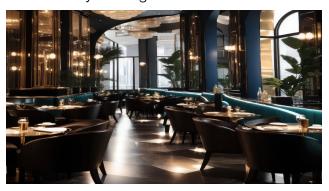
Brand royalties and other intangibles

In case of a foreign brand with Intellectual Property (IP) held in a foreign company, the local hotel operator would be required to pay royalty.

In the case of royalty payments to non-resident brand/IP owners, a 0% withholding tax applies.

Typically, where withholding tax regimes exist, royalties are generally covered within their ambits. As such, if a withholding tax rate is introduced in the UAE CT Law, royalty income (if specified) may be subject to tax in the UAE. In such cases, beneficial withholding rates under applicable tax treaties will need to be reviewed.

For a local brand operating both within and outside the UAE, royalty income will be subject to a 9% corporate tax rate. When receiving royalties from foreign operations, it is essential to consider the following: the tax regulations in the operating country, potential benefits from tax treaties, and the availability of foreign tax credits.



If a local brand has housed its IP right outside UAE in a low-tax jurisdiction with royalty payments taxed below 9%, the participation exemption benefit (available on dividends from foreign companies and capital gains, subject to conditions) may not apply. Consequently, dividends from such entities could become taxable in the UAE in the hands of the parent company.

While income from qualifying Intellectual Property (IP) by free zone entities enjoys a 0% tax rate, this benefit appears tailored for those conducting research and development. Brand being a marketing related IP asset would not be considered as a Qualifying IP.

For related-party transactions, it is essential to evaluate the legal and economic ownership of intangibles, to determine how income generated from them can be divided among related parties. In this regard, a thorough FAR analysis needs to be undertaken to identify the entity performing the Development, Enhancement, Maintenance, Protection, and Exploitation ('DEMPE') function and bearing the associated risks. When it comes to valuing intangibles, the UAE TP Guide, drawing reference from the OECD TP Guidelines, associates appropriate allocation of profits from the transfer or use of intangibles, to be in accordance with value creation.





Shared costs and payment

Considering that headquarters, treasury, and financing services to related parties qualify for a 0% tax rate applicable to a QFZP, an option of housing these functions in qualifying free zones may be evaluated.

Hotel businesses should analyze the shared-cost transactions in detail to determine whether there is a service element or a pass-through arrangement, in order to determine whether the pricing policy adopted meets the arm's length criteria.

In these cases, businesses would be required to maintain adequate TP documentation and intercompany agreements detailing the nature of service availed from/provided to the related party, pricing mechanism, cost allocation, and other supporting documents, in order to demonstrate the substance and fair value of the transaction.

Under staff secondment contracts, if employees (whether management or operational staff) from a foreign entity are seconded to work in the UAE, hotels need to assess the risk of creating a Permanent Establishment (PE) for the foreign entity including options to mitigate the risk through necessary documentation.





Employee benefits and free supplies

Under Article 32 of the UAE CT law, only 50% of any entertainment, amusement, or recreation expenditure incurred for the purposes of receiving and entertaining the customers, shareholders, suppliers or other business partners are tax deductible (the remaining 50% are not allowed in tax computation).

Expenditure can be towards meals, accommodation, transportation, admission fees, facilities and equipment used in connection with such entertainment, amusement or recreation.

The expense is fully deductible when a business provides commercial hospitality (e.g., in-flight entertainment, hotel's packages or mid-week promotions). Also, the above restriction rule does not apply to other marketing expenditures, such as advertising, promotions, attending trade shows, or direct marketing campaigns. E.g., services or products by making them available to the general public at a reduced price or for free, such as a restaurant giving a free meal to a food critic, a spa providing free entry to an influencer, a trial run of hotel facilities offered to a potential bulk buyer of the product, etc., will be fully deductible. However, costs of providing hospitality at an event such as meals, a musical performance, or accommodation will be deductible up to 50%. Given the complexity of the tax deductibility of expenses, a fact-specific review is necessary.

Notably, 100% of entertainment expenditures incurred on staff and employees are deductible for corporate tax purposes. However, hotels often engage manpower service providers to provide personnel often referred to as 'outsourced employees'. Technically, such personnel are not the employees of the company, even though they work with and among other employees. Just like any other supplier, the manpower service providers periodically issue invoices for the supply of manpower services, or the related group company could make a recharge of salary cost. The deduction for entertainment expenditure incurred on such 'outsourced employees' could be restricted to 50 percent.

Hence, costs incurred towards various entertainment expenses need to be documented and tracked properly, which may require changes to the existing IT system.

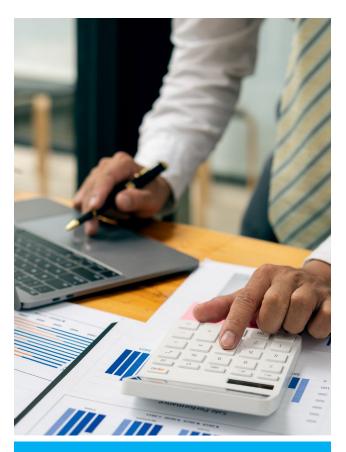
Transfer of free-of-cost supplies amongst related parties could pose a challenge from a TP perspective, unless a strong commercial rationale is built to justify such transfers. It is recommended that the transfer of goods/supply of employees amongst related parties should ideally be undertaken at an arm's length price, to ensure compliance with TP provisions.





Restaurants and food delivery

Interestingly, procurement and distribution of consumables (such as food, beverages, etc.) may qualify as distribution activity, and revenue from such activity could be eligible for free zone exemption. Whether a centralized kitchen established in a qualifying free zone could be more tax efficient can be explored in light of the facts and existing procurement strategies.



Tax grouping option

Tax grouping allows resident parent and subsidiary entities in the UAE mainland to form a tax group, excluding free zones and foreign entities. To qualify, the parent entity must own, directly or indirectly, at least 95% of the shareholding, voting rights, profits, and net assets of the subsidiary. Subsidiaries can join or exit the tax group with FTA approval or if certain conditions are not met. There are specific provisions for carrying forward losses if the tax group changes or ceases to exist.

The benefits of tax grouping include tax savings through the automatic offset of group losses against the tax profits of other entities within the group. It also reduces corporate tax compliance requirements, such as filing returns and maintaining tax records. Intra-group profits are not subject to UAE CT due to elimination, and transfer pricing compliance requirements are reduced. Hotels operating with multiple restaurants as separate entities could explore the option of tax grouping.









VAT

Typically, in tax audits, the FTA notifies a taxable person via email, providing a questionnaire and a template. The files are required to be filled in for the tax period under review/audit, and must submitted within ten working days. The tax period under review can a sample period, or a sample year to the period right from the implementation of VAT.

The statute of limitations for tax audits is five years (or 15 years in the case of tax evasion) from the end of the tax year.

To conduct audits and verify the information submitted in the returns, the FTA has prescribed an FTA Audit File (FAF) with specified fields/information to be maintained by the taxpayer. It would be critical for the taxable person to ensure the audit readiness for data submission, including FAF/sample invoices within the strict timelines, at the time of the actual audit. Failure to submit the required audit data may expose the taxable person to penal implications. The FTA may also conduct field visits to verify the documentation and perform other audit procedures.

Hotels should prepare for tax audits and on-site inspections to demonstrate VAT compliance in their daily business operations.

Corporate Tax

Given that UAE CT Law is practically in its first year of implementation, to our understanding as of today, no CT audit has been initiated by the FTA thus far.

Similar to VAT, the statute of limitations for tax audits for UAE CT is assumed to be five years (or 15 years in the case of tax evasion) from the end of the tax year.

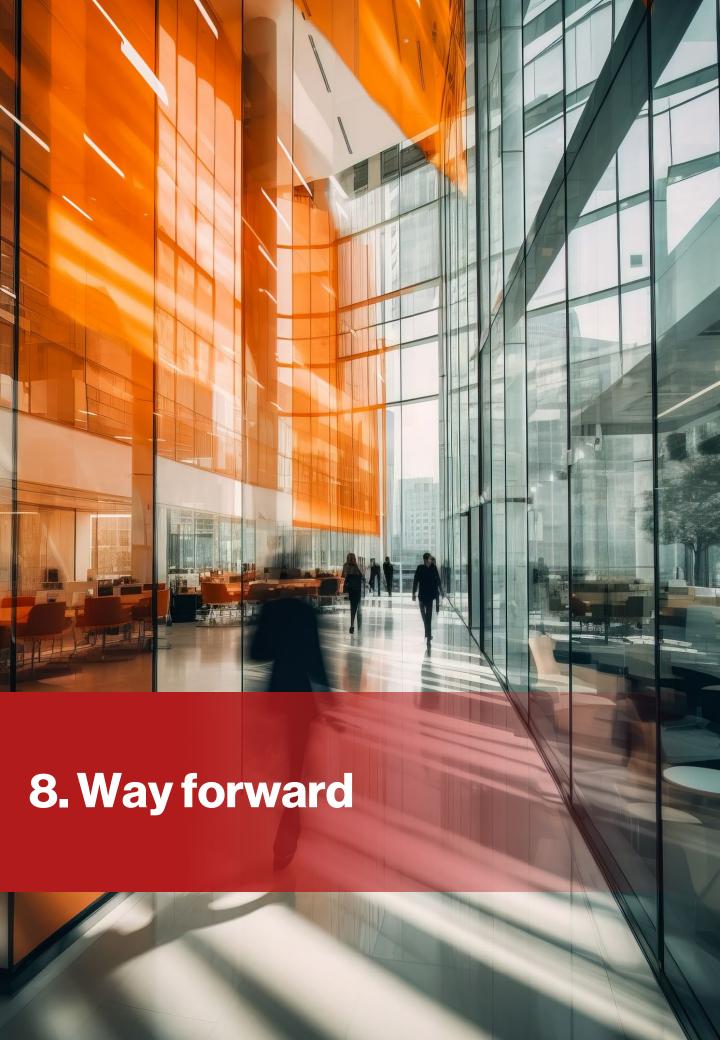
As per UAE CT provisions, businesses are required to maintain all records and documents for a period of seven years following the end of the tax period to which they relate.

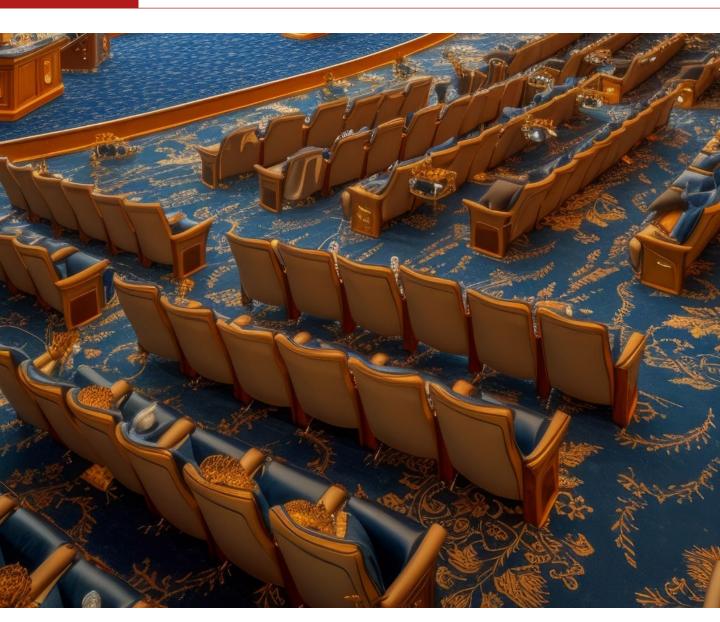
Transfer Pricing

As per the UAE TP regulations, the Local File and the Master File need to be maintained for the financial year in which the prescribed revenue threshold for the business is met (i.e. for tax periods commencing on or after 1 June 2023). The Local File and Master File need to be submitted within 30 days following a request from the FTA, or by such later date as may be directed by the FTA.

It is pertinent to note that the FTA may also request certain information to support the arm's length nature of the transaction, and related documents supporting the TP analysis, from businesses that are not required to maintain a Local File or Master File.

The statute of limitation is five years from the end of the relevant tax period, as prescribed in Federal Decree-Law No. 28 of 2022. In certain specified instances, the period can extend beyond five years.





The UAE hospitality industry is at a critical stage, poised for strong growth while dealing with complex tax environment. At Dhruva, we understand the unique challenges and opportunities this sector faces concerning VAT, Corporate Tax, and Transfer Pricing regulations.

Effective compliance necessitates a comprehensive approach, beginning with employee training to ensure that staff fully comprehend the tax laws. Alternatively, businesses can look at outsourcing their tax functions.

Maintaining detailed documentation and providing clarity and accuracy in financial records while preparing for potential tax audits is vital. We recommend that a yearly tax compliance database is established and maintained, to ensure employee dependency.

Regular audits or health checks are essential for proactively identifying and addressing compliance issues. Our experienced professionals can conduct comprehensive VAT, CT, and TP assessments, enabling you to address gaps and strengthen your compliance framework. Integrating technology solutions can significantly enhance efficiency by automating calculations and transitioning to an e-invoicing regime, which is to be implemented from the start of 2026.



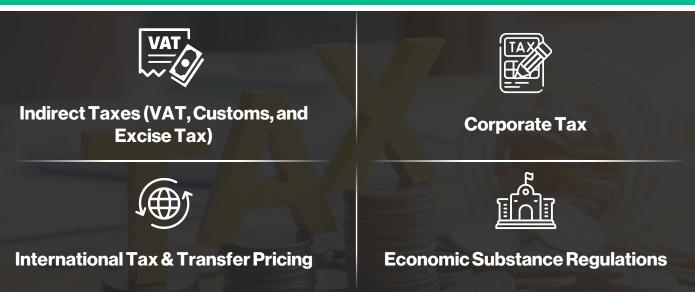


Founded in 2017, Dhruva is the largest tax boutique firm outside the Big4 in the UAE. It comprises a team of over 80 tax professionals. As part of the WTS network, Dhruva has member firms in over 100 countries.

Dhruva has received numerous accolades, including being awarded as the Best Newcomer Firm in Europe and the Middle East for 2020 by the International Tax Review.



Service Offerings



Dhruva's management team brings extensive experience in various sectors, including real estate, hospitality, telecom healthcare, oil & gas, automotive, engineering, pharmaceuticals, IT, consumer/retail, financial services, education, media & entertainment, and hospitality.

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