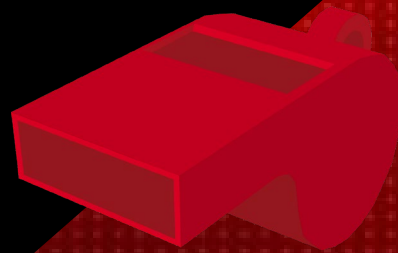


## TAX ALERT

April 30, 2024



# Business Restructuring Relief -UAE CT Guide

## Introduction

The Federal Tax Authority (FTA) has released a helpful guide on Business Restructuring Relief (BRR) under the UAE's Corporate Tax (CT) law. The guide details the covered transactions, eligibility criteria, relief mechanisms, share valuation, tax loss transfers, the impact of clawback provisions on transferors, and transferees, and BRR's interplay with other provisions of the UAE CT law. This alert summarizes the BRR guide's key concepts to aid businesses seeking to apply this relief.

## What is BRR?

Article 27 of UAE CT law allows tax-neutral business transfers between taxable persons in two scenarios: (i) when a business (or independent part thereof) is transferred to another taxable, and (ii) when a business is transferred and the transferor ceases to exist. The following conditions must be met to avail the BRR:

### Essential conditions

- **Legally compliant condition:** Transfer complies with the conditions imposed by applicable UAE legislation
- **Taxable person condition:** Transferor and Transferee are Taxable Persons i.e. either of the following:
  - Resident
    - Entity incorporated in UAE; or

- incorporated outside UAE but effectively managed and controlled in UAE.
- Non-Resident with a Permanent Establishment (PE) in the UAE.
- Neither the Transferor nor Transferee is an exempt person nor a free zone person
- Transferor and Transferee have the same financial year end and prepare financial statements based on the same accounting standards
- **Valid commercial reasons condition:** Transfer is for valid commercial or other non-fiscal reasons reflecting economic reality.

If the conditions are not met or the Transferor does not elect for the BRR, the transfer will be taxable as per the normal provisions of the UAE CT Law. If such a taxable transfer is between related parties, it needs to comply with the arm's length principle.

## Applicability of BRR to illustrative transactions

Applicable	Not Applicable
Conversion of sole proprietorship into LLC	Transfer of assets/liabilities pursuant to liquidation.
Unincorporated partnership opts to be a taxable person, which means a transfer of ownership in business by partners to the unincorporated partnership	Subsidiary merges into its parent and is subsequently dissolved under the law without undergoing liquidation, resulting in the cancellation of its shares by law



Applicable	Not Applicable
Share-based business transfers, mergers/demergers, hive down transactions	Transfer between wholly owned subsidiary and parent without share issuance/ownership interest [ <i>Qualifying Group Relief (QGR)* may apply</i> ]
Transfers between non-resident persons having a PE in UAE	Transfer between the PE and the overseas head office.

*\* Refer to our previous [news alert](#) for details on QGR*

## Consideration for BRR

- Unlike QGR, BRR requires consideration for the transfer to be received by the transferor (*except for transfers from partners to an unincorporated partnership that is treated as taxable persons*).
- Consideration may be received by the Transferor and/or its controlling shareholder (*not required to be a taxable person*), with a direct or indirect ownership interest of at least 50% in the Transferor.
- Consideration may be paid by the transferee and/or its controlling shareholder, who must have a direct or indirect ownership interest of at least 50% in the transferee and be capable of issuing shares or ownership interests.
- Consideration should be in the form of shares or other ownership interests (*determined vide control and economic benefit arising out of such interests*). Ownership interest comprises Ordinary Shares, Preferred Shares, Redeemable Shares, Membership and Partner Interests, and similar securities granting beneficial rights in profit and liquidation, classified as equity under the holder's Accounting Standards.

- Non-share considerations like cash are acceptable if its market value doesn't exceed the *lower of*:
  - the net book value of the assets and liabilities transferred, or
  - 10% of the nominal value of the ownership interest issued.

## Electing BRR

- Similar to QGR, BRR requires an election in the tax return. However, unlike QGR, where one election covers all subsequent transfers, each transaction eligible for BRR demands a separate election by the Transferor (*i.e. no automatic application to future transactions*).

## Consequences of electing BRR

### For the Transferor

- Assets or liabilities transferred are treated as being transferred at net book value. Hence, for the Transferor, there will be no taxable gain or loss on transferring the assets and liabilities.
- Depreciation, amortization, and other adjustments (from the beginning of the tax period in which the transfer is done) up to the transfer date can lower the Transferor's tax. The value of the share and ownership interest received by the Transferor shall be considered as the net book value of the assets/liabilities less the value of any other consideration received by the Transferor. The same value shall be considered as the cost of such shares/ownership interest for computing gains/losses on their subsequent sale.



### For the Transferee

- It is possible that the Financial Statements of the Transferee reflect the Market Value of acquired assets/liabilities. However, for tax purposes and for claiming BRR, the Transferee excludes depreciation, amortization, or other changes in value to the extent attributable to the gain or loss that arose to the Transferor (and was exempt under BRR).
- Unutilized Tax Losses incurred by the Transferor (pertaining to the whole/part of business transferred) before the transfer may be carried forward by the Transferee provided the Transferee genuinely continues a similar business activity i.e. use of the same assets, no change to the core identity/operations, if any, should result from the development or exploitation of pre-existing assets, services, processes, products, or methods. **However, unutilized Net Interest Expenditure cannot be transferred to the Transferee.**

### Implication of subsequent transfer of assets/liabilities

- Upon realization of assets/liabilities i.e. sales, disposal, transfer, settlement, and complete worthiness of any asset and the settlement, assignment, transfer, and forgiveness of any liability, the Transferee is taxed for the previously exempted gain/loss under BRR. Further, it can claim the deduction of the depreciation/amortization /adjustments that have been ignored earlier to the extent of BRR exemption.

### Clawback provisions

- BRR would be clawed back if, within two years, from the date of transfer, any of the following events occurs:

- The shares or ownership interests in the Transferor or Transferee are sold, transferred, or otherwise disposed of, wholly or partially to a non-Qualifying Group member; or
- Subsequent transfer or disposal of the business or independent part of the business.

#### Share transfer Clawback

- Clawback applies only in respect of those shares or ownership interests that the Transferor or the Transferee issued as part of BRR.
- Importantly, the transfer of a single share, which was earlier issued as part of BRR, could trigger the clawback, even if the owners of the other shares in the Transferee remain unchanged
- In cases where a shareholder in the Transferee holds shares obtained through both BRR and other means, if shares are identifiable, clawback applies to those obtained through the relief; otherwise, a "first in, first out" approach is used for shares held.
- It is possible that the Transferor or Transferee will have shareholders who do not meet the conditions to be a part of any Qualifying Group such as an Individual, Exempt Person, Qualifying Free Zone Person, or Non-resident person without PE in UAE. In such cases, clawback provisions would trigger for transfer of shares within two years.

#### Business transfer Clawback

- The clawback provision applies universally to business transfers regardless of whether the transfer is within the tax group/qualifying group, due to liquidations, subsequent transactions covered by BRR, of a transfer of independent business parts by the Transferee.

- BRR is not clawed back in case of operational changes post-restructuring by the Transferee, like consolidating functions resulting in asset disposal or canceling software license not required or altering software, sale, and lease-back of assets, till the same cannot be regarded as a transfer of an independent business.

## Consequences of clawback

- In either case, if clawback is triggered, the original transfer will be treated as having taken place at market value on the date of transfer, and the resulting gain or loss is taxed in the hands of the Transferor in the year of clawback. If the Transferor ceases to exist, the gain/loss is taxed in the hands of the Transferee.
- If the clawback applies, the Transferee will reverse any depreciation, amortization, or other change in the value of the assets and liabilities previously adjusted by the Transferee because of the BRR.

**Clawed back gain/loss for Transferor = Market Value– Original Net Book Value**

*Note - The market value to be considered refers to the market value as on the date of original transfer even if differs from the market value as on the date on which clawback is triggered.*

## Interaction with other provisions granting relief

- **QGR** – A transfer can be eligible for both QGR and BRR. In such a case, a clawback under one relief due to not meeting the conditions under either of the reliefs could nullify the relief, even if conditions for another relief were met.
- **Realisation basis** - If the Transferee has elected for the realisation basis under UAE CT law, the depreciation, amortization, or other change in value adjusted in the previous Tax Period(s) shall be claimed and any gain or loss that was not taxed due to BRR would be taxed on actual realisation. In other words, the transfer of assets and liabilities under BRR is not considered realization.
- **Transitional Relief** – As per the Transitional relief any gain or loss pertaining to the period before the introduction of CT is not subject to tax in the hands of the taxpayer, subject to the applicable conditions. In this regard, the following should be noted:
  - Any transfer made under BRR is not considered a disposal for transitional relief.
  - If a clawback provision is triggered, transitional relief should be claimed in the year in which the clawback is triggered.



## Dhruva comments:

The FTA's BRR guidance clarifies various aspects of the relief to achieve tax neutrality for business transfers. Unlike QGR, it is welcoming to note all business transfers, whether between third parties or related parties, both can seek BRR relief. Businesses should evaluate the applicability and advantages of BRR, considering factors such as accounting treatment, compliance with key conditions, clawback provisions, and alignment with future plans.



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