OVERVIEW OF THE GENERAL ANTI-ABUSE RULES – UAE PERSPECTIVE

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INTRODUCTION AND SCOPE

Anti-abuse rules are a measure to combat tax evasion and the misuse of tax regulations. Anti-abuse rules can target specific types of abuse (Specific Anti-Abuse Rule or SAAR) or these rules can be general in nature. The general rules not specifically designed for a particular abuse are often referred to as the General Anti-Abuse Rules (GAAR), and their primary objective is to deter taxpayers from employing tax planning strategies that lack genuine commercial or economic value and are specifically devised to minimize or evade tax obligations.

Under GAAR, the Federal Tax Authority (FTA) is granted the authority to review any transaction or agreement where the intent is to abuse or violate the purpose of tax laws. It prioritizes the core purpose and economic impact of a transaction or arrangement over its legal form, ensuring that the true intent and financial consequences are evaluated.

A transaction must have a valid commercial or non-fiscal objective in addition to tax benefits. Since virtually all business decisions have tax implications in today's world, it follows that GAAR will radically affect the decision-making process across multiple levels in organizations.

GAAR empowers tax authorities to target sham transactions and colorable devices, and to counteract the abusive elements of arrangements that may otherwise be legally valid. Historically, 'substance' in the form of movement of funds, presence of employees, premises, and/or local expenditure, was a strong defense against allegations that an arrangement was 'sham'. This is not necessarily the case under GAAR, where the focus is on 'purpose' (i.e. whether the arrangement was entered into with the main purpose of obtaining a tax benefit) rather than only on 'form'.

Similarly, GAAR is not restricted to cross-border arrangements, or other arrangements that involve esoteric elements. It could apply to commonly undertaken, routine, day-to-day transactions as well. For instance, it could potentially be invoked in cases of corporate restructurings, funding arrangements, exit planning and other similar structures.

Therefore, the question arises: is tax planning obsolete? Is a taxpayer protected from GAAR solely if he adopts the most inefficient tax-saving option?

If one were to view GAAR as a simplistic 'smell test' that targets transactions giving rise to tax benefits, one may be justified in believing this is the case. But the structure of GAAR is different - though it is wide-ranging, it does not give a carte blanche to the tax authorities to go after anything they disagree with. Thus, the conditions for invoking GAAR are usually specified in the applicable tax statute. Several countries have enacted Statutory GAAR in their tax laws to counter tax avoidance. Some of these are Australia, Canada, Germany, Hong Kong, India, Malaysia, New Zealand, the UK and the USA. At times, even though GAAR provisions are not included in domestic law, the judicial authorities deny tax benefits on the basis that a given transaction abused the law to evade taxes. This is generally termed as Judicial GAAR.

Within the GCC region, UAE is the first country to introduce statutory provisions of GAAR in Corporate Tax (CT) law. Other GCC countries do not have a formal GAAR enactment yet.

Under the UAE Corporate Tax law, GAAR can be invoked by the tax authorities upon fulfillment of the following twin conditions:

A transaction or an arrangement is entered into, **without valid commercial rationale** or **economic justification**.

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The **main purpose** or one of the main purposes of said transaction or arrangement is to obtain a CT advantage.

This publication explains the GAAR provisions under UAE CT law. A methodical approach to these provisions suggests that even after the enactment of GAAR, it ought to be appropriate for businesses to consider tax liabilities when implementing business strategies and, as a matter of fact, to seek methods that are most beneficial from a tax perspective. GAAR will likely be used solely for "tax driven" arrangements with little or no business justification.

The challenging part, of course, lies in knowing where one's transactions fall. What does all this mean for a company, its directors, and its officials? To what extent are existing structures at risk from GAAR? Are there any general safeguards that can be put in place to better manage the risks and uncertainties arising from the introduction of GAAR? Is there still scope for achieving tax efficiency through responsible tax planning? And if GAAR were to be asserted, what defenses could one rely on?

Read on as we try to navigate this.

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CONCEPT OF TAX PLANNING, TAX EVASION AND TAX AVOIDANCE VIS-À-VIS GAAR

TAX PLANNING

"Tax planning" is an acceptable concept within the realm of taxation, where taxpayers utilize fiscal incentives offered by tax laws or the general provisions of the tax laws to minimize tax liability while adhering to the tax law and rules framed. It's important to note that tax planning remains permissible under the prevailing tax regulations, including those enforced under GAAR.

TAX EVASION

"Tax evasion" occurs when an individual or entity deliberately fails to fulfill their tax obligations to the government. It encompasses illegal activities such as intentionally concealing facts, misrepresentation, and fraud. The Organization for Economic Co-operation and Development (OECD) defines tax evasion as "illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from tax authorities.". Tax evasion is strictly prohibited by tax laws across countries.

TAX AVOIDANCE

"Tax avoidance" encompasses actions taken by a taxpayer that are within the bounds of the law, making them technically legal but that are often viewed as undesirable and inequitable. While not forbidden by the law, these actions can undermine taxation's primary goal of collecting revenue effectively. GAAR specifically targets transactions where the sole objective is to avoid taxes. This involves taxpayers employing legal measures that lead to a reduction in their tax liability, measures they would likely not have taken if it weren't for tax savings.

1. Glossary of Tax Terms - OECD

It is widely known that the law does not require people to arrange their affairs so that they incur the greatest possible tax liability. Taxpayers are legitimately entitled to choose the option that requires them to pay the lesser amount of tax. But there comes a point where authorities begin to think that taxpayers are going too far in their attempts to reduce their tax liability. It can be said that at this point taxpayers cease to engage in legitimate tax mitigation or acceptable tax avoidance closer to tax planning, and instead cross over to unacceptable tax avoidance closer to tax evasion.

In general, the term **"unacceptable or impermissible tax avoidance"** is used to refer to artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, arrangement that are usually designed to manipulate or exploit perceived "gaps" in the tax laws to achieve results that conflict with or defeat the intention of the law.

Such tax avoidance strategies are the focus of GAAR.

TAX PLANNING

Method to minimise tax by using all beneficial provisions of the law.

TAX EVASION

Method of evading or reducing tax by dishonest means.

TAX AVOIDANCE

A method to reduce or minimise tax by exploiting or taking advantage of the provisions of law.

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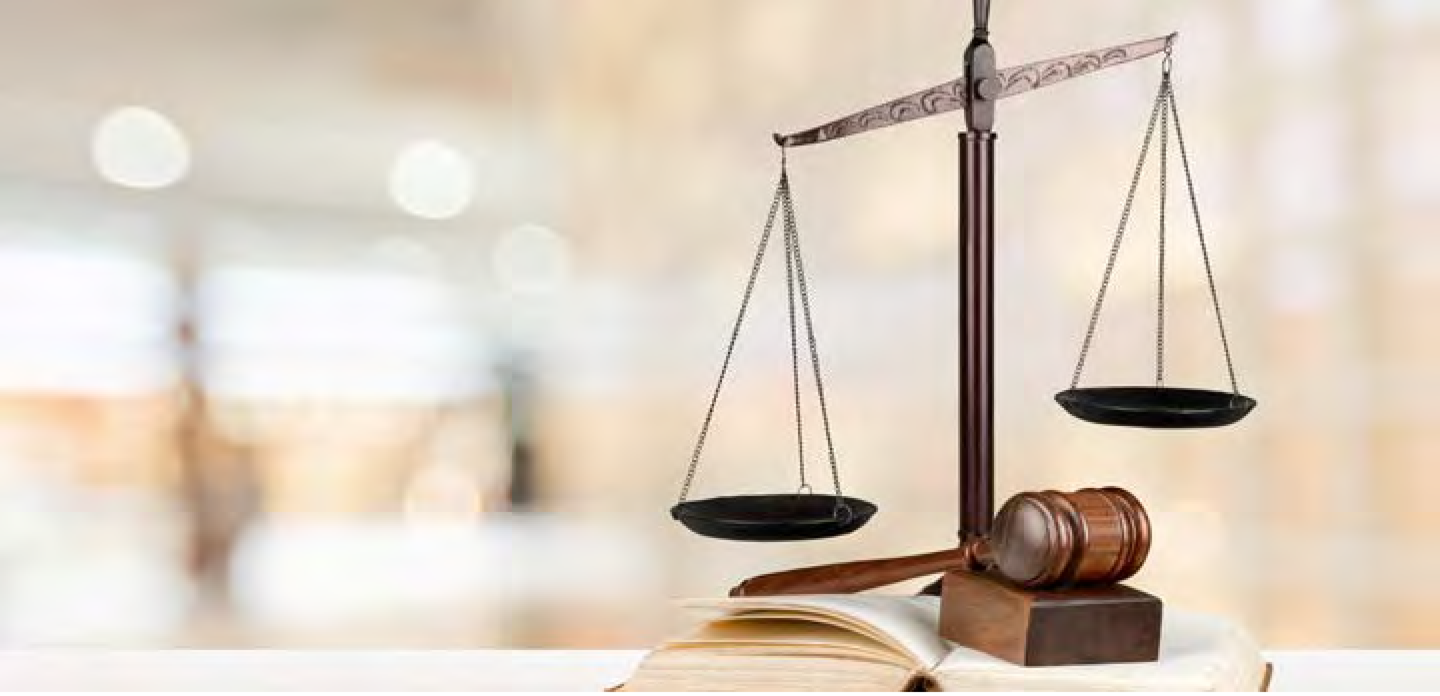
WHEN CAN GAAR BE INVOKED - THE PRECONDITIONS



As per Article 50 of the UAE CT law, GAAR can be invoked where it can reasonably be concluded that:

The taxpayer has **entered into or carried out** a **transaction/ arrangement or any part of it**

There is **no commercial or non-fiscal reason which reflects economic reality**; and

The **main purpose** or one of the main purposes is **to obtain a corporate tax benefit not consistent with the intention of the law**

The above elements may be broadly worded, but they nonetheless carry a specific meaning and are subject to the usual rules of statutory interpretation. Therefore, it is imperative to conduct a thorough, step-by-step analysis of each element, considering the business and commercial implications of the arrangement. This analysis aims to determine the potential applicability of GAAR.

The taxpayer has entered into or carried out a transaction/ arrangement or any part of it

The basic premise of the GAAR concept is the existence of an "arrangement" or "transaction". There is no definition of "arrangement" or "transaction" in the law. The term transaction may be understood to be "a transfer of resources, services or obligations between two parties". Similarly, an "arrangement" may refer to any contract, understanding, plan, action, or set of activities, whether or not they are legally binding. Further, illustratively, a gift, the sale of a business, an amendment to the articles of association of a company, or the opening of a new branch of business could also be considered a 'transaction'. This implies that even unilateral actions could potentially be covered within the ambit of the terms "transaction" and "arrangement".

The law puts the burden of proving the existence of an arrangement/transaction on the tax authorities. However, the words "transaction" and "arrangement" have a very broad meaning and it may be difficult to argue that something does not fall within the scope of a "transaction" or "arrangement". Further, it is relevant to note that the law also provides that any part of the transaction/arrangement can itself qualify as an 'arrangement/transaction'. This makes it easier for the tax authorities to establish the existence of the transaction/arrangement to invoke GAAR.

When can the taxpayer be said to have entered into or carried out the transaction/arrangement?

For the provisions of GAAR to be invoked, it is imperative that the taxpayer has entered into an arrangement. The term 'enter into' is generally understood as 'engaging in' or 'binding oneself by (an engagement, contract, treaty)'.

While the determination of whether the taxpayer has entered or carried out a transaction or an arrangement is intuitive and fact-specific, interesting issues could arise in determining the same in cases of certain shareholder actions such as:

- The casting of a vote by a shareholder in favor of an arrangement;
- Non-exercise of an option available to a shareholder in cases such as buyback, capital reduction, or rights issues;
- A value shift in favor of one shareholder as a result of actions involving other shareholders and the company; and
- A binding arrangement on a shareholder due to a majority decision despite the shareholder having cast his vote against the arrangement.

There is no commercial or non-fiscal reason which reflects economic reality.

Most tax-abusive schemes typically involve little or no economic risk and offer little or no opportunity for pre-tax gain. Rather, the return to the investor takes the form of the significant tax benefits promised by the arrangement. In this manner, a negligible pre-tax profit is transformed into a significant after-tax return. Further, the transaction is generally considered to lack commercial substance if it results in a significant tax benefit for the taxpayer but does not have a significant effect upon either the business risks or net cash flows of that taxpayer.

Bona fide commercial reasons underlying an arrangement or transaction can be considered when it comes to applying GAAR. Such reasons refer to a legitimate business purpose or economic activity not primarily motivated by tax avoidance or evasion. In other words, the reason for undertaking a transaction or arrangement should be based on sound commercial principles and reflect the economic reality of the situation.

In summary, **"commercial substance reflecting economic reality"** is a principle that guides how transactions and events should accurately portray their true economic impact rather than just following their legal form or appearance. Where the transaction or arrangement fails to reflect economic substance, fastening of GAAR is inevitable.

Determining an unjust use of tax laws can be a subjective test. The tax authorities will have to consider various factors to determine the economic reality and applicability of GAAR on transactions and arrangements. UAE law provides an illustrative list of the following factors that should be considered:

- **Manner of transaction:** I.e. how the agreement or transaction was made, signed, and carried out.
- **Nature of the transaction:** The form substance and other relevant details of the arrangement or transaction.
- **Timing of the transaction:** When the transaction or arrangement was entered into or carried out.
- **Result of the transaction:** The outcome of the transaction or arrangement in terms of how the UAE Corporate Tax Law has been applied.
- **Change in Financial Position of Taxable Person:** Any modification to the Taxable Person's financial situation that has been, will be, or may reasonably be anticipated to be caused by the transaction or arrangement.
- **Change in Financial Position of another Taxable Person:** Any modification to another Person's financial situation that has been, will be, or may reasonably be anticipated to be caused by the transaction or arrangement.
- **Creation of rights or obligations of transacting parties:** Whether the transaction or arrangement has created rights/obligations which would not normally be created between independent, unrelated parties.
- **Any other** mitigating facts or circumstances.

In line with the global best practices, GAAR requires that the application thereof must be just and reasonable.

The main purpose or one of the main purposes is to obtain a corporate tax benefit not consistent with the intention of law.

It means the primary purpose of the transaction or arrangement is to obtain a Corporate Tax advantage that is inconsistent with the intent or purpose of the UAE CT Law. Main purpose does not mean sole purpose. The Decree contemplates that an arrangement may have more than one "main purpose" and GAAR provisions can be invoked based on "one of the main purposes" as well.

The purpose is not the same as the motive behind the action. For the purposes of the statute, what is relevant is the 'purpose' and not the 'motive'. In other words, it will suffice to show that the purpose was to obtain the tax benefit, even though the motive may have been (for example) to use the tax savings to obtain a competitive advantage in the market. Takeaways on this point from some judicial precedents in other countries are set out below:

- The mere fact that the arrangement resulted in a tax benefit would not be sufficient to conclude that the main purpose was to obtain a tax benefit. It will also be necessary for the authorities to show the existence of circumstances that point to the conclusion that the main purpose for which the arrangement was entered into was to obtain a tax benefit.
- In many cases, it may not be possible for the tax authorities to provide direct evidence to prove that the main purpose of the arrangement was to obtain a tax benefit. However, this does not shift the burden of proof to the taxpayer to demonstrate that the main purpose was not to obtain such a benefit.
- It is the duty of the tax authorities to demonstrate that the facts and circumstances lead to a reasonable inference that the main purpose was to obtain a tax benefit.
- Once a prima facie inference can be drawn, based on evidence adduced by the tax authorities, that the main purpose of the arrangement was to obtain a tax benefit, the burden may shift to the taxpayer, who must demonstrate that there were other reasons/purposes for undertaking the arrangement.

GAAR provisions may be applied when a person enters into a transaction or arrangement if the main purpose (or one of the main purposes) of the transaction or arrangement is to allow another person to obtain a tax benefit. In other words, the person who has the requisite purpose and the person who obtained the tax benefit need not be the same.

What constitutes tax advantage?

Claiming a refund or an increased refund of Corporate Tax.

Advancement of a Corporate Tax refund or the **postponement** of a Corporate Tax payment.

Avoidance of an obligation to deduct or failing to account for Corporate Tax.

Avoidance or reduction of Corporate Tax due.

The term **"Corporate Tax advantage"** is defined in an inclusive manner and may also include other strategies.

Business shall lead to an optimal allocation of resources, including financial capital and human capital. It is important to note that where taxpayer's activities are driven by the main motive to seek the best allocation of resources and business purpose "outweighs" the tax purpose, GAAR should not apply merely on the grounds that there is a tax advantage. Further, GAAR provisions ought not to apply when a taxpayer satisfies related conditions to avail specific incentives available to him under tax law and thereby reduces his tax liability.

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IMPACT OF GAAR

The impact on taxpayers of invoking GAAR can be significant. When invoked, generally the tax authorities can disregard the transaction/arrangement for tax purposes and tax the taxpayer as if the arrangement/transaction had not been entered. This can result in additional tax liability, interest, and penalties for the taxpayer. The tax authority may cancel the tax benefit or determine a greater obligation when the course of action taken by a taxpayer is so blatant or artificial that it is only explained by the desire to obtain tax saving.

Under UAE CT Law, the tax authority could counteract or adjust CT advantages obtained in the following ways:

- Allowing or disallowing any exemption/deduction/relief
- Allocation of exemption/deduction or relief to another person
- Re-characterization of the nature of any payment disregarding the effect of other CT provisions; and
- If such an assessment impacts the Corporate Tax liability of any other Person, then such effect shall be remedied by making compensatory adjustments to the Corporate Tax Liability of said Person. For instance, if the assessment of the Taxable Person results in the allowance of an expense in a transaction with another Party, thus reducing its overall tax payable, counter-adjustment shall be made by taxing the income that has been recorded in the other party's books.

For a compensating adjustment to be made, it is required that the person is affected by the transaction or arrangement.

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RISKS AND DEFENSE IN GAAR ERA

As we have discussed, GAAR empowers the tax authority to disregard any transaction or arrangement that is considered abusive or contrary to the object and purpose of the tax laws. This provision allows the FTA to re-characterize or disregard any transaction entered with the main objective of obtaining a tax advantage, even if the transaction is legally valid and has economic substance.

Here are some examples of situations that could be at risk under GAAR in the UAE tax laws if the transactions are entered into primarily for tax avoidance purposes without any commercial or economic justification:

1. A company sets up a complex corporate structure involving multiple entities in different jurisdictions purely for tax optimization purposes and with no commercial substance or economic rationale.

2. A business owner enters a series of artificial transactions with related parties, such as loans or transactions with no real economic purpose, with the sole intention of reducing their tax liability.

3. A company shifts its profits to low-tax jurisdictions or countries where it has no real operations or employees, to minimize its tax liability in the UAE.

4. A business owner enters a transaction or arrangement that is specifically designed to take advantage of a tax provision without any commercial or economic reason to do so.

To avoid GAAR risk, businesses may consider the following:

- Taxpayers must demonstrate that transactions have genuine commercial and economic substance and are not solely undertaken for tax avoidance purposes. The following questions may set a guideline for arriving at a conclusion:
  - → Is the true intention of the parties reflected in the agreement, i.e., are any risks and rewards resulting from transactions expected?
  - → Has the taxpayer remained insulated from virtually all economic risk while creating a carefully crafted impression to the contrary?
  - → Is there a realistic possibility of profit?
  - → Does the taxpayer have non-tax reasons (business, commercial, family, investment, etc.) to conduct the transaction?
  - → Have the economic consequences of the transaction/arrangement been adequately researched?
  - → Has the taxpayer genuinely invested capital (at risk) in the transaction/arrangement?
  - → Are the parties conducting transactions at Arm's Length?
- Comprehensive defense documentation explaining the commercial rationale behind transactions is essential.
- The "Look at" approach is no longer valid; focus on explaining the reasons behind actions.
- Only obtaining tax benefits cannot constitute a legitimate reason.
- Validate the intention behind the transactions/arrangements.
- Assess commercial objectives through alternative scenarios.
- The purpose should be adequately substantiated.

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MISCELLANEOUS ASPECTS

Specific Anti Abuse Rules (SAAR) in addition to GAAR	• Specific rules for specific arrangements are part of the UAE CT law. • E.g. interest limitation rules, Related party payment rules, limitation on loss, c/f rules, etc.
GAAR and Transfer Pricing (TP)	• GAAR applies beyond TP regulations. • E.g. transfer pricing can limit certain deductions to arm's length prices whereas GAAR can disallow deductions entirely.
GAAR vs Tax treaties	• Whether UAE GAAR provisions when invoked can deny tax treaty benefits is a question that needs clarity. It may be possible to deny treaty benefits without invoking domestic GAAR.
Absence of a monetary threshold	• Unlike in other countries, there is no monetary threshold provided for invoking GAAR in the UAE.
Absence of specific exclusions	• There are no specific exclusions to the applicability of GAAR under UAE CT law.

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WAY FORWARD

With GAAR in effect in the UAE, businesses need to review their business arrangements, not just those created for tax planning. This includes agreements with both related and unrelated parties, even if tax benefits were obtained unintentionally.

Previously, taxpayers didn't have to keep documents to prove the business purpose of a transaction or arrangement. However, under the new rules, the taxpayer will be responsible for showing that a transaction isn't primarily aimed at avoiding taxes.

Periodic reviews must be performed of existing arrangements from a fresh perspective to evaluate whether GAAR can adversely impact taxation of future income streams and deductions arising out of those existing structures.

In today's context, any discussion on the structuring of a transaction would not be complete without debating its potential exposure to the provisions of GAAR.

The implementation of GAAR in tax matters requires tax authorities to consider all relevant facts and circumstances. It's the authorities' responsibility to make decisions based on just and reasonable grounds.

Review and document the commercial, non-tax rationale for existing structures/arrangements.

Conduct periodic reviews of existing transactions/structures in light of updated laws.

Analyse GAAR risk before entering into new transactions/ arrangements.

While the introduction of GAAR has caused concerns among taxpayers, its impact will largely depend on how tax authorities apply it. If used effectively to prevent abusive tax avoidance, GAAR can be a powerful deterrent.

However, there is still uncertainty about the scope of these provisions, their interaction with SAAR, and their application in the context of tax treaties. Given that GAAR is relatively new, different interpretations may lead to various challenges and issues.

Based on the experiences of other countries, GAAR is a complex and contentious tax legislation for affected taxpayers. It requires entities to pay close attention to the commercial purpose, substance, and documentation of transactions when facing a GAAR review. When GAAR is invoked, the burden of proof shifts to taxpayers, who must demonstrate that their transactions aren't primarily aimed at tax avoidance but are supported by genuine commercial and economic reasons. Thus, having proper documentation explaining the commercial aspects of a transaction becomes crucial.

GAAR is expected to play a significant role in the future of tax administration and compliance.   Taxpayers should stay informed about developments in this area and be prepared.

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