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UAE CT LAW – FROM ACCOUNTING PROFIT TO TAX PROFIT

Swipe

ACCOUNTING VS. TAX PROFIT

The accounting profit of a business entity is stated in its financial statements which are reported to stakeholders

Taxable income is that amount on which Corporate Tax is payable to the Government

Taxable income often differs from accounting profit due to various adjustments made for tax computation

These adjustments can include adding back certain non-tax-deductible expenses, deducting certain payments, and accounting for any tax credits or reliefs available under the tax law

It is important to know the differences and adjustments to the accounting profit for taxable income computation

COMPUTING TAXABLE INCOME UNDER UAE CT LAW

BASIS

Accounting profit from financial statements prepared as per accepted accounting standards

PERIOD

Financial year followed by the companies for accounting purposes

METHOD

Accrual unless permitted otherwise by the authorities

TAX COMPUTING MECHANISM

Particulars	Amount (in AED)
Accounting profit / (loss) as per financial statements	XXX
Add/Less: Tax law adjustments	XXX
Final Taxable Income	**XXX**
Tax on Income upto AED 375,000 @0%	(A) 0
Tax on taxable income above AED 375,000 @9%	(A) YY
Total CT liability (A+B)	**YY**
Less: WHT / Foreign Tax Credit*	(YY)
Final CT Payable	**YY**

* Foreign tax credit allowed = Foreign tax paid or UAE CT payable on foreign sourced income whichever is lower. Further, the balance foreign tax credit left, if any, cannot be carried forward / backwards.

In case of losses, the computation with adjustments must be done to identify the tax loss. Tax losses can be carried forward with no year limit and set-off upto 75% of the taxable income in the year of set off.

GENERAL ADJUSTMENTS IN TAX COMPUTATION

1. **Add/Less:** Unrealised Gain / Losses (including forex gains/losses)*

2. **Reduce** Exempt Income, e.g., dividends from UAE companies or income from the participation exemption

3. **Adjust** reliefs provided for transfers within qualifying groups and business restructuring

4. **Add/Less**: specific provisions as per law

5. **Adjust** differences for related party / connected person transactions where the prices are not at arm's length

6. **Less:** Tax losses of other persons as allowed under the law in prescribed circumstances

* Taxpayer may elect to either tax all unrealised gains/losses on a realisation basis or only capital account unrealised gains/losses to be taxed on a realisation basis.

THE DEFAULT RULE FOR EXPENSES

WHOLLY AND EXCLUSIVELY INCURRED BUSINESS EXPENSES ARE ALLOWED

WHAT IS NOT ALLOWED?

- Any capital expenses – Assets purchased can be claimed in the form of depreciation / amortisation over their life span
- Non-business / personal expenses*
- Expenditure incurred in deriving Exempt Income e.g., collection charges against exempt dividends*
- Losses unrelated to taxable business
- Any other prescribed expenses

* Common expenses incurred, if any, should be allocated on a reasonable basis.

SPECIFIC RULES FOR INTEREST AND ENTERTAINMENT EXPENSES

INTEREST EXPENSE

Net interest expenditure deductible up to **30% EBITDA subject to max prescribed amount**

Net Interest expenditure = Total Interest expenses for the year + b/f Interest expenditure – Taxable Interest Income

Related party debts used to finance exempt income, then interest is not deductible unless commercial rationale proved

Balance net interest expense would be **carried forward** and utilised in the subsequent 10 years

ENTERTAINMENT EXPENSE

50% of entertainment expenditure incurred for customers, shareholders, suppliers, or other business partners

Entertainment expenses include meals, accommodation, transportation, admission fees, facilities / equipment used for entertainment / recreation etc.

100% of entertainment expenditure incurred on staff and employees are deductible

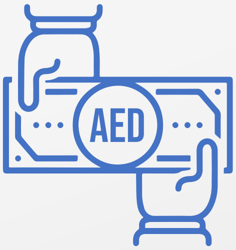
Balance 50% of entertainment expenses **not allowed to be carried forward**

IMPORTANT POINTS

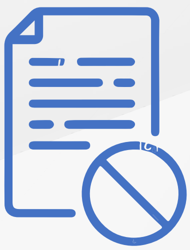
NON-DEDUCTIBLE EXPENSES

- Non qualifying donations/grants/gifts
- Fines/penalties (including business fines and penalties)
- Bribes / Illegal payments
- Dividends
- Capital withdrawal by Individuals / partners
- Corporate Tax
- Recoverable VAT
- Foreign Taxes
- Other prescribed expenses

RISK OF TP / GAAR ADJUSTMENTS



If transactions with the related parties and connected persons are not at arm's length



Commercial and economic substance of transaction resulting in tax advantage not proved

ILLUSTRATION

CALCULATION OF CT LIABILITY OF ABC LLC

Particulars	AED ('000)	AED ('000)
Accounting profit before taxes and dividend		**1000**
Add:		
Unrealised forex losses	100	
Collection charges for dividends	50	
Interest expenses in excess of 30% of EBITDA	70	
Entertainment expenses 50%	50	
Unapproved charity	100	
Penalty	30	400
Less:		
Dividend received in UAE	100	
Unrealised forex gains	50	(150)
Taxable Income		**1250**
Taxable Income upto AED 375,000	0%	0
Taxable income in excess of AED 375,000, i.e. (AED 1250,000-375,000)	9%	78.75
Less: Foreign tax credit (Foreign Sourced income assumed as AED 100,000) Country A WHT 100,000*15% =15,000 or UAE Tax 100,000*9%=9,000, whichever is lower		9
Final CT Payable		**69.75**

POINTS TO BE NOTED

- Apportionment of common expenses incurred for business / non-business and exempt / taxable income to be substantiated with appropriate documentation
- Bifurcation in capital and revenue expenses as per accounting and tax to be validated – especially, to ensure that all capital expenses are available as depreciation or amortisation for tax purposes
- Entertainment expenses on employees are to be identified and separated since they are allowed at 100% for tax purposes.
- Penalties are not tax deductible and need to be tracked and disallowed
- Arm's length prices between related parties / connected persons need to be benchmarked and documented appropriately
- Capital gains which are not exempt under participation exemption are taxed as regular income at 9%
- Foreign tax payment proof to be documented for claiming credit

PARTING THOUGHTS

With the implementation of Corporate Tax Law, taxpayers may consider preparing draft tax computations based on their latest financials

With a forward-looking approach, scenario planning and assumptions would help in planning and implementing changes as may be required

OUR TEAM

Nimish Goel
Partner

K Venkatachalam
Partner

Hany Elnaggar
Associate Partner

Kapil Bhatnagar
Associate Partner

Anna Nikolaiko
Senior Manager

Harpal Chudasama
Senior Manager

CONTACT US

WTS Dhruva Consultants

207, Emaar Square, Building 4,
PO Box 127165, Dubai, UAE

1905, Addax Tower, City of Lights,
Al Reem Island, Abu Dhabi, UAE

Email: corporatetax@dhruvaadvisors.com

Website: https://www.wts-dhruva.com/