CLEARY GOTTLIEB

ALERT MEMORANDUM

The United Arab Emirates Taxation of Corporations and Businesses

January 10, 2023

On December 9, 2022, the much awaited Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses (the "**CBT Law**") was published by the United Arab Emirates (the "**UAE**") Ministry of Finance.

The background

A January 2022 announcement by the UAE Ministry of Finance, concerning the introduction of a federal corporate and business tax ("**CBT**") on business profits, set out the contours of the new tax framework. Following release of a Public Consultation Document in April 2022, aimed at obtaining input from interested stakeholders, the finalized legislation has been published and will apply to tax periods commencing on or after June 1, 2023. Relevant and useful guidance can be found in recently updated FAQs and other guidance published by the UAE Ministry of Finance.

What are the objectives of the new tax legislation?

As declared by the Ministry of Finance, the CBT Law is an important milestone in building an integrated tax regime that supports the strategic objectives of the UAE and enhances its global economic competitiveness. The overall objective of this regulation is to meet international standards for tax transparency and prevent harmful tax practices.

This alert memorandum provides a high-level overview of the CBT Law and its key provisions. It does not purport to be an exhaustive summary of the CBT Law.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

ABU DHABI

Gamal Abouali
+971 2 412 1720
gabouali@cgsh.com

Lynn Ammar
+971 2 412 1714
lammar@cgsh.com

Rawad Abou Jaoude
+971 2 412 1721
raboujaoude@cgsh.com

Misthura Otubu
+971 2 412 1813
motubu@cgsh.com

PARIS

Anne-Sophie Coustel
+33 1 40 74 68 00
acoustel@cgsh.com

Hugo Latrabe
+33 1 40 74 68 00
hlatrabe@cgsh.com

NEW YORK

William L. McRae
+1 212 225 2188
wmcrae@cgsh.com

LONDON

Richard Sultman
+44 20 7614 2271
rsultman@cgsh.com

clearygottlieb.com

© Cleary Gottlieb Steen & Hamilton LLP, 2023. All rights reserved.
This memorandum was prepared as a service to clients and other friends of Cleary Gottlieb to report on recent developments that may be of interest to them. The information in it is therefore general, and should not be considered or relied on as legal advice. Throughout this memorandum, "Cleary Gottlieb" and the "firm" refer to Cleary Gottlieb Steen & Hamilton LLP and its affiliated entities in certain jurisdictions, and the term "offices" includes offices of those affiliated entities.

I. In a Nutshell

The CBT Law will create a regime levying tax at a standard rate of 9 percent on taxable profits exceeding a level set by the UAE cabinet of ministers, currently expected to be AED 375,000 (equivalent to USD 102,000).

Free zone entities meeting certain requirements will benefit from a 0 percent CBT rate on qualifying income.

Numerous exemptions are available and will benefit different organizations such as government entities, certain government controlled entities, pension funds, investment funds, and public benefit organizations.

II. Timing

June 1, 2023	The UAE CBT Law will become effective for financial years starting on or after June 1, 2023.
Examples	Companies with their financial year starting on July 1 and ending on June 30 will become subject to CBT as of July 1, 2023. Companies with their financial year starting on January 1 and ending on December 31 will become subject to CBT as of January 1, 2024.

III. Scope

Local entities (including free zone entities), foreign companies that operate in the UAE through a permanent establishment[1] and natural persons operating a business or a business activity in the UAE[2] are subject to the provisions of the CBT Law.[3] In addition, foreign persons that do not have a permanent establishment, but have other income sourced from the UAE, are in principle subject to withholding tax, though the rate is currently 0 percent.

Entities exempted under the CBT Law include government entities, government-owned or government-controlled entities, certain companies engaged in the natural resources business (extractive and non-extractive), qualifying charitable bodies, qualifying investment funds ("**QIFs**"), and public pension or social security funds (or private, if regulated) ("**Pension Funds**"). Wholly-owned subsidiaries of government entities, QIFs, or Pension Funds that exclusively hold assets or invest funds for the benefit of the exempt entity or undertake some or all of the activities (or ancillary activities) of the exempt entity are also exempt from CBT.

In order to prevent the unintentional creation of a permanent establishment for foreign funds though the existence of an investment manager (whether a natural person or a legal entity), the CBT Law introduced the investment manager exemption referred to in footnote 1 in light of international principles.

Unincorporated partnerships will be treated as fiscally transparent and therefore not subject to CBT at the entity level, except in the case where a partnership applies to be treated as a taxable person under the CBT Law and thereby elects to be subject to entity-level tax. In the absence of such an election, the income of a partnership is taxed at the level of the partners.

[1] Criteria for the operations of a foreign company to be considered a permanent establishment are set out under the CBT Law and include having a fixed place of business in the UAE. Subject to meeting certain criteria set out by the CBT Law, an investment manager acting as an independent agent of a foreign company shall not be deemed a permanent establishment.

[2] A cabinet decision will provide further details on the businesses and business activities of natural persons that are subject to the CBT Law.

[3] CBT will not apply to an individual's salary, other employment income (whether received from the public or private sector) or other personal income earned from bank savings or deposit programs or from investment in real estate in his or her personal capacity.

IV. Key Provisions

CBT Rates: The applicable CBT rate for taxable income is 9 percent and would be triggered where the income of the relevant entity exceeds an amount to be set by cabinet decision, currently expected to be AED 375,000. The CBT rate for income not meeting that threshold is 0 percent.

Free Zones: For qualifying free zone entities, qualifying income would remain untaxed, whereas, for non-qualifying taxable income, the 9 percent rate will apply. The term "qualifying income" is currently undefined, but a definition is expected to be provided in the future through a cabinet decision. The 0% tax rate for qualifying income applies for the remainder of the tax holiday period specified under the law establishing the relevant free zone (such period may be discretionally extended for a period not exceeding 50 years, subject to the fulfilment of required conditions). To be considered a qualifying free zone entity, such entity must, *inter alia*, maintain adequate substance in the UAE, derive qualifying income, comply with transfer pricing rules, and not have otherwise elected to be subject to the CBT Law. Notably, qualifying free zone entities, like other taxable entities, are required to register and file a CBT return. The tax benefits from using qualifying free zone entities have been limited by virtue of their exclusion from certain dispositions of the CBT Law relating to the formation of tax groups and to group and business restructuring relief.

Exempt Income: Dividends and other profit distributions received from a UAE legal entity, as well as distributions received from a participating interest (5% or more held for at least 12 months) in a foreign company, are tax-exempt. Similarly, capital gains, foreign exchange gains/losses and impairment gains/losses derived from a participating interest, and income from certain foreign permanent establishments are also tax-exempt, in addition to income derived by non-resident businesses from operating aircraft or ships in international transportation.

Deductions: Net losses can be carried forward to future tax periods indefinitely, subject to certain conditions. Such loss carryforwards can offset up to 75% of the taxable income of future periods. In addition, CBT payers may deduct net interest expenditure up to 30% of EBIDTA, if such CBT payer's net interest expenditure is above a threshold to be specified by the Minister of Finance. Where a loan is obtained by way of an intra-group transaction from a "Related Party" of the taxable person (e.g., close relatives of natural persons and affiliated companies of legal entity taxpayers), interest will not be deductible unless the CBT payer can demonstrate a valid commercial reason behind obtaining the loan. Entertainment expenditure will be deductible at 50%.

Withholding Tax: The withholding tax rate for cross-border payments of certain UAE derived income[4] is set at 0 percent, subject to modification by cabinet decision.

Foreign Tax Credit: Tax paid under the laws of a foreign jurisdiction for income or profits earned outside the UAE can be credited against taxes due under the CBT Law, up to the full amount of such taxes. Any excess foreign tax credits in a given year cannot be carried forward or back to offset liabilities in other years.

Transfer Pricing: Transactions between UAE CBT payers and their "Related Parties" and "Connected Persons" (e.g., owners and directors) must meet the arm's length standards for the purposes of determining taxable income. The CBT Law sets out a detailed methodology to determine if a transaction is on arm's length terms[5]. If a transaction is not deemed to be at arm's length, the tax authority will adjust the amount of taxable income to achieve arm's length results.

[4] A cabinet decision will provide further details on the income subject to the withholding tax.

[5] In short, a transaction is considered arm's length if the same result would have been realized had the transaction been entered into between independent parties, under similar circumstances.

Tax Groups: A parent company that directly or indirectly holds 95% or more of the share capital, voting rights, profits, and net assets of its subsidiaries may apply to the tax authority to form a consolidated tax group with these subsidiaries. All companies forming part of such a tax group must be UAE-based and shall be treated as a single taxable person for the purposes of the CBT Law. Under most circumstances, transactions between members of a tax group do not need to comply with transfer pricing rules.

Anti-abuse provisions: The CBT Law's anti-abuse provisions would need to be considered in case of any restructuring.

International Agreements: The terms of international agreements in force, including double-taxation treaties, would take precedence over the terms of the CBT Law in the event of inconsistency.

V. Further Observations

- The CBT Law does not specify a special CBT rate for UAE entities belonging to multinational groups within the scope of Pillar Two of the OECD's BEPS project (the model rules for a 15% global minimum tax). As the UAE is a member of the OECD BEPS Inclusive Framework, additional guidance may be released in due course on the implementation of the Pillar Two rules.
- Many provisions of the CBT Law remain subject to further clarification by way of decisions of the cabinet and the Minister of Finance.

…

CLEARY GOTTLIEB