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UAE Corporate Tax Law and IFRS Perspectives on 'Deferred Taxes'

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IAS-12 Income Taxes

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- International Accounting Standard (IAS) - 12 prescribes guidelines for accounting of income taxes.
- The primary complexity in tax accounting stems from the difference between taxable profits and accounting profits.
- In essence all the differences can be divided into two categories.

Permanent differences

Do not impact future taxable profits

Eg: exempt income, fines and penalties, entertainment expenditure in excess of 50%, etc.

Interesting fact

Unlike countries like India, depreciation is not a temporary difference in UAE.

Temporary Differences

- Impact future taxable profits
- Differences that arise between Carrying Amount (CA) and tax base of an Asset/Liability

Eg: interest expenditure (thin capitalization), unrealized gains/losses, tax losses, etc.

Tax Expense: A broad overview

Tax expense

- **Current Tax**
  Income tax payable for **current period**
  - arises in respect of **taxable profit** for current tax period
- **Deferred Tax**
  Income tax payable for **future periods** due to temporary differences
  - **Deferred Tax Asset (DTA)***
    arises in respect of **deductible temporary differences**
  - **Deferred Tax Liability (DTL)**
    arises in respect of **taxable temporary differences**

*DTA is recognized only if it is probable that taxable profits will be available in the future

UAE CT Law – Enacted or Substantively Enacted

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According to IAS-12:

Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been **enacted** or **substantively enacted** by the end of the reporting period.

Here's a breakdown of the key dates related to the introduction of corporate tax in the UAE:

October 10, 2022

- The **Corporate Tax Law** was published in the Official Gazette, making it legally effective 15 days later

December 9, 2022

- The UAE Ministry of Finance published the full text of the law, **Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses**

January 16, 2023

- The **Cabinet of Ministers Decision No. 116** clarified that businesses would be subject to corporate tax starting from the beginning of their first financial year **on or after June 1, 2023**.

UAE CT Law- Potential Temporary Differences

- Unrealised gains & losses
- Interest capping i.e thin capitalisation
- Tax losses
- Goodwill arising on business acquisition

Deferred Tax Assets (DTA)

- It arises due to deductible temporary differences.
- The fundamental principle is that you pay more taxes today, which will be allowed as a deduction in future while calculating tax expense.
- Instances that may lead to creation of Deferred Tax Asset:

Assets | Carrying Amount < Tax Base

Liabilities | Carrying Amount > Tax Base

Carried forward losses

Interest expenditure carried forward

Provisions for bad debts

Deductible Temporary DIfference x Tax Rate = DTA

Deferred Tax Assets (DTA)

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Example- Net Interest Expenditure

Amount in AED

Relevant extracts of Company X	Amount	Amount
Year-1		
A- Net Interest Expenditure (assumed no interest income)		**80,000,000**
EBITDA	200,000,000	
(a) 30% EBITDA	60,000,000	
(b) de-minimis threshold	12,000,000	
B- Deductible interest expenditure for the tax period being higher of (a) and (b)		**(60,000,000)**
Interest expense disallowed and carried forward to subsequent tax period (A-B)		**20,000,000**
Deferred Taxes		
Amount booked in books of accounts (C)		**80,000,000**
Tax base (D)		**60,000,000**
Deductible temporary difference (E=C-D)		**20,000,000**
Tax rate(F)		**9%**
Deferred Tax Asset (E*F)		**1,800,000**

Deferred Tax Assets (DTA)

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Example- Carried Forward Losses

Amount in AED

Relevant extracts of Company X	Year- 1	Year- 2
Taxable Income/(Losses)	**(12,000,000)**	**13,000,000**
Brought Forward Tax Losses	-	(12,000,000)
75% of taxable income	-	(9,750,000)
Loss eligible for set-off	-	(9,750,000)
Loss carried forward for indefinite period	**(12,000,000)**	**(2,250,000)**
Deferred Taxes:		
DTA – Opening Balance	**-**	**1,080,000**
DTA – For the Period	**1,080,000**	**(877,500)***
DTA – Closing Balance	**1,080,000**	**202,500**

*DTA created in year – 1 reversed in year -2 up to set-off of AED 9,750,000

Deferred Tax Liabilities (DTL)

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- It arises due to taxable temporary differences.
- The fundamental principle is that you pay less taxes today, which will be added while calculating tax expense in future.
- Instances that may lead to creation of Deferred Tax Liability:

Assets	Carrying Amount	>	Tax Base
Liabilities	Carrying Amount	<	Tax Base

Taxable Temporary Difference x Tax Rate = DTL

Interesting fact

Corporate Tax doesn't provide any unconditional benefit which may result into creation of DTL.

Deferred Tax Liabilities (DTL)

Company -A
(UAE Resident)

invests AED 200,000

Shares/securities

Indian stock market

Year-1 end

Cost -200,000

Fair Value- 250,000

Deferred Tax Implications	Amount in AED
Historical cost	200,000
Carrying Amount	250,000
Tax Base	200,000
Taxable Temporary difference	50,000
Tax rate	**9%**
Deferred tax liability	**4,500**

*Company-A measures it's investments at FVTPL
**Company-A opts to tax gains on realization basis

Thoughts to Ponder

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Small Business relief

Are People opting for Small business relief required to account for DTA/DTL?

Free-Zones

Do QFZPs need to account for DTA/DTL?

Participation exemption

Will this create a permanent difference or a temporary difference?

BEPS Pillar II

Are MNCs expected to create DTL since the 15% tax rate is substantively enacted?

Deferred Tax Evaluation – Opening balances

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However, Cabinet of Ministers Decision No. 116 states that businesses would be subject to corporate tax starting from the beginning of their first financial year on or after June 1, 2023

No corporate tax liability will arise for any gains during the financial year 2023. That is, even if the assets/liabilities are settled in future, the gain attributable to financial year 2023 will not be liable to tax.

According to IAS-12, the tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Since the economic benefits derived during the year 2023 are not subject to corporate tax, their tax base is equal to their carrying amount

Hence, DTA/DTL provisions may not be necessary for the financial year 2023.

(However, one may adopt a conservative approach and create DTA/DTL).

Summary

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- **Tax expense**
  - **Current Tax**
    - **Income tax payable for current period**
  - **Deferred Tax**
    - **Income tax payable for future periods due to taxable differences**
      - **Permanent Difference**
        - **they do not impact future taxable profits**
          1. Entertainment expenditure in excess of 50%
          2. Fines and penalties paid to government
          3. Participation exemption
      - **Temporary Difference**
        - **difference between C.A and Tax base**
          - **Deductible temporary difference**
            - **Deferred Tax Asset**
              1. Interest expense disallowed
              2. Tax losses carried forward
              3. Unrealised loss on Assets/Liabilities
              4. Gain on bargain purchase
          - **Taxable temporary difference**
            - **Deferred Tax Liability**
              1. Unrealised gain on Assets/Liability
              2. Goodwill arising on business combination

Thank You!

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