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Expenditures and Exemptions under UAE CT

Simplified for you by MICS

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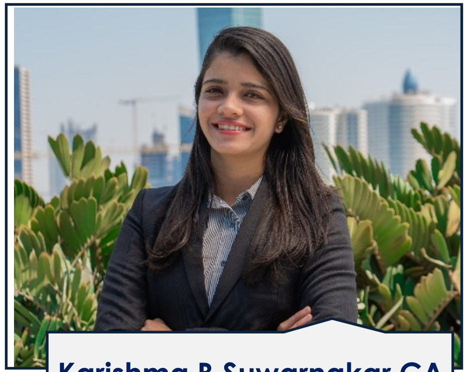

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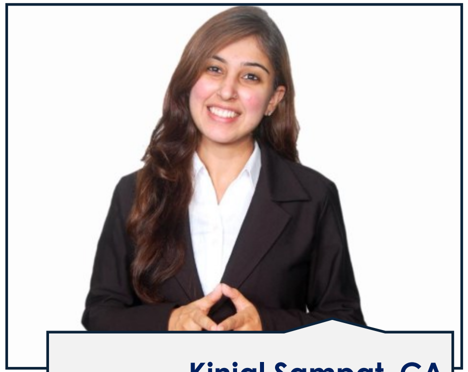

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Our Webinars/Seminars/Staff Trainings

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19 MAY 2022

Understanding Public Consultation Document

23 JUNE 2022

Understanding UAE CT with SME souk

19 DEC 2022

UAE CT Law Simplified

25 MAY 2023

Unravelling UAE CT

14 JUNE 2023

Taxability of Free Zone entities

rakez

10 AUG 2023

Simplifying freezone taxation

11 AUG 2023

Revaluation of Assets / Liabilities

17 AUG 2023

Seminar at ICAI Abu Dhabi Chapter

31 AUG 2023

UAE CT Fund and Fund Manager Taxation

07 SEPT 2023

Staff Training for Shipping industry

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14 SEPT 2023

UAE CT In partnership with Tally Solutions

15 SEPT 2023

Staff Training for real estate industry

27 SEPT 2023

CT in association with ***Dubai eye & EY***

21 DEC 2023

Natural Person Taxation

21 JAN 2024

Taxation on Tax Groups under UAE CT

rakez

22 FEB 2024

Family Foundations in UAE

07 MAR 2024

CT Registration Deadlines explained

21 MAR 2024

TP - Managerial Remuneration

25 APR 2024

Taxability of Free Zone Entities

Our videos on UAE Corporate Tax

UAE CT Simplified

UAE CT Explained as per Public Consultation Document

SMEsouk presents Webinar on Corporate Tax

UAE CT Law Simplified (Federal Decree Law)

Revaluation of Assets & Liabilities

Taxation on Natural Person

Family Foundations in UAE

CT Registration

Our videos on UAE Corporate Tax

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Transfer Pricing – Managerial Remuneration

Deciphering the complexities of UAE Free Zone Taxation

UAE CT Opinion Articles in Newspapers

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- 11 Sep 2023 Impact of corporate tax on real estate investors in the UAE
- 18 Sept 2023 Impact of corporate tax on Investment funds investment managers and investors
- 25 Sep 2023 Impact of corporate tax on freezone entity
- 2 Oct 2023 Impact of corporate tax on manufacturing companies
- 23 Oct 2023 Exempt Income
- 26 Oct 2023 Tax Groups
- 31 Oct 2023 Transfer Pricing and arms Length Principle ,Documentation

UAE CT Opinion Articles in Newspapers

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- 5 Nov 2023 Commodity traders in UAE
- 11 Nov 2023 UAE's single-digit corporate tax regime: Redefining global standards for fiscal efficiency
- 10 Dec 2023 MNE Taxation
- 19 Dec 2023 Accounting standards
- 28 Dec 2023 Taxation on Foreign Entities
- 03 Jan 2024 Taxation on Natural Persons
- 09 Jan 2024 Understanding BEPS 2.0 pillar two rules and implementation strategies

UAE CT Opinion Articles in Newspapers

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- 24 Jan 2024 UAE family foundations
- 31 Jan 2024 A guide to foreign tax credits in UAE corporate tax law
- 07 Feb 2024 UAE tax exemption dynamics
- 16 Feb 2024 Key Management compensation & transfer pricing dynamics
- 26 Feb 2024 Tax groups and qualifying groups
- 13 Mar 2024 CT Registration Deadline
- 02-Apr-24 Treatment of incorporated vs unincorporated partnerships

UAE CT Opinion Articles in Newspapers

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22-Apr-24 CT Registration for Foreign Entities

05-May-24 CT implications on UAE real estate investors

13-May-24 Tax Treaties Transforming UAE's Corporate Tax

Topics covered

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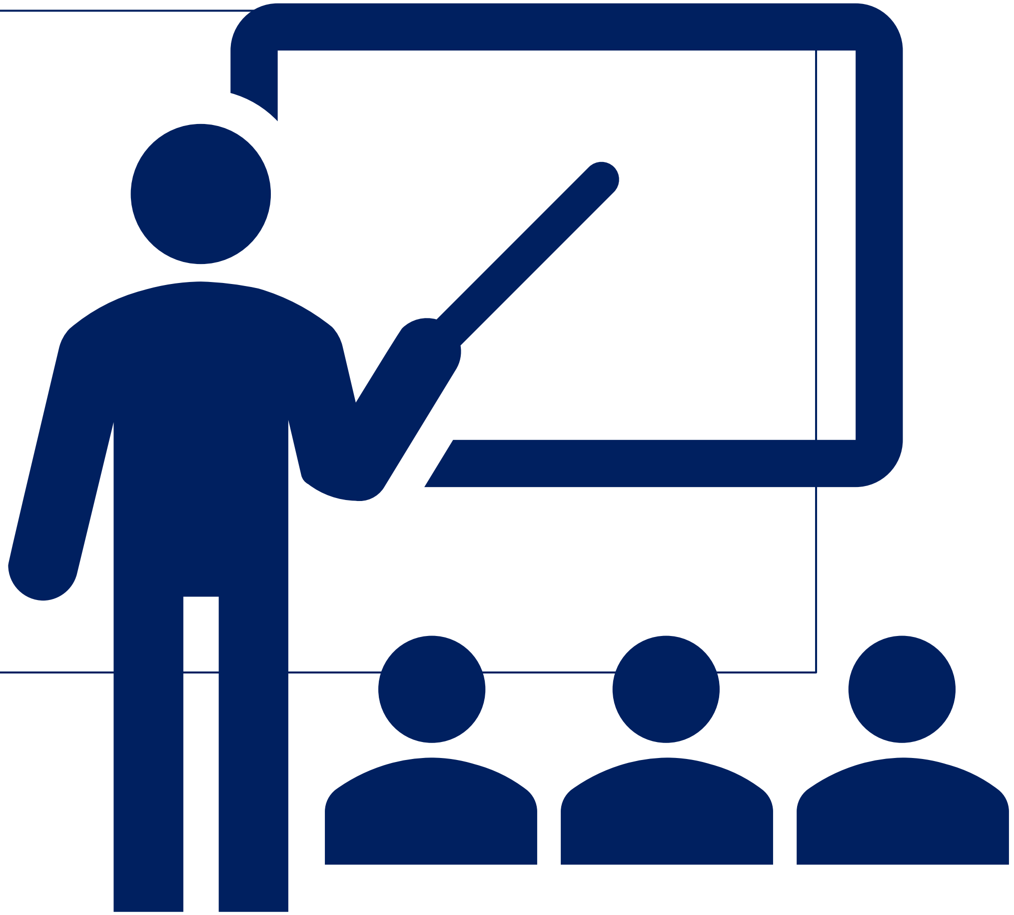
In this Webinar we will understand about

- Taxable Income and it's computation
- Deductible & non-deductible expenses
- Capital vs Revenue expenditure
- Special provisions for expenditures
- Entertainment and Interest expenditure
- Exempt Income
- Participation Exemption & Interest
- Holding, Ownership and Asset Test
- Foreign PE Exemption



Taxable Income

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- ❑ Taxable Income = Accounting net profit (or loss) as stated in FS as per IFRS , IFRS for SME
- ❑ Financial Statements prepared on accrual basis, unless opt for cash basis
  - *small businesses and individual entrepreneurs may opt for cash basis if Revenue < AED 3 million or,*
  - *exceptional circumstances, submitting application to the FTA*

Adjustments to Taxable Income

1. Unrealised gains/losses (subject to the election made);
2. **Deductions not allowable for tax purposes;**
3. Intra-group transfers;
4. **Exempt income such as dividends, Capital Gains,etc**
5. Adjustments for transactions with Related Parties and Connected Persons;
6. Any incentives or special reliefs reliefs; and
7. Tax Losses (subject to 75% of taxable income)
8. Any other adjustment specified by the Ministery

Computation of taxable income

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Particulars	Amount (AED)
Accounting Profits as per Profit & Loss Account	XXX
Adjustments -	
• Unrealized Gains/Losses on Capital Assets/Liabilities	XX
• Exempt Income - QFZP Relief	XX
• Qualifying Group/Business Restructuring Relief	XX
• **Deduction of Allowable Expenditure/Addition of Disallowable Expenditure**	XX
• Transaction with Related Parties or connected persons	XX
• Tax Loss Relief	XX
• Any Incentives or Special Reliefs for a Qualifying Business Activity	XX
• Any Income/ Expenditure previously not taken into consideration	XX
Net Taxable Income	**XXX**
Qualifying Income	**XX**
Non- Qualifying Income	**XX**
CT Payable @ 0% on Qualifying income	**XX**
CT Payable @ 9% on Non-Qualifying income	**XX**

Deductions

Deductible & non-deductible expenses

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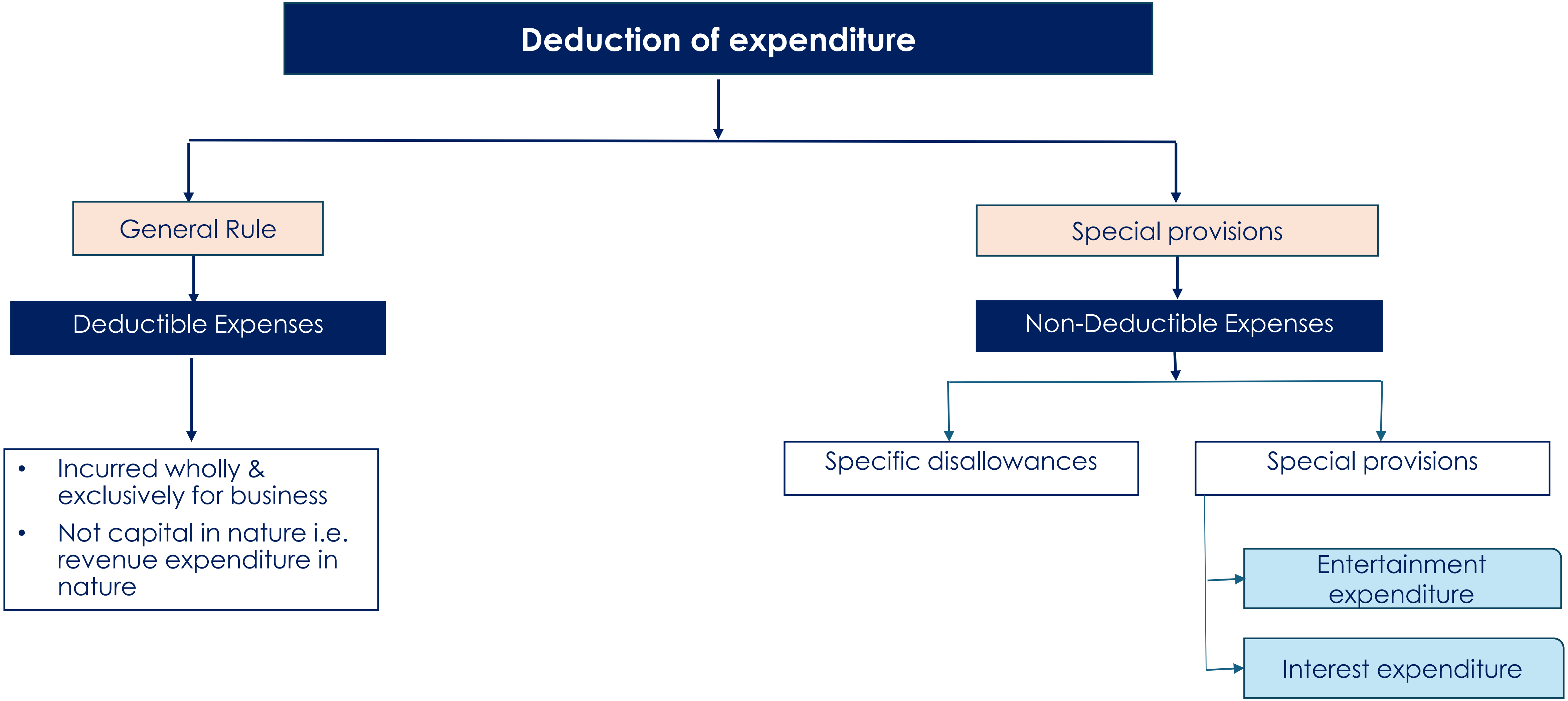

General Rule

Wholly and exclusively for business

Purpose of the expenditure

Wholly and exclusively for business

Fully deductible

Partly for business and partly for some other purposes

Apportion
- Identifiable wholly and exclusively for business
- Fair and reasonable basis

Fully deductible

What is fair and reasonable basis?

- Depends on facts and circumstances
- Accurately reflect the activity
- No burdensome and complex
- Understandable by FTA for review

General Rule

Capital vs Revenue expenditure

Capital Expenditure	Revenue Expenditure
Creates enduring benefit i.e. a long term benefit to the business	Supports the day-to-day operations of the business
Increases your earning capacity	Does not increase the earning capacity
Significant one-time cost	Routine regular costs
Deduction over the period of time (depreciation or amortization)	Deduction in the same year in which incurred
Not Deductible in Y1	Deductible in Y1

General Rule

Capital expenditure

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Tax period 1

Company A

Purchase of Land

On 1 April 2023
Purchase cost
AED 3 Mn

Fees paid to real
Estate Agent AED
0.09 Mn

Total cost of land = 3.09 Mn

Fees of AED 0.09 Mn
Capitalized as per IFRS

Tax period 4

Company A

Sold the land

Selling Price
AED 3.3 Mn
(no depreciation
on land)

Taxable gain = AED 3.3 – AED 3.09 = AED 0.21 Mn

Special provisions

Expenditure specifically disallowed

- Deriving exempt income
- Losses not connected with business
- Donations, Grants, Gifts to non QPBE
- Fines, Penalties, not being compensation for damages or for breach of contract
- Bribes or illicit payment
- Dividends, Profit distributions
- Drawings by sole proprietor or partner
- Corporate Tax
- Recoverable input VAT
- Tax imposed outside UAE i.e. foreign taxes (withholding or direct payments)
- Transactions with Related party not at ALP (market value of the service)
- Others, as specified

Special provisions
Expenditure in earning exempt income

Company A

Derives dividend income only from another UAE entity

pays salary to employee

Salary expense – Not deductible

Company A

Derives dividend income and other taxable income

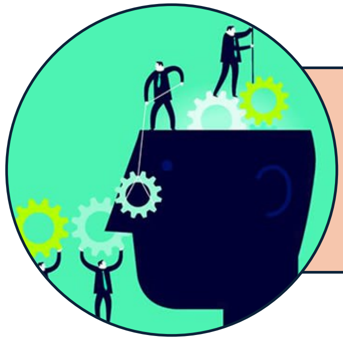
pays salary to employee

Salary expense partially deductible

Suitable documents (for instance timesheets), for apportionment of time in earning dividend income and other income to be maintained.

Special provisions

Managerial remuneration



Sole Establishment/Proprietorship :

Remuneration – Not Deductible/Allowable

Company/ LLC/FZC :

Remuneration to KMP – Allowable , if at ALP

Special provisions
Entertainment expenditure

Entertainment expenditure includes:

- Meals
- Accommodation
- Transportation
- Admission fees
- Recreation and amusement
- Such other as specified

Taxable person's

- Clients
- Partners
- Suppliers
- Customers
- Shareholders

50% deduction subject to general rule

Taxable person's

Employees

100 % deduction subject to general rule

Special provisions

Entertainment expenditure

Company A

Organizes golf for clients and spends AED 10,000

AED 5,000 allowed as entertainment expenditure

Company A

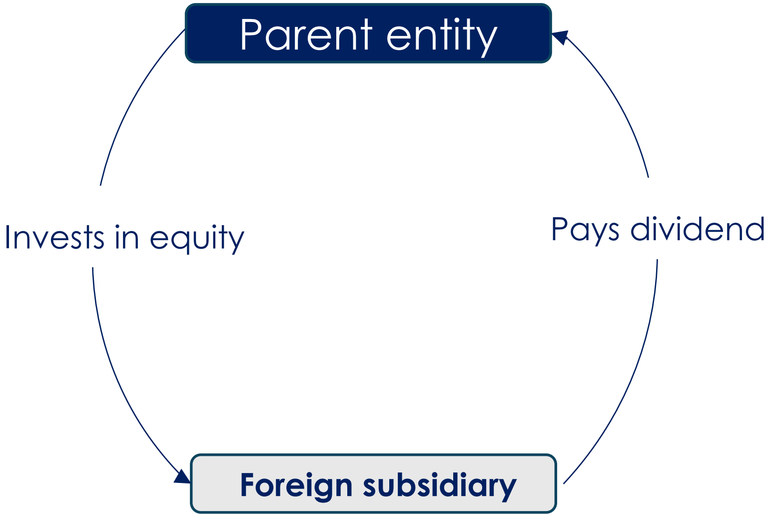
Organizes golf for clients and family and spends AED 10,000 where 25 percent audience is family and 75 percent audience is client

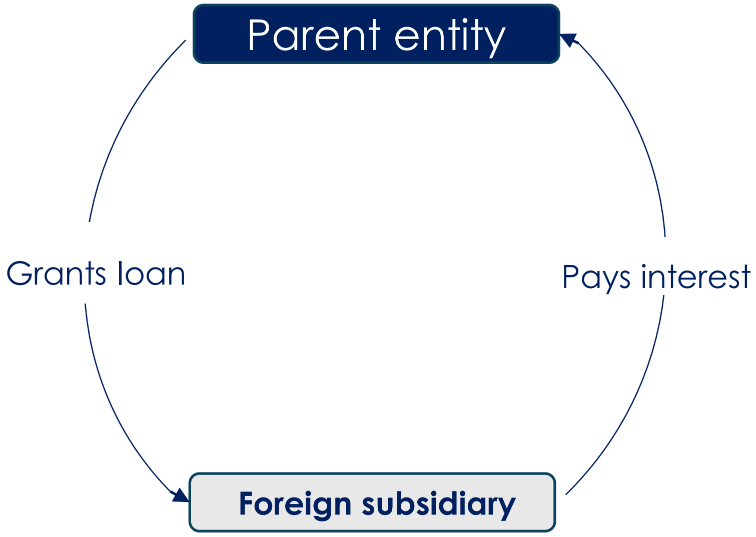
AED 3,750 allowed as entertainment expenditure (10000*75%*50%)

Special provisions

Interest deduction – thin capilization

- Interest on debt is generally deductible from taxable income at the corporate level as against dividend which is not deductible.
- Institution of thin capitalisation rules to restrict deductibility of interest above a certain debt level.
- Typically, for restriction of payment of interest to related parties. However, no such provisions in UAE CT law and applicable for all.





- Dividend taxable in the hands of parent entity
- No deduction of dividend available to F Co.

- Interest taxable in the hands of parent entity
- Deduction of interest available to F Co.

Special provisions

Interest deduction – thin capilization

Taxable person's **Net Interest Expenditure*** would be deductible up to **higher** of:

a) 30 percent of EBITDA (excluding exempt income)
b) AED 12,000,000.

***Net Interest Expenditure**= Interest Paid during the tax periods (+) Interest disallowed in earlier tax period and carried forward (–) Interest Income derived during the tax Period
All foreign exchange gains and losses accruing from interest shall be considered Interest

- Excess expenditure to be disallowed
- Carry forward up to **10 subsequent periods**
- No difference in treatment for related person and unrelated person (varies from OECD BEPS Action Plan)

The above provision is not applicable to the following persons:

a) Banks
b) An Insurance provider
c) A natural person undertaking a business or business activity in the state.
d) Any other person as may be determined by the Minister.

Not applicable on Qualifying Infrastructure Project person in relation to Qualifying Infrastructure Project.

Special provisions

Interest deduction – thin capilization

Relevant extracts of Company X	AED	AED
Year-1		
A- Net Interest Expenditure		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**
Year-2		
A- Net Interest Expenditure (AED 9,000,000 for CY + 20,000,000 for PY)		29,000,000
EBITDA	50,000,000	
(a) 30% EBITDA	15,000,000	
(b) de-minimis threshold	12,000,000	
B- Deductible interest expenditure for the tax period being higher of (a) and (b)		15,000,000
Balance to be carried forward to future years		**14,000,000**

Special provisions

Interest deduction – other considerations

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What about the loan agreements entered in past?

Grandfathered for loan agreements entered into prior 9 December 2022

Can I deduct interest incurred in relation to loans from related parties?

Yes, subject to end use. Not allowed if, used by related party for:

a) dividend or a profit distribution
b) capital contribution
c) acquisition of an ownership interest

Exception

- Not to gain CTA
- Deemed no CTA, if

Related party subject to tax rate > 9 percent

Exempt Income

Exempt Income

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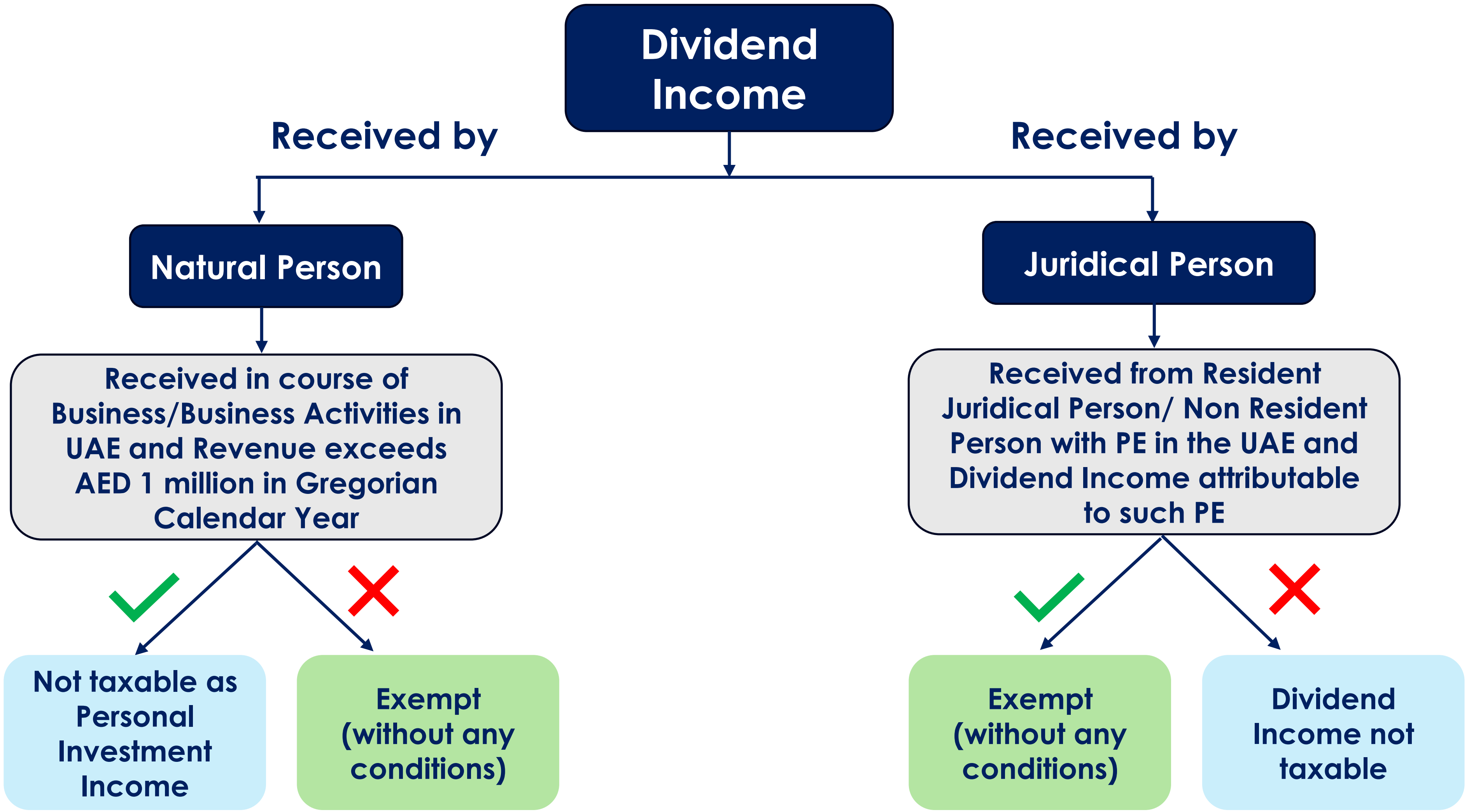
- Dividends & other Profits Distribution from Resident Juridical Person
- Dividends & other Profits Distribution from Foreign Juridical Person subject to Participation Interest*
- Any other Income from Participation Interest
- Income from Foreign Permanent Establishment (subject to conditions)
- Income from Non Resident Person Operating Aircraft /Ships in International transportation (subject to conditions)

Domestic Dividend Income



Participation Exemption

USA

Company A

Profits earned: USD 100,000
Taxes paid in USA : USD 10,000
Distributes Dividend : USD 10,000

Distributes Dividend USD 1,000

UAE

Company B

10% Shareholding in Company A
Dividend received : USD 1,000
Taxes to be paid : USD 90

USD 1,000 Dividend leads to double taxation, as taxable in Company A as well as Company B, thus Participation Exemption

Participation Interest

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Significant , Long Term Ownership Interest in a Juridical Person i.e. Participation

< 5% ownership interest in Participation *(minimum ownership test)*	Acquisition cost of the ownership Interest <= AED 4 million *(minimum acquisition cost test)*	Participating Interest held or intended to be held for uninterrupted period of at least 12 months *(holding period test)*
Participation liable to CT or foreign tax at least 9% *(subject to tax test)*	Ownership Interest entitles holder to at least 5% of the profits/liquidation proceeds in participation *(entitlement to profits/liquidation proceeds test)*	Not more than 50% of direct/indirect assets of the participation must consist of ownership interests which would not qualify for PE if held directly *(Asset Test)*

Taxable Person if Tax group/qualifying group all tests , aggregation to be done

Participation Interest

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- **Participating Interest conditions satisfied**
  - **Domestic /Foreign Participation**
    - Gains/Losses on transfer /sale/disposal of Participating Interest (Capital Gains)
    - Foreign Exchange Gains/Losses
    - Impairment Gains/Losses
  - **Foreign Participation**
    - Dividends/ Other profit distributions
    - Any other Income like Income from Services provided or Interest on loan provided

Exempt Income

Taxable Income

Minimum Ownership Test/ Minimum Acquisition Cost Test

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Ownership Interest : any equity/similar interest that carries right to profits/liquidation proceeds of participation
Owner of Ownership Interest : *Economic Owner & not mere legal owner/ person acting as agent, nominee, fiduciary or administrator

Minimum Ownership Test

Ordinary Shares

Membership and Partner Interests

Preferred Shares

Options

Redeem able Shares

Islamic Financial Instruments or combination of arrangements

Treated as equity under IFRS

Minimum Acquisition Cost Test

Acquisition Cost exceeds AED 4million for an uninterrupted period of 12 months

Value of contributions + subsequent contributions – repayment of equity - cost attributable to ownership transferred + expenses incurred for acquisition

- All amounts to be quantified in UAE Dirhams
- Aggregation of acquisition costs of different ownership interest

Holding Period Test

- Participating Interest held for uninterrupted period of 12 months
- Tested on the date when Income from Participating Interest derived
- Benefit can be availed even on Intention to hold
- Different ownerships to be aggregated while testing

Subject to Tax Test

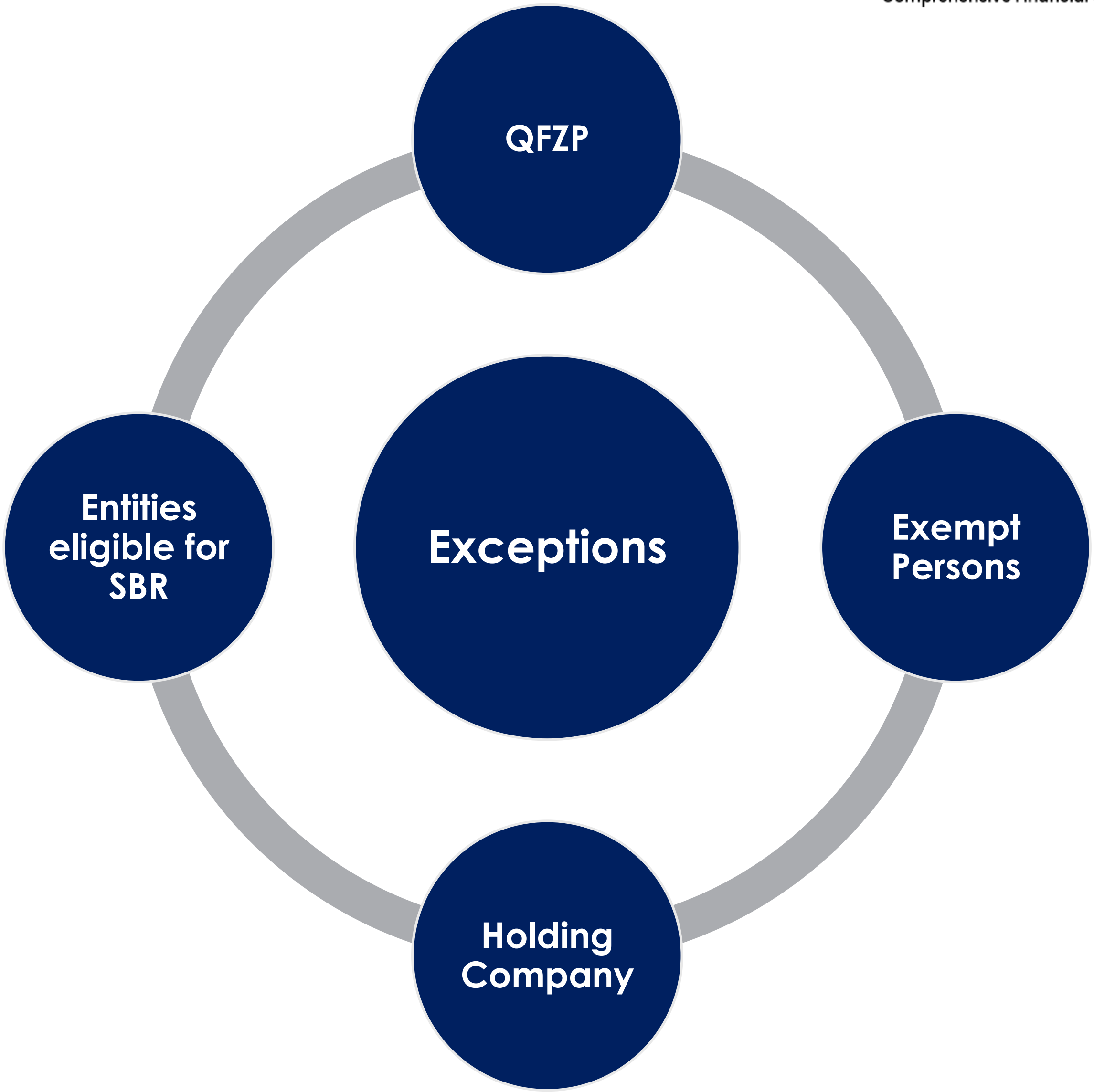
Participation subject to

UAE Corporate Tax

Foreign Tax of at least *9%

*If tax rate less than 9%, then effective (actual/theoretical) tax rate to be calculated

Actual Effective Tax Rate : Actual Tax paid during tax period/ Profits before Tax under Accounting Standards	Theoretical Effective Tax Rate : Recalculating Accounting Net Profits on the basis of UAE CT



Asset Test

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Direct/Indirect Assets meet definition of Ownership Interests

- Assets can potentially constitute a Participation e.g. Equity Investment Assets

Those Assets tested for Participation Exemption

- Qualifying Ownership Interest/ Total Assets <= 50%

50% test to be met throughout the entire tax period

- 50% of consolidated balance sheet or market valuation

Asset Test

Company B (a company incorporated and resident in the UAE) holds 10% of the shares of Company E (a company incorporated and managed outside the UAE). Company E in turn directly and indirectly holds shares in several subsidiaries. All companies have a Financial Year i.e. Jan-Dec. Company E's consolidated balance sheet as of 31 August and 31 October shows the following values (book values) in AED:

Particulars	31st August, 2024	31st October, 2024
Total Assets	100,000	100,000
Investments (ownership interests) consisting of :	70,000	50,000
○ Qualifying Ownership Interest	10,000	30,000
○ Non Qualifying Ownership Interest	60,000	20,000
% of Direct and Indirect Assets consisting of Non-Qualifying ownership interest	60%	20%

Company E resolves to distribute a Dividend as of 31 October.

- Although the asset test is met at the time of the Dividend distribution (i.e. 31 October), the test is not fulfilled for the whole Tax Period of Company B. As such, the asset test is not satisfied.
- Thus, the Dividend is not exempt from Corporate Tax under the Participation Exemption. Assuming the non-qualifying percentage stayed below 50% until the end of the following Tax Period, the asset test could be met in that subsequent period.

Foreign PE Exemption

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- **Resident Person – make an election for Foreign PE Exemption**
  - **Election accepted**
    - Income & associated expenses not taken into account
    - Income & associated expenses calculated as if foreign PE is Resident Person in the UAE
    - No Foreign Tax Credit available for taxes paid in Foreign country
    - Exemption applicable only if the Foreign PE subject to CT or similar tax in foreign (not less than 9%)
    - ALP to apply for dealings between Resident & Foreign PE
  - **Election not accepted**
    - Foreign PE taxable in UAE

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Q & A Session

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