

An aerial photograph of a modern city, likely Dubai, featuring a large canal with turquoise water. On the left, a prominent skyscraper with a curved facade and a star-shaped base is visible. The city is densely packed with high-rise buildings and modern infrastructure. The image is overlaid with a semi-transparent orange banner containing text.

# AURIFER

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# AURIFER MIDDLE EAST TAX

## UAE CIT

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Dubai (UAE) • 27 August 2023

## AURIFER

# Freezones – Are they really free from CIT?

# Qualifying Free Zone Person

## ARTICLE 18 OF CIT LAW

- ▶ Free Zone person to meet following conditions to be Qualifying FZ Person:
  - ▶ Maintain **adequate substance**
  - ▶ Derives **Qualifying Income** (yet to be defined)
  - ▶ **No election** to be subject to 9%
  - ▶ Meets **Transfer Pricing** requirements (ALP and documentation)
  - ▶ Audited financial statements
- ▶ Failure to meet one condition disqualifies FZ entity

# Qualifying Free Zone Person & Qualifying Income



- ▶ Latest Legislation
- ▶ Cabinet Decision **No. 55** of 2023;
- ▶ Ministerial Decision **No. 139** of 2023.
- ▶ Undersecretary of Finance: “FZ regime intended to apply to income derived from **activities** that are performed **exclusively in or from within a FZ**”.
- ▶ Public Consultation closed on 9 August – changes to be expected

# Qualifying Income

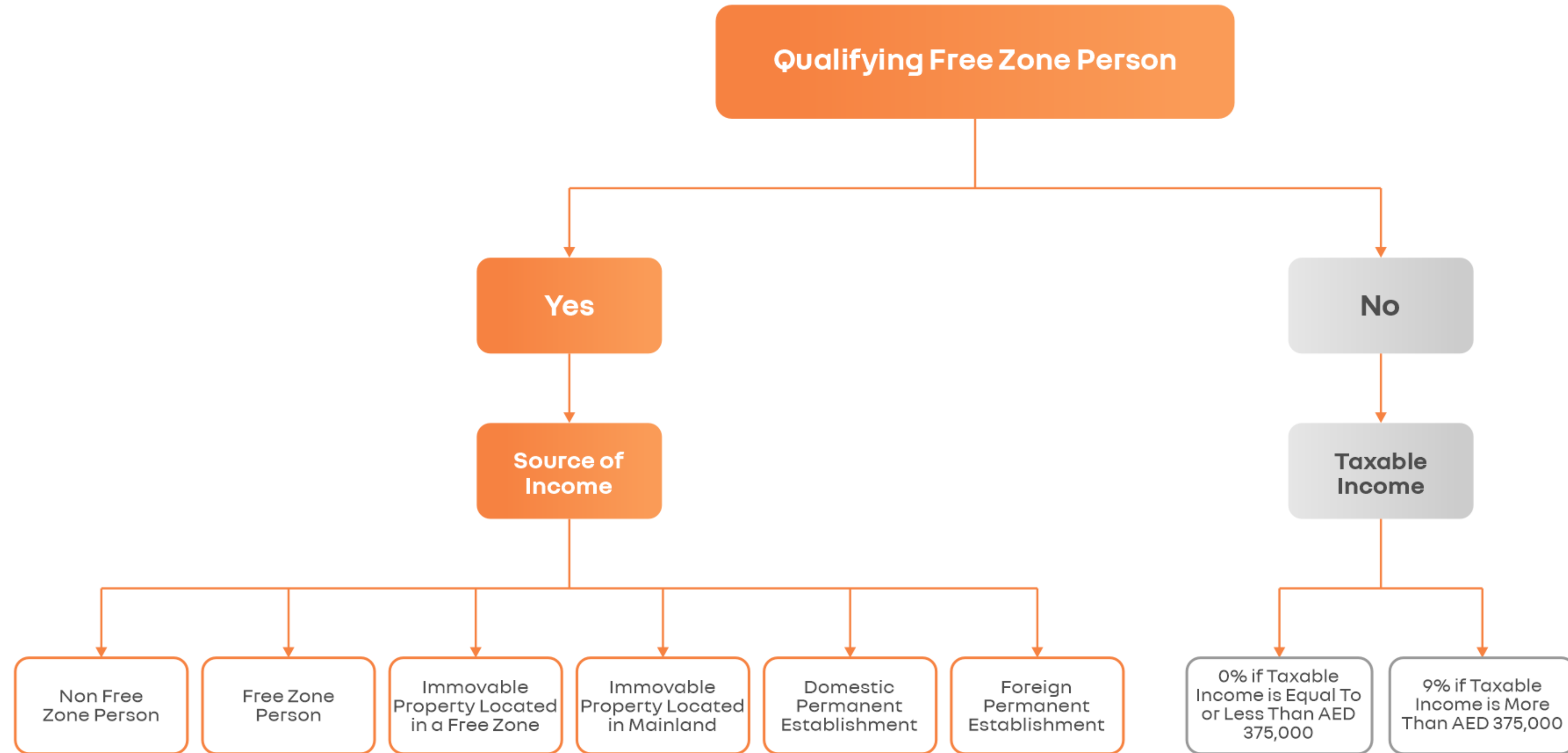
## ARTICLE 3 OF CABINET DECISION NO. 55 OF 2023

- ▶ Qualifying Income includes:
  - Income derived from transactions with other **FZ Persons**,
    - Except for income derived from Excluded Activities;
  - Income derived from transactions with **Non-FZ Person**,
    - Only in respect of Qualifying Activities that are not Excluded Activities;
  - Any other income provided that QFZP satisfies **de minimis requirements**.
- ▶ Non-qualifying mainland or foreign PEs
- ▶ Special regime immovable property

# Qualifying Income

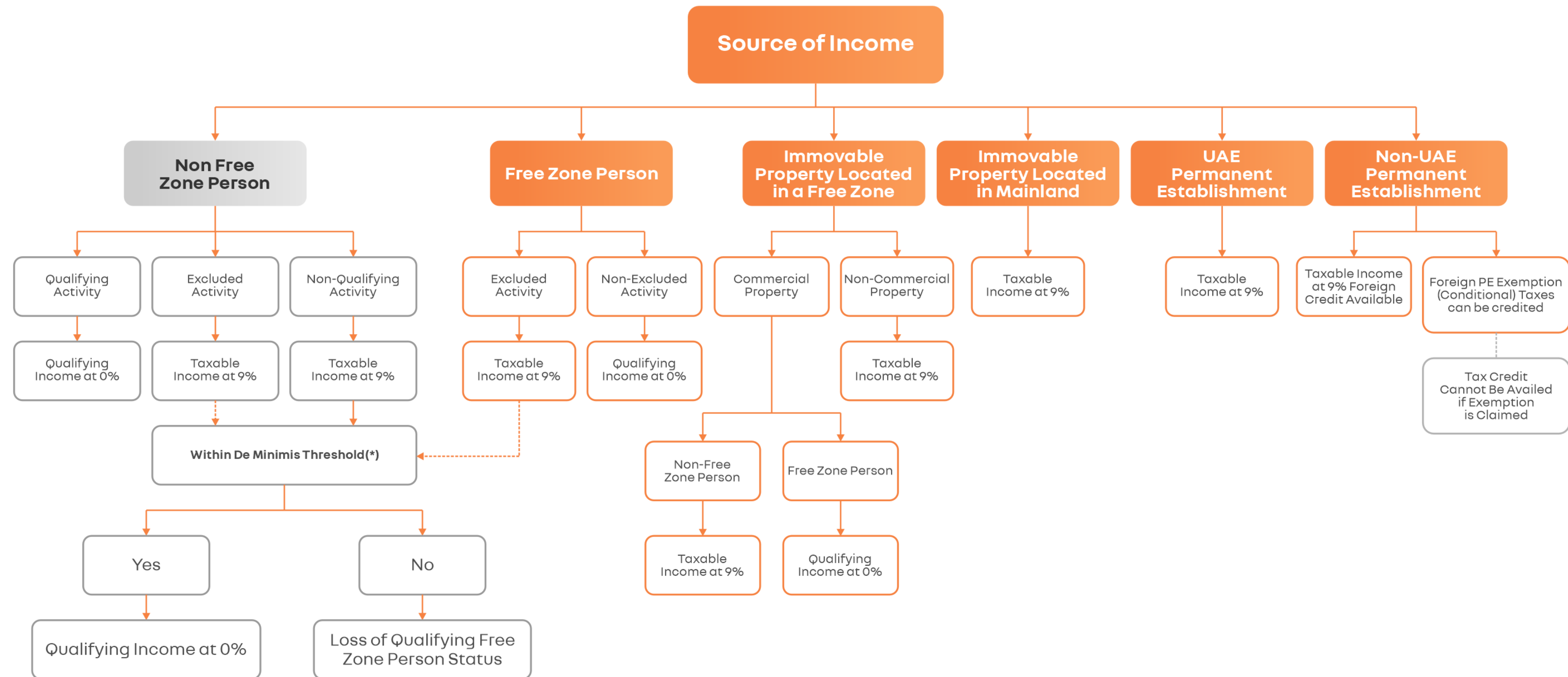
- ▶ Income to be considered as derived from FZ Persons if **Beneficial Recipient** of goods and services.
- ▶ “Beneficial Recipient” - Person who has **right to use** service or the Good. Does not have contractual or legal obligation to pass on such service or Good to another person (~ international tax concept beneficial owner).
- ▶ “Good” – Tangible/intangible property that has **economic value** in dealing including moveable/immovable property.
- ▶ Qualifying Income includes income derived from any Person where **incidental to Qualifying Income**.

# Qualifying Income Determination





# Qualifying Income Determination

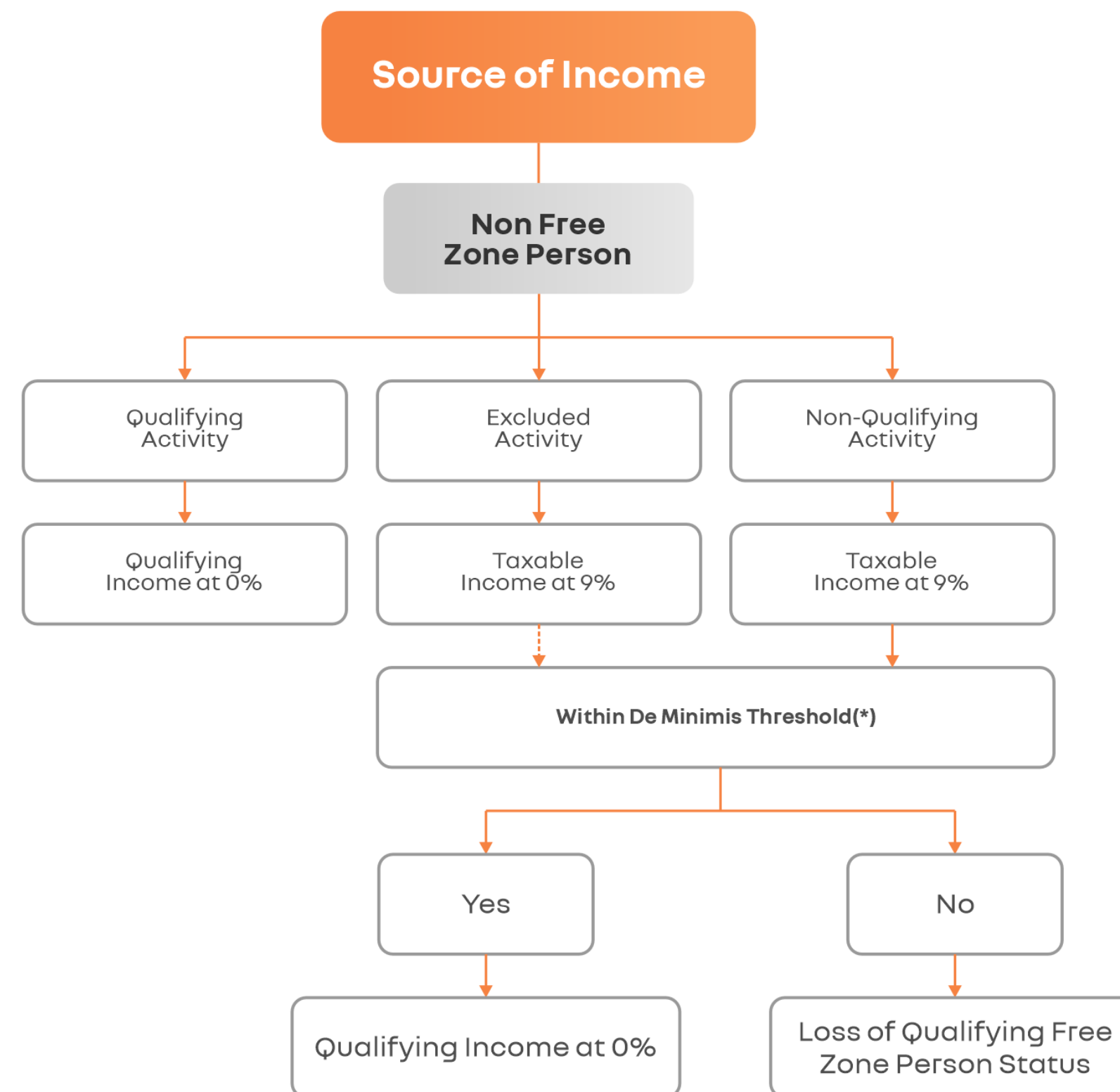


(\*) De minimis threshold shall be considered satisfied where the non-qualifying Revenue derived by the QFZP in a Tax Period does not exceed 5% of the total Revenue of the QFZP in that Tax Period or AED 5 million, whichever is lower.



# Qualifying Income Determination

## NON FREE ZONE PERSON

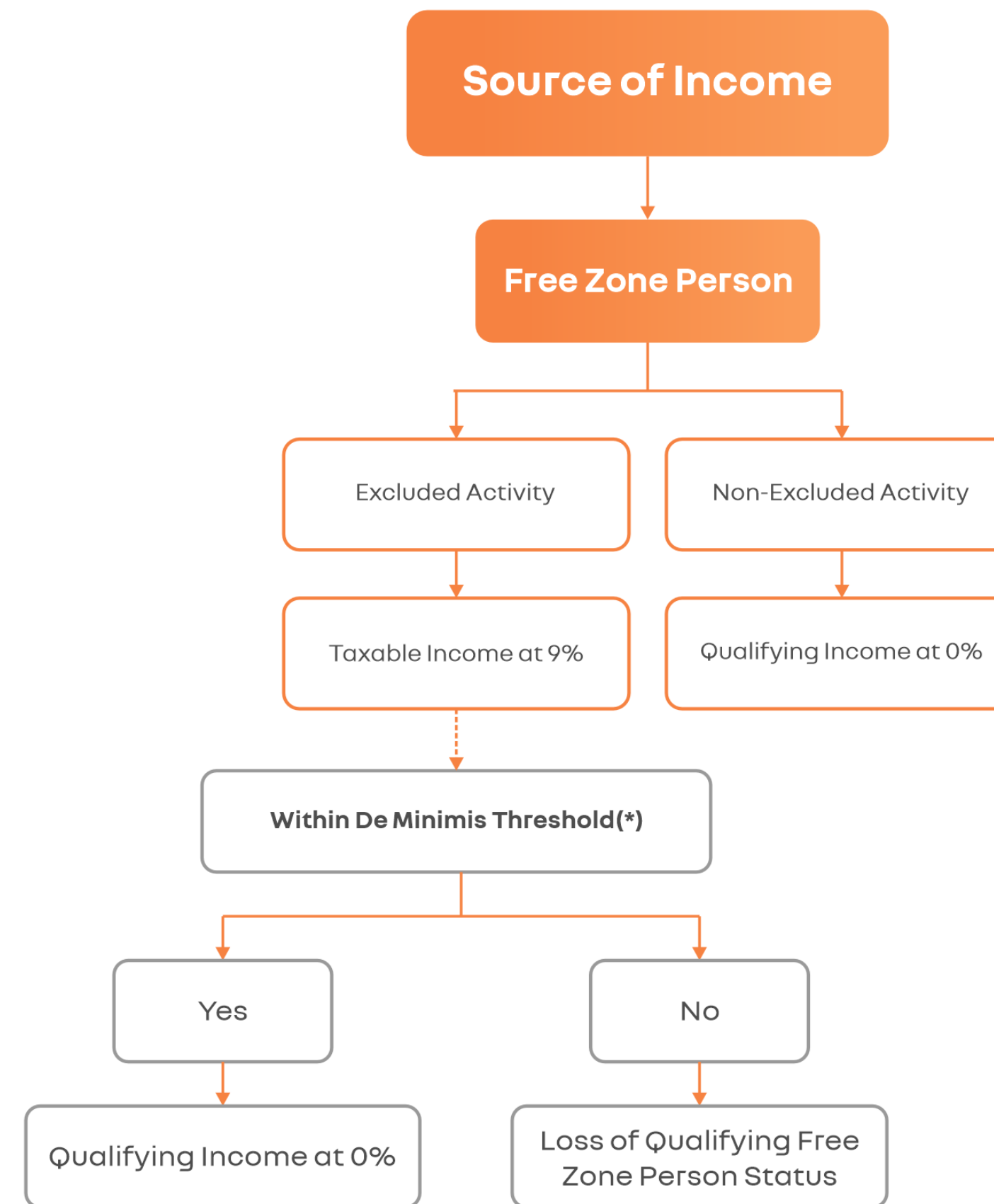


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# Qualifying Income Determination

## FREE ZONE PERSON

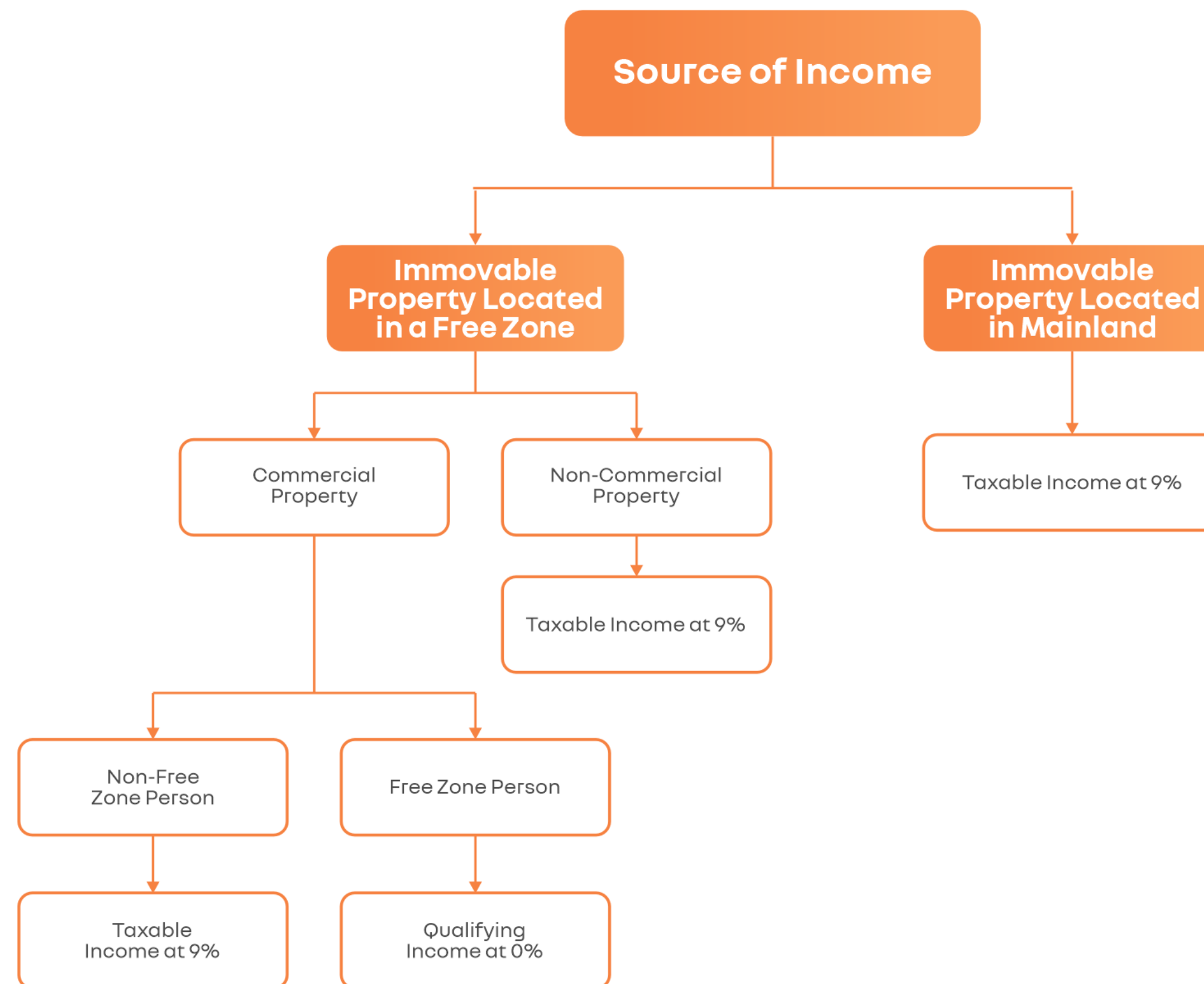


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# Qualifying Income Determination

## IMMOVABLE PROPERTY LOCATED IN A FREE ZONE





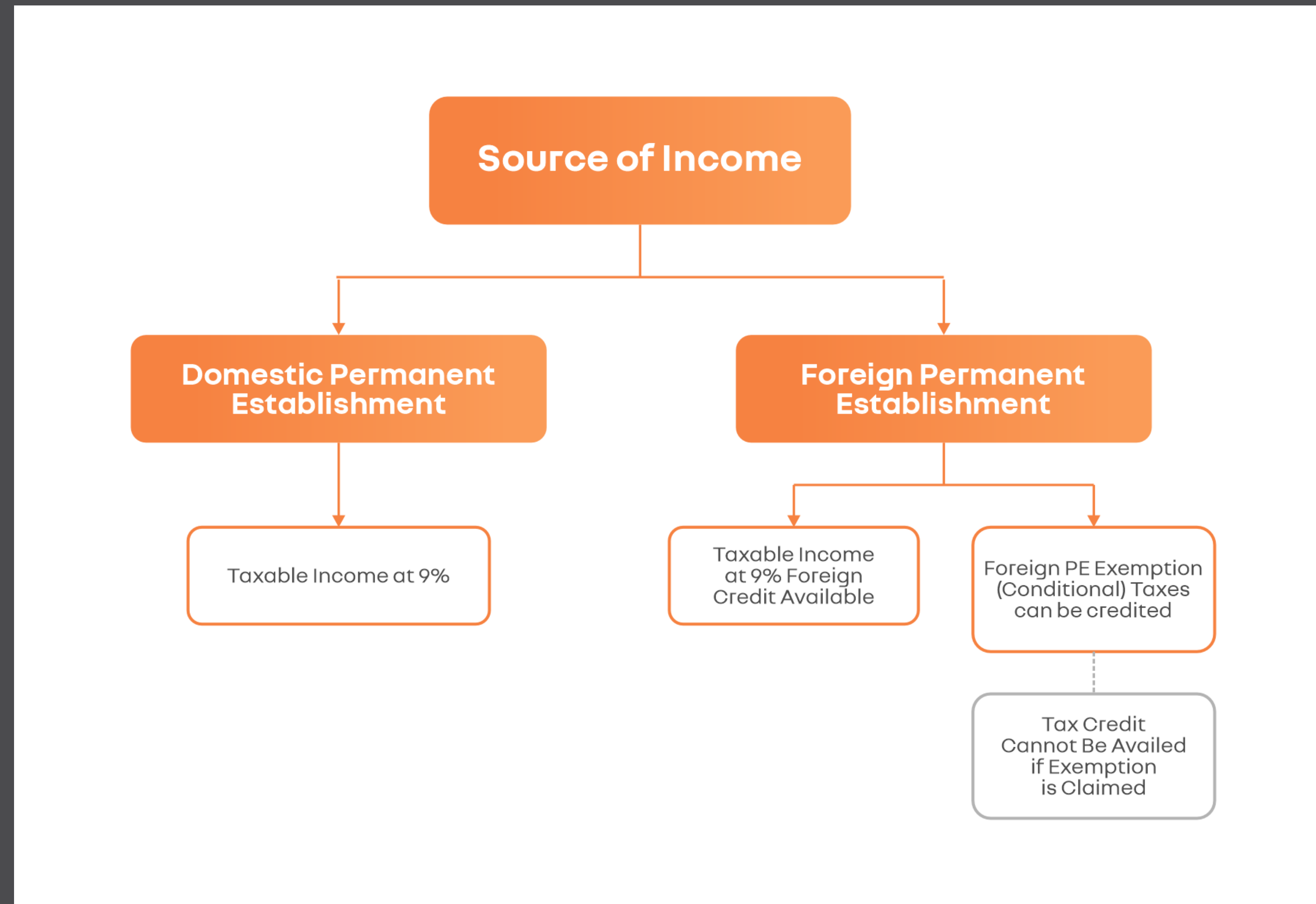
# Income from Immovable Property Located in FZ

- ▶ Only income from **commercial property** earned from **another FZ person** subject to 0%
- ▶ Any other income is subject to 9%
  - Transaction with **non-FZ Persons** with respect to Commercial Property;
  - Transactions with **any Person** with respect to Immovable Property that is not Commercial Property.
- ▶ Commercial property
  - Used exclusively for business or business activity
  - Not used as place of residence or accommodation (hotels, motels, bed and breakfast establishments, serviced apartments).



# Qualifying Income Determination

## DOMESTIC OR FOREIGN PERMANENT ESTABLISHMENT





# Income from Foreign/Domestic Permanent Establishment

- ▶ Income from Domestic or Foreign PE of QFZP is taxable (9% domestically – local CIT rate for foreign PE)
- ▶ Domestic and Foreign PE treated as **separate/independent** Person that is **Related Party of QFZP** and **income derived is taxable**.
- ▶ Profit allocation method: Separate Entity Approach – TP method applying Functions Assets Risks analysis



# Income from Foreign Establishment

## CREDIT VS EXEMPTION

- ▶ By default foreign taxes creditable, but limited to lower of:
  - Taxes paid
  - Taxes payable in UAE
- ▶ **Election** to apply **PE exemption** (required that PE is subject to at least 9%), then exclusion of:
  - **Losses** in any of its foreign PE;
  - **Positive income** and **assoc. expenditure** in any of its foreign PE





# De minimis requirement

## 5/5 RULE

- ▶ Non-qualifying Revenue derived by QFZP **does not exceed 5% of total Revenue**, or **AED 5 million**.
- ▶ Non-qualifying Revenue - Revenue derived from:
  - **Excluded Activities**;
  - **Non-Qualifying Activities** where other party to transaction is Non-FZ Person.
- ▶ Total Revenue - All Revenue derived by Qualifying FZ Person in Tax Period.



# De minimis requirement

## EXCLUDED FROM DE MINIMIS

- ▶ Revenue not included in 5/5 calculation:
  - Revenue attributable to **immovable property** located in FZ:
    - Transactions with **non-FZ persons** with respect to Commercial Property;
    - Transactions with **any Person** with respect of immovable property that is not Commercial Property.
  - Revenue of a Domestic/Foreign Permanent Establishment (PE) of the QFZP.
- ▶ Domestic and Foreign PE treated as **separate/independent** Person that is a **Related Party** of QFZP.



# Adequate Substance in FZ and Outsourcing

- ▶ QFZP to undertake its **core income-generating activities** and demonstrate:
  - Level of activities carried out;
  - Adequate assets;
  - Adequate number of qualified employees;
  - Adequate amount of operating expenditures.
  - No directed and managed criterion (≠ ESR)
- ▶ Activities **can be outsourced** to Related/3rd Party in FZ.
  - QFZP needs to have **adequate supervision** of outsourced activity.

# Qualifying Activities

## PART (1/2)

- ▶ The following are Qualifying Activities:
  - **Manufacturing** of goods or materials;
  - **Processing** of goods or materials;
  - **Holding of shares** and other securities;
  - Ownership, management and operation of **Ships**;
  - **Reinsurance services**;
  - **Fund management services** subject to regulatory oversight;



# Qualifying Activities

## PART (2/2)

- **Wealth and investment management services** subject to the regulatory oversight;
- **Headquarter services** to Related Parties;
- **Treasury and financing services** to Related Parties;
- Financing and leasing of **Aircraft**, including engines and rotatable components;
- **Distribution** in or from a Designated Zone that meets relevant conditions\*;
- **Logistics services**;
- Any activities **ancillary** to above activities.

\*MoF Public statement: no need for goods to enter UAE (to be formally confirmed)

# Excluded Activities

- ▶ The following are Excluded Activities:
  - **Banking activities** subject to regulatory oversight;
  - **Insurance activities** subject to regulatory oversight;
  - **Finance and leasing** activities subject to regulatory oversight;
  - Ownership and exploitation of **immovable property** (other than FZ located Commercial Property);
  - Ownership and exploitation of **intellectual property** assets;
  - Any transactions with **natural person**, except certain transaction in relation to Qualifying Activities;
  - Any activities **ancillary** to above activities.



# Qualifying Free Zone Person

## OTHER CONSIDERATIONS

- ▶ **Election** to be taxed at 9% (why?)
  - ▶ Election effective from commencement of tax period in which election is made;  
(or)
  - ▶ Commencement tax period **following tax period** in which election was made
- ▶ **Cannot** be member of **Tax Group**
- ▶ **Cannot transfer/offset losses** to/from taxable (related) persons
- ▶ **Participation Exemption** applies for income from QFZP (subject to conditions)

# Qualifying Free Zone Person

## OTHER CONSIDERATIONS

- ▶ **Must file tax return**
- ▶ **May be** required to file disclosure form along with tax return (to be notified by Authority)
- ▶ Required to prepare and maintain **audited financial statements**
- ▶ Failure to meet the above results in QFZP to **lose its QFZP status** (current year and next four years).



# Observations FZ regime

- ▶ 0% not as wide as expected – may reduce attractiveness UAE
  - Qualifying activities incomplete to cover all activities conducted with 3rd countries
  - Excluded activities including FS services which should have been exempt?
  - Rationale unclear for some excluded activities
- ▶ Subject to evolution? Comparison with QFC regime (e.g. 3 FTE, 30% Qatar sourced income)
- ▶ Awaiting guidance issued
- ▶ BEPS Action 5
- ▶ Impact DTTs (liable to tax criterion)

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