UAE Corporate Income Tax (CIT): Considerations beyond tax

ICAI session

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UAE CIT Law: Overview

Taxable person's taxable income exceeding AED 375,000 shall be subject to 9% CIT rate in the relevant tax period

For qualifying free zone person, qualifying income will be taxed at 0% and taxable income other than qualifying income will be taxed at 9%

For the companies that follow January to December as their financial year, first tax period will commence from 1 January 2024

Key milestones

31 January 2022	Introduction of CIT law by UAE Ministry of Finance (MOF)
28 April 2022	Public consultation document issued
10 October 2022	CIT Law published in the Official Gazette (effective after 15 days)
9 December 2022	MOF published the full translated text of the CIT Law on its website
16 January 2023	Threshold of taxable Income for levying tax_published in the Official Gazette
1 June 2023	CIT Law to apply to Tax Periods commencing on or after 1 June 2023

UAE CIT Law: Key features

Definition of exempt person & taxable person	Conditions for participation exemption	Tax loss relief, conditions for transfer of tax loss & limitation on carry forward of tax losses
Concept of qualifying free zone person	Reliefs for small business , transfers within a qualifying group & business restructuring	Tax Groups and manner of determining taxable income of tax group
Rules for calculating taxable income	Deductible and non-deductible expenditures	Anti- abuse rule
Exempt income	Principles of arm's length & transfer pricing documentation	Transitional rules

Synopsis of accounting under IAS 12

Accounting for CIT under International Financial Reporting Standards (IFRS) requires **application of IAS 12, Income Taxes**.

IAS 12 implements a **'comprehensive balance sheet method'** of accounting for income taxes which recognises both the current tax consequences of transactions and events and the future tax consequences of the future recovery or settlement of the carrying amount of an entity's assets and liabilities.

In simpler terms, Income taxes, as defined in IAS 12, include **current tax** and **deferred tax**.

Key principles of accounting for Income Taxes under IAS 12
Step 1: Determine if a levy is in scope of IAS 12 Applies to taxes based on taxable profits and taxes that are payable by a subsidiary, associate or joint arrangement on distribution to reporting entity.
Step 2: Recognise and measure the Current tax It is the amount of income taxes payable (recoverable) in respect of the taxable profit (loss) for a period.
Step 3: Recognise and measure the Deferred tax *Calculate the tax base* *Calculation of temporary differences, unused tax losses and credits* *Recognition and Measurement of Deferred tax asset(DTA) and DTL (Deferred tax liability)*
Step 4: Determine where to recognise income tax - profit or loss/OCI/directly in equity
Step 5 : Disclosures The key disclosures include (i) major components of tax expense (tax income) and (ii) reconciliation between the applicable statutory tax rate and the entity's effective tax rate

Key impact areas beyond tax

- Election choice to adjust accounting profit for gains/losses on account of fair value, impairment
- Carry forward of unutilised tax losses
- Business combination and restructuring
- Intra-Group transactions
- Interest expense
- Tax Group
- Transfer of tax losses
- Provision and accruals

Accounting & Reporting – Election choice

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Election choice under Article 20

Taxable person preparing financial statements on accrual basis and calculating taxable income

Option 1:
Election choice as per Article 20(3) is not exercised i.e. no adjustments made to accounting profits

Option 2 :
Election choice as per Article 20(3) is exercised i.e. accounting profits adjusted for gains & losses on a realization basis. This option will result in a deferred tax impact.

Option 2(a):
Accounting profits adjusted for all unrealised accounting gains or losses related to fair value or impairment

Option 2(b):
Accounting profits adjusted for only unrealised gains and losses in relation to assets and liabilities held on capital account (such as plant and machinery or buildings and non-current liabilities such as long-term loans)

Financial statement line items requiring recognition of deferred taxes

Financial instruments at fair value
- Derivatives
- Investments

Non-financial assets at fair value
- Property, Plant and Equipment (PPE)
- Investment property
- Biological assets

Impairment of assets
- Trade receivable, Contract Assets
- Investments
- Investment property
- PPE
- Intangible Assets

Foreign exchange gains/ losses on
- debtors/ creditor
- Loan

Election choice - Case study

IFRS	CIT Law
Gains/losses could get recognized on account of fair value adjustments or impairment where there has been no actual disposal or settlement (i.e. realisation) of the relevant asset or liability	Taxable person preparing financial statements on an accrual basis may elect to take into account gains / losses relating to fair value or impairment on a realisation basis

- Company A prepares its financial statements on an accrual basis and has elected to take into account gains and losses on all assets and liabilities on a realisation basis for CIT purpose. The financial year for the company is January to December and therefore, its first tax period will commence from 1 January 2024.

- Assuming the opening balance as on 1 January 2024 of financial assets at FVTPL is USD 100 million.

- As at 31 December 2024, the financial asset at FVTPL is fair valued at USD 120 million, resulting in unrealized gain of USD 20 million in the accounting books.

- In the year 2025, the company transfers the asset for USD 120 million, resulting in derecognition of the asset and realization of gain of USD 20 million.

FVTPL – Fair value through profit and loss

Amount in USD million

Financial year	Financial Asset at FVTPL as per accounting books			B/S impact	P&L impact	
	Opening balance	Closing balance	Fair value gain/(loss)	Deferred Tax Asset/ (Liability)	Current Tax charge/ (credit)	Deferred Tax charge/ (credit)
Jan-Dec 2024	100	120	20 (unrealized)	(1.8) (20 x 9%)	-	1.8
Jan-Dec 2025	120	-	20 (realized)	-	1.8	-1.8

Fair value or Purchase Price Allocation (PPA) adjustments

On 1 January 202X, Company A acquired Company B for USD 50 million. On the date of acquisition, the fair value of the identifiable assets and liabilities of Company B was USD 40 million including an intangible asset that was not recognised in the individual financial statements of Company B, of USD 5 million. The tax base of the assets and liabilities acquired, other than the intangible asset, was equal to their accounting base. The tax base of the intangible asset was nil.

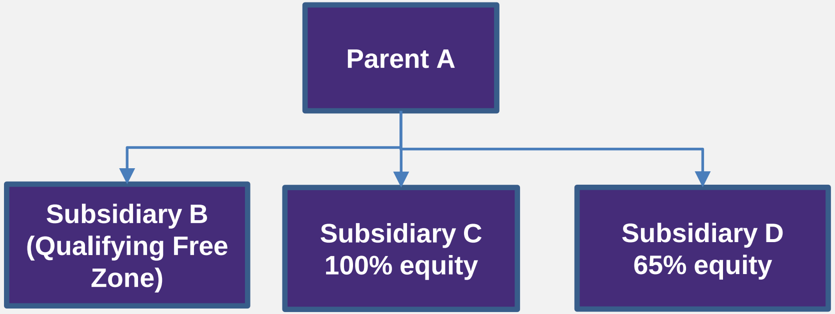
A taxable temporary difference of USD 5 million exists at the date of acquisition requiring recognition of DTL of USD 0.45 million [USD 5 million × 9% (tax rate)] in the consolidated financial statements of Company A. The net assets at the date of acquisition are therefore, USD 39.55 million (USD 40 million – USD 0.45 million) and goodwill USD 10.45 million (USD 50 million – USD 39.55 million) . The DTL will reverse as the recognized intangible asset is amortized over its useful life.

Tax Groups

Multiple resident persons can apply to act as one taxable person, represented by the parent company.

Parent company to hold atleast 95%of share capital and voting rights of the subsidiary.

No such concept of tax group under IFRS - impact for any differences between tax and accounting will require consideration.



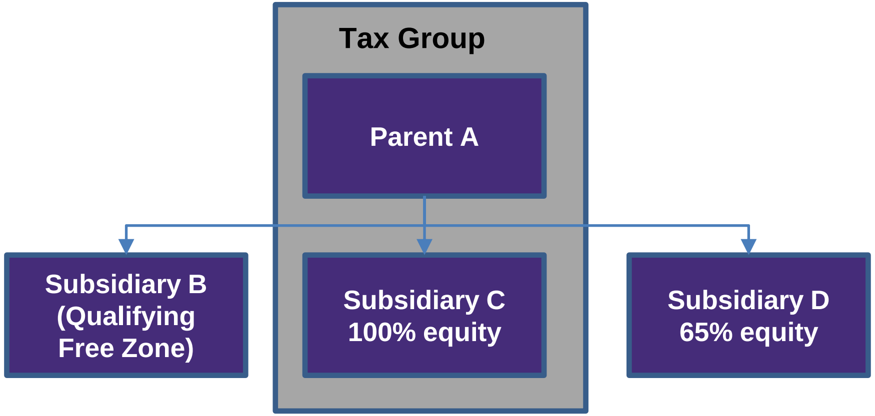
Matters to consider

Who can form a tax group?

Will separate set of financial statements be required for the tax group?

Is there a requirement to audit the financial statements of the tax group ?

Tax Groups - Case study



Matters to consider

Who can form a tax group?

Parent A and wholly owned Subsidiary C may form a tax group

Will separate set of financial statements be required for the tax group?

Separate set of financial statements to be prepared for tax purposes

Financial results, assets and liabilities to be consolidated, transactions between Parent A and Subsidiary C to be eliminated

Is there a requirement to audit the financial statements of the tax group ?

Maintain audited financial statements of the tax group if the revenue exceeds AED 50,000,000 during the relevant tax period

Other considerations regarding accounting

Accounting policy for allocation and treatment of tax expenses between Company A and Subsidiary C to be defined

Intra-group transactions - Case study

Scenario 1: Tax Group is NOT formed

Parent company A sells inventory to a wholly owned subsidiary B for USD 300 million. This results in a profit of USD 50 million in A's separate financial statements. Under CIT law, Parent A and subsidiary B have the option to form a tax group and file a consolidated tax return.

Since the entities have option to not form the tax group, the corporate tax will be calculated separately for each taxable person (i.e. Parent A and Subsidiary B). Parent A will pay a current tax of USD 4.5 million on its profit of USD 50 million (i.e. USD 50 million * 9% tax rate). When Parent A prepares its consolidated financial statements under IFRS, the profit of USD 50 million (arising from intercompany transaction) is reversed against the carrying amount of the unsold inventory of USD 300 million. Therefore, the carrying amount of the inventory on consolidation is USD 250 million while the its tax base is USD 300 million. This difference results in a deductible temporary difference of USD 50 million to be recognized on consolidation at 9% tax rate, subject to the general DTA recognition criteria.

Scenario 2: Tax Group is formed

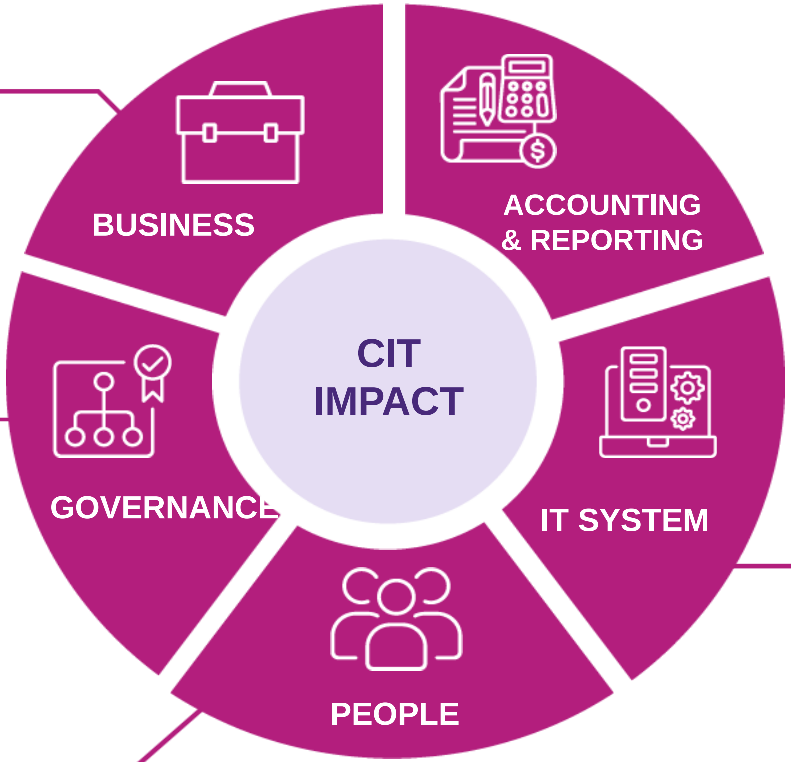
If company A and company B were to form a tax group, subject to conditions of CIT law being met, this intra-group transaction would have been eliminated for tax purposes and thus no temporary difference may arise on consolidation.

Other impact areas beyond accounting and reporting

Whether holistic impact on Business has been evaluated?
Consider tax and accounting impact on various strategic decisions such as business acquisitions, group restructuring, new company set-up (mainland vs free zone), formation of tax groups, intra-group transactions, etc.

Whether clearly defined policies and procedures are developed and communicated within the organization?
Establish adequate policies and procedures with robust governance and internal control framework to meet the tax and accounting compliance requirements.

Whether the people in the organisation possess the required knowledge and experience to cater to the new requirements?
Relevant departments and resources will need to be upskilled and trained on various aspects such as (a) knowledge on additional tax , accounting & reporting requirements (b) increased legal compliances & documentation; and (c) operating digital tax tools and tailored finance & IT systems.



Has the IT system been tailored to account for current and deferred taxes?
IT systems will need to support the new requirements, including (a) managing two sets of accounts for tax and accounting purpose, (b) consolidation of tax groups and (c) computation, reporting and disclosures of CIT.
Companies will have to consider data required for tax computation, accounting and reporting, including the changes required in existing chart of accounts.

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Thank you

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