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CORPORATE TAX IN UAE

Creating resilience through change

Tuesday 28th February 2023

Boulevard Ballroom, The Address Boulevard, Dubai

9:00AM – 1:30PM

Agenda

The UAE economy has been the envy of much of the world in recent years, having ridden better than most of the world-shattering events. Through the Covid-19 pandemic to the geopolitical instabilities to soaring inflation and interest rates, the UAE has presented as a model of stability. Real GDP growth in the UAE is estimated at more than 6% for 2022, while government finances remain healthy. The UAE budget surplus is poised to increase this year, thanks to a projected 11% rise in federal revenues. The country's diversified, open economy is well positioned to sustain growth, thanks to robust public and private sectors and ever-greater integration.

However, businesses in the UAE face a new challenge this year with the introduction of corporate tax. The UAE has traditionally been a low-to-zero tax jurisdiction, but the Organisation for Economic Co-operation and Development (OECD) has made it its mission to reform the global tax system so as to combat international tax avoidance and is looking to ensure multinational corporations pay a minimum of 15% corporate tax. To ensure any revenue raised from corporate tax paid by businesses on UAE soil go into the government's coffers, the UAE will this year introduce its own corporate tax for the first time.

This poses a number of questions for businesses operating out of the country on how they will best adapt to the new regime.

TAX

Presentation | 1

Global and Regional Economic Outlook

SPEAKER

Nikita Pavlov, EMEA Director at London Stock Exchange Group

The first speaker, Nikita Pavlov, provided a broad view of the global economy and the unprecedentedly large number of 'black swans', or unforeseen events, that investors are having to contend with, beginning with the financial crisis of 2008 and stretching through the Covid pandemic, geopolitical instabilities, and now escalating inflation and interest rates. Nikita pointed out, though, that the economic picture is mixed. For example, wage inflation is lagging consumer prices, but jobless rates are returning to pre-pandemic levels. He also noted that there is much room for optimism in the GCC, which can be expected to benefit from the strengthening oil prices. Other commodities are also gaining in strength, he noted, with copper having risen strongly since its pandemic lows, while China's lifting of Covid restrictions has boosted demand for Australian coal. Nikita pointed out that even with rising interest rates, corporates will be less apt to look to banks for funding but will be more likely to invest better, to develop better products, which in the end provides more value for end-users.

Nikita then moved on to the global investments market and how extensively it is being impacted by sustainability considerations. In this regard, Nikita noted, 2023 will be a key year for UAE as it hosts COP28. He noted that global investors are increasingly looking to make passive investments into sustainable funds, with a number of these funds growing rapidly, and this presents future opportunities. Nikita then moved on to what it means for investors when dividend yields are sitting below key interest rates. He pointed out that the GCC market remains one of the world's safest in terms of probability of default, meaning that the region has both a very attractive market and macro economy.

Presentation | 2

Corporate Tax Implications on UAE Businesses

SPEAKER

Mohamed Elswefy, Partner at EY

The second speaker, Mohamed Elswefy introduced his presentation by outlining the reasons for the UAE's introduction of corporate tax. He pointed out how the OECD's efforts to combat international tax avoidance through base erosion and profit shifting and the inclusion of the UAE on the Financial Action Task Force's money laundering grey list has led the UAE government to look at ways to improve the country's tax environment, to make the country a more stable place to do business. He also noted that under BEPS Pillar II, the OECD has determined to establish a global minimum tax rate of 15% for multinationals. He pointed out that given this, if the UAE hadn't introduced a corporate tax regime, corporations operating in the country would still pay it, but the revenue would go elsewhere.

Mohamed then outlined the difference between an application and an election, and how a business might in certain circumstances be able to elect the code under which it wishes to be taxed. He then described the key types of businesses that will be subject to corporate tax in the UAE: legal persons, natural persons, permanent establishments, or any business that has a nexus in the country. He noted that where before everything was very open in this regard, now there will be a need for lot of work to review business models, for example on how a nexus is defined.

Mohamed also detailed on those who will not pay corporate tax. These will include resident persons in UAE free zones, subject to certain conditions; otherwise the rate will be 9%. He then outlined the conditions under which certain businesses will be exempted from corporate tax, such as those mandated by the UAE Cabinet as qualifying public benefit entities. Other businesses that may be exempt, he said, included qualifying investment funds, partnerships, and family foundations. He also pointed to a revenue threshold for small businesses, although this has yet to be announced by the government.

He finished by discussing separately the treatment of unrealised gains and losses, tax losses, entertainment expenses and other deductible expenses, dividends, capital gains, foreign branches, international transport, tax groups, tax losses, group transfers and business restructuring, and transfer pricing.

Panel Discussion

MODERATOR

James Faulkner, Director at London Stock Exchange Group

PANEL PARTICIPANTS

Brian Martin Mulholland, Chief Financial Officer at National Bank of Fujairah
Ben Philip, Senior Tax Associate at Baker McKenzie
Mohamed Elswefy, Partner at EY

Moderator James Faulkner opened the panel discussion by asking how the new tax will change the way that UAE businesses operate. Mohammed said that the change will potentially require large-scale transformation, particularly for larger businesses. He noted that where beforehand organisations were free to work within the mainland or in free zones, outside or within the UAE, as there was no tax obligation, now everything will have to be reviewed and analysed to see what gaps have opened. He cited that transfer pricing will be a particularly important element, as it is related to group entity transactions and related party transactions. He said that documentation will be very important, as will how expenses and revenues are classified, and whether the technology being used is providing the information businesses will need. Brian agreed that gathering the right information is essential, adding that businesses will need to assess what the changes mean for them.

James questioned on how the tax will affect mergers and acquisitions. Ben cited that historically the environment deals have been relatively straightforward in the UAE, but that will change. He said that tax due diligence will need to be done, which could expose historical risks that would need to be factored into any deal. The change also means businesses will have to take into account tax on investment returns. Ben added that the new regime will start to feed through into transaction documentation as well. He said that investors would need to know what policies and procedures are in place so they can be comfortable that the tax is being managed in the right way.

Mohammed was then asked about key definitions within the new law. He replied that some key definitions haven't yet been decided, such as what constitutes a nexus, or how a qualifying income is defined as a condition for a free zone, or what will constitute a permanent establishment.

Brian was asked on how best to allocate resources to ensure compliance with the new tax. He noted that in his experience it was best to keep costs down by bringing in-house the collection, processing and storing of information, as it doesn't take a tax expert to do this. But for deciding which information to gather and the best way to structure an organisation, and the best oversight of the information, it probably pays to have that little bit of advisory.

Ben said that since 100% foreign ownership was introduced in the UAE, a lot of companies have simplified their structures, and the new corporate tax will accelerate that trend. He said that while the only tax currently is VAT at 5%, now is the best time to do this, so businesses can benefit from tax provisions that allow for fiscal unity and consolidation. This means a consolidated group would become one taxpayer rather than several, which would ease the administrative burden that will be imposed as a result of the new tax.

On being about the potential risks going forward, Ben mentioned that businesses need to act now based on uncertain positions. For example, as was seen with the introduction of VAT, this could lead to disputes with the tax authority later down the line. He said businesses just need to ensure that they are taking advice on where are the key risk issues and to have that documented. This would enable them to have the trail that can show the process they have followed to get to the decisions they have taken, so that when challenged by the authorities you can say, “This is the advice we've taken; this is what we've done; this is why we think this is the right position”.

New accounting software was then discussed. Brian said that now the UAE has introduced corporate tax on top of VAT he could foresee quite a few software companies coming into the region and really trying to hit the ground running. Ben noted that the key to using software is to put the policy and procedures in place to deal with whatever changes arise on a year-to-year basis, be that from within a business or from the tax legislation. He said it is easy to become over-reliant on the software provider but there needs to be a level of communication with them about changes that are made. Mohamed noted that it is worth assessing what kind of functionality a business already has in place in its system, to see whether it might be easier to activate existing, though scarcely used, functions than to make any big but not entirely necessary investment.

Key Recommendations

Although the new tax is talked of as being simple, it will pay to do a lot of analysis, to interact with people within the organisation, with relative parties, with suppliers, to get a view from experts and peers in the same industry. Don't miss any opportunity for Ministry of Finance awareness sessions, for example, always get an update regarding what is happening and be aware of whatever clarification is coming in from cabinet decisions, which are expected to be issued from now until June.

Management teams and boards will need to know about the tax. If a business doesn’t have a governance strategy in place, a strategy will need to be formed on the tax function, on what kind of tax work will be done in-house and when it will be necessary to seek external advice. Businesses will need to define their key tax risks and the tax controls that will have to be established.

The most important thing will be the risk model a business adopts, so that a tax governance strategy for any client will align with the normal risk model adopted by the firm itself. There will need to be a discussion with the head of operational risk and the risk officer to understand what has been adopted so far.

A business will need to allocate responsibilities, to create the kind of reports that will govern how risks are monitored and reported to management.

Click here to view the event recording.