



Overview of the taxation system in the United Arab Emirates

Direct and Indirect Tax Rates and Rules for UAE



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Key information:

Direct Taxes:

In practice, although there are Emirate-based income tax decrees which may apply to all businesses, these decrees are currently only enforced in respect of income generated from business activities related to exploration and production of oil and gas. Such an income may attract a tax at a rate of 20% to 55%.

At its Federal level, the UAE does not levy any tax on income earned by corporates or individuals and currently there is no legal framework for tax on income within the UAE Federal Legislation. Upon certain conditions (including management and direction), businesses established in the UAE may be able to obtain tax domicile certificate from the Ministry of Finance based on which they can prove their tax residence in the UAE and also benefit from Double Tax Treaties where applicable.

In addition to the Emirate-based Decrees, branches of foreign banks operating in the Emirates of Abu Dhabi and Dubai are also subject to income tax at a flat rate of 20%.

There is no withholding tax, surtax, capital gains tax, Dividends tax or inheritance tax in the UAE. The UAE also does not impose stamp duty on transfer of shares, but Free Zone Authorities normally levy administrative fees for such a transfer. Nonetheless, Municipality fees may apply to income from rent or sale of real estate property and hotels operations. The rate of such fees may vary from one Emirate to another.

Considering that there is no income tax, the UAE also has no thin capitalization rule, or general anti-avoidance rule. The UAE has established several free trade zones that offer tax incentives of 15 to 50-year tax holidays without restrictions on foreign ownership or capital and profit repatriation. The free zones also provide an exemption from import duties on goods brought into the concerned free zones.

With respect to the income earned by individuals, the only applicable tax is the social security contributions of 12.5% payable by the employer and 5% payable by the employees who are from the Gulf Cooperation Council (GCC) countries (i.e., Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and UAE).

Indirect Taxes:

Under the agreement with the Gulf Cooperation Council (GCC) countries, the UAE applies 5% customs duty. The same rate i.e. 5% is also applicable as a Value Added Tax (VAT) on supply of goods and services in the UAE. Additionally, the UAE also applies excise tax at a rate between 50% to 100% on tobacco products, alcohol, energy drinks and sweetened beverages.

The UAE and the OECD's BEPS Project:

The UAE has joined the Inclusive Framework (IF) of the Organization for Economic Co-operation and Development's (OECD) on Base Erosion and Profit Shifting (BEPS) in May 2018. As a result, the UAE has signed The OECD multilateral instrument (MLI) which entered into force for the United Arab Emirates on 1 September 2019. The UAE also introduced a domestic regulation for Country-by-Country Reporting (CbCR) as well as Economic Substance Regulations (ESR).

However, currently there are no rules or regulations in the UAE with respect to the transfer pricing, interest deduction limitation, controlled foreign company or anti-hybrid.

Tax Authorities:

Ministry of Finance is overseeing the reporting and compliance with respect to CbCR, ESR and also issues tax residence certificates to corporates and individuals. The Federal Tax Authority (FTA) is entrusted to collect indirect taxes, conduct tax assessment and implement administrative penalties where necessary, and General Pension and Social Security Authority is responsible for social security collection.

Income tax:

Tax Residence:

Emirate-level income tax decrees (see "Basis" below) do not contain specific provisions relating to corporate tax residence, so there is no clear legal concept of corporate tax residence in the UAE. Nevertheless, the Ministry of Finance (MOF) issues tax residence certificates to companies that are incorporated in and managed from the UAE and meet the requirements of the MOF (e.g., at least one UAE resident director, a fixed place of business) and any relevant tax treaty.

Legal basis:

Although the UAE does not have a federal Corporate Income tax (CIT) regime; however, most of the Emirates introduced their own income tax Decrees, and taxation is therefore determined on an Emirate-by-Emirate basis. However, currently the local income tax Decrees are not enforced on most businesses and as a result, there is no Corporate taxation.

Notwithstanding the above, oil and gas exploration and production companies are subject to income tax, but usually under the specific terms of a concession agreement (or fiscal letter) signed with the government. The fiscal terms under such agreements generally supersedes the provisions of the Emirati income tax Decrees.

In addition to the upstream supply chain of oil and gas industry, branches of foreign banks are subject to income tax under separate banking tax decrees in the Emirates of Dubai and Abu Dhabi.

Taxable income:

The applicable income tax decrees (or the concession agreement) and banking tax decrees include basic deductibility rules that need to be taken into account when determining taxable income. More specifically, eligibility to deduct certain expenses and intra-banks charges is limited.

Tax Rate:

1. Oil and gas exploration and production companies are taxed at progressive rates of up to 55% under the applicable Emirate-level income tax decree, although in practice different rates may be agreed with the relevant authority under specific government concession agreements.
2. Branches of foreign banks are taxed at rates according to the banking tax decree of the Emirate in which they operate, generally at a flat rate of 20%.

Losses:

Businesses subject to income tax on oil and gas operations, may carry forward losses **indefinitely**. However, branches of foreign banks may only carry forward losses for **two** years. Losses may not be recovered retrospectively i.e. from the income of the previous years.

Social security contributions:

Social security contributions are due only in respect of nationals of the Gulf Cooperation Council (GCC) countries (i.e., Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and UAE). For UAE national employees, the employer and employee pension contribution rates are 12.5% and 5%, respectively, and contributions are based on the monthly contractual salary, including basic allowances, as agreed in the local employment contract. The contribution rates and bases for other GCC nationals vary, but broadly are in line with those for UAE nationals.

Under UAE labor law, non-GCC national employees are entitled to an end-of-service benefit (EOSB) if their employment contract is terminated after completion of at least one year of service. EOSB is payable by the employer and calculated as 21 days per year of basic wages for the first five years of employment, for each additional year of service thereafter, the EOSB will be 30 days per year of basic wage. However, the maximum EOSB payment shall not exceed two years' remuneration.

Implications of Regulations related to BEPS:

The UAE has signed the Inclusive Framework (IF) of the Organization for Economic Co-operation and Development's (OECD) on Base Erosion and Profit Shifting (BEPS) in May 2018. As a result, the UAE is committed to introduce the following BEPS minimum standards:

BEPS Action 5: Countering Harmful Tax Practices, considering transparency and substance

BEPS Action 6: Preventing the granting of Treaty benefits in Inappropriate circumstances

BEPS Action 13: Transfer Pricing Documentation and Country by Country Reporting

BEPS Action 14: Tax Dispute Resolution

Transfer pricing and Country by Country Reporting (CbCR)

While the UAE is yet to introduce transfer pricing legislation, the country has issued Cabinet of Ministers Resolution No. 32 of 2019 on country-by-country reporting rules. UAE CbCR regulations are broadly in line with guidance issued by the OECD. The CbCR rules are effective for financial years commencing on or after 1 January 2019 and apply to entities which are part of Multinational Enterprise Groups (MNE Groups) with annual consolidated revenues exceeding AED 3.15 billion in the preceding fiscal year.

Interest deduction limitations: There are no interest deduction limitation rules in the UAE.

Controlled foreign companies: There are no controlled foreign company rules in the UAE.

Hybrids rules: There are no anti-hybrid rules in the UAE.

Economic substance requirements:

The United Arab Emirates (UAE) has issued the Cabinet Resolution No. 31 of 2019 introducing the Economic Substance Regulations (ESR). The introduction of the UAE Economic Substance Regulations was an important step to fulfill the UAE commitment towards BEPS minimum standards, to align the UAE tax regime with the global tax best practices and also to implement the directives OECD BEPS project.

The UAE recently enacted significant changes to the ESR by issuing the Cabinet Resolution No. 57 of 2020, dated 10 August 2020. Additionally, the Ministry of Finance (MoF) issued an implementation guidance by Ministerial Decision No. 100 of 2020, dated 19 August 2020

The purpose of the UAE Economic Substance Regulations is to establish specific requirements for businesses to demonstrate their actual economic activity in the UAE and also to prove that the incorporation in the UAE was not driven solely to benefit from the "Low, or No" tax regime. Businesses which are incorporated in the UAE and operating in any of the following activities are required to comply with the UAE ES regulations:

- a) Banking
- b) Insurance services
- c) Investment fund management
- d) Finance leasing
- e) Headquarter activities
- f) Shipping
- g) Holding company
- h) Intellectual property (IP)
- i) Distribution and services center activities

Essentially, the economic substance test is based on three common key tests that businesses need to comply with, the three tests are stated below:

- 1) The Directed and Managed Test:** Company should be **directed** and **managed** from the UAE;
- 2) The Core Income Generating Activity (CIGA) Test:** Income Generating Activity (CIGA) related to the business activities should be undertaken in the UAE.
- 3) The adequacy test:** An **adequate** number of qualified employees, office space and annual expenditures in the UAE.

Value Added Tax (VAT):

Taxable supply and Taxable person:

VAT applies on the supply of goods and services, as well as the importation of goods. The concept of taxable person is linked to a status of conducting an economic activity in the UAE for the purpose of earning an income.

Registration Threshold:

Registration is mandatory for taxable persons resident in the UAE whose annual taxable supplies equal or exceed AED 375,000. A resident business may register voluntarily if its taxable supplies exceed AED 187,500 in the previous 12 months (or are expected to exceed AED 187,500 within the next 30 days). No threshold applies to nonresidents that are required to register for VAT to remit any tax payable by them on supplies in the UAE.

VAT Rate:

Standard rate	5%	Applicable to all supplies of goods and services unless exempt or zero rated
Reduced rate	0%	Upon certain conditions, this rate is applicable to the export of goods and services, supply of education services and related goods, basic health care, investment precious metals, international transportation of goods and passengers, means of transports, first supply of residential building as well as buildings utilized for charitable purposes
Exemption	No VAT	Applicable to the supply of financial services, residential real estate, bare land and local transportation.

Filing and payment:

VAT returns are being filed on a monthly or quarterly basis depending on turnover of the taxable person. However, upon approval of the Federal Tax Authority (FTA), small and micro businesses may file on a semi-annual basis.

Tax Returns must be filed electronically via the FTA portal within 28 day following the en of the tax period. Tax liability shall also be settled within the a forementioned period of 28 days.

Other Taxes:

Excise tax

Excise tax is levied on goods that are deemed harmful to human health and the environment and these goods are termed as excise goods. In the UAE, excise tax is levied on carbonated drinks, energy drinks, tobacco and tobacco products. The rates of excise tax in the UAE are mentioned below:

Excise goods	Rate
Tobacco and tobacco products	100%
Electronic smoking appliances and liquids used in the related smoking devices	100%
Energy drinks	100%
Beverages and sugary drinks	50%
Soft drinks	50%

Businesses which are engaged in the import or production of excise goods in the UAE are required to apply and get registered for excise tax. The excise tax becomes payable on the import of excise goods after filing of an import declaration or upon the release of goods into the UAE from customs suspension.

Excise tax is calculated on the basis of the higher retail sales price determined by the importer or producer, or the standard price agreed on these goods excluding other taxes.

Municipality fees on property and hotels

Municipal fees are imposed on property rentals. Some Emirates charge a municipality fee on the annual rental value of the property, which varies according to the Emirate in which the property is situated. Generally, the rates can be between 2.5% to 10% depending on the type of property and whether fees will be paid by the property owner or the tenant.

Additionally, Most Emirates charges hotel levies, which apply on the value of hotel services and entertainment. For example, the Emirate of Abu Dhabi imposes a tourism fee of 3.5% and imposes a municipality fee that is levied on hotel stays at a rate of 2% on the total value of the invoice.

Customs Duty:

Effective January 1, 2003, the UAE acceded to the Gulf Cooperation Council (GCC) Customs Union and customs duty applies import of goods in accordance with the unified GCC agreements on customs.

The general rate applicable for customs duties is 5%. The customs value is calculated on the basis of the classification, value and origin of the goods. The customs duty on imports is calculated by multiplying the customs duty rate with the value of goods plus cost freight insurance.

It worth mentioning that although the Free Zones within the territory of the United Arab Emirates are considered as outside the scope of the customs territory. Accordingly, goods imported into the UAE Free Zones are not subject to customs duty. Customs duty shall only apply when the goods are imported into the UAE mainland.

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