

UAE Corporate Income Tax :

Considerations beyond tax

Introduction

The Federal Tax Authority has issued the Federal Decree Law No. 47 of 2022 on “Taxation of Corporations and Business” (the “CIT Law”) which levies a form of direct tax on corporations and business profits from the beginning of their first financial year commencing on or after 1 June 2023. Eg The first tax period will commence from 1 January 2024 for the companies that follow January to December as their financial year.

The Corporate Income Tax (“CIT”) Law read with the Cabinet Decision No. 116 of 2022 provides that taxable person’s taxable income exceeding AED 375,000 shall be subject to 9% CIT rate in the relevant tax period. In case of a qualifying free zone person, qualifying income will be taxed at 0% and taxable income other than qualifying income will be taxed at 9%.

This publication aims to assist companies as they evaluate the CIT Law impact on their businesses and highlights crucial aspects to be considered for a holistic CIT impact assessment across areas beyond tax accounting and reporting, IT systems, people processes and wider business.

1. Introduction

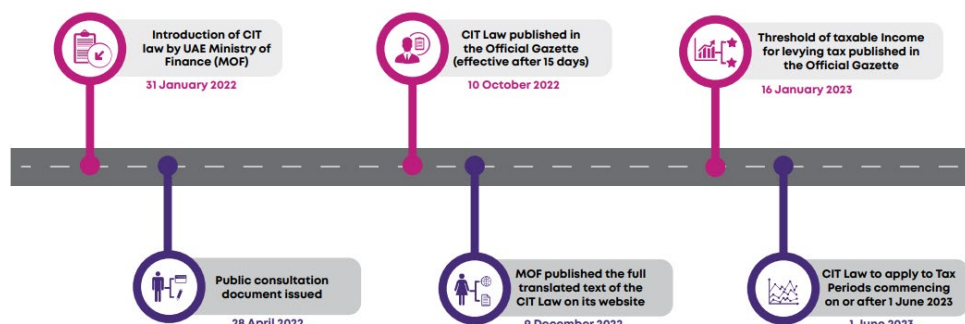
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Key milestones and features



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Definition of exempt person & taxable person

Categories of persons who shall be exempt from CIT are specified and include government entity; government-controlled entity, person engaged in an extractive business that meets the specified conditions.

Taxable person shall be either a resident person or a non-resident Person and the conditions for each are further specified.

Concept of qualifying free zone person

Free zone person is required to meet specified conditions including:

- Maintaining adequate substance in the UAE
- Deriving qualifying income as specified
- Not elected to be subject to corporate tax

Rules for calculating taxable income

General rules for determining taxable income specified including adjustments to be made to the accounting income for any unrealized gain or loss, exempt income, specified reliefs, deductions, transactions with related parties and connected persons, tax loss relief, etc.

Availability of small business relief

A taxable resident person may elect to avail this relief subject to specified conditions being met, including revenue of the tax period and previous tax periods not exceeding AED 3,000,000 for each tax period.

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Principles of arm's length & transfer pricing documentation

In determining taxable income, transactions and arrangements between related parties to meet the specified arm's length standards. The authority may require a taxable person to file together with their tax return a disclosure containing information regarding the taxable person's transactions and arrangements with its related parties and connected persons.

Exempt income

Specified income and related expenditure shall not be taken into account in determining the taxable income including dividends and other profit distributions received from a juridical person that is a resident person or from a participating interest in a foreign juridical person as specified.

Conditions for participation exemption

Income from a participating interest (including dividends and other profit distribution from a foreign participation) is exempt from corporate tax, subject to specified conditions.

Reliefs for transfers within a qualifying group & business restructuring

The CIT law provides for corporate tax neutrality where (i) one or more assets or liabilities are transferred between closely related taxable persons, defined as members of a qualifying group and (ii) certain transactions undertaken as part of the restructuring or reorganization of a business.

Deductible and non-deductible expenditures

Chapter 9 specifies expenditure fully deductible, partially deductible (interest and entertainment expenditure) and nondeductible (specified donations, grants or gifts, bribes etc.).

Tax loss relief, conditions for transfer of tax loss & limitation on carry forward of tax losses

The CIT law allows tax losses incurred in one tax period to be offset against the taxable income of a subsequent tax period under certain conditions and up to 75% of the taxable income for that tax period. No definite time period has been specified in respect of carry forward of tax losses.

Tax losses may also be transferred between resident persons with a common ownership of at least 75% and subject to meeting the prescribed conditions.

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Transitional rules

A taxable person's opening balance sheet for corporate tax purposes shall be the closing balance sheet prepared for financial reporting purposes under accounting standards applied, subject to prescribed conditions or adjustments.

Tax Groups and manner of determining taxable income of tax group

Tax group with one or more other resident persons may be formed subject to meeting prescribed conditions (including "Parent Company" to hold at least 95% of share capital and voting rights of a subsidiary, either directly or indirectly through one or more subsidiaries).

Anti- abuse rule

The authority is permitted to counteract transactions or arrangements for corporate tax purposes where it can be reasonably concluded that there is not a valid commercial or other non-fiscal reason which reflects economic reality for the transaction and one of the main purposes is to secure a corporate tax advantage (including refund or an increased refund of corporate tax; avoidance or reduction of corporate tax payable) that is not consistent with the purpose of the CIT Law.



Synopsis of accounting under IFRS

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. The following table explains the stepped approach in accounting for CIT under IAS 12.

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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.

Examples

Taxes payable on capital and reserves; social security taxes payable by the employer (in the nature of employee benefits) are not a levy in scope of IAS 12

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.

Taxable income for Company A for FY 20XX
Corporate tax rate = 9%
Considering the threshold as per CIT Law, current tax = $9\% \times (475,000 - 375,000)$

(Amount in AED)

475,000

9,000

Step 3: Recognise and measure the Deferred tax
Calculate the tax base:
The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes

Calculation of temporary differences, unused tax losses and credits:
Temporary differences are the differences between the carrying amount of an asset or liability in the statement of financial position and its tax bases and can either be a taxable or deductible temporary difference.

Recognition and Measurement of Deferred tax asset (DTA) and DTL (Deferred tax liability):
Apply tax rates that are expected to apply in the period in which the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the end of the reporting period.

Tax base of liability
Carrying amount of loan payable (net of issue cost of AED 200). The issue cost of AED 200 has been allowed for tax purposes in the year of inception of loan.

DTL = $9\%(\text{tax rate}) \times (19,800 - 20,000)$

Tax base of asset
Carrying amount of property, plant and equipment (PPE) after recording impairment loss of AED 500. The impairment loss has no effect on tax base of PPE (as opted by the Company under Article 20 of the CIT Law)

DTA = $9\%(\text{tax rate}) \times (9,500 - 10,000)$

19,800

18

9,500

45

Key principles of accounting for Income Taxes under IAS 12

Step 4: Determine where to recognise income tax Current and deferred tax is recognized as income or expense and included in profit or loss for the period unless the transactions or events are recognized outside of profit or loss in other comprehensive income (OCI) or equity. In such case, the related tax amount is also recognised outside of profit or loss in OCI / directly in Equity.

Examples

Carrying amount of property, plant and equipment (including revaluation gain of 20,000 recognized in OCI)
Revaluation gains are taxable on realization (as opted by the Company under Article 20 of the CIT Law)
Deferred tax liability on the same will be recognized in OCI.

120,000

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Step 5 : Disclosures

The key disclosures under IAS 12 include:

major components of tax expense (tax income) including (a) current tax expense (income) (b) any adjustments to current taxes of prior periods recognised in the period

Reconciliation between the applicable statutory tax rate and the entity's effective tax rate

Reconciliation of effective tax rate

In thousands of AED	20XX		20XX	
Profit before tax from continuing operations	xx		xx	
Tax using the Company's domestic tax rate	xx%	xx	xx%	xx
Effects of tax rates in foreign jurisdictions	(xx%)	(xx)	(xx%)	(xx)
Reduction in tax rate	(xx%)	(xx)	(xx%)	(xx)
Tax effect of:				
-Share of profit of equity accounted investees reported, net of tax	(xx%)	(xx)	(xx%)	(xx)
-Non-deductible expenses	xx%	xx	xx%	xx
-Tax exempt income	(xx%)	(xx)	(xx%)	(xx)
-Tax incentives	(xx%)	(xx)	(xx%)	(xx)
-Current year losses for which no deferred tax asset is recognised	xx%	xx	xx%	xx
Recognition of previously unrecognised tax losses	(xx%)	(xx)	(xx%)	(xx)
Recognition of previously unrecognised (derecognition of previously recognised) deductible temporary differences	(xx%)	(xx)	(xx%)	(xx)
Changes in estimates related to prior years	xx%	xx	xx%	xx
	xx%	xx	xx%	xx



Key impact areas beyond tax

While many companies in the UAE have begun assessing the impact of the CIT law on their businesses from tax calculation and administration stand-point, not many of them have considered impacts beyond tax. In order to ensure effective implementation of CIT law, the taxable person will need to consider and address the wider implications of CIT, including the impact on accounting and reporting, IT systems, finance and tax processes, governance, people and wider business.

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Accounting and Reporting

As per CIT Law, the Taxable income of each taxable person is determined on the basis of standalone financial statements prepared for financial reporting purposes in accordance with accounting standards accepted in the UAE, like IFRS. The taxable income for a tax period is the accounting income for that period, and to the extent applicable, adjusted for the items as specified in Article 20 of the CIT Law (E.g. unrealized gain or loss, exempt income, reliefs, deductions etc.).

The general rule for CIT purposes is that the treatment in the financial statements applies, unless there is a specific rule in the CIT Law or its implementation regulations that prescribes a different treatment.

In this section we have included certain key impact areas in respect of deferred taxes and other matters of accounting and reporting.

1. Election choice under Article 20

Under IFRS, 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, and therefore no receipts that could be used to pay any CIT liability that may arise as a result.

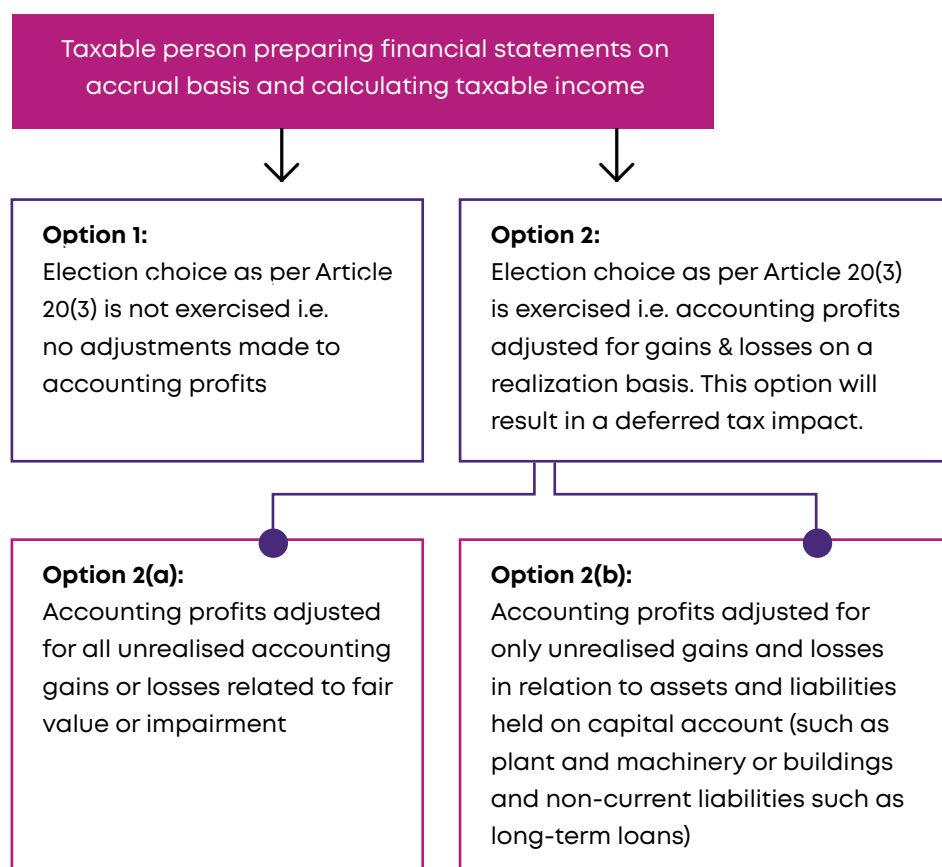
As per Article 20(3) of the CIT Law, where a taxable person prepares financial statements on an accrual basis and has elected to take into account gains / losses on a realisation basis, the potential adjustments will depend on the election option exercised by the taxable person under the law.

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Financial statement line items requiring recognition of deferred taxes depending on the choice elected by the taxable persons :

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



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Worked example

• 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.

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

FVTPL = Fair Value Through Profit & Loss ; FVTOCI = Fair Value Through OCI (Other comprehensive income)

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2. Carry forward of unutilised tax losses

Under IFRS, DTA shall be recognised on the carry forward of unused tax losses and tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and tax credits can be utilised. Article 37 of the CIT law currently prescribes the limit of 75% for tax loss relief available against taxable income of the particular year and Article 39 provides the conditions for carry forward of tax losses. The CIT law does not prescribe a time limit for the carry forward of the tax losses.

Worked example

Company A has a history of recent losses, which is a strong evidence that future taxable profit may not be available. Therefore, the carryforward of tax losses would depend on the evaluation of a) existence of sufficient taxable temporary differences or b) a convincing evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the Company.

Further, in case company A plans business combination or restructuring, the interaction of the tax positions of Company A and its acquiree may result in a change in the assessment of recoverability of company A's DTA. In case company A has not previously recognized a DTA for its tax losses, it may reassess whether as a result of business combination it is able to utilise these tax losses against the future taxable profit of the combined entity.

3. Business combination and restructuring

As per IFRS, in the consolidated financial statements, the identifiable assets acquired and the liabilities assumed as part of a business combination are measured at fair value on the date of acquisition. However, as per CIT Law, in case the entity is not opting to form a tax group, the tax base of assets/liabilities of the acquired subsidiary will be based on the values in acquiree's separate financial statements.

These fair value or Purchase Price Allocation (PPA) adjustments give rise to deferred tax implications requiring recognition of DTA/ DTL in the consolidated financials of the acquirer.

While the CIT law does not provide specific guidance on business combinations, there are certain reliefs available for business restructuring and transfers within a qualifying group whereby no gain or loss needs to be taken into account in determining taxable income.

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Worked example

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.

Note: In the case of formation of a tax group, impact of the PPA adjustments will require further consideration based on the facts of each case.

4. Intra-Group transactions

Under IFRS, intra-group transactions are eliminated on consolidation. Intra-group transaction affects the recognition, measurement and presentation of deferred tax in the consolidation financial statements, mainly due to the effect on tax base and tax rate for the respective assets or liabilities.

The CIT Law also requires elimination of transactions between the Parent and each Subsidiary that is a member of the same tax Group for the purposes of determining the taxable income of the tax group.

Worked example

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.

Scenario 1: Tax Group is NOT formed

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 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.

The recognized DTA will reverse as and when the inventory is sold outside the group.

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.

5. Interest expense

Interest cost under IFRS is generally recognised in profit and loss, based on Effective Interest Rate Method, unless capitalization criteria of IAS 23, Borrowing costs are met. The CIT Law provides that the interest expenditure shall be deductible in the tax period in which it is incurred, subject to specified conditions. Further, net interest expenditure shall be deductible up to 30% of EBITDA (excluding any specified exempt income). The amount of net interest expenditure disallowed in this respect may be carried forward and deducted in the subsequent ten tax periods in the order in which the amount was incurred.

Basis the CIT law read with the relevant ministerial decision No. 126 of 2023, payments economically equivalent to Interest shall be considered interest expenditure or income for the purposes of the general interest deduction limitation rule, regardless of the classification and treatment of the interest component under the applicable accounting standards unless stated otherwise.

Worked example

Company A is subject to tax and has EBTIDA of USD 100 million (excluding any exempt income) for the financial year 20XX. It has recognised in profit and loss, interest on bank loan of USD 20 million and interest on lease liability of USD 25 million. Combined interest expense in the tax year is USD 45 million (i.e. 45% of EBITDA).

Company A can claim interest deduction to the extent of USD 30 million (i.e. 30% of EBITDA) and the remaining USD 15 million will be carried forward for set-off in the subsequent years. On this carried forward balance, DTA shall be recognised subject to the general DTA recognition criteria.



6. Tax Group

The concept of tax group has been introduced by the CIT Law under Article 40, whereby multiple resident persons can apply to act as one taxable person, represented by the parent company. For the purposes of determining the taxable income of a tax group, the parent company shall consolidate the financial results, assets and liabilities of each subsidiary for the relevant tax period, eliminating transactions between the members of the same tax group.

There is no such concept of tax group under IFRS. Accordingly impact for any differences between tax and accounting will require consideration. Also refer point 4. Intra group transactions.

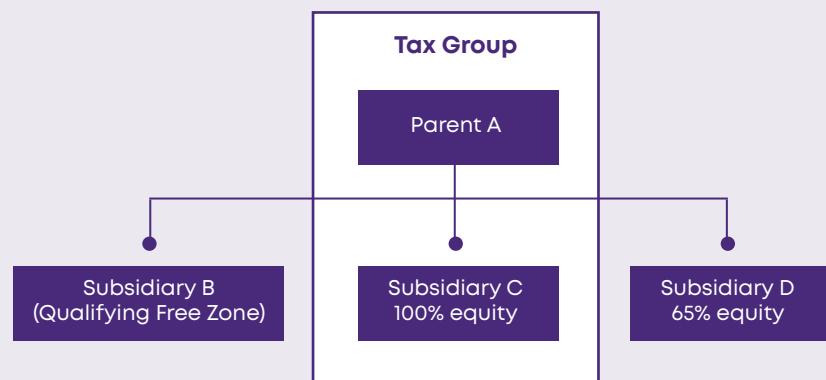
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Worked example



Parent A and wholly owned Subsidiary C have formed a tax group for the CIT law purposes. Subsidiaries B and D are not eligible to be a part of the tax group as per Article 40 of the CIT Law. In this case, management of A is required to:

- Prepare separate set of financial statements for tax purposes, consolidating the financial results, assets and liabilities of the Subsidiary C and eliminating the transactions between itself and Subsidiary C.
- Maintain audited financial statements of the tax group if the revenue exceeds AED 50,000,000 during the relevant tax period.
- Define accounting policy for allocation and treatment of tax expenses between Company A and Subsidiary C.

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7. Transfer of tax losses

Article 38 of the CIT Law allows tax losses to be transferred between the resident persons with a common ownership of at least 75%, subject to prescribed conditions.

In case if the entities opt to avail the benefit of such transfer within the group, it will result in accounting implication of derecognizing the DTA in the books of transferor and recognizing the DTA in the books of the transferee.

Worked example

Company P has a wholly owned subsidiary, Subsidiary S is subject to a tax rate of 9% and has tax losses of USD 100 million. Initially, S recognizes a related DTA of USD 9 million. S agrees to transfer its tax losses of USD 100 million to its parent, company P, at the end of the year.

In such a case, management of S and P is required to :

- Consider if there is any exchange of consideration between P and S for such a loss transfer,
- Derecognize the DTA of USD 9 million related to the tax losses transferred from the books of S and recognise in the books of P.

If tax losses are transferred for no payment, the entities, in their separate financial statements shall choose accounting policy to be applied consistently, to disclose such transfers in their tax reconciliations or to recognise them as equity contributions/ distributions as appropriate.

8. Provision and accruals

As per IFRS, a provision is a liability of uncertain timing or amount and measured at its best estimate. Further, accruals are liabilities to pay for goods or services that have been received or supplied but not yet paid for or invoiced.

Article 28 explains the nature of expenses that are deductible under CIT law. As per Article 28, the expenditure incurred wholly and exclusively for the purposes of the taxable person's business, that is not capital in nature, shall be deductible in the tax period in which it is incurred, subject to the specified provisions. The expenditure is incurred when the obligation to pay arises i.e. when it is irrevocably committed for payment.

Because of the differences in terminology between CIT laws and IFRS, adjustments may be required for taxable profit calculations. Therefore, management should evaluate whether the provisions or accruals under IFRS meet the definition of 'incurred expenditure' as per CIT law. If provisions and accruals do not meet the requirements of CIT law from a deductibility perspective, then the temporary differences will arise requiring recognition of deferred taxes.

Some of the provisions that may need evaluation and assessment include provision for :

- End of service benefits
- Employee stock options plan (ESOP)
- Legal cases

Other impact areas beyond accounting and reporting

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Business

Whether holistic impact on Business has been evaluated?

Management will need to 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.

Governance

Whether clearly defined policies and procedures are developed and communicated within the organization?

Management will need to establish adequate policies and procedures with robust governance and internal control framework to meet the tax and accounting compliance requirements.

People

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.

IT System

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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