

# UAE Deal ahead? Tax points to be aware of to get the deal done

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## Tax points to be aware of to get the deal done

### Highlighting Tax considerations for UAE Mergers and Acquisitions

Last year, M&A markets went into overdrive spurred by the economic boom following the pandemic and increased investor confidence. With this increased activity and a renewed search for value within deals, M&A is at the heart of this region.

The Middle East region is rapidly transforming from a tax perspective - we have seen the introduction of VAT in the UAE, KSA, Oman and Bahrain over the last few years and the proposed introduction of federal corporate income tax in the UAE from June 2023. In addition, in line with BEPS 2.0, significant changes are expected to the current domestic tax legislation across the Middle East which will impact how businesses operate and are liable to taxes.

There is also an increased focus from the regulators and tax authorities to ensure businesses are tax compliant and paying the right amount of taxes (both in the country they are established in and / or in the country they operate in). It is therefore critical for dealmakers to identify “red flags” that could impact deal valuation / cash flows or areas for optimisation going forward. A comprehensive M&A strategy and due diligence process can help enterprises achieve this commercial goal and unlock value for their shareholders.

In line with this focus, this alert covers a general overview and checklist of critical tax elements to keep in mind to help you jumpstart your deal and move it to close.



# Tax due diligence

## Why do a tax due diligence?

Tax due diligence is typically applicable to all deal types, each bringing its own complexities and challenges. When you acquire a business or a target, you would typically inherit the history, including positions adopted by the target which may not be in line with the relevant tax legislation and may result in potential exposures post acquisition (i.e. during a tax audit which could happen anytime within the applicable statute of limitation). We have also seen tax authorities in the region take a more aggressive approach recently and are challenging structures and businesses which have taken aggressive tax positions.

Therefore, whether you are considering an asset or share acquisition, it is critical to understand the historical overview of the target entity through the due diligence process in order to get a better sense of their overall historical tax affairs.

In the UAE currently, tax due diligence should typically consider Corporate Tax ("CT") (only for businesses involved in upstream oil and gas activities and branches of foreign banks in practise), Value-Added Tax ("VAT"), Economic Substance Regulations ("ESR") and Customs and Excise Duty (depending on the industry of the business being acquired).



Generally, diligence work should cover the statute of limitations but can be increased or decreased depending on the nature of the deal (and / or if there are material historical open tax matters which need to be reviewed). As part of the due diligence, the adviser should seek to review a sample of historical tax submissions and underlying documentation to gain comfort that the tax returns being filed are reasonably correct and assess the likelihood of potential risks areas or exposures that may arise (from a technical and practical perspective).

In most cases, appointing an advisor like PwC to support, will not only allow you to get the necessary comfort regarding the target's business operations historically, but also enables you to determine how any exposures identified during the due diligence should be dealt with (for example through protection via a share purchase agreement, adjustment to purchase price, further work that should be done, etc.)

For ease, here's a checklist of focus areas that should be considered during any tax due diligence process.

# Tax due diligence checklist

## Any dealmaker should consider a review of:

1

The tax control environment of the business being acquired, covering the structure and internal controls in place.

2

The tax registration and compliance status and any recent or pending tax audits as well as ongoing litigation with the tax authorities.

3

Any tax liabilities resulting from past material reorganisations, recent acquisitions or disposals.

4

The overall tax profile of the business in relation to input tax recovery position and any material non-recoverable input tax.

5

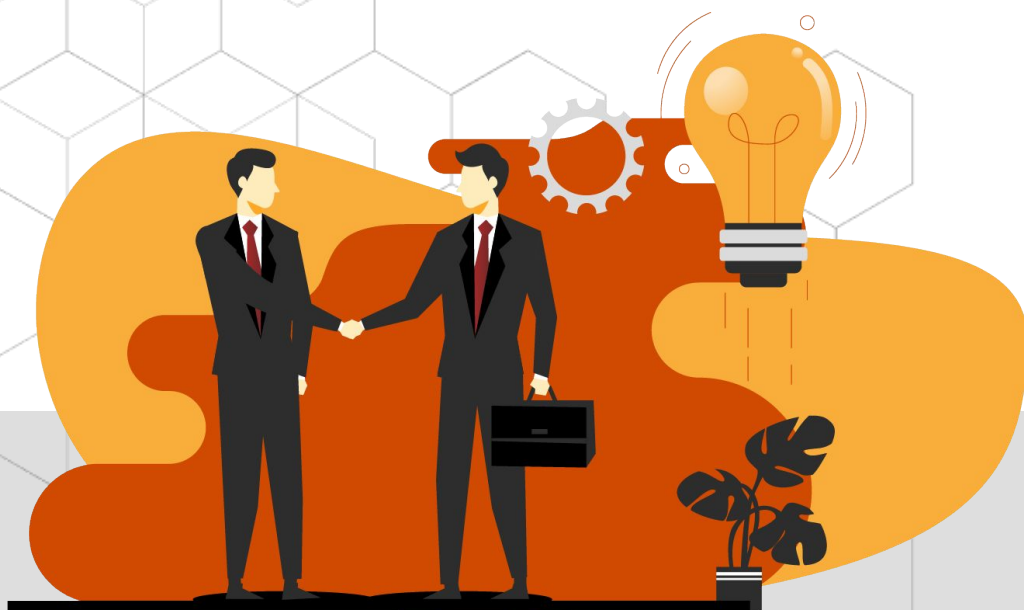
Policies and procedures adopted by the business to identify and report potential tax issues/risks, and how such policies and practices are used in preparing tax returns.

6

Any sector-specific tax risk areas and how the business manages these.

7

Any key tax planning arrangements designed to enhance or accelerate tax recoveries and/or reduce or delay tax liabilities.



# Other tax considerations

## Other key deals tax considerations

### Structuring

Structuring is the backbone of your M&A activity. Properly structuring your deal turns a good deal into a great one. Here one of the main considerations is cash flow. You should aim to shape the deal in a way that has the least amount of impact on one of your most valuable assets, your liquidity.

Closing a deal can be a cash-intensive event. Therefore, to maximise cash flow or limit cash leakage, businesses (particularly those ineligible for full input tax recoverability) should consider whether a transfer of assets could qualify as a transfer of a going concern (TOGC). No VAT should be charged on the sale of the business if the qualifying conditions are met, thus minimising cash flow impact.

In the planning stages of the transaction, spending time to assess the structure of the deal is crucial as you will navigate through rules, regulations, and potential exemptions that could cost you, or could save you.

### VAT

As VAT permeates every transaction a business does, be it standard rated, zero-rated, exempt, or out of scope, it can result in significant issues when a business is not primed to address nuanced VAT matters. A sensible dealmaker will ensure that potential VAT risks are found and identified before moving ahead with the deal. Doing VAT due diligence will not only avoid a lot of unforeseen matters, but it can also lead to opportunities to mitigate past exposures and provide the insights to manage the impact of any vulnerabilities in the future.

### ESR

Businesses should assess whether and which of their activities fall within the scope of the economic substance regulations and how to ensure they meet the economic substance requirements in respect of each Relevant Activity undertaken by the business. This qualitative and quantitative assessment requires considering operational, financial, tax/transfer pricing, legal and governance matters. In addition, there are a number of notification and filing requirements that should be considered by businesses undertaking activity in the UAE. Non-compliance, again, would impact deal-making and negatively impact cash flow due to the significant penalties concerned.

### Customs & Excise (depending on the industry)

The world is changing in trade behaviour, international cooperation and geopolitics, and as a result, customs and excise management are shifting towards a strategic component of managing global operations.

At the same time, changes to the local and regional trade legislation require companies to scrutinise their import, export and indirect tax strategies to comply with increasingly complex local laws. These matters require close attention; otherwise, businesses could incur unnecessary indirect costs during deal-making.

### Proposed UAE Corporate Tax (CT)

Although currently there is no federal corporate tax legislation in the UAE (and business are subject to Emirate level taxation - where in practice CT is only levied on upstream O&G activities or branches of foreign banks), on 31 January 2022, the Ministry of Finance (MOF) announced that a federal corporate income tax will come into effect for financial years starting on or after 1 June 2023. Therefore, any dealmaker considering transaction services should consider the potential CT implications on the structure and how it can impact cash flows / deal valuation.

# Contact Us

For more information on all the deal-making in the UAE, and what tax implications on transaction services might mean for your business, please speak to our specialist PwC contacts listed below.

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