Key UAE CT considerations for financial institutions

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Federal Corporate Tax in the UAE

On 31 January 2022, the UAE Ministry of Finance (MoF) announced the introduction of a federal corporate tax **(CT)** in the UAE that will be effective for financial years starting on or after 1 June 2023.

This will have a substantial impact on banks, insurance companies, investment companies, brokerage firms, etc operating in the UAE.

A number of complexities can arise in relation to freezone entities operating in the UAE, UAE branches of foreign banks, and their tax position once the CT law is enacted. We have summarized a number of key UAE CT considerations below.

General UAE CT considerations

- UAE CT will be applicable across all Emirates and will apply to all business and commercial activities alike including financial services, except for the extraction of natural resources, which will continue to be subject to Emirate level taxation.
- 9% tax rate will apply on income exceeding 375,000 AED. A different tax rate for large multinationals that meet the criteria under ‘Pillar Two’ of the OECD Base Erosion and Profit Shifting project.
- Exemptions will be available for capital gains and dividends earned from qualifying shareholding and qualifying intra-group transactions and restructurings.

Free zone businesses

- Free zone businesses will be within the scope of UAE CT and required to register and file a CT return, but will continue to benefit from CT holidays / 0% taxation if they comply with all regulatory requirements and do not conduct business with mainland UAE.
- It is not clear at this stage what will constitute 'conducting business with mainland'. It may mean that simply earning income from a UAE mainland source could impact the free zone tax holiday / 0% CT rate.
- When more guidance is issued, it is very important that financial institutions operating in free zones check whether they have mixed activities (within free zone and mailand) and assess the tax impact accordingly.

Branches of foreign entities operating in free zones

- Similar to any free zone entity, those should be within the scope of UAE CT and required to register and file a CT return, but will continue to benefit from CT holidays / 0% taxation if they comply with all regulatory requirements and do not conduct business with mainland UAE.

Multinational groups (MNE) / Pillar 2

- The UAE CT regime will have a different tax rate for large multinational groups that meet specific criteria set with reference to 'Pillar 2' of the OECD BEPS project. We assume this means that the UAE will adopt a minimum 15% CT rate or a Qualified Domestic Minimum Top Up Tax for entities that are part of a multinational group. It is not clear whether this will be implemented as a top up tax or a change in rate to 15%.
- To be categorised as an MNE the annual global consolidated revenues of the MNE should be above €750m and the group should operate in more than one jurisdiction (including through branches).
- There are no details as yet on how the UAE will adopt the GloBE rules. Our expectation is that the tax rate applicable to entities that are within the scope of the GloBE rules would also apply to entities located in a free trade zone.
- The effective date of the 15% minimum tax rate should be the same as the CT regime (i.e. for the financial year starting on or after 1 June 2023).
- Financial institutions operating in the UAE (whether in mainland or in free zones) that are part of a large multinational group, need to assess first whether they are categorised as an MNE and accordingly assess the tax position for the UAE subsidiaries, branches, etc.

Key UAE CT considerations for financial institutions

- **Applicability of UAE CT on financial institutions:** all UAE financial institutions will be subject to UAE CT going forward.
- **Applicability of UAE CT for branches of foreign banks**: those will be within the scope of UAE CT and required to register and file a CT return.
- **Applicable tax rate for branches of foreign banks:** UAE CT will apply at 9% on taxable income exceeding AED 375,000, or the higher rate for large multinationals. The current Emirate level taxation (i.e. 20% tax) is expected to cease / be repealed.
- **Deferred tax assets (DTAs) and liabilities recognised by the branches of foreign banks:** this is a concern for branches of foreign banks operating in the UAE as existing DTA's were determined based on the Emirate level law. No transitioning law has been published yet from Emirate Law to federal CT Law and as such there is also no certainty if brought forward Emirate level tax attributes (for example arising from losses or loan impairments) will be available at the Federal level. Our expectation is that the existing DTA's may not be available when the federal tax law is enacted given the uncertainty around transitioning and also as they were calculated at a higher tax rate. Financial institutions will be able to better understand this position once further guidance is available.
- **Bad debt provisioning:** there is uncertainty on whether the UAE CT law will follow the IFRS 9 rules in relation to expected credit losses. If IFRS is to be followed then the impact may be different between taxpayers depending on the nature of the loan assets, for example expected credit losses on secured vs unsecured lending. Financial institutions will need to look into this when more guidance is issued and assess the impact.
- **Asset and wealth management:** the UAE is seeking to enhance its attractiveness as a leading asset and wealth management hub and as a leading centre for the financial services sector. In order to support this, the UAE CT regime is looking into (i) generally treating investment funds as tax neutral vehicles and (ii) including an investment management exemption ("IME"). The IME should allow UAE regulated investment managers to provide discretionary investment management services to foreign funds / customers without triggering adverse UAE tax consequences for those funds or their investors. The IME should be subject to a number of conditions which have not yet been published, however they are expected to be comparable to other leading financial centers.
- **Transfer Pricing rules:**
    - The UAE will introduce Transfer Pricing rules and compliance requirements with reference to the OECD Transfer Pricing Guidelines for financial years starting June 2023 onwards.
    - For UAE branches of foreign banks, there were historically certain guidelines and restrictions in relation to related party charges. In light of this, UAE branches of foreign banks will need to consider any transitional assessments to assess the arm's length nature of such transactions from an OECD perspective.
    - For UAE headquartered banks, all related party transactions will need to be assessed to ensure compliance with the arm's length principle with reference to the OECD Transfer Pricing Guidelines and the necessary compliance documentation will need to be prepared and maintained.

Data, systems, processes and people considerations.

Financial institutions tend to have a large number of IT systems and complex reporting structures, which has led to challenges when compiling VAT returns. Questions to consider the readiness from a CT perspective,

- Do you have entity trial balance data available with sufficient **granularity** for tax purposes in your Chart of Accounts?
- Can you track asset **depreciation for tax** values?
- Can you **extract data** from ERP directly or can your **consolidation system** cater to tax accounting requirements?
- Could you consider **third party technology** to combine functionalities in one platform such as data collection, processing, reporting and filing?
- Who will be **responsible** for Tax matters within the organisation and **sign off the returns**?
- Are there **documented policies** and **procedures** in place?
- To what extent could you be able to **outsource** certain compliance tasks?

How can we help?

Our financial services team works with local and global financial institutions and has a deep understanding of the UAE CT issues typically faced by the sector. We would be delighted to arrange an introductory call to discuss these issues in more detail and how we may be able to support you.

Contact us

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