



# M2K UAE Updates- Taxation of Free Zone Persons

***ALERT***

## PREFACE

The UAE has offered investors with more than 40 options of Free zones ('FZ'), which have been considered as an important part of the UAE economy and have been pivotal to achieving the country's aim of encouraging foreign direct investment and enhancing the ease of doing business.

Various benefits have been granted to foreign investors like 100% foreign ownership, 100% repatriation of Capital and Profits, fast and easy business set-up procedures, easier access to Market, Options for Competitive Costs, independent Laws & Regulations, and tax exemptions.

We intend to discuss the provisions of the Corporate Tax ('CT') Law in relation to taxation of FZ, duly considering:

- The Cabinet Decision No. 55 of 2023 and
- The Ministerial Decision No. 139 of 2023



# Corporate Tax Provisions – Free Zone Persons

- The CT Rates as applicable to a 'Qualifying FZ Person' is as follows:
  - 0% on 'Qualifying Income' and
  - 9% on Taxable Income that is not Qualifying Income<sup>1</sup>.
- A qualifying FZ Person has an option to elect to be subject to Corporate Tax, on par with a non-FZ person.
- A FZ person that meets **all** the below conditions is considered as 'Qualifying FZ Persons':

## Qualifying FZ Persons - Conditions

- Maintains adequate substance in UAE<sup>2</sup>
- Derives Qualifying Income
- Non-qualifying revenue shall not exceed the '*de minimis requirements*'
- Has not opted to be subject to CT on par with a non-FZ Person
- Complies with arm's length requirements and transfer pricing documentation
- Prepares and maintains Audited Financial Statements



<sup>1</sup> Threshold limit of AED 375,000 would not be available to the Qualifying FZ Person. <sup>2</sup> The qualifying FZ Person should undertake its core income-generating activities in a FZ and shall have adequate assets, no. of qualified employees and incur adequate operating expenditure. The activities can be outsourced to other FZ Person, duly exercising adequate supervision over the outsourced activity.

# Corporate Tax Provisions – Free Zone Persons



- Where a qualifying FZ person fails to meet any of the above conditions, he shall cease to be a qualifying FZ person from the beginning of the relevant tax period and subsequent 4 tax periods.
- ‘Qualifying Income’ includes the following:
  - Income derived from transactions with other FZ persons<sup>3</sup> (except, ‘*excluded activities*’)
  - Income derived from Non-FZ Persons from ‘*Qualifying Activities*’ (except, ‘*excluded activities*’)
  - Other income subject to ‘*de minimis requirements*’
- It is to be noted that ‘Qualifying income’ shall not include the following:
  - any income attributable to a permanent establishment (‘PE’) in UAE Mainland and Foreign country.
  - Ownership or exploitation of immovable property

<sup>3</sup> Such FZ person shall have the right to use or enjoy the service or the good and should not have a contractual or legal obligation to pass on the same to another person.

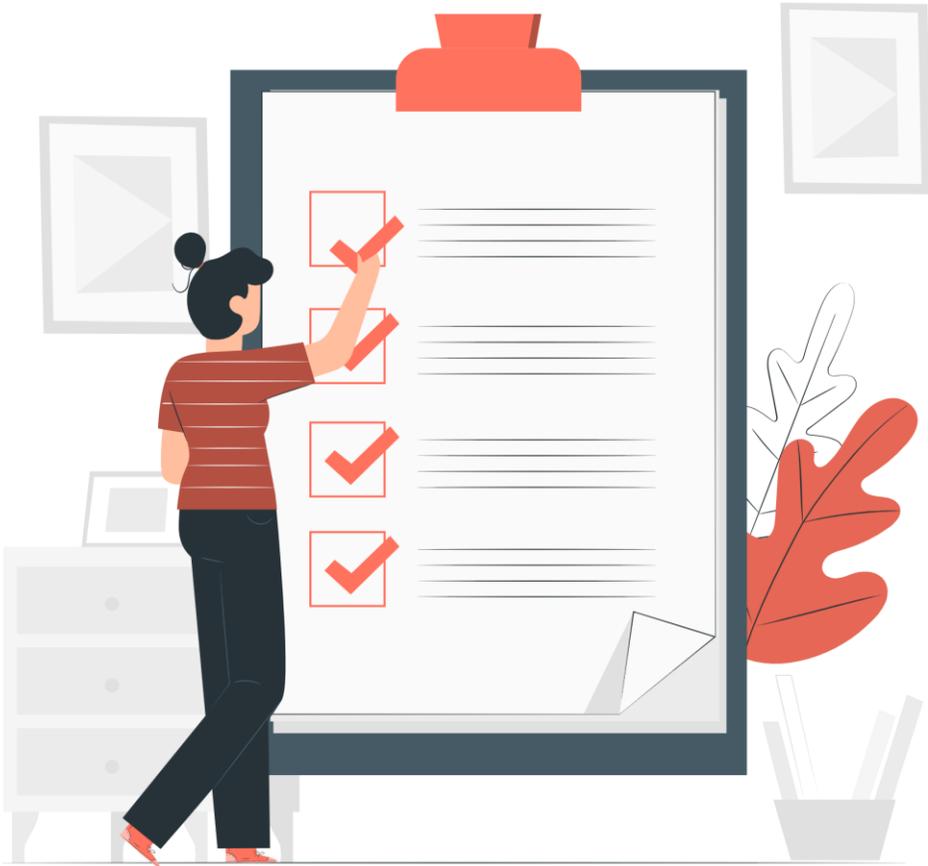
# Corporate Tax Provisions – Free Zone Persons

- **Following are the list of 'excluded activities:**
  - Any transactions with natural persons, except:
    - Ownership, management and operation of Ships, financing & leasing of aircrafts, engines and rotatable components
    - Fund Management Services & Wealth & investment management services, regulated in UAE
  - Banking and insurance (except re-insurance), regulated in UAE
  - Finance and leasing, regulated in UAE except treasury and financing to Related Parties, financing & leasing of aircrafts etc.)
  - Ownership and exploitation of immovable properties (except commercial property in FZ, where transactions are entered into with other FZ Persons)
  - Ownership and exploitation of intellectual property assets
  - Any activities ancillary<sup>4</sup> to the above activities



<sup>4</sup> Ancillary activities serves no independent function, but is necessary for performance of the main excluded activity.

# Corporate Tax Provisions – Free Zone Persons



- **Following are the list of ‘Qualifying activities:**

- Manufacturing or processing of goods or materials, Distribution of goods or materials<sup>5</sup> in or from a ‘Designated Zone’ to a customer who re-sells/ processes or alters the same for sale or re-sale.
- Logistics Services
- Holding of shares and other securities
- Ownership, management and operation of Ships
- Reinsurance, fund management, wealth and investment management services, regulated in UAE
- Headquarter services, Treasury and financing services to Related Parties
- Financing and leasing of aircrafts, engines and rotatable components
- Any activities ancillary<sup>6</sup> to the above activities.

<sup>5</sup> The goods or materials entering the UAE must be imported through the Designated Zone. <sup>6</sup> Ancillary activities serves no independent function, but is necessary for performance of the main qualifying activity.

# Corporate Tax Provisions – Free Zone Persons

- **De Minimis Requirements:**

- Non-qualifying revenue of a qualifying FZ person in a tax period should not exceed the lower of the following:
  - 5% of the total revenue (or)
  - AED 5 million
- The revenue from the following are to be excluded from calculation of non-qualifying revenue and total revenue:
  - Transactions with Non-FZ persons in respect of commercial property
  - Transactions with any Persons in respect of non-commercial property
  - Revenue attributable to a UAE Mainland PE or a foreign PE<sup>7</sup>



<sup>7</sup> A Qualifying FZ person and its PE in UAE mainland/ Foreign Country are to be treated as separate and independent person that is a related party of such person

# Corporate Tax Provisions – Free Zone Persons

We present below, comparative CT rate in respect of various income earned by a qualifying FZ Person from FZ persons and non – FZ persons, based on our understanding at this point of time:

Nature of transactions from which income is derived	Applicable CT rate – Income from	
	FZ Persons	Non-FZ Persons
<b>Sale of manufactured/ processed goods:</b>		
a) to juridical persons	0%	0%
b) to natural persons	9%	9%
<b>Sale of traded goods:</b>		
a) to juridical persons – from a designated zone	0%	0%
b) to juridical persons – from FZ, but not a designated zone	0%	9%
c) to natural persons	9%	9%
<b>Sale/ leasing/ renting of commercial property in free zone</b>		
a) to juridical person	0%	9%
b) to natural person	9%	9%
Sale/ leasing/ renting of other than commercial property in free zone/ mainland – to juridical persons/ natural persons	9%	9%



# Corporate Tax Provisions – Free Zone Persons

Nature of transactions from which income is derived	Applicable CT rate – Income from	
	FZ Persons	Non-FZ Persons
Ownership and exploitation of intellectual property assets	9%	9%
<b>Rendering of Business/ Tax Consultancy Services:</b>		
a) to juridical persons	0%	9%
b) to natural persons	9%	9%
<b>Rendering of Logistics Services:</b>		
a) to juridical persons	0%	0%
b) to natural persons	9%	9%
<b>Services to related parties (juridical persons):</b>		
a) Headquarter services, Treasury and financing services	0%	0%
b) Technical Services	0%	9%



# Corporate Tax Provisions – Free Zone Persons

Nature of transactions from which income is derived	Applicable CT rate – Income from	
	FZ Persons	Non-FZ Persons
<b>Financing (other than banking) activities:</b>		
a) for aircrafts – to juridical persons/ natural persons	0%	0%
b) for other than aircrafts, engines, rotatable components		
i) to related parties - juridical persons	0%	0%
ii) to related parties – natural persons	9%	9%
iii) to third parties	9%	9%
<b>Banking, Insurance (other than re-insurance), financing &amp; leasing (other than for aircrafts etc.) activities</b>	9%	9%
<b>Re-insurance (regulated)</b>		
a) to juridical persons	0%	0%
b) to natural persons	9%	9%
Fund management, Wealth & investment management (regulated) – to juridical persons/ natural persons	0%	0%
<b>Ownership and management of ships - juridical persons/ natural persons</b>	0%	0%

# Corporate Tax Provisions – Free Zone Persons

## Concluding Thoughts

- There has been an understanding that the FZ businesses are exempt from taxes, including the CT. The Public Consultation Document on Corporate Tax had also spelt out that UAE CT regime will honour the tax incentives currently being offered to FZ Persons. It was also proposed in the Public Consultation document that the income earned from transactions with businesses outside of the UAE would be subject to CT @ 0%.
- However, with the definition of ‘qualifying income’ prescribed recently, it is noted that there has been a significant departure from the aforesaid understanding and the exemption from CT in respect of FZ Persons has been granted for limited activities only. Additionally, it is noted that costly consequences have been prescribed for earning non-qualifying income beyond the prescribed de-minimis. *It appears, that FZ aren't totally tax-free anymore!*



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# THANK YOU

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