



M2K UAE Knowledge Series

Taxation of Non-Residents State Sourced Income

ALERT #2



In the last alert, we discussed that the income of a non-resident is taxable in UAE if it is UAE State Sourced Income. This alert of the series aims to discuss the concept of ‘State Sourced Income’ under the UAE Corporate Tax Law briefly.

Internationally, the criteria used widely for imposing tax on a person or on an income has been the residency of such person, and the source of the income. The general principle is that:

- The residents are taxed on their income earned all over the globe (subject to certain relief by way of exemption of income, granting of credit for tax paid in other jurisdictions etc.)
- The non-residents are taxed on certain income which are sourced from the state.

In line with the same, UAE levies tax on non-residents, in respect of income sourced within UAE.

This is an important aspect for the non-residents/ foreign companies that sells goods/ provide services to persons in UAE/ earn any income having nexus to UAE. However, the provisions of the Double Tax Avoidance Agreement (‘DTAA’) entered by UAE with various countries (to the extent beneficial) would prevail over these provisions. The aspect of DTAA is not the subject matter of this alert.

State Sourced Income

Any of the following instances would be considered as 'State Sourced Income' :

A

Income derived from a Resident Person

B

Income attributable to the permanent establishment ('PE') in UAE of a non-resident

C

Income derived from:

- Activities performed in UAE or
- Assets located in UAE or
- Capital invested in UAE or
- Rights used in UAE or
- Services performed or benefitted from UAE.



State Sourced Income - Inclusive List (1/2)

An inclusive list of income considered as 'state sourced income' has been provided as below:

1	<p>Sale of goods in UAE</p> <p>For example, an Indian Company which takes part in an expo conducted in UAE and sells its goods in such expo. Income therefrom would fall within the ambit of 'State Sourced Income'.</p>
2	<p>Provision of services that are rendered or utilised or benefitted from UAE</p> <p>The ambit appears to be very wide and covers every service, unlike many of the jurisdictions that cover only 'technical services' that require application of knowledge, skill and experience under the ambit source-based taxation in the hands of non-residents. Further, India – UAE DTAA does not have an article on Fee for Technical Services. Hence, whether the provisions of the India – UAE DTAA on 'Business Income' or the 'Other Income' should be applied or the provisions of domestic tax provisions on services should be applied has been a debated matter. Hence, where an Indian resident earns any income from services to any person in UAE should watch out for these aspects carefully.</p>
3	<p>Contract to the extent wholly or partly performed or benefitted from UAE</p> <p>There could be composite contracts involving both supply of goods and services (for example, Engineering, Procurement and Construction Contracts/ Supply, installation and maintenance contracts etc.) different parts of which are executed in different states , where it may not be practical to exactly demarcate the transaction into sale of goods and provision of services and evaluate the applicability of the above clauses (i) and (ii). Performance of such contracts in UAE or performance of the same, where benefitted from UAE by non-residents without constituting a PE in UAE are sought to be included under the ambit of taxation by virtue of this clause.</p>
4	<p>Moveable or immovable property in UAE</p>

State Sourced Income - Inclusive List (1/3)

An inclusive list of income considered as 'state sourced income' has been provided as below:

5	Disposal of shares or capital of a Resident Person
6	<p>Interest that satisfies any of the following conditions: (a) Loan is secured by movable or immovable property located in UAE or (b) The borrower is a resident person or a Government entity</p> <p>Consider an example where a Holding Company in UAE provides its immovable property as security in respect of the loan secured by its subsidiary company in India. Scenario: a) from a financial institution in India and b) from a financial institution from a third country.</p> <p>Under Scenario (a), the interest income becomes taxable, supposedly in the hands of the Indian financial institution, in both India (country of residence of the recipient) and UAE (country of situation of the property offered as security is provided).</p> <p>Under Scenario (b), a situation could arise that the interest could be taxed in three countries (India being source country, third country being country of residence of the recipient of the interest income and UAE being the location of property offered as security).</p>
7	Use or right to use in UAE, or grant of permission to use in UAE in respect of any intellectual property or intangible property
8	<p>Insurance or reinsurance premium in any of the following cases:</p> <ul style="list-style-type: none">a) The insured asset is located in UAEb) The insured person is a resident of UAEc) The insured activity is conducted in UAE



Corporate Tax implications of 'UAE Sourced Income' (1/2)

In the hands of foreign individuals

- It has been clarified that foreign individual are subject to Corporate Tax in UAE as a “resident person” to the extent he/ she is engaged in business or business activity (as per cabinet decision to be issued) in UAE.
- A foreign individual who does not conduct business in UAE would generally not be subject to Corporate Tax in UAE. Earning UAE sourced income would not trigger Corporate Tax in the hands of such individuals.

In the hands of foreign companies & other juridical persons

- A clarification has been provided that: “Merely earning UAE sourced income would not trigger CT payable or require the foreign entity to register and file UAE CT”.
- Further, UAE Corporate Tax Law provides for withholding tax in respect of categories of state sourced income derived by a non-resident to be prescribed in the cabinet decision. The withholding tax rate is prescribed as 0% or any other rate as prescribed in cabinet decision.



Corporate Tax implications of 'UAE Sourced Income' (2/2)

Internationally, where source-based taxation is imposed on non-resident persons or foreign companies (not having a permanent establishment in the state), the tax is prescribed as certain percentage on the gross income. Further, the responsibility is cast on the resident making payment to the non-resident person or foreign company to withhold the applicable tax, as a tax collection mechanism. These mechanics ensure that there is no compliance burden (such as maintenance of books of account, calculation of income in accordance with the provisions of the tax laws, filing of return etc.) is cast on the non-resident person or foreign company.

Apparently, UAE Corporate Tax Law has not prescribed for any taxation based on gross income in respect of state sourced income of non-resident persons. However, provision has been incorporated in the Corporate Tax Law for prescribing tax rates for withholding tax in respect of the same.

There should be more clarity in respect of the taxation of state sourced income in the hands of non-residents, once cabinet decisions/ other clarifications are issued in due course. Before we conclude, we re-iterate again that the provisions of the DTAA by UAE with various countries would prevail over UAE Corporate Tax Law, to the extent more beneficial. Hence, the scope of taxation in the hands of the non-residents of UAE would get reduced to the extent provided for in the DTAA.



Stay tuned for more updates on UAE!

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