

# M2K UAE Knowledge Series

## Exempt Persons and Exempt Income

***ALERT #4***

## Preface

In the previous alerts of this series, we discussed the concept of 'taxable person' and the income of a Residents / Non-Resident ('NR') that are included under the ambit of 'taxable income' in UAE.

This alert of the series aims to discuss the concept of 'exempt persons' and 'exempt income' in UAE



# Exempt Persons

The following persons are exempt from the levy of corporate tax:



## 1 Exempt Entities (except income from business / business activities)

- Government Entity
- Government Controlled Entity

## 2 Persons engaged in the following businesses (subject to conditions)

- Extractive Business
- Non-extractive natural resource business

## 3 Other Exempt entities (Subject to conditions)

- Qualifying Public Benefit Entity
- Qualifying Investment Fund
- Pension on Social Security Fund subject to regulatory oversight<sup>\*</sup>
- UAE Juridical Person wholly owned and controlled by specified persons
- Any other person as per cabinet decision

<sup>\*</sup> Government entity or Government controlled entity or qualifying investment fund and Pension or Social Security fund.

# Government and Government Controlled Entity



- The entity's income so far it relates to any business or business activity (to be specified in the cabinet decision) would be taxable. Further, the entity is to be treated as a 'taxable person' for the purpose of certain provisions of Corporate Tax Law<sup>1</sup>.
  - Business or business activity conducted by the said entities under a license are is treated as an independent business in respect of which separate financial statements are required to be prepared and taxable income should be determined separately.
  - Government entities have an option to make an application to the tax authorities for all its taxable business or business activities to be treated as a Single Taxable Person.
- However, there are no provisions for such option for Government Controlled Entity.**
- Transactions between exempt activities and taxable business or business activities are to be subject to the provisions of Transfer Pricing<sup>2</sup>.

<sup>1</sup>Transfer within qualifying group, Business restructuring relief, Transfer of tax losses and Tax Group. These aspects are to be discussed in detail in the subsequent issues of this series. <sup>2</sup>To be discussed in detail in the subsequent issues of this series.

# Extractive & Non-Extractive Natural Resources Business

- The entity's income so far it relates to any business or business activity (to be specified in the cabinet decision) would be taxable. Further, the entity is to be treated as 'taxable person' for the purpose of certain provisions of Corporate Tax Law<sup>1</sup>.
- The income of the captioned nature would be exempt from Corporate Tax, subject to the following conditions:
  - The right, concession or license issued by Local Government to undertake Extractive / Non-Extractive Natural Resource business is held by the person directly/ indirectly.
  - The person is effectively subject to Emirate level Taxation (imposed by Local Government).
  - The person shall calculate the taxable income for its other businesses independently.
- Transactions between the captioned businesses and other businesses or business activities are to be subject to the provisions of Transfer Pricing<sup>2</sup>.
- The exemption under discussion would not be applicable to contractor, sub-contractors, suppliers etc. of the persons engaged in the captioned businesses (unless such third parties satisfy the conditions laid down in their own capacity).



<sup>1</sup> Transfer within qualifying group, business restructuring relief, transfer of tax losses and Tax Group. <sup>2</sup> To be discussed in detail in the subsequent issues of this series.

# Qualifying Public Benefit Entity

- The captioned entity is exempt from tax, provided the following conditions are satisfied:
  - Established for specified purposes<sup>1</sup>
  - Operated for promotion of social welfare or public benefit (Professional entity, Chamber of Commerce etc.)
  - Does not conduct business or business activity, except for the activities directly relate to/ is aimed at fulfil the objectives for which the entity is established
  - No part of income or asset of the Company is for the personal benefit of any related persons

Additional conditions may be imposed through Cabinet decision.

- The exemption is effective from the beginning of the tax-period in which the captioned entity is listed in the Cabinet decision / any other date as granted by the tax authorities.
- The tax authorities may request any relevant information/ records duly prescribing the timelines, for monitoring the compliance of conditions laid down with regard to the exemption granted.



<sup>1</sup> Religious, Charitable, Scientific, Artistic, Cultural, Athletic, Educational, Healthcare, Environmental, Humanitarian, Animal Protection or Similar Purposes.

# Qualifying Investment Fund

- **The captioned entity is exempt from tax, provided the following conditions are satisfied:**
  - The investment fund or the investment fund's manager is subject to regulatory oversight.
  - The interest in the investment fund is traded on a recognized Stock Exchange or
  - The main or principal purpose of the captioned entity is not to avoid Corporate Tax

Additional conditions may be imposed through Cabinet decision.

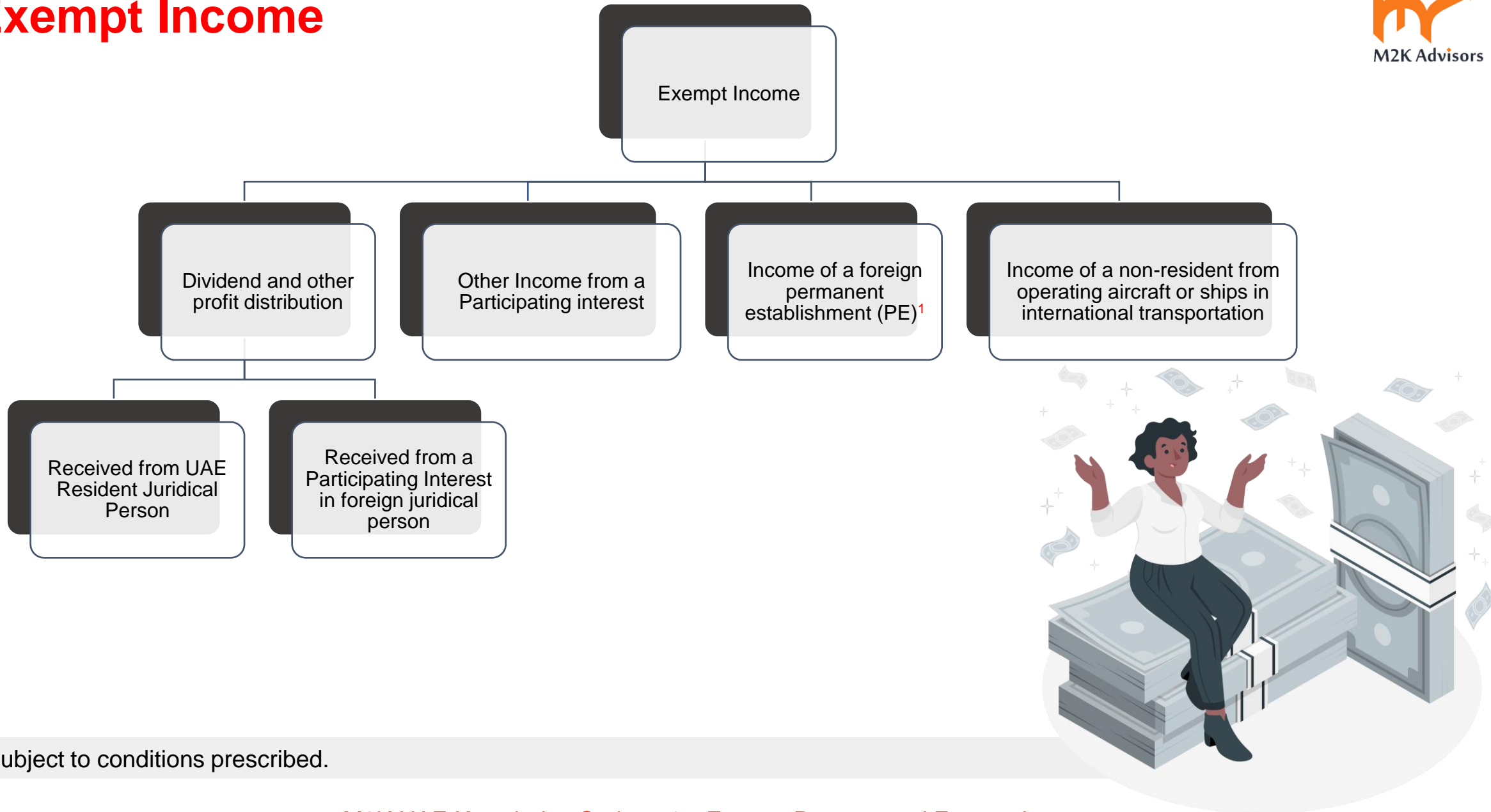
- The tax authorities may request any relevant information/ records duly prescribing the timelines, for monitoring the compliance of conditions laid down with regard to the exemption granted.
- **Application to the tax authorities for tax exemption:** Exempt entities namely, Qualifying investment fund, a pension or social security fund, UAE Juridical person wholly owned and controlled by specified persons<sup>1</sup>, any other person as per cabinet decision are required to make an application to the tax authorities in form/ manner to be prescribed, in order to enjoy tax exemption. The exemption would be available from the tax period specified in the application/any other date as granted by the tax authorities.
- **Consequences of failure to meet any of the conditions:** Such person would cease to be an 'exempt person' from the beginning of the tax period in which the any of the conditions are not met. The finance minister is empowered to prescribe for certain relaxations from these consequences.



<sup>1</sup>Government entity or Government controlled entity or qualifying investment fund and Pension or Social Security fund.



# Exempt Income



<sup>1</sup> Subject to conditions prescribed.



# Participation Exemption (1/6)



- **‘Participating Interest’** means a 5% (five percent) or greater ownership interest in the shares or capital of a juridical person (‘participation’).
- The exemption in respect of income from the participating interest is subject to the following conditions:
  - a) The participating interest is held or intended to be held for an uninterrupted period of at least 12 months.
  - b) The participation is subject to Corporate Tax or Income-tax at a rate not less than 9%.
  - c) The participation holder is entitled for not less than 5% of distributable profits and liquidation proceeds.
  - d) Not more than 50% of the direct and indirect assets of the participation consists of ownership interests or entitlements that would have not qualified for an exemption, if the same were directly held by the taxable person.

*The finance minister is empowered to prescribe any other conditions.*

Conditions (both in terms of the quantum of holding and period of holding, which should have been subject to income tax or corporate tax) have been made for income to be eligible for exemption as income from participating interest.

# Participation Exemption (2/6)



- Where the condition of holding period of 12 months is not satisfied subsequent to availing of the exemption, the income exempt earlier would be taxable in the tax period in which the ownership interest falls below 5%.

The exemption in respect of income from participation interest is available even in a situation where the participation interest has not been held for a period of 12 months as at the date of accrual of income from participating interest, but it is intended to be held for an uninterrupted period of 12 months (i.e. taking into account both the period from the date of acquiring the participating interest and the period after accrual/ receipt of income). The above flexibility provided for claim of exemption would be helpful to enjoy exemption even in the first year of acquiring the participation interest (irrespective of the period for which the same is held till the date of accrual of income).

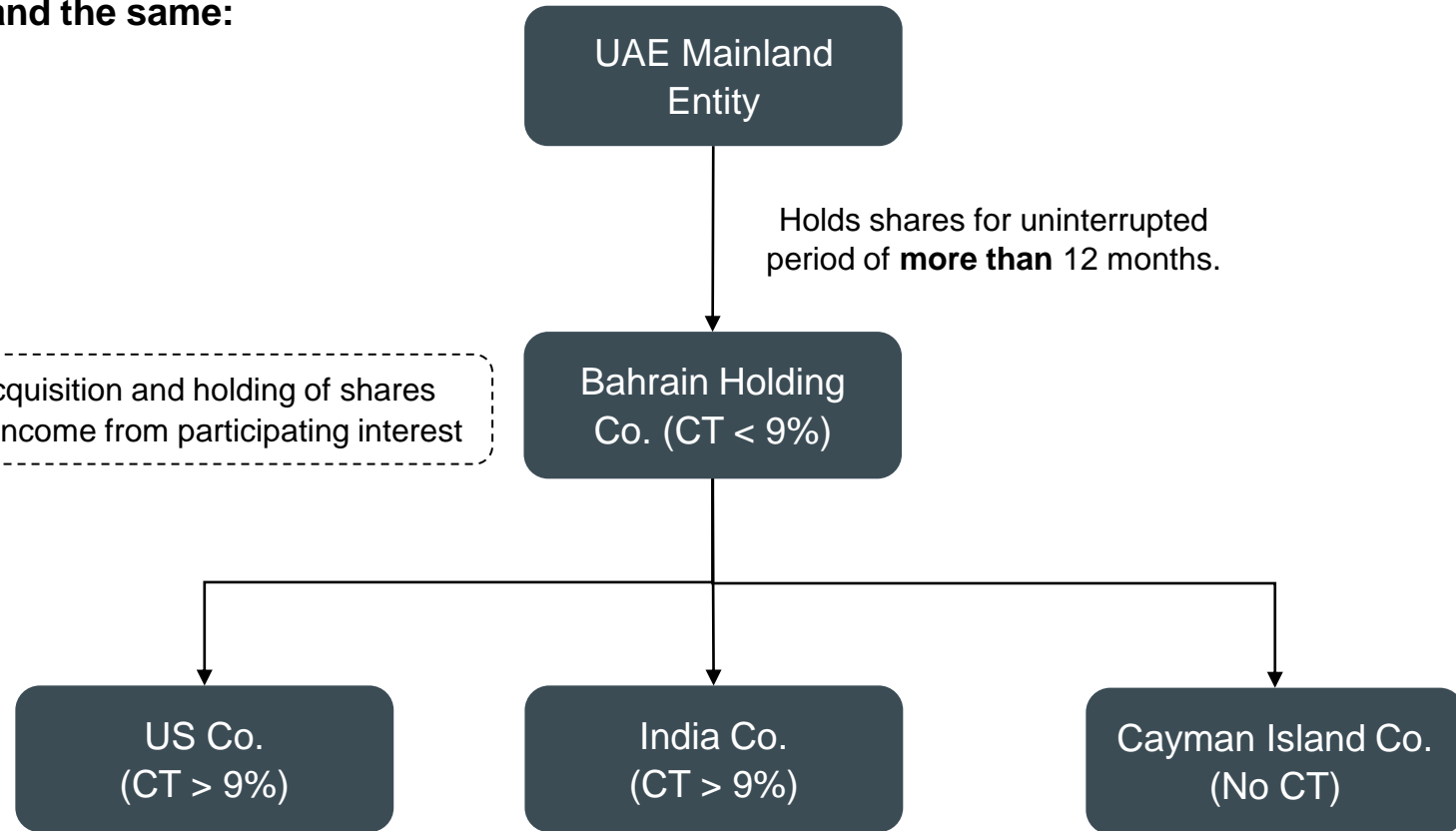
- The [condition \(b\)](#) is considered to be satisfied in the below cases:
  - The principal objective and activity of the Participation is the acquisition and holding of shares or equitable interests that meet the aforesaid condition and
  - The income of the participation received during the relevant tax period(s) substantially consists of income from participating interest.

Certain terms used like 'principal objectives', 'substantially consists of' etc., are capable of different interpretations. We await for clarity on these aspects as of date.

# Participation Exemption (3/6)

Refer the given illustration to understand the same:

**Principal objective & activity** - Acquisition and holding of shares  
**Income substantially** consists of income from participating interest



In the above example, if more than 50% of the net assets of Bahrain Holding Co., are from US Co., and India Co., the dividend income/ capital gains received from Bahrain Holding Co., should be eligible for exemption in the hands of UAE Mainland entity.

# Participation Exemption (4/6)



- Further, a participation in a Qualifying Free Zone Person or an Exempt Person is also considered to be satisfying condition (b) .
- The below income from a participating interest shall be covered by the exemption:
  - Dividend and other profit distributions
  - Gain on transfer, sale or other disposition of participating interest
  - Foreign exchange gains and reversal of impairment
- Certain losses associated with participation interest are not eligible for deduction in determining Taxable Income.

# Participation Exemption (5/6)

The exemption would not be available in the following cases:

- The participation is allowed deduction for the distributions under applicable tax laws
- The taxable person/ related party subject to UAE Corporate Tax had recognized deductible impairment loss in respect of participating interest/ loan receivable from the participation \*

**\* Subsequent reversal of impairment loss is exempt from tax, where exemption was not granted in respect of income from participating interest.**

- The exemption does not cover loss realized on the liquidation of a participation.
- The exemption shall not be applicable for a period of two years if the participation was acquired in specific situations
- The finance minister is empowered to prescribe that an ownership in the shares of capital of a juridical person, whose cost exceeds specified threshold to meet the minimum ownership condition prescribed.

**Different situations that could arise, when dealing with participating interest have been envisioned and specific provisions as applicable to each of those situations have been incorporated in the Tax Law.**



# Participation Exemption (6/6)

In a nutshell,

- **Domestic dividend and other profit distribution** from UAE artificial juridical persons (including exempt entities and Free Zone Persons) are exempt in all cases.

However, the dividend and other profit distribution from foreign juridical persons are subject to participation requirements.

- Thus, economic double taxation of profits and dividend are completely mitigated in case of UAE artificial juridical persons and foreign juridical persons, where participation conditions are met.

However, in case of dividend from foreign juridical persons where participation conditions are not met, there are possibilities of double taxation. The provisions of the Double Taxation Avoidance Agreement (DTAA) between UAE and respective countries should be in such cases.

- **Capital gains** in respect of transfer of shares or ownership interest in both domestic and foreign entities are exempt from tax, subject to meeting the participation conditions.



# Income of a non-resident from operating aircraft / ships in International transportation

The income of non-resident from operation of aircraft or ships in international transportation would not be subject to Corporate Tax, provided such non-resident is engaged in any of the following businesses:

- International transport of passengers, livestock, mail, parcels, merchandise or goods by air or by sea.
- Leasing or chartering aircrafts or ships used in international transportation.
- Leasing of equipment which are integral to the seaworthiness of ships, or the airworthiness of aircrafts used in international transportation.



**Income of a foreign PE:** The provisions of the UAE Corporate Tax Law with respect to the option of not including the income of a foreign PE in its taxable income in UAE have been discussed in the previous alert ([M2K UAE Alert #3](#)).



# Stay tuned for more updates on UAE!

Please find below the list of completed & upcoming alerts from the series. In case you have missed the previous alerts, click on the hyperlink for the completed alerts to refer the same.

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