

Case Study: Exemption and the 0% Corporate Tax Rate – Interplay

The facts

A company is registered in the UAE free zone. It earns dividends and capital gains. Dividends come from foreign entities and from UAE residents.

The company received in a tax period:

73%	dividends from <i>foreign</i> companies on shares held for <i>more than 12 months</i> (income qualifying for both the 0% rate and the Participation Exemption),
20%	dividends from <i>foreign</i> companies on shares held for <i>more than 12 months</i> , Qualifying for the 0% rate but not qualifying for the Participation Exemption (e.g. investment is below the 5% threshold);
7%	dividends from <i>UAE resident</i> companies on shares held for <i>less than 12 months</i> (do not qualify for 0% but are unconditionally exempted ¹).

In the next period, the shares of resident companies have been sold before 12 months of uninterrupted holding has expired. In the subsequent periods 100% of the income qualifies for the 0% Corporate Tax rate.

The question

May the Company apply the 0% Corporate Tax rate in either of these periods?

The analysis

1. The answer depends on whether dividends generated by non-qualifying (for the 0% rate) activity (dividends on shares of residents held for less than 12 months) shall be included in the calculation of de minimis.

Investment in a foreign company also brings exempted income. However, this income qualifies for the 0% rate as well. Thus, such dual qualification doesn't affect the calculation of de minimis.

2. Clause 2 of Article 4 of Cabinet Decision No. 100 determines that for calculating de minimis:

¹ Article 22(1) of the Corporate Tax Law.

- Non-qualifying Revenue is Revenue derived from Excluded Activities and non-Qualifying Activities where the other party to the transaction is a Non-Free Zone Person (or Free Zone Person but not the Beneficial Recipient of the relevant services or Goods).
- Total Revenue is all Revenue derived by a Qualifying Free Zone Person in a Tax Period.

Clause 3 of the same Article lists revenues, which have to be excluded from the calculation of de minimis threshold. Revenues corresponding to exempted income are not in this list.

A literal interpretation of these rules requires exempted incomes to be included in the revenues to be compared with the thresholds set by the Minister.

3. On November 16, 2023, the FTA released [Corporate Tax Guide 'Taxation of foreign source income' No. CTGFSI1](#). Example 5 in this Guide indirectly confirms the above conclusion.

It illustrates how a threshold for the cash basis of accounting (AED 3 mln in revenues) is to be calculated where a taxpayer has exempted revenues. Revenues are derived from UAE and foreign sources. Revenues covered by the Participation Exemption shall also be measured with the threshold set on the basis of the taxpayer's total revenues: *'Additionally, whilst the Dividends received from its subsidiaries ... are not taxable as they are Exempt Income, such receipts still count towards the Revenue threshold of AED 3,000,000 for the purposes of determining whether it can adopt Cash Basis of Accounting'*.

4. Non-Qualifying revenues from shares in Resident Companies exceed threshold established in Article 3 of [Ministerial Decision No. 265 of 27 October 2023](#): *'the de minimis requirements shall be considered satisfied where the non-qualifying Revenue derived by the Qualifying Free Zone Person in a Tax Period does not exceed 5% ... of the total Revenue of the Qualifying Free Zone Person in that Tax Period or AED 5,000,000 ..., whichever is lower'*.
5. In the 3rd year, 100% of the revenues are gained from a shareholding qualifying for the 0% Corporate Tax rate. However, Art. 5(2) of this Decision deprives the Company from the 0% rate *'from the beginning of the relevant Tax Period and for the subsequent (4) four Tax Periods'*. Therefore, in the 2nd, 3rd, 4th and 5th years, the 0% Corporate Tax rate is also not applicable.

The conclusions

In view of the above, we believe that:

- (1) the Company may not apply the 0% Corporate Tax rate to Qualifying incomes in the 1st year because exempted income is compromised by exempted non-qualifying income.

- (2) This precludes the company from applying the 0% Corporate Tax rate in the 4 subsequent periods when all incomes of the Company are qualifying.
- (3) This is not fair and doesn't make sense to us. Art. 20(2) of the [Corporate Tax Law](#) excludes exempted income from 'taxable income' to which a tax rate is applicable. Why, then, should it be factored into the calculation of the de minimis threshold designed to choose the tax rate?
- (4) Maybe, the FTA and the Ministry of Finance will differentiate approaches to calculating revenue-based thresholds [for the Cash Basis of Accounting](#) and for the 0% rate (de minimis). The difference in the goals of these thresholds may be good rationale for this.

The disclaimer

Pursuant to the [MoF's press-release](#) issued on 19 May 2023 "a number of posts circulating on social media and other platforms that are issued by private parties, contain inaccurate and unreliable interpretations and analyses of Corporate Tax".

The Ministry issued a reminder that official sources of information on Federal Taxes in the UAE are the MoF and FTA only. Therefore, analyses that are not based on official publications by the MoF and FTA, or have not been commissioned by them, are unreliable and may contain misleading interpretations of the law. See the full press release [here](#).

You should factor this in when dealing with this article as well. It is not commissioned by the MoF or FTA. The interpretation, conclusions, proposals, surmises, guesswork, etc., it comprises have the status of the author's opinion only. Like any [human](#) job, it may contain inaccuracies and mistakes that I have tried my best to avoid. If you find any inaccuracies or errors, please let me know so that I can make corrections.

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