
UAE FTA issues Corporate Tax Guide on Determination of Taxable Income



Quick Rundown

- The UAE Federal Tax Authority, on July 31, 2024, issued a holistic guide which will serve as a roadmap for computation of Corporate Tax liability of a Taxable person.
- The tax guide provides general guidance on the adjustments to be made to Accounting Income for determining the Taxable Income and for calculating the Corporate Tax payable under the UAE Corporate Tax Law ('UAE CT Law').

Multipurpose Expenditure

- Expenditure must be incurred wholly and exclusively for the purpose of the Taxable Person's Business, provided it is not capital in nature, to be deductible for Corporate Tax Purpose.
- Where expenditure is not exclusive to one purpose, the proportion of expenditure attributable to non-business purposes is non-deductible.
- For multipurpose expenditure where proportion attributable to non-business purpose is unidentified, proportion shall be determined on a fair and reasonable basis.

Basis of apportionment

- Apportionment of expenses must reflect the underlying activity and such apportionment must be based on allocation keys.
- Allocation keys such as revenue centers or cost drivers are considered fair and reasonable.
- When multipurpose expenditure cannot be apportioned on a fair and reasonable basis, the whole amount is non-deductible.

Expenditure nature conundrum

- If Taxable Person adopts an accounting policy to not capitalise low value capital items that do not meet the recognition criteria as per AS, such items are directly expensed.
- In such circumstances, the accounting treatment should be followed and the expense will be fully deductible in the Tax Period in which it is incurred.

Disallowance of depreciation

- When a revenue expenditure is recognised as capital expenditure by a Taxable Person, depreciation/ amortisation is not deductible for such expenditure.
- Depreciation to the extent of non-deductible attributable expenses capitalised is also non-deductible
- If Taxable Person adopts an accounting policy to not capitalise low value capital items that do not meet the recognition criteria as per AS, such items are directly expensed. In such circumstances, the accounting treatment should be followed and the expense will be fully deductible in the Tax Period in which it is incurred.

Treatment of Attributable costs

- Attributable costs such as freight for transportation of capital asset, installation costs once capitalised cannot be claimed as deduction during tax computation.

Pre-incorporation and pre-trade expenses

- Pre-incorporation expenses, not capital in nature, are allowed as a deduction in the period of incurrence insofar recorded in Profit and Loss statement unless it is claimed as a deduction by any other Taxable Person.
- Pre-trade expenses which are not capital expenditure are deductible in the period of incurrence insofar recorded in the Profit and Loss statement. Pre-trade expenses can be claimed as a deduction even when there is no revenue generation by business of Taxable Person in relevant Tax Period.

Notable deductions

- Compensation for damages and breach of contract are deductible for Corporate Tax purposes even if fines and penalties are not deductible.
- Local taxes such as municipal and property tax are deductible even if Corporate Tax and recoverable Input VAT are not deductible.

Reversal of provision

- Where a Taxable Person has recorded a provision prior to their first Tax Period when the liability to pay Corporate Tax has not arisen, the reversal or release of such provision during or post their first Tax Period credited to Profit and Loss statement is considered for tax computation purposes.
- However, deduction on account of creation of such provision cannot be availed by such Taxable Person.

Entertainment expenditure

- There generally exists a private element in entertainment expense which refrains it from being classified as wholly and exclusively for business and hence only a 50% deduction of entertainment expenditure is allowed for Corporate tax purposes.
- A clear-cut distinction is required between *entertainment expense* and *entertainment expense for employees* which qualifies as an employment related expense.

Incidental expenses

- A 100% deduction is allowed for an expense that is incidental to running a business.
- It is pivotal to identify whether an expense is incidental to business or not.
- Providing food for Clients during business meetings is incidental to business whereas Food provided at venues like restaurants to non-employees is entertainment expenditure.

Applicability to hospitality industry

- Taxable Persons engaged in hospitality industry providing hospitality, includes entertainment, as a part of business, are eligible to claim deduction for such expenditure.
- However, where benefits are provided to clients and business partners that are not considered commercial hospitality or promotions, then such expenditure incurred would be considered as entertainment expenditure and would be subject to the 50% restriction.

Employment related expenditure

- Employee costs are usually considered to be wholly and exclusively incurred for business purposes provided that they are not excessive.
- Where employees are Related Parties or Connected Persons, the expenditure is required to meet the arm's length standard.

Marketing expenditure

- The Industry in which an entity operates essentially helps us differentiate whether an expense is marketing expenditure or entertainment expenditure.
- 100% deduction is available for marketing expenditure whereas it is subject to 50% deduction if it is in the nature of entertainment expenditure .

Interest disallowance for Related Party Transactions

- Interest on loans from Related Party for prescribed payouts to RP's is non-deductible.
- Such restriction is not imposed if the parties involved can demonstrate the underlying purpose is not for obtaining Corporate Tax advantage

Tax Loss transfer

- Tax Losses can be set off to the extent of 75% of Taxable Income.
- Transfer of Tax Loss to another Taxable Person is optional while it is mandatory the Tax Loss is utilised by transferor before such transfer.
- Personal Tax Loss precedes over transferred Tax Losses in the order of claiming against Taxable Income

Tax Credit

- As of now, UAE imposes 0% on withholding taxes with categories subject to such taxes yet to be notified.

Foreign Permanent Establishment exemption

- To determine if Foreign Permanent Establishment (FPE) satisfies the "similar tax at 9%" condition, an examination of the foreign tax system and possibly obtaining tax rulings for clarification would be necessary.

CONTACT US FOR FURTHER QUERIES



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