

UAE FTA issues

Corporate Tax Guide on

Free Zone Persons





Executive Summary

On May 20, 2024, the UAE Federal Tax Authority issued Corporate tax guide on Free Zone Person (FZP) to provide general guidance on the application of the UAE Corporate Tax Law (UAE CT Law) to Free Zones (FZ) and FZPs.

The Tax Guide also provides illustrative examples on various aspects relating to FZPs and provides understanding of the definitions and interactions of the different rules under UAE CT law.



Noteworthy points for the Guide



Distribution of goods or materials from Designated Zone

- If a designated zone company perform its activities in or from a Designated Zone and the arrangements do not involve goods or materials entering the UAE (High seas sales), the company will be considered performing Qualifying Activities
- For the distribution of imported goods in UAE, it is key for the goods to be imported through the designated zone to be considered Qualifying activities.
- For the distribution of goods within UAE, the Designated zone company can purchase the goods from a juridical person in the UAE (outside the Free Zone) without the need to pass it through a Designated zone when they are subsequently sold to the retailer/distributor in the UAE and the DZ company will be considered to be performing Qualifying Activities.



Adequate substance requirements

- A Company registered in a Free Zone having a warehouse in a Designated Zone but conducts core income generating activities from FZ **would not meet the adequate substance** requirement in the Designated Zone.



Adequate supervision of outsourced activities

- To have adequate supervision, a QFZP must put mechanisms and means in place to observe, oversee, assess, instruct, and provide guidance over the deliverables of the service provider in terms of quality, quantity, and timeliness.
- A FZP should be able to demonstrate that it has adequate supervision through appropriate documentation, such as contractual agreements that set out how the supervision will be conducted and implemented from both practical and operational standpoints.
- The contractual arrangements should also be confirmed by the actual conduct of the parties.



End-user

- An end-user is an individual who ultimately utilizes the product for its intended purpose, whether for personal, commercial, or industrial use. Therefore, if a distributor sells goods to a customer who is an end-user (i.e., uses or consumes the product), such activity **will not be classified as a Qualifying Activity**.



Separate Financial statements

- A Free Zone Person is not required to maintain separate Financial Statements relating to its activities that generate Qualifying Income. However, a QFZP would need to have sufficient documentation to demonstrate how it calculated its Qualifying Income.



Packing as supplement to manufacturing process

- Revenue from packing and loading activities during manufacturing is typically **treated as non-qualifying Revenue**, but exceptions exist:
 - if they're deemed ancillary to manufacturing, or
 - fall under distribution, or
 - logistics activities, are attributable to a Domestic PE, or
 - involve sales to other Free Zone Persons.



Mixed-use property located in a Free Zone

- Where a property of a QFZP located in FZ is partly occupied by retail establishments being FZPs (Qualifying Income) and partly for residential purposes, the portion of the income that is used for **commercial purposes would be subject to CT at 0%.**



Scope of ancillary activities associated with Qualifying activities

- An activity is ancillary where it is necessary for the performance of the main activity (Support to main activity, Seamlessly integrated) or it makes a minor contribution to the main activity and is so closely related to the main activity that it should not be seen as a separate activity.



Investment of Surplus funds

- The investment of surplus funds is not considered as an ancillary activity. However, it may still be treated as arising from the **Qualifying Activity** of Treasury and Financing Services to Related Parties.



Relief in start-up phase

- A FZP not having qualifying income in a tax period will not automatically disqualify Company from being a QFZP if there is no Revenue and Business operations have not commenced.



Post sale services

- The post-sale and customer support services are treated as ancillary services provided they naturally and integrally complement the main Qualifying Activity and meet the conditions for ancillary activities.



Allocation key

- Allocation keys determine cost allocation in business across departments, products, or services based on factors like headcount or floor space to ensure fair allocation of cost.



Interest income from banks

- The Interest income will be treated as arising from the **qualifying activity** of treasury and financing services to related parties (i.e. treated as self-investment), provided the entity **maintains adequate substance in relation to the activity**.



Sufficiency of written representation

- When a FZP sells services or goods to another Free Zone Person, they must confirm if the purchaser is the Beneficial Recipient.
- This can be verified through a written statement from the purchaser, unless the seller suspects the representation may be incorrect.



Tax losses

- Losses relating to Qualifying Income cannot be transferred, or carried forward or used to offset Taxable Income.



Determining commodities in raw form

- HSN code can serve as an indicator in verifying if a commodity still maintains its raw form. However, it is important to note that mere alteration in HSN code due to some level of processing does not conclusively determine whether that commodity has lost its raw form for the purposes of determining whether it is a Qualifying Commodity.



Income from Qualifying Intellectual Property (QIP)

- To benefit from the 0% rate on Qualifying Income from Qualifying Intellectual Property, a QFZP must be able to demonstrate the nexus between Qualifying Expenditures and the income from Qualifying Intellectual Property.
- Sum of Qualifying Expenditures and Uplift Expenditures must be the lesser of: 130% of Qualifying Expenditures or Overall expenditures.



Single Family and Multi Family Office

- A Single Family Office is to exclusively manage the financial and personal needs of a single family and would **not be considered to provide the Qualifying Activity** of wealth and investment managements services as it is not appropriately regulated by a relevant Competent Authority.
- Multi Family Office is to manage the financial and personal needs of a number of families and would be **considered to provide the Qualifying Activity** of wealth and investment managements services if it is appropriately regulated by a relevant Competent Authority.



Cash pooling

- A UAE head office company renders treasury and financing services to its subsidiaries in different countries and operates as a centralized cash management system which manages all the cash resources within the group including **transfer of surplus** of one subsidiary to another subsidiary which has deficit **to save the group external borrowing costs**. The same qualifies as a Qualifying Activity in relation to the treasury and financing.



Other notable points

- In order to determine qualifying income for qualifying Intellectual property the qualifying expenses and overall expenses shall include expenditure incurred over the life of the property.
- All FZPs should check with their respective Free Zone Authority to confirm if they are considered as a Free Zone for CT purposes.
- Last-mile delivery services conducted outside of the FZ will also be **considered a Qualifying Activity, provided** that the QFZP performs the majority of its logistics services within a Free Zone for its customers, irrespective of their jurisdiction.
- Software embedded in hardware (i.e. it is inherently part of the hardware) generally would be considered as goods.



Key takeaways

- Free Zone authorities have not clarified if the respective Free Zones are considered as such for CT purposes.
- It is advisable to revisit and revalidate the Free Zone tax exemption status on a periodic basis.
- It is important to maintain documentation by performing confirmation from customers to verify if they are not the end user.
- Documentation of qualifying and non-qualifying income and expenditure along with sufficient back up documents.

CONTACT US FOR FURTHER QUERIES



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