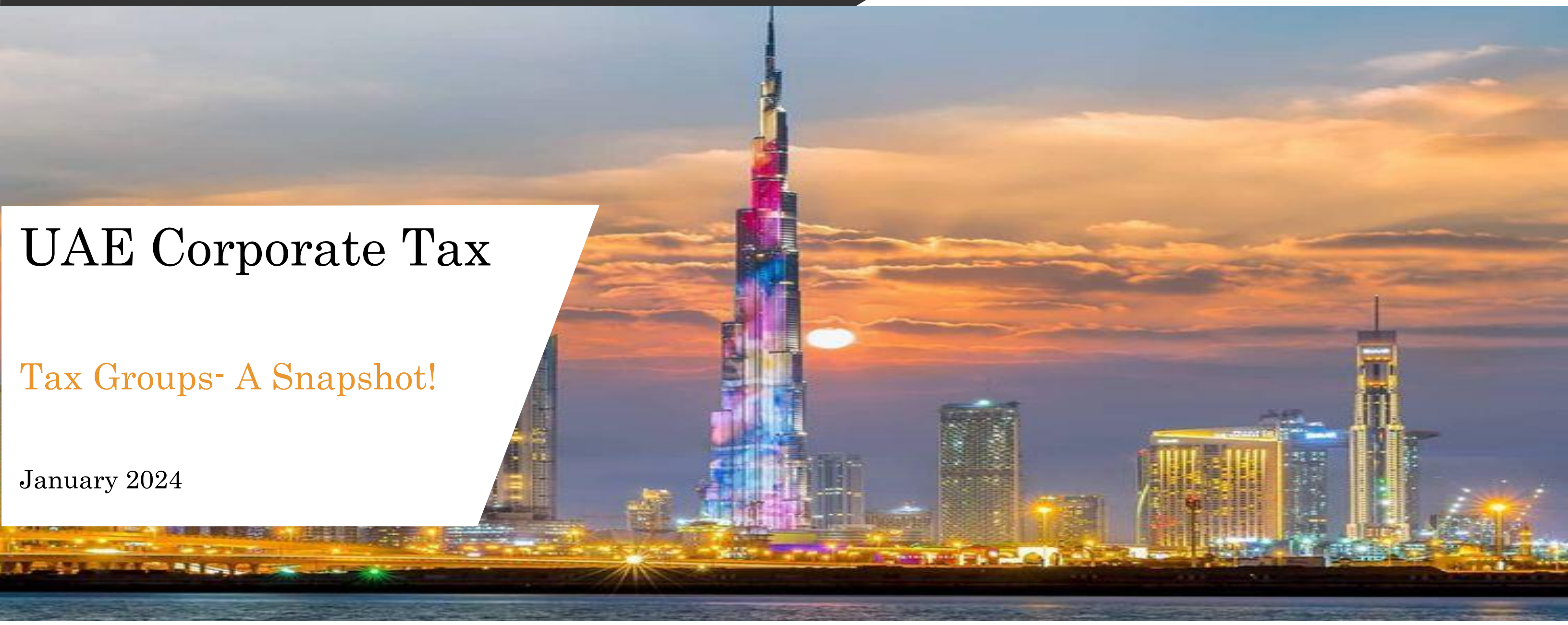


UAE Corporate Tax

Tax Groups- A Snapshot!

January 2024

Introduction

Recently the Federal Tax Authority (FTA), published yet another comprehensive corporate tax guide encompassing the tax provisions governing "Tax Groups".

Like the previous guides, this guide also seeks to provide clarity and better understanding of the aforesaid tax provisions, apart from exhibiting numerous examples with an intent to remove ambiguities in applying the said provisions, covering the following topics:-

- What is Tax Group?
- Who can form a Tax Group
- Attribution of Income, taxability and compliance obligations of Tax Groups
- Special topics pertaining to treatment of Tax losses, Interest deductions, foreign tax credit and foreign PE's
- Changes in members of Tax Groups and Cessation of Tax Group

Forming a Tax Group offers several advantages in terms of:-

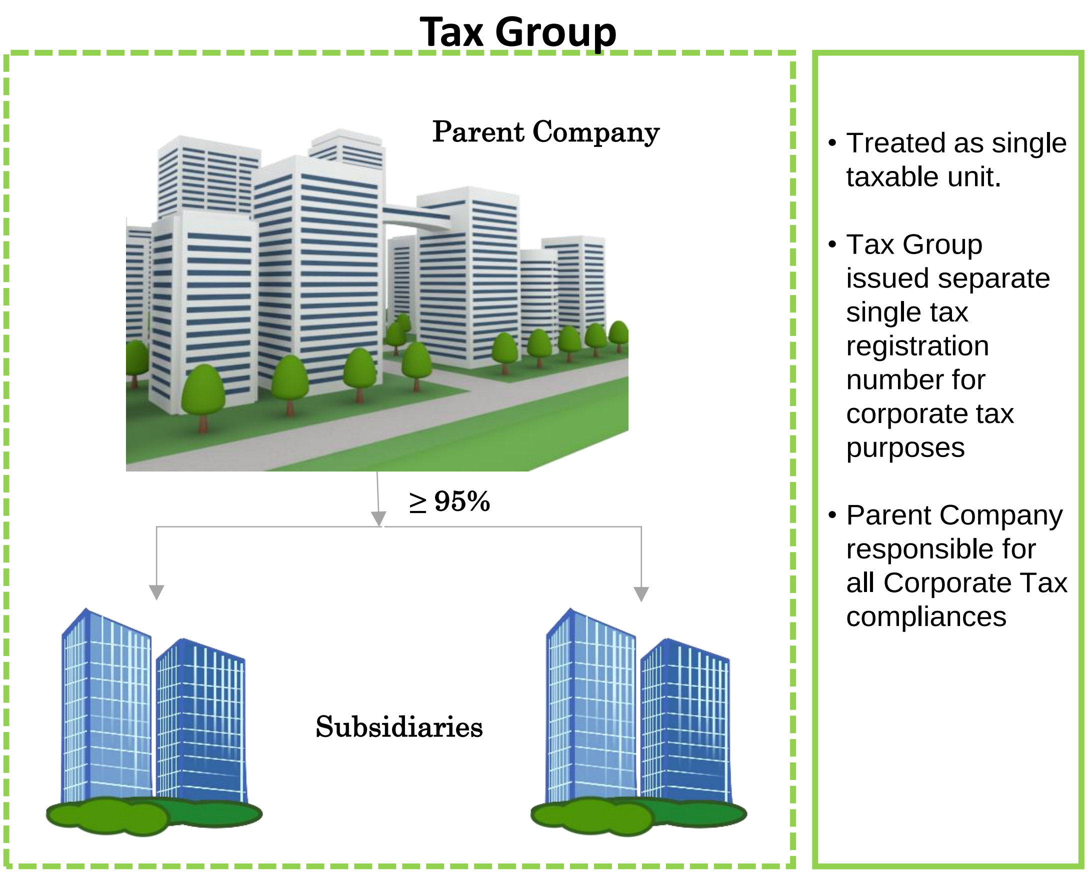
1. Filing of a single tax return by the Parent company of Tax Group on behalf of all members
2. Elimination of income and losses, transfer of assets and liabilities and other transactions between members of the Tax Group
3. Tax Groups are also eligible to opt for Qualifying Group Relief
4. Relief from complying with Transfer Pricing regulations (Arm's length principle) , except in certain cases

However Tax Group do have their share of limitations which also have to be factored while deciding to form a Tax Group.

This alert intends to highlight certain key aspects relating to Tax Groups as brought out in the Guide.

1. What is Tax Group?

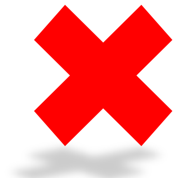
- Tax Group can be formed by a Parent Company and one or more subsidiaries.
- The Parent Company and each subsidiary seeking to form a tax group shall make a joint application to the FTA.
- Once approved by the FTA the Parent Company and subsidiaries shall be treated as a single taxable unit.
- Once Tax Group is formed, the Parent Company shall be responsible for :-
    - Preparing consolidated financial statements for tax group
    - File Tax Return on behalf of the Tax Group (i.e. members of tax group need not file a separate return)
    - Settle the corporate tax payable and apply for tax refund on behalf of Tax Group
    - Maintain sufficient documents related to financial records, Transfer Pricing documentation and submitting clarifications to FTA.



Who can form a Tax Group?

- Resident Juridical Persons and Free Zone entities are eligible to form a Tax Group.
- Qualified Free Zones, Non Resident Persons and Exempt entities not eligible to form a Tax Group.

Who can form Tax Groups?



Resident Juridical persons

Resident Juridical Persons having separate legal personality including
- private/public/limited liability companies and
- certain incorporated partnerships having separate legal status ;

But ***does not*** include;
- natural persons ,
- sole proprietorships; and
- unincorporated partnerships

Free Zone Entities

- Free Zone Entity not being a Qualified Free Zone Entity.
- ***Does not*** include a branch of a foreign entity registered in a free zone.

Non Residents

Non Resident cannot form Tax groups, however subsidiaries of foreign companies which are resident juridical persons can form tax groups

Exempt Entities

Govt. Entities cannot form tax groups however taxable subsidiaries of Govt companies can still form a Tax Group without the Government entities.

Qualifying Free Zones
Qualifying free zone entities are not eligible to form a Tax Group.

Conditions to form a Tax Group

- A parent company and each of the subsidiary companies should meet the eligibility criteria specified above.
- In addition the parent company shall be required to meet <u>**all**</u> the following conditions to be able to form a tax group, namely:-
  - **Share Capital Ownership Condition**
    - Holds ≥ 95% of shareholding in each of the subsidiaries either directly or <u>**indirectly through one or more of its subsidiaries**</u>; **and**
  - **Voting Rights Condition**
    - Owns ≥ 95% of the voting rights in each of the subsidiaries either directly or <u>**indirectly through one or more of its subsidiaries**</u>; **and**

- **Profits and Net assets condition**
    - Entitled to ≥ 95% of the each of the subsidiary's profits **and** [1]net assets either directly or **indirectly through one or more of its subsidiaries; and**
- Financial Year Condition
    - Parent company and each of the subsidiaries should follow the same financial year[2]
- Accounting Standards condition
    - Parent company & each of the subsidiaries should prepare the financial statements using the same accounting standards (i.e. Whether IFRS or IFRS (SMEs)).

▪ Thus if the above conditions are fulfilled the Parent Company and each of its subsidiaries can make a joint application to FTA for forming a Tax Group.
▪ No limit as to number of members in a Tax Group. However an eligible person (Parent company/ Subsidiaries) can only be member in one Tax Group.
▪ For a tax Group to exist, all the above conditions to be met by the Parent company and the subsidiaries.
▪ The Tax Group will cease to exist from the tax period in which such conditions are not met by the Parent company. A Subsidiary not meeting the conditions to be a member of the Tax Group shall cease to be a member from beginning of the tax period in which the conditions are not met.

Conditions to form a Tax Group

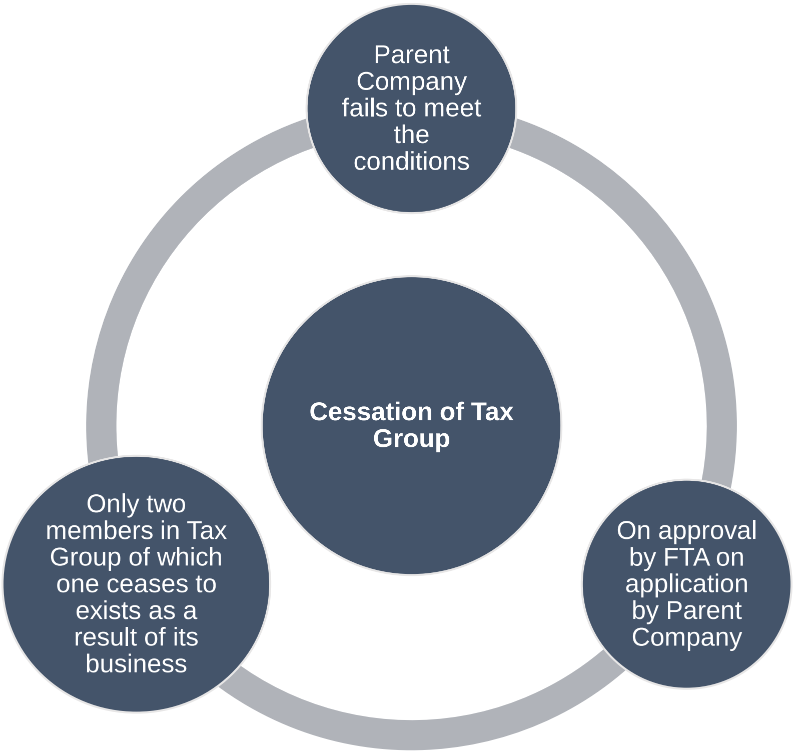
[1] Parent Company should be entitled to at least 95% of subsidiaries both profits and net assets.
[2] Newly incorporated entities can join the Tax group from date of incorporation provided it meets the other criteria

Taxable Income of Tax Group

- Tax Group is treated as a single taxable person
- Taxable Income shall be computed by Parent Company after consolidating the financial results, assets and liabilities of all members of the Tax Group.
- All Intra Group Transactions (except for certain exceptions as provided in Article 40), between the members of the Tax Group are eliminated while determining the consolidated financial results of the Tax Group.
- <u>**Tax Losses**</u>
  - Tax Losses of a Tax Period can be carried forward to subsequent Tax Periods upon satisfaction of certain conditions specified in Article 39 of the Corporate Tax Law
  - A Tax Loss carried forward can be set off against Taxable Income of that period up to 75% of taxable income with any remaining loss available carried forward to subsequent Tax Periods.
  - Pre-Grouping Tax losses can only be offset against the Taxable Income of the Tax Group insofar as this income is attributable to the relevant Subsidiary.

Cessation of Tax Group

A Tax Group will cease to exist in the following situations



Key aspects for consideration

1. **Liability for Corporate Tax Payable**

   Members of Tax Group are **jointly and severally liable** for any corporate tax and administrative penalties due for the Tax Group. Thus even a member of the Tax Group not having taxable income, shall still be liable for any corporate tax dues and administrative penalties.

2. **Threshold for determining Corporate Tax rate**

   - 0% corporate tax rate is limited to AED 375,000 for the Tax Group as a whole and not applied to individual members of the Group which may result in higher tax liability. Consider the following example: - Parent Company, Subsidiary A and Subsidiary B form a Tax Group. Their Taxable income AED 1,500,000, AED 500,000 and AED 300,000 respectively.

Computation of Taxable Income of Tax Group	
Particulars	Amount in AED
Combined Taxable Income	23,00,000
Taxable Income subject to 0% Tax	3,75,000
Remaining Taxable Income	19,25,000
Tax @9% payable Tax Group	**1,73,250**

   - However if no tax group is formed, the tax liability will be as follows:-

Particulars	Parent Company	Subsidiary A	Subsidiary B
Taxable Income	1,500,000	500,000	300,000
0% Taxable Income	375,000	375,000	375,000
Remaining Taxable Income	1,125,000	125,000	-
Tax @9%	101,250	11,250	-
Total Tax Liability of all Companies		**112,500**	

   - Thus formation of Tax Groups results in an additional tax liability of 60,750 to the members of the Tax Group.

   - However in scenarios where certain subsidiaries are into losses, Tax Groups may prove to be beneficial as the losses can offset against the Taxable Income of other members of the Tax Group thereby resulting in lower taxable income.

3. **Small Business Relief**

   - Tax Group is considered as a single tax unit and hence all corporate tax thresholds will apply to the consolidated Taxable income of the group and not to individual members.
   - Accordingly the limit of AED 3 million for claiming SBR will be applied on the consolidated income of Tax Group.

- Thus even members of the Tax Group having Taxable income less than AED 3 million will not be eligible for SBR if the consolidated revenues of the Tax Group exceeds the said limit.

4. **Deduction of Business Expenditure**

- Per Article 28 of the Corporate Tax Law, all expenses related to the Taxable person's business not being a capital expenditure is allowed as deduction in computing the taxable income.
- In case of Tax Groups, all expenditure incurred wholly and exclusively for business of another member of the tax group is deductible.
- No deduction is available if such expenditure is incurred for the purposes of a non group member e.g. foreign parent

5. **Application of Arm's Length Standard**

- Transactions between members of the Tax Groups are not required to comply with Transfer Pricing compliances including arm's length condition except in certain cases where the Tax Group is required to calculate taxable income attributable to one or more members in the following situations:-
  i. A member of the Tax Group has unutilised pre-Grouping Tax Losses[3]
  ii. A member of the Tax Group has earned income for which the Tax Group can claim a Foreign Tax Credit[4].
  iii. A member of the Tax Group benefits from any Corporate Tax incentives as specified under Article 20(2)(g)[5] of the Corporate Tax Law.
  iv. A member of the Tax Group has unutilised carried forward pre-Grouping Net Interest Expenditure[6]

Thus only in the above instances the Tax Group will need to comply with the arm's length principle and related Transfer Pricing compliance regulations.

Way Forward

Whilst the concept of Tax Groups is lucrative and offers several advantages in terms of easing tax compliance and administrative burden for the Group as a whole, the same is not without shortfalls. Hence it is imperative for Businesses to evaluate the relative pros and cons of forming a Tax Group in light of given circumstances and the value addition that it is likely to generate for the business group as a whole before concluding on forming Tax Groups.

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[3] Pre-Grouping Tax Losses are the unutilised Tax Losses of a Subsidiary that joins a Tax Group. Pre Grouping tax losses can be offset against the taxable income of the Tax Group only to the extent of the income attributable to the relevant subsidiary.

[4] Where a member's foreign source income is subject to corporate tax in UAE, foreign tax credit can be claimed by deducting taxes paid in foreign jurisdiction to the extent of the taxable income of the said individual member of the tax group and to that extent it will reduce the corporate tax due of the Tax Group. Any unutilised foreign taxes (if any) cannot be carried forward or carried back and shall be forfeited.

[5] Article 20(2)(g) relates to any incentives or special reliefs for a Qualifying Business Activity as specified in a decision issued by the Cabinet at the suggestion of the Minister.

[6] Similar to the restriction of pre-Grouping Tax Losses, pre-Grouping Net Interest Expenditure can only be utilised against the Taxable Income that is attributable to that Subsidiary.

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