



UPDATED UAE CORPORATE TAX DECISIONS FOR FREE ZONES



On 3rd November 2023, The UAE Ministry of Finance issued two significant decisions, Cabinet Decision No.100 of 2023 on Determining Qualifying Income for the Qualifying Free Zone Person and Ministerial Decision No. 265 of 2023 Regarding Qualifying Activities and Excluded Activities for the purposes of Federal Decree-Law No. 47 of 2022.

The previously issued Cabinet Decision No. 55 of 2023 and Ministerial Decision No. 139 of 2023 have been repealed by Cabinet Decision No. 100 of 2023 and Ministerial Decision No. 265 of 2023, respectively.

In the decision, the scope of 'Qualifying Income' has been expanded to include income derived from ownership and exploitation of 'Qualifying Intellectual Property' and 'Trading of Qualifying Commodities.'

The decisions have modified and incorporated definitions for various "Qualifying Activities," which align closely with the content outlined in the erstwhile Decisions and public consultation document.

The provisions of Cabinet Decision No. 55 and Ministerial Decision No. 139 have been integrated in the new decisions and the major amendments are summarized in this document.

DEFINITIONS



- **Manufacturing of goods or materials** includes the production, improvement or assembly of products and materials from raw materials or components.
- **Fund management services** includes the activities of portfolio management, risk management, discretionary and non-discretionary fund management services and other services relating to the day-to-day management and operation of an investment fund by a fund manager that is appointed by the fund or its investors.
- **Wealth and investment management services** includes the activities of providing discretionary and non-discretionary investment management and advisory services, portfolio management and wealth and investment advisory services.
- **Headquarter services** to related parties includes the administering, overseeing and managing of Business Activities of Related Parties, including the provision of senior and general management, captive insurance services, administrative services, procurement services, business planning and development, risk management, coordination of group activities, and in general incurring expenditures on behalf of related parties and providing other support services to related parties.
- **Competent authority** widened to include the following:
 - Central Bank of the United Arab Emirates,
 - Dubai Financial Services Authority of the Dubai International Financial Centre
 - Financial Services Regulatory Authority of the Abu Dhabi Global Market
 - Securities and Commodities Authority



Ownership and exploitation of 'Qualifying Intellectual Property'

Income from ownership or exploitation of Intellectual Property ('IP') is no longer considered an Excluded Activity. Businesses that earn income from owning or exploiting intellectual property assets should carefully assess whether they can benefit from the 0% tax rate under these new Free Zone tax regulations.

The new Free Zone regulation introduces the concept of Qualifying Intellectual Property ('QIP').

1. Definition of QIP

The definition of QIP includes patents, copyrighted software and any right functionally equivalent to a Patent but does not include any marketing related IP such as trademarks.

2. Qualifying income

The definition of qualifying income has been modified to include income derived from ownership or exploitation of QIP. However, revenue from ownership or exploitation of any IP other than QIP and income in excess of qualifying income will be subject to tax.

3. Calculation of Qualifying income from QIP

A formula is provided to calculate the amount of Qualifying Income derived from IP, which aims to calculate the portion of the income that qualifies for a 0% tax rate by establishing a direct link between the research and development ('R&D') expenditures and the overall income generated from the IP.

The formula is provided below:

$$\text{Qualifying income} = \frac{\text{Qualifying expenditures} + \text{Up-lift expenditures}}{\text{Overall expenditures}} \times \text{Overall income}$$

- **Qualifying Expenditures** means expenditures incurred to fund R&D activities, conducted either by QFZP or outsourced to any person in the State or any person outside the State that is not a Related Party, directly connected with the creation, invention or significant development of the QIP.
- **Overall Expenditures** means total expenditures incurred to fund R&D activities, conducted either by the QFZP or outsourced to any person, directly connected with the creation, invention or significant development of the QIP, including acquisition costs of the QIP.
- **Overall Income** means royalties or any other income derived from QIP as determined according to the provisions of the CT Law, including embedded IP income derived from the sale of products and the use of processes directly related to the QIP as determined in accordance with the arm's length principle.
- **Uplift Expenditures** means the qualifying expenditure increased by 30%. It should be ensured that the amount of qualifying expenditure after up-lift does not exceed the amount of overall expenditure.

4. Documentation for Qualifying income from QIP

The QFZP should maintain adequate records to substantiate the following:

- Ownership and right to exploit the QIP
- Qualifying expenditures and overall expenditures incurred
- Overall income derived from QIP
- The link between qualifying expenditures and overall income derived from QIP



Trading of Qualifying Commodities



This decision now include 'Trading of Qualifying Commodities' as a Qualifying Activity.



Qualifying Commodities comprise metals, minerals, energy, and agricultural commodities traded in their raw form on a Recognized Commodities Exchange Market that is licensed and regulated by a competent authority, whether within or outside the State.



Trading of Qualifying Commodities involves both physical trading and associated derivative trading, which are employed to hedge against the risks associated with these activities.



Maintaining Adequate Substance and Outsourcing in a Freezone



Free zone person will be required to undertake its Core Income Generating Activity ('CIGA') in a free zone to be a Qualifying Free Zone Person ('QFZP').



CIGA varies according to the activity conducted. It is clarified that it should not be exclusively or mostly support activities. CIGA mainly consists of significant functions that drive the business value for activity carried out.



CIGA has to be conducted in a free zone or a Designated Zone, depending on the activities conducted. The QFZP shall have adequate assets and qualified full-time employees in the free zone or Designated Zone, and incur adequate operating expenditure.



The CIGA can also be outsourced to another person in a free zone or Designated zone, provided the activities are supervised by the QFZP.



CIGA in respect of Qualifying IP can be outsourced to any person in the State or any other person who is not a related party outside the State, with adequate supervision by the QFZP.



Other clarifications:



'Incidental income' has been removed from the scope of 'Qualifying Income.'



MD 265 has renamed the qualifying activity of 'Holding of shares and other securities' to 'Holding of shares and other securities for investment purposes. The Decision clarifies that for investment purposes the shares and other securities are required to be held for an uninterrupted twelve (12) month period.



The scope of 'Ownership, management, and operation of Ships' widened to include towing activities and the provision of general assistance to Ships at sea, dredging activities at sea, and leasing and chartering on a bareboat basis. It specifically excludes local transport, leisure, recreational purposes, floating hotels, restaurants, or casinos.



An activity shall be considered 'Ancillary' where it is necessary for the performance of the main activity or where it makes a minor contribution to it and is so closely related to the main activity and that it is not a separate activity.



Key Takeaways:



Detailed analysis and clarity on the entity's activities would be required to determine eligibility as a QFZP.



Adequate Substance to be maintained in free zone or designated zone vis-à-vis the activity conducted.



Transaction in respect of Income from intellectual property and commodity trading to be reviewed to examine the taxability.

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Disclaimer:

The content of this material has been prepared based on the provisions outlined in Cabinet Decision No. 100 of 2023 and Ministerial Decision No. 265 of 2023, released on 03rd November 2023. While every effort has been made to ensure the accuracy and reliability of the information presented, the document is intended for general guidance only, and does not purport to be a legal advise.

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RELEASED ON - 04 TH NOV. 2023 BY ECAG



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