

A Complete Guide for Corporate Taxation in UAE Free Zone Areas

Introduction:

The UAE has long been known as a tax-free Country, attracting investors and entrepreneurs from around the world. However, to ensure sustainable economic growth and contribute to the country's development, the UAE has shifted from a tax-free government to a Corporate Tax system.

The Federal Decree-Law No. 47/2022 on the Taxation of Corporations and Businesses, effective on June 1, 2023, marks a significant change in the UAE's economic landscape.

This article aims to provide a comprehensive guide to proper corporate taxation in UAE Free Zone areas, specifically focusing on Corporate Tax and its impact on Free Zone Persons.

The Significance of Free Zones:

In recent years, free zone areas have gained prominence as strategic business locations due to the numerous incentives they offer to companies. These zones provide businesses with a range of benefits, including 100% foreign ownership, exemption from import and export duties, and a variety of tax advantages.

However, it is essential for companies operating in free zone areas to have a comprehensive understanding of the corporate tax regulations in place to ensure compliance and maximize the advantages available.

Defining Free Zone Persons:

The comprehensive Corporate Tax in UAE Free Zones is to differentiate between two fundamental categories of persons: Natural Persons and Juridical Persons. This distinction is essential to understanding the tax obligations and benefits applicable to entities operating within UAE Free Zones

- **Natural Persons:** Natural Persons include individuals who operate businesses independently, such as freelancers, sole establishments, and civil companies. even if these individuals conduct their businesses from a Free Zone, they are not recognized as Free Zone Persons under the UAE Corporate tax laws.
- **Juridical Persons:** Juridical Persons consist of corporate entities, including Limited Liability Companies. These entities can attain the status of Free Zone Persons if they are incorporated within a Free Zone.

Corporate Tax Rates for Free Zone Companies:

Corporate Tax rates for Free Zone Persons vary depending on their classification.

1. **Qualifying Free Zone Person (QFZP):** A QFZP may be eligible for specific tax benefits, including a 0% tax rate on qualifying income.
2. **Non-Qualifying Free Zone Person (NQFZP):** NQFZPs do not meet the specific conditions required to attain QFZP status, and consequently, they may not access the same tax benefits.

Qualifying Free Zone Person (QFZP) Criteria:

A QFZP must fulfil a set of specific conditions:

- Meet Adequate Substance in the UAE, involving main income-generating activities, sufficient assets, qualified employees, and mandatory operating expenses.
- Derive "Qualifying Income" as specified in Cabinet Decision No. 55 of 2023.
- Avoid opting for the 9% tax rate applicability.
- Comply with Arm's Length & Transfer Pricing Rules.
- Satisfy other specified conditions outlined in Cabinet Decision No. 139 of 2023.

Three Types of Business Activities for Free Zone Taxability:

Under UAE corporate tax regulations, business activities for Free Zone taxability can be categorized into three distinct groups:

- **Qualifying Activities:** These are specific activities explicitly mentioned in Cabinet Decision No. 139 of 2023. Businesses engaged in these activities may be entitled to tax benefits or exemptions.
- **Excluded Activities:** A list of activities outlined in the Cabinet Decision that may not qualify for the same tax benefits or exemptions as Qualifying Activities.
- **Other Activities:** Activities not explicitly mentioned in either the Qualifying or Excluded Activities lists have tax implications determined based on their nature and the relevant tax regulations.

Qualifying Income Categories:

Qualifying Income is categorized based on the nature of transactions and the parties involved:

- **Transactions with Other Free Zone Persons:** Qualifying Income includes income from all transactions except those derived from Excluded Activities.
- **Transactions with Non-Free Zone Persons:** Qualifying Income includes income from Qualifying Activities only. Excluded Activities do not qualify.
- **Income From All Other Transactions:** Qualifying Income may include other income, provided it meets de minimis requirements.
- **Tax on Accountable Income to Establishments:** Income attributable to Domestic Permanent Establishments or Foreign Permanent Establishments of Free Zone Persons is taxed at a rate of 9%.

Tax on Accountable Income to Immovable Property in Free Zones:

Income from immovable property in Free Zones is subject to variable tax rates based on property type and the parties involved:

- Income from commercial property, when dealing with Non-Free Zone Persons, is taxed at 9%, while dealing with Free Zone Persons is considered Qualifying Income and taxed at 0%.
- Income from non-commercial property is taxed at 9%, regardless of the parties involved.

The De Minimis Rule:

The De Minimis Rule sets the conditions that Qualifying Free Zone Persons (QFZPs) must meet regarding their Non-Qualifying Revenue. To attain Qualifying Free Zone Persons (QFZP) status, a company's Non-Qualifying Revenue should be less than the lower of 5% of their Total Revenue or AED 5 million, whichever is lower.

- Non-Qualifying Revenue includes income from Excluded Activities and activities not classified as Qualifying when dealing with Non-Free Zone Persons.
- Total Revenue encompasses all income generated by a Qualifying Free Zone Person during a specific tax period.

Exclusions from Non-Qualifying & Total Revenue:

Certain types of revenue are excluded from both Non-Qualifying and Total Revenue calculations, including:

- Revenue attributable to immovable property located in a Free Zone from specific transactions.
- Revenue attributable to a Domestic Permanent Establishment or a Foreign Permanent Establishment of the Qualifying Free Zone Person.

Conclusion:

Understanding Corporate Taxation in UAE Free Zones is paramount for businesses and individuals aiming to maximize tax benefits while following regulations.