Be Ready for Taxation in the United Arab Emirates

■ ***Tobias Lintvelt***
Partner – Transaction Tax – International Tax Services
Franky Ting
Manager – International Tax Services
Ernst & Young Abu Dhabi
Ernst & Young Dubai

The UAE
– A Well-known Trading Partner of China

The United Arab Emirates ("UAE") is located on the southern coast of the Arabian Gulf and is a federation of seven emirates (Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al Quwain, Ras Al Khaimah, and Fujairah). Geographically, the UAE is situated in the middle of Europe, Asia, the Middle East, and Africa. The UAE is a member country of the Gulf Cooperation Council ("GCC"), which is a regional intergovernmental political and economic union consisting of all Arab states of the Persian Gulf except for Iraq. The six member countries of the GCC are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE. Indeed, the UAE is one of the most developed economies in the Middle East and North Africa ("MENA") region, and it is often the entry point for regional investment.

With the establishment of a strategic partnership between China and the UAE in 2012, the UAE has become an important trading partner of China. The extensive trade and business cooperation between China and the UAE has led to a growing Chinese population in the UAE. The Chinese population in the UAE is now more than 300,000, and there are over 4,000 Chinese companies currently operating in the country. Also, with Dubai having the world's busiest airport for international passenger traffic by mid-2015, China and the UAE are well connected. Moreover, China became Dubai's biggest trading partner in 2014, and it overtook India for the first time, with trading hitting 175 billion United Arab Emirates dirham (47.7 billion US dollars). In addition, trade between Dubai and China topped that of Dubai's other trading partners, with bilateral trade totalling 39 billion United Arab Emirates dirham (around 10.6 billion US dollars) in the first quarter of 2016.[1]

These massive trading operations between the UAE and China have resulted in increasing financial activities in the UAE. Four of the largest Chinese banks, namely Bank of China, Agricultural Bank of China, Industrial and Commercial Bank of China, and China Construction Bank, are operating in the Dubai International Financial Centre ("DIFC"). The presence of these Chinese banks enhances Chinese outbound investments into GCC countries and facilitates their financial activities in the region. It also provides a comprehensive platform for Chinese investors to have business establishments in the UAE and further expand their businesses in other GCC countries.

Currently, no foreign exchange control is imposed by either the federal government of the UAE or the individual emirates, and there is also no withholding tax regime in the UAE. This facilitates Chinese investors' investment activities across the MENA region with the help of the financial institutions in the UAE. They can repatriate profits to China without any withholding tax exposure in the UAE due to the absence of a withholding tax regime. Indeed, most operations in the UAE should generally not be subject to taxation. Therefore, taxes are unlikely to be a key consideration for Chinese investors. However, it is important to note that corporate income tax may be introduced in the UAE in the foreseeable future. Implementation of value added tax ("VAT") is also expected in 2018.

Corporate Tax in the UAE

– Wait and See

There is currently no federal taxation in the UAE. Each of the individual emirates has issued corporate income tax decrees that theoretically apply to all businesses established in the UAE. However, in practice, these laws have not been applied across the emirates. Corporate income taxes are only imposed at the emirate level on companies engaged in actual oil and gas production in the UAE under specific government concession agreements and on branches of foreign banks under the specific tax decrees, regulations, or fixed agreements with the Rule of the emirates in which the branches operate. Furthermore, there is no general exemption in the emirates' tax decree. Anyone investing in the emirates should be aware of the potential risk that the tax decree may be more generally applied in the relevant emirate in the future and of the proposed introduction of corporate income tax at the federal level in the medium to long term.

The economy of the GCC countries has been hit significantly as the price of oil has declined from over 110 US dollars per barrel in mid-2014 to below 30 US dollars per barrel in January 2016. This has led to GCC countries running a significant deficit. Despite the slight recovery in the oil price over recent months, the striking drop in the price of oil has been a signal to the UAE that it may need to speed up the introduction of corporate tax.

On 30 June 2015, the Ministry of Finance ("MOF") of the UAE published its 2014 annual report (the "Report"), in which one of the initiatives outlined was the establishment of a tax system within the UAE by creating a tax department to collect and implement federal taxes. The corporate income tax policy has been approved by the UAE Cabinet. A corporate income tax law of the UAE and a common VAT law framework for GCC countries have been drafted, as indicated in the Report. The introduction of corporate income tax in the UAE is being considered to ensure the development and sustainability of the federal government's financial resources. It appears that concrete steps have been taken towards meeting this objective, although no specific timeline has been set for the implementation of corporate income tax in the UAE. An announcement will be released by the MOF upon finalisation of the tax law, and this requires all business operations in the UAE to prepare to fulfil their corporate income tax obligations no less than 12 months from the date of the announcement.

The current level of completion of the MOF's initiative on the establishment of a taxation system in the UAE indicates that the MOF is in the advanced stages of this initiative. However, the actual introduction of corporate income tax may still be some time away. In particular, there is still a question mark over the tax rate and how the corporate income tax regime that is going to be introduced at a federal level would interact with free zones which are administered at the individual emirate level. It is likely that the interaction of a federal level corporate income tax with the tax legislation at a specific emirate level may cause some challenges. Notwithstanding the difficulties and the time of the establishment and staffing of a federal level tax authority in the UAE, where no tax compliance requirements are currently imposed (with the exceptions of oil and gas production companies and branches of foreign banks), investors should be aware that the introduction of corporate income tax is firmly on the MOF's agenda.

Strong Tax Treaty Network in the UAE

A tax treaty network is also an essential factor for business decisions. There are almost 70 tax treaties currently in force in the UAE, including the tax treaties with China and Hong Kong. In the meantime, approximately 30 treaties are under various stages of negotiation, renegotiation, signature, ratification, translation, or entry into force. The strong tax treaty network makes the UAE a good investment destination for Chinese investors from a tax perspective. It protects investors from direct or indirect double taxation. Given the significant volume of cross-border investments, Chinese investors should also exercise additional caution with regard to the application of double tax treaties and the administrative procedures for obtaining the Tax Resident Certificate ("TRC") in the UAE.

A TRC is issued for a period of one year for a specific tax treaty. To commence the process of obtaining a TRC, the applicant is required to submit documents such as a business licence, audited financial statements, bank statements, and a certified lease agreement to the MOF. The guidelines issued by the MOF suggest that a company may not be able to obtain a TRC until it has been established for at least one year. Thus, Chinese investors should understand the feasibility of obtaining a TRC in the UAE before making any significant cross-border transactions and operations.

VAT

– The Start of Taxation in the UAE

The introduction of VAT has been the subject of discussion in the UAE for many years. On 18 August 2015, the MOF released an official statement regarding the progress made with respect to the introduction of VAT in the GCC countries. The announcement also provides official confirmation that the MOF has been conducting studies in relation to the implementation of VAT in the GCC countries.

The MOF has also recently published new information on VAT in GCC countries on its website in a question-and-answer ("Q&A") format. The Q&A page starts with general questions as to what VAT is and why the UAE would choose to implement such tax, giving readers a backdrop to this GCC-wide development. It also includes a simple illustration as to how VAT works (i.e. how VAT is collected in a supply chain and how the end-use consumer ultimately shoulders the tax burden in general). It also affirms previously communicated information such as the target date for VAT introduction, which is estimated to be 1 January 2018, and the likelihood that the initial standard rate will be 5 per cent. The communication clarifies that not all businesses have to register for VAT, notwithstanding the fact that the specific conditions (e.g. minimum annual turnover) for fulfilling the registration have yet to be finalised by the MOF. The cost of living will increase slightly when VAT becomes effective, but this will vary depending on the individual's lifestyle and spending behaviour, as highlighted by the publication. Certain measurements will be conducted to ensure that businesses will not increase their selling prices on the pretext of the VAT implementation. The tax would include exemptions for basic food, education, and healthcare items. The UAE would need to introduce new legislation to levy the tax, which would not be collected until 18 months after the passing of the new law.

Overall, the introduction of VAT will have an impact on all investors who are doing business in the UAE. VAT will influence the entire value chain across major industries and sectors with respect to procurement, manufacturing, distribution, warehousing, sales, and pricing. To assess the impact of the implementation of VAT, companies must look into every process of the value chain for their businesses' goods and services. Particularly, for smoother execution, it is necessary to invest additional manpower and resources into VAT compliance and reporting. In addition, companies need to learn the procedures and policies before they can implement the tax system. Given the recent VAT reform in China, Chinese investors will have experience in this area when they have to adopt the VAT regime in the UAE in the future.

World Expo 2020

– A Huge Opportunity for Chinese Investors

The World Expo 2020 exhibition to be held in Dubai will provide a great opportunity for investors to start or expand investment prospects. Dubai was nominated to host the World Expo 2020 exhibition in November 2013; this represents a remarkable milestone as Dubai will be the first city in the MENA region host a World Expo exhibition.

The authorities of the UAE are making maximum efforts to ensure that they organise the exhibition at the highest level. According to a forecast analysis conducted worldwide, over 25 million visitors will visit the UAE during the event, which would have the effect of boosting the economy in the UAE across major industries, including tourist infrastructure, retailing, transportation, real estate, and banking and finance industries. The market participation of both international and domestic organisations will be strengthened, and the transaction volume of import and export activities will also be increased. Studies indicate that this incoming event will probably bring as much as 19.6 billion US dollars of economic benefits to Dubai between now and 2021 and create over 275,000 additional jobs across various sectors to service the exhibition.[2] Dubai being the host of such an international exhibition represents a great stimulus for enhancing the continuous development of the UAE in general.

Disclaimer

The views reflected in this article are the views of the authors and do not necessarily reflect the view of the global EY organisation or its member firms.

Endnotes

1. "China remains Dubai's top trading partner in Q1" (Xinhua: 15 June 2016) http://www.chinadaily.com.cn/business/2016-06/15/content_25717732.htm

2. Expo 2020 "The Blog" http://expo2020-dubai.blogspot.ae/2015/09/impact-of-expo-2020-dubai-on-wider.html T