

UAE CORPORATE TAX

–EXPERT TAX INSIGHTS



UNDERSTANDING INTEREST EXPENDITURE AND INCOME UNDER UAE CORPORATE TAX REGULATIONS

Areas Covered:

- Implications for Natural Persons
- Implications for Freezone Persons
- Implications on Unincorporated Partnerships
- Impact of Small Business Relief
- Exempt Income & Qualifying Investment Fund

IMPLICATIONS OF INTEREST EXPENDITURE/INCOME

OVERVIEW

This article provides an overview of various scenarios related to interest deduction and income in corporate tax regulations. It covers the implications for Natural Persons, implications on freezone persons, implications on unincorporated partnership, the impact of small business relief on interest deduction limitations. Additionally, it addresses interest expense related to exempt income and treatment of interest income from a qualifying investment fund.

IMPLICATIONS ON NATURAL PERSON

- For natural persons subject to Corporate Tax, the General Interest Deduction Limitation Rule is not applicable.
- Interest expenditure is fully deductible if it is incurred wholly and exclusively for business purposes and comply with the arm's length principle.

IMPLICATIONS ON FREEZONE PERSON

INTEREST EXPENSE DEDUCTION

Free Zones can only deduct the Net Interest Expenditure while determining its Taxable Income that is not Qualifying Income. In applying this test, income and expenses relating to Qualifying Income are disregarded.

INTEREST INCOME

INTEREST INCOME IN START UP PHASE

The investment of surplus funds cannot be considered as an ancillary activity. Hence, will not be treated as Qualifying income. However, such Interest income can be treated as arising from the Qualifying Activity of treasury and financing services to Related Parties. The relevant core income-generating activities for treasury and financing services and associated level of substance for this activity will still need to be met.

FINANCE ACTIVITIES

In a Free Zone, a Free Zone person engaged in financing activities and earning interest income will not have qualifying income if these activities are not under regulatory oversight by authorities such as the UAE Central Bank, Dubai Financial Services Authority, Abu Dhabi Global Market Financial Services Regulatory Authority, or Securities and Commodities Authority.

However, this will not be applicable on Financing of;

- Ships.
- Financing services to Related Parties (Related Party financing is not a regulated activity in the UAE).
- financing and leasing of Aircraft (including engines and rotables).

HOLDING OF SHARES & OTHER SECURITIES

If a Free Zone Person earns any interest income from a Juridical Person, it will be treated as a Qualifying Activity, provided the 12-month ownership test. e.g. investment in bonds for a period of 12 months.

TREASURY & FINANCING SERVICES TO RELATED PARTIES

Any payment (for example, Interest or a service fee) received as part of conducting the treasury and financing services will be treated as Qualifying Income from a Qualifying Activity from a UAE related or Foreign Related Party.

GENERAL INTEREST DEDUCTION RULE FOR UNINCORPORATED PARTNERSHIP

The applicability on an Unincorporated Partnership will depend on its Corporate Tax status.

FISCALLY TRANSPARENT

- In a fiscally transparent Unincorporated Partnership, the partners are considered as the Taxable Persons in relation to the partnership Business. Hence, the applicability will be tested for individual partners.
- THE General Interest Deduction Limitation Rule does not apply to natural persons conducting business in the UAE, whereas for juridical persons, the General Interest Deduction Limitation Rule applies, with the 30% limitation based on the juridical person's adjusted EBITDA.

FISCALLY OPAQUE

- In a fiscally opaque Unincorporated Partnership treated as a Taxable Person, the General Interest Deduction Limitation Rule is applied irrespective of the partners.
- The 30% restriction is based on the partnership's adjusted EBITDA

IMPLICATIONS OF INTEREST EXPENDITURE/INCOME

APPLICABILITY OF SPECIFIC INTEREST DEDUCTION LIMITATION RULE TO UNINCORPORATED PARTNERSHIP

For an Unincorporated Partnership, the applicability will be tested in the hands of the relevant Taxable Person:

- For fiscally transparent Unincorporated Partnership, the Specific Interest Deduction Limitation Rule is applied to the partners.
- For fiscally opaque Unincorporated Partnership, the Specific Interest Deduction Limitation Rule is applied to the partnership.

Therefore, if an Unincorporated Partnership or its partners receives a loan from its Related Party, the deductibility of Interest on such loan is determined by the Special Interest Deduction Limitation rule.

ALLOCATION OF SPECIFIC INTEREST DEDUCTION LIMITATION RULE

In a fiscally opaque Unincorporated Partnership, unused Net Interest Expenditure carried forward is only available to the partnership, not the individual partners. Exiting partners do not receive a share of this carried-forward Net Interest Expenditure.

IMPLICATIONS ON TAXABLE INCOME

Partnership type & Implication	SCENARIO 1	SCENARIO 2	SCENARIO 3
	Interest on capital contributions paid to partners by the Unincorporated Partnership	Interest on loans provided by partners to the Unincorporated Partnership	Interest expenses incurred by partners for capital contributions
Fiscally transparent Unincorporated Partnership			
Implications on Partnership	<ul style="list-style-type: none">it is not considered as deductible expenditure when calculating the partners' taxable income.	<ul style="list-style-type: none">Not applicable as the fiscally transparent Unincorporated Partnership is not treated as a Taxable Person.	<ul style="list-style-type: none">Not Applicable
Implications on Partners	<ul style="list-style-type: none">Interest received on capital contributions by partners will be considered taxable income and must be included in their taxable income determination.	<ul style="list-style-type: none">Interest income received by partners must be included in their taxable income determination.If an Unincorporated Partnership receives a loan from a partner exclusively for business purposes and the interest paid is at arm's length, the interest expense is deductible in determining the partners' taxable income according to their share.	<ul style="list-style-type: none">Not Applicable
Fiscally Opaque Unincorporated Partnership			
Implications on Partnership	<ul style="list-style-type: none">Interest on capital contributions paid to partners is treated as a profit distribution and is not deductible when calculating the partnership's taxable income.	<ul style="list-style-type: none">Interest on loans provided by partners is deductible when determining the partnership's taxable income, given that the interest was incurred wholly for business purposes and meets the arm's length principle.	If a partner borrows money personally to fund their capital contributions in the Unincorporated Partnership and incurs interest expenses, such expenses will be deductible when determining the partner's taxable income, subject to the General and Specific Interest Deduction Limitation Rules.
Implications on Partners	<ul style="list-style-type: none">Interest on capital contributions received by partners is excluded from their taxable income as it has already been taxed at the partnership level.	<ul style="list-style-type: none">Interest income from loans provided to the partnership is considered taxable income for the partners and must be included in their taxable income calculation.	

IMPLICATIONS OF OPTING FOR SMALL BUSINESS RELIEF

- Disallowed Net Interest Expenditure from previous periods can be utilized in future periods when Small Business Relief is not applied.
- During periods when Small Business Relief is elected, interest expenditure limitations do not apply, and businesses cannot accrue or carry forward Net Interest Expenditure.
- Carried-forward Net Interest Expenditure from previous periods can be used in future periods without Small Business Relief.
- Periods with Small Business Relief still contribute to the ten-period limit for carrying forward disallowed Net Interest Expenditure.

IMPLICATIONS RELATED TO EXEMPT INCOME

Interest paid on income exempt under the Participation Exemption is deductible within the limits set by Article 30 of the Corporate Tax Law. This restricts net interest expenditure to 30% of EBITDA, excluding any income that is exempt under the Participation Exemption and other types of Exempt Income.

Additionally, irrespective of the Participation Exemption, interest expenditure may not be deductible on a Related Party loan that pertains to, among other things, a dividend from a Related Party.

IMPLICATIONS OF INTEREST EXPENDITURE/INCOME

IMPLICATIONS ON A QUALIFYING INVESTMENT FUND

Investors in Qualifying Investment Funds must include their share of net income available for distribution in their taxable income. The Qualifying Investment Fund will categorize the net income available for distribution in its financial statements as follows:

- Exempt Income
- Interest income
- Income from Immovable Property in the UAE
- Other income

RESIDENT NATURAL PERSONS

Taxation of Qualifying Investment Fund income for resident individuals depends on whether it is related to business activities or personal investments.

- Income related to business activities is taxable
- Income from personal investments is not taxable

RESIDENT JURIDICAL PERSONS

Any net income available for distribution in a Qualifying Investment Fund that is not Exempt Income will be considered as Taxable Income.

NON-RESIDENT PERSONS

- Any net income that is not Exempt Income will be included in Corporate Tax calculations if it is attributable to a Permanent Establishment of the Non-Resident Person in the UAE.
- State Sourced Income is subject to a 0% withholding tax rate.

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Manzar Abbas

Engagement Partner



Faheem Shaukat

Director – Taxation

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• Office No. UG04, A6 Building, Silicon Oasis, Dubai, United Arab Emirates



• Contact: +971 52 240 1415



• Web: www.lmkgconsultants.com