

# NAVIGATING FTA's FREE ZONE PERSONS GUIDE



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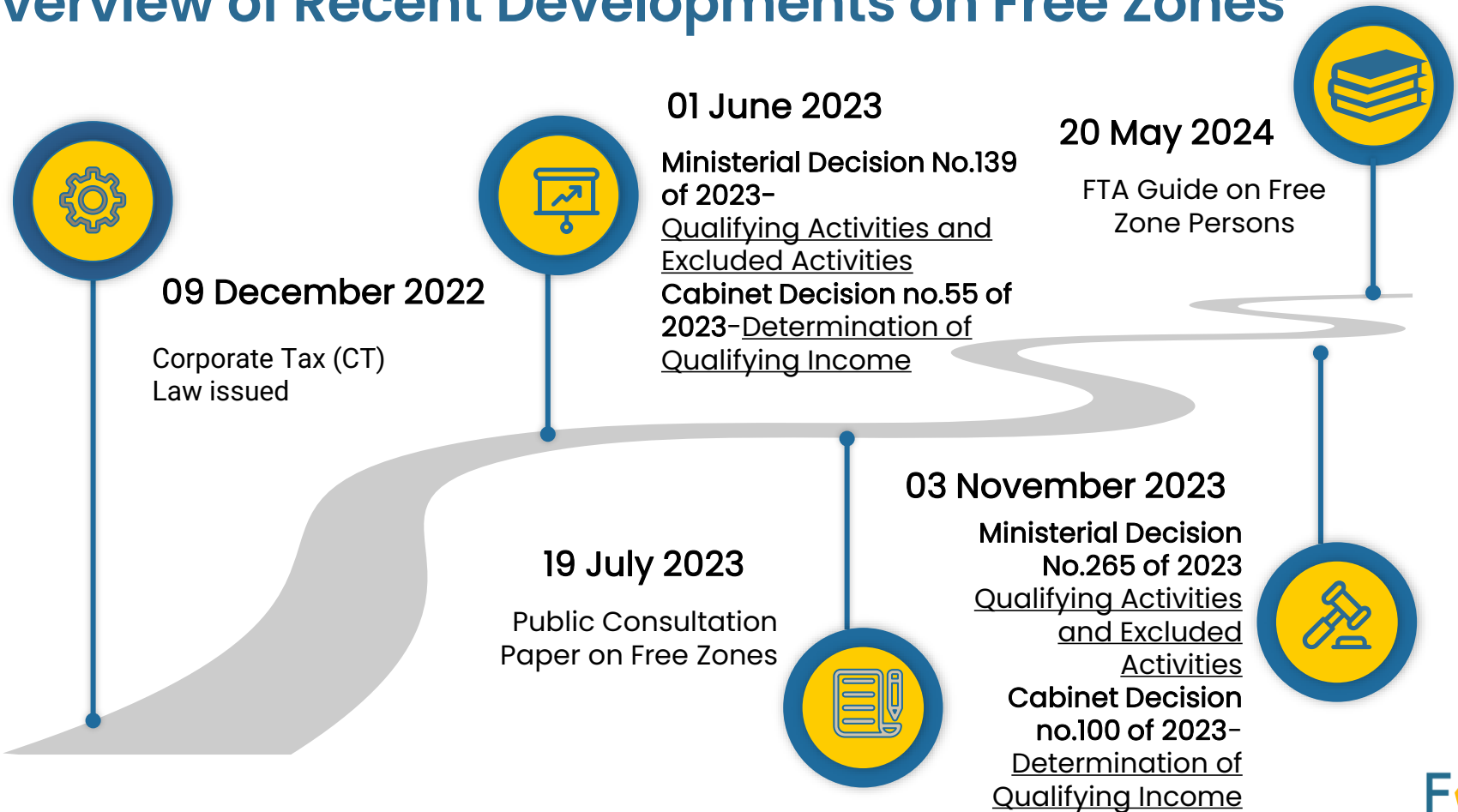
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# OVERVIEW OF RECENT DEVELOPMENTS ON FREE ZONES



# Overview of Recent Developments on Free Zones



# FREE ZONE PERSON

Article No. 18 of CT Law

Cabinet Decision No. 100 of 2023

Ministerial Decision No. 265 of 2023

FTA Guide on Free Zone Persons

# Definition as per CT law

## Free Zone

- ❖ Free Zone is a defined geographic area within the UAE that is specified in a decision issued by the Cabinet at the suggestion of the Minister.

## Free Zone Person(FZP)

- ❖ The definition of a Free Zone Person under the UAE CT Law refers to juridical person incorporated, established or otherwise registered in a Free zone including branch of a Non-Resident Person registered in a Free Zone and branch of mainland entity in a free zone.

# CT Rate for Qualifying Free Zone Person(QFZP)

Corporate Tax shall be imposed on a QFZP at the following rates:-

0% on Qualifying Income

9% on Taxable Income that is not Qualifying Income

# Condition specified under Article 18 for QFZP



Maintain adequate substance in UAE

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Deriving Qualifying Income

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Has **not elected** to be subject to Corporate Tax

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Complies with Arm length principle and transfer pricing documentation

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Meets **any other conditions** as may be prescribed by the Minister.



# Additional Condition for QFZP

Ministerial Decision No. 265 of 2023 specified two additional conditions that Free Zone has to comply with : -

Non -qualifying revenues do not exceed the **de-minimis** requirements.

Prepares **Audited Financial Statements** in accordance with the Law.

**✗** If any of the conditions as outlined in Article 18 and Ministerial Decision No. 265 of 2023 are not met, the taxpayer's status as a QFZP will be revoked starting from the beginning of the relevant Tax Period and for the following four Tax Periods.

# INSIGHTS INTO THE GUIDANCE RELEASED ON FREE ZONE PERSONS



# Highlights of CT guide on FZP

## Confirmation from Free Zone Authority

Every FZP should check with their respective Free Zone Authority to confirm if they operate in a Free Zone or Designated Zone to avail the benefit of CT@0%. There is no separate list of Free Zones/Designated zones issued for CT purposes.

## Election

- i) A FZP will be deemed to be a QFZP unless they fail to meet one of the QFZP conditions or elect to be subject to tax.
- ii) A QFZP that elects to be subject to standard CT (i.e. 9%), or fails to meet the QFZP criteria for a specific Tax Period, will lose its QFZP status starting from the beginning of the Tax Period in which it elects to pay CT or fails to meet the criteria, as well as for the following four Tax Periods. After this period, a new election can be made if the entity wishes to continue not being treated as a QFZP unless it no longer meets the criteria of QFZP in a particular tax period.
- iii) The said election can be made at any point during the Tax Period in question or in the subsequent Tax Return after the Tax Period ends. This election cannot be made after the tax return filing deadline for the concerned tax period.

# Highlights of CT guide on FZP

## Allocation of expenses

If a FZP generates both **Qualifying Income** and **Taxable Income**, it must **allocate expenses between the two** and also **maintain sufficient documentation** that the profits attributed are commensurate with the functions performed, assets used, and risks based on the arm's length principle

## Transaction between free zone persons

In case of **Qualifying Income** derived from transactions between FZP, the seller may **obtain a written statement or undertaking from the purchaser affirming their role as a Beneficial Recipient** and their intention to utilize the services or goods for their free zone business

## No income during start up phase

A FZP who **hasn't earned any Qualifying Income in a Tax Period** because they haven't commenced revenue generation **won't lose eligibility as a QFZP**, as long as they do not derive any non-qualifying revenue and fulfill all other obligations outlined in the CT Law.

# Highlights of CT guide on FZP

## Treatment of Tax losses

- i) Tax Losses incurred by a QFZP on their **Taxable Income** can be carried **forward** to offset against future Taxable Income, except for income from intellectual property.
- ii) **Losses related to Qualifying Income** cannot be used to offset Taxable Income, transferred, or carried forward. Further, **QFZPs cannot transfer or receive Tax Losses** from other Taxable Persons.

## Treatment of Mixed use property

In the case of mixed use of property, **revenues should be allocated between commercial and non-commercial units** on an arm's length basis.

## Ancillary activities

Qualifying Activities include ancillary activities, which are **those necessary for the performance of the main activity or contributing minorly to the main Qualifying Activity and are closely related to it.**  
If an ancillary activity is conducted **independently of the main Qualifying Activity**, it will not be considered a Qualifying Activity.

# Highlights of CT guide on FZP

## Income from Qualifying Intellectual Property

i) In order to benefit from the 0% rate on Qualifying income from Qualifying Intellectual property (QIP), a QFZP must be able to **demonstrate a nexus between Qualifying expenditure and income from QIP**. In such cases, a QFZP must set up an appropriate tracking system in order to avail the benefit.

ii) While calculating the Qualifying income from Intellectual Property, the sum of **Qualifying expenditure and Uplift expenditure shall be lower of the following-**

- 130% of Qualifying Expenditure
- Overall Expenditures

## Compliances

i) A QFZP is **not required to prepare separate Financial Statements for its Qualifying Income and its other income** and should have sufficient documentation to demonstrate the calculation of Qualifying Income.

ii) A QFZP is **not required to prepare separate Financial Statements for any of its branches**.

# Highlights of CT guide on FZP– Adequate Substance

- ❖ To qualify as a QFZP for a Tax Period, a FZP must maintain sufficient substance in a Free Zone (or in a Designated Zone for distribution activities) **throughout the Tax Period**. This entails the following requirements for the FZP :
  - ✓ Conducting **core income-generating activities** for the business within the Free Zone (or Designated Zone for distribution activities).
  - ✓ **Maintaining adequate assets, employing qualified full-time staff, and incurring sufficient operating expenses within the Free Zone (or Designated Zone)** relevant to each core income-generating activity.
- ❖ A FZP may also conduct **non-core activities related to its Free Zone Business outside of a Free Zone**. These activities are considered non-core if they do not directly contribute to sales or are routine in nature.

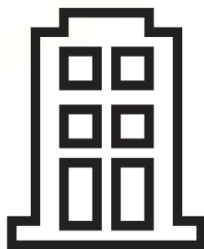
# Highlights of CT guide on FZP– Adequate Substance

- ❖ **Double counting of employees is not permitted** (e.g., if a FZP is engaged in both treasury and manufacturing activities, the same employee cannot oversee both).
- ❖ **Core income-generating activities outsourced to another Person in a Free Zone** (or Designated Zone for distribution activities) are considered as being performed by the QFZP, as long as the QFZP **adequately supervises the outsourced activities where it should be capable of overseeing and controlling the activity adequately** by ensuring that the resources of the entity performing the activity are sufficient for the specific services rendered to the FZP, **for example, without any duplication of assets, employees, or expenses across multiple FZP.**
- ❖ **For distribution activity, core income generating activity must be outsourced within a designated zone.**



# Illustration

ABC engages in distribution activity  
from JAFZA - DZ



- ❑ Tax period Jan 2024 – Dec 2024,
- ❑ Hire employees in Jun 2024

Since ABC does not have full-time qualified employees in the Designated Zone throughout the tax period FY 2024 (Jan to Dec 2024), it fails to demonstrate adequate substance for the entire year. Consequently, ABC is not considered a QFZP.

# Illustration

XYZ, a company registered as an FZP in JAFZA DZ, is engaged in distribution activities and maintains warehousing facilities within JAFZA DZ. However, its office, employees, and core operations are located in DMCC (not DZ)



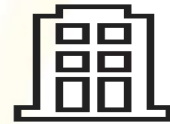
Warehousing facilities  
in DZ

JAFZA Designated  
Zone

Core operations are in DMCC which is  
not DZ



Employee in DMCC

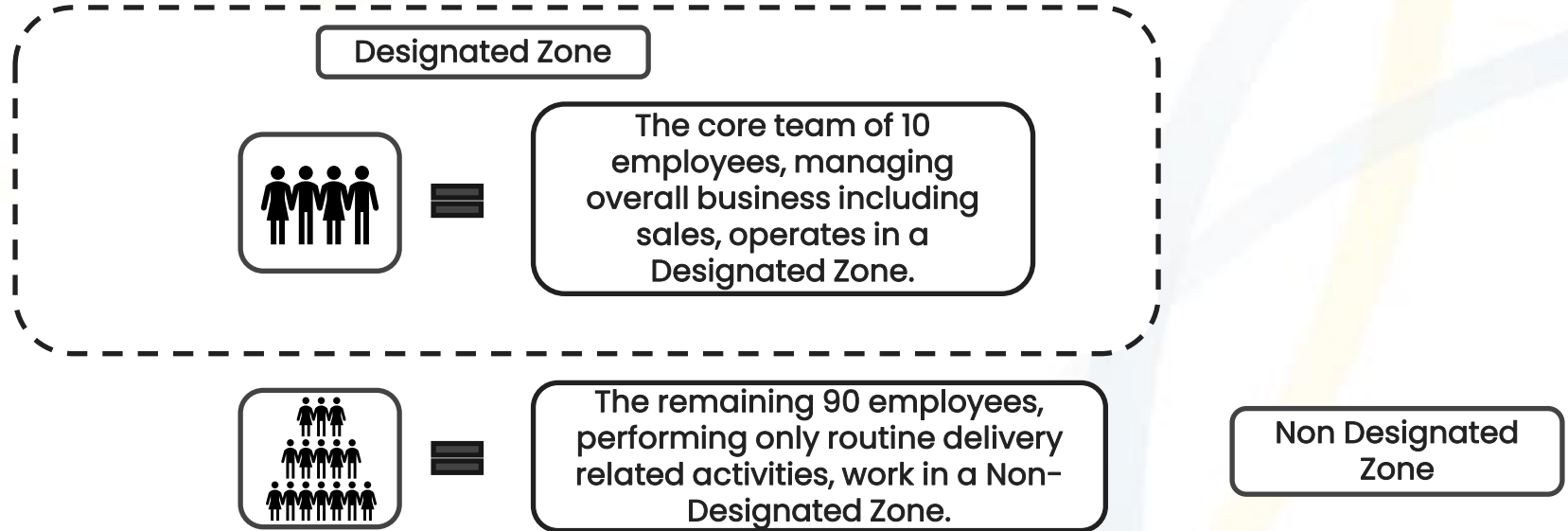


Office in DMCC

XYZ does not qualify as a QFZP because its core income-generating operations, including those of its office and employees, are conducted in DMCC- not DZ. Consequently, it lacks the necessary substance in JAFZA-DZ.

# Illustration

XYZ is registered in JAFZA-DZ and conducts its distribution activities, with 100 staff



The core income-generating activities of XYZ, which include sales, are performed by a team of 10 employees based in the designated zone. Therefore, XYZ qualifies as a QFZP since it satisfies the adequate substance

# QUALIFYING ACTIVITIES



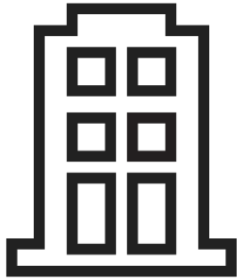
# Manufacturing of goods or materials

- ❖ Goods that are manufactured in the UAE **do not need to pass through a Designated Zone**, however, the distribution activity is required to be conducted in or from a Designated Zone in order to be a Qualifying Activity.
- ❖ **Post-sale activities and customer support activities are considered as ancillary to the Qualifying Activity** of manufacturing goods or materials, provided they naturally and integrally complement the main Qualifying Activity. However, **manufacturing does not include repairs**.
- ❖ **Intangible items like software, which can be sold independently of a physical asset, are not considered goods**. Therefore, the creation of software, ERPs, automation tools, and similar items will not be classified as the manufacturing of goods or materials.
- ❖ However, **Software embedded in hardware** (i.e. it is inherently part of the hardware) generally would be considered as goods.

# Illustration

Company S, a FZP is engaged in the manufacturing of advanced Magnetic Resonance Imaging (MRI) machines at its own risk.

Company Y, a FZP in a Designated Zone is engaged in distribution activity.



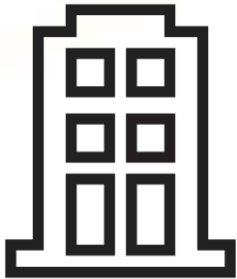
Company S sells the MRI machines to Company Y. Post-sale services required by the end customers (such as installation and maintenance) will be the responsibility of Company S.



**As the post-sale services are closely related to the Qualifying Activity of manufacturing and should not be regarded as a separate activity. Accordingly, the revenue of Company S from sales and post-sale service will be treated as being derived from the Qualifying Activity of manufacturing of goods or materials.**

# Illustration

Company U a FZP is engaged in the creation of Accounting Software.



Company U is engaged in selling of Accounting Software to Company Y

Company Y, is a Non FZP



The creation of software by Company U will not be classified as the manufacturing of goods or materials.  
Therefore it shall not be regarded as a Qualifying activity.

# Illustration



## Car with pre-installed navigation

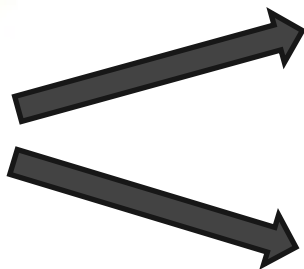
**Software shall be considered as Goods.** This is because it involves a physical product (the hardware) that incorporates an intangible element (the software).

The pre-installed navigation software in Car shall be classified as Goods.



# Illustration : Manufacturing and Distribution of goods

ABC is a free zone company is engaged in the manufacturing and distribution of goods



Supply of goods to customers within the Free Zone



Qualifying Income as it's a transaction between Free zone persons

Supply of goods to customers outside the Free Zone



Qualifying Income ?

Whether Distribution activities to Non Free Zone customers by ABC from free zone that is not a Designated Zone shall be considered as Qualifying activities.



# Distribution of goods or material in or from a Designated Zone

- ❖ A key feature of distribution activity is that the **distributor holds the title to the products which differentiates it from Logistics services.**
- ❖ As per MD 265 of 2023, definition of “Distribution of goods or material in or from a Designated Zone” includes buying and selling of goods, materials, component parts or any other items that are tangible or movable. Accordingly, distribution of intangible products and services such as **licenses, software and financial products/ services will not be covered under distribution activity.** However, the guide has further clarified that if the **product is embedded onto a hardware, income for which is not separately identifiable, they can still qualify for Distribution activity.**

# Distribution of goods or material in or from a Designated Zone

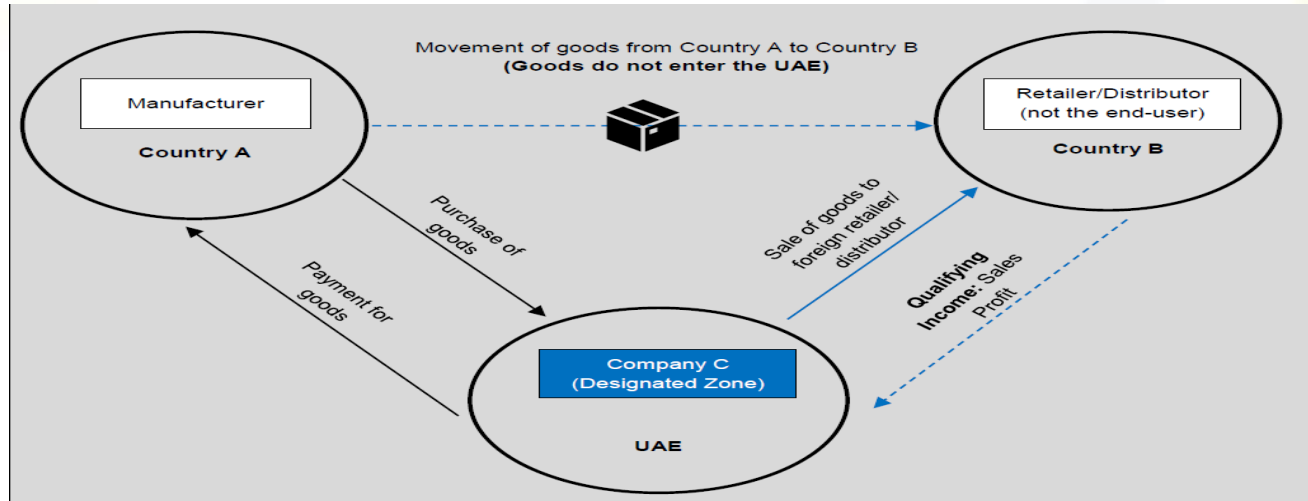
- ❖ The concept of 'end-user' is now defined in the Guide. End-user is the person who eventually uses the product for its intended purpose, **whether they may be personal, commercial or industrial**. Accordingly, if a distributor is engaged in **selling goods to a customer who is end-user** (i.e., uses or consumes the product), then such activity will not be considered as a Qualifying activity.
- ❖ A QFZP has to **conduct necessary due-diligence** (obtain KYC, undertaking etc. from the customer) to demonstrate that the **customer is not an end-user** in order to fall within the scope of the Distribution as a Qualifying activity .

# Distribution of goods or material in or from a Designated Zone

- ❖ Under Ministerial Decision No. 265 of 2023 on Free Zone, it was not clear whether High Seas Sales (Third port shipment) is covered under Qualifying activity –Distribution of goods or materials in or from a Designated Zones, as goods do not physically enter UAE. Now the new guide has clarified that **High Seas Sales (Third Port Shipment) if undertaken from Designated Zones shall be covered under Qualifying Activities.**
- ❖ There are **no limitations on the mode of distribution.** For goods that are **procured from UAE itself and sold in UAE/outside, they do not need to pass through a Designated Zone.** The requirement of distributed goods to **enter a Designated Zone only applies in case goods are imported into the UAE and then sold.**
- ❖ **Buying and selling of goods locally** without the goods being entered in Designated Zone shall be considered as Qualifying Activity.

# Illustration : High sea sales or Third port trading

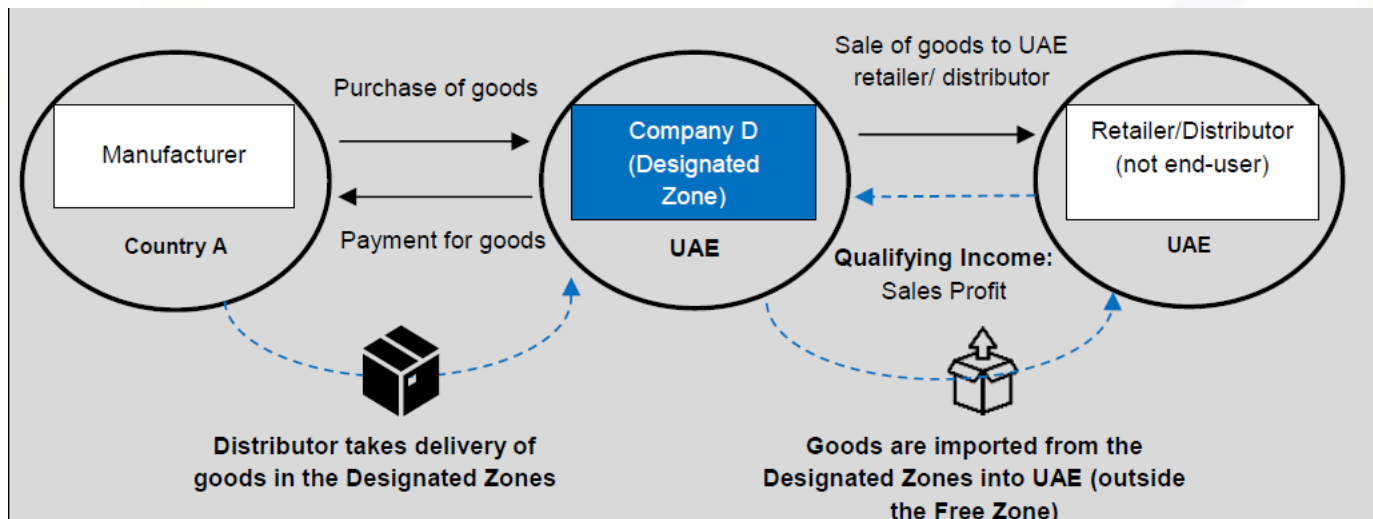
Company C (a Free Zone Person) in a Designated Zone that buys goods from a manufacturer in Country A and sells these goods to a retailer/distributor in Country B. The goods are shipped directly from the manufacturer in Country A to the retailer/distributor in Country B.



Company C performs its activities in or from a Designated Zone and the arrangements do not involve goods or materials entering the UAE. Consequently, Company C is performing Qualifying Activities. Accordingly, Income derived from such distribution activity shall be considered to be Qualifying Income.

# Illustration : Distribution of goods in the UAE (import)

Company D is a Free Zone Person in a Designated Zone that buys goods from Country A and sells these goods to a retailer/distributor in the UAE . The goods are shipped by the manufacturer in Country A to Company D in the Designated Zone from where they are imported into the UAE.

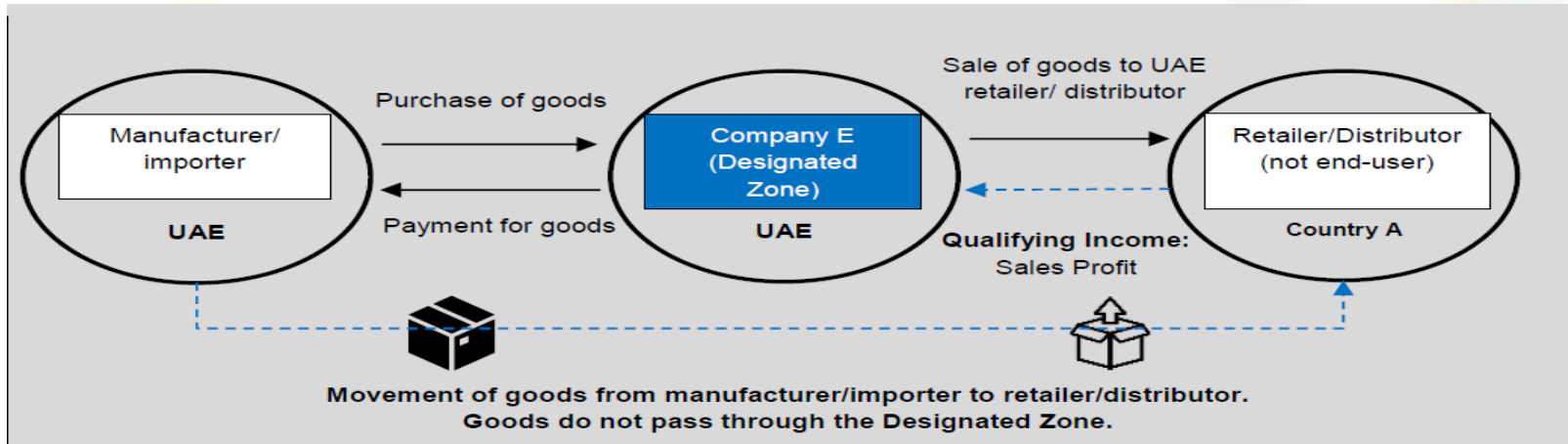


As Company D conducts its activities in or from a Designated Zone and the goods entering the UAE are imported through the Designated Zone, Company D is performing Qualifying Activities.

If the goods or materials were not imported through the Designated Zone, the activities of Company D would not be Qualifying Activities.

# Illustration : Distribution of goods from UAE (export)

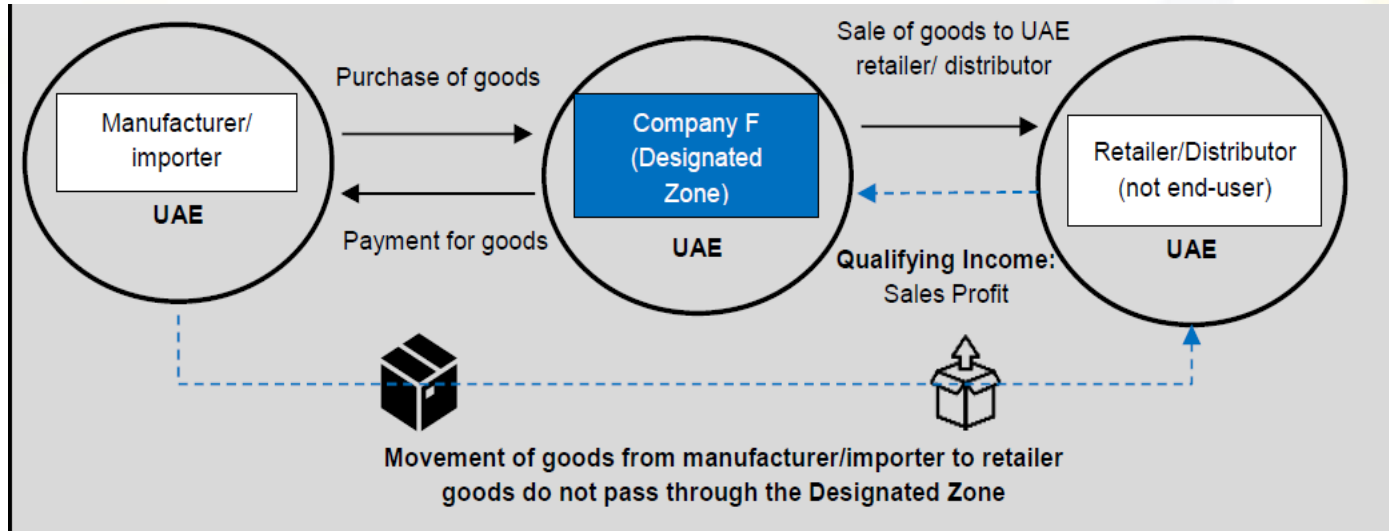
Company E is a Free Zone Person in a Designated Zone that buys goods from a juridical person in the UAE (outside a Free Zone). Company E sells these goods to a retailer/distributor outside the UAE. The goods or materials are shipped/transferred directly by the manufacturer/importer to the retailer/distributor without passing through the Designated Zone as the goods were already in the UAE.



As Company E conducts its activities in or from a Designated Zone, and the goods are already in the UAE at the time Company E purchased them, they do not need to pass through a Designated Zone when they are subsequently sold to the retailer/distributor, Company E is considered to be performing Qualifying Activities.

# Illustration : Distribution of goods within the UAE

Company F is a Free Zone Person in a Designated Zone that buys goods from a juridical person in the UAE (outside a Free Zone). Company F sells these goods to a retailer/distributor in the UAE outside a Free Zone. The goods or materials are shipped/transferred directly by the manufacturer/importer to the retailer/distributor without passing through the Designated Zone



As Company F conducts its activities in or from a Designated Zone, and the goods are already in the UAE at the time Company F purchased them so they do not need to pass through a Designated Zone when they are subsequently sold to the retailer/distributor, Company F is considered to be performing Qualifying Activities.



# Illustration : Distribution of goods

XYZ is engaged in distribution of steels from designated Zone to real estate developer.



Whether Distribution of steels by XYZ from Designated Zone to a real estate developer shall be considered as sale made to reseller or end user



# Trading of Qualifying Commodities

- ❖ The Qualifying Commodity needs to be in a form that is traded on a Recognized Commodities Exchange Market (such as DGCX, LME etc.). Metals, minerals, energy, and agriculture commodities that are traded on a Recognized Commodities Exchange Market will be deemed to be in raw form when they meet the conditions to be traded on the said exchange (for example, gold being 99.4% purity in bullion form).
- ❖ The trade itself does not need to be performed through an exchange.
- ❖ Raw form refers to commodities in their natural, unprocessed state, with no added value, traded on recognized commodities exchange markets before any processing or transformation.
- ❖ Under **agricultural commodities** it includes products like wheat, corn, and soybeans.

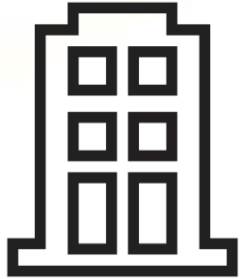
# Trading of Qualifying Commodities

- ❖ **Under Energy commodities** it includes crude oil and natural gas.
- ❖ **Under Metals** it includes items like gold, silver bars, and aluminum ingots.
- ❖ While many commodities are traded in their raw form, it is important to recognize that some degree of processing may be required to meet the trading standards or specifications necessary for trading on a Recognized Commodities Exchange Market.
- ❖ The HSN code can help verify whether a commodity still retains its raw form.

# Illustration

Company A, is a FZP registered in DMCC and is engaged in the trading of Kerosene

Company X, Non FZP



Company A sells Kerosene to Company X



Is selling of Kerosene by Company A be considered as Qualifying commodities



# Holding of shares and other securities for investment purposes

- ❖ The active trading of shares and other securities would not constitute a Qualifying Activity.
- ❖ Cryptocurrency is specifically mentioned in the “Qualified” Financial instruments
- ❖ Shares and other securities shall be deemed to be held for investment purposes **when held or there is an intention to hold for an uninterrupted period of at least 12 months.**
- ❖ Major Shareholder holding shares in a company for investment purpose may also derives **other income such as royalties or management fees from that company.** Said income would not constitute income from Qualifying activities of holding of shares and securities for investment purpose.
- ❖ Income derived from **securities backed by receivables from non-financial asset is excluded from the Qualifying Activity.** However, securities backed by receivables from a financial asset will be considered under Qualifying Activity.

# Illustration

Company Y is a FZP registered in ADGM

Holds a diversified portfolio of shares and other securities for investment purposes.

A Dividend of AED 1,000,000 from shares that have been held for less than 12 months on the date of the Dividend payment. However, Company H has the intention to continue holding the shares for more than 12 months.

A capital gain of AED 2,500,000 on a sale of shares that have been held for more than 12 months.

Interest of AED 250,000 from an investment in bonds that have been held for more than 12 months.



As Company Y has the intention and can demonstrate it has the intention to continue to hold the shares for a period of more than 12 months, the entire Revenue is treated as being derived from the Qualifying Activity of holding of shares and other securities .

# Ownership, management and operation of ships

- ❖ Ships used for local transportation or leisure or recreational purposes, or as floating hotels, restaurants or casinos is not considered under Qualifying Activity.
- ❖ Business consisting solely of maintenance, fit-out or repairing Ships will not be considered as a Qualifying Activity.
- ❖ It also does not include the leasing of shipping containers, unless that activity is ancillary to a shipping business.

# Illustration

## Company F is a FZP registered in DMCC

Involved in the ownership, management, and operation of Ships. In addition to the freight and hire charges, Company F received the following Revenue from its customers:-

Nature of Income	AED
Demurrage Charges	1,100,000
Standby Charges	400,000
Additional war risk insurance premium	300,000
Heating Charges	50,000
<b>Total Revenue</b>	<b>1,850,000</b>



As above Revenue of AED 1,850,000 is closely related to the Qualifying Activity of Ownership, management and operation of Ships. Accordingly, it will be treated as Revenue from a Qualifying Activity.



# Fund management services and Wealth and Investment Management Services

- ❖ Fund management services will be considered as Qualifying Activities if the investment decision are solely taken by the fund manager or investment advisor in a free zone and are subject to the regulatory oversight of the relevant Competent Authority in the UAE. The following shall be considered as Competent Authority in the UAE:-
  - a. Central Bank of the United Arab Emirates
  - b. The Dubai Financial Services Authority
  - c. The Financial Services Regulatory Authority of the Abu Dhabi Global Market or
  - d. The Securities and Commodities Authority

# Illustration

ABC is a Fund Management company registered in DIFC Free Zone

Parent Entity of ABC is located in India



ABC executes all decisions taken by its Parent Entity without independent or further evaluation by its Fund Manager



As all the decisions are taken by Parent entity in India and none of the key decisions are taken from DIFC Free Zone by ABC .Thus, the above services rendered by ABC to its clients shall not be considered as Qualifying Activity of Fund management services.

# Headquarter Services to Related Party

- ❖ Activities that might constitute the Qualifying Activity of headquarter services to Related Parties include:-
  - ✓ Taking relevant management and strategic decisions.
  - ✓ Incurring operating expenditures on behalf of group entities
  - ✓ Coordinating group activities
  - ✓ Financial management
  - ✓ Central procurement services
  - ✓ Human resource management
  - ✓ Technical Support
  - ✓ Legal and compliance services
  - ✓ Intellectual property management

# Illustration

Company T is an FZP that acts as the headquarters for a multinational coffee chain with franchises across the globe for which it charges a single bundle fee based on the % of each subsidiary revenue to cover the use of the brand name and all support services

Franchises across the globe



The above services rendered by Company T to its Franchises across the globe shall be considered as Qualifying Activity of Headquarter Services to Related Party .

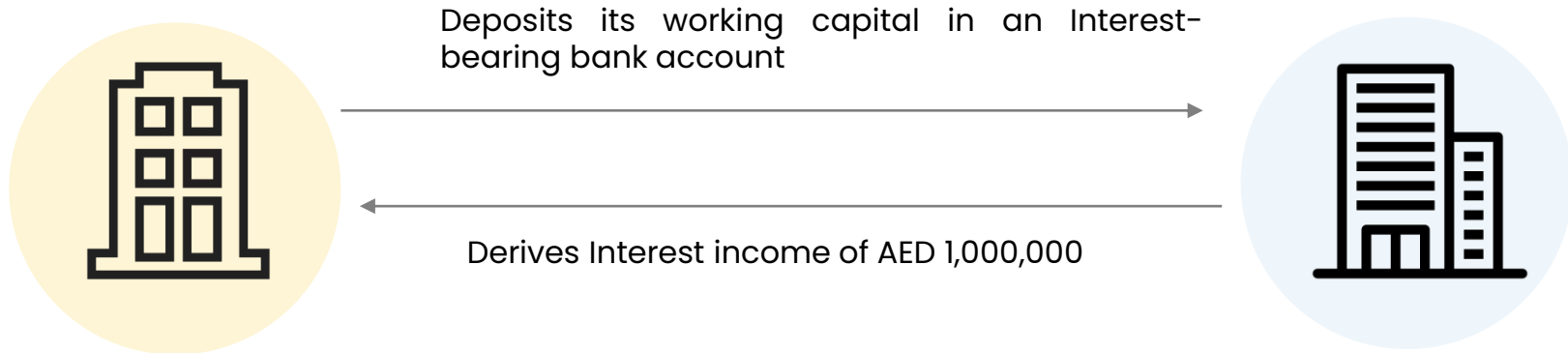
# Treasury and financing services to Related Parties

- ❖ Under this activity, the definition of Related Parties includes Domestic Permanent Establishments and self-investment. Income from investment of surplus funds such as Interest from bank deposits, will be treated under Qualifying Activity as it will be considered as Treasury and Financing services to oneself.
- ❖ The activity of Treasury and Financing is widely defined and includes cash pooling, cash management, risk management, investment management and financing.

# Illustration

Company U is a FZP

Bank in U.A.E.



The Interest income derived by Company U shall not be considered as ancillary activity but will be treated as arising from the Qualifying Activity of treasury and financing services to Related Parties(Oneself), provided Company U maintains adequate substance in relation to the activity.

# Financing and leasing of Aircraft

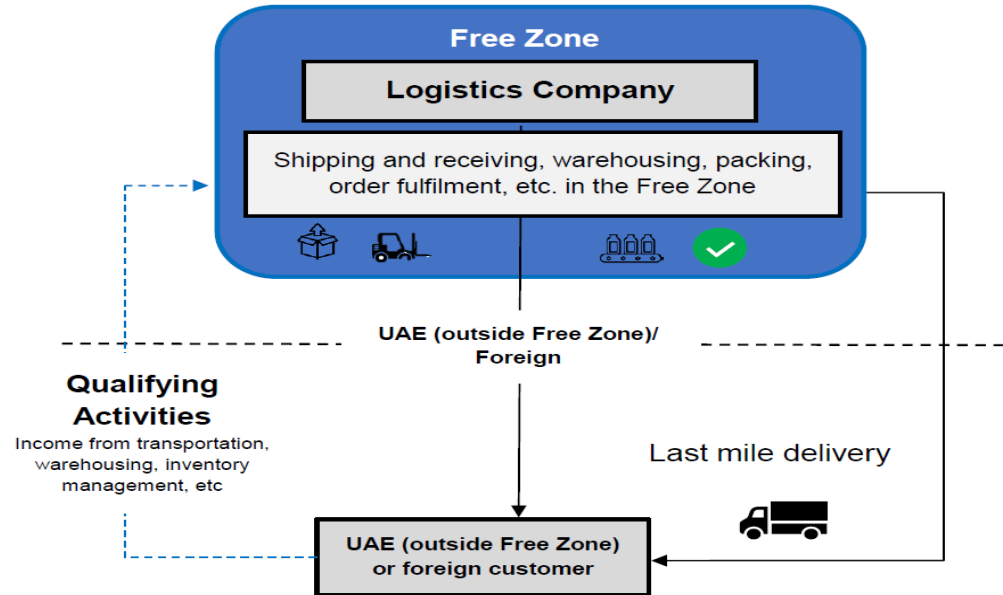
- ❖ Sub-leasing of Aircraft will fall within the scope of Qualifying activity.

# Logistics services

- ❖ Logistics services do not include the movement of people.
- ❖ Last-mile delivery services outside of the Free Zone in the UAE or in a foreign country will also be considered as a Qualifying Activity provided QFZP performs most of its logistics services within a Free Zone for its customers in the UAE outside a Free Zone or foreign customers.

# Illustration

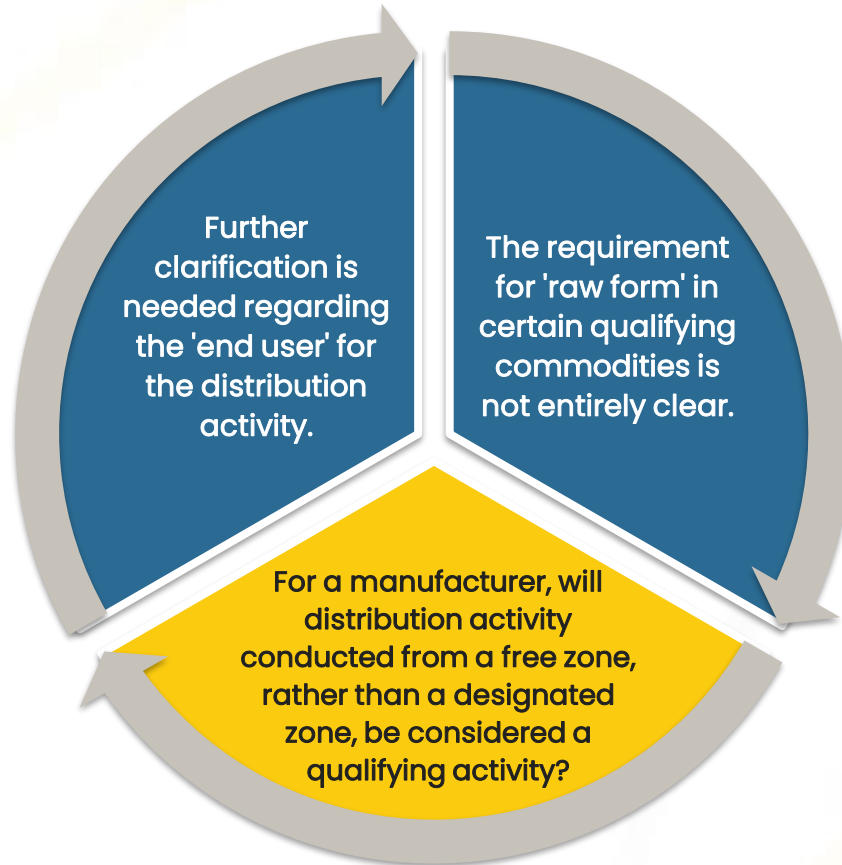
Free Zone Person performs most of its logistics services within a Free Zone for its customers in the UAE outside a Free Zone or foreign customers but provides last mile delivery services outside of the Free Zone in the UAE or in a foreign country.



The last mile delivery services will form part of the Free Zone Person's logistics services under Qualifying Activity.



# Further clarification awaited



# Q & A

# Thank you

In case of any queries, please reach out to us at-

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