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How Can UAE's General Anti-Abuse Rules Impact Your Business?

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Introduction

It is common for businesses to do such tax planning and design strategies to reach the optimum tax liability scenario.

With the announcement of the implementation of Corporate Tax in UAE, businesses would have started evaluating their current profitability scenarios to get an idea of their estimated tax liabilities once their tax assessment is completed for their reporting years.

To ensure that tax planning does not become tax evasion, certain rules have been applied under the CT Law. These rules intend to prevent tax strategies and planning that are made with the intention of evading taxes or reducing tax liabilities. Let us see in detail what these rules are and how they are applicable under UAE Corporate Tax Law.

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What are Anti-Abuse Rules?

Let’s start with understanding the terminology.

In the context of ‘Taxation’, the word ‘Abuse’ means ‘Misuse of tax law’. The rules formulated to prevent the misuse of tax laws are called anti-abusive rules.

Anti-abusive rules (AAR) are common rules around countries worldwide to prevent taxpayers from creating loopholes or manipulating the system to minimize their tax burden.

These rules follow the principle of "substance over form," meaning thereby that the tax authority looks beyond the legal structure of a transaction and focuses on its true purpose to identify the correctness of the taxable income presented by the taxable person in front of the tax authorities.

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GAAR Provisions under CT LAW

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General Anti-Abuse Rules (GAAR):

The CT Law introduced General Anti Avoidance Rules and mandated the principal purpose test for transactions, which states that any transaction should not be conducted with only tax advantage as a motive. If that is the case, those transactions could be adjusted or recharacterized by the tax authority.

Reference to Legal provisions

As per Article 50 of UAE Corporate Tax Law:

(1) The provisions of the GAAR apply where it can be reasonably ascertained that:

(A) Taxable person has undertaken any transactions or arrangements without any valid commercial rationale or other non-fiscal reason which fails to reflect economic reality;

This means that GAAR provisions do not apply to transactions or arrangements carried out with intentions of valid commercial or non-fiscal reasons that reflect economic reality. Here, while evaluating the transactions or arrangements or any part thereof, the intention of the taxable person behind undertaking such transactions shall be deeply examined.

(B) The primary purpose of undertaking such transaction, arrangement, or any part thereof should be to obtain a corporate tax advantage that is not consistent with the intention or purpose of the CT Law.

Here, Corporate tax advantage includes, but is not limited to, the following:

- A refund or
- An increase in the refund of corporate tax or an advancement of the corporate tax or
- Avoidance or reduction of tax payable or
- Deferral of payment of corporate tax.

If the transaction or arrangement avoids an obligation to deduct corporate tax, it shall also be regarded as a corporate tax advantage arising from the transaction or arrangement.

Explanation

It is worth noting that these Rules are applicable even for the transition period from when the law was published until it became effective.

That means If any taxable person has tried to alter their transaction or business model during the transition period to obtain only tax benefits, the GAAR Provisions will apply to such transaction or Business Strategy.

As long as a valid commercial rationale behind any restructuring/changes to the business model can be justified, General Anti-Abuse Rules provisions shall not be invoked under CT law.

Accordingly, we must be careful of this aspect and maintain adequate documentation to justify the commercial rationale behind any restructuring or changes made to the business.

Company A

has a total Income of AED 600,000. Its Corporate Tax Liability under CT Law will be as follows-

- Total Taxable Income = AED 600,000
- Corporate Tax rate = 9%
- Total CT liability= Up to threshold of AED 375,000 – No Tax Liability
- On balance Taxable Income = (600,000 – 375,000) X 9% = AED 20,250

Analysis under UAE's General Anti-Abuse Laws

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Commercial Rationale

This transaction lacks a valid commercial reason. The Split of Company 1 into Company 1 and 2 is intended to avoid Tax payments by taking advantage of the Threshold limit under Corporate Tax Law.

Tax Advantage

In the above example, both the basic conditions for invoking the General Anti-Abuse Rules are satisfied:

(1) Transactions or arrangements should be entered without any valid commercial rationale and

(2) The main purpose of undertaking such a transaction is to take advantage of corporate tax law.

Therefore, the Tax Authority may invoke the GAAR Provision for the above-mentioned transactions.

Cases where GAAR Provisions Can Be Invoked by the Authority

Following are the cases/ situations where the FTA may invoke the provisions of GAAR:

Artificial Separation of Business

Artificial separation refers to the practice of knowingly dividing a business into smaller entities to make it qualify for the tax benefits available as per the provisions of Article 21 related to Small Business Relief. (as explained in the above illustration)

Where the FTA establishes that one or more persons have artificially separated their business or business activity and the aggregate amount of revenue across the persons' entire business or business activity exceeds the threshold of 3,000,000 AED in any tax period, and such one or more persons have elected to apply the small business relief, such artificial separation shall be regarded as tax abusive arrangement and attracts the provisions of General Anti-Abuse Rules under Article 50.

Specific Transaction or Arrangement:

The GAAR provisions can apply to any tax evasion transaction. Under GAAR provisions, the authorities get wide power and coverage to deny the undue tax advantage taken by the taxable person.

Things that Authority Must Consider For the Purpose of Determining GAAR Provisions:

Things that Authority Must Consider For the Purpose of Determining GAAR Provisions:

The tax authorities will have to consider multiple factors to determine the economic reality and applicability of GAAR to transactions and arrangements. UAE law provides an illustrative list of the following factors that should be considered:

Manner of transaction

How the agreement or transaction was made, signed, and carried out.

Nature of the transaction

The form, substance, and other relevant details of the arrangement or transaction.

Timing of the transaction

When the transaction or arrangement was entered into or carried out.

Result of the transaction

The outcome of the transaction or arrangement in terms of how the UAE Corporate Tax Law is applied.

Change in Financial Position of Taxable Person

Any modification to the taxable person's financial situation that has been, will be, or may reasonably be anticipated to be caused by the transaction or arrangement.

Change in Financial Position of another Taxable Person

Any modification to another Person's financial situation that has been, will be, or may reasonably be anticipated to be caused by the transaction or arrangement.

Creation of rights or obligations of transacting parties

Whether the transaction or arrangement has created rights/obligations which would not normally be created between independent, unrelated parties.

Any other mitigating facts or circumstances

Impacts of Invoking GAAR Provision by the Authority

Under UAE CT Law, the tax authority could counteract or adjust CT advantages obtained in the following ways:

Determination by the FTA

The tax authority (FTA) can use GAAR to identify and adjust unintended corporate tax benefits gained through tax avoidance. They have broad power to issue an assessment allowing or denying exemptions, deductions, or reliefs claimed by a person for doing tax avoidance transactions or arrangements.

The invocation of the GAAR of one taxable person can also impact the income calculation of another person. The FTA can essentially shift the denied benefits to another taxpayer to reduce the person's tax liability.

Characterization of Payments

GAAR provisions give wide powers to the tax authorities to re-characterise the payment or any part thereof, disregarding the effect of other CT provisions.

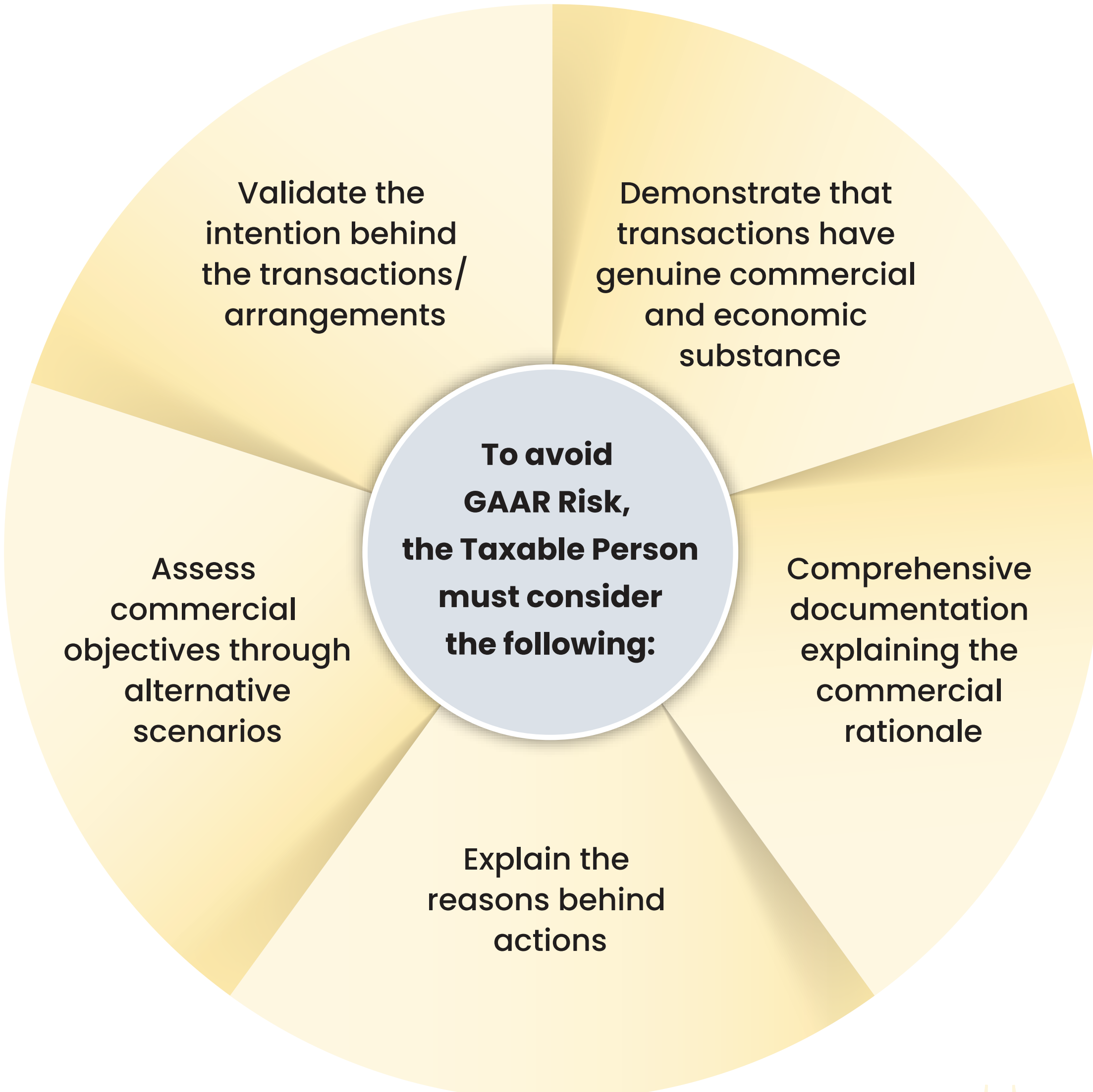
Example:

The company holding properties and earning rental income transfers the property in the name of the Individual to shift the business income to a personal income. Here, the Intention is to avoid tax liability, as rental income from property earned by individuals is not subject to corporate tax. Tax authorities may invoke GAAR provisions to examine the transactions and may consider the rental income as income of the business and hence make it taxable.

Corresponding Compensating Adjustment

While applying GAAR provisions, if FTA has made any adjustment according to the rules, then CT Law specifically provides for a corresponding compensating adjustment to the corporate tax liability of any other person affected by the determination made by the tax authorities.

To avoid GAAR Risk, the Taxable Person must consider the following:



Here, Company 1 splits into Company 1 and Company 2 - so that Corporate Tax Liability is computed separately, and threshold limit is availed by both the companies as against in the initial case.

Before the Split, the liability of the company was AED 20,250.

However, after the split, both Company 1and Company 2 will be individually able to avail the threshold limit for corporate tax computation. As both the company's taxable income is within the threshold limit. Corporate Tax liability is zero

(1) Demonstrate that transactions have genuine commercial and economic substance

Taxpayers must demonstrate that transactions have genuine commercial and economic substance and are not solely undertaken for tax avoidance purposes.

(2) Comprehensive documentation explaining the commercial rationale

Detailed defence documentation explaining the commercial rationale behind transactions is essential.

(3) Explain the reasons behind actions

The "Look at" approach is no longer valid but focuses on explaining the reasons behind actions.

(4) Assess commercial objectives through alternative scenarios

A taxable person must assess the commercial objectives of truncations or arrangements through all the alternative scenarios.

(5) Validate the intention behind the transactions/arrangements

A taxable person should validate the transactions or arrangements before entering the same so that it should not invoke the general anti-abuse rules provisions.

Conclusion

Implementing General Anti-Abuse Rules (GAAR) under Article 50 of the UAE Corporate Tax Law indicates a robust mechanism whose objective is to curb tax avoidance practices and ensure correctness and fairness in the tax system. These rules serve as a deterrent against the misuse of tax laws by individuals or entities seeking to gain undue corporate tax advantages through artificial transactions or arrangements which lack genuine commercial rationale.

Through GAAR provisions, the tax authority possesses broad powers to scrutinize transactions, assess their true economic substance, and counteract any unintended tax advantages obtained through tax avoidance. This includes recharacterizing transactions, disallowing deductions and imposing penalties to mitigate future non-compliance.

Also, the incorporation of Specific Anti-Abuse Rules (SAAR) along with the GAAR provides a comprehensive framework to deal with specific tax evasion practices and ensure transparency and compliance within the tax regulations.

To reduce the risk of GAAR invocation, taxpayers must ensure that their transactions have genuine commercial and economic reality and are supported by comprehensive documentation which explains the commercial rationale behind entering such arrangements or transactions. Moreover, validating the transactions before implementation and assessing their commercial objectives through alternative scenarios are crucial steps in avoiding potential GAAR implications from tax authorities.

Ultimately, the invocation of GAAR provisions helps tax authorities to make sure that every taxable person pays their fair share of taxes which keeps the tax system fair, and it also encourages people to follow the rules. This also ensures that there's enough money for important aspects like supporting the country's growth and development in the long run for sustainable economic growth and development.

FAQ about UAE's General Anti-Abuse Rules

Q1. Can authority invoke GAAR Provisions based on suspicion?

A. Article 50 provides two conditions to apply the GAAR provisions (Valid commercial transaction that reflects economic reality and purpose should be to obtain CT advantage), and both conditions are cumulative and should apply to invoke GAAR. There should be a reasonable conclusion about the satisfaction of both conditions. So, mere suspicion about the satisfaction of conditions cannot trigger GAAR provisions.

Q2. What Constitutes Corporate Tax Advantage?

A. Any transaction or arrangement that results in benefit in the form of, but not limited to, reduced tax liability or evading tax liability completely or results in Refund of Tax/increase in refund of corporate tax or deferment of payment of Corporate Tax

About FAME Advisory DMCC

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With three decades of market presence, FAME Advisory has remained the UAE's most trusted and leading tax advisory and management firm. Along with that, FAME excels in various domains, such as corporate services, succession planning, and corporate structuring. Our primary aim is to align our solutions with the client's problems, educate them, and empower them to take informed decisions.

Better future with FAME Advisory

Vision

To be the region's first choice for tax compliance and advisory in various aspects of the business.

Mission

We at FAME Advisory aim to solve businesses' tax compliance issues and provide advisory services that help them achieve the milestones they dreamt of.

Our Team

Mr. Nirav Shah

Director at FAME Advisory

With over two decades of experience in corporate advisory, consultancy, and compliance, CA Nirav Shah is a qualified Chartered Accountant and a stalwart in the industry, being recognized as amongst the top corporate structuring, international tax, and compliance experts in the UAE, India, and other countries.

For more than 15 years, Mr. Nirav has had a distinguished journey consulting global clients on Corporate Structures and Governance and family asset holding structures and has served as a specialist in providing strategic inputs to organizations.

Hemang Agravat

Manager - Business Development

As a Business Development Manager at FAME, Hemang has had a long professional career with a focus on growing the company's client base.

He holds a successful track record of nurturing clients & has been instrumental in building high-performing teams. He specializes in building programs that add value to the client relationships. Hemang brings in a wealth of experience bridging the gap between Sales & Advisory teams.

Udit Chokshi

Manager- Corporate Tax and VAT Advisory

Udit Chokshi is a Taxpert, helping businesses all across the UAE in getting tax audit-ready, streamlining their VAT and accounting processes, and shield them against tax evasion. Being an active listener, Udit absorbs and understands the client's problem and situation and communicates the facts and solutions honestly.

As a customer service-oriented person, he believes in providing utmost dedication and availability to customers.

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