THE GLOBAL TAX CHRONICLE

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PREFACE

On behalf of the tax team at BDO India, I am privileged to present the seventh issue of The Global Tax Chronicle.

This quarterly publication delivers critical tax developments from an international perspective, covering core subjects of direct & indirect taxation and transfer pricing. This publication has been authored and compiled by BDO India's International Tax team

The publication brings forth an expert's perspective on pertinent trends around taxes across countries, aiming to provide comprehensive yet relevant coverage of the developments in the tax world.

This issue of the GLOBAL TAX CHRONICLE presents:

Tax Conversations

- The opening article provides an overview of the taxability of passive income globally and the significance of structuring passive income for multi-nationals in today's BEPS era
- India and UAE signed the landmark Comprehensive Economic Partnership Agreement on 18 February 2022. The second article provides an overview of the expected benefits for and impact on businesses under the agreement
- The closing article under this section discusses the treatment of passive income as per the Transfer Pricing and Controlled Foreign Corporation Rules

The UAE is one of the most favoured jurisdictions for businesses venturing into global markets, offering competitive and business-friendly setup policies and an attractive tax regime. **The World Tax File Focusing On: The UAE**, shedding light on the tax and regulatory environment in the country, why it is regarded as an attractive gateway for investments and doing business in the region.

Lastly, the publication covers **Tax News from Around the Globe** - a round-up of recent and crucial tax developments worldwide and provides a window to the upcoming compliance calendar for the current and upcoming two months.

We hope you find this an interesting & relevant read for your business and related international strategies.

We look forward to receiving your valuable feedback and comments.

MILIND KOTHARI
Managing Partner
BDO India

TAX CONVERSATIONS

TAXATION OF PASSIVE INCOME

SYNOPSIS

Over years, multi-nationals have commonly adopted structures enabling them to park funds in a tax efficient manner. One way in which this has been achieved conventionally is to structure passive income by way of inter-company transactions, which enables businesses to pay a lower tax on their business profits. The article discusses nuances around the taxability of passive income and the implications on such income with the changing global tax landscape owing to the worldwide adaption of BEPS measures.

WHAT IS PASSIVE INCOME?

As such, there is no formal definition of passive income. Active income, on the other hand, is generally understood as income generated from deployment of active labour such as business income or salary income. Passive income is income other than active income, that requires little or no work to generate.

For corporate structures, common forms of passive income are dividends and interest. The term 'dividends' is typically defined under a tax treaty to include income from shares or participation in profits. The term 'interest' is defined under a tax treaty to mean income from debt claims of every kind, whether or not secured by a mortgage and whether or not carrying a right to participate in the debtor's profits and in particular income from bonds or debentures. The term interest however excludes income that would be taxable as dividends.

TAXABILITY OF PASSIVE INCOME

Countries globally, specially developed countries, offer incentives in the form of low or NIL taxation on passive income. A brief overview of the tax incentives offered is discussed below:

- **UK:** The UK taxes worldwide income of its residents. However, for corporate structures, the UK provides for exemption on most of the dividends received by UK companies from the charge to corporation tax, whether these dividends are received from UK companies or non-UK companies and provided such dividend is not tax-deductible in the hands of the paying company. While there are detailed rules prescribed in this regard, holding companies should be entitled to seek relief from taxation on dividend income. Further, there is no WHT on dividends paid by UK companies to non-resident shareholders. Simply put, dividends received from overseas or local subsidiaries by UK holding companies may be exempt from the UK tax net.
- **Singapore:** For Singapore resident entities, taxes are levied on income derived from sources in Singapore and on overseas income, received in Singapore. In other words, overseas income not repatriated to Singapore shall not be subjected to tax in Singapore. On the payout side, there is no withholding tax in Singapore on dividends paid by a Singaporean company. In other words, dividends earned by a Singapore company from its overseas companies and further repatriated to its shareholders may be exempt from the Singapore taxes.

- **Mauritius**: Income tax is levied at a rate of 15% on net income of the corporations. However, Mauritian resident companies are entitled to avail of a lower tax rate of 3% on specified foreign sourced income such as dividends, interest, etc. When a Mauritian company pays dividends to shareholders, there is no withholding tax in Mauritius. Further, interest paid to non-residents by Mauritian companies out of their foreign sourced income is not subjected to WHT in Mauritius. Thus, dividend and interest income earned by Mauritian entities from overseas sources are effectively subjected to tax at 3%.
- **Netherlands:** The general corporate tax rate in the Netherlands starts from 15%. Subject to meeting the conditions of the participation exemption[1], a Dutch resident company shall not be taxable on dividends income received from such participation. Likewise, dividend payouts that meet the conditions of the participation exemption are exempted from any Dutch withholding tax liability. Though generally there is no domestic withholding tax on interest, with effect from 2021, a conditional withholding tax on interest paid to related companies situated in low-tax jurisdictions and in certain cases of abuse shall apply. A similar proposal is in pipeline to tax dividends in case of situations of abuse i.e., where dividends from the Netherlands are transferred to low-tax jurisdictions.

ANTI-AVOIDANCE MEASURES

Over the years, several measures have been adopted by countries to bring within the tax net of the headquarters country jurisdiction, the passive income that is parked by multinationals in low or nil tax jurisdictions. The provisions of Place of Effective Management (PoEM) deem that the tax residency of the entity in a low/ nil tax jurisdiction is at a place where the effective management of such an entity is undertaken, usually at the headquarters level. Once the residency is deemed as such, the headquarters jurisdiction gets the right to tax the passive income as it would tax its residents.

Like the PoEM rules, certain countries have introduced Controlled Foreign Corporation Regulations (commonly known as CFCs). CFCs are typically entities incorporated in low or nil tax jurisdictions that are controlled directly or indirectly by residents of other jurisdictions. Such other jurisdiction (which is usually the headquarter jurisdiction) considers the passive income of such CFCs within its tax base and subjects the said income to its normal or higher corporate tax rate.

While CFC and PoEM are specific anti-avoidance measures, countries have also introduced the General Anti-avoidance rules within their tax laws. Commonly known as GAAR, these provisions are wide ranging and usually prescribe disregarding multi-layered structures or residency of step-down entities lacking commercial substance, thereby bringing such income to tax in the hands of the entity resident in its jurisdiction.

Pillar 2 of Anti Global Base Erosion Rules (GloBE Rules) prescribes a global minimum tax of 15%. The GloBE tax base however excludes dividends received from a corporate entity, except dividends on stock in corporations in which the multinational group owns a low percentage of the equity interests and profit (or loss) attributable to an investment in an entity accounted for using the equity method of accounting. In other words, GloBE Rules provide for the exclusion of dividend income received from group companies. However, countries are free to adopt other forms of anti-avoidance measures (discussed above) to bring within their tax net such passive dividend income.

CONCLUDING THOUGHTS

With the advent of BEPS measures, economies are channeling efforts constantly to implement laws that bring to tax income at its fair share. However, in a welcome move, the OECD has recommended that dividend income should be kept out of the GloBE tax base, presumably under the context that the same is an application of income, which is usually subjected to corporate taxes. In the context of countries like India which tax dividend income at normal corporate tax rates, structuring of passive income would still be relevant for multi-national businesses.

[1] Participation exemption applies to dividends and capital gains derived from shareholdings of at least 5%, provided: (1) the subsidiary is not held as a mere portfolio investment; (2) the subsidiary is subject to a reasonable effective tax rate based on Dutch tax principles (“subject to tax test”); or (3) less than 50% of the assets of the subsidiary consist of “passive” assets, based on the fair market value of the assets (“asset test”)

INDIA-UAE CEPA: BENEFITS & IMPACT ON BUSINESS

OVERVIEW

India and the UAE signed a Comprehensive Economic Partnership Agreement (CEPA) on 18 February 2022 to strengthen economic ties and boost trade and investment between both countries. The negotiations between India and UAE were concluded in a record span of 88 days and the CEPA was operationalised from 01 May 2022.

Through this CEPA, both the countries are projected to achieve significant economic benefits in the form of access to quality education, liberalisation of customs tariffs, ease in access to respective markets and liberal movement of skilled labour to support these economic initiatives.

The UAE proposes to double its economy in the coming decade and attract top human capital. Foreign trade will be an integral pillar of this development. This is where the CEPA is expected to play an active role in meeting this objective.

The INDIA-UAE CEPA

The India-UAE CEPA was announced by the Government of India on 27 March 2022 wherein the details of the agreement have been provided. The CEPA with the UAE covers trade in goods, trade in services, rules of origin, technical barriers to trade, sanitary and phytosanitary measures, dispute settlement, movement of natural persons, telecom, customs procedures, pharmaceutical products, government procurement, IPR, investment, digital trade and cooperation in other areas. It is presumed to act as a catalyst to bolster economic ties between the countries, which have a history of completing each other's vision toward economic prosperity.

The CEPA specifies the Rules of Origin and origin criteria for obtaining a Certificate of Origin (COO) of Goods to curb the misuse of CEPA, which stipulates those goods are deemed to be originated in a country if it is wholly obtained or produced in the country's territory or has undergone sufficient working or production as per the product-specific rules. A COO must be issued before or within five working days of the date of exportation as per the format set out in the CEPA and this can be issued retrospectively. The COO shall be valid for twelve months from the date of issue. A COO in electronic or hard copy format or an entirely digitised COO (E-Certificate) issued by a competent authority will be treated as a COO under CEPA. Also, an origin declaration made out by an approved exporter can be considered a COO under the CEPA.

The CEPA also focuses on digital trade and provides that India and UAE shall endeavour to maintain a legal framework governing electronic transactions consistent with the UNCITRAL Model Law on Electronic Commerce (1996) and avoid any unnecessary burden on digital trade, which includes that India and UAE shall not adopt any measures regarding authentication that would prohibit an electronic transaction and shall not deny digital signature validity except under the circumstances provided for under its law.

BENEFITS TO BE EXPECTED FROM THE CEPA

The CEPA will promote two-way economic benefits in various sectors. Some of these economic benefits are:

- Increased investment flows, lower tariffs, and new opportunities for key sectors in both India and the UAE such as aviation, environment, hospitality, investment, financial services and digital trade and more.
- CEPA is expected to boost the national economy of the UAE by 1.7% in the next ten years (Gulf News)
- CEPA will also make it easier for small and medium enterprises to go global by granting them access to new customers, networks, and avenues of collaboration. The private sector will benefit from this agreement as it remains at the forefront of innovation and economic growth.

HOW DOES THE CEPA IMPACT BUSINESS IN INDIA AND THE UAE?

In terms of the CEPA, the Tariff Commitments of India for trade in goods cover 11,908 items, whereas the UAE covers 7,581 items. India is expected to benefit from preferential market access provided by the UAE, covering over 97% of its tariff lines which account for 99% of Indian exports to the UAE in value terms, especially for sectors such as gems and jewellery, textiles, leather, footwear, sports goods, plastics, furniture, agricultural and wood products, engineering products, medical devices and automobiles. India will also be offering preferential access to the UAE on over 90% of its tariff lines, including lines of export interest to the UAE.

India has provided market access to approximately 100 sub-sectors of the UAE regarding trade in services. In comparison, Indian service providers will have access to about 111 UAE sub-sectors from the 11 broad service categories such as business services, communication services, construction and related engineering services, distribution services, educational services, environmental services, financial services, health-related and social services, tourism and travel-related services, recreational cultural and sporting services and transport services.

India is the UAE's largest trading partner in terms of exports and the ninth largest recipient of foreign direct investment from the UAE. The CEPA will enhance this longstanding and robust relationship between the UAE and India and is expected to boost the merchandise trade between the two countries to USD 100bn over the next five years.

Some of the key businesses set to benefit from the CEPA are:

- Energy
- Environment
- Digital trade
- Intellectual property rights

CONCLUDING THOUGHTS

The Indian Government's emphasis is on export promotion in this agreement, and it is expected to be a valuable tool in the hands of the Indian industry to make inroads. The UAE is currently India's third-largest trading partner and second-largest export destination after the USA. The CEPA is expected to enhance this robust trade relationship between the two countries and boost merchandise trade to USD 100 bn over the next five years, as against USD 29 bn in 2019-20. It is also expected that the CEPA would generate 1 million jobs across multiple labour-intensive sectors such as gems and jewellery, textiles, leather, footwear, furniture, agriculture and food products, plastics, engineering goods, pharmaceuticals, medical devices, sports goods, etc.

TREATMENT OF PASSIVE INCOME AS PER TRANSFER PRICING AND CFC RULES

INTRODUCTION

MNEs globally operate in multiple jurisdictions, subjecting them to multiple tax territories. To prevent businesses from minimising their tax liability by taking advantage of cross county differences in taxation, the Organization for Economic Co-operation and Development (OECD) developed the Base Erosion and Profit Shifting (BEPS) Project. The 15 Action Plans provide the governments with guidance and instruments to deal with tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created[2]. One of the 15 Actions i.e., Action 3 also known as Controlled Foreign Companies (CFCs) rules outlines approaches to attribute certain categories of income (primarily passive income) of foreign companies to the shareholder(s) to counter offshore structures that shift income from the shareholder jurisdiction[3]. CFCs are corporate entities that are established in low or NIL tax jurisdiction and are controlled directly or indirectly by residents of higher tax jurisdiction.

The Transfer Pricing (TP) Regulations and CFC Rules are not interrelated nor distant. The mechanism of TP regulations is based on the arm's length principle (ALP) which sets transfer prices between associated enterprises (AEs) in controlled transactions. The mechanism of CFC legislation is usually designed to combat the sheltering of profits in companies resident in low- or no-tax jurisdictions. Taxation of foreign passive income is the crux of CFC Rules, while TP applies to a wider gamut of international transactions, including passive income.

On the face of it, CFC and TP regulations seem to address the same income in the context of cross-border transactions, and both are applied to test the price of the controlled transactions, thereby minimising instances of the eroded tax base. However, this might not always be the case and they are not interchangeable. The OECD states that CFC and TP regulations do not "eliminate the need for the other set of rules".

CFC RULES AND TP – KEY DIFFERENCES

Even with the same intent, the two regulations are distinct, and the key differences are highlighted below:

- CFC Regulations focus on profits generated 'by a controlled party from transactions with a variety of counterparties', which means that CFC regulations consider all the controlled foreign entities and neglect the separate identity of each entity. TP regulations work based on the ALP and 'focus on the individual transactions between AEs' by applying the functional analysis of related foreign entities as separate and independent entities. In this regard, CFC rules are contrary to the rationale of determining the ALP, which require individual functional analysis.
- CFC regulations aim to counteract attribution of passive profit to a low level of taxation by taxing CFC income at parent company level even without distribution. Whereas the mechanism of TP regulations is to amend the price between associated enterprises to ensure consistency with the price between unrelated ones, to avoid price manipulation so that it can reflect normal market price.
- The scope of TP regulations is wider than that of the CFC regulations. TP rules are applied to the transactions between AEs which do not necessarily fall within the definition of controlling entity and controlled entity as in CFC regulations. The definition of associated enterprise stipulated in the OECD Model Tax Convention includes 'an enterprise of a Contracting State participates directly or indirectly in the management, control, or capital of an enterprise of the other Contracting State' which is not as stringent or exact as that of the CFC. Therefore, TP regulations can be applied to those companies that are related but do not have control over each other such as associate companies, while the CFC regulations are only limited to companies with control.

TREATMENT OF PASSIVE INCOME IN TP

While Passive income is of pivotal importance and addressed in the CFC Regulations, it is interesting to understand their treatment in TP. Although TP has a wider scope and applies to a whole host of transactions, including passive income, some key attributes/treatment of passive income in TP are discussed below.

Passive income specifically includes interest, royalties, and dividend income. However, for some companies, e.g., financial services companies, some of these types of income may constitute the primary business and be considered active income under the tax laws of some countries. Additionally, corporations can purchase shares of foreign companies and receive a dividend based on the earnings of those companies. Differences in tax rates and the taxation of several types of income may incentivise or lead to shifting income from a high tax jurisdiction to a low tax jurisdiction or by converting a taxable income to exempt income. To counter such issues, it is very important to look at passive income from an ALP perspective as well. Some key points are highlighted below:

Interest: Article 9 of the OECD Model Tax Convention reads as follows: "not only in determining whether the rate of interest provided for in a loan contract is an arm's length rate but also whether prima facie a loan can be regarded as a loan or should be regarded as some kind of payment, in particular, a contribution to equity capital". From an OECD perspective, loans within AEs have the potential to partake nature of equity.

[2] https://www.oecd.org/tax/beps/beps-actions
[3] https://www.oecd.org/tax/beps/beps-actions/action3

A detailed document on Financial Transaction (i.e., OECD Guidance on Financial Transactions 2020) has mentioned that the recharacterisation has to be done by application of accurate delineation analysis of actual transaction, which requires identification of economically relevant characteristics of the transaction and the condition and economically relevant circumstances, including but not limited to, an examination of the contractual terms of the transaction, the actual conducts of the AEs (i.e., functions performed, assets used and risk assumed), the characteristics of the financial instrument, the economic circumstances of the parties and the market and the business strategies pursued by the parties.

To benchmark such interest payment from a TP perspective, comparability analysis needs to be undertaken which requires that the market in which the independent parties and AE operate do not have differences that have a material effect on price. The prices of a financial instrument may vary substantially based on underlying economic circumstances for example different currencies, geographic location, local regulations, the business sector of the borrower and the timing of such transactions. Where differences exist between the tested transaction and the proposed comparable, it will be necessary to consider whether such differences will have a material impact on the price. If so, it may be possible, where appropriate, to make comparability adjustments to improve the reliability of a comparable.

Royalties: Royalty means payment of any kind received as consideration for the use of right to use any intangible property like patent, copyright, design or model, secret formula or process, trademark, tradename, etc. Applying Article 9 of the OECD Model Tax Convention, where the conditions are made or imposed (in the use or transfer of intangibles) between two AEs which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

As per the principles of the OECD, the analysis of cases involving the use or transfer of intangibles should begin with the identification of the commercial or financial relations between the AEs and the conditions and economically relevant circumstances attached to those relations so that the actual transaction inv.olving the use of transfer of intangibles is accurately delineated. However, there is another fundamental factor that requires special attention in a transaction involving the payment of royalties which is the 'substance', that underlies the payment of the royalties, as a result of the value of an intangible asset.

Actions 8, 9, and 10 of the OECD/G20 BEPS project seek to align transfer pricing outcomes with the creation of 'value'. The creation of value may be measured based on DEMPE (development, enhancement, maintenance, protection and exploitation) analysis of intangibles. This analysis allows for the determination of the parties to which the right to a payment for the value of an asset can be allocated. In other words, the entity or entities that have performed the DEMPE functions for an intangible are the entities that would have the right to charge a royalty for the intangible.

To undertake comparability analysis for transactions involving rights of intangibles (such as royalties) it is critical to assess whether potential comparables exhibit similar profit potential. Some of the specific features while undertaking comparability analysis includes exclusivity, geographic scope, useful life, stage of development, rights to enhancements, revisions and updates and expectation of future benefits. Further, it is important to note that differences between intangibles can have significant economic consequences that may be difficult to adjust for reliably.

Dividends: Dividends are considered an appropriation of profits. Such profits are after-tax profits, and therefore, the applicability of TP on dividends from a practical point has no or little relevance. Further, as per the BEPS, Action 13 report for treatment of intracompany dividends by Multinationals in the Country-by-Country report provides that "revenues should exclude payments received from other constituent entities that are treated as dividends in the payer's tax jurisdiction".

The Polish authorities have recently issued guidance on treatment of dividend payment and whether such payments among associated companies fall within the scope of the definition of a 'controlled transaction' for TP purposes. In place of the guidance provided it is understood that the payment of dividends should not be considered as a controlled transaction. By nature, dividends are remuneration for capital, and their allocation and payment are the results of economic activity, not an activity of economic nature (with a profit-seeking purpose). Thus, there is no requirement from a TP perspective to document/test the payment of dividends.

CONCLUDING THOUGHTS

Although the mechanisms of TP and CFC regulations are different, both share the same final purpose to deter profit shifting to AEs, counter deferral and avoidance of taxation and safeguard against the erosion of the tax base.

As TP regulations are not specifically designed to solve the problem of profit shifting to low-tax jurisdictions or tax havens, CFC Rules target this issue. While from a TP perspective, multinationals need to continue to demonstrate that intercompany transactions (including passive income) are undertaken following the ALP and document the analysis undertaken, assumptions made and detailed and methodological search process to substantiate comparable data; companies need to keep in mind the CFC Rules (thresholds, exemptions, activities, taxing mechanisms, etc.) as well in cases of passive income. As CFC Rules are gaining momentum, many jurisdictions are also coming up with specific proposals/changes in their tax regime to adopt CFC Rules e.g., the Dutch authorities are proposing to adopt/strengthen CFC rules, applying the rules to distributed profits and omitting downward transfer pricing adjustments to qualifying CFC income.

THE WORLD TAX FILE: FOCUSSING ON UAE

SYNOPSIS

The UAE is regarded as a global business and technology hub, connecting the world through its strategic midpoint location, linking Europe and Asia or Asia and Africa or Africa and Europe. With a business-friendly environment, international recognition as a central global trading hub, world-class infrastructure, favourable government policies and constant and ongoing governmental efforts to ease doing business, the UAE is a high growth market. According to the World Bank's Doing Business 2020 report, the UAE ranks 16th in terms of Ease of Doing Business, with an overall score of 80.9 out of 100 and ranks 1st in the Middle East and North Africa region. This article highlights the tax and regulatory environment prevailing in the UAE, which makes it a leading jurisdiction to facilitate global trade for multi-national groups.

CHOICE AND LOCATION OF LEGAL ENTITY

At the outset, a business must evaluate what should be the right location for its entity. The UAE offers businesses to setup entities either in the mainland area, a free trade zone or an offshore company. The salient features of each such locations are discussed below:

- **Mainland Area:** An entity setup in the mainland area is regarded as an onshore UAE entity that is permitted to do business freely within and outside the UAE region. Such entities are usually required to obtain physical office space in the mainland region. Physical presence in the UAE is required to setup entities within the mainland area.
- **Free trade zone:** Free trade zones in the UAE are demarcated areas within the UAE that are governed by their framework of regulations. UAE has over 45 free trade zones, with each of the free trade zone designed around one or more business industry categories. Entities established within the free trade zones are only allowed to do business within the free trade zone or outside of the UAE. However, certain free trade zones permit businesses to setup offices outside of the free trade zone to permit them to do business. Amongst several other advantages, the greatest advantage offered by free trade zones for foreign businesses is enabling the setting up of such entities without the need for physical presence in the UAE.
- **Offshore company:** Certain free trade zones permit the setting up of offshore companies by non-resident investors. These entities are usually setup to do business outside the UAE region and are not permitted to do any business within the UAE. While they shall not be subject to the corporate tax laws of the UAE since they are not tax residents of the country, these entities shall not be entitled to access the tax treaties entered into by the UAE. Use of offshore companies is thus restricted for specialised purposes.

The erstwhile corporate law of UAE restricted foreign investment in mainland UAE companies to a maximum of 49%, with the balance to be owned by a local entity. This restriction has now been done away with and except for industries with strategic interest, foreign investors are now permitted to hold up to 100% in UAE entities, irrespective of

the location of such entity. A foreign business can establish its presence in the UAE through various forms of entities; the preferred forms of business for foreign investors are listed below:

- **Branch:**

  Foreign companies are permitted to setup branch offices in the UAE. Such branch offices are allowed to freely conduct business activities in the UAE, similar to the activities carried out by the head office. However, a branch does not enjoy a separate legal identity in the UAE.

- **Limited liability companies:**

  Limited liability companies are the most common corporate structure in the UAE and are extensively used by foreign investors setting up entities in the region . A limited liability company can be formed by a single shareholder. Depending upon the location of the limited liability company, the minimum share capital requirement shall have to be complied with. The limited liability company is required to appoint a manager, who is usually a UAE resident. If it is proposed to appoint more than one manager, the roles and responsibilities of each such manager should be defined appropriately.

  Limited liability companies within free trade zone can further be divided into Free zone establishments i.e., a single shareholder limited liability company or a free zone company, entities with multiple shareholders.

- **Private Joint Stock companies**

  A private joint-stock company shall be formed with a minimum of three 3 founding members. The management of private joint-stock companies is vested in its board of directors with a minimum of 3 directors and a maximum of 15 directors. The board of directors usually assumes all the powers necessary to execute the business required to meet the prescribed objectives of the company. The management and governance structure of private joint-stock companies are thus defined comprehensively.

TAX AND REGULATORY FRAMEWORK

Income Taxes:

- **Present Tax structure:**
  - While the UAE government retains the right to levy corporate tax on UAE entities and its residents, as such there is no corporate or personal tax presently levied in the UAE, except for taxes levied on banks and oil companies
  - There is no WHT or tax when profits are repatriated from the UAE entity by way of dividends
  - The UAE does not levy tax when interest payments are made by UAE residents to non-resident investors
  - There is no capital gains tax in the UAE
  - In absence of taxes, provisions for group consolidation/ relief become academic in nature

- **Economic Substance Regulations (ESR)**
  - The ESR issued in 2019 by the UAE government require UAE onshore and free zone companies and certain other business forms that carry out any of the defined relevant activities to maintain and demonstrate an adequate economic presence in the UAE relative to the activities they undertake
  - Amongst other activities, the relevant activities which trigger the need to adhere to the ESR regulations include Lease - Finance business, headquarters business, shipping business, Holding Company business, IP business and Distribution and service centre business
  - Entities that are within the scope of the Regulations are required to submit an annual Notification form to their Regulatory Authority, and complete and submit to the same Regulatory Authority an Economic Substance Report within 12 months from the end of their financial year

    Failure to comply with the ESR Regulations can result in penalties, spontaneous exchange of information with the Foreign Competent Authority, as well as other administrative sanctions such as the suspension, revocation or non-renewal of the entity's trade license or permit

- **Corporate Tax Reforms**
  - In alignment with the BEPS Pillar Two recommendation on Global Minimum Tax, the UAE Ministry of Finance announced that a 9% federal corporate tax for profits exceeding AED 375,000 will be introduced in the UAE for financial years starting on or after 1 June 2023
  - While the draft law in this regard is yet to be introduced, the Ministry has published a FAQ to provide an initial introduction to the proposed UAE corporate tax regime in advance, followed by a public consultation document
  - Businesses and commercial activities operating within the UAE are likely to be subject to corporate tax. However, individuals earning salary/ personal income would not be brought within the tax net
  - Further, entities incorporated in UAE free trade zones are expected to continue enjoying corporate tax incentives offered to the free zone business provided it complies with regulatory requirements and does not conduct business with mainland UAE
  - The FAQs also provide that provisions shall be prescribed for offsetting tax losses and group tax consolidation
  - Repatriation of profits from UAE entities is not likely to be subjected to WHT in the UAE. Likewise, UAE businesses will be exempt from corporate tax on dividends and capital gains from qualifying shareholdings

Indirect Taxes

The UAE introduced the VAT regime in August 2017. The VAT law is in line with the Unified VAT Agreement reached between the six Member Nations of the GCC. The standard

rate of VAT for supply of goods and services is 5%. Export of goods and services to countries outside the GCC are usually not subjected to VAT.

Non-residents providing digital supplies and services on a B2C basis are liable to register, whereas, in the case of B2B supplies, the VAT is payable by the UAE recipient on a reverse charge basis.

Persons in the UAE are required to register for VAT if at the end of any month their taxable supplies for the previous 12 months exceed the mandatory registration threshold of AED 375,000 or are expected to exceed the mandatory registration threshold in the next 30 days.

Transfer Pricing (TP)

Presently there are no transfer pricing regulations in the UAE. However, with the introduction of the corporate tax regime, transfer pricing rules and documentation requirements are likely to be made applicable as per the OECD transfer pricing guidelines and recommendations under BEPS.

UAE - AN IDEAL INVESTMENT DESTINATION FROM AN INDIAN PERSPECTIVE

The UAE is a strategically important destination for India, both from an inbound and outbound perspective. The UAE remains one of the top 10 largest sources of foreign investment in India. On the other hand, Indian businesses have extensively invested in the UAE in several sectors, such as manufacturing, textiles, engineering products, tourism, hospitality, etc.

India and the UAE signed a Comprehensive Economic Partnership Agreement (CEPA) on 18 February 2022 to strengthen economic ties and boost trade and investment between both countries which would come into effect from 1 May 2022. Through this CEPA, the countries are projected to achieve significant economic benefits in the form of access to quality education, liberalisation of customs tariffs, ease of facilitating access to respective markets and ease of movement of skilled labour to support these economic initiatives. The goods covered under the CEPA includes gems and jewellery, textiles, leather, footwear, furniture, agriculture and food products, plastics, engineering goods, pharmaceuticals, medical devices and sports goods.

CONCLUDING THOUGHTS

The UAE continues to be a favoured investment jurisdiction for several reasons discussed above. The country has witnessed a phenomenal rise on the world map and continues to do so, with a constant adoption of modern technologies and best practices. Even with the introduction of corporate tax, the UAE shall be one of the most competitive corporate tax regimes in the world with the benefits outweighing the potential tax costs. Businesses wanting to expand overseas may consider setting up a legal presence in the UAE for setting up trading and/or an investment hub.

The article has been drawn up basis of the generally prevailing situation. Readers are advised to ascertain the implications, based on the facts and circumstances applicable to them.

TAX NEWS FROM AROUND THE GLOBE

AUSTRALIA

Australia's federal budget was delivered on 29 March 2022. From a corporate tax perspective, the budget appears light on the tax reform agenda. The noteworthy budgetary proposals are:

- Expansion of a patent box regime to medical or biotechnology patents, the proposed patent box regime would effectively result in a concessional tax rate of 17% (instead of the standard corporate rate of 25% or 30%, depending on the taxpayer's size) for ordinary and statutory income derived directly from medical or biotechnology patents for income years commencing on or after 1 July 2022
- The patent box regime scope is further proposed to be expanded to corporate taxpayers undertaking research and development (R&D) in Australia in the areas of certain agricultural sector innovations relating to the commercialisation of listed and registered agricultural and veterinary chemical products or plant breeders' rights and too low emissions technology innovation. This shall apply from 1 July 2023
- Small businesses with an aggregated annual turnover of less than AUD 50mn will be able to deduct an additional 20% of the expenditure incurred on external training courses provided to their employees and deduct an additional 20% of the expenditure incurred to support digital adoption, including on the purchase of depreciable assets. To claim the benefit of such expenditure in the 2023 return, the relevant expenditure in this regard should have been incurred between 29 March 2022 and 30 June 2022.
- From 1 January 2024, the government will allow businesses to align their taxable payments annual report (TPAR) with their activity statement reporting cycle through the businesses accounting software. The government hopes this will result in more accurate and timely reporting while lowering compliance costs for taxpayers.

Source:
https://bdoaustralia.bdo.com.au/acton/attachment/18110/f-472e1bac-4d7d-4411-8911-6b620e38938f/1/-/-/-/-/Federal%20Budget%20Report%202022.pdf?_ga=2.116652559.88339209.1652902040-2120224150.1652902040

EUROPEAN UNION

On 11 May 2022, the European Commission (EC) published a proposed directive (as well as a Q&A document) that set out rules to level the playing field between debt and equity financing for corporate income tax purposes. The proposed directive is designed to reduce the bias in the tax system in favour of debt financing over equity. To this end, the directive provides for a debt-equity bias reduction allowance—or DEBRA—that would eliminate tax as a factor in a company's decision to finance through debt or equity by

limiting the tax-deductibility of interest but allowing the deductibility of increases in equity in certain instances. The proposed directive also contains targeted anti-avoidance rules.

Source: https://www.bdo.global/en-gb/microsites/tax-newsletters/corporate-tax-news/issue-62-may-2022/european-union-draft-directive-aims-to-reduce-bias-that-favours-debt-financing

TRANSFER PRICING – OECD

The OECD on 20 January 2022 issued a new edition of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations to replace the version issued in 2017. This version of the guidelines does not introduce any new guidance; rather, it consolidates into one publication previously issued guidance, including:

- Revised guidance on the transactional profit split method, which had been approved by the OECD/G20 Inclusive Framework on BEPS on 4 June 2018
- Guidance on the application of the approach to hard-to-value intangibles, also approved by the Inclusive Framework on 4 June 2018
- Guidance on financial transactions, which had been adopted by the Inclusive Framework on 20 January 2020

Source: https://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm

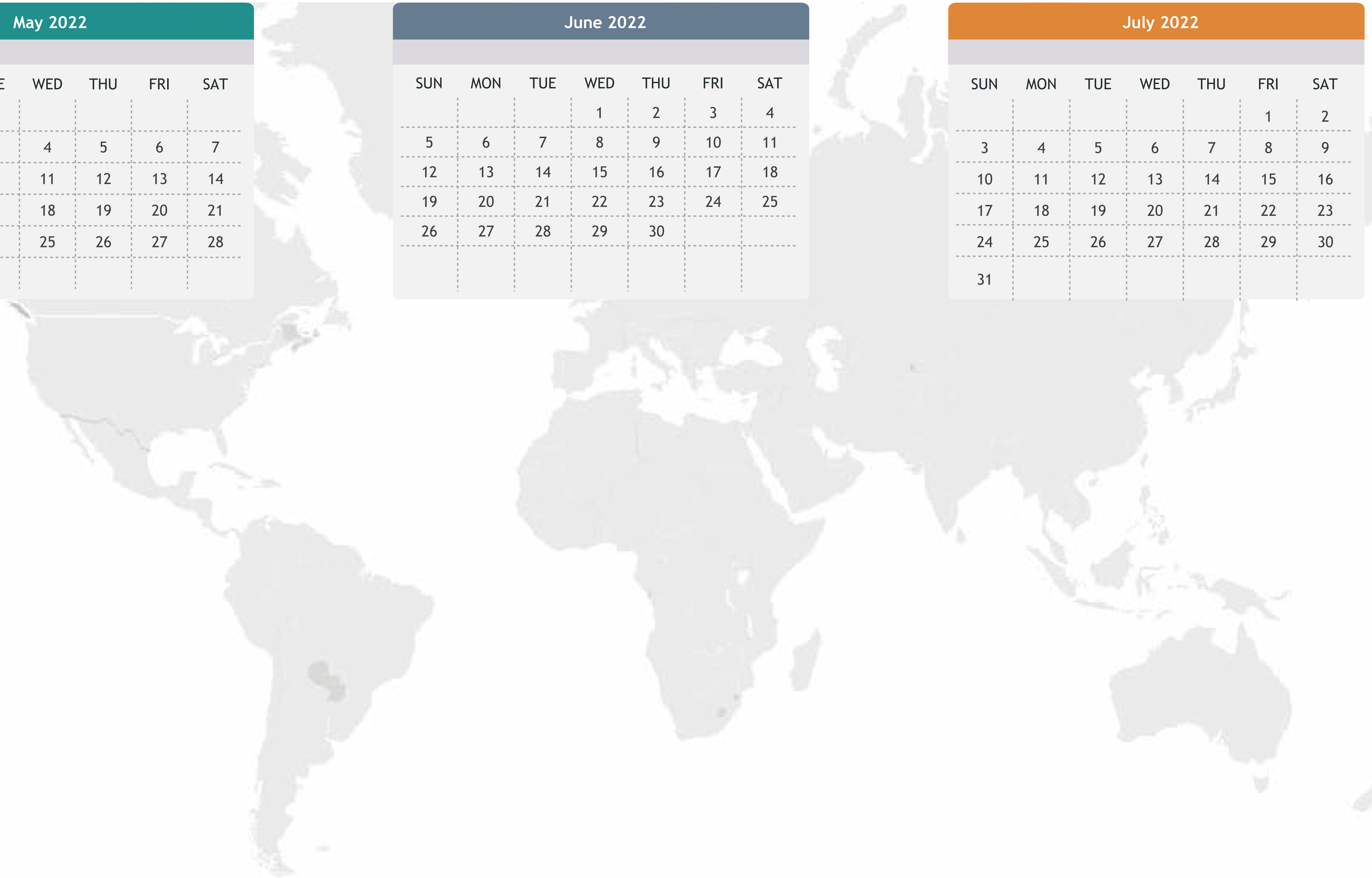
UNITED KINGDOM

The Chancellor of the Exchequer in the UK presented the 2022 spring statement to the House of Commons on 23 March 2022, alongside announcing some changes to the tax system and new spending commitments:

- The basic rate of income tax is to be cut by 1% to 19% from April 2024
- R&D relief – part of the reforms being implemented from April 2023 block deductions for overseas R&D work, but some exemptions have been confirmed (for regulatory reasons, e.g., clinical trials and geographical factors). In addition, companies will be able to claim R&D relief on projects supported by pure maths
- Further reforms to R&D relief will be considered in a consultation to be published in the summer – this may include an increase in the rate of relief to ensure the UK remains a competitive location for R&D
- Capital Allowances - The government will consider alternative options so that it can replace the super-deduction when it expires in April 2023
- VAT on energy-saving materials will be reduced from 5% to 0% from April 2022 to April 2027 (this includes insulation, solar panels and wind turbines)

Source: https://www.bdo.co.uk/en-gb/budget/spring-statement-2022

COMPLIANCE CALENDAR



May 2022

SUN	MON	TUE	WED	THU	FRI	SAT
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

June 2022

SUN	MON	TUE	WED	THU	FRI	SAT
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30		

July 2022

SUN	MON	TUE	WED	THU	FRI	SAT
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

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Contact Us

For any content related queries, you may write in to taxadvisory@bdo.in or get in touch with,

GUNJAN PRABHAKARAN
Partner & Leader
Indirect Tax
gunjanprabhakaran@bdo.in

DEEPA SURESH
Partner
Tax & Regulatory Services
deepasuresh@bdo.in

KUNAL SHAH
Director
Tax & Regulatory Services
kunalshah@bdo.in

For any other queries or feedback, kindly write to us at marketing@bdo.in

BDO in India

Ahmedabad
The First, Block C – 907
Behind ITC Narmada, Keshavbaug
Vastrapur, Ahmedabad 380015, INDIA

Bengaluru
SV Tower, No. 27, Floor 4
80 Feet Road, 6th Block, Koramangala
Bengaluru 560095, INDIA

Chennai
No. 443 & 445, Floor 5, Main Building
Guna Complex, Mount Road, Teynampet
Chennai 600018, INDIA

Delhi NCR - Office 1
The Palm Springs Plaza
Office No. 1501-10, Sector-54 ,
Golf Course Road, Gurugram 122001, INDIA

Delhi NCR - Office 2
Windsor IT Park, Plot No: A-1
Floor 2, Tower-B, Sector-125
Noida 201301, INDIA

Goa
701, Kamat Towers
9, EDC Complex, Patto
Panaji, Goa 403001, INDIA

Hyderabad
1101/B, Manjeera Trinity Corporate
JNTU-Hitech City Road, Kukatpally
Hyderabad 500072, INDIA

Kochi
XL/215 A, Krishna Kripa
Layam Road, Ernakulam
Kochi 682011, INDIA

Kolkata
Floor 4, Duckback House
41, Shakespeare Sarani
Kolkata 700017, INDIA

Mumbai - Office 1
The Ruby, Level 9, North West Wing
Senapati Bapat Marg, Dadar (W)
Mumbai 400028, INDIA

Mumbai - Office 2
601, Floor 6, Raheja Titanium
Western Express Highway, Geetanjali
Railway Colony, Ram Nagar, Goregaon (E)
Mumbai 400063, INDIA

Pune - Office 1
Floor 6, Building # 1
Cerebrum IT Park, Kalyani Nagar
Pune 411014, INDIA

Pune - Office 2
Floor 2 & 4, Mantri Sterling, Deep
Bunglow Chowk, Model Colony,
Shivaji Nagar, Pune 411016, INDIA

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