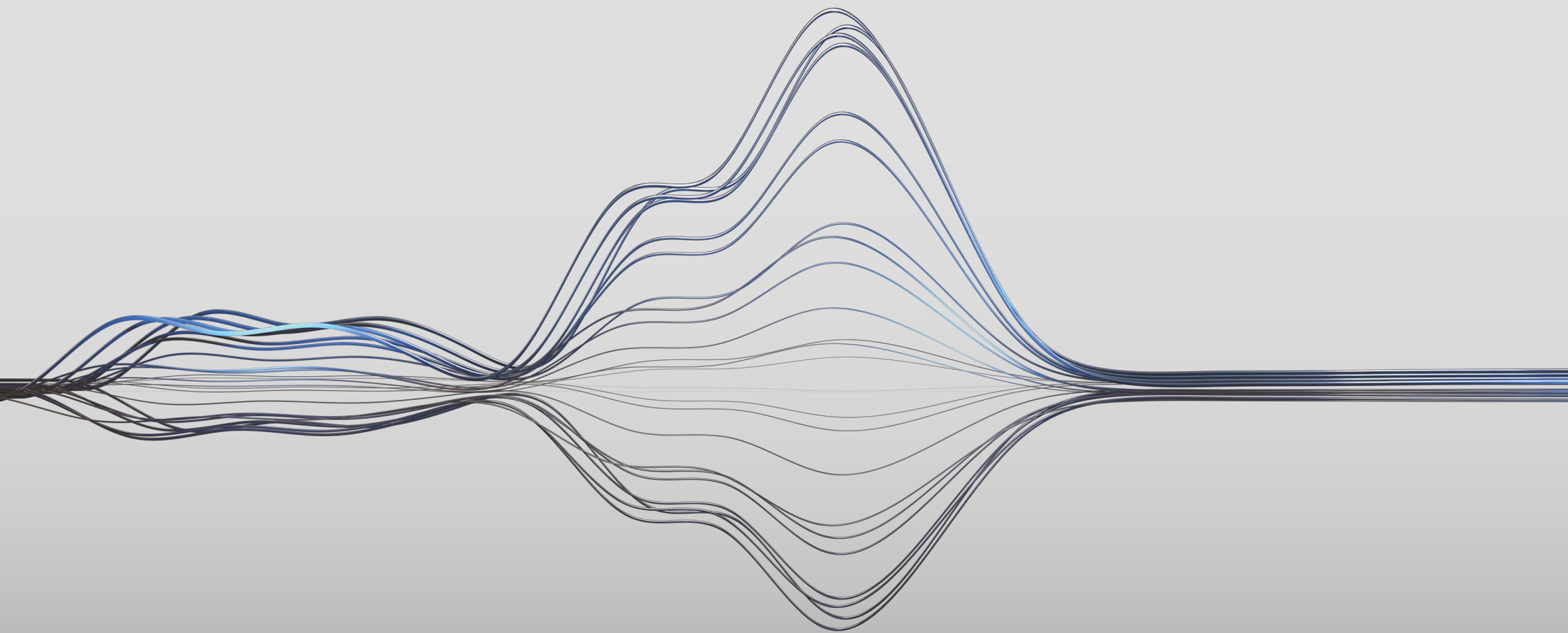


Gulf Tax Insights – August 2023

UAE Ministry of Finance provides further clarity on  
Free Zone Tax Regime in Public Consultation



# Introduction

In recent weeks, there have been significant developments to the UAE's corporate tax landscape. On 1 June 2023, the UAE witnessed the introduction of a Corporate Income Tax (**CIT**) for financial years starting on or after this date. Particularly noteworthy is the 'Free Zone Tax Regime' applicable to juridical persons incorporated, established or registered within the Free Zone. Under the Free Zone tax regime, Qualifying Free Zone Persons can benefit from a 0% tax rate on 'Qualifying Income'. The UAE Cabinet and the Minister of Finance further released two critical decisions on 1 June 2023, which provided further clarity on what constitute 'Qualifying Activities' and 'Excluded Activities' for businesses in the Free Zones.

On 19 July 2023, the Ministry of Finance (**MOF**) initiated a digital public consultation via its official website regarding the scope of the Free Zone Tax Regime<sup>1</sup>. The Public Consultation provided businesses (especially those based in the Free Zones) and other relevant stakeholders with the opportunity to voice concerns, seek clarifications, and provide feedback on the scope of Qualifying and Excluded Activities. While the MOF initially set the deadline for the public consultation round on 2 August 2023, recognizing the importance of extensive feedback from the business community, the deadline was extended until 9 August 2023<sup>2</sup>.

Whilst the information and examples that are provided in the Public Consultation are helpful to further understand the scope and nature of several Qualifying and Excluded Activities, we would like to draw your attention to the inherent preliminary nature of the Public Consultation's content. Although the information and

examples in the Public Consultation offer significant insights into the potential scope of the Qualifying and Excluded Activities stipulated in Ministerial Decision No. (139) of 2023, it is important to note that the Public Consultation should be regarded as preliminary guidance only. As such, any insights and guidelines offered by the MOF within this consultation should be considered provisional as they may be subject to further change, depending on the feedback received by the MOF as part of the consultation process. We anticipate that once the MOF analyses and consolidates the feedback from the Public Consultation, a more comprehensive set of regulations and guidelines will be published in due course.

The details and illustrations provided in the Public Consultation document suggest that the scope of certain activities may be limited through the implementation of additional conditions. For instance, the Qualifying Activity 'holding of shares and other securities' seems to be subject to several additional 'Qualifying Requirements', potentially limiting its scope of application in practice.

The DLA Piper tax team has actively participated in the Public Consultation reflecting our commitment to playing a constructive role in this transformative period. Drawing from our diverse client interactions, we have presented a range of questions and feedback to the MOF rooted in practical use cases and real-world scenarios.

In the following sections, we reflect the MOF's preliminary guidance and illustrative examples as it was included in the Public Consultation<sup>3</sup>.

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<sup>1</sup> <https://mof.gov.ae/ministry-of-finance-launches-digital-public-consultation/>

<sup>2</sup> <https://mof.gov.ae/ministry-of-finance-extends-deadline-for-feedback-on-the-corporate-tax-free-zone-public-consultation-until-9-august/>

<sup>3</sup> The content of these sections is based on the information that was publicly available within the online Public Consultation, until the expiration of its deadline.

# Qualifying Activities

The following section sets out the proposed scope of each Qualifying Activity.

Comments and feedback on the specific questions raised at the end of each Qualifying Activity are welcomed.

## I. Manufacturing of goods or materials

### SCOPE

Manufacturing of goods or materials includes the creation, production, improvement or assembly of products and materials from raw materials or components.

### ILLUSTRATIONS

There are various types of manufacturing activities across different sectors such as, for example, food, textiles, consumer electronics, automotive, pharmaceuticals and the chemical industry.

Irrespective of the type of manufacturing and the manufacturing industry, manufacturers can broadly be categorised into those that manufacture their own products or materials and those that manufacture products or materials for and on behalf of another person (contract or toll manufacturing). The anticipated application of the Free Zone CIT regime to these two categories of manufacturers is illustrated below.

### CONTRACT/TOLL MANUFACTURING

In the case of contract manufacturing, a Free Zone Person (Manufacturing Co) enters into a contract with a person under which Manufacturing Co manufactures products for and on behalf of that person. In addition to the manufacturing of the product, Manufacturing Co also procures all necessary raw materials.

Irrespective of whether the contractor is based in a free zone, in the mainland UAE or in a foreign country, the compensation Manufacturing Co receives for the manufacturing service provided and the supply and usage of raw materials used in the manufacturing process to the contractor would be considered Qualifying Income.

Although toll manufacturing and contract manufacturing are similar modes of production, in the case of toll manufacturing, the contractor would typically supply Manufacturing Co with the necessary raw materials, designs and production specifications. The income earned by a toll manufacturer based in a free zone would also be considered Qualifying Income.

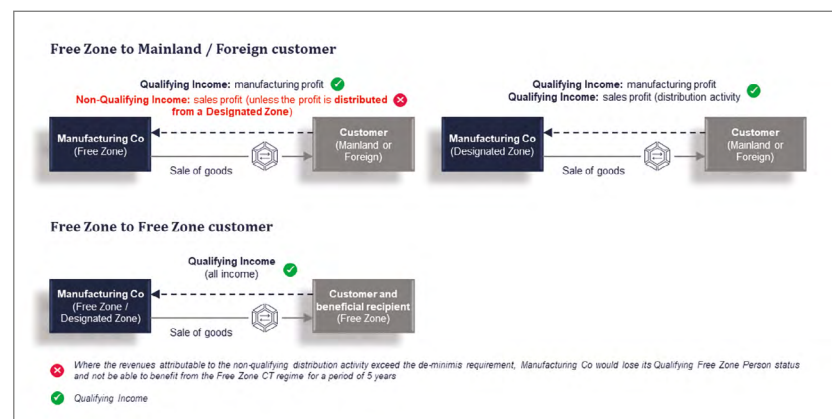


## FULLY FLEDGED MANUFACTURING

In the scenario of ‘fully fledged’ manufacturing, the Free Zone Person (Manufacturing Co) manufactures products in its own name and at its own risk. Manufacturing Co would normally be responsible for procuring the necessary raw materials and may sell the manufactured products or materials to a related party or third-party distributors, retailers or end-customers.

The income derived from the manufacturing of goods or materials by Manufacturing Co would be considered Qualifying Income, irrespective of whether the manufactured products or materials are manufactured for the sale to mainland or foreign juridical persons.

The income (sales profit) that is attributable to the distribution (sale) of the manufactured products or materials would not be considered Qualifying Income from manufacturing, unless the distribution meets the conditions to be treated as a “qualifying distribution activity” (see section XI).



## II. Processing of goods or materials

### SCOPE

Processing of goods or materials includes the preparation, treatment, transformation or conversion of goods or materials into another form of material or good for further commercial or industrial use or sale.

## III. Holding of shares and other securities

### SCOPE

Holding of shares and other securities refers to the holding by way of investment or as security, shares, stocks, debentures, and other securities, or other assets or rights for the sole purpose of issuing securities or other financial instruments that directly or indirectly represent an interest in the economic risks and benefits associated with these assets or rights.

### “holding of shares”

The holding of shares means the holding of shares of any class in the share capital of another juridical person or the holding of other types of equitable interests that entitle the holder to receive profits and liquidation proceeds, whether as legal or beneficial owner or otherwise.

### “holding of other securities, assets or rights”

The holding of “other securities” means the holding of negotiable or non-negotiable financial instruments, including, derivative instruments, financial commodities, and other investment instruments that are or can be traded in a public or private market or that are convertible or exchangeable into a security or which confer a right to purchase a security.

The “active trading” of financial instruments or (non-financial) commodities or conducting any other trade or business activity would not constitute a qualifying holding activity for the purposes of the Free Zone CIT regime.

The scope of other securities, assets, or rights specifically does not include real estate and any other assets and activities that are specifically recognised as constituting Excluded Activities.

#### Qualifying requirements for the “holding of other securities, assets or rights”

The Free Zone Person must be:

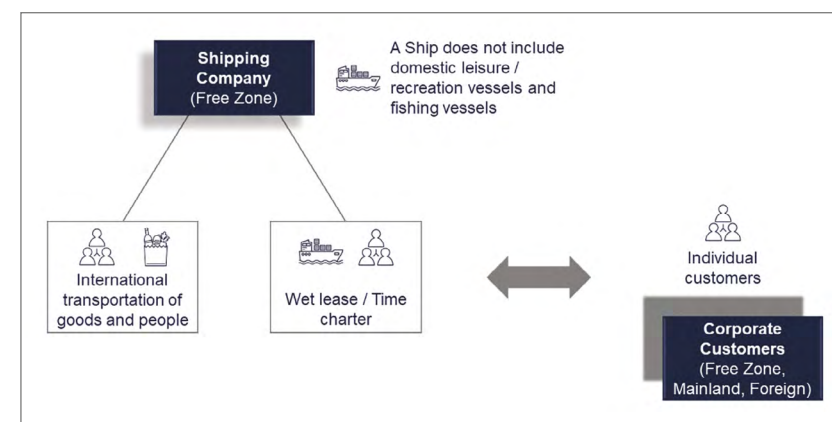
- a. directly or indirectly majority owned or controlled by;
  - i. Government Entity or Government Controlled Entity,
  - ii. Qualifying Investment Fund,
  - iii. Domestic or foreign pension or social security fund,
  - iv. Foreign collective investment vehicle in a Recognised Jurisdiction,
  - v. Family Foundation,
  - vi. Qualifying Public Benefit Entity,
  - vii. Any other Free Zone Person that is regulated by the Dubai Financial Services Authority (**DFSA**) or the Financial Services Regulatory Authority (**FSRA**), and
  - viii. Any other Person as may be specified by the Minister; or
- b. used to hold one or more assets or securities or rights thereover for the sole purpose of:
  - i. Raising or facilitating the raising or refinancing of capital or debt, or
  - ii. The issuance of securities or other financial instruments representing a beneficial interest in the assets or securities or rights thereover held by the Free Zone Person.

## IV. Ownership, management and operation of Ships

### SCOPE

The “ownership, management and operation of Ships” includes the ownership, management and operation of Ships used in the international transportation of goods or persons, including the management of the crew of a Ship and the leasing and chartering of Ships on a bareboat basis.

### ILLUSTRATION



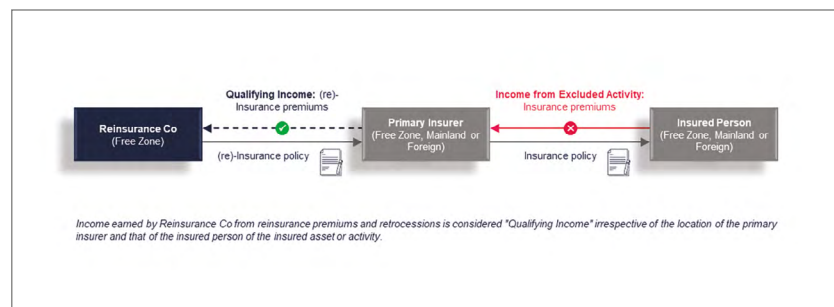
## V. Reinsurance services

### SCOPE

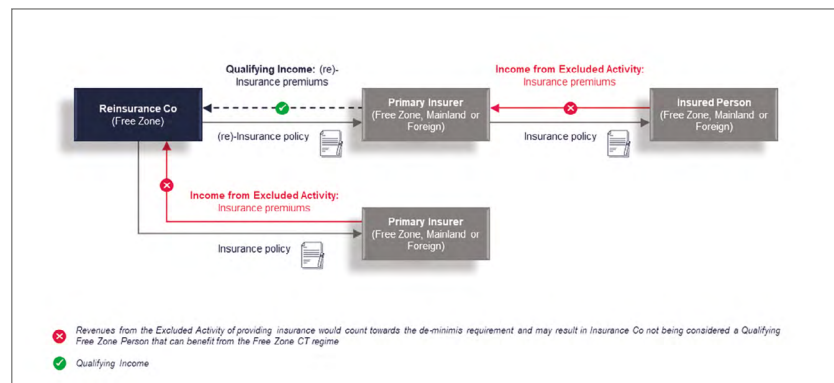
Reinsurance services include the activity of assuming all or part of a risk undertaken by another insurer or reinsurer under a contract or policy of insurance or reinsurance, respectively, provided this is subject to regulatory oversight of a competent authority in the UAE.

### ILLUSTRATIONS

(1) Income earned by Reinsurance Co from reinsurance premiums and retrocessions is considered “Qualifying Income” irrespective of the location of the primary insurer and that of the insured person or the insured asset or activity.



(2) Insurance Co provides reinsurance services to a primary insurer and also provides insurance direct to consumers (e.g., the Insured Person) resulting in Insurance Co earning both Qualifying Income and non-Qualifying Income. Unless the insurance revenues do not exceed the *de minimis* requirement, Insurance Co would not be eligible to benefit from the Free Zone CIT regime on either the income derived from reinsurance and insurance services.



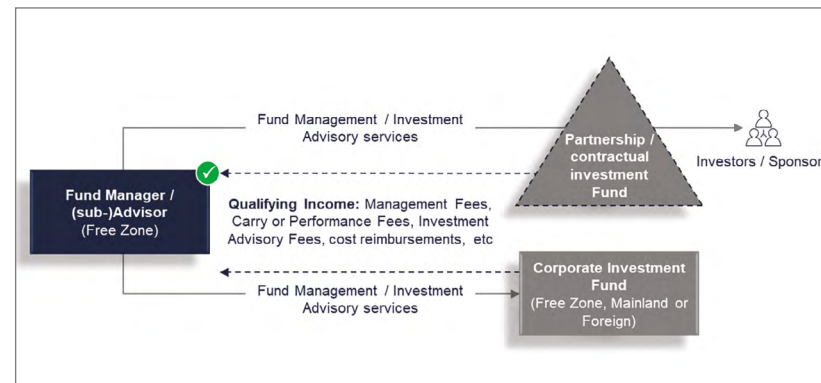
## VI. Fund management services

### SCOPE

Fund management includes the activity of providing portfolio management, risk management and other services relating to the day-to-day management and operation of an investment fund by a fund manager that is appointed by the investment fund or its investors, including those activities that are delegated by an investment fund or its fund manager to an investment advisor or sub-advisor.

The reference to competent authority in Article 2(1)(f) requires the Free Zone Person to be appropriately licensed as an investment fund manager or investment advisor by the Dubai Financial Services Authority (**DFSA**), the Financial Services Regulatory Authority (**FSRA**) or any other regulatory authority as may be prescribed by the Minister.

### ILLUSTRATION



## VII. Wealth and investment management services

### SCOPE

Wealth and investment management includes the activity of providing discretionary and non-discretionary portfolio management and wealth and investment advisory services.

### QUALIFYING REQUIREMENTS FOR WEALTH AND INVESTMENT MANAGEMENT SERVICES

The Free Zone Person must be:

- a. established under the applicable Free Zone Single Family Office (**SFO**) or Multi Family Office (**MFO**) regulations of the Free Zone; or
- b. appropriately licensed by the Dubai Financial Services Authority (**DFSA**), the Financial Services Regulatory Authority (**FSRA**) or any other regulatory authority as may be prescribed by the Minister.

To ensure that the Free Zone CIT regime only applies to appropriately licensed and regulated wealth and investment managers, the Free Zone Person must be regulated by the DFSA or FSRA or Securities and Commodities Authority or another regulatory authority of equivalent standing that may be prescribed by the Minister.

Additionally, appropriately licensed SFOs and MFOs that provide wealth and investment management services to, for example, Family Foundations, may also be eligible to benefit from the Free Zone CIT regime.

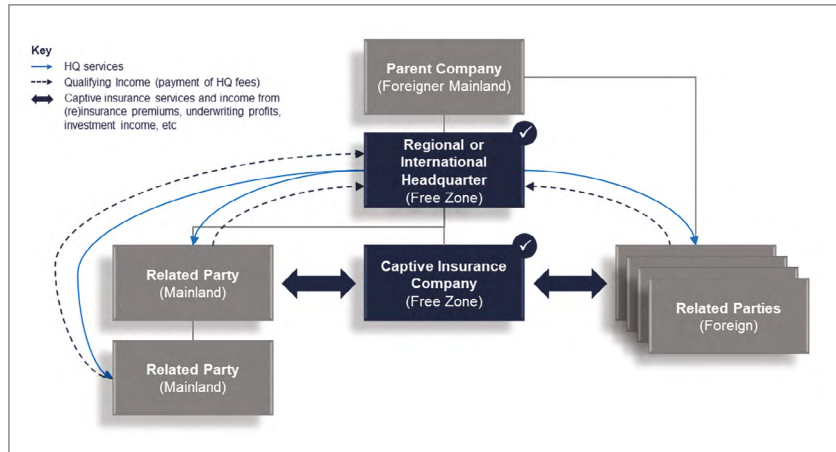
## VIII. Headquarter services to Related Parties

### SCOPE

Headquarter services includes the administering, overseeing and managing of business activities of Related Parties, including the provision of senior and general management, captive insurance services, administrative services, business planning and development, risk management, coordination of group activities, procurement and in general incurring expenditures on behalf of Related Parties and providing other support services to Related Parties.

The reference to "Related Parties" for the purposes of the Qualifying Activity of providing headquarter services shall be limited to juridical persons and branches of juridical persons as per Articles 35(1)(c) and Article 35(1)(d) of the CIT Law.

### ILLUSTRATION





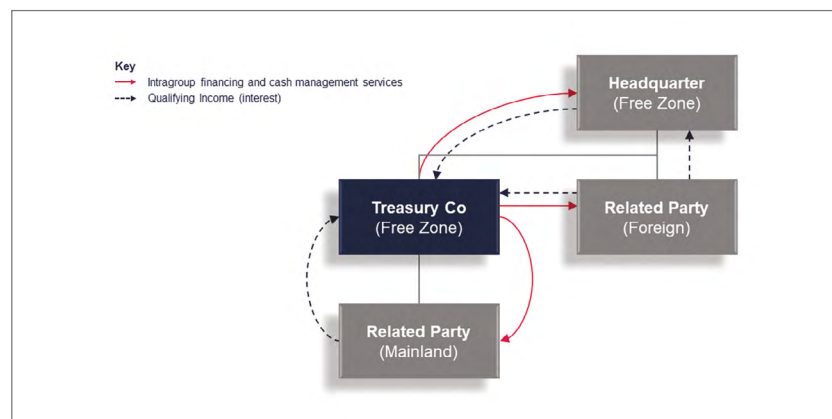
## IX. Treasury and financing services to Related Parties

### SCOPE

Intra-group financing and treasury services includes the provision of cash and liquidity management, financing, debt management, and financial risk management and related advisory services to Related Parties, including centralised payment and collection activities for or on behalf of Related Parties.

The reference to “Related Parties” for the purposes of the Qualifying Activity of providing treasury and financing services shall be limited to juridical persons and branches of juridical persons as per Articles 35(1)(c) and Article 35(1)(d) of the CIT Law.

### ILLUSTRATION



## X. Financing and leasing of Aircraft

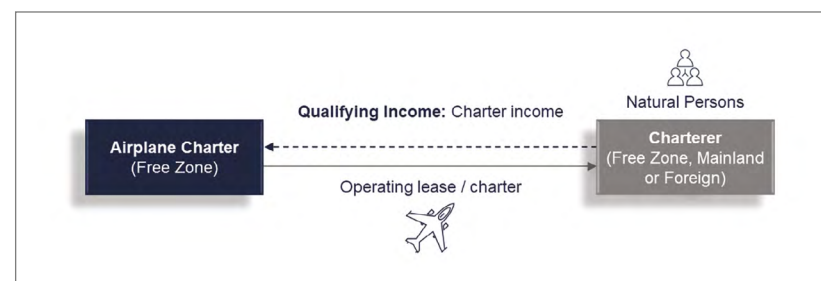
### SCOPE

The financing and leasing of Aircraft includes the financing, leasing and securitisation of the financing and leasing of Aircraft and Aircraft engines or rotatable components, including the letting, hiring out or otherwise granting the right to use Aircraft,

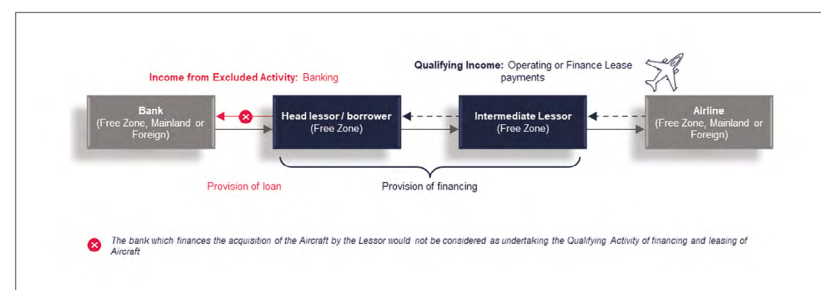
Aircraft engines or rotatable components in exchange for rental or other consideration pursuant to a finance lease, operating lease or other arrangement, and any related advisory, agency, management and brokerage services in relation to the financing or leasing activity undertaken by the Qualifying Free Zone Person.

### ILLUSTRATIONS

(1) **Leasing/chartering of an aircraft** – Free Zone Person (Airplane Charter) charters an aircraft to natural persons. The income derived from chartering the aircraft is Qualifying Income.



(2) **Provision of aviation financing** – Free Zone Person (“Lessor”) provides financing to an Airline to acquire an aircraft and aircraft engines in the form of a finance lease. The financing is secured over the aircraft and aircraft engines. The finance lease payments from the Airline to the Lessor and the income derived by the head lessor from the intermediate lessor are Qualifying Income.





## XI. Distribution of goods or materials

### SCOPE

The distribution of goods or materials includes the buying and selling of products, materials, component parts or any other items that are tangible or movable, but not including financial assets and instruments, in or from a Designated Zone\*.

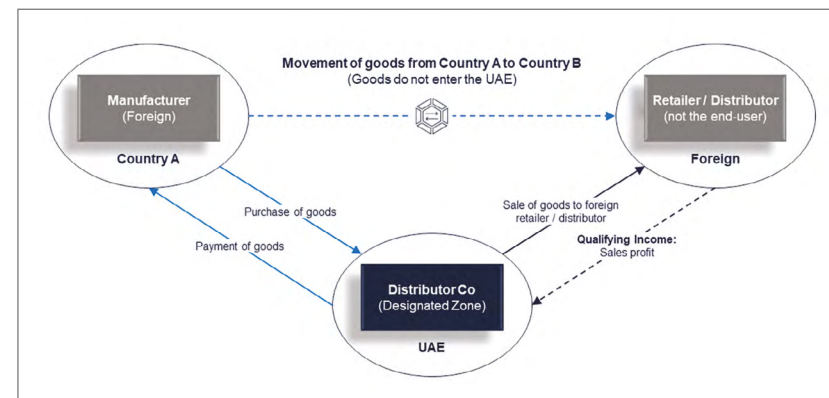
The Qualifying Activity of distributing goods or materials may include functions such as the importation, storage, inventory management, handling, transportation and exportation of those goods or materials.

\*A designated zone as defined in Federal Decree-Law No. 8 of 2017 referred to above, and which has been specified as a Free Zone for the purposes of the CIT Law.

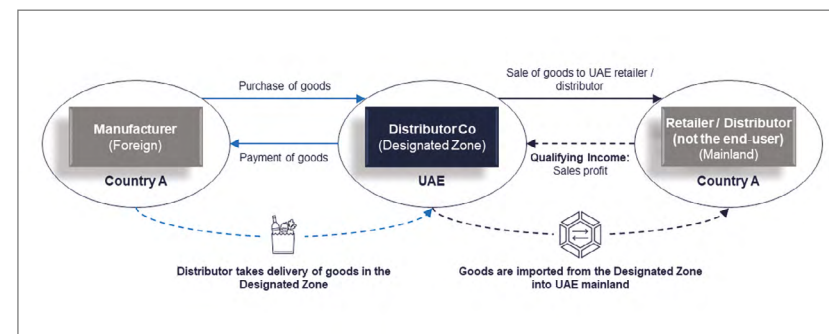
The distribution of goods or materials does not include the distribution of intangible products and services such as licenses, software and financial products/services.

### ILLUSTRATIONS

(1) **Distribution of goods or materials outside of the UAE** – Designated Free Zone Person (Distributor Co) buys goods from a manufacturer in Country A, and sells these goods to a retailer in Country B. Distributor Co earns a profit/margin on the goods sold to the retailer in Country B. The goods are shipped directly from the Manufacturer in Country A to the Retailer in Country B.



(2) **Distribution of goods or materials in the UAE** – The Designated Free Zone Person (Distributor Co) buys goods from Country A, and sells these goods to a retailer in the UAE. Distributor Co earns a profit/margin on the goods sold to the retailer. The goods are shipped by the Manufacturer in Country A to Distributor Co in the Designated Zone from where they are imported into the UAE.



Logistics services includes the storage and transportation of goods or materials on behalf of another Person without taking title to the good or material of that other Person, including cargo handling, warehousing, container storage, transport agency services, customs brokerage services, order and inventory management, freight forwarding and brokerage services, document preparation, packing and unpacking and other related services.

The diagram illustrates the Free Zone Logistics model. It shows a 'Logistics Free Zone Person' operating within a 'Free Zone'. This person handles shipping, receiving, warehousing, packing, and order fulfillment. The goods are then delivered to a 'Mainland / Foreign' customer. The diagram highlights the 'Qualifying Income' generated from transportation, warehousing, inventory management, etc., and the 'Taxable Income' generated from last mile delivery fees.

Where the Logistics Free Zone Person performs its logistics services within the Free Zone, but provides last mile delivery and other services outside of the Free Zone in the mainland UAE or in a foreign country, the income attributable to the activities performed outside of the free zone may be subject to the regular 9% CIT rate or foreign CIT if they give rise to a permanent establishment or are carried on through a branch in the UAE or overseas respectively.

# Excluded Activities

The following section sets out the proposed scope and description of each Excluded Activity.

## I. Banking

### SCOPE

Banking activities mean the following activities that are subject to regulatory oversight:

1. Receiving all types of deposits, including sharia compliant deposits;
2. Providing all types of credit facilities;
3. Providing all types of funding facilities, including Sharia-compliant funding facilities;
4. Providing currency exchange and money transfer services;
5. Providing monetary intermediation services;
6. Providing stored values services, electronic retail payments and digital money services;
7. Providing virtual banking services;
8. Arranging and/or marketing Licensed Financial Activities;
9. Acting as principal for financial products that affect the financial position of the Licensed Financial Institution, including but not limited to foreign exchange, financial derivatives, bonds and sukuk, equities, commodities, and any other financial products approved by the Central Bank.

The suggested scope of banking activities does not include fund or wealth management services. Such activities are regarded as a separate and distinct activity that can be performed by a Free Zone Person.

## II. Insurance activities

### SCOPE

Insurance activities include activities that are subject to regulatory oversight, such as, the business of accepting risks by effecting or carrying out contracts of insurance, in both the life and non-life sectors. They do not include however reinsurance activities.

Captive insurance and reinsurance activities that fall within the scope of the Qualifying Activity of “Headquarter services to Related Parties” or “Reinsurance services” are specifically excluded from the scope of this Excluded Activity.

## III. Financing and leasing activities

### SCOPE

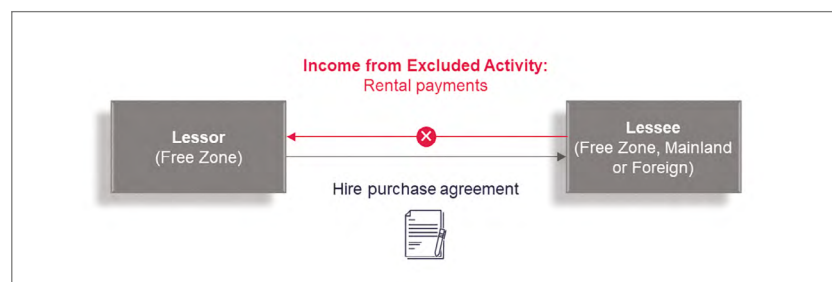
Financing and leasing activities include activities that are subject to the regulatory oversight, such as the provision of credit or financing for any kind of consideration, and the letting, hiring out or otherwise granting the right to use an asset in exchange for rental or other consideration pursuant to a finance lease, operating lease or other arrangement. They do not include however financing and leasing of aircraft (including engines and rotables) and financing services to Related Parties.

Excluded finance and leasing activities for the purposes of the Free Zone CIT regime are suggested to include those finance and leasing activities that are regulated by the Central Bank, the Dubai Financial Services Authority (DFSA) or the Financial Services Regulatory Authority (FSRA).

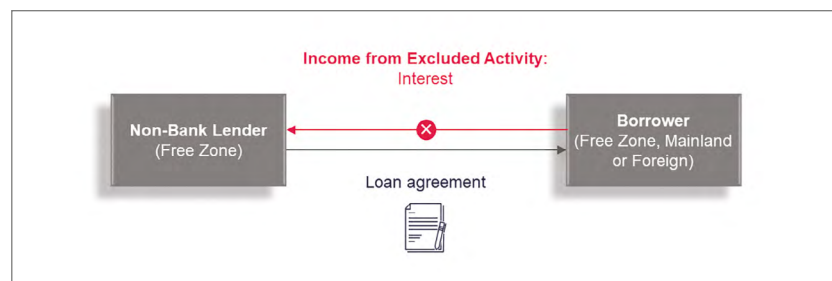
Related party financing is not a regulated activity in the UAE and should therefore not fall within the suggested scope of this Excluded Activity. However, even in the event that related party financing was a regulated activity, group financing and treasury activities and aviation financing activities that fall within the scope of the respective Qualifying Activity categories are specifically not included in the scope of this Excluded Activity.

#### ILLUSTRATIONS

(1) **Leasing** – Free Zone Person (Lessor) enters into a hire purchase agreement under which it leases a forklift to the Lessee for consideration (irrespective of the location of the Lessee). The rental income derived from the leasing activity is considered income from an Excluded Activity.



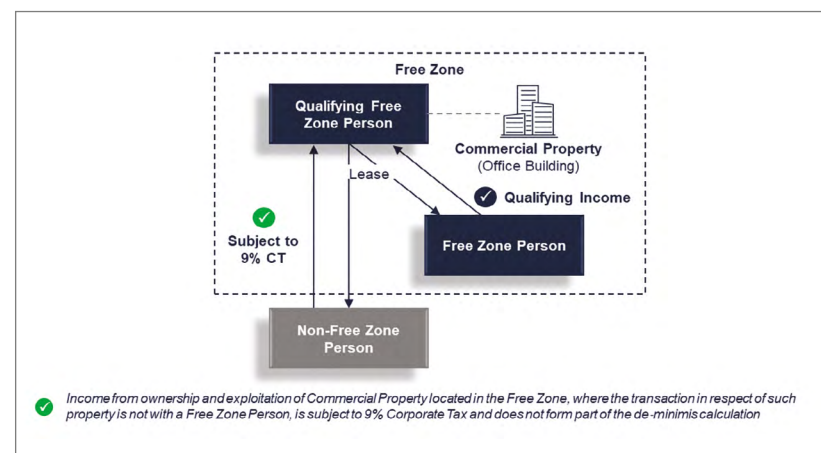
(2) **Financing** – Free Zone Person (a regulated non-bank Lender) makes a loan to a borrower and earns interest on the loan (irrespective of the location of the borrower). The interest income is considered income derived from an Excluded Activity.



#### IV. Ownership or exploitation of immovable property, other than Commercial Property located in a Free Zone where the transaction in respect of such Commercial Property is conducted with other Free Zone Persons

The Free Zone CIT regime accommodates income derived by Free Zone Persons from other Free Zone Persons in respect of Commercial Property located in a Free Zone. Income derived from a Commercial Property located in a Free Zone would, however, generate income from an Excluded Activity where it is derived from a person who is not a Free Zone Person.

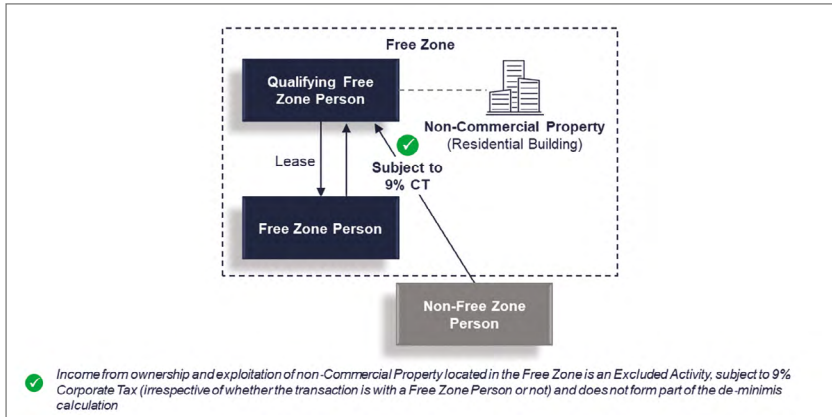
#### ILLUSTRATIONS



Income from ownership and exploitation of Commercial Property located in the Free Zone, where the transaction in respect of such property is not with a Free Zone Person is subject to 9% CIT and does not form part of the *de minimis* calculation.

Income derived from immovable property located in a Free Zone that is not Commercial Property, as well as income in respect of immovable property located outside of the Free Zone, shall also be treated as income from an Excluded Activity, irrespective of the use of the property.

Earning income from immovable property located in a Free Zone that does not benefit from the Free Zone CIT regime does not need to be taken into account for purposes of the de – minimis requirement and would not disqualify the Free Zone Person from the Free Zone CIT regime. Instead, such income will be subject to CIT at the regular 9% rate.

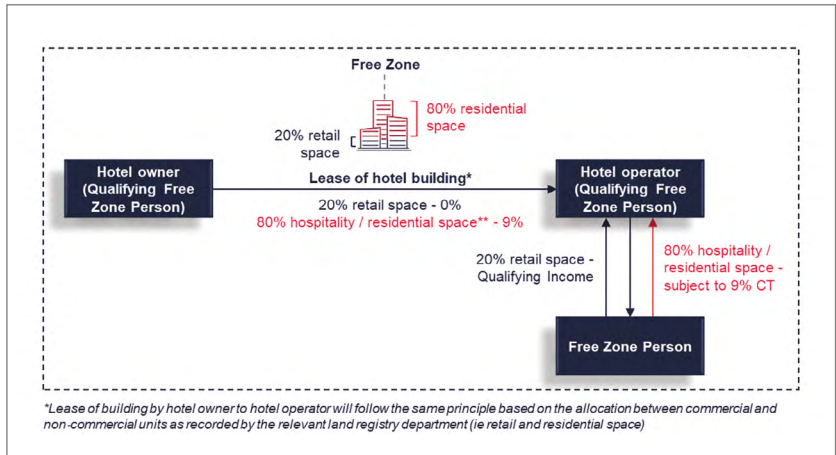


Income from ownership and exploitation of non-Commercial Property located in the Free Zone is an Excluded Activity, subject to 9% CIT (irrespective of whether the transaction is with a Free Zone Person or not) and does not form part of the de-minimis calculation.

Income derived from a mixed-use property located in a Free Zone (a property that includes both a Commercial Property and a non-Commercial Property component) shall be subject to CIT at 0% and 9%, respectively, based on the use of the respective components of the property.

Example: an apartment building located in a Free Zone that has retail units on the ground floor can generate both:

- Qualifying Income from the renting of retail space to Free Zone Persons; and
- Taxable Income from the renting of residential apartments to any Person (under Article 6 of Cabinet Decision No. 55 of 2023)<sup>4</sup>.



\*Lease of building by hotel owner to hotel operator will follow the same principle based on the allocation between commercial and non-commercial units as recorded by the relevant land registry department (i.e., retail and residential space).

<sup>4</sup> As the relevant income is always subject to CIT at 9%, the associated revenues from the sale or leasing of residential/hospitality units (including hotel rooms and conference rooms in hotels) are not included in non-Qualifying Revenues for the purposes of the de minimis requirement and calculation.

## V. Ownership or exploitation of intellectual property (IP) assets

### SCOPE

The ownership or exploitation of intellectual property assets means activities that generate separately identifiable income from intellectual property assets that are owned and legally protected, for example, trademarks, patents, copyrights, brands and technical know-how.

The reference to “separately identifiable” income means that income such as royalties, licence fees, capital gains and other income that is directly attributed to the intellectual property assets would be considered income from an Excluded Activity.

On the other hand, income derived from the use of intellectual property assets that is used in or otherwise contributes to a product or service for which no separate remuneration is received should generally not generate income from the ownership or exploitation of intellectual property assets for the purposes of the Free Zone CIT regime.

### ILLUSTRATIONS

(1) IP Co develops (or acquires) IP and licences the IP to its customers in exchange for a royalty. The royalty income is directly attributable to the licensed IP asset and hence considered income from an Excluded Activity.



(2) A manufacturer in a free zone produces and sells branded goods to its customers. The value of the branded goods includes ‘embedded IP’ (i.e. the sales price intrinsically includes a value associated with the ‘brand’ which cannot be separately determined). Given no separately identifiable income from intellectual property assets is earned in this scenario, the manufacturer may benefit from the Free Zone CIT regime where it meets the conditions of undertaking the Qualifying Activities of “manufacturing; and “distribution”.

## Conclusion

The introduction of the CIT and the Free Zone Tax Regime marks a significant shift in the UAE's fiscal landscape. It is crucial for businesses to recognize that the Public Consultation's guidance is provisional and further refinements are anticipated. Given the potential limitations on certain activities, proactive reassessment of previous tax structuring advice and operational strategies is advised. Engaging with tax experts and staying abreast of updates will be essential in navigating the evolving UAE tax landscape effectively.

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