

Taxing Times: Does the UAE remain unaffected?

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Tax planning has always been a topic of international debate and adjudication.

The borderlines between permitted tax planning/avoidance and unlawful tax evasion have occupied the centre stage across the globe with several modern economies emphasizing the need for corporate transparency and striking a fine balance between fiscal reforms agenda and the need to stimulate inclusive growth.

It is well known that several multi-national enterprises are paying very small amounts in taxes in comparison to their global revenues, by shifting and parking their profits in low tax countries, commonly called 'tax havens' or 'tax friendly jurisdictions'. Several corporations are increasingly resorting to shifting their profits, parking their intellectual property and setting up intermediate holding companies ("IHC") in offshore jurisdictions with low or nil taxes, exploiting the distinction between tax planning and tax evasion.

Tax planning with IHC

Tax planning may be defined as an arrangement of affairs by a person to benefit fully and take advantage of all available tax concessions and rebates in accordance with statutory provisions, so that the tax burden is minimised without violating the letter of the law. Several courts in western jurisdictions have held that for tax planning to be legitimate it must be within the legal framework and colourable (sham) devices cannot be part of tax planning.

A validly established holding structure adopted by the corporations has stood the test of time and the recent aggressive pursuit of revenue authorities across the globe. Establishing an IHC requires not only complex structuring involving corporate, regulatory, tax and corporate governance considerations and significant legal analysis, but also scrutiny of the political stability and investment climate of the jurisdiction of the IHC.

The United Arab Emirates: An economic hub for investment

Evaluation of an IHC is done on several parameters including but not limited to political stability, investor-friendliness, financing constraints, business and operational requirements, tax considerations and exchange control and repatriation norms. As may be noted, though tax is a driving force for corporates choosing to establish IHCs, it can never be the sole factor in making the decision for establishing an IHC.

The United Arab Emirates ("UAE") is not known to be a classical 'tax haven', but has been the preferred choice for establishing IHC for several corporates seeking to do business in Asia and Africa, for the reasons outlined below:

i. Political stability

The UAE is amongst the top 10 oil producers in the world, is a market-driven economy and is politically stable and sheltered, which ensures that the country has a robust advantage as a commercial hub for economic activities for corporates.

ii. Location advantages

The UAE can be said to be strategically located for conducting and exploring business opportunities in the emerging markets of the Middle East, Asia and Africa.

Further, infrastructure in the UAE is well developed with growth in property development in both residential and industrial spaces, which presents an added advantage for multinational corporates seeking to establish an IHC in the UAE.

iii. Investor-friendly climate

The traditional notion that corporations cannot be wholly owned by foreign nationals or a foreign corporation is no longer such a concern with numerous free zones established across different emirates in the UAE. There is no restriction on the nationality of free zone company directors and shareholders.

Entities in the UAE free zones can be registered as either new companies or as branches or representative offices of local or international companies. The requisite share capital for setting up companies depends on the chosen free zone, nature of the company's business activity and the number of shareholders in the company, with few restrictions on use of share capital.

The UAE is also a contracting party to the International Centre for Settlement of Investment Disputes Convention ("ICSID") and has signed several bilateral investment treaties with other countries which provide protection to foreign investors in several respects, including fair and equitable treatment and protection against imposition of any unreasonable, arbitrary or discriminatory measures.

iv. Nil tax regime

The UAE has a nil-rate tax regime for most corporations with the exception of oil, gas and petrochemical companies and branch offices of foreign banks, which are required to pay taxes.

The UAE has a broad network of Double Taxation Avoidance Agreements with over 50 countries, which provides investors with favourable treatment in respect of withholding taxes, tax credits and avoidance of double taxation in the residence country and source country.

With focus being drawn to offshore companies' tax residency across the globe, establishing IHCs has become complicated. In such an environment, free zone companies established in the UAE with local regulatory authorities offer effective solutions as they draw less attention to themselves from tax authorities.

v. Ease of repatriation

There are no exchange control regulations in the UAE and hence this provides investors with the ability to easily park profits in UAE companies and to use them for financing their activities across the world with no regulatory approvals required to be sought for remittances outside the UAE.

Recent developments

In today's world the only constant is the assurance of continuing change. The developments in several modern tax systems across the globe signify that several countries have introduced the concept of "beneficial ownership" in their tax codes to curb the use of intermediate holding companies.

Some examples of countries adopting legislations to curb use of IHCs are the French General Tax Code which has included the term 'beneficial owner' in two provisions involving anti-abuse directions, EC directives, which have included a beneficial ownership condition in relation to

interest, royalties and dividends and China, which has issued administrative circulars stating that a beneficial owner must have substantive operating activities and should not be an agent or a 'conduit'. The courts in several jurisdictions like Canada, India and Indonesia are closely examining holding company structures to determine the beneficial ownership of income.

The question that faces every corporation looking to establish an IHC is how safe is it to establish an IHC in a given jurisdiction and it being accorded *bona fide* status despite any judicial scrutiny.

The key is to ensure that the IHC is not merely a 'conduit' or a pass-through entity. In the UAE, the free zones and the other competent authorities require all the details of the ultimate beneficial owner at the time of establishing a new entity or introduction of a new foreign shareholder in an existing company. Further, the UAE is not traditionally a tax haven (even though there are no taxes in the UAE) as it has not permanently denied the source country the right to tax the investor at the time of exit and therefore, there is usually a business case or sound commercial justification for the IHC to be located in the UAE rather than merely being a tax evasion device. The UAE has an established history of international trade, finance and business and is not dependant on any other country. The UAE is also not on the black list of the Organisation of Economic Co-operation and Development. Recently in January 2015, Implementing Regulations for Federal Law No. (4) of 2002 concerning anti-money laundering (as amended in 2014) have been published and the UAE has also opened its doors to countries like India, which has posted eight senior tax officers in Abu Dhabi clearly suggesting that it does not portray itself as a tax haven but is a commercial and economic hub for foreign investments.

Concluding remarks

The UAE was ranked 14th on the 2013 A.T Kearney Global Foreign Direct Investment Confidence Index due to its investor friendly legislation and ease of access to emerging markets in the Middle East, Asia and Africa. In summary, it can be said that the UAE continues to be a preferred choice for setting up IHCs due its investor-friendly climate despite the tendency of the tax authorities around the world to seek to curb the use of IHCs.