



# Exempt Income: Dividends and Participation Exemption

## Corporate Tax Guide | CTGEXI1

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## 1. Glossary

**Accounting Standards:** The accounting standards specified in Ministerial Decision No. 114 of 2023.

**Accrual Basis of Accounting:** An accounting method under which the Taxable Person recognises income when earned and expenditure when incurred.

**AED:** The United Arab Emirates dirham.

**Authority:** Federal Tax Authority.

**Business:** Any activity conducted regularly, on an ongoing and independent basis by any Person and in any location, such as industrial, commercial, agricultural, vocational, professional, service or excavation activities or any other activity related to the use of tangible or intangible properties.

**Business Activity:** Any transaction or activity, or series of transactions or series of activities conducted by a Person in the course of its Business.

**Business Restructuring Relief:** A relief from Corporate Tax for business restructuring transactions, available under Article 27 of the Corporate Tax Law and as specified under Ministerial Decision No.133 of 2023.

**Cash Basis of Accounting:** An accounting method under which the Taxable Person recognises income and expenditure when cash payments are received and paid.

**Connected Person:** Any Person affiliated with a Taxable Person as determined in Article 36(2) of the Corporate Tax Law.

**Corporate Tax:** The tax imposed by the Corporate Tax Law on juridical persons and Business income.

**Corporate Tax Law:** Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses and any of its amendments.

**Dividend:** Any payments or distributions that are declared or paid on or in respect of shares or other rights participating in the profits of the issuer of such shares or rights which do not constitute a return on capital or a return on debt claims, whether such payments or distributions are in cash, securities, or other properties, and whether payable out of profits or retained earnings or from any account or legal reserve or from capital reserve or revenue. This will include any payment or benefit which in substance or effect constitutes a distribution of profits made in connection with the acquisition or



redemption or cancellation of shares or termination of other ownership interests or rights or any transaction or arrangement with a Related Party or Connected Person which does not comply with Article 34 of the Corporate Tax Law.

**Double Taxation Agreement:** An international signed by two or more countries for the avoidance of double taxation and the prevention of fiscal evasion on income and capital.

**Exempt Income:** Any income exempt from Corporate Tax under the Corporate Tax Law.

**Exempt Person:** A Person exempt from Corporate Tax under Article 4 of the Corporate Tax Law.

**Financial Statements:** A complete set of statements as specified under the Accounting Standards applied by the Taxable Person, which includes, but is not limited to, statement of income, statement of other comprehensive income, balance sheet, statement of changes in equity and cash flow statement.

**Financial Year:** The Gregorian calendar year, or the twelve-month period for which the Taxable Person prepares Financial Statements.

**Foreign Permanent Establishment:** A place of Business or other form of presence outside the UAE of a Resident Person that is determined in accordance with the criteria prescribed in Article 14 of the Corporate Tax Law.

**Free Zone:** A designated and defined geographic area within the UAE that is specified in a decision issued by the Cabinet at the suggestion of the Minister.

**Free Zone Person:** A juridical person incorporated, established, or otherwise registered in a Free Zone, including a branch of a Non-Resident Person registered in a Free Zone.

**FTA:** Federal Tax Authority, being the Authority in charge of administration, collection and enforcement of federal taxes in the UAE.

**General Interest Deduction Limitation Rule:** The limitation provided under Article 30 of the Corporate Tax Law.

**IFRS:** International Financial Reporting Standards.

**Interest:** Any amount accrued or paid for the use of money or credit, including discounts, premiums and profit paid in respect of an Islamic Financial Instrument and



other payments economically equivalent to interest, and any other amounts incurred in connection with the raising of finance, excluding payments of the principal amount.

**Islamic Financial Instrument:** A financial instrument which is in compliance with Sharia principles.

**Licence:** A document issued by a Licensing Authority under which a Business or Business Activity is conducted in the UAE.

**Licensing Authority:** The competent authority concerned with licensing or authorising a Business or Business Activity in the UAE.

**Market Value:** The price which could be agreed in an arm's-length free market transaction between Persons who are not Related Parties or Connected Persons in similar circumstances.

**Membership and Partner interests:** The equity interests owned by a member or a partner in the juridical person, which entitles the member or the partner to a share of the profits, determined with reference to the member's or the partner's capital contribution, and which may be transferred to others.

**Membership or Partnership Capital:** The capital paid to a juridical person where the paid capital is divided into membership or partnership interests by a Person in order to be a member or partner and have the rights of membership or partnership in that juridical person.

**Net Interest Expenditure:** The Interest expenditure amount that is in excess of the Interest income amount as determined in accordance with the provisions of the Corporate Tax Law.

**Non-Resident Person:** The Taxable Person specified in Article 11(4) of the Corporate Tax Law.

**Ordinary Shares:** The category of capital stock or equivalent ownership interest, which gives its owner, on a share-by-share basis, equal entitlement to voting rights, profits, and liquidation proceeds.

**Parent Company:** A Resident Person that can make an application to the FTA to form a Tax Group with one or more Subsidiaries in accordance with Article 40(1) of the Corporate Tax Law.

**Participating Interest:** An ownership interest in the shares or capital of a juridical person that meets the conditions referred to in Article 23 of the Corporate Tax Law.



**Participation:** The juridical person in which the Participating Interest is held.

**Participation Exemption:** An exemption from Corporate Tax for income from a Participating Interest, available under Article 23 of the Corporate Tax Law and as specified under Ministerial Decision No.116 of 2023.

**Permanent Establishment:** A place of Business or other form of presence in the UAE of a Non-Resident Person in accordance with Article 14 of the Corporate Tax Law.

**Person:** Any natural person or juridical person.

**Personal Investment:** Investment activity that a natural person conducts for their personal account that is neither conducted through a Licence or requiring a Licence from a Licensing Authority in the UAE, nor considered as a commercial business in accordance with the Federal Decree-Law No. 50 of 2022 Issuing the Commercial Transactions Law.

**Preferred Shares:** The category of capital stock or equity interest which gives its owner priority entitlement to profits and liquidation proceeds ahead of owners of Ordinary Shares.

**Qualifying Free Zone Person:** A Free Zone Person that meets the conditions of Article 18 of the Corporate Tax Law and is subject to Corporate Tax under Article 3(2) of the Corporate Tax Law.

**Qualifying Group:** Two or more Taxable Persons that meet the conditions of Article 26(2) of the Corporate Tax Law.

**Redeemable Shares:** The category of capital stock or equity interest which the juridical person issuing this instrument has agreed to redeem or buy back from the owner of this instrument at a future date or after a specific event, for a predetermined amount or with reference to a predetermined amount.

**Related Party:** Any Person associated with a Taxable Person as determined in Article 35(1) of the Corporate Tax Law.

**Resident Person:** The Taxable Person specified in Article 11(3) of the Corporate Tax Law.

**Revenue:** The gross amount of income derived during a Tax Period.





**Small Business Relief:** A Corporate Tax relief that allows eligible Taxable Persons to be treated as having no Taxable Income for the relevant Tax Period in accordance with Article 21 of the Corporate Tax Law and Ministerial Decision No. 73 of 2023 on Small Business Relief.

**State Sourced Income:** Income accruing in, or derived from, the UAE as specified in Article 13 of the Corporate Tax Law.

**Subsidiary:** A Resident Person in which the share capital or Membership or Partnership Capital, as applicable, is held by a Parent Company, in accordance with Article 40(1) of the Corporate Tax Law.

**Tax Group:** Two or more Taxable Persons treated as a single Taxable Person according to the conditions of Article 40 of the Corporate Tax Law.

**Tax Loss:** Any negative Taxable Income as calculated under the Corporate Tax Law for a given Tax Period.

**Tax Period:** The period for which a Tax Return is required to be filed.

**Tax Return:** Information filed with the FTA for Corporate Tax purposes in the form and manner as prescribed by the FTA, including any schedule or attachment thereto, and any amendment thereof.

**Taxable Income:** The income that is subject to Corporate Tax under the Corporate Tax Law.

**Taxable Person:** A Person subject to Corporate Tax in the UAE under the Corporate Tax Law.

**Turnover:** The gross amount of income derived during a Gregorian calendar year.

**UAE:** United Arab Emirates.



## 2. Introduction

### 2.1. Overview

Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses (“Corporate Tax Law”) was signed on 3 October 2022 and was published in Issue #737 of the Official Gazette of the United Arab Emirates (“UAE”) on 10 October 2022.

The Corporate Tax Law provides the legislative basis for imposing a federal tax on corporations and Business profits (“Corporate Tax”) in the UAE.

The provisions of the Corporate Tax Law shall apply to Tax Periods commencing on or after 1 June 2023.

### 2.2. Purpose of this guide

This guide is designed to provide general guidance to Taxable Persons, helping them to understand the exemptions in the Corporate Tax Law for Dividends and other profit distributions, such as the Participation Exemption. The Participation Exemption permits certain income, such as Dividends and capital gains, to be exempt from Corporate Tax, where a Taxable Person holds a significant, long-term ownership interest in a juridical person. This guide explains some of the terms and conditions in the Corporate Tax Law, and covers the following:

- How Dividends and other profit distributions are defined;
- Which income (and related expenditure) from a Participation is exempt;
- Who is eligible for the exemption;
- How the Participation Exemption operates; and
- What are the related implications in terms of Tax Groups.

This guide does not cover Unincorporated Partnerships.

### 2.3. Who should read this guide?

This guide should be read by Taxable Persons who receive Dividends from a Resident juridical person, and income or gains from a Participating Interest. A Taxable Person includes both juridical persons and natural persons where the income is not their Personal Investment income.<sup>1</sup> This guide needs to be read in conjunction with the Corporate Tax Law, implementing decisions and other relevant guidance published by the FTA.

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<sup>1</sup> Article 2(2)(b) of Cabinet Decision No. 49 of 2023.



## 2.4. How to use this guide

The relevant articles of the Corporate Tax Law and the implementing decisions are indicated in each section of the guide.

It is recommended that the guide is read in its entirety to provide a complete understanding of the definitions and interactions of the different rules. Further guidance on some of the areas covered in this guide can be found in other topic-specific guides.

In some instances, simple examples are used to illustrate how key elements of the Dividends and Participation Exemption apply. The examples in this guide:

- show how these elements operate in isolation and do not show the interactions with other provisions of the Corporate Tax Law that may occur. They do not, and are not intended to, cover the full facts of the hypothetical scenarios used nor all aspects of the Corporate Tax regime, and should not be relied upon for legal or tax advice purposes; and
- are only meant for providing the readers with general information on the subject matter of this guide. They are exclusively intended to explain the rules related to the subject matter of this guide and do not relate at all to the tax or legal position of any specific juridical or natural persons.

## 2.5. Legislative references

In this guide, the following legislation will be referred to as follows:

- Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses is referred to as “Corporate Tax Law”;
- Cabinet Decision No. 49 of 2023 on Specifying the Categories of Businesses or Business Activities Conducted by a Resident or Non-Resident Natural Person that are Subject to Corporate Tax is referred to as “Cabinet Decision No. 49 of 2023”;
- Ministerial Decision No. 73 of 2023 on Small Business Relief for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses is referred to as “Ministerial Decision No. 73 of 2023”;
- Ministerial Decision No. 114 of 2023 on the Accounting Standards and Methods for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses is referred to as “Ministerial Decision No. 114 of 2023”;
- Ministerial Decision No. 116 of 2023 on the Participation Exemption for the Purposes of Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses is referred to as “Ministerial Decision No. 116 of 2023”; and



- FTA Decision No. 13 of 2023 on Determination of Conditions for Conversion of Amounts Quantified in a Currency other than the United Arab Emirates Dirham for the Purposes of the Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses is referred to as “FTA Decision No. 13 of 2023”.

## 2.6. Status of this guide

This guidance is not a legally binding document, but is intended to provide assistance in understanding the provisions relating to the Corporate Tax regime in the UAE. The information provided in this guide should not be interpreted as legal or tax advice. It is not meant to be comprehensive and does not provide a definitive answer in every case. It is based on the legislation as it stood when the guide was published. Each Person’s own specific circumstances should be considered.

The Corporate Tax Law, the implementing decisions and the guidance materials referred to in this document will set out the principles and rules that govern the application of Corporate Tax. Nothing in this publication modifies or is intended to modify the requirements of any legislation.

This document is subject to change without notice.



## 3. Dividends and other profit distributions

Under the Corporate Tax Law, Dividends and other profit distributions received from a juridical person that is a Resident Person are exempt with no further conditions.<sup>2</sup> Dividends and other profit distributions received from a foreign juridical person are exempt under the Participation Exemption, provided the relevant conditions are satisfied.<sup>3</sup>

The purpose of the exemption from Corporate Tax is to prevent Dividends and other profit distributions from potentially being subject to double taxation.

### 3.1. What is a Dividend?

#### 3.1.1. Overview

A Dividend is not defined in the Corporate Tax Law. However, Ministerial Decision No. 116 of 2023 provides a definition of “Dividend”. While the Ministerial Decision is issued specifically in relation to the Participation Exemption, the FTA will apply the same definition to Dividends from a juridical person that is a Resident Person under Article 22(1) of the Corporate Tax Law.

The definition of a Dividend includes a number of important concepts listed below, each of which will be addressed separately:

- Ordinary Dividend: Any payment or distribution that is declared or paid on or in respect of shares or other rights to participate in the profits of the issuer of such shares or rights, payable out of profits or retained earnings or from any account or legal reserve or from capital reserve or revenue (see Section [3.1.2](#)).
- Dividend in kind: Dividend in kind includes stock dividends, bonus shares (for example scrip dividends), and other forms of actual or constructive profit distributions. Thus, a Dividend can take the form of cash, securities, or other property or assets (see Section [3.1.4](#)).
- Other distributions: Any payment or benefit made in connection with the acquisition of shares by the issuing entity, or redemption or cancellation of shares or termination of other ownership interests or rights which in substance constitutes a distribution of profit will be treated as a Dividend (see Section [3.1.5](#)).
- Non-arm’s length payments: Any payment or benefit that arises to a Related Party or Connected Person (who is a shareholder) as a result of a transaction or arrangement which does not comply with the arm’s length principle will constitute

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<sup>2</sup> Article 22(1) of the Corporate Tax Law.

<sup>3</sup> Article 22(2) of the Corporate Tax Law.



a distribution of profit in substance and accordingly, qualify as a Dividend, to the extent to which it is not at arm's length (see Section [3.1.6](#)).

### 3.1.2. Ordinary Dividend

This refers to a payment or distribution that is declared or paid in respect of shares or other rights to participate in the profits of the issuer.

#### 3.1.2.1. What is a share?

The term “share” refers to a unit of ownership in a company which may entitle the holder to a number of rights including the right to vote, the right to participate in a distribution of the company's profits, and the right to a return on the company's capital. The particular rights attaching to a share will depend on the constitutional documents of the company.

The term includes all types of shares issued by a company which carry a right to participate in the company's profits, for example Ordinary Shares, Preferred Shares, Redeemable Shares, non-voting shares, bearer shares, registered shares, etc.

The instruments that are recognised as share capital and the rights attaching to shares are usually determined by the terms under which they are issued within the framework of the company law of the jurisdiction in which the company is incorporated.

For the application of the Participation Exemption, shares or similar interests shall be treated as ownership interests only if the Accounting Standards applied by the Person owning them treats those instruments as equity instruments<sup>4</sup> (see Section [5.1.1](#)).

#### 3.1.2.2. Other rights to participate in profits

“Other rights to participate in profits” can cover instruments (other than shares) issued by entities, which grant holders the right to participate in the relevant entity's profits. This concept makes provision for distribution of profits of other entities which are juridical persons, but are not companies, to also benefit from the exemptions under Article 22 of the Corporate Tax Law, provided all other requirements are met. For example, a member's interest in an incorporated partnership or units of a trust where such entities are treated as a separate legal person according to the law under which they are incorporated.

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<sup>4</sup> Article 2(2) of Ministerial Decision No. 116 of 2023.



“Other rights to participate in profits” also includes instruments such as Membership and Partner Interests as well as Islamic Financial Instruments referred to in Ministerial Decision No. 116 of 2023.

### **3.1.2.3. “In respect of” shares or rights to participate in profits**

The phrase “in respect of” as used in the definition of Dividend, is the reason something is done or a benefit is granted to a Person, in their capacity as a shareholder or holder of the right to profits.

#### **Example 1: Amount not received in capacity of shareholder**

A parent company receives a payment of Interest in respect of a loan to a wholly owned subsidiary. This is not a Dividend because the payment is not received by the parent company in relation to its shares held in the subsidiary, but rather in its capacity as a lender.

### **3.1.2.4. Profits out of which Dividends are distributed**

Subject to applicable governing corporate laws and regulations, a Dividend can be paid out of current year profits or retained earnings, or from any account or legal reserve, or from capital reserves or revenue. This does not affect the treatment for Corporate Tax purposes.

Profits available for distribution (i.e. distributable profits) may be determined from the Financial Statements or the notes thereto. For Corporate Tax purposes, it does not matter whether distributions are made out of current period profits, or those of earlier periods.

### **3.1.3. Payments that do not qualify as a Dividend**

As defined, a return on debt-claims does not qualify as a Dividend. Accordingly, income from convertible debentures or bonds cannot be considered a Dividend, until and unless the instruments are actually converted into shares.

Some debt-claims, such as bonds and debentures, carry an indirect right to participate in a debtor’s profits. Generally, income from such debt-claims does not qualify as a Dividend if the terms of the arrangement evidence a loan arrangement, for example, where loans merely carry a right to Interest dependent or contingent, to some limited extent, on the profits made by the debtor but do not have any other characteristics of a share or other form of ownership interest in a juridical person.





However, Interest on a loan may qualify as a Dividend insofar as the lender effectively shares the risks run by the company, i.e. when repayment depends largely on the success or otherwise of the company's Business and the loan is therefore classified as equity under the Accounting Standards applied by the Taxable Person. The question as to whether the lender shares the risks run by the company and whether this means that the Interest on the loan is in substance a Dividend must be determined in each individual case in light of all the relevant facts and circumstances.

### **3.1.4. Dividend in kind**

#### **3.1.4.1. General**

A Dividend will usually take the form of a cash amount. However, as defined, it can also take a different form, such as securities or other properties, or some other asset of the entity making the distribution. This is referred to as a Dividend in kind.

In the case where a Dividend in kind is received, the value of the Dividend in the hands of the Taxable Person is the value recorded in its Financial Statements prepared as per the applicable Accounting Standards, as long as the value is recorded at Market Value.

#### **3.1.4.2. Issuance of bonus shares**

Bonus shares usually refer to additional shares that a company allocates to its existing shareholders out of its profits or reserves, without receiving new consideration from the shareholders. Since bonus shares are in effect a payment out of a company's profit and reserves, they meet the definition of a Dividend.

### **3.1.5. Other distributions**

#### **3.1.5.1. In substance distributions**

As per the definition of Dividend, a payment or benefit made in connection with the following would be considered a Dividend to the extent it constitutes, in substance, a distribution of profit:

- The acquisition by a company of its own shares (buy-back of shares);
- The redemption of shares;
- The cancellation of shares (capital reduction); or
- The termination of other ownership interests or rights.





This Section must be read in conjunction with the discussion of ordinary Dividend (see Section [3.1.2](#)). Hence, it is possible that only part of such payments or benefits would be classified as a Dividend.

In order to fall within the definition of a Dividend in any of the above instances, payments or benefits should be made out of distributable profits (see Section [3.1.2.4](#)). Thus, where payments are made to shareholders or rights holders in connection with the acquisition, redemption or cancellation of shares or termination of other ownership interests or rights, the Dividend amount will be the difference between the proceeds received by the shareholder and the paid-up value of the shares, limited to the amount of distributable accumulated profits (or retained earnings). The balance amount (if any) may be an exempt capital gain if the conditions of the Participation Exemption are satisfied.

### Example 2: Distribution on cancellation of shares

Company A (a company incorporated and resident in the UAE) wholly owns Company Z (a company incorporated and managed outside the UAE).

Out of 100 shares issued to Company A, Company Z cancels 50 shares by paying AED 450 to its shareholder, Company A. This represents the Market Value of those shares. The distribution on cancellation of shares is paid out of capital contributed and Company Z's retained earnings.

The balance sheet of Company Z just before cancellation of shares is as follows:

Equity and Liabilities	Amount (AED)	Assets	Amount (AED)
Capital (100 shares of AED 5 each)	500	Cash	700
Distributable profits	200		
<b>Total</b>	<b>700</b>	<b>Total</b>	<b>700</b>

Balance sheet of Company Z after cancellation of shares is as follows:

Equity and Liabilities	Amount (AED)	Assets	Amount (AED)
Capital (50 shares of 5 AED each)	250	Cash	250



<b>Total</b>	<b>250</b>	<b>Total</b>	<b>250</b>
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The taxation of AED 450 received by Company A will be as follows:

- AED 250 represents the capital initially subscribed and is not taxable.
- AED 200 is a Dividend because it is sourced from distributable profits. This Dividend is exempt provided the conditions of the Participation Exemption are satisfied.

### 3.1.6. Non-arm's length: constructive Dividend

Constructive Dividends are payments or benefits received by a shareholder as an assignment of income, despite the absence of a formal distribution. This could arise, for example, as a result of a transaction under which a parent company receives compensation that exceeds the fair value of the goods or services provided by it, to its subsidiary. As defined, any payment or benefit that arises to a Related Party or Connected Person (who is a shareholder) as a result of a transaction or arrangement which does not comply with the arm's length principle will constitute a distribution of profit in substance and accordingly, qualify as a Dividend, to the extent to which it is not at arm's length.

## 3.2. Taxation of Dividends and other profit distributions

### 3.2.1. Personal Investment income (natural person only)

For a natural person, whether resident or non-resident, Personal Investment activities are excluded from the definition of Business or Business Activity for Corporate Tax purposes.<sup>5</sup> Hence, where Dividend income received by a natural person is Personal Investment income, it is not Taxable Income for Corporate Tax purposes.

#### Example 3: Natural person as a shareholder

Mr A and Mrs B are both shareholders in Company A (a company incorporated and resident in the UAE). Mr A purchased his shares as a Personal Investment, while Mrs B did it as part of her Business Activity. Company A makes a Dividend distribution to both shareholders.

The Dividend income received by Mr A is Personal Investment income and not subject to Corporate Tax. The Dividend income received by Mrs B is specifically

<sup>5</sup> Article 2(2)(b) of Cabinet Decision No. 49 of 2023.



exempted as a Dividend received from a juridical person that is a Resident Person.<sup>6</sup>

### 3.2.2. Dividend from a Resident Person

A Dividend received from a juridical person that is a Resident Person is always Exempt Income for Corporate Tax purposes with no further conditions.<sup>7</sup>

### 3.2.3. Foreign Dividends

A foreign Dividend is a Dividend received from a foreign juridical person that is a Non-Resident Person. A foreign Dividend is Exempt Income for Corporate Tax purposes if the conditions of the Participation Exemption are satisfied (see Section 5).<sup>8</sup>

If the conditions are not satisfied, the foreign Dividend will be included in the Taxable Income of a juridical person that is a Resident Person.<sup>9</sup> In the case of a Resident Person who is a natural person, the foreign Dividend will similarly be included in the Taxable Income if it is attributed to a Business or Business Activity, unless it represents Personal Investment income.<sup>10</sup>

In the case of a juridical person that is a Non-Resident Person, foreign Dividend income is subject to Corporate Tax only insofar as it is attributable to a Permanent Establishment of that Non-Resident Person in the UAE.<sup>11</sup> However, it will be Exempt Income if the conditions of the Participation Exemption are satisfied.<sup>12</sup>

## **Figure 1: Overview of taxation of Dividend income under the Corporate Tax Law**

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<sup>6</sup> Article 22(1) of the Corporate Tax Law.

<sup>7</sup> Article 22(1) of the Corporate Tax Law.

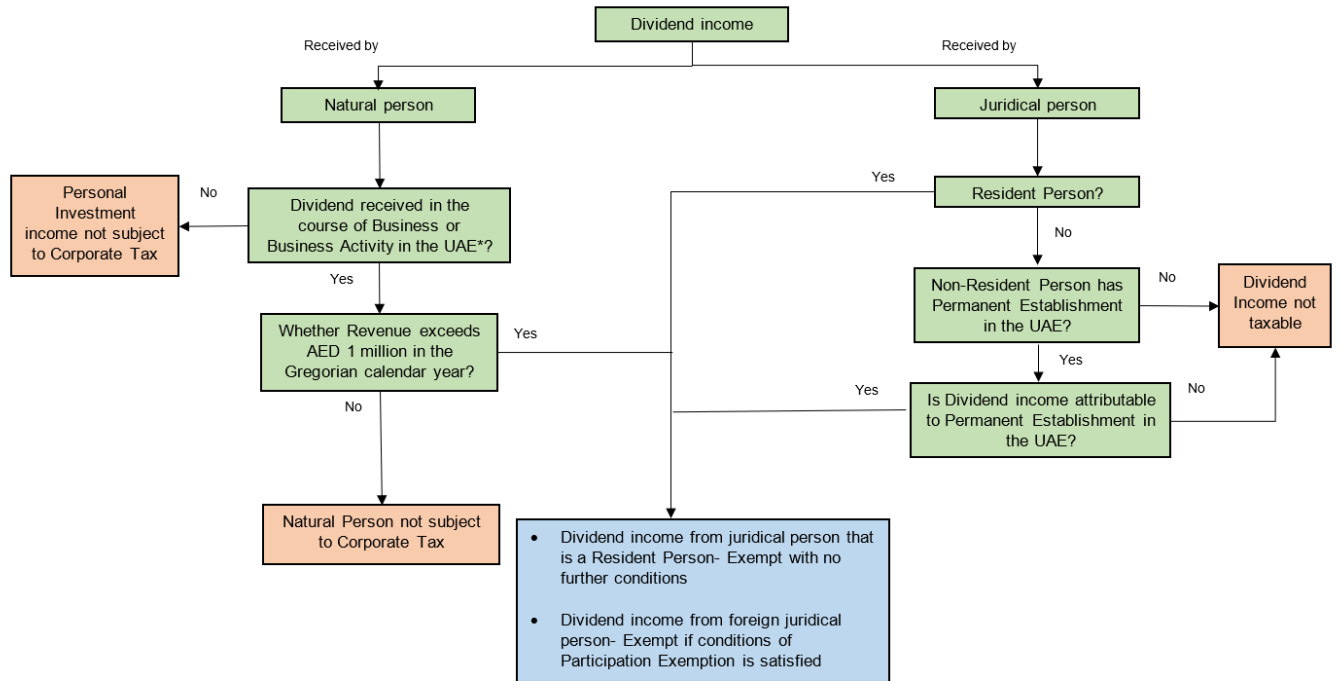
<sup>8</sup> Article 22(2) of the Corporate Tax Law.

<sup>9</sup> Article 12(1) of the Corporate Tax Law.

<sup>10</sup> Article 12(2) of the Corporate Tax Law.

<sup>11</sup> Article 12(3)(a) of the Corporate Tax Law.

<sup>12</sup> Article 22(2) and 22(3) of the Corporate Tax Law.



\*Natural Person conducting Business in the UAE qualifies as Resident Person under the Corporate Tax Law.



## 4. Participation Exemption: overview

### 4.1. Introduction

Certain income received by a Taxable Person from a Participating Interest in a juridical person is exempt from Corporate Tax.<sup>13</sup> This goes beyond the automatic exemption for Dividends from a juridical person that is a Resident Person, and provides an exemption (subject to conditions) for foreign Dividends, capital gains or losses, foreign exchange gains or losses, and impairment gains or losses. Similarly, as is the case for Dividends in Section 3, the intention of the Participation Exemption is to eliminate double taxation.

To illustrate this, Company A earns profit of USD 1,000 in its state of residence (Country A) on which it pays tax in Country A. Out of these taxed profits, Company A distributes USD 100 to its sole shareholder as a Dividend. In this case, taxing the Dividend income of USD 100 in the hands of the shareholder will lead to double taxation (i.e. the USD 100 profits being taxed both at the level of Company A as well as at the level of its shareholder), which the Participation Exemption regime aims to eliminate.

The Participation Exemption rules are broadly structured as follows:<sup>14</sup>

- Providing the definition and conditions of a Participating Interest;<sup>15</sup>
- Clarifying the types of income and losses from a Participating Interest which are exempt from Corporate Tax;<sup>16</sup>
- Clarifying the implications of a failure to meet the conditions of the Participation Exemption.<sup>17</sup>

### 4.2. Definition of Participating Interest

In broad terms, a Participating Interest is a significant, long-term ownership interest in a juridical person (the “Participation”) that suggests some degree of control or influence over the Participation. In line with this principle, several conditions must all be satisfied in order to qualify as a Participating Interest:

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<sup>13</sup> Article 22(2) and Article 22(3) of the Corporate Tax Law.

<sup>14</sup> Article 23 of the Corporate Tax Law.

<sup>15</sup> Articles 23(2), 22(3), 23(4), 23(6), 23(7) and 23(11) of the Corporate Tax Law.

<sup>16</sup> Article 23(5) and Article 23(8) of the Corporate Tax Law.

<sup>17</sup> Article 23(9) and Article 23(10) of the Corporate Tax Law.



- A Participating Interest represents a 5% or greater ownership interest in a Participation (“minimum ownership test”).<sup>18</sup>
- Alternatively, the ownership test can be satisfied if the acquisition cost of the ownership interest is equal to or exceeds a specific threshold (AED 4 million) (“minimum acquisition cost test”).<sup>19</sup>
- The Participating Interest must be held, or intended to be held, for an uninterrupted period of at least 12 months (“holding period test”).<sup>20</sup>
- The Participation must be subject to Corporate Tax, or equivalent foreign corporate tax at a rate of 9% or more (“subject to tax test”).<sup>21</sup> Qualifying Free Zone Persons, Exempt Persons and holding companies, subject to certain conditions, are treated as having met the subject to tax test.<sup>22</sup>
- The ownership interest in the Participation must entitle the holder to receive at least 5% of the profits and liquidation proceeds (“entitlement to profits and liquidation proceeds test”).<sup>23</sup>
- Not more than 50% of the direct and indirect assets of the Participation must consist of ownership interests which would not qualify for the Participation Exemption if held directly (“asset test”).<sup>24</sup>

For more detailed discussion on these conditions see [Section 5](#).

### 4.3. Exempt Income and losses

The Participation Exemption can, provided the necessary conditions are met, provide an exemption from Corporate Tax for the following:<sup>25</sup>

- Dividends and other profit distributions received from a foreign Participation that is not a Resident Person.<sup>26</sup>
- In relation to a Participating Interest, whether derived from a Resident Person or a foreign juridical person that is a Non-Resident Person:
  - Gains or losses on the transfer, sale, or other disposition of a Participating Interest (or part thereof).<sup>27</sup>

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<sup>18</sup> Article 23(2) of the Corporate Tax Law.

<sup>19</sup> Article 23(11) of the Corporate Tax Law and Article 8(1) of Ministerial Decision No. 116 of 2023.

<sup>20</sup> Article 23(2)(a) of the Corporate Tax Law.

<sup>21</sup> Article 23(2)(b) of the Corporate Tax Law.

<sup>22</sup> Article 23(3) and Article 23(4) of the Corporate Tax Law.

<sup>23</sup> Article 23(2)(c) of the Corporate Tax Law.

<sup>24</sup> Article 23(2)(d) of the Corporate Tax Law.

<sup>25</sup> Article 23(5) of the Corporate Tax Law.

<sup>26</sup> Article 23(5)(a) of the Corporate Tax Law.

<sup>27</sup> Article 23(5)(b) of the Corporate Tax Law.



- Foreign exchange gains or losses.<sup>28</sup>
- Impairment gains or losses.<sup>29</sup>

The Participation Exemption applies the same treatment to both gains and losses. Thus, no deduction for Corporate Tax is allowed for capital losses, foreign exchange losses or impairment losses where the conditions for a Participating Interest are met. For more discussion on Exempt Income and losses under the Participation Exemption, see Section 6.

In general terms, other income that is not directly related to the ownership of a Participating Interest, such as income from services provided to the Participation or Interest income earned under a loan granted to the Participation, will in principle not be exempt from Corporate Tax by virtue of the Participation Exemption.

Expenditure incurred in relation to Exempt Income, which includes where the Participation Exemption applies, is not deductible for Corporate Tax purposes,<sup>30</sup> except for Interest expense.<sup>31</sup> See Section 7 regarding the non-deductibility of expenditure.

#### **4.4. Automatic exemption: no election required**

The Participation Exemption applies without the need for the Taxable Person to make an election or file an application with the FTA. Accordingly, if the relevant conditions are met, the Participation Exemption will apply automatically with regards to all relevant income derived from Participating Interests. All conditions of the Participation Exemption must be satisfied at the time income is derived from a Participating Interest. The timing of when income is derived will normally be based on the Financial Statements prepared by the Taxable Person under the applicable Accounting Standards (an exception would be where the Cash Basis of Accounting is applied).

#### **4.5. Availability of exemption to both Resident Person and Non-Resident Person**

Any Taxable Person, Resident or Non-Resident Persons, can benefit from the Participation Exemption in respect of relevant income if the conditions are satisfied. Thus, income from a Participating Interest that is attributable to a UAE Permanent Establishment of a Non-Resident Person will be exempt if the conditions of the Participation Exemption are met.

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<sup>28</sup> Article 23(5)(c) of the Corporate Tax Law.

<sup>29</sup> Article 23(5)(d) of the Corporate Tax Law.

<sup>30</sup> Article 22 and Article 28(2)(b) of the Corporate Tax Law.

<sup>31</sup> Article 29 of the Corporate Tax Law.

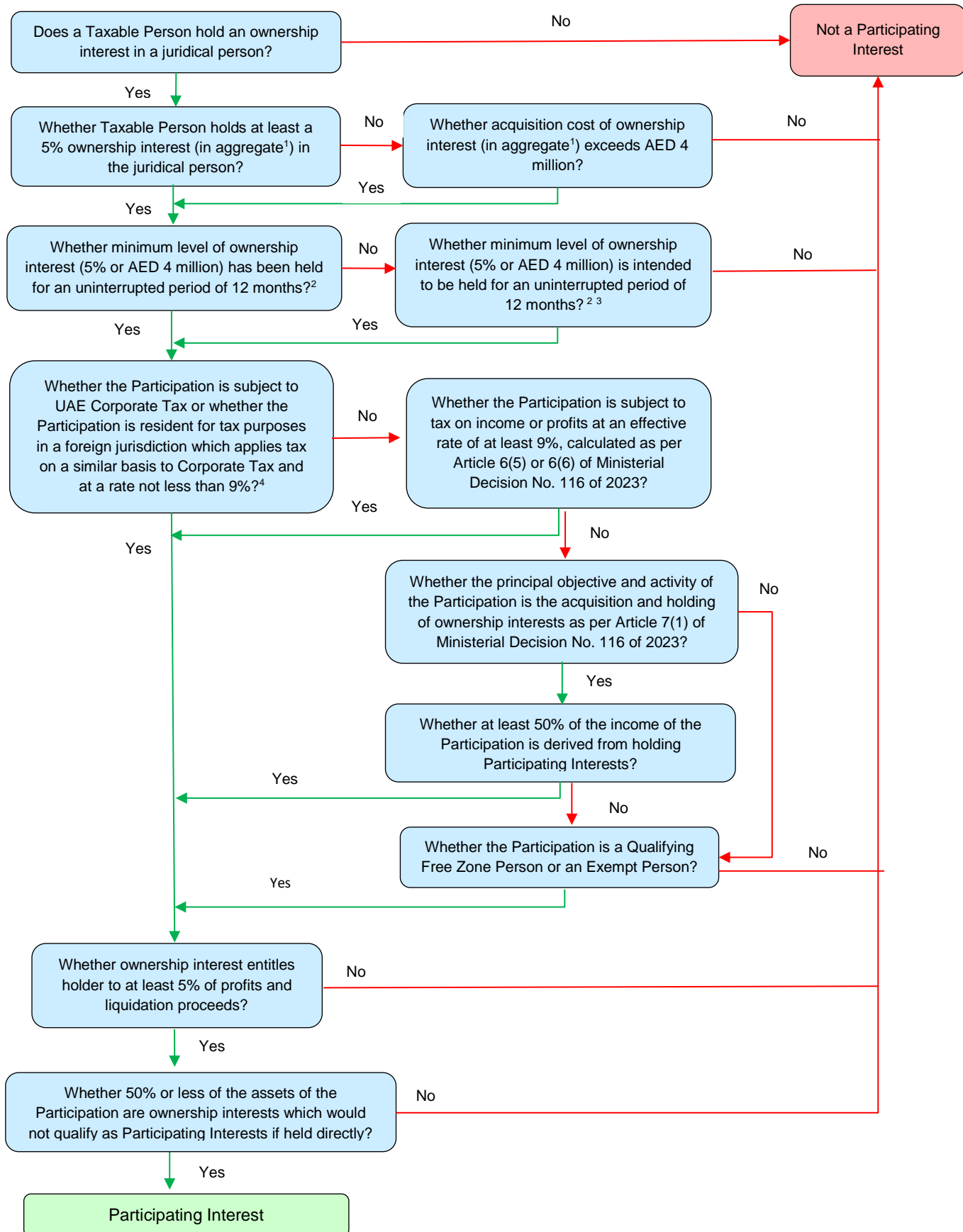


## 5. Participation Exemption: definition of Participating Interest

In order for income to benefit from the Participation Exemption, it must relate to a Participating Interest. The following flowchart sets out the conditions to qualify as a Participating Interest. It follows the order they are listed in Article 23 of the Corporate Tax Law. In practice it may not be necessary to consider the conditions in sequence in order to reach a conclusion.

Figure 2: Overview of conditions to qualify as a Participating Interest





<sup>1</sup> Aggregation of ownership interests as per Article 3 of Ministerial Decision No. 116 of 2023. See Section 5.2.1

<sup>2</sup> Article 4 of Ministerial Decision No. 116 of 2023 provides a relaxation in holding period condition where ownership interest is acquired in accordance with Article 27(1) [business restructuring relief]. See Section 5.3.3.

<sup>3</sup> In the case of capital gains, the intention to hold an ownership interest does not apply. The ownership interest must have actually been held for a period of 12 months, or for a period of 2 years where the ownership interest is acquired in scenarios covered under Article 23(9). Refer Section 5.3.4

<sup>4</sup> Determined as per Article 6(2), 6(3), 6(4) of Ministerial Decision No. 116 of 2023. See Section 5.5.2



## 5.1. Ownership interest test

The first condition to qualify for the Participation Exemption is that a Taxable Person must hold an “ownership interest” in the shares or capital of a juridical person. The meaning of the term “share” is discussed in Section [3.1.2.1](#). Further, other methods of dividing capital that would constitute ownership interests include membership interests and other securities or rights that entitle the holder to profits and liquidation proceeds of the entity. Examples include interests in certain incorporated partnerships or units issued by an investment fund.

### 5.1.1. What is an ownership interest?

An ownership interest can be understood as any equity or similar interest (for example, a partnership interest) that carries rights to the profits and liquidation proceeds of the Participation.

A holding can qualify as an ownership interest for the purposes of Article 23 of the Corporate Tax Law only if it is treated as an equity interest under the Accounting Standards applied by the Taxable Person holding the ownership interest.<sup>32</sup> This would distinguish between an ownership interest and other rights to the profits and liquidation proceeds of an entity, such as profit-sharing agreements with employees that do not carry any equity rights to the entity or creditors’ rights to compel the sale of certain assets to satisfy an obligation of an entity that is in default.

To the extent that shares or capital held by a Taxable Person grant the same rights to both the profits as well as the liquidation proceeds of the Participation, no consideration needs to be given to the different classes of shares or capital issued. An ownership interest can include, but is not limited to, holdings in any one or a combination of the following instruments:<sup>33</sup>

Type of instrument	Description
Ordinary Shares	Category of capital stock or equivalent ownership interest, which gives its owner, on a share-by-share basis, equal entitlement to voting rights, profits, and liquidation proceeds.
Preferred Shares	Category of capital stock or equity interest which gives its owner priority entitlement to profits and liquidation proceeds ahead of owners of Ordinary Shares.

<sup>32</sup> Article 2(2) of Ministerial Decision No. 116 of 2023.

<sup>33</sup> Article 2(1) of Ministerial Decision No. 116 of 2023.



Type of instrument	Description
Redeemable Shares	Category of capital stock or equity interest which the juridical person issuing this instrument has agreed to redeem or buy back from the owner of this instrument at a future date or after a specific event, for a predetermined amount or with reference to a predetermined amount.
Membership and Partner Interests	Equity interests owned by a member or a partner in the juridical person, which entitles the member or the partner to a share of the profits, determined with reference to the member's or the partner's capital contribution, and which may be transferred to others.
Islamic Financial Instrument or a combination of arrangements that form part of the same Islamic Financial Instrument	Islamic Financial Instrument is a financial instrument which is compliant with Sharia principles.

The above list of ownership instruments is only illustrative. Other types of participating rights to the profits and liquidation proceeds of the Participation and treated as an equity interest under the applicable Accounting Standards, may also qualify as ownership interests. For example, the definition of Ordinary Shares refers to capital stock which gives its owner equal entitlement to voting rights, profits, and liquidation proceeds. However, shares that do not carry voting rights but have rights to profits and liquidation proceeds can also qualify as an ownership interest.

Ownership interests may carry rights to profits and liquidation proceeds in different percentages. For example, an ownership interest may carry a right to 20% of the profits of an entity but only 10% of the liquidation proceeds. These will need to be looked at separately when determining the "entitlement to profits and liquidation proceeds test" (see Section [5.7](#)).

### 5.1.2. Debt instruments issued by the Participation

Debt instruments can be contrasted with equity instruments in the nature of the liability and risk. Whilst equity gives a residual claim on the assets of the entity, a debt instrument involves an obligation to pay an amount of principal and / or interest usually according to a predefined formula. Typically, the creditor (the lender) is paid in priority to equity holders, having less risk than equity holders, though may not have recourse



to the entity's assets. Hence, ordinarily debt instruments do not qualify as an ownership interest for the purposes of the Participation Exemption.

However, a debt instrument (including those convertible into equity) is treated as an ownership interest if it is classified as an equity interest under the Accounting Standards applied by the Taxable Person.<sup>34</sup> Thus, compound financial instruments or hybrid instruments which have features of debt as well as equity may qualify as an ownership interest depending on their accounting classification under the Accounting Standards applied by the Taxable Person.

### 5.1.3. Options

An option is a right to buy (call option) or sell (put option) something for a fixed price at a future date. Accordingly, holding an option does not imply that the holder actually or in fact has an ownership interest in an entity. Therefore, the holding of an option would not be considered as holding an ownership interest.

### 5.1.4. Owner of ownership interests

The specified income from a Participation is exempt only if it is received by a Taxable Person in their capacity as "owner" of an ownership interest or ownership interests in the Participation. Income derived from a Participation in any other capacity, such as a lender or service provider, is not exempt from Corporate Tax under the Participation Exemption.<sup>35</sup>

A Taxable Person shall be treated as holding an ownership interest where the ownership interest is controlled by the Taxable Person and the Taxable Person has the right to the economic benefits produced by the ownership interest under the Accounting Standards as applied by the Taxable Person.<sup>36</sup>

The person receiving the income must be the economic owner of the ownership interest. A person is the economic owner when they have (or are entitled to) all or substantially all the benefits and burdens of ownership, including rights to profits, liquidation proceeds, or voting in respect of the Participation, and they have not renounced or transferred such rights under another arrangement.

Thus, if a person holds the ownership interest in the capacity of an agent, nominee, fiduciary or administrator, so that they are simply a conduit for another person who in fact is entitled to the benefits and burdens of ownership, the former is not the economic

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<sup>34</sup> Article 5 of Ministerial Decision No. 116 of 2023.

<sup>35</sup> Article 11 of Ministerial Decision No. 116 of 2023.

<sup>36</sup> Article 2(3) of Ministerial Decision No. 116 of 2023.



owner of the ownership interest. Accordingly, they will not be entitled to the Participation Exemption with respect to income from the Participation.

Even if a person legally holds the ownership interest in their own name (i.e. legal owner), they may potentially not qualify as the economic owner if the right to use and enjoy the benefits of the ownership interest is constrained by a contractual or legal obligation to pass on the benefit received to another person. Such an obligation will normally derive from relevant legal agreements but may also be found to exist on the basis of facts and circumstances showing that, in substance, the legal owner does not have the right to use and enjoy the benefits of an ownership interest in an unconstrained manner.

## 5.2. Minimum ownership test

A Participating Interest must represent a 5% or greater ownership of the shares or capital of the juridical person.<sup>37</sup> A less than 5% ownership interest in a juridical person will not qualify for the Participation Exemption, unless the minimum acquisition cost test is met (see Section [5.4](#)).

### 5.2.1. Computation of percentage ownership

The percentage ownership must be calculated as:

Percentage ownership (PO) =  $\frac{X}{Y} * 100$  where:

X = Paid-up capital of ownership interests held by a Taxable Person in the Participation. Different types of ownership interests held by the Taxable Person in the same juridical person can be aggregated for the purposes of applying the 5% threshold test.<sup>38</sup>

Y = Total paid-up capital of the Participation or the total equity interest contributions made to the Participation, as applicable.<sup>39</sup>

#### Example 4: Computing percentage of holding

Company A has paid-up share capital of AED 10,000: AED 1,000 towards Ordinary Shares and AED 9,000 towards Preferred Shares. Company B holds 20% of the Ordinary Shares in Company A and does not hold any Preferred Shares.

<sup>37</sup> Article 23(2) of the Corporate Tax Law.

<sup>38</sup> Article 3(1)(a) of Ministerial Decision No. 116 of 2023.

<sup>39</sup> Article 2(5) of Ministerial Decision No. 116 of 2023.



- Paid-up capital of ownership interest held by Company B (X): 20% of AED 1,000 Ordinary Shares = AED 200.
- Total paid-up capital of the Participation (Y): AED 10,000 (Ordinary and Preferred Share capital together)
- Company B's percentage ownership:  $\frac{200}{10,000} * 100 = 2\%$

Accordingly, Company B's ownership interest amounts to only 2% of the total paid-up share capital in Company A, i.e. Ordinary and Preferred Share capital together. In this case, Company B does not meet the 5% ownership interest threshold required for the Participation Exemption.

### 5.2.2. Aggregation of Qualifying Group holdings

Ownership interests in the same juridical person held by other members of a Qualifying Group are aggregated with those of the Taxable Person.<sup>40</sup>

### 5.2.3. Falling below the 5% ownership threshold

Since the Participation Exemption is automatic and applies without the need for an election or an application, all conditions must be satisfied at the time income is derived from a Participating Interest (see Section [4.4](#)).

Therefore, if at the time the income is derived, the Taxable Person does not hold at least a 5% ownership interest, the condition is not met and accordingly, the income is not exempt under the Participation Exemption, unless the minimum acquisition cost test is met (see Section [5.4](#)).

The timing of when income is derived will normally be based on the Financial Statements prepared by the Taxable Person under the applicable Accounting Standards (an exception would be where the Cash Basis of Accounting is applied).

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<sup>40</sup> Article 3(1)(b) of Ministerial Decision No. 116 of 2023.



### Example 5: Sale of ownership interests in tranches

Company A (a company incorporated and resident in the UAE) adopts a Tax Period of 1 January to 31 December. Company A has acquired shares in Company Z (a company incorporated and managed outside the UAE) and has the following transactions with respect to the investment:

Date	Transaction
1 November 2022	Acquired 20% of shares of Company Z below AED 4 million
1 March 2024	Sold 17% of shares of Company Z for proceeds exceeding original cost
1 June 2024	Received Dividend from Company Z
1 August 2024	Acquired additional 2% of shares of Company Z
1 August 2025	Acquired additional 2% of shares of Company Z
31 December 2025	Received Dividend from Company Z

Assuming that the other relevant conditions are satisfied, the tax treatment of the various income items is as follows:

- Gain from sale of shares on 1 March 2024: At the time of sale, Company A held more than 5% ownership interest for more than 12 months, so the gain on sale is exempt. (If the sale had resulted in a loss, the loss would have been excluded from the Taxable Income of Company A).
- Dividend received on 1 June 2024: At the time the Dividend income is received, Company A holds only 3% of the shares in Company Z with an acquisition cost of less than AED 4 million. This is below the required 5% ownership and minimum acquisition cost threshold, and consequently, the Dividend is not exempt.
- Dividend received on 31 December 2025: At the time the Dividend income is received, Company A holds 7% of the shares in Company Z so the ownership threshold condition is met. Further, a shareholding of 5% has been held for more than 12 months (the additional 2% acquired on 1 August 2024 resulted in a 5% holding – the 2% acquired on 1 August 2025 would be considered for the purpose of this test if there is an intention to hold these shares for at least 12 months). Thus, the 12-month holding period test is also met. Therefore, the Dividend received on 31 December 2025 is exempt.





### 5.3. Holding period test

A Participating Interest must be held, or intended to be held, for a continuous period of at least 12 months.<sup>41</sup> The 12-month holding period is provided to prevent a scenario where a Taxable Person, holding less than 5% of a Participating Interest, increases their holding shortly before receiving income from the Participating Interest, primarily for the purpose of securing the benefits of the Participation Exemption. Thus, a 12-month holding period ensures that the benefit of Participation Exemption is available to long-term holdings.

#### 5.3.1. Intention to hold Participating Interest for at least 12 months

Whether the Taxable Person has held a Participating Interest for 12 months is tested on the date when income from a Participating Interest is derived.

However, there is no requirement for the Participating Interest to be held for the full Tax Period, nor is it required for the minimum holding period to be met at the time the income is derived (subject to the exceptions noted in Section [5.3.4](#)). Income received before the minimum holding period is completed can also benefit from the Participation Exemption, as long as the Taxable Person has the intention to hold the Participating Interest for at least 12 months, indicating that it is not merely a short-term investment.

Whether or not the Participating Interest is intended to be held for at least 12 months may generally be inferred from the relevant facts and circumstances, including, for example:

- Whether the Taxable Person is engaged in the Business of buying and selling securities (as a trader).
- The accounting treatment of the Participating Interest in the Financial Statements of the Taxable Person (fixed asset investment as opposed to stock/inventory, for example).
- The intention at the time of acquiring the Participating Interest – was it acquired with the intention of disposing of it at a profit, or was it acquired as a long-term investment?

Where a Taxable Person benefits from the Participation Exemption on the basis of an intention to meet the 12-month holding period, but subsequently does not achieve that condition, the income previously not taken into account in determining Taxable Income must be included in the calculation of Taxable Income in the Tax Period where the condition is breached.<sup>42</sup>

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<sup>41</sup> Article 23(2)(a) of the Corporate Tax Law.

<sup>42</sup> Article 23(10) of the Corporate Tax Law.





### **Example 6: 12-month holding period not satisfied subsequently**

Company A (a company incorporated and resident in the UAE) purchases 10% of the shares of Company Z (a company incorporated and managed outside the UAE) in October 2024 with the intention of holding them as a long-term investment. Company A receives a Dividend from Company Z in November 2024. Company A follows the Gregorian calendar year as its Tax Period.

For the 2024 Tax Period, Company A treats the Dividend income as exempt on the basis that it intends to hold the shares for at least 12 months. However, due to commercial reasons, in March 2025, Company A sells 8% of the shares of Company Z. In such a case, the Dividend income treated as exempt in 2024 will be added to the Taxable Income of Company A in the 2025 Tax Period. The reason why Company A was unable to satisfy its intention of holding the shares for at least 12 months is not relevant.

### **5.3.2. Different ownerships interests in a juridical person held for different periods**

A Taxable Person can hold different ownership interests (which can be the same or a different class of shares) in a single juridical person which are purchased on different dates such that some of the ownership interests are held for 12 months while some are not. In such a case, where the Taxable Person disposes of part of their ownership interests, the question arises as to whether the holding period test is satisfied.

Different types of ownership interests held by the Taxable Person in the same juridical person are to be aggregated while testing the conditions of the Participation Exemption.<sup>43</sup> Once the conditions of the Participation Exemption are met, the ownership interests form a single Participation. Accordingly, where part of a Participating Interest is disposed of, the holding period condition is to be tested in respect of the Participation as a whole and not each ownership interest individually.

### **Example 7: Disposal of part of ownership interest**

Company A (a company incorporated and resident in the UAE) purchases and sells shares of Company Z (a company incorporated and managed outside the UAE) as follows:

<sup>43</sup> Article 3(1)(a) of Ministerial Decision No. 116 of 2023.



Transaction	Holding %	Holding Period
Purchase of Ordinary Shares of Company Z	6%	5 years
Purchase of Preferred Shares of Company Z	3%	3 months
Sale of Preferred Shares of Company Z	2%	N/A

In this case, even though the Preferred Shares sold have been held for only 3 months, the holding period test is satisfied based on Company A's overall ownership interest in Company Z, which is over 12 months.

### 5.3.3. Transfer of ownership interest in case of business restructuring

Where a Taxable Person exchanges an ownership interest in one juridical person for that in another juridical person, and where this exchange does not give rise to Taxable Income, due to the application of Business Restructuring Relief,<sup>44</sup> the ownership of the two interests is treated as a single continuous ownership (not two separate ownership periods) provided that both qualify as Participating Interests.<sup>45</sup> This means the period of ownership can look through a qualifying business restructuring.

### 5.3.4. Required holding period exceptions

Generally, income from a Participating Interest before the 12-month holding period is completed can still benefit from the Participation Exemption, as long as the intention is to hold the interest for at least 12 months. However, there are two exceptions when the intention is not sufficient, and in such cases the Participation Exemption only applies after the relevant holding period requirement has actually been met.

The first case is in the case of capital gains or losses (see Section [6.2](#)). To be exempt, the Participating Interest must have been held for the required period of 12 months. Thus, where a Participating Interest has not been held for at least 12 months, a capital gain or loss on the sale, transfer or other disposition of the asset will not be exempt.<sup>46</sup>

In the second case, the Participation Exemption does not apply for a period of two years where the Participation is acquired under the following circumstances:<sup>47</sup>

<sup>44</sup> Article 27 of the Corporate Tax Law.

<sup>45</sup> Article 4 of Ministerial Decision No. 116 of 2023.

<sup>46</sup> Article 23(5)(b) of the Corporate Tax Law.

<sup>47</sup> Article 23(9) of the Corporate Tax Law.



- In exchange for the transfer of an ownership interest that is not a Participating Interest, i.e. the asset held previously would not have qualified for the Participation Exemption;
- In the case of an exempt transfer within a Qualifying Group;<sup>48</sup> or
- In the case of an exempt transfer covered by Business Restructuring Relief.<sup>49</sup>

In the above circumstances, the Participating Interest must be held for at least two years (i.e. 24 months) before the Participation Exemption can apply.

#### **Example 8: Participation acquired in exchange for transfer of an ownership interest that is not a Participating Interest**

Company A (a company incorporated and resident in the UAE) holds 10% of the shares of Company F (a company incorporated and managed outside the UAE). The shares do not carry the right to liquidation proceeds of Company F and hence do not satisfy one of the necessary conditions to qualify as a Participating Interest.

Company X (a company incorporated and resident of the UAE) holds 6% of the Ordinary Shares in Company G (a company incorporated and managed outside the UAE). The shares of Company G satisfy the conditions to be a Participating Interest.

Company A transfers shares held in Company F to Company X in exchange for shares of Company G. In this case, even if Company A has the intention to hold shares of Company G for more than 12 months, the Participation Exemption will not be available with respect to income derived from Company G shares for 2 years from the date of acquisition of the shares. This is because the shares of Company G were acquired in exchange for an ownership interest (i.e. the shares of Company F) which does not qualify as a Participating Interest.

#### **5.4. Minimum acquisition cost test**

As an alternative to the requirement to have a 5% or greater ownership interest (see Section [5.2](#)), a Taxable Person will be treated as having a Participating Interest if the acquisition cost exceeds AED 4 million.<sup>50</sup>

The minimum acquisition cost threshold serves as an administrative simplification, recognising that a material investment in a juridical person is often representative of the long-term nature of the investment and would generally provide the holder with some degree of control or influence over the entity.

<sup>48</sup> Article 26 of the Corporate Tax Law.

<sup>49</sup> Article 27 of the Corporate Tax Law.

<sup>50</sup> Article 23(11) of the Corporate Tax Law read with Article 8(1) of Ministerial Decision No. 116 of 2023.



If the Taxable Person does not meet the minimum acquisition cost threshold (i.e. AED 4 million) for an uninterrupted period of at least 12 months, income previously not taken into account in determining Taxable Income on the basis of the Participation Exemption is included in the calculation of Taxable Income in the Tax Period where the condition is breached.<sup>51</sup>

#### 5.4.1. Aggregation of acquisition costs

For the purposes of this test, the acquisition cost of different types of ownership interests held by a Taxable Person in the same juridical person are aggregated. What needs to be determined is if the aggregate acquisition cost is equal to or exceeds the minimum acquisition cost (currently AED 4 million).<sup>52</sup>

##### **Example 9: Determining acquisition cost on aggregate basis**

A Taxable Person has acquired the following ownership interests in Company A (a company incorporated and resident in the UAE):

- Firstly, Ordinary Shares for AED 1 million;
- Secondly, Preferred Shares for AED 2 million; and
- Thirdly, Redeemable Shares for AED 2 million.

In this case, the minimum acquisition cost test is met when the Redeemable Shares are acquired since the aggregate acquisition cost of all ownership interests held in Company A exceeds AED 4 million.

Further, the acquisition costs of ownership interests in the same juridical person held by members of a Qualifying Group (as defined in Article 26(2) of the Corporate Tax Law) in which the Taxable Person is a member, are aggregated.<sup>53</sup> The minimum acquisition cost test is met if the aggregate acquisition cost of ownership interests held by all members of the Qualifying Group together exceed the threshold of AED 4 million. Thus, the intra-group transfer of ownership interests between members of a Qualifying Group does not have an impact on the minimum acquisition cost test.

<sup>51</sup> Article 23(11) of the Corporate Tax Law read with Article 23(2) of the Corporate Tax Law..

<sup>52</sup> Article 3(2) of Ministerial Decision No. 116 of 2023.

<sup>53</sup> Article 3(2) of Ministerial Decision No. 116 of 2023.



#### 5.4.2. Computation of acquisition cost

The aggregate acquisition cost is computed as follows:<sup>54</sup>

Cost	Notes
Value of contributions made or consideration paid towards ownership interest in Participation. <sup>55</sup>	<ul style="list-style-type: none"> <li>Includes consideration paid/repaid in cash or in kind.<sup>56</sup></li> <li>The value is determined at the time of the transaction, i.e. when the capital contribution was made. No account is taken of any subsequent value adjustments made under the Accounting Standards applied by the Taxable Person holding the ownership interest.<sup>57</sup> Thus, what is relevant here is the actual historical cost of acquiring the ownership interest (e.g. cash paid) and not, for instance, the adjusted book value or Market Value of the ownership interest.</li> </ul>
Add: Value of any subsequent contributions made or consideration paid towards ownership interest in Participation. <sup>58</sup>	
Less: Value of equity/ capital repayment made by the Participation (for example on redemption or buy back of shares). <sup>59</sup>	
Less: Cost attributable to part of the ownership interest sold, transferred or otherwise disposed of.	<p>Where an ownership interest is partly sold, transferred, or otherwise disposed of, the aggregated acquisition cost shall be reduced in proportion to the average acquisition cost attributable to the part of the ownership interest that is sold, transferred or otherwise disposed of.<sup>60</sup></p> <div style="border: 1px solid black; padding: 5px;"> <p><b>Example 10: Determining cost on partial sale</b></p> <p>A Taxable Person holds the following interests in a juridical person:</p> </div>

<sup>54</sup> Article 8 of Ministerial Decision No. 116 of 2023.

<sup>55</sup> Article 8(2)(a) of Ministerial Decision No. 116 of 2023.

<sup>56</sup> Article 8(2)(a) of Ministerial Decision No. 116 of 2023.

<sup>57</sup> Article 8(3) of Ministerial Decision No. 116 of 2023.

<sup>58</sup> Article 8(2)(b) of Ministerial Decision No. 116 of 2023.

<sup>59</sup> Article 8(2)(b) of Ministerial Decision No. 116 of 2023.

<sup>60</sup> Article 8(5) of Ministerial Decision No. 116 of 2023.



Cost	Notes										
	<table border="1"> <thead> <tr> <th>Type of interest</th> <th>Cost</th> </tr> </thead> <tbody> <tr> <td>Preferred Shares</td> <td>AED 2 million</td> </tr> <tr> <td>Ordinary Shares</td> <td></td> </tr> <tr> <td>• Tranche 1: 10,000 shares</td> <td>AED 1 million</td> </tr> <tr> <td>• Tranche 2: 20,000 shares</td> <td>AED 5 million</td> </tr> </tbody> </table> <p>The Taxable Person sells 5,000 Ordinary Shares. In this case, the cost will be average acquisition cost attributable to the Ordinary Shares <math>[(5,000 / 30,000) * 6 \text{ million}] = \text{AED } 1 \text{ million}</math>.</p>	Type of interest	Cost	Preferred Shares	AED 2 million	Ordinary Shares		• Tranche 1: 10,000 shares	AED 1 million	• Tranche 2: 20,000 shares	AED 5 million
Type of interest	Cost										
Preferred Shares	AED 2 million										
Ordinary Shares											
• Tranche 1: 10,000 shares	AED 1 million										
• Tranche 2: 20,000 shares	AED 5 million										
Add: Expenditure incurred by the Taxable Person in relation to the acquisition or transfer of ownership interests which is capitalised as an acquisition cost of Participating Interest. <sup>61</sup>	Expenses incurred in relation to the acquisition, sale, transfer, or disposal of an entire Participating Interest or part of a Participating Interest should be capitalised for Corporate Tax purposes, even if such expenses are not capitalised in the Financial Statements. <sup>62</sup> For examples, see Section <a href="#">7.2.1</a>										

In addition to above, the following aspects should be taken into account when computing the acquisition cost:

- Foreign currency: for Corporate Tax purposes, all amounts must be quantified in UAE dirham. Hence, if an acquisition cost is incurred in another currency, it must be converted to UAE dirham.<sup>63</sup> The relevant exchange rate at the date of acquisition or formation of the relevant ownership interest should be used.<sup>64</sup>
- The cost of acquisition can be zero for certain ownership interests. As mentioned above, the minimum acquisition cost test requires the use of the actual cost regardless of the accounting treatment. Thus, where no cost is incurred, for example on the issue of bonus shares not in lieu of a Dividend, there will be no cost of acquisition for the purpose of this test.
- The cost of acquisition of an ownership interest is the cost in the hands of the previous owner where the Taxable Person has acquired the ownership interest

<sup>61</sup> Article 8(2)(c) of Ministerial Decision No. 116 of 2023.

<sup>62</sup> Article 10(4) of Ministerial Decision 116 of 2023.

<sup>63</sup> Article 43 of the Corporate Tax Law read with FTA Decision No. 13 of 2023.

<sup>64</sup> Article 8(4) of Ministerial Decision No. 116 of 2023.





from another Qualifying Group member and the relief under Article 26 of the Corporate Tax Law was applied to the relevant transaction.

- In the case where Business Restructuring Relief applies, the cost of acquisition of the ownership interests received by the Taxable Person is the value to the other Person of the Business transferred.<sup>65</sup>

## 5.5. Subject to tax test

Under the “subject to tax” test, the Participation must be subject to an adequate level of taxation.<sup>66</sup> This test will be satisfied if the Participation is subject to:

- UAE Corporate Tax; or
- Any other tax similar to Corporate Tax in its country of residence at a rate of at least 9%.

As mentioned, the purpose of the Participation Exemption is to prevent double taxation where a Participation that distributes a profit or whose shares or other ownership interests are being sold may have already been taxed on its profits. Accordingly, and to prevent income from being shifted to foreign jurisdictions to inappropriately benefit from the Participation Exemption, income derived from subsidiaries that are resident in no or low-tax jurisdictions would generally not benefit from the Participation Exemption regime (see Section [5.6](#) for exceptions).

### 5.5.1. Subject to Corporate Tax or similar

It should normally be clear when a Participation which is a Resident Person in the UAE is subject to UAE Corporate Tax.

The Participation is considered to have met the subject to tax requirement under Article 23(2)(b) of the Corporate Tax Law for a specific Tax Period when it is resident for tax purposes throughout that same Tax Period in another country or a foreign territory that levies a tax meeting all of the following requirements:

- The tax is applied on a similar basis to Corporate Tax; and
- The tax is levied at a rate not less than 9%.<sup>67</sup>

For a Participation which is tax resident in a foreign jurisdiction to meet the subject to tax test, the relevant foreign jurisdiction must have a corporate tax regime that is

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<sup>65</sup> Article 27(3) of the Corporate Tax Law.

<sup>66</sup> Article 23(2)(b) of the Corporate Tax Law.

<sup>67</sup> Article 6(1) of Ministerial Decision No. 116 of 2023.



similar in nature to the UAE Corporate Tax for the entire Tax Period during which the Taxable Person holds the Participation).

The following factors regarding the jurisdiction in which the Participation is resident do not imply that the jurisdiction does not have a similar tax to Corporate Tax:<sup>68</sup>

- Differences in reductions and reliefs (e.g. different treatment of entertainment expenditure or interest expense, a more favourable exemption for capital gains and dividend income, or the ability to carry back tax losses incurred).
- Lower tax rates applicable to certain brackets of income.
- Targeted incentives or exemptions of a temporary nature, e.g. tax credits or exemptions from corporate tax for setting up a manufacturing site or moving headquarter functions to a foreign country. The incentives must be granted for a certain period. A permanent tax exemption would not be considered as being of a temporary nature.
- Application of alternative taxes on income or profits such as:
  - A system which requires the 'standard' tax liability to be compared with an alternative calculation on a secondary basis, with tax payable being the higher of the two, e.g., certain countries apply a corporate alternate minimum tax on the adjusted financial statement income of a taxpayer if the amount of tax liability determined under the alternative minimum tax rules exceeds the tax liability determined under regular income tax rules; or
  - A broad-based corporate tax regime that does not apply to locally or regionally owned companies for instance being exempt from corporate taxation but subject to Zakat or a different form of effective taxation.

The determination of being subject to Corporate Tax (or any other tax of a similar character to Corporate Tax), must be made based on a consideration of all relevant facts and circumstances concerning the tax legislation of the jurisdiction in question.

In the following cases, the tax imposed by the jurisdiction in which the Participation is resident will not be treated as having a similar nature to Corporate Tax and therefore the condition will not be satisfied:<sup>69</sup>

- The tax is applicable only to selected activities performed in the jurisdiction such as banking and insurance activities, resulting in most businesses not being within the scope of the foreign country's corporate tax regime.
- The tax paid is refunded at the time of distribution of the relevant profits or income, resulting in the profits earned by businesses in that jurisdiction not being taxed.

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<sup>68</sup> Article 6(3) of Ministerial Decision No. 116 of 2023.

<sup>69</sup> Article 6(4) of Ministerial Decision No. 116 of 2023.





- The tax is only due in the event of a distribution of profits or income. Thus, it is required that income and profits of businesses in the foreign jurisdiction are taxed as earned / accrued irrespective of when distributed.

### 5.5.2. Foreign tax rate of at least 9%

If a Participation is resident in a jurisdiction that levies a corporate tax of a similar character to the UAE, at a statutory tax rate of at least 9%, the subject to tax test is met. A recalculation of the foreign Participation's tax base to apply UAE Corporate Tax principles is not required.

However, if the statutory corporate tax rate in the foreign jurisdiction is below 9%, the subject to tax test can be met if the Participation's effective tax rate is at least 9% on any of the following alternative bases:<sup>70</sup>

- Actual effective tax rate: the actual tax paid in respect of the period divided by the profit before tax under the Accounting Standards as applied by the Participation.

#### **Example 11: Actual effective tax rate (calculated based on the rules as applied by the foreign Participation)**

Company A (a company incorporated and resident in the UAE) holds 100% of shares of Company B (a company incorporated and managed outside the UAE). Company B is resident in Country B, which levies corporate tax at the rate of 5%. In order to benefit from the Participation Exemption, Company A would need to demonstrate that the income of the Participation is subject to effective taxation of at least 9%. In respect of the current period, Company B paid total corporate tax of USD 5,500 in Country B and the entity has an accounting profit before tax of USD 50,000. Whilst the statutory tax rate for Company B is less than 9%, the effective tax rate is 11% (i.e. USD 5,500 / USD 50,000), therefore the subject to tax test is met.

- Theoretical effective tax rate: the effective tax rate if the Participation recalculated its accounting net profits on the basis required by the UAE Corporate Tax.<sup>71</sup>

#### **Example 12: Theoretical effective tax rate (calculated based on UAE rules)**

Company A (a company incorporated and resident in the UAE) holds 100% of

<sup>70</sup> Article 6(5) of Ministerial Decision No. 116 of 2023.

<sup>71</sup> Accounting net profits calculated in accordance with the Accounting Standards specified in the Ministerial Decision No. 114 of 2023.



shares of Company B (a company incorporated and managed outside the UAE). Company B is resident in Country B, which levies a statutory corporate tax at the rate of 5.5%. Company A needs to provide evidence that the income of Company B is subject to effective taxation of at least 9% according to the basis provided for in the UAE Corporate Tax Law.

For the current Tax Period, Company B paid taxes of total USD 4,000 and the entity has an accounting profit before tax of USD 50,000 according to local accounting standards, so the actual effective tax rate of 8% (i.e. USD 4,000 of USD 50,000) is below the 9% threshold.

When applying IFRS, the accounting net profit of Company B would have been USD 40,000. Thus, the theoretical effective tax rate is 10% (i.e. USD 4,000 of USD 40,000), therefore the subject to tax test is met.

- Other taxes: in case the jurisdiction in which the Participation is resident does not impose a tax that is similar to Corporate Tax, the total tax charged on income, equity or net worth, or a combination of any or all of these, divided by the accounting net profit.<sup>72</sup>

#### **Example 13: Participation taxed on net worth**

Company A (a company incorporated and resident in the UAE) holds 100% of shares of Company B (a company incorporated and managed outside the UAE). Company B is resident in Country B. Under the corporate tax regime of Country B, local companies are charged a levy at the rate of 2% on the company's net worth.

For the current Tax Period, Company B paid USD 5,000 on its net worth and has an accounting profit before tax of USD 50,000 according to local accounting standards. Thus, the effective tax rate is 10% (i.e. USD 5,000 of USD 50,000) and therefore the subject to tax test is met.

## **5.6. Exceptions to the subject to tax test**

The following exceptions mean that income from Participations which are Qualifying Free Zone Persons, Exempt Persons, holding companies and entities that elect to apply Small Business Relief are treated as satisfying the subject to tax test, even if they are not taxed, or are taxed but at a rate of less than 9%.

### **5.6.1. Qualifying Free Zone Persons and Exempt Persons**

<sup>72</sup> Article 6(6) of Ministerial Decision No. 116 of 2023.



Dividends from a Free Zone Person, as a juridical person that is a Resident Person in the UAE, would be automatically exempt, so the following is relevant in respect of Qualifying Free Zone Persons for income other than Dividends and other profit distributions.

For the purpose of the subject to tax test, a Participation that is a Qualifying Free Zone Person under Article 18 of the Corporate Tax Law, or an Exempt Person under Article 4 of the Corporate Tax Law, is deemed to satisfy the subject to tax test.<sup>73</sup>

In case a Participation ceases to be a Qualifying Free Zone Person or an Exempt Person during a Tax Period, there would be no practical impact on the subject to tax test as described in Section [5.5](#), as the Participation would then become subject to UAE Corporate Tax which would satisfy the subject to tax test.<sup>74</sup>

### 5.6.2. Holding companies

Holding companies are treated as having satisfied the subject to tax test if both of the following conditions are met:<sup>75</sup>

- The principal objective and activity of the holding company is the acquisition and holding of investments that also meet the conditions of Participating Interest.<sup>76</sup>
- The income of the holding company substantially consists of income from the Participating Interests.<sup>77</sup>

#### 5.6.2.1. Intention of holding of investments

The following conditions must be met by a holding company to be considered that its principal objective is the acquisition and holding of shares or equitable interests:<sup>78</sup>

- Be directed and managed in the relevant other country or foreign territory.<sup>79</sup> This condition should be interpreted in view of the concept of place of effective management. This is where the most senior person or group of persons (for example board of directors) make key management and commercial decisions,

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<sup>73</sup> Article 23(4) of the Corporate Tax Law.

<sup>74</sup> Article 4(5) and Article 18(2) of the Corporate Tax Law.

<sup>75</sup> Article 23(3) of the Corporate Tax Law.

<sup>76</sup> Article 23(3)(a) of the Corporate Tax Law.

<sup>77</sup> Article 23(3)(b) of the Corporate Tax Law.

<sup>78</sup> Article 7(1) of Ministerial Decision No. 116 of 2023.

<sup>79</sup> Article 7(1)(a) of the Ministerial Decision No. 116 of 2023.



the place where the actions to be taken by the entity as a whole are determined. However, all relevant facts and circumstances must be considered.

- Comply with the requirement to submit any documents, records or information to the relevant authority under the laws and regulations applicable to such Participation in the relevant other country or foreign territory.<sup>80</sup> This includes all general obligations that must be met by the Participation in the foreign country, including but not limited to regulatory, financial and tax compliance.
- Have adequate personnel and premises for the acquisition and holding of the shares or equitable interests in the relevant other country or foreign territory, having regard to the level of activity carried on by the Participation and the extent to which those activities are performed on behalf or for the benefit of the Participation by another Person in that other country or foreign territory.<sup>81</sup> Such substance requirements should include for example an adequate number of full-time employees with necessary qualifications required to perform the activities conducted by the holding company, along with incurring an adequate amount of operating expenses to generate the income received by the Participation.
- Not conduct any other activities other than those that are incidental or ancillary to the acquisition and holding of shares or equitable interests.<sup>82</sup> Such activities may include management functions provided to the subsidiary's operations, e.g. financial and risk management, corporate governance, human resources, legal and compliance, communication, and stakeholder management etc. Moreover, financing of subsidiaries (e.g. granting loans) can also be seen as ancillary to the core Business of a holding company.

#### 5.6.2.2. Income substantially consists of income from Participating Interests

The holding company's income must consist of an average of at least 50% of Dividends, capital gains and other income from investments which qualify as Participating Interests during the relevant Tax Period and the preceding Tax Period.<sup>83</sup>

The percentage of income is computed as follows:

Percentage income =  $\frac{X}{Y} * 100$  where:

X = Sum of the holding company's income from Participating Interests

Y= Total income in the relevant or the preceding Tax Period

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<sup>80</sup> Article 7(1)(b) of the Ministerial Decision No. 116 of 2023.

<sup>81</sup> Article 7(1)(c) of the Ministerial Decision No. 116 of 2023.

<sup>82</sup> Article 7(1)(d) of the Ministerial Decision No. 116 of 2023.

<sup>83</sup> Article 7(2) of Ministerial Decision No. 116 of 2023.



The percentage income is computed for the relevant Tax Period and the preceding Tax Period. If the average result of the relevant Tax Period and the preceding Tax Period is at least 50%, the condition is met.

The relevant Tax Period is the one in which the Participation Exemption would apply to a Taxable Person's income.

#### **Example 14: Exception to the subject to tax test – holding company**

Company A (a company incorporated and resident in the UAE) holds 100% of the shares of Company D (a company incorporated and managed outside the UAE and resident in a foreign country) and subject to 7% corporate tax. Company D respectively holds 100% of the shares of Companies X, Y and Z. Company D also holds 3% of the shares in Company P with an acquisition cost of less than AED 4 million. Company D provides management functions to subsidiaries and takes the strategic investment decisions. Further, Company D owns an office building and has 15 employees, including a board of directors. All strategic decisions are taken in the country of residence of Company D. All involved entities comply with the local rules.

For the purpose of the Participation Exemption, Company D will be treated as having satisfied the subject to tax test if the principal objective is the holding of Participating Interests and more than 50% of its income is from Participating Interests. Based on the facts above, it could be said that the principal objective of Company D is the holding of the Participating Interests.

Since the shares in Company P do not qualify as a Participating Interest due to the holding being below 5% and the minimum acquisition cost, its income will not be counted for the purpose of the calculation. Only Companies X, Y and Z will be considered as Participating Interests. Therefore, only income from these companies will be considered for the purpose of assessing whether the 50% threshold is met.

Description	Tax Periods		Total
	Previous	Current	
	AED in millions		
Dividend income from Companies X, Y and Z	8	3	11
Interest income received from Companies X, Y and Z	3	3	6
Dividend income from Company P	2	1	3
Interest income received from Company P	4	4	8



Total Income	18	20	38
<b>Total income from Participating Interest</b>	<b>11</b>	<b>6</b>	<b>17</b>
<b>% of income from Participating Interest</b>	<b>61%</b>	<b>30%</b>	<b>45%</b>

Therefore, Company D has only 45% income from Participating Interests. This is below the requirement of 50% and so it will not be considered as having met the subject to tax test in the current period. Thus, the Participation Exemption would not apply when Company A received, for example, Dividends from Company D.

### 5.6.3. Small Business Relief

#### 5.6.3.1. Where a Participation elects for Small Business Relief

The subject to tax test requires that the Participation is subject to:

- Corporate Tax, or
- Other tax of similar character to Corporate Tax imposed in the foreign jurisdiction in which the Participation is resident, at a rate not less than 9%.

Where the Participation is subject to UAE Corporate Tax, the effective tax rate is not relevant. As regards to a Participation in a Resident Person that elects Small Business Relief, it would satisfy the subject to tax test as it remains, in principle, subject to Corporate Tax in the UAE, albeit being treated as having not derived any Taxable Income.<sup>84</sup> Therefore, Small Business Relief would not prevent it from being a Participating Interest.

#### 5.6.3.2. Where a Taxable Person elects to the Small Business Relief

A Resident Person which had elected Small Business Relief would not need to consider the Participation Exemption in relation to income it received, as it is treated as not having derived any Taxable Income. Thus, any exemptions, including the Participation Exemption, are disregarded. This has no Corporate Tax implication as a Taxable Person would not need to rely on the Participation Exemption until they exceed the threshold for Small Business Relief (currently where Revenue does not exceed AED 3 million).<sup>85</sup>

If a Taxable Person does not elect to apply Small Business Relief or the conditions for this relief are not met, the general Corporate Tax principles apply, including the Participation Exemption.

<sup>84</sup> Article 21 of the Corporate Tax Law.

<sup>85</sup> Article 2(1) of Ministerial Decision No. 73 of 2023.





## 5.7. Entitlement to profits and liquidation proceeds test

The Corporate Tax Law requires the ownership interest in the Participation to have an entitlement to at least 5% of both the profits available for distribution, and the liquidation proceeds.<sup>86</sup>

Ownership interest for this purpose generally means the legal and beneficial ownership of the shares or other ownership interests (see Section [5.1.4](#)).

Profits available for distribution are determined by the corporate or other legislation which governs the formation or existence of the Participating Interest. This may be in either the UAE or a foreign jurisdiction. Often this will be the accumulated realised net profits based on the relevant Accounting Standards though certain profits may not be available for distribution,<sup>87</sup> such as those allocated to a non-distributable legal reserve.

Profit allocation can be determined by various factors, such as shareholder agreements, company bylaws, or specific arrangements made among the shareholders or members. These factors can allow for different profit-sharing ratios from the shareholding/ownership percentages. Irrespective of the percentage of an ownership interest, it is the actual percentage entitlement to profits available for distribution and liquidation proceeds which is relevant here.

### Example 15: Entitlement to profits and liquidation proceeds test

Company A (a company incorporated and resident in the UAE) holds 6% of the shares of Company D (a company incorporated and managed outside the UAE and resident in a foreign country). Based on a specific clause in the shareholder agreement, Company A is entitled to receive 6% of the profits available for distribution, but only 3% of the liquidation proceeds in the event Company D is liquidated.

Although Company A is entitled to receive at least 5% of the profits available for distribution, the 5% requirement to receive liquidation proceeds is not satisfied. Thus, Company A cannot benefit from the Participation Exemption when it receives income from or in relation to Company D.

<sup>86</sup> Article 23(2)(c) of the Corporate Tax Law.

<sup>87</sup> Ministerial Decision No. 114 of 2023.





## 5.8. Asset test

A Participating Interest does not qualify for the Participation Exemption if more than 50% of the Participation's direct and indirect assets consist of ownership interests or entitlements that by themselves would not qualify for the Participation Exemption regime if held directly by the Taxable Person.<sup>88</sup> This means that if more than half of the Participation's direct and indirect asset base is made up of such assets, the Participation Exemption would not apply.

This test is intended to prevent potential abuse whereby significant non-qualifying Participations are held through an intermediary entity in order to nonetheless benefit from the Participation Exemption in respect of the intermediary's income (i.e. income which would not otherwise qualify for the Participation Exemption).

The first consideration for the asset test is which direct or indirect assets meet the definition of ownership interests (see Section [5.1.1](#)) or entitlements, i.e. which assets can potentially constitute a Participation, such as equity investment assets.

Subsequently, those assets must be tested as to whether they meet the conditions of the Participation Exemption. After the qualifying ownership interests or entitlements have been identified, they must be compared with the Participation's total direct and indirect assets. If more than 50% of the assets constitute non-qualifying ownership interests, then the asset test would not be met.

For the purposes of calculating the 50% threshold, the determination can be made based on either of the following:<sup>89</sup>

- The consolidated balance sheet of the Participation and the accounting asset values (reflected book values) according to the applicable Accounting Standard of the Participation; or
- A Market Value valuation of the direct and indirect ownership interests and direct and indirect other assets of the Participation.

If a consolidated balance sheet is not readily available or is not prepared for this purpose, then the first approach cannot be followed and a Taxable Person can only consider the second approach.

In the case of the second approach, Market Value valuation, any valuation considered should not be older than 12 months.

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<sup>88</sup> Article 23(2)(d) of the Corporate Tax Law.

<sup>89</sup> Article 9(1) of Ministerial Decision No. 116 of 2023.



The asset test is a continuous test and should be met throughout the entire Tax Period in which the income from or in relation to the Participation is received.<sup>90</sup> This means that the asset test must be satisfied from the beginning of the Tax Period until the end of the Tax Period of the Taxable Person without any interruption. In situations where there is a disposal of the Participation, the asset test must be satisfied until the date of the disposal.

#### Example 16: Asset test – Consolidated balance sheet

Company A (a company incorporated and resident in the UAE) holds 10% of the shares of Company D (a company incorporated and managed outside the UAE). Company D in turn directly and indirectly holds shares in several subsidiaries. The consolidated balance sheet of Company D shows the following values (book values):

- Total assets: AED 100,000
- Investments (ownership interests): AED 60,000 consisting of:
  - qualifying ownership interest: AED 20,000
  - non-qualifying ownership interest: AED 40,000

Since less than half of the Participation's total direct and indirect assets consist of ownership interests that do not qualify for the Participation Exemption (only 40%, i.e. AED 40,000 of AED 100,000), the threshold of the asset test of the Participation Exemption is met.

#### Example 17: Asset test – Failing the condition within a Tax Period

Company B (a company incorporated and resident in the UAE) holds 10% of the shares of Company E (a company incorporated and managed outside the UAE). Company E in turn directly and indirectly holds shares in several subsidiaries. All companies have a Financial Year that is the Gregorian calendar year. Company E's consolidated balance sheet as of 31 August and 31 October shows the following values (book values) in AED:

	31 Aug	31 Oct
• Total Assets	100,000	100,000
• Investments (ownership interests) consisting of:	70,000	50,000
○ qualifying ownership interest:	10,000	30,000
○ non-qualifying ownership interest:	60,000	20,000

<sup>90</sup> Article 9(2) of Ministerial Decision No. 116 of 2023.



<b>% of direct and indirect assets consisting of non-qualifying ownership interest</b>	<b>60%</b>	<b>20%</b>
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Company E resolves to distribute a Dividend as of 31 October.

Although the asset test is met at the time of the Dividend distribution (i.e. 31 October), the test is not fulfilled for the whole Tax Period of Company B. As such, the asset test according to Article 23(2)(d) of the Corporate Tax Law is not satisfied. Thus, the Dividend is not exempt from Corporate Tax under the Participation Exemption. Assuming the non-qualifying percentage stayed below 50% until the end of the following Tax Period, the asset test could be met in that subsequent period.



## 6. Participation Exemption: Exempt Income and loss

Certain income and losses from, or in relation to, a Participating Interest are excluded from Taxable Income. These are: Dividends from a foreign Participation, gains or losses on the transfer, sale or other disposition of a Participating Interest, foreign exchange gains or losses and impairment gains or losses in relation to Participating Interest.<sup>91</sup>

### 6.1. Dividends and other profit distribution

Article 23(5)(a) of the Corporate Tax Law provides an exemption for Dividends and other profit distributions received from a foreign Participation. In this respect note that:

- For the scope of the term “Dividend and other profit distribution” and determination of Dividend income, see Section [3](#).
- The use of the term “received” indicates that the exemption is available only on actual receipt. In the case of the Accrual Basis of Accounting, this is when the income is recorded, rather than when the cash payment is received. This principle applies to the types of Dividends discussed in Section [3](#).
- Article 23(5)(a) of the Corporate Tax Law covers only Dividends and other profit distributions from a foreign Participation. A Dividend or other profit distribution received from a juridical person that is a Resident Person is excluded from Taxable Income under Article 22(1) of the Corporate Tax Law with no further conditions (see Section [3.2.2](#)).

#### **Example 18: Back-to-back Dividends**

Company A (a company incorporated and resident in the UAE) holds 100% of the shares in Company B (a company incorporated and resident in the UAE). Company B holds 100% of the shares in Company C (a company incorporated, resident and managed outside the UAE). Company C and Company B both declare Dividends.

The Dividend received by Company B from Company C is exempt under the Participation Exemption, provided all conditions of the Participation Exemption are satisfied.

The Dividend received by Company A from Company B, being a Dividend from a juridical person that is a Resident Person, is exempt with no further conditions.

<sup>91</sup> Article 23(5) of the Corporate Tax Law.



### 6.1.1. Tax deductible Dividends: Participation Exemption not available

The Participation Exemption in respect of Dividends and other profit distributions does not apply if the Participation can claim a deduction for Dividends or other profit distributions.<sup>92</sup> Thus, to the extent a Dividend or a profit distribution distributed by a Participation reduces its Taxable Income; the distribution does not benefit from the Participation Exemption in the hands of the receiving Taxable Person.

This condition is intended to prevent situations of potential double non-taxation that would arise if the Participation can claim a deduction for a Dividend or a profit distribution made to a Taxable Person, but which would have been exempt at the level of the Taxable Person benefitting from the Participation Exemption.

For the condition to be triggered, the Participation would have to have actually claimed the tax deduction for the Dividend. The Participation Exemption is not impacted if the law in the relevant foreign jurisdiction permits the Participation to claim a deduction, but the Participation does not claim the deduction.

## 6.2. Capital gains or losses

### 6.2.1. General

According to Article 23(5)(b) of the Corporate Tax Law, gains resulting from the transfer, sale or other disposition (“disposal”) of a Participating Interest, or part thereof, derived after expiry of the 12-month holding period are generally exempt from Corporate Tax. Moreover, capital losses are not deductible for Corporate Tax purposes. This ensures that realising the value of the Participating Interest by way of a sale is treated the same as a realisation by way of a Dividend and other distribution of the reserves and/or assets.

The gain or loss resulting from the disposal of the Participating Interest will be the amount recorded under the Accounting Standards applied by the Taxable Person. The calculation will typically be as follows:

Proceeds  
Less: cost of the disposal (see Section [6.2.2](#))  
Less: book value of the Participating Interest at the time of the disposal  
Equals: capital gain/loss

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<sup>92</sup> Article 23(6)(a) of the Corporate Tax Law.



### 6.2.2. Costs of the disposal

All costs directly related to the disposal are to be taken into account when calculating the capital gain or loss (see Section [7.2.1](#)).

Since the costs of disposal are included in the calculation of the gain or loss, they are not otherwise deductible for the purposes of calculating Taxable Income.<sup>93</sup>

Disposal costs which are recorded in a subsequent Tax Period to the one in which the disposal occurred are also non-deductible.

Costs incurred in a Tax Period prior to the Tax Period of a disposal present a particular challenge. The initial treatment of the costs should be determined with the knowledge available when the Tax Return is prepared. If at that time, they are not clearly linked to an intended disposal, the costs are deductible. However, if these costs (which are deducted in a previous Tax Period) are associated with an eventual disposal from which the Taxable Person earns Exempt Income in a subsequent Tax Period, an adjustment should be made to disallow an amount equal to these costs while determining the Taxable Income in the Tax Period in which the disposal takes place.

Further, expenses which are clearly linked to a disposal which was not finalised (in the sense that there is no formal commitment to a disposal, for instance because a sales contract has not been concluded), would still be derived in relation to Exempt Income and hence, the costs are non-deductible.

### 6.2.3. Deferred consideration and other changes in proceeds

A subsequent change to the proceeds of a disposal could occur for several reasons. There may be default on the part of a purchaser in relation to an instalment payment or deferred consideration which is contingent, for example, an earn-out arrangement. In theory, there is a distinction between changes which affect the original disposal and those which constitute the disposal of a separate asset. However, in practice, to the extent that the Participation Exemption applies to the original disposal, any additional gain or loss is treated as exempt from Corporate Tax. If this is recorded in the Financial Statements of a Tax Period other than that of the original disposal, there is no need to amend the Taxable Income of the original Tax Period, as the tax liability would not be altered.

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<sup>93</sup> Article 23(5)(b) and Article 28(2)(b) of the Corporate Tax Law.



#### 6.2.4. Meaning of disposal

The term “disposal” (defined as transfer, sale or other disposition) will generally mean a sale for cash consideration, but it can also comprise of other transfers or realisations of a Participating Interest that are comparable with a sale from an economic perspective.<sup>94</sup> The following are illustrative examples.

##### 6.2.4.1. Share exchange

Where a Participating Interest is transferred in exchange for shares in another entity at a valuation that is different from the book value of the Participation at the time of the disposal (for example at Market Value), a gain or loss may ordinarily arise.

##### **Example 19: Sale in exchange of shares**

Company A (a company incorporated and resident in the UAE) holds 50% of the shares of Company D (a company incorporated and resident in the UAE). The ownership interest in Company D qualifies as a Participating Interest. The book value of the shares amounts to AED 100,000, the Market Value amounts to AED 500,000. Company A agreed to transfer the shares in Company D in exchange for new shares in Company X. Company X recognises the shares in Company D at their Market Value.

The Market Value would be considered as the sale price for Company A. Thus, a capital gain arises of AED 400,000 (sale price of AED 500,000 less book value of AED 100,000) that is exempt from Corporate Tax.

It is assumed that this is not a transfer eligible for Qualifying Group relief and that Business Restructuring Relief is not available.

##### 6.2.4.2. Non-arm’s length transaction

Where a Participating Interest is wholly or partially transferred to a Related Party by way of a non-arm’s length transaction, the Taxable Income of the transferor needs to be adjusted in accordance with the rules for transactions with Related Parties to deem the sale as taking place at Market Value when determining the resulting capital gain or loss.<sup>95</sup> The Participation Exemption would equally apply to the adjusted income.

<sup>94</sup> Article 23(5)(b) of the Corporate Tax Law.

<sup>95</sup> Article 34 and Article 35 of the Corporate Tax Law.





### 6.2.4.3. Reduction or repurchase of capital

The repayment, reduction or repurchase of capital subscribed, for instance a restructuring of a company's share capital, may result in a gain in respect of the Participation (see Section [3.1.5.1](#)).

### 6.2.4.4. Distribution of a Participation as a Dividend in kind

The distribution of a Participating Interest as a Dividend in kind may result in a gain at the level of the transferring entity, i.e. Taxable Person (see Section [3.1.4](#)).

## 6.2.5. Liquidation

A Participation is considered as liquidated if it ceases to have a legal existence.<sup>96</sup> For a company this could mean its formal closure as evidenced by its removal from the relevant register of companies.

Gains in respect of the liquidation of a Participating Interest are exempt from Corporate Tax. As an exception to the general rule, losses realised on the liquidation of a Participating Interest are not exempt, but rather they are deductible from Taxable Income.<sup>97</sup>

The gain or loss from a liquidation is computed as the difference between the acquisition cost of the Participation for Corporate Tax purposes (which will include any related capitalised costs or fees – see Section [7.2](#)) and the fair value of the liquidation proceeds received by the Taxable Person.<sup>98</sup> All liquidation proceeds (even to the extent they may represent accumulated net profit of the entity which is being liquidated) received by the Taxable Person will be considered as capital distributions and not Dividends or other profit distributions, and accordingly will be included in the calculation of the gain or loss from liquidation. Insofar as any part disposals of the Participation have taken place, the aggregated historical acquisition costs are to be reduced in proportion to the average acquisition cost attributable to the part of the ownership interest that is disposed of.<sup>99</sup>

Any of the following items taken into account in the Tax Period in which the liquidation took place and the previous Tax Period must be reversed by the Taxable Person when determining the liquidation loss:<sup>100</sup>

<sup>96</sup> Article 12(1) of Ministerial Decision No. 116 of 2023.

<sup>97</sup> Article 23(8) of the Corporate Tax Law.

<sup>98</sup> Article 12(2) of Ministerial Decision No. 116 of 2023.

<sup>99</sup> Article 8(5) of Ministerial Decision No. 116 of 2023.

<sup>100</sup> Article 12(4) of Ministerial Decision No. 116 of 2023.



- Tax Losses transferred from the Participation to the Taxable Person.
- Exempt Dividends or other profit distributions received by the Taxable Person from the Participation.
- Income or gains on the transfer of assets or liabilities between the Taxable Person and the Participation which benefited from relief for transfers within a Qualifying Group or Business Restructuring Relief.

### Example 20: Liquidation loss

Company A holds 100% of the shares of Company D, both are resident and incorporated in the UAE. The acquisition cost of the Participating Interest in Company D is AED 50,000, and the Market Value of Company D's net assets is AED 10,000.

During the Tax Period ending 31 December 2024, Company D paid a Dividend of AED 10,000 to Company A. In addition to this, Company D transferred Tax Losses of AED 20,000 to Company A, who deducted this from their Taxable Income.

On 15 June 2025, Company A resolves to liquidate Company D. It is removed from the commercial register on 30 June 2025, and ceases to have legal existence. Legal fees incurred in relation to the liquidation are AED 5,000.

In the course of the liquidation, all assets will be transferred to Company A at their Market Values for tax purposes (no application of reliefs). The liquidation loss is calculated as follows:

- Acquisition cost of the Participating Interest in Company D: AED 50,000
- Less: liquidation proceeds received by Company A (Market Value of the net assets of Company D less liquidation costs borne by Company D): AED 10,000 - AED 5,000 = AED 5,000
- Equals: liquidation loss of AED 45,000

The liquidation loss that can be deducted from Taxable Income, however, must be adjusted for the following items:

- Exempt Dividend received in 2024 (i.e. preceding Tax Period): AED 10,000
- Transferred Tax Losses received in 2024: AED 20,000

Thus, the liquidation loss (after adjustment) amounts to AED 15,000 (i.e. AED 45,000 - AED 10,000 - AED 20,000).



### **6.2.6. Interaction with other reliefs: transfers within a Qualifying Group and Business Restructuring Relief**

Where other reliefs are claimed, specifically for a transfer within a Qualifying Group or Business Restructuring Relief, no gain or loss is taken into account in relation to the disposal of a Participating Interest when calculating the Taxable Income of the transferring entity. In principle, the Participation Exemption would take priority over these reliefs as it is an automatic exemption. However, where other elected reliefs have a different tax treatment, such as no gain or loss treatment (i.e. rather than exemption), the other tax treatment will prevail.

However, in scenarios where a Participating Interest is disposed of within two years after that Participating Interest was acquired as a result of a transaction that benefited from the relief transfers within a Qualifying Group or Business Restructuring Relief, the Participation Exemption shall not apply.<sup>101</sup>

### **6.2.7. Interaction with the Tax Group**

Where a member of a Tax Group receives income from the disposal of a Participating Interest that is a member of the same Tax Group, the application of the Participation Exemption is not required since those transactions will generally be eliminated when the Parent Company prepares its consolidated Financial Statements for Corporate Tax purposes.

However, in scenarios where the Participating Interest has been transferred between the members of a Tax Group and either the transferor or transferee leaves the Tax Group within two years from the date of the disposal, a possible gain or loss from the disposal needs to be taken into account when determining the Taxable Income of the Tax Group unless the income would have been exempt from Corporate Tax under the Participation Exemption or other reliefs (either transfers within a Qualifying Group or Business Restructuring Relief, see Section [5.3.4](#)).<sup>102</sup>

Where a member of a Tax Group disposes of a Participating Interest in an entity that is not a member of the Tax Group, the Participation Exemption may be available (for further details see Section [8](#)).

## **6.3. Foreign exchange gains or losses in relation to Participating Interest**

Article 23(5)(c) of the Corporate Tax Law states that foreign exchange gains in relation to a Participating Interest are exempt, and likewise foreign exchange losses are not

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<sup>101</sup> Article 23(9) of the Corporate Tax Law.

<sup>102</sup> Article 42(9) of the Corporate Tax Law.



deductible. The use of the phrase “in relation to” a Participating Interest means that the foreign exchange gain or loss must arise from, or by reason of, or in connection with the Participation Interest. The following discusses foreign exchange gains or losses which can be considered to arise “in relation to” a Participating Interest.

### **6.3.1. Increase or decrease in value of Participating Interest due to exchange rate fluctuation**

A foreign exchange gain or loss can be realised or unrealised.

A gain or loss realised on the value of a Participating Interest (for example on sale of Participating Interest) will be “in relation to” the Participating Interest and hence excluded from Taxable Income under Article 23(5)(c) of the Corporate Tax Law.

#### **Example 21: Currency fluctuation between date of sale of Participating Interest and receipt of foreign currency (realised gain)**

Company A (a company incorporated and resident in the UAE) sold shares held in Company F (a company incorporated and managed outside the UAE) which qualified for the Participation Exemption. The sale price was fixed at GBP 10,000. At that time, the value of GBP 1 was equal to AED 4.5, so Company A recorded sale proceeds of AED 45,000 in its Financial Statements. The sale consideration was only received after 2 months. At the time of receipt, the value of GBP 1 was AED 5, meaning Company A received the equivalent of AED 50,000. The additional gain of AED 5,000 is attributable solely to foreign currency fluctuation and is, therefore, exempt from Corporate Tax under the Participation Exemption.

Unrealised foreign exchange gains or losses may arise where a change in the value of an asset due to currency fluctuation is recorded in the Taxable Person’s Financial Statements, but no transaction to realise a gain or loss has yet taken place. Taxable Persons, who prepare their Financial Statements on an accrual basis, may elect to take into account gains and losses on a realisation basis.<sup>103</sup> The election can either be made so that all unrealised accounting gains and losses are not taken into account,<sup>104</sup> or only unrealised gains and losses in relation to those assets and liabilities held on the Taxable Person’s capital account.<sup>105</sup> In either scenario, unrealised gains and losses may include unrealised foreign exchange gains and losses.<sup>106</sup>

<sup>103</sup> Article 20(3) of the Corporate Tax Law.

<sup>104</sup> Article 20(3)(a) of the Corporate Tax Law.

<sup>105</sup> Article 20(3)(b) of the Corporate Tax Law.

<sup>106</sup> Article 20(4)(d) of the Corporate Tax Law.



If the Taxable Person has elected to include gains and losses only on a realisation basis, unrealised foreign exchange gains and losses on the value of a Participating Interest will be excluded from Taxable Income under Article 20(2)(a) of the Corporate Tax Law. Accordingly, there is no need for the Participation Exemption to apply. However, if the Taxable Person does not elect to include gains and losses on a realisation basis, unrealised foreign exchange gains and losses on the value of a Participating Interest will be excluded from Taxable Income under the Participation Exemption where the conditions are met.<sup>107</sup>

#### **Example 22: Revaluation of Participating Interest (unrealised gain)**

Company A (a company incorporated and resident in the UAE) acquired shares in Company F (a company incorporated and managed outside the UAE which is a Participation Interest) for GBP 1,000. At the time of purchase, the value of GBP 1 was equal to AED 4.5, and so Company A recorded the shares at AED 4,500 in its Financial Statements.

At the end of the following year Company A revalued Company F's shares in its Financial Statements to their market price. At that time, the market price of Company F shares has increased to GBP 2,000, and the value of GBP 1 is AED 5. Accordingly, in Company A's Financial Statements, the value of the Participating Interest in Company F is increased from AED 4,500 to AED 10,000. Out of total revaluation gain of AED 5,500, a gain of AED 1,000 is attributable solely to foreign currency fluctuations which is exempt from Corporate Tax under the Participation Exemption.

### **6.4. Impairment gains or losses**

Article 23(5)(d) of the Corporate Tax Law provides for impairment gains or losses in relation to a Participating Interest to be exempt from Corporate Tax.

#### **6.4.1. Deductible impairment loss restricts the availability of the Participation Exemption**

Article 23(6)(b) of the Corporate Tax Law provides that the Participation Exemption does not apply if the Taxable Person has recognised a deductible impairment loss in respect of the Participating Interest prior to that Participating Interest meeting the other conditions of the Participation Exemption regime.

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<sup>107</sup> Article 23(5)(c) of the Corporate Tax Law.



This will apply to reversals of partial impairments on the Participating Interest. It is also applicable in respect of any other income type covered by the Participation Exemption including Dividends and capital gains in respect of a Participating Interest.<sup>108</sup>

Generally, any income or gain resulting from the reversal of impairments in respect of a Participating Interest would also fall under the Participation Exemption and, therefore, be treated as exempt from Corporate Tax. However, if an impairment loss recognised in relation to a Participating Interest was deductible from Taxable Income (i.e. prior to the ownership interest becoming a qualifying Participating Interest, as otherwise it would not have been deductible), Article 23(6)(b) of the Corporate Tax Law provides that any subsequent income that would otherwise be exempt under the Participation Exemption is not exempt, up to the amount of the impairment loss that was treated as deductible for Corporate Tax.

Article 23(6)(b) of the Corporate Tax Law applies to juridical persons that are Resident Persons as well as Non-Resident Persons.

#### **Example 23: Capital gain and impairment loss in relation to a Participating Interest**

Company A holds 100% of the shares of Company D (acquisition cost AED 100,000), both are incorporated and resident in the UAE. Company A performs a write-down on the shares of Company D in the amount of AED 70,000. At this time Company D does not qualify as a Participating Interest and Company A treats the impairment loss as deductible for Corporate Tax purposes.

In the following year, the shares of Company D are sold for AED 120,000. By this time Company D qualifies as a Participating Interest. The capital gain resulting from the disposal of the shares of Company D of AED 90,000 (AED 120,000 – AED 30,000) is treated as follows:

- AED 70,000 is not exempt from Corporate Tax due to the impairment loss being treated as deductible.
- The remaining gain of AED 20,000 is exempt from Corporate Tax under the Participation Exemption.

In circumstances where a Taxable Person has made both deductible impairment losses and non-deductible impairment losses, the question arises as to how the impairment losses are matched with any income which might be covered by the Participation Exemption. The wording of Article 23(6) of the Corporate Tax Law is clear that the Participation Exemption does not apply “insofar as” there has been a

<sup>108</sup> Article 23(5) of the Corporate Tax Law.





deductible impairment loss in respect of the Participating Interest. This means that all deductible impairment losses must be matched with the relevant income/gain in priority to any non-deductible impairment losses.

#### **Example 24: Deductible and non-deductible impairment loss**

Company A owns shares in Company D, both are incorporated and resident in the UAE. Company A records an impairment loss of AED 30,000 (tax deductible) and subsequently an impairment loss of AED 10,000 (not tax deductible) in respect of Company D. Company A later sells the shares of Company D realising a capital gain of AED 50,000. At the time of disposal Company D meets the conditions to be Participating Interest. The gain is treated as follows:

- The first AED 30,000 of the capital gain cannot benefit from the Participation Exemption due to the tax-deductible impairment loss, and so is subject to Corporate Tax;
- The remaining capital gain of AED 20,000 can benefit from the Participation Exemption.

#### **6.4.2. Impairment loss on loan receivable from a Participation**

Article 23(6)(c) of the Corporate Tax Law provides that the Participation Exemption does not apply if the Taxable Person or its Related Party has recognised a deductible impairment loss in respect of a loan receivable from a juridical person in which the Taxable Person or a Related Party of the Taxable Person holds a Participating Interest.

The concept of this clause is similar to impairment losses in respect of Participations according to Article 23(6)(b) of the Corporate Tax Law (see Section [6.4.1](#)). Any income in relation to the Participation is not exempt from Corporate Tax to the extent that an impairment loss has been deducted for a loan receivable. An example of an impairment loss would be a write-off of a loan receivable, for example, as part of a restructuring measure.

#### **Example 25: Impairment on loan receivable and subsequent reversal**

Company A (a company incorporated and resident in the UAE) holds 100% of the shares in Company F (a company incorporated and managed outside the UAE) and grants a loan to Company F of AED 100,000. Subsequently, due to the financial distress of Company F, Company A makes a 50% provision against the loan in the current year and treats this impairment loss of AED 50,000 as tax deductible.





In the following year, Company A receives a Dividend from Company F of AED 20,000. Due to the recognition of a tax-deductible impairment loss of AED 50,000 in the previous year, the Dividend is not treated as exempt from Corporate Tax and thus is fully taxable.

Due to an improvement in the financial situation of Company F one year later, Company A fully reverses its provision against the loan and recognises a gain of AED 50,000.

The gain resulting from the reversal is treated as Exempt Income to the extent the Dividend income in the previous year has been treated as subject to Corporate Tax due to the non-application of the Participation Exemption in relation to the initial loan impairment. Hence, AED 20,000 of the reversal gain will be Exempt Income and accordingly, the remaining AED 30,000 will be taxable.

#### **6.4.3. Reversal of impairment loss which has restricted the availability of the Participation Exemption**

A reversal of an impairment loss is exempt from Corporate Tax to the extent that the Participation Exemption was not applied to income from a Participating Interest due to a previously deducted impairment loss or impairment losses.<sup>109</sup>

#### **6.5. Interplay between Participation Exemption and Foreign Permanent Establishment Exemption**

Where a Resident Person has a Foreign Permanent Establishment, the Resident Person can make an election to not take into account the income or loss and associated expenditure of its Foreign Permanent Establishment in determining its Taxable Income.<sup>110</sup>

If a Resident Person has elected for the Foreign Permanent Establishment Exemption, then it becomes theoretical whether the Participation Exemption is available in respect of income from a Participating Interest attributable to a Foreign Permanent Establishment. In such instances, the income and associated expenditures of the Foreign Permanent Establishment shall not be taken into account in the calculation of the Taxable Income of the Resident Person. On the other hand, if a Resident Person has not elected for the Foreign Permanent Establishment Exemption, income from a Participation which is attributable to a Foreign Permanent Establishment can benefit from the Participation Exemption if the conditions are satisfied.

<sup>109</sup> Article 23(7) of the Corporate Tax Law.

<sup>110</sup> Article 24(1) of the Corporate Tax Law.



### 6.5.1. Impact of Foreign Permanent Establishment Tax Losses

If a Taxable Person has utilised a Tax Loss arising in a Foreign Permanent Establishment and not subsequently included in its Taxable Income the same amount of profit from the Foreign Permanent Establishment, any income arising upon incorporation of the Foreign Permanent Establishment subsequently cannot benefit from the Participation Exemption. This ceases to be the case once profit from the Foreign Permanent Establishment equal to the Tax Loss used by the Taxable Person has been included in the Taxable Person's Taxable Income.<sup>111</sup>

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<sup>111</sup> Article 13 of Ministerial Decision No. 116 of 2023.



## 7. Expenditure related to Exempt Income

Expenditure related to Exempt Income cannot be taken into account in determining Taxable Income.<sup>112</sup> In other words, such expenditure is non-deductible for Corporate Tax purposes, which is symmetrical with the non-taxability of the Exempt Income. Accordingly, expenditure (other than Interest expense<sup>113</sup>) incurred in relation to income which benefits from the Participation Exemption is not deductible.

### 7.1. Related expenditure

The use of the term “related expenditure” in Article 22 of the Corporate Tax Law indicates that the expense must be in connection with Exempt Income. There should be a clear and direct nexus or connection which can be established between the expense and the Exempt Income. Expenditure which is unrelated to Exempt Income or has a remote or indirect connection with Exempt Income is not subject to disallowance.

In some instances, a Taxable Person incurs a common expense for more than one purpose, i.e. incurred for the purpose of earning both Exempt Income and non-Exempt (i.e. Taxable) Income. The tax treatment of such common expense will be as follows:

- Any part or proportion of a common expense that can be clearly identified as being incurred wholly and exclusively to derive Taxable Income is deductible;<sup>114</sup>
- Any part or proportion of a common expense that can be clearly identified as being incurred wholly and exclusively to derive Exempt Income is non-deductible;
- Any remaining unidentifiable balance of a common expense shall be apportioned between Taxable Income and Exempt Income on a fair and reasonable basis, having regard to the relevant facts and circumstances of the Taxable Person’s Business.<sup>115</sup>

#### **Example 26: Common expense incurred towards Exempt Income and Taxable Income**

Mr A, as part of his Business, paid fees of AED 1,000 to a financial consultant for investment related consultancy. Mr A purchased shares of Company B (a company incorporated and resident in the UAE) for AED 8,000 and debentures of Company C (a company incorporated and managed outside the UAE) for AED 2,000. The

<sup>112</sup> Article 22 and Article 28(2)(b) of the Corporate Tax Law.

<sup>113</sup> Articles 29, 30 and 31 of the Corporate Tax Law.

<sup>114</sup> Article 28(3)(a) of the Corporate Tax Law.

<sup>115</sup> Article 28(3)(b) of the Corporate Tax Law.



Dividend income from Company B is exempt but the Interest income from the debenture is taxable. Based on the proportionate cost of the investments:

- 20% of the consultant's fees are deductible: AED 2,000 / (AED 8,000 + AED 2,000); and
- 80% of the consultant's fees are non-deductible: AED 8,000 / (AED 8,000 + AED 2,000).

## 7.2. Expenditure in relation to a Participating Interest

### 7.2.1. Expenditure in relation to acquisition and disposal of a Participating Interest

Expenditure incurred in relation to the acquisition, sale, transfer, or disposal of an entire Participating Interest, or part of a Participating Interest, is not tax deductible (with the exception of Interest expense).<sup>116</sup> Instead, such costs should be capitalised as part of the cost of the Participating Interest.<sup>117</sup> Capitalisation of the expense is required for Corporate Tax purposes regardless of whether such expenses are capitalised in the Financial Statements.

Examples of relevant expenses include, but are not limited to, professional fees, due diligence costs, litigation costs, commissions and brokerage fees, stamp duty, registration duties and other irrecoverable taxes, appraisal and valuation costs, and refinancing costs.<sup>118</sup>

### 7.2.2. Expenditure in relation to a failed acquisition of a Participating Interest

Sometimes expenses are incurred with the intention of acquiring a Participating Interest but ultimately the acquisition is not completed. In such a case, since the Participating Interest is not acquired, the expense cannot be said to relate to a Participating Interest. Where the expense is incurred wholly and exclusively for the purposes of a Taxable Person's Business, the expense may be deductible.<sup>119</sup>

#### **Example 27: Expenditure in relation to a failed acquisition of shares**

Company A (a company incorporated and resident in the UAE) wants to invest in shares of Company F (a company incorporated and managed outside the UAE) as

<sup>116</sup> Article 10(1) and Article 10(3) of Ministerial Decision No. 116 of 2023.

<sup>117</sup> Article 10(4) of Ministerial Decision No. 116 of 2023.

<sup>118</sup> Article 10(2) of Ministerial Decision No. 116 of 2023.

<sup>119</sup> Article 28(1) of the Corporate Tax Law.



a long-term strategic investor. In this regard, Company A pays professional fees to carry out due diligence before investing in Company F. Based on the due diligence report, Company A decides not to invest. In this case, the professional fees expense will be taken into account while determining Taxable Income and will be deductible if it is a Business expense and it is not capital in nature.

### 7.2.3. Other expenditure in relation to a Participating Interest

Other than expenses related to the acquisition and disposal of a Participating Interest, there could be expenses incurred, for example, to manage and administer a Participating Interest. Such expenses which have a direct connection with Exempt Income will not be taken into account in determining Taxable Income, i.e. no deduction is allowed.<sup>120</sup>

### 7.3. Expenditure in relation to short-term investment in a juridical person that is a Resident Person

Dividend income received from a juridical person that is a Resident Person is exempt with no further conditions.<sup>121</sup> However, other income, for example capital gains or losses on the disposal of a Participation Interest in a juridical person that is a Resident Person, is exempt subject to the conditions of the Participation Exemption. In other words, Dividends received from a juridical person that is a Resident Person are exempt, even if the holding in that Person does not qualify as a Participating Interest.

Irrespective of the accounting treatment adopted (i.e. whether or not fees, etc. associated with the acquisition are capitalised, for instance because the asset is held on the trading account for short term buying and selling of securities rather than as a long-term investment), a question can arise as to how much of the expense incurred in acquiring shares of a juridical person that is a Resident Person (which does not qualify as Participating Interest) is non-deductible. This is because the expense can relate partially to Exempt Income and partially to Taxable Income. A Dividend from a juridical person that is a Resident Person is always Exempt Income, but capital gains may be Taxable Income if the conditions of the Participation Exemption are not met.

Accordingly, the expenses related to the acquisition of shares of a juridical person that is a Resident Person may be considered as common expenses towards earning Exempt Income and Taxable Income. As discussed in Section [7.1](#), the share of expenses relating to Exempt Income, as apportioned on a fair and reasonable basis, will be non-deductible.

<sup>120</sup> Article 22 and Article 28(3)(b) of the Corporate Tax Law.

<sup>121</sup> Article 22(1) of the Corporate Tax Law.



#### 7.4. Interest expense

Interest paid in relation to Exempt Income, such as that which benefits from the Participation Exemption, is prima facie deductible unlike other expenditure incurred in deriving Exempt Income.<sup>122</sup> However, the amount of Interest deductible is also subject to the General Interest Deduction Limitation Rule provided in Article 30 of the Corporate Tax Law. Broadly, this limits Net Interest Expenditure to 30% of the Taxable Person's accounting earnings before the deduction of Interest, tax, depreciation and amortisation ("EBITDA"), excluding any income that is exempt under the Participation Exemption and other types of Exempt Income. In addition, regardless of whether the Participation Exemption applies, Interest expenditure may not be deductible on a Related Party loan which relates to amongst other things a Dividend from a Related Party.<sup>123</sup>

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<sup>122</sup> Article 29 of the Corporate Tax Law.

<sup>123</sup> Article 31(1) of the Corporate Tax Law.



## 8. Tax Groups

Where the conditions of Article 40 of the Corporate Tax Law are met, a Taxable Person (referred to as “Parent Company”) can make an application to form a Tax Group with one or more Resident Persons (referred to as “Subsidiary”) and, therefore, be treated as a single Taxable Person.<sup>124</sup>

### 8.1. Income from a Participating Interest within a Tax Group

Since all members of a Tax Group are treated as a single Taxable Person, any transactions between members of a Tax Group need to be eliminated when determining its Taxable Income.<sup>125</sup> In this context, a Parent Company is required to consolidate the financial results, assets and liabilities of each Subsidiary and prepare consolidated Financial Statements.<sup>126</sup>

As a result, any income from a Participating Interest in the same Tax Group (for example, Dividend income) will be disregarded when the Parent Company prepares consolidated Financial Statements. Thus, the Participation Exemption is not required or relevant in relation to Dividends or other profit distributions from Subsidiaries within a Tax Group to the extent it is received by a member of the same Tax Group.

### 8.2. Income from a Participating Interest outside a Tax Group

Where a member of a Tax Group receives income from a Participating Interest that is not a member of the Tax Group, the Participation Exemption may be available.

Hence, when determining the consolidated Taxable Income of the Tax Group (after eliminating intra-group transactions), an adjustment should be made for any remaining income and losses which are exempt, including related expenses.

Since a Tax Group is treated as a single Taxable Person, for the application of the Participation Exemption, each condition of Article 23 of the Corporate Tax Law must be applied in relation to the entire Tax Group and its members, that is to say on an aggregated basis. This is in line with Article 42(1) of the Corporate Tax Law, which requires the Taxable Income of a Tax Group to be determined by consolidating the financial results, assets and liabilities of its members.

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<sup>124</sup> Article 40(1) of the Corporate Tax Law.

<sup>125</sup> Article 40(4) of the Corporate Tax Law.

<sup>126</sup> Article 42(1) and Article 42(11) of the Corporate Tax Law.





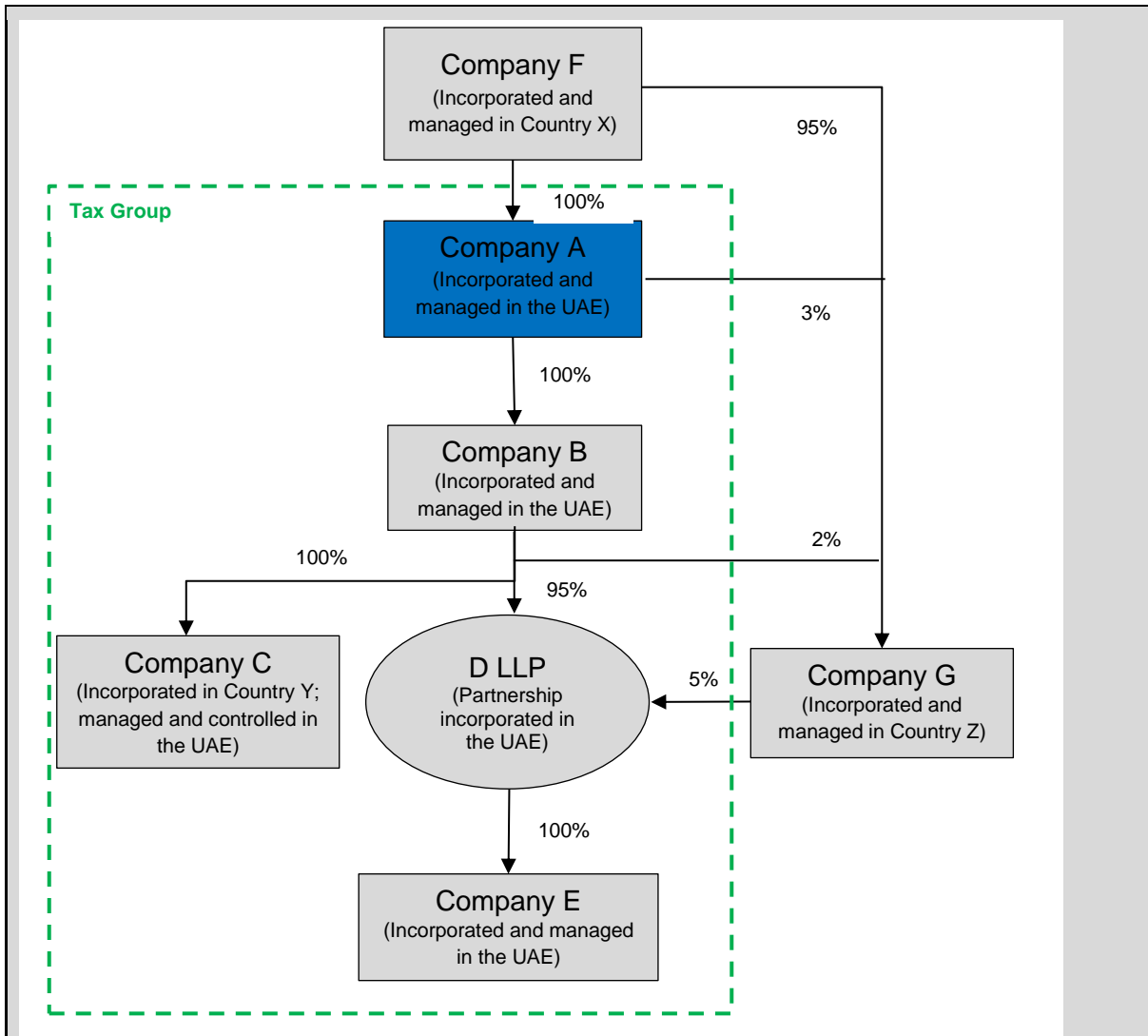
### Example 28: Dividend from a Participating Interest outside the Tax Group

A Multinational Group has the following entities:

Entity name	Place of incorporation/formation	Place of effective management and control	Whether UAE Resident Person under Article 11	Whether member of the Tax Group under Article 40
Company F	Country X	Country X	No	No (not a UAE resident)
Company A	UAE	UAE	Yes	Yes
Company B	UAE	UAE	Yes	Yes
Company C	Country Y	UAE	Yes	Yes
D LLP (incorporated partnership)	UAE	UAE	Yes	Yes
Company E	UAE	UAE	Yes	Yes
Company G	Country Z	Country Z	No	No (not a UAE resident)

Provided the relevant conditions are met, Company A (Parent Company) can make an application to form a Tax Group with Company B, Company C, D LLP and Company E (Subsidiaries).

The group structure is as follows:



- Company A acquired 3% of the shares of Company G on 1 June 2024
- Company B acquired 2% of the shares of Company G on 1 December 2024
- Company G paid a Dividend on 1 July 2025

Company A and Company B do not individually satisfy the 5% minimum ownership test in respect of Company G. However, the Tax Group is the Taxable Person in this case, and it satisfies the 5% minimum ownership test considering the aggregation of the ownership interests held by Company A (3%) and Company B (2%). The minimum holding period could be satisfied if the intention is to hold the aggregate 5% for 12 months, i.e. until at least 1 December 2025.

Assuming the other conditions of Article 23 of the Corporate Tax Law are met, the Dividend paid by Company G to Company A and Company B is excluded from the Taxable Income of the Tax Group by virtue of the Participation Exemption.



Absent the Tax Group, Company A and Company B would still be able to meet the minimum ownership requirement if both chose to be members of the same Qualifying Group. In this case their respective ownership interests shall be aggregated.<sup>127</sup> Hence, the Dividend paid by Company G will still be exempt by virtue of the Participation Exemption.

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<sup>127</sup> Article 3(1)(b) of Ministerial Decision No. 116 of 2023.



## 9. Updates and Amendments

Date of amendment	Amendments made
October 2023	<ul style="list-style-type: none"><li>• First version</li></ul>