CORPORATE TAX AND REAL ESTATE PROFITS

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Dr Peter Wilson is an international taxation adviser with more than 43 years of experience. He has a PhD in international tax law, qualified as a chartered accountant In Australia and the United Kingdom, has two master's degrees in tax and is legally qualified. He is also the UAE Ministry of Economy's (via the ACCA) subject matter expert on the UAE's corporation tax laws and teaches UAE real estate taxation via the Innovation Experts Real Estate Institute as Faculty Member.

Dr Peter has advised companies (public and private), individuals, partnerships, pension funds and governments on domestic taxation, international tax law and associated planning and compliance, firstly from a base in Sydney, Australia, then London, New York and now in Dubai. He was a senior international tax partner of a Big four firm in Sydney, London and New York, followed by a second Big four firm in London also as a senior international tax partner. Perhaps the only person in the world to be a partner of three different country firms of the same network.

He focusses on real estate, manufacturing, food and beverage, distribution, finance, regulated businesses, intangibles and his areas of expertise include FATCA, CRS and ESR reporting obligations for corporate service providers, financial institutions, investment managers, and administrators.

Dr Wilson advises clients on tax risk mitigation and the potential applicability of anti-avoidance rules to transactions and structuring. He assists in defending domestic and cross-border tax disputes and in subsequent litigation before Tribunals and Courts. He also advises family lawyers on the taxation consequences of disputed family investment entities, including in contested divorces.

Dr Wilson's practice includes the taxation considerations (including indirect and miscellaneous taxes) on mergers and acquisitions, including demergers, splits and divisions; cross-border financial transactions, both third party and intra-group; post-acquisition subsidiary and asset restructures; acquisition due diligence; individual and corporate re-domiciliation; cross border services, intellectual property and profits; transfer pricing and international taxation conventions both bilateral and multilateral.

For further Information on Dr Peter Wilson please use this QR code.

CONTENTS

WHAT IS MY PRESENTATION GOING TO COVER :

- With corporation tax in the UAE very new, and since the rules covering real estate rentals and gains are complex, my presentation's objective is to shed light on the likely taxation consequences on rentals and gains if earned in different structures.

- We start with natural persons and finish with real estate investment trusts.

NATURAL PERSONS AND INVESTMENT

- **Core Rule:**

Real Estate Investment Activities if neither a Business nor a Business Activity conducted by a resident or non-resident natural person, are not subject to corporation tax, regardless of the Turnover amount derived from those Investment activities.
- A UAE resident: A natural person UAE tax resident is not subject to corporation tax on UAE property rental income nor on gains if the holding of properties is not a business nor a business activity.

- UAE non-resident: The taxation outcome does not change if the natural person is not a UAE tax resident.

- **Business or Business Activity:**

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

A Business Activity is any transaction or activity, or series of transactions or series of activities conducted by a Person in the course of the Business.

- **Real Estate Investment Activity:**

Any investment activity is a Real Estate Investment Activity if conducted by a natural person related to, directly or indirectly, the sale, leasing, sub-leasing, and or renting of land or real estate property in the UAE that is not conducted nor requires to be conducted through a Licence from a Licensing Authority.

- **Corporation tax registration**

A natural person conducting a Real Estate Investment Activity is not required to register for corporate income tax.

NATURAL PERSONS AND BUSINESS OR BUSINESS ACTIVITY

The corporation tax outcome changes if the natural person is conducting a Business or a Business Activity

- **Core Rule:**

Any activity that is not an investment activity conducted by a natural person related to, directly or indirectly, the sale, leasing, sub-leasing, and renting of land or real estate property in the UAE or any activity that is conducted or requires to be conducted through a Licence from a Licensing Authority will not be an investment activity.

It follows that the natural person conducting an activity which is not a Real Estate Investment Activity, whether that person is a UAE tax resident or not a UAE tax resident, must register for corporate income tax and pay corporate income tax on the taxable profits.

- **Turnover test:**

Businesses or Business Activities, conducted by a resident or non-resident natural person, are subject to corporation tax only where the total Turnover derived from those Businesses or Business Activities exceeds AED1,000,000 within a Gregorian calendar year.

- **Taxable Real Estate**:

Real estate turnover exceeding AED1,000,000 will be taxable if the natural person has, or is required to have a license to conduct the activity or if a license is not required, but the activity is a Business or is a Business Activity.

- **How to determine whether the Activity is a Business or a Business activity:**

The FTA has written into the Corporation income tax Guide that 'Business is defined as any economic activity, whether continuous or for a set period of time, conducted by any Person.' It is implied that the activity will be conducted with the intention of generating profits, if a system and organization exists for the activity conducted. The FTA has confirmed that to be a Business or Business Activity, the activity does not necessarily need to generate a profit.

- **Potentially at-risk fact Real Estate fact patterns**

-Turnover exceeding AED1,000,000.

-Ownership of multiple properties, with most of the properties being held for short term.

-Property flipping.

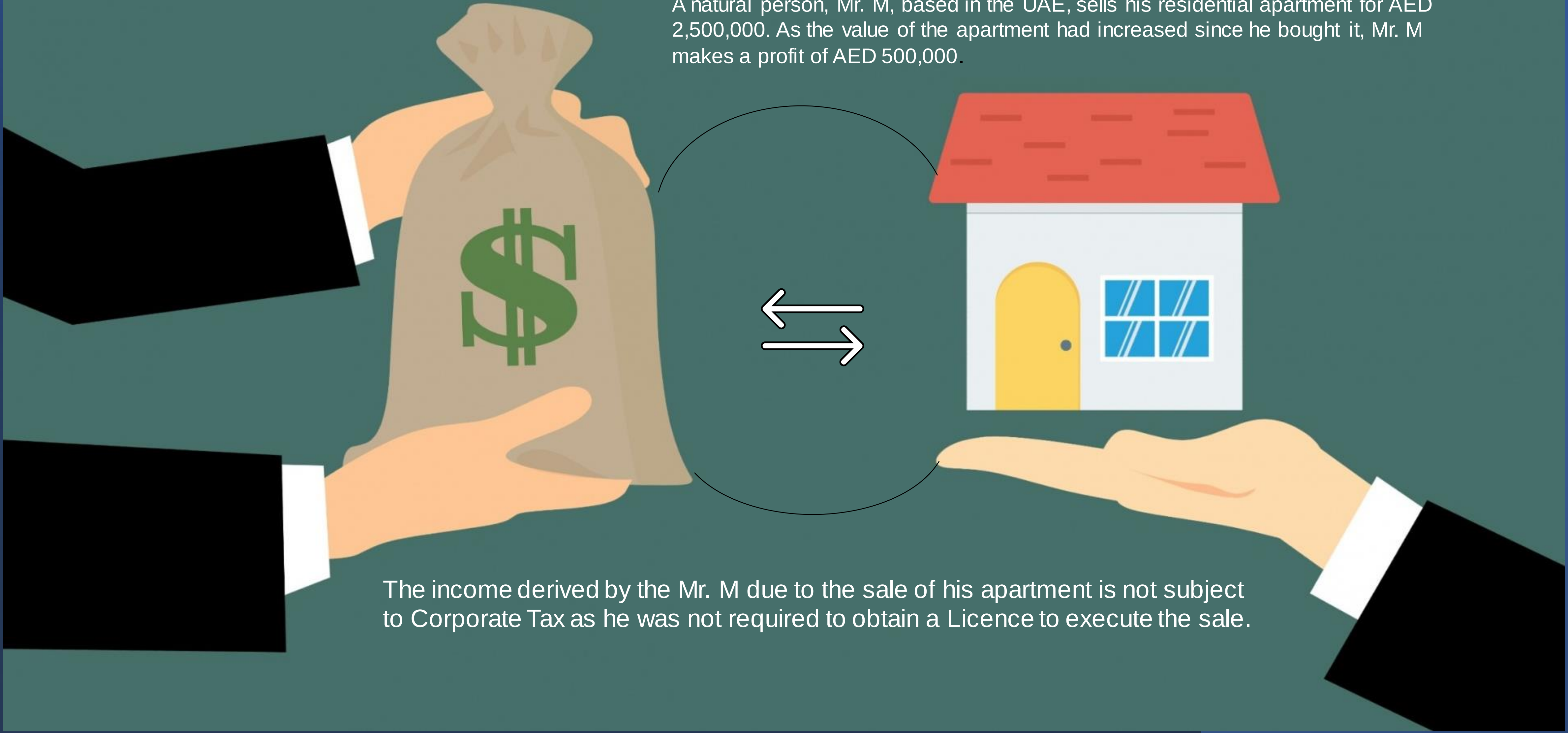
-Purchase, renovation, and resale of multiple properties.

-Having an established infrastructure such as an office, personnel, and third-party financial leverage, perhaps at a ratio greater than one part debt and one part equity.

-Having a Plan such as that of purchasing a property portfolio to renovate and then sell to a third party or to an investment trust using more than 50% third-party finance.

EXAMPLE NO -14

A natural person, Mr. M, based in the UAE, sells his residential apartment for AED 2,500,000. As the value of the apartment had increased since he bought it, Mr. M makes a profit of AED 500,000.

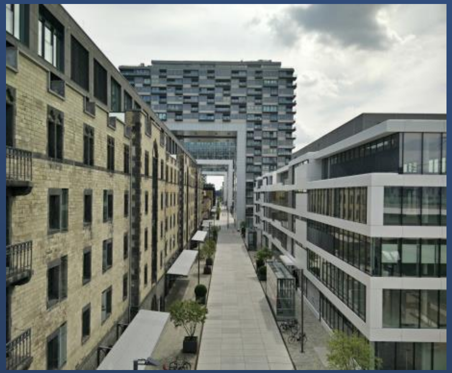


The income derived by the Mr. M due to the sale of his apartment is not subject to Corporate Tax as he was not required to obtain a Licence to execute the sale.

EXAMPLE- 15

UAE

A natural person, Mrs. N, based in the UAE, owns several properties located in the UAE and rents them for AED 1,200,000 per calendar year.



As long as that activity is not required to be conducted through a Licence from a Licensing Authority, the income derived by Mrs. N is not subject to Corporate Tax. This is because the activity is Real Estate Investment and not a Business

In this slide we consider how a property company's taxation position is determined.

- **Core Rule:**

If a UAE mainland company owns UAE immovable property, then the net rentals and gains are liable to 9% corporate income tax to the extent the taxable profits exceed AED375,000, subject to Small Business Relief not being applicable.

A Free Zone company's net rentals and gains from Commercial Property will be taxed at 0% providing the immoveable property is (a) situated in a Free Zone, (b) rented to another Free Zone company, (c) is not used for residential purposes PLUS the company satisfies the myriad of other tests including (a) having substance in a Free Zone, (b) all the pricing satisfying the arm's length standard, (c) the financial statements being audited and (d) the deminis rule not having been breached. This is a tall ask!

- **Immovable Property Rule:**

To qualify as 'Immoveable property' to be taxed at the 0%, the property or part of it must be used exclusively for a Business or Business Activity and not used as a place of residence or accommodation including hotels, motels, bed and breakfast establishments, serviced apartments and the like. It is even irrelevant if the user is a Free Zone company!

- **Real Estate Investment:**

The natural person Real Estate Investment rule is NOT applicable to company rentals or gains. For this reason, it is irrelevant whether the company's Business or Business Activity is Real Estate Investment or a Business or Business Activity.

- **Small Business Relief:**

A company will not pay corporate income tax on its net rentals and gains if its Taxable Revenue for the current relevant Tax Period and each of the previous Tax Periods does not exceed AED 3,000,000.

The AED3,000,000 threshold is applicable to Tax Periods commencing on or after 1 June 2023 and ceasing to apply to Tax Periods ending on or before 31 December 2026.

CALCULATING A COMPANY'S REAL ESTATE PROFITS

In this slide we consider how the taxable real estate profits are calculated.

- **Core rule:**

The Resident Company's taxable income earned from rentals and gains inside or outside the UAE are its book profits calculated using acceptable international accounting standards adjusted in accordance with the rules in the Corporate Income Tax Law and in the Ministerial and Cabinet Decisions.

- **Adjustments:**

The potential adjustments to book profits are:

(a) Unrealized gain or loss.

(b) Exempt Income.

(c) Specified Reliefs.

(d) Specified Deductions.

(e) Transactions with Related Parties and Connected Persons.

(f) Specified Tax Loss Relief.

(g) Incentives or special reliefs for a Qualifying Business Activity.

(h) Any income or expenditure not otherwise been taken into account when determining the Taxable Income as may be specified in a decision issued by the Cabinet at the suggestion of the Minister.

(i) Specified Ministerial adjustments.

- **Revenue Recognition Adjustments:**

A Company applying IFRS 15 must consider whether it is in its best interests to accept being taxed on unrealised gains and if it does not wish to be taxed on that basis then it can elect to be taxed on a realisation basis.

While electing to be taxed on a realisation basis should defer booked gains, the election also defers claiming deductions for expenses not yet paid. The company needs to balance which is the better position to adopt.

- **Accrual vs Realisation Accounting:**

A Taxable Person that prepares financial statements on an accrual basis may elect to take into account gains and losses on a at year end realisation basis on:

(a) all assets and liabilities that are subject to fair value or impairment accounting under the applicable accounting standards, or

(b) all assets and liabilities held on capital account, whilst taking into account any unrealized gain or loss arising in connection with assets and liabilities held on revenue account.

- **First Tax Period: Transitional Rules**

To prevent a company from being taxed after corporation tax commences for the portion of the income or gain accruing to an in an Accounting Period commencing BEFORE the company's first Tax Period, an election may be made to rebase the asset or liability at the beginning of the first Tax period. In relation to a property company the more important elections are:

FUTURE GAINS/LOSSES ON REALISATION OF IMMOVABLE PROPERTY AND FINANCIAL ASSETS AND LIABILITIES ON THE BOOKS AT THE BEGINNING OF THE FIRST TAX PERIOD	
Immovable Property	Financial Gains and Financial Liabilities
An election can be made on each unit (unit by unit basis) of immovable property at the commencement of the first Tax Period.	An election must be made on all the gains and liabilities at the commencement of the first Tax Period.
The election is deemed irrevocable except under exceptional circumstances and pursuant to approval by the FTA	The election is deemed irrevocable except under exceptional circumstances and pursuant to approval by the FTA.
The taxpayer calculates the fair market value at 31 December 2023 of each immovable property for which an election has been made by adopting an amount notified by the Government approved valuer if the asset had been booked at cost rather than on an impairment basis.	The Taxpayer calculates the fair market value at 31 December 2023 of each financial asset and of each financial liability. Calculating the market value does not require assistance of a Government approved valuer.

The taxpayer should elect to adopt the 31 December 2023 market value if doing so realizes a smaller taxable gain than would otherwise arise were the taxpayer to adopt the time apportionment basis.	The taxpayer should elect to adopt the 31 December 2023 market if doing so realizes a smaller taxable gain than would otherwise arise were the taxpayer to adopt the book value basis.
The taxpayer can elect time apportionment if doing so realizes a smaller taxable gain than would otherwise arise if it were to adopt the 31 December 2023 basis.	NA
The taxpayer cannot elect if the realization produces a book loss.	The taxpayer cannot elect if the realization produces a loss.

In this slide we explain how the profits of a Real Estate Partnership are taxed.

- **Core Rule**

Rule 1: An Unincorporated Partnership is not considered a Taxable Person in its own right unless an (irrevocable) application is made to the FTA for it to be so. Absent such an election, the Persons conducting that Business as an Unincorporated Partnership are treated as individual Taxable Persons for corporate income tax purposes.

Rule 2: The Person who is a partner in an Unincorporated Partnership is treated as (a) conducting the Business of the Unincorporated Partnership, (b) having a status, intention, and purpose the same as that of the Unincorporated Partnership, (c) holding assets that the Unincorporated Partnership holds and (d)being party to any arrangements to which the Unincorporated Partnership is a party.

Rule 3: The assets, liabilities, income and expenditure of the Unincorporated Partnership are allocated to each partner in proportion to that person's distributive share in that Unincorporated Partnership, or in the manner prescribed by the FTA where the distributive share of a partner cannot be identified.

- **Juridical Person Rule:**

The Unincorporated Partnership is not considered to be a Taxable Person in its own right, provided it is not a juridical person.

- **Real Estate Investment Rule:**

A Natural Person member of a non-juridical partnership can apply this rule to the person's share of the Partnership's net income.

The Natural Person remains liable to corporate income tax on profits allocated which do not satisfy the Real Estate Investment Rule.

Juridical person partners in a Partnership are liable to corporate income tax on their distributive share even if the Partnership conducted a Real Estate Investment activity.

In this slide we explain how a Foundation is taxed on net rentals and gains.

- **Core rule:**

A foundation formed in the DIFC, ADGM or RAKICC is a juridical person and it follows that the Foundation's taxable income based on property rentals and gains made inside or outside the UAE are its book profits calculated using acceptable international accounting standards adjusted in accordance with the rules in the Corporate Income Tax Law and in Ministerial and Cabinet Decisions.

A Family Foundation is deemed for corporate tax persons not to be a juridical person when having successfully made an application to the FTA to be treated as an Unincorporated Partnership for corporate income taxation purposes.

- **Family Foundation Election conditions**

Any foundation, trust or similar entity that satisfies the following election conditions.

A valid election is dependent upon the Family Foundation:

(a) being established for the benefit of identified or identifiable natural persons, or for the benefit of a public benefit entity, or both.

(a) The Family Foundation does not conduct any activity that would constitute a Business or Business Activity for corporate income tax purposes had the activity been undertaken, or its assets been held, directly by its founder or any of its beneficiaries.

(b) The main or principal purpose of the Family Foundation is not the avoidance of Corporate Tax.

(c) Any other conditions as may be prescribed by the Minister.

- **Tax Consequences**

Once the election is approved, the Family Foundation is deemed an Unincorporated Partnership from the commencement of the Tax Period in which the application is made, or from the commencement of a future Tax Period, or any other date determined by the FTA.

The Person who is a Family Foundation Qualified Recipient (i.e a beneficiary) is treated as (a) conducting the Business of the Family Foundation, (b) having a status, intention, and purpose of the Family Foundation, (c) holding assets that the Family Foundation holds and (d) being party to any arrangement to which the Family Foundation is a party.

The assets, liabilities, income and expenditure of the Foundation are allocated to each Qualified Recipient in proportion to that person's distributive share in that Family Foundation, or in the manner prescribed by the FTA where the distributive share of a qualified recipient cannot be identified. The FTA is yet to publish this sharing.

The Natural Person Qualified Recipient is free from corporate tax on the distributive share when the Real Estate Investment rule applies.

In this slide we explain how a Property Trust is taxed on net rentals and gains.

- **Core Rule**

A Qualifying Investment Fund is a Fund satisfying Corporate Income Tax law conditions. Regardless of the type of Investment Fund, the Corporate Tax Law seeks to ensure the tax neutrality of investment funds so that investors, whether domestic or foreign, are in the same or a similar tax position as if they would be had each invested directly in the underlying assets of the fund.

- **Investment Entity**

An Investment Entity is any entity the principal activity of which is the issuing of investment interests to raise funds or pool investor funds or establish a joint investment fund to enable the holder of that investment interest to benefit from the profits or gains from the entity's acquisition, holding, management or disposal of investments, in accordance with the applicable legislation which satisfies the corporate income Tax law's conditions

- **Conditions**

The qualifying conditions are:

(a) the investment fund or the investment fund's manager is subject to the regulatory oversight of a UAE competent authority, or a foreign competent authority recognized for UAE corporate income tax purposes.

(b) interests in the investment fund are traded on a Recognized Stock Exchange or are marketed and made available sufficiently widely to investors.

(c)the main or principal purpose of the investment fund is not to avoid Corporate tax.

(d) the main Business or Business Activity conducted by the investment fund is an Investment Business activity, and any other Business or Business Activity conducted by the investment fund is ancillary or incidental.

(e) A single investor and its Related Parties do not own (i) more than 30% of the ownership interests in the investment fund, where the investment fund has less than ten investors, (ii) more than 50% of the ownership interests in the investment fund, where the investment fund has ten or more investors, (iii) the investment fund is managed or advised by an Investment Manager that has a minimum of three investment professionals and (iv) the investors shall not have control over the day-to-day management of the investment fund.

- **Real Estate Investment Trust (REIT) Conditions**

To be a qualifying fund if the fund is structured as a REIT, in addition to the above conditions each of the following is to be met:

(a) the value of real estate assets, excluding land, under the management or ownership of the REIT exceeds AED 100,000,000.

(b) At least 20% of the REIT share capital is floated on a Recognised Stock Exchange, or it is directly wholly owned by two or more qualifying institutional investors provided that at least two of those institutional investors are not Related Parties.

(c) The REIT has an average Real Estate Asset Percentage (excluding gains on an income to asset test) of at least 70% during the relevant Gregorian calendar year or the relevant (12) twelve-month period for which the financial statements are prepared.

Thank you and questions

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