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India and the new UAE tax on corporations and businesses: Should Indian businesses be concerned?

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March 2023

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With the passage of time from early December 2022, when we first scrutinised the UAE Decree-Law 47 of 2022 (Decree-Law), to now, more and more uncertainty has been identified on just how the Decree Law could impact business relationships and transactions between India and the UAE.

In this technical analysis, I consider three of the many conflicts identified between the Decree Law and the 1993 Indian/UAE Double Tax Convention (DTC). Indian resident entities or natural persons individuals doing business in the UAE are entitled to be clear on the Decree Law's implications so they can determine whether they are at risk unless a transaction or an entity is restructured.

Indian Tax Credit: Is it at risk?

Whether an Indian business entity or natural person taxpayer is entitled to a credit against Indian taxation for the tax deducted in the UAE is a valid question. The answer should be obvious and straightforward, but it isn't.

We know from Article 25(2) of the DTC that residents of India deriving income from, or owning capital in the UAE, which the DTC permits to be taxed in UAE, will be allowed to deduct from the Indian tax on that income or capital the 'income-tax paid in UAE'.

We also know from Article 2(2) of the DTC that the taxes in the UAE to which the DTC applies are (a) income-tax, (b) corporation tax and (c) wealth-tax unless under Article 2(3) of the same DTC, any identical or substantially similar taxes on income or capital are imposed at the UAE Federal or State level in addition to, or in place of, the taxes listed in Article 2(2). Additionally, we know that the competent authorities of the UAE and India must notify each other of any substantial changes made in their respective taxation laws. We do not know whether the UAE Competent Authority has made that disclosure, but we can work out the potential consequences of a failure for it to have done so.

A credible argument can be made that the tax to be payable in the UAE on Taxable Incomes in Tax Periods commencing on or after 1 June 2023 is neither identical to nor substantially similar to the UAE's existing (a) income-tax, (b) corporation tax and (c) wealth-tax because presently there is no income tax in the UAE while the corporation tax on the books today is an Emirate level tax and is only applicable to oil companies and UAE branches of foreign banks. There is no wealth tax. If this argument is sound, then the Article 25 tax deduction potentially available to Indian taxpayers would be hollow. This would be bad news!

The second but associated question is that assuming the Decree Law 'Corporate Tax' is an Article 2(2) tax for purposes of the DTC, then does it satisfy the meaning of 'income-tax paid in UAE' as used in Article 25. The tax needs to be such a tax because Article 23 DTC allows a credit for 'income-tax paid in UAE'. We know Article 2(2) of the DTC tells us that the existing UAE taxes to which the DTC is to apply are (a) income-tax, (b) corporation tax and (c) wealth-tax.

Could the Indian tax authority sensibly argue that the Decree Law Corporate Tax is neither an income tax nor a corporation tax because the UAE Corporate Tax is neither exclusively applied to income nor to corporations?

In my opinion, relevant to this discussion is that 'Corporate Tax' is defined (Decree Law, Article 1) to mean the tax imposed on juridical persons and business income. With the UAE tax to be imposed on natural persons and juridical persons, how can it be a corporation tax when that concept is generally accepted to mean a tax paid on any corporate profits.

It is also clear from the Indian Central Board of Direct Taxation Notification 54/2016, 27 June 2016 (clause 2(a)) that the tax credit to be given in India for the UAE foreign tax must be in relation to the taxes established under the relevant DTC. Currently, these taxes would not be the taxes payable under the Decree Law.

Before accepting that a tax imposed on corporations and non-corporations is a corporation tax, the intellectual gap is to be closed. The most appropriate means of doing so would be by amending the DTC accordingly to refer to the Decree Law 47 of 2022 Corporate Tax, but while waiting for the States to do so, Indian resident entities and business owners should consider restructuring their UAE activities. A proper restructure should mitigate this tax risk.

UAE Agents and a UAE Permanent Establishment: Are the rules bad news for Indian businesses?

An example of complex Decree Law drafting giving rise to confusion is considering whether the DTC PE Agent provision can counter the similar agent provision in the Decree Law. In context, can the Decree Law resulting in an Indian resident business entity having a UAE Permanent Establishment (PE) be countered by the DTC?

The Decree Law (Article 14(1)(b)) tells us that an Indian entity should probably have a UAE PE if the person in the UAE has and habitually exercises the authority to conduct a Business or Business Activity in the UAE on behalf of the Indian Entity. The Decree Law informs us (Article 14(6) that an Article 14(1)(b) tax presence, i.e., a PE, should not arise were the person conducting that UAE Business or Business Activity to be an independent agent and in doing so acted for the Indian Entity in the ordinary course of that Agent's Business or Business Activity.

There is nothing particularly novel about the agency PE or the independent agent exception, but there is an interesting twist in the wording of the exception to the independent agent exclusion. This comes from the Decree Law's reference to a person in the UAE acting 'exclusively or almost exclusively' on behalf of the Indian Entity being deemed a PE, or where that person cannot be considered 'legally or economically independent from the Indian Entity' also being deemed a PE.

Unfortunately, the Decree Law fails to define either 'exclusively or almost exclusively' or where that person 'cannot be considered legally or economically independent from the Indian Entity', leaving both open to a potential conflict.

f the DTC counters the Decree law's exclusion to the exemption position, then the lack of a definition is irrelevant. However, with the different but very similar wording used in the DTC to that used in the Decree Law, it is difficult to determine whether the DTC confirms or contradicts the Decree Law's exclusion to the exemption.

This conundrum arises from the DTC's Article 5(5) using the words 'wholly or almost wholly' when the Decree Law uses the words 'exclusively or almost exclusively'. Article 5(5) DTC also does not incorporate the legally or economically independent test.

With 'wholly' meaning entirely or fully and 'exclusively' meaning entirely or solely, we are entitled to conclude they mean the same. With the words 'exclusively or almost exclusively' incorporated into Article (5)(5) of the OECD Model Tax Convention, while 'wholly or almost wholly' are included in the DTC, maybe the reason for using the different words is that the Indian tax authorities have a different abuse in mind which they want to counter to the abuse covered by the words 'exclusively or almost exclusively'. This would not be entirely surprising when considering India has a different view to other countries on the agent exclusion, as is evidenced by it taking three positions against the wording of Article 5(5) in the OECD Commentary and another 29 reservations to the Article 5(5) OECD Commentary. In the absence of clarity, Indian businesses should be prudent when selecting an agent in the UAE to conduct business for them and on the nature and extent of the agent's rights and powers incorporated into the agency.

Another question to be resolved is whether the nature and extent of the activity undertaken by the agent can result in a UAE PE. The Decree Law's Article 14(5) definition results in an appointee causing a PE to exist when the person has and habitually exercises an authority to conduct a Business or Business Activity in the UAE on behalf of that Indian Entity or when the person habitually negotiates contracts that are concluded by the Indian person without the need for material modification by the Indian person.

In the absence of a 'material modification' definition in Article 14(5), disputes with the UAE's FTA are likely for Indian businesses, but fortunately, with this wording not included in the DTC, any appeal from an FTA decision through the UAE Tax Review Committee and onto the UAE courts should stand a reasonable chance of success if the case is argued correctly and if the facts support the position being taken.

With this uncertainty, Indian businesses should ensure that any agreement negotiated by the agent requires material changes to be made by the Indian business before being in a fit state for a conclusion.

Another potential ground for dispute arises from the DTC (Article 5(4)) potentially countering the likelihood of a UAE PE arising from an application by Article 14(5) to deem the Indian company to have a UAE PE when the activities of that person are limited to the purchase of goods or merchandise for the enterprise. I do not anticipate the FTA concluding a UAE PE exists in those circumstances because the same exclusion is written into Article 14(3)(c) of the Decree Law.

Transfer Pricing Adjustment: Will Indian groups be doubly taxed?

How does the Decree Law deal with the situation in which a UAE taxpayer becomes taxed on income already taxed to a related Indian taxpayer or a deduction already allowed to the UAE Taxable Person reversed because the actual transaction price between the UAE Taxable Person and the Indian counterpart fails to meet the arm's length standard? The answer is found in Article 34(11) of Decree-Law but is the answer a complete and satisfactory answer? Maybe not!

Article 34 states that where a foreign Competent Authority (in this case, the Indian Competent Authority) makes an adjustment to a transaction or arrangement involving a UAE Taxable Person to ensure that the transaction satisfies the arm's length standard, the UAE Taxable Person can make an application to the UAE Federal Tax Authority to make a corresponding adjustment to its Taxable Income. It should not go unnoticed that the UAE Taxable Person is not given a right to an adjustment: it is given a right to make a claim for an adjustment: big difference. The UAE's position is compatible with its general refusal to allow its tax sovereignty to be compromised.

The absence of the right to an adjustment in the Decree Law is unsatisfactory, as is the absence of a sub-paragraph in Article 34(11) requiring the UAE Cabinet to issue a decision setting out the circumstances in which the FTA would accept the right to make a claim. Again, this is understandable when seen against the background of a refusal to compromise tax sovereignty.

Without that right to an adjustment, the UAE company has no certainty that were the Indian tax authority to increase the Indian company's taxable income, a compensatory adjustment would be made in the UAE.

This is unsatisfactory but can the UAE Ministry of Finance state that the DTC takes care of the conflict? It is arguable that it does but were there to be no bilateral DTC or were the DTC not to include an adjustment provision, then the UAE Taxable Person would be left with double tax.

What, then, is the strength of the Ministry of Finance's likely defence? How does the UAE/India DTC fix this problem? The problem was very real before both India, and the UAE signed the OECD's Multilateral Instrument because the DTC did not originally include the standard Article 9(2) compensatory adjustment Article. With both the UAE and India signing the Multilateral Instrument and with neither reserving on Article 17, both India and the UAE are now required to make compensatory adjustments, and the wording requiring both to do so is included in the synthesised DTC.

All this sounds well and good, but is there scope for the Ministry of Finance to conclude that the appropriate amount is nil? I can envisage circumstances in which the FTA could do just that because the Competent Authorities are to have due regard to other provisions of the DTC, and the UAE and Indian Competent Authorities are required, if necessary, to consult each other.

Therefore, while the Multilateral instrument Article 17 establishes the principle and that principle has been incorporated into Article 9 of the DTC under the synthesised text can the UAE, in adjusting to nil, do so on the grounds that the parties entered into an arrangement resulting in a corporate tax advantage (Decree Law Article 50)?

Answering this question is complex, but maybe part of the answer lies in the Article 29 DTC Limitation of Benefit, while the other part lies in the domestic anti-abuse provision always being available to counter a benefit offered by a DTC?

To improve the climate for Indian investment into the UAE, these uncertainties should be removed.

Conclusion

Unfortunately, the Decree-Law and the DTC have many incompatibilities, with these three just representing the tip of the iceberg.

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Dr Peter Wilson is an international taxation adviser with more than 40 years of experience. Peter has advised companies, individuals, partnerships, trusts, foundations, collective investment funds, pension funds and governments on taxation, international tax law and associated planning and compliance, firstly from a base in Sydney, Australia, then London, New York and now in Dubai.

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