

What does “wholly and exclusively for the purpose of the Taxable Person’s Business” mean?

Without being “wholly and exclusively”, deductions aren’t available in the UAE

Section 28 of the UAE Corporate Tax law prescribes that to be deductible in the UAE “Expenditure incurred wholly and exclusively for the purposes of the Taxable Person’s Business that is not capital in nature shall be deductible in the Tax Period in which it is incurred”. This adopts the UK’s use of the words “wholly and exclusively” and Australia’s use of the word “incurred”. If we want to know what these actually mean we need to identify and guidance in the FTA but then focus on guidance and precedent in the UK and in Australia.

We can begin to understand the complexities by considering the deductibility of legal expenses which would have been incurred by the employer in a recent Dubai Court of First Instance Case No. 309 of 2025 when defending its position. That case considered whether an employee or an employer was liability to pay a fine imposed by the FTA on a company for late registering for corporate income tax and the impact of that action on unpaid employment benefits

Framing the Background to the case

In case No 309, the employee sued the employer for various entitlements including gratuity, unpaid salary and wrongful dismissal compensation. The employer counterclaimed, asserting the employee’s negligence led to a penalty of AED 10,000 from the FTA for the company’s delayed corporate tax registration.

The employee was working in the employer’s accounts department and the employer stated the employee’s failure to complete the tax registration on time caused the company material damage. Relying on tortious liability principles under UAE Civil Transactions Law, the employer maintained the employee’s omission — a wrongful act — led directly to the company incurring the penalty, and therefore, the employee was financially responsible for the company’s loss. The court set out to determine if the employer had sufficient evidence to confirm this assertion.

Application of Legalities

Departing from labor law, the court analysis considered basic civil liability principles related to ‘wrongful acts’. These principles require that, for an individual employee to be held personally liable for penalties incurred by the company, the onus is on the employer to prove: (a) Fault (Wrongful Act): either intentionally or negligently, the employee omitted to carry out a specific duty, (b) Damages (Loss): as a result of this omission, the company suffered a verifiable financial loss and (c) Causation: The employee’s fault and the damage incurred were clearly linked.

Aligning with Article 282 of UAE Civil Transactions Law, these principles emphasize the burden of proof rests firmly on the employer to convincingly prove each of the three principles:

Rationale behind the Court's Findings

Dismissing the employer's counterclaim, the court noted (a) Failure to Prove Fault and Causation: The employer was unable to demonstrate the employee's specific fault i.e. neglecting to register for corporate tax on time, was the only reason for the penalty. The court ruled that the employer needed to provide concrete evidence that Corporate Tax Registration was the employee's formal responsibility, and that he neglected this responsibility, and that this neglect was the direct cause of the FTA fine and (b) Failure to prove Material Loss or Damage: No official FTA penalty notice or confirmation of the fine's payment, was offered by the employer.

A mere assertion that a fine was settled was insufficient, the court concluded. Documentary evidence, in the form of a bank receipt or FTA confirmation was required to verify any claim for damage and (c)

Deductable Legal Fees

Theory

How then can the legal fees incurred by the employer in defending a position which was ultimately a losing be defended as being deductible for corporate tax purposes?

Some support is in the FTA's Corporate Income Tax Guide which asserts that for expenditure to be fully deductible, the full amount must have been incurred solely for Business purposes. (General Corporate Tax Guide | Corporate Tax | CTGGCT1 page 61).

The FTA also states that if the expenditure is incurred partly for Business purposes and partly for some other purposes, the expenditure must be apportioned so that only that part relating to the derivation of Taxable Income will be allowed as a deduction and the apportionment must be done on a fair and reasonable basis.

The FTA says that what is fair and reasonable depends on the circumstances and facts of each case. In many cases, there would be more than one method of apportioning expenses which is fair and reasonable. The fair and reasonable approach chosen should accurately reflect the underlying activity, should not be unnecessarily burdensome and complex for the Taxable Person to determine and justify, and for the FTA to understand and review.

Practice

In determining whether these specific legal fees would be deductible should we focus on the underlying problem, which was an FTA fine or should we focus on the case being an employment matter ie failure to pay benefits?

If the prime focus of the case is the former then the legal fees would not have been wholly and exclusively incurred for the purpose of the Business but if the latter then they would because most, but not all employment matters must be a business matter.

So in this case we expect the legal fees would be deductible for UAE corporate income tax purposes to the employer because the case concerned the employer's defence of a failure to pay a gratuity, unpaid salary and wrongful dismissal compensation each of which are Business issues.

Action

The "wholly and exclusively" concept is complex.

So we recommend a company about to enter into legal action or anticipating legal action or in the middle of it, should properly consider the deductibility of the legal fees and while doing so also consider whether it is entitled to claim as an input tax credit for the VAT charged by the lawyer on those fees!

Dr Peter Wilson

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Dr Peter Wilson
Founder & Global Tax Advisor
PB First FZ LLC

40 Years of experience with PwC and EY in London, Sydney, New York and Dubai. PhD from Queen Mary, University London.

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