Taxation of cross-border mergers and acquisitions

United Arab Emirates

kpmg.com/tax

KPMG International
Introduction

The United Arab Emirates (UAE) is a federation of seven emirates: Abu Dhabi, Dubai, Sharjah, Fujairah, Ras Al Khaimah, Ajman and Umm Al Quwain.

The information in this report applies to all emirates unless there is a material difference, which is addressed separately.

Legislative position in the United Arab Emirates

Federal Companies Law

The Federal Companies Law No. 2 (superseding Federal Companies Law No. 8 of 1984) concerning commercial companies (the Law) is relevant when considering mergers and acquisitions (M&A) in the UAE.

The scope of the Law covers all commercial operations established in the UAE except companies operating in a free trade zone (FTZ) (unless the law of the FTZ permit its free zone companies to operate outside the relevant free zone), companies with activities in the oil and gas industry, and companies that have special agreements with the UAE government or one of the emirates, such as foreign oil companies and branches of foreign banks.

The Law also takes into account a takeover regime for the shares of publicly listed companies through rules to be issued by the Securities & Commodities Authority (SCA).

A merger under the Law can be effected either by one company absorbing another company or by a combination of two or more companies being absorbed by a new company. However, the Law does not distinguish between merger by acquisition and merger of two companies into one new company. Instead, the Law allows companies to merge by contract specifying the method of conversion of the existing entity’s (or entities’) shares. The Law also introduces a short-form merger procedure between a holding company and a fully owned subsidiary, as well as between two or more fully owned subsidiaries of the same holding company where no merger contract is required.

An acquisition can also take place by buying shares in a company, subject to foreign investment regulations.

Foreign investment

Although the Law permits foreign participation, unless the company is incorporated in a FTZ, local sponsorship or ownership is mandatory. As an alternative, foreign entities seeking only to export goods to the UAE may simply appoint a local commercial agent.

A limited liability company (LLC) can be set up for trading purposes in an emirate by a foreign parent, provided 51 percent of the shares is held by a UAE national or a company controlled by UAE nationals. Management of the company can vest in either the majority or minority shareholder. If a foreign company wishes to open a branch in the UAE, it must appoint a UAE national or UAE company that is wholly owned by UAE nationals to act as the national/local service agent.

A foreign company can set up a representative office in the UAE, but a national/local service agent is required. However, this representative office can only undertake marketing and promotional activities.

Tax decrees

The UAE currently has no all-encompassing corporate tax legislation at the federal level. Most of the UAE’s seven emirates have issued their own income tax decrees, which are quite similar in nature and wording. In theory, corporate income tax is applicable to all corporate entities. In practice, corporate income tax is presently only enforced for foreign oil companies (e.g. companies dealing in oil or oil rights, including crude oil, or other hydrocarbon materials produced in the UAE) and branches of foreign banks.

Foreign oil companies enter into concession agreements with the ruler of the emirate in which they extract/produce the oil. In practice, the tax paid by an oil company can range from 55 to 85 percent. Individual emirates have issued separate corporate income tax decrees for the assessment of tax on the branches of
foreign banks. For branches of foreign banks, corporate tax is generally calculated at the rate of 20 percent of taxable income.

The tax decrees are quite concise. They do not mention the consequences of company mergers and acquisitions (M&A) or disposals.

In 2015, the UAE Ministry of Finance announced the introduction of both corporate tax and value added tax (VAT) in the UAE. The details of the laws have not been published, but it has been confirmed that businesses in the UAE will have 12 months to prepare for compliance with the new corporate tax laws and 18 months to comply with VAT once the laws are announced. It is understood that VAT is being introduced in the region at the level of the Gulf Cooperation Council (GCC) states. Each country will have its own VAT laws, but they will be governed under a common VAT legal framework.

The implementation date of corporate tax has not yet been determined, and VAT is expected to be implemented in 2018 at rates ranging from 3 to 5 percent, with exemptions for certain sectors such as education, healthcare, food staples (94 types confirmed) and social services.

Asset purchase or share purchase

Purchase of assets
There are no specific provisions relating to an asset purchase or M&A in any of the tax decrees. Where a merger or acquisition involves an entity or entities that are currently subject to corporate tax in the UAE, the tax implications, including purchase price allocation, treatment of goodwill and continuity of tax attributes, should be considered case-by-case.

Value added tax
There is currently no sales tax or VAT legislation in the UAE. As noted above, the UAE and other GCC states are actively considering the introduction of a VAT regime (see this chapter’s section on tax decrees).

Transfer taxes
There is no stamp duty on the acquisition of assets, except on the acquisition of real property, where a registration fee may be payable. The asset registration fee percentage varies, depending on the emirate in which the property is situated.

Purchase of shares
As mentioned previously, an acquisition can be achieved by buying shares in a company, subject to foreign investment restrictions. There are no specific provisions governing M&A in any of the tax decrees. Where a merger or acquisition involves an entity or entities that are currently subject to corporate tax in the UAE, the tax implications, including treatment of pre-sale dividends and tax losses, should be considered case-by-case.

Transfer taxes
There is no stamp duty on the acquisition of shares.

Choice of acquisition vehicle

Generally, foreign businesses can operate in the UAE by establishing an entity within any one of the two investment locations: mainland UAE (areas outside of the FTZs) and FTZs. The following entity types are generally available:

— In mainland UAE, a limited liability company or joint stock company may be incorporated, subject to foreign investment restrictions that restrict foreign ownership to only 49 percent of the share capital of the entity. Under the new Law, it is now also permissible to establish holding companies, investment funds and single shareholder limited liability companies (subject to foreign investment restrictions).

— In mainland UAE, a branch of a foreign company may be established (a national/local service agent is required).

— A company could be incorporated in one of the FTZs, in which 100 percent foreign ownership is allowed. Branches are also possible without local sponsorship.

All of the above entities must obtain trade licenses on registration (renewable annually) from the relevant authorities.

Local holding company
A holding company can be established in the UAE in mainland UAE or FTZs.

In mainland UAE, foreign ownership is restricted to 49 percent. Management of such a company can be vested in either the majority or minority shareholder.
Some FTZs offer the ability to set up an investment holding company under a specific offshore company regime or by approval on a case-by-case basis. An offshore holding company can only hold 49 percent of the share capital of a mainland UAE entity.

Foreign parent company
A foreign company can make an acquisition in the UAE, subject to the foreign investment restrictions outlined earlier.

Local branch
Branches of foreign companies cannot generally be used as acquisition vehicles.

Joint venture
A joint venture is not a specific type of entity. A limited liability company must be set up to conduct a joint venture. See this chapter’s section on local holding companies.

Choice of acquisition funding
There are no specific thin capitalization rules in the income tax decrees and no exchange control regulations in the UAE. Funds can be easily repatriated. In the case of limited liability companies, the Law requires the company to allocate at least 10 percent of its net profits every year to a legal reserve. Such allocations may cease once the reserve reaches 50 percent of the company’s issued share capital.

There are no specific tax provisions relating to M&A in any of the tax decrees. Where a merger or acquisition involves an entity or entities that are currently subject to corporate tax in the UAE, the tax implications of various forms of funding, including debt, equity, hybrids and discounted securities should be considered on a case-by-case basis.

Other considerations
Company law and accounting
The Companies Law requires locally registered companies to appoint auditors to audit their annual financial statements. Registered companies in some FTZs are also required to have their financial statements audited annually.

Group relief/consolidation
The tax decrees contain no provisions for group relief and/or consolidation of tax returns.

Transfer pricing
Currently, there are no provisions relating to transfer pricing in the UAE.

Dual residency
There are no provisions in the tax decrees relating to dual residency in the UAE.

Employment of nationals
Employment of UAE nationals is encouraged, but formal targets have not yet been set, except in certain sectors, such as banking.

Withholding tax on debt and methods to reduce or eliminate it
There are currently no withholding taxes in the UAE.

Tax treaties
The UAE has concluded treaties relating to income and capital with: Algeria (income only), Armenia, Austria (income only), Azerbaijan, Bangladesh, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Canada, China (income only), Cyprus, Czech Republic, Egypt (income only), Estonia, Finland (income only), France, Georgia, Germany, Hungary, Hong Kong, India, Indonesia (income only), Ireland, Italy (income only), Japan, Kazakhstan (income only), Korea (income only), Kyrgyzstan, Latvia, Lebanon (income only), Luxembourg, Lithuania, Malaysia (income only), Malta, Mauritius, Mexico, Mongolia (income only), Morocco, Montenegro, Mozambique (income only), the Netherlands, New Zealand (income only), Pakistan (income only), Panama, Philippines, Poland, Portugal, Romania, Russia, Seychelles, Serbia, Singapore (income only), Spain, Sri Lanka (income only), Sudan (income only), Switzerland, Syria (income only), Slovenia, Tajikistan (income only), Thailand (income only), Tunisia, Turkey (income only), Turkmenistan (income only), Ukraine, Uzbekistan, Venezuela, Vietnam and Yemen (income only).
Treaties with many other countries are currently under negotiation. These countries include Albania, Andorra, Argentina, Australia, Barbados, Belize, Benin, Comoros Islands, Croatia, Ecuador, Ethiopia, Fiji, Greece, Guernsey, Guinea, Jersey, Jordan, Kenya, Libya, Liechtenstein, Macedonia, Malawi, Mauritania, Moldova, Nepal, Nigeria, Palestine, Senegal, Slovak Republic, South Africa, Sweden, Uganda, United Kingdom, Uruguay and Uzbekistan.

**Comparison of asset and share purchases**

According to the income tax decrees, a profit from a sale or transfer is taxable. When a merger or acquisition involves one or more entities that are currently subject to corporate tax in the UAE, the brevity of the legislation does not mean that the tax authorities will accept without argument that the value at which the asset is transferred for accounting purposes is the value for tax purposes. Even where assets are sold or transferred at book value, the authorities can argue there is a profit. The tax authorities scrutinize transactions for fairness.