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TAX GUIDE ON PARTICIPATION EXEMPTION

A Comprehensive Guide to the GCC Corporate Tax Participation Exemption Regime

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INTRODUCTION

The Gulf Cooperation Council (GCC) region continues to offer some of the world's most investor-friendly tax regimes, characterized by 0% personal income tax, 0% withholding tax, and low corporate taxes, even with the introduction of new tax reforms.

In this tax guide, we have explored one of the key reliefs provided under the United Arab Emirates (UAE) corporate tax (CT) regime which is termed as “Participation Exemption” and how this relief provided by the UAE compares with its other GCC counterparts. Further, we have provided insight into interplay of Participation Exemption with tax treaty protection measures and foreign tax relief.

OVERVIEW OF PARTICIPATION EXEMPTION

The UAE's Participation Exemption, under its CT Law[1], eliminates tax on dividends, capital gains and related profits from qualifying investments in both local and foreign companies. While dividends and other profit distributions earned by a UAE taxable person from local investee companies is explicitly exempt, capital gains earned on disposal of shares of local/foreign investee companies, foreign exchange gains or losses and impairment gains or losses resulting from investment in local and foreign investee companies as well as dividends and other profit distributions from foreign investee companies are exempted under Participation Exemption regulations after satisfying certain conditions. The exemption is symmetrical, in case participation exemption applies, capital losses, foreign exchange losses, and impairment losses of the same investment are equally non-deductible against other taxable income.

[1]Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses

The purpose of this exemption is to avoid double taxation on corporate profits. For example - when a UAE company receives dividend from its foreign investee companies, such distribution would likely be subjected to CT in the country of origin. Levying tax again in the UAE would lead to economic double taxation, which the UAE tax regime seeks to eliminate. However, where such dividend payout by the foreign investee company is deductible from its taxable income under the applicable foreign tax legislation, then such dividend income would not qualify for participation exemption in the UAE parent company's hands.

Under Article 23 of the UAE CT law, dividends, capital gains and other profit distributions as well as foreign exchange & impairment gains or losses from "Qualifying Participations" are exempt from CT. A Qualifying Participation requires:

- Minimum Ownership Threshold: 5% or greater ownership interest in the shares or capital or a juridical person

In this regard, the FTA has clarified[2] that ownership interest for the purposes of participation exemption would include:

- Ordinary shares
- Preferred shares
- Redeemable shares
- Membership and Partner interests
- Other types of securities, capital contributions and rights that entitle the owner to receive profits and liquidation proceeds
- Debt instruments provided such instrument is classified as equity interest under the applicable accounting standards

If a Taxable Person holds various types of ownership interest in a juridical person, all such ownership interests would be aggregated to determine whether the ownership test is met.

[2] Article 2, Article 3 and Article 5 of Ministerial Decision No. 116 of 2023

Further, the FTA has also clarified that an ownership interest with a historical acquisition cost of AED 4 million or greater will be deemed to have met the ownership test i.e. 5% ownership criteria need not be satisfied in such a case. However, other tests viz. holding period, subject to tax, profits and liquidation rights and asset composition test as mentioned below will need to be met.

- Holding Period: Held or intention to hold ownership for an uninterrupted period of 12 months

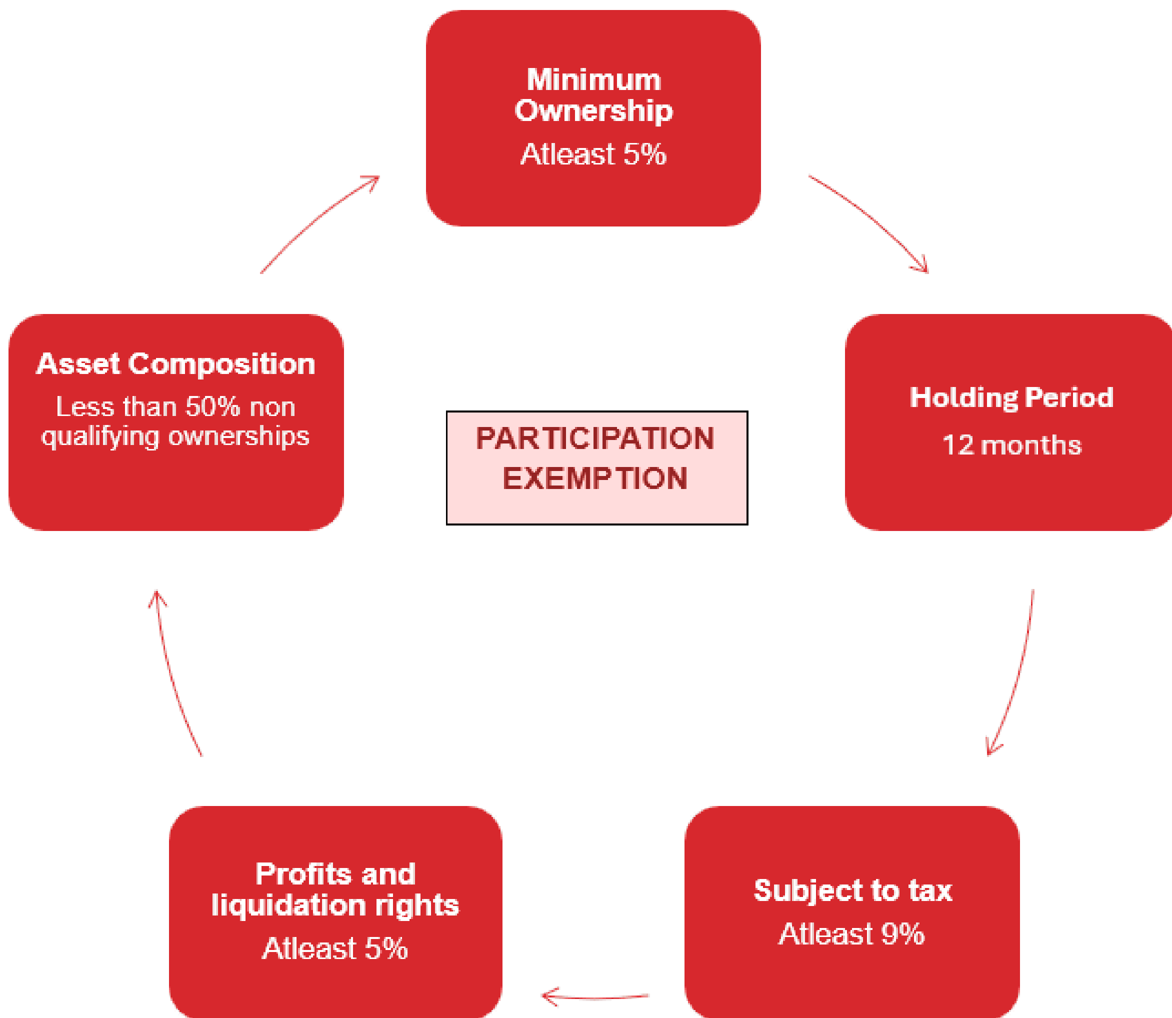
- Subject to Tax: Subject to CT or any other tax of similar character to CT at a rate not less than 9%

In this regard, the FTA has clarified[3] that due to certain temporary tax incentives, reductions or reliefs or application of alternative taxes on income or profits (such as Zakat) or differences in tax treatment (such as for certain expenses) would not mean that the foreign jurisdiction does not apply tax of a similar character as CT.

- Profits and Liquidation Rights: Entitlement to receive at least 5% of the profits available for distribution and at least 5% of the liquidation

- Asset Composition: No more than 50% of the participation's direct or indirect assets can consist of non-qualifying ownership interests or entitlements. This is an anti-abuse test whereby it adopts a look through approach to check if the intermediary company's assets (which is the investee company) does not hold more than 50% of the assets which would not qualify for participation if held directly by the UAE investor company.

[3] Article 6 of Ministerial Decision No. 116 of 2023



Certain provisions of the erstwhile Ministerial Decision 116 of 2023 created certain practical challenges as follows:

- The minimum acquisition cost of AED 4 million only replaced the condition of minimum ownership criteria and not the condition of 5% entitlement in profits and liquidation proceeds. Typically, entitlement to profits and liquidation proceeds stems from ownership rights which was not addressed in the erstwhile Ministerial Decision.

- In certain structures such as investments made by private equity funds in UAE, it is not practically feasible to obtain the last level of investment to determine whether the subject to tax is met.

With effect from 1 January 2025, the FTA has released a new Ministerial Decision 302 of 2024 which has replaced Ministerial Decision 116 of 2023. Under the new provisions, the following changes have been introduced:

- The minimum acquisition cost criteria i.e. 4 million has replaced the threshold of 5% across all the tests of minimum ownership percentage and minimum entitlement in profits and liquidation. This is a welcome clarity as the erstwhile provisions created certain confusion in the interpretation of the benefit of the minimum acquisition cost as explained above.

- Subject to tax test would be met when the other country levies a statutory rate of not less than 9%. The earlier Ministerial Decision did not specify the reference to a statutory rate. However, similar to earlier provisions, the new Ministerial Decision specifies that where the effective tax rate is at least 9%, the subject to tax test would be met.

- The asset composition test needs to be met only when the Participation is a related person. This means when the ownership interest is held by a UAE taxable person in another juridical person who is not a related party, this test need not be evaluated.

However, the erstwhile Ministerial Decision continues to apply for financial periods before 1 January 2025.

Key Requirements	2025 updates
1. 5% or greater ownership interest	No change
2. Held or intention to hold Participation for an uninterrupted period of 12 months	No change
3. Subject to corporate tax or similar at a rate of 9%	Foreign tax rate is by reference to the statutory rate
4. Entitles the holder to at least 5% of the profits and liquidation proceeds	No change
5. 50% or less of the assets of the Participation consist of non-qualifying interests	Only applies to participations which are Related Parties
6. Minimum acquisition cost of AED 4 million	Substitutes all the 5% requirements i.e. 1 and 4.

Interaction with Business Restructuring and Qualifying Group Relief

- Ownership interests in the same juridical person held by other members of a Qualifying Group are aggregated with those of the UAE taxable person. Further, the acquisition costs of ownership interests in the same juridical person held by members of a Qualifying Group in which the UAE Taxable Person is a member, are aggregated i.e. 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 ownership percentage or the minimum acquisition cost test. However, aggregation relief is not provided in respect of holding period which means that each member of the Qualifying Group will have to individually satisfy the 12-month holding period threshold in order to qualify for participation exemption.

- 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. For example, where the transferor entity does not satisfy certain criteria to qualify for Qualifying Group Relief or Business Restructuring Relief and the same is taxable, but by virtue of Participation Exemption, the underlying transaction is exempt, Participation Exemption will govern the tax treatment. However, once Qualifying Group Relief or Business Restructuring Relief is claimed, there is a cooling period of 2 years prescribed for subsequent disposal of assets or investments which were originally tax exempt. To plug the possibility of the taxpayer claiming participation exemption on such subsequent disposal, Participation Exemption conditions provide that in case of such transfers, the exemption will not be available. Similarly, to avoid double taxation, any tax liability arising due to the trigger of clawback period of 2 years, if taxed due to exclusion of Participation Exemption, will not be taxed again under the clawback provisions of Qualifying Group Relief or Business Restructuring Relief.

Interaction with Qualifying Free Zone Relief

- There is no restriction in the UAE CT Law provided for a Qualifying Free Zone Person (QFZP) to not claim Participation Exemption. Accordingly, a QFZP can claim Participation Exemption on eligible income earned through eligible shareholdings.

- Further, the FTA has clarified that income received by virtue of shareholding in a QFZP (or an Exempt Person) by a UAE taxable person (other than local dividend income which is automatically exempt), will deem to satisfy the subject to tax test.

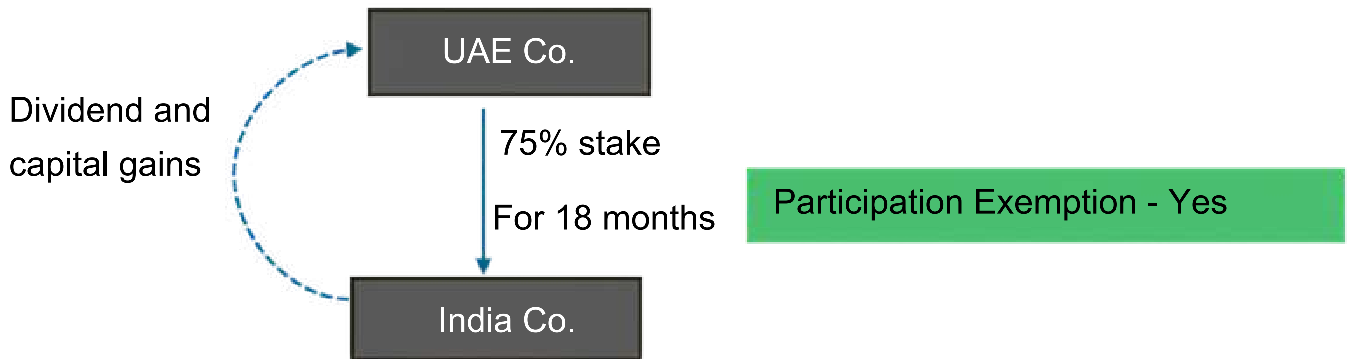
Interaction with Small Business Relief (SBR)

- Where a UAE taxable person elects to be governed under SBR provisions (i.e. revenue below AED 3 million), Participation Exemption on its income, if applicable would be disregarded as a Taxable Person opting for SBR is treated as having no taxable income and no tax liability.

- Further, if a UAE taxable person receives income by virtue of its shareholding in a UAE taxable person which has opted for SBR (other than local dividend income which is automatically exempt), this will also satisfy the subject to tax test as in principle the UAE taxable person opting for SBR is subject to CT in UAE.

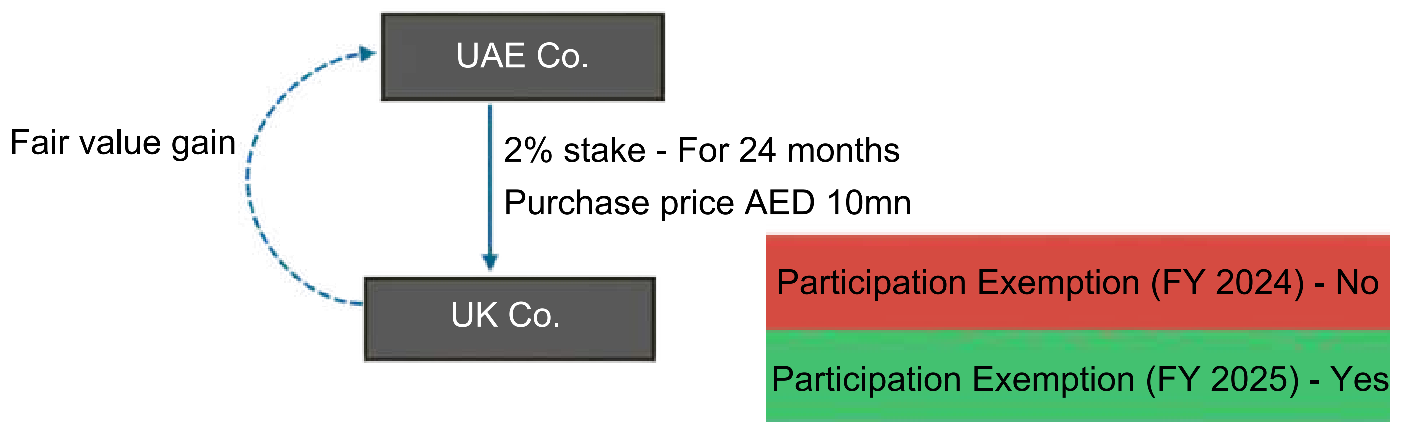
SOME RELEVANT CASE STUDIES:

1. Foreign Subsidiary Dividends and Capital Gains (Active Income)



- **Scenario:** A UAE Parent Company holds a 75% stake in an Indian operating subsidiary for 18 months. Indian subsidiary generates active business profits that are taxed in India.
- **Application:** UAE Parent receives dividends and later sells its stake for a profit.
- **Outcome:** Both the dividends and capital gains are exempt from UAE CT as all the tests required for Participation Exemption are met.

2. Minimum Acquisition Cost

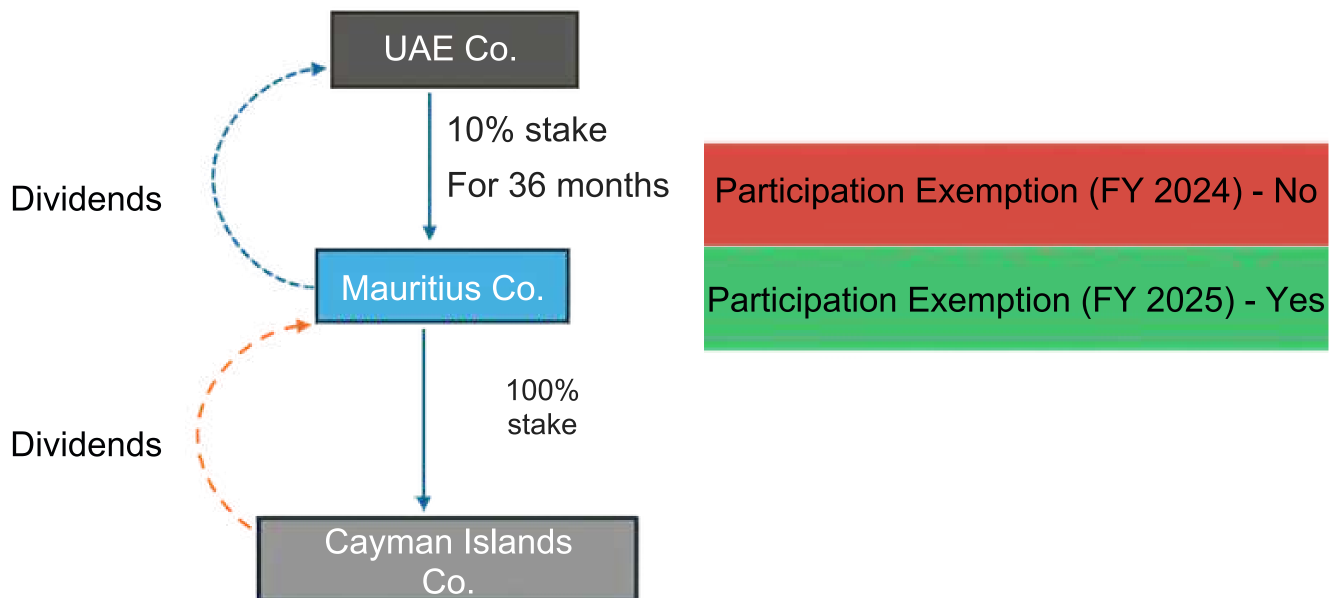


- **Scenario:** A UAE company holds 2% stake in a UK based company for 24 months which provides it with the same entitlement in distributable profits and liquidation proceeds. The UK based company is an operating entity and does not have non-qualifying ownership interests. The UAE company had acquired the stake at a cost of AED 10 million in FY 2023.

- **Application:** UAE company recognizes a fair value gain of AED 50,000 and AED 70,000 respectively in its profit and loss account for FY 2024 and FY 2025, respectively.

- **Outcome:** In FY 2024, participation exemption is not met as the 5% entitlement to profits and liquidation proceeds test is not met even though acquisition cost is at least AED 4 million. However, a possible solution to this is that UAE company can choose to opt for realisation basis on its assets and liabilities and choose to exclude such unrealised/notional fair value gain from its taxable income. In FY 2025, the minimum acquisition cost criteria replaces all the other tests and participation exemption can be claimed on the unrealised/notional fair value gains. Nevertheless, if realisation basis is opted in FY 2024, then such option being irrevocable, unrealised/notional fair value gains would anyways not be taxable in any tax period, hence the analysis under participation exemption is not required.

3. Anti-Abuse: Pass-Through Entities (No Tax Jurisdiction)



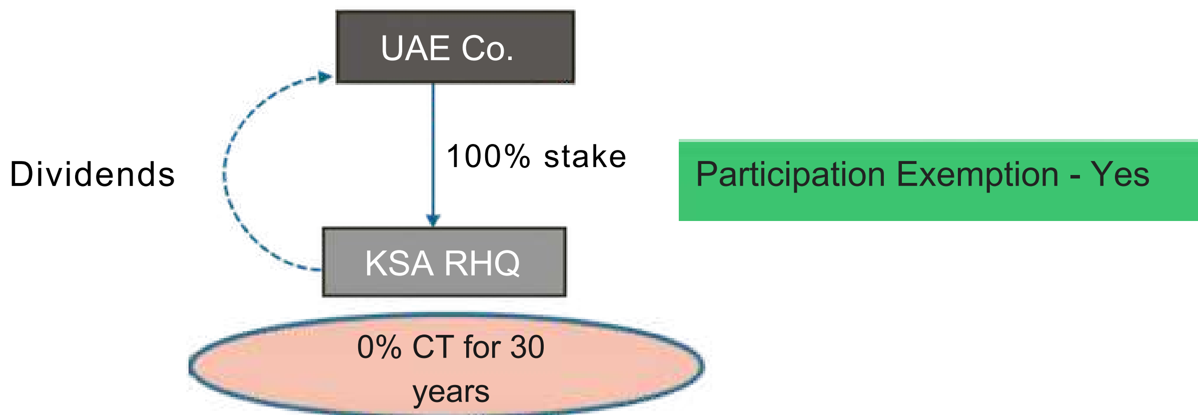
- **Scenario:** A UAE company holds 10% stake in a Mauritius based third party entity for 36 months. However, the Mauritius entity is merely a holding vehicle whose only assets are 100% of a subsidiary located in a zero-tax jurisdiction (e.g., Cayman Islands).

- **Application:** Dividends are paid from Cayman Islands to Mauritius, then to the UAE in FY 2024 and FY 2025.

- **Outcome:** In FY 2024, the participation exemption is denied as the ‘Asset Composition’ test is not met. However, in FY 2025, participation exemption can be granted as the participation is in an unrelated/third party. The other tests i.e. ownership, holding period, subject-to-tax, profit/liquidation rights are independently satisfied in this case.

4. The "Subject to Tax" Test

Case 1

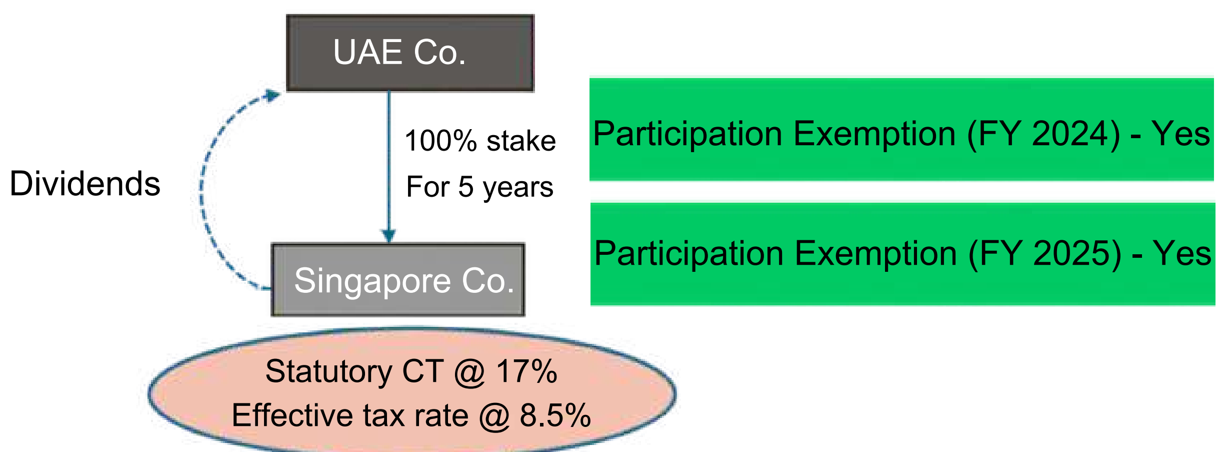


- **Scenario:** A UAE company makes 100% investment in a Saudi Arabian Registered Headquarter (RHQ) for a long term. The RHQ is ultimately held by non-GCC nationals. RHQ regime is a special tax incentive granted for 30 years.

- **Application:** RHQ distributes dividends to the UAE company.

- **Outcome:** The participation exemption applies even if the RHQ is in a special incentive zone, as the Saudi tax regime is generally similar to UAE CT and such incentive is temporary in nature and restricted to specific streams of income. Further, the general CT rate in Saudi is 20% for companies ultimately held by non-GCC shareholders.

Case 2

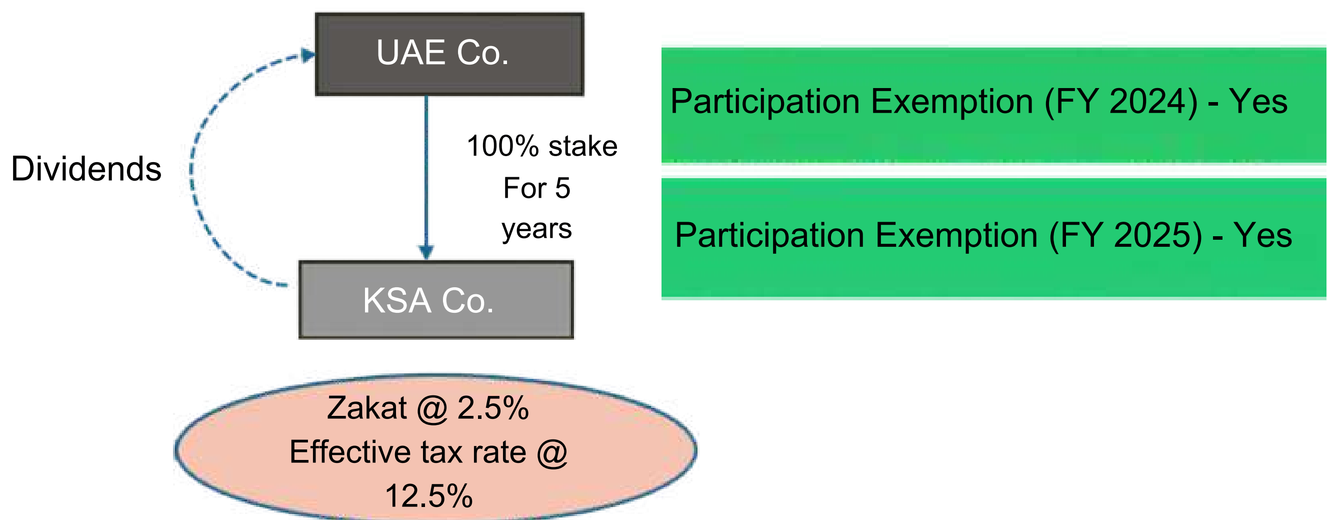


- **Scenario:** A UAE company holds 100% shares in a Singapore based company for 5 years. The Singapore company has an accounting profit of AED 1 million in FY 2024 and FY 2025. The statutory CT rate in 17%, however, due to certain special deductions, the taxable profit is AED 0.5 million each in FY 2024 and FY 2025 making the effective tax rate of 8.5%

- **Application:** The Singapore company distributes dividends to the UAE company in FY 2024 and FY 2025.

- **Outcome:** In FY 2024 as well as FY 2025, the participation exemption can be claimed by the UAE company as the statutory tax rate is atleast 9% even though the effective tax rate is less than 9% [for FY 2024, though the Ministerial Decision 302 of 2024 is not in effect, guidance can be taken from the CT Guide on Exempt Income (CTGEX1)]

Case 3



- **Scenario:** A UAE company holds 100% shares in a Saudi company which is subject to Zakat at 2.5% on its profits. In FY 2024 and FY 2025, the Saudi company has accounting profit of AED 1 million and net worth of AED 5 million. Zakat is calculated at 2.5% of net worth which is AED 0.125 million making the effective tax rate on accounting profits of 12.5%

- **Application:** The Saudi company distributes dividends to the UAE company in FY 2024 and FY 2025.

- **Outcome:** In FY 2024 as well as FY 2025, the participation exemption can be claimed by the UAE company as the effective tax rate is atleast 9% even though the statutory tax rate is less than 9%.

5. Non-Deductibility of Costs

- **Scenario:** A UAE company sells a 10% stake in a subsidiary, realizing a tax-exempt gain of AED 1,000,000. It incurred AED 50,000 in legal fees for this sale and AED 1000 as interest expense on third party loan taken to incur related expenses to complete the sale.

- **Outcome:** The gain is exempt, but the AED 50,000 in expenses is not tax-deductible. However, interest expenses is deductible (subject to General Interest Deduction Limitation Rules).

OTHER GCC HOLDING REGIMES - KSA

Under the KSA Income Tax Law[4] (read with the Executive Regulations of Income Tax System[5]) and under the KSA Zakat Law[6], dividends and capital gains earned by local companies are subjected to normal income tax or Zakat as applicable. However, under the amended provisions of Article 10 of the KSA Income Tax Law, capital gains realised on selling Saudi listed company shares traded on the Saudi stock exchange as well as foreign stock exchange (but listed on the Saudi stock exchange too) are exempt if certain conditions are met viz. the disposal should be done in compliance with KSA Capital Market Law and the disposed shares are not acquired before July 30, 2004. Further, under Article 10 of the KSA Income Tax Law, local or foreign dividend income (cash or in kind) received by a KSA resident company is exempt from tax subject to meeting the ownership criteria of at least 10% and period of ownership at least one year.

The draft KSA Income Tax Law released on 25th October 2023 by ZATCA proposes a participation exemption for dividends, capital gains, and liquidation proceeds from direct investments in resident or non-resident entities. To qualify, the taxpayer must hold at least a 10% stake for a continuous period of at least 365 days (including the distribution date). However, the exemption may not apply if the investee is in a jurisdiction deemed a ‘preferential tax regime’. A preferential tax regime is a regime where the applicable income tax rate is less than 15%, lacks adequate information exchange arrangements with KSA and tax benefits are accorded without underlying economic or commercial substance. However, the draft KSA Income Tax Law is not yet implemented and accordingly, the provisions of the same are not in effect.

[4] Royal Decree M/1 issued on March 6, 2004
[5] Ministerial Resolution No.(1535) dated 1425/6/11 AH
[6] The Implementing Regulation for Zakat Collection (1445 H), issued by the Minister of Finance's Decision No. (1007) dated 19/8/1445 H

OTHER GCC HOLDING REGIMES - QATAR

Dividends are not subject to tax in state of Qatar under the regular tax regime[7] or Qatar Financial Centre (QFC) tax regime. However, under the regular tax regime, if the distributable profits are not subjected to tax in Qatar or not explicitly exempt from tax under the Qatar tax regime, then the corresponding dividends would become taxable. Accordingly, foreign dividends received by a Qatari legal entity from a foreign company can become taxable unless the foreign entity is linked to a permanent establishment within Qatar and subject to the standard CT rate of 10%.

With respect to capital gains, capital gains earned by a Qatari project on foreign shares/quotas/rights is exempted from taxation. No similar exemption is available on disposal of local shareholdings by the Qatari company except in certain scenarios of internal corporate structuring. Under the QFC tax regime, tax exemption is provided on capital gains derived from ‘Qualifying shareholdings. **Qualifying shareholding would require satisfaction of following conditions:**

- **Minimum Holding:** The QFC entity must hold at least 10% of the Ordinary share Capital of the company.
- **Holding Period:** The interest must have been held for a continuous period of at least 6 months immediately preceding the date of disposal.
- **Purpose:** The shares must not have been held wholly or mainly with a view to resale

[7] Law No. 24 of 2018

OTHER GCC HOLDING REGIMES - KUWAIT

Kuwait does not have a general, formalized "participation exemption" regime similar to typical holding company regimes in other jurisdictions, meaning foreign corporate income, including dividends from foreign investee companies, is generally taxable if it falls within the scope of Kuwaiti tax law.

However, dividends and capital gains earned on shares of companies listed on the Kuwait Stock Exchange are exempt from tax.

OTHER GCC HOLDING REGIMES - OMAN

Oman does not have a general participation exemption regime for corporate dividends or capital gains on share sales. Under the provisions of the Oman CT law[8], dividends received from Omani entities is exempt. Income from shares and securities listed on the Muscat Securities Market is exempt. Income from investment funds established in Oman under the Capital Market Authority Law or overseas (for dealing in Omani listed securities) are also exempt.

[8] Royal Decree No. 28/2009 Promulgating the Income Tax Law

OTHER GCC HOLDING REGIMES - BAHRAIN

Bahrain currently has no general corporate income tax for most businesses, but a 10% CT is expected to be introduced by 1 January 2027 for companies with annual revenue exceeding BHD 1 million or net profit over BHD 200,000.

The new CT regime is expected to incorporate participation exemption for qualifying dividends and shareholdings. It may be noted that Bahrain introduced the Domestic Minimum Top-Up Tax via Decree-Law No. (11) of 2024 effective for financial years starting on or after 1 January 2025, marking a major shift in its regional tax landscape. The framework aligns with the OECD's Pillar Two global minimum tax.

APPLICABILITY OF TAX TREATY

Participation Exemption focuses on eliminating tax at the parent company level regarding income from participating holdings. Whereas the tax treaty focuses on reducing/eliminating withholding tax at the source (i.e. country of foreign investee company) on income paid to a UAE based parent company.

For example, under the UAE-Kuwait tax treaty, capital gains on sale of listed shares of a Kuwaiti based company held by a UAE parent can only be taxed in UAE. Further, if the sale is of unlisted shares of a Kuwaiti based company by a UAE parent not deriving more than 50% of the value from immovable property situated in Kuwait, capital gains can only be taxed in UAE. Under the UAE CT regime, if the UAE parent is eligible for participation exemption, capital gains arising on sale of such shares can be get exempted at both Kuwait and UAE level. This can result into tax efficient restructuring at a group level.

FOREIGN TAX CREDIT RELIEF

In case where a resident taxpayer has suffered foreign taxes on income earned abroad and such income is also taxed in the country of residence, a mechanism known as "Foreign Tax Credit" is implemented to avoid double taxation of the same income. The underlying purpose of granting a relief or credit from foreign taxes is to avoid double taxation. However, where the income is already exempted in the country of residence by virtue of any exemption or participation exemption especially, there could be a challenge to claim the underlying foreign tax credit.

Let's have a look at the mechanisms in place by the GCC countries for foreign tax credit

UAE

Any foreign taxes paid by a UAE taxable person are disallowed for tax purposes. Such foreign taxes need to be claimed separately as a foreign tax credit relief which requires satisfaction of certain conditions and documentation requirements. It is critical that the underlying foreign income is not exempted from taxation in UAE.

KSA

Do not include provisions allowing for foreign tax credit relief. Taxes paid abroad cannot be claimed as a deductible expense. However, foreign tax credit relief can be availed in KSA under the applicable tax treaty subject to satisfaction of certain procedures. Such foreign tax credit can potentially be challenged by ZATCA as the underlying income was not doubly taxed due to exemption claimed by the KSA company. ZATCA has clarified that foreign tax credit relief provisions outlined in the tax treaty will not interfere or override the provisions of Zakat.

QATAR

Foreign taxes paid are not allowed as an expense, instead the same can be deducted from the total tax due provided the foreign tax is actually paid. Foreign taxes on income exempted under the Qatar tax regime cannot be claimed as a relief.

KUWAIT

A Kuwaiti based company can claim foreign tax relief only if it covered within the applicable tax treaty. Participation exemption is not covered within the domestic tax laws of Kuwait and accordingly, interplay with foreign tax relief measures is not discussed.

OMAN

Where a tax treaty exists, an Omani company can claim deduct foreign taxes suffered against the total Omani tax payable subject to it not exceeding the total Omani tax payable. Where a tax treaty does not exist, the Omani company is required to submit an application before the Secretariat General within 2 years from the end of the year in which foreign tax is paid and obtain requisite approval

BAHRAIN

There is currently no legislation in Bahrain governing foreign tax relief measures.

Case 1

Scenario

- UAE company holding 60% stake in the KSA company since 36 months.
- Dividend paid by KSA company to UAE parent.

Outcome

- Dividends would be subject to withholding tax @ 5% in KSA
- Dividend income is exempt from tax in the UAE parent company's hands under participation exemption rules.
- No possibility to claim foreign tax relief or deduction in UAE by the UAE parent.
- Foreign withholding tax would be a cost to UAE parent.

Case 2

Scenario

- KSA company holding 20% stake in a Dutch company for 24 months.
- Dividend paid by Dutch company to KSA parent.

Outcome

- Dividends would be subject to withholding tax at applicable rates in Netherlands.
- Dividend income would be exempt from taxation in the hands of the KSA company
- Withholding tax deducted by Dutch company not available to KSA company as deduction.
- No mechanism to claim foreign tax relief under the KSA domestic tax laws.
- Application of foreign tax relief under the KSA-Netherlands tax treaty to be made to ZATCA. Under the KSA-Netherlands tax treaty, if income is subject to tax in Netherlands, KSA to exempt the same income from taxation. However, practical challenges may arise with ZATCA as intent of tax treaty is to eliminate double taxation and the dividend income is not subject to tax in KSA as well under the KSA Income Tax Law.
- Foreign withholding tax potentially a cost to KSA company.

CONCLUSION

Participation Exemption is a crucial tax structuring tool that eliminates economic double taxation. A company operating with multi-tier structure, navigating the eligibility criteria is essential when dealing with cross border structuring involving multinational groups. While the participation exemption is flexible, it is essential that common mistakes such as failure to maintain appropriate documentation to demonstrate intent of holding investments, automatic assumption of exemption without checking the foreign statutory tax rate, not allocating and disallowing expenses in relation to participation should be avoided to defeat the intent of the provision.

As the Domestic Minimum Tax provisions will impact multinational enterprises, Participation Exemption remains as one of the best tax planning tool under the ambit of the legal provisions.

However, every taxpayer should be mindful that typically under the GCC tax statutes, a General Anti-Abuse Rule (GAAR) or Tax Anti-Avoidance measure is applied which is an overriding provision over every section of the tax law under which the tax authorities can disregard or recharacterize artificial structures without any underlying commercial substance and the intention was only to obtain a CT advantage which is not consistent with the intention of the law.

In the participation-exemption context, GAAR risks typically arise where groups artificially create multi-tier structures to benefit from the exemption and route funds in a manner to qualify for the exemption on paper rather than substance. Accordingly, tax planning with a reasonable commercial rationale and within the boundaries of the Law should be undertaken to mitigate GAAR exposure.

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