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Game Changer

The New UK-UAE Double Taxation Convention

Executive Summary

The new UK-UAE Double Taxation Convention (the UK-UAE DTC) entered into force on 25 December 2016 and took effect (broadly) on 1 January 2017. It represents another welcome addition to the UAE's burgeoning network of bilateral tax treaties.

The key points are as follows:

- The taxation of certain foreign direct investments from the UAE into the UK is now potentially far more favourable. The result is that the available range of tax-efficient investment opportunities has significantly increased for UAE investors.
- UAE nationals, and some non-UAE nationals based in the UAE, should now be able to spend more time in the UK without becoming UK tax resident.
- The UK-UAE DTC is helpful in providing more favourable and certain UK tax treatment for UAE nationals, and some non-UAE nationals based in the UAE, working temporarily in the UK.

Although the availability of relief is subject to a number of anti-abuse provisions, and the future application of the OECD Multilateral Instrument implementing the tax treaty-related measures to prevent Base Erosion and Profit Shifting has not yet been determined, the UK-UAE DTC will be welcomed by UAE businesses and individuals, as it gives rise to new tax-efficient investment planning opportunities; it is a game changer for the UAE.

Background

The first ever comprehensive Double Taxation Convention (DTC) between the United Kingdom (UK) and the United Arab Emirates (UAE) was signed on 12 April 2016 in Dubai.

Having completed the formal parliamentary ratification procedures in each country, and the exchange of diplomatic niceties, the UK-UAE DTC entered into force on 25 December 2016. It takes effect:

- With regard to taxes withheld at source, in respect of amounts paid or credited on or after 1 January 2017
- With regard to other taxes, in respect of taxable years beginning on or after 1 January 2017 (6 April 2017 for personal income tax)

The UK-UAE DTC represents a noteworthy step forward in the recent, remarkably rapid, expansion of the UAE's portfolio of DTCs. The UAE now has more than seventy DTCs in force (with a significant number of other DTCs at various stages of negotiation and ratification). For a country that does not have generally applicable corporation, income or withholding taxes, this is impressive and is in part due to its worldwide financial clout and the pre-eminent role of Emirates and Etihad in global aviation.

The DTC with the UK is consistent with the UAE's efforts to align its tax framework with the wider, global tax framework, including:

- Its intention to introduce a Value Added Tax (VAT) on 1 January 2018 (although, it should be noted that the UK-UAE DTC does not, as with all DTCs, cover VAT)
- The creation of a new Federal Tax Authority (FTA) to administer taxes (including VAT)

From the UK's perspective, the UK-UAE DTC is advantageous because it:

- Plugs one of the holes in its own network of DTCs (completing-the-set in terms of having DTCs with all six members of the Gulf Cooperation Council (GCC))
- Ensures potential tax risks are minimized by providing future tax certainty for:
  - UK businesses (particular in relation to withholding taxes) with UAE operations
  - UK nationals living and working in the UAE
- Strengthens its political, financial and commercial ties across the Middle East more generally

Residence and Employment Income

Article 4 (Residence)

The term "resident of a Contracting State", as defined in Article 4, differs for the UAE and the UK.

An individual will be resident in the UAE if that individual either:

- Is domiciled
- Has their habitual abode
- Has their centre of vital interests

in the UAE.

This is noteworthy because of the absence of any "liability to tax in the UAE" requirement, which causes problems in relation to, for example, persons who are domiciled in Oman, a country without income tax, for the purposes of the UK-Oman DTC. It also makes no requirement that an individual spends a certain number of days in the UAE unlike, for example, the UK-Kuwait DTC. Conversely, the residency requirements applied to the UK for the purposes of the UK-UAE DTC apply a "liable to tax in the UK" test.

This means that it will not be definite, although it will certainly not be impossible, that non-UAE nationals who spend the majority of time in the UAE will be treated as resident in the UAE under the UK-UAE DTC.

This is because they may have insufficient ties to demonstrate that their domicile, habitual abode or centre of vital interests lie there. UAE-based individuals and businesses will need to review the position of each individual on a case-by-case basis.

Where, under the UK-UAE DTC, an individual is a resident of both the UAE and the UK, the country that can claim exclusive residence is determined in accordance with a tiebreaker. The determinative factors are (in order of priority) where the individual's:

- Permanent home is
- Centre of vital personal and economic interests are
- Habitual abode is
- Nationality is

Again, this is helpful for UAE residents who spend a significant amount of time in the UK because, in many cases, it will disapply the day counts in the UK's statutory residence test, which can trigger UK tax residence after a surprisingly short period of time in the UK. This is encouraging for wealthy UAE nationals who wish to spend more time in the UK.

Article 14 (Employment)

The UK-UAE DTC ensures that a UAE-resident individual's employment income earned in the UK will nonetheless be exempt from UK income tax (and, therefore, exempt from tax altogether) provided:

- The employee is not present in the UK for more than 183 days in any relevant 12-month period
- The employment income is paid by a non-UK resident employer (and not by a UK permanent establishment of that employer)

Again, the provisions in the UK-UAE DTC ensure that UAE-based businesses can, from 6 April 2017, be more relaxed about seconding UAE nationals and certain expats to the UK without prompting UK tax liabilities and compliance obligations. This should afford UAE businesses and certain employees greater flexibility in building their UK commercial operations, and exploring investment opportunities.

Dividends, Interest and Royalties

Subject to the imposition of targeted anti-abuse provisions that will limit relief in circumstances where the main purpose is to obtain the benefit of the DTC, cross-border investment by UAE entities in the UK should be dramatically eased and enhanced by the combination of Articles 10, 11 and 12 addressing withholding taxes on the payment of dividends, interest and royalties.

Article 10 (Dividends)

Generally speaking, the UK-UAE DTC provides that dividends will not be subject to withholding taxes in the state of source.

The UK does not, as a matter of domestic law, generally withhold taxes on dividends but there is an important exception relating to distributions paid by real estate investment trusts (REITs).

In the case of UK REITS, distributions of income profits and capital gains are treated as UK property income in the hands of shareholders and subject to withholding tax equal to the basic rate of income tax (currently 20%).

Under the UK-UAE DTC, however, the UK is only allowed to withhold tax at 15%. Where available, therefore, the UK-UAE DTC operates materially to reduce the tax leakage incurred by UAE investors on distributions received from their investments in UK REITs. This reduction, representing an immediate 5% uplift in the return on an investment, will make UK REITS more attractive to, for example, sovereign wealth funds.

The position is even better for UAE pension schemes, which will be entitled to receive distributions from UK REITS without any withholding tax.

Article 12 (Royalties)

Under the provisions of the UK-UAE DTC, intellectual property royalties payable by a UK business to the UAE will only be taxable in the UAE.

Again, this represents a significant development for UAE businesses that own intellectual property and wish to licence it into the UK, which previously gave rise to UK withholding tax at the rate of 20%.

Article 11 (Interest)

The treatment of interest (defined broadly to cover income from debt-claims of every kind, including sharia-compliant financial products) is less straightforward but should, in most cases, lead to a similar position; namely no withholding tax at source in the UK rather than 20%, as previously.

This is of huge benefit to UAE-based Islamic banks lending to customers buying UK property, who have often been advised that customers should withhold tax even if they themselves are not based in the UK.

It is also of benefit to UAE investors who may have previously only considered equity rather than debt investments, due to the absence of withholding tax on dividends.

The UK will not be entitled to impose a withholding tax if the UAE lender is either:

- An individual
- A listed company
- A pension scheme
- A financial institution (unrelated to, and dealing wholly independently with, the UK debtor)
- Any other company (provided, critically, one of the main purposes the UAE company exists is not to secure the benefit of the interest Article)

This means that interest or equivalent finance return paid to the UAE from the UK should be exempt from withholding tax in the majority of cases.

Conclusion

The new UK-UAE DTC both:

- Provides for complete relief for tax withheld in the UK on interest and royalties and significantly improves the after-tax treatment of property income distributions from UK REITs
- Simplifies and improves employment and residency tax issues

All-in-all, therefore, the UK-UAE DTC represents another milestone in the evolution of a new, and stable, fiscal framework that:

- Encourages the expansion of trading and investment links between the UK and the UAE in particular (and across the GCC more generally)
- Dramatically broadens tax-efficient investment opportunities for UAE entities in the UK (e.g. in UK REITs, the licencing of intellectual property and debt financing)

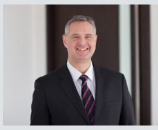
The relative certainty provided by the UK-UAE DTC to existing, and future (the DTC expressly covers any identical or substantially similar future taxes), cross-border transactions will be widely welcomed by the investment community.

All that said, a couple of final notes of caution:

- The benefits of the UK-UAE DTC are not automatically available, are often subject to anti-avoidance provisions and the precise application and interaction of Articles will inevitably depend on the specific facts and circumstances of any particular case and will demand careful consideration.
- The impact of the OECD Multilateral Instrument to implement DTC-related measures to prevent Base Erosion and Profit Shifting (the MLI) on the UK-UAE DTC is not yet clear but it could, materially, automatically restrict the benefit of the UK-UAE DTC through, among other things, the automatic imposition of:
  - A treaty-wide, anti-abuse “principle purpose test” and/or “limitation of benefits” clause
  - Minimum holding period and/or minimum holding threshold conditions before relief from withholding tax on dividends and interest (under Articles 10 and 11) is available

  With the UK set to be first in line to sign the MLI in June 2017, its position in relation to the impact of the MLI on its portfolio of DTCs, including the UK-UAE DTC will need to be carefully considered.

Contacts



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