

# Kluwer International Tax Blog

## CIT in the UAE: The PE Clause for Companies

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Corporate Taxation (CT)

Federal Decree No. 47 of 2022 (UAE CT Law)

Federal Tax Authority (FTA)

Ministry of Finance (MoF)

OECD MC Convention (OECD MC)

Permanent Establishment (PE)

United Arab Emirates (UAE)

UN MC Convention (UN MC)

### 1. Introduction

The United Arab Emirates (UAE) announced the introduction of a Corporate Taxation (CT) regime on 31 January 2022. On 9 December 2022, the Ministry of Finance (MoF) of the UAE published Federal Decree-Law No. 47 of 2022 (UAE CT Law), issued on 3 October 2022, after a public consultation process initiated on 28 April 2022. The UAE CT Law applies only to business profits – i.e., no personal income tax is levied on other types of income such as proceedings from real estate, employment or private investment and savings earned in a personal capacity [1].

The UAE CT Law has been effective since 25 October 2022, and the CT liability applies for financial years starting on or after 1 June 2023. The UAE CT Law is also complemented by several implementing decisions to be adopted by the UAE Cabinet, the UAE Ministry of Finance (MoF) and the UAE Federal Tax Authority (FTA). Only a minor part of this detailed legislation has been issued at the time of writing.

Some of the main objectives for implementing the UAE CT regime are:

1. Cementing the UAE's position as a world-leading hub for business and investment.
2. Meeting international standards for tax transparency and preventing harmful tax practices.
3. Accelerating the UAE's development and transformation to achieve its strategic objectives [2].

Overall, the UAE CT Law is designed relatively straightforwardly and aims to be as business friendly as possible. It applies a relatively moderate headline rate of 9% on business profits above AED 375,000 (i.e., USD 100,000) [3]. There is also a separate rate of 0% on ‘Qualifying Income’ earned by ‘Qualifying Free Zone Persons’, which applies to Free Zone companies [4]. Details on what constitutes ‘Qualifying Income’ are expected to be released through a Cabinet Decision soon.

Further, the UAE CT Law has incorporated, where possible, recommendations and best practices from the 2013-15 BEPS project (e.g., the 30% EBITDA interest deduction limitation from BEPS Action 5 [5] and the Principal Purpose Test (PPT) under BEPS Action 6 [6]).

Remarkably, there is no direct reference under UAE CT Law itself to the OECD/G20-Inclusive Framework BEPS Project, which involves the implementation of a Global Minimum Tax, otherwise known as ‘Pillar Two’. The only indication towards adopting Pillar Two can be read in the UAE MoF FAQs, where the UAE reiterated its commitment to the Inclusive Framework to adopt the proposal in due course [7].

Overall, the UAE CT implements a worldwide taxation system for entities with tax residency in the UAE. For non-resident entities, the UAE CT has sourcing rules and definitions of what constitutes a Permanent Establishment (PE). Those sourcing rules give the UAE the right to tax certain transactions which have a link with the UAE. Those transactions would usually be taxed by way of a withholding tax. However, Article 45 of UAE CT Law has provided it will only apply a 0% withholding tax with no reporting obligations.

## **2. PE Definition under UAE CT Law**

When a business activity of a non-UAE resident enterprise amounts to a certain threshold of presence or activity in the UAE, the PE definition becomes crucial. Non-UAE resident businesses with a PE in the UAE are subject to 9% UAE CT on the profits allocated to that PE.

This article discusses the PE concept under UAE CT Law and contrasts this definition with international tax principles. In the article, the authors analyse the UAE’s PE policy and approach with a few practical examples, focusing on applying the PE clause to companies and other legal entities. The operation of the so-called ‘Separate Entity Approach’ for allocating profits between the head office (HO) and the PE is not addressed.

## **3. Article 14 of UAE CT Law**

UAE CT Law provides a definition of PE under Article 14. The PE definition under UAE CT Law shows similarities and differences with the related concepts in the [OECD Model Tax Convention on Income and Capital 2017](#) (OECD MC) and the [United Nations Model Double Taxation Convention between Developed and Developing Countries 2017](#) (UN MC). Notably, UAE CT Law develops a preference for the PE definition under the OECD MC, with some deviations.

Article 14(1) of UAE CT Law sets forth the instances where a non-resident is considered to have a PE in the UAE, i.e., where, alternatively:

1. A non-resident person has a fixed or permanent place in the UAE through which the business of the non-resident or any part thereof is conducted (commonly known as ‘Fixed Place PE’, also including the so-called ‘Construction PE’).
2. A Person has and habitually exercises an authority to conduct a business or a business activity in

the UAE on behalf of the non-resident person (commonly known as ‘Agency PE’).

3. Where a non-resident person has any other form of nexus in the UAE (to be specified in a UAE MoF’s Cabinet Decision).

#### **4. Comparing the PE Definition under UAE CT Law with the OECD and UN MCs Approaches**

Article 14(1)(a) and (2) of UAE CT Law delineates the so-called ‘Fixed PE’, while Article 14(1)(b) and (5) of UAE CT Law lay down the so-called ‘Agency PE’. Both types of PEs closely follow the corresponding definitions under Article 5 of the OECD MC. Nevertheless, some different nuances between the PE definitions under UAE CT Law and the OECD MC can be noted.

##### **4.1. Fixed PE under UAE CT Law and the OECD MC**

Article 14(2) of the UAE CT Law contains eight instances of fixed PEs [8]. In general, Article 14(2) of UAE CT Law mirrors Article 5(2) of the OECD MC, except in the situations below:

1. The term ‘*place of management*’ under UAE CT Law also covers the following words, ‘*where management and commercial decisions that are necessary for the conduct of the Business are, in substance, made*’. The authors submit that this wording under UAE CT Law – in particular, a reference not only to ‘*management*’ but also to ‘*commercial*’ decision – might suggest that not the place of ‘management and control’ but that of ‘effective management’ of the business should be considered, i.e., the place where the day-to-day management decisions of the business are routinely taken [9].
2. UAE CT Law includes the expression ‘*land, buildings and other real property*’. This expression is not found in either the OECD or the UN MCs. However, it is unclear whether the expression ‘*land, buildings or other real property*’ marks an effective departure from the corresponding provision under the OECD and UN MCs or is merely clarificatory [10].
3. The so-called ‘Construction PE’, while separately listed in Article (14)(2)(i) of UAE CT Law as one of the instances of a fixed PE, deserves some attention, given that it includes a duration of 6 months, unlike the other types of fixed PEs. This duration is shorter than the Construction PE under the OECD MC, which prescribes a 12-month period [11]. Instead, the 6-month threshold is used under the UN MC [12].

##### **4.2. Exceptions to a ‘Fixed Place PE’ under UAE CT Law and the OECD MC**

Article 14(3) of UAE CT Law contains a list of activities which, taken in isolation, do not amount to a PE, similarly to the exclusionary provision under Article 5(4) of the OECD MC. The scope of this exclusionary provision involves situations, where, notably, certain activities are conducted in isolation and are of a ‘preparatory’ or ‘auxiliary’ nature.

In detail, the coverage of Article 14(3) of UAE CT Law mirrors that of Article 5(4) of the OECD MC, except in the situations below:

1. UAE CT Law does not have a provision equivalent to ‘*[m]aintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery*’, as laid down in Article 5(4)(b) of the OECD MC.
2. OECD MC uses the term ‘*[m]aintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity*’, while Article 14(3)(d) of UAE CT Law has a slightly broader wording, i.e., ‘*conducting any other activity of a preparatory or auxiliary nature*

*for the non-resident person*'.

3. OECD MC covers the term as '*[m]aintenance of a fixed place of business solely for any combination of activities above provided that the overall activity is of a preparatory or auxiliary nature*', while Article 14(3)(e) of UAE CT Law has a slightly broader wording, i.e., '*[c]onducting any combination of activities mentioned in paragraphs (a), (b), (c) and (d) of Clause 3 of this Article, provided that the overall activity is of a preparatory or auxiliary nature*'.

Overall, the scope of the exclusionary provision under the PE definition of Article 14(3) of UAE CT Law seems slightly broader than that of Article 5(4) of the OECD MC. Therefore, a non-resident person may benefit from the PE exclusionary clause in more situations than based on the corresponding provision under the OECD MC.

### **4.3. Comparing the Anti-Fragmentation Rule under Article 14(4) of UAE CT Law and Article 5(4.1) of OECD MC**

Article 14(4) of UAE CT Law provides an exception to Article 14(3) of UAE CT Law (effectively, an exclusion to the exception to the UAE general rule for PE) [13].

The core of the provision is that the exception under Article 14(3) of UAE CT Law does not apply, so a PE exists in the UAE, if all of the following four requirements are fulfilled:

1. A fixed or permanent place in the UAE is used or maintained by a non-resident.
2. The same non-resident or its Related Party carries on a Business or a Business Activity at the same place or another place in the UAE.
3. The same place or the other place constitutes a PE for either the non-resident or its Related Party.
4. The '*overall activity*' resulting from the combination of the activities carried out by the non-resident and its related party at the same place or at the two places is not of a preparatory or auxiliary nature. Such overall activity would form a '*cohesive business operation*', had the activities not been fragmented.

The mirror provision in the OECD MC is laid down in Article 5(4.1.), which refers to the term '*or*' (i.e., disjunctive) when delineating the requirements under (iii) and (iv) above. On the other hand, UAE CT Law uses the term '*where all of the following conditions are met*' (i.e., conjunctive, equivalent to '*and*'). This might suggest that, for the exclusion of the PE exception to apply under UAE CT Law, both the conditions under (iii) and (iv) above must be jointly fulfilled.

The difference is material. Take the situation of a company, Alpha, based in the United States, with which the UAE does not have a tax treaty. It has a closely related enterprise in the United States, Beta. Both companies are part of 'AB Group'. Alpha maintains a place of business 'A' in the UAE. Beta also maintains a place of business 'B' in the UAE. In A, the sole activity of invoicing is performed. In B, the sole activity of account reconciliation is performed. Both A and B individually do not constitute a PE of the respective non-resident companies, their activities being merely 'preparatory' and 'auxiliary' within the meaning of Article 14(3) of UAE CT Law. When viewed together, the activities of A and B form a '*cohesive business operation*', since the combined finance function of invoicing and account reconciliation can no longer be holistically considered 'preparatory' or 'auxiliary'. And yet, the anti-fragmentation rule under Clause 4 of Article 14 of UAE CT Law cannot apply since none of the two fixed places is of '*a preparatory of auxiliary nature*' as prescribed under point b) of that Article [14].

#### **4.4. Comparing the ‘Agency PE’ and ‘Independent Agent’ Concepts under Article 14(5) of UAE CT Law and Article 5(5) of OECD MC**

As explained above, Article 14(1)(b) delineates the ‘Agency PE’ concept along with Article 14(5) of UAE CT Law. These two provisions fundamentally reflect Article 5(5) of the OECD MC.

Essentially, Article 14(5) of UAE CT Law provides that the so-called ‘Agency PE’ is triggered if either of the conditions is met:

1. The Person habitually concludes contracts on behalf of the non-resident.
2. The Person habitually negotiates contracts that are concluded by the non-resident, without the need for material modification by the non-resident.

Article 5(5) of the OECD MC also provides these two alternative conditions. The only meaningful difference between the two systems is that UAE CT Law does not refer to the *type* of contracts, as covered under both the OECD and UN MCs [15]. Also, UAE CT Law does not include the additional clause under Article 5(5)(b) of the UN MC, i.e., ‘*habitual maintenance of stock of goods from which the person regularly delivers goods or merchandise on behalf of the enterprise*’ [16].

An exception to the PE rule is the ‘Independent Agent’ concept covered under Article 14(6) of UAE CT Law. Under this provision, a PE is not triggered when the agent resident in the UAE performs certain activities for the non-resident in the ‘*ordinary course*’ of its own Business or Business Activity. This is because such an agent’s activities represent a separate and independent enterprise [17].

Article 14(6) of UAE CT Law also significantly mirrors Article 5(6) of the OECD MC. The only meaningful difference is that the OECD MC also refers to ‘*closely related*’ enterprises. The distinction is nuanced. The OECD MC excludes from the scope of the ‘independent agent’ provision the case in which the person acting (almost) exclusively on behalf of ‘*one or more enterprises that are closely related*’. This exclusion of ‘*closely related*’ enterprises is missing in UAE CT Law.

Importantly, Clause 6 of Article 14 of UAE CT Law also becomes relevant in relation to Article 15 of UAE CT Law, which lays down the so-called ‘Investment Manager Exemption’ (IME). This clause – which is not contained in the OECD or UN MCs but only under the PE definition of some countries [18] – provides a series of conditions based on which, if all are fulfilled, ‘*an Investment Manager shall be considered an independent agent when acting on behalf of a Non-Resident Person*’.

#### **4.5. Article 14(1)(c) of UAE CT Law: A Nexus or Service PE?**

Based on Article 14(1)(c) of UAE CT Law, a PE can also be established on a non-resident person having ‘*any other form of nexus*’ in the UAE. A UAE MoF’s Cabinet Decision is expected to provide additional details on the scope of this provision. Even though it is not expressly stated so far, the open-ended nature of this provision may allude to a possible expansion to other types of PEs, such as a Service PE (inspired by Article 5(3)(b) of the UN MC) [19] or an Insurance PE (inspired by Article 5(6) of the UN MC) [20], both types of PEs laid down in the UN MC. The expression ‘any other form of nexus’ could also be linked with Clause 7 of Article 14 of UAE CT Law, detailing the ‘*conditions under which the mere presence of a natural person in the State does not create a permanent establishment for a Non-Resident Person*’. A forthcoming blog from the

authors of this blog will discuss the scope and issues relating to Clause 7 of Article 14 CT Law.

## **5. Conclusion**

This article has shown how the PE policy under UAE CT Law must still be fully ‘decodified’. The authors believe that implementing decisions to be adopted by the UAE Cabinet, the UAE MoF, and the UAE FTA will help shed some light on (still) unclear elements of the PE policy under UAE CT Law. Meanwhile, businesses operating in the UAE should rely on qualified interpretation by tax experts to fill in other (non-)intended legislative blind spots. Also, other than the PE Clause under UAE CT, businesses should include the examination of tax treaty provisions applicable to their individual situation in their PE analysis.

**For Thomas Vanhee and Varun Chablani: The views expressed in this article are sole of the authors and do not necessarily reflect the position of the employers or the parties with which the authors are affiliated.**

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[1] See FAQs no. 36, 38, 39 and 40 of UAE Ministry of Finance (MoF).

[2] See FAQ No. 2 of UAE MoF.

[3] See UAE Cabinet of Ministers Decision No. 116 of 2022 on the annual Taxable Income subject to Corporate Tax.

[4] See Article 18 of UAE CT Law, read with the definitions of ‘Qualifying Free Zone Person’ and ‘Qualifying Income’ in Article 1 of UAE CT Law.

[5] See Article 30 of UAE CT Law.

[6] See Article 50 of UAE CT Law.

[7] See FAQ No. 157 of UAE MoF.

[8] Clause 2 of Article 14 of UAE CT Law reads as follows: *‘[f]or the purposes of paragraph (a) of Clause 1 of this Article, a fixed or permanent place in the State includes: a) A place of management where management and commercial decisions that are necessary for the conduct of the Business are, in substance, made. b) A branch. c) An office. d) A factory. e) A workshop. f) Land, buildings and other real property. g) An installation or structure for the exploration of renewable or non-renewable natural resources. h) A mine, an oil or gas well, a quarry or any*

*other place of extraction of natural resources, including vessels and structures used for the extraction of such resources. i) A building site, a construction project, or place of assembly or installation, or supervisory activities in connection therewith, but only if such site, project or activities, whether separately or together with other sites, projects or activities, last more than (6) six months, including connected activities that are conducted at the site or project by one or more Related Parties of the Non-Resident Person’.*

[9] Regarding the concept of ‘place of effective management’ under Article 5(2)(a) of the OECD MC, the OECD Commentary only provides the following: *‘[t]he term “place of management” has been mentioned separately because it is not necessarily an “office”. However, where the laws of the two Contracting States do not contain the concept of “a place of management” as distinct from an “office”, there will be no need to refer to the former term in their bilateral convention’.* The UN MC Commentary on Article 5 merely reproduced these statements from the OECD MC Commentary on Article 5.

[10] Notably, one may consider that since UAE CT only applies to income derived from ‘Business’ and ‘Business Activities’, if no business activity is conducted on ‘*land, buildings and other real property*’ in the UAE, no PE issue arises. This seems to support the view that the expression ‘*land, buildings and other real property*’ is merely clarificatory and does not have any substantive effect from a UAE CT’s standpoint.

[11] Article 5(3) of the OECD MC.

[12] Article 5(3) of the UN MC.

[13] Clause 4 of Article 14 of UAE CT Law reads as follows: *‘[c]lause 3 of this Article shall not apply to a fixed or permanent place in the State that is used or maintained by a Non-Resident Person if the same Non-Resident Person or its Related Party carries on a Business or Business Activity at the same place or at another place in the State where all of the following conditions are met: a) Where the same place or the other place constitutes a Permanent Establishment of the Non-Resident Person or its Related Party. b) The overall activity resulting from the combination of the activities carried out by the Non-Resident Person and its Related Party at the same place or at the two places is not of a preparatory or auxiliary nature and together would form a cohesive Business operation, had the activities not been fragmented’.*

[14] See E. Reimer, *Klaus Vogel on Double Taxation Conventions. Commentary to Article 5(4.1)*, (5<sup>th</sup> ed., 2021), paragraph 355: *‘[m]oreover, the two (or more) business activities need to be part of a cohesive business operation. The context suggests that the indefinite term ‘operation’ is not a synonym for ‘function’ but designates a higher (more aggregate and more complex) concept, i.e. an amalgam of two or more function. This is in line with the multiple use of ‘business operation(s) in the OECD Commentary. The functions need to be ‘cohesive’, i.e. need to show a direct connection. Where goods are processed, this direct connection (the cohesion) can be assumed where the products/by-products remain on side (or in the case of two PoBs, where the goods are transported directly between these two PoBs) and are not shipped/transported via a third place like, e.g., a PoB (including the head office) in the State of residence or in a third state’.*

[15] See Article 5(5) of the OECD MC which refers to contracts *‘a) in the name of the enterprise, or b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or c) for the provision of services by that*

*enterprise*’.

[16] Paragraph 70 of the UN MC Commentary on Article 5 interprets this phrase as follows to determine when Article 5(5)(b) of the UN MC triggers a PE in the source state: *‘[t]he former Group of Experts understood that paragraph 5(b) was to be interpreted such that if all the sales-related activities take place outside the host State and only delivery, by an agent, takes place there, such a situation would not lead to a permanent establishment. The former Group of Experts noted, however, that if sales-related activities (for example, advertising or promotion) are also conducted in that State on behalf of the resident (whether or not by the enterprise itself or by its dependent agents) and have contributed to the sale of such goods or merchandise, a permanent establishment may exist’*.

[17] Reference is made to Paragraph 102 of the OECD MC which reads as follows: *‘[w]here an enterprise of a Contracting State carries on business dealings through an independent agent carrying on business as such, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of that business (see paragraph 83 above). The activities of such an agent, who represents a separate and independent enterprise, should not result in the finding of a permanent establishment of the foreign enterprise’*.

[18] See, e.g., UK Government, *Find Out About the Investment Manager Exemption for Non-Resident*; R. Russo & A. Papotti, *The Italian Investment Management Exemption: A New Dawn for Asset Management in Italy?*, Kluwer International Tax Blog (13 January 2023).

[19] See Article 5(3)(b) of the UN MC which reads as follows: *‘[t]he term ‘permanent establishment’ also encompasses: ... b) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned’*.

[20] See Article 5(6) of the UN MC which reads as follows: *‘6. Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person’*.

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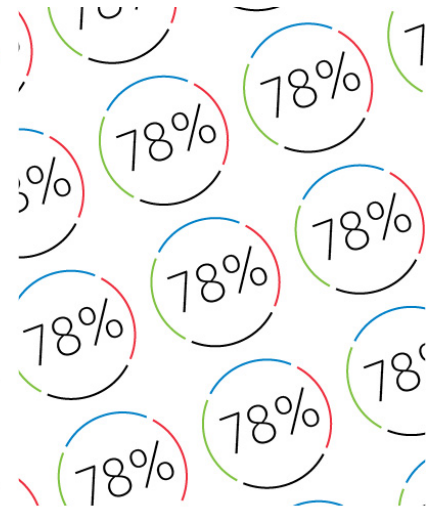
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