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CIT in the UAE: The PE Clause for Individuals

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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. 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 a UAE 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 UAE 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.

In the previous article, the authors discussed the PE concept under UAE CT Law and contrasted this definition with international tax principles. This article deals with the PE concept applied to individuals operating as solo entrepreneurs or freelancers (including investment managers) in the UAE territory. In particular, the authors discuss when an individual physical presence and/or a home office in the UAE may qualify as a PE under UAE CT Law.

3. Article 14(7) of UAE CT Law

Besides establishing when a fixed place of business or a non-independent agent acting on behalf of a non-resident enterprise qualify as a PE in the UAE, the PE definition in Article 14 of UAE CT Law considers, under Clause 7, whether and when the physical presence of an individual in the UAE territory may lead to a foreign enterprise having a PE therein.

Notably, Clause 7 of Article 14 of UAE CT Law stipulates that *‘[f]or the purposes of Clause 3 of this Article [i.e., Article 14 of UAE CT Law], the Minister may prescribe 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 ...’*.

The provision in Article 14(7) of UAE CT Law is neither part of any ‘standard’ PE definition under national CT laws nor included in Article 5 of the OECD Model Convention (OECD MC) or

the UN Model Convention (UN MC). The exact scope of this provision is somewhat vague, also given that its actual coverage is explicitly made subject to a future determination by a UAE MoF's Cabinet Decision. A systematic interpretation of Clause 7 of Article 14 of UAE CT Law (in light of other Clauses within Article 14 of UAE CT Law) would suggest reading it in parallel with Point c) of Clause 1 of Article 14 of UAE CT Law. From this perspective, Clause 7 of Article 14 of UAE CT Law might be read as designating when the mere presence of an individual does not amount to 'any other form of nexus' in the UAE, as stipulated under Point c) of Clause 1 of Article 14 as a third type of PE under UAE CT Law (for further reference, see our previous considerations in this blog).

There are, however, a few elements of Clause 7 of Article 14 of UAE CT Law which already appear sufficiently explained:

1. Clause 7 applies only to natural persons, i.e., individuals. It follows that companies or other legal entities are not affected by this provision [8]. On the other hand, one may wonder whether unincorporated partnerships may somehow fall within the scope of this provision since, under Articles 16 of UAE CT Law, these legal entities may not be considered taxable persons of their own rights, but instead their partners assume UAE CT liability on their behalf [9].
2. Clause 7 explicitly refers and, therefore, must be read jointly with Clause 3 of Article 14 of UAE CT Law concerning the list of specific activities whose carrying on through a fixed place of business is insufficient to constitute a PE [10]. The rationale behind excluding any relevance of such activities for PE purposes is likely to be found in the OECD MC Commentary, which, in paragraph 58, stipulates that the analogous exclusionary list under Article 5(4) of the OECD MC relates to activities which only contribute marginally to the profits of the enterprise, i.e., '*are so remote from the actual realisation of profits that is difficult to allocate any profit to the fixed place of business in question*'.
3. Clause 7 establishes no link to Clause 5 of Article 14 of UAE CT Law concerning the personal PE. Therefore, it can be assumed that a person habitually concluding or negotiating contracts on behalf of a Non-Resident Person always constitutes a PE, without any possibility for such an activity to be excluded under Clause 7 of Article 14 of UAE CT Law [11]. Clause 7 of Article 14 might be of concern also to an investment manager in case any of the conditions to be considered an 'independent agent' under Clause 6 of Article 14 of UAE CT Law, as detailed explicitly in Article 15 of UAE CT Law, are not fulfilled [12]. This is because, in case any of the conditions for the 'Investment Manager Exemption' (IME) to apply, according to Article 15 of UAE CT Law, are not fulfilled, whether the investment manager triggers a PE for a foreign investment fund is to be checked against all the clauses of Article 14 of UAE CT Law and, in particular, Clause 7 of that Article, concerning the '*mere presence of a natural person*' [13].

4. Applying Article 14(7) of UAE CT Law to the Case of an Individual Physically Present in the UAE

Since Clause 7 of Article 14 of UAE CT Law refers to '*any of the following instances*', the cases under which the mere presence of an individual in the UAE does not constitute a PE as detailed in Points a) and b) appear to be alternative (contrary to the subparagraphs 1) and 2) under Point b), which instead refer to '*all of the following conditions*'). Therefore, the PE exclusion applies even if only one of the requirements specified in any of the two subparagraphs of Clause 7 is fulfilled.

Point a) of Clause 7 of Article 14 of UAE CT Law sets forth a PE exclusion in the case of the mere presence of a natural person being '*a consequence of a temporary and exceptional situation*'.

Arguably, this exclusion only applies in limited circumstances, such as the one that occurred during the outbreak of COVID-19 in 2020-21, where many employees were stranded in locations other than where they used to live and/or work [14]. The authors also note that the expression used under Point a) of Clause 7 of Article 14 of UAE CT Law is somewhat comparable to that of ‘*exceptional circumstances*’ used for counting the days of physical presence leading to the tax residence of a natural person in the UAE [15].

Point b) of Clause 7 of Article 14 of UAE CT Law is only applicable to an individual who is employed by a foreign enterprise. However, how the concept of ‘employee’ should be interpreted is not (yet) specified. In this connection, one may wonder whether only a formal relationship of employment is acknowledged or, instead, this provision might also apply in cases of international hiring-out-of-labour (IHOL), where, following a substance-over-form approach, the ‘real’ employer might differ from the ‘formal’ employer [16]. The authors also note that a definition of ‘*employment*’ for tax residency purposes is provided by a decision issued by the UAE FTA on 1 March 2023. And yet, the definition contained in that decision does not refer to the concept of ‘*employment*’ under Article 14 of UAE CT Law, so the interpretive value of that expression for PE purposes cannot simply be assumed [17].

Subparagraph 1 of Point b) of Clause 7 of Article 14 of the UAE CT Law refers to ‘*core income-generating activities of the Non-Resident Person or its Related Parties*’. This expression, as well as Clause 7 in general, is not included in either the OECD MC or the UN MC. Reference to ‘core income-generating activities’ suggests the need to determine whether business activities conducted in the UAE territory have a preparatory or auxiliary character. In this regard, the OECD MC Commentary provides that, in order ‘*to distinguish between activities which have a preparatory or auxiliary character and those which have not*’, ‘*[t]he decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole*’ [18]. The authors also note that the UAE MoF’s Economic Substance Requirements (ESRs) resolution contains an identically worded expression [19]. One may therefore wonder whether such an identical wording implies that the carrying out of any of the activities within the scope of ESRs always triggers a PE in the UAE.

5. Applying Article 14(7) of UAE CT Law to the Case of a ‘Home Office PE’ in the UAE

The actual business operations carried out in the UAE *vis-a-vis* the overall business activity of a foreign enterprise might also be critical to determine the existence of a PE in the UAE in the form of a ‘home office’. This occurs when the employee physically present in the UAE uses a home therein *in lieu* of an office so that such a private dwelling in the UAE can be considered at the disposal of the foreign employer of the individual who lives there [20]. Actual relocations in the UAE might eventually be facilitated by applications for a special residence visa by foreign employees moving to the UAE territory or the city of Dubai while retaining employment in their respective foreign countries [21].

Regarding the case of a ‘home office PE’ in the UAE, the authors would advise that the clarifications to be released by the UAE MoF under Clause 7 of Article 14 of UAE CT Law for ‘*core income-generating activities*’ help determine when activities carried out at a private dwelling of an employee (e.g., a hotel room) amounts to a PE, such activities not being instead ‘merely auxiliary’ [22]. In this connection, the authors are of the view that no home office PE should be triggered when an employee’s activities performed in the UAE are not aimed at the UAE market or

customers [23]. On the other hand, it must be recalled that the circumstance that business activities performed by an individual through his/her presence in the UAE are not part of the ‘*income-generating activities*’ of a foreign enterprise is, by itself, insufficient to exclude the existence of a PE in the UAE. This is because of the operation of the anti-fragmentation rule in Clause 4 of Article 14 of UAE CT Law in the case of business activities by two or more parties which are linked to one another [24].

Subparagraph 2 of Point b) of Clause 7 of Article 14 of UAE CT Law also requires that ‘*[t]he Non-Resident Person does not derive State Sourced Income*’. This condition might prove difficult to escape from a foreign enterprise considering the broad scope attributed to ‘*State Sourced Income*’ under Article 13 of UAE CT Law. Notably, this provision sourced in the UAE not only services performed but even services ‘*benefitted*’ in the UAE territory. Moreover, Clause 2 of Article 13 includes a broad list of ‘*State Sourced Income*’, some of which, arguably, have only a weak nexus with the UAE, such as ‘*income from a contract insofar as it has been wholly or partly performed or benefitted from in the State*’ or ‘*income from the use or right to use in the State, or the grant of permission to use in the State, any intellectual or intangible property*’. In this connection, it is also unclear whether a natural person might constitute a PE for a foreign enterprise even if the State Source Income derived by the foreign enterprise is unrelated to the specific activities the employee performs in the UAE.

6. Conclusions

UAE CT Law and the PE clause contained in Article 14 therein have been designed to adopt international tax best practices. In this regard, the PE clause in UAE CT Law generally follows the corresponding provisions in Article 5 of OECD and UN MCs and explanations provided in the related Commentaries. However, applying and interpreting the concepts and definitions contained in Article 14 of UAE CT Law is not always straightforward. This article has focused on the implications of the PE clause for individual entrepreneurs and freelancers (including investment managers). It has shown that, in certain instances, based on Article 14(7) of UAE CT Law, individuals may trigger a PE in the UAE if they are physically present or have a home office therein. Individual entrepreneurs and freelancers (including investment managers) should therefore examine attentively whether and when their activities and/or presence may trigger the UAE PE clause and, consequently, a UAE CT liability.

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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] It should be noted that the physical presence of an individual in the UAE territory might cause that individual also becoming UAE tax resident and, therefore, if conducting business activities, potentially liable to UAE CT. Notably, the UAE MoF’s Cabinet Decision No. 85 of 2022 provides, at Article 4, that a natural person is considered resident if s/he is physically present in the UAE for a period of 183 days or more within 12 consecutive months or, in the case of a UAE national or a holder of a resident permit in the UAE or a national of a Gulf Cooperation Country (GCC) country, even for a shorter period (i.e., 90 days within 12 consecutive months). With respect to the calculation of the time periods of an individual’s physical presence, see also Article 3 of Ministerial Decision No. 27 of 2023 on the Implementation of Certain Provisions of Cabinet Decision No. 85 of 2022 on Determination of Tax Residency. Concerning UAE CT liability, Clause 6 of Article 11 of UAE CT Law provides that ‘*[t]he Cabinet shall, upon a suggestion of the Minister [i.e., the UAE MoF] and in coordination with the relevant competent authorities, issue a decision specifying the categories of Business or Business Activity conducted by a resident or non-resident natural person that are subject to Corporate Tax under this Decree-law*’. Concerning the UAE CT’s taxable base, Clause 2 of Article 12 of UAE CT Law stipulates that ‘*[t]he Taxable Income of a Resident Person, which is a natural person, is the income derived from the State or from outside the State insofar as it relates to the Business or Business Activity conducted by the natural person in the State as set out in Clause 6 of Article 11 of this Decree-Law*’. As of time of writing, the UAE MoF has still to issue the relevant Cabinet Decision for implementing these provisions.

[9] Notably, regarding unincorporated partnerships, Article 16 of UAE CT Law stipulates that ‘*[p]ersons conducting a Business as an Unincorporated Partnership shall be treated as individual Taxable Person for the purposes of this Decree Law*’.

[10] Clause 3 of Article 14 of UAE CT Law reads as follows: ‘*[n]otwithstanding Clauses 1 and 2 of this Article, a fixed or permanent place in the State shall not be considered a Permanent Establishment of a Non-Resident Person if it is used solely for any of the following purposes: a) Storing, displaying or delivering of goods or merchandise belonging to that Person. b) Keeping a stock of goods or merchandise belonging to that Person for the sole purpose of processing by another Person. c) Purchasing goods or merchandise or collecting information for the Non-Resident Person. d) Conducting any other activity of a preparatory or auxiliary nature for the Non-Resident Person. e) Conducting 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’.

[11] Clause 5 of Article 14 of UAE CT Law reads as follows: *‘[f]or the purposes of paragraph (b) of Clause 1 of this Article, a Person shall be considered as having and habitually exercising an authority to conduct a Business or Business Activity in the State on behalf of a Non-Resident Person if any of the following conditions are met: a) The Person habitually concludes contracts on behalf of the Non-Residence Person. b) The Person habitually negotiates contracts that are concluded by the Non-Resident Person without the need for material modification by the Non-Resident Person’*.

[12] Article 15 of UAE CT Law, which contains the so-called ‘Investment Manager Exemption’ (IME) reads as follows: *‘1. For the purposes of Clause 6 of Article 14 of this Decree-Law, an Investment Manager shall be considered an independent agent when acting on behalf of a Non-Resident Person, where all of the following conditions are met: a) The Investment Manager is engaged in the business of providing investment management or brokerage services. b) The Investment Manager is subject to the regulatory oversight of the competent authority in the State. c) The transactions are carried out in the ordinary course of the Investment Manager’s Business. d) The Investment Manager acts in relation to the transactions in an independent capacity. e) The Investment Manager transacts on an arm’s length basis with the Non-Resident Person and receives due compensation for the provision of services. f) The Investment Manager is not the Non-Resident Person’s representative in the State in relation to any other income or transaction that is subject to Corporate Tax for the same Tax Period. g) Any such other conditions as may be prescribed in a decision issued by the Cabinet at the suggestion of the Minister. 2. For the purposes of Clause 2 of this Article, “transactions” means any of the following: a) Transactions in commodities, real property, bonds, shares, derivatives or securities of any other description. b) Transactions of buying or selling any foreign currency or placement of funds at interest. c) Such other transactions permissible to be carried out by the Investment Manager on behalf of a Non-Resident Person under the applicable legislation of the State’*.

[13] The so-called ‘Investment Manager Exemption’ or ‘Investment Management Exemption’ (IME) is not included in the OECD and UN MCs, but it has been implemented by a few countries. 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).

[14] Regarding the impact on international tax law of exceptional situations occurring during the COVID-19 pandemic, see OECD, *Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic* (21 January 2021) and OECD, *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 April 2020).

[15] See Article 4 of Ministerial Decision No. 27 of 2023 on the Implementation of Certain Provisions of Cabinet Decision No. 85 of 2022 on Determination of Tax Residency, which, upon considering the any day that the natural person’s presence in the UAE due to ‘*exceptional circumstances*’ may be disregarded by the FTA, defines ‘*[a]n exceptional circumstance*’ as ‘*an event or situation beyond the natural person’s control, occurring while he is already in the State, which he could not reasonably have predicted or prevented and which prevents him from leaving the State as originally planned*’.

[16] Regarding the implication of IHOL in international tax law, see Paragraph 8.3 of OECD MC

Commentary on Article 15.

[17] See, in particular, Article 6(1) of Ministerial Decision No. 27 of 2023 on the Implementation of Certain Provisions of Cabinet Decision No. 85 of 2022 on Determination of Tax Residency, stipulating that *'[a] natural person shall be considered as carrying on employment in the State in either of the following two cases: a) if he is party to a contract with an employer, which is incorporated or otherwise formed or recognised in the State, under which the natural person undertakes to offer a service to the employer under their administration or supervision for a promised remuneration paid by the employer in the State. (b) If he is in a continuing relationship where all or substantially all of his income for his labour is derived from one party whereby the income received by him constitutes remuneration for his labour performed in the State'*.

[18] See Paragraph 59 of OECD MC Commentary on Article 5, also stipulating that *'a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise does not exercise a preparatory or auxiliary activity'*.

[19] Article 3(2) of UAE MoF's Cabinet Resolution No. 57 of 2020 revoking Cabinet Resolution No. 31 of 2019 concerning 'Economic Substance Requirements' (ESRs) defines 'Core Income Generating Activities' as *'activities that are of central importance to a Licensee for generating income from a Relevant Activity'*. Article 3(1) of UAE MoF's Cabinet Resolution No. 57 of 2020 lists nine 'Relevant Activities', i.e.: a) Banking Business. b) Insurance Business. c) Investment Fund Management Business. d) Lease-Finance Business. e) Headquarters Business. f) Shipping Business. g) Holding Company Business. h) Intellectual Property Business. i) Distribution and Service Centre Business.

[20] See Paragraphs 18 and 19 of OECD MC Commentary on Article 5. Concerning the concept of 'home office', see also OECD, *The Interpretation and Application of Article 5 (Permanent Establishment) of the OECD MC Tax Convention* (2011), pp. 12-13.

[21] Reference is made to the UAE 'Virtual Work Residence Visa' and the Dubai's 'Virtual Working Programme', <https://u.ae/en/information-and-services/visa-and-emirates-id/residence-visas/residence-visa-for-working-outside-the-uae>.

[22] See Paragraph 19, last sentence of the OECD MC Commentary on Article 5 stipulating that *'the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4'*.

[23] In this regard, see, e.g., DK: Skatterådet (Tax Council), Decision No. 21-0702381 of 26 October 2021, where no home office PE was found since an employee's duties were geared towards development-related research projects in Africa and were not specifically aimed at the Danish market or customers.

[24] 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'.

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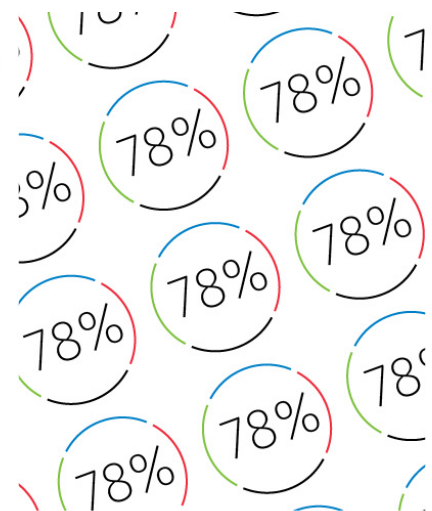
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