The tax situation in Dubai

Dubai, the least oil-rich emirate of the UAE, has its own tax decree. Jan Kooi of Omnicom Europe looks at how it has found a way to promote foreign investment.

Like the other emirates, Dubai only levies an income tax on the profits of corporate bodies. Each emirate has its own tax decree but the rates are similar and range from 0% on the first million dirhams (Dh) to 50% on profits in excess of Dh5m. The rates increase by 10% for each tranche of Dh1m.

Dubai's tax system

Dubai has a particular system of calculating tax. Contrary to the other emirates it taxes all income at the rate that applies to the bracket in which the total amount of profit falls, rather than applying successive rates on each separate tranche. To alleviate the effect of a marginal amount of profit above the borderline between two brackets, a special computation is applied as follows:

A profit of Dh3.1m would normally be taxed at 30%, which applies to profits between DH3m and Dh4m. The special computation prescribes that the tax is calculated at 20% up to Dh3m (being the borderline with the proceeding bracket) and is increased with the entire amount of the excess. This leads to an effective tax of Dh700,000, while the ordinary rule in Dubai would lead to a tax of Dh930,000.

However, if the special computation leads to higher taxes than the normal system, then the normal rules apply. Thus, a profit of Dh3.5m would bear a tax of Dh1.05m (30%), while the special computation would lead to a tax of Dh1.1m or 20% on Dh3m, plus Dh5m.

In practice the tax is only levied from oil companies and banks. Dubai levies tax from most foreign banks at a special flat rate of 20%.

Since Dubai has much less oil revenue than other emirates a special free trade zone has been established to promote foreign investment. The companies in the Jebel Ali free trade zone engage in trading and distribution as well as some light manufacturing, including assembly.

> Far more important than any tax benefits is the fact that companies operating in the free trade zone can be 100% foreign-owned. Normally, 51% of a company should be owned by emirate nationals

The free trade zone

From a tax point of view the free trade zone does not add too many benefits to companies operating outside of it, in view of the fact that the corporate income tax decree is in any event not enforced for companies other than the oil industry and banks. The free trade zone, however, exempts companies operating there from customs duties. Normally customs duties are levied at 4%, but typically 3% is rebated to attract investments, as a consequence of which the actual tax benefit of operating in the free trade zone is really a saving of 1% customs duty.

Jan Kooi

Far more important than any tax benefits is the fact that companies operating in the free trade zone can be 100% foreign-owned, while normally 51% of a company should be owned by emirate nationals. Furthermore, the registration procedures for companies operating in the free trade zone are much simpler than for 'ordinary' companies. In addition to the exemption of payment of taxes and duties, companies operating in the Jebel Ali free trade zone are guaranteed freedom of transfer of capital, profits and salaries. The enterprise in the free trade zone can be either a branch of a foreign company or in the form of a wholly owned subsidiary.

Tax treaties with western Europe

The emirates have concluded a limited number of tax treaties with countries in western Europe, these are France, Italy, Germany and Finland. However only the treaty with France is currently in force. There are several treaties with countries around the Mediterranean sea, in Asia and former eastern Europe. In addition, there are limited tax treaties that deal solely with shipping income concluded with The Netherlands, Switzerland, Singapore, India, Sri Lanka and the US.

According to the latest information treaty negotiations are under way with the UK, Belgium and Canada.

The latest development in Dubai taxation is an increase of the Dubai municipality tax, which is levied on hotel rooms and furnished apartments from 5% to 10%. This became effective 1 May 1998. ■

Jan Kooi is European tax director of Omnicom Europe Limited.