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TAX ALERT

Pillar Two Update

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Tax Alert
Pillar Two Update

This alert is based on Cabinet Decision No. (142) of 2024 and its annexure, Cases, Provisions, Conditions, Rules, Controls, and Procedures on the Imposition of Top-up Tax on Multinational Enterprises.

1. Introduction

The UAE has introduced a supplementary tax in the form of a Domestic Minimum Top-up Tax ("DMTT") on Multinational Enterprises ("MNEs") vide Cabinet Decision No. (142) of 2024 (the "CD 142") and the supporting legislation, "Cases, Provisions, Conditions, Rules, Controls, and Procedures on the Imposition of Top-up Tax on Multinational Enterprises" ("UAE Pillar Two Rules").

This legislation demonstrates the UAE's commitment to the Organisation for Economic Co-operation and Development (OECD) Two-Pillar Solution and implementing a DMTT of 15% on large MNEs. This alert provides a broad overview of the key provisions of the UAE's Pillar Two Rules.

CD 142 and UAE Pillar Two Rules apply to fiscal years on or after 1 January 2025.

2. Background

In July 2021, the OECD introduced an international tax reform framework, known as the two-pillar solution, to address base erosion and profit shifting (BEPS) risks arising from the digitalization of the economy—commonly referred to as "BEPS 2.0." By October 2021, over 130 jurisdictions within the OECD/G20 Inclusive Framework on BEPS (IF) had reached an agreement on this initiative [1].

[1] Pillar-2-Guidance-document.pdf

[2] Ministry of Finance Launches Digital Public Consultation on Implementation of Global Minimum Tax in UAE-Ministry of Finance-United Arab Emirates.

On November 24, 2023, the United Arab Emirates (UAE) issued Federal Decree Law No. (60) of 2023, amending specific provisions of Federal Decree Law No. (47) of 2022 on the Taxation of Corporations and Businesses ("UAE CT Law") in order to facilitate the future implementation of domestic minimum taxes.

As part of this initiative, the UAE's Ministry of Finance (MoF) launched a public consultation on Pillar Two implementation on March 15, 2024 [2]. Thereafter, the Ministry of Finance on December 09, 2024, announced certain amendments to the UAE Corporate Tax Law that will cover the following aspects:

1) Implementation of a domestic minimum top-up tax to be made effective for financial years on or after 1 January 2025; and

2) The introduction of the following tax incentives to support growth and innovation:

a) The R&D tax incentive will be expenditure-based, offering a potential 30-50% tax credit, and will be refundable depending on the revenue and number of employees of the business in the UAE.

The proposed incentive is expected to take effect for tax periods starting on or after 1 January 2026.

b) A refundable tax credit for high-value employment activities. This incentive is proposed to take effect on 1 January 2025 and will be granted as a percentage of eligible salary costs for employees engaged in high-value employment activities.

To implement the DMTT, the UAE has introduced Cabinet Decision No. 142 of 2024 (CD 142) along with the UAE Pillar Two Rules.

3. What is Pillar Two and Domestic Top-up Tax?

Pillar Two is intended to ensure that MNEs with a consolidated revenue equal to or above EUR 750 million pay a minimum tax of 15%.

In this relation, Global Anti-Base Erosion (GloBE) Rules and other supporting guidance documents have been issued by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) that provide for the framework for implementing such a Global Minimum Tax.

[3] Tax Challenges Arising from the Digitalisation of the Economy–Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), Central Record of Legislation with Transitional Qualified Status.

Broadly, the GloBE rules operate by charging a top-up tax on MNE Groups that have profits that have an effective tax rate (ETR) below 15%. The calculations are done on a jurisdiction-by-jurisdiction basis, and the ETR is calculated for all in-scope entities in a jurisdiction.

There are detailed rules prescribed within the GloBE Rules to determine the tax base (GloBE Income), what would be considered to be covered taxes, how to calculate the ETR, and how to impose the top-up tax. The GloBE Rules have two interlocking rules:

a) Income Inclusion Rule ("IIR"): It takes a top-down approach, and it requires the Ultimate Parent Entity ("UPE") of the group to pay to the authorities in its jurisdiction the top-up tax due by the MNE group for all jurisdictions that have been taxed below the minimum rate of 15%.

b) Under the Tax Profits Rule ("UTPR"): This is the second charging mechanism and operates as a backstop to the IIR. Thus, the UTPR will apply when low-taxed subsidiaries/CEs are not held by parent entities that are required to apply a Qualified IIR.

Qualified Domestic Minimum Top-up Tax ("QDMTT"):

In addition to IIR and UTPR (GloBE rules), many countries that have signed up for Pillar Two can opt to implement a Domestic Minimum Top-up Tax (DMTT). If a jurisdiction implements a DMTT that is consistent with the outcomes of the GloBE Rules, such DMTT will qualify QDMTT and can be deducted from the Top-up Tax liability under the GloBE Rules in respect of that jurisdiction. Thus, QDMTT would apply over the GloBE rules of IIR and UTPR.

Adopting a QDMTT will ensure that any top-up tax that would have otherwise been collected in an overseas jurisdiction will remain in the country where the taxable profits are generated. A DMTT introduced by a jurisdiction will be assessed by a peer review process to establish whether it is functionally equivalent to the GloBE Rules so that it can be treated as a QDMTT. Recently, the OECD published a Central Record of Legislation with Transitional Qualified Status for IIR and DMTT [3].

4. Scope of Application of UAE's Pillar Two Rules

The legislation applies to **Constituent Entities** ("CEs") of MNE Groups with annual revenue of EUR 750 million or more in the Consolidated Financial Statements of the UPE in at least two of the four fiscal years immediately preceding the tested fiscal year (Article 1.1.1).

If the FY is not 12 months. In these cases, the EUR 750 million threshold is proportionally adjusted (Article 1.1.2).

The following entities are required to pay top-up tax:

- UAE-based CEs located, including those that are members of a minority-owned subgroup.
- UAE-based Joint Ventures and JV Subsidiaries.
- Stateless Constituent Entities as per UAE laws that are Reverse Hybrid Entities.

4.1. What is a Group, MNE Group, Constituent Entity, and an UPE?

The definitions of key terms are broadly consistent with OECD's GloBE Rules

A **Group** means a collection of Entities that are related through ownership or control such that the entities are consolidated at the UPE level or are only excluded from consolidation solely on size or materiality grounds, or on the grounds that the Entity is held for sale (Article 1.2.2).

A Group also includes an entity in one jurisdiction ("Main entity") with Permanent Establishments (PEs) in other jurisdictions (Article 1.2.3).

A **MNE Group** means any Group that includes at least one Entity or Permanent Establishment that is not located in the Jurisdiction in which the Ultimate Parent Entity (Article 1.2.1).

A **Constituent Entity** includes any entity included in a Group and PE of a Main entity (Article 1.3.1).

A **UPE** means an entity that owns Controlling Interest in any other Entity and is not in turn held by another Entity (Article 1.4.1).

4.2 Permanent Establishments

Permanent Establishments ("PEs") are treated as separate entities from their Main Entity and other Permanent Establishments for reporting purposes.

Specific rules have been provided for the allocation of income between a Main Entity and PEs.

Where a Group is the Main entity and its PEs in other jurisdictions, then the Main Entity will be considered an UPE.

4.3. JVs and MOCEs

JVs are treated as separate MNE Groups, with the JV being considered the UPE for top-up tax calculation.

There is similar treatment for minority-owned subgroups and minority-owned CEs ("MOCEs") and minority-owned subsidiaries that are part of the subgroup. Where an MOCE is not part of a minority-owned subgroup, then a top-up tax is calculated at the entity level, i.e., MOCE.

4.4 Excluded Entities:

The MoF has identified the following excluded entities from UAE's DMTT scope (Article 1.5.1):

- Governmental Entities
- International Organizations
- Non-profit Organizations
- Pension Funds
- Investment Funds that are Ultimate Parent Entities (UPEs)
- Real Estate Investment Vehicles that are UPEs

Certain subsidiary entities owned (directly or through a chain of Excluded Entities) by one or more Excluded Entities (other than a Pension Services Entity) may also benefit from this exclusion in the following cases:

- where there is at least 95% ownership and such subsidiary **a)** operates exclusively or almost exclusively to hold assets or invest funds for the benefit of the Excluded Entity/Entities and/or **b)** only carries out activities ancillary to those carried out by the Excluded Entity/Entities (Article 1.5.2(a)).

- Where there is at least 85% ownership and substantially all of the subsidiaries income is Excluded Dividends or Excluded Equity Gain or Loss that is excluded from the computation of Pillar Two Income or Loss (Article 1.5.2(b)).

The ownership condition is deemed to be met where the first-mentioned Entity is held by an Investment Fund or a Real Estate Investment Vehicle that is not a Group Entity.

A **Sovereign Wealth Fund ("SWF")** that meets the definition of a Governmental Entity will not be considered an UPE and DMTT rules will not apply at the level of SWF. The UPE will be an investee entity in which the SWF has a controlling interest.

Entities that are 100% owned by **Non-Profit Organizations** may qualify as Excluded Entities, subject to meeting specific revenue conditions.

Permanent Establishments of Main Entities considered Excluded Entities will follow the same exclusions as their Main Entities.

Election: A Filing Constituent Entity may elect not to treat an entity as an Excluded Entity. This election is a Five-Year Election.

5. Are there any exclusions or safe harbours?

5.1. Safe Harbors

The UAE legislation includes two key safe harbors designed to simplify compliance.

5.1.1. Transitional Country-by-Country Reporting (CBCR) Safe Harbor (Article 8.2.1):

Based on an election, during any FY starting before 1 January 2027 and ending before 1 July 2028 (effectively 2025 and 2026), the Jurisdictional Top-up Tax of the UAE shall be deemed to be zero if:

a) De Minimis Test: the MNE Group reports Total Revenue of less than EUR 10 million and profit/loss before Income Tax of less than EUR 1 million in the UAE on its Qualified Country-by-Country Report ("CBCR") for the FY;

b) Simplified ETR Test: the MNE Group has a Simplified ETR that is equal to or greater than 16% (for FYs beginning in 2025) and 17% (for FYs beginning in 2026) in the UAE the Transition Rate.

The Simplified ETR is calculated by dividing the Jurisdiction's Simplified Covered Taxes by its Profit (Loss) Before Income Tax as reported on the MNE Group's Qualified CBCR; or

c) Routine Profits Test: the MNE Group's profit/loss before Income Tax in the UAE is equal to or less than the Substance-Based Income Exclusion ("SBIE") amount as calculated under the UAE Pillar Two Rules for entities reported in the UAE in the CbCR.

Where the MNE Group is not required to file a Qualified CBC Report, data from Qualified Financial Statements can be used, subject to it being the data that would have been reported as Total Revenues and Profit (Loss) Before Income Tax in a Qualified CbCR.

This election shall apply to JVs (and its subsidiaries) as if they are a separate MNE Group, except that the financial information to be used will be the ones reported in their Qualified Financial Statements.

Qualified CbCR Report means a CbCR prepared and filed using Qualified Financial Statements irrespective of whether different Qualified Financial Statements are used for different Jurisdictions.

Qualified Financial Statements means:

a) the accounts used to prepare the CFS of the Ultimate Parent Entity;

b) separate financial statements of each CE prepared in accordance with Acceptable/ Authorized Financial Accounting Standard, and it is reliable; or

c) in the case of a CE that is not consolidated, the financial accounts that are used for the preparation of the MNE Group's CbCR.

5.1.2. Permanent Safe Harbours

a) De Minimis Exclusion: Upon election by the filing CE, the Top-up Tax for UAE-based Constituent Entities shall be deemed to be zero for a Fiscal Year if the following conditions are met for such FY:

- The Average Pillar Two Revenue is less than EUR 10 million for the Fiscal Year.
- The Average Pillar Two Income or Loss is either a loss or less than EUR 1 million for the Fiscal Year.

This election must be made annually and is not available to a Stateless Constituent Entity.

The Average Revenue and Pillar Two Income or Loss shall be the average for the current and the two preceding Fiscal Years. If the CE did not exist in either of the preceding FY, such year(s) shall be excluded from the calculation.

b) Simplified Calculations Safe Harbor (Article 8.2.2): This Safe Harbour applies based on meeting similar tests as specified in the transitional CCR Safe Harbour. However, instead of considering CbCR data, MNEs may have to use a combination of CbCR data and UAE Pillar Two computation rules.

Specific rules govern the disapplication of the Transitional CbCR Safe Harbor and Simplified Calculations Safe Harbor.

5.1.3. Initial Phase of International Activity

a) The Top-up Tax shall be reduced to zero during the initial phase of an MNE Group's international activity, provided that none of the ownership interests of the Constituent Entities located in the UAE are held by a Parent Entity subject to a Qualified Income Inclusion Rule ("IIR") in another Jurisdiction.

b) An MNE Group is in its initial phase of its international activity if, for a FY:

i. it has Constituent Entities in no more than six Jurisdictions; and

ii. the sum of the Net Book Values of Tangible Assets of all Constituent Entities located in all Jurisdictions other than the reference Jurisdiction does not exceed EUR 50 million. Reference Jurisdiction of an MNE Group is the Jurisdiction where the MNE Group has the highest total value of Tangible Assets for the FY in which the MNE Group originally meets the Pillar Two thresholds, i.e., Euro 750 million.

The benefit is available for five years after the first day of the first FY when the MNE Group originally meets the Pillar Two thresholds, i.e., Euro 750 million. If the MNE Group meets the threshold as of 31 December 2023, the period of five years will start at the time a Qualified UTPR comes into effect.

5.1.4. Substance-based Income Exclusion (SBIE)

Before discussing adjustments to income, it's important to note the SBIE, which reduces the Net Pillar Two Income for the UAE. The SBIE (Article 5.3) reduces Net Pillar Two Income in the UAE, thus lowering potential top-up tax. It's calculated as the sum of:

- **5% of Eligible Payroll Costs**: Costs of employees performing activities in the UAE for the MNE group (with specific rules on proportional allocation if an employee works less than 50% of their time in the UAE).

- **5% of the Carrying Value of Eligible Tangible Assets**: Property, plant, and equipment, natural resources, rights-of-use, and licenses for immovable property/natural resources exploitation located in the UAE (with specific rules on proportional allocation if an asset is not located in the UAE the whole year).

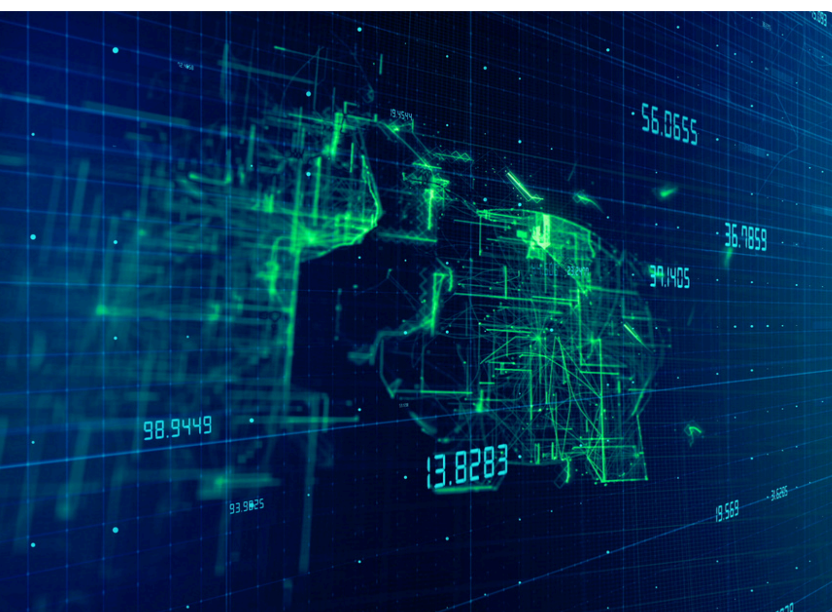
The rules provide for a 9-year transition period and start with a 9.6% carve-out for payroll costs and a 7.6% carve-out for tangible assets, with these percentages finally declining to 5% over a 9-year time.

A Filing Constituent Entity can elect annually not to apply the SBIE, meaning they would not deduct it when calculating Top-up Tax. The exclusion does not apply to Investment Entities. There are special rules for Permanent Establishments (PEs) and Flow-Through Entities (FTEs) as well.

6. How will the Top-up tax be calculated?

Broadly, the steps involved in determining the DMTT for a Constituent Entity are as follows:

1. *Identify whether the UAE CE is within the scope of the Pillar Two Rules.*
2. *Determine Pillar Two income/loss of the in-scope UAE CEs.*
3. *Determine the amount of Covered Taxes attributable to Income of CEs in the UAE.*



4. *Based on the Pillar Two Income and the Covered Taxes determined, calculate the Jurisdictional Effective Tax Rate (ETR).*

   In the event the ETR is below 15%, Step 5 sets out the mechanism for calculating the top-up tax in respect of that low tax jurisdiction.

5. *Impose Top-Up Tax as per the following calculations:*

Top-Up Tax = Excess Income * Top-Up Tax percentage

- Jurisdiction to check on relevant safe harbours and exclusions

Top-Up Percentage = 15% minimum rate (less) ETR

Excess Income = Pillar Two Income/loss (less) SBIE

ETR = Adjusted Covered Taxes (divided by) Net Pillar Two Income/Loss

6.1. Pillar Two Income or Loss

The Pillar Two Income or loss of each CE is the Financial Accounting Net Income or Loss determined for the Constituent Entity for the Fiscal Year adjusted for the items described below (Article 3.1.1).

Financial Accounting Net Income or Loss is determined based on standalone financial statements prepared in accordance with IFRS or the net income or loss determined in the CFS of the UPE and excluding certain consolidation adjustments (Article 3.1.2).

If adhering to IFRS for the consolidated financial statements is unfeasible, an alternative acceptable/authorized financial accounting standard can be applied subject to meeting certain conditions like reliability and adjustment for any permanent differences (Article 3.1.3).

6.2. Adjustments Required to Financial Accounting Net Income or Loss

The following adjustments are made to a Constituent Entity's Financial Accounting Net Income or Loss to arrive at the Pillar Two Income or Loss (Article 3.2.1):

I. Net Taxes Expense
II. Excluded Dividends
III. Excluded Equity Gain or Loss
IV. Included Revaluation Method Gain or Loss
V. Asymmetric Foreign Currency Gains or Losses
VI. Policy Disallowed Expenses
VII. Prior Period Errors and Changes in Accounting Principles
VIII. Accrued Pension Expense
IX. Accrued Pension Income
X. Excluded Insurance Reserves Expense

6.3 Other Considerations and Elections Affecting Pillar Two Income/Loss

I. Stock-based compensation can be substituted with the amount allowed in tax under UAE law provided an election is made. The election applies for 5 years and must be consistently used for all UAE entities. Certain adjustments are required if the election is applied after some stock-based compensation has been recorded or if the election is revoked (Article 3.2.2).

II. Transactions between Constituent entities must be consistent with the Arm's Length Principle (Article 3.2.3).

III. Qualified Refundable and Marketable tax credits are treated as income. (Article 3.2.4).

IV. Election to use the realization principle for fair value or impairment accounting. It is a Five-Year Election that applies to all Constituent Entities in the UAE. The election applies to all assets and liabilities, unless it is limited to tangible assets or to Investment Entity CEs. Under this election (Article 3.2.5):

- Gains/losses from fair value or impairment accounting are excluded from Pillar Two Income/Loss.
- The carrying value of assets/liabilities is adjusted for accumulated depreciation.
- If revoked, Pillar Two Income/Loss is adjusted for the difference between fair value and carrying value.

V. Aggregate Asset Gain in UAE in fiscal year lookback: This provision allows for an *Annual Election* by the Filing Constituent Entity to adjust Pillar Two Income or Loss for previous fiscal years in a prescribed manner and within a defined "look-back period" when there is an "Aggregate Asset Gain in the UAE" in the current fiscal year (the "Election Year") (Article 3.2.6).

The goal is to smooth out the impact of large asset gains on the Effective Tax Rate (ETR) and Top-up Tax calculations.

VI. Intragroup Financing Arrangement (Article 3.2.7): Provides for a low-tax jurisdiction entity to exclude expenses related to intragroup financing arrangements from its Pillar Two income calculation if those expenses are designed to reduce the low-tax entity's income without a corresponding increase in taxable income for the high-tax counterparty.

VII. An UPE can elect for a consolidated accounting treatment to eliminate income, expense, gains, and losses from transactions between Constituent Entities that are located and included in a tax consolidation group in the UAE. The election under this Article is a Five-Year Election (Article 3.2.8).

VIII. Certain adjustments to be made by Insurance companies in relation to amounts charged to policyholders for Taxes paid by the insurance company in respect of returns to the policyholders. (Article 3.2.9).

IX. Adjustment in the Pillar Two Income or Loss for amounts recognized as a decrease or increase to the equity of a Constituent Entity attributable to distributions paid or payable in respect of Additional/Restricted Tier One Capital issued by the Constituent Entity (Article 3.2.10).

X. Adjustment in Pillar Two Pillar Two Income or Loss for adjustments specified in the relevant Articles in UAE Pillar Two Rules dealing with Corporate Restructurings and Holding Structures and Tax Neutrality and Distribution Regimes. (Article 3.2.11).

XI. Income attributable to a Qualified Debt Release from the computation of a Constituent Entity's Pillar Two Income or Loss may be excluded in certain circumstances (Article 3.2.12).

XII. Dividend Inclusion: A five-year election to include all dividends from Portfolio Shareholdings in Pillar Two income, regardless of whether they are considered short-term with respect to Portfolio Shareholdings (Article 3.2.13).

XIII. Five-Year Election to treat foreign exchange gains or losses that are attributable to effective hedging instruments for currency exchange rate risk in non-portfolio shareholding Ownership Interests as an Excluded Equity Gain or Loss (Article 3.2.14).

XIV. International Shipping Income/loss and Qualified Ancillary International Shipping Income/loss shall be excluded from the computation of its Pillar Two Income or Loss (Article 3.3).

6.4. Adjusted Covered Taxes

Covered Taxes generally mean:

a) Taxes on Income/Profits: Taxes recorded in the financial accounts of a CE with respect to its income or profits, or its share of income/profits of another entity in which it owns an Ownership Interest;

b) Taxes in Lieu of Income Tax; and

c) Taxes on Retained Earnings/Equity: Taxes levied by reference to retained earnings and corporate equity, including taxes on multiple components based on both income and equity.

6.4.1. Covered Taxes generally do not include the following:

a) IIR Top-up Tax: Top-up Tax accrued by a Parent Entity under a Qualified IIR in another jurisdiction.

b) QDMTT Top-up Tax: Top-up Tax accrued by a CE under a QDMTT in another jurisdiction.

c) UTPR Adjustments: Taxes attributable to adjustments made due to a Qualified Undertaxed Profits Rule (UTPR) in another jurisdiction.

d) Disqualified Refundable Imputation Tax

e) Taxes paid by an insurance company in respect of returns to policyholders.

6.4.2. Adjustments to Covered Taxes

This section outlines the key adjustments to Covered Taxes required under the UAE's DMTT legislation.

6.4.2.1. General Principles (Article 4.1.1)

The Adjusted Covered Taxes of a CE for a Fiscal Year equals the current tax expense accrued in its Financial Accounting Net Income or Loss concerning Covered Taxes for the FY.

This is then adjusted by:

- The net amount of Additions to and Reductions to Covered Taxes for the FY.
- The Total Deferred Tax Adjustment Amount.
- Any increase or decrease in Covered Taxes recorded in equity or Other Comprehensive Income (OCI) related to amounts included in Pillar Two Income or Loss and subject to tax under local rules.

6.4.2.2. Additions to Covered Taxes (Article 4.1.2)

These items *increase* the amount of Covered Taxes:

- Any Covered Taxes previously reduced due to allocation to a Tax Transparent Entity.
- The amount of Pillar Two Loss Deferred Tax Asset.
- Covered Taxes paid in the FY relating to an uncertain tax position, previously treated as a Reduction to Covered Taxes.
- Any credit, refund, or transferable amount from a Qualified Refundable Tax Credit or Marketable Transferable Tax Credit recorded as a reduction to the current tax expense.

6.4.2.3. Reductions to Covered Taxes (Article 4.1.3)

These items decrease the amount of Covered Taxes:

- The amount of current tax expense related to income excluded from Pillar Two Income or Loss under Article 3.
- Any credit, refund, or transferable amount for a tax credit not recorded as a reduction to current tax expense and not derived from a Qualified Refundable Tax Credit or Marketable Transferable Tax Credit.

- Refunds or credits of Covered Taxes to a CE, or amounts received for tax credit transfers, are not treated as adjustments to current tax expense (except those from Qualified Refundable Tax Credits or Marketable Transferable Tax Credits).
- Current tax expense related to an uncertain tax position.
- Current tax expense not expected to be paid within three years of the FY's end.

6.4.2.4. Total Deferred Tax Adjustment Amount (Article 4.4)

This involves adjusting for deferred tax expenses for the prescribed items, potentially re-casting at the minimum rate, and considering temporary differences. Exclusions include deferred tax expense related to:

- Items excluded from Pillar Two Income or Loss.
- Disallowed Accruals and Unclaimed Accruals.
- Valuation or accounting recognition adjustments to deferred tax assets.
- Changes in the applicable domestic tax rate.
- The generation and use of tax credits.

6.4.2.5. Allocation of Covered Taxes (Article 4.3)

Detailed rules exist for allocating Covered Taxes related to Permanent Establishments, Tax Transparent Entities, Hybrid Entities, and Controlled Foreign Company (CFC) taxes. These rules prevent inappropriate cross-jurisdictional allocation.

6.4.2.6. Important Considerations

- ·Covered Taxes cannot be counted more than once (Article 4.1.4).
- ·Specific treatment applies to cases where there is no Net Pillar Two Income and Adjusted Covered Taxes are negative (Article 4.1.5).

7. Thresholds and other rules for Merger and Demerger and when a CE joins or leaves a MNE Group

There are specific rules on how the EUR 750 million consolidated revenue threshold is applied in cases where a MNE Group undergoes a merger or demerger. Scenarios of a standalone entity (not previously in a Group) that is acquired by an MNE Group is also covered. There are also specific rules explaining how an entity (referred to as the target) is treated when it becomes or ceases to be a CE of an MNE Group due to the transfer of direct or indirect ownership interests.

The rules address how such entities should be treated for the purposes of QDMTT calculations (thresholds, financial accounting income/losses, adjusted covered taxes, SBIE, etc.), ensuring a consistent approach when entities enter or exit an MNE Group.

8. Interplay with the UAE CT Law

Supplement tax/DMTT regime will also follow certain UAE Corporate Tax provisions such as general anti-abuse rules (GAAR), record-keeping requirements, the option to file FTA private clarification, and the assessment of corporate tax and penalties. Thus, anti-abuse provisions will have to be evaluated in case any restructuring is carried out.

No penalties or sanctions may apply in connection with the filing of a Top-up Tax Return or the Pillar Two Information Return for any FYs that ends up till 30 June 2028, where the FTA considers that an MNE Group has taken reasonable measures to ensure the correct application of the provisions of this Decision.

9. Compliances and Timelines

Constituent Entities, Joint Ventures, and JV Subsidiaries within scope are required to file a Top-up Tax Return with the Federal Tax Authority (FTA) no later than 15 months after the end of the Reporting Fiscal Year. An extended deadline of 18 months applies to the first Transition Year for any Constituent Entity within the MNE Group (Article 8.1.2).

The Top-up Tax Return developed by the Federal Tax Authority shall require the equivalent information and reporting requirements set out in the Pillar Two Information Return. While not explicitly stated in this document, payment of the Top-up Tax is likely due on or before the filing deadline; we await further guidance from the FTA to confirm this point.

MNEs have an option to designate a single UAE domestic filing entity to pay Top-up tax and submit annual returns on behalf of all the UAE CEs (however, all UAE CEs will be jointly and severally liable for top-up tax). A Pillar Two Information return is also required to be filed by Entities that will be specified in a separate ministerial decision. The Pillar Two Information Return shall be filed no later than 15 months after the last day of the Reporting FY.

10. Andersen Takeaways

- **Qualifying Domestic Minimum Top-up Tax**: Based on our preliminary analysis, the UAE rules are aligned with GloBE Model Rules and thus, the UAE's top-up tax may qualify as a qualifying DMTT. This ensures that UAE-based MNE Groups can minimize exposure to additional taxation under the GloBE's IIR or UTPR, effectively achieving the intended policy goal of retaining tax revenues domestically.

- **Potential Impact on Free Zone CT Benefits**: It appears that the DMTT rules do not exclude qualifying free zone persons as per the UAE CT Laws. Free zone entities may likely need to pay top-up taxes up to 15% if they fall within the ambit of these rules.

- **Maximizing Safe Harbors and Compliance Simplification**: Transitional and permanent safe harbors offer relief, but businesses must proactively assess eligibility to avoid unnecessary tax liabilities. While the UAE rule on the exemption for initial international expansion states that Top-up Tax shall be reduced to zero, its reference to UTPR conditions aligns more closely with OECD's UTPR exclusion framework. Further clarity from the authorities would be required on this point.

- **Substance as a Competitive Advantage**: The SBIE carve-outs for payroll and tangible assets underscore the need for genuine business substance, which can significantly reduce top-up tax exposure.

- **Compliance Framework**: The legislation outlines a compliance framework, establishing a 15-month deadline (extendable to 18 months for the initial transitional year) for both filing the Top-up Tax return and remitting Top-up Taxes. Details on the Federal Tax Authority (FTA) registration process are forthcoming.

- **Digital Compliance**: Data-driven tax reporting is essential. MNEs should invest in tech-driven solutions to streamline compliance and enhance decision-making.

- **Maximizing UAE Tax Incentives**: The UAE's new R&D and employment tax credits present growth opportunities. MNEs should integrate these incentives into their future plans.

11. Key Actions Items for MNEs

- **Assess the Impact and Applicability**: Determine if the MNE Group meets the revenue threshold (EUR 750M+), has Constituent Entities in the UAE, determines inclusions and exclusions, applicable safe harbours, etc. Groups are also required to register in accordance with the timelines that will be prescribed.

- **Carry out the Quantitative Impact and Evaluate the Top-up Exposure**: Model the potential impact of the DMTT on the Group's overall tax liability, considering the various elections available.

- **Data Readiness**: Evaluate data availability and systems to collect and process the information required for Pillar Two calculations and reporting.

- **Training and Awareness**: Conduct training sessions for finance and tax teams to ensure understanding of Pillar Two implications and compliance requirements.

- **Develop and Implement Compliance Strategies**: Select the appropriate vendor/consultant to handle filings, compliances and implement appropriate compliance solutions.

- **Stay Informed**: Monitor updates from the UAE Ministry of Finance and FTA regarding Pillar Two implementation and guidance.

By taking these steps, MNEs can proactively prepare for the implementation of the UAE's DMTT and ensure compliance with the new rules.

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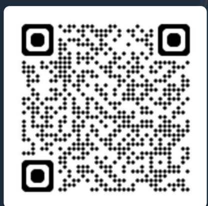
Senior Manager



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