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FEBRUARY 2025

UAE Pillar 2 Overview

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UAE Pillar 2 Journey

2015
Reports issued on the BEPS Action Plans-OECD

2016
Establishment of an Inclusive Framework-OECD

October 2020
Pillar Two Blueprint- OECD

October 2021
OECD Inclusive Statement consensus after political agreement reached by 139 member countries

December 2021
Pillar Two Model GloBE Rules - OECD

March 2022
Pillar Two Model GloBE Rules commentary-OECD

2023
Agreed administrative guidance on GloBE Rules-OECD

March 2024
Public Consultation on Pillar 2 -UAE

December 2024
UAE Announced Implements DMTT from Jan 01, 2025

February 2025
UAE Released the legislation introducing DMTT

Applicability

- MNE Group that has **annual revenue ≥ €750 million** in the consolidated financial statements of UPE (ultimate Parent entity) in **at least two of the four years** immediately preceding the tested fiscal year.
- For MNE group fiscal year another than 12 months, the EUR 750 million threshold is adjusted proportionally to correspond with the length of the relevant Fiscal Year

Key Definitions

MNE Group

- MNE group is a group that consists of entities located in more than one jurisdiction.
- A group is a collection of entities that are related through ownership or control and that either are:
- Included in the consolidated financial statements of the UPE; or
- Excluded from such statements solely on size or materiality or because the entity is held for sale.

Constituent Entity (CE)

- A Constituent Entity is any entity in a Group or a Permanent Establishment of such an entity.
- Excluded Entities are not Constituent Entities.

Ultimate Parent Entity (UPE)

Ultimate Parent Entity means either;
An entity that:
i) Owns directly or indirectly a Controlling Interest in any other Entity; and
ii) Is not owned, with a Controlling Interest, directly or indirectly by another Entity; or

Key Definitions

Excluded Entities

An Excluded Entity includes government entities, international organizations, non-profits, pension funds, investment funds, and real estate investment vehicles that are Ultimate Parent Entities.

It also includes entities where:

- 95% or more of their value is owned by Excluded Entities (excluding Pension Services Entities) and they primarily hold assets, invest funds, or perform ancillary activities for Excluded Entities.
- 85% or more of their value is owned by Excluded Entities (excluding Pension Services Entities), with most income being Excluded Dividends or Excluded Equity Gains/Losses under Pillar Two rules.

A Filing Constituent Entity may elect not to treat an entity as Excluded Entity status for five years.

Top up tax

- Top-up tax is a mechanism intended to ensure that MNEs pays a minimum ETR of 15% in each jurisdiction in which they operate.

Covered Taxes

- Taxes on a constituent entity's income or profits recorded in financial accounts of the constituent entity –Current taxes & Deferred taxes, Pillar One Tax, gross taxes without deductions unless it is taxes in lieu of income taxes
- Taxes under an eligible distribution system – taxes payable on distribution of profits
- Taxes in lieu of corporate income tax –WHT on interest, royalty, STTR
- Taxes levied by reference to retained earnings and corporate equity –Saudi Arabia Zakat
- Includes domestic and foreign taxes
- Does not include Excise taxes, payroll taxes, Unilateral taxes, stamp duties, property taxes, sales taxes, VAT

Approach to Determining the Top-up Tax Liability

An MNE group must follow these steps to determine its Top-up tax liability under the UAE Pillar 2 Rules.

1. Entities within Scope
2. Pillar 2 Income or Loss
3. Substance – Based Income Exclusion
4. Adjusted Covered Taxes
5. Effective Tax Rate
6. Top-up Tax

Step 1: Entities within Scope

Inclusions	Exclusions
• MNE's with consolidated revenue of EUR 750m and more	• MNE with no foreign presence or having less than EUR 750m in consolidated revenue. • Government Entities • International organizations • Non-profit organizations • Pension fund, investment or real estate fund

Step 2: Pillar 2 Income or Loss

Pillar 2 Income/Loss Calculation

The Pillar 2 income or Loss is used as the denominator for calculating the jurisdictional Effective Tax Rate (ETR). It starts with the Financial Accounting Net Income or Loss (FANIL).

Financial Accounting Standards

FANIL must be based on acceptable financial standards like IFRS. If not, adjustments are needed for Material Competitive Distortions. Intra-group eliminations are excluded from FANIL.

Adjustments to FANIL

To determine Pillar 2 income (or loss), FANIL is adjusted for items like net tax expenses, excluded dividends, capital gains, foreign currency gains/losses, policy disallowed expenses, pension costs, and stock-based compensation.

Net Pillar 2 income Computation

Net Pillar 2 income (or loss) is calculated by adjusting FANIL with the prescribed adjustments, ensuring accurate income reporting for Pillar Two compliance.

Step 3:Substance Based Income Exclusion (SBIE)

To calculate the Excess Profit for Top-up Tax, the Net Pillar Two Income for the UAE is reduced by the Substance-based Income Exclusion applicable to the UAE. This will not be applicable to investment entities located in UAE.

Payroll Care-out	Tangible Assets Carve-out
• The payroll carve-out for a CE equal to 5% of the eligible payroll costs of eligible employees that perform activities for the MNE group in UAE jurisdiction, • **Exceptions :** Capitalized Payroll costs and Payroll cost related to International Shipping income .	• Tangible asset carve-out for a CE is equal to 5% of the carrying value of eligible tangible assets located in UAE jurisdiction • Exception : Tangible assets related to Property held for sale, lease or investment and international shipping income.

Step 4: Adjusted Cover Taxes

The UAE Pillar Two rules outline the calculation of Adjusted Covered Taxes for a Constituent Entity, ensuring accurate Effective Tax Rate (ETR) and Top-up Tax computations.

- **Adjusted Covered Taxes Calculation**: Begins with the current tax expense in financial statements, adjusted for tax refunds, credits, and deferred tax adjustment.
- **Additions**: Accounts Covers current tax expenses, utilized deferred tax assets, and prior-year uncertain tax payments and Includes refundable/transferable tax credits that lower the total tax expense.
- **Reduction**: Adjustments related to taxes on excluded income, unclaimed tax credits or refunds, refunded/transferred taxes, uncertain tax positions, and unpaid taxes over three years
- **Deferred Tax Adjustments**: Accounts for temporary differences, loss carry-forwards, and valuation allowances to reflect future tax obligations.

Adjusted Covered Taxes = Current Tax Expense + Additions − Reductions + Deferred Tax Adjustments

Step 5: Determination of Effective Tax Rate

The Effective Tax Rate of the MNE Group with Net Pillar Two Income shall be calculated for each Fiscal Year.

$$\text{Effective Tax Rate (ETR)} = \frac{\text{Adjusted Covered Taxes of each Constituent Entity located in the UAE}}{\text{Net Pillar Two Income of the UAE for the Fiscal Year}}$$

The Net Pillar Two Income of the UAE for a Fiscal year is the positive amount, if any, computed in accordance with the following formula;

Where:

a) the Pillar Two Income of all Constituent Entities is the sum of the Pillar Two Income of all Constituent Entities located in the UAE determined in accordance with Article 3 for the Fiscal Year, and

b) the Pillar Two Losses of all Constituent Entities is the sum of the Pillar Two Losses of all Constituent Entities located in the UAE determined in accordance with Article 3 for the Fiscal Year.

Adjusted Covered Taxes and Pillar Two Income or Loss of Constituent Entities that are Investment Entities are excluded from determination of the Effective Tax Rate.

Step 6: Top - Up Tax

The Top-up Tax Percentage for a Fiscal Year shall be the positive percentage point difference, if any, computed in accordance with the following formula:

$$\text{Top-up Tax} = [\text{Top-up Tax Percentage} \times \text{Excess Profits}] + \text{Additional Current Top-up Tax}$$

Top-up Tax Percentage: 15% (minimum rate) - ETR

Excess Profits: Net Pillar 2 Income – Substance based income exclusion

Additional Current Top-up Tax: Additional top –up tax in respect of a prior period

Transition Rules

The Transition Period is a temporary phase during which MNE Groups can benefit from simplified Safe Harbor rules to reduce compliance burdens under Pillar Two.

Transition Period- The transition period covers Fiscal Years from the start of any Fiscal Year before January 1, 2027, to the end of any Fiscal Year before July 1, 2028.

Purpose of the Transition Period

- Allows MNE Groups time to adjust to Pillar Two requirements.
- Offers a temporary relief mechanism by setting Jurisdictional Top-up Tax to zero if certain conditions are met.

The following aspects are covered in Transitional rules

1. Losses and Timing Differences

Deferred tax assets and liabilities are considered at the lower of the Minimum Rate or domestic tax rate for Effective Tax Rate calculations in Transition Years. Deferred tax assets tied to Pillar Two Losses can be recorded at the Minimum Rate, ignoring valuation or accounting adjustments.

2. Higher SBIE:

Temporary Higher Exclusion Rates: Starts at 6% for payroll and 7.6% for tangible assets in 2025, gradually decreasing to 5.8% and 5.4% by 2032.

Purpose: Provides transitional relief to MNE Groups, lowering Top-up Tax liability during the initial Pillar Two implementation.

3. MNE Group in their initial Phase of International Activity

Zero Top-up Tax: During the initial phase of international activity, Top-up Tax is reduced to zero if no UAE Constituent Entities are owned by a Parent Entity subject to a IIR in another jurisdiction. This relief is limited to a maximum of five years.

Eligibility Criteria: An MNE Group qualifies if it operates in no more than six jurisdictions and its Net Book Value of Tangible Assets outside the reference jurisdiction does not exceed EUR 50 million.

The reference Jurisdiction is where the MNE Group has the highest Net Book Value of Tangible Assets in the year it meets the Pillar 2 threshold.

Transitional Safe Harbour Rules

The Transitional Safe Harbour rules encompass the following important aspects

CBCR Safe Harbour

During the transition period Jurisdictional Top-up Tax of the UAE shall be deemed to be zero for a Fiscal Year if any of the following tests are satisfied

De Minimis Test

MNE Group Total Revenue of < Euro 10 million and Profit (Loss) before Income Tax < EUR 1 million

ETR Test

MNE Group's Effective Tax Rate in UAE is ≥ Transition Rate (set at 16% for 2025 and 17% for 2026).

Routine Profits Test

MNE Group's Profit (Loss) before Income Tax in UAE ≤ Substance-based Income Exclusion amount.

Safe Harbour Disqualification (all conditions must be satisfied)

Safe Harbour will not apply if

- Top-Up Tax applies if the UAE's Effective Tax Rate, calculated under Article 5, is below the Minimum Rate.
- The Federal Tax Authority can notify the Liable Constituent Entity within 36 months of filing the Top-Up Tax Return about facts that may impact Safe Harbour eligibility, requiring clarification within six months.
- Constituent Entity fails to prove within the response period that the facts did not impact Safe Harbour eligibility

Joint Venture

- Joint Ventures and JV Subsidiaries are treated as separate MNE Groups and pay the Top-up Tax for the Fiscal Year in the UAE.
- They can appoint a Domestic Designated Filing Entity to pay on behalf of their Domestic JV Group.
- Pillar Two calculations (income/loss, Adjusted Covered Taxes, ETR, and Top-up Tax) apply as if the JV was the Ultimate Parent Entity.

Top-up Tax Return Filing

Filing Obligation

Every Constituent Entity, Joint Venture, and JV Subsidiary in the UAE must file a Top-up Tax Return with the Federal Tax Authority (FTA).

The return can be filed by:

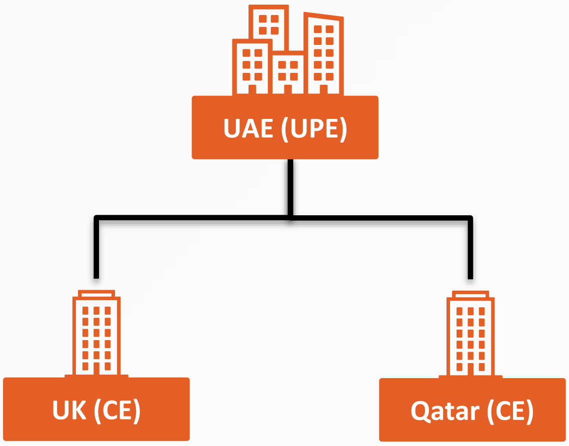
- The entity itself (Constituent Entity, Joint Venture, or JV Subsidiary).
- A Domestic Designated Filing Entity on behalf of the group.

Filing Deadline

The Top-up Tax Return must be submitted within

- 15 months after the end of the Reporting Fiscal Year.
- 18 months after the end of the first Transition Year for any newly covered Constituent Entity in an MNE Group

CS : Top-up Tax Calculation- UAE UPE



Particulars	UAE	UK	Qatar
UPE	✓	-	-
CE	-	✓	✓
IIR	-	✓	-
QDMTT	✓	✓	✓
UTPR	-	✓	-

Particulars	UAE	UK	Qatar
GloBE/Pillar 2 Income	20 Million	10 million	15 million
Payroll Cost	1 Million	1.5 Million	1.2 Million
Tangible Assets	5 Million	4 Million	2 Million
Covered Taxes	1.2 Million	2.5 Million	1.5 Million
Jurisdictional ETR (%)	6%	25%	10%
Top-up Tax (%)(15%-ETR)	9%	-	5%
Excess Profit	19.7 Million	-	14.83 Million
Top-up Tax	1.77 Million	-	0.74 million
Top-up Tax Jurisdiction	✓ (QDMTT)	-	✓ (QDMTT)
Top-Up tax Return	15 Months/18 Months	-	-

Interplay between Pillar 2 with others

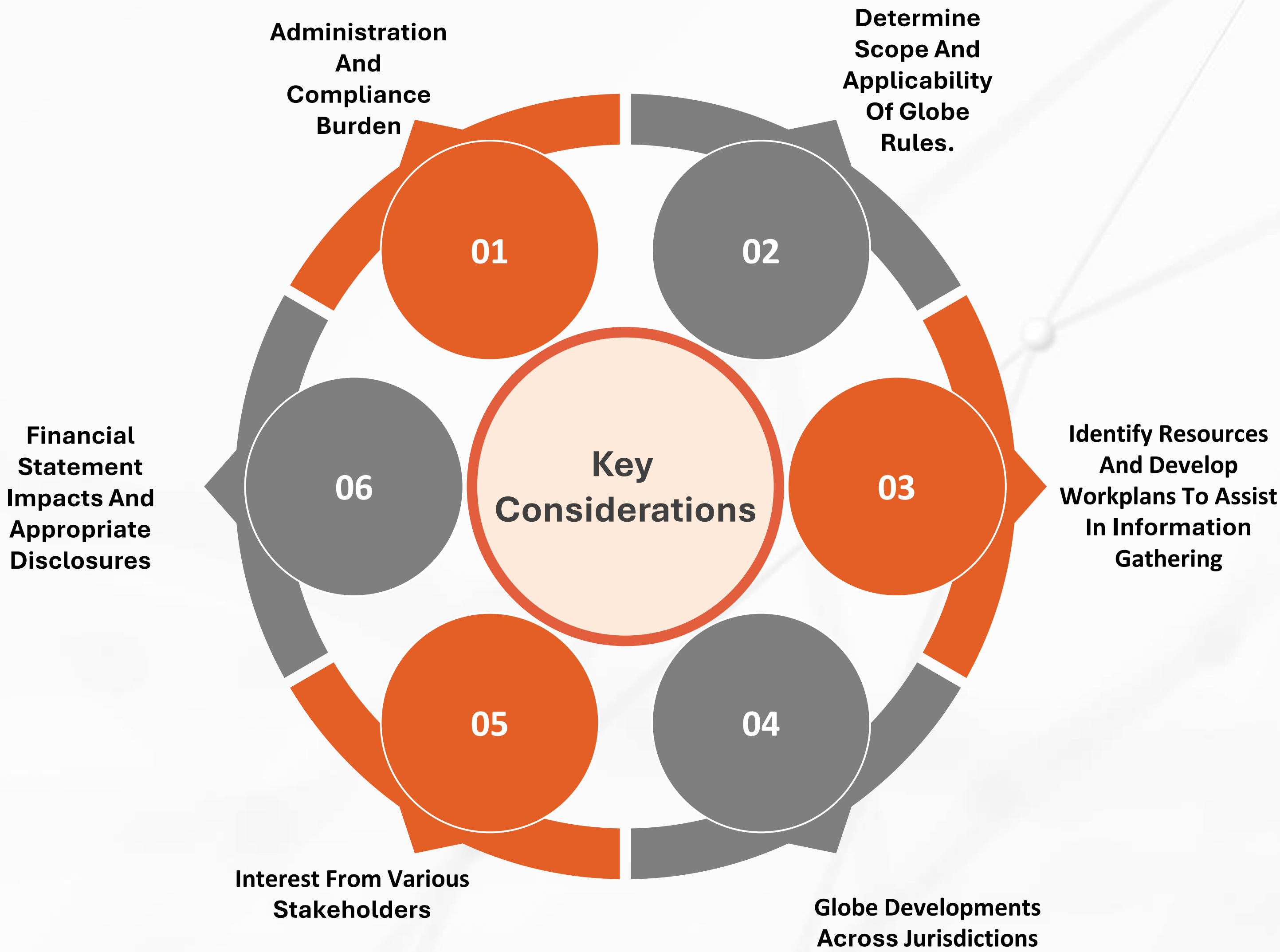
The following highlights the interactions of Pillar 2 with other tax measures.

Interplay between Pillar 2 with others

	TP	Financial Reporting	Domestic Tax Regulations	Pillar 1	Anti Tax Avoidance Rules
Interplay	TP allocates profits based on value creation; Pillar Two ensures profits meet minimum tax levels.	Pillar Two affects deferred tax accounting and financial disclosures.	QDMTT ensures local jurisdictions retain tax revenue before triggering IIR or UTPR.	Pillar One reallocates profits to market jurisdictions; Pillar Two ensures minimum tax on those profits.	Pillar Two complements GAAR and CFC rules to prevent profit shifting.
Risks	Aggressive TP policies can trigger Top-Up Tax if profits are low-taxed.	Increased compliance costs and potential impact on investor perceptions due to reconciliation.	Misalignment with domestic laws may lead to disputes or double taxation.	Need for coordinated implementation to avoid overlap and inconsistencies between the two pillars.	Administrative challenges in aligning with existing anti-avoidance measures.

Key Considerations for MNEs

Pillar Two requires MNEs to analyze their global tax footprint for increased liabilities and compliance challenges. These Key considerations are essential for MNEs.



SBC Scoping and Approach

SBC offers tailored guidance and strategic insights on UAE Pillar 2 and Corporate Tax (CT) regulations, ensuring clients stay compliant while optimizing their tax position and maximizing efficiency.

SBC adopts a following strategic approach to navigate UAE Pillar 2 regulations.

Coverage

- ✓ Identify the UPE & CE
- ✓ Identify whether the MNE is within scope
- ✓ Identify excluded entities
- ✓ Identify where each of the constituent entities is resident, scenario analysis if needed for jurisdictional blending.

Pillar 2 Income or Loss Calculation

- ✓ Calculate Pilar 2 income or Loss.
- ✓ Calculate covered taxes
- ✓ Calculation of ETR for each jurisdiction
- ✓ MNE Group uses any simplifications or safe harbors when calculating its GloBE tax liability.

Top-up Tax Calculation

- ✓ The top-up tax rate equal 15% - ETR if the ETR is below 15%.
- ✓ Apply the UAE substance-based carve out.
- ✓ Apply UAE loss carry forwards.
- ✓ Top up tax = (Pillar 2 income – substance based carve out – carry forward losses) * top up tax rate.

Top-up Tax Allocation

- ✓ Determine top-up tax due for the UPE under the DMTT/IIR.
- ✓ Allocation of Top-up Tax with in MNE group.
- ✓ Determine whether any top-up tax is rolled over to the next year.

Compliance

- ✓ Collect the reportable data
- ✓ Make sure Pillar Two consequences are properly incorporated in financial statements and tax returns.
- ✓ Identify the filing entities
- ✓ Filing Top-up tax return

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