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Interest Deduction Limitation Rules (CTGIDL1)

Tax Update

Summary of the CT Guide

April 2025

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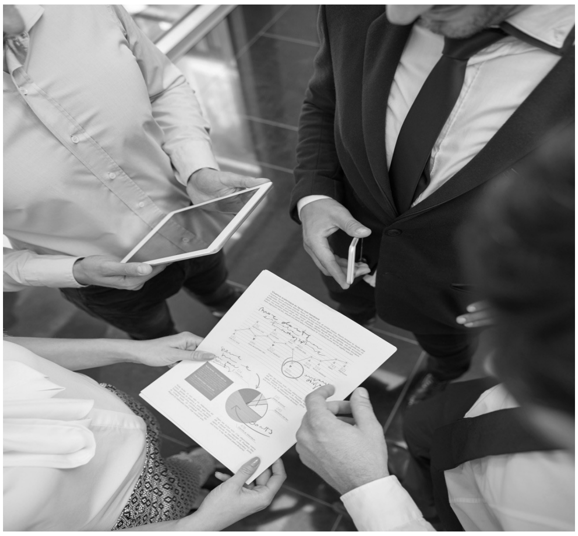
Executive Summary



The UAE Federal Tax Authority (**FTA**) has published a detailed Corporate Tax (**CT**) Guide in April 2025 that provides a comprehensive explanation of the Interest Deduction Limitation Rules under Federal Decree-Law No. 47 of 2022 (**UAE CT Law** or **CT Law**).

These rules are crucial in determining the extent to which interest and related financing costs are deductible while computing taxable income under the UAE CT regime.

With a view to preventing base erosion and profit shifting (**BEPS**), the UAE has aligned its interest limitation rules with global standards such as the OECD BEPS Action 4, introducing both general and specific interest deduction limitation mechanisms. This alert distills the key provisions, conditions, and examples from the FTA's Guide, providing tax practitioners and CFOs with actionable insights as per CT Law read along with Ministerial Decision 126 of 2023.

What does this CT Guide provide in relation to Interest limitation under the CT Law?

Summary of the definition and scope

Overview of the Deductibility

Specific and General Interest Rules

Exception and Carve-outs

Compliance measures and recommendations

Key Takeaways

AREA	KEY INSIGHTS
Definition of Interest	Covers any compensation for the use of money or credit, including Shariah-compliant profits and financial fees.
Scope of Deductibility	Interest is deductible only if incurred wholly and exclusively for business and not capital or private in nature.
Specific Deduction Limitation Rule	Applies if the principal purpose of a debt arrangement is to gain a tax advantage; disallows entire interest.
General Deduction Rule	Caps annual interest deduction to 30% of Adjusted EBITDA beyond a threshold of AED 12 million.
Capitalised Interest	Amortised over the life of the asset and included proportionately in EBITDA adjustments.
Exemptions	Certain sectors and situations are excluded from the application of the general rule (e.g., Banks, Insurance Providers, Natural Persons, Infrastructure).

What constitutes Interest?

- Interest
  - Accrued or paid for use of money or credit
    - Recognised on cash or accrual basis
  - Discount & Premiums
    - **Exceptions:**
      - Trade/ Volume Discounts & Sales/Payment incentive
      - Sales Promotions & Rebates
      - Premium/ discount on equity instruments
      - Loyalty point/rewards
  - Profit/ Mark-up paid on an Islamic financial instrument
  - **Residual:**
    - Others
    - Payments economically equivalent to interest
    - Amounts incurred in connection with the raising of finance

    (Refer Note 1 to 3 below)

Note 1: Some Important transactions for Interest Definition

Transaction Type	Example / Key Fact	Tax Treatment
Foreign Exchange Movements	Foreign exchange gains or losses (FX) linked to interest or equivalent payments are treated as interest.	✅ FX on interest = Interest ❌ FX on loan (principal) ≠ Interest
Capitalised Interest	Income and expenditure attributable to the capitalised interest	✅ Part of Net Interest Expenditure in the Tax Period where amortised over the useful life of asset, and not in the Tax Period in which the interest is incurred/capitalised
Hybrid Instruments	Financial products that combine features of both debt and equity on which the holder earns returns.	If classified as: ✅ Liability = Interest ❌ Equity = Dividend
Late Payment – Statutory Dues	Incurred due to breach of Law	❌ Fine/Penalties/ Interest ≠ Interest and are not deductible in general
Late Payment – Commercial Dues	Incurred in regular course of business	✅ Compensatory Charges = Interest ❌ One-off Fixed Charges/Penalty≠ Interest

What constitutes Interest?

Note 2: Payments economically equivalent to interest

Transaction Type	Description	Tax Treatment
Performing & Non-performing Debt Instruments	Regular loan repayments vs. default with penalties	✅ Interest on loan = Interest ❌ Provision/ write-off in lender books ≠ Interest
Collective Investment Schemes (CIS)	Investment in CIS - For the interest income to be considered while calculating Net Interest Expenditure	✅ If CIS primarily (> 50%) invests in cash & cash equivalents, entire dividend (from equity)+ Interest (from cash equivalents) = Interest
Collateralised Asset-backed Securities	The holder of mortgage-backed security receives principal along with interests	✅ Interest Component received = Interest income
Sale and subsequent repurchase agreement Repo Transactions	Security sold (say AED 100) with a promise to buy back at an agreed upon price (AED say 150).	✅ Cost of borrowing = AED 50 = Interest expense/Interest Income depending upon borrower or lender
Stock Lending Agreements	When the lent stocks are returned, the lender receives both the stock lending fee.	✅ Fee = Interest
Securitisation (SPVs)	SPV issues securities backed by loans	✅ Investor's return = Interest Income ✅ SPV's payout = Interest expense
Hire Purchase / Finance Lease	Implicit Interest is charged in a hire purchase/ finance lease	✅ Implicit Interest = Interest ❌ Terminations/ Cancellation charges ≠ Interest
Non-finance (Operating) Lease	Arrangement where the lessor allows the lessee to use an asset for a specific period in exchange	For the Lessee ✅ Finance Element for accounting purposes = Interest For the Lessor ✅ Formula is provided by the FTA
Factoring of Receivables and similar transactions	Factoring fee is charged by the Factor	✅ Factoring Fee/ Cost of Factor recognised under IFRS or (IFRS for SMEs) = Interest

What constitutes Interest?

Note 3: Amounts incurred in connection with the raising of finance and others

Transaction Type	Description	Tax Treatment
Guarantee fees	Charged by a guarantor for this would be considered an amount incurred in raising finance	✅ Actual fee/ Deemed ALP if not charged by Related Party = Interest
Arrangement fees	Charged by financial institutions for setting up a loan or credit facility	✅ To be treated as Interest
Commitment fees	Charged by lenders for agreeing to provide a loan or credit facility, even if the borrower does not draw down the loan	✅ To be treated as interest even if charged on undrawn facility
Underwriting fees	When a company issues bonds or other debt securities, fee to underwriter to guarantee a certain price for the securities to investors	✅ To be treated as interest
Legal and professional fees	Related to the structuring and negotiation of financing	✅ If for Financing = Interest ❌ Others ≠ Interest
Early or pre-payment of loan	To compensate for the loss of expected income due to a loan being paid off before its maturity date	✅ To be treated as interest
Other charges apart from above		
Derivative contracts	May be used as a way of raising finance but they are more typically used to hedge risks connected with the raising of finance	✅ Any interest component ✅ Costs directly related to entering into derivative contracts
Disposal, sale or transfer	Where a debt instrument is disposed, sold or transferred, it may result in a gain or loss.	✅ To be considered as Interest to the extent it is treated as interest or other financing amount under IFRS

Order of application for limitation

Deductibility of Interest is subject to various Corporate Tax rules. These Corporate Tax rules should be applied in the following order:

Prescribed order for deductible interest calculation

- **Step 1** General principles of deductibility of expenditure
- **Step 2** Arm’s Length Principle
- **Step 3** Specific Interest Deduction Limitation Rule
- **Step 4** General Interest Deduction Limitation Rule

Note: Step 4 must be applied after all the Corporate Tax rules, apart from the Tax Loss Provisions.

General principles of deductibility of expenditure & ALP (Step 1 & 2)

General Rule:
Expenses are deductible if:

- Incurred wholly and exclusively for **business** purposes
- **Not** capital in nature
- Incurred **within** the relevant Tax Period

Certain expenses, including interest, though recognized in accounting, may be non-deductible for tax purposes.

Adjustments/ cases where interest is not deductible:

- Expenditure **not incurred** for the purposes of the Taxable Person’s Business
- Expenditure that is **capital** in nature
- Interest expenditure related to deriving **Exempt Income**
- Interest expenditure due to Connected Persons and/or Related Parties **not meeting the arm’s length standard**

Specific Interest Deduction Limitation Rule (Step 3)

INTENT OF THE PROVISION (Article 31 of the UAE CT Law):

To ensure that no corporate tax advantage is accrued to the taxpayer by undertaking financing or other specified transactions with the Related Parties.

Corporate Tax Advantage includes –

- a refund or an increased refund of Corporate Tax,
- avoidance or reduction of Corporate Tax Payable,
- deferral of a payment of Corporate Tax or advancement of a refund of Corporate Tax, or,
- avoidance of an obligation to deduct or account for Corporate Tax.

Interest Expenditure incurred on Loan from Related Parties

General rule - Inadmissible as deduction when such loan is availed directly/ indirectly for the below transactions

- ✗ Dividend or profit distribution to a Related Party,
- ✗ Redemption, repurchase, reduction or return of share capital to a Related Party,
- ✗ Capital contribution to a Related Party,
- ✗ Acquisition of ownership interest in a Person who is or becomes a Related Party after the acquisition.

Exception – Admissible when

- ✓ The Taxpayer demonstrates that the main purpose is **not to gain** a Corporate Tax advantage.
- ✓ Related party is subject to **effective tax rate of 9%** in a foreign jurisdiction

General Interest Deduction Limitation Rule (Step 4)

INTENT OF THE PROVISION (Article 30 of the UAE CT Law):

To prevent the misuse of debt financing to erode the UAE tax base, a general interest deduction limitation rule has been introduced.

Interest Capping Rules

Is Net Interest Expenditure exceeding AED 12 Million in a Tax Period?

Yes

Deductible Expenditure is greater of –

- 30% Adjusted EBITDA (or)
- De-Minimis Threshold of AED 12 Million*

Carried Forward Rules –

Carried forward **up to 10 years** following the **'first in, first out'** principle.

No

Claim 100% deduction

If the Tax Period is not 12 months, the AED 12 million de minimis threshold is **prorated based on the period's length.*

Key

EBITDA (Note 1)

Adjusted EBITDA (Note 2)

Net Interest Expenditure (Note 3)

Detailed notes discussed on next page............

General Interest Deduction Limitation Rule (Step 4)

Note 1: EBITDA implies Earnings before the deduction of Interest, tax, depreciation and amortization

Note 2 – Adjusted EBITDA Calculation

Adjust	Item	Amount (AED)
	Accounting Income / (Loss)	xxx / (xxx)
Add/ Less	Adjustments as per Article 20 of the Corporate Tax Law (excluding General Interest Deduction Limitation Rule and Tax Loss provisions)	xxx / (xxx)
Add	Depreciation expenditure subject to any adjustments	xxx
Add	Amortisation expenditure	xxx
Add	Net Interest Expenditure for the relevant Tax Period (before carry forward of Net Interest Expenditure)	xxx
Add	Net Interest Expenditure relating to historical financial assets or liabilities held prior to 9 December 2022	xxx
Add	Net Interest Expenditure on Qualifying Infrastructure Projects	xxx
	Total: Adjusted EBITDA	**xxx**
	30% of Adjusted EBITDA	**xx**

If the adjusted EBITDA results is a negative amount, then the adjusted EBITDA will be AED 0.

Note 3: Net Interest Expenditure Calculation

Adjust	Item	Amounts (AED)
	Net interest expenditure as per Financial Statements (i.e., Interest expenditure less Interest income)	xxx
Add	Items not included as interest for accounting purposes but treated as Interest expenditure	xxx
Less	Items not included as interest for accounting purposes but treated as Interest income	(xxx)
Less	Interest expenditure disallowed under any other provisions of the Corporate Tax Law (including disallowed amounts under Arm's Length Principle and Specific Interest Deduction Limitation Rule)	(xxx)
Less	Net Interest Expenditure related to grandfathered debts	(xxx)
Less	Net Interest Expenditure related to Qualifying Infrastructure Projects	(xxx)
Subtotal	Net Interest Expenditure for the relevant Tax Period (before carry forward)	**XXX**
Add	Net Interest Expenditure carried forward from previous 10 Tax Periods	xxx
Total	Net Interest Expenditure for the relevant Tax Period	**XXX**

Special Cases

Exempt Persons

- **Taxable for Other Activities:** Exempt Persons are taxable on non-exempt business income.
- **Direct Attribution:** Interest tied to taxable activities is deductible (subject to limits).
- **Fair Allocation:** Non-attributable interest must be fairly apportioned.
- **Revenue Basis:** For natural resource businesses, apportionment is typically based on revenue.
- **No Deduction for Exempt Activity:** Interest for exempt activities is non-deductible.

Non Resident Persons

- **Scope of Taxation:** Non-Residents are taxed on (i) PE income, (ii) Nexus income, and (iii) State Sourced income. Interest deduction rules apply only to (i) and (ii), not to State Sourced income.
- **Carry Forward:** Disallowed Net Interest Expenditure can be carried forward for 10 Tax Periods.
- **Interruption Impact:** If PE/nexus ends, unused interest deductions are forfeited.
- **No Revival:** Re-establishing PE/nexus later doesn't revive forfeited amounts.

Cash Basis of Accounting

- **Cash Basis Usage:** Allowed if Revenue ≤ AED 3 million; else, Accrual Basis applies unless FTA approval is obtained.
- **Recognition Timing:** Income and expenses recorded when **cash is received or paid**, not when accrued.
- **Interest Deduction:** Interest expenses deducted in the period of payment, subject to limitation rules.
- **De Minimis Exemption:** If Net Interest Expenditure ≤ AED 12 million, General Interest Deduction Limitation does **not** apply.

Exceptional Cases

Exceptions

- **Who's Exempt**: Banks, insurers, and sole proprietors are **not subject** to interest deduction limits.
- **Who's Not**: Treasury firms, captive insurers, and investment vehicles **must apply** the limit.
- **Banks & Insurers**: Licensed entities are exempt, but **interest rules still apply** separately.
- **Natural Persons**: Individuals are exempt; **companies owned by individuals are not**.
- **Tax Groups**: **Bank/insurer's interest ignored** in group interest calculations.

Qualified Infrastructure Project

- **Definition:** A person engaged in providing, maintaining, or operating a qualifying infrastructure project (or related ancillary activities) is termed a Qualifying Infrastructure Project Person.
- **Tax benefit**: Exempt from general interest deduction cap for qualifying projects.
- **Purpose**: Must serve UAE's public in transport, utilities, education, healthcare, etc.
- **Asset rules**: Assets must stay in UAE, last 10+ years, and can't be freely disposed.
- **Interest rule**: Interest income & expense must arise within the UAE.

Historical Financial Liabilities

- **Pre-existing Debt Exemption**: Interest on loans agreed before **9 Dec 2022** is **not subject to the General Interest Deduction Limitation Rule**.
- **Hedging Allowed**: Interest rate swaps or similar contracts entered **after 9 Dec 2022** are still covered if they purely hedge loans agreed before the cut-off date.
- **Conditional Drawdowns**: Additional principal drawn after 9 Dec 2022 is covered **only if** disbursal was **mandated by pre-agreed project milestones**, not merely borrower requests.
- **Cap on Deductible Interest**: Deduction allowed is the **lower of** actual interest in the tax period or interest based on original loan terms as of 9 Dec 2022.
- **Other Rules Still Apply**: Interest must still meet **general deduction conditions** (e.g., incurred wholly for business) and **Specific Interest Deduction Limitation Rule**.

Small Business Relief

- Taxpayers opting for **Small Business Relief cannot deduct** or **carry forward** Net Interest Expenditure.
- If interest was disallowed **before** opting in, the **carry forward period pauses** during relief years.

Compliance Actions & Tax Planning

Evaluate All Interest Arrangements

Identify interest, profit equivalents (e.g., Islamic instruments), and related finance charges per tax definitions—not just accounting.

Apply Deduction Rules in Correct Order

(1) General deductibility
(2) Arm's length test
(3) Specific Limitation Rule
(4) General Interest Deduction Limitation Rule.

Segregate Business Activities

Separate eligible infrastructure projects, exempt income-related expenses, and unrelated business arms.

Track Capitalised Interest

Spread it over asset life and adjust depreciation while computing adjusted EBITDA.

Assess Related Party Transactions

Ensure all interest payments to connected/related parties are at market value.

Small Business Relief

If elected, no deduction or carry forward of net interest expenditure—track paused periods.

Where can we help?

Advise on the allowability/ identification	SBC conducts a detailed review of all financing arrangements — conventional and Islamic—to determine whether payments qualify as deductible interest, in line with tax and accounting principles.
Structuring for Compliance & Efficiency	We assist clients in aligning intra-group loans, guarantees, and related-party transactions with arm's length standards, minimising the risk of disallowance under Specific and General Interest Deduction Limitation Rules.
Advisory on Infrastructure Project Qualification	SBC provides end-to-end support in evaluating and documenting projects for Qualifying Infrastructure Project status, enabling clients to benefit from full deduction exemptions where applicable.
Capitalised Interest Management	Our experts guide clients in capitalising and amortising interest efficiently, while ensuring correct EBITDA adjustments and monitoring the impact of asset disposals on remaining interest balances vis-à-vis treatment under IFRS.
Tax Strategy & Compliance Monitoring	SBC enables clients to develop a robust interest deduction strategy, ensuring compliance, optimised carry-forward utilisation, and preparedness for tax authority scrutiny, including under Small Business Relief.

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