UAE Interest deduction Limitation Rules

FTA Guidance

April 2025

Background

The Federal Tax Authority (FTA) on 07 April 2025 issued a guide on interest deduction limitation rules. The Guide is to aid taxpayers on the aspect of deductibility of interest while computing the Taxable income. Broadly, the guide covers definition of interest (including payments economically equivalent to interest), elaborates on general & specific interest deduction limitation rules, carry forward & utilization of net interest expenditure and interaction of these limitation rules with other aspects of Corporate Tax. The Guide underlines that limitation rules ensure interest deductions does not erode UAE's tax base.

This alert summarizes the key aspects of the Guide in the following sections.

Interest and its Types

The UAE Corporate tax law defines interest as:

- Any amount accrued or paid for the use of money or credit (overdraft),
- discounts, premiums,
- profit paid for an Islamic financial instrument,
- other payments economically equivalent to interest,
- any other amounts incurred in connection with the raising of finance, excluding payments of the principal amount.

The key points in connection with interest are as follows:

1. Interest can be recognised either on accrual or cash basis. Interest can be in consideration of loan or credit facility (such as overdraft facility).
2. Loan issued on discount or premium would be part of interest expense. However, certain line items such as trade / volume discounts, sales promotion & rebates, premium / discount on equity instruments or loyalty points / rewards will not be considered as interest.
3. Islamic financing structures use different nomenclature such as profit or mark-up. This element of 'profit' or 'mark-up' is economically equivalent to interest, irrespective of treatment under IFRS. Examples include Mudarabah, Ijara, Sukuk, Istisna and Salam.
4. Payments economically equivalent to interest include the following:
    i. Any penalties or higher interest charges due to default - for non-performing debt instrument.

ii. In a sale and subsequent repurchase agreement of securities, the differential i.e., the price higher than original price
iii. Fee paid by borrower in case of a stock lending agreement
iv. In Hire purchase, the implicit interest as per IFRS. However, cancellation charges incurred due to the early termination of a hire purchase is not treated as interest.
v. The finance element in case of non-finance lease
vi. Factoring fees in case of factoring or similar transactions

5. Foreign exchange loss depreciation of functional currency against the loan currency between the accrual and payment of interest would be treated as interest
6. Charges in relation to late / non-payment of statutory dues will not be allowed as interest.
7. Guarantee fees, arrangement fees or commitment fees will be considered as interest.
8. Any fees paid in connection with raising finance will also be treated as interest viz., underwriting fees, legal and professional fees, early or pre-payment of loan

Deductible Interest expenditure

Business expenses, including interest, is allowed as a deduction while computing taxable income for a taxpayer. Expenditure follows accounting classification as per IFRS (or IFRS for SMEs), as the case maybe. In the following cases interest expense will not be deductible:

a) Interest not wholly and exclusively incurred for the purposes of the taxpayers business –Example where loan taken by business is used for the personal benefit of Director.
b) Expenditure is capital in nature
c) Interest payments relating to deriving Exempt Income
d) Interest payments to connected persons / related parties more than the market value

Specific Interest deduction limitation rule

Specific Interest Deduction Limitation Rule has been introduced to prevent misuse of financial transactions between taxpayer and its related parties / connected persons. It is important to note that specific interest deduction limitation rule applies after the abovementioned deductible interest expenditure rule, including application of the arm's length principle – but before application of the general interest deduction limitation rule (enumerated in the following section). In this limitation rule, interest w.r.t. loan from related party / connected person is disallowed w.r.t. following transactions:

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

However, specific special interest deduction limitation rule is subject to "main purpose test". That is specific interest deduction limitation rule will not apply where the main purpose of obtaining the loan and carrying out one of the transactions listed in 1-4 above is **not** to obtain Corporate Tax advantage. The definition of Corporate tax advantage includes:

- Obtaining a refund / higher refund of corporate tax

- Avoidance or reduction of corporate tax payable
- Deferral of corporate tax payment or advancement of refund
- Avoidance to deduct or account for corporate tax

Note: *The onus is on the taxpayer to demonstrate that the main purpose is not to gain a Corporate Tax advantage.*

Further, where the related party is subject to effective tax rate of 9% in a foreign jurisdiction, no corporate tax advantage is deemed to be arise.

General Interest deduction limitation rule

To prevent abuse of debt financing to reduce tax base of UAE, general interest deduction limitation rule has been introduced. This rule states that where any taxpayer 's net interest expenditure exceeds AED 12 million in a tax period, the amount of deductible interest would be greater of

1. 30% of EBITDA, or
2. de minimis threshold - AED 12 million

The explanation for various terms is provided below:

Net Interest Expenditure – Interest expenditure incurred including any carried forward Net Interest expenditure less interest income derived during the tax period. This would be adjusted for the following:

Adjust	Particulars	Amount in AED
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 disallowed under any corporate tax law including 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 net interest expenditure from previous years)**	**xxx**
Add	Net Interest Expenditure carried forward from previous 10 tax periods	xxx
Total	**Net Interest Expenditure for the relevant Tax Period**	**xxx**

EBITDA – Earnings before the deduction of Interest, tax, depreciation and amortization

Adjusted EBITDA – The computation of adjusted EBITDA would be as follows:

Adjust	Particulars	Amount in AED
	Net profit (loss) as per financial statements	xxx /(xxx)

	(i.e., Accounting Income/(loss))	
+/ -	All adjustments as per Article 20 of Corporate Tax, except general interest deduction limitation rule	xxx /(xxx)
+	Depreciation expense (In case interest capitalized forms part of depreciation, the said capitalized interest to excluded)	xxx
+	Amortization expenditure	xxx
+	Net Interest Expenditure (before carry forward from previous years)	xxx
+	Net Interest Expenditure relating to grandfathered debt instruments	xxx
+	Net Interest Expenditure relating to Qualifying Infrastructure Projects	xxx
Total	**Adjusted EBITDA**	**xxx**
	30% of Adjusted EBITDA	

Note: *Where adjusted EBITDA is negative, it would be treated as 0*

Carry forward and Utilization – The net interest expenditure disallowed in a tax period can be carried forward and utilized in the subsequent 10 tax periods. The carry forward would take place in the order in which it was incurred under the 'first in, first out' principle. For example, a taxpayer has AED 10 million as net interest expenditure carried forward from 2025. In 2026, this carry forward interest would be first deducted followed by the net interest expenditure incurred in 2026. In case of disallowance on account of application of general interest deduction limitation rule, the interest for 2026 will be first disallowed, followed by any carry forward net interest expenditure.

Special Cases

Interaction of General Interest Deduction Limitation Rule with certain special cases is summarized below:

Exempt Persons

Business activities undertaken by exempt persons are subject to corporate tax including application of general interest deduction limitation rule. Where interest is not directly identifiable or attributable to business that is taxable, interest has to be apportioned on a "fair and reasonable" basis.

Non-Resident Persons

For income attributable to PE or to a nexus in UAE in case of a non-resident, general interest deduction Limitation will apply. Where the PE or nexus of non-resident is interrupted i.e., it ceases to taxable person, any carry forward of unutilized net interest expenditure will be cancelled / forfeited. Even where the non-resident has income attributable to PE / nexus in UAE for the later years, such unutilized net interest expenditure will stand cancelled.

Cash basis of accounting

Taxpayers may opt for cash basis of accounting where the revenue does not exceed AED 3 million in a tax period, and interest is deductible on payment of interest – subject to specific and general interest deduction limitation rules

Exemptions to General limitation rule

The following are the exceptions to the application of the general interest deduction limitation rule:

1. Banks
2. Insurance providers
3. Business activities by natural persons
4. any other Person as may be determined by the Minister (currently no persons have been specified)

Where Banks or insurance companies are part of a tax Group, any interest expenditure or income attributable to such bank / insurance providers is not considered for the purpose of computing net interest expenditure or EBITDA. The aforementioned exception does not apply to captive insurance companies, treasury companies or other non-regulated financial entities.

Historical Financial Liabilities

Debt instruments / liabilities with terms agreed upon before 9 December 2022 are defined as pre-existing debt instruments or liabilities / historical financial liabilities. For such historical financial liabilities net interest expenditure will not be subject to the general interest deduction limitation rule. This includes agreements where their sole purpose was to hedge against interest risk, can be entered into either before or after 9 December 2022.

Where principal of a historical financial liability includes certain undrawn value, the net interest expenditure will not be subject to general interest deductions limitation rules only where the lender was legally required to provide the funds upon completion of deliverable / project phase and it is agreed prior to 9 December 2022. It should not be merely at the request of the borrower.

For historical financial liabilities, net interest expenditure attributable is lower of:

- actual net interest expenditure that arises in the Tax Period or
- net interest expenditure that would arisen as per the terms as at 09 December 2022.

Note: *Historical financial liabilities would be subject to general rules for deduction i.e., wholly and exclusively for the business, should not be capital expenditure, etc.. It would also be subject to specific Interest Deduction Limitation Rule.*

Qualifying Infrastructure Projects

A person undertaking (i.e., into provision, maintenance or operation) a qualifying Infrastructure Project or undertakes activities that is ancillary or facilitates undertaking of a qualifying Infrastructure Project is defined as a qualifying Infrastructure Project person. Such qualifying person may undertake another business activity as well.

A qualifying person undertaking qualifying infrastructure project is not subject to the general interest deduction limitation rule.

Qualifying Infrastructure Project is one that satisfies all of the following conditions:

- exclusively for public benefit of UAE.
- exclusively for the purposes of transport, utilities, education, healthcare or any other service within the UAE,
- its assets may not be disposed of at the discretion of the relevant Qualifying Infrastructure Project Person,
- the assets provided, operated or maintained by the project should last, or be expected to last not less than 10 years,
- all its assets must be situated in UAE, and
- its Interest income and Interest expenditure must arise in the UAE.

Note: *Net interest expenditure arising for a qualifying person engaged in business unrelated to qualifying infrastructure project would be subject to general interest deduction limitation rules.*

Small Business Relief

Taxpayers electing under small business relief cannot deduct Net Interest expenditure and will not be eligible to carry forward any net interest expenditure. However, when the taxpayer was not under the small business relief & net interest expenditure was disallowed under general limitation rule, the carry forward period would be paused during period in which the taxpayer had subsequently elected under small business relief. For example, where taxpayer has disallowance under general limitation rule in 2024 and elects under small business relief in 2025 and 2026, the net interest expenditure can be carried forward upto 2036.

Key takeaways

The Guide on interest deduction limitation rules provides detailed explanation on various elements of interest expense as well as deductibility or non-deductibility of the said expense in various instances, including various illustrations. The Guide aligns with the Action Plan 4 of the BEPS (Base Erosion and Profit Shifting), 2015 issued by the OECD - wherein UAE has adopted the Fixed ratio rule viz., 30% of EBITDA.

With closure of CY 2024 as well as FY 2024-25 this Guide would throw light on deducibility of interest expenses and would aid taxpayers evaluate their financial transactions in light of filing the corporate tax return.

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