Howard R. Hull | Roberto Scalia

UAE International Tax

IBFD

UAE International Tax

Why this book?

UAE International Tax provides an in-depth analysis of the taxation of international cross-border investments involving the United Arab Emirates. Whether the United Arab Emirates is the source or the destination of investments, both domestic and international laws are addressed in detail.

The United Arab Emirates has been undergoing a fundamental tax transformation in recent years. Whilst it has successfully maintained its position as a tax-competitive jurisdiction, the country has recently introduced a number of indirect taxes. It has also managed to significantly enhance its tax treaty network, whilst respecting its international commitments with new base erosion and profit shifting measures, as well as new measures to enhance transparency and exchange of information. These have all had a significant effect on international cross-border investments.

In addition to examining the United Arab Emirates' significant network of international tax treaties, UAE International Tax addresses the complex rules for the avoidance of treaty abuse, international VAT law, country-by-country reporting, economic substance regulations, beneficial ownership disclosures, financial account information and other recent developments.

UAE International Tax was written in the context of the "Year of the Fiftieth", celebrating 50 years since the formation of the United Arab Emirates.

Title: UAE International Tax
Author(s): Howard R. Hull, Roberto Scalia
Date of publication: November 2021
ISBN: 978-90-8722-735-7 (print), 978-90-8722-736-4 (ePub), 978-90-8722-737-1 (PDF)
Type of publication: Book
Number of pages: 460
Terms: Shipping fees apply. Shipping information is available on our website
Price (print/online): EUR 135 / USD 160 (VAT excl.)
Price (eBook: ePub or PDF): EUR 108 / USD 128 (VAT excl.)

Order information

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IBFD, Your Portal to Cross-Border Tax Expertise

UAE International Tax

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ISBN 978-90-8722-735-7 (print)
ISBN 978-90-8722-736-4 (eBook, ePub); 978-90-8722-737-1 (eBook, PDF)
NUR 826

Foreword

The United Arab Emirates has been undergoing a fundamental tax transformation over recent years.

Whilst it has successfully maintained its position as a tax-competitive jurisdiction, the country has recently introduced a number of indirect taxes. It has also managed to significantly enhance its tax treaty network whilst respecting its international commitments with new base erosion and profit shifting measures, as well as new measures to enhance transparency and exchange of information. These have all had a significant effect on international cross-border investments.

UAE International Tax was written in the context of the United Arab Emirates' "Year of the Fiftieth", which celebrates 50 years since the formation of the union.

Its purpose is to modestly introduce the main characteristics of UAE international tax law. It is not a contribution to the complex science of comparative international tax law, nor is it a commentary on international tax policy in the United Arab Emirates.

In particular, *UAE International Tax* is designed for practitioners wishing to acquire a working knowledge of the tax issues involved in international cross-border investment. Whether the United Arab Emirates is the source or the destination of income, both domestic and international laws are explained in detail.

UAE International Tax pays particular attention to tax treaty relief granted to UAE-resident individuals and businesses on their outbound investments, as well as relief granted to non-UAE-resident individuals and businesses on their inbound investments into the country. *UAE International Tax* also addresses the complex rules for the avoidance of treaty abuse, international VAT law, country-by-country reporting, economic substance regulations, beneficial ownership disclosures, financial account information and other recent developments.

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Introduction

The United Arab Emirates has established itself as a hub for international trade and finance.

In recent years, it has been ranked amongst the world's leading nations by institutions such as the United Nations, the World Bank, the World Economic Forum, the International Institute for Management Development and the INSEAD Institute.

However, one of the core strategic initiatives of the United Arab Emirates is to continuously strive to further develop its financial and economic standing on the international stage.

To this aim, the UAE Ministry of Finance has undertaken significant measures to develop and improve relations with international financial organizations and institutions, develop and promote international financial relations bilaterally and activate opportunities and advantages from GCC joint financial and economic integration. The United Arab Emirates' international tax framework represents an important component of these initiatives.

The United Arab Emirates' involvement with international financial institutions includes a long-standing strategic partnership with the OECD in matters of international taxation. The United Arab Emirates is an active member of the OECD's Inclusive Framework on Base Erosion and Profit Shifting (BEPS), with the involvement of G20 and non-G20 countries to ensure consistent implementation of the BEPS package worldwide. It is also heavily involved in the OECD's Global Forum on Transparency and Exchange of Information, which includes having signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MCMAA).

The UAE Ministry of Finance has taken important steps to develop bilateral agreements with its international trading partners and has signed over 130 comprehensive tax treaties to date. These agreements strengthen the country's trade and economic relations, provide more investment opportunities for companies, boost foreign investments and promote trade, commodity exchange and the cross-border movement of capital.

More regionally, the United Arab Emirates works with other Gulf Cooperation Council (GCC) member states collaborating on the implementation of taxes in the Gulf. This has led to agreements on indirect taxes such as customs, excise and value added tax. More recently, it has led to the first

intra-GCC tax treaty between the United Arab Emirates and the Kingdom of Saudi Arabia, which entered into force in January 2020.

UAE International Tax aims to recognize all these different initiatives in the field of international taxation on the occasion of the United Arab Emirates' golden jubilee celebrations.

Part 1 starts by giving an overview of the domestic tax system in the United Arab Emirates. This includes the differences between the federal, emirati and free zone jurisdictions before highlighting the direct and indirect tax rules and regulations across the country. Since the United Arab Emirates is a tax-competitive jurisdiction, the authors focus in particular on value added tax (VAT), customs duty and excise tax.

Part 2 introduces UAE tax treaty law. This is based on more than 130 comprehensive income tax treaties signed by the United Arab Emirates with its international partners. After an examination of their scope of application, the book offers an introduction to the methods by which tax treaties should be interpreted, as well as the interrelation between domestic law and tax treaty law.

A summary of the international allocation of taxable income under UAE tax treaty law follows. This determines which state is granted the right to tax income under treaty law, and to what extent. The reader's attention is drawn to the allocation of business profits, transfer pricing, income from immovable property, investment income, personal services income and pension income, as well as other types of income not expressly covered in tax treaties. The power to tax income is generally granted to one or other of the contracting states. However, taxation in both contracting states is possible on dividends, interest, royalties and sometimes pensions.

This is followed by a number of specific international issues within UAE tax treaty law, such as the methods to qualify for double taxation relief, anti-abuse provisions, non-discrimination clauses and the implementation of mutual agreement procedures.

Part 3 examines the United Arab Emirates' relatively recent international VAT law. It highlights the VAT implications of importing and exporting goods and services to and from the country, with a particular focus on free zones, designated zones, suspension regimes and exemptions.

Part 4 addresses the measures taken by the United Arab Emirates around BEPS. After covering the work leading to the OECD's Inclusive Framework, this part details the introduction of country-by-country reporting and economic substance regulations.

Finally, part 5 introduces the United Arab Emirates' approach to transparency and the exchange of information. This includes an outline of the OECD's Global Forum, as well as a review of the new UAE beneficial ownership and international financial account information disclosure rules.

The information and material referenced herein is as available on 15 June 2021.

Whilst every effort has been made to accurately reflect the principles of UAE international taxation, for the official position on all matters of UAE international taxation, reliance can only be made on UAE laws, regulations and administrative practice as governed by UAE competent authorities.

Although tax treaty law generally limits the application of domestic law, different jurisdictions may have different ways of interpreting and enforcing the principles of international tax law. It cannot be assumed that all jurisdictions apply the principles of international taxation consistently.

All and any references to international case law, publications and opinions are for illustrative purposes only. They are not binding in any way on the United Arab Emirates, the UAE Ministry of Finance, the UAE Federal Tax Authority or any other legislative, executive or judicial body within the United Arab Emirates.

Chapter 9

Dividends

9.1. Definition

Dividends are generally defined as distributions of current or accumulated profits by a company to its shareholders or holders of participation rights. However, since no strict definition of "dividends" has been unanimously recognized, tax treaties tend to propose a list of examples of distributions that are characterized as dividends. Article 10(3) of the OECD Model gives the following non-exhaustive list of profit distributions, which fall under the general definition of "dividends": "The term dividend as used in this Article means income from shares, jouissance shares or jouissance rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident."[606]

The OECD Commentary goes further by defining dividends as distributions of profits decided by annual general meetings of shareholders as well as other benefits in money or money's worth, such as bonus shares, bonuses, profits on a liquidation and disguised distributions of profits.[607] It is immaterial whether any such benefits are paid out of current profits made by the company or are derived, for example, from reserves (i.e. profits of previous financial years). However, normally, distributions by a company that have the effect of reducing the membership rights (e.g. payments constituting a reimbursement of capital in any form whatsoever) are not regarded as dividends.

606. UAE tax treaties largely follow the OECD Model, with some differences, such as (i) referring to "share of any kind" (art. 10(3) *Alb.-UAE. Income and Capital Tax Treaty*); (ii) including income even if paid in the form of interest (art. 10(5) *Belg.-UAE Income and Capital Tax Treaty*; *see* para. 25 *OECD Model: Commentary on Article 10*); (iii) including the "distributions on certificates of an investment fund or investment trust" (art. 10(3) *Ger.-UAE Income and Capital Tax Treaty*); (iv) excluding from the scope of art. 10 "profits on a liquidation or redemption of shares and capital appreciation" (Protocol 3, for the purposes of para. 5 of art. 13 (capital gains) *Liech.-UAE Income and Capital Tax Treaty*); and (v) including income received in connection with "the (partial) liquidation of a company or a purchase of own shares by a company" (Protocol XI with reference to arts. 10 and 13 *Neth.-UAE Income Tax Treaty*. *See also* art. 10(2) *Alg.-UAE Income and Capital Tax Treaty*.

607. Para. 28 *OECD Model: Commentary on Article 10*.

Apart from the autonomous treaty definition of “dividend”, as per the first two sentences of article 10(3),[608] for a more precise definition, reference is made to the domestic law of the state of which the distributing entity is a resident.[609] Indeed, payments are characterized as dividends for the purposes of the OECD Model when the state, of which the paying company is a resident, taxes such benefits in the same manner as dividends. The same approach is adopted for share redemptions.[610]

In certain UAE double tax treaties, there are special rules that consider pre-defined financial instruments to be dividends[611] or that intend to avoid conflicts of qualification.[612]

608. These are shares – “jouissance” shares, “jouissance” rights, etc., and rights other than “debt-claims” – that carry a right to income distribution. According to M. Helminen, *Classification of Cross-Border Payments on Hybrid Instruments*, 58 Bull. Intl. Taxn. 2, p. 58 (2004), Journal Articles & Opinion Pieces IBFD: “The phrase ‘as well as from other corporate rights’ indicates that the rights mentioned in the first two parts of the definition are also corporate rights.” *See also* E. Eberhartinger & M. A. Six, *Taxation of Cross-Border Hybrid Finance: A Legal Analysis*, 37 Intertax 2, p. 4 (2009); and H. Pijl, *Interest from Hybrid Debts in Tax Treaties*, 65 Bull. Intl. Taxn. 9, pp. 482 and 490 et seq. (2011), Journal Articles & Opinion Pieces IBFD.

609. Where the notion of dividends is not “autonomously” defined, the notion of “other corporate rights” (*see* M. Helminen, *The International Tax Law Concept of Dividend* p. 175 et seq. (Wolter Kluwer 2010)) shall be interpreted according to domestic law (*see* V.S. E. G. Lopes Dias, *Tax Arbitrage through Cross-Border Financial Engineering* p. 116 (Wolters Kluwer 2015)).

610. *See* OCSE, *2014 Update to the Model Tax Convention* (15 July 2014), para. 57. The opinion of the OECD has been contested by J. Schuch & E. Pinetz, *The Definition of Dividend, Interest, Royalties and Capital Gains*, in *The OECD-Model-Convention and its Update 2014* p. 11 (M. Lang et al. eds., IBFD 2015), Books IBFD.

611. *See* Protocol 4 with reference to arts. 10 and 11 *Ger.-UAE Income and Capital Tax Treaty*, holding that “dividends and interest may be taxed in the Contracting States in which they arise, and according to the law of that State, a) if they are derived from rights or debt claims carrying a right to participate in profits, including income derived by a silent partner (‘stiller Gesellschafter’) from his participation as such, or from a loan with an interest rate linked to borrower’s profit (‘partiarisches Darlehen’) or from profit sharing bonds (‘Gewinnobligationen’) within the meaning of the tax law of the Federal Republic of Germany and b) under the condition that they are deductible in the determination of profits of the debtor of such income”.

612. Protocol III with reference to art. 3(2) and art. 24 *Neth.-UAE Income Tax Treaty*, for example, holds that in cases of “differences in *qualification* (for example of an element of income or of a person)”, the competent authorities may achieve an agreement that “after publication thereof by both competent authorities, shall also be binding for the application of the provisions of the Convention in other identical or similar cases”.

9.2. Taxation in the beneficiary state

Where the resident of one contracting state receives dividend income from a resident of the other contracting state, such income is, in principle, subject to income tax in the state of residency of the beneficiary (article 10(1) of the OECD Model).

Generally, the above principle is followed by UAE tax treaties. However, in its Protocol, the Canada-United Arab Emirates Income and Capital Tax Treaty (2002) provides that nothing in article 10 of the treaty affects the fiscal privileges available under the doctrine of sovereign immunity to the government of a contracting state or its local governments and their agencies and institutions.

In the United Arab Emirates, there is no taxation on dividends received by UAE residents. However, where non-residents invest in UAE businesses, any resulting dividends may be taxed in the country of the beneficiary, as per the domestic laws of that other country.

9.3. Taxation in the source state

9.3.1. Limited tax liability

The beneficiary residence state does *not* have an exclusive right to subject dividends to taxation because a limited right to tax is also granted to the source state (article 10(2) of the OECD Model).[613]

As a rule, under the OECD Model, the tax rate in the source state of dividend income is limited to 15% of the gross amount of the dividends. However, where the recipient shareholder is a company (other than a partnership)[614] that holds directly at least 25% of the gross amount of the capital of the company paying the dividends, the tax rate in the source state is limited to

613. The United Arab Emirates' treaty with Finland provides for exclusive taxation in the state of residence (art. 10(1) *Fin.-UAE Income Tax Treaty*). *See also* art. 11 *Barb.-UAE Income Tax Treaty*; art. 11 *Cyprus-UAE Income Tax Treaty*; and art. 10 *Austria-UAE Income Tax Treaty*. The Protocol with reference to arts. 10, 11 and 13 *Austria-UAE Income Tax Treaty* states that "it is understood that dividends … derived by a resident of a Contracting State, including the government, financial institutions or investment companies of that State *shall be taxable only* in that State of residence" [emphasis added].

614. In the 2017 version of the *OECD Model*, reference to "partnerships" was deleted "in recognition of the fact that if a partnership is treated as a company for tax purposes by the contracting State in which it is established, it is appropriate for the other State to

5% (article 10(2) of the OECD Model). This additional treaty relief is justified by the fact that payments of profits by a subsidiary to its foreign parent company should be taxed less heavily to avoid recurrent taxation and, hence, facilitate international investment.

Dividend distributions received by UAE residents from non-resident companies may be subject to withholding tax under the other state's domestic withholding tax laws.[615] However, dividends paid by UAE entities are not subject to withholding tax according to UAE domestic law.[616]

Whilst UAE tax treaties generally follow the OECD Model to reduce the tax at source on dividend distributions, there may be different (i) tax rates (e.g. 5%,[617] 7%[618] and 10%[619]); (ii) exemptions;[620] (iii) percentage of holding thresholds;[621] (iv) voting powers;[622] (v) entity qualifications;[623] or (vi)

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grant the benefits of subparagraph a) to that partnership … as long as it holds directly at least 25 per cent of the capital of that company" (para. 11 *OECD Model: Commentary on Article 10*).

615. Switzerland, for example, levies a 35% withholding tax on dividends under domestic law, whereas the United Kingdom has no such withholding tax on dividend distributions made by UK resident entities.

616. Protocol III with reference to art. 10 *HK-UAE Income Tax Agreement* clearly recognizes that "under the current law of the respective Contracting Parties there is no tax chargeable on dividends in addition to the tax chargeable on the profits or income of a company".

617. Art. 11(2)(a) *Azer.-UAE Income and Capital Tax Treaty* that applies, subject to Protocol III of said treaty, providing that "if the tax rate in one of the Contracting States is changed for lower than which accrued this Convention, such lower rate should apply automatically to resident of the other Contracting State to the extent that it is more favourable".

618. Art. 10(2) *PRC-UAE Income Tax Treaty*.

619. Art. 10(2) *India-UAE Income and Capital Tax Treaty*, as amended through art. 3 of Protocol (2007).

620. Art. 10(2)(a) *UAE-UK Income Tax Treaty*.

621. As per art. 10(2)(a) *Bel.-UAE Income and Capital Tax Treaty* and art. 10(2)(a) *Italy-UAE Income Tax Treaty*, the 5% tax rate is granted to shareholders holding at least 25% of the capital of the company paying the dividend. The holding threshold to be entitled to the "qualifying shareholder" tax rate is 10% in art. 10(2)(a) *Can.-UAE Income and Capital Tax Treaty*. Art. 10(2)(b) *Belr.-UAE Income and Capital Tax Treaty* provides for a 5% rate subject to the following condition: "[T]he beneficial owner is a company (other than a partnership) *which holds directly at least 100,000 USD* of the company paying the dividends" [emphasis added].

622. Art. 10(2)(b) *Can.-UAE Income and Capital Tax Treaty*.

623. Art. 10(2)(c) *Ger.-UAE Income and Capital Tax Treaty* applies when the recipient of the dividend is a "real estate investment company which is tax-exempt" and (as clarified in the Protocol with reference to art. 10, sub-para. (c) of para. (2) to the *Ger.-UAE Income and Capital Tax Treaty*) "[i]n the case of Germany a real estate investment company is a company according to paragraph 1 of section 1 of the German Act on German Real Estate Stock Corporations with Listed Shares (REIT Act)".

other preconditions.[624] The Saudi Arabia-United Arab Emirates Income and Capital Tax Treaty (2018), for example, allows for a flat 5% residual withholding tax on dividends, regardless of the participation threshold.

In addition, the Luxembourg-United Arab Emirates Income and Capital Tax Treaty (2005) and Netherlands-United Arab Emirates Income Tax Treaty (2007) exempt dividends paid by a company in a contracting state from tax in that state if the recipient in the other contracting state – who is the beneficial owner – is the state itself, a local government, a local authority or its financial institution,[625] which is a resident of the other contracting state.[626]

9.3.2. Beneficial ownership

In order to qualify for treaty relief on dividend income, it is necessary for UAE recipients of dividends to be the "beneficial owner of the dividends".[627]

The "beneficial ownership" clause is a common element of articles 10, 11 and 12 of the OECD Model, which address dividends, interest and royalties.

9.3.3. Treaty abuse

Treaty relief is not to be granted in cases of abuse.

The discussions undertaken by the OECD in the BEPS Project have led to a rethinking of the topic, which is analysed in greater detail in part 4 (*see* sections 24.2. and 24.4.2.).

The guidance in the OECD Commentary is helpful in this respect.

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624. This is the case of art. 10(2)(a) *Jap.-UAE Income Tax Treaty*, which provides for a 6-month holding period.
625. In some double tax treaties, the list of entities (though not exclusive) is included in the treaty article itself (*see*, e.g. art. 10(3) *Bulg.-UAE Income Tax Treaty* and art. 10(3)(b)(vii) and (viii) *Greece-UAE Income and Capital Tax Treaty*). Entities that are not wholly state-owned enterprises (art. 10(2)(a) *HK-UAE Income Tax Agreement*) are entitled to treaty benefits under art. 10, subject to a minimum holding threshold held by the state (e.g. under art. 10(3)(b) *PRC-UAE Income Tax Treaty*, the minimum holding threshold is 20%).
626. *See also* art. 10(3) *Greece-UAE Income and Capital Tax Treaty*. The same is true in double tax treaties, providing that such income "shall be taxable only" in the state of residence.
627. *See* art. 10(1) *Arm.-UAE Income and Capital Tax Treaty*.

The 2017 version of the OECD Commentary clarifies that, whilst the concept of "beneficial owner" deals with some forms of tax avoidance (namely, those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of abuse.[628]

Under the 2014 version of the OECD Commentary,[629] there would be an abuse when a company with a holding of less than 25% has, shortly before the dividends become payable, increased its holding primarily for the purpose of securing the benefits of the above-mentioned provision, or otherwise where the qualifying holding was arranged primarily in order to obtain the reduction. To counteract such manoeuvres, it was suggested that contracting states may introduce a provision indicating that the 5% reduction may be secured provided that this holding was not acquired primarily for the purpose of taking advantage of this provision. A similar provision has been included in some of the tax treaties ratified by the United Arab Emirates.[630]

Where a UAE resident receives income from a non-resident entity, the reduced tax at source is not automatically applied. Indeed, before applying the treaty rate, it is first necessary to determine whether all the conditions laid down by the treaty are fulfilled. It is only when there is no doubt that these requirements have been met that the reduced treaty rate may be applied.[631]

A key amendment has been the introduction, as of 2017, to article 29 (labelled "entitlement to benefits") of the OECD Model.[632] This topic is further dealt with in section 18.4. of this book and *seq*. hereinunder.

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628. *See* para. 12.5 *OECD Model: Commentary on Article 10*.
629. *See* cross-reference under paras. 12.5 and 17 *OECD Model: Commentary on Article 10* (2014).
630. Notably, OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2015 Final Report* (OECD 2015), Primary Sources IBFD [hereinafter *BEPS Action 6*] led to a modification of sub-para. a) of art. 10 in order to restrict its application to situations where the company that receives the dividend holds directly at least 25% of the capital of the company paying the dividends "throughout a 365 day period that includes the day of the payment of the dividend" not considering, however, in computing that period "changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation" (*see* para. 16 *OECD Model: Commentary on Article 10*).
631. Para. 19 *OECD Model: Commentary on Article 10* clarifies that "[t]he paragraph does not settle procedural questions. Each State should be able to use the procedure provided in its own laws".
632. In furtherance of *BEPS Action 6*.

The rationale behind the limitation to treaty entitlement under article 29 is that "[a]llowing persons who are not directly entitled to treaty benefits (such as the reduction or elimination of withholding taxes on dividends … to obtain these benefits indirectly through treaty shopping would frustrate the bilateral and reciprocal nature of tax treaties".[633]

9.3.4. Extraterritoriality

The extraterritorial taxation of dividends is the practice by which dividends distributed by a company in one contracting state are subject to taxation in the other contracting state solely because the corporate profits from which the distributions are made originate in their territory (for example, through a permanent establishment situated therein).

Article 10(5) of the OECD Model excludes the extraterritorial taxation of dividends. Therefore, a contracting state may not impose any tax on the dividends paid by a company in another contracting state, nor subject the company's undistributed profits to a tax on the company's undistributed profits (except if such dividends are paid to a resident of that state or if the holding in respect of which the dividends are paid is effectively connected to a permanent establishment or a fixed base situated in that state).

Certain treaties signed by the United Arab Emirates leave open the possibility of extraterritorial taxation. It is therefore necessary to analyse the domestic laws of each state involved (in addition to the relevant double tax treaty) to determine the practical application of extraterritoriality.

9.4. Procedural considerations

Profit distributions made by non-UAE corporations are often subject to a withholding tax based on the domestic law in the state of the distributing entity.

In many countries, the distributing company is required to withhold tax on the gross amounts of dividends paid, irrespective of whether or not the recipient is entitled to a full or partial refund under the tax treaty.

633. Para. 4 *OECD Model: Commentary on Article 29.*

The OECD Model does not contain provisions on the procedure for obtaining a full or partial refund of withholding tax. It is therefore accepted that this issue may be covered by the legislation of the source country.[634] Regarding UAE tax treaties, rules of procedure have been introduced in various different ways. Depending on the contracting state, these rules may be laid down in the tax treaty itself,[635] in subsequent bilateral agreements or by means of internal rules of application.

Some countries allow companies distributing qualifying dividends to directly apply the treaty withholding rates prospectively and are, therefore, not required to make any withholding tax prepayment.

634. Para. 19 *OECD Model: Commentary on Article 10*.
635. *See*, e.g. Protocol 3 to the *Malay.-UAE Income Tax Treaty*; Protocol 5 with reference to art. 10 *Malta-UAE Income Tax Treaty*; and Protocol X to the *Neth.-UAE Income Tax Treaty*.

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