Tax challenges in the GCC

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Agenda

- Introduction & recent developments
- Impact of corporate tax
- Value added tax (VAT)
- Impact of VAT
- Preparing for corporate taxes
- Preparing for VAT
- Other tax developments
- Questions

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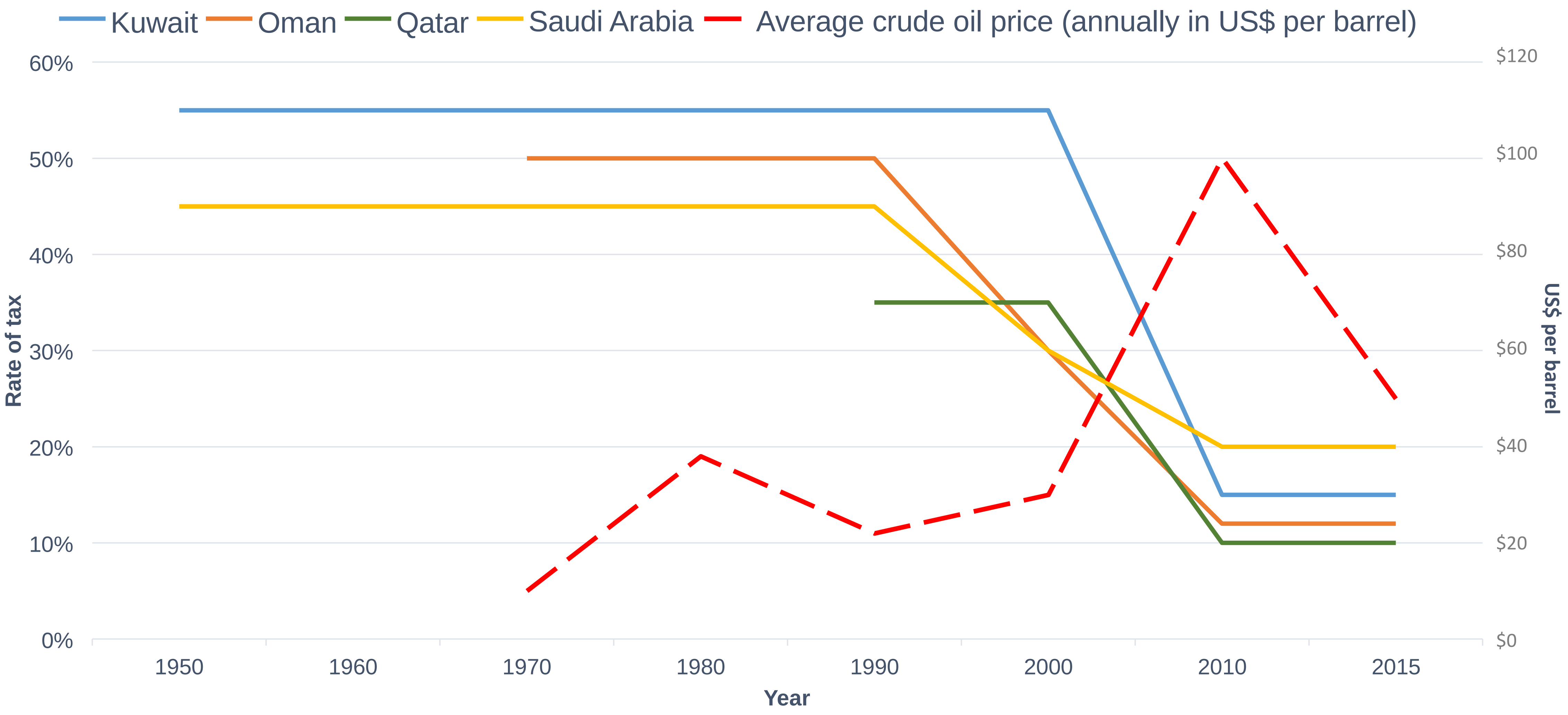
Introduction & recent developments

Tax: Oil prices



Tax milestones

Year	Oil price (US$/bbl)	Milestone
1994	16	• Oman introduces corporate tax on Omani owned businesses
1996	21	• Oman introduces 10% withholding tax on specified payments to foreigners
2001	24	• Kuwait introduces national labour support (NLS) tax of 2.5% on net profits
2004	38	• Saudi Arabia introduces withholding tax on specified payments ranging from 5% to 20%, which includes dividends and interest • Corporate tax rate reduced from 30% to 20%
2007	73	• Kuwait introduces zakat at 1% of net profits on all Kuwaiti joint stock companies (closely held and listed)
2010	79	• Qatar introduces withholding tax at 5% and 7% on specified payments (including interest) • Corporate tax rates reduced from 35% to 10%
2015	45	• Corporate tax and VAT reforms announced - GCC

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Corporate tax developments to date

Known	Unknown
• Feasibility studies already conducted • Corporate tax law being drafted • Legislation to be ready imminently • 12 month preparation time assured	• Tax rate (although likely to be competitive) • Coverage • Exemptions and incentives • Withholding tax • Arm's length principle • Unilateral credit for overseas taxes

Corporate tax principles

- A direct tax
- Levied on business profits and other forms of corporate income earned during a given time period
- Impacts distributable earnings
- Increases cost of business
- Generally, audited financial statements are the starting point for calculating taxable profits
- Adjustments to accounting profits as set out in the tax law. For example, depreciation, head office expenses
- Certain expenses and allowances are treated differently for tax as compared to the accounting treatment. For example, provisions and warranties, bad debts

Key corporate tax issues

- Cross charges and payments to non-residents:subject to a withholding tax?
- Intra-group charges and deductibility: For example, will there be restrictions on head office expenses or related party fees?
- Permanent establishment (PE) versus taxable presence: Will PE be defined – service, agency and virtual?
  - Attribution of profits
- Thin capitalization: Will there be restrictions on interest deduction on loans from related parties?
- Transfer pricing: Will there be bespoke rules or only the arm's length principle? What impact will BEPS have?
- Compliance:
  - Taxable businesses generally need to be registered
  - Returns must be filed on an annual basis
  - Payments could be made in advance (estimated) or an annual basis

Impact of corporate tax

Tax liability

- Generally calculated on taxable profits
- Audited financial statements are generally the starting point for calculating taxable profits

Considerations

- Directly impacts distributable earnings
- Increases cost of business
- Key element of corporate governance and compliance
- Will liabilities be the same across the GCC?
- Will the tax law include adjustments for depreciation, specific and non-specific provisions and allowances?
- Groups need to ensure financial statements are audited according to the tax law - each legal entity in a group needs to prepare separate financial statements
- Groups need to review their financial systems and make any necessary changes to allow for separate financial statements
- Will there be double taxation for banks and oil companies - or will there be some form of relief mechanism?

Cross charges

- Many multi-national companies have a regional office in Dubai

Considerations

- Deductibility of regional costs where incurred for managing other countries
- Restrictions on deductible head office charges
- Withholding taxes on cross charges
- Withholding taxes on payments to head office – such as franchise payments and royalties
- Financing charges – thin capitalization, interest deductions and withholding tax implications

Transfer pricing

- Key focus for tax authorities around the world
- BEPS initiatives have increased awareness
- Increasing area of focus across the GCC

Considerations

- Bespoke transfer pricing rules?
- Regional trends on transfer pricing
- Detailed transfer pricing or arm’s length principle
- Under corporate tax versus customs law?
- Current inter-company transactions – both domestic and international

Permanent establishment

- One of the most important international tax concepts
- Any company having a PE could be subject to corporate tax in their own GCC state (specifically where currently there is no corporate tax

Considerations

- Will PE be defined in the tax law?
  - OECD based
  - Service clause
  - Agency PE
  - Virtual PE
  - BEPS proposals – negotiation of contracts, auxiliary and preparatory character
- Attribution of profits
  - Separate profit and loss
  - Attribution for agency, service and virtual PE

Compliance

- Key corporate governance area
- Penalties for non-compliance

Considerations

- Registration
- Payments – advance/estimated taxes and final taxes
- Preparation and filing of tax returns
- Tax audits and assessments
- Tax appellate processes
- Electronic filing or paper returns?
- 100% corporate tax audits or self assessment?
- Preparing for tax audits
- Corporate tax strategy, policies and procedures must ensure that the tax approach is well defined and embedded within various business processes

Free zones

- Very successful in the UAE & Bahrain
- Groups may have free zone and mainland UAE entities

Considerations

- Many free zone regulations expressly promised corporate tax holidays
- No indication of how free zones would be treated under a federal tax law
- If free zones continue to be tax exempted:
  - Many regional offices are set up in free zones – how will costs relating to mainland entities incurred in a tax free entity be dealt with?
  - Impact on treaty access for free zone entities
  - Will local sales and supplies to mainland companies continue to be exempted?
  - Grandfathering of existing free zone entities?
  - Credit for overseas taxes
  - Will tax reporting be required?

Value added tax (VAT)

VAT developments to date

Known	Unknown
• VAT is a GCC proposal • Various feasibility studies already conducted • GCC “state specific” VAT laws being drafted according to the common GCC VAT framework • Some VAT principles yet to be agreed at GCC level • Law likely to be ready imminently	• Exempted and out-of-scope supplies • Introductory VAT rate? • VAT refunds for tourists? • VAT implementation date? • Registration threshold • Treatment for free zones • Excise tax on cars?

VAT principles

- A broad based consumption tax intended to be a tax on end users
- Based on expenditure, not income
- Imposed on goods and services at every production and distribution stage in the supply chain including importation of goods and services
- Charged on the amount by which the value of an article has been increased at each stage of its production or distribution
- Taxed when the goods and services are supplied
- Exports are generally zero rated
- Flow through cost - businesses can generally recover VAT on purchases, subject to various conditions
- Reverse charges - businesses are required to self-account the VAT on services imported from non-resident supplier

Illustration

Before VAT

Assumption: VAT @ 5%

VAT payment to tax authority

Supplier sale price = AED 500

Supplier

Sale price	AED 525 (inclusive of VAT)

Service provider sale price = AED 1000

Service provider

Sale price	AED 1,050 (inclusive of VAT)

Final consumer

Payment to service provider	AED 1,050

By supplier

Output tax	25
Less: Input tax	--
VAT payable	25

By service provider

Output tax	50
Less: Input tax	25
VAT payable	25

Total VAT cost to final consumer = 50

Impact of VAT

Scope

- VAT covers supply of both goods and services

- Importation of goods and services could be subject to VAT

Considerations

- Directly impacts pricing, cash flow, working capital and margins
- Increases cost of doing the business
- What will the scope of VAT in the region be?
- Which services and goods will be out-of-scope for VAT?
- How will inter-GCC transactions be treated?
- Companies should review their financial systems and identify any changes required to facilitate VAT collection and payment

Taxable person

- Responsible for charging and accounting for any VAT applicable on the supply of goods and services

Considerations

- Who is a taxable person?
- Must businesses register for VAT purposes?
- Is there a value threshold for VAT registration?
- What if supplies made by a business do not reach the value of the threshold?
  - Will there be a voluntary registration option?
- What happens if you don’t register for VAT?
- What are the implications of transacting with non-registered business?
- How will inter-group transactions be treated?
- Will group registration be possible?

Types of supplies and VAT implications

Scope	Type	Input tax credits	Examples
Taxable supplies	Standard rate	Recoverable	Most goods and services
	Zero rate	Recoverable	Exports and sale of essential goods (such as, food items and medicines)
Non-taxable supplies	Exempted	Non-recoverable	Real estate, certain financial services, education services and land
	Out-of-scope	Non-recoverable	Transfers of businesses as a going concern, sales of property outside the country

Types of supplies

Can be categorized as:

- Standard rated
- Zero rated
- Exempt
- Out-of-scope

Considerations

- What is supply of goods and services under VAT regime?
- All supplied goods and services are taxable unless exempted
- Are you making taxable supplies in your GCC country?
- What is the correct VAT treatment for the supplies you are making?
- Can businesses claim input tax credit on each type of supply?
- What are the implications if a business only makes exempt supplies?
- Does your business need to account for VAT on imported services?
  - Is there a reverse charge mechanism?

Time of supply/tax point

- The date on which a liability to account for VAT is created

Considerations

- What is the time of supply for accounting VAT liability?
  - Time of supply for importation of goods?
  - Time of supply for importation of services?
- Implications of not quickly accounting for VAT:
  - Cash flow impact
  - Fines and penalties
- What should the tax point be, if an invoice has been issued and but no payment has been received?

Place of supply

- In general, the supply of goods and services is taxed in the place where they are consumed

Considerations

- Place of supply rules are important to determine the country to which goods or services are considered to be supplied
- Where are the goods physically located at the time of supply?
- Where was the customer established at the time of the supply of services?
- Where was the service provider established at the time of the supply of services?
- What happens if services are supplied from a free zone company?
- What happens if you import from a GCC member state? Will VAT be payable twice?

Compliance

- VAT registered businesses are required to submit VAT returns on a quarterly or monthly basis

Considerations

- Typical compliance requirements:
  - VAT registration
  - VAT return preparation and filing
  - VAT payments – advance/estimated taxes and final taxes
  - VAT audit and assessment
- Once business is registered for VAT, it must charge VAT on all supplies at the prevailing rate. The output tax must be paid to the tax authority after deducting any input taxes
- Companies must maintain and preserve prescribed documents and records (such as invoices, sales and purchase reports)
- Accurate reporting is key – reliable system support will be needed
- Will there be electronic or paper returns?
- Will there be 100% VAT audits or self assessment regime?

Preparing for corporate taxes

What can you do now and once the law is finalized?

Now	Once the law is finalized
• Continue monitoring tax developments and updates • Assess the financial impact of corporate tax at 8%, 10% and 15% – and VAT at 3% and 5% • Review financial systems to assess overall tax readiness and map possible changes to accounting systems • Map intra-group transactions and dependencies • Prepare revised financial statements for prior year comparison when taxes are eventually introduced • Revisit contract clauses dealing with price and taxes (change in law clause, taxes inclusive/exclusive), quantum of tax to be passed on gross or on net basis • Assess your organization’s tax awareness, especially in the finance function	• Identify and map changes to accounting systems based on the tax law • Assess impact on intra-group transactions and determine specific transfer pricing policy/methodology • Revisit tax clauses in current inter-company and third party agreements • Get ready for tax compliance (train, hire and develop resources) • Prepare an implementation plan up to the end of the first year to test all tax compliance aspects

Preparing for VAT

KPMG's VAT roadmap for companies in the GCC

Phase 1 – Get ready	Phase 2 – Assess impact	Phase 3 – Final preparation	Phase 4 – Go live
Preliminaries • Monitor tax developments • Assess tax awareness of relevant staff in Finance and Accounts • Conduct workshops for all relevant staff • Review operating model and supply chain to assess VAT impact • Map major contracts and flag tax clauses	**VAT Impact Assessment** • Analyze and read the VAT law • Conduct transactional analysis and identify relevant VAT issues for analysis • Analyze transactions and identify relevant VAT issues • Define the VAT treatment of transactions (including intercompany transactions) • Analyze allocation and attribution models for input tax credits • List all issues where clarification is needed from the tax authorities • Re-visit major contracts for potential changes for tax clauses / tax impact • Set up and deliver training programs for key staff	**Validation/Identify IT changes** • Identify any required IT changes • Identify any required changes existing policies and procedures, including HR, legal, contract and accounting. • Identify tests scenarios • Make required IT changes • Get a new IT system, if changes can't be made **Registration** • Register for VAT	**Implementation** • Train remaining staff in VAT awareness • Prepare and file VAT returns • Address any VAT queries arising from operations • Ongoing compliance
Now	July 2016 to Dec 2016 (assuming draft law is available)	January 2017 to December 2017	January 2018 onwards

Other tax developments

International tax developments

Base erosion profit shifting (BEPS)

- Collaborative effort between the OECD and G20 countries to address tax evasion strategies
- 15 Action points address: treaty abuse, transfer pricing, hybrid mismatch, AEOI, etc.

Recent developments

- Final reports on the action points issued in October 2015
- Action 6 calls for simplified limitation-on-benefits (LOB) and principal purposes test (PPT) for treaty benefit access
- Action 7 discusses permanent establishment (PE) definition: contract negotiations, preparatory and auxiliary activities
- Action 13 re-examines transfer pricing documentation
- Further work required on tax treatment for non-collective investment vehicles, LOB clause implementation, interest deductions for foreign financial institutions, treaty abuse

Impact

- Increased focus on substance
- New reporting obligations (CbyC, CRS, FATCA)
- Uncertainty on which measures will be adopted
- Greater tax burden

Questions?

Thank you

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