THE GCC EVOLVING TAX LANDSCAPE

By Reggie Mezu, The Cragus Group

First published: Euromoney Legal Media Group's *Guide to the World's Leading Tax Advisers*
August 2016

The Gulf Cooperation Council (GCC) countries have in the past few years faced significant fiscal challenges, heightened by reduced revenues from their traditional oil and gas resources. The low oil price, the increasingly volatile nature of the oil market and the additional demands on government expenditure (partly to meet growing regional security needs) have resulted in pressures on the governments to diversify their economies, stabilize government revenues and focus more on taxation. The IMF and the OECD have also for some time been putting subtle pressure on the GCC countries to introduce tax reforms, perhaps also motivated by self-interest to ensure BEPS is effected worldwide.

The revenues of the GCC governments have over the years, and to date, been derived mainly from oil and gas sales proceeds, with tax revenues not significantly contributing to the treasury. In Bahrain, imposition of income tax is virtually on oil production and refinery only. Within the UAE, income tax is in practice imposed only on oil and gas production and on branches of foreign banks. In Qatar, Kuwait and the Kingdom of Saudi Arabia (KSA) only foreign companies or local companies which are wholly or partially owned by foreigners are subject to income tax at 10%, 15% and 20% respectively. KSA also imposes Zakat at 2.5% on nationals, but the others do not. Income tax is imposed in Oman at 12%, but only on companies or establishments.

The income tax rates on oil and gas production in all countries is significantly higher than the standard rates, where applicable, and the governments also derive royalties and shares in profits from oil production.

Customs duty is currently the only indirect tax imposed within the GCC and it is imposed at 5% on imports into the GCC, with intra GCC imports broadly exempted. However, the scope of indirect tax is to change soon, with the introduction of VAT.

Value Added Tax

VAT is to be introduced from 2018 in the GCC countries. A GCC wide framework for the VAT is expected to be concluded in June this year, to come into effect in 2018. Once the framework agreement on implementation of VAT is reached, GCC countries would have from January 1, 2018 to January 1, 2019 to implement VAT, with each country having the flexibility to introduce VAT within this time frame. The UAE announced that it will be introduced in the country with effect from 1 January 2018 but has yet to publish the legislation.

VAT is considered neutral; taxpayers collect it on their sales and then remit their net collections, after deducting VAT paid on invoices from suppliers, within specified periods to the government. It is therefore more convenient and politically easier to introduce, relative to income tax, although it requires much compliance on the part of the taxpayers and intensive administration by the governments. Its ultimate success, particularly on the economy and on revenue generation for the government, will depend on its design features, including the tax base, the number of exemptions and the compliance requirements.

The details of the rules have yet to be made public by any of the GCC governments, but the legislative provisions and enforcement mechanism on the following areas would be critical:

(a) Compliance responsibilities and cycles; including the thresholds for registration, whether foreign companies without commercial registration would be subject to VAT and be required to register, the documentary requirements (including accounting records).
(b) The treatment of intra GCC trading.
(c) The treatment of supplies to, from and within the free zones.
(d) The exemptions zero rated items
(e) Input VAT recovery and the refund of excess VAT.
(f) Treatment of imports of goods and services.

Income Tax

Some GCC countries are, in addition to VAT, at various stages of considering the introduction of, or reform of existing, income tax systems.

The KSA government recently released an economic reform plan which includes the imposition of an income tax on expatriates by 2020. The matter is still being considered, and no firm decision has been made yet.

As part of its own economic reform plan, the Kuwait Cabinet proposes, based on the recommendation of the IMF to introduce a unified business profit tax, to impose 10% tax on the profits of all companies. As earlier indicated, income tax is currently imposed at 15% but only on profits of foreign companies (and on local companies to the extent that they are owned by foreigners) derived from activities wholly or partly conducted in Kuwait. The reform aims to impose tax on companies owned by Kuwait or GCC nationals, with the tax base being determined in accordance with conventional “Permanent Establishment” concepts rather than on income generated from activities inside Kuwait. The approval of the Kuwait parliament will be required before the proposal can become effective.

In Oman, the State Council and the Shura Council approved in May 2016 the increase of the corporate tax rate on liquefied natural gas companies to 55%, and the corporate tax rate on petrochemical and mining companies to 35%; this is being awaited. Previously (in December 2015) both councils approved a proposal to increase the standard income tax rate from 12% to 15%; the promulgation of these proposals into law is currently being awaited.

The UAE is also considering the introduction of a federal income tax law, but this seems to be tentative and in the early stages. It appears that it is still being considered by the Technical Committee for Legislation at the Ministry of Justice. It is uncertain whether it would evolve into a government plan and then into a law in the near term.

Bahrain does not seem to be proposing to introduce income tax, but plans to introduce new rates for traffic registrations and inspections, fees for expatriate students at government schools and increased rates for unused plots of land, sewage services and road tax.

Conclusion

With the exception of VAT, it is unclear at this stage whether many of the tax reform plans of the GCC countries would result in laws or in changes to existing law. What is certain however, is there is a strong momentum to derive additional revenues from the private sector, and this has resulted in very active reconsideration of the government's traditional reluctance to extract taxation from the business sector. The non-imposition of income tax within some GCC countries, the exemption of nationals from income tax in some countries, the relatively low income tax rates and the narrow tax bases in some countries are current features which likely to be changed within the near to medium term. This certainly appears to be the direction of the GCC governments, and would need to be factored in the forward plans, preparedness and financial projections of businesses operating or investing in the region.