INTERNATIONAL TAX REVIEW

Could drop in crude oil prices mean changes to GCC tax regime?

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Meredith McBride in Hong Kong

With the prices of crude oil hovering near $50 per barrel and no bottom in sight, economists and tax professionals say that the reliance on oil sales could leave the six countries of the Gulf Cooperation Council (GCC) over-exposed to price fluctuations.

"Our economy is robust ... our 2015 budget is balanced ... we don't have any deficit and there are no plans for imposing any taxes next year as a result of the falling oil prices," said Obaid Humaid Al Tayer, minister of state for financial affairs of the United Arab Emirates.

The UAE, Saudi Arabia, and Bahrain collect zero income and withholding taxes from local businesses.

The vast majority of revenues in the Gulf region come from the taxation of oil, with rates ranging from 35% in Qatar to 85% in Saudi Arabia. The UAE taxes oil exploration and production at 55%, as well as foreign-owned banking activities, though operates dozens of free trade zones (FTZs) which reduce companies' tax exposure through various incentives.

Kuwait has the highest dividend tax at 15%. Saudi Arabia taxes royalties at 15%. Oman, generally more susceptible to economic fluctuations, taxes foreign corporations at 12%.

"I think all of them, directly or indirectly, will be affected," said Suleman Mulla, director of international tax and zakat at PwC Saudi Arabia.

"Saudi tax revenue is largely revenue made up of tax on foreigners and zakat on Saudi and GCC nationals - that rule is not expected to change," said Mulla.

Saudi Arabian nationals are required to pay 2.5% of their income and wealth above a prescribed level (nisaaab) as zakat, or donations to Islam.

Balancing the budget and broadening the base

Despite Al Tayer's positive outlook for the UAE, other GCC economies may not be as secure.

In December 2014, the International Monetary Fund recommended that the GCC broaden its economy to prevent over-reliance on fuel exports. The IMF's survey specifically mentioned tax incentives, like those seen in Mexico and Malaysia, as a possible solution.

"Difficulties are, of course, the lack of management and experience outside the oil sector," said John Mitchell, a research fellow at Chatham House and author of '*The New Economy of Oil*'.

The UAE, and Dubai in particular, has made an effort to attract foreign banks and financial businesses, though many have reportedly struggled to stay afloat. Standard Chartered and Barclays retail bank have recently closed their UAE operations.

"While some states, such as Dubai - who have already sought to diminish their reliance on shrinking oil reserves in past years - will have strong incentives to broaden their tax base, others such as Saudi - who have far larger oil revenues - may not be in such a rush to do so," said Dominic Treays, managing director at Cragus Group, an independent tax advisory firm.

"There is a plan to introduce GCC-wide VAT, but I think due to possible sensitivities and political issues, it might be pushed back," said Mulla.

Mulla pinpoints customs duty on goods coming from non-GCC countries as a possible starting point: "This is the only tax that can be changed with immediate effect."

"The introduction of VAT in the UAE or GCC will presumably have effects on the customs union, therefore one can assume that successful implementation can only be achieved if all the member states agree in both concept and timing," said Treays.

"In terms of Dubai in particular, there are now many free trade zones where companies have tax holidays for up to 50 years," said Treays. It's unclear whether businesses in such trade zones would continue to be tax exempt under a new tax regime.

An even riskier move would be the introduction of corporate tax rates. Such a programme would be more complex than a VAT scheme, and could undermine the Gulf's reputation as a low-tax destination for business structuring.

"Independent of the oil price issues, there is a possibility that the UAE has been internally debating the introduction of a federal corporate tax system. There are however no confirmed reports or draft law announced as regards the possibility or timing of such introduction," said Nilesh Ashar, tax partner at KPMG in Dubai.

"Many countries are keen to either enter into automatic exchange of information agreements or include an exchange of information clause in bilateral tax treaties, and having a corporate tax system could supplement the UAE's efforts in being able to adhere to these agreements. This, along with augmenting non-oil revenues from a long term perspective, could be the factors driving this agenda," said Ashar.

Tax treaties in flux

The UAE in particular has an impressive tax treaty network encompassing more than 70 other countries.

"If any form of corporate tax was introduced, it could potentially help the argument for UAE based companies accessing treaty benefits, although the position for free zone companies could still be unclear," said Ashar.

Despite such agreements, lack of tax and transfer pricing regimes can potentially impact relationships with trade partners as most countries move towards greater collusion and exchange of tax information.

"If you're not taxing people or companies, you have the obvious challenge of what information do you exchange and how to gather it," said Treays.

Because GCC members do not tax individuals, collecting personal information is made difficult for the purposes of exchange of information for tax avoidance purposes.

"I think the tax authorities here are becoming more sophisticated in recent years, in part because they are becoming exposed to international issues via treaties, international tax, or transfer pricing, by the nature of the dialogue with multinational companies and other tax authorities," said Treays.

Despite the tax rumours floating around the Gulf, tax professionals feel confident that the GCC is still several years away from introducing changes to the tax regime, though the drop in crude oil prices might be a good excuse for them to do so.