Overview: Middle East

Reggie Mezu
The Cragus Group, Dubai

Introduction

The Middle East has generally seen stronger economic growth in more recent years, boosted in part by high oil prices in some countries. After the emerging markets' debt crisis in the late nineties, there was increased focus on creating high foreign reserves and low external debts and a stronger push to encourage FDI and diversify from single resource dependent economies to the creation of more stable government revenues. This has also driven deregulation, privatisation and trade liberalisation. The current global recession has dampened the economic boom especially in real estate and financial services, but there are also wider concerns about gainful employment and inflation. Socio-economically there is now closer integration between the countries, and much regulatory reform (particularly of the tax systems).

The Gulf Co-operation Council ("GCC") states comprise Bahrain, Saudi Arabia, Kuwait, Qatar, Oman and UAE. Yemen has yet to join. The GCC union commenced in January 2003. Custom duties are not levied on intra GCC trade, and there is a common customs tariff of 5 percent on all foreign goods imported from outside of the Customs Union. Foreign goods imported into the GCC States from the free zones are subject to customs duties when exiting the zones. There are also common restrictions on foreign ownership of businesses (except within free zones) although the UAE is more liberal on this than the other states. The tax laws in the GCC states are relatively simple, but there are a few uncertainties and the application of the rules may sometimes be unclear. Saudi Arabia comprehensively reformed its tax system in 2004, Kuwait recently significantly reduced its tax rate, and Oman and Qatar will soon be introducing significant amendments to the tax law mainly to reduce rates and align the laws with international norms. Corporate income tax is generally imposed only on foreign interests or businesses only (except in Oman). In Bahrain, corporate income tax is limited to oil companies and in the UAE income tax is enforced only on banks and oil producing countries.

The wider Middle East covers Jordan, Lebanon, Syria, Palestine, Iraq, Iran and Israel. Overall, the difficult political environment in many of these countries creates some uncertainty for investors and has affected FDI growth. But there are common trends towards tax reform. Jordan, Syria and Lebanon which have much in common through historic and cultural ties, have each been extensively reforming their tax systems. The general drive is to lower the corporate tax rates (the rates currently range from 15 percent to 25 percent), strengthen tax compliance enforcement and provide tax incentives for investments in economically deprived areas. All impose indirect taxes and customs duty is high. Iran's tax system was revised in 2003, but still needs updating; the social security obligations are a significant element of the tax cost for companies operating in the country. Iraq's system is very much in a transition phase, and is likely to be revised once the socio-political structures become more settled. With the exception of Iraq, VAT or sales tax (at varying rates) is common across all of these countries, as it is seen as an easier way to widen the tax collection base.

Tax regimes

Gulf Co-operation Council (GCC)

Saudi Arabia

In Saudi Arabia, corporate income tax rate is 20 percent. The tax is levied on foreign shareholders of a resident capital company or foreign nationals doing business in the Kingdom as residents or through permanent establishments or deriving income from sources in the Kingdom. GCC nationals are subject to Zakat at 2.5 percent (effectively on capital employed). There is no tax for foreigners or nationals on employment income. Withholding tax applies on payments to non-residents at various rates ranging from 5 percent to 20 percent depending on the nature of the payment and on whether or not the payee is an affiliate. Tax treaties are few but more are being negotiated. Natural Gas Investment Tax (NGIT) applies to gas companies at rates ranging from 30 percent to 85 percent. Oil-producing companies are subject to tax at 85 percent.

Kuwait

In Kuwait, there is now a corporate tax rate of 15 percent on foreign corporate entities. Gains from sales of stocks listed on the KSE are tax exempt. Pre 2009, corporate tax was imposed on foreign corporate entities carrying trade or business in Kuwait at tax rates ranging from 0 percent and 55 percent. There are no domestic withholding taxes but companies are required to retain 5 percent of payments to non-residents pending the payee's settlement of its tax liability with the authorities.

Qatar

In Qatar, corporate income tax is levied at progressive rates rate up to 35 percent on foreign entities or interests on their Qatari source income. There is also no withholding tax, but 5 percent of sums paid on contracts by government agencies to foreign entities is retained until the foreign entities settle their taxes. The tax laws are being comprehensively reviewed; and the standard tax rates may be reduced in 2009, to between 12 percent to 15 percent. A separate tax regime applies to the Qatar Financial

Centre, for which based on draft legislation the tax rate is likely to be 10 percent. It is possible that the QFC tax legislation, once passed, would be retroactively effective from May 1, 2008. Effective May 1, 2008; the standard tax rate in the Centre may be 10 percent.

Oman

Omani companies subject to tax at 12 percent on income exceeding 30,000 OMR, and foreign companies are subject to tax at progressive rates up to 30 percent. Comprehensive revised tax law expected shortly. Oil-producing companies are taxed at 55 percent based on model production sharing agreements. Any activity in Oman, of any duration with or without a permanent presence, that creates Oman source income, is taxable. There is no withholding tax on payments of dividends or interest, but tax is withheld at 10 percent from royalties, rent for equipment, management fees, R&D fees and fees for transfer of technical know-how.

Bahrain

As indicated earlier, Bahrain taxes only oil companies and within the UAE income tax is enforced only on oil-producing companies and branches of foreign banks.

Other Middle East countries

Jordan

In Jordan, corporate tax rates vary, depending on the industry sector. 25 percent is the standard, banks are taxed at 35 percent and favoured sectors (hotels, mining, industrials, transportation, construction and hospitals) are taxed at 17 percent. All payments to non-residents (except for the importation of goods) are subject to 15 percent WHT. Advance tax payments (at 2 percent) are also due on imports and professional fees, unless clearance is obtained. Tax incentives are available, many depending on the location of the project. Personal income tax ranges from 5 to 20 percent. The General Sales Tax is 16 percent and customs duty is generally from 5 to 35 percent; the duty on some items ranges from 80 to 180 percent. Draft tax law amendments are now before Parliament and are expected to be passed soon.

Lebanon

There is a corporate income tax rate of 15 percent in Lebanon. Tax is withheld from dividends at 10 percent. Capital gains are taxed at 10 percent. Lebanese special holding companies are not subject to income tax (other than reduced rates of tax on interest, royalties and fees received from Lebanese companies) and pay annual tax on capital and reserves instead. Offshore companies pay annual tax of LL1m, instead of income tax. Ten years' tax exemption is available for industrial enterprises, subject to limits based on amount of capital investment. There are other incentives, depending on the location of the project. Tax package deals may be negotiated. Personal income tax ranges from 2 to 20 percent. The standard value-added tax rate is 10 percent. Customs duty ranges generally from 0 to 138 percent.

Syria

Syrian companies are taxed at 22 percent (plus a surcharge of 2 to 10 percent of tax due), banks and insurance companies are taxed at 25 percent, and companies 50 percent of whose shares are offered to the public are taxed at 24 percent. Syrian national oil and gas companies are taxed at 28 percent. For others, there are progressive tax rates ranging from 0 to 28 percent. Deemed profits basis of taxation is not uncommon. There is no tax on dividends, but withholding taxes apply at various rates to payments for purchase of materials (2 percent), contracts and construction works (3 percent), services (7 percent), and services to oil companies (10 percent). Non-residents are exempt from tax on the value of offshore services and supplies are exempt from tax. Onshore supplies and services are taxed at 7 percent in total (10 percent for oil and gas companies). If no split is done, then total value is subject to tax at 4 percent in total. The consumption tax is 5 to 20 percent on luxury goods and services. Customs duty generally ranges from 1 to 100 percent.

Iraq

There is a flat corporate income tax rate of 15 percent in Iraq. Income earned from contracts under CPA Order 17 and in the connection with work performed under special agreements, such as "Agreement for Economical and Technical Cooperation between the USA and Iraq" are exempted from tax. Personal income tax rates range from 3 to 15 percent. There is a real estate levy of 10 percent on the value of real estate (fewer deductions) and 2 percent on the value of vacant land. There is also a real estate transfer tax (3 to 6 percent) and a reconstruction levy of 5 percent on goods (subject to exemption) imported.

Iran

In Iran, the income tax rate is 25 percent. Deemed profits, depending on types of income is common (e.g. 12 percent for construction contracts). Dividends on bearer shares are taxed at 25 percent. There is no withholding tax on dividends, interest or branch profits. The withholding tax (advance tax) on contract works is 5 percent, and 2.5 percent on subcontracts to Iranian entities. Foreign companies receiving technical fees or royalties are taxed on 20 to 45 percent of income received. Contractors are required to pay social security contributions on the value of their contracts (7.78 percent if materials are included, and 16.67 percent if the contract does not include materials). 5 percent of the contract value is retained until SSO contribution is settled. Personal income tax rates range from 0 to 35 percent. Value-added tax is currently imposed at 1.5 percent, and there is customs duty is imposed on imports.

Recent developments

Driven by the need for more stable government revenue base, and the dwindling government revenues following the Customs Union and the various signed FTAs, the GCC Finance Ministers adopted in October 2004 a proposal to introduce VAT, whilst deferring a final decision to the respective heads of state. UAE has been in the forefront of the move to introduce VAT, and it plans to do so soon, although it would seem that those plans may have been delayed by the global economic recession. Other Gulf States are expected to follow suit, and 2012 is the tentative GCC-wide implementation date. The rate is expected to be low (at the start) probably 5 percent or less.

Kuwait recently slashed its income tax rates, Qatar and Oman are expected to follow suit and significant tax law amendments are expected in Jordan. Yemen is also reviewing its tax law. Many of the Middle East countries, particularly the GCC countries, have been aggressively expanding their tax treaty network.

Tax planning

The tax authorities, as with authorities in other countries, may take aggressive positions against schemes deliberately aimed at avoiding taxes. But legitimate tax planning is generally acceptable.

At the risk of over generalising and over simplifying the issues, much of the tax planning in the Middle East revolves around avoiding the creation of a taxable presence inadvertently in the countries. Some of the Permanent Establishment rules could be quite stringent.

Given the wider treaty network now available, investors with a choice should consider carefully the optimal location for holding an investment and means of minimising tax leakages (mainly withholding taxes) on intercompany outflows (e.g. service fees, royalties, licence fees). They might also consider optimal financing structures (including gearing ratios) to minimise tax at both the local levels and the home country level. It should also be possible to create tax efficient distribution and management structures.

Although there are no specific transfer pricing rules in almost all the countries, the tax authorities typically scrutinise related party transactions. It would therefore be helpful to put adequate transfer pricing documentation in place in order to ensure inter-company pricing is at comparable arm's length prices.

There are numerous tax incentives, including free zones (particularly in the UAE) and tax holidays for specific projects and/or investments in deprived areas, and it would be sensible to explore the tax incentives available before making the investments.

Future trends

The trend has generally been towards progressive tax reform, through amendments of tax laws to align with international practice, improve the systems, build capacity and simplify the administrative process. There has also been a stronger push to expand the tax treaty network to attract investments, but also protect outbound investments.

VAT or sales tax is increasingly being seen as fairer and more neutral. It is already levied in many of the Middle East countries outside the GCC and it is possible that it would be introduced GCC-wide within the next few years, although there remain concerns about its inflationary effect and the adverse impact on competitiveness.

The shifts towards more stable government revenues and reduced dependence on oil means competition to attract FDIs in non-oil sectors by reducing corporate tax rates, widening the tax base, and amending tax legislation to conform to international norms (definition of Permanent Establishments, transfer pricing, deductible items etc). However, whilst the tax regimes are likely to be more progressive and stable, the administrative capacity and dispute resolution process may lag behind the reforms, and consequently many uncertainties are likely to remain.

In due course, tax holidays and industry targeted incentives may become less common, so that the conventional tax planning techniques (financing structures and double tax mitigation) would increasingly become the norm for investments. The push to widen the tax base could on the other hand mean more anti-avoidance regulations and transfer pricing may become a bigger issue than it currently is.

Within the Gulf States, the future is likely to be low corporate tax rates (10–20 percent) for those imposing income tax, nil personal income taxes and the introduction of VAT (likely to be 5 percent to start with and then increase in the future). Within the other Middle East countries it is likely to be similarly low corporate income taxes, more streamlined tax regimes (with less number of taxes) but high VAT.