

Yemen introduces new tax law

The Republic of Yemen enacted a new tax law on 29 August 2010 (Presidential Decree No. 17/2010 (PD 17)) that repeals the Income Tax Law No. 31 of 1991 and its amendments. PD 17, which makes broad changes to the 1991 law, takes effect for tax years ending on 31 December 2010 for business income and income from real estate, and as from that date for salaries, wages and property tax.

In addition to expanding the tax base and reducing tax rates, the law includes many new terms and clarifications. For example, new definitions are introduced for "foreign taxpayer," "Yemen-source income," "foreign tax credit," "permanent establishment" (PE) and "royalties," among others. PD 17 introduces the concept of related parties and the arm's length price and requires that transactions between affiliated parties conform to the arm's length principle. Two parties will be deemed to be related if: (1) where the second party is a company, the first party holds, directly or indirectly, at least 50% of the shares, value or voting power of that company; (2) where both parties are companies, the same third person holds at least 50% of the shares, value or voting rights in both of those companies; or (3) where the second party is a partnership, the first party is an acting and/or limited partner of that partnership. The government will be issuing executive bylaws to provide more detail on the basis and methodologies to be used in related party transactions.

Scope and imposition of tax

It is now enshrined in legislation that Yemeni companies will be taxed on their worldwide income, even though previously this was the case in practice. A company will be deemed to be resident if its place of business or management or supervision is in Yemen. Nonresident companies will be taxed only on Yemeni-source income. Individuals will be subject to tax on income earned in Yemen from a foreign source.

The law also formalizes the classification of taxpayers as large, medium and small. The Minister of Finance may define the bases and levels of taxpayer categories through a Ministerial decree if proposed by the Chairman of the tax authorities.

Corporate income tax

Income tax rates – The general corporate tax rate is reduced from 35% to 20%. Investment projects are to be taxed at 15% (previously 20%). However, projects that were registered under the Investment Law before the enactment of PD 17 generally will remain exempt from tax until the expiration of the tax holiday period (generally five to seven years). Mobile phone service providers are to be taxed at 50% and international telecommunications service providers and cigarette manufactures/importers at 35%. Small firms (i.e. those whose annual turnover is more than YER 1.5 million but less than YER 20 million and that have between three and nine employees) are subject to progressive rates ranging from 10% to 20%, depending on the type of activities.

The provisions on lump sum taxation applied to revenue have been abolished – under the 1991 law, taxpayers that failed to maintain proper books of accounts were subject to a lump sum rate. PD 17 requires all taxpayers to maintain proper books of accounts/records, with certain exceptions for small and micro businesses.

Taxable income – PD 17 introduces measures to broaden the tax base whereby worldwide income will now be subject to corporate tax, although a foreign tax credit is granted on certain taxes paid overseas. The definition of Yemen-source income is extended to include:

- Capital gains, gains derived from a merger or liquidation, currency exchange differences, income from communications and information technology, proceeds derived from abroad from licenses in Yemen and income of companies in the oil and gas sector;
- Income from rent, license fees and royalties received from a PE/nonresident; and
- Income from services carried out in Yemen by a nonresident.

Dividend income received by all types of legal entities is exempt from tax. However, the new law abolishes the tax exemptions available to the Central Bank and certain financial institutions.

Loan interest and bad debts are deductible expenses for tax purposes provided certain criteria are met (an exception applies where the interest is on a loan from an acting partner or individual that is exempt from, or not subject to, tax). Employee-related deductible expenses are expanded to include training costs and medical reimbursements. Additional deductions are available for creating new employment opportunities for Yemeni nationals.

Accelerated depreciation is allowed for IT equipment, software and other assets in addition to the normal depreciation rates for the first year. Further, the annual depreciation rates for IT equipment and software are increased from 25% to 50%.

Losses – Losses may be carried forward for five years (previously four), unless there has been a 100% change in ownership. The carryback of losses is allowed only on long-term contracts accounted for under the percentage-of-completion method.

Withholding tax – PD 17 law includes rules governing withholding taxes and applicable rates, which previously were regulated by various tax circulars and ministerial decrees. Liability to withholding tax is extended to include more types of payments made to nonresidents and it is now specifically required to remit tax withheld to the government within 15 days from the date that tax has been withheld.

A 10% withholding tax applies on payments made to residents in respect of brokerage and commissions; and nonresidents in respect of interest, commissions, patent, trademark and copyright royalties, service fees, fees for the transfer or use of technology/licenses, technical know-how and administrative knowledge. No withholding tax is levied on interest paid to foreign banks approved by the Yemeni Central Bank and payments made to nonresidents in respect of transport, shipping, insurance, training and head office expenses.

Thin capitalization rules – PD 17 introduces thin capitalization rules for the first time and sets a general debt-to-equity ratio of 70:30. If interest is paid to an affiliate party, the loan interest amount may not exceed prevailing international rates or the Central Bank of Yemen rate plus 4%. Interest exceeding these amounts is nondeductible.

Permanent establishment – PD 17 specifically defines activities of a nonresident that will give rise to a PE in Yemen. Activities that will create a PE include: having a place of management, branch, office, farm/plant, factory, construction or assembling equipment and supervision.

Tax year – PD 17 clarifies that a tax year other than the calendar year may be adopted and a taxpayer can choose a tax assessment period of 12 months (tax year) that coincides with its accounting/reporting period.

Compliance – PD 17 introduces a self-assessment system, under which a taxpayer must determine its own tax base and calculate tax due. The taxpayer is required to pay the amount due based on the return. All taxpayers (even if exempt) must submit a tax return. The tax authorities reserve the right to audit selected returns and issue additional assessments.

The tax return must be certified by a licensed chartered accountant and submitted along with original audited financial statements. The chartered accountant will be subject to penalties for issuing a misleading audit opinion on the financial statement (e.g. stating they are prepared/presented according to generally acceptable accounting principles when they are not) or for certifying a misstated taxable amount in the tax declaration. Exempt taxpayers also are required to have their returns certified. Failure to comply with the certification requirements could lead to penalties.

The tax return is due by 30 April or within four months of the end of the tax year. A tax rebate of 0.5% to 1.5% will be available for filing the tax declaration within the first three months of the following year, as an incentive for early payment of tax.

The provisions for calculating penalties for a delay in the submission of a tax return are clarified by including specific provisions for entities incurring losses or that are exempt from tax. In such cases, penalties range from YER 200,000 to YER 5,000,000, depending on the type of legal entity. The penalty for tax evasion is increased from 50% to 150% on the amount of tax evaded to 100% to 150%.

Individual income tax

Tax rates – Individuals are taxed under the new rules at progressive rates ranging from 10% to 15% (previously, 10% to 35%). For resident salaried individuals, the top rate is 15% (down from 20%). Nonresidents are taxed at a flat rate of 20% (previously subject to progressive rates). The exempt annual income ceiling is increased from YER 36,000 to YER 120,000.

Benefits, privileges and rewards, regardless of what they are called, are taxable at a flat rate of 15%.

Taxable income – Details of deductible allowances from employment income will be defined in executive regulations. PD 17 clarifies the income that is subject to salaries and wages tax to include income received by an employee for work done outside Yemen for a resident employer, income received by a nonresident from a PE in Yemen and salaries, rewards and allowances paid to the chairman, members of the administration board and managers of capital associations.

Comments

The reductions in the tax rates are generally welcomed, although the telecommunications sector is subject to a rate higher than the standard corporate income tax rate of 20% (50% for mobile phone service providers and 35% for international telecommunications service providers). The provision for accelerated depreciation and the increase in the depreciation rates, however, will facilitate investment in new technologies and the replacement of old equipment.

Companies in the oil and gas sector will be governed in accordance with the provisions of Production Sharing Agreements. Exploration companies normally are subject to the exploration tax during the exploration phase and a corporate tax of 35% during the development period. Corporate taxes during the latter period are assumed by the Ministry of Oil and Minerals, which discharges the taxes on behalf of oil and gas companies. PD 17 does not make any changes to these practices, although it is now an obligation to file a tax return duly certified by a licensed chartered accountant and the tax return must be accompanied by the audited financial statements.

The classification of taxpayers likely means that oil and gas companies will fall into the large taxpayer category, thus subject to more regulations and significant penalties for noncompliance.

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