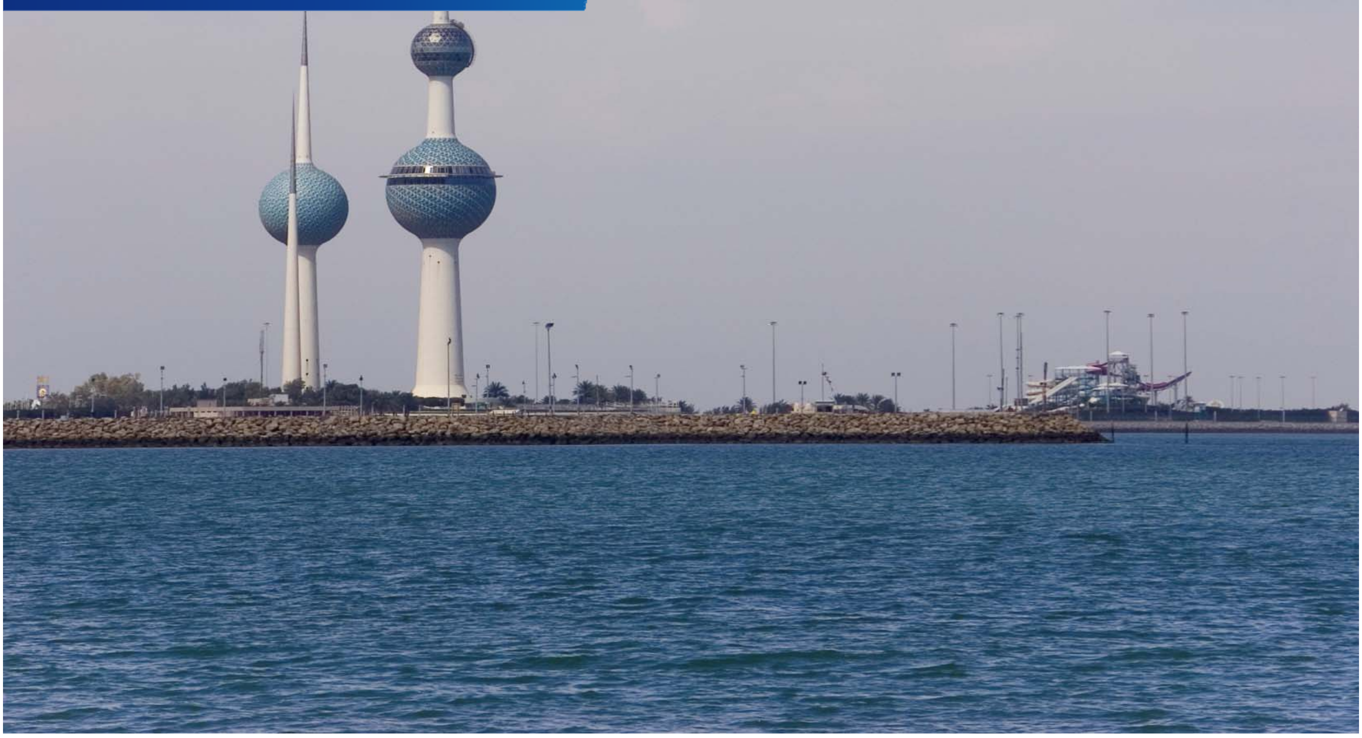
cutting through complexity

# KUWAIT TAX ALERT

14 February 2013



# Kuwait Tax Alert

## *Circular 1 of 2013 providing new guidance on submission of tax declarations and issuance of tax assessments.*

The Kuwait tax law, defined by Decree No. 3 of 1955 as amended by Law No. 2 of 2008 and the Executive Bylaws to Law No. 2 of 2008, is brief and the application of the tax law very much depends on the practice of the Kuwait Tax Authority (KTA). The KTA has in the past issued Circulars and Executive Rules that set out guidance on tax administrative matters and on deductibility of expenses allowed for Kuwait tax purposes. The last set of Executive Rules and Regulations were issued by the KTA in 2010. The KTA is known to be inconsistent in its practices which change from time to time without prior notice.

This week the KTA has issued Circular No. 1 of 2013 ("the Circular") setting out new guidance regarding the submission of tax declarations in Kuwait.

The Circular is effective for tax declarations submitted to the KTA after 10 February 2013 (the date the Circular was issued). This includes tax filing for 31 December 2012 which are due for submission to the KTA by 15 April 2013, and any subsequent period thereafter. It is also applicable on companies that have yet to file their 2010 and 2011 tax declarations having had an assessment for 2009 issued.

Overall it appears that the Circular is shifting the burden of work which would typically be carried out by the tax inspector at the time of the tax inspection onto the tax payer. The aim of the Circular appears to impose greater requirements at the time of filing the annual tax declaration in turn for a quicker turn around for issuance of the tax assessment and therefore allowing companies to obtain release of their tax retentions earlier. Additionally, the regulations appear to provide the tax authority with greater information (especially on subcontractors used) in order to identify companies that may not be currently complying with their tax obligations in Kuwait and widen the tax base for the KTA, potentially leading to higher tax collections. There is also greater emphasis on reviewing the application of the tax retention regulations as provided under Article 37 of the Executive Bylaws of Law No. 2 of 2008 which is inconsistently applied in practice.

A key additional requirement for tax payers that has been introduced by the Circular is that companies that file their tax declaration on an actual basis are required to formally submit a report to the KTA within 3 months of submitting the tax declaration. The report should provide a computation of tax and incorporate the adjustments applied by the KTA in its most recent tax assessment for the company (provided it is for 2009 or later). This report would be reviewed by the KTA during the tax inspection process for any potential changes (either increases or decreases) in the amounts disallowed in the past assessment and form the basis of the final tax assessment to be issued for the current year.

While we are clarifying certain areas of the Circular with officials at the KTA, based on our initial review of the Circular, we set out below our general comments on the key impacts of the Circular on Kuwait tax filings. It is yet to be seen how the Circular is applied in practice by the KTA and how strictly the timelines, requirements contained therein and consequences of non-compliance are enforced. This would become apparent as tax filings are submitted and the tax inspection process leading to issuance of tax assessments are completed by the KTA.

### ***Applicability and Effective date***

The requirements of Circular No. 1 of 2013 ("the Circular"), apply to those companies filing tax declarations for corporate income tax under Decree No. 3 of 1955 as amended by Law No. 2 of 2008 and the Executive Bylaws to Law No. 2 of 2008 and also those companies that are subject to Law No. 23 of 1961 for operations in the Partitioned Neutral Zone between Kuwait and Saudi Arabia (collectively "the Kuwait tax law").

Based on Clause 5 of the Circular, it is effective from 10 February 2013, i.e. the date of issuance.

Clause 4 of the Circular mentions that the requirements of the Circular would not be applicable to companies filing their first tax declaration in Kuwait or to those companies which have not had their 2009 tax assessments finalised. Therefore the requirements under the Circular are applicable for tax declarations to be submitted of those companies which have a 2009 assessment finalised, including tax declarations for the year ended 31 December 2012 that are due for submission on 15 April 2013, and any subsequent period thereafter.

There are separate requirements for companies that are filing their tax declaration on an actual basis (based on audited financial statements) and those companies that are filing their tax declaration on a deemed profit basis.

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***Companies filing tax declarations on an actual basis***

*Basis of preparing the tax declaration and settlement of tax*

- The Kuwait tax law and Executive Rules issued by the Kuwait Tax Authority ("KTA") include certain restrictions on the deductibility of expenses for Kuwait tax purposes. To date, the general practice was that companies would file their tax declaration on the basis of actual costs incurred and attributable to the company's income in Kuwait and waited for the KTA to make adjustments to costs in line with the Kuwait tax law or Executive Rules in its tax assessment that it issues for each declaration filed. The Circular now requires that tax payer make necessary adjustments to expenses that are provided for within the Kuwait tax law and Executive Rules issue by the KTA. Typical items of costs that would now require adjustments at the time of the tax filing include, but not limited to:
  - Depreciation
  - Agent's commission
  - Head office expenses
  - Imputation of profit on income earned from supply of materials / equipment from outside Kuwait
  - Imputation of profit on income earned from design and consultancy expenses from outside Kuwait
  - Provisions for leave salary and end of service indemnity

- The Circular is also reiterating the requirement of settlement of taxes by the due date of filing the tax declaration or under the installment scheme following filing of the tax declaration.

*Additional documentation / information requirements*

- In accordance with Article 13 of the Executive Bylaws of Law No. 2 of 2008, the following documents are required to be submitted together with the tax declaration:
  - Fixed asset register
  - List of subcontractors together with last payment certificate of each subcontractor and details of amounts retained in accordance with the tax retention regulations
  - Inventory listing as at the year end
  - Copies of contracts from which the tax payer earns income from Kuwait and final payment certificates issued by the respective contract owners
  - Trial balance as at the year end

  In the past this was inconsistently applied by tax payer and the Circular appears to reiterate the need to comply with above requirements of Article 13 of the Executive Bylaws of Law No. 2 of 2008.

- A revenue confirmation from contract owners should be submitted with the tax declaration. Where revenue confirmations are not available, the tax payer would need to evidence that a revenue confirmation has been requested and provide the KTA with a copy of the revenue confirmation request letter sent to contract owners. In practice, the KTA would typically request a revenue confirmation at the time of the tax inspection. This requirement has been reiterated through the Circular and ideally a signed revenue confirmation from all contract owners should be submitted with the tax declaration.

- Tax declarations would typically have a supporting schedule which provides a breakdown of total revenue between the various contracts undertaken during the year. The Circular now requires greater detail on revenue earned during the year with a breakdown of revenue indicating:
  - Contracting body
  - Total contract value
  - Contract value executed up to the year of filing
  - Tax retentions suffered

*Submission of report following the tax declaration*

- A key additional requirement for tax payers introduced by the Circular is that companies that file their tax declaration on an actual basis are required to formally submit a report to the KTA within 3 months of submitting the tax declaration. The report should provide a computation of tax and incorporate the adjustments applied by the KTA in its most recent tax assessment for the company (provided it is for 2009 or later).

- This report would be reviewed by the KTA at the tax inspection stage for any potential changes (either increases or decreases) in the amounts disallowed in the past assessment and form the basis of the final tax assessment to be issued for the current year.

- According to the KTA's continuing normal practice, any additional information / documents may be requested at the time of the tax inspection in order to verify revenue and expenses reported in the tax declaration.

*Incentive to tax payers*

- The Circular appears to commit the KTA in expediting issuance of the tax assessment within 6 months of submitting the above-mentioned report (effectively 9 months from the date of the tax filing) for companies which completely comply with the above requirements of the Circular. This may result in greater predictability in regards to timing of release of amounts deducted for tax retention purposes.

- Where companies do not comply with the requirements of the Circular, their tax assessments would be delayed thereby delaying the release of tax retentions. The Circular also indicates that the KTA might apply aggressive disallowances on companies which choose not to comply with the requirements of the Circular.

- It is yet to be seen how the Circular is applied in practice by the KTA and how strictly the above timelines are adhered to by the KTA.

### *Companies filing tax declarations on a deemed profit basis*

*General comment*

Interestingly, the process of filing tax declarations on a deemed (or estimated) profit basis has not been mentioned in the Kuwait tax law, while the KTA in practice have accepted this basis of filing in the past with a tendency to gradually increase the deemed profit assessed on companies year on year. The Circular provides guidelines for tax declarations submitted on a deemed profit basis. Key points from the Circular are as follows:

*Basis of preparing the tax declaration and settlement of tax*

- The tax declaration should be prepared on the basis of the deemed profit applied by the KTA in its most recent assessment issued for the tax payer. In the past, companies would file tax declarations at an estimated profit considered appropriate for the activities in Kuwait, which typically ranged from 5% to 10%. At the time of the tax assessment, the KTA would inevitably increase the profit percentage resulting in further tax payable.

- The Circular is also reiterating the requirement of settlement of taxes by the due date of filing the tax declaration or under the installment scheme following filing of the tax declaration.

*Additional documentation / information requirements*

- The Circular requires all revenue invoices and corresponding evidence of receipt of funds from contract owners (i.e. bank advices / extract of bank statements) to be submitted with the tax declaration. This may lead to practical issues where companies have several hundred invoices issued in the year and puts a heavy burden on companies at the time of filing the tax declaration. Previously, verification of revenue by the KTA was carried out on a sample review basis.

- A revenue confirmation from contract owners should be submitted with the tax declaration. Where revenue confirmations are not available, the tax payer would need to evidence that a revenue confirmation has been requested and provide the KTA with a copy of the revenue confirmation request letter sent to contract owners. In practice, the KTA would typically request a revenue confirmation at the time of the tax inspection. This requirement has been reiterated through the Circular and ideally a signed revenue confirmation from all contract owners should be submitted with the tax declaration.

- Companies filing on a deemed profit basis and wish for their assessment to be expedited would also need to provide a full list of subcontractors / services providers used while executing contracts reportable for Kuwait tax purposes. If no subcontractors / services providers are used, the tax payer should provide the KTA with a written confirmation to this effect at the time of filing the tax declaration.

- Tax declarations would typically have a supporting schedule which provide a breakdown of total revenue between the various contracts undertaken during the year. The Circular now requires greater detail on revenue earned during the year with a breakdown of revenue indicating:
  - Contracting body
  - Total contract value
  - Contract value executed up to the year of filing
  - Tax retentions suffered

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*Incentive to tax payers*

- The KTA appears to provide an incentive for companies that file their tax declarations on a deemed profit of 30% or more as stated in the most recent tax assessment for the tax payer by accepting the deemed profit as indicated in the tax declaration and allowing for release of tax retentions held by contract owners within 6 months of submitting the tax declarations. The conditions set by the KTA for this incentive are:
  - The past declarations were filed correctly with no unreported revenue being discovered by the KTA
  - The tax (and any applicable penalties) for all prior years have been settled
  - The level of income declared is similar to the past year with no significant change (the KTA has not defined what constitutes "significant" in this context)
  - The company complies with the remaining requirements of the Circular with respect to submission of documents with the tax declaration (see above)

- It is yet to be seen how the Circular is applied in practice by the KTA and whether deemed profit assessments would indeed be in line with the tax declarations submitted and if no increases are applied on deemed profit percentages declared.

- According to the KTA's continuing normal practice, any additional information / documents may be requested at the time of the tax inspection in order to verify revenue reported in the tax declaration.

- Companies that do not comply with the requirements under the Circular risk a more aggressive approach from the KTA with the potential of an increase in the deemed profit percentage being applied as compared to prior years and a potential delay in finalising the tax assessment.

***The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.***

## Contact details

***Zubair Patel***
Tax Director
Tel: +965 2228 7531
Email: zpatel@kpmg.com

***Fahim Bashir***
Senior Tax Manager
Tel: +965 2228 7532
Email: fbashir@kpmg.com

***Reem Abbas***
Tax Manager
Tel: +965 2228 7533
Email: reemabbas@kpmg.com

KPMG Safi Al-Mutawa & Partners

Al Hamra Tower, 25th Floor
Abdulaziz Al Saqr Street
P.O. Box 24, Safat 13001
State of Kuwait

Tel – +965 2228 7000
Fax – +965 2228 7444

www.kpmg.com/kw