Taxation of cross-border mergers and acquisitions

Kuwait Country Report

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Kuwait

Introduction

M&A in the GCC region is primarily driven by consolidation, especially in the banking and financial services sector, which witnesses several national and cross-border mergers.

The next sector, followed by financial services is retail and consumer goods, where traditional retailers and online platforms continue to seek efficiencies to build scale. Investors based out of GCC continue to lead the M&A activity in the region with domestic deals making up the majority of the transactions within the GCC region.

During the last three years, Kuwait has been second to the UAE in terms of the numbers of M&A transactions. According to a report published by Kuwait Financial Centre, around 127 deals were closed involving Kuwaiti entities between 2014 and 2018, representing 23% of all M&A in the GCC during that period. Furthermore, Kuwait accounted for around 34% of all regional M&A transactions in the fourth quarter of the last year, with the move towards consolidation in the financial sector expected to continue this year.

Recent developments supposedly will drive other investors in the region to consider M&A as a way of remaining competitive. Furthermore, consolidation may help larger and more prominent players sustain and potentially expand market share and therefore incentivize additional M&A.

Overview of key Kuwait tax provisions

- Law No. 2 of 2008, the Executive Bylaws to Law No. 2 of 2008 and Executive Rules issued by the Kuwait Tax Authority ("KTA") set out the Kuwait tax regulations (collectively "tax regulations"). The tax regulations provide for a 15% flat rate of tax and in practice the KTA apply this to Kuwait sourced income earned by foreign (i.e. non-GCC) companies.
- Capital gains are treated as normal business profits under the tax regulations, specifically Article 2 of the Executive Bylaws to Law No. 2 of 2008 ("the Executive Bylaws") state the following are taxable at 15%:

  "Profit resulting from the disposal of assets including the sale of an asset in whole or part, conveyance of its title to third parties and other acts including disposal of shares of a company whose assets are mainly immovable properties in the State in Kuwait"

  Capital gains / losses would be computed based on the sale price less purchase costs. Capital losses may be offset against other trading profits of the investor entity.
- Due to certain changes at the time, as of 10 November 2015, returns (taken to imply dividends) in respect of securities, bonds, financial sukuk (i.e., Sharia- compliant bonds) and similar securities are exempt from income tax.
- According to the tax regulations, tax losses for a financial year can be carried forward for 3 years.
- Capital gains/losses incurred by local companies on transactions would be reflected in their respective Zakat and National Labour Support Tax declaration, where applicable, in line with treatment disclosed in their respective audited financial statements.
- The KTA can challenge transactions that are carried out on a NIL gain/loss position and potentially deem a capital gain on a basis considered appropriate by the KTA.

Asset purchase or share purchase

An acquisition may take the form of a purchase of assets or a purchase of shares.

Purchase of assets

For tax purposes, it is necessary to determine the total consideration given for the purchases of assets. It is advisable for the purchase agreement to specify the allocation of consideration to the acquired assets, based on current market prices. Allocation of purchase consideration is needed both for claiming tax depreciation and determining goodwill.

Goodwill

Amortization of goodwill is not allowed for tax purposes, under the tax regulations.

Depreciation

Depreciation is normally allowed on the cost of assets acquired at rates prescribed under tax regulations. When assets are transferred between related parties from abroad, the depreciable cost to the acquirer is limited to the allowable cost of the asset to the purchaser.

Tax attributes

Under the tax regulations, the right to adjust or carry forward tax losses ceases to exist in the following cases:

- liquidation of the incorporated body
- change of the legal status of the incorporated body or its expiry
- merger of the incorporated body with another incorporated body.

Value added tax

Currently, value added tax (VAT) is not levied in Kuwait. Kuwait is a signatory to the GCC Value Added Framework Agreement, however, no implementation date has been announced by the Kuwait government.

Transfer taxes

Stamp duty and stamp duty land tax are not levied by the KTA.

Purchase of shares

Tax indemnities and warranties

In negotiated acquisitions, it is usual for the purchaser to request, and for the vendor to provide, indemnities or warranties, as to

any of undisclosed tax liabilities of the target. In practice, the Kuwaiti tax authorities do not deem the acquirer liable for taxes due from the vendor.

Tax losses

The acquirer does not derive any potential tax benefit from the target company's pre-acquisition losses because the target's pre-acquisition tax losses cannot be transferred.

Tax clearances

While companies incorporated in Kuwait are not subject to corporate income tax, the tax authorities do not issue tax clearance in advance for Kuwaiti companies until all foreign shareholders (if any) of the Kuwaiti company have obtained their respective tax clearance certificates.

Choice of acquisition vehicle

The Companies Law No.1 of 2016, as amended, is relevant when considering a merger or acquisition in Kuwait. Mergers can take place in one of the following ways:

— dissolving one or more companies and transferring the assets and liabilities to another existing company

— dissolving two or more companies and establishing a new company by transferring the assets and liabilities of the dissolved companies to the new company

— dividing the assets and liabilities of a company into two or more parts and merging the parts into existing companies.

In Kuwait, most acquisitions are completed through the purchase of shares in the target company. The consideration given is normally cash, shares or a combination of both.

Local branch

The Companies Law No.1 of 2016, as amended, does not permit foreign companies to establish a registered branch office in Kuwait. Branch operations may be carried out by a foreign entity through the sponsorship arrangement.

Joint venture

Under the Companies Law No.1 of 2016, as amended, foreign entities can carry out business in joint ventures with Kuwaiti entities under the trade license and sponsorship of the venture's Kuwaiti member or in a joint venture with other foreign entities by appointing a Kuwaiti sponsor/agent.

Joint ventures with limited liability companies and Kuwaiti shareholding companies (KSC) require a minimum 51 percent of Kuwaiti shareholding. However, foreign entities are considered subject to income tax based on economic interests held in Kuwaiti entities regardless of the legal shareholding.

Choice of acquisition funding

Interest is a tax-deductible expense under certain circumstances, whereas dividends are not tax-deductible.

There are no thin capitalization rules in Kuwaiti tax law. Interest paid to banks on the purchase of assets generally can be capitalized as part of the asset cost. Interest incurred on share purchases is not allowed as a deductible expense. There are no foreign currency restrictions in Kuwait.

Deductibility of interest

Financial charges paid locally on bank facilities for capital expenditure can be capitalized and added to the cost of the asset. Interest paid to a local bank is deductible where the loan is used for main activities of the company. Interest paid by a foreign entity operating in Kuwait in respect of its current account with its head office is not deductible for tax purposes. Interest paid outside Kuwait would be disallowed unless it can be proved that the funds were utilized for loans and bank facilities to finance the incorporated body's activities in the State of Kuwait.

Withholding tax on debt and methods to reduce or eliminate it

There is no withholding tax in Kuwait. However, the KTA enforces compliance with the law through tax retention regulations covered under Article 16, 37 and 39 of the Executive Bylaws of Law No. 2 of 2008 ('tax retention regulations').The tax retention regulations require contract owners to retain 5 percent tax from contractors and release it only on the provision of a tax clearance certificate.

Other considerations

Transfer pricing

There are no specific transfer pricing regulations in Kuwait. However, the KTA deem certain percentages of the cost of the equipment or services rendered outside Kuwait as inadmissible. The percentage disallowance depends on the nature of relationship between the foreign company and the purchaser. Similarly, interest charged by the head office for its current account is not allowable for tax purposes. There is also a general provision within the tax regulations which allows the KTA to verify that related party transaction are conducted on a "sound basis and not for the purpose of obtaining illegal tax privileges". It is on this basis that the KTA could potentially challenge transaction between related parties on a NIL gain/loss basis. The KTA may also deem a capital gain where the KTA consider appropriate.

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