Kuwait Tax Alert

August 2024

Tax treaty between Kuwait and the United Arab Emirates

On 8 July 2024, the Council of Ministers of Kuwait issued Decree Law No. 7 of 2024, approving the Kuwait – United Arab Emirates ("UAE") Income and Capital Tax Treaty ("the Tax Treaty"). The Arabic text of the Tax Treaty has been published in Kuwait's official Gazette on 14 July 2024, along with an explanatory memorandum highlighting the treaty's key provisions.

Businesses in Kuwait that have a presence in UAE should consider the impact of the Tax Treaty from a UAE and Kuwait perspective in light of the respective jurisdictions local tax legislation.

The Tax Treaty is yet to be made effective and entered into force. We await further updates in this respect.

Based on our review of the Tax Treaty, we set out below key aspects:

- The following Kuwait taxes are specifically covered under the Tax Treaty:
    - Income Tax Decree No. 3 of 1955 as amended by Law No. 2 of 2008;
    - Kuwait Income Tax Law in the (designated area) No. 23 of 1961; and
    - Law No. 19 of 2000 on National Labor Support and Encouraging nationals to work in Non-Governmental Bodies.
- Sets out a six-month threshold for creating a Permanent Establishment ("PE") in respect of a building site, a construction, assembly or installation project or supervisory activities
- A service PE is created where activities continue for a period or periods, aggregating more than three months within any twelve-month period commencing or ending in the fiscal year concerned
- Creation of a PE where substantial equipment is being used or installed for more than three months within any twelve-month period commencing or ending in the tax year
- The Tax Treaty includes typical wordings for business profits being subject to tax only to the extent attributable to a PE.
- Tax on royalties and technical services should not exceed 10% of the gross royalties, provided the royalties are not connected to a PE.

Further detailed analysis and practical application of the articles of the treaty are yet to be undertaken.

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Presenting documents for tax inspections

As part of the annual tax compliance process, the Kuwait tax authority ("KTA") undertakes a tax inspection/tax audit of all tax returns submitted.

The KTA is actively seeking to close open years and tax inspections are moving forward at a quick pace. In this respect, we have recently seen the KTA issue a greater number of letters setting dates by which taxpayers should present supporting documents. Where supporting documents are not presented in due time, there is a high risk that taxpayers face disallowances to expense.

Additionally, where the KTA issues two letters setting dates for tax inspections and the taxpayer does not fully present the required documents, the KTA reserves the right to finalize open years on a deemed profit basis (i.e. impose a minimum 30% deemed profit revenue earned and apply the 15% corporate tax).

Tax payers are urged to take notices issued by the KTA setting dates for tax inspections seriously and to expedite collation of supporting documents.

Tax retentions

A. Areas of focus

Tax retentions remains a key area of focus for the KTA's inspections and failure by taxpayers to comply with obligations could lead to disallowance of the entire related cost.

Compliance with the corporate income tax law is enforced by Articles 16, 37 and 39 of the Executive Bylaw of Law No.2 of 2008 (collectively "tax retention regulations"). Under the tax retention regulations, every business entity, authority, ministry and individual operating in Kuwait should:

- Notify names and addresses to the KTA of contractors, subcontractors or any kind of beneficiary with whom contracts or agreements have been concluded;
- Submit copies of all the contracts, subcontracts or other agreements with any beneficiary entered into; and
- Retain 5% from payments to contractors, subcontractors or any beneficiary until such time the contractor, subcontractor or beneficiary provides a valid Tax Clearance Certificate ("TCC") and/or No Objection Letter ("NOL") issued by the KTA authorizing the release of amounts retained for tax retention purposes.

In the event tax retentions are not applied correctly, the KTA would disallow the entire related cost for tax purposes. Meaning, taxpayers not in compliance with tax retention regulations would have a tax impact of 15% of the entire related costs for the service provider/beneficiary.

This is the mechanism used by the KTA for enforcing the corporate income tax law in Kuwait.

The following points are a key focus:

- The scope of tax retentions is broad and includes, but is not limited to, subcontractors, service providers, vendors, material suppliers and manpower suppliers; and
- Includes foreign companies, Kuwaiti companies and GCC companies.

During tax inspections, the KTA seeks evidence of 5% tax retentions being applied on each payment. Exceptions to this are advance payments (subject to these being specified in contacts).

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B. Application on payments to individuals

Historically, while application to payments to entities were strictly followed, tax retentions on payments to individuals were treated inconsistently as income earned in an individual capacity is not subject to tax in Kuwait.

Recent experience has shown that tax retentions should also consistently be applied to payments to individuals for services rendered. In the absence of tax retentions being applied on payments to individuals under service contracts, the entire related cost would be disallowed for tax purposes resulting in additional tax liability of 15% of the related expenses

Individuals can apply to the KTA for a TCC or NOL to obtain the release of tax retentions deducted on payments. The process would include providing documentations for proof of identity together with a written confirmation that the individual is not acting in a nominee capacity for any corporate entity.

Tax retentions do not apply to payment of salaries to individuals.

C. Disclosure of subcontractor and service providers

As noted above, part of the requirement under the tax retention regulations is to notify the KTA the names of subcontractors, services providers, etc. This is typically done through the submission of a tax retention return ("TRR") on a periodic basis.

In addition, tax returns should also include a schedule of subcontractors, service providers, etc. We understand that the KTA is now placing greater focus in reconciling subcontractor, services provider, etc., costs in the tax return to the data submitted in the TRR.

Any discrepancies whereby the TRR is incomplete and does not provide details of subcontractors, services providers, etc., which are then claimed in the tax return, may lead to disallowances of related costs.

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