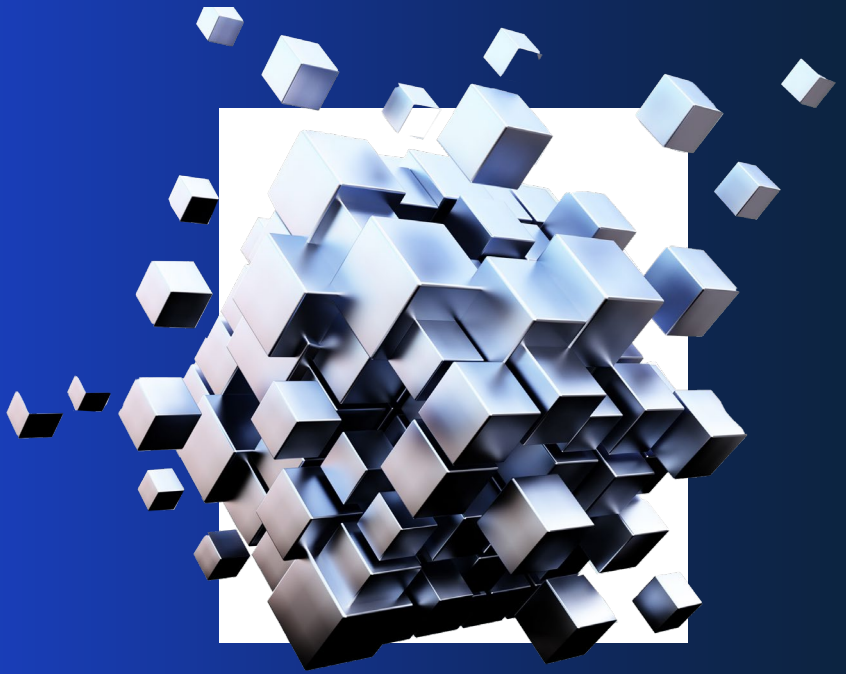


How to calculate taxable income?

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Background

With the UAE implementing CIT from 1 June 2023, we have entered a new era for tax in the region. Given the Kuwait CIT is likely to apply to all commercial activities with limited exclusions, this will be a paradigm shift for Kuwait businesses. Key stakeholders in Kuwait businesses will need to ensure their business and systems are ready for the introduction of CIT in Kuwait.

What is Corporate Income Tax (CIT)?

Corporate Income Tax, also referred to as Business Profits Tax, is a direct tax levied on the 'taxable income' earned by a taxable person during an annual tax period. CIT liability is generally calculated on a self-assessment basis by filing an annual CIT return which may be audited by the tax authority. In a Kuwait context, a taxable person could include a

company, an establishment, a Kuwait branch of a foreign company, an individual (with a commercial registration) carrying on a business.

Under the current regulations, CIT is imposed on the foreign (non-GCC) corporate bodies earning Kuwait sourced income at 15% of the net profits.

How is 'taxable income' calculated?

The starting point for calculating taxable income is a taxable person's accounting profit/loss as per the audited financial statements.

The accounting profit/loss is then subjected to certain adjustments (additions & deductions) to determine the taxable income.

These adjustments fall under two categories - timing differences and permanent differences.

Timing differences are differences between taxable profit and accounting profit that are given effect in one period and reversed in subsequent periods whereas permanent differences are given effect in

one period but are not reversed in subsequent periods.

We have outlined below some key adjustments to the reported accounting profit/loss which may increase or decrease the taxable income along with an overview of the CIT treatment based on general principles and what is prescribed under the CIT laws of some of the other GCC countries.

[Click here to see an example on tax calculation](#)

How is 'taxable income' calculated? (Continued)

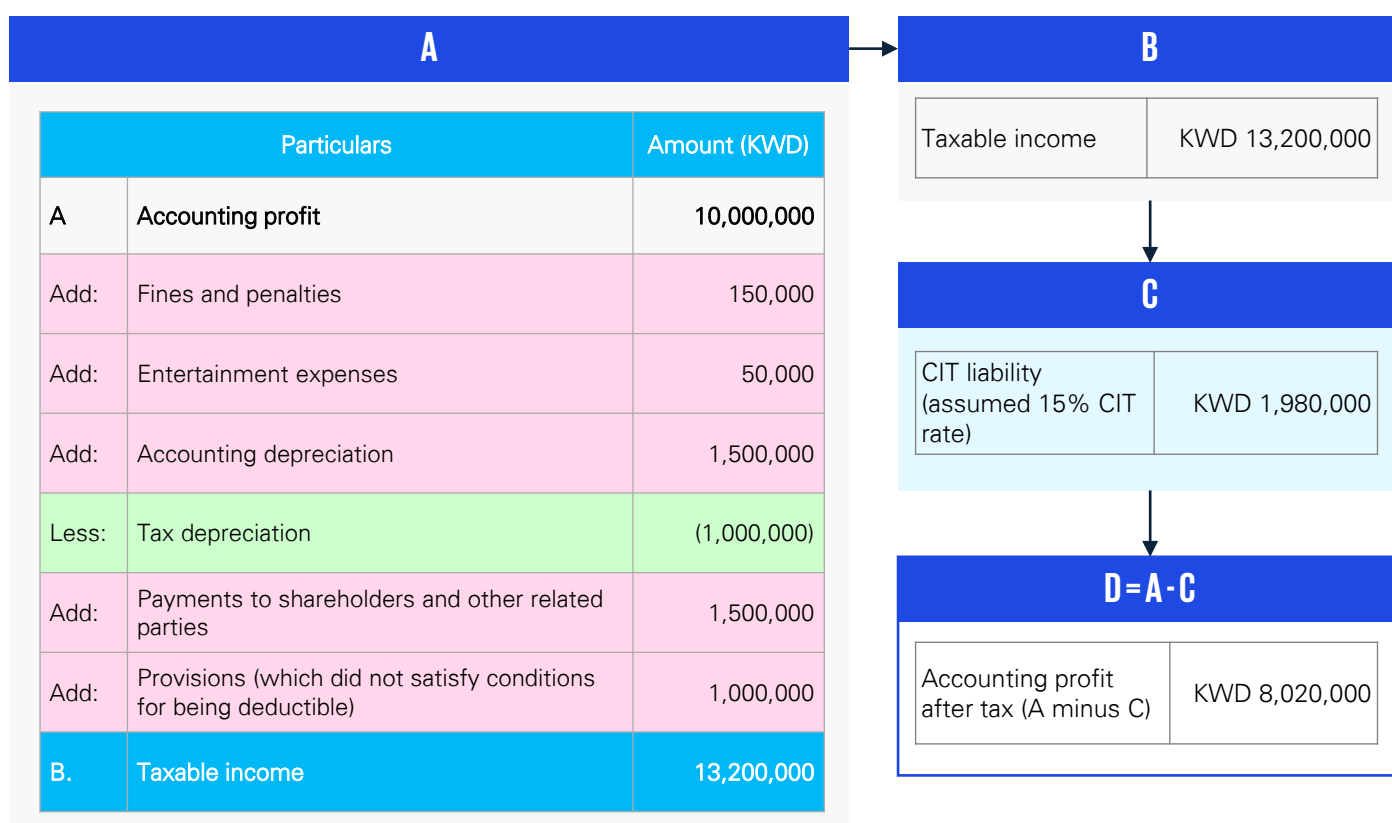
Adjustable item	CIT treatment
Fines and penalties	Almost universally a non-deductible expense. Some jurisdictions allow a deduction for compensation paid for breach of contract.
Donations	Generally deductible where it is paid to a 'qualifying' charitable organization (as defined in the CIT law). Some jurisdictions limit the deductible amount to a fixed percentage of gross income. For example, Oman limits it to 5% of gross income subject to it being paid to a 'specified' institution.
Entertainment expenses	Almost universally a non-deductible expense. Some countries like the UAE may allow a deduction for up to 50% of the entertainment expense subject to meeting certain conditions.
Provisions	Generally, a non-deductible amount unless the provision has been incurred. The CIT law will prescribe what is considered to have been incurred. From a CIT perspective generally, there must be a commitment or obligation to pay the actual expense, i.e. more in the nature of an accrual (it cannot just be a provision for a future expense that may not be incurred).
Depreciation	<p>Almost universally, a deductible expense to the extent allowed by the CIT legislation. The CIT law will prescribe the tax depreciation rates for each asset category as well as the method of depreciation (straight line or declining balance).</p> <p>Some countries like the UAE allow deduction based on accounting depreciation rates and method whereas countries like the Kingdom of Saudi Arabia (KSA) prescribe specific tax depreciation rates to be used.</p>
Related party payments	<p>Dividends and other payments to shareholders and related parties are generally not deductible for tax purposes. Some countries may allow a deduction for related party payments up to a limit prescribed in the legislation.</p> <p>For example, in Oman, deduction for related party payments is allowed up to certain caps prescribed in the legislation whereas the KSA denies deduction for any payment made to a shareholder or related party and the UAE allows deduction subject to meeting the arm's length or market value test and other conditions.</p> <p>A deduction is generally allowed for payments for services received from related parties (for example, interest on loans from related parties) provided the transactions are carried out at on an arm's length basis.</p>
Interest	<p>Interest payments under financing arrangements for business activities are generally tax deductible. Deduction for interest payments to related parties will be subject to transfer pricing rules/arm's length principles.</p> <p>Certain jurisdictions prescribe an upper limit for deduction of interest expenses which may be calculated as a percentage of gross income (UAE) or based on a prescribed formula (KSA). In certain jurisdictions, deduction of interest expense is subject to maintaining a specified debt-to-equity ratio.</p>
Foreign tax credits (FTC)	FTC of taxes paid in a foreign country is generally available for reduction of CIT liability. The conditions and mechanism for utilization of FTC may be prescribed under the relevant Double Tax Avoidance Agreement or the local CIT law.
Tax losses carried forward	<p>Tax losses incurred in a particular tax period are generally deductible against the taxable income of future tax periods subject to conditions. For example, in the UAE, carried forward tax losses can be used to offset up to 75% of the taxable income in a future tax period.</p> <p>In some jurisdictions, an upper limit is prescribed on the number years for carry forward of tax losses after which the tax losses lapse. Tax losses will generally also be lost where there is a change in ownership or change in business activity of the entity.</p>

How is 'taxable income' calculated? (Continued)

Adjustable item	CIT treatment
Head office expenses	Local branches/permanent establishments may allocate certain expenses towards their foreign head offices for management services. Such expenses are generally not deductible when computing the taxable income of the local branch/permanent establishment. However, in certain jurisdictions, such expenses are deductible subject to prescribed limits. For example, in Qatar, such expenses are deductible up to a specified percentage of the entity's revenue.
Exemptions	Dividends received from/ capital gains from sale of shares in qualifying foreign or local subsidiaries are generally exempt. Further, capital gains arising from business restructuring or sale of a business as a going concern are also generally exempt. Other special exemptions may be provided for specified businesses/activities.
Employee benefits	Generally, a deduction for employee salaries and benefits is available subject to any restrictions on payments to related parties. In some jurisdictions, benefits given to employees may be deductible subject to conditions and limits. For example, in the KSA, school fees paid by a company for children of employees are tax deductible if this benefit is stated in the employment contract and the fee relates to a local licensed school.

What does the above mean for my business?

We have set out below a simplified example of taxable income calculation. We have assumed an entity reported an accounting profit of KWD 10,000,000 which included certain non-deductible items from a CIT perspective.



What should Kuwait businesses be doing now?

As can be seen from the above, CIT will have a direct impact on the return to shareholders of a company. A company that is reporting an accounting loss may end up in a taxable position and have to still pay CIT. Therefore, businesses in Kuwait should focus on the following:

Assessment and planning	Administration*	Implementation*
<ul style="list-style-type: none">• Conduct CIT impact assessment on an as-is basis• Review legal structure, current business operations and future business plans• Review and identify risks in relation to related party transactions	<ul style="list-style-type: none">• Tax registration• Tax filing process• Transfer pricing documentation• Preparing for tax audits/assessments	<ul style="list-style-type: none">• Consider impact of transitional rules• Seek clarification on ambiguities or uncertain tax positions• Review impact of tax accounting adjustments• ERP setup to support tax calculation and tax return preparation

* once law and regulations are released

Reach out to us



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