

# *Middle East Tax and Legal Update*

*June 2011*



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# Introduction

Welcome to the latest edition of PwC's Middle East Tax and Legal Update.

In this edition, we continue to highlight fiscal policy developments as well as developments on international tax treaties within the Middle East region. This publication is divided into four sections:

1. Introduction
2. Regional Tax Update
3. International Tax Update
4. Legal Update

Our regional tax update covers significant tax, regulatory and legal developments in the Middle East including:

- Recent developments in double tax treaties
- Customs and duties updates
- Developments in individual tax compliance
- An overview of key international tax issues
- Legal developments.

PwC has the largest team of dedicated tax and legal specialists currently operating in the Middle East region. Our regional tax team has significant experience in International Tax, M&A, Private Equity, Fund Structuring, Islamic Finance, Zakat, Indirect Tax (VAT) and Domestic Corporate Taxes. Our priority is to provide you with leading tax knowledge and insights to keep you up to date, as well making sure we deliver services of the highest quality and which add value to you and your business.

We hope you find this tax update informative and interesting. Naturally, for assistance or further explanation on any of the issues in this update (or any other taxation matters), please feel free to contact any of our in-country tax leaders or our regional tax and legal specialists as detailed at the back of this publication.

Finally, if you would like to add anyone to this distribution list, please e-mail [MiddleEastTaxPublications@ae.pwc.com](mailto:MiddleEastTaxPublications@ae.pwc.com).

Yours faithfully,

**Dean Rolfe**  
Tax Partner  
Middle East Tax and Legal Services Leader  
PwC

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# Leading Middle East tax and legal expertise

**2,500 people  
in offices  
covering 13  
territories**

PwC is the fastest growing professional services firm in the Middle East region with the market leading tax advisory practice. Our expert tax advisory partners are able to combine specialist internationally acquired consulting skills with relevant local experience.

In 2005, PwC was the first professional services firm in the Middle East region to establish specialist tax and consulting teams including international tax, mergers and acquisitions, indirect tax (including VAT and customs), as well as teams that provide industry focused solutions.

In 2010, PwC was also the first firm to establish a dedicated Legal capability which is registered to provide legal advice alongside our market leading practice.

Our International Assignment Services team was established in 1976 and further illustrates our distinctive and specialist capabilities which are the result of extensive practical knowledge gained while operating in the Middle East region.

Many of these capabilities are unique in the Middle East region and no other firm of taxation advisers can match our regional capabilities.

The combination of global experience and local knowledge allows PwC to provide our clients with a unique service offering.

In addition, we have been established in the region for over 35 years and have around 2,500 people in offices covering 13 territories and can therefore provide taxation services in:

- Bahrain
- Egypt
- Jordan
- Iraq
- Kuwait
- Lebanon
- Libya
- Oman
- Qatar
- Saudi Arabia
- Syria
- United Arab Emirates
- West Bank & Gaza

## Why choose PwC?

PwC has the largest tax practice globally and are recognised as the leading brand for the provision of taxation services; combining the knowledge of over 46,000 individuals in over 151 countries and territories.

The Global Tax Monitor (“GTM”) recognises PwC as the leading tax adviser globally by reputation, with a very strong lead over the competition.

This statement is based on an independent survey conducted by GTM. Launched in 2000, the GTM is an independent survey conducted by the research agency TNS. Further details are available on our website: [www.pwc.com](http://www.pwc.com)

Globally we comprise tax professionals, economists, lawyers and other professionals who have the insight, combined with market knowledge and technical skill to provide you with innovative practical advice.

We have experience of working in the public and private sectors; we have advised governments on fiscal matters; and we help our clients to structure their business to optimise tax effectiveness locally, regionally and globally.

*PwC is the leading provider of tax services worldwide*

According to the annual International Tax Review survey, of the tax advisory firms in the Gulf Cooperation Council, PwC has, for the past 4 years, been recognised as a Tier 1 firm in recognition of our depth of resources and range of specialist tax capabilities.

## Our tax and legal services in the Middle East

PwC are leaders in the provision of tax advisory services in the Middle East region and this position was achieved by being the first professional services firm to establish specialist teams in the region, including:

### **International Tax Services (ITS)**

Our International Tax Services team was the first to be established in the region and has the largest team of international tax structuring experts. Our global market-leading knowledge will help you to understand the impact of tax and regulatory developments throughout the world.

### **Mergers & Acquisitions (M&A)**

Our M&A tax team was also the first M&A tax practice to be established in the region. Moreover, we have the largest team in the region with tax specialists based in all major markets.

### **Indirect Taxes**

PwC was also the first firm in the region to establish an indirect tax practice in 2006 and is uniquely qualified to provide extensive regional knowledge. We are therefore uniquely placed to provide unparalleled tax advice to manage current or future VAT/GST obligations.

### **Transfer Pricing**

As the first firm in the region to establish a transfer pricing practice, we are able to leverage our Global Transfer Pricing group, comprising more than 100 partners and 1500 dedicated professionals based in over 50 territories – more than any other professional services firm.

### **Legal Services**

We were the first to establish and the only accounting firm to offer a specialist legal team that is able to provide legal regulatory and secretarial services.

Our regulatory group has extensive experience of advising inbound investors on all aspects of business start up, registrations and deregistrations and liquidation services.

### **International Assignment Services (IAS)**

We have the oldest specialist IAS team in the region, established in 1976 and we are the only firm to offer this service. We provide unrivaled advice on individual tax compliance, share plans strategic tax structuring, expatriate and HR communication and repatriation advice.

### **Global Compliance Services (GCS):**

- **Corporate compliance**
- **Indirect tax compliance**
- **Accounting services**

Our unique Global Compliance Services (GCS) network, comprises a local territory compliance service team, supported by proven process, innovative technology and effective central coordination to provide direct and indirect tax compliance, tax accounting and reporting and payroll services.

# *Introduction*



# Thought leadership in taxation

The combination of local knowledge with specialist tax advisory capabilities allows us to advise governments and our many other clients on all aspects of taxation. This also provides us with a unique opportunity to deliver thought leadership material and other insights.

Visit [www.pwc.com/middle-east](http://www.pwc.com/middle-east) for our latest thought leadership insights.

## **Paying Taxes**

This study, from the World Bank Group and PwC, measures the ease of paying taxes across 183 economies worldwide by assessing both the cost of taxes and the administrative burden of tax compliance.

## **Worldwide Tax Summaries**

Globalisation and the increase in cross-border activity means that tax professionals often need access to details of current tax rates and major features of the tax laws in a wide range of territories. Our “Worldwide tax summaries” provide a synopsis of corporate and individual tax regulations in 120-plus countries, as well as contact details for local PwC tax professionals.

[www.pwc.com/taxsummaries](http://www.pwc.com/taxsummaries) for more details.

## **Tax Update**

Twice a year the PwC Middle East tax team compiles an update of significant developments in fiscal policy and international tax treaties within the region to make sure you are up-to-date with cutting edge tax and regulatory news.

Would this knowledge and experience add value to your business?

Visit our Middle East tax website: [www.pwc.com/m1/en/tax](http://www.pwc.com/m1/en/tax)

## Partner profiles

Our partners include some of the region’s thought leaders.

### **Mohammed Yaghmour**

Mohammed is a Tax Partner based in Jeddah with more than 22 years of professional experience in the Saudi market and is one of the most well known tax advisors in the country. He is responsible for all income tax and Zakat affairs of our clients with the Department of Zakat and Income Tax. During his career, Mohammed has acquired a wide range of professional experience in industries, such as the trading, maintenance, transportation, manufacturing, investment, advertising and services industries.

### **Dean Rolfe**

Dean is a market leading authority on international taxation and the Middle East region. He has been published in a range of tax and technical journals and is also regularly asked to speak on international tax and Middle East taxation issues. He is also regularly interviewed on radio and television on regional tax matters including taxation reform.

## Bahrain

### Regulatory Reforms

#### Temporary suspension of monthly expatriate levies

In Bahrain, employers are required to pay a monthly BHD 10 levy to the Labour Market Regulatory Authority for each non-Bahraini employed. However given the recent unrest in Bahrain, the authorities have implemented various incentives to stimulate Bahrain's economy, including a suspension of the above levy from April 2011 to September 2011.

#### Proposed waiver of government fees on hotels

The Bahrain Chamber of Commerce and Industry has recently proposed to temporarily waive the five percent fee levied by the government on hotels for three months, in an effort to revitalise the tourism sector in Bahrain. Initial approval has already been obtained by the Minister of Culture and the proposal will be submitted to the Bahrain Cabinet of Ministers for final approval soon.

#### Double tax treaty updates

**Bahrain has continued to expand its double tax treaty network and has recently signed two new double tax treaties:**

- **Bahrain – Isle of Man double tax treaty**  
The Bahrain – Isle of Man double tax treaty was signed on 3 February 2011. According to this treaty, withholding tax on dividends, interest, and royalties remitted by a resident entity to non-residents is eliminated as these income streams are only taxable in the beneficial owner's state of residence. That said, there is no immediate benefit in respect of withholding taxes as neither country currently levies withholding tax on cross-border payments.
- **Bahrain – Turkmenistan double tax treaty**  
The Bahrain – Turkmenistan double tax treaty was signed on 9 February 2011. According to this treaty, dividends, interest and royalties remitted by a resident entity to non-residents may be subject to 10 percent withholding tax in the beneficial owner's state of residence. The cross-border payments of dividends,

interest and royalties are generally subject to the non-treaty withholding tax rate of 15 percent in Turkmenistan.

The above treaties will only enter into force after the instruments of ratification have been exchanged between the respective countries.

Additionally, the following treaties have also recently entered into force:

- **Bahrain – Austria double tax treaty**  
The Bahrain – Austria double tax treaty became effective on 1 January 2011. According to this treaty, dividends, interest and royalties remitted by a resident entity to non-residents are only taxable in the beneficial owner's state of residence. Austria does not levy withholding tax on interest remitted by a resident entity to non-residents. However, dividends and royalties remitted by a resident entity to non-residents are generally subject to a 25 percent and 20 percent withholding tax respectively.
- **Bahrain – Bulgaria double tax treaty**  
The Bahrain – Bulgaria double tax treaty became effective from 1 January 2011. According to this treaty, dividends, interest and royalties remitted by a resident entity to non-residents may be subject to a maximum withholding tax rate of five percent. In Bulgaria, the general non-treaty withholding tax rates on payments by a resident entity to non-residents are five percent for dividends and 10 percent for interest and royalties.



*The Bahrain Chamber of Commerce and Industry has recently proposed to temporarily waive the five percent fee levied by the government on hotels for three months*

- ***Bahrain – France tax treaty protocol***

The protocol to this treaty is retroactively effective from 1 December 2010 and introduces a new article, allowing the competent authorities in Bahrain and France to exchange information in accordance with OECD standards.

- ***Bahrain – Ireland double tax treaty***

The Bahrain – Ireland double tax treaty is retroactively effective from 1 January 2010. According to this treaty, withholding tax on dividends, interest, and royalties remitted by a resident entity to non-residents is eliminated as these income streams are only taxable in the beneficial owner's state of residence. In Ireland, a 20 percent non-treaty withholding tax rate generally applies to the remittance of dividends, interest and patent royalties by a resident entity to non-residents.

- ***Bahrain – Luxembourg double tax treaty***

The Bahrain – Luxembourg double tax treaty is effective from 1 January 2011. Under this treaty, dividends are exempt from withholding tax if the beneficial owner is an entity that holds directly at least 10 percent of the dividend payer's capital, and a maximum rate of 10 percent applies in other cases. Withholding tax on interest and royalties remitted by a resident entity to non-residents are only taxable in the beneficial owner's state of residence. In Luxembourg, the general non-treaty withholding tax rate on dividend payments by a resident entity to non-residents is 15 percent, whereas interest and royalties remitted by a resident entity to non-residents are generally exempt from withholding tax.

Bahrain has also commenced negotiations for double tax treaties with Barbados and Portugal. Further details on these new agreements are not yet available.

## Egypt

### *Egypt raises sales tax rates and eyes transition to VAT*

The recent Egyptian youth revolution and the recent change in political leadership has revealed a deep appetite for constitutional, legal and political reform with the hope it will deliver on the promise of better outcomes across Egyptian society. At the same time, political change and the evolutionary nature of early stage reform have led to a great deal of uncertainty about the future direction of government and economic policy, which in turn impacts on the national economic outlook.

The implications of reform and uncertainty on the investment climate, specifically for current and potential foreign investors, are significant. This briefing paper considers the direction of tax policy in Egypt, given the evolving reforms and their potential impact on investors.

#### *The fiscal climate*

Following President Hosni Mubarak's departure in February 2011, early indicators suggest a range of policy reforms and other developments are now underway which should have a positive impact on the economy on the long term:

- Tax policy and administration are likely to continue to move in business's favour as a key plank of the Egyptian Government's policies to encourage local and foreign direct investment.
- The current Finance Minister is driving policies to attract investors – providing incentives such as land grants and reform of business licenses. His public comments make it clear he favours competitive tax rates to encourage economic growth – including the continuation of the current 20 percent flat rate corporate income tax or even gradual reductions in the corporate tax rate over the long term.
- Signs of a much-hoped-for clampdown on corruption are sending a positive signal to potential investors.

- Despite these encouraging signs, it is also clear that public finances are under pressure. Foreign currency reserves are down to the dangerously low figure of \$34 bn, threatening currency stability, although the stock market did stabilise on re-opening. The regime is in urgent need for cash budgetary support and has asked the US to forgive \$3.6bn in debts. Public demand for political reform, improved infrastructure and a higher standard of living also put considerable additional pressure on the public purse.

#### *What is the likely future direction of the Egyptian economy?*

According to the World Bank, Egypt has undertaken many positive economic reform initiatives in the past years and achieved good growth, but the pace of reform was not sufficient to accommodate the growing needs for jobs, nor did it address major imbalances in wealth distribution.

Egypt's recent political developments have opened a new chapter for the economy, filled with opportunity and the promise for a better future. We believe it is likely that these developments will derive and deliver much-needed reform to support the growth and development of the Egyptian economy. It has been widely recognised that the Egyptian economy has been in decline for many years, despite many positive fundamentals: central geographic location, competitive labour cost and supply of educated, bi-lingual (English and Arabic speaking) young workers. Economic reforms, the opening up of the Egyptian economy and Egypt's new commitment and energy for change have the potential to derive rapid economic growth and development.

Widespread corruption under the former Mubarak regime also severely affected the economy's ability to create employment and fund much needed public infrastructure. Tackling this effectively will be key to the country's prosperity.

With respect to taxation, the previous pace of reform was slow and administration of existing tax laws was poor and inconsistent, causing a lack of certainty with respect to the calculation and payment of taxation for the business community and foreign investors.

While there are clearly many challenges going forward, there is also a great deal of optimism that political reform and a new government will deliver economic and tax reform, in turn delivering economic growth, development and opportunity.

### **Economic challenges**

Economists predict that in 2011, growth in consumption will cause Egypt to switch from a net oil exporting country to a net importer. In the long run, this can only lead to higher prices, meaning that the Egyptian people will have to pay significantly more for petroleum products such as gasoline, diesel and kerosene as well as for the other subsidised goods and services.

On the other hand, Egypt has recently increased its domestic natural gas industry. It is worth noting that Egypt's natural gas reserves are the third largest in Africa (after Algeria and Nigeria) and the 11th

## **According to the World Bank, Egypt has undertaken many positive economic reform initiatives in the past years and achieved good growth**

largest in the world. Further expansion is under discussion and this is likely to provide a significant source of additional revenue for the government.

Other challenges facing the new government include the nation's poor infrastructure and, given Egypt's large and growing population in need of employment – the lack of social security, health and education provided to the majority of the population.

All of these challenges must be addressed by promoting economic growth and increasing government revenues. Clearly the new government must carefully consider how to generate the revenue necessary to fund a whole range of new social and infrastructure policies, in turn putting tax collection and administration high on the national agenda.

However, given constitutional and political reform will see the focus on rewriting the Egyptian constitution and finalising governance and legislative arrangements, any such developments are likely to take place slowly, remaining uncertain for some time to come. The interim government is also somewhat restricted in its ability to make any major changes until these broader reforms are finalised.

The new Prime Minister, Dr. Essam Sharaf, has stated that he expects it will take between six and twelve months for the current economic situation to begin to improve and our conversations with business leaders suggest they foresee a similar timeframe. Recognising the need to make some immediate changes, Dr. Sharaf and his new Minister of Finance, Dr. Samir Radwan, are meeting regularly to evaluate different options for generating revenue and any associated need for tax reform.

### **Egyptian tax administration in the short term**

Corporate taxation in Egypt changed fundamentally in 2005 with the introduction of new Tax Law 91. This introduced a self-assessment regime, a 20 percent tax rate (reduced from the former 42 percent top rate) and introduced checks and balances designed to prevent an unduly aggressive approach from the Tax Authority.

At the time of the 2011 revolution, the first returns filed under this regime were subject to widespread audit, given the five year statutory limit on tax claims. Following the revolution, the Egyptian Tax Authority announced a circular letter (No.3 /2011) regarding tax audits for the year 2005. The circular advises that the Tax Authority will no longer select sample returns to be audited for FY 2005 and that they are satisfied with the inspected samples for corporate tax. There are signs that some tax officials are resisting this concession, but this circular remains the official position and it is expected that the Tax Appeals Committee and, ultimately the courts, will uphold its authority.

Commencing with review of the FY 2006 returns, the Tax Authority will select samples to be audited using its standard procedures and methodologies.

With respect to the submission of current tax returns, the Egyptian Tax Authority have announced that they will not charge Egyptian entities penalties due on late submission of monthly sales tax returns due to be filed in January and February 2011, given the difficulties caused by recent events. For corporate income tax returns, filing to obtain an extension until the end of June 2011 is already possible under the existing mechanism.

# Regional Tax and Legal Update

Additionally, Law 8 for the year 2011 was issued on February 2011 to allow taxpayers to pay any income taxes due in three-monthly instalments rather than a one-off payment, for 2010 corporate tax due to be paid in April 2011. As a result, the final payment of corporate income taxes may be delayed until June without any penalties or interest.

## **Tax rates**

There has been some speculation that the Minister of Finance is planning to change the corporate income tax rate from a current flat rate of 20 percent to a progressive system with a series of rates that 'step up' at rising levels of taxable revenue. However the Minister made his position clear on 13 March at a meeting of the American Chamber of Commerce where he declared his support for the current system. We will continue to monitor this situation, given the potential impact on foreign investment decisions.

## **Paying corporate tax by instalments**

Generally, according to the Egyptian income tax law, the deadline for filing an Egyptian company's corporate tax return, for a financial year ending December 31 is April 30. The law provides a chance for extending this deadline for an additional 60 days, if the tax payer wishes; however in such a case the tax payer must file a certain form (form 26) before April 16 of the concerned year. Upon submitting the form the tax payer is required to settle the amount of corporate tax due as per the tax return (to be submitted later). Thus, extending the deadline doesn't result in delaying the payment of tax.

Due to the current political and economic circumstances in Egypt, the Military Supreme Council - which is in power until presidential and parliamentary elections later this year - has issued a decree (decree no. 8 of 2011) whereby an Egyptian company can pay the corporate tax due on three equal installments as follows:

- The first one should be submitted along with form 26, before 16 April 2011
- The second to be paid in May

- The third and final installment to be settled before 30 June 2011.

The extension of the deadline of filling the tax return, or paying the tax due on installments as prescribed above, should not result in any interest or delay fines.

It is not clear whether the above decree would apply in future years, we are still waiting for a formal announcement in this regard.

## **Tax inspection closed for financial year 2005**

On 22 February 2011 the Egyptian Tax Authority issued circular letter no. 3 regarding tax inspections for financial year 2005, in consideration of the current political circumstances. This circular states the following:

- The Tax Authority is satisfied with the inspection performed for financial year 2005 samples, and therefore decided to close financial year 2005 for tax inspection. Accordingly no further tax inspections will be performed for financial year 2005, and it will accordingly be applicable to financial years from 2006 to 2008.
- Based on the above, the 2005 taxes due on companies' which had not been inspected for 2005 until 22 February 2011, are considered final.
- However, the Tax Authority will continue the inspection of the files that are still in review process, until inspection is complete. Also, the same will apply to files for which inspection has been performed, and the taxpayers were not notified of its outcome.
- Continuing the inspection and applying all other procedures for the samples of the financial years 2006, 2007 and 2008.

## **Exemption of sales taxes due from penalties**

The Military Supreme Council has issued law no. 4 of 2011 to exempt sales tax payers from additional tax penalties for late filing of tax returns that were due in January and February.

## **Concluding arguments between tax payers and the Tax Authority**

Ministerial decree no. 363 of 2009 provided the procedures to be followed in order to conclude specific tax court cases between tax payers and the Egyptian Tax Authority. This ministerial decree specifies the topics of arguments to which it applies.

Another ministerial decree was issued on 3 April 2011 amending the part of ministerial decree no. 363 of 2009 which specifies the topics of arguments. This makes it more comprehensive in terms of covering arguments related to income taxes for years preceding application of income tax law no. 91 of 2005, as well as arguments related to stamp taxes for the years prior to application of law no. 143 of 2006. Furthermore, it dictates that the amended ministerial decree applies to natural persons as well as judicial persons.

## **Real Estate tax**

It has been announced by the Prime Minister that the application of the Real Estate Tax Law 196 for the year 2008 will be held off for now.

## **Social insurance thresholds increased**

The monthly social insurance thresholds shall increase from EGP 850 to EGP 875 for basic salaries, and from 900 to 1050 for variable salaries. This should be effective 1 July 2011.

However, in order to be effective, an official proclamation must be made, which still has not taken place.

## **New regulation on granting work permits to expatriates**

It has been decided to grant expatriates working in Egypt a renewable work permit for a maximum limit of three years.

- In order to allow granting a work permit, an expatriate should prove a relevant experience in the position he will be filling in the local company and this requires presenting the relevant experience certificates reflecting this fact.
- Finally, this regulation is newly introduced and we expect to be

amended if the concerned parties demonstrated a clear opposition towards it, on the grounds of being in need to specific expatriates' experience which might require staying in Egypt beyond the three year limit.

### **Transfer pricing**

Transfer pricing legislation was introduced to the Egyptian statute books in 2005. As has been the case in many other jurisdictions, a transfer pricing regime has been identified as a potential source of a substantial amount of tax revenue.

Subsequently, and following extensive cooperation with the OECD, the Egyptian Tax Authority has developed the most sophisticated transfer pricing infrastructure in the region. Over the past year, the Egyptian Tax Authority has continued to invest substantially in its transfer pricing infrastructure. With a dedicated transfer pricing team, transfer pricing guidelines launched in November 2010, and substantial investment in training tax inspectors, the Egyptian Tax Authority is well placed to administer the transfer pricing law.

The Tax Authority noted that this launch does not represent an inauguration of transfer pricing rules in Egypt because transfer pricing law has existed since 2005.

The guidelines are to be issued as a series of parts - the first of which provides guidance on the arm's length principle, how to establish comparability, choosing the most appropriate transfer pricing method(s), and documentation requirements. The coming parts should cover more complex transfer pricing topics, specifically transactions involving intellectual property, intra-group services, cost contribution arrangements, and advanced pricing agreements.

Tax payers are required to prepare contemporaneous documentation studies to support the arm's length nature of their controlled transactions since issuance of transfer pricing law in Egypt in 2005. The Egyptian Tax Authority specified, however, that they do not

require the submission of transfer pricing documentation studies with the tax return – rather, they are required to be available upon request in a tax audit. Studies are acceptable in English but a translation may be requested from the tax payer.

Post-Revolution, there has been no public discussion of any specific reforms or changes impacting the transfer pricing laws, administration or agenda within the Egyptian Tax Authority. However with greater transparency and less potential corruption as a result of the prospective political changes, we expect transfer pricing is increasingly likely to be utilised as a key tax revenue collection tool, in part because the infrastructure to administer transfer pricing law is available, ready and robust. We expect transfer pricing to continue to be a primary focus of the Egyptian Tax Authority and that they will be vigorous in their efforts to increase tax collections, particularly from foreign multinationals.

### **The new Finance Minister**

Dr. Radwan was appointed by the Military Supreme Council and the Prime Minister as the new Minister of Finance in February 2011. Dr. Radwan is one of the Arab World's most respected development economists and employment specialists and is widely considered to be 'pro-reform'.

He is currently a member and advisor on the Board of Trustees of the Investment and Free Zones Authority of Egypt (GAFI). From 2003 – 2006, he was Managing Director of the Economic Research Forum for the Arab Countries, Iran and Turkey, a regional think-tank based in Cairo. Prior to that he had spent close to 30 years in the International Labour Organization where he held key positions including Adviser to the ILO's Director-General on Development Policies and Counselor on

Arab Countries. He is the author of a number of seminal books and publications on labor markets, industrialisation, development and agrarian systems and poverty.

Dr. Radwan holds a PhD in Economics from the School of Oriental and African Studies, University of London, a Masters in Economics of Underdeveloped Countries from the University of London and a BA in Economics from Cairo University.

The Minister's public statements indicate increased public and welfare spending will need to be financed by economic growth rather than by "new taxes". He has stated an intention to introduce a minimum wage, however his comments suggest this may be limited to low-paid public sector workers, suggesting a particular focus on 'fairer' spending of Egyptian taxpayers' money. He has also made reassuring comments that "the private sector will remain the main pillar of the economy."

### **The role of the Supreme Council of the Armed Forces in tax decisions**

The Egyptian Supreme Council of the Armed Forces started governing the country following the departure of former President Hosni Mubarak in early February 2011. The Council has the power to appoint the Prime Minister, oversee decisions taken by Government Ministries and approve or disapprove and issue laws at this critical period.

Tax decisions are therefore issued by the Council. However in practice, their role appears to be ratification of decisions that are actually made by the Ministry of Finance. As a result, the new Minister of Finance has the capacity to make decisions which impact tax laws but material changes to tax laws are not anticipated until the formation of a new government in Egypt later this year.

***There has been some speculation that the Minister of Finance is planning to change the corporate income tax rate from a current flat rate of 20 percent***

## Proposals on tax changes based on governmental budget of 2011- 2012

The Egyptian Ministry of Finance announced a series of proposed tax changes on 1 June, with the stated aims of helping to meet:

- The recent Egyptian youth revolution's calls for liberty, equality and social justice in Egypt
- Government Ministers' plans for economic reform and creation of employment
- Governmental 2011/12 budget plans to address the fiscal deficit.

The key proposed changes are subject to public consultation, but may be summarised as:

- An increase to the current income tax rates for individuals and companies by an additional 5 percent where profits exceed EGP 10 million (profits up to this limit continuing to be taxed at the existing 20 percent rate)
- The introduction of:
  - Capital gains tax arising due to merger or acquisition of resident entities
  - Capital gains tax arising from revaluation of assets due to mergers and acquisitions
  - Profit distributions (dividends) to shareholders.
- Sales tax on tobacco and cigarette products to increase to 50 percent (from 40 percent)
- The personal annual exemption on wages and salaries to increase from EGP 4,000 to EGP 7,000.

At the time of writing, the detail and draft legislation supporting these proposals is yet to be released. The above summary is based on draft budget information announced in newspapers and on the Ministry of Finance's website.

### PwC Observations

While the draft legislation is not available, it is difficult to comment on these proposals, but there are a number of issues to be considered.

It would seem that the intention to extend taxation to corporate re-organisations via a new capital gains tax will present many challenges for corporate groups who need to restructure their operations for legal or other commercial reasons. The imposition of a tax on such reorganisations is therefore unlikely to be welcomed by the business community.

Furthermore, the introduction of a new tax on profit distributions is likely to lead to double taxation. That is to say, unless the shareholder receives a credit for this new tax levied, it is likely that corporate profits could be subject to taxation at multiple levels thereby imposing a large tax burden on the Egyptian economy. This would likely impact direct foreign investment especially if corporate reorganisations needed to simplify group structures are also taxed under these proposals.

PwC will discuss these proposals with the Ministry of Finance. If you would like further information on these proposals please contact AbdAllah El Adly Tax Partner, PwC Egypt.



*It would seem that the intention to extend taxation to corporate re-organisations via a new capital gains tax will present many challenges for corporate groups who need to restructure their operations for legal or other commercial reasons.*

## Iraq

### Withholding tax

The supplier will be subject to withholding tax at the rate of 3 to 3.3 percent. We note that for the oil and gas industry, these rates are expected to double to seven percent in the near future. New instructions issued in this regard are expected to be approved by the legislators soon.

### Social Security

The Social Security contribution for companies operating in Iraq ( including branches of foreign companies operating in Iraq ) is fixed at 17 percent (12 percent being the employer's share of the contribution and five percent being the employee's share of that contribution).

The latest development implemented by the Social Security Department is to increase the contribution to 30 percent for international oil companies operating in Iraq. This is shared by the employer and employees as follows:

- Five percent contribution by the employee
- Twenty five percent contribution by the employer.

Foreign employees that are able to produce adequate document evidence of being covered by social security (or a similar system) in their home country, are exempt from social security in Iraq. Such documentation is required to be notarised and legalised by the Iraqi embassy in the employee's home country.

## Jordan

### *New Income Tax Regulation enacted*

Regulation number 15 for 2010, gross and net profit percentages on goods and services dealt with by the commercial, industrial and services sectors issued in accordance with Article 23e of the Temporary Income Tax Law No. 28 for the year 2009.

The regulation applies to taxpayers who do not keep proper records of accounts as per article 3a of the law, or who are exempted from keeping as per article 23d of the law. All taxpayers who are assessed based on this regulation cannot be assessed in future on keeping proper records and accounts. The regulation applies from 2010 onwards and is applied as outlined below.

#### *Gross profit*

Fixed gross profit percentages will be used. These will be based on the annual cost of sales figures for over 200 items of goods identified in the commercial sector, including wholesale or retail sales. The percentages range from 3 to 60 percent.

#### *Net profit*

Net profit percentages were introduced in the following sectors and at the following rates:

- 10 percent of revenue for the construction sector
- 10 percent of the sale value of buildings and apartments for investors in the housing sector
- 18 percent of the revenue relating in the engineering offices sector.

The above net profit percentages do not apply to non-Jordanian juristic persons.

The regulation also introduced monetary net profit amounts for the jewellery and bakery sectors.

### *New Income Tax Rule enacted*

Rule number 70 for 2010, exempting profits from tax on exports of goods and services issued in accordance with Article 7e of Temporary Tax Law No. 28 for the year 2009.

According to this rule, net profits generated from sale of goods of Jordanian origin to locations outside Jordan are fully exempted from tax, except for sales of phosphate, potash, cement, and fertilizers and any of their derivatives.

In addition, net profits generated from the following services, provided the services are preformed in the Kingdom and exported abroad, are fully exempted from tax:

- Computers
  - Feasibility studies
  - Legal, engineering, accounting and auditing consultations
  - General management consultations
  - Financial management consultations
  - Human resources consultations
  - Production management consultations
  - Pharmaceutical studies
  - Information Technology
  - Internet services provided to customers outside the Kingdom
  - External contracting services
  - Any other service approved by the Cabinet of Ministers.
- To benefit from the exemption, tax payers must maintain proper records accounts and proof that the services or goods were exported.
- Sales of goods and services to the Free Zones, Aqaba Special Economic Zone or to the Development Areas Zones, are not considered to be export sales for these purposes.
- It should also be noted that losses from export sales cannot be carried forward for tax purposes.

## Kingdom of Saudi Arabia

### *Are Saudi joint stock companies subject to tax or to Zakat?*

According to the income tax regulations, Saudi joint stock companies are subject to income tax on their non-Saudi shares and to Zakat on their Saudi shares. However, since these shares are listed and traded on the Saudi Capital Market (Tadawul), it is quite difficult to determine the Saudi and non-Saudi shares in a Saudi joint stock company due to the fact that the owners of these shares are subject to change on a daily basis. Therefore, the ownership percentages are continually changing throughout the year.

To overcome this dilemma, the Department of Zakat and Income Tax (DZIT), has clarified that a Saudi joint stock company is subject to income tax at the rate of 20 percent on the non-Saudi shares and to Zakat on its Saudi shares based on the specified allocation in the company's Articles of Association regardless of the nationality of the listed shares' owners.

The DZIT added that new Saudi or non-Saudi stock holders investing in such companies and ownership resulting from the daily trading of stocks, should not affect the Saudi and non-Saudi ownership percentage for income tax and Zakat purposes.

Accordingly, the DZIT stated that, subject to any new instruction, Saudi joint stock companies should file their income tax and Zakat returns based on their Articles of Association and any related amendments without taking into account the effect of any subsequent change in stockholders.

In conclusion, for Saudi income tax and Zakat purposes, the current practice is that the joint stock companies are generally

treated like the limited liability companies. Both of them are subject to income tax on their non-Saudi shares and to Zakat on their Saudi shares.

#### *Zakat rules for banks*

Since 2007 the Saudi banking system has experienced particularly unfavourable treatment for Zakat purposes. Several announcements by the tax and religious authorities in 2007 and thereafter, have resulted in an unbalanced calculation of the Zakat base for financial institutions.

Although the financing sources for several long-term investment products are to be added to the Zakat base, some of the corresponding investments are not allowed as deductible assets. This imbalance has resulted in major Zakat leakages for most Saudi banks. These leakages go significantly beyond the Zakat burden which other Saudi companies suffer.

With the banking sector becoming ever more important for the development of the Saudi economy and the tax authorities becoming more sophisticated, some banks

have started discussions with the Saudi authorities to achieve a more favourable Zakat treatment. PwC's Zakat and Shariah experts are at the forefront of these discussions. More detailed information will be circulated as the discussions develop.

#### *Permanent establishment risk in relation to manufacturing agreements*

The Saudi tax authorities have recently taken the view that manufacturing agreements between a Saudi producer and a non-resident company may constitute a permanent establishment for the non-resident. Such a risk exists in particular, where a Saudi manufacturer commits to sell its entire output at pre-agreed prices to a foreign customer which, at the same time, supplies raw materials at fixed prices and where that customer has the right to determine the output levels.

Consequently, the foreign party may have to pay tax on all income related to the goods bought from the Saudi manufacturer.

investment in such facilities either as intangible assets or receivables. These standards have been effective since 2008.

Until recently, the Zakat consequences of the new accounting rules were unclear. In particular, receivables were unlikely to be accepted as Zakat deductible assets. With respect to intangible assets several Zakat experts took the view that the corresponding assets might also be disallowable, which for most operators, would result in massive Zakat leakages.

Thus, even after the new rules were announced, some operators continued to apply the old accounting treatment and accepted qualified audit opinions on this basis, hoping that the tax authorities would accept the deduction of tangible assets. However, the DZIT has now issued the first Zakat assessments for several BOT/ROT projects, and in those cases where the construction costs were recorded as intangible assets the Saudi tax authorities have accepted the deductibility for Zakat purposes.

#### **Labour market reforms in Kingdom of Saudi Arabia**

Ten programmes are being considered to be implemented in the Kingdom in order to regulate the labour market. Companies will be given time till 7 September 2011 (approximately five months from the date of the announcement) to regularise their situation with respect to achieving the prescribed quota of Saudi employees before the actual conditions and penalties under the programmes are implemented without any scope for leniency in its application. These reforms are aimed at boosting the employment opportunities for Saudi nationals and increasing their competitive edge in the labour market. The minister has also confirmed that the reforms will help tackle the black market for employment visas by about 99%.

#### **The Nitaqat policy**

Putting a six-year cap on foreign / expatriate resident visa's for companies not complying with the Saudization policies.

Under this policy, private companies will be categorised under four categories, of which two – the categories of complying companies – will be able to recruit foreign workers from the other two categories.

#### **The categories are:**

**Platinum category** – companies having exceptional track record in employing Saudi nationals

**Green category** – private companies that have met with the Saudization quota (no restriction on visas, foreign workers from the yellow and red category can move to companies of green and platinum category without being blocked by their previous employers i.e. requirement of no-objection certificate from employer does not apply)

**Yellow category** – private companies that have not reached Saudization quota levels of employment (visas of foreign employees working with these companies for six years or more will not be renewed, although visas can be renewed UPTO six years)

**Red category** – private companies that have flouted the Saudization rules (foreign employees working with such companies will not be able to renew their visas and the company will not be allowed to recruit any foreign worker)

This policy is proposed to act as an incentive to employers because recruiting foreign workers locally costs less as employers are not required to provide periodic round trip tickets for home visits or pay international labour recruitment fees.

#### **Submitting audited financial statements along with Zakat and tax returns**

On 12 March 2011, the Saudi tax authorities issued a circular stating that audited financial statements must be submitted when filing tax and Zakat returns for Saudi and mixed companies. This rule was not consistently applied in the past. However, tax offices may refuse to issue certificates to Saudi and mixed companies going forward, unless the companies have complied with the circular.

Moreover, the DZIT may not accept returns if the financial statements are not attached. This may trigger late filing penalties if submission is delayed beyond the prescribed statutory deadline.

#### **IFRIC 12 and the Zakat treatment of long-term infrastructure operations**

Based on International Financial Reporting Standards and Saudi GAAP operators of facilities under so called BOT ("build, operate and transfer") or ROT ("rehabilitate, operate and transfer") contracts, are required to report their

## Double tax treaty updates

### General remarks

Saudi Arabia is currently very successful in expanding its treaty network. Since the last issue of the Middle East Tax Update in December 2010 the country concluded three new treaties (details below) and commenced negotiations for at least one new treaty. Since then, five treaties have entered into force, effective as of 1 January 2011:

- Belarus
- Greece
- Netherlands
- Russia
- Syria

#### • *Saudi Arabia – Netherlands double tax treaty*

For tax planning purposes, the Dutch treaty is perhaps of most interest, since this is the only treaty with Saudi Arabia which grants an exemption from Saudi tax on gains from the disposal of substantial shareholdings.

#### • *Saudi Arabia – Romania double tax treaty and Saudi Arabia – Bangladesh double tax treaty*

Two new income tax treaties have recently been signed with these countries.

#### • *Saudi Arabia – Poland double tax treaty*

The two countries signed an income tax treaty in Riyadh on 22 February 2011. Under the treaty, dividends and interest may be taxed in the source country at a maximum of five percent, and royalties may be taxed at a maximum of 10 percent. Both countries generally use the credit method for elimination of double taxation.

The treaty will enter into force one month after the countries exchange ratification instruments, and its provisions generally will apply from 1 January of the year following its entry into force.

#### • *Saudi Arabia – Vietnam double tax treaty*

The tax treaty with the Socialist Republic of Vietnam will enter into force on 1 January 2012.

Under the treaty, dividends are subject to a five percent (which is also the Saudi Arabian domestic rate) withholding tax rate if the beneficial owner is a company that directly holds at least 50 percent of the dividend payer's capital or has invested at least \$20 million, or its equivalent in any currency, in the dividend payer's capital. A 12.5 percent rate applies in

other cases. Interest is subject to a 10 percent (The Saudi Arabian domestic rate is five percent) withholding tax rate.

Royalties paid for technical or managerial services and assistance are taxable at a maximum rate of 7.5 percent, and a 10 percent rate applies in other cases. Both countries use the credit method to eliminate double taxation.

#### • *Saudi Arabia – Singapore double tax treaty*

Saudi Arabia's Cabinet on 4 April 2011 approved the income tax treaty between Saudi Arabia and Singapore, signed 3 May 2010, in Riyadh.

Under the treaty, dividends and interest are taxable at a maximum rate of five percent, and royalties are taxable at a maximum rate of eight percent. Both countries generally use the credit method for the elimination of double taxation.

This is the first treaty between the two countries. It will enter into force 1 June 2011 and will generally apply from 1 January 2012 in Saudi Arabia and from 1 January 2013 in Singapore.

#### • *Saudi Arabia – Tajikistan double tax treaty*

Tajikistan announced that it plans to negotiate a tax treaty with Saudi Arabia in the near future.

## Legal Update

### *New Registration Requirements for Engineers*

Pursuant to a directive issued by Second Deputy Premier and Minister of Interior Prince Naif, foreign engineers wishing to work in Saudi Arabia must be registered with the Saudi Council of Engineers for the issuing and renewal of their resident permits.

The Saudi construction industry, including Saudi Aramco, the Royal Commission for Jubail and Yanbu, the Saline Water Conversion Corporation and King Abdulaziz City of Science and Technology have welcomed the new registration requirements as an effort for the improvement of engineering standards in the Kingdom.



# Regional Tax and Legal Update

## Kuwait

### Significant developments

The Tax Authority in Kuwait has recently issued updated Executive Rules and Regulations for implementation of Law No. 2 of 2008.

The Department of Inspection and Tax Claims (DIT) in Kuwait intends, by issuing these rules, to update some of the existing Executive rules previously issued following the publication of Law No. 2 of 2008. The rules also determine/regulate the tax treatment for fund investment, trading on the Kuwait Stock Exchange (KSE), and dividend distributions for foreign investors operating in Kuwait.

Key areas of the new Executive Rules elaborate on and set out tax treatment for the following:

- Design and consultancy costs
- Reimbursable costs
- Foreign currency exchange gains and losses
- Disposal of foreign entity shares
- Dividend distributions for fund investments traded on the KSE.

These key changes are summarised below.

#### **Design and consultancy costs**

Executive Rule No. 25 of 2010 was issued to update Executive Rule No. 22 of 2008 pertaining to design and consultancy services provided outside Kuwait.

The DIT has now determined the allowable profit for consultancy work conducted outside Kuwait. Under this new rule, consultancy and design costs incurred outside Kuwait will be allowed as deductible cost. However the allowable costs will be restricted, depending on the party providing the services.

#### **For design costs incurred outside Kuwait:**

	Work conducted by	Maximum allowed costs as percent of revenue
1.	Head Office	75 - 80
2.	Affiliated Companies	80 - 85
3.	Third Parties	85 - 90

#### **For consultancy costs incurred outside Kuwait:**

	Work conducted by	Maximum allowed costs as percent of revenue
1.	Head Office	70 - 75
2.	Affiliated Companies	75 - 80
3.	Third Parties	80 - 85

#### **Reimbursable costs**

Reimbursable costs claimed by the taxpayer shall now be allowed, provided that the following conditions are met:

- The reimbursable costs must be necessary to perform the operations as per the contract and must be clearly stated in the contract
- Such costs must not exceed 30 percent of the annual revenue
- The reimbursed costs must be supported by adequate supporting documentation

#### **Foreign currency exchange gains and losses**

The new Executive Rules stipulate that only realised gains and losses resulting from the fluctuation of exchange rates shall be allowed as gains or deductible costs provided that the taxpayer is also able to substantiate the basis of the calculations and provide documents in support of such transactions, during tax inspections by the Kuwait Tax Authority.

### Disposal of foreign entity shares

New requirements have recently been introduced for foreign companies disposing of their shares and business in Kuwait. As per Executive Rule No. 49 of 2010, the following are needed to substantiate the result of these transactions:

- Submission of a copy of the selling contract stamped by the Ministry of Justice to the DIT
- A copy of the amended Articles of Association
- Documents in support of the share sale transaction, such as proof of assets acquired and consideration of assets sold. The transaction may also be disclosed in the company's Financial Statements.

### Dividend distributions

New forms and requirements have now been introduced to regulate withholding tax on dividends and the registration process for foreign investors operating through fund investments that involve stocks traded on the KSE.

### Memorandum of Understanding signed between Kuwait and the US for tax exemptions on revenue from aircraft operations

During March 2011, Kuwait and the US signed a Memorandum of Understanding (MoU) for tax exemptions on revenue of aircraft operations. The Kuwait Ministry of Finance issued a

public statement that the aim of the MoU was to support the operations and activities of airlines and boost overall air transport, as well as reducing tax paid in both countries.

Further details regarding the above MoU are not yet available.

### Treaty updates

No new income tax treaties have been signed during the first half of 2011.

However, new bilateral Agreements on Encouragement and Reciprocal Protection of Investment have recently signed with the State of Kuwait. However, further details of these Agreements are not yet available:

Country	Date of signing	Type of Agreement	Status of treaty
Nigeria	23 March 2011	Bilateral Agreement on Encouragement and Reciprocal Protection of Investment	Signed
Pakistan	14 February 2011	Bilateral Agreement on Encouragement and Reciprocal Protection of Investment	Signed

## Oman

### Double tax treaty updates

#### • Oman – UK double tax treaty

The protocol to the agreement, signed in London on 26 November 2009, is now in force. The instruments of ratification were exchanged by the two countries earlier this year.

The protocol updates the tax treaty by eliminating the withholding tax on dividends (previously a maximum of 10 percent), with a carve-out of 15 percent for UK REITs (Real Estate Investment Trusts), and by providing for a withholding tax rate of 8 percent on royalties. It also includes an 'assistance in collection' article which reflects the modern OECD approach and the UK's commitment on mutual administrative assistance in tax matters.

The provisions on withholding taxes will be effective from 1 January 2012.

#### • OECD Model Tax Convention

On July 2010, the Commentary to Article 12 of the OECD Model Tax Convention on Income and on Capital (OECD Model) was amended to clarify the interpretation of the phrase 'for the use of, or right to use, industrial, commercial and scientific (ICS) equipment' included in the definition of the term 'royalties'.

According to the OECD Commentary, the phrase should not be interpreted as including payments for telecommunication services where the use of ICS equipment is merely incidental (e.g. payments under transponder leasing agreements, contracts granting indefeasible rights of use and roaming contracts).

Although the definitions of the term 'royalties' under the Oman tax law, and tax treaties, and the OECD Model are similar in all relevant aspects, the Oman tax authorities do not follow the OECD interpretation on royalties. In practice, payments made to foreign providers of telecommunications services may be subject to a 10 percent withholding tax where there is an incidental use of ICS equipment.

## Lebanon

### Tax treatment of profits of an entity declared bankrupt

To provide clearer information on the tax treatment of profits of an entity declared bankrupt, Instruction No. 4065, dated 23 December 2010, stipulates that profits determined upon performing a tax audit on an entity (SAL or SARL) declared bankrupt are not deemed distributed and are therefore not subject to Chapter 3 tax (tax on distributed profits).

#### Accounting system that may be adopted by institutions exempt from income tax

Institutions exempt from income tax (other than companies) may adopt either the cash or accruals basis of accounting.

Tax declaration deadlines remain the same as other taxable companies, except for the annual returns, which must be filed according to the following deadlines:

- Before 1 February for institutions adopting the cash basis of accounting
- Before 1 April for institutions adopting the accrual basis of accounting and for representative offices that represent non-corporate entities
- Before 1 June for representative offices that represent corporations.

#### Family allowance benefits

Individuals subject to both Chapter 1 and Chapter 2 taxes benefit from the family allowance only when calculating their Chapter 1 tax.

However, individuals subject to Chapter 2 tax (tax on salaries) who have a professional or business activity TIN (tax identification number), may benefit from the family allowance upon calculation of Chapter 2 tax on salaries, only when:

- The registered profession or business is not active, or
- They are partners in a dormant partnership.

#### MoF R7 “List of terminated employees form”

R7 is a form newly introduced by the Ministry of Finance (MoF) that should be presented by the employer with the R5 (yearly tax declaration form) and R6 (individual tax declaration form) before 28 February each year, to cover the previous year.

The R7 should include the name of the employer, the fiscal year, the employer’s tax identification number (TIN), the employer’s social security number and the full list of all employees with both start and end of contract dates, along with their personal TIN and social security numbers.

R7 forms apply retroactively to the year 2010 and hence all employers should extract a listing of all employees registered in their company from the MoF and submit R7 forms for all terminated employees (whether terminated in 2010 or in previous years) still listed under their company’s name.

#### Jobs restricted to Lebanese individuals

This decision replaces Decision No.94/1 dated 24 May 2008 and lists the professions and jobs that should be held by Lebanese nationals only.

By exception, the following non-Lebanese individuals may practice these restricted activities:

- Palestinian individuals born in Lebanon and registered at the Ministry of Interior

- Foreign individuals that fall under one of the cases below, on condition that the individual’s home country allows Lebanese individuals to exercise the same activity that the foreign individual will be practicing in Lebanon:
  - The foreign individual, based on a statement from the national employment organisation, is a specialist whose occupation cannot be filled by a Lebanese individual
  - The foreign individual is the manager or representative of a foreign company registered in Lebanon, or is the manager of an offshore company
  - The foreign individual has been resident in Lebanon since birth
  - The foreign individual is of Lebanese origin or their mother is Lebanese
  - The foreign individual (man) has been married to a Lebanese woman for more than one year.

(NB: where a foreign woman marries a Lebanese man, she becomes Lebanese immediately).

This decision aims at reducing the burden on employers and tackles the growing demands of the labour market.

# Qatar

## *Final executive regulations for Qatar tax law*

The final executive regulations for the Qatar tax law (Law No. 21 of 2009) were published by the Ministry of Economy and Finance on 9 June 2011. The tax law has been effective since 1 January 2010 and the executive regulations provide greater clarity on the intention of the provisions in the law and how they will be interpreted by the Public Revenue and Taxes Department, although in some areas uncertainties persist.

With regard to withholding tax (“WHT”), the executive regulations have provided further details on what payments are defined as royalties and technical fees, and have confirmed that no WHT is due on interest in most circumstances. In respect of the general anti-tax avoidance provision that was introduced in the tax law, the executive regulations have clarified how an “arm’s length value” (i.e. the market value) will be computed and have introduced a wide definition of “related party transactions”.

Following the issuance of the bye laws, we are continuing our dialogue with the Qatar tax authorities on issues which taxpayers require further clarity. We will update you if there is any progress in the future.

## *Circular on retention policy*

The Ministry of Economy and Finance issued Circular No. 2/2011 on 12 June 2011. This circular replaces the existing “retention rules.” It specifies that in the case of registered branches with an activity restricted to a fixed period, contract or project of at least one year, retention should be made on the higher of the final payment or 3% of the value of the contract (after excluding the value of supplies and work performed outside Qatar). In the cases of resident taxpayers and permanent branches (whose activities are not associated with a fixed period, contract or project), the final payment should be made when the taxpayer or branch submits a valid tax card. Payments to taxpayers that do not have a commercial registration, or that are registered for an activity, contract or project of less than one year, will be subject to WHT. In regard to payments to taxpayers registered in the Qatar Financial Centre (“QFC”), contractual payments should be made once the taxpayer submits a certificate issued by the QFC confirming that the taxpayer is registered there.

## **Double tax treaty updates**

### • **Qatar – Slovenia double tax treaty**

The double tax treaty between Qatar and Slovenia came into force on 1 December 2010 and is effective from 1 January 2011.

The treaty provides a definition of ‘permanent establishment’ (PE), which is broadly in line with the OECD model tax convention. The definition states, amongst other things, that a building site and assembly project would only be considered a PE where the activities or projects continue for a period or periods of more than six months within any twelve month period. A PE is also deemed to exist where an entity furnishes services through employees or other personnel and these services are provided for a period or periods aggregating more than six months in any twelve month period.

The treaty restricts the WHT on dividends, interest and royalties paid to non-residents to five percent. Given that the highest rate of Qatar WHT is currently 7%, the treaty does not significantly further lower the WHT rate. The domestic Slovenian WHT rate applicable to interest and royalties is 15 percent.

### • **Qatar – Greece double tax treaty**

The double tax treaty between Qatar and Greece came into force on 21 March 2010 and its provisions are effective from 1 January 2011.

The treaty provides an exemption in respect of WHT on interest for certain entities, including financial institutions fully owned or financed by the Government as agreed from time to time by the respective Competent Authorities.

### • **Qatar – Monaco double tax treaty**

The double tax treaty between Qatar and Monaco came into force on 15 June 2010 and is generally effective from 1 January 2011.

The provisions of the treaty are broadly similar to that negotiated with Slovenia and Greece above. The treaty restricts WHT on dividends and interest to zero, and royalties to five percent.

## **Other Treaties**

A number of other treaties have been ratified. These include treaties with Algeria, Austria, Georgia, Panama and Sudan.

## **Legal Update**

### **Qatar becomes Party to the Patent Contracting Treaty (“PCT”)**

Qatar became the 143rd PCT State on 3 May 2011. The PCT will enter into force on 3 August 2011. The PCT makes it possible to seek patent protection for an invention simultaneously in a number of countries by filing an “international” patent application. Such an application may be filed by anyone who is a national or resident of a PCT State.

The PCT sets out detailed requirements with which any international application must comply.

## Syria

### *Syria regulates operations of reinsurance brokers*

The Ministry of Finance has issued Decision 385/2010 allowing the licensing of reinsurance brokerage companies in Syria with no restriction on foreign ownership. Moreover, foreign reinsurance brokerage houses are able to set up a branch in Syria or directly register with the Syrian Supervisory Commission (SISC) with no need for a physical presence in Syria.

The minimum capital requirement has been set at USD one million for branches of foreign entities and SYP 50 million for Syrian companies. Capital structure requirements are in line with those of insurance companies, with a maximum of 40 percent stake for moral persons and five percent stake for physical persons.

The decision by the Ministry of Finance also stipulates that starting 1 January 2012, insurance companies operating in Syria will not be allowed to deal with any reinsurance broker that is not registered with the SISC.

#### *Foreign ownership of real estate*

The Syrian Government has recently approved a draft law that will allow non-Syrians to purchase property without a minimum threshold (previously set at 200 sqm by law No. 11 of 2008). It also allows foreign ownership through inheritance, which was not allowed previously.

#### *New company law brings improvements to business sector and opens door for privatisation*

Several reforms and measures have been put in place by the Syrian Government in response to increased demand for liberalisation and modernisation to affect businesses by the private sector.

Law No. 13 of 2011, enacted on 19 January 2001, extends the facilities provided by Law No. 61 of 2007 for one more year, until 31 December 2011, and also grants additional facilities to companies.

The government's aim is to modernise the legal structure of companies and to allow for a revaluation of assets to their actual worth, instead of their book value, with the possibility of optimising taxation through minimal rates of one or two percent instead of rates between 14 and 28 percent. These laws also allow for further exemption of taxation and/or fees normally applied to revaluations of companies.

The new bill also provides additional benefits. For example, real estate properties previously not registered under the name of the company can now be registered in the company's books as assets within the revaluation process, without bearing any historical tax consequences; a 50 percent discount on stamp fees applied to all companies' assets instead of being applied only on the differential in the value of the assets; stamp duties on life insurance policy premiums, savings and health insurance premiums, are reduced from three percent to one percent.

In addition to the above, Syria has approved Law No. 29 of 2011 regulating the establishment and operations of companies, less than three years after a similar bill was passed. When the previous text was passed in 2008, it replaced a 59-year old bill - the Commerce Law of 1949. The new bill brings a number of additions and improvements to the rules regulating the establishment of companies in Syria, including:

- The establishment of one-person limited liabilities

- The transformation of state-owned entities into companies
- The establishment of holding firms as limited liabilities
- The establishment of non-public (private) shareholding companies.

The previous regulation restricted shareholding companies to either limited liability or publicly traded joint-stock companies.

#### *Joint Stock Companies*

Law No. 29 of 2011 now allows for both public and private Joint Stock Companies. Private JSCs enjoy a lower threshold of five shareholders compared to 25 for public JSCs making it more accessible to new business ventures. The founding shareholders of a public JSC can now own up to 75 percent (and at least 10 percent) of the participations of the company, instead of a more conservative 45 percent previously allowed by Law No. 3 of 2008. An individual cannot subscribe for more than 10 percent of the shares of a public JSC's capital and the founders must insure at least 40 percent of the value of their shares before public issuance of the remaining shares.

The minimum face value of shares to be sold by JSCs has been lowered from SYP 500 to SYP 100 to encourage investment by a larger portion of the population.

In addition, state owned entities can now opt to become public JSCs, post-approval from the Prime Minister, and as long as these entities abide by the Company Law.

### **Limited Liability Companies**

LLCs should have a minimum capital of SYP one million, as is currently the case, while partnerships should have a minimum capital of SYP 300,000. An LLC should have at least two shareholders (who need not be Syrian) or one shareholder in certain special situations. In order to ease the burden of establishing a new LLC, the Syrian authority has decentralised the set-up process and allocated more power to regional offices of the Syrian Investment Agency, the Industrial Cities located across the country and the Domestic Trade Directorate of the Government.

### **Holding Companies**

Holding companies are now able to assume the form of a limited liability company, whereas previously they were constrained to a JSC form.

### **The Syrian Central bank's race towards monetary policy liberalisation**

#### **Reserve requirements reduced to encourage lending to SMEs**

The Central Bank of Syria has reduced the compulsory reserve requirements for local banks in order to stimulate lending to SMEs and companies from the manufacturing and tourism sectors.

Further incentives have been granted; such as a complete exemption from legal reserves for any bank that provides more than 45 percent of their lending portfolio to SMEs.

#### **Sale of foreign currencies to local residents regulated**

The Central Bank also amended its decision taken on November 2010 and increased the maximum amount of foreign currencies sold to residents by local banks to USD 120,000 from USD 10,000, with no requirement for residents to explain the need for such amounts. The change is an effort to liberalise one of the most rigid foreign exchange systems in the world.

These measures also aim to reduce uncontrolled trading of currencies in the black market and avoid massive withdrawal of Syrian Pound deposits.

Additionally, Law No. 25 of 2011 states that local suppliers of Government-owned companies may be paid in a foreign

currency for the supply of imported goods and equipment.

#### **Rates raised, compulsory requirements reduced**

The Central Bank of Syria announced a two percent average increase in interest rates to strengthen the national currency after the Syrian Pound lost as much as 15 percent of its value compared to the US dollar in black market transactions.

#### **Presidential decrees reduce taxes and fees on food items as well as on long term investment tools**

According to the Central Bank of Syria, food price inflation reached 11 percent as of end of 2010, mainly due to several natural disasters which occurred in the past year – affecting agro-business output and disrupting supply chains worldwide.

Decree No. 70 of 2011 reduced, to between two and 10 percent, the customs tariffs imposed on agricultural commodities such as tea, rice, bananas, powder milk and roasted coffee. All these products are imported in high quantities due to the lack of domestic supply.

Along the same lines, Law No. 23 of 2011, approved by the President, reduced consumption tax on certain essential agricultural commodities and reduced to 10 percent the tax rate applied on commercial rent income. These measures are an attempt to decrease the under-reporting of real estate value by landlords. The Law also exempts income generated from government backed securities in order to increase their sales, which are targeted at SYP 30 billion this year. A fee reduction from two percent to one percent on import documentation was also enacted by the same law.

Another text approved on the same day, Law 24/2011, reduced taxes and fees levied on insurance for debt collateral and mortgages to 0.25 percent.

#### **Syria shelves VAT plans until 'appropriate time and conditions'**

Syrian Finance Minister, Mohammad Hussein, stated in early March 2011 that his country was still not ready for a VAT inception, which should have taken place at the end of 2011. He reiterated that Syria

should wait for “the appropriate conditions and time”, without clarifying what would constitute appropriate conditions and when he expected the time to be appropriate.

The lack of an invoicing culture in Syria caused by the mistrust felt by Syrian residents towards the country's fiscal authority led to the creation of a cash based economy, fostering high levels of fraud and tax evasion. Also, Mr Hussein feels that the final consumers (the ultimate bearers of the tax), are still not ready to withstand the potential price hikes caused by its implementation.

VAT is meant to simplify the tax system and replace 12 various taxes and fees currently applied.

#### **Syrian companies banned from recruiting foreign nationals without working permits**

Government owned newspaper, Tishreen, stated that the Syrian Government has issued a decision banning all state and private sector companies to work with any foreign national without them having proper work and residence permits. This decision does not appear in any official government source however.

Syrian media refers to ‘foreigners’ as anyone who is not from Arab dissent and that Arab nationals are referred to as Arabs and not foreigners. The latter are supposed to comply with permit regulations but the procedure is often bypassed. Moreover, the size of the ‘unofficial’ economy is a clear reflection of the number of foreigners working without proper contracts or Social Security registration.

### **Double tax treaty updates**

- Syria – Germany double tax treaty  
The treaty was signed on 17 February 2010 and is effective from 1 January 2011.
- Syria – Slovak Republic double tax treaty  
This treaty was signed on 18 February 2009 and is now effective – as of 1 January 2011.
- Syria – China double tax treaty  
This treaty was signed on 31 October 2010 but is still pending and has not yet entered into force as expected.

## UAE

### Treaty updates

- **UAE – Bangladesh double tax treaty**

The two countries signed a treaty in Abu Dhabi on 17 January 2011. The treaty will enter into force after each country has completed and notified the other of the completion of its ratification procedures and its provisions. The countries also signed an Agreement to promote and protect cross-border investment on the same day. Further details of the tax treaty and the Agreement are not yet available.

- **UAE – Venezuela and UAE – Georgia double tax treaties**

The United Arab Emirates Cabinet, on 6 February 2011, approved pending income tax treaties with Georgia - originally signed on 25 November 2010, and Venezuela - originally signed on 7 June 2010. Both treaties will enter into force after each country has notified the other of the completion of its ratification procedures.

- **UAE – Cyprus double tax treaty**

The two countries signed a treaty in Abu Dhabi on 27 February 2011. The treaty will enter into force after each country has completed and notified the other of the completion of its ratification procedures and its provisions. This treaty was earlier initialled on 21 October 2010. Further details of this tax treaty are not yet available.

- **UAE – Estonia double tax treaty**

The treaty was signed in Abu Dhabi on 21 April 2011 and will enter into force after each country has completed and notified the other of the completion of its ratification procedures and its provisions. This treaty was earlier initialled on 14 October 2010. Further details of this tax treaty are not yet available.

- **UAE – Montenegro double tax treaty**

A draft treaty was initialled on 10 May 2011 in negotiations held between 9-11 May. The double tax treaty is expected to be formally signed by the competent authorities of the UAE and Montenegro after the countries receive approvals from their respective governments. Further details of this draft tax treaty are not yet available.

### Customs Update

At the 44th meeting of the GCC Committee for Trade Cooperation and the 33rd meeting for the GCC Committee for Industrial Cooperation on the 18 May, the ministers of trade and economy in the region extended the exemption for national taxes on industrial inputs.

This exemption was originally granted by the GCC Supreme Council in its 22nd Session in December 2001. It provides GCC manufacturing plants an exemption from customs duties on their imports of industrial inputs (such as raw materials, machinery and equipment). This exemption was further cemented in the Implementation Procedures for the GCC Customs Union.

The purpose of the exemption is to encourage national industry in the GCC States, contribute to the growth of national exports, and to attract foreign investment. This in turn will create more employment opportunities for the national workforce.

Although the procedures for taking advantage of this exemption can vary from state to state, in general, the manufacturing plant, holding an industrial licence issued by the competent authority in the member state, must apply for the exemption on the approved form at least two weeks prior to the arrival of the goods. In many cases, an exemption may be granted for specific inputs of the manufacturing plant for a renewable period of one year.



*The purpose of the exemption is to encourage national industry in the GCC States, contribute to the growth of national exports, and to attract foreign investment.*

# Regional Tax and Legal Update

**The regulations provide for new maximum exposure limits, borrowing/ fund raising limits and limits on exposure to specific groups or individuals. The Central Bank will be required to determine penalties for the violations of such regulations.**

## UAE Legal Update

### New UAE Central Bank Regulations

Regulation No.29/2011 was introduced in February 2011 by the UAE Central Bank in relation to Bank Loans and Services offered to Individual customers. These regulations set limits on fees and commissions charged by banks on their customers. The changes introduced are aimed at establishing a control on lending activities and have been welcomed by many as a step forward towards enforcing responsible lending and transparency between the banks and the customers.

### Key Features

#### Personal loans:

- Customers are now enabled to borrow only up to 20 times their salary or monthly income.
- Instalment repayments should not exceed 50% of the borrowers' gross salary or regular income. Maximum period of loan repayment is fixed at 48 months.
- Early settlement of fees / loan buyouts for personal loans are now limited to a maximum of 1% interest against the current practice of 5% by many banks in the UAE

#### Car Loans:

- Car loans are now limited to 80% of the value of the vehicle

#### Credit Cards:

- Credit cards can now only be issued to customers having annual income equal to or exceeding AED 60,000. Credit cards may also be provided against a pledged deposit (not including blank cheques) of AED 60,000 or more.

#### The Regulation applies to:

- Conventional and Islamic banks and financial institutions.
- Retail loans including personal loans, housing and car loans, overdraft facilities, credit card loans, loans made to sole proprietorship firms and firms or companies secured by the salaries of the owners or partners of such firms or companies are covered by these regulations
- New applications for loans and existing loans are covered
- Shari'a compliant banking services are covered (exception being computed interest in accordance with Shari'a principles subject to these details being furnished with the Central Bank for publication).
- Bank transfers and currency exchange activities of money exchange bureaus

The Banking Supervision & Examination Department is expected to issue a guide to clarify how banks and finance institutions should comply with the provisions of

the Regulations and how to submit the required data to the Central Bank.

### New Draft concerning Central Bank regulations for investment and finance companies

In December 2010, the Central Bank of the UAE released draft regulations addressed to investment companies and finance companies.

Scope of the draft regulations is to reduce the financial exposure of investment and conventional finance companies, by introducing corporate governance rules and anti-money laundering and anti-terrorism regulations. The Central Bank will exercise greater control over investment and finance companies.

The regulations provide for new maximum exposure limits, borrowing/ fund raising limits and limits on exposure to specific groups or individuals. The Central Bank will be required to determine penalties for the violations of such regulations.



### **The New Commercial Agency Committee**

The UAE Cabinet Resolution No 3 of 2011, issued to complement the existing commercial agency laws, establishes a new supervising entity, the Commercial Agency Committee.

Pursuant to the resolution, the Commercial Committee will have the authority to

- receive applications for settling agency disputes and responsible for the process of cancelling registered agencies
- to abstain from settling a dispute referred to it when it deems that litigation would be more appropriate
- to seek the assistance of any expert or “appropriate person” for performing its duties.

The Resolution regulates the formation of the Commercial Agency Committee (meetings of the Committee and the procedures for the submission of applications for settling disputes and cancelling registered agencies.



Decisions issued by the Committee may be challenged by the parties before UAE courts within thirty (30) days of the date of receiving notice of the Committee’s resolution.

The Resolution sets a fee of AED 6,000 before an application shall be recorded. Once recorded, the Committee shall schedule a date for examining the dispute within sixty (60) days.

### **Personal Credit Information Protection Law**

Federal Law 6 of 2010, pertaining to personal credit information protection in the United Arab Emirates, regulates the request, collection, preservation, analysis, classification, use, handling and protection of credit information and anything related to that information.

At high level, the Law prohibits the collection and circulation of information and data relating directly or indirectly, to details concerning the life of a natural person, his views, his beliefs or his state of health. The Law stipulates that its provisions apply to the company collecting the data, the information provider, the recipient of the report and anyone who has to do with credit information as determined by the executive regulations of the Law.

### **A New Legal Framework for Private Sector Participation in Power and Water Projects**

#### **Dubai**

Law No. 6 of 2011, for “private sector participation in the production of electricity and water” was designed to create a template for private sector participation in utilities generally in Dubai. The law further delineates the legal framework for IPPs in the UAE, which to-date was only regulated by the Abu Dhabi detailed legislation providing for the granting of concessions to the private sector in relation to power and water generation.

Law No. 6 of 2011 provides the basic structure for a regulatory framework for participation of the private sector in the power and water sector in Dubai at an equity level and is considered by many as an important step forward for the development of the utilities sector in Dubai.

Key features are:

- Power and/or water production in Dubai is permitted to only provided a licence by the Regulation and Supervision Bureau for the water and electricity sector is granted. The only entity exempt from the licensing requirement is the Dubai Water and Electricity Authority (DEWA).
- The Bureau has the duty to establishing standards and controls required for undertaking power and/or water production in Dubai.
- The Supreme Council of Energy will determine the quantity and nature of licences to be granted, and will receive and assess applications for licences.
- The Supervision Bureau has the power to amend any licence granted for reasons related to the public interest.
- DEWA is allowed to establish project companies, either on its own or in cooperation with third parties, not necessarily of UAE nationality.
- All sales of produced electricity or water must be to DEWA.
- All contracts between the licensed party and DEWA must be governed by the laws of Dubai and subject to dispute resolution (including arbitration) in Dubai.

# International Assignment Services (IAS) update

## Home Country Individual Income Tax

Most countries do not continue to tax their citizens once tax residency has been broken. Generally an individual breaks tax residency from their home country by remaining outside the country for a fixed amount of time. If the family remains in the home country or assets (such as a home) are retained in the home country tax residency may not be broken. Every country has different rules regarding tax residency and everyone's facts and circumstances are different. Therefore it is important that an individual fully understand whether they have a continuing individual income tax filing obligation in their home country.

Below is an overview of the United Kingdom and the United States.

### United Kingdom

The UK taxes individuals based on their residency and domicile status. Once an individual is able to break residency in the UK the individual will usually only be taxed on UK source income.

There is a non statutory exemption for individuals who leave the UK to work abroad in full time employment or self-employment which will normally treat them as not resident and not ordinarily resident in the UK from the day after departure provided the following conditions are met:

- The absence from the UK and the full time employment/self-employment abroad must last for at least a whole tax year; and
- During the absence, visits to the UK must be less than 183 days in any tax year and less than 91 days on average (calculated over a period of up to four years).

Days of arrival in and departure from the UK were previously ignored when applying this test, but from 6 April 2008 a day in which a person is present in the UK at midnight will normally count as a day of residence in determining whether the 91 day rule is met.

It is becoming more difficult to break UK residence for tax purposes. The rules described above where an individual not living in the UK for a certain period of time or limiting visits to the UK can no longer be relied upon. HM Revenue & Customs now need to see a definite break from the UK to show that an individual has become non UK resident. As an example, this would include selling or renting out the UK property and not leaving immediate family or business activities back in the UK.

The first challenge is proving that an individual has left the UK in the first place, and that he/she is leaving the UK for a 'settled purpose'. HM Revenue and Customs has not yet defined what they regard as 'working full time overseas', however, ensuring there are no ongoing UK business responsibilities should help in guaranteeing that the individual remains outside of the scope of UK taxation.

Days back in the UK must be managed effectively. Any more than 10 workdays per year spent back in the UK per year may bring back a person into the scope of UK residence for the entire period of leave. More than 90 days per year for any purpose on average back in the UK would also mean you remain resident in the UK.

For the majority of people leaving the UK to work on a full time basis abroad with no work commitments back in the UK, breaking residency from the UK should not be a complicated affair. However, as HMRC continues to examine the residency rules specific advice should be sought before departure from the UK.

**More than 90 days per year for any purpose on average back in the UK would also mean you remain resident in the UK.**

## United States

### Individual Income Tax Return

The United States (US) taxes their citizens on the basis of citizenship rather than residency. US Citizens and Green Card Holders (GCH) are taxed on their worldwide income no matter where they are living and working in the world. Therefore, a US citizen or GCH are required to file an annual individual income tax return with the Internal Revenue Service (IRS) reporting the income earned during the year and to claim certain deductions and exclusions which they may be entitled to claim. Many individuals mistakenly believe that they are not required to file an annual tax return if they work outside the US.

The IRS considers not just base salary but also any foreign allowances such as housing, dependent education, home leave airfare, overseas premium or cost of living, etc., to be taxable compensation. Even if the company pays an expense directly to a third party for the benefit of the employee, such as dependent education, the IRS would consider the amount paid to be additional compensation.

Other forms of income, whether earned from US or foreign sources are also required to be reported on the annual tax return. These other forms of income include interest or dividend income, rental income, retirement income, income from partnerships or personal businesses, etc.

There are exclusions available which can decrease the tax liability but certain requirements need to be fulfilled in order to claim the exclusions. If married, both spouses may be eligible to claim the foreign exclusions. The IRS may disallow these foreign exclusions if a proper election is not made on a timely filed return. An individual has an obligation to file an annual US tax return even if they earn less than the foreign earned income exclusion for the year.

State tax filing obligations vary from state to state. Individuals may still be required to file a state tax return even while

residing overseas. Whether an individual is required to continue to file a state return is determined by their specific facts and circumstances. Additionally, not all states allow the federal foreign earned income exclusion which means 100 percent of the income earned outside the US may be liable to state taxation.

#### *New for 2011*

In late December 2010 Congress extended a number of tax cuts that had been set to expire. The top tax rate will remain at 35 percent increasing in 2013 to 39.6 percent. The maximum 15 percent long-term capital gains rate and qualified dividend tax rate will also continue until the end of 2012. Additionally, the child tax credit remains at \$1,000 per child, and the American Opportunity Credit for certain higher education expenses has been extended through 2012.

The personal exemption and standard deduction amounts increased slightly in 2011. The reduction in personal exemptions and itemised deductions has been eliminated again for 2011, regardless of income level. Beginning in 2010, a qualified IRA rollover contribution to a Roth IRA is allowed, regardless of modified adjusted gross income.

Social Security withholding has been reduced by 2 percent for 2011. The employees' portion of Social Security taxes will be reduced to 4.2 percent from 6.2 percent (a potential savings of \$2,136). The employer portion remains unchanged at 6.2 percent.

Gain on the sale of a main home or primary residence is no longer excludable if allocable to periods of non-qualified use, specifically when neither you nor your spouse/former spouse used it as a main home.

#### *Foreign Bank Account Reporting*

In addition to federal and state filing requirements, foreign bank and securities accounts may have to be reported to the US Treasury Department depending upon the aggregate value of the accounts during the year. There are no extensions to filing this report and the penalties for non filing range from \$10,000 to criminal penalties.

This requirement also applies to individuals who have signatory authority over a foreign bank account such as an officer in a company that has signatory authority over a company bank account.

This report is due by 30 June each year.



## **OECD releases new discussion draft on the meaning of ‘beneficial owner’**

*On 29 April, the OECD released a discussion draft which sets out proposed changes to the Commentary on Articles 10, 11 and 12 of the OECD Model Tax Convention concerning the meaning of the term ‘beneficial owner’.*

### **Background**

There has been a significant rise in controversy around the world, in recent years, as businesses struggle to interpret what is meant by ‘beneficial ownership’, in relation to treaties. So, for the last couple of years, the OECD has been carrying out some work to help clarify the concept. The main issue has been the lack of any clear – let alone common – understanding of what constitutes beneficial ownership. There is also a distinct lack of clarity around whether, and to what extent, the concept can be used by tax authorities as a general anti-avoidance tool.

Another important issue is around whether it is right to apply a state’s domestic law in interpreting the term or whether it should be given a more general treaty-based meaning. This is, essentially, a debate over the interpretation of Article 3(2) of the OECD model, which indicates that where a term is not defined in the OECD treaty, unless the context requires otherwise, it should take on the meaning that it has under the domestic law of the state applying the treaty. The key question here has been around whether the words “unless the context otherwise requires” are intended to require a treaty-based interpretation of the term.

### *The OECD discussion draft*

The ten-page discussion draft on the meaning of the term 'beneficial owner' was released by the OECD on 29 April 2011. Proposed new text has been inserted into the Commentaries on Articles 10, 11 and 12. This new wording aims to give further guidance around interpretation, to address the difficulties experienced to date. The key points in the revised text are as follows:

1. The wording clarifies that the term 'beneficial owner' is intended to address potential difficulties arising from the use of the words in the relevant Article, "paid to... a resident", and should be understood in that on-text. This clearly suggests the need for a treaty-based approach, although it is recognised that domestic law may be applicable if consistent with the general guidance in the Commentary. The text also highlights that domestic interpretation, based on a narrow technical meaning of the term, is not appropriate.
2. The existing wording on conduit entities not generally being 'beneficial owners' where they have very narrow powers in relation to the income concerned is retained.
3. In the new text, an attempt has been made to clarify why agents, nominees and companies acting in a similar capacity are not beneficial owners. It states that the recipient in such cases does not have the "full right to use and enjoy the dividend" (i.e. the powers of the recipient are constrained, as the recipient is obliged to pass the payment on to another person). The text goes on to state that the beneficial owner, on the other hand, has the "full right to use and enjoy" the income unconstrained by any contractual or legal obligation to 'pass on the payment' to another person. It also states that it is normally possible to tell if there is any obligation to 'pass on payment' from the relevant legal documentation. However, "facts and circumstances" may also be relevant in showing that, in substance, the recipient clearly does not have the full right to use and enjoy the income. It is also emphasised that the relevant test relates to the income itself, and not the underlying asset from which it is derived.
4. The text certainly clarifies that, being the beneficial owner of the income concerned does not guarantee a reduced treaty rate given the existence of other ways in the treaty of addressing treaty shopping. It is noted that the 'beneficial ownership' test addresses one type of situation – i.e. where a recipient is interposed and obliged to pass on the income collected to someone else – but it does not deal with other types of treaty abuse.

### *PwC's perspective*

The discussion draft is helpful in moving towards a common approach to the interpretation of term, based on its treaty context, and also in giving further clarification of what the term actually means. However, we don't believe that the new wording, as it stands, will remove, or materially reduce, disputes in this area. In particular, the test of having "the full right to use and enjoy the income unconstrained by a contractual or legal obligation to pass the payment received to another person" is likely to prove difficult to interpret in practice – especially given the wording in the draft OECD text that states that this may be determined based on the "substance" of the relevant facts and circumstances.

There are certain situations in which this test would prove particularly problematic. For example, in financing vehicles, where interest on a loan may be derived but may be used wholly or partly to defray the financing costs of the vehicle concerned. Does the recipient financing the vehicle forfeit its beneficial ownership of the interest received because some or all of the interest collected is on-paid in meeting obligations under a separate financing arrangement? Similarly, the problem of income equivalents is not dealt with at all in the text, and this will cause particular issues in the financial sector (where the beneficial ownership test is already complicated). For example, if an asset is hedged so that income arising on securities wholly or partly funds amounts paid away under a derivative, does this mean the beneficial ownership of the income on the asset is forfeit by this test?

In both these examples, the ownership of the actual income concerned is retained by the recipient. However, the suggestion in the discussion draft that it is possible to look at the 'substance' of the facts and circumstances, may encourage some tax authorities to take a blanket (and presumably non-OECD compliant) approach based on ultimate economic ownership. These are hugely important questions and it would be helpful if, in finalising the draft text, some further wording or examples were included to clarify the boundaries of the beneficial ownership concept.

## China

### Equity transfers by non-tax resident enterprises

Since the China corporate income tax law (“CIT Law”) came into effect on 1 January 2008, the State Administration of Taxation (“SAT”) has released many tax circulars addressing the enforcement and administration of CIT in relation to income derived from China by non-tax resident enterprises (Non-TREs”).

On 29 March 2011, the SAT released another circular, Public Notice [2011] No.24 entitled “the Public Notice issued by the SAT regarding the administration of certain CIT issues relating to non-TREs” (hereafter referred to as “PN 24”). The PN aimed to clarify the taxation of certain income (mainly passive income) derived from China by non-TREs, such as, the timing of the withholding obligation on passive income, the treatments of rental income, etc. It also clarifies a few unclear issues in circular Guoshuihan [2009] No.698 (“Circular 698”), which addresses various tax issues on equity transfers by non-TREs.

#### Timing for recognising equity transfer gains under instalment payment

In the situation where a Non-TRE directly transfers the equity of Chinese TREs and derives income by instalment from the transferee, the income of the Non-TRE transferor should be recognized at the time the equity transfer agreement takes effect and the relevant procedures for the change in equity ownership are completed.

#### Circular 698

Circular 698 deals with “indirect offshore share disposals” undertaken by investors. Such disposals may be required to be disclosed to the PRC in-charge tax authorities and may potentially be subject to PRC taxation where they are considered to be motivated by tax-avoidance purposes.

The main operating articles of Circular 698 are twofold: firstly, investors are required to disclose reportable transactions to PRC tax authorities where the offshore investor undertakes an indirect shares disposal of offshore investment holding companies that ultimately hold PRC-resident enterprise(s) (“Offshore

Disposal”); secondly where such Offshore Disposal triggers the application of the General Anti-Avoidance Rules (GAAR) the transaction would be subject to tax authorities’ adjustment and be treated as a taxable disposal of the underlying PRC company directly.

For investors who currently have an offshore holding company structure for China would be well advised to assess the potential application of Circular 698 with respect to (i) confirming whether reporting and tax compliance obligations would likely arise; and (ii) ensuring that any required disclosures to the PRC tax authorities appropriately addresses and minimises any GAAR risks from crystallising.

#### Exclusion to Circular 698

Article 1 of Circular 698 states that the circular shall apply to the equity transfer gains derived by Non-TREs from transferring the equity of Chinese TREs, with an exclusion for the gains derived from the buying and selling of shares of Chinese TREs effected through public stock exchanges (the “Exclusion”).

According to PN 24, the term “buying and selling of shares of Chinese TREs effected through public stock exchanges” should only refer to those transactions whereby the following three elements are not pre-determined up front between the buyer and the seller; but are determined in accordance with the ordinary trading rules of the public stock exchanges instead:

1. Parties to the buying and selling transaction
2. The quantity of the shares being transferred
3. The transaction price.

Diagram 1

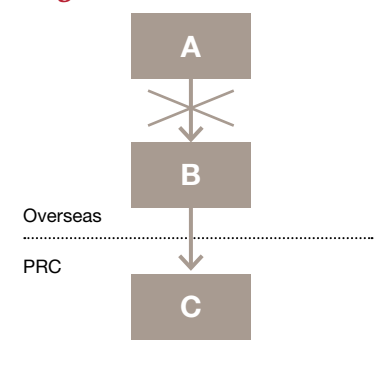


Diagram 2

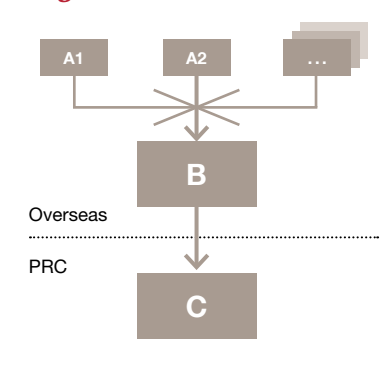
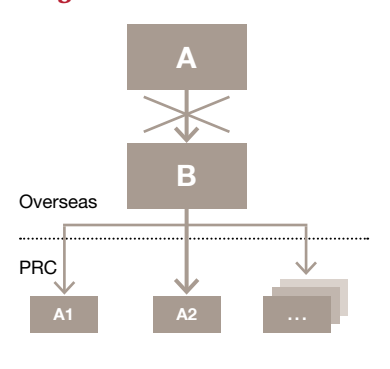


Diagram 3



**Since the release of Circular 698 in late 2009, some Non-TRE transferors that are minority shareholders in Company B had been arguing that they should not be subject to the reporting obligation because they were not the “effective controlling party” in terms of the percentage of shareholding stake.**

#### **Clarifications for indirect equity transfer in particular**

Fact patterns for indirect equity transfers are depicted in the opposite diagrams so as to illustrate what PN 24 is trying to clarify. In Diagram 1 for example, Company A disposes of its equity in Company B, an intermediate holding company holding the equity of Chinese Company C (a Chinese TRE).

#### **Scope of “Non-TRE transferor (effective controlling party)”**

PN 24 clarifies that the term “Non-TRE transferor (effective controlling party)” (i.e. Company A in Diagram 1) refers to all Non-TRE transferors that indirectly transferred the equity in Chinese Company C.

#### **Tax profiles of the jurisdiction where Company B is a tax resident (Diagram 1)**

According to Article 5 of Circular 698, the Non-TRE transferor A shall report the indirect equity transfer to the local-level tax bureau in charge of Chinese Company C if Company B is located in a foreign tax jurisdiction:

1. With an effective tax rate of less than 12.5 percent
2. That does not tax foreign income of its TRE.

PN 24 now clarifies that both profiles should refer to the tax on equity transfer income in that jurisdiction. In other words:

1. An effective tax rate of less than 12.5 percent on equity transfer income; or
2. No taxation of foreign equity transfer income.

#### **Procedural matters for reporting of indirect equity transfer**

In Diagram 2, where two or more Non-TRE transferors (i.e. A1 and A2) indirectly transferred the equity of Chinese Company C at the same time, either one of them can report the indirect transfer to the local-level tax bureau in charge of Company C.

In Diagram 3, where a Non-TRE transferor (A) indirectly transferred the equity of two or more Chinese companies (i.e. C1 and C2) that are located in different provinces (municipalities) at the same time:

1. Company A may choose to report the indirect transfer to the local-level tax bureau in charge of either Company C1 or C2
2. The in-charge tax bureau should coordinate with other in-charge tax bureaus to determine whether to impose Chinese CIT (in the form of withholding income tax) on the indirect equity transfer and report to the SAT
3. If it is confirmed that CIT should be imposed on the indirect equity transfer, Company A should file and pay CIT to the respective local-level tax bureaus in charge of each of the Chinese companies being transferred.

#### **Effective date**

PN 24 takes effect from 1 April 2011. For tax matters occurred before 1 April 2011 and have not been settled, they shall be dealt with in accordance with PN 24.

#### **PwC Observations**

##### **Exclusion to Circular 698**

The Exclusion clause in Article 1 of Circular 698 is crucial for Non-TREs earning income from disposing shares of listed Chinese TREs through public stock exchanges. PN 24 has obviously narrowed the scope of the Exclusion. It appears that the SAT would just wish to allow the Exclusion for those trading at the public stock exchanges where the reporting obligation and tax collection are difficult to enforce from administrative perspective; whereas for those where the three prescribed elements are pre-determined, the SAT would not regard it as difficult to enforce and thus would still apply Circular 698 on the latter. Non-TRE investors that buy and sell listed Chinese TREs' shares even through public stock exchanges should observe the three elements for the Exclusion newly introduced by PN 24.

# International Tax Update

## *Scope of “effective controlling party” (see Diagram 2)*

Since the release of Circular 698 in late 2009, some Non-TRE transferors that are minority shareholders in Company B had been arguing that they should not be subject to the reporting obligation because they were not the “effective controlling party” in terms of the percentage of shareholding stake. Now PN 24 clarifies that the term “effective controlling party” should include all Non-TRE transferors indirectly transferring the Chinese Company C, regardless of their shareholding in Company B.

## *Tax profiles of the jurisdiction where Company B is a tax resident (see Diagram 1)*

PN 24 clarifies that the tax profiles stipulated in Circular 698 refer to the tax on equity transfer income as opposed to income in general. With that clarification, one of the tax profiles for reporting the indirect transfer to the Chinese tax authorities is that the location of Company B being transferred has an effective tax rate of less than 12.5 percent on equity transfer income. However, such clarification would cause other questions, such as:

Would a jurisdiction satisfy that profile if it does not tax equity transfer gains of capital nature, but it taxes trading gains?

Does a jurisdiction that adopts a “participation exemption” regime meet that profile, bearing in mind that the gain on equity transfer will still be taxable at the statutory rate if the “participation exemption” criteria are not met?

## *Indirect equity transfer of multi-Chinese companies (see Diagram 3)*

Allowing a Non-TRE transferor which has indirectly transferred multi-Chinese companies to choose one location for the C698 reporting should be welcome, as this would substantially reduce the administrative burden of reporting.

However, the selection of a reporting location should still deserve careful consideration.

## *The power to invoke General Anti-avoidance Rules (“GAAR”) on indirect equity transfer (see Diagram 3)*

PN 24 articulates that the Chinese local-level tax bureaus should determine whether to impose Chinese CIT on the indirect equity transfer and report to the SAT. Albeit this articulation, it is important to note that Chinese CIT cannot be imposed until GAAR is invoked to disregard Company B and, according to GAAR, the authority to invoke GAAR only lies with the SAT. In other words, the Chinese local-level tax bureaus are not empowered to impose Chinese CIT on the indirect equity transfer before they get approval from the SAT to invoke GAAR.

## *Effective date*

The articulation of the effective date under PN 24’s clarification in relation to the equity transfer may present another uncertainty to the previous transactions before 1 April 2011. For instance, many Non-TRE investors earning income from disposing shares of listed Chinese TREs through public stock exchanges before 1 April 2011 did not come forward to report to the Chinese tax authorities with the reliance on the Exclusion provided under Article 1 of

Circular 698. So if the three prescribed elements of their transactions were pre-determined up front between the buyer and the seller, would their disposals be regarded as tax matters not having been settled, and hence should be re-opened in accordance with PN 24?

## *The Way forward*

It is good to see the SAT’s efforts in providing clarifications to some of the unclear issues in Circular 698. To a certain degree, this could help both local-level tax bureaus and Non-TRE transferors to implement or comply with Circular 698 respectively. This said, apart from our observations above on the tax profiles, there are still many issues in relation to indirect equity transfer that are left unaddressed in PN 24; just to name a few:

- How to ascertain “substance” and “reasonable commercial purpose”?
- How to calculate the gains derived by the Non-TRE transferor from the indirect equity transfer, or, in other words, how to determine the tax basis of the equity of the Chinese companies being indirectly transferred where the intermediate holding company is disregarded?
- If the intermediate holding company is disregarded, would the Non-TRE transferor be able to claim treaty protection under the double tax agreement between China and the jurisdiction where the Non-TRE transferor is a tax resident?

Non-TRE transferors and relevant parties concerned are highly recommended to assess the merits of each indirect equity transfer from both technical and practical perspectives to mitigate their potential Chinese tax exposures.

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***It is good to see the SAT’s efforts in providing clarifications to some of the unclear issues in Circular 698. To a certain degree, this could help both local-level tax bureaus and Non-TRE transferors to implement or comply with Circular 698 respectively***



## Luxembourg

### *Luxembourg tax authorities issue additional guidance on transfer pricing*

On 8 April 2011, the Luxembourg tax authorities issued an additional Circular (L.I.R. n°164/2bis), clarifying the application of the Circular (L.I.R. n°164/2) issued on 28 January 2011, in respect of Luxembourg entities that are mainly engaged in intra-group financing – i.e. intra-group lending activities financed by borrowings.

The additional Circular clarifies the situation of companies engaged in intragroup financing, and which obtained a confirmation from the authorities before 28 January 2011 regarding the arm's length nature of the pricing of that activity. The additional Circular clarifies that such confirmations will no longer have effect as from 1 January 2012.

Taxpayers that wish to benefit from a new confirmation with respect to their intra-group financing will need to comply with the requirements set out in the 28 January 2011 Circular, and file a request in this respect with the Luxembourg tax authorities.

The 28 January 2011 Circular outlined the more restricted circumstances in which, going forward, the Luxembourg tax authorities would be prepared to give advance confirmation on pricing relating to intra-group financing arrangements under which Luxembourg companies make loans to affiliates. The key specific requirements of the 28 January 2011 Circular include:

- The inclusion of a transfer pricing study (in line with OECD norms) together with the application to the tax authorities for confirmation
- The Luxembourg company having at least a minimum amount of equity genuinely at economic risk (this minimum being set at 1 percent of the financing being provided, or EUR 2 million if lower)
- A minimum level of operational substance in Luxembourg, including a board that has as a majority of its directors individuals whose principal professional activity is in Luxembourg.

## US

### Global information reporting and withholding

On March 18, 2010, the final version of the highly anticipated Foreign Account Tax Compliance Act of 2009 (“FATCA”) became law as part of the Hiring Incentives to Restore Employment (“HIRE”) Act. FATCA’s principal objective is to prevent tax evasion by US persons who use foreign financial institutions, foreign trusts and foreign corporations to shield their identities and U.S. tax status from the IRS. The new law attempts to achieve this by requiring foreign entities to provide the U.S. Internal Revenue Service (“IRS”) with additional information about their U.S. clients, investors and/or shareholders. Non-compliance with FATCA will result in a 30% US withholding tax on a wide range of U.S. sourced payments (including, gross sale proceeds from the sale of U.S. securities, interest and dividends) made to foreign financial institutions (FFIs) and non-financial foreign entities (NFFE) on or after January 1, 2013.

On 8 April 2011, the IRS issued Notice 2011-34. This second round of FATCA guidance contained in IRS Notice 2011-34, addresses a number of priority concerns, revises earlier guidance, and introduces new key concepts. Highlights of the Notice include:

1. Updated guidance for identifying U.S. accounts among pre-existing individual accounts: The procedures provided in an earlier notice (Notice 2010-60) were modified and new procedures have been developed for participating FFIs to certify their completion of the steps required for determining the status of their pre-existing individual accounts. Additionally, participating FFIs will be required to certify that they determined the status of their pre-existing individual accounts in accordance with the new procedures.

The revised process outlined in the Notice demonstrates that the IRS and Treasury listened to the comments provided and made an effort to simplify and relieve some of the compliance burdens for the FFIs by modifying the identification process of the re-existing individual accounts and the reporting only on year-end account balances and values. However, additional

requirements have been imposed on the Private Banking functions of the FFI and the relationship managers of such accounts to identify U.S. account holders.

2. Initial guidance on pass-through payments: FATCA requires participating FFIs to withhold 30 percent of any “passthrough payment” made to a recalcitrant account holder or non-participating FFI.
  - Determination: A payment to a recalcitrant account holder or non-participating FFI is treated as a pass-through payment to the extent of (a) the amount of the payment that is a “withholdable payment” plus (b) the amount that is not a withholdable payment multiplied by the “passthrough payment percentage”.
  - Calculation: The FFI’s passthrough payment percentage will be determined by dividing the sum of the FFI’s US assets on each of the last four quarterly testing dates by the sum of the FFI’s total assets on those dates.

## **Treasury and the IRS intend to issue regulations requiring that each FFI in an FFI group be a participating or deemed compliant FFI.**

- Determination of assets: Based on participating FFI's quarterly or the most recent financial statements, all on and off-balance sheet assets (as specified in future guidance) should be included while excluding assets held by the FFI as a custodian, agent or nominee for the benefit of an account holder.
  - U.S. assets include any investment of debt or equity in a domestic corporation and any other asset that could give rise to a passthrough payment.
3. Deemed compliant FFIs must apply for such status with the IRS, obtain a FFI EIN and certify every three years that it continues to satisfy the requirements for such treatment. The following entities are eligible for deemed compliant FFI status:
- Certain local banks
  - Local FFI members of participating FFI groups
  - Certain investment vehicles
  - Other categories of deemed compliant FFIs.
- 4 Further guidance on the reporting on U.S. accounts by FFIs: Participating FFI account balance reporting will be limited to year-end balances or values, and in the case of investment fund accounts, as determined for the purpose that require the most frequent determination of value. Furthermore, participating FFIs must report annually (a) gross dividends paid or credited to the account, (b) gross interest paid or credited to the account, (c) other
- income paid or credited to the account, and (d) gross proceeds from the sale or redemption of property paid or credited to the account of a U.S. account when the FFI acts as custodian, broker, nominee or agent for the account holder. Separate branch-level reporting can be elected to accommodate local restrictions on the transfer of account information.
5. Treatment of qualified intermediaries (QIs): FFIs currently acting as QIs will be required to become participating FFIs, unless they qualify as deemed compliant FFIs, effective January 1, 2013. The same rules will apply to FFIs acting as Foreign Withholding Partnerships (FWP) or Foreign Withholding Trusts (FWT). Treasury and the IRS anticipate modifying the current QI, FWP and FWT agreements to require each to be a participating FFI.
6. Application of FATCA to expanded affiliated groups: FATCA requires that all reporting, withholding and other requirements apply to U.S. accounts maintained at a participating FFI and at all other FFIs that are members of the same expanded affiliated group. Affiliate is defined by an FFI's ownership of more than 50 percent of another FFI.

- FFI affiliates will apply for FFI or deemed compliant FFI status through a coordinated application process for which a "lead FFI" will be designated for each group and will file an application on behalf of each group member, provide the IRS with documentation evidencing that each affiliate has agreed to the FFI agreement, and represent that it is authorized to act as agent in contracting with the IRS. Furthermore, Treasury and the IRS intend to provide the option for one FFI to act as a "compliance FFI", handling compliance with FATCA for all group members (e.g., establishing and enforcing policies and procedures).
7. Clarification on the effective date of FFI agreements: FFI agreements will become effective on the later of (a) the date they are executed, or (b) the effective date of section 501 of the Act. Treasury and the IRS intend to issue proposed regulations and related guidance incorporating the principles contained in the two Notices and addressing other matters necessary to implement FATCA. Future guidance is expected to include a draft FFI agreement and draft information reporting and certification forms. Notably, the IRS did not provide any significant guidance on the application of FATCA to the insurance and alternative investment industries, nor did the Notice address the scope of the exemption for retirement plans or other employee benefit plans.

Treasury and the IRS have requested comments on the issues addressed in this Notice and the priority of other issues that should be addressed in future guidance. Future analyses will be provided as guidance is provided by Treasury or the IRS.



### ***Employment law changes***

As part of its ongoing reforms in the labour market, the Ministry of Labour of UAE has issued notable changes to the UAE employment regulations which will grant foreign workers more freedom in the employment market. We have indicated below, the changes in comparison with previous provisions of law. These changes have taken effect since January 2011.

Topic	Prior to the changes	Changed provisions
Short-term / temporary work permits	Previously, there was no option for issuing short-term work permits	Non-GCC nationals who are above 18 years of age, possessing a passport valid for more than six months can now enter the UAE on a short-term work permit having validity for 60 days. These valid short term work permits can be extended / renewed up to six times (subject to a specific fee and bank guarantee). However, if the extension / renewal is not done on time, a penalty fee of AED 500 for every 10 days after the expiry date is levied on the sponsor. This facility is not extended to UAE or GCC nationals.
Non-requirement of consent from the previous employer for temporary work permits	In the past, an NOC and consent letter had to be obtained from the previous employer to avoid a six-month work permit ban	The amended law now allows new employers the freedom to obtain an approval from the Ministry of Labour for temporary work permits without the consent of the former employer. This approval can only be obtained if the current residence visa and labour / employment card of the employee are valid and clear. These changes could make it easier for expatriate workers to change jobs in the UAE without the written consent of their employers.
Cost of Emirates ID cards	There was no clear guidance on who would bear the costs of ID cards for employees.	According to a decision issued by the Emirates Identity Authority, employers in Abu Dhabi are now required to bear the cost of issuing the Emirate Identity cards for their expatriate employees.
Retirement age limit increase for expat employees	Earlier limit for the retirement age of expatriate employees was fixed at 60 years.	The Labour Ministry has now extended this limit for expatriate employees to 65 years of age. This gives expatriate employees to obtain work visas up to the new extended limit of 65 years.
Introduction of new work permits	No previous provisions	<p>Five new work permits have now been introduced through Cabinet Resolution 25 of 2010, in an attempt to liberalise the labour market while giving a wider range of choices to potential employers. These 5 new internal work permit categories include:</p> <ol style="list-style-type: none"> <li>1. Worker transfer – allowing transfer of sponsorship of expat employees regardless of the six-month labour ban provided the current / existing work permit and labour card are valid as on the date of the application for transfer and provided the termination is consensual (exceptions include) <ol style="list-style-type: none"> <li>a. Breach of legal or contractual obligations committed by employer</li> <li>b. an existing case filed by the employee with the Ministry of Labour</li> <li>c. a labour claim filed by the employee with the Dubai courts</li> <li>d. unilateral termination or non-renewal of employment by the employee</li> </ol> </li> </ol> <p>The requirement of the continuous two year employment is also excluded in the cases below:</p> <ol style="list-style-type: none"> <li>a. change in skill levels</li> <li>b. if the termination is not caused by something the employee has done or failed to do or if the termination is on account of violation of legal obligations by the employer towards the employee</li> <li>c. the move of the employee is to an establishment either controlled or partially controlled by the previous employee</li> </ol> <ol style="list-style-type: none"> <li>2. Temporary work permit – allowing any non-UAE national to be engaged on any projects or assignments for a period not exceeding six months.</li> <li>3. Part-time work permit – under which employees can be employed on part time basis.</li> <li>4. Kinship sponsored permit : allowing persons with valid work permits or labour cards to sponsor their dependents, as if they are employed for them</li> <li>5. Permits for Juveniles : a very specific permit for persons between 15 to 18 years of age provided custodian approval has been sought on the minor’s employment and HSE restrictions are imposed. There are restrictions in respect of the types of work that can be performed, the time of work and the hours of work.</li> </ol>
Students sponsored by institutes		From May 2011, university and college students sponsored by and enrolled at institutes in the UAE, can also legally work under part-time conditions. The part-time work application must be done by the students to the Ministry of Labour directly.
New Emiratisation Requirements		The new Emiratisation rules are reported to aim for at least 15% of a company’s workforce to be UAE nationals in the private sector.

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