I Am Just a Start-up, Do I Need to Worry About Tax?

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Introduction

You have secured funding for your start-up. Your minimum viable product and marketing strategy is in place. Your newly hired team looks promising. With so many aspects of establishing a start-up to consider, do you really need to worry about taxes for your start-up? In short, the answer is ‘yes’.

The Gulf Co-operation Council (‘‘GCC’’) region remains an attractive region for starting a business due to the favourable tax regimes in most GCC countries. However, there is a general misconception that there are few or no issues with taxes in the GCC. In line with the GCC’s diversification strategy and its attempt to reduce its dependence on revenue from hydrocarbons, individual countries have committed to introducing new indirect taxes and other tax reforms. The evolving tax regimes of the region pose a challenge to entrepreneurs who are seeking to establish a presence in the GCC, or investors looking to sell, divest or acquire a business in the GCC.

In this article, we will provide an overview of some of the key taxes in the GCC that start-ups should consider as part of their business planning.

Overview of the taxes in the GCC region

1. Corporate tax

Generally, corporate tax is a form of direct tax levied on the taxable profits of entities. Non-residents of a GCC country may be subject to corporate income tax or withholding tax depending on the domestic rules in the specific GCC country in question. Non-residents who conduct business in a GCC country (through a permanent establishment) are subject to corporate income tax whereas non-residents who generate taxable income from sources in that GCC country may be subject to withholding tax.

In practice, certain GCC countries such as the UAE and Bahrain only enforce corporate tax in specific sectors such as the oil and gas production sector. In Kuwait, the KSA and Qatar, corporate tax is imposed in respect of the non-GCC shareholding.

2. Withholding tax

Withholding tax is a tax that is deducted at the source on payments made by a resident in a GCC country to non-residents. Different withholding tax rates apply depending on the nature of the payments made by the resident to the non-resident. The UAE, Kuwait and Bahrain do not impose withholding taxes whilst the other GCC countries generally impose withholding tax on payments of interest, dividends and royalties from its residents to a non-resident or retention taxes.

The domestic withholding tax rates of a jurisdiction may be reduced under a double tax treaty that is in force between the countries of the payor company and the recipient of the income, provided certain conditions are met.

Prior to entering into any cross-border transactions, start-ups should carefully assess the withholding tax implications and obligations in making any payments to non-residents.

3. Zakat

Zakat is a form of Islamic tax that is currently only enforced in certain GCC countries such as the KSA and Kuwait. For instance, in the KSA, Zakat is imposed in respect of the shareholding in resident companies attributable to Saudi or GCC nationals. Zakat is paid by the resident company at the rate of two and a half per cent based on the higher of adjusted net profits or the Zakat base.

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4. Value added tax (‘‘VAT’’)

VAT is a form of consumption tax imposed on the supply of goods and services and is charged on the value added at each stage of the supply chain. The unified GCC VAT Agreement sets out broad principles that should be followed by all the GCC countries in their VAT laws whilst also providing flexibility in certain matters. Each GCC country will enact its own VAT legislation based on these common principles.

To date, only the UAE, KSA and Bahrain have implemented VAT. Oman and Qatar are expected to introduce VAT in 2021 and Kuwait is likely to implement VAT at some point in the future.

Under the GCC VAT Agreement, all GCC countries have agreed to implement VAT at the standard rate of five per cent. However, the KSA recently announced that it will increase the standard rate of VAT to fifteen per cent effective from 1 July 2020, as part of the KSA’s measures to mitigate the economic impact of the COVID-19 pandemic. To date, the UAE has ruled out any immediate plans to increase VAT in the UAE beyond its current standard rate of five per cent.

5. Excise tax

Dubbed the ‘sin tax’, excise tax is a form of indirect tax levied on specific goods which are typically harmful to human health or the environment. In a joint effort to reduce the consumption of unhealthy and harmful commodities, the GCC countries agreed to implement excise tax by way of the Common GCC Excise Tax Agreement.

To date, the UAE, KSA, Bahrain, Oman, and Qatar have implemented excise tax for certain tobacco products at 100 per cent, energy drinks at 100 per cent, and carbonated drinks at 50 per cent. In Oman and Qatar, excise tax is also imposed on ‘special purpose goods’ (such as alcohol or pork products) at 100 per cent. The UAE and the KSA also recently extended the scope of excise tax to include sweetened drinks and other tobacco products.

6. Customs duty

The GCC has a unified customs duty regime. Customs duty is imposed at the first point of entry of goods into the GCC. Imported goods are generally subject to customs duty at the rate of five per cent of the cost, insurance, and freight invoice value. However, certain goods may be subject to customs duty at a higher rate whereas other goods may be exempt.

7. Real estate transfer taxes/stamp duty

In Oman and Bahrain, stamp duty is imposed on the transfer or registration of real estate. In the UAE, a registration fee is levied on the transfer of ownership of land and the transfer of shares in companies holding real estate.

8. Payroll taxes

Generally, the GCC countries do not impose payroll taxes. However, it is important to note that employers are subject to social contribution obligations in all GCC countries.

Final remarks

Given the limited taxation in the GCC, establishing a start-up in the region is an attractive option compared to other more established economies which often have convoluted tax webs. However, investor awareness needs to be heightened – an additional layer of complexity for start-ups in the region may materialise due to: (i) the introduction (and proposed introduction) of new taxes such as VAT; and (ii) discrepancies between domestic tax legislation, double tax treaties and the approach of the tax authorities. In view of the international pressure on tax transparency and the GCC’s diversification strategy, it is anticipated that the tax regimes in the GCC will continue to evolve. Entrepreneurs with current or potential business interests in the GCC should continuously monitor GCC tax developments and regularly assess their tax risk management strategies.