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Taxation of cross-border mergers and acquisitions

Kuwait

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Introduction

Mergers and acquisitions (M&A) are less common in Kuwait than in other Gulf Cooperation Council (GCC) countries. Most expansions into Kuwait by foreign entities are achieved by establishing a limited liability company or through a sponsorship arrangement.

Recent developments

— The tax liability of foreign companies investing in Kuwait for fiscal years commencing after 3 February 2008 is set by tax law no. 2 of 2008 at a flat rate of 15 percent on net taxable income. This replaced a range of rates from 0 percent to 55 percent under the Amiri Decree no. 3 of 1955, which applied to fiscal years that started before 3 February 2008.

— Gains derived by a foreign company on the disposal of assets, including conveyance of title to a third party, are taxable under Tax Law no. 2 of 2008 at a rate of 15 percent.

— As of 10 November 2015, the Capital Markets Authority (CMA) has provided that returns (taken to imply dividends) in respect of securities, bonds, financial sukuk (i.e., Sharia-compliant bonds) and similar securities are exempt from income tax (Article 150, Law No. 22 of 2015).

— Furthermore, the Ministry of Finance (MOF) issued a letter clarifying that all profits/returns (as referred to above) made on or after 10 November 2015 are exempt from income tax. Profits/returns made before 10 November 2015 are taxable, even where the resolution of distribution was issued after 9 November 2015. Despite this clarification letter, the implementation of the cut-off date and apportionment of distribution is still uncertain. Given this uncertainty, the above changes may only be implemented in practice in 2016.

— According to the tax law, tax losses for a financial year can be carried forward for 3 years. Previously, tax losses could be carried forward indefinitely (under the Amiri Decree no. 3 of 1955).

Asset purchase or share purchase

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

Purchase of assets

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

Goodwill

Amortization of goodwill is not allowed for tax purposes, under the Tax Law no. 2 of 2008 and related circulars.

Depreciation

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

Tax attributes

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

— liquidation of the incorporated body

— change of the legal status of the incorporated body or its expiry

— merger of the incorporated body with another incorporated body.

Value added tax

Currently, value added tax (VAT) is not levied in Kuwait.

Transfer taxes

Stamp duty and stamp duty land tax are not levied in Kuwait.

Purchase of shares

Tax indemnities and warranties

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

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

Tax losses

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

Pre-sale dividend

Capital gains earned by a foreign company from mere trading on the Kuwait Stock Exchange (KSE) are exempt. As noted earlier, dividends on securities listed on the KSE are tax-exempt as of 10 November 2015. Given this uncertainty, the above changes may only be implemented in practice in 2016.

Cash dividends earned from investment in KSE stocks, directly or through investment trusts and managed funds, are subject to 15 percent tax. A seller may prefer to realize the gain on investment as income by means of a pre-sale dividend. However, since any pre-sale dividend earned by foreign entities is also subject to 15 percent tax, each transaction should be structured according to other considerations.

Tax clearances

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

Choice of acquisition vehicle

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

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

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

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

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

Local branch

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

Joint venture

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

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

Choice of acquisition funding

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

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

Deductibility of interest

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

Withholding tax on debt and methods to reduce or eliminate it

There is no withholding tax in Kuwait. However, the MOF enforces compliance with the law through Ministerial Order no. 44 of 1985 and article 16,37 and 39 of the Executive Bylaw of Law no. 2 of 2008 ('tax retention regulations'). These regulations require contract owners to retain 5 percent tax from contractors and release it only on the provision of a tax clearance certificate. A treaty may reduce the 15 percent tax rate on the net taxable profits to a lower rate.

Other considerations

Transfer pricing

There are no specific transfer pricing regulations in Kuwait. However, the tax authorities deem certain percentages of the cost of the equipment or services rendered outside Kuwait as inadmissible. The percentage disallowance depends on the nature of relationship between the foreign company and the purchaser. Similarly, interest charged by the head office for its current account is not allowable for tax purposes.

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