KUWAIT UAE TAX TREATY

Insights & Analysis

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Kuwait government ratifies tax treaty with the UAE

On 14 July 2024, the State of Kuwait issued Decree No 7 of 2024 approving the Double Taxation Avoidance Agreement ("DTAA" or "the Treaty") between the State of Kuwait ("Kuwait") and the United Arab Emirates ("UAE"). The Treaty adopts various provisions found in the United Nations Model Tax Convention ("UN MTC"), but also encompasses certain elements found in OECD MTC.

This new agreement will help enhance the economic relations between the two countries and minimize the risk of double taxation for businesses operating between these two countries, while not creating opportunities for non-taxation. The Treaty includes provisions to prevent treaty abuse and to resolve tax disputes.

The Treaty enters into force from 1 January following the year of ratification of the Treaty by each of the countries.

This is the first tax treaty with a GCC country that Kuwait has ratified, and is a welcome development particularly given the recent introduction of corporate tax in the UAE and the potential introduction of business profit tax in Kuwait in the future.

Key Highlights

Provision	Description
Interest and Dividends	Taxable in the state where the taxpayer is a resident.
Royalty and Technical services fees	Taxable in the source state at 10%.
Capital Gain	Sale of unlisted shares are taxable in the source state, subject to certain conditions.
	Sale of listed shares are *not* taxable in the source state.
Zakat and KFAS	Not part of the covered taxes of Kuwait.
Elimination of Double Taxation	The Treaty adopts a tax credit mechanism to eliminate double taxation
BEPS MLI provisions	The Treaty incorporates the minimum standard provisions of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the “BEPS MLI”) such as: • The preamble adopts Article 6 of BEPS MLI stating that the intention is to eliminate double taxation without creating opportunities for non-taxation or reduce taxation through tax evasion or avoidance, including through treaty shopping arrangements. • Principal Purpose Test to prevent treaty abuse. • Dispute resolution mechanisms through Mutual Agreement Procedures (MAP).

Detailed Analysis

Applicability of the Treaty (Persons covered (Article 1) and Residents (Article 4))

The Treaty is applicable to residents of Kuwait and / or the UAE. The following persons are covered within the definition of "resident" under Article 4 of the Treaty (non-exhaustive list):

In respect of Kuwait:

1. Any company or entity incorporated in Kuwait.
2. Any Kuwaiti citizen who is domiciled in Kuwait.

In respect of the UAE:

1. Any company or entity incorporated in the UAE.
2. Any UAE citizen.
3. Any individual who is a legal resident of the UAE (or has the usual place of abode or center of vital interest in the UAE).

Non-Kuwaiti individuals residing in Kuwait will not be treated as tax residents of Kuwait for the purposes of the Treaty. Other than individuals, where a person is a dual resident of the UAE and Kuwait, the place-of-effective-management will be applied as a tie-breaker rule for determining the residence state.

The Treaty should, in principle, cover all UAE incorporated companies, including those registered in UAE free zone areas. The Treaty does not include any provision to exclude entities registered in free zone areas.

Taxes covered (Article 2)

The following taxes of Kuwait and UAE are covered under the Treaty.

Kuwait:

a) Income Tax Decree No. 3 of 1955 amended by Law No. 2 of 2008 – *Corporate Income Tax*
b) Kuwaiti Income Tax Law in (Designated Area) No. 23 of 1961 – *Partitioned Neutral Zone Tax*
c) National Labor Support Tax

UAE:

a) Income tax; and

b) Corporate tax

Kuwait Zakat (of 1%) and the contribution to Kuwait Foundation for Advancement of Sciences (KFAS) (of 1%), applicable on Kuwait shareholding companies, have not been included under the definition of covered taxes of Kuwait. Notably, article 2(4) allows the Treaty to cover future taxes of similar nature. Therefore, a possible introduction of business profit tax in Kuwait should be covered by the Treaty.

Detailed Analysis (Contd.)

Permanent Establishment (PE) (Article 5)

Business profits of an enterprise of a contracting state are taxable in the other state only if the enterprise establishes a PE in the other state. Article 5 of the Treaty broadly follows the UN MTC and describes situations where a PE may arise.

Type of PE	Description
Fixed Place PE	Fixed Place PE is created if the enterprise carries on business in the source state through a fixed place of business.
Construction PE	Construction PE arises if a construction / building site, construction, assembly or installation project or related supervisory activities continue for a period exceeding six months.
Service PE	Service PE arises if the provision of services, through own employees or other personnel, continue for a period (continuous or in parts) totaling more than three months within any twelve-month period commencing or ending in the fiscal year.
Equipment PE	Equipment PE arises if substantial equipment is used or installed under a contract, for a period exceeding three months during any twelve-month period commencing or ending in the fiscal year.
Agency PE	Agency PE arises if a “dependent agent” carries out activities (*except those of preparatory of auxiliary in nature*) for the benefit of the enterprise and has, or habitually exercises, the authority to conclude contracts on behalf of the enterprise.

Exclusions for PEs are defined in the Treaty to cover certain activities of preparatory or auxiliary nature.

Business Profit (Article 7)

Business profits of an enterprise shall be taxable in the source state only when such an enterprise carries out business through a PE in the source state. Further, only profits that are attributable to such PE shall be taxable in the source state.

Article 7(4) adopts profit attribution rules typically found on UN MTC (and pre-2010 OECD MTC) where profits are attributed to a PE based on an apportionment of total profit of the enterprise, rather than the arm’s length principle. The Treaty does not allow profits to be attributed to a PE merely on purchase of goods or merchandise by the PE.

Any expense that are attributable to the PE in Kuwait, including any executive or general administrative expenses, is deductible for the purpose of determining the profits attributed to a PE.

Dividends & Interest (Article 10 & 11)

As per the Treaty, dividends and interest are taxable only in the contracting state in which the recipient is a resident, subject to meeting certain conditions.

Detailed Analysis (Contd.)

Royalty and Technical Services Fees (Article 12 & 12A)

The Treaty entitles the source state to tax royalty payment at 10% subject to certain conditions. Interestingly, the Treaty includes a technical services fees provision (typically found in UN MTC) permitting the source state to tax such payments at 10%, subject to meeting certain conditions.

Currently, the UAE applies 0% WHT on payments to non-resident. Kuwait does not have a WHT regime and does not generally apply its domestic income tax to UAE companies.

Capital gains (Article 13)

Subject to meeting certain conditions, capital gains from the sale of unlisted shares could be taxable in the source state. The Treaty exempts capital gains from sale of listed shares in the source state.

Elimination of double taxation (Article 24)

The Treaty adopts a tax credit method for the elimination of double taxation i.e. a credit against tax payable in the Kuwait and UAE. From the first read of the Treaty, taxes imposed but exempted or reduced under domestic laws may be claimable for the purpose of the tax credit mechanism. It will be interesting to note how the above provision will be implemented in the future.

Mutual Agreement Procedures (MAP) (Article 26)

As required under the BEPS minimum standards, the Treaty provides for dispute resolution mechanisms through MAPs, allowing taxpayers to resolve disputes related to the interpretation and application of the tax treaty. Through this, the aggrieved party may submit the case to the Competent Authority within 3 years from the first notification of the action that led to violation of the provisions of the Treaty.

Prevention of treaty abuse (Article 29)

The Treaty includes a Principal Purpose Test (PPT), found in Article 7 of BEPS MLI, with the aim to deny treaty benefit if it is found that obtaining the benefit is one of the principal purposes for entering into a particular transaction or arrangement.

Taxpayers will therefore need to ensure that there is economic reasonableness to transactions for which they are seeking tax benefits under the Treaty.

Entry into force (Article 31)

The Treaty will enter into force from 1 January following the year in which both Kuwait and UAE complete the domestic ratification process and notify the other in writing. Assuming this process is completed fully by the end of this year, the Treaty will come into force from 1 January 2025.

BDO Comments

The new Kuwait and UAE tax treaty will play a crucial role in enhancing the economic relations and tax cooperation between the two nations, with the aim of eliminating tax avoidance and double taxation issues by aligning with the provisions of the BEPS MLI.

The recent introduction of corporate tax in the UAE, and the proposed business profit tax in Kuwait, signals a significant shift in the tax landscape of both countries and the Treaty will assist in reducing the tax burden and in providing tax certainty for taxpayers involved in cross border transactions.

This hybrid treaty, drawing aspects from both the OECD MTC and the UN MTC, is tailored to suit the specific requirements of Kuwait and the UAE. Entities operating in these countries should reassess their tax positions, and future investments decisions, in light of the Treaty.

As with all new treaties, it remains to be seen how the provisions of the Treaty will be applied in practice.

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