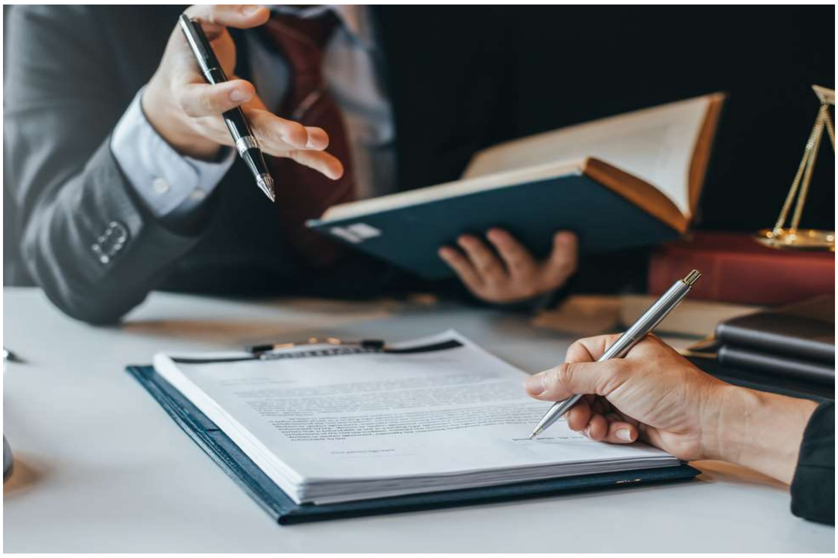
Outcome of the OECD review of preferential tax regimes in the GCC



CONTEXT(1)

Since the start of the Base Erosion and Profit Shifting (BEPS) project, the Forum on Harmful Tax Practices ("FHTP") has reviewed a significant number of preferential regimes. The results of these regimes are published in the BEPS Action 5 report and on a regular basis on the OECD's website as new results become available.

In 2017, commitments were made in respect of more than 80 regimes to be made compliant with the BEPS Action 5 minimum standard. In 2018, jurisdictions have in almost all cases delivered on these commitments. In addition, the FHTP has started the review of preferential regimes of new Inclusive Framework (IF) members, as well as newly introduced regimes, bringing the total number of regimes reviewed since the start of the BEPS project to 255.

During its October 2023 meeting, the Forum on Harmful Tax Practices (FHTP) reached new conclusions on four regimes as part of the implementation of the BEPS Action 5 minimum standard on harmful tax practices. The regimes in Hong Kong (China) and the United Arab Emirates (UAE) were found to be 'not harmful' and two regimes in Albania and Armenia have now been abolished.

(1) Main source - OECD 2018 - Harmful Tax Practices - 2018 Progress Report on Preferential Regimes

The FHTP's review process of preferential regimes

- The FHTP reviews preferential regimes of the IF members to ensure that they do not contain features which can negatively impact the tax base of other jurisdictions and cause a race to the bottom.

- The review work by the FHTP is focused on preferential regimes that provide benefits to geographically mobile business income (such as income from the provision of intangibles, financial services, etc.), which present a risk of BEPS. The review does not include regimes that relate to non-geographically mobile activities such as manufacturing, given that these present an inherently lower risk of BEPS.

- FHTP review process is based on selected determining factors. These factors were originally set out in previous OECD Reports which laid the foundation for the OECD's work on harmful tax practices and have been revisited subsequently. These determining factors are split into Five Key Factors and Five Other Factors, of which a summary overview is presented in the table below ([2]):

Five key factors
The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities.
The regime is ring-fenced from the domestic economy.
The regime lacks transparency.
There is no effective exchange of information with respect to the regime.
The regime fails to require substantial activities.[1]
Five other factors
An artificial definition of the tax base.
Failure to adhere to international transfer pricing principles.
Foreign source income exempt from residence country taxation.
Negotiable tax rate or tax base.
Existence of secrecy provisions.

- In case the FHTP review concludes that a tax regime is potentially harmful, the next step is to assess whether the regime has harmful economic effects. When a reviewed tax regime is found to be potentially harmful but is effectively not, it means that the latter regime is not to be amended but that it will be subject to a yearly monitoring process by the FHTP and where changes in economic effects are identified, the conclusion can be revisited. On the other hand, when a tax regime is found to be effectively harmful, the jurisdiction is expected to amend or abolish the regime in accordance with the FHTP guidance and timelines.

(2) Source: Harmful Tax Practices - 2018 Progress Report on Preferential Regimes *(OECD)*

SUMMARY OF THE FHTP REVIEW OF SELECTED GCC(3) REGIMES

- Selected GCC favourable tax regimes have been subject to a review by the FHTP amongst which are the economic substance requirements in Bahrain and in the United Arab Emirates (UAE). Additionally, the recently updated Free Zone tax regime in the UAE has also been reviewed and assessed by the FHTP.

- The outcome of the review of the selected GCC tax regimes resulted in positive conclusions for the regimes not being considered as harmful from the FHTP point of view.

- Bahrain's economic substance requirements regime was introduced taking effect from 1 January 2019 and the review concluded that the domestic legal framework of said regime meets all aspects of the FHTP standards. Further, no issues nor specific follow-up points have been identified subsequent to the review.

- Regarding the UAE, the economic substance regime was introduced with effect on April 30, 2019 and was subsequently amended on August 10, 2020. The domestic legal framework of the UAE economic substance regime, as amended, meets all aspects of the FHTP standard. Further, no issues not specific follow-up point were identified subsequent to the review. It is worth noting that this is the last monitoring year, as the UAE introduced a corporate income tax regime applicable on financial years starting from 1 June 2023.

- Further, in terms of new preferential regimes reviewed by the FHTP, the October 2023 meeting concluded that the UAE Free Zone regime – under the new corporate income tax regime – has been designed according to the FHTP standards and is hence considered 'not harmful'.

NEXT STEPS AND CONCLUSION

- The FHTP will continue its work assignment by ensuring that substantial activities requirements are in place in no or only nominal tax jurisdictions.

(3) GCC, Gulf Cooperation Council

NEXT STEPS AND CONCLUSION

- In this sense, the FHTP will continue to review newly identified tax regimes, monitor the progress and implementation of the comments and observations, and evaluate the effectiveness of the assessment criteria to continue to deliver outcomes that contribute to a fair and coherent international taxation framework.

- The FHTP will also continue reviewing any preferential tax regimes that are due to remain under monitoring, any regimes of jurisdictions that newly join the Inclusive Framework, and any additional “jurisdictions of relevance” as needed. In addition, the FHTP will review any newly introduced regimes going forward.

- For the GCC reviewed tax regimes, Bahrain’s economic substance regime will continue to be monitored under the category of substantial activities for no or only nominal tax jurisdictions. It is however to be seen on what would be the impact from the expected introduction of corporate income tax regime in Bahrain.

- In terms of the UAE, the economic substance regime will not undergo future monitoring given the introduction of a corporate tax regime applicable to financial years starting on June 1, 2023. On the other hand, the UAE free zone regime designed under said new corporate tax regime has been reviewed and assessed as ‘not harmful’.

- For businesses operating in both Bahrain and the UAE, the FHTP review results represent a positive outcome since the reviewed regimes have been assessed as ‘not harmful’ hence providing additional tax certainty to taxpayers operating in said jurisdictions.

- As a best practice, it is recommended for businesses to keep up to date with the annual FHTP review reports and conclusions in regard to the jurisdictions where they operate / are willing to expand their operations to.

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