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Managing tax

What companies and Governments can do to make tax less taxing in the Middle East

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Executive summary

In the late summer of 2015 we asked Tax and Finance leaders at some of the largest companies operating in the Middle East (both based here in the region and overseas) about the tax and business challenges they face, the way their tax functions are organised, and the impact of international and domestic tax reforms. Here we set out issues raised in our survey; some findings are relevant to the whole region, others are specific to particular countries. We also set out observations for companies and tax authorities to overcome those issues raised.

Many consider the Middle East to be a low tax, or even a 'no tax' area, but as our survey shows, the taxation regimes in the region can be complex and challenging to manage, and their implementation can give rise to uncertainty creates risk. As a result, companies need to manage their Middle Eastern tax affairs with the same care and attention to detail that applies everywhere else in the world. This will be even more important with the expected introduction of Value Added Tax (VAT) across many countries in the region, and the reforms that are likely to be made in response to the OECD's recommendations on Base Erosion and Profit Shifting (BEPS).

The results of the survey support the observation, that there is considerable scope for the region's authorities to reform, modernise and streamline their tax regimes, which would make their markets more attractive to foreign investors.

Both authorities and businesses could increase efficiency and speed up their processes, by employing more digital technology, and need to look at the skills they require now, and as tax regimes evolve. Many businesses in the region have little or no dedicated in-house tax resource, despite the significant challenges in areas like compliance, and the need to integrate tax planning more closely into business decision-making.

In the pages that follow, we look at the implications for business, both now and as the region's tax regimes evolve – at how companies can organise their tax affairs more efficiently, and what Middle Eastern tax authorities can do to encourage inward investment by reducing risk and uncertainty.

We make observations for tax authorities, these include:

- The need for greater clarity and consistency in the application of tax laws.
- More extensive use of technology and IT systems.
- Ensuring they have the skills, processes, and people required to apply these effectively.

As well as observations for companies:

- Companies need to focus in particular on the possibility that VAT will soon be introduced in some countries.
- The same need for preparedness arises in relation to BEPS.
- Companies should consider whether their tax function is the right size, and has the right level of skills, seniority, and systems.

We hope our report helps company C-suite, Boards and Tax Authorities to consider and plan their approach to tax and managing the current and anticipated reforms to taxation in the Middle East.

Dean Kern
Middle East Tax and Legal Services Leader

Business challenges, tax challenges

It is an interesting time to be talking about tax in the Middle East. After decades of being perceived by some as a 'low tax' environment, tax is back on the agenda for many of the region's governments, even within the Gulf Co-operation Council (GCC). With the oil price at a historical low, some countries are facing for the first time budget deficits, and others selling assets to fund their expenditure. Countries across the Middle East want to have sustainable revenue streams to fund their long-term policy objectives, away from hydrocarbon revenues, and hence they are exploring how to broaden the tax base and collect money more efficiently. GCC Countries – are looking at introducing sales taxes like VAT; others are considering raising or establishing corporate taxes. Elsewhere in the region, the tax environment is more like that of other developing nations - corporate tax is a primary source of government revenue (unlike in the GCC), and there are personal income taxes as well as sales taxes or VAT.

Operating in a low tax environment

Whether inside or outside the GCC, tax is a significant issue for businesses already operating in the region - both domestic and overseas-owned – and for those which might be considering doing so. As PwC and The World Bank Group's 2016 Paying Taxes report showed, the Middle East still has the least demanding tax systems in the world, with the lowest Total Tax Rate and the shortest time required to comply; Qatar and the UAE were ranked joint easiest in the world, with Saudi Arabia in third position. However, these headline results mask some specific issues within those countries, and across the region as a whole.

Practical challenges

The tax regimes in many Middle Eastern countries pose both practical and compliance challenges, ranging from uncertainty about the amount of taxes owed, to pragmatic problems with filing and paying tax due – there has been very little progress on electronic filing or payments, for example, which leaves companies relying on cheques and manual paperwork. And while the overall tax burden may be low, foreign businesses are often surprised by how many taxes they face, and how complex these can be.

> *"You need to pay as much attention to your tax affairs in the Middle East as you do everywhere else in the world – in fact, probably more."*
>
> *Survey respondent*

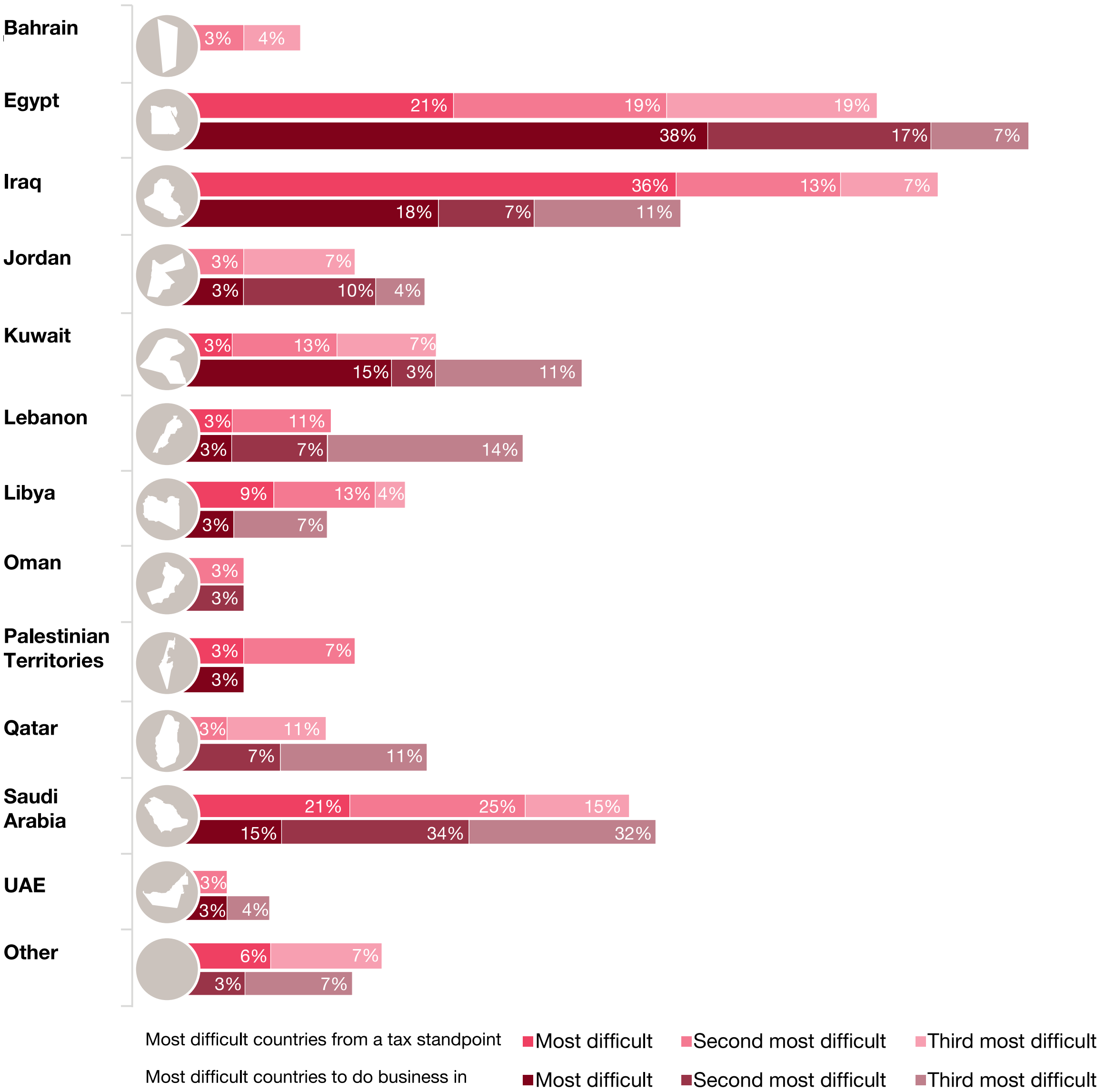
Unclear rules, uncertainty and risk

Even in countries where there is no corporate tax or personal income tax, there are other indirect taxes such as property taxes or social security payments, where the rules can be ambiguous or unclear. Withholding taxes often apply as well, which can have a significant impact on corporate cash-flow. Likewise tax legislation can often be less detailed, which leaves considerable room for interpretation on a case by case basis.

This, in turn, leads to uncertainty, and significantly adds to the risk that overseas companies face when doing business here. This is borne out in the survey results: only 3% of our respondents said they considered there was a high level of certainty in relation to the tax legislation in the region. And it's probably no coincidence that the countries our respondents found most difficult from a tax perspective are also those where it's hardest to do business.

> ***Only 3% of our respondents said they considered there was a high level of certainty in relation to the tax legislation in the region***

Most difficult countries from a tax standpoint and to do business in



Attracting overseas investment

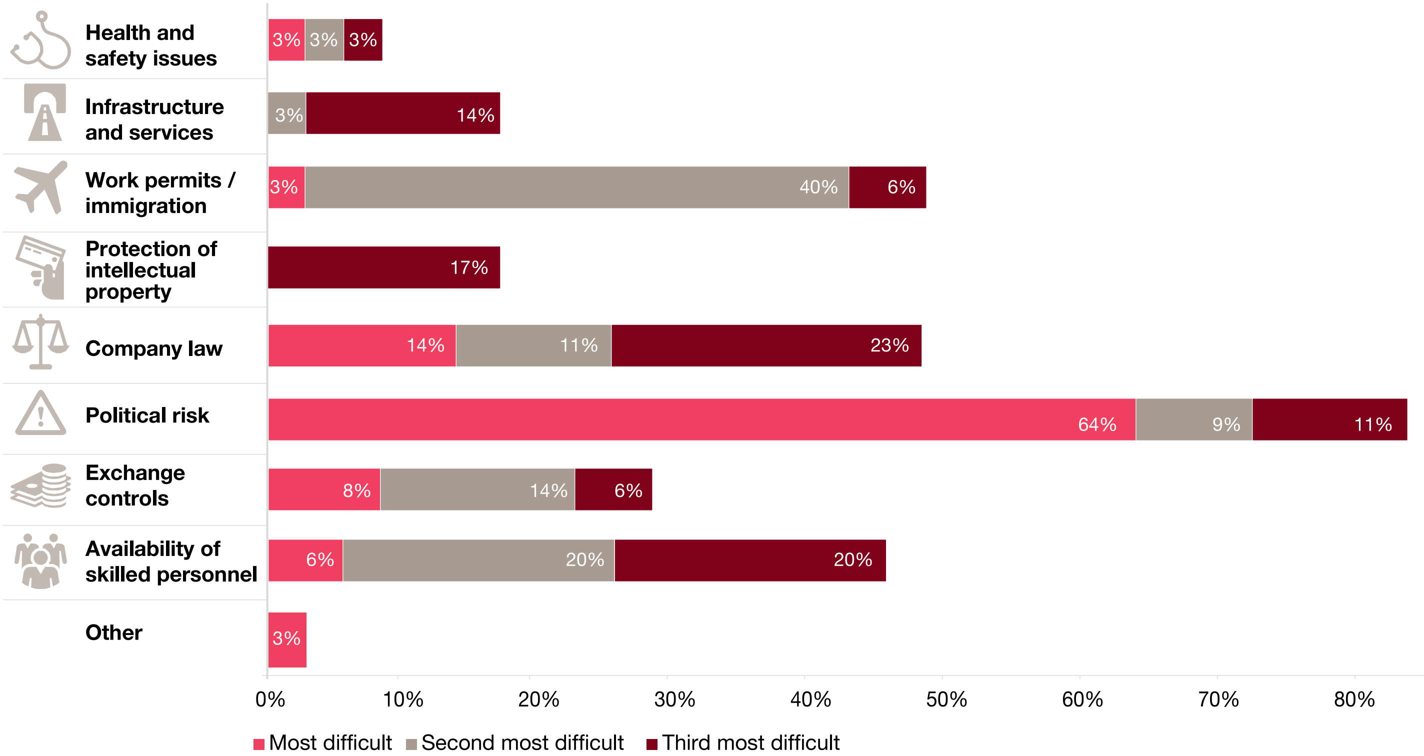
The Kingdom of Saudi Arabia (KSA) and Egypt stand out in our survey in relation to the difficulty from a tax standpoint and doing business, and we look in more detail at the tax challenges in these jurisdictions in the box-outs below. But despite this, the majority of our survey respondents saw these two economies as among the most likely to receive increased investment in the short to medium term – Saudi Arabia scored highest at 71%, followed by Qatar at 46%, and Egypt at 40%. The attractiveness of Saudi Arabia is driven by the sheer size of the prize – even though the oil price is low, the government is still investing vast sums in infrastructure, and the country has a sizeable and prosperous population, which means there are huge opportunities in sectors as diverse as oil and gas, construction, retail, and consumer goods.

Both Saudi Arabia and Egypt could make their economies even more attractive to overseas investors by reforming and streamlining their tax and business regimes. In Egypt, for example, foreign companies have to obtain 35-40 separate approvals before they can start trading, and while the authorities acknowledge that a 'one-stop shop' for inward investment would be a helpful development, it hasn't yet been fully established. The Egyptian tax framework has been subject to constant change since 2011, and this lack of stability, combined with problems obtaining hard currency to pay dividends and royalties, is now prompting some multinationals to relocate their operations.

Instability creates a major business challenge

Stability is important in general, and not just in relation to tax. It's about ensuring a predictable operating environment where rules and regulations can be relied upon. Our survey respondents consider political instability to be the most significant threat to the future growth of the region (63%), followed by frequent regulatory change (11%). As the graph below shows, political instability is also the most significant business challenge faced by companies already operating in the region. Foreign ownership laws are another ongoing source of frustration for overseas companies, by forcing them to operate through joint ventures in many parts of the region.

The three areas of business and regulation that present the most difficult challenges



Saudi Arabia: Progress and potential

Before 2004, there was no formal tax framework in Saudi Arabia, but this has become more systematised in the last decade, and more in line with international norms. A significant number of double taxation treaties have been introduced (for example, with India, the UK, China, and Russia, but not, thus far, with the US or Germany). New transfer pricing regulations have also been drafted, but not yet issued, and there has been discussion of a new land tax, to encourage landowners to use the land they acquire, rather than just stockpile it.

Uncertainty can arise, for example, from the rules governing tax residency, which can be interpreted differently by different tax authorities within the Kingdom. The same lack of clarity applies to some social security taxes, and the tax consequences of listing on the Saudi Stock Exchange, which has recently been opened up to foreign companies.

Corporate tax is another area where more clarity would help create a more stable taxation regime.

Unlike Bahrain and the UAE, the KSA has corporate taxes, but there are different rules for foreign and domestic businesses: overseas-owned firms pay 20%, while local companies pay a 2.5% 'Zakat' derived from Islamic law, which is charged on their net worth. But because Zakat is governed by decree and not by law, its precise interpretation is left to individual officials, which can create uncertainty about current and likely future liabilities.

Looking ahead, there's the possibility that KSA could introduce VAT in the next few years, not least because of the pressure to raise more government revenue. To do this effectively, the Kingdom will probably require more skilled staff and more comprehensive systems, and this may delay the process. However, as a member of the G20, Saudi Arabia may be one of the first to adopt the reforms recommended by the OECD project on Base Erosion and Profit Shifting (BEPS), which we look at later in this report.

"Tax administrations are also facing the challenge of being asked 'to do more with less'. Increased use of co-operative compliance models may help increase clarity and consistency for taxpayers and more efficiently utilise resources in tax administrations."

Mohammed Yaghmour, Tax Partner, PwC Saudi Arabia

"There has been a good deal of progress, but uncertainty remains in some key areas."

Suleman Mulla, Director – Tax, PwC Saudi Arabia

Egypt: Revolution and reform

In 2005, the Egyptian authorities introduced comprehensive tax reforms. The aim was to streamline the system and align it with international good practice, while increasing the tax take and reducing evasion. Personal and corporate taxes were aligned at 20%, and the fines for evasion were significantly increased. OECD definitions of concepts like transfer pricing were also adopted. It was a successful move, and went a long way to create a more stable tax system and build trust and confidence with international investors. But with the 2011 revolution, all that changed.

Since then, the political situation has been very unpredictable: with no parliament in place, laws have been made by presidential decree, and as government revenues from the Suez Canal have fallen, tax has had to bridge the gap; existing taxes have been changed or raised, and new ones have been introduced; Corporate tax was increased to 30%, which meant an effective rate of 37% for foreign-owned firms, after adjusting for withholding tax; and a new Capital Gains Tax was announced, then frozen, and then re-introduced later with different rules. All in all, the picture was confused and unpredictable, with little clarity on the scope and implementation of all the new taxes, and very high penalties for non-compliance.

Companies could neither clarify what they owed, nor plan for the future, and foreign investors like Private Equity houses had reduced confidence in their ability to realise any potential investments. In the last couple of years, the government has been trying to stabilise the system and rebuild trust. Corporate tax has recently been reduced to 22.5%, and new mechanisms have been introduced to protect the rights of payers, but it's too early to evaluate the impact of these measures, which are still subject to ratification by the new parliament, as and when it's elected.

It's possible that Egypt will also introduce VAT to replace the current sales tax with a potential increase in tax rate from 10% to 12%, and higher taxes for alcohol, cigarettes and cars. Fears about VAT's inflationary impact have delayed the implementation so far, but this, in turn, is increasing uncertainty for the business community, many of whom lack the reporting systems or resources to deal with VAT.

"The shift from a general sales to a VAT could add to the attractiveness of Egypt for investors from a tax perspective. Political leadership, and a coherent tax policy for the long term are important features of a stable and resilient fiscal regime."

Karim Emam, Tax Partner, PwC Egypt

Dealing with difficulty: The most taxing taxes

According to our respondents, the taxes that present the greatest challenges are withholding taxes (40%), transfer pricing regulations (31%), and corporate taxes (29%). Bahrain and the UAE have very limited corporate taxation, but the vast majority of countries in the Middle East have some sort of corporate tax regime, and this brings with it the usual technical and compliance requirements.

"It can be hard to work out which rules apply and what their impact might be. You end up always taking the most conservative view, just in case."

Survey respondent

Defining Permanent Establishment

However, there are some aspects of corporate tax that are particularly challenging in the region. Our respondents cited retention payments, for example, and issues with the definition of Permanent Establishment (the test authorities apply to determine whether a business is liable to pay tax and file returns in its jurisdiction).

The latter is a common issue across the world, of course, but there are specific factors at play in the Middle East which can make it more problematic. In Saudi Arabia, for example, the rules are more aggressive than they typically are elsewhere, and certain types of transaction give rise to a Permanent Establishment which would not be the case if they were undertaken in other countries.

Transfer pricing legislation

Transfer pricing is another live issue. Many authorities in the region have legislation referring to transfer pricing, including Kuwait, Oman, and Saudi Arabia. The Kingdom also has a transfer pricing manual in draft which could be published in the next two years. The most sophisticated regime in this respect is Egypt, where the provisions are broadly in line with OECD good practice, including a four-step approach covering how transfer pricing should be implemented and documented. Elsewhere, the picture is far less clear, and it's much harder for multinationals to know how best to structure intragroup transactions, and how these will be audited and taxed.

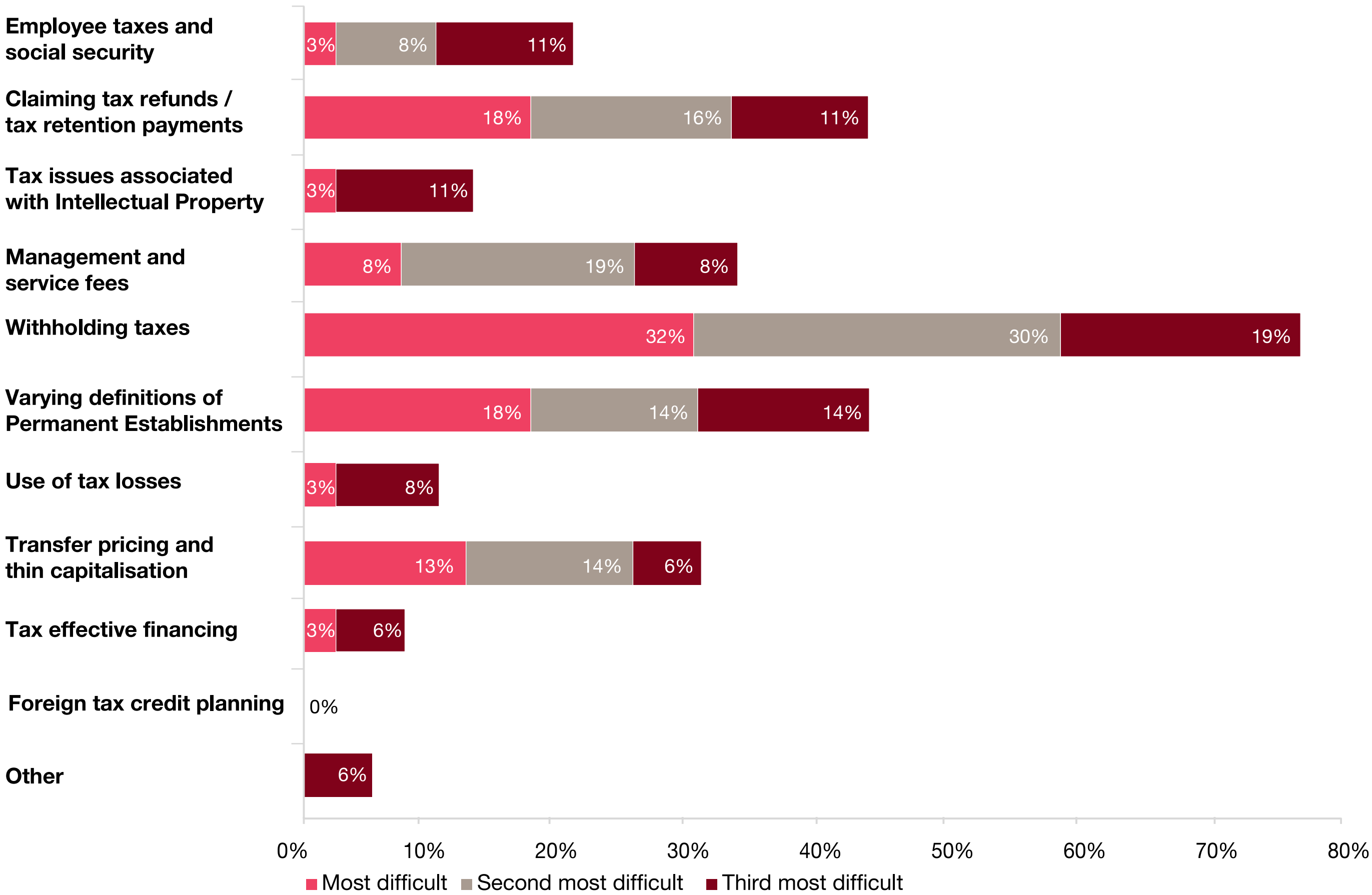
Ambiguous operating environments

The same problems can arise in other areas: for example, some of our respondents were granted tax holidays before starting to operate in the region only to find the terms were changed later; others reported agreeing customs exemptions on certain goods, which the tax authorities subsequently withdrew. In some countries it can take years for tax audits to be signed off, which means assessments can be left open - and the amount due uncertain - for all that time. It all adds up to an uncertain operating environment, where there's a risk that business decisions can be taken on the basis of information or assumptions that don't prove to be reliable.

> ***"The rules often give the authorities the right to step in and adjust the terms of intragroup transactions to an 'arms-length' basis, without giving very much clarity about how this is defined, and how these transactions should be recorded."***
>
> ***Mohamed Serokh, Partner, PwC Middle East***

> ***"We operate in good faith, and try to have productive relationships with the tax authorities, but in practice, it's hard to manage."***
>
> ***Survey respondent***

The three areas of corporate taxes that present the most difficult challenges



The cash-flow question: Withholding taxes and retention mechanisms

Withholding taxes may have largely disappeared in Europe and North America, but they remain a feature of business life in the Middle East, where the tax authorities still rely on this particular source of revenue. The same holds true across large parts of Africa as well.

As with other types of tax in the region, it's often difficult to determine which transactions are covered: withholding mechanisms usually apply to dividends, especially those paid to foreign holding companies, but in the Middle East the regulations can apply more widely as well, and this creates uncertainty about what has to be withheld and when tax can be remitted. This often results in payments being made to the tax authorities earlier or more often than they strictly need to be. And if refunds are due it can be a prolonged process to get them back.

In Qatar, for example, companies making contract payments to businesses which are foreign owned have to withhold tax, even where a double-taxation treaty exists.

The contractor may be entitled to reclaim the tax, but it's a lengthy process taking years rather than months.

Similar concerns arise in relation to retention payments. In many Middle Eastern countries, foreign firms in industries like oil and gas have to lodge a large deposit with the authorities before they can start operating.

In Qatar, for example, companies employing foreign-owned contractors have to retain 3% of the value of the contract or the final payment, whichever is the greater. The contractor can only get these funds released at the end of the term, after proving that all the relevant taxes have been paid. So with a ten year contract, it can be another five years before they get the refund.

"Retention mechanisms may not be 'taxes' in the strict sense, but they cause similar issues with cash-flow."

Upuli Kasthuriarachchi, Senior Manager, PwC Qatar

Under the radar?: Managing business travel

In PwC's 2014 mobility survey, *Moving people with purpose*, 57% of the respondents expected to see more short-term business travel. It's a fact of life in our increasingly globalised world, but one that has tax consequences too: if employees travel abroad to work, even for short periods, it can create a tax liability. For the authorities, it's a relatively easy source of new revenue; for most companies, it's not even on the radar. Formal secondments are part of business-as-usual, with full documentation and the appropriate intragroup charging, but even large multinationals often don't track the shorter trips their employees make, or the countries they travel to. And many of these visits are being carried out under tourist visas, so technically the people in question shouldn't be working at all.

Tax authorities across the world are paying much closer attention to this issue now – in the UK, for example, HMRC has added the topic to its annual 'know your client' discussions with corporations.

The HMRC want to know how many employees are travelling into the UK to work for short periods, how senior they are, and – crucially – how much tax the company or employee should be paying as a result. Most companies simply don't have the information to answer those questions, and few have resources dedicated to managing the issue.

There is no tax treaty, for example, between the UK and the UAE, so if an employee based in Dubai incurs a personal tax liability by working in the UK, the employer will need to gross up that liability and pay it on their behalf. It's also important to track the seniority of the people travelling and what they're doing, as agreeing strategy or contracts overseas could give rise to problems with the company's tax residency.

"Managing overseas working can be even more of a challenge in the Middle East, where the tax function is often either small or non-existent, and where there are few double taxation treaties."

Stuart Carter, Global Mobility Director, PwC UAE

So what should companies in the region do? Here are four key steps:

New digital technologies are now available to help implement these steps and reduce the administrative burden for companies and their employees.

1. Identification

Make sure you know who is travelling and where they're going, especially if it's a regular occurrence. Consider establishing systems to track and monitor this data.

2. Quantification

Use the data on who's travelling to quantify your potential tax exposure, including any grossing up of liabilities paid on employees' behalf.

3. Governance

Put a framework in place that sets out how overseas working should be approved and managed, so that employees and their managers know what is and isn't permitted. Make sure everyone knows the tax implications.

4. Support

Make sure your employees have the support they need to meet their tax obligations, from identifying their liabilities, to making their tax declarations.

Tax reform

We'll conclude the report by looking at some of the tax reforms currently underway, both in the Middle East and across the world. The most significant of these is the OECD's project on Base Erosion and Profit Shifting (BEPS).

What is BEPS?

The BEPS project is the OECD's response to harmful tax competition by countries, aggressive tax planning by multinationals, and the lack of transparency which can impede tax authorities from making fair assessments of what companies owe. 'Base erosion' refers to the failure to pay tax in countries where companies are making profits, and 'profit shifting'; to the artificial movement of these profits to lower-tax regimes. The BEPS project is backed by the G20 and many governments will revise their tax laws and policies based on the recommendations issued by the OECD.

The OECD's Action Plan, which was drafted with the active participation of its member states, contains 15 separate action points, and has now been endorsed by the G20 and OECD countries. The implementation phase is likely to include changes to the international taxation system, changes to domestic laws, double taxation treaties, and the development of a multilateral instrument to ensure a swift application of these changes.

Companies need to urgently consider how the BEPS recommendations will impact them, and put in place the policies and systems to comply with the increased reporting requirements. For example, the Action Plan covers issues such as transfer pricing, and how governments define whether a company is 'resident' for tax purposes – in a digital age, firms can make profits in a jurisdiction without needing any physical presence in that market.

Overall, the OECD plan is designed to help tax authorities ask the right questions to businesses, and they in turn will be required to provide an unprecedented level of disclosure, from how they are structured, to where exactly they are making their money on a country-by-country basis.

BEPS in the Middle East

As a member of the G20, the Kingdom of Saudi Arabia (KSA) will take the lead in implementing BEPS in the region. They will also have another incentive: BEPS is designed to clamp down on evasion and raise governments' tax take, and it's coming at a time when the Kingdom is looking for new ways to bolster its revenues. However, it's likely that the authorities in the KSA will wait to assess the experience of more developed economies and learn any lessons from them, before making a formal move. Egypt and Oman will probably follow, along with Qatar and Kuwait. The overall effect, over time, will therefore be to tighten tax regulation within the Middle East, and it could also accelerate the introduction of measures like VAT.

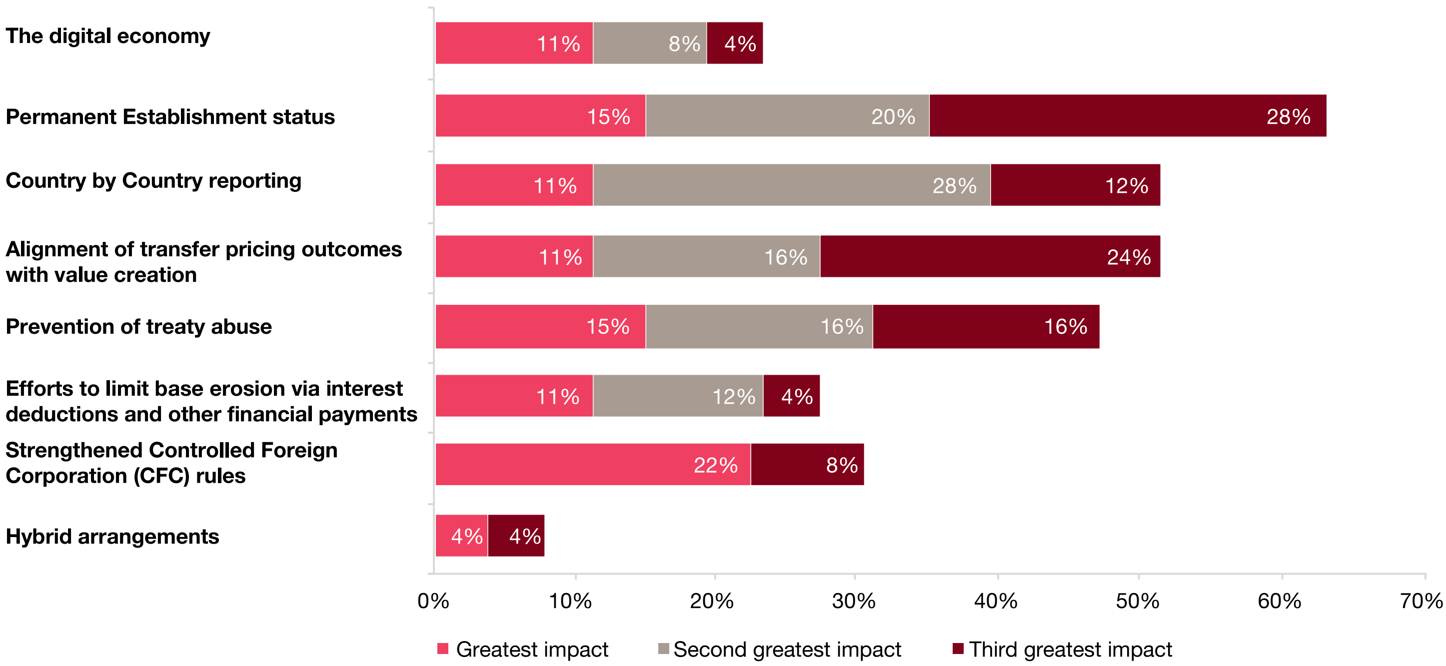
The effect on the region's companies will depend on whether they have an international presence. Those that do - like airlines or oil companies or sovereign funds with overseas investments – will come within the scope of BEPS more quickly, while purely domestic players will be affected last. At present, there is a low level of knowledge about the impact BEPS could have, and an equally low level of preparedness for these changes – only 9% of our survey respondents said they had a detailed understanding, while 39% said their knowledge level was low; likewise, only 6% have done any detailed preparation work, and 36% have done little or nothing. Clearly companies need to start preparing for the requirements associated with BEPS now, and we expect many more to start doing so over the next few months.

As the graph below suggests, the BEPS action area that is likely to have the greatest impact in the region relates to Controlled Foreign Corporations (22% cited this as the biggest issue). Transfer pricing, country-by-country reporting, and definitions of Permanent Establishment will also be significant.

"Companies need to review their business models and structures to check their compliance with BEPS. Planning, approvals, changes to legal entities and operational adjustments will all take significant management time and resources."

Sajid Khan, Tax Partner, PwC Qatar

BEPS: Of the different BEPS action points please rank the three that will have the greatest impact



Looking ahead: VAT and corporate tax

For governments looking to increase their revenue stream, VAT has many advantages: it is an efficient tax that is levied on consumption at all stages of the supply chain, which makes it a substantial source of revenue for Governments. It is also neutral for businesses who are tax collectors and do not bear the burden of VAT, as cumulative taxation is avoided through the right to deduct/refund input VAT. The GCC States are in the course of agreeing a common framework for VAT and implementation at national level could happen in the coming two to three years. It will be important to ensure that the system adopted is business-friendly and easy to administer: the governments in the region are well aware that the easier it is to comply, the higher the revenue stream will be. There will also be localised issues to resolve notably in terms of evaluating other forms of existing local consumption taxes/fees that would apply in addition to the VAT.

60% of our survey respondents believe it is likely or very likely that the GCC will start to introduce VAT by the end of 2017, with 36% seeing this as unlikely. On balance, therefore, most seem to think this will happen.

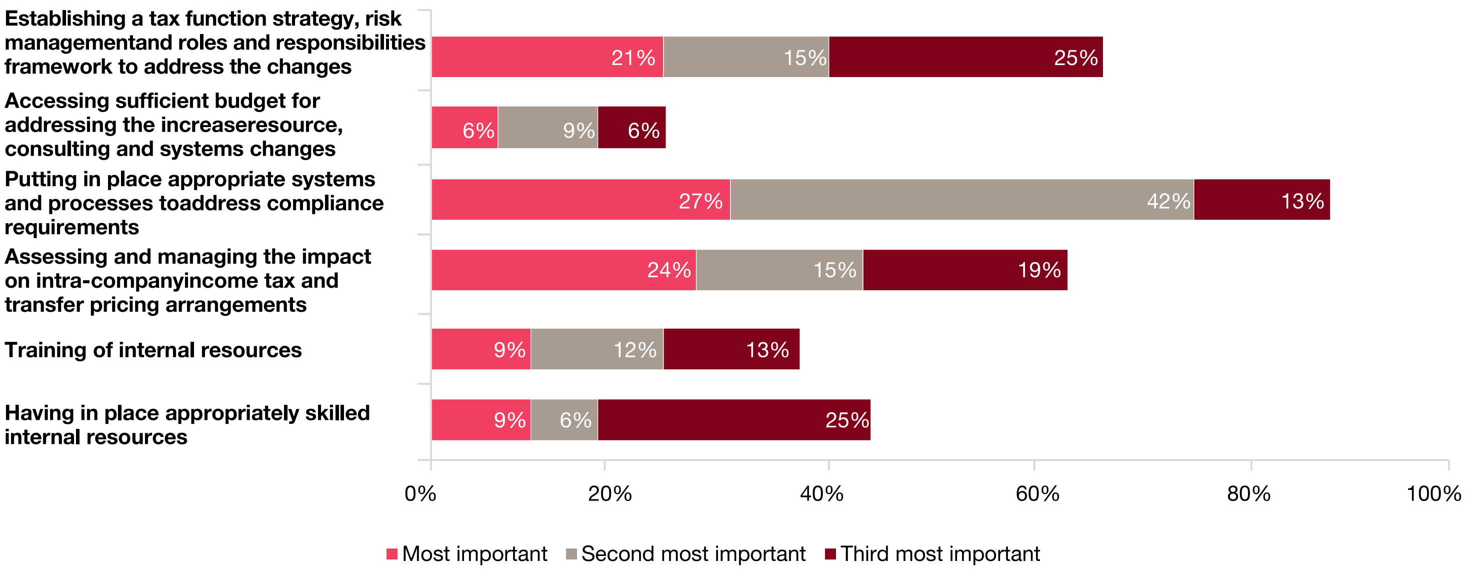
Turning to corporate tax, 60% of our survey respondents believe that it is likely or very likely that Bahrain and the UAE will implement a corporate tax regime by the end of 2017. 64% say this will have some negative impact on the two countries' attractiveness to investors, with 30% believing the effect would be more severe.

So what are the implications for companies in the region, if VAT and corporate taxes are extended further across the Middle East?

"The Paying Taxes 2016 Report prepared by PwC and The World Bank Group indicates that stable tax systems and strong tax administration are important for businesses, helping them to operate in an environment where the tax treatment of transactions is predictable and where governments operate transparently. In addition, the way in which the tax system collects and administers its taxes has an impact on businesses in terms of the time required and the costs associated with that time."

Jeanine Daou, Partner, PwC Middle Ea

The three most important challenges raised by VAT and corporate regimes in the GCC



Harnessing technology, people and process to manage increasing tax demands

As the graph shows, our respondents think processes and systems will be the biggest challenge, ranging from managing the additional workload, to collecting and analysing the data, to internal reporting and external compliance. This is a particular issue in the Middle East, because so many businesses in the region need to upgrade – or indeed install – systems to automate their tax processes (and the same can be said for many of the Middle East's tax authorities as well). 34% of our respondents have no automated processes at all, and another 60% have only partial systematisation.

The introduction of VAT, in particular, would put even greater demands on these tax departments, given the huge number of transactions that would be covered, and the volume of data that would be generated: it will be almost impossible to manage this without effective systems. It's instructive in this context to look at what happened in Malaysia, when the government introduced a goods and services tax in 2015. Many companies under-estimated the time and resources required to implement the new regime properly, and how much it would cost. Using digital technology can save both time and money, and improve accuracy and efficiency.

Technology can also help with another issue identified by our respondents. The foreign ownership rules that apply across most of the Middle East make it very hard for overseas businesses to get accurate and comprehensive information from their local minority-owned subsidiaries. This is even harder when the parent company has to rely on manual reporting or relationships between individuals. Many of these problems can be eliminated - and efficiency improved - if the reporting processes are automated.

The respondents to our survey also highlighted the need to adapt the tax function's strategy and way of working to any new regimes, and we look at this in more depth in the next section. Concerns about the availability of internal resources come rather lower down the list, which may indicate that companies in the region are underestimating the skills they will need. In Malaysia, for example, many of our clients found it harder than they expected to secure the people and know-how they needed, so companies in the Middle East would be well advised to start planning as early as possible. This is an area where expert advisers can also play a useful role.

> ***"Communications and co-ordination are an ongoing challenge. There's not much trust and transparency, even between different countries in the region, and it's very hard to ensure you're kept in the loop."***
>
> ***Survey respondent***

Pre-announcement

- Understand how VAT impacts your business
- Assess capability of existing systems to cater for VAT
- Identify VAT implementation strategy: in-house, outsourced, combined
- Identify the contractual arrangements that need a VAT action
- Identify intercompany transactions and set policy on intra-group documentation

Post-announcement

- Review VAT legislation and impact on business
- Set up new General Ledger account codes as per anticipated VAT treatment
- Amend and negotiate transitional contracts; ensure VAT clauses are inserted in new/renewed contracts
- Address and complete staff training needs across the business
- Document intercompany transactions (e.g. VAT invoice)

Pre-implementation

- Map transactions/begin tax coding exercise
- Ensure all business areas are ready: supply chain, logistics, finance, tax, accounting, etc.
- Inform management of anticipated disruption/ issues, ifany
- Analysis of VAT optimisation opportunities, reducing the impact of any potential irrecoverable VAT
- Simulation and test before go-live date

Post-implementation

- VAT health-check toensure systems arecompliant with VAT rules, and make adjustments where needed
- On-going training to staff
- Monitor periodical formal obligations and reporting requirements
- Monitor new developments
- Ensure cash flow impact is efficiently managed and optimised where possible

The evolution of the tax function

27% of our survey respondents have no dedicated resource at all, and another 43% have only one or two people.

Given the 'low tax/no tax' image of the Middle East, it's not surprising to find that even very large businesses often have very small tax functions: 27% of our survey respondents have no dedicated resource at all, and another 43% have only one or two people. Without knowing the seniority of these people, it's hard to say if companies in the region have the skills and resources they need to manage an increasingly complex area. There is also the wider question of the 'right' size for a tax function, which can only be determined on a case-by-case basis. The size of the company is certainly a relevant factor, but not necessarily the most important one. A mature, stable business will need less resource than a fast-growing company, especially one which is actively acquiring assets, or moving into new territories. A more mature business may also have developed useful tax know-how within its business units.

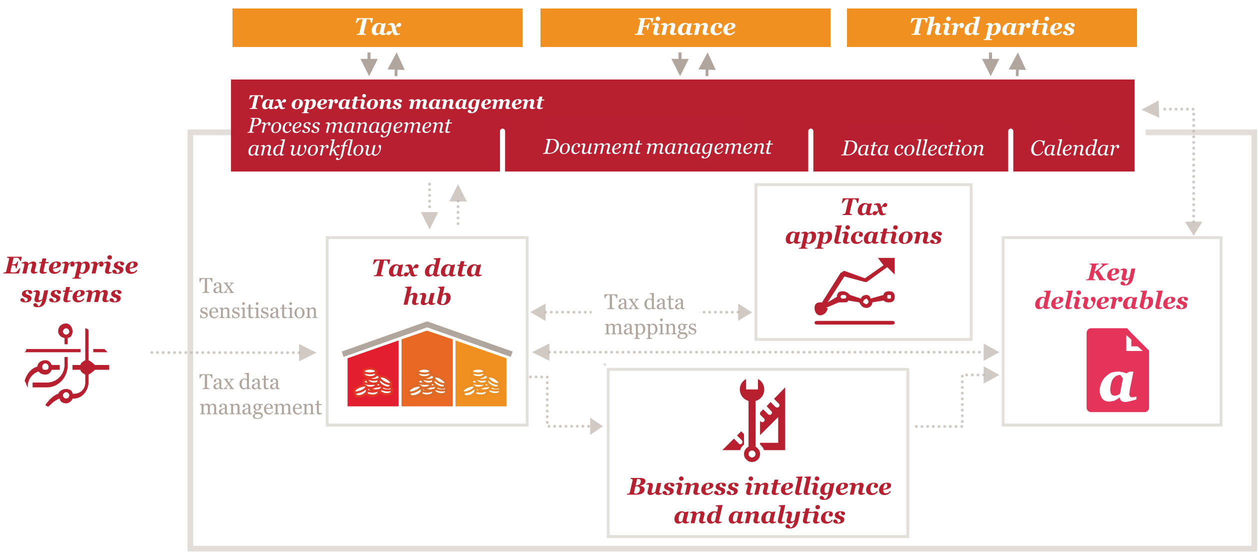
Introducing the technological and technical tax function

Companies in the region also need to bear in mind that the skills required by tax functions are changing, and now include leadership, business acumen, and data analysis skills. With so many processes becoming automated, businesses need technological as well as technical skills in their tax functions.

That last point is particularly crucial in the Middle East: as we have already discussed, companies in the region generally lack the tax systems they need for effective monitoring and reporting, both internally and to the relevant authorities. Taking advantage of digital technology should be a much higher priority than it currently is: dedicated software can analyse the data, calculate the liabilities, and prepare the filings.

The latter, however, will require the tax authorities in the region to modernise their own processes, if it is to be fully effective, and as our 2016 Paying Taxes survey highlighted, there has been very little progress in this area.

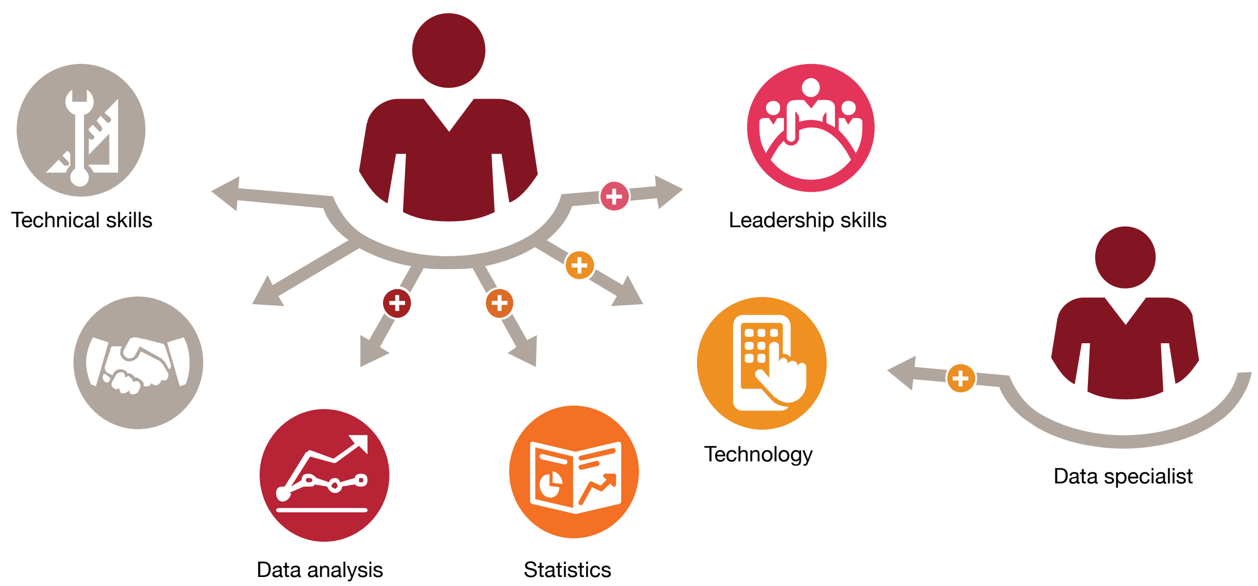
Tax functions of the future will increasingly feature technology



Building an efficient and effective tax function

Taking all these factors into account, it may not necessarily be the case that the best way forward is to build large in-house tax functions for Middle East groups, but rather look to optimise the use of systems, finance and other terms and specialist external advisers where required. However, some firms may need more staff, or more senior staff, to ensure their tax affairs are being given the priority and oversight they require. In either case, it will be vital to ensure clear accountability and efficient communications between everyone making tax decisions, both internal and external. A responsibility assignment matrix can be a good way to work through the issues and priorities, to determine where there are gaps, and where the accountabilities should sit.

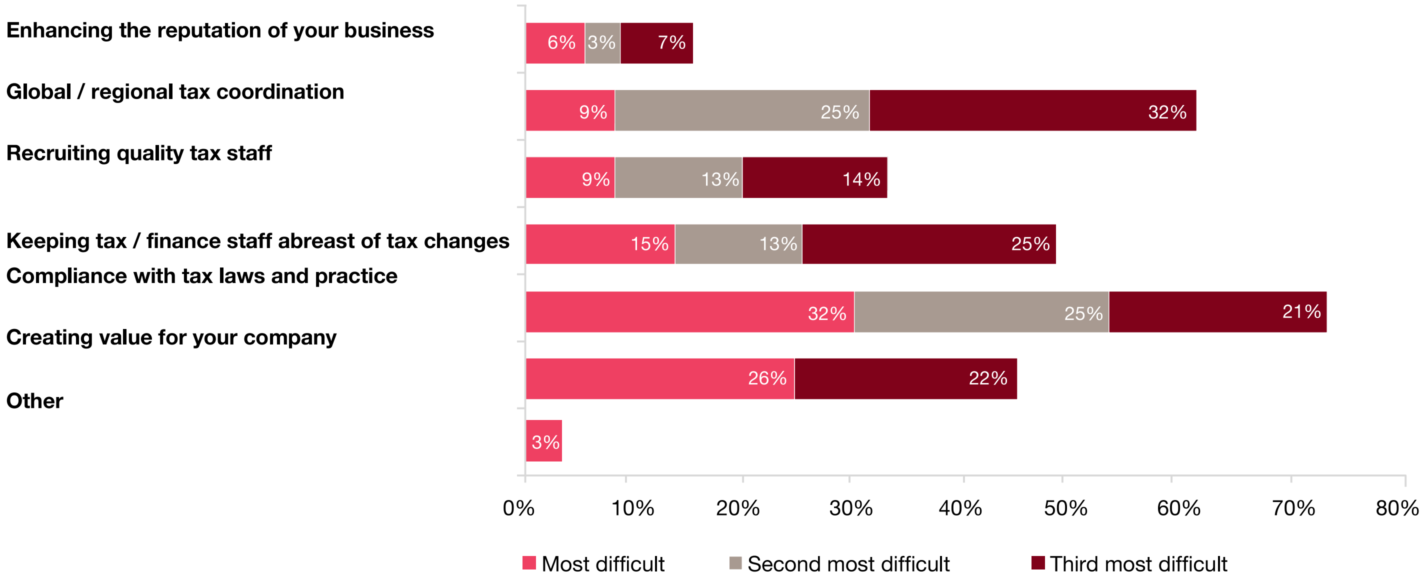
The skills found in tax functions increasingly go beyond tax technical needs



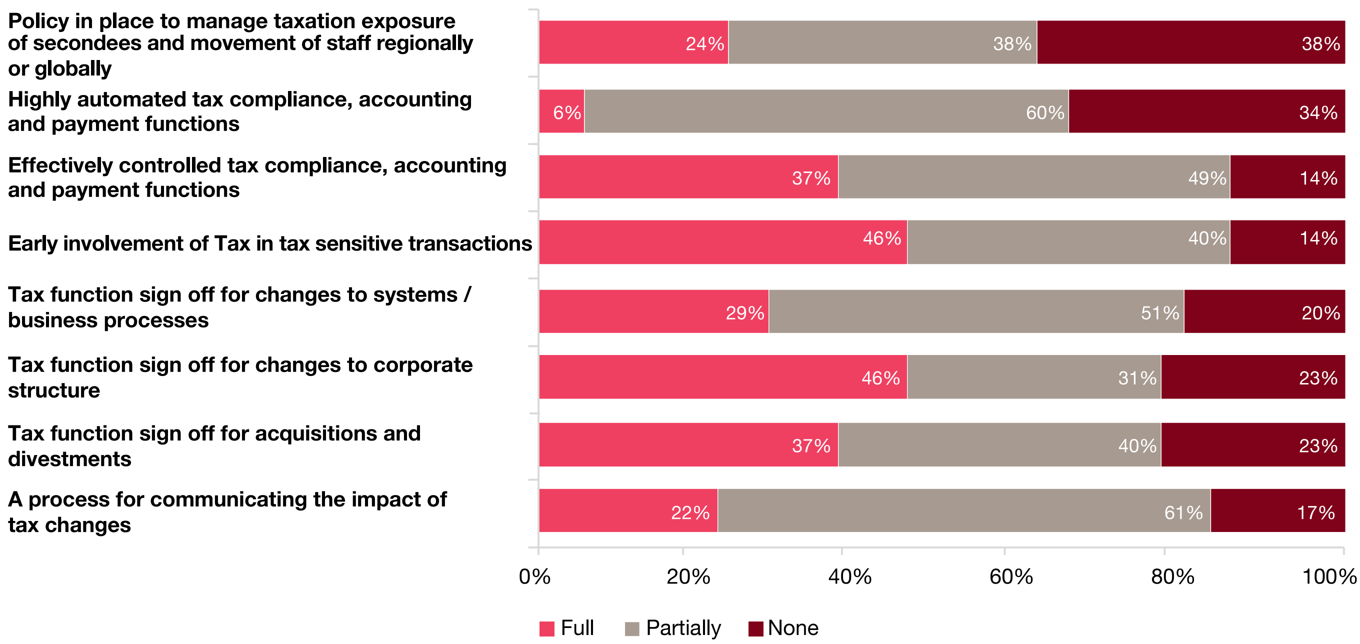
Challenges and opportunities

We asked our survey respondents what they considered to be the biggest challenges for the tax function.

The three most difficult challenges facing the tax function



The implementation of compliance controls



The complexity of tax compliance

As the first graph shows, compliance is the single biggest task: it's at the heart of the tax department's role, of course, but its priority in the Middle East may reflect the greater complexity of the operating environment in the region, which we've discussed already in this report. 81% of respondents said compliance was one of their three most difficult tasks, and for 32% it was the most difficult. The second graph looks at these compliance challenges in more detail. A significant number of companies have no controls to ensure that the tax function is involved in major business decision-making – 23% have nothing in place in relation to acquisitions or changes to corporate structure, and 14% have nothing for sensitive transactions. An even larger number of respondents reported only partial coverage in these areas, which may reflect an over-reliance on the know-how of individual employees rather than proper documented processes. The risk here is that companies in the Middle East could be exposing themselves to huge and unquantifiable risks by failing to involve tax practitioners at the earliest possible stage, particularly in relation to potential acquisitions or new overseas operations.

Creating value, protecting value

Looking again at the first graph, the biggest challenge after compliance is to create value for the company. But what does creating value mean for a tax function? The key here is to ensure that the tax function is supporting the commercial objectives of the business. These days, tax specialists need to be business generalists as well – they need to understand issues like production, logistics and supply chains, financing and HR, and the impact tax can have on their efficient management.

Protecting value is another way to create value, and 'value' in this respect can be both money and the intangible asset of the company's reputation. Multinationals, in particular, are under increasing scrutiny, both from governments and other stakeholder and pressure groups.

Recent calls for public boycotts of certain brands and businesses based on their 'inadequate' tax payments is only the most high-profile example of a much wider trend. It's vital that companies understand the issues and risks they are facing, and have plans in place to deal with them.

Protecting value also means saving money, of course, not only by efficient tax planning, but by using technology to speed up internal processes and ensure that filings are done on time and refunds secured as early as possible. If VAT taxes are introduced or increased across the region, this will become even more important. Tax departments also need to ensure they are gathering data on the taxes they collect on the government's behalf –customs duties and withholding taxes are good examples. This is important because it is part of the contribution companies make to the wider community, by ensuring the government receives all the money it is due.

Skilled talent pool

One final observation on the first graph: it's interesting to note that – contrary to popular perception – our survey respondents do not find it particularly difficult to hire skilled tax staff. This could reflect the calibre of people now available on the market, but it could also suggest that most companies are still hiring at a relatively junior level, where positions are easier to fill.

Strategy and communications

These findings are particularly revealing. Most tax functions in the region have clear roles and responsibilities (40%) and regular communication with senior management (42%). So far, so good. The greater challenge is in the area of tax strategy, where 40% have no agreed strategy document at all, and 38% do not measure value creation as part of the assessment of the tax function's performance.

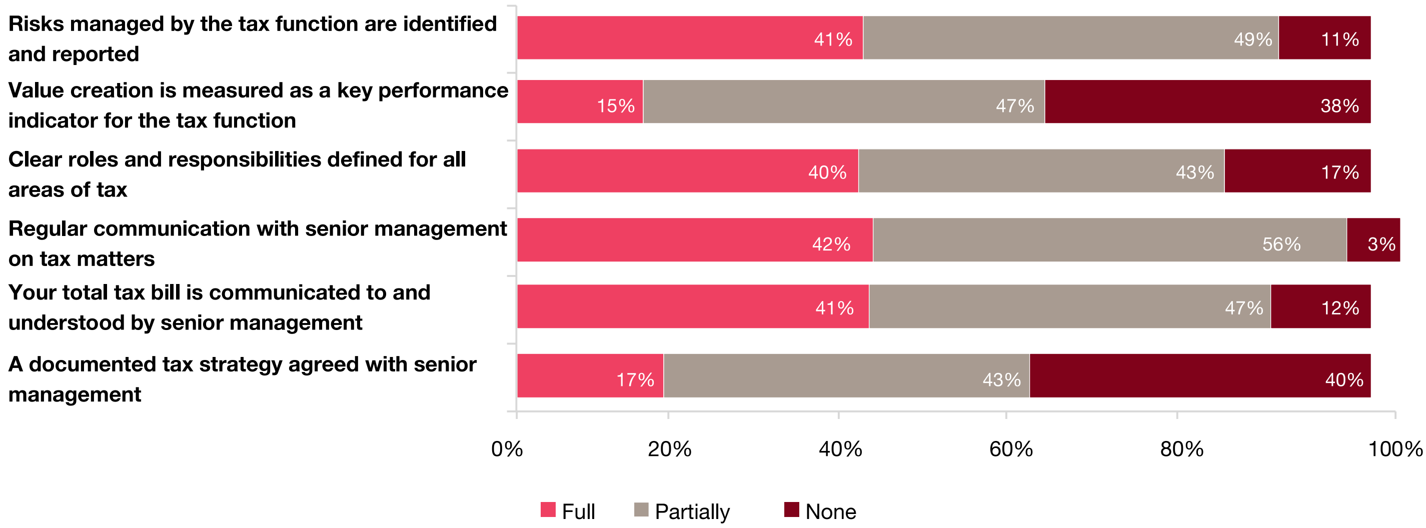
"The key is to develop an effective controls framework, so you know what's being filed and paid, and where."

Survey respondent

"Having a clear and documented tax framework helps address sometimes grey areas – who is accountable for group wide matters compared to day to day local compliance as an example. More importantly it boosts the profile of the tax function at senior levels and can be a key tool in demonstrating the existence of controls to revenue authorities. "

Phil Beswick, Director
PwC Dubai

Extent to which the following tax function features have been implemented



The lack of a documented strategy is especially worrying, given that this is now accepted good practice around the world, and in some countries is enforced by legislation. So what is a tax strategy and what should it include?

Five key components of an effective tax strategy

Set out the business, tax and regulatory **context**, and define the **purpose** of the tax function

1

Establish the **governance** structure and **accountability** for taxation, and set out where specific taxes are managed (for example, employment taxes)

2

Set out the company's **approach** to taxation, and the **controls** in place to manage this

3

Define the **priorities** of the tax function – whether reputation, cash tax, controls, or other issues such as earnings per share or effective tax rate

4

Be **signed off** by senior management.

5

Conclusion and observations

Taking all the survey results into account, the key observations can be summarised as follows:

Key observations from a tax administration perspective:

An overwhelming majority of our survey respondents want authorities in the region to provide greater clarity and consistency in the application of tax laws. This includes the publication of more comprehensive information about tax laws and administrative processes.

- There is a clear need for greater automation in tax administrations notably to manage and analyse data. This will speed up processes and help reduce the need to recruit more staff.

- Authorities would likely benefit from further investment in the skills, processes, and people required to apply tax systems effectively. This includes improved processes for audits, to focus resources on the more substantive issues, and a greater investment in skills, to ensure tax teams are armed with the knowledge they need to understand the issues domestic and international businesses are facing.

These observations are all the more important in jurisdictions which are making changes to their tax regimes, or considering new taxes such as VAT, since the current lack of clarity and consistency can only worsen otherwise.

The advantages for tax authorities taking action in these areas would be significant – it would make it easier for them to raise revenue, make their countries more attractive to foreign investors, and improve the business climate for companies already within their market.

Key observations from a business perspective:

The key point for companies is to manage their tax affairs in the Middle East as rigorously, and with as much attention to detail, as they do anywhere else in the world. The comparatively rudimentary nature of the tax regimes in many of the region's markets make this even more crucial.

- Companies need to focus in particular on the possibility that VAT will soon be introduced in some countries. This will raise a number of practical challenges, including staffing and compliance, and businesses will need to ensure they have the necessary staff and systems ready and prepared. This is not yet a high enough priority for many companies.

- The same need for preparedness arises in relation to BEPS: companies need to assess the scope of the possible changes this could prompt, and develop action plans appropriate to their own particular tax positions.

In general, companies should consider whether their tax function has the right framework in place and with the right level of skills, seniority, and systems. A more effective team, supported by effective IT and rigorous controls, will make it much easier to implement VAT, respond to BEPS, improve efficiency, and reduce risk.

Methodology

Invitations to participate in an online survey were sent to tax clients in various industries with operations in the Middle East. The survey targeted clients from a tax or financial background and a total of 52 respondents completed the survey. Questions focused on tax, business and regulatory challenges, with a specific emphasis on BEPS, as well as the implementation of VAT in the region.

Respondents represented groups with a range of experience within the region, 43% of respondents' companies have been operating in the Middle East for less than 10 years, whilst 56% have been active in the region for over 10 years (**Figure 1** shows the breakdown of responses).

Looking closely at the number of respondents whose companies' have headquarters based in the Middle East compared to those that are inbound, there is a relatively even split, with 49% and 51% respectively (**Figure 2** shows the breakdown of responses).

This range of maturity in the region and the level of practical understanding of the operating environment provides a solid basis for understanding and appreciating the variety of challenges with doing business in the Middle East.

Not all the questions were relevant to all respondents, therefore, not all the questions had the same response rate. Due to this factor and the rounding of percentages, not all the questions total 100%. Few, if any, of the companies surveyed do business in every Middle East country, so all responses should be interpreted in the context of the universe of countries they are active in. In addition, some countries are attracting more foreign investment than others – and it stands to reason that countries in which companies do more business may be likely to cause them more problems.

Figure 1: Number of years with operations in the Middle East

Years (percentage)

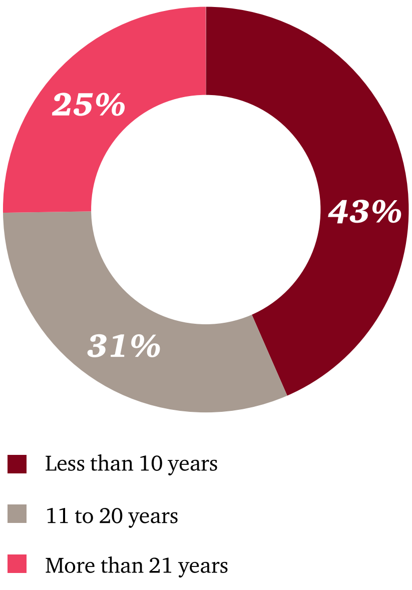
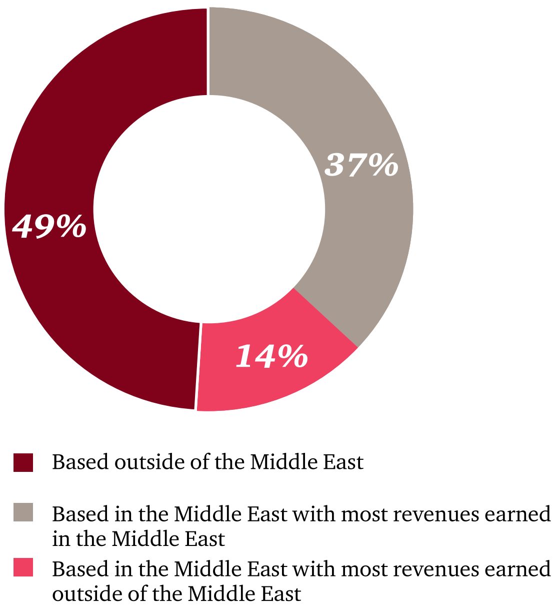


Figure 2: Is your company global head-quarter

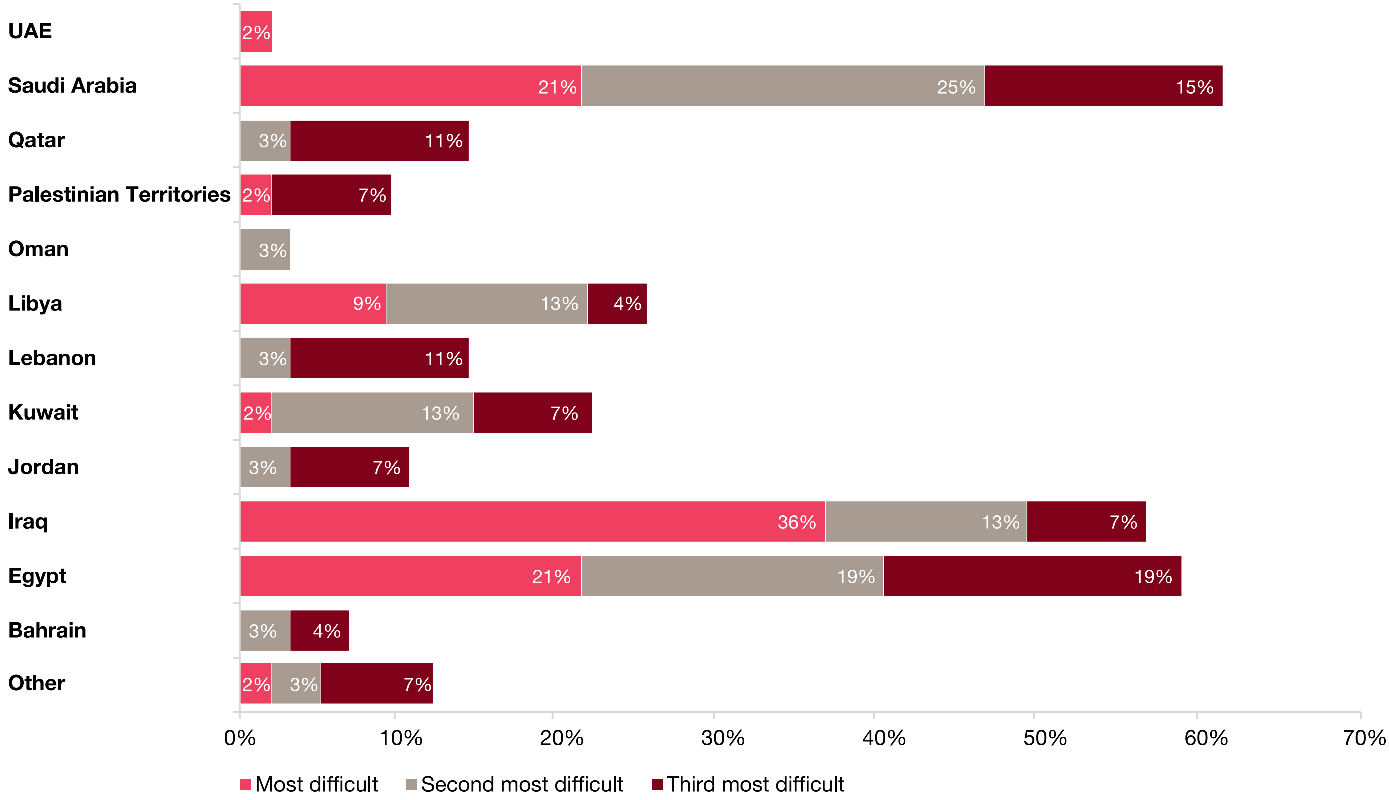
HQ Location of participants (percentage)



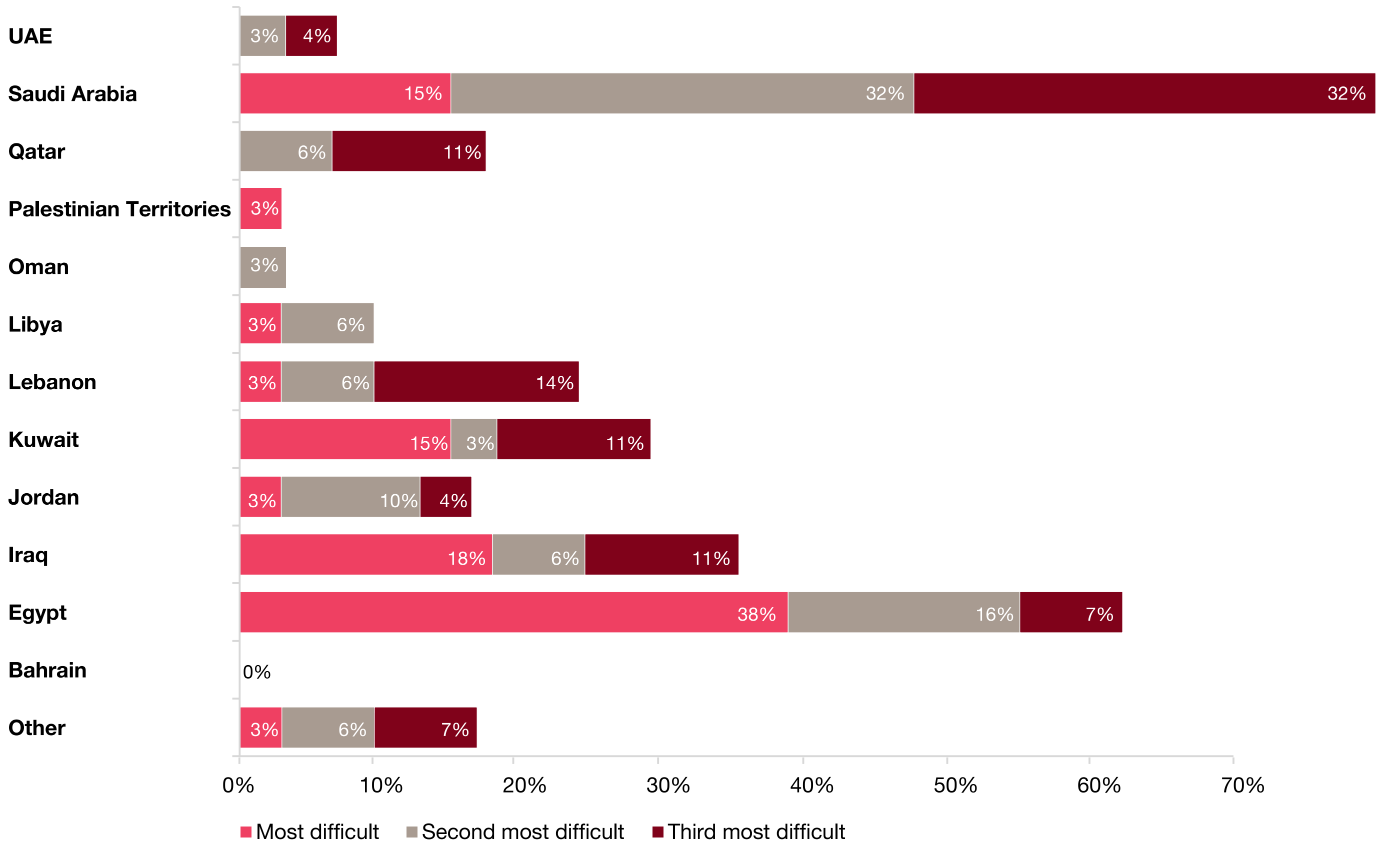
Middle East Tax Survey

Full results

1. Please rank the three Middle East countries that present the most difficult business challenges for your company

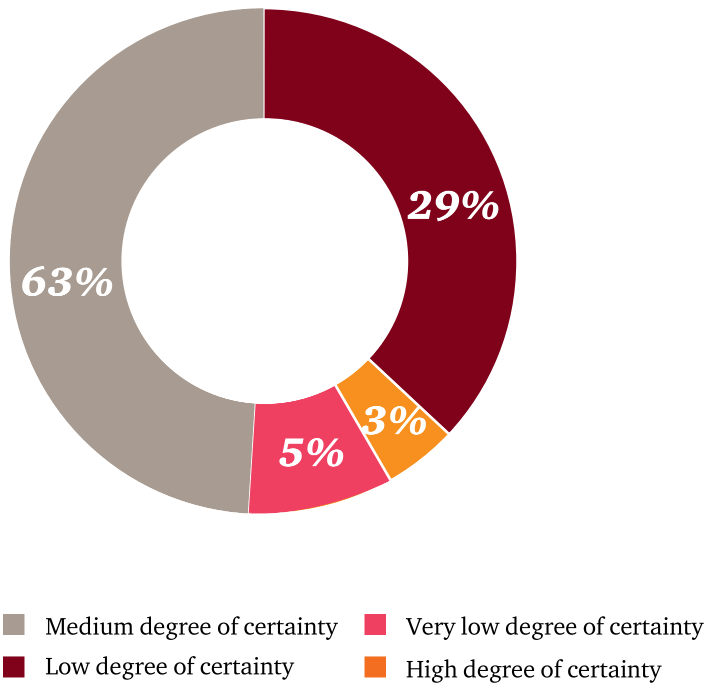


2. Please rank the three Middle East countries that present the most difficult tax challenges for your company

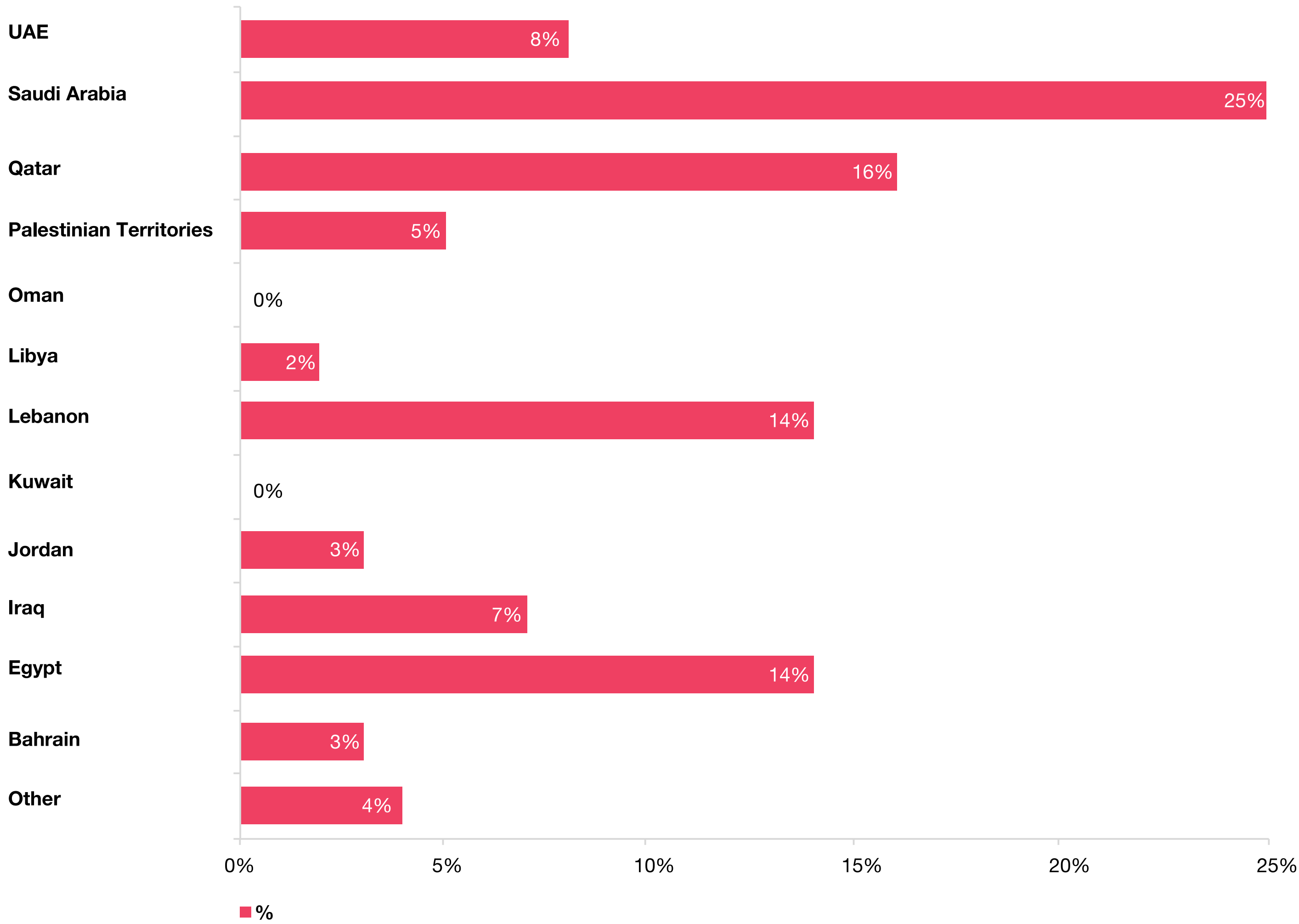


3. What level of certainty do you have on the practical application of the taxation and regulatory legislation to your business across the Middle East?

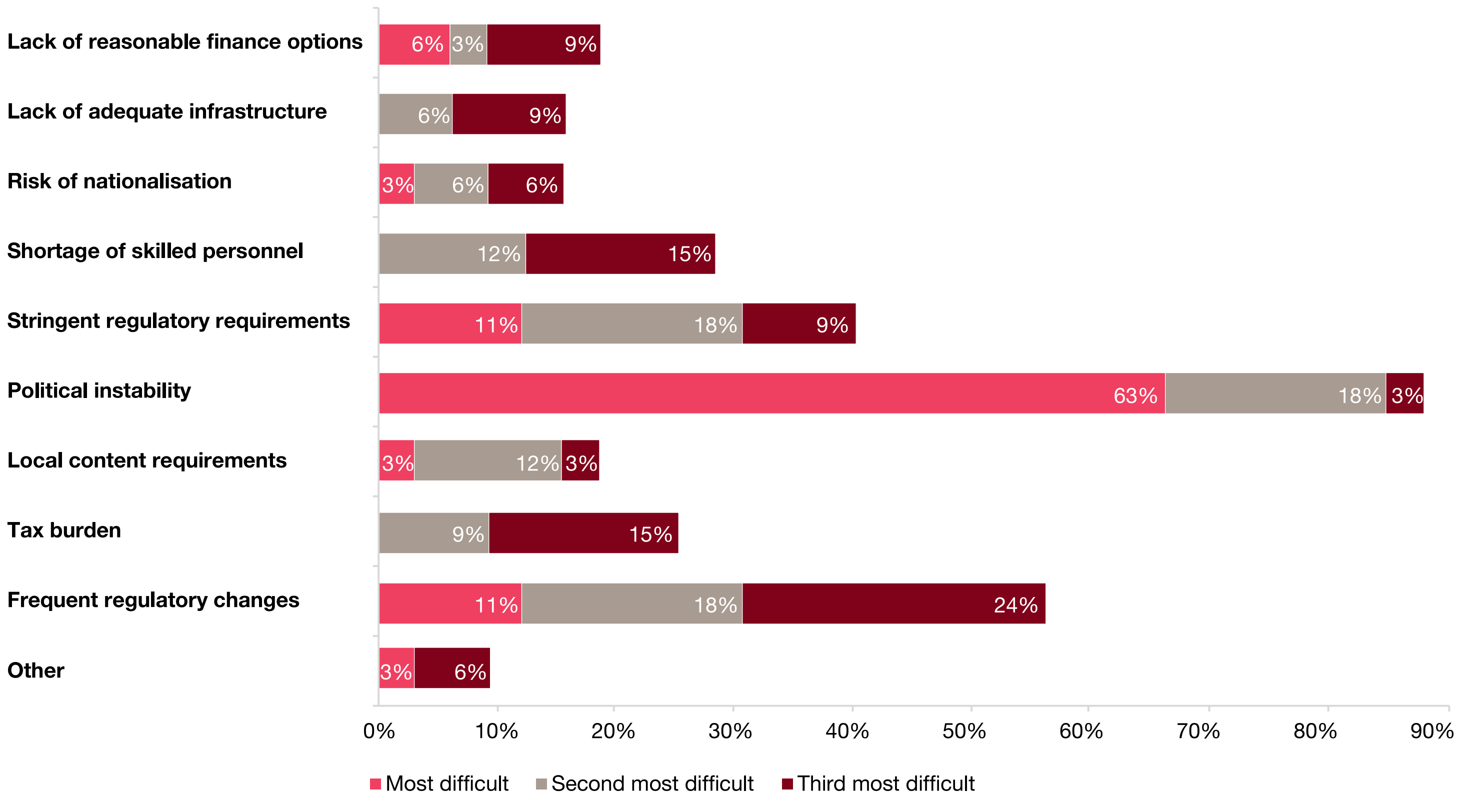
Degree of certainty (percentage)



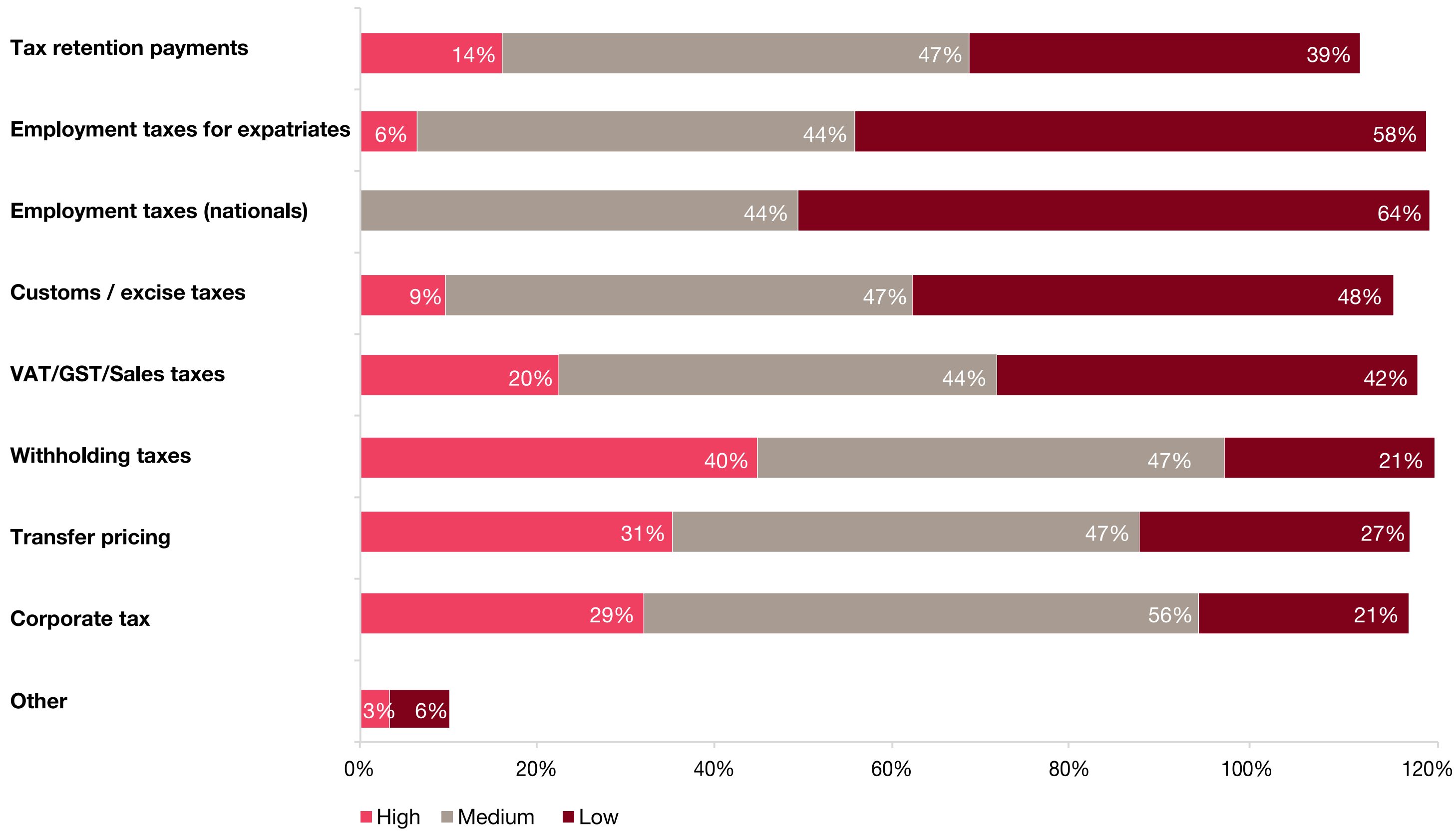
4. In which countries across the Middle East will your business be likely to increase investment over the next 3 years?



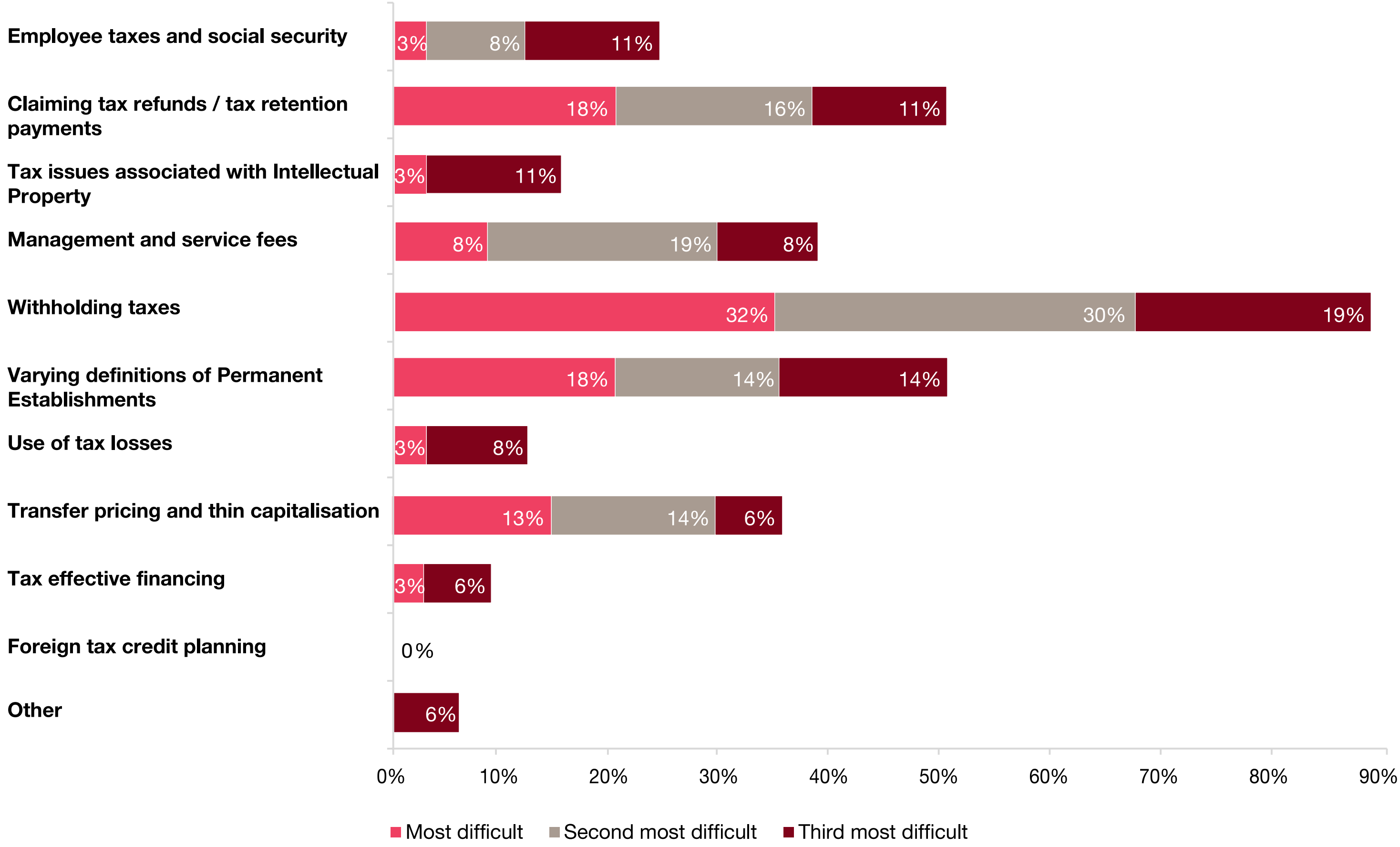
5. What are the top three business threats to growth across the Middle East?



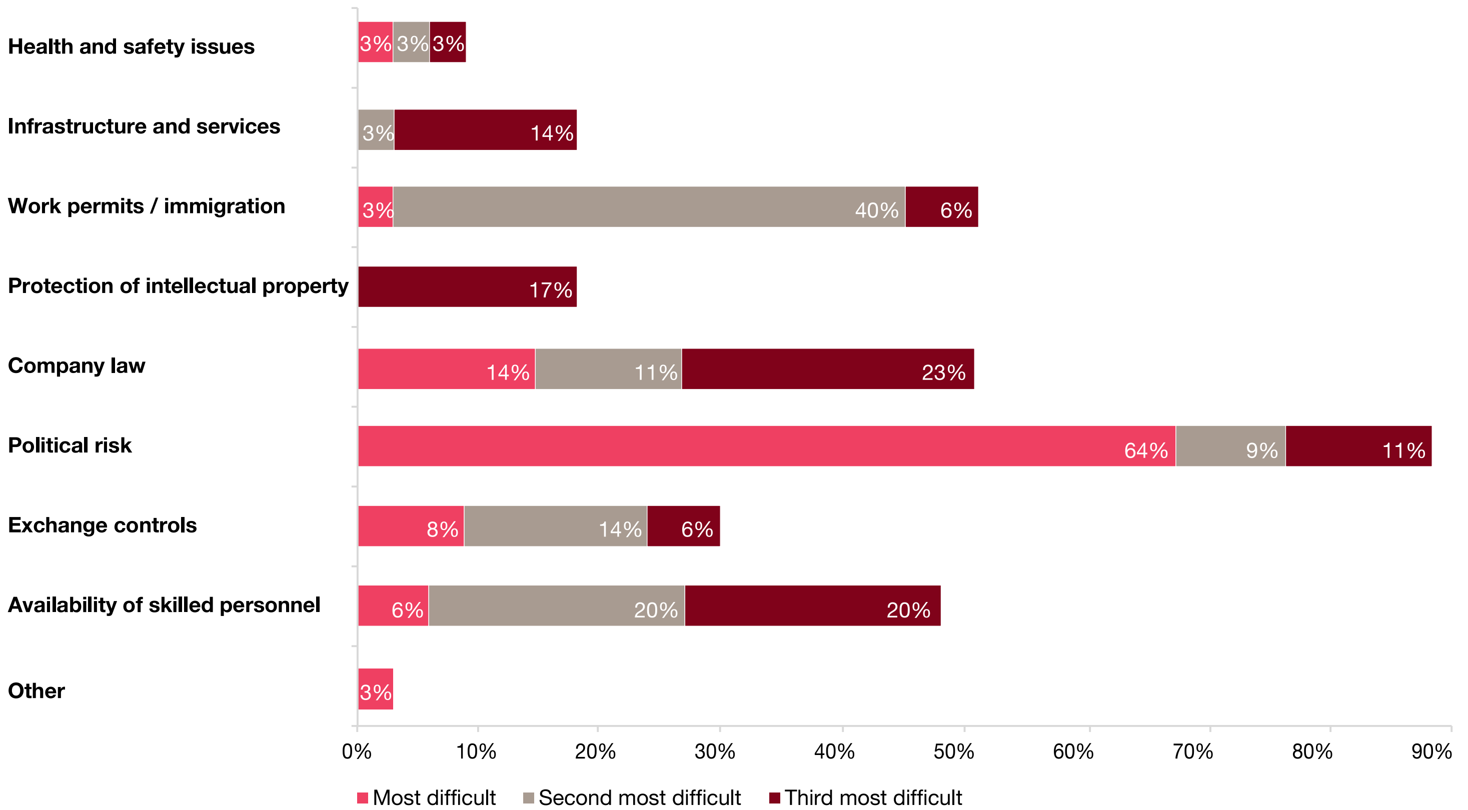
6. What degree of risk do you associate with the following areas of taxation across the Middle East?



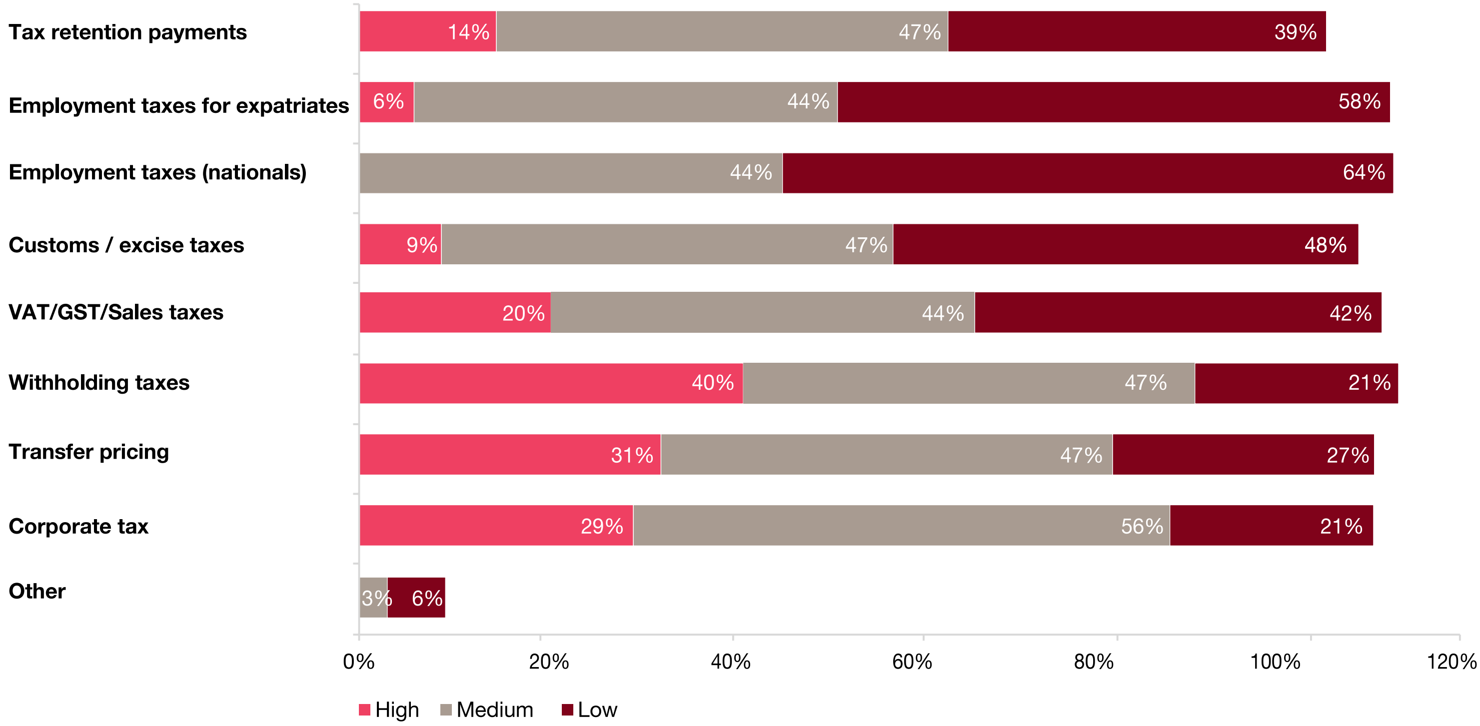
7. Please rank the three areas of corporate taxes that present the most difficult challenges for your company with respect to your operations across the Middle East.



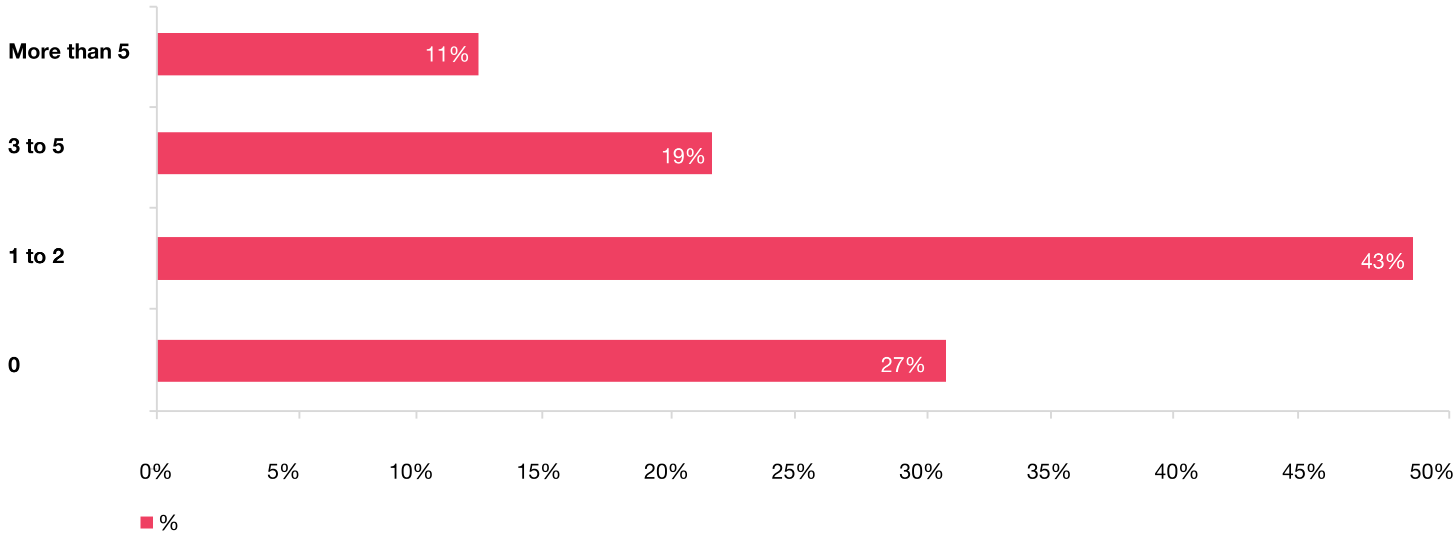
8. Please rank the three areas of business and regulatory challenges that present the most difficult challenges for your company with respect to your operations across the Middle East.



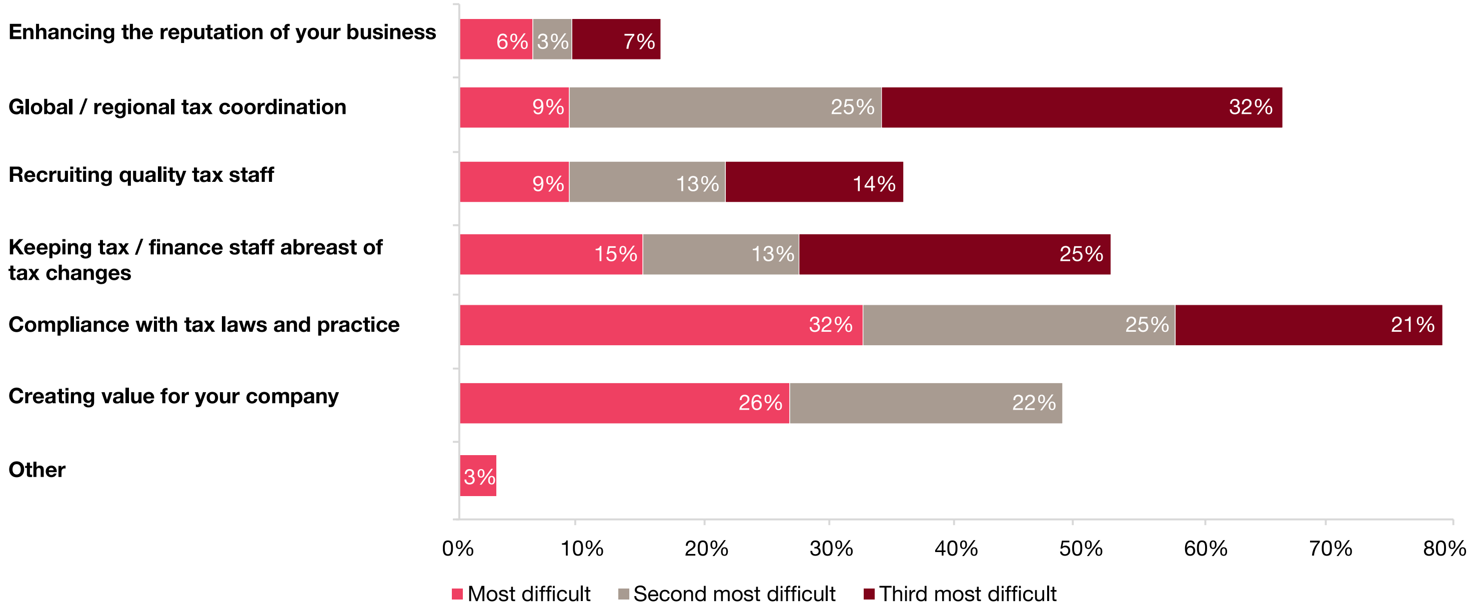
9. What has been your company's experience in relation to tax and regulatory compliance across Middle East countries where you operate



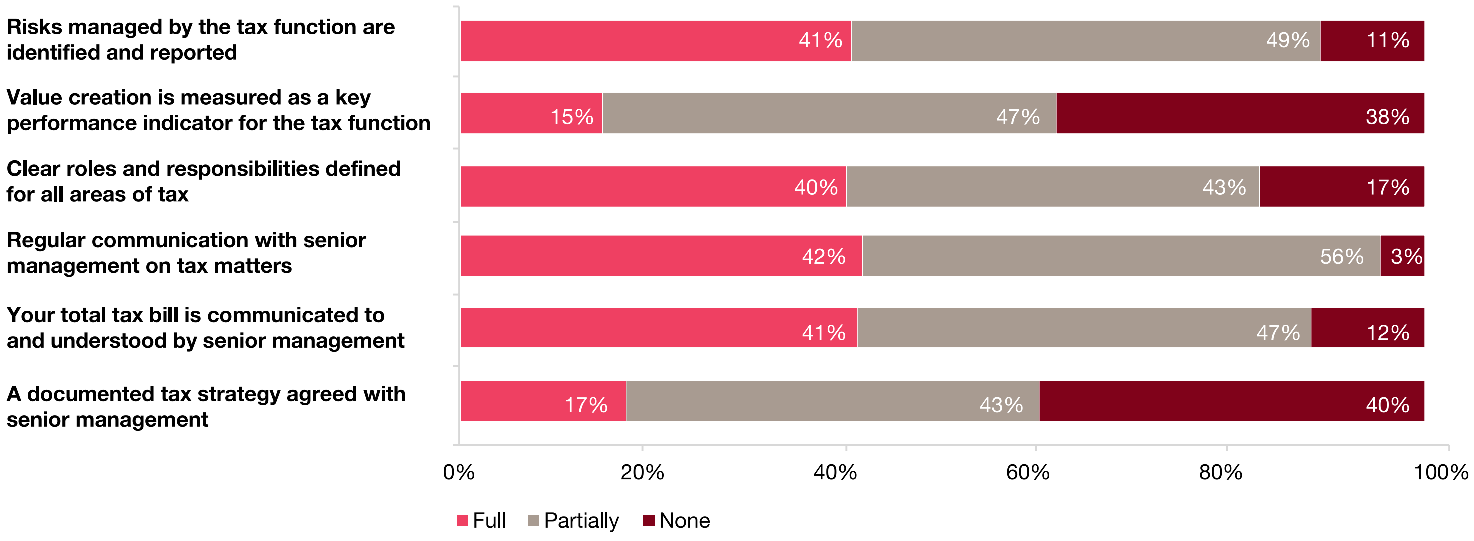
10. Tax function - how many people are 100% dedicated to taxation matters for your Middle East operations or based in the Middle East and also manage countries outside of the Middle East?



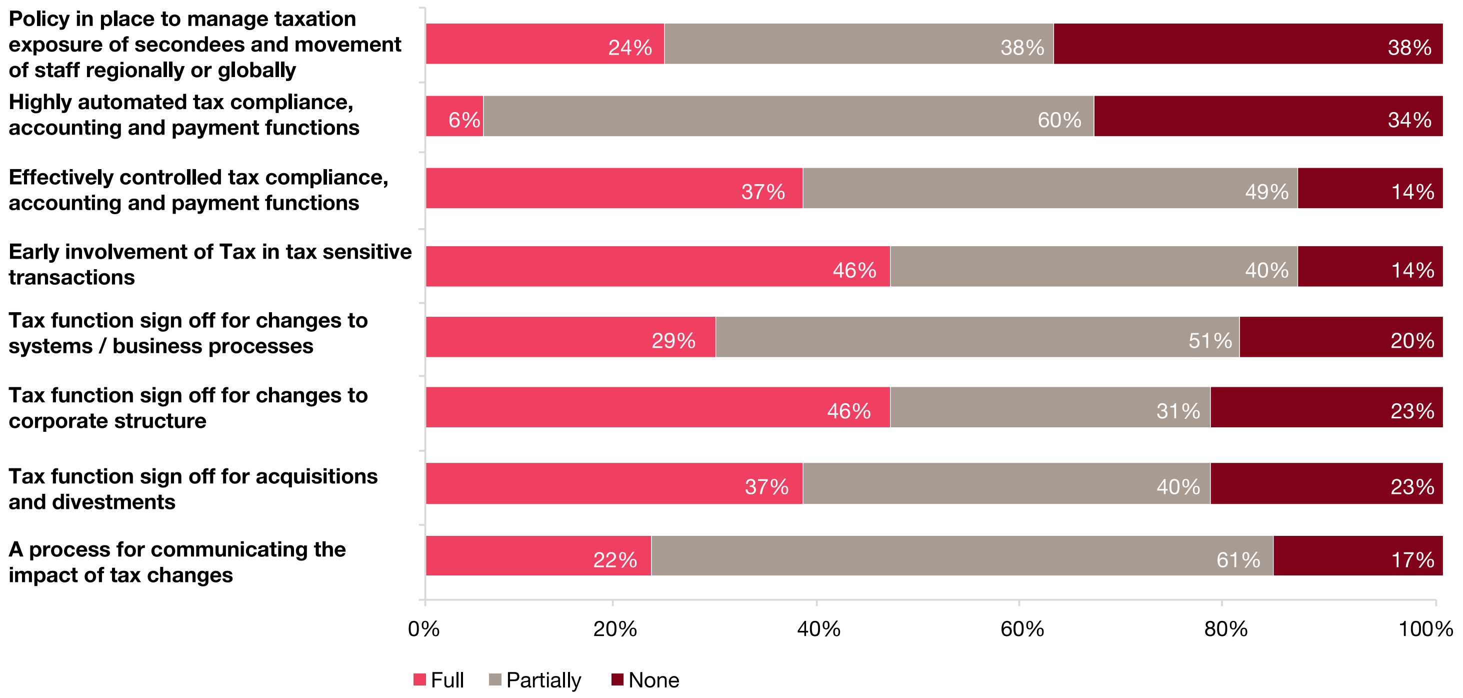
11. Please rank the three most important challenges facing your tax function with regard to your Middle East operations.



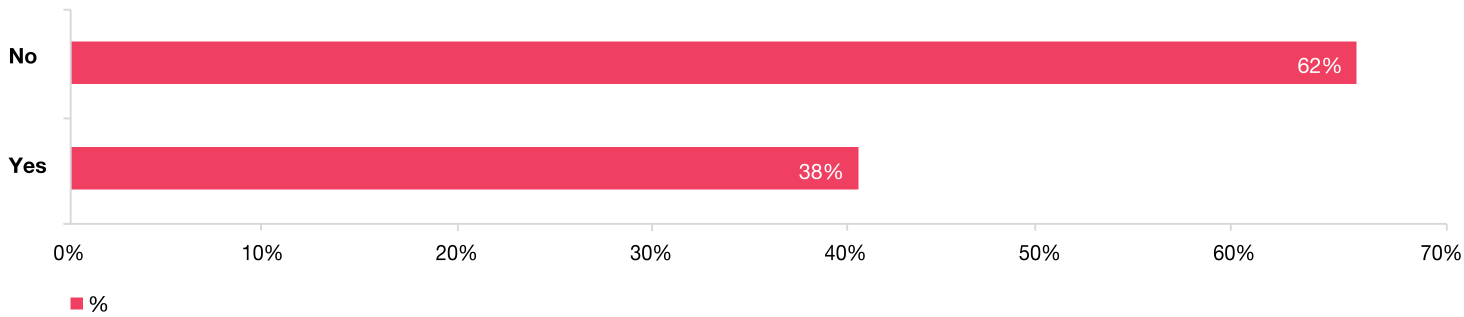
12. Tax strategy - Please indicate the extent to which the following have been implemented in your company with regard to Middle East operations or if based in the Middle East, your global operations:



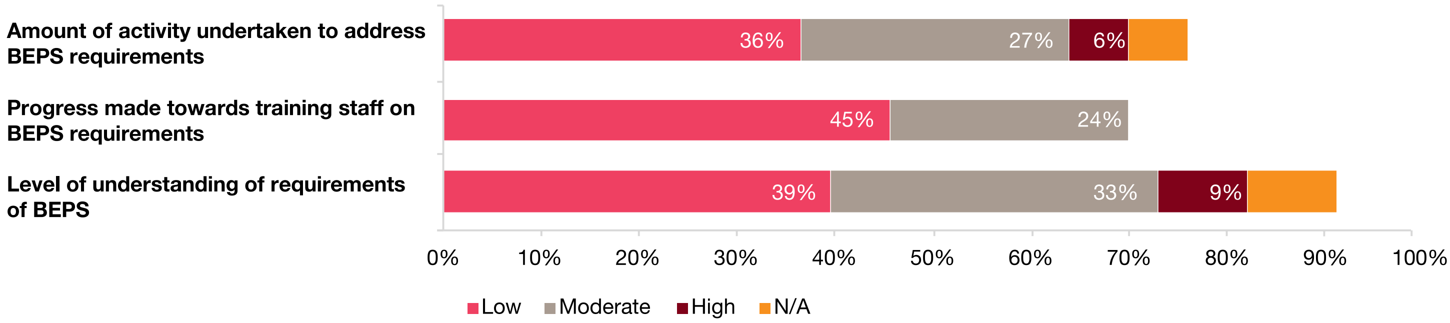
13. Tax compliance and advisory - Please indicate the extent to which the following have been implemented in your company with regard to Middle East operations or if based in the Middle East, your global operations:



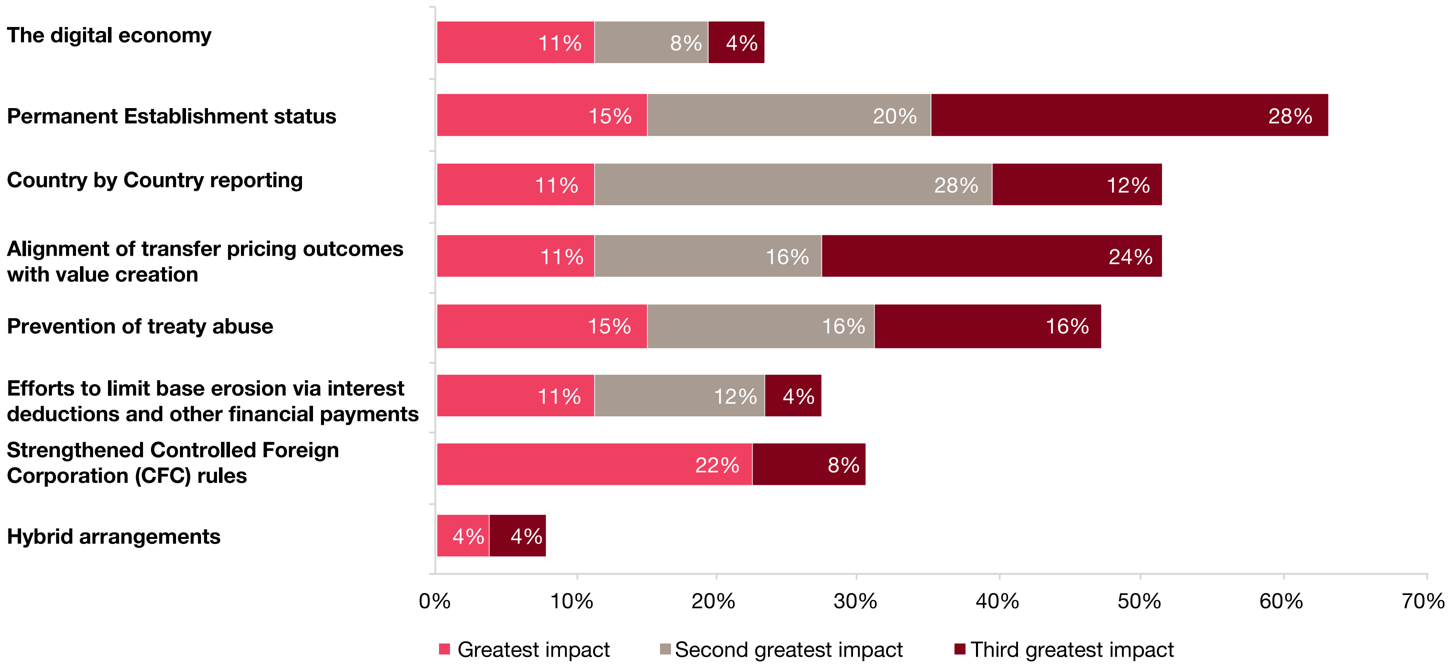
14. Are the recent discussions around base erosion and profit shifting (BEPS) concerns impacting your investment decisions?



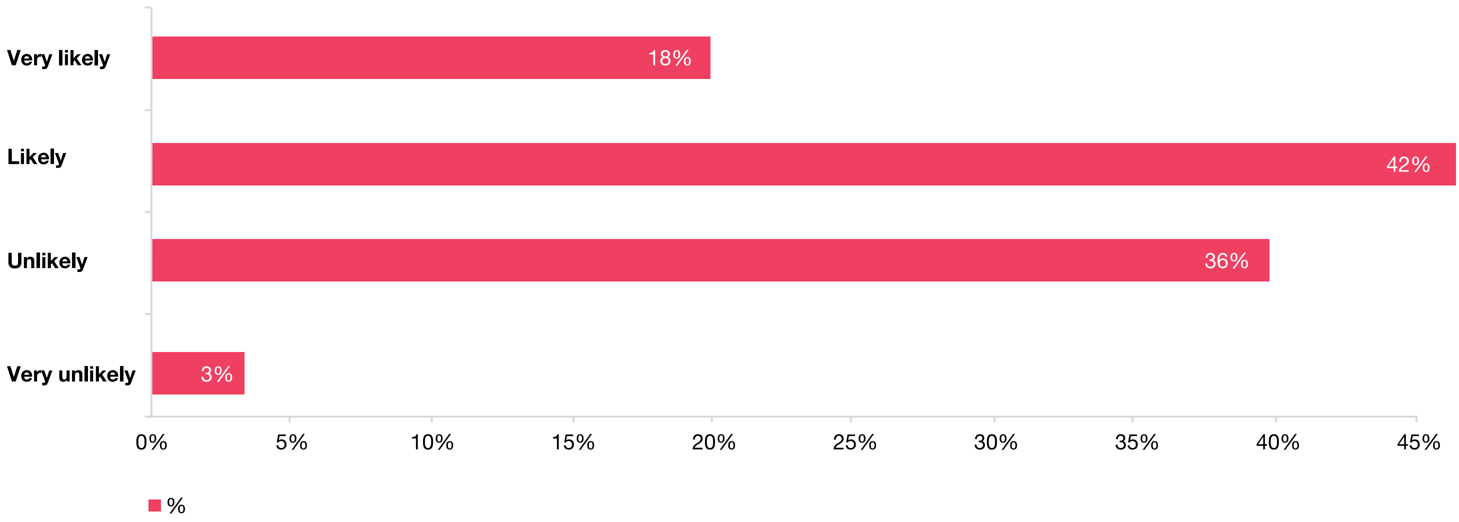
15. Please indicate the level of knowledge within your company of the requirements of Base Erosion and Profit Shifting (BEPS) and the progress that your company has made towards addressing the BEPS requirements.



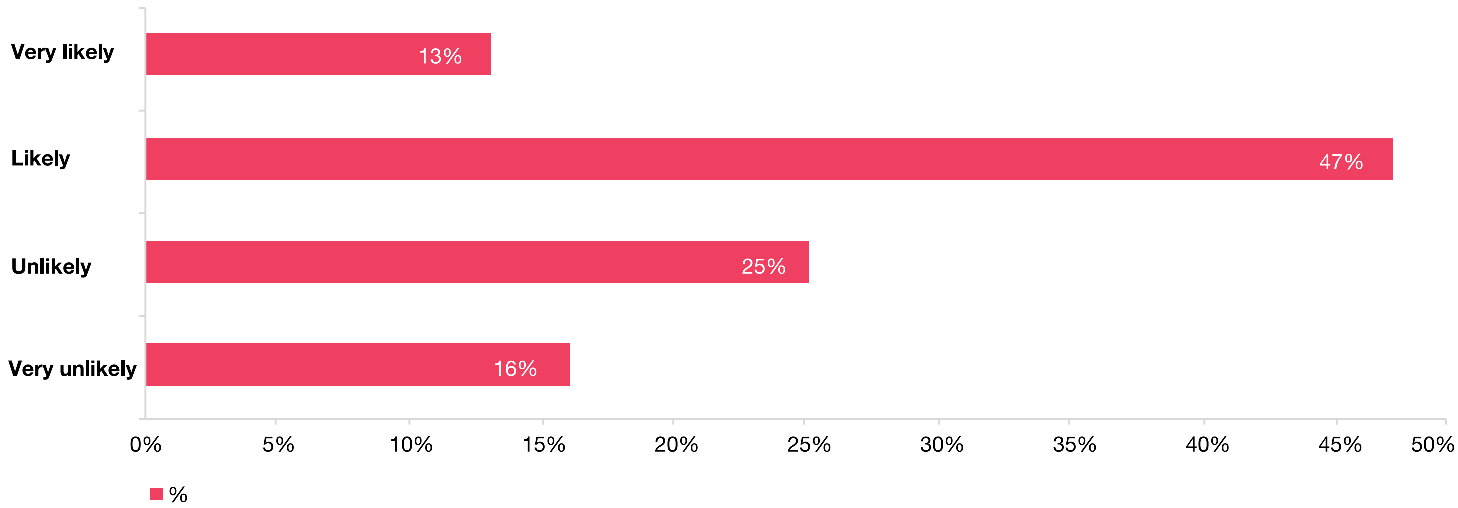
16. BEPS: Of the different BEPS action points please rank the three that will have the greatest impact.



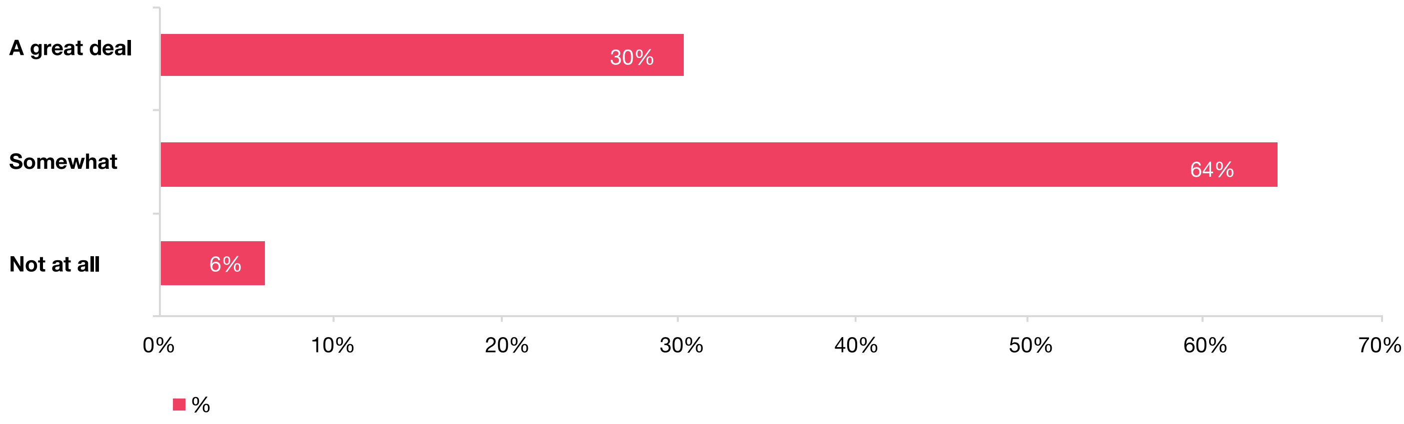
17. Middle East Tax reform: How likely do you believe countries in the GCC will start to implement a VAT by the end of 2017?



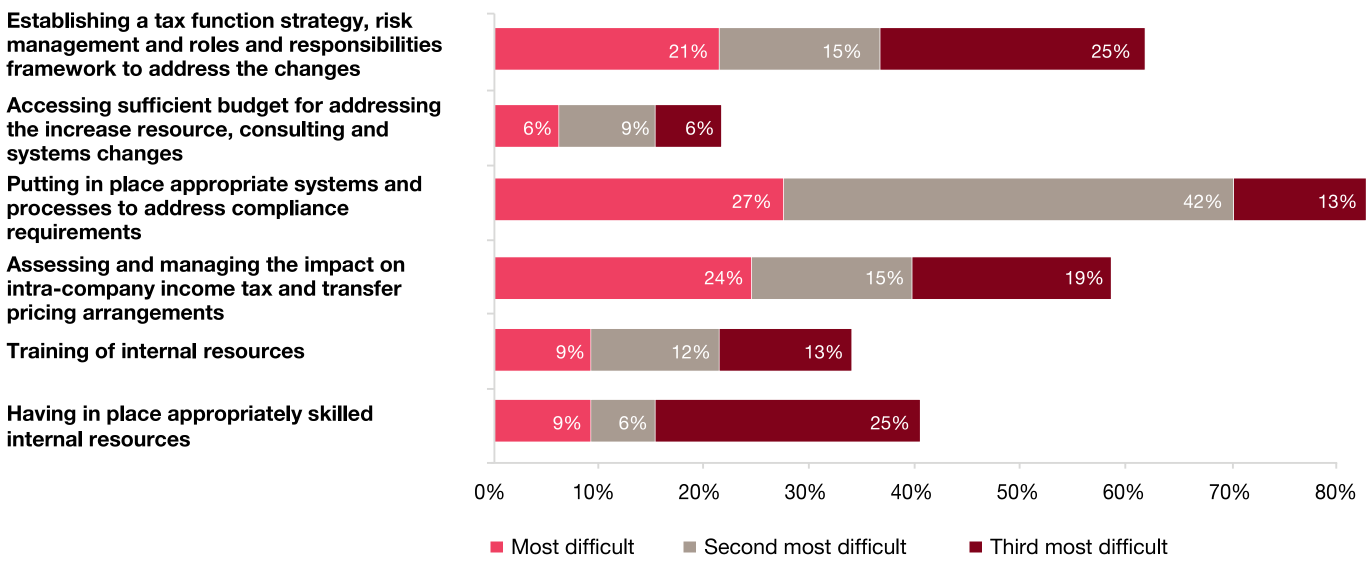
18. Middle East Tax reform: How likely do you believe those countries in the GCC, Bahrain and the UAE without a corporate income taxes regime will start to implement one by the end of 2017?



19. Middle East Tax reform: If Bahrain and the UAE were to implement a corporate income tax to what extent would that impact investor attractiveness of those countries.



20. Please rank the three most important challenges you believe will exist in responding to VAT and CIT regimes across the GCC.



How we can help

PwC Middle East Tax and Legal Services

PwC Middle East Tax & Legal Services has over 500 people across 12 countries in the Middle East region, all advising and working with companies and tax authorities on tax strategy and implementation. Clients engage us because we combine a strong understanding of their business and economic environments with specialist tax knowledge in hundreds of national and local jurisdictions across the globe.

As tax codes become increasingly complex and tax planning more controversial, we help companies to:

- Identify and reduce tax risks
- Understand and meet their compliance obligations
- Implement tax strategies that complement their business and operational objectives
- Resolve disagreements with tax authorities when they arise
- Manage tax accounting and reporting issues and design of best in class tax functions

The advice we provide to clients is based on our Global Tax Code of Conduct, which guides the way as we help organizations think through the legal basis for their planning and the reputational issues that may result.

In the context of challenges faced by companies and tax authorities operating in the Middle East we can advise and help on:

- Indirect taxes
- International taxation
- Legal services
- Mergers and acquisitions
- People and organisation
- Tax reporting and strategy
- Tax and Zakat advisory
- Tax policy and administration
- Transfer pricing

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