

RSM Kuwait Tax Newsletter

Dealing with Transfer Pricing Issues under Kuwaiti Tax Laws





The digitalization of the global economy has brought about unprecedented opportunities for international trade, allowing businesses to connect and transact across borders with ease. However, along with these benefits come challenges for policymakers in ensuring fair and legitimate taxation. Transfer pricing rules have emerged as a crucial mechanism to regulate international transactions and ensure they are conducted at arm's length.

In Kuwait, while there are no explicit transfer pricing rules in the tax laws, Executive Regulations No. 25 and No. 26 of the Kuwait Income Tax Decree No. 3 of 1955, as amended by Law No. 2 of 2008, provide guidelines for controlling costs claimed on material, design, and consultancy services incurred abroad. These rules are particularly relevant for companies operating in Kuwait, especially when dealing with related parties or transactions conducted with entities outside Kuwait. Here we provide a breakdown of the key points and highlight areas for companies to consider in relation to this issue:

Key Points:

Maximum Allowable Costs

The regulations specify the maximum allowable costs as a percentage of revenue of imported materials, design, and consultancy services.

For materials and equipment, the maximum allowable costs range from 85% to 95% depending on whether they are imported from the head office, related parties, or third parties.

Similarly, for design and consultancy services, the maximum allowable costs range from 70% to 85% depending on the source of the services.

Applicability

These rules are applicable mainly when company has profit margins below specified limit prescribed in Executive Regulations. They aim to ensure that companies are not artificially inflating costs to minimize taxable income, especially in cases where the company's net result is losses.

Calculation of Revenue

If the value of imported material, design, or consultancy is not explicitly mentioned in the contract, the revenue for such items is calculated using a formula. This formula determines the revenue based on the cost of the imported item relative to the total direct cost and contract revenue.





Considerations for Companies:

Documentation and Contracts

It's crucial for companies to maintain detailed documentation and contracts that clearly specify the value of revenue earned from material, design, and consultancy services. These documentations can help justify the actual profitability of these transactions, especially in cases where the company is facing losses overall.

Profitability Analysis

Companies should conduct thorough profitability analyses to determine whether they are actually making profits on the sale of materials, design, and consultancy services, even if their overall net result is negative. Understanding the profitability of each aspect of the business can help in justifying costs and complying with Executive Regulations.

Related Party Transactions

For transactions with related parties, it's essential to ensure that the prices charged are consistent with those that would be charged in similar transactions with unrelated parties. This helps in avoiding disallowances at the time of tax inspections.

Compliance and Reporting

Companies should ensure compliance with these Executive Regulations and accurately report their transactions in accordance with Kuwaiti tax laws. This includes proper documentation, adherence to maximum allowable costs, and accurate calculation of revenue.

Seek Professional Advice

Given the complexities of Executive Regulations and their implications for taxation, it's advisable for companies to seek professional advice from tax experts or consultants familiar with Kuwaiti tax laws and transfer pricing regulations.

By understanding and adhering to these Executive Regulations, companies operating in Kuwait can ensure compliance with tax regulations while conducting international transactions in a fair and legitimate manner and minimize their tax disallowances/exposures.

We have a dedicated tax team,
who can provide tax compliance
services in Kuwait.

Our tax clients are provided with strategic tax planning as well as various aspects of tax compliance work tailored to meet their specific circumstances.

RSM Albazie & Co. has qualified personnel with bilingual skills, and experience and knowledge of local and international taxation.

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