# The Role of Taxation in a Post-Oil Kuwait

**By**

**Fatima S. Al Matar**

**A Thesis Submitted in Partial Fulfilment of the Requirements for the Degree of Doctor of Philosophy (Ph.D.) in Law**

**University of Warwick, School of Law**

**September 2011**

# Table of Contents

ACKNOWLEDGMETS ..... v
DECLARATION ..... vi
ABSTRACT ..... vii
TABLE OF LEGISLATION ..... vii
TABLE OF CASES ..... x
LIST OF TABLES AND FIGURES ..... xi
Chapter 1: Introduction ..... 1
1.1 An Overview of the Thesis ..... 1
1.2 Research Questions and Methodology ..... 4
1.3 Existing Literature and Scope for Future Research ..... 5
Chapter 2: Finding an Alternative Source of Income for Oil Dependent Kuwait: Redistribution of Wealth in Islamic Philosophy and Western Theory with Themes drawn from Zakat and Taxation ..... 7
2.1 Introduction ..... 7
2.2 Zakat in Islam ..... 9
2.2.1 The Benefits of Zakat ..... 10
2.2.2 The Theoretical Basis for Zakat ..... 11
2.2.3 Assets Subject to Zakat ..... 13
2.2.4 Conditions Required in *Amwal* (wealth) for Zakat Collection ..... 14
2.2.5 Persons Liable to Pay Zakat ..... 15
2.2.6 Beneficiaries of Zakat ..... 16
2.2.7 The Four Classic School of Fiqh (Islamic Jurisprudence) ..... 18
2.3 The Idea of Social Justice in Zakat ..... 19
2.3.1 The Difference between Zakat and Taxation ..... 22
2.4 Limitations of Zakat as a System of Redistribution of Wealth ..... 23
2.5 The Effect of Religion upon Economic Development ..... 29
2.6 Western Theoretical Foundation for Taxation ..... 36
2.6.1 Western Theories on what Constitutes an Optimal System of Redistribution ..... 37
2.6.2 Rawls's Principles of Justice ..... 39
2.6.3 Rawls's Original Position ..... 40
2.6.4 Rawls's Social Primary Goods versus Sen's Capabilities Approach ..... 42
2.6.5 Rawls's Difference Principle ..... 47
2.7 Conclusion ..... 48

Chapter 3: The Political and Economic Development of Kuwait Pre - and Post - Oil ..... 52
3.1 Introduction ..... 52
3.2 Kuwait Pre-Oil ..... 52
3.2.1Tracing the Origins of Pre-Oil Kuwait ..... 54
3.2.2 Politics and Economics Interrelate in Pre-Oil Kuwait ..... 57
3.3 Discovering Oil in Kuwait ..... 63
3.4 Kuwait Post-Oil ..... 64
3.4.1 Political and Economic Changes in Post-Oil Kuwait ..... 66
3.4.2 Politics in Post-Oil Kuwait: The Decline of the Merchants and the Beginning of a Limited Democracy ..... 68
3.4.3 Kuwait's National Assembly ..... 68
3.4.4 Society in Post-Oil Kuwait ..... 75
3.4.5 Drawbacks of Oil Dependency in General and in Kuwait specifically 76
3.5 What is a Rentier State? And does Kuwait Qualify as One? ..... 87
3.5.1 Drawbacks of Rentierism ..... 89
3.6 The Crucial need for Kuwait to Move away from Dependency on Oil Revenues ..... 95
Chapter 4: An Overview of the Kuwaiti Tax System ..... 98
4.1 Introduction ..... 98
4.2 Taxation in Kuwait ..... 99
4.2.1 Income Tax ..... 99
4.3 Other taxes in Kuwait ..... 102
4.3.1 Custom Duties ..... 102
4.3.2 Contribution to the Kuwait Foundation for Advancement of Sciences (KFAS) ..... 102
4.3.3 The National Labour Support Tax (NLST) ..... 103
4.3.4 Zakat ..... 103
4.3.5 Offset Program Law No. 9 of 2007 ..... 104
4.3.6 Deemed Profits ..... 105
4.3.7 Foreign Direct Investment Law No. 8/2001 ..... 106
4.4 Explaining the Income Tax Decree 3/1955 in Sections ..... 108
4.4.1 Definition of Tax under the Income Tax Decree 3/1955 ..... 108
4.4.2 In the Case of National and GCC Companies with Foreign Shareholders ..... 110
4.4.3 The Meaning of a Body Corporate provided in Article 1 and defined under Article 2 (f) of Income Tax Decree 3/1955 ..... 111

4.4.4 The Term Carrying on Trade or Business in Kuwait ..... 114
4.4.5 The meaning of agent under the Income Tax Decree 3/1955 and the circumstances by which an agency relationship is taxed under the Decree 115
i. Other Laws pertinent to the Income Tax Decree 3/1955 ..... 115
ii. Article 2 of Income Tax Decree 3/1955 and the definitions of agent ..... 121
iii. The Agency Relationship between a Foreign Enterprise and a Kuwaiti National Agent ..... 122
iv. The Kuwaiti Courts on Agency and the Income Tax Liability. 127
v. The meaning of agent under Commercial Law 68/1980..... 133
4.5 Meaning of Income and Computation of Tax under the Income Tax Decree 3/1955..... 136
4.6 The 2008 Amendments ..... 137
4.6.1 Article 2 of Tax Law 2/2008 Explicitly Excludes the Sole Distributor from Tax Liability ..... 138
4.6.2 The Tax Rates Before and After the Amendments of Tax Law 2/2008: From a Progressive Tax Rate to a Flat Tax (Article 1 of Tax Law 2008) .. 143
4.6.3 Reducing the Allowable Expenses..... 146
4.6.4 The Method of Deducting Allowable Expenses from National Companies with Foreign Shareholders ..... 149
4.6.5 The Depreciation of Assets According to the Income Tax Decree 3/1955 and the Amendments of Tax Law 2/2008..... 151
4.6.6 Withholding a 15% Tax on Dividends and Exempting Trade Profits 152
4.7 Conclusion ..... 154
Chapter 5: International Tax Obligations I The Unified Economic Agreement of the Gulf Co-operation Council: A study of the UEA agreement and its impact on Kuwait's Fiscal Sovereignty. ..... 156
5.1 Introduction..... 156
5.2 The UEA in 1981 ..... 156
5.2.1 What is the UEA?..... 156
5.3 The Customs Union Realized under the Amended UEA of 2001 ..... 163
5.3.1 What is the CU? ..... 164
5.4 How Far Can the UEA Influence Kuwait's Tax Reform? ..... 168
5.4.1 The UEA has influence on Kuwait's Taxes..... 168
Chapter 6: International Tax Obligations II Kuwait's Double Taxation Treaties [between the OECD and the UN Model Convention]: Finding an Approach to Attract Foreign Income ..... 170
6.1 Introduction..... 170
6.2 Relieving Double Taxation of Cross-border Investment Income ..... 171

6.3 Methods to Eliminate Double Taxation ..... 172
6.4 Choosing an Optimal Method for Double Taxation Relief..... 175
6.5 Models for Double Taxation Treaties: UN or OECD Model Convention? ..... 177
6.6 Kuwait's double taxation treaties: How Kuwait negotiates its double taxation treaties ..... 183
6.6.1 The Definition of Permanent Establishment (PE) in Kuwait's DTTs 183
6.6.2 When an Agent Constitutes a PE ..... 186
6.7 DTTs Treatment of Income..... 190
6.7.1 Attribution of Business Profits to PEs ..... 190
6.7.2 Dividends, Interest and Royalties ..... 196
6.7.3 Treatment of Capital Gains ..... 206
6.7.4 Administration Provisions in DTTs ..... 217
6.7.5 Exchange of information under the OECD and the UN Models ..... 224
6.7.6 Article 27 of the OECD Model: Assistance in the Collection of Taxes ..... 226
6.7.7 Methods for Eliminating Double Taxation ..... 227
6.7.8 Dispute Settlement: Mutual Agreement Procedure..... 233
6.8 Conclusion ..... 234
Chapter 7: An Empirical Survey of Aspects of Kuwait's Tax System ..... 236
7.1 Introduction ..... 236
7.2 Field Work ..... 236
7.2.1 Research Samples..... 238
7.2.2 Constructing Questions: Open vs. Closed questions ..... 240
7.3 Assessment of Tax Law Amendments 2/2008 as against the Tax Decree 3/1955..... 241
7.4 Assessment of the Kuwaiti Tax Department [in the Ministry of Finance] 268
7.5 Recommendations on how Kuwait can attract more Foreign Direct Investment ..... 291
7.6 Conclusion ..... 301
Chapter 8: Conclusions and Recommendations..... 303
Bibliography..... 344

# ACKNOWLEDGMETS

I am grateful to my sponsor The Law Department at Kuwait University for giving me this invaluable opportunity to do my Master's and Ph.D. at Warwick University, an opportunity of a life time and one which will continue to benefit me throughout my professional life.

I owe my deepest gratitude to my Supervisor David Salter who this thesis would not have been possible without, his constant encouragement, assistance and reassurance was most vital throughout the challenging journey of my research and the writing of my thesis. David always found the time to see me and discuss my work and was always and an e-mail away whenever I needed guidance, support, and sound judgment.

I thank my five year old daughter Jori who has accompanied me throughout the long and demanding years of my postgraduate studies during which she has on many occasions suffered my regrettable neglect and lack of attention due to my deep commitment and devotion to writing this thesis.

**Fatima S. Al Matar**
September 2011

# DECLARATION

I hereby declare that this thesis is my original work. I also confirm that it has not been submitted either in part or in full for any Degree or Diploma to this or any other university.

Fatima S. Al Matar
September 2011

# ABSTRACT

Kuwait does not only depend on oil as a sole source of revenue, but has also nullified all taxes since the discovery of oil in 1938. Under the request of foreign oil companies extracting and exporting Kuwaiti oil, the Kuwaiti government founded a primitive tax law which imposes a tax instead of a royalty on foreign oil companies in order to enable them to credit taxes paid to the Kuwaiti government against taxes they owe to their home states. This poorly drafted piece of legislation which is criticised for being ambiguous and lacking the adequate provisions to regulate crucial tax related issues is Income Tax Decree 3/1955, the Decree continued to govern taxation in Kuwait even after the full nationalization of the oil company in 1979, imposing income tax upon the profits of foreign enterprises carrying out trade and business in Kuwait.

Depending on a sole source of wealth and a highly unstable one such as oil means that the Kuwaiti economy fluctuates considerably; from the oil boom in the 1970s to the sharp economic stagnation in the 1980s this economic instability coupled with the fast depletion of oil reserves, the government's over spending, the poor social responsibility due to the absence of individual tax and finally the extravagant welfare system, have all contributed to the current deficit in the Kuwaiti budget and have stimulated the government to rethink the possibility of introducing taxes back into the state.

With taxation being an infinite source of revenue, this thesis argues that there is an imminent need for Kuwait to advance its fiscal system in an attempt to possibly turn taxation into a secondary source of revenue in the state. Kuwait has the potential to attract foreign direct investment which in turn can yield more tax revenues to the state; however, much improvement needs to be made to Kuwait's fiscal law. The government's attempt to reform the Income Tax Decree of 3/1955 through the 2008 Amendments did not eliminate much of the Decree's shortfalls. This thesis studies the Kuwaiti tax system closely from a legal economic point of view and provides realistic recommendations on how to reform the current system in order to make Kuwait a more attractive jurisdiction for foreign investment.

# TABLE OF LEGISLATION

## National Legislation

Article 1 of Kuwait Tax Decree 3/1955
Article 2 of Kuwaiti Tax Decree 3/1955
Article 1 of Decree No. 33/1988
Article 1 of Kuwaiti Tax Law Amendments 2/2008.
Article 2 (f) of Kuwaiti Tax Law Amendments 2/2008
Article 23 of the Kuwaiti Commercial Law 68/1980
Article 24 of the Kuwaiti Commercial Law 68/1980
Article 186 of the Kuwaiti Commercial Law No. 68/1980
Articles 260 - 305 of the Kuwaiti Commercial Law No. 68/1980
Article 6 of the Kuwait Industrial Law No. 56/1996
Article 2 of the Kuwaiti Company Law 15/1960
Article 3 of the Kuwait Company Law 15/1960
Article 42 of the Kuwait Company Law 15/1960
Article 47 of the Kuwait Company Law 15/1960

## Kuwait's Ministry Resolutions

The Kuwaiti Council of Minister's Resolution 287/2006

## The Kuwaiti Tax Department Circulars

Circular No. 34/ 2002

Circular No. 37/2002

Circular No. 2/ 2005

## International Legislation

The GCC Unified Economic Agreement & Customs Law, *Section 4:Priviledges and Exemptions, (2002),* p. 13.

The GCC Unified Economic Agreement & Customs Law, *Section2:Permited Activities,(2002)*

Article 21 of Chapter 6 of the 1981 Unified Economic Agreement.

Article 22 of Chapter 6 of the 1981 Unified Economic Agreement

Article 23 of Chapter 6 of the 1981 Unified Economic Agreement

Article 1 of Chapter 1 of the amended 2001 Unified Economic Agreement

Article 3 of Chapter 1 of the amended 2001 Unified Economic Agreement

Article 5 of Chapter 3 of the amended 2001 Unified Economic Agreement

Article 1 of the GCC Custom Union Agreement of 2003

**The OECD and the UN Double Taxation Model Conventions:**

**The OECD**

Article 5 (1) and (2) of the 2010 OECD Double Taxation Model Convention.

Article 5 (3) of the 2010 OECD Double Taxation Model Convention

Article 5 (5) of the 2010 OECD Double Taxation Model Convention

Article 5 (6) of the 2010 OECD Double Taxation Model Convention

Article 7 (1) of the 2010 Double Taxation Model Convention

Article 7 (2) of the 2010 Double Taxation Model Convention

Article 10 (a) and (b) of the 2010 OECD's Double Taxation Model Convention

Article 11 of the 2010 OECD Double Taxation Model Convention

Article 12 (1) of the 2010 OECD Double Taxation Model Convention

Article 13 of the 2010 OECD's Double Taxation Model Convention

Article 23 (A) and (B) of the 2010 OECD Double Taxation Model Convention

Article 24 (1) of the 2010 OECD Double Taxation Model Convention

**The UN**

Article 5 (3) (a) of the 2001 UN Double Taxation Model Convention
Article 5 (3) (b) of the 2001 UN Double Taxation Model Convention
Article 5 (5) (b) of the 2001 UN Double Taxation Model Convention
Article 10 (1) and (2) of the 2001 UN Double Taxation Model Convention
Article 11 of the 2001 UN Double Taxation Model Convention
Article 12 (2) of the 2001 UN Double Taxation Model Convention
Article 13 of the 2001 UN Double Taxation Model Convention

**Kuwait's DTTs with other States**

Article 5 Kuwait's Double Tax Treaty with Pakistan, 1998

Article 7 Kuwait's Double Tax Treaty with Indonesia, 1997

Article 7 of Kuwait's Double Tax Treaty with Sri Lanka, 2002

Article 7 of Kuwait's Double Tax Treaty with Ethiopia, 1996

Article 10 (1) of Kuwait's Double Tax Treaty with Singapore, 2002

Article 11 of Kuwait's Double Tax Treaty with Austria, 2002

Article 11 of Kuwait's Double Tax Treaty with Poland, 1996

Kuwait's Double Taxation Treaty with Ukraine, 2003

Article 13 of Kuwait's Double Tax Treaty with Canada, 2002

Article 11(3) of Kuwait's Double Tax Treaty with France, 1982

Article 13 (5) of Kuwait's Double Tax Treaty with the UK, 1999

Article 13 (5) of Kuwait's Double Tax Treaty with the Netherlands, 2001
Article 23 (1) (b) and (c) and Paragraph (2) of Kuwait's Double Tax Treaty with the Netherlands, 2001
Article 24 (1) and (2) of Kuwait's Double Tax Treaty with Romania, 1992
Article 24 of Kuwait's Double Tax treaty with Germany, 1987
Article 24 (a) and (b) of Kuwait's Double Tax Treaty with the Mauritius, 1997

# TABLE OF CASES

Coca Cola v. The Ministry of Finance and The Beverages Trading Company (2006), Case No. 2012/2006.

Matsushita Electric Industrial Limited Company v. The Minister of Finance, The Under Secretary of the Ministry of Finance and the Director of the Tax Department (2006), Case No. 2325/2006.

Jassim Mohammed Thunayan Al Ghanim and Sons for General Trading and Contracting v. The Ministry of Finanace (2001), Case No. 351/2001.

Jassim Mohammed Thunayan Al Ghanim and Sons for General Trading and Contracting v. The Ministry of Finance (2001), Appeal No. 1422/2001.

# LIST OF TABLES AND FIGURES

Table 3.1: GCC States Exports and GDP from 1980 - 2007

Table 4.1: Tax Rates under Tax Decree 3/1955, Article 2 (j)

Figure 4.2: The Kuwaiti Judicial System

Figure 7.1: Tax Auditors' opinion on the new tax rate

Figure 7.2: Taxpayers' opinion on the new tax rate

Figure 7.3: Tax Department's opinion on the new tax rate

Figure 7.4: Tax Auditors' opinion on whether Tax Law 2/2008 eliminated the short falls of Tax Decree 3/1955

Figure 7.5: Taxpayers' opinion on whether Tax Law 2/2008 eliminated the short falls of Tax Decree 3/1955

Figure 7.6: Tax Department's opinion on whether Tax Law 2/2008 eliminated the short falls of Tax Decree 3/1955

Figure 7.7: Tax Auditors' opinion on whether Tax Law 2/2008 has clarified most debated issues in Tax Decree 3/1955

Figure 7.8: Taxpayers' opinion on whether Tax Law 2/2008 has clarified most debated issues in Tax Decree 3/1955

Figure 7.9: Tax Department's opinion on whether Tax Law 2/2008 has clarified most debated issues in Tax Decree 3/1955

Figure 7.10: Tax Auditor's opinion on the new low tax rate

Figure 7.11: Tax Department's opinion on the new low tax rate

Figure 7.12: Taxpayers' opinion on the new low tax rate

Figure 7.13: Tax Auditors' opinion on single flat tax rate and progressive tax rate

Figure 7.14: Tax Department's opinion on single flat tax rate and progressive tax rate

Figure 7.15: Taxpayers' opinion on single flat tax rate and progressive tax rate

Figure 7.16: Tax auditor's opinion on how the new tax rate affected the foreign enterprise in Kuwait

Figure 7.17: Tax Department's opinion on how the new tax rate affected the foreign enterprise in Kuwait

Figure 7.18: Taxpayers' opinion on how the new tax rate affected the foreign enterprise in Kuwait

Figure 7.19: Tax Auditor's opinion on how important taxation is to foreign investment's decision to invest abroad

Figure 7.20: Tax Payer's opinion on how important taxation is to foreign investment's decision to invest abroad

Figure 7.21: Tax Department's opinion on how important taxation is to foreign investment's decision to invest abroad

Figure 7.22: Tax Auditors' opinion on what foreign investors consider a priority when deciding to invest abroad

Figure 7.23: Tax Department's opinion on what foreign investors consider a priority when deciding to invest abroad

Figure 7.24: Taxpayers' opinion on what foreign investors consider a priority when deciding to invest abroad

Figure 7.25: Tax Auditor's opinion on most important incentive to give to foreign enterprise investing in Kuwait

Figure 7.26: Tax Department's opinion on most important incentive to give to foreign enterprise investing in Kuwait

Figure 7.27: Taxpayer's opinion on most important incentive to give to foreign enterprise investing in Kuwait

Figure 7.28: Tax Auditor's opinion on what changes to make on the Tax Law 2/2008

Figure 7.29: Tax Employees' opinion on what changes to make on the Tax Law 2/2008

Figure 7.30: Taxpayers' opinion on what changes to make on the Tax Law 2/2008

Figure 7.31, 7.32, 7.33, 7.34, 7.35: Tax Auditors' opinion on the Tax Law's fairness, clarity, convenience, certainty, and efficiency

Figure 7.36, 7.37, 7.38, 7.39, 7.40: Tax Department's opinion on the Tax Law's fairness, clarity, convenience, certainty, and efficiency

Figure 7.41, 7.42, 7.43, 7.44, 7.45: Taxpayers' opinion on the Tax Law's fairness, clarity, convenience, certainty, and efficiency

Figure 7.46: Tax Auditors' opinion on whether the tax department is efficient in collecting tax

Figure 7.47: Tax Department's opinion on whether they are efficient in collecting tax

Figure 7.48: Taxpayers' opinion on whether the tax department is efficient in collecting tax

Figure 7.49: Tax Auditor's opinion on whether the tax department is fair in its tax assessment

Figure 7.50: Tax Department's opinion on whether the tax department is fair in its tax assessment

Figure 7.51: Taxpayers' opinion on whether the tax department is fair in its tax assessment

Figure 7.52: Tax Auditor's opinion on the authority of tax inspectors

Figure 7.53: Tax Department's opinion on the authority of tax inspectors

Figure 7.54: Taxpayer's opinion on the authority of tax inspectors

Figure 7.55: Tax Auditor's opinion on tax inspector's competence

Figure 7.56: Tax Department's opinion on tax inspector's competence

Figure 7.57: Taxpayers' opinion on tax inspector's competence

Figure 7.58: Tax Auditors' opinion on whether the tax inspectors make unfair decisions

Figure 7.59: Taxpayer's opinion on whether the tax inspectors make unfair decisions

Figure 7.60: Tax Auditors' opinion on whether objections towards tax inspector's decisions have been taken into considerations

Figure 7.61: Tax Department's opinion on whether objections towards tax inspector's decisions have been taken into considerations

Figure 7.62: Tax Department's opinion on whether objections towards tax inspector's decisions have been taken into considerations

Figure 7.63: Tax Auditors' opinion on whether tax inspectors make arbitrary decisions

Figure 7.64: Tax Department's opinion on whether tax inspectors make arbitrary decisions

Figure 7.65: Taxpayers' opinion on whether tax inspectors make arbitrary decisions

Figure 7.66: Tax Auditors' opinion on whether on whether inspectors follow certain rules in their decision making

Figure 7.67: Tax department's opinion on whether on whether inspectors follow certain rules in their decision making

Figure 7.68: Taxpayers' opinion on whether on whether inspectors follow certain rules in their decision making

Figure 7.69: Tax Auditors' opinion on whether tax inspectors' procedures are efficient

Figure 7.70: Tax Department's opinion on whether tax inspectors' procedures are efficient

Figure 7.71: Taxpayers, opinion on whether tax inspectors' procedures are efficient

Figure 7.72: Tax Auditors' opinion on compliance costs

Figure 7.73: Taxpayers' opinion on compliance costs

Figure 7.74: Tax Auditors' opinion on the objection and appeal process in tax department

Figure 7.75: Tax department's opinion on the objection and appeal process in the tax department

Figure 7.76: Taxpayers' opinion on the objection and appeal process in the tax department

Figure 7.77: Tax Auditors' opinion on the tax department's fairness when rejecting appeals and objections

Figure 7.78: Tax Department's opinion on its fairness when rejecting appeals and objections

Figure 7.79: Taxpayers' opinion on the tax department's fairness when rejecting appeals and objections

Figure 7.80: Tax Auditors' opinion on their relationship with the Tax Department

Figure 7.81: Tax Auditors' opinion on Tax Department's competence approached with a legal question

Figure 7.82: Tax Auditors' opinion on how tax inspectors use authorities provided to them by the law

Figure 7.83: Tax Auditors' opinion on whether Kuwait is an attractive environment for foreign investment

Figure 7.84: Tax Department's opinion on whether Kuwait is an attractive environment for foreign investment

Figure 7.85: Taxpayers' opinion on whether Kuwait is an attractive environment for foreign investment

Figure 7.86: Tax Department's opinion on foreign companies' ignorance of the Kuwaiti tax system

# Chapter 1: Introduction

## 1.1 An Overview of the Thesis

The need to find a second source of income for an oil dependant Kuwait has become a fundamental one. The discovery of oil in 1938 replaced a relatively adequate tax system that had existed in the country from 1752 until the beginning of oil exportation in 1946. Kuwait's dependency on a single source of revenue (oil) has resulted in numerous social, economic and political disparities. First, socially; by pumping enormous oil revenues into the state, oil allowed Kuwait to create an increasingly growing government bureaucracy that plays the role of the main provider for the people, employing 88% of the population, and offering a lavish subsidising policy that has caused unequal wealth distribution, where the more an individual consumes, the larger his share of the public funding will be. Second, economically; Kuwait extracts oil and does not produce it, thus the country lives off its capital and not income, the instability of oil prices (fluctuating according to economic ups and downs), and oil being a non-renewable source of income makes relying on it an even more acute problem. Third, politically; oil provides large financial assets in the hands of political leaders opening opportunities for theft and to maintain themselves in power, also oil wealth can produce weak state structures that make corrupt practices considerably easier for government officials especially when the country is associated with concentrated bureaucratic powers which increases the difficulty of securing transparency.

Chapter 2 provides the philosophical background for this thesis, by exploring the Islamic and Western theory on the concept of redistribution of wealth. Kuwait being an Islamic country where many believe that there needn't be tax reform due to the existence of the Islamic duty of almsgiving (Zakat), has raised the need to carry an assessment of Zakat in Islamic philosophy and an assessment of taxation in Western theory, with an emphasis on the advantages and disadvantages of both, and setting both Zakat and taxation against Adam Smith's four requirements for an efficient tax system, namely: equity, certainty, convenience, and efficiency.

Chapter 3 describes Kuwait before and after oil, how oil has changed the dynamic of social, political and economic life in Kuwait, with reference to the economic term "Rentier State" an economic political phenomenon that results from total oil dependency. This chapter also touches on other domestic and international economic downturns of oil dependency and stresses on the need to diversify economic resources.

Chapter 4 provides an outline of the Kuwaiti tax system with a close assessment of the previous Income Tax Decree No. 3/1955 and the new Tax Law Amendments of 2/2008 by highlighting the shortfalls of each of the legislations with a special emphasis on the problem of the agency and distribution relationship between nationals and foreign enterprises carrying on business in Kuwait.

This thesis argues in favour of tax reform that can assist in attracting more foreign investment into Kuwait's jurisdiction and thus raise the tax revenues. However, since Kuwait is a member of the Gulf Cooperation Council (GCC), and the Unified Economic Agreement (UEA) which call on the harmonization of some fiscal regulations between Member States of the Agreements, an important

question arises on whether or not Kuwait has the discretion to reform its domestic fiscal system unilaterally or do such agreements pose a restriction upon Kuwait's fiscal freedom? Chapter 5 answers this question.

Chapter 6 of this thesis examines Kuwait's Double Taxation Treaties (DTTs), as International taxation plays the most crucial role in Foreign Direct Investment, this chapter looks closely at how Kuwait's DTTs tackle key issues such as: Permanent Establishment, profits and other types of income, the Elimination of Double Taxation, and the concept of Non-discrimination, it also proposes possible amendments to Kuwait's DTTs that may assist in yielding more international tax revenue.

Chapter 7 provides an empirical study, with questionnaires and interviews conducted with three survey samples who work closely with Kuwait's Tax Law, i.e. the Tax Auditors, the Taxpayers (foreign enterprises) and finally the Tax Department employees. The survey conducted reveals the samples attitudes towards Kuwait's fiscal laws and proposes possible amendments to help make Kuwait more attractive for FDI.

The final Chapter, Chapter 8, revisits what this thesis is seeking to establish and takes an overall look at each of the areas of inquiry in earlier chapters. Chapter 8 also proposes tax reform and possible effective recommendations to improve Kuwait's tax legislation and the services of the Kuwaiti Tax Department. In addition to this, Chapter 8 discusses what might be achievable in Kuwait in the short and longer term and sheds light on possible future research on relative questions outside the scope of this thesis and concludes with overall recommendations.

## 1.2 Research Questions and Methodology

The fact that Kuwait depends entirely on one source of income; that being oil, has provoked the question of what other resources a country such as Kuwait with no industry or agriculture can rely on after oil has become insufficient to satisfy the countries growing economic, and financial demands. This has led to the main research question of this thesis i.e. how to enhance Kuwait's tax system in order to transform the Kuwaiti market into a more attractive and inviting jurisdiction for foreign enterprises? This question has led to many other questions, such as, whether or not Zakat, an Islamic method of redistribution of wealth could replace taxation in Kuwait? This is addressed in chapter 2. What were the damaging effects of the current situation of total oil dependency? This is explored in chapters 3. What are the shortcomings of the current fiscal system in Kuwait? This has been explored extensively in Chapter 4. Chapter 5 examines the restraints which economic agreements Kuwait is a member of may have on Kuwait's ability to reform its tax legislation unilaterally. Chapter 6 answers the question; what is Kuwait's international tax policy, and how does Kuwait construct its DTTs with other states. Empirical work and findings on what foreign enterprises think of the Kuwaiti tax law and how it can be improved is provided in Chapter 7 in addition to the opinions of Tax Auditors and the Tax Department employees. The last chapter of this thesis concludes with recommendations on how to improve Kuwait's fiscal system.

In the process of writing this thesis both qualitative and quantitative methods were used; qualitative methods such as interviews with foreign enterprises doing business in Kuwait, Tax auditors in Kuwait and tax inspectors from the Kuwaiti Tax Department, in addition to a number of case studies were used to answer many questions regarding the agency problem in Kuwait's tax law. Quantitative methods were also used in questionnaires that were distributed to the same samples mentioned above.

### 1.3 Existing Literature and Scope for Future Research

Although some insignificant research has been done on the assessment of the Kuwaiti Tax Policies, the literature found was either outdated or does not answer all of the questions mentioned above. Baker (1986) touches very briefly on the aspects of international taxation in Kuwait; however this is was conducted under the rules of the previous Kuwait Income Tax Decree No. 3/1955. Al Rashed (1992, 2000, and 2006) asses the Kuwaiti tax system from an economist perspective, and provides a comparison between Zakat and tax from an accountancy point of view, these publications however are earlier than the amendments of 2008 and thus include nothing about the changes and amendments made to the law. Al Muzaini (1984) provides a historical development of the Kuwaiti tax system, and argues that Zakat can serve as an adequate instrument of redistribution of wealth; this publication is again outdated and concentrates more on Zakat than taxation. The annual tax brochures which are produced by Auditing Firms in Kuwait such as Ernst and Young, and AlBazie& Co. are informative but

too brief and target potential clients (foreign enterprise looking to invest in Kuwait) thus they tend to leave question un-answered to attract more potential clients. Although the latest editions do touch on the amendments of 2008, they do so very briefly without any analysis, and there is no mention of DTTs.

There is tremendous scope for future research on the topic of Kuwait's taxation: VAT and Individual Income Tax are definitely worth revisiting. However the reformation of the Kuwaiti Tax Department, and other departments linked to intensifying FDI in the country such as the Foreign Direct Invest Bureau and the Free Trade Zone are entities that suffer from poor management and are in desperate need of improvement. Taxing National Companies can also be a useful future project.

# Chapter 2: Finding an Alternative Source of Income for Oil Dependent Kuwait: Redistribution of Wealth in Islamic Philosophy and Western Theory with Themes drawn from Zakat and Taxation

## 2.1 Introduction

Kuwait's complete dependency on oil revenues [1] has resulted in the need to find a new source of revenue, a renewable and stable source that helps eliminate the downsides of oil dependency. Taxation is of course a consistent method to raise revenue for government expenditure[2]. However, before suggesting tax reform in Kuwait there are some important social, religious and economic elements to consider: first, Kuwait as a Muslim country[3] exercises the Islamic alms duty of Zakat[4]. Although paying Zakat is now voluntary in Kuwait, some Muslim scholars call for the implementation of Zakat rather than taxation and argue that Zakat has many advantages over taxation, these arguments are discussed in more detail below[5]. Second, in the past (1752 – 1946) Kuwait had a fairly adequate tax system where duties on imports were collected. Today Zakat is voluntary and although duties on imports are still collected, no taxes are imposed other than a

[1] See pp.76 - 95 in Chapter 3 for a discussion on the economic downsides of oil dependency.
[2] Governments direct tax revenues towards services which private enterprise cannot provide, such as defence and law and order. Tax revenues are also spent on services thought better provided on a universal basis, such as social security benefits and education. Other important purposes for taxation include the redistribution of wealth and income, controlling the economy by imposing high custom duties on rival imported goods to protect domestic industries, and social control.
[3] With 85% of the Kuwaiti population being Muslims, UN data, Country profile, http://data.un.org/CountryProfile.aspx?crName=KUWAIT, [8/3/2010].
[4] A system of redistributing wealth in Islam, one of the pillars of Islam, Zakat is the obligatory transfer of a prescribed proportion of property by a Muslim who owns more wealth than the limit dictated under Islamic Law (shari'a), Richardson, G. (2004), *Islamic Law and Zakat: Waqf Resources in Pakistan*, in Islam and Social Policy, Vanderbilt University Press, p.156.
[5] See pp. 20-23.

flat rate 15% corporate income tax on foreign enterprises carrying out business in Kuwait[6]. Thus the idea of imposing a new system of taxation after more than sixty years of non taxation will not be an easy task, with such little fiscal awareness the Kuwaiti people will most probably reject a tax on their income. Third, there is a strong opposition from the Kuwaiti people towards the implementation of a western income tax[7], Kuwaiti domestic enterprises are also opposed to paying taxes and claim they are entitled to a more favourable fiscal treatment than foreign enterprises working in Kuwait[8]. In addition to this domestic hostility towards taxes, Kuwait's objective of attracting more FDI creates a restriction when taxing foreign enterprises, as a competitive tax rate is vital to materialize Kuwait's objective of attracting more FDI and maximising tax revenues[9].

This chapter attempts to provide a close look at Zakat, what it is from the viewpoint of Islamic philosophy, and its advantages and limitations as a method of redistribution of wealth. Also, due to the religious nature of Zakat, this chapter attempts to underline what positive and negative affects religion has on economic development. Finally, this chapter discusses the theoretical foundation of western taxation, looking at different western theories which attempt to justify why the state has a right over the personal property of individuals, with special emphasis on John Rawls's social primary goods approach in which he focuses on individuals' resources and explains why the better off must always use their endowments to relieve the suffering of the worse off in society, otherwise known

---

[6] See p. 143.
[7] The Kuwaiti people argue that their payment of voluntary Zakat represents redistribution of wealth and thus they should not be liable to pay tax.
[8] See p.101 and p.113.
[9] The issues of treating Kuwaiti domestic enterprise more favourably tax wise and attracting foreign investment through a more competitive corporate income tax rate is discussed in more detail in chapter 4, p. 113.

as the *difference principle*, with reference to the opposite opinion of his rival Amartya Sen and his capabilities approach, in which he does not put as much weight on ones resources as on ones capability for turning such resources into functionings.

The claim by the Kuwaiti people that their voluntary payment of Zakat substitutes a western tax, and the argument by Muslim scholars[10] that Zakat is an efficient system of redistribution of wealth opens up the opportunity to explore what Zakat is, and whether Zakat suffices as a system for redistribution of wealth.

## 2.2 Zakat in Islam

Although the word "Zakat" holds numerous meanings in the literary sense[11], in Islamic terminology, Zakat is the process where a certain amount of property or money is collected from those who are sufficiently endowed to be given to the needy, with donors, recipients, and the proportion of required donations being clearly specified in both the Qur'an and Sunna[12]. Zakat with its specific *Nisab* (required minimum wealth) and conditions was decreed compulsory as the third pillar of Islam[13]. There are verses in the Qur'an which provide evidence for the obligation of Zakat:

"Establish Salat[14] and pay Zakat[15]..."

[10] Including the jurists of the four main schools of thought in Islam: the Hanafi, Maliki, Shafi, and Hanbali. Other scholars such as Al Qardawi, Al Ghazalli, Siddiqi, Jehle, Abdul Rahman, Qutb, Turtushi, Khadduri and many others.
[11] To profit, to purify, to increase, to be worthy, mercy, truth, and blessing.
[12] Senturk, O. (2007), *A comprehensive Guide to Zakat: charity in Islam*, The Light, pp. 3-4.
[13] Following *salat* (prayer) and fasting.
[14] Prayer.
[15] The Qur'an, Surat *Al Ahzab* 33:33.

"If you establish Salat, disburse Zakat and believe in my messengers[16]..."

In the Sunna[17] the prophet Mohammed provides the following when asked by his followers "what is Islam?";

"Islam is for you to worship God alone, to establish Salat, to give the obligatory Zakat and to fast Ramadan[18]."

Kuwait as a Muslim country recognizes the religious duty of almsgiving 'Zakat' as a method to redistribute wealth from the rich to the poor; although Zakat used to be obligatory[19], with time it gradually became voluntary[20] in some countries such as Kuwait, However in countries such as Pakistan, Saudi Arabia and Malaysia Zakat is to this day mandatory.

The reasons Zakat plays an important role in Islamic faith are the benefits Zakat can bring to society. A quick glance at the categories of Zakat recipients who are specifically numbered in the Qur'an reveals the important social aspect of Zakat:

*"Collected Zakat is for: the poor, the destitute, those who collect it, reconciling people's hearts, freeing slaves, those in debt, spending in the way of Allah, and travellers. An obligation imposed by Allah[21]"*

### 2.2.1 The Benefits of Zakat

1. **A Social Insurance System**

[16] The Qur'an, Surat *Al Maida* 5:12.
[17] Sayings and actions by Prophet Mohammed followed by Muslims.
[18] Bukhari, Muslim.
[19] It was enforced by Abu Bakr the first Khalifa (successor of the Prophet Mohammed) who justified using force in collecting Zakat from those refusing to pay it, implying that those who refuse to pay Zakat are not true Muslims: "I will fight those who differentiate between prayer and Zakat".
[20]Over time Zakat slowly began to be interpreted as a voluntary offering of charity, this misconception stemmed especially from confusing Zakat with another voluntary form of charity in Islam named "Sadaqa". Sadaqa is used in the Qur'an as a synonym for Zakat; however, it often refers to the broader concept of charitable offerings.
[21] AL Qur'an, Surat Al Tawbah, The Qur'an 9:60.

Zakat is the cornerstone of Islam's social insurance system; it provides relief to those in need and collects funds from those who have access to money. Zakat does not depend on individual voluntary charity, but on a governmental institution that collects regular contributions and distributes organized relief to all those who are in need[22].

2. **Reducing Social Disparities**

According to Jehle[23] on the effects of Zakat in Pakistan – where Zakat is obligatory[24] Zakat has led to a reduction in income inequality and to an unambiguous increase in the social welfare in every province of Pakistan. Others also agree that Zakat helps achieve economic justice by reducing the gap between the rich and the poor[25]. In addition, Abdul Rahman [26] argues that Zakat increases the purchasing power of the poor, so eventually this would lead to "economic growth through an increase in consumption expenditure and aggregate demand"[27].

### 2.2.2 The Theoretical Basis for Zakat

---

[22] Qardawi, Y. (1999), *Fiqh Az-Zakat: A Comparative Study*, Dar Al Taqwa, pp. 550-551.
[23] Jehle, G. A. (1994), *Zakat and Inequality: Some Evidence from Pakistan*, 1994, Review of Income and Wealth, Series 40, Number 2, June, pp. 205-216.
[24] Only five Islamic countries today enforce an obligatory Zakat system: Saudi Arabia, Sudan, Pakistan, Malaysia, and Brunei.
[25] Molla, R.I., Moten R.A, Gusau, S.A., Gwandu A.A. (1988), *Frontiers and Mechanics of Islamic Economics*, University of Sokoto, Nigeria, pp. 73.
[26] Abdul Rahman, A. (2002), *Zakat Accounting: Creating Business Wealth*, Akauntan Nasional, pp. 11-16.
[27] Azharuddin, M. (1998), *Role of Zakat in a Modern Economy with Reference to Bangladesh*, (cited in) Molla, R. (et al) (1988), *Frontiers and Mechanics of Islamic Economics*, University of Sokoto, Nigeria 68 – 155.

There are also several theories that attempt to explain the theoretical basis for Zakat. The first of these theories is the theory of obligation. The supporters of this theory explain Zakat the same way that other Islamic religious duties are explained, i.e. God who is the creator and provides has the right to charge his servants with an obligation in thankfulness to him. Another theory is the theory of vicegerency (the position of authority). The basic element of this theory is that all goods, in fact, belong to God, and that human beings are only vicergents, while God is the owner of everything[28]. Also through the theory of solidarity, human beings are social creatures, thus even in the procuring of wealth and income by an individual, society plays an important role. Consequently, private wealth must have a facet that is, at the same time, part of the wealth of society as a whole. Allah addresses the Muslim community,

*"Do not hand over to the simple minded any property in your hands for which Allah has made you responsible."* (4:5)[29]

The passage from the Qur'an indicates that property and wealth belong to society as much as to individuals, to the extent that Muslim jurists deduce that abusers of their private wealth must be prevented from practising control over their assets since wealth belongs to the whole society as well as the individual owners. Finally, the theory of brotherhood among Muslims, which is rooted deeper than the idea of solidarity, and is considered more influential, since solidarity is a mutual exchange while brotherhood implies selfless giving and sacrifice[30].

---

[28] Mahjub, R. (2004), *Al Iqtisad Al Siyasi,* Vol. 1, pp. 191-192. Arabic Reference.
[29] The Qur'an, Surat Al Nisa (4:5).
[30] Al Qardawi (note 22 supra).

### 2.2.3 Assets Subject to Zakat

The Qur'an does not give the definition of the kinds of wealth on which Zakat should be paid. It is left to the *Sunna* to give, by example or by directives, details of the general Qur'anic command and to convert the theoretical axioms of the Qur'an into a living reality in human life. The Qur'an does mention, however, a few zakatable assets, these are: (1) gold and silver, according to the Qur'anic verse:

*"As for those who hoard up gold and silver and do not spend it in the way of Allah, give them the news of their punishment"* (9:34)[31].

(2) Crops and fruits, referred to in the Qur'an:

*"Eat of their fruit when they bear fruit and pay their due on the day of their harvest"* (6:141)[32];

(3) What is extracted from the earth: the above Qur'anic verse continues:

*"and some of what the earth produces for you"*(6:141)[33];

(4) Earning from trade and other business ventures, referred to in the verse:

*"O you who believe, give away some of the good things you have earned"* (2:267)[34].

Except for the examples above, the Qur'an mentions Zakat in general and the word *amwal* (assets or wealth) in its plural form such as in the Qur'anic verse: *"Take sadaqa*[35] *from their wealth to purify and cleanse them"* (9:103)[36] and *"and the beggars and destitute received a due share of their wealth"* (51:19)[37].

---

[31] The Qur'an, Surat Al Tawba (9:34)
[32] The Qur'an, Surat Al An'am (6:141).
[33] *Id.*
[34] The Qur'an, Surat Al Baqara (2:267).
[35] Another form of alms giving in Islam, however, Sadaqa has always been voluntary as opposed to Zakat which is obligatory.

### 2.2.4 Conditions Required in *Amwal* (wealth) for Zakat Collection

Three conditions must exist in the wealth in order for it to be liable for Zakat: ownership, growth, and reaching a minimum threshold *Nisab*[38].

1. Ownership: meaning the Muslim who owns the wealth subject to Zakat must have control and authority over this wealth and have exclusive right of disposition over it. From this first condition the exceptions to the wealth which is not liable to Zakat can be defined:

a. Property in public trust, this includes public trusts for the poor, for mosques, orphans, schools etc., is not subject to Zakat.
b. Unlawful wealth, this excludes any wealth acquired through unlawful means such as theft, counterfeiting, bribery, interest, monopoly or cheating.
c. Debt: Zakat on debt is disputable, there are three views. The first, is that the creditor must pay Zakat for all the past years upon repayment of the debt[39]. The second is the creditor should pay Zakat for the past year only upon repayment of the debt[40]. And the third, is that the creditor does not owe any Zakat whatsoever[41].

2. Growth: the second condition for Zakat is that the wealth concerned must either be actually growing or have the potential for growth. Growth means something that provides the owner with profit and benefit. The rational for this condition is that Zakat has been legislated to help and relieve the poor without impoverishing the rich, by having the rich pay from their surplus, taking a little from the plenty. Imposing Zakat on wealth that does not by definition grow reverses this purpose[42].
3. Reaching Nisab: Zakat is not imposed on all amounts of growing wealth, there is a minimum required for Zakat which is called Nisab. A saying by the prophet Mohamed exempts anything that is less than five camels, forty sheep, two hundred silver dirhams[43], or five wasqs[44] of grain, fruits or agricultural crops. The equivalent of Nisab today is 2.5% (or 1/40) of one's eligible growing wealth.

---

[36] The Qur'an, Surat Al Tawbah, (9:103).
[37] The Qur'an, Surat Al Zariyat, (51:19).
[38] Al Qardawi (note 22 supra).
[39] The view of Muslim scholars Ali and Ibn Abbas.
[40] The view of Muslim scholars Al Hasan, Umar Ibn AbdulAziz and Malik.
[41] The view of Muslim scholar Abu Hanifa.
[42] Al Qardawi (note 22 supra).
[43] A silver coin used as currency.
[44] A measure of volume used in agriculture.

The condition of Nisab as a minimum for paying Zakat is agreed upon among all scholars, except in the case of crops, fruit, and minerals. Abu Hanifa[45] considers anything that comes out of the earth to be subject to Zakat, while other Muslim scholars see Nisab as a necessary condition for Zakat on all kinds of wealth whether it comes from the earth or not.
There are three conditions which must be satisfied in the Nisab:

a. Excess above essential need: this means that Nisab must be in excess of the basic need of the owner, i.e. Zakat is imposed only on the surplus of wealth, the surplus understood and defined as the excess after satisfying needs.
b. Freedom of debt: if the owner of the wealth is burdened by debts that exceed the Nisab or reduce the assets worth to below the Nisab Zakat is not obliged.
c. The passage of a year: twelve full lunar months should pass from the beginning of the ownership or past the due date of Zakat for Zakat to accrue again[46].

The above are the requirements outlining the wealth liable to Zakat, but who are the Zakat payers?

### 2.2.5 Persons Liable to Pay Zakat

There is an agreement amongst most Muslim jurists that Zakat is an obligation for any Muslim who has reached puberty, who is sane, who is free[47], and who owns the minimum Nisab. Thus Zakat is only obligatory upon Muslims and is not required upon non-Mulims because it is part of the religion and could not be expected from those who do not believe in Islam. The fact that Zakat is only obligatory upon Muslims has raised the question of whether it is possible in an Islamic State for an equivalent of Zakat to be taken from non-Muslims as tax. During the reign of prophet Mohamed and the two Khalifat who succeeded him, Abu Baker and Umar Ibn Al Khatab non-Muslims living in Muslim countries did

[45] The leader of one of the four main schools of jurisprudence in Islamic Fiqh, the others are *Ibin Malik, Al Shafi,* and *Al Hanbali.*
[46] Al Qardawi (note 22 supra).
[47] The issue of slavery is not discussed any more as it is not relevant to our time anymore.

pay a financial duty to the Islamic State they resided in called by the Qur'an *'Jizya'*[48] as a contribution towards the public expenditure of the State that covers disability, old age and poverty insurance. However, *Jizya*, is not implemented today and Muslim jurists have not reached a consensus as to whether non-Muslims living in Muslim States should pay an equivalent to Zakat in taxation[49].

### 2.2.6 Beneficiaries of Zakat

Zakat is divided equally among appropriate groups of beneficiaries. Zakat's beneficiaries are restricted to eight groups which are mentioned in the Qur'an:

*"The alms are only for the poor and the needy, and those who collect them, and those whose hearts are to be reconciled, and to free the captives and the debtors, and for the cause of Allah, and for the wayfarer; a duty imposed by Allah"* (9:60)[50]

This Qur'anic passage is important in jurisprudence as it defines eight proper beneficiaries of Zakat, the first group of recipients is the poor, those who are in material need. The second group are the needy, they are similar to the poor, some scholars have treated two groups as synonymous, however, a more traditional view is to describe an order of priority, so that the poor take priority over the needy. The third category is "those who collect them" this has been interpreted as an allocation to cover the costs of collecting and distributing alms. Historically when Zakat was collected by Muslim States as a tax, this category was used to justify State administrative costs. The fourth category are "those whose hearts are to be reconciled" this category represents those who were recently converted to

[48] A tax imposed upon non-Muslims who resided under the authority of an Islamic State.
[49] Al Qardawi (note 22 supra).
[50] The Qur'an, Surat Al Tawbah (9:60).

Islam, another interpretation includes those who are sympathetic to Islam but are not yet believers, this second interpretation has been used to justify financial support for missionary activities and potential converts.[51] The fifth and sixth recipients are captives and debtors. The freeing of captives refers to ransoming prisoners captured in war, or the purchasing of slaves' freedom, although debtors may include those who are enslaved, it also includes those who are burdened in debt. The seventh category is "for the cause of Allah", historically, this was used to support those who served as warriors for the defence of Islam. The final category of recipients is the "wayfarers" this justifies expenditure of Zakat money to support travellers[52]. Thus it is concluded from this that those who are to receive Zakat monies are limited and that Zakat was not meant to be allocated towards financing public goods and services[53].

When it comes to regulating Islamic matters not clearly treated by the Qur'an or the Sunna, Islamic theorists turn to '*Ijtihad'*. *Ijtihad* in Islam is the art of interpretation within Islamic jurisprudence; it is the process of seeking to form correct legal opinions through reasoning from the Quran and the Sunna. Whenever there was no clear text on a particular issue, jurists used methods of analogy and consensus, and depending upon the school of thought, custom, public policy analysis, necessity, and judicial discretion to reach a decision consistent with Qur'anic principles[54]. And as has been mentioned above[55] the Qur'an does

---

[51] Kassis, E. H. (1983), *A Concordance of the QUR'AN,* University of California Press, p. 431.
[52] Al Ghazali, A. H. (1975), *The Mysteries of Alms Giving*, Books Concern, translated by Nabin Faris, pp.5-11.
[53] See pp. 23-28 for a discussion on the limitation of Zakat as a method of redistribution of wealth.
[54] Hallaq, W. B. (1997), *A History of Islamic Legal Theories: An Introduction to Sunni Usul Al Fiqh*, Cambridge University Press, pp.10-15.

not give the definition of the type of wealth upon which Zakat should be paid. Also there are different opinions on matters such as paying Zakat on debt[56]. And even when most Muslim theorists believe that Zakat should only be imposed on Muslims, there are still some who believe that non-Muslims living in a Muslims States should be liable to pay Zakat[57]. This means that Muslim scholars must use *Ijtihad* to reach a consensus, however, and agreement between different jurists isn't always achieved. There are four main schools of thought in Islamic jurisprudence:

### 2.2.7 The Four Classic School of Fiqh (Islamic Jurisprudence)

In Islamic theory, the four main schools of *fiqh* are *Hanafi*, *Maliki*, *Shafi*, and *Hanbali*. These schools of thought and interpretation take their names from the Islmaic jurists who established them.

(1) The Hanafis believe that although government authorities may collect Zakat, they are limited to collecting "visible" property (live stock and crops). Also the Hanafi scholar Abu Yusuf specifically excludes non-Muslims as possible Zakat beneficiaries, and donors may not give in ways that benefit themselves[58]. (2) The Malikis allowed Zakat to be imposed upon non-Muslims; along with Shafis (see below) the Malikis believe that the poor have an actual property right in the wealth of the rich. Unlike Hanafis, however, the Malikis consider all Zakatable property to be subject to government collection whether the property is visible or

---

[55] See p. 13.
[56] See p. 14.
[57] See pp. 15-16.
[58] Calder, N. (1993), *Studies of Early Muslim Jurisprudence*, Oxford University Press, pp. 32- 154.

not.[59] (3) Al Shafis, on the other hand, do not view debt as any sort of adjustment or limitation on the amount of the Zakat owed. Although Shafis adopt the Hanafi distinction between visible and non-visible goods, nearly all goods are considered non-visible to the Shafis, thus removing them from the collection powers of the government. Further, Shafi jurisprudence generally requires equal distribution to the applicable beneficiary categories in order to avoid human discretion in the allocation process[60]. (4) The *Hanbali* was influenced by the work of Imam Shafi. His jurisprudence emphasized a literal reading of the Qur'an and the Sunna, limiting the use of analogy and other interpretive sources which tended to increase judicial discretion and innovation. According to the Hanablis, Zakat liability does not apply to debt owed on gold, silver, or trade goods in order to avoid the situation in which a person might owe Zakat even when his actual net worth does not exceed Nisab.[61]

The above has been an introduction to the meaning of Zakat in Islam; the following however, attempts to shed some light on the advantages of Zakat in the viewpoint of Islam, as Zakat is believed to achieve social justice in the Muslim society. After that some emphasis will be given to the limitation of Zakat as a system of redistribution of wealth.

### 2.3 The Idea of Social Justice in Zakat

---

[59] Hodgson, M. (1985), *The Venture of Islam: Conscience and History in a World Civilization: The Classical Age of Islam: Volume 1,* The University of Chicago Press, pp. 97-113.
[60] Aghnides, N. (2009) *Mohamedian Theory of Finance*, pp. 526-27. In Powell, R. (2009) *Zakat: Drawing Insight for Legal Theory and Economic Policy from Islamic Jurisprudence*, Seattle University.
[61] Coulson, N. J. (2003), *A History of Islamic Law*, Edinburgh University Press, pp.71-73.

Justice in Islam stands for human equality. Islam does not demand compulsory economic equality in the narrow literal sense of the term. This is against nature and conflicts with an essential fact which is the differing natural endowments of individuals. Enforced economic equality arrests the development of outstanding ability and makes it equal to lesser ability. Since different individuals also have different methods by which they earn their livelihood Islam admits the reasonable causes of these differences as being differences in strength and endowment. Hence, absolute justice demands that men's rewards be similarly different and that some obtain more than others so long as human justice is upheld by the provision of equal opportunity for all. Ideally Zakat could ensure, if implemented carefully, that the rich do not become poor, but the poor cease to be poor[62]. From this perspective, Islam makes Zakat an obligatory claim on the property of the wealthy in favour of the poor. It is a due which the government can exact by the authority of the law and by the power of its administration.

Siddiqi [63] argues that Zakat satisfies the four famous principles of a fair taxation system as set up by Adam Smith[64] the four principles are: fairness, certainty, simplicity and convenience. Smith considered these four pillars as the back bone to a just system of redistribution of wealth[65]. In his attempt to sustain his argument that Zakat is an Islamic system of redistribution which parallels with the Western idea of taxation, Siddiqi provides that in regards to fairness, Zakat is

---

[62] Benthall, J. (1999) *Financial Worship: The Quranic Injunction to Almsgiving*, The Journal of Royal Anthropological Institute, pp.27-42.
[63] Siddiqi, S. A. (1992), *Public Finance in Islam*, (2nd edn.) Adam Publishers and Distributors, India, p. 113.
[64] Smith, A. (1776), *An Inquiry into the Nature and Causes of the Wealth of Nations*, Clarendon Press 1976, Oxford, p.1152.
[65] *Id.*

levied on the individual's savings for the period of twelve months; therefore, people with bigger savings contribute more. As an effect the poorer people of the community would not be prejudiced, for those with no savings Siddiqi asserts are not obliged to pay Zakat. Taxes on the other hand are levied on the income of individuals and increase proportionally as there is an increase in income, leading relatively to more sacrifice being made by the poor than the rich, as no account is taken of the amount of wealth accumulated by the individual. Furthermore, it is the poor who benefit more from the revenues of Zakat, which helps to serve one of its main objectives, that is to provide social justice. Siddiqi adds that Zakat provides certainty for the payer, with its fixed rate which equals 2.5% of an individual's wealth[66]. He supports this argument by referring to the fact that the rate, objectives, and forms of expenditure of Zakat are immutable, unalterable, and based on its divine sanction. He adds that in regard to time, amount of payments, and forms of expenditure, both for the contributors and the governments, no man-made tax could offer more certainty than Zakat does.

Siddiqi continues by adding that Zakat is also convenient because it is paid annually, and by those who are able pay it, i.e. those with wealth which exceeds *Nisab*[67]. And as far as the manner of payment is concerned, Zakat offers the convenience of paying it according to its manner of production (i.e. land produce, cattle, or articles of trade, or in cash). When it comes to simplicity Siddiqi argues that the religio-economic character of Zakat, and simplicity of its calculation, its fixed and understandable rate, all of this makes its collection costs lower than those of any other tax system.

---

[66] This fixed rate is also called *Nisab* See p. 14.

[67] *Nisab* is a minimum amount which determines if a person's wealth is subject to tax.

### 2.3.1 The Difference between Zakat and Taxation

Muslim jurists like to stress that the main difference between Zakat and taxation is that Zakat falls on the annual accumulated wealth of the Zakat payer, whilst tax falls on the income of the taxpayer; they argue that it is this difference that makes Zakat fairer than taxation as it falls more heavily on the rich than the poor[68], and thus achieves more social justice. However, the response to this is claim is that taxes in most fiscal system are levied on capital gains - through the alienation of movable and immovable property, taxes are also levied on inheritance, and some States impose a mansion tax, proving further that there is a wider basis for extracting revenue in taxation than there is in Zakat. The issue of social justice rises again when Muslim jurists stress that Zakat as a religious duty cannot be changed or altered whether in terms of the wealth it falls on, the *Nisab* (the minimum wealth that raises Zakat liability), those who are liable to pay it or it's beneficiaries, none of these can be reformed[69] whilst this characteristic may be viewed as adding certainty to Zakat[70]on the other side of the argument it can be viewed as undermining the idea of social justice.

Despite Siddiqi's emphasis on the virtues of Zakat (above)[71], there is a need to take a closer look at what limitations Zakat can have as a system of redistribution of wealth.

---

[68] See pp. 20-21.
[69] Al Qardawi (note 22 supra).
[70] See p. 21.
[71] See pp. 20-21.

## 2.4 Limitations of Zakat as a System of Redistribution of Wealth

### 1. Marginalizing non-Muslims

Zakat in Kuwait is to this date voluntary; collection of Zakat is made through a governmental institution named 'Bait Al Zakat' established in 1982[72].

Kuwaiti people argue they reject the idea of personal tax because Zakat can serve as an efficient tax system. However the situation is not that simple. Kuwait's Society is now a secular one, with 50% Sunni Muslims, 40% Muslim Shi'a, and 10% of Christians, Jews and Hindus[73]. A significant number of non-Muslims living and working in Kuwait do not believe in Zakat and thus refuse to pay it[74]. Also the Muslims *Shi'a* do not pay Zakat as it is known in the *Sunni* jurisprudence. The *Shi'a* alms are called *Khumus* (the giving of the fifth in *Shi'ism*). This alm requires every Muslim from the Shi'a belief to pay a fifth of certain goods, plus a donation of 20% on income, which will then be distributed by the *Imam*[75] on the proxy of *Shi'a* who he is responsible for[76].

So there is a crucial need to consider the challenges of institutionalizing Zakat. Also the efficiency of Zakat as a welfare system ought to be considered by the Kuwaiti government which aims to modify a Zakat policy to meet modern economic challenges. Questions such as who collects and distributes Zakat raises similar considerations. Because Zakat is rooted in religious law, its enforcement by a modern state raises questions such as those regarding the appropriate role of

---

[72] Abdullah, N., (2005), *The Effect of Introducing Statutory Zakat in Kuwait,* MSc in Finance Accounting, University of West England, Bristol, p.1.
[73] The CIA the World Fact Book, https://www.cia.gov/library/publications/the-world-factbook/geos/ku.html accessed on Thursday 24/6/2010.
[74] Abdullah (note 72 supra).
[75] In Shi'ism, an Imam is a recognized authority on Islamic theology and law and a spiritual guide.
[76] Housseini, Z., M., (1999), *Islam and Gender,* Princeton University Press, p.12.

religion in the government; these issues are particularly salient for religious minorities. The adaptation of Islamic jurisprudence also raises questions related to the appropriateness of new interpretations; finding new interpretations of the Qur'an and Sunna through *Ijtihad* as has been discussed above[77] may be viewed as allowing too much freedom in finding new meanings for the verse of Qur'an and the Sunna different from what was initially intended, or interpreting the Qur'anic verse in ways to serve the interest of some of the groups in society and not others. However, closing the door completely to *Ijtihad* can also constitute a problem as there are some issues such as the implementation of Zakat or the equivalent of Zakat in tax on non-Muslims in Muslim States which needs to be resolved through *Ijtihad*[78].

### 2. The Progressivity of Zakat

In the simplest sense, a progressive tax takes a larger percentage from the income of the wealthy than it does from the poor. Tax exemption to the extent of *Nisab* ensures some degree of progressivity in Zakat as a "tax" regime. This is particularly true if *Nisab* accurately measures minimal living costs. However at the upper end of the wealth and income spectrum, there is a drop in progressivity because rates are fixed[79].

There are a number of rates for Zakat. Crops from irrigated land are subject to 5%. Crops that do not require irrigation are taxed at 10%. Found treasure, ambergris

[77] See pp. 17-19.
[78] See pp. 15-19 for a discussion on the scope of donors and beneficiaries of Zakat.
[79] Bankman, J. & Griffith, T. (1987), *Social Welfare and the Rate Structure: A New Look at Progressive Taxation,* 75 California Law Review, pp. 1905-1908.

and pearls are subject to 20% Zakat. The main default rate for all other taxable goods is 2.5% of the value[80].

The degree of progressivity also depends on the item taxed. Agricultural products which are measured annually are likely to represent something like income, particularly in agrarian societies. As a form of "income tax" these 5-10% rates can be viewed as regressive, particularly because those who produce well above their needs pay the same rate as those who make just over *Nisab*. However the 2.5% tax on wealth does not function as an "income tax" and is less subject to criticism[81].

### 3. What system of Zakat to adopt?

Some mandatory Zakat systems emphasize the elements of Zakat that function as income tax (Malaysia)[82]. Others emphasize tax on wealth (Pakistan).[83] Others claim to enforce Zakat according to classical jurisprudence (Yemen)[84]. Each of these options creates particular advantages and challenges for making Zakat an effective system of poverty alleviation. Emphasis on taxing agricultural production risks putting a disproportionate burden on the poorer segment of society. Emphasis on taxing wealth creates challenges in both estimating and

---

[80] Al Bukhari, S. (1997), *The Translation of the Meanings of Sahih Al Bukhari,* Dar Assalam Publications, pp. 275-338, Translated by Dr. Mohammed M., Khan.
[81] Shakow, D. & Shuldiner, R. (2000), *A Comprehensive Wealth Tax,* 35 Tax Law Review, pp. 499-578.
[82] Bin Mohammed, A. (1993), *Zakat and Rural Development in Malaysia*, Berita Publishing: Kuala Lumpur, pp. 185-186.
[83] Mayer, A. E. (1986), *Islamization and Taxation in Pakistan, in Islamic Reassertion in Pakistan,* Syracuse: Syracuse University Press, p. 68.
[84] Fallon, G. M. (1993), *The Taxation of Companies and Individuals in Yemen,* Arab Law Quarterly, pp.37-41.

collecting Zakat. In Pakistan deducting Zakat from bank accounts on a fixed date caused massive withdrawals to avoid compliance.

### 4. The Scope of Zakat: Donors, Beneficiaries and Nisab

As was mentioned above[85], the beneficiaries for Zakat are the eight groups numbered in the Quran. This is particularly challenging for the development of Zakat, and the need to broaden its beneficiaries and its base if Zakat can be considered as an efficient redistributive system of wealth. The first and main challenge standing in the way of Zakat's development is closing the door to *Ijtihad*. This means following the Qur'an and the Sunna literally, and not allowing broader interpretation or innovation[86]. Also the fact that Zakat is a religious Muslim alms giving limits its beneficiaries and its donors by marginalizing non-Muslims living in a Muslim society since Zakat requires that Zakat money be paid by Muslims, and given to poor Muslims[87]. The question of how to treat minorities within a legal Zakat framework is complex. Zakat as a form of 'tax' levied only on Muslims reinforces the classical distinction between Muslims and non-Muslims which legally disadvantages non-Muslims even if the system provides for religious toleration[88].

---

[85] See pp.16-17.
[86] Fadel, M. (1996), *The Social Logic of Taqlid* and *the rise of Mukhtasar, Islamic* Law and Society, Vol.3, 193, p.193.
[87] Prihatna, A. A. (2005), *Muslim Philanthropy: Potential and Reality of Zakat in Indonesia: Survey Results in Ten Cities,* Kota Depok: Pirmedia, pp.67-70.
[88] Al Na'im, A. A. (1996), *Toward an Islamic Reformation: Civil Liberties, Humane Rights and International Law,* Syracuse University Press, pp. 88 – 91.

### 5. Allowing Donors to choose their beneficiaries

In the absence of alms laws, alms are given on a voluntary and decentralized basis[89]. Economic evidence has provided that voluntary giving to local groups or individuals favours certain categories of beneficiaries, for example those with a relationship with the giver, and that this pattern of giving tends not to provide for sufficient redistribution of wealth to alleviate systemic poverty[90]. And although most Islamic states have established government supported entities to receive and distribute voluntary Zakat contributions, donors still prefer to make donations to the people they personally know who are in need of it.

### 6. Zakat's lack of flexibility

A number of commentators have observed that Zakat systems might become more effective if they remained consistent with Qur'anic principles but not necessarily according to the rules of traditional *fiqh*, as some scholars argue that *Nisab* ought to be recalculated to reflect the true basic cost of living rather than relying exclusively on measures of commodities (whether gold, silver, wheat, rice, or cows) that have different values in contemporary economies. This move would allow countries to ensure that basic living costs are exempt from Zakat and contribute to progressivity, but it would require a reinterpretation of the sources of

[89] Hassan, R. (2005), *Giving and Gaining: Philanthropy and Social Justice in Muslim Societies,* paper presented at a workshop at Flinder University 7-8 Nov. 2005.
[90] Prihatna (note 87 supra).

*fiqh*, however such reinterpretation has been disallowed in Islamic jurisdictions for more than 700 years[91].

### 7. The Collection of Zakat

The question of who collects and distributes Zakat also raises questions, because Zakat is rooted in religious law. Its enforcement by a modern state raises questions regarding the appropriate role of religion in government. These issues are particularly salient for religious minorities. In multi-faith societies such as Egypt rumours occasionally surface indicating government plans to legally enforce Zakat contributions, such proposals have been met with widespread opposition; even Islamic scholars from Al-Azhar University in Egypt (The world's oldest University and the most important historical centre in Islamic Scholarship) suggest that direct government control and enforcement of Zakat would be fraught with inefficiencies and would encourage evasion and corruption[92].

The above discussion on Zakat in terms of its definition, its advantages and its limits as a system of redistribution of wealth in the Muslim world is particularly important in order to address the claims by the Kuwaiti people that there needn't be a westernized tax system in Kuwait due to the fact that people see the religious duty of Zakat as an efficient method of taking from the wealthy and giving to the less fortunate, and also that people seem to comply to paying Zakat voluntarily

[91] Hallaq, W. B. (1984), *Was the Gate of Ijtihad Closed?,* International Journal Middle East Studies, Vol. 16, pp. 3-14.
[92] Al Nahhas, M. (2002), *Whose the Poorer,* Al-Ahram Weekly News Paper, Jan 24-30 2002.

simply for its divine nature, an attribute not found in taxation[93]. This view of the Kuwaiti people comes from the ancient correlation between religion and the economy. But does religion and religious value have a positive or a negative effect on economic development?

### 2.5 The Effect of Religion upon Economic Development

The modern study of religion and economics begins with Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776). In his book Smith applies his innovative laissez-faire philosophy to several aspects of religion. However, Smith's fundamental contribution to the modern study of religion was that religious beliefs and activities are rational choices. As in commercial activity, people respond to religious costs and benefits in a predictable observable manner.

McCleary[94] in her paper *Religion and Economic Development* provides that showing no preference for one religion over others, but rather permitting any and all religions to be practiced, creates an open market in which religious groups engage in rational discussion about religious beliefs. This setting creates an atmosphere of "good temper and moderation". Where there is a State monopoly on religion or an oligopoly among religions, one will find zealousness and the imposition of idea on the public; where there is an open market for religion and freedom of speech, one will find moderation and reason. McCleary suggests that the more religious people are, the less economically developed they will be. She

[93] See pp. 8-9.
[94] McCleary, R. (2008), Religion and Economic Development, Policy Review, p.148.

defends her theory by providing four primary indicators of the influence of economic development on religion; education, value of time, life expectancy and urbanization. Education; the more educated the person is, the more likely he is to turn to science for explanations of natural phenomena, with religion intended to explain super natural phenomena and psychological phenomena for which there is no rational explanation. According to this view the higher the level of educational attainment the less religious people will be. On the other hand, a study undertaken by sociologist Schwadel (2011) University of Nebraska – Lincoln, found that people actually tend to become more religious -by some definition- as they further their education. When it comes to Value of time McCleary argues that economic reasoning tells us that anything that raises the cost of religious activities would reduce these activities. Economic development and participation in the work force raise the value of a person's time as measured by the value of market wages. Thus, economic development implies a rising opportunity cost of participating in time-intensive activities, such as religious services and prayer. Hence, people will participate less in religious activities because their time is now more valuable to them. In terms of life expectancy, with people living longer around the globe McCleary argues that participation in certain religions will be low and then rise as the population ages. Finally, urbanization, in urban areas religion activities competes with others, such as the symphony, theatre, museums, and volunteer activities. Thus religion takes up your leisure time and competes with other leisure activities in addition to work[95].

[95] *Id.*

Max Weber (1905) identified the significant role that religion plays in social change; He went as far as to state that the protestant reformation triggered a mental revolution that made possible the advent of modern capitalism. Other scholars prefer to avoid correlating religion directly with economic prosperity, they try to relate it to fundamental institutions that have been shown to be conducive to growth. In his study of development across Italy, for instance, Putnam (1993) attributes the prevailing lack of trust toward others in the South to the strong Catholic tradition, which emphasizes the vertical bond with the Church and undermines the horizontal bond with fellow citizens. In a cross-country study, both La Porta et al. (1997) and Inglehart (1999) find evidence for this theory. On a similar note, Landes (1998) attributes the failure of Spain to develop in the 16th and the 17th century to the culture of intolerance diffused by the Catholic Church, which forced some of the most skilful people out of the country. Finally Stulz and Williamson (2001) attribute the low level of creditors' protection present in Catholic countries to the anti-usury culture pervasive in the Catholic tradition[96]. Unlike Weber, most of these authors provide compelling evidence in favour of their arguments. Guiso, Sapienza and Zingales in their article *People's Opium? Religion and Economic Attitudes* suggest that such evidence, however, can be interpreted in two ways. One possible interpretation is that there is something intrinsic to certain religions, such as Catholicism, that makes them inimical to the development of talents and institutions that foster economic growth. An alternative interpretation, which is equally consistent with the results, is that there was something in the past (correlated with religion, but not necessarily religion)

[96] Guiso, L. *et al*, (2002), People's Opium? Religion and Economic Attitude, Journal of Monetary Economics 50 (2003) 225-282.

that trapped a country in a bad equilibrium. According to this interpretation, there is nothing fundamental, but it is hysteria that keeps a country trapped in this equilibrium[97].

In their paper *Religion and Development: Are they Complimentary*, Khan and Bashar (2008)[98] argue that religion may act as a negative force; possible negative effects of religion on economic growth include religious restrictions on capital accumulation, profit making, credit markets and interest; religion may also increase resource allocation towards church activities, such as cathedral building, and thereby remove resources from free market activities. Daniels and Ruhr (2005) used individual survey data of U.S. residents to test the impact of religious affiliation on attitudes towards trade and immigration policies. The results show that in general religious affiliation is a significant determinant of individual international policy preferences. Specifically, members of the three largest U.S. denominations Catholics, Baptists, and Methodists are more likely to favour policies that restrict imports into the United States, It was also found that views on these issues differ among pre-Vatican II Catholics and post-Vatican II Catholics, and among Baptist and non-Baptist African Americans. The authors hence suggest that religion is an important form of identity and may represent an important source of resistance to a greater economic integration[99].

On the positive side of religion's connection to economic development, religion has been found to enhance economic growth and development by promoting a

---

[97] *Id.*
[98] Khan, H. and Bashar, O. (2008), *Religion and Development are they Complimentary,* U21 Global Working Paper, p.5.
[99] Khan and Bashar (note 98 supra).

positive attitude toward honesty. Since the concept of 'truthful living' is a major emphasis in religious practice, it induces people to bring a sincere attitude in all interactions and dealings. Religion may increase levels of trust and reduce levels of corruption and criminal activity. It may also encourage thrift, which would stimulate saving, investments, and therefore economic growth. Besides, religion may lead to better health levels by discouraging sinful activities as drugs, overeating, gambling, alcohol, etc., for instance alcohol and gambling are strictly forbidden in Islam. The principles of Islamic banking and finance are based on the premise that any kind of financial arrangements leading to investments in such activities are unproductive and socially undesirable and thereby strictly prohibits them[100]. Other supporters of the theory that religion is positively linked to economic development are Dahejia and Dahejia (1993)[101] who have attributed the period of the Mauryan Empire in ancient Indian history (c. 321-c. 185 BC), also called 'The Golden Age', to strong religious faith. The Mauryan Empire witnessed the pinnacle of Advaita Vedantic monotheism, the idiom of Hindu thought of that day. The Mauryan Empire become known for its thriving sea and land trade with China and Sumatra to the east, Ceylon to the south and Persia and the Mediterranean to the west, in addition to the silk routes from Europe to China which put India at the centre of a vibrant trade route. This economy of the Mauryan Empire was outward looking and confident with a clear parallel between the self-assured and bold religious thought of that day and the economy of the Mauryan Empire where religion relied on and stressed the actions of individuals to generate progress. The authors compare India's economy during the Mauryan

[100] *Id.*
[101] Dehejia, R. and Dehejia, V. (1993), *Religion and Economic Activity in India: a Historical Perspective,* American Journal of Economics and sociology, Vol.52, Issue 2, p. 145-153.

Empire to India's economy today, where despite impressive infrastructure and technical manpower and despite the phenomenal growth of consumerism in India's 200 million strong middle class, the country remains largely grounded realizing only a fraction of its growth potential. Religiously India has moved away from the Advaita Vedantic principle ancient India had followed, the decline of Hinduism – the authors argue – seems to parallel the stagnation of the economy[102].

The above provides the disparities between opinions that link religion to economic development and opinions opposite of that claim. There are also claims that ancient civilizations often ruled their States by mixing religion with law, as did Islamic civilization when it first emerged. Samson[103] points to the fact that until the 18th century, most Islamic countries were ruled according to the framework of the Sahri'ah; nevertheless, in the nineteenth century and as an effect of colonization, most Islamic countries were influenced by western economic theories on taxation[104]. However, is the argument that Zakat is another form of taxation a plausible one? Siddiqi[105] argues that the Industrial Revolution and the emergence of the banking industry had an influence on the Islamic nation and its adaptation of western theories. He believes that the Islamic nation should abandon western theories, and adopt Zakat as a mechanism to redistribute wealth. Siddiqi supports his theory by pointing to the constant development and change which

---

[102] *Id.*
[103] Samson, W. (2002), *History of Taxation* (cited in) Lymer, A. and Hasseldine, J. (eds.), *The International Taxation System*, Kluwer Academic Publishers, Boston, pp. 21-41.
[104] Zaid, O. (2000), *The Appointment Qualifications of Muslim Accountants in the Middle Ages*, Accounting Education, 9 (4), pp. 329-342.
[105] Siddiqi (note 63 supra).

Western tax systems have undergone throughout history, whilst the objectives, rates, and form of the Islamic Zakat has not been changed since it was required of Muslims by the Qur'an. This stability, Siddiqi claims, gives Zakat a great deal of familiarity and certainty. However, in addition to the limitations of Zakat as a system of redistributing wealth provided earlier in this chapter[106] Siddiqi's above claim can be viewed as a disadvantage against Zakat, there is a need to reform fiscal regimes to suit the rapid economic changes occurring worldwide during the outbreak of the current wave of globalization thus it is crucial to have a fiscal system with the flexibility to develop and the resilience to adapt to change. If Kuwait wants to succeed as an emerging economy and be able to attract FDI to its jurisdiction and reap the benefits of yielding more tax revenues then it must also think very seriously about adopting a system that fits with other fiscal systems implemented internationally. Kuwait must move forward and prove that it too can keep up with the rapid spread of globalization which, since its outbreak in the 1980's, has suggested that States no longer enjoy the prerogative of opting out of international rule. Thus there is a need for Kuwait to adopt a system not so deeply embedded in ancient religious thought that it keeps Kuwait alienated from the rest of the developing world, and not too foreign to the social values stemming from Islam which the Kuwaiti people regard and want to keep holding on to.

As the above discussion hints on the convenience of taxation in a highly globalized world, there is a need to look at the theoretical foundation for levying taxes and the different theories on what constitutes an optimal taxation system.

[106] See pp. 23-29.

## 2.6 Western Theoretical Foundation for Taxation

There are many Western theorists such as Hobbes[107], Locke[108], Rousseau[109], Smith[110], Murphy and Nagel[111] and others who have endorsed taxation as a means of financing governments and redistributing wealth. These theorists shared a concern over poverty and excessive unequal distribution of wealth and income and sought taxation as a means of relieving the disparities between the wealthy and the less advantaged[112].

In his theory of the social contract, Jean-Jacques Rousseau argues that tax levying is based on a contractual relationship between the State and the individual whereby taxes are paid in exchange for services provided by the State, such as security and other public services. According to Adam Smith, the contract is a rental one whereby the State provides individuals with services and they pay rents for them. Smith's argument is that taxation comes with government, and that people must agree to give up a little of their property in order to maintain government; what governments do aside from protecting property is important enough to justify taxation. Smith suggests that people have a reasonable expectation that they will be taxed. Hobbes on the other hand argues that it is an insurance contract where tax is a premium paid by the individual to insure the protection of the rest of his wealth[113]. Murphy and Nagel in 'The Myth of

---

[107] Hobbes, T. (1651), *Leviathan,* Cambridge University Press, p. 238
[108] Locke, J. (1824), *Two Treaties of Government,* London, p.220.
[109] Rousseau, J. J. (1762), *The Social Contract,* Wordsworth edition, 1998, p.115.
[110] Smith (note 64 supra).
[111] Murphy, L. and Nagel, T. (2002), *The Myth of Ownership*, *Taxes and Justice*, Oxford, p. 108.
[112] Bradley, M. (2010), *The Invisible Handout, Smith, J.S. Mill and Marshall on Inequality and Progress,* University of Maryland, p.1.
[113] Hilmy, M. (1955), *Mizaniyat Al Dawla,* Nahda Misr, pp.73-75 (Arabic Reference), found in Qardawi, Y. (1999), *Fiqh Az-Zakat: A Comparative Study*, Dar Al Taqwa, p. 628.

Ownership' reject the idea that people's pre-tax income and wealth are theirs in any morally meaningful sense. Property rights are the rights people have in the resources they are entitled to control after taxes, not before[114]. Whilst Locke makes property a personal right and regards the protection of personal rights as the central task for which governments are established. However he finds no alternative to taxation to maintain government and redistribute wealth.

### 2.6.1 Western Theories on what Constitutes an Optimal System of Redistribution

Thomas Hobbes proposed that tax be imposed according to the benefit derived by each individual from the existence of the State and from the services it provides[115]. The ensuing centuries saw scholars debate the structure of such a tax and, in particular, whether the "benefit principle" could be used to justify redistribution of wealth. Some scholars argue that since the wealthy obtain more benefit from the protections afforded by that State, they should be subject to a higher tax burden. Adam Smith focused on the protection of property and argued for a proportional tax on income: "the subjects of every State ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State[116]". John Stuart Mill suggested that in order to promote the utilitarian ideal of "the greatest happiness for the greatest number" taxes should impose the least aggregate sacrifice on society by imposing

[114] Murphy and Nagel (note 111 supra).
[115] Hobbes (note 107 supra).
[116] Smtih (note 64 supra).

equal sacrifice on tax payers[117]. Those supporting Mill's theory provide that if sacrifice is negative happiness, then minimizing aggregate sacrifice will necessarily maximize the aggregate happiness[118]. Optimal tax theorists want a tax base that is inelastic; favouring utilitarianism over equity. This school goes back to the sacrifice theory; they argue that all taxpayers should suffer an equal sacrifice while also saying that the least sacrifice should be occasion to the whole[119]. In more recent times, the search for the ultimate principle of taxation seems to have abated. Commentators routinely claim that taxation seeks to achieve a multiplicity of goals. These goals include supplying public goods, redistributing wealth, encouraging beneficial behaviour, discouraging behaviour considered detrimental to society and so forth. Tax structures and individual tax provisions are evaluated by their ability to contribute to the realization of these goals[120]. Richard Musgrave[121] believed that the most important role of taxation was provide the means for adjusting the distribution of income. This was based on the firm belief that a free private market system, while contributing to the achievement of efficiency and growth, should necessarily result in an acceptable distribution of income that is important for the quality of life and social stability. His interest was to find a system of taxation which would be understandable and acceptable to the electorate as he considered most optimal tax policies marred by questionable assumptions made and the fact that equity implications were less than transparent, moreover he saw that these models often conflict thus raising

---

[117] Mill, J.S. (1848), *Principles of Political Economy,* The Great Mind Series, p.805.
[118] Elkins, D. (2009), *Taxation and the Terms of Justice*, University of Toledo Law Review, Vol. 41, pp. 73-75.
[119] Tiley, J. (2008), *Revenue Law*, Hart Publishing, p.14.
[120] Elkins (note 118 supra).
[121] Musgrave, R. A. (1958), *The Theory of Public Finance*, New York: McGraw-Hill, 312.

questions about their applicability. There are two dimensions to Musgrave's concept of tax equity; the choice of an appropriate tax base and the rate structure which it applies. Musgrave believed in a broad based tax founded on the concept of ability to pay. As in recent years public finance economists have turned away from income to consumption as a tax base, Musgrave, although acknowledging the advantages of a consumption tax, stuck to his belief that income should be the preferred base[122].

However, the theory of fair distribution which this chapter places most weight on is the very influential *Theory of Justice* by John Rawls; to Rawls justice is "a proper balance between competing claims"[123]. Rawls explains that 'justice as fairness' is a very general conception of justice, in which inequalities are permitted, Rawls provides that: "the general conception of justice imposes no restrictions on what sort of inequalities are permissible; it only requires that everyone's position be improved...[124]"

The following looks closely at three of Rawls' theories on how to achieve social justice: the first, Rawls's 'principles of justice' and the 'original position', the second, Rawls's 'social primary goods approach' and the third the 'difference principle'. The following also provides the theories which rival Rawls's and opinions which criticise his approach to achieving social justice.

### 2.6.2 Rawls's Principles of Justice

[122] Head, J. and Krever, R. (2009), *Tax Reform in the 21st Century*, Kluwer, p.8.
[123] Rawls, J. (1971), *A Theory of Justice*, Harvard University Press, p.9 -123.
[124] *Id.*

As a secular State[125], Kuwait should be promoting social justice for all members and groups of its society, however, the marginalizing of non-Muslims living in Kuwait who do not pay Zakat due to its religious nature and thus cannot be beneficiaries of Zakat even when they are deprived[126] constitutes a discrimination against non-Muslims in the Kuwaiti society and breaches the universal concept of justice for all. Rawls's idea of justice for all is that which allows discrimination so long as such differentiation in the treatment of individuals with different resources helps make the worse off better off.

The *Theory of Justice* is Rawls's [127] rework of the old theory of social contract brought by early theorists[128], however, the distinction between Rawls and his predecessors lies in a fundamental difference as to their aims. Rawls is concerned with the principles of justice in relation to the distribution of social goods, while his predecessors on the other hand generally aimed to defend the legitimacy of specific legal systems or regimes[129].

### 2.6.3 Rawls's Original Position

Rawls's theory calls on distributing equally amongst all members of society, social primary goods liberty and opportunity, income and wealth. Rawls stresses that such social goods, income and wealth, should be distributed fairly unless unequal distribution of such goods is to the advantage of the least favoured. Rawls

---

[125] 50% of the Kuwaiti people are Sunni Muslims, 40% are Shi'a and 10% are Christians, Jews and Hindus.
[126] The Majority of Muslim jurists agreed that Zakat should not be paid to non-Muslims, See Al Qardawi (note 22 supra).
[127] Rawls (note 123 supra).
[128] See pp. 35-38.
[129] Mcleod, I. (2010), *Legal Theory,* Palgrave MacMillan, p. 171.

lays out a comprehensive system of justice and proposes that justice is fairness and is based on two principles:

1. Each person has the same indefeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all;
2. Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second, they are to be the greatest benefit of the least advantaged members of society (the difference principle).

Rawls provides that his principles of justice would be chosen by rational actors in an 'original position'.[130] The original position occurs when two conditions are satisfied: limited knowledge and motivation. Under these limitations, individuals do not have knowledge of their social position, or what stage of economic development their society has reached, and Rawls refers to this as the 'veil of ignorance'. As a result, whatever principles are chosen in an 'original position', as defined above, constitute the principles of justice.

Rawls's concept of chosen rational actors in the original position can be criticised for not including other groups of society who decisions made under the original position will effect. Thus decisions on tax reform made under the original position in order to reach social justice will reach that objective if most people of the society were not given the right to express their opinion[131].

Rawls's original position is criticised for its exclusive nature, or as Sen[132] puts it; Rawls's 'original position' causes 'exclusionary neglect' which Sen explains can lead to 'closed impartiality' which excludes the voice of people who do not

[130] The Original Position occurs when two conditions are satisfied: limited knowledge, and motivation.
[131] Pogge, T.W. (1998) *Realizing Rawls*, Cornell University Press, pp. 66-69.
[132] Sen, A. (2010), *The Idea of Justice*, Penguin, pp. 124-152.

belong to the focal group, but whose lives are affected by the decisions of that group.

Sen's criticism of Rawls's 'original position' as being exclusive in nature and neglectful to the people who do not belong to the focal group i.e. the rational actors of the 'original position' is similar to the criticism aimed at the limitation of Zakat in promoting social justice. Zakat as has been mentioned above[133] is fixed and does not allow reform or amendment, and due to its divine nature only Muslim jurists are entrusted to interpret its meaning, thus if any new interpretation of how Zakat revenue should be distributed or the expansion of the beneficiaries entitled to Zakat, should arise, it can only be done through Muslim jurists who are believed to have the credibility to reform this divine duty, this will exclude the voice of the people who do not belong to the limited group of Muslim jurists and whose lives are affected most by the decisions made on the reform of Zakat.

### 2.6.4 Rawls's Social Primary Goods versus Sen's Capabilities Approach

In *A theory of Justice* Rawls defends the Social Primary goods on the grounds that together they constitute a thin theory of the good, an account of what people want whatever else they may want. In subsequent analysis, he grounds the primary goods, instead, in the idea of free and equal persons possessed of the two moral powers, namely, the capacity for a conception of justice and the capacity for a conception of the good. The primary goods approach says that for the purpose of

[133] See pp. 24-27.

justice we should compare an individual's holdings of social primary goods[134]. The list of social primary goods is arrived at by considering what conditions and resources are necessary for the development and exercise of the two moral powers of free and equal persons which are: the capacity for a sense of justice and the capacity for a conception of the good. Those goods are:

1. The basic liberties (freedom of thought and liberty of conscience, etc) are the background institutions necessary for the development and exercise of the capacity to decide upon and revise, and rationally to pursue a conception of the good. Similarly these liberties allow for the development and exercise of the sense of right and justice under political and social conditions that are free.
2. Freedom of movement and free choice of occupation against a background of diverse opportunities are required for the pursuit of final ends as well as to give effect to a decision to revise and change them, if one so desires.
3. Powers and prerogatives of offices of responsibilities are needed to give scope to various self-governing and social capacities of the self.
   Income and wealth understood broadly as they must be, are all purpose means (having an exchange value) for achieving directly or indirectly a wide range of ends, whatever they happen to be.
4. The social basis of self-respect are those aspects of basic institutions that are normally essential if citizens are to have a lively sense of their own worth as moral persons and are to be able to realize their highest order interests and advance their ends with self-confidence.

Rawls makes implicit claims about the relative importance of the contributions these goods make to overall wellbeing. His principles of justice are structured so that no compromises are permitted with the equal liberties principle for the sake of other goods, and no compromises with the fair equality of opportunity principle are permitted for the sake of increased income and wealth. However, the implicit assumptions about the relative importance of the different social primary goods to

[134] Brighouse, H. and Unterhaulter, E. (2009) *Primary Goods Versus Capabilities: Defending the Good against the Equally Good?* in *Reflections on Rawls, An Assessment of his Legacy*, (Edit) by Shaun P. Young, (2009), Ashgate, pp.46-58.

wellbeing, even for the purpose of justice, are not essential to the primary goods approach[135].

Sen's Capabilities approach[136] rivals Rawls's Social primary goods theory. The capabilities approach does not look to the resources people have, but to their opportunities, or real freedoms, to achieve functioning. Sen takes issue with the approaches to evaluating social policy that focus on the aggregated benefits an initiative has for the whole society or for future generations, without regard to how it effects individuals. According to these views for example, investing in education for women and girls is justified by its benefits not for them but for the societies in which they live. These approaches to evaluations do not look at whether any adult or child is discriminated against in the provision of education, because the education is not for these individuals but for a larger grouping, the community, then nation, then future generations.

The capabilities approach looks at a relationship between the resources people have and what they can do with them. As Sen puts it, in a good theory of wellbeing,

"Account would have to be taken not only of the primary goods the person respectively holds, but also of the relevant personal characteristics that govern the conversion of primary goods into the person's ability to promote her ends"

The notion of capability is essential to Sen, because someone's actual functionings need not tell us very much about how well off she is.[137]

One of the apparent advantages of the capabilities approach over the social primary goods approach is that it is sensitive to inequalities of natural

[135] Brighouse and Unterhaulter, (note 130 supra).
[136] Sen (note 132 supra).
[137] Brighouse and Unterhaulter (note 130 supra).

endowments. Whereas the social primary goods are always resources, whose value, for the purpose of justice, is defined without regard to what the particular individual who has them can do with them, the capabilities approach always looks at how well the individual can convert her bundle of resources into functionings. On the social primary goods approach, two people with the same holding, one of whom is ordinarily-abled and the other paraplegic, are equally well off, but the capabilities approach counts the paraplegic as worse off (from the point of view of justice)[138].

From the above, it can be concluded that Rawls' social primary goods approach is more concerned with taking from the more advantaged and giving to the less fortunate in order to narrow the gap between the rich and the poor. However, in terms of accomplishing maximum utility Sen's capabilities approach can be considered more advanced as it calls on looking at the individual's ability for turning the resources they have and the resources they are given into a utility, according to this giving more resources to a poor disabled individual will probably not achieve the highest utility if he is not capable of using such resources to their full potential, however, putting such resources towards building better facilities for the disabled in the community where he and other disabled individuals live can achieve higher benefits and relatively more justice since the threshold of capability can differ significantly from one poor (or disabled) person to the other. In addition to this, Sen's theory aims to benefit the whole society and not just the group of people who are worse off, thus taking from the better off to

[138] Pogge, T. (2002), *Can the Capabilities Approach be Justified,* Philosophical Topics 20/2 (2002): pp. 167-170.

build a school in a disadvantaged area will create more utility and benefit for the children who live in that area than distributing such resources amongst the poor families in that area, firstly, because we cannot measure the beneficiaries' level of capability in turning such recourses into functionings, and secondly, when the poor children of that area gain an education it benefits the society as a whole not just the children. Although it can be argued here that Sen's approach is more difficult to implement and harder to prove than Rawls's social primary goods approach, the latter approach cannot only be used, but can also be seen to being used, allowing public discussion and debate; the former is harder to monitor because it's difficult to measure people's capability which makes assessing it publically also difficult[139].

Applying the above to a country such as Kuwait, where oil resources for the time being are available and the people are not considered poor, and there is a need to consider new sources of income for a post-oil Kuwait, Sen's capability approach can be seen as achieving greater benefits for a society such as Kuwait's. However, with Zakat funds being exclusively rewarded to specific, fixed beneficiary groups[140] who display certain characteristics of poverty and neediness, this doesn't leave much scope for Sen's capabilities approach on redistribution to reach its objective, which may also support the argument to reconsider a more efficient redistribution system, or allow more flexibility in Zakat in allocating Zakat funds towards services as well and not excluding Zakat as a mere charity paid to individuals.

---

[139] Pogge (note 138 supra).
[140] See p. 17 and p. 26.

In Norman Daniels' point of view, as countries pursue development, and external agencies assist or hinder them in this pursuit, they need to consider what policies to adopt; some policies will enhance the wellbeing of some people and some will enhance the wellbeing of others and some will enhance no one. Both the social primary goods approach and the capabilities approach complement each other and have advantages over each other and a redistribution scheme can be beneficial when it is drawn from both approaches[141].

### 2.6.5 Rawls's Difference Principle

The second limb of Rawls's second principle (the difference principle)[142] is an application of the maximum principle; this principle requires decision makers to imagine the worst of all possible outcomes flowing from all possible solutions to a given problem, and then to choose the solution which provides the least favourable outcome, or, in other words, they are required to maximise the minimum outcome[143].

Nozick[144] and Sandel[145] criticise Rawls's *difference principle*; in his *Theory of Justice,* where Rawls provides that his concept of justice "nullifies the accident of natural endowments" and that the *difference principle* is an agreement to use the natural endowments which some individuals have as a "collective" or a "social

---

[141] Daniels, N. (2003) *Democratic Equality: Rawl's complex Eglittarianisim*, in Samuel Freeman (eds.) *The Cambridge Companion to Rawls* (Cambridge: Cambridge Press), pp.241 -277.
[142] See p. 39.
[143]Mcleod (note 129 supra).
[144] Nozick, R. (1974), *Anarchy, State and Utopia*, New York (Basic Books), p. 185.
[145] Sandel, M. (1982), *Liberalism and Limits of Justice*, Cambridge: Cambridge University Press, p.87.

asset to be used for the common advantage", meaning that those who have been favoured by nature, gain from their good fortune only on terms that improve the situation of those who have lost out. But the question remains why would the "exceptionals" (those who have exceptional natural endowments) owe the "normals" (who have no special or exceptional endowments) any compensation? Why should they be forbidden to exercise their superior endowments without helping the "normals"? As Nozick puts it; the "exceptionals" are harnessed to serve others, like a horse is harnessed to a wagon, the horse doesn't ever have to move, but if it does, it will have to draw the wagon along with it. What Nozick wants to conclude is that Rawls's conception of justice, by favouring institutional schemes under which the exceptionals are harnessed, encourages the use of some persons as means for the benefit of others. Nozick affirms that people ought to have what flows from their work and their efforts and according to Rawls's difference principle, people can be entitled to less than what they ought to have.

Rawls's *difference principle* echoes Siddiqi's justification for the Islamic duty of Zakat[146] where he claims that Zakat is necessary to make the worse off better off by taking from the more highly endowed to give to the less endowed.

## 2.7 Conclusion

[146] See pp. 20-21.

In addition to the limits of Zakat as a system of redistribution, there are also many instances where Muslim jurists could not agree on crucial practices, such as the type of wealth that falls under the base of Zakat[147]

As has been seen, Zakat helps reduce income inequality by narrowing the gap between the rich and the poor, and it increases the purchasing power of the poor. The Qur'an and Sunna provide: *'The alms are only for the poor and the needy'* (the Qur'an, surrah 9:60), and in a Hadith (saying) by the prophet Mohammed, he provides: *'He should help the distressed one who is in need'*. However, this has also proven to be limiting and restricting in terms of beneficiaries, and its marginalizing of non-Muslims. Also the fact that Zakat is voluntary in Kuwait means there's a high rate of non-compliance; Zakat also allows the payers to choose their beneficiaries leading many Zakat payers to give to relatives or acquaintances who they might think are in need, which can completely undermine the objective of allocating the funds to the individuals and communities who are more entitled to it.

Closing the door to *Ijtihad* has disallowed innovation in Zakat whether in broadening the scope of its tax base, or reforming it beneficiaries. All the above can help confirm that Zakat cannot in its current form be the sole welfare system that can finance government expenditure. But does this necessarily mean that taxation can provide more social justice in areas where Zakat did not? Or to put it differently, can taxation play a more efficient role in redistribution where Zakat was found limiting i.e. in redistribution and financing the government in its provision of public goods and services? Western theories which argue in favour of

[147] See p. 18.

the foundation of taxation are convincing, one of such theories is Adam Smith's argument that as individuals we must contribute (in proportion to our abilities) towards the state in proportion to the revenue we as individuals could not have enjoyed or earned if it weren't for the protection of the state. Smith's theory that there exists a contract between the people and the state, whereby the state provides us with services and we in turn pay for them, is a plausible one, especially if we as people took into account that without roads and infrastructure we cannot practice our professions, work or business and without health services we would not be well enough to work or have healthy clients and consumers. Also, without the security which a police force and a justice system provides, we would not feel safe and would not be able to secure what flows from our work and efforts. However, the implementation of taxation is not as straight forward as the theory. When it comes to measuring the proportion which individuals are capable of contributing towards the state and whether this contribution should differ according to individual capability, taxation becomes more problematic in achieving social justice.

Rawls has argued that injustice is permitted so long as it serves the interest of the worse off, i.e. it is not considered unfair (in Rawls's opinion) to impose a heavier tax on the wealthy so long as this makes the worse off better off. Yet Rawls neglects in his theory three important issues: the first, is related to the people who decide what the ultimate just decision is; Rawls provides that any decision made by the 'rational actors' under the 'veil of ignorance' in the 'original position' constitutes justice. This neglects the voice of individuals who are not the 'rational actors' in the 'original position' but who are deeply affected by the decisions

made in the ‘original position’. Second, Rawls concentrated on transferring resources from the better off to the worse off without giving much consideration on whether or not the worse off have the capability to turn such resources into functionings. Finally, Rawls’s ‘difference principle’ suggests that the better off who have been naturally endowed have a responsibility towards the less endowed (the worse off) in that they (the better off) must sacrifice some of their earnings to help improve the lives of the worse off. This Nozick provides, can be viewed as unjust if we believe that people ought to have what flows from their work.

In conclusion, taxation is a successful tool for redistribution and financing the government’s provision of public goods and services, however, finding a just system of taxation is not a straight forward process.

# Chapter 3: The Political and Economic Development of Kuwait Pre - and Post - Oil

## 3.1 Introduction

This chapter examines Kuwait's political and economic development by analysing the economic and political condition of pre- and post-oil Kuwait. This chapter also manifests how the dependency upon a single natural resource i.e. oil, has transformed the political and economic structure of Kuwait, and has led to Kuwait being classified by some as a 'rentier' state.

## 3.2 Kuwait Pre-Oil

The desert provided Kuwait with little before oil was discovered. The arid stormy climate and the sandy soil did not naturally allow agriculture. Only the village of "Jahrah" provided efficient crops to supply Kuwait with vegetables, but not with grain. The desert economy was strong enough to sustain only the Bedouin, who traded in the products of sheep and camels skins, wools, dairy products, and, occasionally, meat. Indeed, the harshness of the desert and its productive limits virtually forced Kuwait to trade. The sea provided alternative resources. One of Kuwait's first attractions to early settlers was its sheltered harbour. From the

beginning of the eighteenth century, the tribe of "Bani Utub"[148] took advantage of the harbour to send boats out to trade, and the industry of pearl diving was the first Kuwaiti industry to flourish. The pearl banks of the Gulf are among the richest natural banks in the world, providing for what was in the nineteenth century the basis of the Gulf countries' economy. The pearl trade also had a well-marked hierarchy, with a distinction drawn between middlemen, who brought the pearls directly from the deep sea to the boats and then to the pearl merchants, who sold them to the foreign markets of Iraq, India, and Europe[149]. The crew members on the boats were tied to the merchants through a system of debt bondage. The captains lent the crews the money their families needed to survive their absence at sea, and the crews were obliged to work to repay the loans. Wages were rarely high enough to allow a sailor to escape from the system. Most were in debt their entire lives and beyond, as the debt became a part of a pearl diver's estate, and thus an obligation on his children and relatives. For most Kuwaitis this was a hard life, a life of poverty, work, debt, and thereby early death (caused by drowning, shark attacks, and malnutrition from a paucity of fresh food on board).

Boat building was an important local industry in Kuwait also, and the small state was soon exporting its ships to other Gulf ports. Kuwaiti boats sailed to Africa to bring wood for construction; they sailed to Europe to bring manufactured goods such as guns. Fishing was a significant industry in Kuwait pre-oil, not only feeding the local population, but also providing a small surplus for export, and

[148] The first tribe to settle in what later became Kuwait.

[149] Lockhart, L. (1947) *Outline of the History of Kuwait*, J. Royal Central Asian Soc., XXXIV (July-Oct. 1947), pp. 262-274.

even after the discovery of oil, shrimps remained one of Kuwait's few non-oil exports[150].

### 3.2.1Tracing the Origins of Pre-Oil Kuwait

It was in 1716 that three clans descending from the Bani Utub[151] decided to give up their nomadic life and migrate to Kuwait to settle there. During the 17th century the powerful tribe of Bani Khalid dominated the Arab Peninsula. Their territory extended to Kuwait, however when the rule of Bani Khalid began to weaken, the people of Kuwait elected a member of the Al Sabah family to rule the small state[152]; it was Shaikh Sabah Al Abdullah who was the first ruler from the Al Sabah family in 1756[153].

Subsequently, the practice by which the ruler of Kuwait was chosen was very simple. The first rule was that the Shaikh had to be a male member of the Al Sabah family, and to be elected by the Al Sabah family as the next ruler of Kuwait. The second rule was for all the heads of the other Kuwaiti tribes, merchants and nationals to pay tribute to the new Shaikh on the day following his election by the Sabah family, and to demand that he rule fairly, and consult them on all significant matters relating to the state. Despite the provision for the people's demand on the ruler to consult with them, in practice the ruler made all

---

[150] Pillai R. V. Kumar M. (1962), *The Political and Legal Status of Kuwait,* The International and Comparative Law Quarterly, Vol.11, No.1, pp.108-130.
[151] The tribe of Bani Utub is divided into three clans: Al Sabah (the ruling dynasty today), Al Khalifa and Al Jalahima.
[152] Taqi, H. (2010)*, Two Ethnicities,Three Generations: Phonological Variation and Change in Kuwait,* PhD Thesis, New Castle University, pp.11-20.
[153] Pillai and Kumar (note 150 supra).

decisions (legislative, administrative and judicial) relating to the state exclusively[154].

The close contact between Kuwait and Great Britain began when Karim Khan of Persia captured Basra[155] in 1776. As a result of this action the English East India Company made Kuwait, instead of Basra, the south-eastern end of its desert mail route to Aleppo[156]. The subsequent British influence in Kuwait is considered later in this chapter[157].

When Shaikh Mubarak came into power (1896-1915) he transformed the Sabah house into a centralized power structure in Kuwaiti society. One of the first symbols of this power was Mubarak's ability to arbitrarily levy taxes. Prior to Mubarak, custom duties imposed on certain goods were voluntary contributions from merchants that were aimed at maintaining the Sabah house. Khazal (1962)[158] reports: 'when Mubarak ruled Kuwait… he established a regular custom's office in 1899 and imposed a five percent tax on all goods coming to Kuwait by land or sea. This increased gradually until it reached ten percent on some goods. He also imposed a real estate tax which required the payment of one-third of the total value of a house sold in Kuwait'.

During Shaikh Mubarak's reign there was increasing external pressure because of Kuwait's strategic geographical position, therefore, Turkey was increasingly trying to exert more influence and power over Kuwait and intervene in Kuwait's

---

[154] Al Muzaini, A. (1984), *Zakat and Taxes in Kuwait: Past and Present*, Dar El Salaseil, pp.16-20, (Arabic).
[155] Basra lies to the North of Kuwait and forms a part of modern Iraq.
[156] Lockhart (note 149 supra).
[157] See pp. 62-66.
[158] Khazal, H. (1962) *Tarikh Al-Kuwiat Al Siyasi* (The Political History of Kuwait), Beirut, Dar al Kutub, Arabic (cited from) Ismael, J. S. (1993), *Kuwait: Dependency and Class in a Rentier State*, Gainsville: University Press of Florida, p.55.

domestic policies. Germany too was looking to extend its proposed Berlin-Baghdad railway into Kuwait[159]. In 1897, Mubarak asked Britain for protection against the Turks and Germans, and although the position of Kuwait was important to Britain, Mubarak's request to Britain was refused at first due to costs. However, in 1898, many factors inclined Britain to reconsider its policy towards Kuwait: the Ottoman military activities near Basra, Russia's intrusion threats and the German railway plans that were all threatening British interests in the region of the Arabian Gulf, and the Russian construction of the "Transcaspian Railroad" connecting it to the most wealthy and influential countries in Central Asia, including the Persian Gulf countries. Further the Ottomans were seeking and receiving diplomatic and economic help from the Germans who had pencilled in Kuwait as the terminus of their Berlin-Baghdad railway project. Kuwait feared the Ottoman expansion while Britain feared being displaced by Germany and Russia. It was, therefore, in Britain's interest to come to a protective agreement with Kuwait. Lord Curzon (the British Viceroy in India). realizing the threat of Russia particularly through its new route to British interests in the Persian region, argued for an exclusive British presence in the Persian Gulf. Curzon was eventually successful in convincing his government to establish Britain as the unofficial protector of Kuwait. On 23rd January 1899, the British Political Resident in the Arabian Gulf, Colonel Meade, concluded a protectorate agreement, the Anglo-Kuwaiti Agreement with the Shaikh of Kuwait (Mubrark Al Sabah), which defined Kuwait as 'an independent country under the British protection'. Within a few years of signing the agreement, the first British political agent took up a

[159] Anscombe, F. (1997), *The Ottoman Gulf: The Creation of Kuwait, Saudi Arabia, and Qatar* Columbia University Press, pp.113-132.

permanent post in Kuwait with a view to influence the Shaikh into advancing British interests in the area. The Royal Navy were quick to turn Shuwaikh port[160] into a British coaling station, and a telegraphic line was passed through Kuwait in 1913. The effect of the protectorate agreement was evident with the outbreak of World War I in 1914 when the position of Kuwait was threatened. Britain provided Kuwait with protection against any invasion and recognized Kuwait as an independent state[161]. The First World War, however, caused serious damage to Kuwait's economy, when the British banned the caravan trade in Kuwait in order to limit supplies reaching Ottoman forces. The Kuwaiti economy as a whole suffered from this, and the resulting recession deepened after the First World War when Ibn Saud (Saudi Arabia today) demanded a 7% transit tax on goods crossing Kuwait that were destined for Central Arabia. When Kuwait refused, Ibn Saud threatened to attack Kuwait. Finally, the Japanese invention of cultured pearls in 1920 lowered the price of natural pearls dramatically, mortally wounding the Kuwaiti pearling industry[162]. The last, and perhaps least appreciated by the Kuwaiti people, result of the Anglo-Kuwaiti Agreement was that it gave Britain a monopoly over the exploration and production of oil reserves which was exploited as will be seen[163] in the early 1920s[164].

### 3.2.2 Politics and Economics Interrelate in Pre-Oil Kuwait

---

[160] Shuwaikh port lies on the south shore of Kuwait Bay. Shuwaikh port is the main commercial port in the country.
[161] Anscombe (note 159 supra).
[162] Pillai and Kumar (note 150 supra).
[163] See pp. 61-62 and pp. 68-69.
[164] Anscombe, (note 159 supra).

Before oil, politics in Kuwait was - as indicated above - dominated by the ruling Shaikh. However what is also noteworthy about the pre-oil period was that politics interrelated very closely with the economics of the state. The wealthy merchant families of Kuwait were the link connecting the Shaikh to the funds he needed. Merchants extracted revenues from pearl divers rather than from peasants and gave a portion of these extracted revenues to the Shaikh through customs, pearl boat taxes, and personal loans. Thus the merchants' political powers grew from their economic strength. The independent strength of these merchants lay in their control of the mobile pearling and nomadic work force. In the event of a dispute with the Shaikh the merchants would simply leave Kuwait taking with them their pearl divers. This "temporary exit"[165] was a powerful check on the Shaikh.

In 1910, when Mubarak increased the taxes on the pearl merchants, the pearl merchants expressed their opposition by leaving with their ships and divers to other Gulf ports in an attempt to persuade him to drop the tax increase. However, ultimately, Mubarak's will prevailed. This incident made the merchants determined to gain more power over decision making in the state[166].

Mubarak was succeeded by Salim (1915-1921) and the merchants presented him with the idea of forming a Council which would allow them to share the decision making in the state. This was rejected by Salim. Over time, the merchants' struggle with a continuous increase in taxes inspired them to try again and, in particular, use was made of the transition of power after Salim's death in 1921

[165] 'Exit' was used frequently until the early twentieth century, and it was last used in an important political way in 1909, when Kuwait's leading merchants in a successful protest against new taxes, left for Bahrain with 6-8,000 men.

[166] Anscombe (note 159 supra).

and with the succession of his nephew, Ahmed (1921-1950). At this time, the merchants were politically aware due to other reform movements that were taking place in the Arab world. They decided to try to make alterations to the regime in Kuwait. They met with the ruling Al Sabah family to inform them about their decision to form a Council, and insisted on participation in the country's affairs. In 1921, they presented the family with a pledge which they signed. It provided:

"We the subscribers of this document concur and decide to make these provisions:

1) The reform of the ruling dynasty (the Al Sabah family) to avoid any disagreement between them in the appointment of the ruler (Shaikh)[167];

2) That the candidates for a position of ruler are: Ahmed Al Jaber Al Sabah, Hamad Al Mubarak Al Sabah, and Abdullah Al Salem AL Sabah;

3) That when the people choose one of them, their decision will be referred to the government for sanction;

4) That the selected one will be called a president of the advisory council; and

5) That the election of a specific number of Ministers should be undertaken between the people and Al Sabah family for the purpose of managing States Affairs on the basis of justice and equality[168]."

As a result, Ahmed Al Jaber was chosen to rule Kuwait, and a Consultative (Advisory) Council was formed. It comprised twelve prominent personalities and businessmen in Kuwait. One of the leading merchants of Kuwait Hamad Al Saqer

[167] Al Shamlan, S. (1959), *Min Tareekh AL Kuwait (Some of the Kuwaiti History),* Cairo, pp. 212-220 (Arabic).
[168] Al Shamlan (note 167 supra).

was elected president of the Council[169]. The important points that must be noted about this council are:

1. The members were not elected in accordance with the above document (pledge) but instead were appointed by the ruler (Shaikh Jaber Al Sabah);

2. All the members of this Council represented the merchants and notable persons in Kuwait's society;

3. The function of this Council was limited to giving advice on state affairs.

This Council did not last long. It disintegrated after only two months because of differences between its members. There is no doubt, however, that this Council should be regarded as a landmark in the Kuwaiti state's political development. The older system of personal rule was restored under ruler Ahmed Al Jaber (1921-1950) and, as HRP Dickson has noted, "It had always been the custom for the Shaikh of Kuwait to rule personally and autocratically and to avoid all delegation of authority"[170].

In the early 1930s, the natural transition of Kuwait city into a municipality occurred, resulting in administrative regulations being made and giving new meaning to local political life. Elections were held for the Kuwaiti Municipality Council in 1930 and for an Education Council in 1934. These two steps proved that there was significant progress within the ruling family towards encouraging some popular participation in order to develop the public administration of the state on the one hand, and as a response to pressure from the people to participate in the state's affair on the other. Another attempt from the merchants to gain

---

[169] Al Farhan, R. (1960), *The Summary of the Kuwaiti History*, Cairo, Dar Al Orooba, pp. 55-65 (Arabic).

[170] H.R.P. Dickson, (1856), *Kuwait and her Neighbours*, London: Allen & Unwin, pp. 270-276 and pp. 301-302.

power and authority in the decision making process, was the creation of the National Block. It was secretly formed by twelve people in 1938; the purpose of it was to demand the people's participation in decision making. The National Block selected three of its members to meet with Shaikh Ahmed to demand the establishment of an elected assembly to discuss the problems of Kuwait's domestic and foreign affairs and to make the Kuwaiti people aware of all decisions in these matters[171]. The National Block succeeded in convincing the Shaikh and a Council was formed in July 1938 which consisted of fourteen elected members, where all the members of the Council were elected by the people; this was the first organized and important election held in Kuwait. In the same month as its formation the Council introduced its first constitutional document which was approved by Shaikh Ahmed Al Jaber. This constitutional document consisted of the five following provisions[172]:

Article 1: The nation (people) is the source of power through its representatives.

Article 2: The Council is to enact the following laws:

- Budget law: to control the country's income and expenditure and to regulate them fairly, with the exception of Al Sabah properties which the Council does not have the right to be involved in.
- Judicial Law: to administer justice in a fair manner.
- Law of public order: to enforce public security.
- Law of education: to advance education.
- Law of health: to develop a health service.
- Law of public work: road extension, prison construction, drilling for water and other public works.
- Law of public emergency: to enact the law to cope with a national emergency.

[171] Pillali and Kumar (note 150 supra).
[172] Al Moqatei, M. (1987), *A Study of the Kuwaiti Constitutional Experience 1962-1986,* Ph.D Thesis, University of Warwick, Department of Law, pp. 24-28.

Article 3: The legislative Council (The same Council) is the ultimate authority regarding treaties and concessions in connection with foreign affairs and any agreement which does not receive the Councils' approval is null and void.

Article 4: The legislative Council is vested with the authority to act as an appeal court until one is formed.

Article 5: The Head of the Legislative Council is in the meantime the head of the executive power[173].

It is very important to understand the British attitude to the formation of this Council. For the British agent in Kuwait it meant that the political life and system in Kuwait would take another direction in the operation of the State's affairs, whether in the local or the international arena. Despite this the British government advised the Shaikh to accept the Council when The National Block presented him with the idea in July 1938, so as not to ignore the demands for reform and also due to the British agent's belief that this council would lead to better relations between Britain and Kuwait[174]. The British Political Agent in Kuwait informed the Shaikh:

> HMG trust that this step will lead to the prosperity of Kuwait and to the continuation of the happy relations which have existed in the past between the ruler and his majesty's government [175]

However, shortly after the formation of the Council and the declaration of the constitutional document, the British agent in Kuwait discovered that this Council was in fact going to become a hindrance to the relations between Kuwait and Britain.

The British agent in Kuwait found the projected activities of this Council to be too ambitious; as it drafted a number of laws which called for abolishing existing

---

[173] Al Roumi, M. (1981), *Kuwait and Malta British Imperial Policy*, Masters Thesis, Malta University, pp. 134-156.
[174] *Id*.
[175] Al Moqatei (note 172 supra).

monopolies, taxes and forced labour for the ruling family. Both the Council's activities and ambitions which included control over foreign affairs, the army and calling for the abdication of Shaikh, evoked British opposition[176]. These facts caused Shaikh Ahmed to dissolve the Council only five months after its formation in December 1938, which meant the end of this democratic period and the resumption of Kuwait's traditional autocrat rule.

### 3.3 Discovering Oil in Kuwait

After oil was found in commercial quantities in Bahrain, Britain was certain that oil existed in Kuwait and was determined to find it. However, Britain postponed searching for oil in Kuwait due to the outbreak of World War I. After World War I Britain purchased a majority ownership in the Anglo-Persian Oil Company (APOC). The company put forward an offer for the exclusive right to explore for oil in Kuwait to Shaikh Ahmed (1921-1950) in 1922. At this time however competition had already appeared in the form of a New Zealand Company, Eastern and General Syndicate (EGS). In 1923, it offered Shaikh Ahmed higher revenues than APOC. In 1927, the American company 'Gulf Oil', purchased the EGS interests in the area. This purchase changed the dynamics of the negotiations as, unlike EGS, Gulf Oil was a major international company and a respectable competitor to APOC. This allowed Shaikh Ahmed to see an opportunity to play the two companies against each other for the best deal. It also meant that he could balance his British alliance with another strong power, the United States. Initially,

[176] Al Roumi (note 173 supra).

the competition between the two companies intensified, but then, the two companies decided to join forces and to form a joint company, the Kuwait Oil Company (KOC), which then approached Shaikh Ahmed with a much lower offer than Gulf Oil or APOC's previous offers.

Subsequently a new company was established, 'Traders Limited', which offered a better deal to him, and with this new competition, the Shaikh demanded a better offer from KOC and got it. In 1934, Shaikh Ahmed signed the first oil concession agreement with KOC, giving the company a seventy five year exclusive grant to explore for oil in Kuwait.

Oil operations had to be halted during World War II, and for the next few years Kuwait slipped back into a recession. However, when the War ended, operations quickly resumed and, in 1946, the first barrel of oil sailed out of Kuwait's harbour[177].

### 3.4 Kuwait Post-Oil

As seen above, Shaikh Ahmed granted the first oil concession for seventy five years to KOC in 1934. This concession granted KOC exclusive ownership of all petroleum produced as well as its derivatives. KOC had the right to explore, drill for, and produce petroleum, natural gas, asphalt and cognate substances throughout the entire country, including all islands and territorial waters[178]. The concession also granted KOC the right to refine and transport petroleum, and to

[177] Crystal, J. (1992), *Kuwait: The Transformation of an Oil State,* Westview Press, Boulder, p.149.
[178] Lucani, G. (1984), *Oil Companies and the Arab World,* Library of Congress Publications, US, p.146.

either export it or sell it for use within Kuwait. Shaikh Ahmed received an initial royalty of $178,000 and $35,000 a year until the first oil export, and $94,000 after oil had been exported. While Shaikh Ahmed negotiated the 1934 Concession, he could not demand control over oil prices and policies since exploration risks were still high. Therefore Kuwait only received 13 cents per barrel, much less than the 22 cents per barrel Saudi Arabia, Iran and Iraq were receiving at this time[179]. However, in 1951 profit sharing agreements were introduced in Kuwait after their adoption by Saudi Arabia in 1950. The main reason for this was to credit the taxes paid to producing countries (by oil companies) against income taxes paid at the oil companies' state of residence. Since 1939 the US government had offered a tax incentive to its American oil companies in the form of percentage depletion allowance. It applied by exempting 27 per cent of the gross income generated by oil from income tax. Under pressure from British Companies, HM Treasury revised its tax rules to make the new producing country taxes deductible against UK income tax obligations. These respective tax credit advantages influenced oil companies and in this case KOC to introduce a 50-50 profit sharing arrangement. Indeed in 1951 Kuwait and KOC signed a 50-50 profit sharing agreement. However, this profit sharing agreement eliminated the royalties which were paid to the Shaikh, by including the royalties in the payment of 50% of profits of crude oil production to Kuwait[180]. It was also much to KOC's benefit when it managed to pressure HM Treasury in 1951 to deduct royalties paid in Kuwait against its

[179] Abulhasan, A. (2004), *Future Relations Between Kuwait Petroleum Corporation and the International Oil Companies: Success of Failure?* A Thesis of Master of Art in Law and Diplomacy, The Fletcher School, pp.7-9.
[180] Al Sabah, Y.S.F. (1980), *The Oil Economy of Kuwait,* Kegan Paul International Ltd, London, pp. 39-59.

British income tax obligations[181]. This was also the original purpose of Kuwaiti Tax Decree 3/1955 which was introduced to enable KOC to pay royalties to the Kuwaiti government by way of taxation in order to obtain tax relief in their country of origin. This is discussed extensively in the next chapter[182].

During the 1950s, Kuwait was flooded with oil monies. The economy grew and the power of the Shaikh also grew. The need for the delegation of powers became imperative. However, it was precisely the presence of these external funds that allowed for a dynastic formation whereby senior members of the Al Sabah family assumed duties which, in effect, turned them into ministers in charge of departments. Thus oil 'rents' helped the Shaikh to establish a regular source of revenue and to sustain his powers.[183]

### 3.4.1 Political and Economic Changes in Post-Oil Kuwait

Oil revenues had shifted power from the hands of the wealthy merchant families who were once the link connecting the Shaikh to the funds he needed. The revenues once extracted by the merchants[184] from the pearl divers as customs, the pearl boat taxes and personal loans that were paid to the Shaikh by the merchants were now dispensable. The discovery of oil had transformed all of that, and transferred power from the merchants to the Shaikh.

---

[181] Parra, F. (2004), *Oil Politics: a Modern History of Petroleum,* LB Tauris London, pp.20-21.
[182] See p 100.
[183] Herb M., Moore, P. W. (2000), *All in the Family: Absolution, Revolution, and Democracy in the Middle Eastern Monarchies*, The American Political Science Review, Vol.94, No.2,( June 2000), pp. 478-479.
[184] See p 55-56.

**"Buying the Merchants Off"**

The merchants' withdrawal from public politics post-oil suggests that participation in decision-making became tied to the extraction of oil and the ability of those who mediated the extraction to influence the distribution of extracted wealth. Since with oil, extraction of wealth from the population by the state does not occur, there is no demand for political participation. The merchants' historical claim to participate, founded originally on their extractive capacity gave them a sense of entitlement and the ability to organize politically. They were the one group in the early days of oil capable of sustained, organized and possibly successful political opposition to the Shaikh. However, the Shaikh, recognizing this possibility offered them economic advantages. Since money was no object it was easier for the state to offer economic and financial advantages than to repress them[185], in order to do this the Shaikh persuaded them that their economic opportunities would increase once the protectorate (British Clientcy) had ended, and sectors of the economy then dominated by British Nationals were available to them to exploit. And in 1960 the Law of Commercial Companies No. 15/1960 was implemented, and the Kuwaiti merchants were then able to construct their own companies, and were not subject to tax under the Tax Decree 3/1955 which came to impose corporate income tax liability on foreign enterprises in Kuwait and excluded domestic enterprises, even though, theoretically, the Decree had scope to tax domestic enterprises. This is discussed extensively in the next

[185] Crystal (note 177 supra).

chapter[186]. Oil also gave the regime the resources necessary to develop new allies among the national population through its distributive policies.

### 3.4.2 Politics in Post-Oil Kuwait: The Decline of the Merchants and the Beginning of a Limited Democracy

Oil brought new forces into play and restructured political life in Kuwait. Within a few years oil revenues dominated the local economy. The most important impact of oil was that it gave rulers direct access to external revenues generated outside the local economy. Whereas once revenues had to be squeezed from the population through merchants who in turn exacted a political price, the Shaikhs now received income independently, they did not need to extract taxes from the merchants, they were also not keen to win the merchants' support any longer. This type of independence was uniquely attributed to oil. The immediate consequence was a breakdown of the economic bases of the historical governing coalition, the alliances binding the ruling families, and the development of new unstable arrangements which largely excluded the merchants from formal political life. The Shaikh turned increasingly inwards to inner family councils that formed within the ruling family of Al Sabah. This reaction from the Shaikh caused the merchants to try and resurrect their historical claim to decision making. This is how Kuwait's National Assembly came about.

### 3.4.3 Kuwait's National Assembly

[186] See p. 101 and p.113.

During his Shaikhdom, Shaikh Abdullah, (1950-1965) ended the Anglo-Kuwaiti Agreement in 1961[187]. And although all Kuwaiti rulers had traditionally ruled personally, Shaikh Abdullah decided to move Kuwait towards a limited form of constitutional government. He introduced the Kuwaiti Constitution in 1962, and the first Kuwaiti National Assembly was partially elected on January 23rd 1963[188]. In the election 50 candidates were elected; representing twenty five constituencies. The first cabinet of Kuwait was formed on January 28, 1963; the Shaikh[189] appointed the Prime Minister who was a member of the ruling family and the Prime Minister appointed 15 Ministers, three of which were elected members of the National Assembly[190], together they formed the Kuwaiti government[191]. From the moment the first National Assembly convened, it quickly asserted itself. A close examination of its proceedings from 1963-1976 shows a lively National Assembly actively participating in the formulation of public policies. Members showed themselves to be well informed on domestic and international issues concerning the state, and often unearthed critical information

[187] See pp. 55-56 for more on the Anglo-Kuwaiti Agreement.

[188] The National Assembly is comprised of 50 democratically elected members. The Prime Minister and the cabinet of 15 ministers are appointed. Although not stated in the constitution, the Prime Minister and Ministers of critical Ministries i.e. defence, foreign affairs and energy are always members of the ruling family. The members of the appointed executive branch (The Cabinet) participate in legislation i.e. members of Cabinet vote on any legislation put forward by elected members of the National Assembly. This system of forming government is still practised today.

[189] The Shaikh has the power to appoint the Prime Minister, who is always a member of the ruling family. The Shaikh also has the power to dissolve the National Assembly; The Kuwaiti National Assembly was suspended in 1976 for five years, and again dissolved in 1986 for six years. It was also dissolved for a number of months in 2006.

[190] Three of the elected members of the National Assembly are then appointed by the Prime Minister as Ministers joining the other non elected 12 Ministers appointed by the Shaikh. This system is still practised today.

[191] http://www.kuwaittimes.net/read_news.php?newsid=NjEzNDUxODEw , accessed [8/11/2010] 1st Kuwait Parliament's major accomplishments, (2009), Kuwait Times (Daily New Paper).

not made public by the government[192]. Legislative debates were vivid. Outside observers - from neighbouring states with no democratic advancement - were repeatedly struck by their honesty, openness and frankness. Attendance was high since the National Assembly's internal rules penalized unauthorized absence, and because it could not meet unless a majority of its members were present. Although parties were illegal the political preferences of the members were well known. There were three main political blocs; the first bloc consisted of tribal supporters of the ruling family. During the 1960s the regime had granted citizenship to large numbers of Bedouins and offered them various advantages: low income housing, social services, and jobs in the bureaucracy and the army. In effect, the government used these material incentives to turn tribes into political allies. As a result, representatives of these tribes became the backbone of support for the ruling family in the National Assembly. Members of Kuwait's business oligarchy formed a second important bloc in the National Assembly, and, although this bloc wasn't homogenous, it included primarily independent and moderate reformist elements intent on pressing the government to become more accountable and to open up the political process[193]. The third and most vocal were the Arab Nationalists. In time, eight members of this bloc were to leave their seats in the Assembly in protest against some laws they brandished as freedom chaining[194].

---

[192] Baaklini, A. et al. (1999), *Legislative Politics in hr Arab World, the Resurgence of Democratic Institutions of Domestic Institutions*, Lynne Rienner Publishers, US, p. 178.

[193] The merchants decided to re-announce their historical claim to participate in decision making and held a vestige of formal influence through the National Assembly, however gradually the Shaikh came to contain even this institution through his new Bedouin allies. The National Assembly's re-accruing suspension has invalidated any remaining merchant power. See Tretreault, M. A. (1991), *Autonomy, Necessity and the Small State: Ruling Kuwait in the Twentieth Century,* International Organization, Vol. 45, No. 4, (Autumn 1991) pp. 565-591.

[194] Herb, M. (2005), *TheTtransition from Liberalized Autocracy? New Options for Promoting Democracy in the Arab World (The Case of Kuwait)*, Georgia State University, a paper prepared for the USIP-Muslim World Initiative Working Group and Study Project: pp.14-16.

The 1963 National Assembly passed key pieces of legislation on imports, the oil industry, obligatory education, reshaping Kuwait's Airways Corporation, setting up savings and loan banks, the state's public budget, and real estate. The first National Assembly was also responsible for finding Law No. 12/1963, regarding the interior regulation and explanatory memorandum of the National Assembly, this law regulates the National Assembly's formation procedure, membership, sessions, and activities[195].

Over time, the National Assembly also started pushing to nationalize the oil companies and devoted considerable attention to other oil-related issues: the marketing of oil in Kuwait, payment schedules, production levels, gas flaring, employment and the training of Kuwaitis in the oil sector. Oil soon became the National Assembly's main concern and a source of conflict between the National Assembly and the government[196]. The conflict soared in the 1960s when the oil industry in oil producing countries, including Kuwait, was ultimately controlled by US and European oil companies. These foreign oil companies paid the host governments income either in taxes or royalties based on the posted price the companies charged for crude oil on the world market. However, in 1960, new oil-producing countries began to emerge, causing more competition and with it a sharp decline in oil prices. Oil production greatly exceeded world demand. This prompted the major oil companies to cut the posted price and thus the royalties paid to producing countries diminished. The oil companies reduced the posted prices on which the Kuwaiti government's 50% share of the profit was based. In

[195] Moore, P. and Salloukh, B. (2003), *Professional Associations, The State, and Fiscal Crisis in the Middle East*, University of Miami, pp.17-19.
[196] Al Shamlan (note 167 supra).

1960, the Jersey Standard[197] cut the prices for its crude oil by 14 cents a barrel (7,5%). This was done unilaterally without informing or consulting the governments of oil countries. Due to these oil price cuts The Organization of Petroleum Exporting Countries (OPEC)[198] was founded in 1962, in order for the oil exporting states to have control over oil prices, to coordinate and unify oil policies, stabilize oil prices in international oil markets, and finally to eliminate harmful and unnecessary fluctuations in prices, due regard being given at all times to the interests of oil-producing nations and to the necessity of securing a steady income for them[199]. However, OPEC failed to restore oil prices before the oil companies cut them again in 1962[200]. The oil companies also pushed to reduce the royalties paid to the governments of the producing states and demanded that the royalties paid to OPEC members be considered as expenses. This would mean that the foreign oil companies would register the royalties they gave to the host governments as an expense before they (the oil companies) are taxed, thus reducing the revenues for the producing governments which, in turn, meant reducing the 50% of the profits which the producing governments were entitled to under profit sharing agreements. The Kuwaiti government, initially, agreed to accept the new arrangement, but when the Shaikh brought the agreement home, the National Assembly refused to ratify it, and called instead for consideration of royalties as expenses without any further reduction in the price of oil[201]. Oil soon

---

[197] Later named, ESSO, this was one of the world's first and largest multinational corporations, established in 1970.
[198] OPEC was found in 1960 by Iran, Iraq, Kuwait Saudi Arabia, and Venezuela.
[199] *Global Oil Outlook, Future Economic Development and Investment Requirement for OPEC Countries*, The Organization of the Petroleum Exporting Countries (OPEC), http://www.opec.org/opec_web/en/press_room/896.htm [accessed on the 1st July 2010].
[200] Crystal, J. (1973), *Middle East Oil and Energy Crisis: Part Two*, MERIP Report, 1973, No. 21, p.34.
[201] Abdulhasan (note 179 supra).

became a major source of conflict between the government and the National Assembly; the latter wanted to be part of every decision made regarding its main national resource, and to play a role in other policies made by the government. Shaikh Abdullah's successor, Shaikh Sabah (1965-1977), was not as keen on the democratic advancement in Kuwait as featured in the National Assembly. He was not impressed by the new and vocal legislative power of the National Assembly[202], and the constant scrutiny of the government's policies was not the Shaikh Sabah's idea of a peaceful state. Thus when the National's Assembly's first term came to end in 1967, the government used in the following election various forms of electoral interference and ensured for itself a more docile body; one that lacked, in particular, dissenting members.

However, the government had the means to secure the people's alliance and support, through oil revenues. Oil also enabled successive Kuwaiti Shaikhs (Shaikh Sabah 1965-1977 and his successor Jaber 1977-2006) to introduce new goals. These goals were directed towards binding the people to the state, and to catalyzing the growth of large bureaucracies[203]. The state became the first employer of working nationals with its proverbial "Cradle to Grave" welfare system. These welfare and development policies also aided the formation of new, relatively large and complex bureaucracies. Power and decision-making remained un-institutionalized i.e. there was no meaningful distinction, either political or legal, between the person of the Shaikh and the institution of state, the Shaikh's sovereignty was re-asserted. Increasingly, the National Assembly was excluded from most important decisions. In time Shaikh Sabah dissolved the National

[202] See pp. 69-71.
[203] *Abdulhasan (note 179 supra).*

Assembly for five years in 1976 (now called the Parliament). The impetus for dissolution came from two sources; members of the National Assembly were too vocal for the comfort of Kuwait's autocratic neighbours, and the members were also too vocal for the comfort of the ruler and his family[204].

Kuwait began negotiations in the early 1970s to gain full control over its own natural oil resources. By mutual agreements with the company's two original partners; British Petroleum[205] and Gulf Oil, the State's shareholding in KOC was increased progressively until full control was achieved. On March 5th, 1975, an agreement was signed by the State of Kuwait and the two oil companies giving Kuwait complete control of its oil resources; KOC was nationalized[206]. Today, Kuwait is one of the world's top exporters of oil, with about 2.4 million barrels per day exported in 2009[207]. Kuwait's economy is heavily dependent on oil export revenues, which account for roughly 90 percent of total export earnings. However, oil in Kuwait has shown serious signs of depletion. Analysts have been concerned by the Kuwaiti government's reluctance in recent years to disclose information on oil reserves. Since January 2006[208], when Petroleum Intelligence Weekly (PIW) published a report stating that the internal records of Kuwait only show 48 billion barrels of reserves as opposed to official figures of 99 billion, the scale of reserves in OPEC's fifth largest producer has remained sensitive and uncertain[209].

---

[204] *Crystal (note 200 supra).*
[205] Anglo-Persian Oil Company (APOC) became British Petroleum (BP) in 1954.
[206] Jacob, K. and El Malakh, R. (1981), *The Absorptive Capacity of Kuwait: Domestic and International Perspective,* Lexington Books, p. 113.
[207] Arabian Oil and Gas.com, (2009), *Top 10 National Oil companies by Production,* http://www.arabianoilandgas.com/article-5460-top-10-national-oil-companies-by-production/1/print/
[cited on 13/9/2009].
[208] Luft, G. (2006), *The Oil Crisis and its Impacts*, The Institute for the Analysis of Global Security (IAGS), pp.6-9.
[209] *Id.*

### 3.4.4 Society in Post-Oil Kuwait

Oil has been a benefit to Kuwait, but it has also brought real costs. Economic development has led to over-spending, corruption, inefficiencies, inflation, shortages, and bottlenecks. Each of the major social welfare programmes has produced unintended side effects. In education, the expansion of schools led the government to rely on foreign teachers. In the late 1950s, almost 90% of Kuwait's teachers were non-Kuwaitis, most of them were Arabs, many were from Egypt and often brought with them political ideas that troubled the regime[210]. Nor was the system as successful as hoped in matching trained Kuwaitis to the necessary standards. In higher education the system turned out more graduates than jobs in liberal arts, and the government was particularly unsuccessful in encouraging Kuwaitis to enrol on vocational programmes. The result was a bad match between graduates and the needs of the economy. In health care, very expensive medical equipment was rapidly purchased with little attention given to priority needs or to the ability of the system to maintain and use the equipment. Treatment received more emphasis than prevention, and as in education the state remained dependent on foreign health care workers. The housing programme expanded with little planning, resulting in long waiting lists; the programme also drove up the price of the land[211]. To an even greater extent than health and education the housing

[210] Chalcraft, J. (2010), *Monarchy, Migration and Hegemony in the Arabian Peninsula,* LSE Global Governance, pp. 18-20.
[211] Ghabra, S. (1997), *Kuwait and the Dynamics of Socio-Economic Change*, Middle East Journal, Vol. 51, No.3, p. 358.

programme led to the emergence of an industry based almost entirely on foreign labour[212].

### 3.4.5 Drawbacks of Oil Dependency in General and in Kuwait specifically

There are various drawbacks to high dependency on oil. It is important to highlight such drawbacks in general, but also to focus on the particular disadvantages suffered by Kuwait.

*1.1 Unequal expertise: Bargaining Power*

Governments face significant challenges in their contact with international corporations, which have great knowledge and know-how in particular fields. Since oil and gas exploration is both capital and technologically concentrated, extracting them requires co-operation between governments and experienced international companies. In most of these cases, the oil company is more knowledgeable than the producing state, especially when it comes to the value of the good being sold [213]. This situation gives oil companies very strong bargaining powers over the producing state, while the latter attempts to find means to contract with oil companies in a manner that ensures them a fair deal as well.

In the case of Kuwait, the oil producing company (KOC) had a wide discretion in its decision making when the Shaikh granted KOC the first concession in 1934[214] simply because KOC had the expertise to unearth and export oil. Further, this

[212] Beblawi, H. Luciani, G. (1987) *The Rentier State*, London: Croom Helm, pp. 48-60.
[213] Humphreys, M. et al. (2007), *Escaping the Resource Curse*, Columbia University Press, pp.1-4.
[214] See pp. 64-66.

situation has not changed much today. In 2006, Kuwait began negotiations with the Chevron, BP, Exxon Mobil, and Royal Dutch Shell corporations to obtain foreign technology, and reach its production target of 4 million bpd while keeping control over its oil and gas reserves. However, negotiations were brought to a halt due to opposition from some of the members of the National Assembly, who argued that the contracts – the subject of the negotiations – were overpriced[215]. An official of the National Assembly's Finance and Economy Committee had provided that Kuwait will not reach its productions target of 4 million barrels-per-day (from its current 2.4 million bpd) without the help of established oil companies, who deal with challenging oil fields. Also, due to the slowness of the talks and the constant clashes between the National Assembly and the Kuwaiti government, both Chevron and BP withdrew their top executives from Kuwait in April 2009[216].

*1.2 Dutch Disease*

In the 1960s, the Netherlands witnessed significant wealth abundance when large natural gas deposits were discovered. This positive, however, had brought major negative challenges to the Dutch economy. Whilst the country's currency soared the non-oil exports declined. This syndrome has been named 'Dutch Disease'[217]. The Dutch manufacturing sector, in particular, had suffered and became less

[215] Similar conflicts over oil concerns soared between the National Assembly and the Government in the 1960s, see pp. 68-70.
[216] Daya, A. (2009), *BP, Chevron Managers Leave Kuwait as Projects Delayed,* Bloomberg, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=avRG0YvHHPBk. [25/11/10].
[217] Ebrahim-Zadeh , C., (2003), *Dutch Disease: Too Much Wealth Managed Unwisely,* Finance and Development Vol. 40 (1), pp. 50-51.

competitive. Subsequently, oil-rich countries that similarly experienced a decline in the pre-existing domestic sectors of their economy have been branded with the same Dutch Disease[218]. The disease's symptoms are shared in all resource-rich countries highly dependent on exploiting such resources;

> "a sudden rise in the price of natural resource exports produces an appreciation in the real exchange rate. This makes exporting non-natural resource commodities more challenging and competing with imports across a wide range of commodities becomes almost impossible (the spending effect). Foreign exchange earned from the natural resource meanwhile may be used to purchase internationally traded goods at the expense of domestic manufacturers of the goods" (Humphreys, M. et al. (2007), *Escaping the Resource Curse*, Columbia University Press, pp. 10-14).

Domestic resources such as labour and materials, are consequently shifted to the natural resource sector (the resource pull effect), causing prices to rises on the domestic market and therefore increasing the costs to producers in other sectors[219].

Kuwait's heavy dependency on oil has left it with similar symptoms as the Dutch Disease. The booming economic conditions of the 1970s which Kuwait had enjoyed attributed mainly to vast oil revenues failed to continue in the 1980s. In 1981, the government announced a fiscal budget deficit for the first time in Kuwait's recent history, and in 1982, the deficit was twice as large. The economic slowdown was reflected in the change in real gross domestic production (GDP) in

---

[218] *Id.*
[219] Humphrey (note 213 supra).

1981, which was 9.1 percent lower than that of 1980, and declined a further 15.4 percent in 1982[220].

The decline in revenues from oil exports was responsible for the country's economic stagnation. Revenues from oil exports had been a major source of financing government expenditures. These revenues had been responsible for generating and sustaining non-government revenue as well. Like most Gulf countries, Kuwait's revenues from oil had been more than 90% of government fiscal revenues between 1970 and 1980. This decline in world demand for oil followed by reduced oil prices in the early 1980s affected Kuwait's revenues negatively.

However, the past half decade (2003-2008) has proven to be good for oil exporters. Kuwait's Ministry of Finance figures show that oil revenues almost trebled since the fiscal year 2003/2004 going from $23 billion to $67 billion in 2007/8. This was, again, attributed to oil income rising to 93% in the fiscal year 2007/8, up from 89% five years earlier.

Oil in Kuwait accounted for 95% of its export revenues, and 95% of government income in 2009[221]. Also, Kuwaiti officials had committed themselves to increasing oil production as has been discussed above[222] to 4 million bpd by 2010, however, these plans did not materialize. Due to its high dependency on oil revenues, Kuwait has done little to diversify and reform its economy and has done very little to improve its poor business climate. In addition, there is acrimonious relationship between the National Assembly and the government which revolves

---

[220] Kaboudan, M. (1984), *Oil Revenue and Kuwait's economy: An Economic Approach,* Middle East Economic Digest MEED, pp.45-66.

[221] Standard Forum, (2009), Financial Standard Foundation, *Business Indicators, Kuwait,* http://www.estandardsforum.org/kuwait/business-indicators [cited 3/7/2009].

[222] See p. 77.

mainly around the Assembly's views on the government's corruption, unwise spending of oil revenue and poor distribution of oil wealth[223].

### 1.3 *Volatility*

Oil and gas revenues are highly volatile. This volatility is due to the variation over time in rates of extraction, and timing of payments by oil companies to producing states. The disadvantage of highly volatile income sources is that long term planning for future financing is almost impossible to predict, especially when the commodity's value is fluctuating. The result can be high levels of expenditure in good years followed by deep cuts in bad years. This in turn can lead to 'boom-bust cycles' and all too often the benefits in the good years are transitory, whereas the problems generated during the bad years endure[224].

Applying this to Kuwait, the state witnessed oil stagnation in the 1980s[225], and another sharp decline in oil prices in 2005 where the price of a barrel of oil dropped from $100 to $50. [226]

### *1.4 Living off Capital*

Because oil and gas resources are non-renewable, oil-rich states face problems as they are constantly consuming their capital rather than income. If all revenues are

---

[223] Al Tony, N. (2009), *Economic Diversification in the Arab World*, Arab Planning Institute, p.212.
[224] Humphrey, (note 213 supra).
[225] See pp. 78-79.
[226] Hargreaves, S. (2006), *Oil Surges Defying Expectations*, CNN, http://money.cnn.com/2006/09/27/markets/oil_eia/index.htm, [visited 25/11/10].

consumed in each period, then the value of the country's total capital declines. Also when there is an increase in the state's income, there exists a pressure to spend. This is either due to politicians with an uncertain hold on power having an incentive to spend sooner rather than to leave opportunities for future political opponents, or pressures arising from the people who demand rapid and visible improvements in welfare [227].

Kuwait too had experienced pressure to spend its oil wealth amidst its abundance in the 1960s and the 1970s, that need to spend also created the Kuwaiti bureaucracy. The main factors underlying the emergence of a Kuwaiti bureaucracy were the ambitious plans to establish a welfare state, the accelerated pace of this establishment, the limited administrative capacity, low productivity and qualifications and limited participation of the "native" labour force.[228] While the ruling family secured its powers through oil revenues, and the National Assembly's powers were diminishing, a third institution was inexorably developing; namely the Kuwaiti Bureaucracy. The bureaucratic demands of the oil industry, as such, were relatively small as oil operations were handled by foreign-owned companies. However, a small government bureaucracy did emerge to monitor the oil companies, to handle some oil-related operations, and, eventually, to take over the industry after nationalization. The real force for expanding the bureaucracy, however, came from the need to spend the vast revenues created by oil[229]. Following the introduction of the 1962 constitution new ministries were formed from the old departments. Rapid growth continued as Kuwaitis were hired in large numbers as a means of redistributing the oil revenues nationally, and even

[227] Humphrey (note 193 supra).
[228] Shehab, F. (1964), *Kuwait, a Super Affluent Society,* Foreign Affairs, Vol.42, pp. 461-474.
[229] Kuwait's independence in 1961 from the Anglo-Kuwaiti alliance signed with Britain in 1899.

larger numbers of expatriates carried out the vast technical functions which nationals, who were small in number and poorly educated, could not[230]. The first international oil price hike in 1973 resulted in a significant change in the economics of Kuwait and the scope of its activities. For instance, the GDP and per capita income in Kuwait grew by 137.7 percent and 125.1 percent respectively between the years 1973 and 1974. The increase in per capita income resulted in a surge in demand for goods and services which, as a consequence, increased the demand for imported goods and labour, thus contributing to an imbalance in the labour force and the population mix. Economic and service demands, such as education, health and utilities continued to grow during the early 1970s, far exceeding the growth in population. In this period, public spending was 80% of the total revenues. Wages accounted for 45% of total permanent expenditure; this reflected the policy of the state of distributing wealth by guaranteeing employment to its citizens[231]. The Kuwaiti government also initiated and supported a policy for massive naturalization of the Bedouin population and encouraged their settlement. Many of the tribesmen lacked qualifications and were not given the opportunity to be trained, which led to continuous pressure to increase the budget allocation for unskilled jobs to absorb them within the bureaucracy[232].

When the influence of the merchants in decision-making declined gradually throughout the 1950s and the 1960s, this paved the way for other political groups

---

[230] Beblawi and Luciani (note 212 supra).
[231] Central Bank of Kuwait *The Kuwaiti Economy in Ten Years 1969-1979,* Kuwait: Central Bank Press 1981, p.150.
[232] Al Omar, F. (1997), *Bureaucracy State and Development in Kuwait and Arab Gulf States: A Comparative Study*, Institute of Policy Studies The Islamic Foundation, p. 76.

to influence decision-making through increasing political participation[233]. Decision-making was carried out in the old autocratic fashion. Department heads or ministers from the ruling family had great discretion over their own decisions without effective accountability. As a result, the central government suffered from a lack of uniformity and coordination. Many major decisions were either not taken or postponed to maintain balance among the ruling family members, and decision-making focused on day to day business with little or no emphasis on policy formulation. The quality of decision-making was impeded by the low profile of top officials. Most decisions reflected particularistic interests rather than the public interest. Decision making was carried out on an ad-hoc basis, without reference to strategic planning or studies[234].

*1.5 Insufficient Investment in Education*

Studies have shown that exaggerated consumption yields poor investment in education. When states rely on natural resource wealth there is a tendency to forget the need for a diversified and skilled workforce that can support other economic sectors once the resource wealth has dried up. As a result, the share of national income spent on education declines. While the costs of such declines might not be felt in the short term, as capital-intensive activities take up a larger share of national production, their effects are likely to become more significant in the longer run as soon as economies start trying to diversify. It is possible to understand this problem in terms of the nature of the source of wealth. When a

[233] Salih, K. (1991), *Kuwait: Political Consequences of Modernization, 1950-86,* Middle Eastern Studies, Vol.27, No.1, pp. 46-66.
[234] Al Omar (note 232 supra).

country's wealth depends on investments in manufacturing or other productive activities, human capital investment is an essential part of wealth creation. However when a country relies mainly on extracting and selling oil, investment in human skills will not have priority[235].

Applying the above to Kuwait, as has been seen earlier in this chapter[236], the Kuwaiti government has failed to match trained Kuwaitis to the necessary standards and was unsuccessful in encouraging Kuwaitis to enrol on vocational programmes. However the oil and gas sector has also limited employment opportunities because of its very capital intensive nature[237].

*1.6 Spoliation*

Almost all oil-rich countries suffer from high levels of corruption. The temporary availability of large financial revenues increases the opportunity for theft of such assets by political leaders. Politicians in control of the assets use that wealth to maintain themselves in power, either through legal means (e.g. spending in political campaigns) or coercive ones (e.g. funding militias). To some extent, corruption is a hallmark of the oil business itself. But oil and gas dependence can also affect corruption indirectly. The presence of oil and gas wealth can produce weak state structures that make corrupt practices considerably easier for government officials. Statistics show that natural resource dependence is a strong

[235] Gylfason, T. (2001), *Natural Resources, Education, and Economic Development*, European Economic Review, 45 (4-6) 847-59.
[236] See pp. 75-76.
[237] Basher, S. (2010), *Has the Oil Sector Decoupled from Oil Sector? A Case Study of the Gulf Cooperation Council Countries,* Department of Research in Qatar Central Bank, p.3.

predictor when seeking to account for variation in levels of corruption across different countries[238]. Corruption related to natural resources takes many forms; bribing government officials when mining and oil companies seek to lower their costs, obtaining the resource below market value. In other cases, the natural resource is sold to domestic firms at below full value, with government officials either getting an ownership or share. In practice, the risk of corruption in resource-rich environments is considerable and the costs of such corruption to national economies are enormous[239].

Applying the above to Kuwait, a former chairman of Kuwait Petroleum Corporation (KPC) commented on the contracts which the Kuwait government had planned to sign with BP and Chevron in 2006[240] to increase its oil production, by saying:

"We've been producing our own oil for 60 years, and we've been able to develop oil abroad in difficult areas, which leads us to think there must be some financial reward involved for oil officials to insist on giving contracts to foreign companies[241]".

*1.7 Weak, Unaccountable States*

Resource-rich states use their resources to finance expenditure, thus they are less reliant on their citizens in wealth extraction. When citizens are not taxed, on the other hand, they know less about the state's activities and, in turn, demand less

---

[238] Leite, C. and Weidmann, J. (1999), *Does Mother Nature Corrupt?* Working Paper IMF, pp. 2-5.

[239] Ayittey, G.B.N. (2006), *Nigerea's Struggle with Corruption, Testimony*, U.S. House of Representatives, Washigton DC, pp. 1-2. http://www.globalsecurity.org/military/library/congress/2006_hr/060518_3-transcript.pdf [2/3/2009].

[240] See p.79.

[241] Daya (note 216 supra) this quote was taken from the said reference; no direct reference to this quote was found.

from the state. Even if they disapprove of the state's actions they lack the means to withdraw their financial support from states. As a result, states have less need to engage with civilians. Relying on external income sources rather than domestic revenue, states have less need to develop an apparatus to collect tax [242]. The need to collect taxes is widely thought to have contributed to the emergence of state and even democratic institutions in many Western Countries[243]. The lack of reliance on tax revenue in favour of reliance on external sources of revenue is thus thought to hinder the development of effective states in many resource-rich developing countries[244].

Applying the above to the situation in Kuwait, as has been discussed above[245], oil diminished the need for the ruling family to exact taxes from the people. It also gave the Shaikhs the power to provide for the people and secure their alliance. The Shaikh also had the power to dissolve the National Assembly, whenever the latter became too vocal for the comfort of the ruling family.

The fact that oil still to this day accounts for 95% of the Kuwaiti government income suggests that Kuwait is still enveloped in rentierism as its dependency on oil rises[246]. But what is rentierism? And what are its drawbacks?

---

[242] Fearon, J.D. and Laitin, D. (2003), *Ethnicity, Insurgency, and Civil War*, American Political Science Review, 97 (1): 75-91.
[243] Ross, M. (2004), *Does Taxation Lead to Representation?* British Journal of Political Science, 34: 229-249.
[244] Moore, M. (1998), *Death Without Taxes: Democracy, State Capacity, and Aid Dependence in the Fourth World*, (cited in) Robinson, M., and White, G., eds., (1998) *The Democratic Development State*, Oxford: Oxford University Press, pp. 84-128.
[245] See pp. 66-68.
[246] Al Khouri, R. (2008), *Kuwait: Rentierism Revisited*, Arab Reform Bulletin, http://www.carnegieendowment.org/arb/. [visited 11/11/10].

### 3.5 What is a Rentier State? And does Kuwait Qualify as One?

The Iranian economist, Hussein Mahdavi[247], introduced the rentier concept in 1970. Other economists, notably Giacomo Luciani and Hazem Beblawi, also elaborated on and applied the theory of rentier states to the oil producing Arab Gulf States[248]. Since the theory of a rentier state was postulated by Mahdavi, it was appropriated by a community of Middle East specialists in their discussion of the Arab World. The theory in its broadest sense defines rentier states "as those countries that receive on a regular basis substantial amounts of external economic rent". The theory doesn't define the rentier state with references exclusively to the Persian Gulf or the Middle East. However, rentier theorists have had Arab oil exporting and oil transiting states in mind, particularly during the historical period 1951-1981 when these states appropriated a larger share of the economic rents associated with the petroleum industries[249]. For Mahdavi, the stage at which a state can be called a rentier state is determined arbitrarily but he was primarily interested in cases in which "the effects of the oil sector are significant and yet the rest of the economy is not of secondary importance". He cites Kuwait and Qatar as extreme examples of the phenomenon, with, in his opinion, limited capabilities for industrialization and few alternatives to rentierism[250]. On the other hand, another commentator, Beblawi[251], delineates four characteristics of a rentier state;

---

[247] Mahdavi, H. (1970), *The Patterns and Problems of Economic Development in Rentier States: The Case of Iran, in Studies in the Economic History of the Middle East,* ed. M.A. Cook., Oxford University Press: London, p. 428.
[248] Al Khouri (note 246 supra).
[249] Yates, D. A. (1996), *The Rentier State in Africa, Oil Rent Dependency and Neo-colonialism in the Republic of Gabon,* Africa World Press, pp.11-13.
[250] *Id.*
[251] Beblawi and Luciani (note 212 supra).

> "first, the rentier economy of which the state is subset must be one where rent situation predominates. Beblawi argues that, in this respect, there is no such thing as a pure rentier economy and concurs with Mahdavi's view that the determination of when an economy becomes rentier is matter of judgment. Second, the origin of this rent must be external to the economy. In other words, the rents must come from foreign sources. Domestic rent, even if it were substantial enough to predominate, is not sufficient to characterize the rentier economy, because domestic rent is a factor income that only results from production (labour), investment (interest), and management of risk (profit) i.e. internal forces of production. Third, in a rentier state, only the few are engaged in the generation of rent, while the majority is involved in its distribution and consumption. Therefore, an open economy with high levels of foreign trade is not rentier, even if it depends predominately on rent (e.g. tourism), because the majority of society is actively involved in the creation of wealth. Finally, the government must be the principal recipient of the external rent in the economy. This last characteristic is closely related to the concentration of rent in the hands of the few, it also, using a phrase popular among contemporary political scientists "brings the state back in" to the idea of the rentier state" (Beblawi, H. and Luciani, G. (1987) The Rentier State, London: Croom Helm, pp. 48-60).

Conversely, Luciani[252] places less emphasis on the nature or "structure" of state revenue i.e. (rent and taxes) and more on its origins or sources (external/internal). The key feature of a rentier state according to Luciani is that

> "external rent liberates the state from the need to extract income from the domestic economy. Mahdavi notes that the oil industry's most significant contribution is that it enables governments of the oil producing countries to embark on large public expenditure programmes without resorting to taxation" (Beblawi, H. and Luciani, G. (1987) The Rentier State, London: Croom Helm, pp. 48-60).

Before the discovery of oil, Kuwait had a relatively efficient tax system[253], however, the large oil revenues had allowed the government to depend entirely on oil revenues to cover expenditure and abandon taxation; this dependency has had drawbacks and disadvantages as has been seen earlier[254] and in this discussion on rentier states.

---

[252] Beblawi and Luciani (note 212 supra).
[253] See p. 7 and p. 103.
[254] See pp. 76 – 88.

Luciani takes this state autonomy as his point of departure and proposes a new categorization which defines states by their allocative and productive functions. Unlike the productive state that relies on taxation of the domestic economy for its income and in which economic growth is therefore inevitable, an allocation state does not depend on domestic sources of revenue, but rather is the primary source of revenue itself in the domestic economy. The policy of a production state is, therefore, designed to increase economic growth while an allocation state fails to formulate anything deserving the appellation of economic policy. The primary goal of economic policy in an allocation state is spending. But beyond spending (which all states must do) Luciani breaks from Mahdavi and Beblawi and specifies conceptual boundaries for his rentier allocation state as one whose revenue derives predominately more than 40% from oil, and whose expenditure is a substantial share of GDP[255].

### 3.5.1 Drawbacks of Rentierism

Countries with large endowments of natural resources, such as oil and gas, often perform worse in terms of economic development and good governance than countries with fewer resources as has been seen in the discussion on the Dutch Disease[256]. Paradoxically, despite the prospects of wealth and opportunity that accompany the discovery and extraction of oil and other natural resources, such endowments all too often impede rather than further balanced and sustainable

[255] Ross, M. (2001), *Does Oil Hinder Democracy?* World Politics 53:(3), pp.325-361.
[256] See pp. 77 – 79.

growth[257]. On the one hand, the lack of natural resources has not proven to be a fatal barrier to economic success for the star performers of the developing world - the Asian Tigers (Hong Kong, Korea, Singapore, and Taiwan). All achieved booming export industries based on manufactured goods and rapid economic growth without large natural resource reserves, while many natural resource-rich countries have struggled to generate self-sustaining growth. Thus, resource-rich countries grew less rapidly than resource-poor countries during the last quarter of the twentieth century and alongside these growth failures are strong associations between resource wealth and the likelihood of weak democratic development, corruption, and civil war[258]. There is also a high degree of variation in well-being across resource-rich countries. The United Nation's Human Development Index illustrates this by measuring income, health, and education across countries worldwide. Thus Norway, a major oil producer, ranks at the very top of the index, yet Equatorial Guinea, Gabon, the Republic of Congo, Yemen, Nigeria, Angola and Chad, all oil-producing countries, fall at the other extreme[259]. To understand the natural resource paradox there is a need for a sense of what makes natural resource wealth different from other types of wealth. As has been mentioned above[260] natural resources of wealth - unlike other sources of wealth - do not need to be produced, they simply need to be extracted (even if there is often nothing simple about the extraction process). Since it is not a result of a production process, the generation of natural resource wealth can occur quite independently

---

[257] Auty, R. (1993), *Sustaining Development in Mineral Economies: The Resource Curse Thesis*, London: Routledge, pp.154-160.
[258] Ross (note 255 supra) and Humpheys, M. (2005), *Natural Resources, Conflict and Conflict Resolution*, Journal of Conflict Resolution, 49: pp. 508-37.
[259] Human Development Report 2005, http://hdr.undp.org/reports/global/2005 [visited 2/10/2009].
[260] See pp. 77-82.

of other economic processes that take place in a country; it is, in a number of ways "enclaved"[261]. A government can often access natural resource wealth regardless of whether it commands the co-operation of its citizens or effectively controls institutions of state, through the government can - and in the case of Kuwait does – give a false perception of oil revenues and the state's budget. In April 2010, oil revenues in Kuwait appeared larger than estimated, the reason behind this is that the Kuwaiti budget is calculated according to the next year's oil revenue, and since there is no way to accurately estimate such a fluctuating resource each year there appears to be a surplus in the revenues. The Kuwaiti Ministry of Finance calculates its budget at a very modest price. In the Financial Year 2010-2011, the budget was calculated according to a price $37.8 per barrel, and a daily production of 2.2 million barrels a day. However, prices of oil in this year reached $80.8 per barrel at a production rate of 2.45 million bpd in the first quarter of the financial year. Hence actual income reached KD 16.8 billion[262], higher by 8.2 billion than the budget estimated; only 1 billion of the revenue came from non-oil resources. The total budget for 2010-2011 would reach KD 17.9 billion, and this when compared to the estimated expenditure of the state KD 16.162 should mean a surplus of KD 1.7 billion for the entire fiscal year[263].

The fact that extraction of rent is undertaken quite separately from the political process means that rulers do not need their people's consent or participation in the process of extracting that wealth. This also results in a false political stability

[261] Natural resource extraction is referred to by social scientists as 'Enclaved', Hirschman 1958; Seers 1964.
[262] No Easy Solution for the Social Service Deficit: Time Adds to the Costs, Al Qabas Daily News Paper, 19/5/2007, http://www.kw/final/newspaperwebsite/ [visited 2/9/2007].
[263] Al Shall Economic Report, vol. 6., issue 44, November 4th 2010, http://www.alshall.com/admin/downloads/20101111041453-2-eng-report-44-10%20e.pdf. [visited16/11/2010].

produced by the rentier economy's effect on social structure[264]. Because these states do not tax their citizens, they do not have to worry about taxpayer-based groups pressuring them for accountability, demanding to know how their tax dollars are spent, or demanding something in return for their contribution to the state. If there are groups with complaints, the large revenues allow the rentier state to buy their compliance, to co-opt them[265].

Applying the above i.e. the description and requirements of a rentier state, the drawbacks of rentierism – to Kuwait, it is evident that rentierism does exists in Kuwait[266]. Oil revenues in Kuwait have historically come from foreign oil companies. The industry itself creates few local upstream and downstream linkages. It normally employs few local workers, as it is a very capital intensive industry, and it is almost an economic enclave. In a rentier economy, revenues go directly to the state. A rentier economy is distinguished from most economies highly dependent on foreign trade, because the income from foreign trade goes to the private owners of the commodity-producing properties and not directly to the state. This was the case in Kuwait before oil. As seen above[267], the Shaikhs collected taxes on the pearling and trading boats owned by the merchants. Oil revenues, however, go directly to the state. The fact that oil revenues go directly to the state is important because it means that money is centralized in the state. Individuals can become rich only through their relationship to the state, or with

[264] Ross, Michael L., (2004), *What do we Know about Natural Resources and Civil War?,* Journal of Peace Research, 41(3): pp. 337-356.
[265] See pp. 84-85.
[266] Beblawi and Luciani (note 212 supra).
[267] See pp. 55-56.

the state elite[268]. Finally, in a rentier economy rents are large. Unless rents are the only important revenues in the economy, they will not dominate the economy. As has been mentioned above[269], Kuwait is highly dependent on oil; sales of oil account for 95% of the state's revenues[270]. The most important administrative functions of most states, rich and poor alike, is to extract revenues, that is, to draw taxes from the population. Because rentier states do not rely on taxes from the local population for income, they do not have to carry out this extractive function. Instead of extracting revenues, they distribute them. In Kuwait, pre-existing traditions - patterns of paternalism and group solidarity[271]- already predisposed Kuwait to distribute revenues.[272] This function has become institutionalized, and revenues are now distributed by the state through direct transfer, social services, and state jobs. One result of this distributive function is that the institutions of rentier states differ from most other states. In Kuwait, as will be seen[273], there is only an embryonic tax system and consequentially, a small non-independent tax department within the Ministry of Finance. On the other hand, it has extensive distributive institutions representing the state such as the Ministry of Health, Social Affairs, and Education. It also has a large Oil Ministry to ensure that its capacity to distribute will continue. Kuwait, however, despite its excellent distributive capacity, has virtually no redistributive capacity. It can give to the poor, but it cannot take from the rich. The lack of an extractive, hence

---

[268] Beblawi and Luciani (note 212 supra).
[269] See p. 79.
[270] KAMCO Research, (2011), *Kuwait, Economic Outlook*, p.6 http://www.menafn.com/updates/research_center/Kuwait/Economic/kamco170211ee.pdf [visited 14/6/2011].
[271] See chapter 2 of this thesis on more about the Islamic Almsgiving of 'Zakat' practiced in Kuwait p.7-9.
[272] Auty (note 257 supra).
[273] See pp. 99-104

redistributive, capacity means that the state has fewer policy tools, fewer fiscal options, and less flexibility should it need it. All the above cover the first and second requirements which Beblawi argued[274] satisfy the definition of a rentier state i.e. a state economy where rents predominates, and where the origin of these rents are from a foreign source. The third consequence of a rentier economy, which Beblawi points out, is that the rents – on which a rentier state predominately depends radically change the relationship between state and society, primarily by creating new social classes. In Kuwait, oil weakened the old classes who had previously prevailed, such as the merchants, because the state no longer depended on them for money, and Kuwaitis no longer depended on the merchants for employment. However if oil 'destroys' certain social groups, it also creates new ones. These were the bureaucrats and middlemen-contractors, groups defined by their dependence on the state for their creation and sustenance[275]. The third and the fourth requirements which constitute Beblawi's rentier state[276] provide that in a rentier state only a few are involved in the generation of the rent, while the majority are beneficiaries of its distribution[277]. And finally, the government of a rentier state is the principal receiver of the rents. In this context, Kuwait has the oil company, KOC, which is run by a limited number of employees and executives, while the rest of the state's service providing institutions spend the revenue it generates. Oil revenues in Kuwait have allowed the Kuwaiti government to spend not only on essential services such as health,

---

[274] See p. 88.
[275] Smith, B. (2004), *Oil Wealth and Regime Survival in the Developing World,* 1960-1999, American Journal of Political Science, 48 (2): pp. 232-246.
[276] See p. 88.
[277] Stauffer, T. (1987), *Income Measurement in Arab States,* in Beblawi H. and Luciani (note 212 supra).

education, housing, and social insurance, but also on water provision, benefits, social allowances and loans[278]. The state pays premium wages, and collects minimal rents on its properties. It sells goods, especially food, below cost, and charges only a fraction of the market price for energy. Bus and aeroplane fares are subsidised[279]. The state covers medical expenses and student fees, and assists almost every commercial or agricultural venture with inexpensive land and interest-free loans[280]. Finally, the rent yielding company in Kuwait, KOC, is state owned and thus its revenues go straight to the state[281].

### 3.6 The Crucial need for Kuwait to Move away from Dependency on Oil Revenues

From the above, it can be seen that oil has brought Kuwait a curtailed democracy in the shape of a National Assembly answerable to the ruler of the state, a society dependant on its government for income and provision of welfare, and an unstable source of income - oil revenue. Oil has led to a rigid and increasingly growing bureaucracy, and turned Kuwait into a Rentier state. The general drawbacks that are found in states totally reliant on oil (or any extracted natural wealth) i.e. poor social responsibility, Dutch Disease, volatility, etc. are evident in Kuwait[282]. And thus there is a crucial need for Kuwait to move away from its dependency upon oil which over time is initially, a diminishing resource. However with no industry,

[278] Khalaf, S. and Hammoud, H. (1988), *The Emergence of the Oil Welfare State: The Case of Kuwait*, Dialectical Anthropology, Kluwer Academic Publishers, Vol., 12, pp. 343-350.
[279] Kuwait, Ministry of Planning, a Report of the Main Characteristics of Inhabitants and Labour Force, April 1993.
[280] Pipes, D. (1982), *The Curse of Oil Wealth,* The Atlantic, http://www.danielpipes.org/163/the-curse-of-oil-wealth, [visited on Saturday 2nd of July 2010].
[281] Stauffer (note 277 supra).
[282] See pp. 76-88.

zero tourism and a very poor environment for agriculture and investment[283] this task is a challenge. The six members of the Gulf Cooperation Countries (GCC): Kuwait, Bahrain, Qatar, Saudi Arabia, and the UAE, have shown some willingness to diversify their economies through industrialization and the development of productive activities, spending part of their oil revenue on infrastructural works and large industrial projects. Until recently, there was little or no co-ordination between these States, in these respects. Within the limitations imposed by a shortage of labour, relatively small markets and the strong dependency of most projects on the availability of free oil and gas, the scope for 'diversification by industry' has of course to be questioned [284]. Indeed, the success which some individual members states of the GCC have enjoyed in lowering their dependency on oil in their government revenues and exports have been modest. However, Kuwait (alongside Bahrain) can be considered the least successful of the GCC states in decreasing its dependency on oil in its government revenues and exports. The table below shows the role of oil in GCC countries' government revenues, exports and GDP from 1980 – 2007[285].

| Government Revenues | | | Exports | | GDP | |
|---|---|---|---|---|---|---|
| | 1980 | 2007 | 1980 | 2007 | 1980 | 2007 |
| Bahrain | 77.0 | 80.0 | 33.6 | 79.2 | 28.0 | 24.6 |
| Kuwait | 82.0 | 93.1 | 90.0 | 94.4 | 59.7 | 53.2 |
| Oman | 86.0 | 76.4 | 92.4 | 75.8 | 59.3 | 45.1 |

[283] Al Tony (note 223 supra).
[284] Beblawi and Luciani (note 212 supra).
[285] Basher (note 237 supra).

| | | | | | | |
|---|---|---|---|---|---|---|
| Qatar | 94.0 | 60.0 | 95.0 | 80.8 | 64.0 | 56.4 |
| Saudi Arabia | 91.2 | 82.5 | 99.9 | 88.0 | 65.8 | 50.9 |
| UAE | 96.0 | 77.0 | 94.0 | 38.5 | 57.0 | 11.1 |

**Table 3.1: GCC States Exports and GDP from 1980 - 2007**

The ambition of the Kuwaiti ruling elite to 'industrialise' has always been limited[286], and the cautious plans for industrial diversification have been shelved in the recent period[287].

Also as has been discussed earlier[288] the Kuwaiti government only plans to unearth new oil wells and increase its daily oil production from the current 2.1 million bpd to a substantial 4 million bpd with the help of foreign oil companies. Thus, there is more need than ever to break away from oil dependency and diversify the economy; taxation is an option which a rentier state such as Kuwait can benefit from, especially when rentierism and other drawbacks such as spoliation and a weak, unaccountable state presently prevail[289].

The next chapter provides an overview of Kuwait's economic tax system which reflects, in many ways, the existence of Kuwait's rentier economy.

[286] Robert G. Fowler D. (1995), *Built by Oil,* Ithaca press, 1995, pp. 30-37.
[287] Reuters, (2011), *Kuwait in Crisis as Ruling Family Splits, MPs Rebel*, http://www.defenceweb.co.za/index.php?option=com_content&view=article&id=16048:kuwait-in-crisis-as-ruling-family-splits-mps-rebel&catid=54:Governance&Itemid=118 [visited, 15/6/2011].
[288] See p. 77.
[289] See pp. 80-88.

# Chapter 4: An Overview of the Kuwaiti Tax System

## 4.1 Introduction

Tax is a compulsory levy imposed by an organ of the government for public purposes[290]. Income tax in Kuwait is currently only applied to foreign income[291] attributed to a foreign enterprise carrying on business or trade inside Kuwait.[292]There are also duties and other fiscal charges, such as zakat, which are discussed in more detail later in this chapter[293].

Chapter 3[294] emphasized the downside of oil dependency in general and in the case of Kuwait especially, this chapter suggests taxation as a possible solution to help reduce Kuwait's oil dependency. Thus, it is important to analyse and assess closely Kuwait's current tax system and to understand its shortcomings in order to be able to suggest a fiscal system that might best suit a post-oil economy in Kuwait. The Income Tax Decree 3/1955 was the first major attempt of constructing a tax system in Kuwait[295], this Decree continued to govern the imposition of income tax in Kuwait until it underwent some amendment in 2008. However, it should be noted that the 2008 amendments reinforced the majority of the Income Tax Decree 3/1955 Articles except for a few changes which will be

[290] Morse, G. and Williams, D. (2004), *Davies: Principles of Tax Law,* fifth edition, Thomson, p.3.
[291] The term 'Income' means gains and profits of a body corporate derived from carrying trade or business in Kuwait, Article 2 (h) of Kuwait's Income Tax Decree 3/1955. The same definition is repeated in Article 2 (g) of the 2008 amendments to Income Tax Decree 3/1955.
[292] Article 1 of the Income Tax Decree 3/1955.
[293] See pp.103-104.
[294] See pp. 76-88.
[295] A preliminary Income Tax Decree was implemented in 1951 which was then replaced by Income Tax Decree 3/1955.

discussed in more detail below[296]. Thus, there is a need to look closely at the Kuwaiti tax system pre and post the 2008 amendments.

This chapter starts by outlining the taxes and duties currently implemented in Kuwait, then provides a detailed description of Income Tax Decree 3/1955 with special emphasis on the shortcomings of the Decree and concludes with a critical analysis of the 2008 amendments.

## 4.2 Taxation in Kuwait

### 4.2.1 Income Tax

As has been discussed in Chapter 3[297], foreign oil companies paid royalties for the oil they extracted and exported from Kuwait to their home countries and thus the original purpose of the Income Tax Decree 3/1955 and the former income Tax Decree of 1951 was to enable the Kuwaiti Oil Company (KOC), which was jointly owned by the British Petroleum Company and Gulf Oil to pay royalties to the Kuwaiti government by way of taxation in order to obtain tax relief in their country of origin[298]. However, when reading the Articles of the Income Tax Decree 3/1955 the language used does not specify taxpayers as foreign oil companies only, but uses the general term 'corporate body' to define taxpayers under the Decree[299]. Nevertheless, tax liability under the Decree falls in practice

[296] See pp. 138 - 154.
[297] See pp. 65 - 66.
[298] Baker, P. (1986), *Kuwait: The Taxation of International Commercial Transactions*, Arab Law Quarterly, Vol. 1, No. 2, pp. 141-156.
[299] "The term 'taxpayer' means any body corporate subject to income tax imposed by this Decree" Article 2 (a) of the Income Tax Decree 3/1955.

on any foreign enterprise carrying on trade or business in Kuwait[300]. When KOC was nationalized by the Kuwaiti government in 1976, income taxes continued to be imposed on the income attributed to enterprises applicable to all foreign companies carrying on trade or business in Kuwait.[301]

Income Tax Decree 3/1955 applies a progressive tax rate[302] that ranged from 5% to 55%[303]. Both natural persons and national enterprises[304] are not liable to pay taxes in practice. Although domestic enterprises are not explicitly excluded from tax in the Decree, it should be established here that the Kuwaiti tax system has scope to tax domestic enterprises, although this situation of excluding domestic enterprises from income tax remains until this day. The reason behind excluding domestic enterprise from income tax, is the legislator's intention to encourage nationals to start up businesses. However, it should be noted here that some national enterprises are subject to a 1% zakat, whether such companies are public[305] or closed shareholding companies[306]. Domestic enterprises must also make a 1% contribution to Kuwait's Foundation for Advancement of Sciences

[300] "There shall be imposed on every body corporate wheresoever incorporated, carrying on trade or business in Kuwait an income tax.." Article 1 of the Income Tax Decree 3/1955.

[301] Although there is no Article in the Income Tax Law 3/1955 explicitly excluding domestic enterprises, they are in practice (to this day) excluded from taxation.

[302] See p. 109 for the Decree's table of tax rates. The 2008 amendments abolished the progressive rate for a single 15% flat tax rate.

[303] Article 2 of the Income Tax Decree 3/1955.

[304] i.e. domestic companies which are fully owned by nationals, with no foreign shareholders.

[305] A public shareholding company's shares are available for trade on Kuwait's Stock Exchange. Foreigners could not own shares in such companies until the Ministerial Resolution No. 205/2000 came into practice.

[306] A closed shareholding company's shares are not open for public ownership. They are held only by the partners who incorporated the company. This company is usually fully owned by Kuwaiti nationals. Foreign nationals can only hold 49% of a company's shares; however, in the case of 49% foreign ownership the company cannot engage in banking or insurance activities, Articles 63-179 of the Kuwaiti Company Law 15/1960.

(KFAS) and the 2.5% National Labour Support Tax (NLST)[307]; each of these tax liabilities will be discussed in more detail below[308].

Foreign individuals are also not subject to income tax in Kuwait. There are no taxes on the personal income of individuals in Kuwait, including the salary income of employees. There is no stamp duty, property tax, sales tax, value added tax, or inheritance tax[309].

The Income Tax Decree 3/1955 does not differentiate between the different types of income of foreign enterprises carrying on trade or business in Kuwait. So business profits, capital gains, dividends, interests or royalties fall under a single income tax base and are taxed at the applicable tax rate. Tax under the Decree was and continues to be imposed on Kuwaiti sources of income[310]. The Kuwaiti Tax Department continues to interpret the phrase "carrying on business or trade in Kuwait..."[311] in the widest sense possible, thus, in the case of contracts involving performance inside or outside Kuwait, the entire revenue from the contracts, including the revenue relating to the performance outside Kuwait, must to be reported for tax to the Department of Income Tax in Kuwait. This includes work carried out outside Kuwait (offshore activity) under a contract that also involves activity in Kuwait (onshore activity)[312]; royalties, franchise, licence, trademark and copyright fees received by overseas foreign corporate bodies from Kuwait are

---

[307] Kumar, R., Albazie & Co. (2010), *Taxation in Kuwait,* Albazie & Co. Public Accountants, pp.19-20.
[308] See pp. 103 - 109.
[309] Ernst & Young, *Kuwait Taxation,* (2010), pp.8-10.
[310] Article 2 (h) of the Income Tax Decree 3/1955.
[311] Article 1 of the Income Tax Decree 3/1955.
[312] See Article 2 (i) (ii) of Income Tax Decree 3/1955, also see Ernst and Young (note 290 supra).

also subject to income tax in Kuwait[313]. Kuwait's jurisdiction to tax in an international context is discussed in more detail in Chapter 6[314].

### 4.3 Other taxes in Kuwait

#### 4.3.1 Custom Duties

Duties have always been a part of the Kuwaiti fiscal system as has been mentioned in Chapter 2[315]. For many years, beginning in 1752, 5% duties were collected on all imports into Kuwait.[316] These duties were reduced, however, to a 4% import duty by the Kuwaiti Importation Law No. 43/1964 which now regulates import duties in Kuwait with the exception of products imported from the Gulf Cooperation Council (GCC); for the treatment of products from GCC states see Chapter 5[317].

#### 4.3.2 Contribution to the Kuwait Foundation for Advancement of Sciences (KFAS)

Although national companies do not pay income tax under the Income Tax Decree 3/1955, Kuwait shareholding companies whether public or closed are required

---

[313] See Article 1 (c) of Income Tax Decree 3/1955, also see Ernst and Young (note 290 supra).
[314] See pp. 183 - 233.
[315] See pp. 7-8.
[316] *Al Muzaini, A. (1984), Zakat and Taxes in Kuwait: Past and Present, Dar El Salaseil, pp.16-20. (Arabic).*
[317] See pp. 157 - 159.

under Article 6 of the Memorandum of Associations of KFAS to contribute 1% to the KFAS which supports scientific progress within Kuwait[318].

### 4.3.3 The National Labour Support Tax (NLST)

The National Labour Support Tax (NLST) Law No. 19 of 2000 came into force in May 2001. The law was originally proposed in order to support and encourage Kuwaiti nationals to work in non-governmental institutions[319]. The law imposed a duty on all Kuwaiti Shareholding Companies to register with the Ministry of Finance. The NLST is computed at 2.5% of the annual net income of their companies before the board of director's remuneration, contributions to KFAS, donations, grants, Zakat and NLST have been taken into account. However the annual net income is computed after deducting costs and expenses incurred by the company in earning its profits[320].

### 4.3.4 Zakat

Zakat played a key role in the redistribution of wealth in Kuwait for many years when it was compulsory and collected on livestock. However, after the discovery and exportation of oil in 1946 zakat was made voluntary[321]. Zakat became mandatory again for national companies in 2006. Law No. 46 of 2006 imposes a mandatory Zakat of 1% on all Kuwaiti public and closed shareholding companies

---

[318] Al Bazie & Co. (Member of RSM International), 2009, *Taxation in Kuwait,* p.9.
[319] This law has been amended through Ministerial Resolution 24 of 2006, See Al Bazie & Co. (note 319 supra).
[320] Albazie (note 319 supra).
[321] See pp. 9-10

excluding government entities and foreign companies. The zakat is computed at 1% of annual net profits before board of director's remuneration, contribution to Kuwait Foundation for advancement of Sciences, donations, grants, NLST and zakat are taken into account, and after deducting costs and expenses incurred by the company in earning those profits. For more details on Zakat in Kuwait see Chapter 2[322].

### 4.3.5 Offset Program Law No. 9 of 2007

A National Offset Company was incorporated in 2006 to manage and administer the offset programme on behalf of the government. The programme obliges foreign companies which win procurement contracts from Kuwaiti government entities to invest 35% of the contract's value in either a project suggested by the Offset Programme management which meets the economic priorities of the Kuwaiti government, or investment projects proposed by foreign companies as long as they meet the Offset Programme's requirements. Alternatively foreign companies can participate in one of the Offset's funds.[323] Contracts that fall under the Offset Programme are civil contracts of value equal to or greater than KD 10 million, and defence contracts of value equal to or greater than KD 3 million[324].

The above outlines the taxes of Kuwait's fiscal system. However, in December 2007, the Kuwaiti National Assembly approved amendments to Income Tax Decree 3/1955. The amendments took effect and were published in the Kuwaiti

[322] See p. 9 – 28.
[323] AlBazie (note 319 supra).
[324] *Id*.

Gazette in February 2008. It should be noted here that the amendments were only made to some of the articles in Income Tax Decree 3/1955; other fiscal liabilities mentioned above i.e. custom duties, Zakat, KFAS, NLST, and the Offset Programme continue to be implemented as described above. The amendments to Income Tax Decree 3/1955 were made to attract more foreign direct investment to Kuwait. The high tax rates imposed on foreign companies under the Income Tax Decree 3/1955 were seen to hinder the flow of foreign investment into the country. Thus, the value of FDI in Kuwait had in the years prior to the 2008 amendments barely reached $110 million in 2006, which was the lowest in the Gulf region and far smaller than the $8.3 billion attracted by the United Arab Emirates or even the $2.9 billion attracted by Bahrain[325] during the same period.

### 4.3.6 Deemed Profits

The concept of deemed profits is perhaps not another added fiscal liability upon foreign enterprises carrying on trade in Kuwait, however, it does constitute a fiscal barrier for foreign investment, as Circular No. 43/2002 provides that whenever the Tax Department is not satisfied with or convinced by the taxpayers' (foreign enterprises) accounts, or whenever the taxpayer (foreign enterprises) declares losses, the Tax Department will automatically assume that the Taxpayer (foreign enterprise) has made a profit, and will impose a tax according to 'deemed profits' of a rate of 15%.

[325] The Kuwait Times, *Change to Corporate Income Tax Law to Attract more Foreign Investment,* (2008), The Kuwait Times Website, http://www.kuwaittimes.net/read_news.php [visited 11/7/2010].

Circular 43/2002 on the unification of the bases of tax inspection No. 14 on disregarding the books of accounts provides:

"In accordance with the department's targets to unify the bases of tax inspection, and in the interest of work requirements, the following has been resolved:

Bases of disregarding the books of accounts:

First: The accounts books of the company shall be disregarded in case of express violation of the Income Tax Decree No. 3 of 1955 especially in the following cases:

1. Violation of the Ministerial Resolution No. 206 of 1985 concerning the commercial books, which stipulates the keeping of books as general journal and inventory sheets registered, and that these books should be kept regularly and updated and registered with the Ministry of Justice.
2. Unavailability or lack of documents in support of the accounts, or inconsistency of the documents with the records.
3. Taxable revenues are not reported in the tax declaration.
4. The Auditors withholds the company's account books.
5. The company did not adhere to providing the company's books and records required for inspection after not complying to two official letters sent to it by the Tax Department.

Second: The deemed profit percentage is determined by the following:

1. Similar cases.
2. The amount of revenues.
3. Type of activity.
4. Stagnation and stability of the economy.
5. Accounting year and profitability in prior years."

### 4.3.7 Foreign Direct Investment Law No. 8/2001

The Foreign Direct Investment Law 8/2001, which came into force on April 17th 2001, does not impose another fiscal liability upon foreign enterprises carrying on trade in Kuwait; on the contrary, it was found as an initiative to create an incentive to draw foreign investment to Kuwait. The Foreign Direct Investment Law allows 100% foreign ownership for certain economic activities and

projects[326]. It also - on the condition of satisfying certain requirements - offers between 3 – 10 years' tax holidays for foreign enterprises carrying on trade or business in Kuwait. However, Law 8/2001 has proved to be more effective in theory than in practice, imposing numerous restrictions and burdensome requirements for foreign investments to fulfil; Article 3 of the Foreign Investment Law 8/2001 stipulates that in order for a foreign enterprise to obtain a license to own 100% of its business in Kuwait it will require the approval of the Minister of Commerce, the Ministry of Commerce Committee's recommendations, and the approval of the competent authorities. Also, the time to issue a license can take up to eight months. Article 13 (5) of the Foreign Investment Law 8/2001 also provides that the Kuwaiti Council of Ministers shall issue a decision determining the ratio of national labour in respect of projects subject to the provisions of this law, i.e. obliging foreign investors who wish to own 100% of their business in Kuwait (under Law 8/2001) to employ a specific number of national labourers.

Income Tax Decree 3/1955 as will be seen below[327], is a poorly drafted piece of legislation; the fact that it was founded to answer the request of foreign oil companies that demanded paying taxes instead of royalties to the Kuwaiti government in order to gain tax credits in their state of residence in return[328] meant that it had to be drafted in a short period of time by a novice Kuwaiti government that did not have much experience in dealing with foreign

[326] See Al Bazie, (note 319 supra).
[327] See pp. 124-125.
[328] See pp. 65 - 66.

corporations or the exploration of natural resources[329]. In order to maintain a clear and comprehensive overview of the pre-amended Income Tax Decree 3/1955 there's a need to fragment it into sections: the first section defines the meaning of tax as provided in the Income Tax Decree 3/1955. The second section defines the meaning of a body corporate which is in current practice the only taxable subject under the Decree. Section three defines the debatable meaning of agency and attempts to differentiate between what is considered a taxable agency and an excluded distribution relationship under the Decree. The Final section deals with method of tax computation under the Decree.

## 4.4 Explaining the Income Tax Decree 3/1955 in Sections

### 4.4.1 Definition of Tax under the Income Tax Decree 3/1955

Article 1 of the Income Tax Decree provides the tax implemented under the Income Tax Decree.

Article 1 of Income Tax Decree states:

"There shall be imposed for each taxable period ending after 31st December 1954 on every body corporate wheresoever incorporated, carrying on business in Kuwait during such taxable period, an income tax the amount of which shall be determined as follows:

[329] The Kuwaiti ruler at the time (1922) Shaikh Ahmed, had to trust the foreign oil companies' and satisfy their fiscal demands as he relied entirely on them for the exploration and yielding of oil (see pp. 63-65). With oil wealth came economic expansion and development which raised the need for the delegation of power, this is when the Kuwaiti ruler formed his first government (see pp. 66-70); the combination of a novice inexperienced government that relied entirely on the foreign expertises of foreign oil companies produced a weak inadequate tax legislation that only focuses on the oil companies' requirements.

(a) Compute the appropriate percentage of the income of the body corporate for the taxable period such percentage being determined under article 2 (j) in accordance with the bracket into which the income of the body corporate for the taxable period falls:

(b) Compute the appropriate percentage of the maximum amount of income falling in article 2 (j) bracket immediately below that applicable to the body corporate for the taxable period and add to such amount the excess of the income of the body corporate for the taxable period over such aforesaid maximum amount of income[330]"

The table in Article 2 (j) shows the manner in which the income of a company carrying on trade or business in Kuwait is computed for the purposes of Article 1 (a):

**Figure 4.1: Tax rates of Income Tax Decree 3/1955[331]**

| Exceeding K.D. | But not Exceeding K.D | The percentage shall be |
|---|---|---|
| 0 | 5.250 | nil |
| 5.250 | 18.750 | 5% |
| 18.750 | 37.500 | 10% |
| 37.500 | 56.250 | 15% |
| 56.250 | 75.000 | 20% |
| 75.000 | 112.500 | 25% |
| 112.500 | 150.000 | 30% |
| 150.000 | 225.000 | 35% |
| 225.000 | 300.000 | 40% |
| 300.000 | 375.000 | 45% |
| 375,000 | -- | 55% |

To explain provision (b) above more clearly, a company may pay tax at the preceding tax rate, plus pay over the entire profits in excess of the top of that tax rate. For example, on an income of 375,005 Kuwaiti Dinars (KD) a company would pay income tax at 50% plus 5 KD as the excess profit over the top of the preceding tax band. This means that if the taxable profit is only slightly higher than the previous limit, tax is then calculated by adding the actual excess to the amount payable on the previous limit.

[330] Article 1 of Income Tax Decree 3/1955, p.3.
[331] Table of Tax Rates, Article 2 (j) of the Income Tax Decree 3/1955.

It is relevant to mention here how income earned by foreign corporate bodies holding shares in national and GCC entities are taxed under the Income Tax Decree 3/1955.

### 4.4.2 In the Case of National and GCC Companies with Foreign Shareholders

National companies as mentioned earlier[332] are - in practice - excluded from income tax in Kuwait, this is also the case with companies owned wholly by nationals from the GCC, which are excluded on the grounds of national treatment; this is discussed in more detail below[333]. However, in the case of foreign corporate bodies owning shares in companies registered in Kuwait or any of the GCC countries and carrying on business or trade in Kuwait or in the areas known as the Specified Territory[334] . Income tax is imposed on the share of taxable profit of the Kuwaiti or GCC companies attributable to the foreign corporate bodies.[335]
In order to understand how taxation is implemented under the Income Tax Decree 3/1955, there is a need to understand the meaning of a taxable body corporate mentioned in Article 1[336] and defined in Article 2 (f) of the Decree.

---

[332] See p. 101.
[333] See pp. 113 - 114.
[334] This includes Kuwait's Islands: Kubar, Qaru, and Umm Al Maradim, and the offshore area of the neutral zone between Kuwait and Saudi Arabia.
[335] As mentioned on p. 102 the Kuwait Tax Department interprets the phrase "carrying on trade or business in Kuwait.." in Article 1 of the Income Tax Decree 3/1955 in the broadest sense, thus foreign bodies that own shares in national domestic entities will be liable to pay tax on this foreign earned profit in Kuwait. See Ernst and Yong (note 310 supra).
[336] See pp. 109-110.

### 4.4.3 The Meaning of a Body Corporate provided in Article 1 and defined under Article 2 (f) of Income Tax Decree 3/1955

The following provides a clarification to what is considered a taxable body corporate under the Income Tax Decree 3/1955 and when under the Decree is a body corporate excluded from tax. Article 2 (f) defines a body corporate as:

"the term body corporate wheresoever incorporated, carrying on trade or business in Kuwait includes any body corporate carrying on trade or business in Kuwait either directly or through an agent provided such agent is a body corporate, and also any body corporate carrying on trade or business in Kuwait as an agent for others".

Article 2 (f) provides a definition of a body corporate for the purposes of defining an agent and specifying the cases in which the relationship between a foreign company and a domestic agent raises tax liability. In this respect, it is also critical to ascertain the meaning of 'body corporate' in the Decree's interpretive notes, these notes are at the end of the Income Tax Decree 3/1955, they have binding authority when it comes to interpreting different provision of the Income Tax Decree 3/1955. In this respect, interpretive notes provide:

"A 'Body Corporate' refers to an association that is formed and registered under laws of any country or state and is recognised as having a legal existence entirely separate from that of its individual members"[337].

The interpretive notes continue:

'since there is at present no law in Kuwait which provides for the formation and registration of such associations, the term 'Body Corporate' can be applied only to companies or other associations registered abroad[338]'

The Interpretative Note appears to exclude national companies from the definition of a body corporate due to the fact that a national body corporate simply did not

[337] Definition of Body Corporate and agent in Income Tax Decree 3/1955 Interpretive Notes, p. 9.
[338] The Income Tax Decree 3/1955 Interpretative Notes.

exist in Kuwait at the time of the Decree's enactment in 1955. However, the situation is different today where a large number of national companies operate in Kuwait. Although nowhere in the Income Tax Decree 3/1955 does the legislator mention that the term 'body corporate' applies only and exclusively to foreign enterprises and excludes national companies, in practice, national companies are not liable to pay income tax, but may be liable for small percentage tax liabilities that fall on national companies such as the zakat, KFAS, and NLST which are mentioned above[339]. Thus, it may be concluded from the above that it was not necessarily the intention of the legislator to exclude national companies from taxation under the Income Tax Decree 3/1955.

Provision for the establishment of national companies emerged in Kuwait following the introduction of the Kuwaiti Company Law No. 15/1960, and the Kuwaiti Commercial Law No. 68/1980. So why then are national companies still not liable for taxes under the Income Tax Decree 3/1955? The undeclared reason behind relieving national companies from income tax is the intention of the Kuwaiti government to encourage the creation of local and national businesses. There is also an unofficially declared consensus that national businesses should be treated favourably as an initiative to protect local goods and services against foreign competition[340].

Another undeclared reason behind relieving national companies from taxation is the very strong opposition which any proposition to tax them would generate from those who have a vested interest in the majority of such domestic businesses.

---

[339] See pp. 103 – 105.
[340] See p. 101.

Kuwait's apparent difference in the treatment of foreign and domestic corporations may conflict with the fundamental principles of the WTO agreement[341], especially the Most Favoured Nation (MFN), and the National Treatment Principles[342]. Kuwait became a WTO member in January 1995[343].

In addition to relieving national businesses from income tax liability, no income tax is currently imposed on companies registered in other Gulf Co-operation Council (GCC) countries which are owned wholly by nationals of Kuwait or other GCC nationals[344]. Thus, Gulf companies are treated like national companies provided their activities abide by the provisions of the Unified Economic Agreement (UEA) and the resolutions of the GCC Supreme Council[345]. A more detailed discussion on the GCC Unified Economic Agreement and the implications it has on the economic activities of its member states follows in Chapter 5[346].

Article 1 of the Income Tax Decree 3/1955, as has been seen above[347], does not explicitly exclude national companies from taxation, in practice however, this has always been the case, leaving only foreign enterprises liable for income tax in Kuwait. However, in terms of understanding the second half of the definition of body corporate i.e. '...carrying on trade or business in Kuwait..." there is a need to

---

[341] See pp. 159-160.
[342] Article 1 and 3 of General Agreement on Tariffs and Trade (GATT), replaced by the WTO. The same text of GATT applies to the WTO.
[343] A more detailed discussion about Kuwait's attitude towards international trade and its Double Tax Treaty negotiation strategy can be found in Ch. 6, pp. 172 – 219.
[344] The GCC Unified Economic Agreement & Customs Law, *Section 4:Priviledges and Exemptions, (2002),* p. 13.
[345] The GCC Unified Economic Agreement & Customs Law, *Section2:Permited Activities,(2002),* pp.4-8.
[346] See pp. 157-169.
[347] See p. 111.

see Article 2 (i) of the Income Tax Decree which lists activities that fall under the meaning of carrying on trade or business in Kuwait.

### 4.4.4 The Term Carrying on Trade or Business in Kuwait

Article 2 (i) provides: "carrying on trade or business in Kuwait, includes:

(i) The purchasing and selling in Kuwait of property, goods or rights thereto and maintaining a permanent office in Kuwait where the contracts of purchase and sale are executed;
(ii) The operating of any other manufacturing, industrial, or commercial enterprise in Kuwait;
(iii) The letting of any property located in Kuwait; and
(iv) The rendering of services in Kuwait;
but do not include the mere purchasing in Kuwait of property, goods, or rights thereto".

Article 2 (i) lists the activities which raise tax liability when undertaken by foreign enterprise in Kuwait under the Income Tax Decree 3/1955. However, foreign body corporates carrying on any of these activities in Kuwait must do so either through a national agent or through holding 49% of shares in a national company where national shareholders hold no less than 51% of the company. This is also according to the meaning of Article 2 (f): [348]

"the term body corporate ... includes any body corporate carrying on trade or business in Kuwait either directly or through an agent ..."

Where 'carrying on trade or business directly' means holding 49% of a national company, and 'through an agent' implies doing business indirectly. Both these

[348] For full Article see p. 111.

concepts of minority shareholdings and the relationship between the national agent and the foreign company are discussed below.

### 4.4.5 The meaning of agent under the Income Tax Decree 3/1955 and the circumstances by which an agency relationship is taxed under the Decree

In order to understand fully the position of foreign investment in Kuwait, i.e. the restrictions that surround the ability of foreign persons to engage in economic activities in the country, which in general are the insistence upon domestic participation, this is done either by demanding that a foreign enterprise carries on business in Kuwait through a national Kuwaiti agent[349], or demanding a wider domestic participation i.e. requiring that 51% of the foreign enterprise carrying on trade in Kuwait is owned by Kuwaiti nationals[350]; there is a need to study other laws linked to the Income Tax Decree 3/1955 such as Company Law 15/1960 which restricts foreign participation to certain forms of enterprise and also restricts the percentage of a foreign shareholding in an enterprise[351]. There are also other technical restrictions to foreign investment in Kuwait such as limiting the ability to import goods to Kuwaiti nationals; all such restrictions will be discussed in more detail below.

#### i. Other Laws pertinent to the Income Tax Decree 3/1955

[349] Article 24 Kuwaiti Commercial Law 68/1980.
[350] Article 23 Kuwaiti Commercial Law 68/1980.
[351] See pp.116 - 122.

For a better understanding of the commercial activities which raise taxable foreign income under the Income Tax Decree 3/1955, and the restrictions which foreign investments face in Kuwait, there is a need to look at other laws involved i.e. The Kuwaiti Commercial Law 68/1980, Kuwaiti Company Law 15/1960, Kuwaiti Industrial Law 56/1996, the Kuwaiti Importation Law 43/1964, and Agency Law 36/1964.

### 1. Commercial Law 68/1980

All commercial activities in Kuwait are subject to the Commercial Law 68/1980, Article 23 provides:

"No person other than a Kuwaiti may carry out trade in Kuwait unless he has one or more Kuwaiti partners, provided that the capital investment by the Kuwaitis in the joint trading firm is no less than 51% of the total capital of the trading firm".

In addition, Article 24 provides:

'No foreign company may establish a branch thereof nor carry on trading activities in Kuwait except through a Kuwaiti agent'.

### 2. Industrial Law 56/1996 and Importation Law 43/1964

Article 6 of the Industrial Law No. 56/1996 provides that only enterprises with a 51% Kuwaiti ownership may receive a licence or be registered under that law[352], and Article 1 of the Importation Law No. 43/1964 stipulates that:

"A licence shall be necessary for the importation of all goods (except a small excluded group of goods). The right to import goods, material, and equipment however, shall be confined to the citizens of Kuwait, and Kuwaiti partnerships; if all the partners hold Kuwaiti nationalities, and joint stock and limited liability companies where Kuwaitis hold 51% or more of the total capital".

[352] Article 6 of Industrial Law No. 56/1996.

### 3. The agency Law 36/1964 and Company Law 15/1960

In effect, therefore, foreign enterprises in Kuwait are restricted to carrying on trading activities in Kuwait in one of the following forms:

1. Activities carried out through an agency: a foreign enterprise may sell its goods in Kuwait through a local commercial agent. Here the Agency Law 36/1964, provides that only Kuwaiti citizens or Kuwaiti legal persons may act as commercial agents. Thus a foreign company can operate in Kuwait through a branch. This is subject to Commercial Law 68/1980 which states in Article 24 that a foreign branch must be established through a commercial agent who is a Kuwaiti national and the liability of the branch to Kuwaiti tax will depend on the scope of the agent's activities and authority. The definition of agent, and what constitutes an agency relationship liable to corporate income tax in Kuwait is discussed in more detail below[353].

2. Partnerships and joint ventures: the Kuwaiti Company Law of 15/1960 contains provisions permitting the formation of joint ventures in Kuwait. A joint venture does not have a separate legal personality, but takes the

[353] See pp.122-136.

form of a partnership contract between the joint venture parties[354]. In the case of an integrated joint venture between a Kuwaiti and a non-Kuwaiti entity tax is imposed on the non-Kuwaiti share of the profit[355]. However a set of financial statements covering the full operations of the joint venture is required to be submitted to the Department of Income Tax (DIT). For divided joint ventures (where each partner's responsibilities and share of contract revenue is specified in a joint venture agreement)[356] between Kuwaiti and foreign entities, only the foreign partner is required to submit a tax declaration and pay tax, and in this case the foreign partner's status for tax is that of a branch of a foreign company[357]. See below[358] for types of partnership i.e. General and limited partnership.

3. Participation in a Kuwaiti legal entity: There are three types of legal entities in Article 2 of the Company Law 15/1960 which are open to foreign participation all of which (with the exception of a joint venture) enjoy separate legal personality. The forms of legal entities which may be established under Company Law 15/1960 are:

   a. Shareholding Companies:

[354] Article 2 of the Kuwaiti Company Law 15/1960.
[355] Circular No. 02 of 2005 provides that in the event of a partnership, a joint venture or any other form of enterprise where a foreign shareholding exists tax is imposed only on the foreign share of income. This is computed by taxing all the profits as if the entity is fully foreign owned, then compute 49% of the taxed profits in order to show the foreign share of the income.
[356] See Ernst &Young (note 310 supra)
[357] *Id.*
[358] See pp.120-121.

1. Public shareholding company: also called an open joint stock company, where the company's shares are available for public subscription. Under Article 68 of the Company Law 15/1960, shareholding companies are generally restricted to Kuwaiti ownership, although the same Article allows as an "exceptional measure" of non-Kuwaiti participation if it is "necessary to invest foreign capital or use foreign expertise". However a foreign share may not exceed 49% of the company's share capital and in the case of banks and insurance companies the national share of the company must be no less than 60%. Any income attributable to the foreign shareholding is subject to corporate income tax[359]. When there's a foreign shareholding the tax liability is computed by taxing all the profits as if the entity is fully foreign owned, then compute the foreign share which in this case is 40% (in most cases its 49%) of the taxed profits in order to show the foreign share of the profit.

2. Private Shareholding Company: also called a closed joint stock company, As opposed to the Public Shareholding Company, the shares of the Private Shareholding Company are not available for the public's subscription. The maximum foreign ownership in this type of company is again 49%[360]. All income attributable to the foreign shareholder is subject to Kuwaiti income tax[361]. A Private Shareholding Company can be With Limited Liability[362] (WLL), or With Unlimited Liability. In the former, the shareholder's liability is limited to their share in the company. In the latter, shareholders

[359] Gerald, J. (1991), *Legal Aspects of Doing Business in Kuwait,* Arab Law Quarterly, Vol. 6, No. 4, p. 325.
[360] Article 23 of Commercial Law 68/1980. See also p. 111.
[361] See pp. 110-111.
[362] Holding shares in a WLL used to be restricted to natural persons until Article 195 of the Commercial Company Law 15/1960 was amended in 1995 to allow corporate shareholding in a WLL.

are all equally liable for all the company's debt. In both cases, Kuwaiti nationals are required to hold 51% of the shares[363].

b. Partnerships: Partnerships are treated similarly to Joint Ventures discussed above[364]. They are not popular in Kuwait, except with respect to certain small businesses where unlimited liability is not of primary concern. Foreign companies seldom use partnerships as a means to conduct or invest in business in Kuwait, since partners generally have unlimited liability. There are two types of partnerships in Kuwait:

1. General Partnership: in this partnership, partners "shall jointly be liable to the extent of all their property for all obligations of the partnership[365]". A general partnership may include non-Kuwaitis. However 51% of the partnership must be owned by Kuwaiti nationals[366].
2. Limited Partnership: in this partnership there are partners with limited liability[367] who are liable to cover the partnership's obligations (debts) to the amount of the share of the capital for which they own in the partnership. However such partners are not allowed to participate in the management of the partnership[368]. There are also general partners who are liable with all their property for all obligations of the

[363] Article 23 of the Commercial Law 68/1980. Also in Kassim, A., *Joint Venturing in Kuwait Company Law Explained,* (1986), Arab Law Quarterly, Vol.1, No.4, pp. 432-435.
[364] See p. 118.
[365] Article 3 of chapter 1 of the Company Law 15/1960.
[366] Article 23 of the Commercial Law 68/1980.
[367] The Limited Partnership can also be a partnership limited by shares, also called "commandite partnerships by shares" in which the capital of the partnership is divided into shares.
[368] Article 42 of Chapter 2 of the Company Law 15/1960.

partnership. Income tax is imposed on the foreign share of partnership income and Kuwaiti nationals must own at least 51% of the partnerships capital[369].

The above discussion provides guidance on the meaning of tax, taxpayer and the definition of a body corporate liable to tax under the Income Tax Decree and shows the restrictions surrounding the carrying on of trade and business by foreign enterprises in Kuwait. In this section it has also been concluded that when a foreign entity carries on trade or business in Kuwait through a minority shareholding (usually 49%) in a national enterprise, a tax liability will only arise in regards to the foreign share of income. However, there is a need to identify the second method by which a foreign entity can carry on trade or business in Kuwait i.e. through a national agent; what is an agent under the Income Tax Decree? And when does an agency relationship cause a tax liability to arise under the Decree? This is what the forthcoming discussion provides.

### ii. Article 2 of Income Tax Decree 3/1955 and the definitions of agent

Article 2 is another critical article in the Income Tax Decree 3/1955. Its importance lies in the definitions it provides for the terms used in the Decree, such as the definition 'agent'. It also sets out incidents which raise tax liability, whether

[369] See Gerald (note 360 supra).

they were commercial activities[370] or an agency relationship between a foreign company and a national agent.

### iii. The Agency Relationship between a Foreign Enterprise and a Kuwaiti National Agent

Article 2 (f) of the Income Tax Decree provides:

"...a body corporate carrying on trade or business in Kuwait either directly or through an agent provided such an agent is a body corporate, and also anybody corporate carrying on trade or business in Kuwait as an agent for others."

It must be established here that a body corporate carrying on trade or business in Kuwait directly, when a foreign company owns 49% of the shares in a domestic company; this method of undertaking business in Kuwait by foreign businesses has been discussed above[371]. Understanding the meaning of the term 'agent' and the agency relationship that may exist between a Kuwaiti national and a foreign enterprise is important in terms of distinguishing between taxable and non-taxable corporate income. The Interpretive Notes at the end of the Income Tax Decree 1955define an agent as:

"a person authorised by a principal to enter into a binding contract with a third party on the principal's behalf within the scope of that authority."

The interpretative notes continue:

"Income derived by a foreign body corporate from carrying on trade or business in Kuwait through an "Agent" who is not himself a body corporate is not liable to tax under this Decree, provided that the "Agent's" authority is in accordance with the terms of the definition given above.

The payment of commission or other remuneration will not of itself be deemed as constituting an "Agency" under the Decree. Similarly, in the case of a partnership

[370] See p.114.
[371] See pp.116-120.

between a foreign body corporate and a person who is not a body corporate the latter will not necessarily be considered as the "Agent" of the former for the purposes of the decree unless he has full authority to enter into a binding contract on behalf of the partnership.

Income derived by a foreign body corporate from carrying on directly any trade or business in Kuwait will be liable to tax under this Decree notwithstanding the appointment of an "Agent" in Kuwait for the conduct of other business"[372].

Taking the first part of the interpretative notes for the meaning of agent:

"Income derived by a foreign body corporate from carrying on trade or business in Kuwait through an "Agent" who is not himself a body corporate is not liable to tax under this Decree, provided that the "Agent's" authority is in accordance with the terms of the definition given above[373]..."

When reading this definition with the definition provided in Article 2 (f)[374] a confusion may stem from the wording; the statement that: "income derived from a foreign business through a national agent who is not himself a company i.e. a natural person will not be liable to tax **Provided** he has the authority" is unclear. The reason being, that the word 'provided' changes the meaning, using the word 'provided' here may lead to the interpretation that foreign enterprises deriving income from Kuwait through an agent, who is not himself a company, are not liable for tax. This is misleading because the tax law imposes income tax on a foreign enterprise whose income is derived through an agent. However, when the agent is not a body corporate, the Income Tax Decree 3/1955 does not tax the principal **Unless** this agent has authority to sign binding contracts with third parties on behalf of his principal.

Thus, instead of using the word **'provided'**, the legislator should have used the word **Unless**, changing the interpretative note to:

"Income derived by a foreign body corporate from carrying on trade or business in Kuwait through an "Agent" who is not himself a body corporate is not liable to tax under this Decree **Unless** the "Agent's" authority is in accordance with the terms of the definition given above"

---

[372] Definition of 'Agent' in the Income Tax Decree 3/1955, p.9.

[373] i.e. a person authorised by a principal to enter into a binding contract with a third party on the principal's behalf within the scope of that authority, see Tax Decree 3/1955 interpretative notes, p. 101.

[374] See p.122.

This leads to the conclusion that where an agent, who is a natural person, has authority to sign binding contracts with third parties, the foreign enterprise will be liable to income tax in Kuwait.

Further, reading Article 2 (f) in isolation may lead to the understanding that there is no tax liability upon a foreign enterprise engaging in business in Kuwait through an agent where the agent is not a body corporate. The reality is that an income tax liability rises when a foreign enterprise undertakes business in Kuwait through an agent whether that agent is a body corporate or a natural person as long as - the agent - has the authority to enter into a binding contract with third parties.

So without the interpretative notes, it might be argued that a natural person as an agent for a foreign principal yielding income in the state of Kuwait will lead to the exemption of such foreign principal from income taxation in Kuwait. This could not have been the intention of Article 2 (f) as it has been established earlier[375] that domestic companies were not established in Kuwait until the Kuwaiti Company Law 15/1960 came into practice in 1960, thus there were no domestic body corporates to begin with in order for them to serve as national agents for foreign enterprises. Also the insinuation that foreign enterprises with natural persons for agents are exempt from tax liability would have created a loophole and provided a very easy opportunity to avoid taxation by hiring a Kuwaiti natural person as an agent for the foreign enterprise to carry on business or trade in Kuwait. This interpretation is supported by Circular No. 34 of 2002 issued by the Ministry of

[375] See pp. 122 – 123.

Finance, entitled "On Unifying the Base of Tax Inspection, Regarding the Agent and the Guarantor"[376]. The Circular provides the following definition of "Agent":

"He is the person, who is continuously negotiating for concluding the deals on behalf of the principal for fees. His engagement may include entering into these deals and execution thereof in the name of the principal and on behalf of him or his engagements shall be restricted to negotiating with the others as introduction for including the deals for the account of the principal. The agent may be the sole distributor of the industrial and commercial products in certain area[377]"

The Circular does not confine the meaning of "agent" to a legal person, so that a foreign principal may be taxed on the corporate income yielded in Kuwait whether the national agent is a natural person or a legal person as long as such an agent has authority to negotiate and conclude business deals on behalf of the principal.

Later in 2006, a binding resolution by the Council of Ministers was issued to confirm that in a distribution relationship, a foreign principal merely supplies the Kuwaiti sole distributor with goods for the latter to sell inside Kuwait i.e. the distributor does not have the authority to enter into binding agreements with third parties on behalf of his principal (the foreign enterprise). Such a distributor was excluded from the statue of agent for tax purposes, the Resolution provides:

"an agent in the 1955 tax decree, refers to the person authorized by the principal to conclude contracts on his behalf with third parties within the given authorities, which will exclude the sole distributor from the scope of the Income Tax Decree implementation[378]. The status of a sole distributor will be discussed later in this chapter[379].

The Kuwaiti Courts have also confirmed that it is the authority which the agent has that determines whether or not the relationship between him (the agent) and foreign enterprises yielding income in Kuwait is an agency which raises income

---

[376] Circular No.34/ 2002, issued by the Ministry of Finance on 11th September 2002.

[377] Circulars relating to tax are issued by the Ministry of Finance and signed by the Director of the Department of Income Tax. They are binding legal instruments. According to Article 10 of the Income Tax Decree 3/1955: "The Director shall administer and enforce this decree...".

[378] Council of Ministers Resolution No. 287/2006. This is a binding resolution which excludes a foreign principal, who only supplies a Kuwaiti sole distributor with goods, from tax liability in Kuwait.

[379] For a discussion on the difference between an agent and a distributor, see pp.121 -136.

tax liability. The Kuwaiti courts are competent to hear all disputes concerning personal status (matrimonial), civil, commercial (including taxes) and criminal matters. There are three levels of courts:

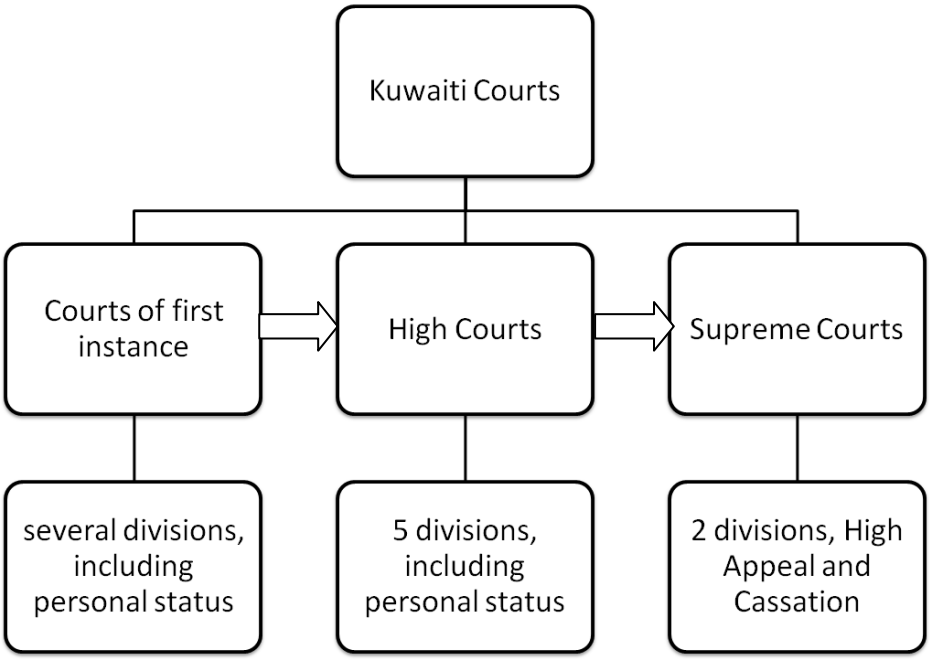



**Figure 4.2 Kuwait's Judicial System.**

For purposes of personal status, the courts divided into 3 sections, Sunni, Shi'i, and non-Muslim (for laws applicable to religious minorities). Under the 1959 Law Regulating the Judiciary [380] following rulings by the courts of first instance, tax appeals are transferred to the High Court. Further appeals are transferred to the Cassation Division of the Supreme Court.

### The Tax Objection and Appeal Process

new added

If the taxpayer objects to the department's assessment, he can file an objection in the Tax Department within 60 days from the date of the tax assessment letter, if the Department responds within 90 days from filing he objection but the taxpayer is not satisfied with the department's decision, he may raise the issue to The Tax Appeal Committee (appointed from Tax Department employees) within 30 days from the Department's decisions to his initial objection. However, if the Department fails to respond to his initial objection within 90 days from the date of

[380] The Kuwaiti Judiciary system is regulated by law No. 15/1959 as amended by law No. 19/1990.

filing the objection, he can file an appeal through The Tax Appeal Committee within 30 days after the end of the 90 days period. If the taxpayer is still not satisfied with the Committees decision, he has an option of referring the case to the Settlement Division (also within the Tax Department), if the taxpayer is not satisfied with the decision of the Settlement Division, he has the right to pursue the tax dispute through civil courts within 60 days from the date of rejection by the Tax Appeal Committee.

### iv. The Kuwaiti Courts on Agency and the Income Tax Liability

In Coca Cola versus The Ministry of Finance and the Beverage Trading Company[381], in this case of Coca Cola (the plaintiff) against The Under Secretary of The Ministry of Finance (1st defendant) and the Beverage Trading Company (2nd defendant), the court found that the relationship between the plaintiff and the 2nd defendant did not constitute an agency relationship in respect of a tax liability in Kuwait.

The Ministry of Finance had issued a tax assessment holding the plaintiff liable for corporate income tax in Kuwait for the years between 1993-2001, arguing that the plaintiff conducted business and generated profits in Kuwait through its agency agreement with the Beverage Trading Company (a domestic company).
Coca Cola, an American company, whose business activity is confined to the manufacturing and the selling of soft drinks objected to the tax liability imposed on it and argued that it was not liable to pay corporate income tax in Kuwait because its agreement with the Beverage Trading Company did not constitute an agency. Coca Cola argued that the agreement between itself and the Beverage Trading Company entitled "The Bottle Filler Agreement" only gave the Beverage Trading Company a licence to prepare and fill the drinks to distribute and sell them in Kuwait. It did not give this company the authority to conclude contracts with third parties on behalf of Coca Cola. Also the Beverage Trading Company as

[381] Coca Cola versus The Ministry of Finance and the Beverage Trading Company, Case No. 2012/2006, Court of first instance, Circuit 3, Civil Commercial and Government matters

required by Coca Cola had no authority under this agreement to sign contracts that were binding on Coca Cola.

The court indicated that Tax Decree 3/1955 defines an 'agent' as the person authorized by his principal to conclude binding agreements with a third party on his behalf within the scope of the authorized powers[382]. However after examining the agreement concluded between Coca Cola and the Beverage Trading Company, the court found that the latter only had a limited licence to purchase the drinks from a third party and the manufacturer, fill the drinks in bottles bearing the plaintiff's trade mark and distribute and sell the drinks at a price not exceeding the maximum limit specified by Coca Cola. Also under the agreement the Beverage Trading Company had to bear all costs incurred due to the manufacturing, promoting and commitment to provide management and acceptable publicity for the product. Nowhere in the agreement was there a provision which obligated Coca Cola to pay a certain fee to the Beverage Trading Company. Also the court found that the Beverage Trading Company had no authority to conclude binding contracts on behalf of Coca Cola, both of which are necessary requirements in constituting an agency according to Article 2 (f) of Tax Decree 3/1955. Thus the court concluded that there existed no tax liability upon Coca Cola to pay corporate income tax in Kuwait, as the agreement between itself and the Beverage Trading Company did not constitute an agency according to the meaning of agency in Tax Decree 3/1955.

This case illustrates that the significance of an agency agreement which gives rise to taxable income lies in the actions undertaken by the agent with third parties and whether or not such actions reflect directly on the principal.

The meaning of agency for tax purposes can be compared with the meaning of "agency" under the Kuwaiti Commercial Law 68/1980. Under this law agency can take several forms: Contract Agency, Commission Agency a Distribution

[382] The interpretative notes of Income Tax Decree 3/1955, p.9.

Agreement and a Commercial Representation[383]. In each of the above types of agencies the authority of the agent differs. In a contractual agency[384], the agent undertakes to handle the negotiation and conclusion of transactions in a certain territory under the knowledge of the principal and in the principal's name in return for a fee. In a commission agency[385], however, the agent enters into contracts in the agent's own name for the principal's benefit in return for a fee. While in a distribution agreement[386] a local agent distributes the principal's product in a specified area provided he is the sole distributor of the product, for a share of profit. Finally, a commercial representative is a national individual/entity employed by a merchant or a commercial entity to carry out some of the principal's commercial work.

The court, in the Coca Cola case, effectively found that the relationship between the two parties – Coca Cola and the Beverage Trading Company- did not go beyond a distribution relationship and, as seen, most definitely did not amount to an agency for tax purposes. The court added that restrictions and obligations imposed by Coca Cola upon the Beverage Trading Company militated against an agency. Moreover Coca Cola's need to ensure that the Beverage Trading Company's production of the product complied with international measures, came from its need to maintain its worldwide reputation, since any deficiency in the manufacturing of the product would jeopardise that reputation, and this did not, the court found, qualify the relationship as an agency.

Further, the fact that the relationship between Coca Cola and the Beverage Trading Company was in effect a distribution agreement meant that Coca Cola was not liable to income tax, by virtue of resolution No. 287 made by the Kuwaiti Council of Ministers in 2006 which excludes distributors from generating income tax liability for their principals, as seen above.[387]

---

[383] The Kuwaiti Commercial Law No. 68/1980, Articles 260-305.
[384] Articles 271 of the Kuwaiti Commercial Law No. 68/1980.
[385] Article 287 of the Kuwaiti Commercial Law No. 68/1980.
[386] Article 286 of the Kuwaiti Commercial Law No. 68/1980.
[387] See p.125.

It should be added here that although this resolution was made relatively recently, the exclusion of the sole distributor of a foreign business from agency status had been adopted, in practice, for some time. This practice was prompted by the national sole distributors' arguments that their foreign principals only supply them with the goods which they (the sole distributors) then sell in Kuwait bearing all the costs associated with the selling of such products, and thus if the Department of Income Tax began to tax these foreign principals or the income derived from these agreements, there was a chance they would stop supplying national sole distributors with their products.

It should also be mentioned here that the mere payment of commission or other remuneration will not, in itself, be deemed as constituting an 'agency' under Tax Decree 3/1955. The interpretive notes to the Decree also provide:

"the payment of commission or other remuneration will not of itself be deemed as constituting an 'agency' under the decree[388]"

In the following case, the Kuwaiti courts have confirmed that the mere payment of a commission does not qualify a relationship between a foreign enterprise and a national distributor as an agency which yields taxable corporate income in Kuwait.

In Matsushita Electric Industrial Limited Company versus The Minister of Finance, The Under Secretary of the Ministry of Finance, the Director of the Tax Department, and the Chief of Tax Appeals Committee[389], Matsushita, a Japanese manufacturer of electric appliances, sought to write off the claimed taxes imposed on it by the defendants on the basis that it was a company that conducted business in Kuwait under the agreement it had with a local agent, namely Essa Al Yousifi Company (Al Yousifi). The defendants required that Matsushita pay corporate

[388] The interpretative notes of Income Tax Decree No. 3/1955, p.9.
[389] Case No. 2325/2006, Court of First Instance, Commercial, Civil and Governmental Circuit/2, December, 2006.

income tax upon the corporate profits it had allegedly yielded in Kuwait for the period between1996-2003.

Matsushita argued that it was not liable to pay taxes in Kuwait due to the fact that the contract it had with Al Yousifi did not amount to an agency contract. Matsushita also argued that the agreement with Al Yousifi was a mere distribution agreement, whereby the latter was not entitled to conclude contracts in Matsushita's name or to create any rights or obligations on its behalf. Further, the fact that Al Yousifi determined the selling price and received the sale proceeds including profits then delivered them to Matsushita (the principal) did not qualify the relationship as an agency.

The defendants claimed that the contract between Matsushita and Al Yousifi provided that the latter (Al Yousifi) received 5% of the value of the sales as a commission, and by virtue of this provision the contract qualified as an agency. Also the defendants referred to Article 286 of the Commercial Law 68/1980 which states that "a distributing contract shall be considered equivalent to the contract agency[390]"

The court agreed with Matsushita, accepting that Al Yousifi was not an agent as it simply carried out the sales of the products manufactured by the plaintiff under its own name, and on its own account, and received the sale proceeds.

In its judgment, the court indicated that when it comes to analysing an agreement signed between a foreign business and a domestic representative, each contract should be examined separately according to the nature of the contract between the two parties. In this case, the agreement provided that Al Yousifi distribute Matsushita's products in Kuwait exclusively and undertook to exercise its best efforts to sell the principal's products and promote them. All purchases were to be made at prices which were determined by Al Yousifi and in consideration for these activities Al Yousifi received 5% of the value of the sales as a commission.

The court explained that the commission received by Al Yousifi referred to in the agreement was not due to its capacity as an agent for Matsushita but as consideration for the distributor's dedication and activity in selling the commodities. The court held that the payment of commission or other

[390] Article 186 of the Kuwaiti Commercial Law No. 68/1980.

remuneration would not of itself be deemed as constituting an 'agency' under the Tax Decree 3/1955, as indicated in the interpretative notes in the Decree[391]. Also the court dismissed the defendants' argument that Article 286 of the Commercial Law 68/1980 provides that a distributor is the equivalent of a contract agent. The Article states:

"The distribution contract shall be considered equivalent to the contract agency and is subject to the provisions of Articles 275, 281, 282, 283, 284, and 285, under which the merchant undertakes to promote and distribute the products of an industrial or a commercial entity in a certain territory provided that such a merchant shall be the exclusive distributor in that territory".[392]

The court provided that although Article 286 states that a distribution contract is considered the equivalent of a contract agency, Article 286 also provides that this similarity between the two contracts lies exclusively in relations to the Commercial Law 68/1980 mentioned in Article 286. The court provided that these Articles relate to the common features of the status of distributor and contract agent, to the treatment of external and procedural issues concerning the contracts (agency and distribution) and are not relevant to the authority of the agent in relation to these contracts e.g. Article 275 provides that a contract agency must not be shorter than 5 years when the agreement holds the agent responsible for the provision of a warehouses for the principal's products, or for a venue to exhibit its products. While Article 281 provides that the principal is not entitled to terminate the contract without a fault from the agent's side, and in the case of the principal doing so, he will be liable to compensate the agent for damages. These mutually applicable Articles are not, therefore, significant in defining the authority of a distributor and a contract agent; the scope of authority for a contract agency is defined in Article 271[393] as:

"A contract where a local agent undertakes on a continuous basis and in a specified territory to promote the principal's business, negotiate and conclude transactions on behalf of the principle in return for a wage. The agent may conclude and execute such transactions in the name of the principal and to his account".

[391] Page 9 of Tax Decree 3/1955.
[392] Article 286 of Commercial Law 68/1980.
[393] Article 271 of Commercial Law 68/1980.

While the definition of a distribution contract is in Article 286 of the Commercial Law 68/1980 which provides:

"the merchant who undertakes to promote and distribute the products of an industrial or a commercial facility in a certain territory provided that that such a merchant shall be the exclusive distributor in that territory".

The definition, the court added, does not include negotiating and concluding contracts in the name of the principal or on his account.

For the above mentioned reasons the court found that Matsushita was not liable to pay income taxes in Kuwait.

It is concluded from the case above that a payment of a commission by a principal to a domestic distributor does not constitute an agency, and that a court will always look at each contract separately and analyse its provisions closely in order to reach a decision whether or not it represents a taxable agency contract. However, the difference between the term agency in the Kuwaiti Commercial Law and the Kuwaiti Tax Law needs to be closely examined.

### v. The meaning of agent under Commercial Law 68/1980

The Kuwaiti Commercial Law 68/1980 recognises two types of agents (a contract agent and a commission agent); it also recognises the commercial representative, and finally the distributor[394]. The definition of distributor is provided above[395]

Then there is the Contract Agent and the Commission Agent. The contract agent is:

"a local agent who undertakes to promote the principal's business by negotiating and concluding transactions on behalf of the principal on a continuous basis in a specified territory and in return of a wage. The agent may conclude and execute such transactions in the name of the principal and to his account[396]".

[394] See p.132.
[395] See p.132.
[396] Article 271 Commercial Law 68/1980.

In a Commission Agency on the other hand:

"the agent enters into contracts in his own name for his principal's account in return for a fee, the agent may not disclose his principal's name without the principal's consent[397]".

Articles 197 – 305 of the Commercial Law 68/1980 define and regulate the commercial representation contract. The commercial representative is defined as:

"a Kuwaiti individual or entity employed by a merchant or a commercial entity through contract to carry out some of the principal's commercial work"[398].

These definitions do not follow the definition of agent in Income Tax Decree 3/1955[399], thus the contract agent, commission agent, and the commercial representative can not be agents for the purpose of the Income Tax Decree 3/1955.

An example of a contract agency is provided in the case of Jassim Mohammed Thunayan Al Ghanim and Sons for General Trading and Contracting versus The Ministry of Finance. In this case[400], filed by Jassim Mohammed Thunayan Al Ghanim and Sons for General Trading and Contracting (Al Ghanim) against the Ministry of Finance, Al Ghanim rejected the Ministry of Finance's order to submit its financial statements and a tax declaration covering the contract it had with a supplier of information systems, a foreign company called "Oracle". It was alleged that Al Ghanim was the national agent for Oracle and that it should submit to the Ministry of Finance its agency contract, and its financial statements for 1993-1998, on the grounds that Oracle had provided services in Kuwait through its national agent, Al Ghanim for that period. This information would enable the Ministry of Finance to issue a tax statement upon the profits of Oracle in Kuwait. Al Ghanim challenged the Ministry's order and objected to the assumption that it had served as a domestic agent for Oracle. The Court of First Instance examined

[397] Article 287 Commercial Law 68/1980.
[398] Article 297 Commercial Law 68/1980.
[399] A person authorized by a principal to enter into a binding contract with a third party on the principal's behalf within the scope of that authority, see interpretive notes of Tax Decree 3/1955.
[400] Case No. 351/2001, The Court of First Degree, Commercial circuit/ 5.

the contract between Al Ghanim and Oracle and found that the latter had authorized the former to enter into contracts with third parties on its behalf, and to carry out marketing activities for Oracle. Therefore, the court found that the relationship between Al Ghanim and Oracle constituted an agency and Oracle's profits in Kuwait were taxable under the Tax Decree of 1955.

Al Ghanim appealed to the Court of Appeal[401]. It stated that its relationship with Oracle was that of a licensor and a licensee and that it was not an agent or a representative of Oracle. It further alleged that it maintained and sold software inside Kuwait to several parties while Oracle provided training services. It stated that all contracts it concluded were in its own name and for its own account and not in the name of Oracle or for its account, and that there existed no agency contract between the two companies.

The court indicated that should any dispute arise in regard to the description of a contract it was for the court to interpret the contract or the disputed articles therein and verify the intent of the contracting parties as long as the interpretation was within the text and meaning of the contract. The Court of Appeal upheld the decision of the Court of the First Instance by recognizing the relationship as an agency. The court concluded that the contract allowed Al Ghanim to contract with third parties. Also it was evident from the contract that Oracle was entitled to receive certain fees from Al Ghanim in return for undertaking its obligations to provide consultations. In the event, the Court of Appeal rejected the appeal and supported the ruling of the Court of First Instance, confirming that the relationship between Al Ghanim and Oracle was an agency, and that the revenue Oracle raised in Kuwait was liable to corporate tax in Kuwait.

It is concluded from these case studies that a distribution agreement between a principal and a local distributor does not yield a taxable income in Kuwait so long as the distributor does not have the authority to conclude transactions with third parties for his principal's account. Also the payment of commission from the principal to a distributor does not necessarily qualify the relationship as an

[401] Appeal No. 1422/2001, Commercial Appeal Circuit/5, 27/3/2002.

agency. The courts need to examine each case separately and to look closely at the provisions of the contract between the foreign company and the domestic merchant to determine whether or not the relationship does constitute an agency.

After attending to the Income Tax Decree's most problematic Articles and definitions and before moving on to the 2008 amendments of the Decree, it's important to explain the meaning of 'Income' and how the computation of tax is carried out under the Decree.

### 4.5 Meaning of Income and Computation of Tax under the Income Tax Decree 3/1955

The Income Tax Decree 3/1955 defines income as the gains and profits of a body corporate derived from carrying on trade or business in Kuwait[402].

Under the Income Tax Decree 3/1955, taxable income is derived by deducting all costs, expenses and losses incurred in connection with carrying on trade or business in Kuwait from gross revenue[403] and after the adjustment of certain costs such as staff indemnities, depreciation as per tax rates, head office administrative overhead allowance, etc.

Taxable profit of foreign shareholder's participation in local enterprises is determined on its share of the taxable profit; when the foreign share in the company is 49%, the tax inspector computes all the taxable profits of the enterprise as if it was fully foreign owned, then the inspector computes 49% from all the profits to show the share profit of the foreign entity. In the case where the foreign enterprise is carrying on business or trade in Kuwait through an agent, the

[402] Article 2 (h) of the Income Tax Decree 3/1955.
[403] Article 3 of Income Tax Decree 3/1955.

same procedure is carried out; 3.5% is allowed as agent's commission[404] any commission paid in excess of 3.5% is added to the taxable profits[405].

As was mentioned at the beginning of this chapter[406], the Income Tax Decree 3/1955 was amended in some respects in 2008. Not all the articles of the Income Tax Decree were amended in 2008, in fact only four amendments can be considered significant; the explicit exemption of the national sole distributor who buys and transfers goods to his own account, the reduction of the tax rate imposed, the reduction of some allowances, and finally the withholding of a 15% tax on foreign earned dividends whilst excluding trading profits.

### 4.6 The 2008 Amendments

In 2007, the Kuwaiti Parliament approved a bill amending Tax Decree 3/1955. The Kuwaiti government introduced these amendments with a view to attracting more FDI. Law 2/2008 was passed by the Kuwaiti Parliament in December 2007 and was published in Kuwait's Gazette in February 2008. This law amends a number of the articles in Tax Decree 3/1955; it also repeals others[407].
Kuwait's Government found that the majority of the profits of foreign enterprises engaging in business in Kuwait fell within the K.D. 375,000 slot and thus were taxed at the highest tax rate of the income tax table[408]. A rate of 55% income tax on the net profit of foreign enterprises was considered a very high tax rate and not a very competitive one, especially when compared at that time to neighbouring countries such as Saudi Arabia which imposes a 30% tax on the net profits of

[404] Administrative Order No. 274/1998.
[405] Al Bazie (note 319 supra).
[406] See pp. 99-100.
[407] Articles 1, 3, 7, and provision 2 (f), and provision a (5) have been amended. Article 2 (h) is now 2 (g) and 2 (i) has been amended to Article 1 and 2 (j) has been replaced by a single flat tax of 15%, and new Articles 13 (bis) and 13 (bis A) have been added by Law 2/2008.
[408] See tax table p. 109.

foreign corporations[409]. In Bahrain the rate is 46%,[410] whilst in UAE there are no corporate income taxes except a 55% rate on foreign oil companies, and a 20% on foreign banks[411]; Oman imposes 30% on foreign companies[412] and finally Qatar has a gradual tax rate between 5% - 35% on foreign corporations[413].

The government realized that in order to make its tax system more attractive to foreign investors[414] and more competitive in the region it needed to amend the tax rate, and so a new low flat tax rate of 15% was introduced on all body corporates carrying on business in Kuwait. The reduction in the tax rate was one of the significant 2008 amendments (see later) [415] but the focus here is the 2008 amendments and their impact on the meaning of agency for tax purposes.

### 4.6.1 Article 2 of Tax Law 2/2008 Explicitly Excludes the Sole Distributor from Tax Liability

Under Tax Law 2/2008, both the definitions of 'taxpayer' and 'body corporate' have not been changed; they appear exactly the same as they were in Income Tax Decree 3/1955[416]. However when it comes to the definition of agent for tax purposes, the amendments in Tax Law 2/2008 differ from Tax Decree 1955. Here, Tax Law 2/2008 clearly and explicitly exempts a distributor[417] from the meaning of 'agent' for income tax purposes. Article 2 (f) of Tax Law 2/2008 provides:

"The term 'Agent' mentioned in (e) means, the authorized person by his principal to practice the business or trade or any of the activities provided in article (1) of

[409] Ernst & Young (2010), World Wide Corporate Tax Guide, 2010, p. 57.
[410] Association of International Life Office (2007), Bahrain Tax Facts, pp. 1-2.
[411] KPMG's International Tax Centre (2006) KPMG's Corporate Tax Rate Survey, p.23.
[412] Foreign trade Barriers, The Office of the United States Trade Representative, p. 461.
[413] Ernst & Young, Middle East Tax Review, 2010, p. 2.
[414] In a view that revenue brought into the state by FDI can possibly create a source of income.
[415] See pp. 142 - 145.
[416] The definition of Body Corporate in Article 2 (e) of the 2008 amendments is the exact replica of 2 (f) in the Income Tax Decree 3/1955, see definition of body corporate on pp. 109-110 and definition of taxpayer on pp. 109-112.
[417] The definition of the Kuwaiti distributor in Article 2 (f) Tax Law 2/2008 is different from the definition of 'distributor' in Article 286 Commercial Law 68/1980, see p. 115.

this law or to contract with a complied agreement with third party on behalf of his principal and for his account and within the authorized power given to him, that the profits of the Kuwaiti merchant, of his sale to some goods he bought and transfer to his own account shall not be subject to this tax."[418]

So the definition of agent in the 2008 amendments differs from the definition of agent in Tax Decree 3/1955 in that it is more expansive then the interpretative notes of Tax Decree 3/1955 which defined an agent as follows:

"An agent is a person authorized by a principal to enter into a binding contract with a third party on the principal's behalf within the scope of the authority".[419]

The above definition of 'agent' in Tax Law 2/2008 states the functions which the agent can carry out when authorized by his principal i.e. business or trade or any of the activities provided for in Article (1) of Tax Law 2/2008. Such activities include concluding contracts, selling, leasing, granting franchises, and exploiting trademarks, patents design or copyrights, other activities include entering into representation agreements, commercial mediation, undertaking industrial and commercial businesses, disposing of assets, the selling of properties and goods, the leasing of property and finally rendering any services. To this point, the definition of 'agent' in Tax Law 2/2008 seems to coincide with the previous definition of agent in Tax Decree 3/1955, although the new definition adds more detail by explicitly referring to the commercial and industrial activities listed in Article 1 that can fall within the authority of the agent.

A confusion similar to that in Income Tax Decree 1955 on whether a natural person can serve as a national agent for a foreign enterprise[420] or not, rises again

[418] Article 2 (f) of Tax Law 2/2008.
[419] The definition of agent in the interpretative notes of Tax Decree 3/1955, p. 9.
[420] See pp. 122 – 136.

in the 2008 amendments, as Article 2 (e) of the amendments repeats the same mistake as 2 (f) of Decree 3/1955 by requiring the agent to be a body corporate[421]:

"The term body corporate ... includes any body corporate carrying on trade or business in Kuwait... through an agent, provided such an agent is a body corporate.." [422]

However 2 (f) of the 2008 amendments provides that the term agent in (e) means an authorized person , without specifying whether that person is natural or legal.

Then there are the Bylaws of the 2008 amendments, where Article 1 (3) provides that an agent is:

"Every and each natural or corporate person authorized by his principal to carry out business, trade or any of the activities stipulated in the law or to enter into a binding agreement with a third party on behalf and for the account of his principal within the limits of his powers..." [423]

The bylaws contradict Article 2 (e) of the 2008 amendments by asserting that a natural person can in fact serve as a national agent for a foreign enterprise carrying on trade in Kuwait. This confusion and contradiction can be attributed to the poor wording of the amendments which will be underlined again below[424].

What is particularly interesting in the new definition of 'agent' is whether the legislator has succeeded in distinguishing between an agent and a distributor which under the previous Tax Decree 3/1955 was a matter of debate until Ministerial Resolution 287/2006 was issued[425]. Is it possible now under the new definition to identify clearly and easily when an agency is established for tax purposes, with the consequent effect this may have for foreign enterprises?

---

[421] See p. 122.
[422] Article 2 (e) of the 2008 amendments.
[423] Article 1 (3) of the 2008 Amendments Bylaws.
[424] See p. 141.
[425] See p.125.

In this respect there may be some uncertainty. Although Article 2 of Tax Law 2/2008 clarifies that a national merchant buying foreign products for his own account and reselling them in Kuwait for his own account will not be an agent for tax purposes, this fact can be easily concluded as it has been established[426] that national companies are excluded from income tax in practice, even when such a company is serving as a national agent for a foreign enterprise, although in this last case the foreign principal is liable for income tax.

The position of a foreign supplier under Tax Law 2/2008 has not changed either; the foreign company is not taxed on the profits it makes when it supplies a national distributor with products while the distributor sells the product to his own account in Kuwait and bears all expenses vital to the selling the product i.e. marketing and promoting, etc. This is the same practice as under Tax Decree 3/1955, where as long as the distributor does not have the authority to conclude contracts on behalf of his foreign principal, the latter will remain excluded from tax in Kuwait[427]. However, the later part of Article 2 (f) of Tax Law 2/2008 which exempts the national distributor from agency status is poorly drafted:

"...that the profits of the Kuwaiti merchant of his sale to some goods he bought and transferred to his account shall not be subject to this tax.[428]"

Despite the poverty of the drafting, this final part of Article 2 (f) of Tax Law 2/2008 appears to restate the intent of the 2006 Ministerial Resolution that domestic distributors (Kuwaiti merchants) do not qualify as agents for income tax purposes.[429] Also, although this part of Article 2 (f) of Tax Law 2/2008[430] appears

[426] See p.100.
[427] See pp. 122 - 136.
[428] Article 2 (f) of the 2008 Amendments.
[429] See pp. 122-136 for a discussion on the agency and distribution contract with supporting cases.

to exempt the distributor, it does not describe him (the Kuwaiti merchant) as a 'sole distributor', which is how the distributor is defined in Commercial Law 68/1980:

"a distributor promotes and distributes a product in a certain territory, as long as he is the sole distributor in that territory."[431]

Not requiring that a distributor be the 'sole distributor' may allow more than one Kuwaiti merchant to buy and sell the same foreign principal's product on their own account in Kuwait and still avoid being classified as an agent in Kuwait for tax purposes. What could also result from this broad exemption is that a foreign principal may supply products to more than one Kuwaiti merchant (distributor) and make profits without bearing any tax liability in Kuwait, on the basis that he (the foreign principal) is only a supplier and his relationship with the Kuwait merchant is merely a non taxable distribution relationship.

Neither does the definition of agent in the bylaw of Tax Law 2/2008[432] mention the sole status of the distributor, thus echoing Article 2 (f) of Tax Law 2/2008 by not requiring that a distributor be a sole distributor.

Ministerial Resolution 287/2006 mentioned earlier[433], clarifies the difference between agent and distributor for the purpose of excluding the 'sole distributor' as an agent for tax purposes.[434]

---

[430] See p.138.
[431] Article 286 of Commercial Law 68/1980.
[432] See p. 139 for definition of agent in Article 1 (3) of the 2008 Bylaws.
[433] See p. 125.
[434] Resolution 287/2006 provides: "the agent in this law is referred to the person authorized by the principal to conclude agreements on his behalf with a third party within the given authorities, which will exclude the sole distributor from the scope of implementation of the income tax decree."

The second significant reform brought by the 2008 amendments is replacing the progressive tax rate under the Tax Decree with a single flat tax rate of 15%.

### 4.6.2 The Tax Rates Before and After the Amendments of Tax Law 2/2008: From a Progressive Tax Rate to a Flat Tax (Article 1 of Tax Law 2008)

Changing the tax rate from a progressive 5% - 55% rate[435] to a single flat 15% tax rate, can be considered the most significant amendment made to Tax Decree 3/1955. Tax Law 2008 amends Article 1 of Tax Decree 3/1955, where Article 1 of the 2008 amendments provides:

"An annual income tax is hereby imposed on the income of every body corporate wherever incorporated, carrying on trade or business in the state of Kuwait, particularly:

1. The profit realized from any contract that may be totally or partially completed in the State of Kuwait.
2. The amounts collected from the sale, lease, granting franchise to use or exploit any trademark, patent design, or copyrights.
3. Commissions due or resulting from representation agreements or commercial mediation.
4. The profits of the industrial and commercial business.
5. Profits realized from disposing assets.
6. Profits resulting from the purchase and the sale of properties, or goods, related rights and opening a permanent a permanent office in the State of Kuwait where in sale and purchase contracts are concluded.
7. Profits resulting from the lease of any properties.
8. Profits resulting from rendering any services.

However Tax amounts in accordance with this law is hereby fixed at 15% of net taxable income[436].

[435] See tax rate table p. 109.

[436] It should be noted here that the term 'income' has the same definition as in the Tax Decree 3/1955, Article 2 (g) of the amendments of Tax Law 2/2008 provides: "The term 'income' means gains and profits of a body corporate derived from carrying on trade or business in Kuwait".

The profits of the incorporated entity resulting from trading operations within the Kuwait Stock Exchange shall hereby be exempted from the tax already imposed under this law, whether it has been executed directly or via portfolios and investment funds"[437].

Thus Article 1 outlines the commercial activities which yield taxable income[438], and it's evident from Article 1 that the 2008 Amendments like the Income Tax Decree of 1955[439] do not differentiate between different types of income and profits, thus everything from business profits, capital gains, royalties and interest fall under a single income tax base and all is taxed under a 15% tax rate after deducting all expenses[440]. Article 2 (g) of the 2008 Amendments provides:

"The term income means gains and profits of a body corporate derived from carrying on trade or business in Kuwait".

Distributed dividends, however, are subject to a withholding tax of 15%; this will be discussed in more detail below.[441]

This non differentiation in the treatment of different types of income and profits can cause uncertainty when the foreign beneficiary transfers' revenues yielded in Kuwait to its state of residence, where the latter requires a clear statement distinguishing between taxes paid on each type of income, in order to grant tax credit. Although Kuwait's Double Tax Treaties differentiate between their tax treatment of different profits and incomes, this will be discussed in more detail in Chapter 6.[442] The Kuwaiti Department of Income Tax have, however, confirmed

[437] The exact wording of Article (1) of Tax Law 2/2008.
[438] Taxable Income means: Net Income, and Net Income means: The gross income realized by the tax payer after allowable expenses. See interpretive notes of the amendments of Tax Law 2/2008, p. 20.
[439] See p. 101-102.
[440] Article 1 (9) of the Bylaws of the 2008 amendments provide: "Net Income is the gross income realized by the taxpayer after allowable deductions". Article 1 (10) of the same Bylaws provides: "Taxable income is net income".
[441] See p.151.
[442] See pp.182-233.

that a statement of the treatment of different types of income is given to the tax payer upon request[443].

Focusing again on the extreme drop in the tax rate applied to foreign taxable income needs more attention here. Although a reduction in the tax rate is welcome especially for foreign companies with incomes that exceed K.D 56.250 whom according to the previous progressive tax rates used to pay between 20% to 55% tax on their income, it is on the other hand very damaging for small businesses with incomes of K.D 56.250 and under, who used to (under the Decree) pay between 5 – 10% tax, now under the amendments pay 15% tax, which means they now pay 5% - 10% more tax than they did under the Decree. Furthermore, although no exclusion of domestic companies from tax is provided for in the amendment, in practice, national companies are still exempt from tax in Kuwait. This exclusion and favourable treatment of national companies is due to the facts mentioned earlier in this chapter.[444]

It should also be mentioned here, that in practice the income of natural persons whether nationals or foreign, was excluded from tax under the Income Tax Decree 3/1955. The 2008 amendments, however, explicitly exempt the income of natural persons, where Article 8 (2) of the executive bylaws of the 2008 amendments provides:

"Without prejudice to the exemptions stipulated under the provisions the Decree and its amendments and the provisions of other laws or international treaties, the following shall be exempted from tax:

[443] From a personal interview conducted with the head of the Tax Claims division at the Kuwaiti Tax Department, 12/3/2009.
[444] See p. 100 and p. 112-113.

2. The income realized by a natural person (shareholders) from practicing a trade or business in the state of Kuwait unless he proves that he is representing the share of an incorporated body."[445]

Thus a natural person (national or a foreign) shall not be liable to pay income tax Kuwait unless proven to be a representative of a corporate entity.

As has been mentioned before[446] the 2008 amendments have brought some change to the Income Tax Decree 3/1955. The explicit exclusion of the national sole distributor from tax liability and the reduction of the tax rate have already been discussed above. However, some amendments have also been made to allowable and disallowable expenses and finally, the withholding of 15% tax on foreign earned dividends whilst excluding trade profits.

### 4.6.3 Reducing the Allowable Expenses

The 2008 amendments have had some effect on the allowable and disallowable expenses implemented recognised in Tax Decree 3/1955. The amendments of Tax Law 2/2008 reduce some of the allowable expenses in Tax Decree 3/1955. This reduction is perhaps surprising when the amendments were introduced in order to attract FDI to Kuwait.

The Tax Decree 3/1955 was supported by Administrative Circulars issued by the Department of Income Tax. Issues such as allowable expenses were not provided for specifically within the Tax Decree 3/1955 and thus guidance on issues such as

[445] Article 8 (2) of chapter 2 of the Executive Bylaw of Law No. 2/2008.
[446] See pp. 136-137.

these had to be made official in these binding Administrative Circulars in order to unify the basis of tax inspection. These circulars were issued and enforced by the Director of the Department of Income Tax (DIT) and they were binding. Article 10 of Tax Decree 3/1955 simply stated:

"The director shall administer and enforce this decree...[447]"

So the circulars relate to the administration of tax issues not covered by the articles of the law such as conditions for filing a tax declaration[448] and the maximum rate for the commission that an agent or a guarantor is allowed to deduct from taxable income[449]. Further, some tax practices were regulated through Administration Orders and Ministerial Orders which were issued by the Minister of Finance and are also binding according to Article 13 of the 2008 amendments; the Article states:

"The Minister of Finance will issue the executive regulation within six months from the date of publishing this law in the official gazette."

By clarifying issues not made clear in the Decree such circulars and Orders unify the base of taxation. They cover vital allowable and disallowable expenses of taxable income. It's crucial here to outline the most important amendments made to allowances in 2008.

**Head Office Expenses and Agent Fees**

Head Office Expenses and Agent fees were under the Income Tax Decree 3/1955 as follows:

[447] An exact replica of Article 10 as reproduced in the amendments of Tax Law 2/2008.
[448] Circular No. 37/2002.
[449] Circular No. 34/2002.

1. In the case of contractors and others operating through an agent only 3.5% of revenue is allowed as head office expenses (excluding sub-contract costs);
2. Foreign shareholders: in this case foreign entities who are shareholders in Kuwaiti companies can only deduct 2% of their foreign entity's share of revenue from their taxable income as head office expenses. This is also applied to joint ventures[450].
3. Insurance companies operating in Kuwait shall be allowed to calculate and add to their expenses 3.5% of their net premiums (direct premiums, less the share of re-insurance, plus re-insurance commission collected)[451].

**After the 2008 amendments the agent fees were reduced as follows:**

1. Agent's fees are restricted to 3% of contract revenue excluding reimbursed revenues, subcontracts costs and other income;
2. Agent's commission shall not be calculated in the case of foreign companies participating in Kuwaiti companies. It will also not be calculated in joint ventures where the partner is the agent[452].

The Head Office Expenses were reduced as follows:
"The expenses of the head office shall be debited... after deducting the following:

1. The works executed by subcontractors and the like;
2. Incidental revenues;
3. Reimbursed costs;
4. Design costs (except for the design costs of the head office)."

The branch share of the head office expenses is as follows:

1. The companies operating in Kuwait are allowed to calculate and add 1.5% of the direct revenue realized in the state of Kuwait, less the amount in paragraph (1)
2. Body corporates which are partners in Kuwaiti companies, or firms participating in Kuwaiti companies or companies carrying out contracts, are allowed to calculate and add 1.5% of the revenues realized in the state of Kuwait, less the amount in paragraph (1). This rate shall be deducted from the share of the foreign partner.

[450] See p. 118.
[451] Administration order No. 274/1998.
[452] Circular No. 34/2002,

3. Insurance companies operating in Kuwait are allowed to add 1.5% of the direct premiums less the reinsurance rate and plus collected insurance commission.
4. Banking companies are allowed to add 1.5% of the direct revenues realized in the state of Kuwait less the amount stated in paragraph (1)[453].

### 4.6.4 The Method of Deducting Allowable Expenses from National Companies with Foreign Shareholders

No provision is made for the calculation of allowable expenses of national companies with foreign shareholding under Tax Decree 3/1955 or the 2008 amendments. However, in practice, when there's a joint venture or a shareholding company where a national owns 51% of the company while the foreign partner owns 49%, the first thing a tax inspector does is to disregard the fact that 51% of the company is under national ownership i.e. exempt from tax liability. The tax inspector will do a full inspection of the company as if it is a 100% foreign owned company and disallow all allowable costs available. Thereafter the inspector takes only 49% of the total disallowances which equals only that portion of disallowances relating to the foreign share of the company[454]. Below is an example[455]:

[453] Article 5 of the 2008 Amendments.
[454] This practice was undertaken under Tax Decree 3/1955, and is still followed today after the amendments of Tax Law 2/2008. This practice is not in any formal legal shape such as a tax department circular or a ministerial order, it is also not mentioned in the existing laws.
[455] This computation example was provided by a practicing tax auditor in Kuwait.

| Net Profit as Per Tax Declaration = KD 570,603[456] | |
|---|---|
| Add: | KD |
| 1. Insurance expense | 42,580 |
| 2. Salaries | 41,070 |
| 3. Communication expenses | 12,812 |
| 4. Advertising expenses | 76 |
| 5. Stationary expenses | 2,477 |
| Total Additions = 99,015 | |
| Share of foreign partner 49% = | 48,517 |
| Net profit subject to tax | 619,120 |
| Tax due at 15% | 92,868 |
| Less: paid as per declaration | 85, 590 |
| Due amount | 7,278 |

[456] In Kuwaiti Dinars (KD).

Further under the old circulars, insurance companies were allowed to deduct 3.5% of their net premiums (less the share of re-insurance, plus collected re-insurance collected), Today, under the 2008 amendments, the rate is lowered to only 1.5%. As for Agent fees, foreign companies used to be able to deduct 3% of what they paid their national agents from their taxable income (under the old circulars), today they can only deduct 1%. This leads to the conclusion that although the tax rates were reduced[457], the allowable expenses on the other hand were reduced as well, undermining the objective of the lower tax rate (15%) imposed by the amendment of Tax Law 2/2008.

### 4.6.5 The Depreciation of Assets According to the Income Tax Decree 3/1955 and the Amendments of Tax Law 2/2008

Most of the depreciation rates on buildings and equipment of foreign enterprises carrying on business in Kuwait have not changed. However some of them have been reduced[458] causing the taxable income of foreign companies doing business in Kuwait to rise[459].

There is no clear explanation why the amendments of Tax Law 2/2008 have reduced the allowable expenses. However, in personal correspondence with

[457] See pp.142-145.

[458] Under the 2008 Amendments; the depreciation rate of plants and buildings was reduced from 20% to 10% Amendments also the depreciation rate of Drilling equipment has been reduced from 33 1/3% to 25% , Cars were reduced from 33 1/3% to 20% and finally Trucks and Trailers were reduced from 25% to 15%.

[459] Article (3) of the amendments of Tax Law 2/2008 covers asset depreciation, and Article (4) the bylaw of Tax Law 2/2008 covers the depreciation rates of companies.

Kuwait's Tax Department[460] enquiring why the allowances were lowered when the objective was to lower the tax liability in order to attract more FDI to Kuwait, the department's justification was that since a significant reduction was made to the tax rate, there was a need to compensate for the loss in tax revenues by reducing some of the allowances. A number of foreign companies doing business in Kuwait have indicated to the author that the drop in the tax rate – from a progressive rate between 5% - 55%[461] to a 15% flat rate under the 2008 amendments, has not really accomplished the decrease which they had hoped to see in their tax liability. The companies confirmed that although the overall tax rate upon their taxable income has dropped, the deductions which they are entitled to on agent fees and head office expenses have dropped too, causing the incentive behind lowering the tax rate – attracting more foreign business – to lose its effect. The attitudes of foreign enterprises working in Kuwait towards the amendments of Tax Law 2/2008 will be the focus of Chapter 7.[462]

The final significant 2008 amendment is the withholding of 15% tax on foreign earned dividends by the distributing company whilst excluding trade profits.

### 4.6.6 Withholding a 15% Tax on Dividends and Exempting Trade Profits

As previously emphasized[463] the 2008 amendments are poorly drafted, the amendments themselves do not tell us directly that a withholding tax is imposed on profits distributed to foreign beneficiaries, however, the amendments loosely imply this by explicitly excluding trade profits, initially in Article 1 of the

[460] Correspondence with Head of the Tax Department, Ms. Aseel Asad, 12/5/2009.
[461] See page 109 for the tax table under Tax Decree 3/955.
[462] See pp. 251-261.
[463] See p. 141.

amendments and again in Article 8 (1) of the Executive Bylaws of the 2008 Amendments[464].

Article (1) of the 2008 amendments provides:

"The profits of the incorporated entity resulting from trading operations within the Kuwait Stock Exchange shall hereby be exempt from the tax already imposed under this law, whether it has been executed directly or via portfolios and investment funds"

Article 8 (1) of the Executive Bylaws provides:

"... the following shall be exempt from tax:

1. The incorporated body's profit resulting only from trades in Kuwait Stock Exchange Market, whether directly made or through investment portfolios or funds."

Although the legislator here does not clearly differentiate between distributed and undistributed profits, in practice[465], dividends earned by a foreign beneficiary[466] and distributed by a national company registered in Kuwait Stock Exchange (KSE) shall be subject to a 15% withholding tax, where the national company distributing the dividends withholds 15% at source and forwards them to the Department of Income Tax (DIT)[467]. However if the foreign company who owns shares in a national company registered in KSE sells its shares in the market and makes gains due to such sales, then such profits shall not be subject to a 15% withholding tax.

---

[464] Profits and gains but not collected by the foreign beneficiary. As long as such trade profits remain in Kuwait Stock Exchange (KSE) they remain exempt from taxation, once they are distributed then they are taxed in the hands of the distributed company.

[465] Through communication with Department of Income Tax in Kuwait via e-mail between myself and tax auditor Mr. Ravi Kumar, May 12th 2011.

[466] Only a foreign enterprise is taxed upon dividends in Kuwait, as natural persons foreign and national are exempt.

[467] The national distributing company is responsible for withholding a 15% tax upon dividends distributed to foreign beneficiary and forwarding such taxes to the DIT within 30 days.

When a foreign enterprise yields dividends in addition to other profits due to carrying on trade or business in Kuwait directly by holding 49% of a national enterprise or indirectly through an agent, this situation will not give rise to double taxation, as the national company will withhold 15% on the dividends at source and forward them to the DIT. The foreign enterprise is required to report the 49% profits it had made through holding shares in a national company to the DIT, where the latter imposes tax on such profits minus the 15% withheld tax already forwarded by the distributing company[468].

The 2008 amendments are clear in their exemption of trading profits made by foreign enterprises holding shares in domestic enterprises registered in KSE, but not explicit on their treatment of dividends. Through personal communication with Kuwait's DIT enquiring on the position of dividends, the department confirmed that dividends are taxed with a rate of 15% at source while profits made by foreign shareholders in KSE are exempt.

### 4.7 Conclusion

This Chapter has provided an outline of the Kuwaiti fiscal system before and after the 2008 amendments and has highlighted the ambiguities and disadvantages of the Kuwaiti tax system under the Tax Decree 3/1955 and the 2008 amendments. The amendments have carried on a lot of the previous Decree's inefficiencies and

[468] The same process is carried out if the foreign enterprise carries on trade or business in Kuwait through an agent. This information is provided by Tax Auditor Mr. Ravi Kumar, The Department of Income Tax, Kuwait, May 12th 2011.

the study below proves there is scope for improvement and reform[469], however, if tax reform is unavoidable special attention should be given to any regional or international obligation which might impose some restrictions upon the ability of Kuwait to undertake reform. The next chapter explores the Unified Economic Agreement and WTO agreement to which Kuwait is a party and examines whether this economic agreement provides any limitation on Kuwait's ability to undertake fiscal reform.

[469] See Ch. 7, pp. 289-292.

# Chapter 5: International Tax Obligations I The Unified Economic Agreement of the Gulf Co-operation Council: A study of the UEA agreement and its impact on Kuwait's Fiscal Sovereignty.

## 5.1 Introduction

Tax competitiveness has become a crucial matter which each country must consider carefully, as harmful tax competition can hurt a state's prospect of attracting foreign direct investment.

Kuwait is a member of the Gulf Co-operation Council Unified Economic Agreement (UEA) to which other Gulf States (Saudi Arabia, Bahrain, UAE, Qatar, and Oman) with mutual economic and fiscal similarities are also a party. This chapter examines this agreement and whether or not the UEA imposes any restrictions upon Kuwait in reforming its fiscal system and its fiscal sovereignty.

The first unified economic agreement was implemented between the members of the Gulf Co-operation Council (GCC) in 1981. However this agreement was later amended in 2001. Thus there is a need to dedicate some attention to the early 1981 unified economic agreement (UEA) then give some focus to its amendments in 2001.

## 5.2 The UEA in 1981

### 5.2.1 What is the UEA?

Investors from the six Member States of the GCC, which as seen above are Saudi Arabia, Kuwait, Bahrain, Qatar, UAE and Oman, are entitled to a wide range of reciprocal entitlements, benefits and privileges. The UEA which originated in the GCC is ratified by all of its Member States and gives all the citizens of the GCC countries equal treatment in other Member States without any discrimination or differentiation in the following domains[470]:

(1) The freedom of movement; and

(2) The right of ownership, guiding and bequeathing; and

(3) The freedom to conduct economic activity; and

(4) The freedom of transfer of financial institutions[471].

The first UEA was signed in Riyadh, Saudi Arabia, on 11 November 1981 and it came into operation four months from the date of signature. Its first chapter, Articles (1-7), deals with commercial exchange and requires free movement within the GCC of agricultural produce, livestock, industrial products and products from natural resources of national origin and their treatment on an equal basis with the goods produced in each member state. Article 1 provides:

"a. The member states shall permit the importation and exportation of agricultural, animal, industrial, and natural resource products that are of national origin. Also they shall permit exportation thereof to other member states;
b. All agricultural, animal, industrial and natural resource products that are from member states shall receive the same treatment as national products."
Article 2 provides:

a. all agricultural, animal, industrial and natural resource products that are of national origin shall be exempted from reciprocal charges;
b. fees charged for specific services such as demurrage, storage, transportation, freight or unloading, shall not be considered as customs duties when they are levied on domestic products.

---

[470] These domains are set out in the UEA of 1981; see Article 8 of Chapter 2.
[471] Al Hayyan, A. (2003) *The Kuwaiti Foreign Investment Law: Comments and Suggestions*, Arab Law Quarterly, p.328.

As has been mentioned in Chapter four of this thesis,[472] Kuwait had traditionally imposed a 4% duty on all imported goods. Other Member States of the GCC imposed different rates of import duties on foreign goods entering their territories[473]. Under the UEA such duties are abolished when the goods imported are products which are produced in any of the GCC Member States. This is according to Article 2 (a) above which states that:

"... products that are of national origin shall be exempted from reciprocal charges[474]".

Article 3 (a) of the UEA provides that 'products with national origin' means:

"For products of national origin to qualify as national manufactured products, the value added ensuing from their production in Member States shall not be less than 40% of their final value as at the termination of the producing plant shall not be less than 51%".

The above Article provides the conditions required in order to designate industrial products as "national products" which enjoy exemption from Member States duties, Article 3 (a) requires products to have additional value added to them during their production in the GCC countries, and that this added value is not less than 40% of the final value of the product upon completion of its production and that the producing company is fully owned by nationals of GCC countries or a minimum of 51% is owned by GCC nationals[475].

Article 3 (2) states how to prove that such products satisfy the rule of national origin which will entitle them to be exempt from import duties when entering any of the GCC Member States it provides:

"Every item enjoying exemption hereby shall be accompanied by a certificate of origin duly authenticated by the appropriate government agency."

---

[472] See p. 102.
[473] GCC Member States had different import tariff rates implemented before the UEA's Customs Union came into force in 2001: Kuwait, Qatar and UAE all imposed a 4% import tariff, while Bahrain, Saudi Arabia and Oman all had an escalating tariff structure ranging between 12% to 20%.
[474] The different rates of import duties imposed in each of the Member State of the GCC.
[475] The GCC Unified Economic Agreement and Customs Law, 2002.

A customs free entry into Member States of the GCC for national products is not the only advantage which the UEA provides for products that are of national origin. Such national products are also entitled to the 'National Treatment' given to local products in the Member State where they are imported, Article 1 (b) provides:

"... products that are from Member States shall receive the same treatment as national products."

'National treatment' - for products of national origin - here means allowing importation and exportation of national products throughout the GCC States without the requirement of a local agent or taking any other procedures except for the certificate of origin and the export manifest. And in the event of duties being levied on any national origin goods due to questions as to their origin, those duties shall be reimbursed to the importer after their national origin[476] has been ascertained.

As mentioned in chapter 4[477]Kuwait does not follow the WTO's MFN and National Treatment principles by providing a more favourable treatment to national enterprises which are excluded (in practice) from the income tax Kuwait imposes on foreign enterprises carrying business in its jurisdiction; Kuwait's favourable treatment of its national entities has not been challenged by the WTO[478]. However, there is here another breach of the WTO agreement, where the GCC provides National Treatment for GCC companies i.e. companies with 51% of shareholding belonging to nationals from GCC states. The UEA also provides

[476] Objectives of the Trade Cooperation between the GCC States, The GCC Website, http://www.gccsg.org/eng/index.php?action=Sec-Show&ID=56 [visited on 5/9/2010].
[477] See pp. 113-114.
[478] See WTO websites.

National Treatment for products of national origin, i.e. products that have been produced in GCC, states and exempts such products from import duties; this favourable treatment is not available for foreign products imported into GCC states. There are no cases where the GCC's treatment of GCC companies and GCC products was challenged by the WTO.

In the second chapter of the 1981 agreement, Articles 8-9 establish the principle of freedom for all citizens of Member States to move, work, reside, acquire property, engage in economic activity and transfer capital throughout the GCC. They also call for the encouragement of inter-state joint ventures in the private sector to help create the right climate for such interchange. Here states can impose restrictions, such as requiring certain degrees of local participation in certain GCC ventures for up to five years. In this respect, Kuwait, for instance, allows GCC citizens to own up to 75% of the capital of a Kuwaiti company formed for the pursuit of permitted activities under the UEA. Qatar has a similar provision. In addition, Kuwait has published Ministerial Resolution No. 75/1984 providing that nationals of GCC states shall enjoy the same employment conditions as Kuwaitis. Kuwait has also allowed GCC citizens to own shares in Kuwaiti shareholding companies through Decree No. 33 of 1988.[479] Decree No. 33/1988 was issued in an attempt to strengthen the economic, financial and commercial ties between the Member States of the GCC by allowing citizens from Member States to own shares in local Kuwaiti companies registered on the Kuwait Stock Exchange. Article 1 of the Decree states:

[479] Roy, J. and Zarrouk, J. (2006), *Completing the GCC Customs Union*, The World Bank, pp.5- 6.

"Citizens of the Gulf Co-operation Council may hold shares in Kuwaiti shareholding companies which were established at the time when this law came into force, and in Kuwaiti shareholding companies which were established after the implementation of this law".[480]

The third chapter (Articles 10-13) of the GCC UEA calls for co-ordinated development programmes, oil policy, industrial regulation and joint ventures in various fields.

Chapter four (Articles 14-17) is concerned with scientific co-operation where Member States are encouraged to negotiate "transfer of technology agreements with foreign governments jointly at GCC level".

Chapter five (Articles 18-20), recommends the free movement of passengers, and goods traffic (if not detrimental to local facilities), and calls for cooperation and integration in all fields. The UAE, for example, has ordered all insurance companies to recognize driver's licences issued in GCC states as equivalent to the UAE driver's licence. Oman has provided for the equal treatment of ships owned by GCC states or their nationals in Omani ports.

The sixth chapter (Articles 21-23), outlines the nature of financial and economic cooperation aspired to. Article 21 states that Member States shall seek to unify investment rules and regulations in order to achieve a joint investment policy aimed at directing their domestic and foreign investment towards serving their interest[481]. Article 22 states that Member States shall seek to coordinate their financial, monetary and banking policies, including the endeavour to establish a joint currency[482]. Lastly, Article 23 states that Member States shall seek to

[480] Article 1 of the Decree No. 33/1988 on allowing citizens from the GCC to hold shares in Kuwaiti shareholding companies.
[481] Article 21 of Chapter 6 of the 1981 UEA.
[482] Article 22 of Chapter 6 of the 1981 UEA.

coordinate their external policies in the sphere of international and regional development aid.[483]

When the GCC was established in May 1981, the aim and desire was to develop and enhance economic, monetary and financial ties between Member States by concluding the UEA. Within the Articles of the 1981 UEA lie the provisions of the GCC Free Trade Area (FTA), i.e. the FTA was characterised by the exemption of industrial, agricultural goods and the natural resources of the GCC States from customs duties subject to the presentation of a certificate of origin. (see above, Article 2 (a) and Article 3 of the 1981 UEA).

The GCC FTA came into force in 1983. It continued until 2001 when it was replaced through the amended UEA of 2001 by the GCC Customs Union[484]. When Member States agreed on the FTA with its main objective i.e. eliminating tariff on goods of national origin[485] while each country of the Member States maintained its own external tariffs, the GCC had a bigger ambition of an economic union whereby the FTA would serve as a preliminary step towards a Customs Union (CU) followed by an economic union. Thus, the FTA represented a modest integration by means of an agreement to apply symmetric preferential treatment of imports. The reason why the FTA was a strategic move towards the CU was that it abolished tariffs among Member States yet demanded little or no economic harmonization. The attractiveness of the FTA amongst the GCC States was the benefit of free trade between Member States without the immediate

[483] Article 23 of Chapter 6 of the 1981 UEA.
[484] Article 1 of Chapter 1 of the amended 2001 UEA. This Article states that trade between Member States will be conducted under the framework of a Customs Union that should be implemented by Member States no later than the first of January 2003.
[485]See p. 143 for Article 3 (a) of Chapter 1 of the 1981 UEA .

giving up of economic independence. The disadvantage of the FTA, however, and the reason why the FTA was a temporary measure for the GCC Member States, was that countries outside the area redirected their trade and targeted the country with the lowest tariffs in order to access the market within the area. Thus in order to prevent this problem which could have caused tension between the Member States, there was a need to adopt a form of economic integration, this took the shape of the CU which was implemented through the amended UEA and signed by Member States in 2001[486].

### 5.3 The Customs Union Realized under the Amended UEA of 2001

The UEA was in force until it was replaced in 2001 by the new "Economic Agreement between the States of the Cooperation Council" concluded at the GCC summit in Muscat in 2001.

Forming the UEA in 1981, the GCC Member States had already agreed on two main issues: first, they set up the objectives, rules and functions of the GCC and its structure; second, they decided on implementing gradually a unified economic agreement towards establishing an economic union. Thus, since the establishment of the UEA in 1981 and the insertion of the FTA within its Articles the plan to advance the economic integration between the GCC by implementing the amended UEA of 2001 and replacing the FTA with the CU already existed[487]. However, this advancement had to be achieved gradually due to the fact that the

[486] Although the CU was imposed by Article 1 of the amended UEA of 2001, the Member States had until January 2003 to implement it according to Article 1, Chapter 1 of the 2001 UEA.
[487] Rettab, B. and Istaitieh, A. (2007), *GCC Economic Integration in Focus with Special Reference to the UAE,* Dubai's Chamber of Commerce and Industry, pp.19-20.

CU, when compared to the FTA, required a much greater level of institutional integration. Under the CU, Member States do not only give up their capacity to set up external tariffs, but also harmonize and make compatible other aspects of their respective national trade policies[488].

The amended UEA of 2001 set out ambitious targets for the next stage of the integration process, drawing up a map for the creation of a fully integrated common market and preparation for a monetary union. In this respect, the Supreme Council of the GCC agreed on a timetable that called for the implementation of a CU in 2003[489], the establishment of guidelines, including criteria, for a Monetary Union by 2005, and finally the adoption of a single currency by 2010[490]. To date only the first of these three objectives i.e. the CU, has been introduced.

### 5.3.1 What is the CU?

As has been mentioned above[491], the UEA was amended in December 2001 during the GCC Summit. It called in its first Article on Member States to implement a CU:

"Trade between the GCC Member States will be concluded within the framework of a Customs Union that will be implemented no later than the first of January 2003. It shall include, at a minimum, the following:

i. A common external customs tariff (CET)
ii. Common customs regulations and procedures

[488] *Id*.
[489] The 2001 UEA introduced the CU and gave Member States until January 2003 to implement it, Article 1 of Chapter 1 of the 2001 UEA.
[490] Kamar, B. and Naceur, S. (2007), *GCC Monetary Union and the Degree of Macroeconomic Policy Coordination*, IMF working paper, pp.25-28.
[491] See p. 164.

iii. Single entry point where customs duties are collected
iv. Eliminating of all tariff and non- tariff barriers…
v. Goods produced in any Member State shall be accorded the same treatment as national products"[492].

In accordance with the Customs Union Agreement that followed in 2003[493] the GCC Heads of State adopted an across-the-board Common External Tariff (CET) of 5%[494] on most foreign products entering the GCC countries[495]. Certain commodities are exempted [496] and Member States may nominate a list of 'protected commodities' on which they charge a duty of 12% or 20%[497] .

The objectives of the CU include: 1) minimizing the difficulties and restrictions hindering the movement of foreign and national goods in the GCC countries, as it applies a single common duty of 5% on foreign goods at a single point of entry once, allowing foreign goods to move freely between Member States without collecting Customs Duties on such goods again; 2) increasing intra-GCC trade between members; 3) increased competition, high production rates, and optimal utilization of the available resources due to the facilitation of the flow of the intra-GCC trade leading to reduced consumer prices; 4) enhancement of the collective

[492] Article 1 of Chapter 1 of the 2001 UEA.
[493] The amended UEA was signed by Member States in December 2001, while the CU Agreement was signed in 2003.
[494] Article 1 of the CU Agreement of 2003 states: "An external Common Customs Tariff (ECT) charging a 5% duty rate on all foreign exports..."
[495] Article 1 of the 2001 UEA states: "Trade between Member States will be conducted within a framework of a Customs Union that will be implemented no later than the first of January 2003".
[496] Article 1 (i) of the CU Agreement of 2003 provides a list of 417 items of food stuff and agricultural products exempt from tariff and other goods such as tobacco, pork, and alcohol products attract a tariff of 100% taxed in countries (this differs from one Member State to the other) where importation of such products is permitted.
[497] For example Saudi Arabia identifies a list of 483 products to which a 12% tariff is applied to protect local industries and a 20% tariff is applied to infant industries.

negotiating position of the GCC Members, which would bring in better conditions with their trading partners in the field of trade and investment[498].

The CU is the most significant step taken by GCC states, through the UEA, towards realizing the economic integration which the Member States of the GCC aim for[499].

Boosting mutual trade is the main objective of any CU. Historically, continuous regulatory barriers contribute to low levels of intra-regional trade[500]. Several studies show that a CU of any economic bloc pushes up mutual trade[501]; intra-regional trade in the case of the European Union (EU) accounts for 60% of total trade in the EU[502].

However, trade between the states of the GCC has proven to be limited and the markets for goods and services across the GCC countries are far from being integrated. In fact, between the years 1980 and 2008, the share of intra-GCC trade in total GCC trade with the rest of the world rose from only 3.8 percent to 6 percent. This suggests that though there is a tendency for trade creation, the process of trade integration is very slow[503]. That said, there is no dispute as to the importance of the CU in enhancing GCC-foreign trade, as it allows foreign goods to move freely within the GCC Member States after having paid a single common

---

[498] See Rettab, (note 489 supra).

[499] The GCC Customs Union: Implementation Procedures of the Customs Union, the GCC website, http://www.gcc-sg.org/eng/index.php?action=Sec-Show&ID=84 [visited 1st of September 2010].

[500] *Id.*

[501] AL Twaijiri, M. (2007) *Customs Union: First Step towards GCC Integration*, Article Published in The Arab Times Daily News Paper, Kuwait, http://www.arabtimesonline.com/NewsDetails/tabid/96/smid/414/ArticleId/142708/ren/r/Default.aspx [visited 20/7/2007].

[502] Fink, S. and Krapohl, S.(2010), *Assessing the Impact of Regional Integration: Do Regional Trade Institutions Shape Trade Patterns?,* Paper prepared for the PSA conference 2010, p. 5.

[503] Nechi, S. (2010), *Assessing Economic and Financial Cooperation and Integration Among the GCC Countries,* Jouranl of Buisness and Policy Research, Volume 5. Number 1. July 2010, p. 158.

duty levied on them at the first point of entry into any Member State. Although between 2006 and 2010 an annual growth of 20% has been achieved in intra-GCC flow of national and foreign goods[504] there is reason to believe that the rise in the inter-GCC trade was not a result of implementing the Customs Union but due rather to the global economic downturn and a determination by the private sector in member states to expand regional co-operation[505]. The reason why the CU has not yielded the level of growth expected, is that it was not initially fully implemented by the GCC Member States. When the CU was proposed to come into force in January 2003 in the 2001 UEA[506], the GCC states agreed on a transitional period (1-3 years) covering the years from 2003 – 2006 for the partial application of the requirements of the CU[507]. During this transitional period certain customs procedures continued to be applied to intra-GCC movement of national and foreign goods. These procedures ceased to be applied from the end of the transitional period which was 2006. However, eight years from the launch of the CU in 2003, indecision between Member States over the distribution of tariff revenues, in addition to the persistent delays at border points are still hindering the full implementation of the CU[508].

Further, although the Customs Union is perceived to boost economic trade between GCC Member States, a final decision is yet to be made by the six

---

[504] Al Mazrooie, M. (2010), *The Process of the Customs Union of the Cooperation Council for the Arab States of the Gulf*, A Paper Produced for the GCC, Analysing the Development of Implementing the Customs Union in the GCC States from 2002-2010, pp. 8-10.
[505] Kawach, N. (2010), *Tariff Rift Delays Block Customs Union,* Zawya, http://www.zawya.com, [visited 28/12/2010].
[506] Article 1 of the 2001 UEA, see p. 142.
[507] The Supreme Council, in its 23rd Session held in Qatar (21 - 22 December 2002), approved the launch of the Customs Union of the GCC States as of 1/1/ 2003. It also approved the procedures and steps recommended by the Financial and Economic Cooperation Committee (the GCC Ministers of Finance and Economy) for the establishment of the Customs Union of the GCC States.
[508] Kawach (note 505 supra).

Member States on the modality for the distribution of customs revenues or the mechanism of collection[509].

The GCC has achieved slow progress in its efforts to overcome regional barriers and coordination between its Member States through the UEA which aims to enhance and strengthen economic ties among Member States and harmonize their economic, financial and monetary policies. Also the GCC's attempt to introduce a CU has not to this day been fully executed despite its launch in 2003[510].

### 5.4 How Far Can the UEA Influence Kuwait's Tax Reform?

The main objective of this chapter has been to examine whether or not the UEA imposes any restrictions upon Kuwait in reforming its fiscal system. To answer this question there is a need to differentiate between direct taxes and indirect taxes.

#### 5.4.1 The UEA has influence on Kuwait's Taxes

The UEA, which aims to achieve greater economic integration between the Member States of the GCC by unifying their Customs Duties, does not in its current form restrict Kuwait in reforming its domestic direct taxes such as income tax, Although Kuwait – and other Member States - cannot act in a way that is

[509]Shaheen, A. (2010), *GCC Countries Postpone Customs Union Move*, Gulfnews.com, p.1, http://gulfnews.com/business/general/gcc-countries-postpone-customs-union-move-1.678788, [visited 8/9/210].

contrary to the UEA when it comes to reforming their fiscal treatment of inter-regional trade i.e. their Customs Duties, therefore, Kuwait does not have the freedom to reform the 5% rate Customs Duties imposed by the UEA's CU as an obligation upon all the Member States to implement, however, Kuwait under the UEA must give national treatment to GCC owned enterprises i.e. exclude them from corporate income tax, see chapter 4[511].

[511] See pp. 100-101 and pp.112-114.

# Chapter 6: International Tax Obligations II Kuwait's Double Taxation Treaties [between the OECD and the UN Model Convention]: Finding an Approach to Attract Foreign Income

## 6.1 Introduction

When planning tax reform one cannot ignore the issue of double taxation and how it affects international commerce and a multinational's decision making. As has been seen in chapter four,[512] Kuwait's fiscal system focuses mainly on the taxation of the corporate income of foreign enterprises, i.e. the current tax rate of 15% is in practice only imposed on the net taxable income of foreign enterprises carrying on trade or business in Kuwait[513].

With taxation on foreign enterprise being the main source of tax returns in Kuwait, it is a concern of this thesis to consider reform of the Kuwaiti tax system in order to motivate FDI to enter Kuwait. This is precisely why it is important to study Kuwait's Double Tax Treaties (DTTs) and to understand Kuwait's fiscal attitude towards multinationals.

DTTs play a key role in facilitating FDI through eliminating the double taxation of foreign earned income[514] in addition to other purposes[515] thus, Kuwait's

[512] See p. 99 - 103.
[513] Article 1 of the 2/2008 Amendments.
[514] Barthel, F. Busse, M. *et al,* (2010), *The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence From Large Dyadic Panel Data,* Contemporary Economic Policy, Vol. 28, No. 3, pp. 366-377, July 2010.
[515] Other important purposes of DTTs include the exchange of information, helping combat tax evasion and tax avoidance, mitigating the uncertainty an investor faces when dealing with foreign fiscal systems, and finally DTTs may help to reduce harmful international tax competition from tax havens, even though DTTs are an insufficient measure (due to their bilateral character) to completely avoid harmful tax competition. See Toumi, M. (2006), *Anti-avoidance and Harmful*

approach to constructing and negotiating its DTTs with other states will play a crucial role in its magnetism to FDI.

### 6.2 Relieving Double Taxation of Cross-border Investment Income

When a business decides to invest abroad, it needs to consider double taxation issues, since its foreign earned profits may be subject to both home and host taxation which results in double taxation. A home state's relief from double taxation may take one of three forms: deduction, credit, or exemption[516]. International investors have at their disposal numerous methods of structuring and financing their investments. These methods have important tax considerations which strongly influence the choices that firms make[517] e.g. garment manufacturers are operating in highly competitive markets with very slim margins; they are also highly mobile and are likely to compare taxes across alternative locations[518]. Start-up companies, on the other hand, prefer incentives which reduce their initial expenses e.g. equipment and material exemption, while expanding companies prefer tax incentives that target profit e.g. reduced tax rates and repatriation schemes[519]. Manufacturing industries also prefer incentives

---

*Tax Competition: From Unilateral to Multilateral Strategies,* in Lymer A., & Hasseldine, J. (eds.), (2006), The International Tax System, Kluwer, pp.83-105.

[516] Davies, R. (2004), *Tax Treaties and Foreign Direct Investment: Potential Versus Performance*, International Tax and Public Finance, 11, p.777.

[517] Reuber G et al. (1973), *Private Foreign Investment in Development*, Clarendon Press for the OECD Development Centre, Oxford, pp. 112-116.

[518] Wells, L.T. (1986), *Investment Incentives: An unnecessary Debate*, CTC Reporter U.N. Centre on Transnational Corporations, New York, No 22, Autumn, pp. 58-60.

[519] Multinationals are often taxed on their worldwide income in their home state. When their income is repatriated as dividends the home state may eliminate double taxation through the implementation of the credit system which attenuates but often does not eliminate the tax burden, leading to the generation of a tax liability that could otherwise be deferred or potentially avoided altogether. This causes the paying of dividends between subsidiaries and the parent company - as opposed to reinvesting – to be a costly alternative for the parent company, especially when the

related to depreciable assets because they utilize more fixed assets than service industries[520]. Small investors have proven to be more responsive to tax incentives than large ones, since they may have the financial and human capacity to develop sophisticated tax avoidance strategies[521].

Kuwait aims to attract new, start-up foreign companies but it also aims to encourage existing foreign companies to expand their businesses. Thus one might expect Kuwait to focus on tax incentives which reduce companies' initial expenses for start-up companies and tax incentives which target profits for larger expanding companies. Further information on the businesses that Kuwait aims to attract and businesses which have and have not responded to Kuwait's fiscal system is provided in Chapter 7[522].

### 6.3 Methods to Eliminate Double Taxation

There is no international consensus on the appropriate method for granting relief from international double taxation. The three common methods: deduction, exemption and credit are in common use; a country may use one of them or a combination of methods.

1. **Deduction:**

---

repatriations of dividends are subject to the home state's higher tax rate. *See* Desai, M., *et al*., (2001), *Repatriation Taxes and Dividends Distortion,* Bureau of Economic Analysis, U.S. Department of Commerce, p. 34. *And*, Altshuler, R. *et al.* (2000), *Repatriation Taxes, Repatriation Strategies and Multinational Financial Policy,*a paper prepared for the Trans-Atlantic Public Finance Seminar, Switzerland, p. 27.

[520]Rolfe R. J. et al. (1993), *Determinants of FDI Incentive Preferences of MNEs*, Journal of International Business Studies, 24(2), pp. 335-355.

[521] Coyne E. J. (1994), *An Articulated Analysis Model for FDI Attraction into developing Countries*, Florida: Nova Southeastern University, pp. 234-246.

[522] See pp. 247-261.

Under the deduction method a state which taxes its residents on worldwide income allows its tax payers to take a deduction for foreign taxes paid in the computation of their taxable income. In effect, foreign taxes (income and profit taxes) are treated as current expenses of doing business or earning income in the foreign jurisdiction[523]. The effect of the deduction method is that residents earning foreign source income and paying foreign income taxes on that income are taxable at a higher combined tax rate than the rate applied to domestic-source income. As a result, the deduction method creates a bias in favour of domestic investment over foreign investment whenever the foreign investment is likely to attract a foreign income tax[524]. When only tax revenues and investors' income are taken into account by a home state, a small open economy would encourage outbound investments as long as the return on those investments exceeds the return on domestic investments (excluding taxes paid to the foreign government and including taxes paid to the home state government)[525]. Under these circumstances the home state would encourage investment abroad by applying a personal taxation system (i.e. taxing residence/citizens on their world wide income) allowing taxpayers to deduct foreign taxes from their taxable income[526].

---

[523] Arnold, B., and McIntyre, M., (2002), *International Tax Primer*, Kluwer Law International, p.32.
[524] *Id*.
[525] Figueroa, A.H. (1992), *Comprehensive Tax Treaties in Double Taxation Treaties between Industrial and Developing Countries: OECD and UN* Models – *a Comparison*. Seminar Held in Stockholm in 1990 during the 44 Congress of International Fiscal Association, Deventer: Kluwer, pp. 9-13.
[526] *Id.*

2. **Credit:**

Under the credit method the home state allows its residents to offset the domestic tax on their foreign income by the foreign tax paid to the host state on that same income[527] . This is also known as "Capital Export Neutrality"[528]. The home state indicates that it is willing to give up all of its tax revenues in order to achieve a moderate level of outbound investment; it does so when a moderate level of investment outweighs what it loses in tax revenues by granting the credit. A home state will only go for the credit system when it has secured a moderate amount of outbound investment with the host state as this compensates what it loses in tax revenues[529].

3. **Exemption:**

Under the exemption method, residents of a country are taxed only on their domestic income, i.e. the home state does not tax foreign sourced income[530]. When a residence country adopts an exemption policy it indicates that it believes it would gain more from larger levels of outbound investment than from the

[527] Lymer, A., and Hasseldine, J., (2002), *The International Taxation System,* Kluwer, p.139.
[528] The term Capital Export Neutrality was introduced in the 1960s to describe a situation in which the overall burden of taxation on capital owned by resident entities of a given country is the same whether that capital is invested abroad or at home. In tax terms Capital Export Neutrality requires the same proportionate tax wedge (a measure of a market's inefficiency after a tax had been imposed which causes the market equilibrium to shift creating a wedge of dead weight loss) between the before and after tax return wherever the capital owned by the resident entities of a country is invested. If this condition is met, this tax system neither encourages nor discourages capital export, and the investor's choice of investing in the domestic economy or in foreign economies will not be influenced by tax considerations. Cordes, J. J., *et al*, *The Encyclopaedia of Taxation and Tax Policy,* The Urban Institute Press, p.45.
[529] Blonign, B.A. Davies, R.B. (2004), *Do Bilateral Tax Treaties Promote Foreign Direct Investment?* U.S. FDI Activity, International Tax and Public Finance 11(5), pp. 601-622.
[530] Holmes, K. (2007), *International Tax Policy and Double Tax Treaties,* IBFD, p. 25.

revenues of tax levied on profits derived from outbound investment[531]. The exemption policy is also known as Capital Import Neutrality (CIN)[532]. If the host state imposes tax, this means low to moderate levels of outbound investment for the home state, also the home state will not collect the entire amount of tax revenue levied. All the home state can do is allow a moderate level of outbound investment while collecting no tax, or allow a low level of outbound investment while collecting some tax. If however the host state did not tax foreign investment, the choice will be in the hands of the home state, it can either tax and limit the level of outbound investment, or not tax and maximise the level of outbound investment[533]. Although the exemption method is relatively simple and effective in eliminating international double taxation, it offends against the tax policy objectives of fairness and economic efficiency, as the resident taxpayers with an exempt foreign source income are treated more favourably than other residents[534].

### 6.4 Choosing an Optimal Method for Double Taxation Relief

Foreign-source income earned by residents of a country that uses the deduction method generally is taxable at a higher effective rate than it would be under either the credit method or the exemption method. The exemption method and the credit method typically give equivalent results whenever the effective foreign tax rate is

[531] Dagan, T. (2000), *The Tax Treaties Myth*, Journal of International Law and Politics, Vol.32:939, p.974.
[532] A condition in which the same effective tax rate applies to all capital income earned within a given country, regardless of the investor's country of residence. Cordes, J. J., *et al*, *The Encyclopaedia of Taxation and Tax Policy,* The Urban Institute Press, p.50.
[533] Dagan (note 531 supra).
[534] Arnold and McIntyre (note 523 supra).

equal to or greater than the domestic effective rate is equal or greater than the domestic effective rate. The exemption method generally is the most favourable to the tax payer when the foreign effective tax rate is less than the domestic effective tax rate[535]. The deduction method as has been mentioned above[536] is an unfavourable method for foreign investment. The full exemption method is also undesirable for the reasons mentioned above[537], and also because it encourages resident tax payers to invest abroad in countries with lower tax rates, especially in tax havens and it encourages them to divert domestic-source income to such countries. A partial exemption system might be justified, however, if it is used as a convenient and simple proxy for the credit method. Under this system, a country exempts residents on income derived from foreign countries that are committed to imposing taxes at rates comparable to its own. The alleged virtue of this partial exemption system is that is minimizes compliance costs for taxpayers and administrative costs for tax authorities, as long as the exemption is limited to a foreign source income that is subject to foreign tax comparable to domestic tax. This system requires vigorous sourcing of income and expense rules, it also requires anti-avoidance rules to prevent low-taxed foreign source income from qualifying for exemption, and finally it requires anti-avoidance rules to prevent taxpayers from deducting against their domestic income the expenses incurred to earn exempt foreign source income[538]. The credit method avoids the shortcomings of the deduction method. Resident taxpayers are treated equally from the perspective of the total domestic and foreign tax burden, except if foreign taxes

[535] See Arnold &McIntyre (note 523 supra).
[536] See p.173.
[537] See pp.174 - 175.
[538] See Arnold & McIntyre (note 523 supra).

exceed domestic taxes. Also, subject to the same exception the credit method is neutral with respect to a resident taxpayer's decision to invest domestically or abroad. On tax policy grounds, the credit method is generally recognized to be the best method for eliminating international double taxation. The operation of the credit system however is complex. Highly complicated legislative provisions are needed to resolve matters such as: what foreign taxes are creditable? How should the limitation on the credit be calculated? And what rules should be adopted to determine the source of income and deductions?[539]

The method for relieving double taxation which two countries agree to adopt in their bilateral business activities is included within the double taxation treaty they sign with each other. Although there are several Model Conventions for Double Taxation Treaties, the two most popular ones are the UN and the OECD Double Taxation Model Conventions (the UN and the OECD Models respectively).

### 6.5 Models for Double Taxation Treaties: UN or OECD Model Convention?

An increasing number of governments compete to attract multinational companies through different fiscal incentives. Many African countries rely on tax holidays and import duty exemptions, while industrial countries allow investment allowances or accelerated depreciation[540]. This trend is mirrored in an explosion of economic research studying the forces driving the creation of multinational

[539] Arnold & McIntyre (note 523 supra).
[540]Morrisset, J. Pirnia, N. (2001), *How Tax Policy and Incentives Affect Foreign Direct Investment*, (FIAS) Foreign Investment Advisory Service, a Joint Service of the International Finance Corporation and the World Bank, 2001, p. 3.

enterprises (MNEs). A subset of this literature considers the effect of government policies on FDI with a particular eye on the use of tax policy especially in regard to bilateral tax agreements. Given the variety of countries using tax treaties and the spectrum of FDI activities treaties cover, it is not surprising that tax treaties exhibit considerable heterogeneity. Most treaties loosely follow the recommendations of the model tax agreements provided by the Organization for Economic Cooperation and Development (OECD) or the United Nations (UN). Although these model treaties have undergone several revisions, they continue to form the basis for most double tax treaties. These models have also provided the basis for much of the economic literature that has considered tax treaties as a means of reducing the double taxation of FDI[541]. There are other DTT models besides the OECD and the UN convention, these include The United States Model Income Tax Convention (1996). This convention ensures that the U.S. is the country that taxes its residents' worldwide income. Other countries with their own DTT model include: Croatia (1999), Malaysia (2000), Mexico (2000), Peru (2001), and Sweden (1998)[542].

Although some theorists have naturally focused on the potential of tax treaties in relation to co-ordinating tax policies, reducing the combined level of taxation of home and host states and increasing FDI, it is important to remember that tax policies are capable of affecting the volume and location of FDI since tax rates reduce after-tax returns. Further, countries differ not only in their tax policies but also in their commercial and regulatory policies, market size, natural endowment and human capital all of which influence the desirability of an investment

[541] OECD Double Tax Treaty Model Convention 2010, p. 1.
[542] Holmes (note 530 supra).

location[543]. Emphasis on such social, economic and political (non-tax) factors which foreign investors find attractive in a host country will be mentioned in the next chapter[544].

However, DTTs can also discourage FDI in as much as they reduce tax avoidance and other legal tax saving strategies such as transfer pricing by multinational companies[545]. So why do developing countries invest time and other resources to negotiate, conclude, sign and ratify DTTs especially when such DTTs can impose significant restrictions on developing states' authority to tax corporate income from foreign investors[546]? It might be agreed that developing states resort to bilateral tax treaties to signal their commitment to stable, correct and often favourable treatment from foreign investors. By signing DTTs, developing countries provide foreign investors with security and stability as regards the issue of taxation in addition to relief from double taxation. This may also represent developing countries' commitment to granting certain relative standards such as national treatment (foreign investors may not be treated any worse than national investors, but may be treated better) and most-favoured nation treatment (privileges granted to one foreign investor must be granted to all foreign investors).[547] They also agree to guarantee certain treatment standards such as fair and equitable treatment for foreign investors in accordance with international standards after the investment has taken place. Multilateral organizations, namely the United Nations and the Organization for Economic Co-operation and

---

[543] Davies (note 516 supra).
[544] See pp. 252-262.
[545] Figlio, D. and Blonigen B. (2000), The Effects of Direct Foreign Investment on Local Communities, Journal of Urban Economics, Vol.48, Issue 2, pp. 338-363.
[546] Blonigen and Davies (note 529 supra).
[547] United Nations Conference on Trade and Development UNCTAD, (2004), *World Investment Report The Shift towards Services*, 2004, United Nations New York and Geneva, pp. 73-99.

Development, have promoted DTTs from an early stage[548] through their model treaties, which are regularly updated and on which treaty partners can base their treaty if they wish to do so. Not surprisingly, the OECD Model favours residence taxation, which benefits developed countries especially OECD members since it is mainly developed countries that invest in developing countries. The UN Model, on the other hand, provides more room for source-based taxation, which is more beneficial to developing countries. Critics argue that the UN Model is not sufficiently different from the OECD Model and that it is still biased against developing country interests[549]. Also the vast majority of DTTs are based on the OECD Model[550]. Article 5 of the UN Model is a good example of how the UN Model preserves the interest of developing states. Article 5 sets the requirements for when a "permanent establishment" exists in the host state allowing a wider definition of what constitutes a PE than that which appears in the OECD Model which in turn allows wider taxing jurisdiction for the host states. Thus, while a "permanent establishment" according to the OECD Model is a building site or construction or installation project which must last more than 12 months[551], the UN Model requires only 6 months for a building site, a construction or an installation project to continue in order to consider it a PE [552]. The UN Model also considers "the furnishing of services, including consultancy services by an enterprise through employees or other personnel engaged by the enterprise[553]" as constituting a PE, allowing a host state to widen its jurisdiction to tax. Such

[548] Degan (note 531 supra).
[549] Figueroa (note 525 supra).
[550] Arnold, B. et al., (2002), *Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21Century. Bulletin for International Fiscal Documentation*, No. 56, pp.233-243.
[551] Article 5 (3) 2010 OECD Model.
[552] Article 5 (3) (a) 2001 UN Model.
[553] Article 5 (3) (b) 2001 UN Model.

provision does not exist in the OECD Model. Also the definition of agent, who in turn constitutes a PE, is wider in the UN Model than it is in the OECD Model[554]. In another example, the OECD Model restricts taxing royalties to the beneficiary state of residence i.e. home state[555], while the UN Model allows royalties to be taxed in the state where the royalties arose i.e. the host state[556].

So the UN Model facilitates for the host state the collection of tax from foreign businesses, for example, by expanding the meaning of the "permanent establishment" and by widening the jurisdiction of the host state, allowing foreign capital and income to be taxed in it. The OECD Model has a higher threshold than the UN Model in many respects, as favoured by capital exporting countries[557].

Policy makers in developing countries often believe that the conclusion of DTTs increases inward FDI. However, as mentioned above, the vast majority of DTTs concluded between developed and developing countries limit home based taxation, which means that developing countries can only collect tax revenues from foreign investors to a limited extent.[558]

It should be noted that DTTs are reciprocal. Thus the presumption that treaties eliminate tax competition[559] is misleading since the terms of the treaty (and the distribution of the gain from treaty formation) must be bargained over. If countries differ in their preferences, then there remains unresolved conflict which

---

[554] Article 5 (5) (b) UN Model, includes in the definition of PE the agent who has no authority to conclude contracts in the name of the enterprise, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise. Article 5 (5) OECD Model restricts the agent who constitutes a PE only to the agent who has authority to conclude contracts on behalf of the enterprise.

[555] Article 12 (1) 2010 OECD Model.

[556] Article 12 (2) 2001 UN Model.

[557] Brooks, K. (2007), *Tax Treaty Treatment of Royalty Payment from Low-Income countries: A Comparison of Canada and Australia's Policies,* e-Journal of Tax Research, Vol.5, No.2, pp.169-199.

[558] Arnold and McIntyre (note 523 supra).

[559] Toumi and Lymer (note 515 supra) .

will be played out through the negotiation process. Thus rather than eliminating tax competition, tax treaties change the nature of that competition. Recognizing the patterns of this bargaining has important implications for understanding the potential of tax treaties[560] which is to coordinate tax policies, reduce the combined level of taxation and increase FDI[561]. Dagan[562] shows that FDI efficiency gains from DTTs are a myth. Instead she argues that in U.S. tax treaty formation two other aspects dominate policy development: reduction in tax losses overseas and the alleviation of administration costs. Radaelli [563] also suggests that U.S. tax treaty policy is not driven by a desire to improve efficiency, but rather to reduce tax evasion through mechanisms such as transfer pricing. Davies[564], on the other hand, argues that if the provisions addressing tax evasion which most DTTs contain were actually effective, they could reduce FDI; that is because FDI flows are highly asymmetric (as is common between developed and developing countries) so these anti-evasion provisions may be contentious and thus inadequately enforced. However, even if both signatories truly desire a reduction in tax evasion, this may be difficult to achieve bilaterally in a multilateral world. Other gains, however, can be derived from treaty formation including information sharing between governments, dispute resolution mechanisms for fiscal disputes, and co-ordinated policies on items such as transfer pricing and expense allocation.

---

[560] Janeba, E. (1995), *Corporate Income Tax Competition, Double Taxation Treaties and Foreign Direct Investment*, Journal of Public Economics 56 (2), pp. 311-325.
[561] Davies (note 516 supra).
[562]Degan (note 531 supra).
[563] Radaelli, C., (1997), *The Politics of Corporate Taxation in the European Union*, Routledge Research in European Public Policy, London, pp. 112-134.
[564] Davies (note 516 supra).

## 6.6 Kuwait's double taxation treaties: How Kuwait negotiates its double taxation treaties

Kuwait has signed 48 double taxation treaties (DTTs). In some treaties Kuwait applies the OECD Model convention rather than the UN Model; in other cases it does the opposite. One of the most important provisions in a double taxation treaty is Article 5 which determines what constitutes a Permanent Establishment (PE), as it is the definition of a PE which sets the tax base for the two states party to the double taxation treaty in relation to the taxation of business profits. What Kuwait and its double taxation treaty partners consider as a PE allows the host country to expand (or contract) its tax jurisdiction in relation to the taxation of business profits accordingly.

### 6.6.1 The Definition of Permanent Establishment (PE) in Kuwait's DTTs

#### (i) Business Activity

The definition of "permanent establishment" in Kuwait's DTTs tends to be a blend of the definitions in the OECD and the UN Models. Usually, however, the basic business activity test in Article 5 (1) of the OECD Model is adopted. This provides:

1. The term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term 'permanent establishment' includes:

a. such as a place of management,
b. a branch,
c. an office,

d. a factory,
e. a workshop,
f. a mine, an oil or gas well, a quarry or any other place of extraction or natural resources
3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months[565].

When it comes to types of business activity that may constitute a permanent establishment, Kuwait's DTTs tend to deviate from Article 5 (3) of the OECD Model and adopt a definition closer to that of the UN Model[566], for example, most of Kuwait's DTTs provide that the term "permanent establishment" includes:

"(a) a building site or a construction assembly or installation project or a supervisory activity in connection therewith constitutes a permanent establishment only if such site project or activity continues for a period of more than six months; (b) the furnishing of services, including consultancy services, by an enterprise of a contracting state through employees or other engaged personnel in the other contracting state constitutes a permanent establishment provided that such activities continue for the same project or a connected project for a period or periods aggregating more than nine months within any twelve-month period."[567]

It should be noted that seven of Kuwait's DTTs[568] do not include "the furnishing of services" within the definition of a permanent establishment.

On the other hand, Kuwait takes the substance of the 'business activity' definition of a "permanent establishment" further when it includes "using substantial equipment", in eighteen of it's DTTs[569] thereby deviating from both the OECD and the UN Model[570]. This extended provision provides:

"An enterprise of a contracting state shall be deemed to have a permanent establishment in the other contracting state if substantial equipment in that other

[565] Article 5 (1),(2) and (3) OECD Model 2010.
[566] Article 5 (3) of the UN Model 2001 requires the furnishing service in provision to continue for at least 6 months.
[567] See, for example, Article (5) Kuwait and Pakistan DTT, 1998.
[568] Tunisia, Switzerland, Turkey, Belgium, France, Germany, and Italy.
[569] These are with: The Netherlands, Lebanon, Jordan, Pakistan, Singapore, Indonesia, Thailand, Sri Lanka, Mongolia, Uzbekistan, Greece, The Czech Republic, Croatia, Malta, Mauritius, South Africa, Ethiopia, Egypt.
[570] In some of its DTTs Kuwait deviates from the standard provisions of the OECD and the UN Models, although there is no clear reason why this is so.

contracting state is being used or installed by the enterprise, or for the enterprise, or under contract with the enterprise and such contract continues for more than three months".

The broadest manifestations of the 'business activity' definition in Kuwait's DTTs expands source jurisdiction in four main respects. First, the duration for a project, a building site, etc., to constitute a "permanent establishment" is 12 months in the OECD Model, but only 6 months in most of Kuwait's DTTs[571], in some cases 3 months suffices in considering a project, etc. as a "permanent establishment"[572]. Secondly, the OECD Model does not mention "supervisory activities" in connection with a building site, construction, assembly or installation project, whereas Kuwait tends to treat supervisory activities relating to these activities as a basis for finding a "permanent establishment". Thirdly, the OECD Model does not specify whether providing services may constitute a "permanent establishment", whereas some of Kuwait's DTTs, as seen above, provide that the "furnishing of services" constitutes a "permanent establishment" if the activity continues for more than 9 months in any 12 month period[573]; while most of Kuwait's DTTs require only 6 months[574], and in some cases 3 months suffices[575]. Fourthly, neither the OECD nor the UN Model mention 'substantial equipment' being used or installed for or under a contract with the enterprise and such contracts continuing for more than three months as a basis for a "permanent establishment". As

[571] See note 569 above.
[572] Such as Kuwait's DTTs with Sri Lanka, Lebanon, Mauritius, Mongolia, Indonesia, and Ethiopia.
[573] These include Kuwait's treaty with Mauritius, Poland, Yugoslavia, Bulgaria, and Pakistan.
[574] These include Kuwait's treaties with Jordan, Egypt, Czech Republic, Greece, Croatia, Romania, Hungry, Canada, Singapore, China, Korea, Syria and Ukraine.
[575] As in Kuwait's DTT with Sri Lanka, Lebanon, Mongolia, Indonesia, and Malta, Belarus, Russia, Venezuela, Thailand, Uzbekistan, and Ethiopia.

mentioned above,[576] 18 Kuwaiti DTTs provide for using 'substantial equipment' to constitute a "permanent establishment" in defined circumstances.

It is concluded from this that Kuwait has in some instances expanded its jurisdiction to tax business profits by either going further than the standard UN and OECD business activity test for a PE, or by requiring shorter periods of existence for the relevant activities that constitute a PE in the host state. It should be noted here that Kuwait allows foreign enterprises to carry on business in its jurisdiction either through a 49% shareholding in nationally owned enterprises, or by allowing a foreign investor to carry on business in Kuwait through a national agent, as has been seen in Chapter 4[577].

In addition to founding a "permanent establishment" on a business activity test the OECD and the UN Models provide for a "permanent establishment" to be established through agency. The next section considers to what extent Kuwait's DTTs make provision for an agency "permanent establishment".

### 6.6.2 When an Agent Constitutes a PE

The definition of agent and what constitutes a taxable agency relationship between a national and foreign enterprise under Kuwait's domestic tax system was discussed in length in chapter 4[578]. The following, however, discusses when an agent constitutes a 'permanent establishment' under Kuwait's DTTs.

[576] See note 569.
[577] See pp. 114-117.
[578] See pp. 122 – 136.

### (i) Agency

First, it is important to clarify when an agent may constitute a PE according to the OECD Model, Article 5 (5) provides:

*"*... where a person - other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of the enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4[579] which, if exercised though a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph."

Article 5 (6) then provides:

"An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business"

So according to the OECD Model, a person - other than an agent with an independent status - who acts on behalf of an enterprise and has and habitually exercises, in a Contracting State, an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a "permanent establishment" in that State in respect of any activities which that person undertakes for the enterprise, unless these activities are limited to those mentioned

[579] Activities in Article 5 (4) include: a. the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; b. the maintenance of a stock of goods and merchandise belonging to the enterprise solely for the purpose of storage, display or delivery; c. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; d. the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise; e. the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; f. the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs a. to e. provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

in Article 5(4)[580]. Also, according to the OECD Model, the enterprise that carries on business in a contracting state through a broker, general commission agent or any other agent of an independent status, - provided that such persons are acting in the ordinary course of their business - shall not be deemed to have a "permanent establishment" in that contracting state[581]. (whether or not there is a fixed place of business in the other contracting state) unless the activities of the agent are limited to activities which would not constitute a permanent establishment if they are carried on directly by the enterprise[582]. In this regard, Kuwait follows the OECD Model in eight of its DTTs[583] when determining the circumstances in which a dependent agent's actions constitute a "permanent establishment".

In some of its DTTs[584], Kuwait follows the broader approach of the UN Model in determining when a dependent agent constitutes a "permanent establishment", as the UN Model considers there to be a dependent agent acting on behalf of an enterprise in a contracting state as a "permanent establishment" in the following circumstances Article 5 (5) (b) of the UN Model provides:

".. where a person other than an agent of an independent status whom paragraph 7 applies is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise if such person:

(b) has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise[585]"

---

[580] See note 579.
[581] Article 5 (6) of the OECD Model 2010.
[582] Article 5 (5) of the OECD Model 2010.
[583] In its DTTs with Germany, UK, Switzerland, Greece, Croatia, Turkey, Sudan, and South Africa.
[584] In 14 of its DTTs, with Morocco, Austria, Netherlands, Belgium, Poland, Yugoslavia, Czech Republic, Ukraine, Cyprus, Pakistan, Singapore, China, Korea, Sri Lanka.
[585] Article 5 (5) (b) UN Model 2001.

Unlike Article 5 (6) of the OECD Model, the UN Model includes in its definition of a "permanent establishment" an enterprise that carries on business in a contracting state through a broker, general commission agent or any other agent of an independent status when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise. Article 5 (7) of the UN Model provides:

"An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, <u>and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises,</u> he will not be considered an agent of an independent status within the meaning of this paragraph".

This broader concept of the UN Model for the agent who constitutes a "permanent establishment" is adopted in most of Kuwait's DTTs mentioned above[586].

In addition, most of Kuwait's DTTs[587] also deviate from the UN Model by expanding the definition of agency which establishes a taxable "permanent establishment" as follows;

"An agent who manufactures or processes in the contracting state for the enterprise goods or merchandise belonging to the enterprise will also constitute a permanent establishment.[588]"

In the above mentioned DTTs, it is obvious that Kuwait adopts a very broad definition of "permanent establishment", especially where it deviates even from the UN Model. This will allow Kuwait a wider jurisdiction over the taxation of

[586] See note 554.
[587] With these countries: Mauritius, Tunisia, Ethiopia, Egypt, Bulgaria, Romania, Hungry, Malta, Belarus, Malaysia, Indonesia, Thailand, Mongolia, Uzbekistan, Lebanon, Jordan, and Syria.
[588] Article 5 (5) (c) of the DTT signed between Kuwait and Bulgaria in 2002, (still in force).

the profits of foreign enterprises. However, the broad definitions tend to be adopted in DTTs signed with less developed states (developing ones), whilst in DTTs with developed states such as Germany, the UK, Switzerland and Italy the definitions adopted are those of the OECD Model, thus narrowing Kuwait's jurisdiction to tax, and thus limiting its tax revenue. This reinforced the argument mentioned earlier[589] that the OECD Model tends to favour developed countries while the UN Model benefits developing countries.

## 6.7 DTTs Treatment of Income

### 6.7.1 Attribution of Business Profits to PEs

Article 7 is arguably the most significant article in a DTT as it deals with business profits. Based on Article 7 of the OECD Model, Kuwait's DTTs generally provide that where an enterprise has a permanent establishment in Kuwait the profits of the enterprise are taxable in Kuwait to the extent that the profits are attributable to that permanent establishment. Initially, Article 7 provides:

"1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

2. For the purpose of this Article and Article [23 A] [23 B] the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar

[589] See pp.177-181.

conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise"

Article 7 of the OECD Model allocates taxing rights with respect to the business profits of an enterprise of a contracting state to the extent that these profits are not subject to different rules under other Articles of the Model. It incorporates the basic principle that unless an enterprise of a contracting state has a permanent establishment situated in the other State, the business profits of the enterprise may not be taxed by that other State unless these profits fall into special categories of income under which other Articles of the Model give taxing rights to that other State[590]. The principles underlying Article 7, and in particular paragraph 2 of the Article, have a long history. When the OECD first examined what criteria should be used in attributing profits to a permanent establishment, this question had previously been addressed in a large number of tax conventions and in various models developed by the League of Nations. The separate entity and arm's length principles, on which paragraph 2 is based, had already been incorporated in these conventions and models and the OECD considered that it was sufficient to restate these principles with some slight amendments and modifications for the main purpose of clarification[591]. Practical experience has shown, however, that there was considerable variation in the interpretation of these general principles and of other provisions of earlier versions of Article 7. This lack of a common interpretation created problems of double taxation and non-taxation. Despite the work of the Committee on Fiscal Affairs in trying to ensure more consistent

[590] Kees Van Raad. edit, *2010/2011 Materials on International and EU Tax Law,* OECD's Commentary on the new Article 7, IBFD, p. 1343.
[591] *Id*.

interpretation and application of the Article, the practice of OECD and non-OECD countries regarding the attribution of profits to permanent establishments and these countries' interpretation of Article 7 continued to vary considerably. The Committee acknowledged the need to provide more certainty to taxpayers in a 2008 report entitled "Attribution of Profits to Permanent Establishments". The report focused on how to formulate the most preferable approach to attributing profits to permanent establishments under Article 7. After the Committee had approved the report in 2008, it recognised that there are differences between some of the conclusions of the report and the interpretations of article 7 given previously in the Commentary. For that reason a new version of Article 7 was included in the latest Model Convention which was adopted in 2010.

The first principle underlying Article 7 (1), i.e. that the profits of an enterprise of one contracting state shall not be taxed in the other State unless the enterprise carries on business in that other State through a permanent establishment situated therein, has a long history and reflects international consensus that, as a general rule, until an enterprise of State sets up a permanent establishment in another State, it should not be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits[592].

The second principle, which is reflected in the second sentence of the paragraph, is that the right to tax of the State where the permanent establishment is situated does not extend to profits that the enterprise may derive from that State but are not attributable to the permanent establishment. This is a question on which there

[592] Kees Van Raad (note 590 supra).

have been historically differences of view; some countries have pursued a general principle of "force of attraction" according to which income such as other business profits, dividends, interest and royalties arising from sources in their territory was fully taxable by them if the beneficiary had a permanent establishment therein even though such income was clearly not attributable to the permanent establishment. Whilst some bilateral tax conventions include a limited anti-avoidance rule based on a restricted 'force of attraction' approach that only applies to business profits derived from activities similar to those carried on by a permanent establishment, the general 'force of attraction' approach described above has now been rejected in international tax treaty practice. The principle that is now generally accepted in double taxation conventions is based on the view that in taxing the profits that a foreign enterprise derives from a particular country, the tax authorities of that country should look at the separate sources of profit that the enterprise derives from their country and should apply to each the permanent establishment test, subject to the possible application of other Articles of the convention. This solution allows simpler and more efficient tax administration and compliance, and is more closely adapted to the way in which business is commonly carried out[593].

Kuwait implements in some of its DTTs[594]the 'force of attraction' principle recommended in the UN Model[595], allowing the income of a foreign enterprise to

[593] See Kees Van Raad (note 590 supra).
[594] Sudan, Ethiopia, Belarus, Indonesia, Sri Lanka, Mongolia, and Syria.
[595] Article 7 (1) of the UN Model 2001, provides: "The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much

be taxed in the host country not only on profit directly attributable to the permanent establishment, but also on the profits made due to the sale of similar goods to those sold by the permanent establishment, and profits derived from business activities carried on in the host country that are the same as or similar to those carried on by the permanent establishment. For example Article 7 of Kuwait's DTT with Indonesia provides:

"The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other Contracting State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other Contracting State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other Contracting State of the same or similar kind as those effected through that permanent establishment"[596].

However, the scope of the 'force of attraction' principle in Kuwait's DTTs differs from one DTT to the other. Thus, in Kuwait's DTTs with Mongolia, Sudan and Sri Lanka, the 'force of attraction' principle is limited. It allows a contracting state to tax the profits of an enterprise situated in it only if those profits were attributable to that permanent establishment and to tax the sales of goods and merchandise of the same or similar kind as those sold through the permanent establishment. The 'force of attraction' principle here excludes the third provision, outlined above, which allows the source state to tax other business activities of the same or similar kind as those carried on by the permanent establishment. Article 7 of Kuwait's DTT with Sri Lanka provides:

---

of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment."

[596] Article 7 of the DTT between Kuwait and Indonesia signed April 23rd, 1997, (still in force).

"The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State, unless the enterprise carries on business in the other Contracting State through a permanent establishment situated in that other Contracting State. If the enterprise carries on business in that manner, the profits of the enterprise may be taxed in the other Contracting State but only so much of them as attributable to that permanent establishment and to sales in that other Contracting State of goods or merchandise of the same or similar kind as those sold through that permanent establishment[597]."

Also in Kuwait's DTTs with Ethiopia, Belarus, and Syria, the scope of the 'force of attraction' principle is narrowed to include only profits attributable to the permanent establishment and payments received as consideration for the use of the right to use, industrial, commercial and scientific equipment. Further, Article 7 of the DTT between Kuwait and Ethiopia provides another variation:

"...the profits of the enterprise may be taxed in the other Contracting State but only so much of them as is attributable to that permanent establishment. However, payments of any kind received as a consideration for the use of, or the right to use, industrial, commercial or scientific equipment shall be deemed to be profits of an enterprise to which the provisions of the Article shall apply[598]."

The 'force of attraction' was a principle tailored by the UN to protect the interests of the developing countries that usually play the role of the host country in bilateral tax treaties by allowing those countries to extend their tax jurisdiction. However, such a clause in a bilateral DTT can have two disadvantages: a) the difficulty of implementing such a clause as it requires a very sophisticated tax administration system, and (b) the force of attraction principle discourages enterprises based in developed states from investing in developing countries. Kuwait's objective is to try and attract revenues from FDI in an attempt to reduce its high dependency on oil revenues which resulted in Kuwait suffering from

[597] Article 7 of Kuwait's DTT with Sri Lanka, signed February 5th, 2002, (still in force).
[598] Article 7 of Kuwait's DTT with Ethiopia, signed September 14th 1996 (still in force).

rentierism, a subject discussed in chapter 3[599]. Thus it may have to refrain from including such 'force of attraction' provisions in the majority of its DTTs, although in some of its treaties, as seen above, Kuwait does apply the 'Force of Attraction' principle thereby allowing a broader jurisdiction for taxing business profits arising through a permanent establishment.

When it comes to attributing business profits to a foreign enterprise, there is a need to understand how this is undertaken in regards to the Kuwaiti fiscal system[600] seeing that all foreign enterprises in Kuwait must carry on business in Kuwait either through a national agent or by holding 49% of a national company (while the national shareholder owns 51%); for details see chapter 4[601]. When it comes to calculating the business profits attributable to the foreign shareholder carrying on business in Kuwait i.e. the foreign profits raised in the state of Kuwait and thus taxable under its jurisdiction, the tax inspector disregards the fact that 51% of the enterprise is owned by a national. The tax inspector will do a full inspection on all the income, profits and allowances of the company as if it were a 100% foreign owned company; for details see chapter 4[602].

### 6.7.2 Dividends, Interest and Royalties

When it comes to taxing dividends, interest and royalties, Kuwait has in general followed the OECD Model. Articles 10, 11, and 12 of the OECD Model limit the

[599] See pp. 88 - 94.
[600] See pp.111-118.
[601] See pp.111-118.
[602] See pp. 112- 120.

taxes imposed upon the recipient of cross-border dividends, interests and royalties.

1. Dividends

Under Article 10 (3) of the OECD Model, The term "dividends" means

"Income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the state of which the company making the distribution is a resident." [603]

Articles 10 (1) and (2) of the OECD Model provide:

"1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

a. 5% of the gross amount of dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying dividends;
b. 15% of the gross amount of the dividends in all other cases.[604]"

Article 10 (1) does not give the right to tax dividends exclusively to either the home State or the host State. Taxation of dividends exclusively in the home State would not be acceptable as a general rule as it would be unrealistic to relinquish all prospects of taxing dividends in the host State. Nevertheless, Article 10 (2) imposes limitations on the right of the host state to tax dividends, normally 15% of the gross amount of dividends (see above). The Commentary to Article (2)

[603] Article 10 (3) 2010 OECD Model.
[604] Article 10 (a) and (b) of the OECD Model, 2010.

provides that a higher rate than 15% could hardly be justified since the host State can already tax the company's profits[605]. On the other hand, when the recipient of the dividends is a parent company receiving dividends from a subsidiary, the rate of tax withheld is lowered to 5% of the gross amount of dividends when the beneficiary is a parent company which owns directly a holding of 25% of the subsidiary paying the dividends. The Commentary explains that it is reasonable that the payments of profits by the subsidiary to its foreign parent should be taxed less heavily in order to avoid recurrent taxation and to facilitate international investment[606].

The UN Model's treatment of dividends does not deviate too far from that of the OECD Model. The difference is that the UN Model allows the state parties to decide the percentage of tax to be paid when the beneficiary is a resident of the other contracting state. Article 10 of the UN Model provides:

> 1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State maybe taxed in that other State.
> 2. However such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
>
> a)___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;
> b)___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting State shall by mutual agreement settle the mode of application of these limitations.

---

[605] Kees Van Raad (note 590 supra).
[606] *Id.*

When it comes to the tax treatment of dividends, some of Kuwait's DTTs adopt the OECD Model, some adopt the UN Model and some deviate from both. In a number of Kuwait's DTTs with countries such as Lebanon, Syria, Singapore, Malaysia, Mauritius, South Africa, Austria, Croatia, and Hungary, dividends are taxed only in the home State, without any allowance for taxing dividends in the host State. Limiting the taxation of dividends to the home State, Article 10 of the DTT between Kuwait and Singapore provides:

> Dividends arising in a Contracting State and paid to a resident in the other Contracting State shall only be taxable in that other Contracting State if such resident is the beneficial owner of the dividends.
> The provisions of this paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid[607].

This is one of the examples where Kuwait's DTTs with some contracting states deviate and vary from the standard provisions of the OECD and the UN Models[608], although there is no clear reason why in some of Kuwait's DTTs[609] such disparities from the provisions of the OECD and the UN Models.

Despite the fact that the provisions of DTTs are reciprocal, limiting the right to tax dividends to the home State only, such as the case in Kuwait's DTTs with the States mentioned above[610] – does not constitute the optimal tax situation for Kuwait. In cases where Kuwait is serving as the host State, this prevents Kuwait from taxing dividends that are remitted to the other jurisdictions (home States) that are party to the DTTs. Kuwait could negotiate with the above countries to

---

[607] Article 10 (1) of the DTT between Kuwait and Singapore, signed on February 21st 2002, (in force).
[608] See p.179 for another example of Kuwaiti DTTs deviating from the standard provisions of the OECD and the UN Model in defining what constitutes a PE.
[609] Such as the DTTs signed with countries mentioned above, see p. 187.
[610] See p. 199.

implement the UN version of Article 10[611] where the percentage of tax is agreed upon by both contracting States, reaching an optimal rate for both States can ensure that both receive a fair amount of taxes when dividends raised in their jurisdictions are remitted to the other State.

Another example of the tax treatment of dividends arises in Kuwait's DTTs with Indonesia, Thailand, Korea, Egypt, Turkey, and Tunisia. These DTTs allow dividends to be taxed in the host State. However, the host state in the above DTTs is limited to a single tax rate of 10%, and in some DTTs such as those with China, and the Czech Republic that single rate is limited to 5%. In Kuwait's DTT with Switzerland, the host State is limited to the relatively higher single rate of 15% withholding tax. Other DTTs distinguish between government investing entities and other investors. In Kuwait's DTTs with China, for example, while dividends earned by natural persons and corporate investors are subject to a withholding tax at a rate of 5%, other entities, owned directly or indirectly by government, and companies where the government owns, directly or indirectly 20% of the shares are exempt from tax in the host state. Other DTTs which include a similar provision are those entered into with Sri Lanka, Mongolia, Ukraine, Poland, The Russia Federation, Belarus, Bulgaria, and Belgium. A further modification arises in DTTs that do not exempt governmental entities but instead impose a reduced rate of withholding tax e.g. in the DTT between Kuwait and Morocco where dividends are subject to a rate of 2.5%.

[611] See p. 198.

Other Kuwaiti DTTs which adopt the OECD Model in their tax treatment of dividends distinguish between income derived from direct and indirect investment. Here there is a clear diversity in the tax rates imposed on direct and portfolio investors in the host state. In such DTTs dividends are primarily taxed in the beneficiary's home state (State of residence). However they can also be taxed in the host state (residence state of the dividend distributing company) but such taxes withholdings are limited and their extent depends on the type of investment yielding the dividends. For example, in Kuwait's DTT with Germany, dividends raised by a company (not a partnership) holding at least 10% of the distributing company's shares are taxed at a rate of 5%, while in all other cases dividends are taxed at 10%. A similar tax treatment is applied in Kuwait's DTT with the UK, Yugoslavia, France, and Venezuela, whilst in Kuwait's DTT with Canada dividends are subject to a withholding tax of 5% when the beneficiary entity owns 10% or more of the issued and outstanding voting stock, or 25% or more of the value of all the issued and outstanding stock of the company paying the dividends, and at a rate of 15% in all other cases.

In other cases such as Kuwait's DTTs with The Netherlands and Romania respectively the former taxes beneficiary entities holding 10% of the distributing company's capital at 0%, whilst the latter (Romania) exempts dividends earned by entities which own directly or indirectly 51% of distributing company's capital.

From the above it is clear that Kuwait's DTTs vary in their treatment of dividends; some apply the OECD Model, and some the UN Model and some deviate from both standard Models. The DTTs carry obvious disparities when it

comes to the rate of tax applied, and diversity in the incentives offered to direct investors and government owned entities.

2. Interest[612]

When it comes to Kuwait's DTTs treatment of interest a wide range of policies are adopted. Some of Kuwait's DTTs follow the OECD Model, and some follow the UN Model, while a significant number of Kuwait DTTs have deviated from both Models.

On the taxation of interest, Article 11 of the OECD Model provides:

> 1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
>
> 2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax charged shall not exceed 10 percent of the gross amount of the interest. The competent authorities of the Contracting State shall by mutual agreement settle the mode of application of this limitation...

Whilst in its tax treatment of interest, Article 11 of the UN Model provides:

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if <u>the beneficial owner of the interest is a resident of the other Contracting State</u>, the tax so charged shall not exceed____per cent (the percentage is to be established through bilateral negotiations) of the gross amount of interest. The competent authorities of the

[612] Article 11 (3) of the OECD 2010 Model: "The term "interest" means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profit, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article".

> Contracting States shall by mutual agreement settle the mode of application of this limitation[613].

Here the UN Model gives the contracting States the freedom to agree on the rate of withholding taxes that may be imposed on the interest arising in the host State to the benefit of the resident of the home State as it does with dividends[614].

Kuwait's DTTs tax interest in a number of ways. Nine DTTs[615] adopt the OECD Model, i.e. taxing interest in the home state; however, allowing the host state to impose tax on interest arising in its jurisdiction yet limiting the host State to a rate of 10% when the beneficiary is a resident of the other contracting state. Four DTTs[616] adopt the UN Model by applying a limit to the tax rate allowed for the host State to impose on interest arising in its jurisdiction and paid to a beneficiary from the other contracting state. The rate of tax imposed is agreed upon by the competent authorities of both contracting States, in Kuwait's DTTs that apply the UN Model, the tax rates vary between 5%, 7%, and 8%.

In their treatment of interest many of Kuwait's DTTs show a wide diversity; in fourteen DTTs[617] interest is taxed only in the home state of the beneficiary. For example, Article 11 (1) of the DTT between Kuwait and Austria provides:

> "Any interest arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State if such resident is the beneficial owner of the interest."

The OECD Commentary suggests that taxing interest exclusively in the home State can be a solution in some cases. It states:

---

[613] Article 11 of the UN Double Taxation Model Convention, 2001.
[614] See pp 198-199.
[615] Those DTTs signed with Switzerland, Yugoslavia, Turkey, Cyprus, Pakistan, Korea, Syria, Morocco, and Egypt.
[616] DTTs signed with Singapore, China, Uzbekistan, and Jordan.
[617] With Germany, UK, Austria, The Netherlands, Belgium, Czech Republic, Ukraine, Croatia, Hungry, Malta, Russian Federation, Lebanon, Mauritius and South Africa.

"... The Contracting States may agree in bilateral negotiations upon a lower tax or even on exclusive taxation in the State of the beneficiary's residence with respect to all interest payments... in certain cases, the approach adopted in Article 11 (2) which is to allow source taxation of payments of interest, can constitute an obstacle to international trade... for instance, when the beneficiary of the interest has borrowed in order to finance the operation which earns the interest, the profit realized by way of interest will be much smaller than the nominal amount of interest received; if the interest paid is equal to or exceeds the interest received, there will be either no profit at all or there will be a loss. The problem in that case cannot be solved in the State of residence, since little or no tax will be levied in that State where the beneficiary is taxed on the net profit derived from the transaction. That problem arises because that tax in that State of source is levied on the gross amount of interest regardless of the expenses incurred in order to earn such interest. In order to avoid that problem, creditors will shift to the debtor the burden of the tax levied by the State of source on the interest and therefore increase the rate of interest charged to the debtor, whose financial burden is then increased by an amount corresponding to the tax payable to the State of source[618]".

In other exceptions to the standard treatment of interest, some of Kuwait's DTTs limit the host state to a tax rate when taxing interest paid to a beneficiary who is a resident of the other contracting state. However, these DTTs[619] also allow exemptions for some beneficiaries; such as when the beneficiary is the government of the other contracting state, a government-owned enterprise, or when the interest arises from a loan guaranteed by a government. For example Article 11 (3) of Kuwait's DTT with Poland provides:

"Notwithstanding the provisions of Article 11(2), interest arising in a Contracting State shall be exempt from tax if derived by or on:

a. The government of the other Contracting State or any governmental institution.
b. A company which is a resident of the other Contracting State and at least 25% of its paid-up capital is owned or controlled directly or indirectly by the Government on a governmental institution.
c. Loans guaranteed by the Government of the other Contracting State or any governmental institution or other entity…"

[618] Kees Van Raad (note 590 supra).
[619] DTTs signed with Poland, Greece, Bulgaria, Belarus, Indonesia, Mongolia, Sudan, Ethiopia, Romania, Sri Lanka, and Tunisia.

The governmental shareholding in the beneficiary company referred to in Article 11 (3) (b) above[620] may vary between 25% in DTTs with Poland, Greece, Bulgaria, Belarus, Romania, Sri Lanka and Indonesia, to 49% in the DTTs with Indonesia, Mongolia, Sudan, Ethiopia, and Tunisia.

The OECD's Commentary explains the rationale for exempting interest when it is paid to the government of a company owned by the government, or a government entity:

"Where the payer of the interest happens to be the State itself, a political subdivision or a statutory body, the end result may well be that the tax levied at source may actually be borne by that State if the lender increases the interest rate to recoup the tax levied at source. In that case any benefits for the State taxing the interest at source will be offset by the increase of its borrowing costs[621]."

3. Royalties[622]

When it comes to Kuwait's DTTs' treatment of royalties, all of them adopt the UN Model, i.e. allowing royalties to be taxed by the host state when the beneficiary is a resident of the other contracting state with a limited rate of the tax agreed upon through bilateral negotiations between both states. Article 12 of the UN Model provides:

"1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but <u>if the beneficial owner of the royalties is a resident of the other Contracting State,</u> the tax so charged shall not

[620] See p.204.
[621] Kees Van Raad (note 590 <u>supra</u>).
[622] Article 12 (2) of the OECD 2010 Model provides: "The term "royalties" as used in this Article means payment of any kind received as a consideration of the use of, or the right to use any, copy right of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial and scientific experience.

exceed___ per cent (the percentage is to be established through bilateral negotiations)
of the gross amount of royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation".

The OECD Model, on the other hand, leaves taxing royalties exclusively for the beneficiary's state of residence[623].

In adopting the UN Model in its tax treatment of royalties, Kuwait's DTTs vary as to rate of tax allowed for the host state to impose on royalties paid to a beneficiary resident of the other contracting state - twenty six DTTs[624] adopt the standard 10% rate of tax, whilst seven DTTs[625] adopt a 20% rate of tax, five DTTs[626] adopt a 5% rate tax, three DTTs[627] adopt a 30% rate of tax and in Kuwait's DTT with Greece, the rate of tax adopted is 15%.

### 6.7.3 Treatment of Capital Gains

#### (i) Eliminating Double Taxation on Capital Gains

In general, the initial tax treatment of capital gains under the OECD and the UN Model is very similar when it comes to taxing capital gains from the alienation of immovable property. Article 13 (1) of both the OECD and the UN provides:

"Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 income from immovable property and situated in the other Contracting State may be taxed in that other State."

[623] Article 12 (1) OECD Model, 2010, provides: "Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State be taxed only in that other State."
[624] With Germany, UK, Switzerland, Austria, Belgium, Yugoslavia, Czech Republic, Ukraine, Bulgaria, Croatia, Turkey, Hungry, Malta, Belarus, Russia, Canada, Pakistan, Malaysia, Singapore, China, Mongolia, Mauritius, Morocco, Sudan, South Africa, and Egypt.
[625] With Romania, Venezuela, Indonesia, Thailand, Sri Lanka, Uzbekistan, and Syria.
[626] With The Netherlands, Poland, Cyprus, Korea, and Tunisia.
[627] With Lebanon, Jordan, and Ethiopia.

When it comes to the taxation on capital gains from the alienation of movable property the UN Model offers a slightly wider jurisdiction for the host state.

Both the OECD and the UN Models apply the same rule when it comes to capital gains from the alienation of movable property which forms a part of the business property of a permanent establishment which is an enterprise a contracting state has in the other contracting state. Article 13 (2) of the OECD Model provides:

"Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State."

The UN Model adopts the above paragraph in the first part of Article 13 (2) of the UN Model, but adds capital gains from alienating movable property belonging to a fixed base of an enterprise of one contracting state situated in the other contracting state for the purpose of performing independent personal services. This latter provision provides:

"... or movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services."

Thus, Article 13 (2) of the UN Model allows a wider jurisdiction for the host State to tax capital gains by including the alienation of movable property belonging to an enterprise performing independent personal services in the host state, in addition to capital gains arising due to the alienation of movable property belonging to a permanent establishment which an enterprise has in the host state.

The OECD and the UN Models similarly tax gains from the alienation of ships, aircraft and boats, or movable property pertaining to such transport vehicles, in

the contracting State in which the place of effective management of the enterprise is situated[628].

In its treatment of capital gains from the alienation of shares, the UN Model also allows a slightly wider jurisdiction for the host State to tax than the OECD Model. Article 13 (4) of the OECD Model provides:

"Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other Contracting State."

The UN Model, on the other hand, expands the equivalent of Article 13 (4) to include capital gains from the alienation of interests in partnerships, trusts and estates in addition to the shares of companies. Article 13 (4) of the UN Model provides:

"Gains from the alienation of shares of the capital stock of a company, <u>or of an interest</u> in <u>a partnership</u>, <u>trust or estate</u>, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. <u>In particular:</u>

1. Nothing contained in this paragraph shall apply to a company, partnership, trust or estate , other than a company, partnership, trust, or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.
2. For the purpose of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding fifty percent of the aggregate value of all assets owned by the company, partnership, trust or estate."

The UN Model goes further in Article 13 (5) by allowing the alienation of shares - other than those mentioned in Paragraph 4 – to be taxed in the host state where the

[628] Special provision is made in the OECD and the UN Models for taxation of "capital gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated". Article 13 (3) of the OECD Model 2010, and the UN Model 2001.

company alienating the shares is a resident. The OECD Model has no equivalent of the UN Model of Article 13 (5) which provides:

"Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of ___per cent (the percentage is to be established through bilateral negotiations) in a company which is a resident of a Contracting State may be taxed in that State."

The UN Model concludes with Article 13 (6) which is the equivalent of the OECD Model's Article 13 (5), each of these paragraphs provides that the alienation of any property not included in the other Article 13 paragraphs will be taxable only in the contracting state of which the alienator is a resident.

**(ii) Kuwait's DTTs Treatment of Capital Gains**

Kuwait's DTTs vary in their treatment of the taxation of capital gains. The most adopted version of Article 13 on the taxation of capital gains in Kuwait DTTs is a hybrid between the OECD and the UN Model. This appears in twenty eight of Kuwait's DTTs[629] and adopts in its first paragraph the standard treatment of gains on the alienation of immovable property found in both the OECD and the UN Models, which allows gains derived by a resident of a contracting state from the alienation of immovable property in the other contracting state to be taxed in that

[629] DTTs signed with Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Germany, Hungry, Italy, Malta, the Netherlands, Montenegro, Poland, Turkey, Russia, Switzerland, Yugoslavia, China, Korea, Malaysia, Singapore, Thailand, South Africa, Sudan, Syria, Tunisia, Egypt, and Jordan.

other state[630]. However, when it comes to Article 13 (2), in these 28 DTTs the UN Model of provision for the taxation of gains on movable property is followed.

The following Article 13 (2) taken from the Kuwaiti Austrian DTT is illustrative:

"Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, maybe taxed in the other State."

The above paragraph allows a wider jurisdiction for the host state to tax gains from the alienation of movable property whether such movable property forms a part of the business property of a permanent establishment which an enterprise from a contracting state has in the other state, or gains from the alienation of movable property pertaining to a fixed base available to a resident of a contracting state in the other contracting state for the purpose of performing independent personal services. The OECD tax treatment of capital gains from movable property includes specifically only the first part of the above paragraph, i.e. gains from the alienation of movable property forming part of the business property of a permanent establishment, and does not expand the host's jurisdiction to tax gains from movable property of a fixed base used for the purpose of providing independent personal services.

Article 13 (3) in 28 of Kuwaiti DTTs[631] provides for the standard treatment of gains from the alienation of ships and aircraft as applied in both the OECD and the UN Model[632].

[630] Article 13 (1) of the 2010 OECD Model provides: "Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other Contracting State."

The 28 DTTs[633] constitute the majority of Kuwait's DTTs, conclude Article 13 with a paragraph 4 which provides that any gains rising from the alienation of any property not mentioned in provision 1, 2 or 3 of the Article shall only be taxable in the contracting state of which the alienator is a resident[634]. This provision replicates the standard last concluding paragraph of the OECD and the UN Models i.e. taxing gains derived from the alienation of any property not mentioned in earlier paragraphs in Articles 13 shall occur in the home state of the alienator. Thus Article 13 (5) of the OECD Model and Article 13 (6) of the UN Model provide:

"Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 4 shall be taxable only in the Contracting State of which the alienator is a resident"[635].

These Kuwaiti DTTs - unlike the OECD and UN Models (in Article 13 (4) and Article 13 (4) and (5)) – do not contain a provision in respect of capital gains on the alienation of shares. There is no clear reason why these DTTs fail to include a particular paragraph that deals with the taxation of gains derived from the alienation of company shares, and gains from the alienation of interests from partnerships, trusts and estate. However the answer may be found in the OECD's Commentary on Article 13 (5) of the OECD Model. It provides:

---

[631] See note 629.
[632] Article 13 (3) OECD and UN Model provide: "Gains from the alienation of ships or aircraft operated in international traffic or movable property to the operation of such ships or aircraft shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated."
[633] See note 629.
[634] Article 13 (5) of the OECD Model and Article 13 (6) of the UN Model provide: "Gains from the alienation of any property other than that referred to in paragraph 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident".
[635] The UN Model's version of Article 13 has 6 paragraphs, thus paragraph 6 provides that any gains from the alienation of property not referred to in paragraphs 1, 2, 3, 4 or 5..."

"Paragraph 5 of Article 13 includes shares, bonds, and other securities, although the paragraph does not contain special rules for gains from the alienation of shares in a company (*other than the shares dealt with in paragraph 4*) or of securities, bonds, debentures and the like. Such gains are therefore taxable only in the State of which the alienator is a resident[636]".

Thus, the concluding paragraph of Article 13 of the OECD and the UN Model, whether it is paragraph 5 or 6, provides comprehensive treatment taxing the gains derived from shares, interests and other types of alienated property not mentioned previously in the Article. The OECD Commentary also provides:

"Article 13 leaves it to the domestic law of each Contracting State to decide whether capital gains should be taxed and, if they are taxable, how they are taxed. The Article can in no way be construed as giving a State the right to tax capital gains if such right is not provided for in its domestic law..."

Both of the above passages in the OECD Commentary may help to explain why these Kuwaiti DTTs do not include the specific paragraphs in the OECD and the UN Models which make a particular provision for taxation of gains on the alienation of certain property such as shares. This is the reason, therefore, why Kuwait is happy to rely on the general provision in Article 13 (4) of these DTTs.

In addition to having 28 DTTs which deviate from the standard capital gains Article in the OECD and the UN Models, Kuwait's other DTTs also include variations in their treatment of certain capital gains under Article 13. In eight of Kuwait's DTTs[637] the first and the second paragraph of Article 13 provide for a 50% reduction when capital gains are taxed in the host state. For example, the DTT between Kuwait and Indonesia provides:

"1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting

[636] Kees Van Raad (note 590 supra).
[637] DTTs signed with Indonesia, Mongolia, Pakistan, Uzbekistan, Ethiopia, Mauritius, Venezuela, and Lebanon.

State maybe taxed in the other Contracting State, but the tax charged shall be reduced by an amount equal to 50% of such tax.

2.Gains from the alienation of movable property forming part of the business property of the permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in the other Contracting State, but the tax so charged shall be reduced by an amount equal to 50% of such tax."

In Kuwait's DTTs with Belarus and Ukraine, Article 13 (1) on gains from immovable property concludes with a condition which provides that in the case of the liquidation of an enterprise the tax so charged shall be reduced by an amount equal to 50% of such tax:

"1. Gains derived by a resident of a Contracting State from the alienation of immovable property... in the other Contracting State may be taxed in that other State. However, in the case of liquidation of an enterprise the tax so charged shall be reduced by an amount equal to 50% of such tax[638]."

Only in Kuwait's DTTs with Canada and India does Article 13 appear in its most comprehensive form[639]. Interestingly in these two DTTs Article 13 (4) is in its most expansion form in comparison with Kuwait's other DTTs. Both DTTs provide, as follows, in Article 13 (4) for the taxation of gains arising from the alienation of company shares, interest in partnerships trust or estate. In particular the DTT between Kuwait and Canada provides:

"4.Gains derived by a resident of a Contracting State from alienation of:

a) shares of the capital stock of a company the property of which consists wholly or principally of immovable property situated in the other Contracting State, and

[638] Article 13 (1) of Kuwait's DTT with Ukraine, signed January 20th, 2003, (in force).
[639] See p. 107 for full wording of Article 13 (2) of the UN Model.

b) an interest in a partnership, trust or estate, the property of which consists wholly or principally of immovable property situated in the other Contracting State[640]".

Kuwait's DTT with France adopts a slightly different version of treatment of capital gains derived from the alienation of shares. It provides in Article 13 (3) as follows:

"3.gains from the alienation of shares representing a substantial shareholding in the capital of a company are taxable in the State of which the company is a resident. A substantial shareholding is deemed to exist when the seller holds, directly or indirectly, shares which, in their entirety give right to 25% or more of the company's profits."

Finally, the most unusual treatment of the taxation of capital gains is in Kuwait's DTTs with The Netherlands and the UK which not only deviate from the OECD and the UN Models, but also contain provisions not mentioned in any of Kuwait's other DTTs. For example, in the UK DTT Article 13 (4) provides:

"Gains from the alienation of any property other than that referred to in paragraph 1, 2, and 3 of this article shall be taxable only in the contracting state of which the alienator is a resident".

Article 13 (5) then continues:

"The provisions of paragraph 4 of this Article shall not affect the right of a Contracting State to levy according to its law a tax on capital gains from the alienation of any property derived by an individual who is a resident of the other Contracting State and has been a resident of the first-mentioned Contracting State at any time during the five years immediately preceding the alienation of the property."[641]

The above paragraph extends the jurisdiction of the host state, where the property alienated is situated, whenever a resident of a contracting state who is also the alienator has resided in the host state any time during the first five years

[641] Article 13 (5) of Kuwait's DTT with the UK, signed in February 23rd, 1999, (still in force).

consequent to the alienation. Under these circumstances the host state is allowed to tax the gains. The purpose of this Article may well be to recognize the host state's equal entitlement to impose taxation on capital gains from the alienation of any property once the alienator has resided in the host state following the alienation, when the beneficiary is alienating property with an intention to depart the state where the property was alienated, there is reasonable rational in providing the host state - where the alienation took place – with the right to tax the resulting gains.

In Kuwait's DTT with The Netherlands, a novel Article 13 (5) allows the host state to tax gains from the alienation of shares in its jurisdiction by an alienator residing in the other contracting state under defined circumstances, Article 13 (5) provides:

"... A Contracting State may levy tax on gains derived by an individual who is a resident of the other Contracting State from the alienation of shares of a company and which under the laws of the first mentioned Contracting State, is a resident of that State, and from the alienation of part of the rights attached to that said shares, if that individual, either alone or with his or her spouse, or one of their relations by blood or marriage in the direct line directly or indirectly holds at least 5% of the issued capital of a particular class of shares in that company. This provision shall apply only if the individual who derives the gains has been a resident of the first mentioned State in the course of the last ten years preceding the year in which the gains are derived and provided that, at the time he became a resident of the other Contracting State, the above mentioned conditions regarding share ownership in the said company were satisfied."

The above paragraph requires the satisfying of a number of conditions before allowing the host state to tax gains from the alienation of shares (and other rights linked to the shares alienated) yielded by a resident of the other contracting state, from the shares of a company resident in the first mentioned State. Indeed, the

purpose of this Article may well be as mentioned above[642] to recognize the host state's equal entitlement to levy taxation on capital gains from the alienation of shares once the alienator has satisfied one or all of the conditions mentioned in the Article 13 (5), i.e. residency or holding 5% of the distributing company's issued capital. It is a plausible argument that the host state should have the equal right to tax gains under the circumstances mentioned in the Article above since the beneficiary has shown considerable signs of residing in the host state for a significant amount of time after his/her alienation of the said shares or by holding[643] a substantial amount of shares in the distributing company either alone or with a spouse or a relative (directly or indirectly).

This provision is a complex and restricting one as it requires many conditions to be satisfied before allowing the host state to tax gains alienated by a resident of the other contracting state even when the gains are derived from the alienation of shares of a company residing in the host State.

From the above it is clear that Kuwait's DTTs with other states adopt a wide variation of treatments when it comes to taxing capital gains derived from the alienation of movable and/or immovable property. As has been explained earlier[644], there is no clear reason why such deviations exist, as the provisions and the wording of each DTT depends on the mutual negotiations of the contracting states, in each instance.

[642] See p. 201 Article 13 (5) of Kuwait's DTT with The UK.
[643] Either alone or with his/her spouse or blood relative, directly or indirectly.
[644] See p. 199.

### 6.7.4 Administration Provisions in DTTs

#### 1) The Non-Discrimination Provision

Discrimination in tax can be regarded as the unfavourable treatment of a taxpayer in comparison with another taxpayer or category of taxpayers in respect of the same taxable item(s) and in the same circumstances[645]. The non-discrimination provision included in both the OECD and the UN Models seeks to provide fairness in the tax treatment of: (1) a national of the other state in similar circumstances; (2) stateless persons who are residents of either state; (3) a permanent establishment located in a state carrying on the same activities as domestic enterprises of the state; (4) the tax deductibility of otherwise deductible business expense when paid to a non-resident; and (5) foreign owned and controlled domestic enterprises[646].

When it comes to eliminating discriminatory tax treatment, a state's right of regulation in this area is tempered by bilateral international tax treaties which contain Paragraphs that are usually based on Article 24 of the OECD Model. Consideration of sovereignty and jurisdiction are of fundamental relevance to the application of Article 24. The OECD Model is not the only place where the problem of discrimination is dealt with, there are also non-discrimination Paragraphs in the UN and the US Models and in commercial trading treaties from which the OECD Paragraphs are derived. However the reason why attention has

[645] Holmes (note 530 supra)
[646] See p. 220 for Article 24 of the OECD Model 2010.

been focused on Article 24 of the OECD Model, is that as previously indicated[647], the OECD Model is the more influential model treaty. This is especially true with respect to the non-discrimination Article, since the UN Model non-discrimination Paragraphs of the OECD and the US treaty conform to it for the most part. The first point to note in regard to Article 24 of the OECD Model is that it applies to taxes of every kind and description, unlike the other provisions which only apply to taxes on capital and income[648].

In this following analysis, emphasis will be directed to paragraph 1 of Article 25 of the OECD Model concerning nationals from the other state in similar circumstances.

### a) The scope of the non-discrimination obligation in the OECD model

Under the OECD: the non-discrimination obligations under the OECD Model convention broadly obligate contracting states to;

"provide no less favourable taxation (1) of a national of the other state in similar circumstances, recognizing that the residents and non-residents are not in the same circumstances; (2) of stateless persons who are residents of either state; (3) of a permanent establishment located in a state carrying on the same activities as domestic enterprises of the state; (4) as to the tax deductibility of otherwise deductable business expenses when paid to a non-resident; and (5) of foreign owned and controlled domestic enterprises[649]".

These obligations apply to taxes of every kind and description (i.e. to all direct and indirect taxes) levied by, or on behalf of the state, its political subdivisions or

---

[647] See pp. 177-181.

[648] Jeffery R., (1999), *The Impact on State Sovereignty on Global Trade and International Taxation*, Kluwer, p. 63.

[649] The OECD Negotiation Group on the Multinational on Investment (MAI), (2010), *Non-Discrimination in Bilateral Tax Conventions,* http://www.oecd.org/daf/mai/pdf/ng/ng988r1e.pdf [visited 13/7/2011].

local authorities. Thus the non-discrimination provision under the OECD Model provides for national treatment covering all types of taxes to enterprises with a significant presence, i.e. through a local subsidiary or PE in a contracting state. The provision also provides national treatment regarding the deductibility of payments made to foreign persons, thereby indirectly protecting non-resident investors[650]. However, it is important to explain what kinds of non-discrimination the OECD Model does not provide for under Article 24. The OECD Committee on Fiscal Affairs has concluded[651] that under the various Paragraphs of Article 24 non-discrimination can only arise when all factors are equal and the different treatment is solely based on the difference that is prohibited by the relevant paragraph. Article 24 does not seek to ensure Most Favoured Nation Treatment and is not intended to provide foreign nationals or non-residents with a tax treatment that is better than that of nationals or resident enterprises. The Article does not cover covert or indirect discrimination, and the non-discrimination provisions of the Article are precisely drafted and do not introduce an all encompassing non-discrimination rule[652].

There is a need to look closely at how the OECD non-discrimination provision is applied, and how Kuwait tackles the discrimination issue when it comes to its DTTs.

---

[650] Non-Discrimination in Bilateral Tax Conventions, OECD, Negotiating Group on the Multilateral Agreement on Investment (MAI), (1996), (document issued during the MAI negotiations which took place between 1995 and 1998), p.3-5 http://www1.oecd.org/daf/mai/pdf/eg2/eg2rd961e.pdf [visited 4/8/2009].
[651] *Id.*
[652] *Id.*

### b) Application of Article 24 (1) of the OECD 2010 Model

#### (i) Nationality and Residency

Article 24 (1) of the OECD Model prevents discrimination based on nationality but only with respect to companies which are in the same circumstances:

"1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or maybe subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States." [653]

Under the domestic laws of many states, incorporation or registration constitutes the criterion or one of the criteria to determine the residence of the companies for the purpose of Article 4 of the OECD Model. Under the definition of the term 'national' in Article 3 (1) (g) of that Model, however, registration or incorporation will also be the criterion to determine the 'nationality' of a company since a company will usually derive its status from the laws of the state in which it has been incorporated or registered. It is not always clear how the residence of a company can be distinguished from its nationality for the purpose of Article 24 (1). The OECD Working Group[654] has clarified, recently, that resident and non-resident companies are not in the same circumstances for the purpose of paragraph 1. The group accepted that different treatment of resident and non-resident companies is allowed by Article 24 (1), even when residence and nationality are

[653] Article 24 (1) of the OECD Model, 2010.
[654] The Working Party is the sub-group of the OECD Committee on Fiscal Affairs which is responsible for updating the OECD Model Tax Convention. (2007), *Application and Interpretation of Article 24 Non-Discrimination*, p.10. http://www.oecd.org/dataoecd/59/30/38516170.pdf [visited 1/9/2010].

linked through the criterion of incorporation or registration. Thus, paragraph 1 only prohibits a different tax treatment that is based exclusively on the fact that the entity derives its status from the domestic law of another state and requires that all other relevant factors including the residence of the entity be the same[655].

**(ii) Interpretation of 'In the same circumstances'**

There is some uncertainty as to the relevant factors for determining whether taxpayers are 'in the same circumstances' for the purpose of Article 24 (1). Paragraph 8 of the Commentary on Article 24 states that the phrase refers to taxpayers who are placed from the point of view of the application of the ordinary taxation laws and regulation in "substantially similar circumstances". However the term 'substantially' requires clarification. The above Working Group[656] indicated that taxpayers with limited tax liability are usually not in the same circumstances as taxpayers with unlimited tax liability. The Working Group added that 'in the same circumstances' might include, for example, the situation when a state subjects its nationals or some of them to a more comprehensive tax liability than non-nationals, as long as the treatment is not itself a violation of Article 24 (1).

[655] Jeffery (note 648 supra).
[656] Negotiation Group (note 649 supra).

### c) The Principle of National Treatment and Most Favoured Nation

A further question that arises is whether Article 24 (1) allows a national of one contracting state to obtain benefits granted by the other contracting state to a national of a third state. Here, the Working Group agreed that the wording of paragraph 1 was restricted to national treatment so that it was impossible to argue that the tax treatment, in one contracting state, of a national in the other contracting state should not be other or more burdensome than the taxation of nationals of third states in the same circumstances to which benefits may have been granted by reason of their nationality. The group has indicated that in its opinion, a national of state (A) cannot according to Article 24 (1) of a treaty based on the OECD Model between states (A) and (B) require that state (B) treat him for tax purposes, in the same way as another resident of state (A) who is a national of state (C).[657]

### 2) Kuwait's Application of Article 24 in its DTTs

Kuwait's "discrimination" against foreign enterprises carrying on business in Kuwait's jurisdiction is evident in both the scope of business activities permitted to foreign investors in Kuwait and in the taxation of their profits. The "discrimination" exercised in terms of the scope of business activity is evident in the Kuwaiti Company Law No. 15/1960, which restricts foreign participation in Kuwaiti companies to 49% shareholding and requires a national to hold at least

[657] OECD, (2007), *Application and Interpretation of Article 24 of the OECD's Non-Discrimination*, pp.1-4, http://www.oecd.org/dataoecd/59/30/38516170.pdf [visited 22/5/2010].

51% of the company's shares[658], this is discussed in length in chapter 4[659]. Also Article 23 of Kuwaiti Commercial Law No. 68/1980 states that non-Kuwaitis are not permitted to carry on trade in Kuwait unless they have a Kuwaiti partner who is required to own 51% of the business[660]. Moreover, Article 24 of the same law states that foreign enterprises are not allowed to either establish a branch or conduct a commercial transaction in Kuwait unless through an Kuwaiti agent[661]. Kuwait also 'discriminates' against foreign enterprises in terms of the taxation of their profits[662]. Both the Tax Decree No. 3/1955, and the 2008 tax amendments apply to national and foreign companies, however, in practice, taxation is only imposed on the profits of foreign enterprises. Even in the case where a foreign entity holds shares in a national company, taxes will only fall on the profits attributable to the foreign enterprise[663].

This said, Kuwait adopts Article 24 of the OECD Model[664] in all of its DTTs[665], thus, less favourable treatment of foreign enterprises does not constitute a violation of Article 24 of the OECD Model for the reasons mentioned above[666]; that according to the OECD Working Group[667] resident and non-resident

---

[658] Article 47 of the Kuwait Company Law No. 15/1960.
[659] See pp. 115 – 123.
[660] See pp. 116-117.
[661] Al Hayan, A. (2003), *The Kuwaiti Foreign Investment Law: Comments and Suggestions*, Arab Quarterly, pp.327-328.
[662] See pp. 112-114.
[663] See p. 110-112.
[664] "1.Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or maybe subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States."
[665] Except those with Germany, France and Canada.
[666] See note 664.
[667] See note 654.

companies are not in the same circumstances for the purpose of Article 24 (1), and that the different treatment of resident and non-resident companies is allowed by Article 24 (1).

### 6.7.5 Exchange of information under the OECD and the UN Models

The wording of Article 26 concerning the exchange of information in both the OECD and the UN is very similar. Article 26 of the OECD Model provides:

1. The competent authorities of the Contracting States shall exchange such information as is foreseeable relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivision or local authorities, insofar as the taxation there under is not contrary to the Convention. The exchange of information is not restricted by Article 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment and collection of, the enforcement or prosecution in respect of, the administration of appeals in relation to the tax referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

3. In no case shall the provisions of paragraph 1 and 2 be construed so as to impose on a Contracting State the obligation:

a. to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
b. to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
c. to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy.

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain

> the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the proceeding sentence is subject to the limitation of paragraph 3 but in no case shall such limitation be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information."

The above Article underlines the importance and the limitation of exchanging information between the two contracting states. The UN Model version of Article 26 does not differ significantly from the OECD Model: however there is no equivalent to Article 26 (4) of the OECD Model in Article 26 of the UN Model, and the UN Model runs together paragraphs 1 and 2 of Article 26 in the OECD Model, combining them in Article 26 (1) of the UN Model. Further, Article 26 of the UN Model allows the contracting states more freedom in terms of developing the methods by which the exchange of information is undertaken, so the ending of Article 26 (1) of the UN Model provides:

"... the competent authorities shall, through consultation, develop appropriate conditions, methods and techniques concerning the matter in respect of which such exchange of information shall be made, including, where appropriate, exchanges of information regarding tax avoidance."

**(i) Kuwait's DTTs policy on the Exchange of Information**

All of Kuwait's DTTs include an exchange of information clause. The paragraphs adopted in Kuwait's DTTs are closer to the UN Model as they do not include an equivalent to paragraph 4 of the OECD Model.

### 6.7.6 Article 27 of the OECD Model: Assistance in the Collection of Taxes

In the absence of inter-governmental agreements to the contrary, generally, tax judgements of the courts in one country cannot be enforced in another country. Therefore, judgements in favour of a tax administration, which permit recovery of assets from a non-resident taxpayer to meet its tax liability, are ineffective in practice in the absence of a specific article in a DTT that provides for assistance in the recovery of taxes. Where such provision is made, assistance in the collection and recovery of tax can take many forms, including assistance in serving documents (such as tax returns and assessment notices), exchanging information relevant to collection, preservation of assets, issuing demands for payment, prosecution, and seizure of assets[668]. The new Article 27 of the OECD Model is concerned with assistance in the collection of tax. However, this Article does not exist in any of Kuwait's current DTTs. According to the OECD Commentary this is intended to achieve the following:

"This article provides the rules under which Contracting States may agree to provide each other assistance in the collection of taxes. In some States national law or policy may prevent this form of assistance or set limitations to it. Also, in some cases, administrative considerations may not justify providing assistance in the collection of taxes to another State or may similarly limit it. During the negotiations, each Contracting State will therefore need to decide whether and to what extent assistance should be given to the other State[669]."

Although Kuwait's DTTs do not implement this Article, some of Kuwait's DTTs[670] implement an Article 27 that deals with different subject matter and is

[668] Holmes (note 530 supra).
[669] Kees Van Raad (note 590 supra).
[670] Signed with Germany, Austria, the Netherlands, Poland, Bulgaria, Belarus, Russia, Canada, Venezuela, Thailand, Sri Lanka, Mongolia, Uzbekistan, Lebanon, Jordan, Syria, Indonesia,

entitled "Miscellaneous"[671]. This Article provides that the authorities of both contracting states shall arrange the manner in which the limitation and exemptions of the Articles in the DTT are implemented. It also protects the rights of residents of a contracting state to benefit from incentives and allowances provided for in the domestic laws of the other contracting state. For example, the DTT between Kuwait and Austria provides:

"1. The competent authorities of the Contracting States shall mutually agree on arrangements concerning the manner in which the limitations and exemptions contained in the foregoing Articles are to be implemented.

2. This Agreement shall not affect the right of the residents of a Contracting State to benefit from tax and investment incentives, exemptions and allowances provided for by the other Contracting state in accordance with its domestic laws, regulations and administrative practices[672]."

Such an Article is very important in terms of the two party states agreeing on the manner of implementation, but it also provides important protection for the beneficiary of one contracting state who benefits from tax incentives provided in the domestic law of the other contracting state.

### 6.7.7 Methods for Eliminating Double Taxation

The manner by which double taxation may be eliminated can vary as has been mentioned earlier in this chapter.[673] There are three methods: exemption,

---

Singapore, China, Malaysia, Pakistan, Mauritius, Morocco, South Africa, Tunisia, Ethiopia, and Egypt.

[671] Other Kuwaiti DTTs signed with the UK, Switzerland, Greece, Ukraine, Croatia, Turkey, Romania, Cyprus, Hungry, Malta and Korea do not have the "Miscellaneous" clause in them.

[672] Article 27 of the DTT between Kuwait and Austria, signed June 13th 2002, (in force).

[673] See pp. 172-175.

deduction and the credit system. As will be seen, Kuwait's DTTs are not consistent in the application of these methods.

a) Eliminating double Taxation under the OECD and the UN Model

Article 23 of the OECD and UN Models state the methods by which double taxation may be eliminated. Thus, Article 23 of the OECD Model provides for two methods :

"Article 23 A. Exemption Method

1.Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

2.Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10 and 11 may be taxed in the other Contracting State, the first mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

3.Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income of capital of such resident, take into account the exempted income or capital.

4.The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions for paragraph 2 of Article 10 or 11 to such income.

Article 23 b. Credit Method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provision of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:

a. as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;
b. as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in the other State.
Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2.Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital".

The only difference between Article 23 in the OECD and the UN Models is that Article 23 in the UN Model does not include an equivalent to paragraph 4 of the OECD Model. As mentioned above,[674] Kuwait's DTTs adopt various ways to eliminate double taxation:

b) The Methods for Eliminating Double Taxation in Kuwait's DTTs

In three of Kuwait's DTTs signed with Germany, the UK and France[675], the latter contracting states apply two methods credit and exemption, whilst Kuwait applies the deduction method. Thus, in the DTT between Kuwait and Germany it is provided:

"1. In the case of Germany:

a)unless the provisions of subparagraph (b) apply, there shall be excluded from the basis upon which German tax is imposed, any income arising in the State of Kuwait and any item of capital situated in the State of Kuwait...

...the foregoing provisions shall apply only to such dividends as are paid to a company (not including partnerships) being a resident of Germany by a company being a resident

[674] See p. 227.
[675] Kuwait's DTT with UK and France are more or less fashioned very similarly to Kuwait's DTT with Germany in their approach to their elimination of double taxation.

of the State of Kuwait at least 10% of the capital of which is owed directly by the German company.

For the purposes of taxes on capital there shall also be excluded from the basis upon which German tax is imposed any shareholding, the dividends of which are excluded or if paid, would be excluded according to the immediately foregoing sentence, from the basis upon which German tax is imposed.

b)subject to the provisions of German tax law regarding credit for foreign tax, there shall be allowed as a credit against German income and corporation tax payable in respect of the following items of income arising in the State of Kuwait the tax paid under the laws of the State of Kuwait and in accordance with this agreement on:

(1) Dividends not dealt with in sub-paragraph (a);
(2) Royalties to which Article 12 applies;
(3) Remuneration to which Article 16 applies;
(4) Income to which Article 17 applies;
(5) Income from immovable property to which Article 6 applies.

2.In the case of Kuwait:

Where a resident of Kuwait derives income or owns capital which in accordance with this agreement may be taxed in both Germany and Kuwait, Kuwait shall allow as a deduction from the tax on the income or on the capital of that resident an amount equal to the tax paid on the income or on the capital in Germany[676]."

In 3 of Kuwait's DTTs[677] both contracting States implement the credit system:

"(a) where a resident of Mauritius derives profits or income from sources within Kuwait... Mauritius shall allow the Kuwaiti tax payable as a credit against any Mauritius tax computed by reference to the same profits or income by reference to which the Kuwaiti tax payable is computed.

(b) If a resident of Kuwait derives profit or income from sources within Mauritius...Kuwait shall allow the Mauritius tax payable as a credit against any Kuwaiti tax computed by reference to the same profit or income by which the Mauritius tax payable is computed.[678]"

[676] Article 24 of the DTT between Kuwait and Germany signed December 4th 1987, (in force).
[677] Signed with Lebanon, Mauritius, and Morocco.
[678] Article 24 (a) and (b) of the DTT between Kuwait and Mauritius, signed in March 24th 1997.

Within other Kuwaiti DTTs there are contracting States which adopt two methods for eliminating double taxation in the DTT, treating particular income and profits differently when eliminating double taxation;

In 8 of Kuwait's DTTs[679] the other contracting State adopts two different methods i.e. exemption and deduction to eliminate double taxation whilst Kuwait implements the deduction method only. In Kuwait's DTT with The Netherlands[680], the latter exempts income from immovable property, business profits, dividends, interest, royalties and capital gains, while it adopts the deduction method for other dividends, interest, royalties and capital gains. Article 28 (1) of the DTT between Kuwait and The Netherlands provides

b) when a resident of the Netherlands derives income which according to Article 6, Article 7, paragraph 5 of Article 10, paragraph 3 of Article 11, paragraph 4 of Article 12, paragraph 1 and 2 of Article 13, Article 14, paragraph 1 of Article 15, paragraph 1 (subparagraph) and 2 (subparagraph) of Article 19, and paragraph 2 of Article 22 of this agreement may be taxed in Kuwait... The Netherlands shall exempt such items of income...

c) Further, the Netherlands shall allow a deduction from the Netherlands tax as computed for the item of income which according to paragraph 2 of Article 10, paragraph 2 of Article 12, paragraph 5 of Article 13, Article 16, Article 17, paragraph 2 and 3 of Article 18 of this agreement...the amount of the deduction shall be equal to the tax paid in Kuwait on these items of income...

2)... Kuwait shall allow as a deduction from the tax on the income of that resident, an amount equal to the tax on income paid in the Netherlands. Such deduction shall not, however, exceed the part of the tax on income as computed before the deduction is given.[681]"

---

[679] Signed with Switzerland, Austria, Belgium, Bulgaria, Hungry, Malaysia, Poland and the Netherlands.

[680]Other DTTs Kuwait has signed with Switzerland, Austria, Hungry, Malaysia, and Poland, implement more or less the same strategy as the Netherlands in differentiating between different income/profit when it comes to eliminating double taxation. However, the type of income and profit which the treaties mentioned here might exempt or deduct differs from one DTT to the other.

[681] Article 23 paragraph 1 (b) and (c) and paragraph 2 of the DTT between Kuwait and the Netherlands signed May 29th 2001, (in force).

In 22 of Kuwait's DTTs[682] both contracting states apply the deduction method.

For example, in the DTT between Kuwait and Romania it is provided:

"2. It is agreed that double taxation shall be avoided in accordance with the following sub-paragraphs:

a) In the case of Romania:

taxes paid by Romanian residents in respect of income or capital taxable in Kuwait, in accordance with the provisions of this agreement , shall be deducted from the Romanian taxes due according to the Romanian fiscal laws.

Such deduction shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable to the income on the capital which may be taxed in Kuwait

b) Where a resident of Kuwait :

… Kuwait shall allow as a deduction from the tax on income of that resident, an amount equal to the income tax paid in Romania.

Such deductions shall not, however, exceed that part of the income tax computed before the deduction is given, which is attributable to the income which may be taxed in Romania[683]."

The second most popular method of eliminating double taxation adopted in Kuwait's DTTs is when Kuwait adopts a deduction method whilst the other contracting State implements DTT between the credit method. In 7 of Kuwait's DTTs[684] this practice has been followed for example in the DTT between Kuwait and Pakistan:

"a) in the case of Pakistan:

[682] Signed with Yugoslavia, Czech, Italy, Ukraine, Greece, Croatia, Turkey, Romania, Cyprus, Malta, Belarus, Canada, Venezuela, Sri Lanka, Mongolia, Jordan, Syria, South Africa, Tunisia, Ethiopia, Egypt, and Zimbabwe.
[683] See Article 24 (1) and (2) of the DTT between Kuwait and Romania, signed in July 26th 1992, (in force).
[684] Signed with Russia, Pakistan, Singapore, Indonesia, Uzbekistan, China, and Korea.

Subject to the provisions of the law of Pakistan... the amount of Kuwaiti tax and in accordance with the provisions of this agreement... in respect of income from sources within Kuwait which has been subjected to tax both in Pakistan and Kuwait, shall be allowed as a credit against the Pakistan tax payable in respect of such income but in an amount not exceeding that proportion of Pakistan Tax which such income bears to the entire income chargeable to Pakistan tax.

b) in the case of Kuwait:

... Kuwait shall deduct from the taxes so calculated the tax paid in Pakistan but in an amount not exceeding that proportion of the aforesaid Kuwaiti tax which such item of income bear to the entire income[685]."

### 6.7.8 Dispute Settlement: Mutual Agreement Procedure

Finally, Kuwait adopts in all of its DTTs Article 25 of the OECD and the UN Models; this article provides the procedure of settling any arising disputes, difficulties or doubts.

There is no difference between Article 25 in the OCED and the UN Models. Article 25 of the OECD Model 2010 provides:

1. Where a person considers that the actions of one or both of the Contracting States results or will result for him in taxation not in accordance with the provisions of this convention, he may, irrespective of the remedies provided by the domestic laws of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the convention.
2. The competent authority shall endeavour, if the objection appears to it to be justified and of it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the

[685] Article 22 (a) and (b) of the DTT between Kuwait and Pakistan, signed June 30th 1998, (in force).

Contracting State, with a view to the avoidance of taxation which is not in accordance with the convention. Any agreement reached shall be implemented notwithstanding anytime limits in the domestic law of the Contracting State.

3. The competent authorities of the Contracting State shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation of application of the convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.
4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission for the purpose of reaching an agreement.

## 6.8 Conclusion

Kuwait being a country that aims to attract FDI to its jurisdiction has entered into DTTs which, as has been seen, are in some cases beneficial to its fiscal interest and in some cases are not. The various DTTs which Kuwait has entered into with other states show on many occasions deviation from the standard OECD and the UN Model Convention. However, in the present era of global economic integration and interdependence of countries, states cannot shape their attitudes towards international investment without carefully considering external fiscal relations with other states. In some instances, a constraint on a country's freedom of fiscal action may be market led, for example a developing country may offer tax incentives to attract foreign direct investment not because it necessarily wishes to do so (as it is likely to lose tax revenue) but in order to compete with other countries which also offer incentives[686].

[686] Salter, D. (2010) *Tax Constraints on Developing Countries and the Global Economic Recession*, cited in Faundez, J., and Tan, C., (2010) *International Economic Law, Globalization and Developing Countries*, Edward Elgar, pp.132-142.

In some cases Kuwait might be sacrificing tax revenues when allowing incomes arising in its jurisdiction to be taxed in the home state in return for the job opportunities or the technical experience and know-how which an enterprise brings to Kuwait. There is no single or accepted template for a tax system, every state endeavours to design a tax system which is a reflection of its needs and requirements set against its projected need for resources[687]. As to why Kuwait enters into DTTs and what does it benefit or lose from doing so? The simple answer may be to attract more FDI, an assumption supported by the argument provided earlier in this chapter[688], but since Kuwait is looking to attract FDI this means it is potentially serving as a host state, thus entering into DTTs can also be restricting to a host state's authority to tax corporate income from foreign investors[689] but to potential investors a state entering into DTTs is signalling its commitment to stable, correct and often favourable treatment towards foreign investors[690].

[687] *Id*.
[688] See pp. 177-181.
[689] See pp. 179- 181.
[690] See pp. 179 -182.

# Chapter 7: An Empirical Survey of Aspects of Kuwait's Tax System

## 7.1 Introduction

This chapter is the product of various interviews and questionnaires carried out with tax experts working in Kuwaiti tax audit firms, financial directors of foreign enterprises doing business in Kuwait, and tax inspectors (employees) in Kuwait's Department of Income Tax. All such persons work closely with Kuwait's tax law and have witnessed the transition from the old Tax Decree 3/1955 to the new Tax Law Amendments 2/2008 and have a clear idea of the advantages and disadvantages of both tax provisions and they can assess the effects which Tax Law Amendments 2/2008 have on foreign enterprises working in Kuwait.

## 7.2 Field Work

Between February and May 2009 the following empirical data was collected. This empirical research includes quantitative and qualitative methodology, through personal interviews with the financial controllers of foreign taxable entities operating in Kuwait. Interviews were also conducted with tax auditors; these interviews are useful in understanding how Kuwait's tax policy can be improved in order to attract more FDI. Their opinions also indicate, indirectly, whether or not the Tax Department is effective in collecting tax revenue. Questionnaires were

also distributed to the employees of the Tax Department in the Ministry of Finance.

In practice, arguably, no research method is entirely qualitative or quantitative[691]; for example, a survey may collect qualitative data using open ended questions as well as closed questions. The selection of an appropriate research method is critical to the success of any research project, and must be driven by the research question and the state of knowledge in the area being studied. In general, a combination of research methods may be the most effective in achieving a particular research objective. Mixing qualitative and quantitative research methods is called triangulation of method. While most researchers develop expertise in one style, the two types of methods have different complementary strengths and when used together can lead to a more comprehensive understanding of a phenomenon[692].

The samples in this survey were selected carefully; all 11 auditing firms operating in Kuwait are included, this insignificant number of auditing firms in Kuwait is not surprising since the size of the Kuwaiti economy is quite small and taxation is only implemented on foreign enterprises. In addition to local Kuwaiti auditing firms, some of the auditing firms operating in Kuwait - included in this sample - are branches for international auditing firms; these are Deloitte, PricewaterhouseCoopers, Ernst & Young, KPMG and Rödl & Partners. The financial controllers of foreign enterprises interviewed were also carefully

[691] Yin, R.K. (1994), *Case Study, Design and Methods*, 2nd edition Newbury Park, Sage Publications, p.84.
[692] Moody, D. (2002), *Empirical Research Methods*, Monarch University, p.2, http://www.idi.ntnu.no

selected to represent various businesses from small caterers such as *Caesar* (Indian Cuisine) restaurant, telecommunication providers such as *Nokia and Siemens* to Global Oil field service providers such as *Schlumberger*. Finally the employees of the Kuwaiti Tax Department - for this sample, copies of the questionnaire were given to the head of each of the three divisions in the Tax Department: The Inspection and Tax Claim Division, The Tax Liability and Planning Division, and The International Tax Treaty Division, more on the work description of each division below[693], the questionnaires were distributed to the employees of each division according to the head's discretion.

### 7.2.1 Research Samples

A research sample is a portion or subset of a larger group (called a population). The criteria for inclusion in a survey are that the characteristic respondents have to be eligible for participation in a survey and the exclusion criteria consist of characteristics that rule out certain people. The inclusion and exclusion criteria are applied to the target population. Once all those who fail to meet the inclusion criteria are excluded, a study population consisting of people who are eligible to participate remains[694].

For the purpose of this thesis, interviews and questionnaires were distributed to three main research groups:

---

[693] See p. 239.
[694] Fink, A. 2003, *The Survey Hand Book*, 2nd edition, SAGE Publications, p.35

1. The Auditing Firms - they manage tax assessments for foreign enterprises liable to tax in Kuwait, and also file and follow up the tax objections and appeals at the Tax Department.

2. The Taxpayers - these included foreign enterprises operating in Kuwait either through a Kuwaiti agent or by holding 49% of a national enterprise, while a Kuwaiti national holds 51%.

3. The Tax Department: this is divided into three divisions:

1. The Inspection and Tax Claims Division (Tax inspectors) – it conducts inspection procedures; issues tax assessments and also constitutes the panels deciding the outcome of tax objections and appeals.
2. The Tax Liability and Planning Division - it informs liable entities of their tax liability and also conducts various researches on taxation.
3. The International Tax Treaty Division - it studies future DTTs and mutual tax agreements which Kuwait plans on entering into and suggests amendments. It looks into disputes resulting from DTTs and international trade agreements before transferring them to the courts. Lastly, it conducts research on international tax treaties and international tax issues.

| 1. Sample size (of main research groups): |
|---|
| - 11 Auditing Firms;<br>- 30 Taxable Foreign Enterprises;<br>- 22 Employees in the Kuwaiti Tax Department |
| 2. Objectives: |
| - Assessment of the 2/2008 amendments against the Tax Decree 3/1955.<br>- Assessment of the Kuwaiti Tax Department performance in the Ministry of Finance<br>- Understanding what foreign companies want in terms of tax reform. |

| |
|---|
| - Possible proposals to improve the tax system, whether in tax policy or in the Tax Department.<br>- Possible recommendations on how Kuwait can attract more FDI. |

### 7.2.2 Constructing Questions: Open vs. Closed questions

The issue of questions and how to ask them comes down to how the responses are to be analyzed. There are two kinds of questions; those where the answer is left 'open' and those where the answer is 'closed'. An open question might be: which of the following newspapers do you read most often? A closed equivalent might be: which of the following daily news papers do you read most often? Followed by a list of tick boxes and probably an 'other' category. The closed question with its simple tick response is a more efficient way of posing the question and less trouble to answer. It also prompts people, reminding them of the elements they might overlook. With specific 'factual' questions about behaviour (what people do) there is not much of a problem: the closed question works well. However, when you are dealing with opinions, the choice is not so clear-cut, for example if you want to survey attitudes to the war in Iraq an open question would be: what were your views at the time on the allied invasion of Iraq in 2003? That is a complicated question which requires an extended answer[695]. In this survey closed questions were used more frequently for the reasons mentioned above i.e. they are efficient, easy to answer and can prompt the persons surveyed, reminding them of answers and elements they may have overlooked, although open question were also used to allow respondents give a free opinion, questions such as: Can you say

[695] Gillham, B. (2008), *Small Scale Social Survey Methods*, Continuum, p.8.

that Kuwait is an attractive environment for foreign investment? Why? And others are used towards the end of the survey.[696]

### 7.3 Assessment of Tax Law Amendments 2/2008 as against the Tax Decree 3/1955

The first question posed to research samples in this respect was:

♦ How would you rate the Tax Law Amendments 2/2008 against Tax Decree 3/1955? Would you say it is:

Better than the old tax decree ( )
Worse than the old tax decree ( )
The same ( )
Other, please specify ( )

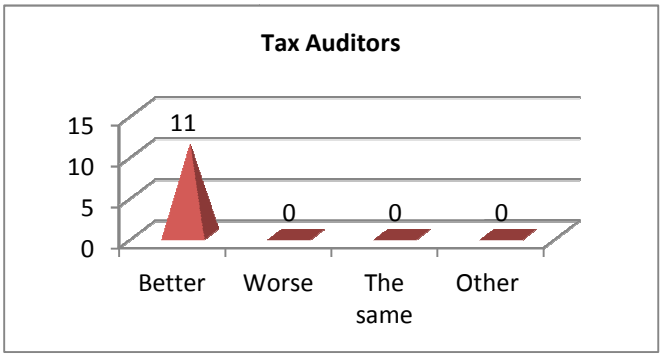


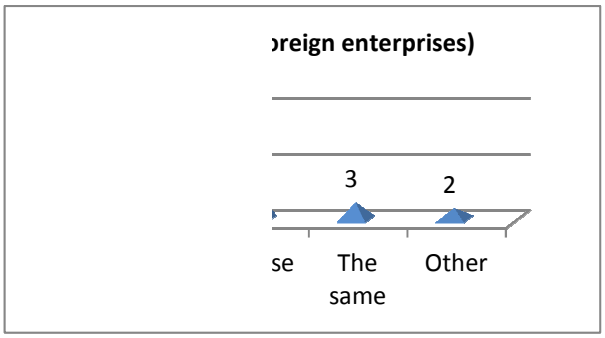

**Figure 7.1**

All eleven Tax Auditors confirmed that the Tax Law Amendments 2/2008 are better than Tax Decree 3/1955. They provided the following reasons:

1. The old Tax Decree was outdated, the new one is better; it addresses many issues that are current, especially that the old tax decree was imposed for negative reasons (to benefit foreign oil companies concessions).
2. The reduction in the tax rate has had a very positive effect on foreign investment.

[696] See pp. 292-293.

3. The new tax law is a lot clearer; it clarifies many issues that were ambiguous.



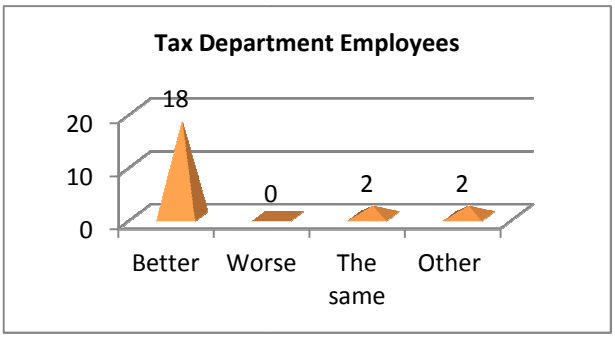




**Figure 7.3**

Although there was a general consensus from the Tax Auditors and the employees of the Tax Department that the new amendments are better, not all Taxpayers agreed. Almost all taxpaying foreign enterprises explained that it was mainly the decrease in the tax rate that has made them in favour of the new amendments. Smaller foreign enterprises which used to pay 5% or 10% corporate income tax under the Tax Decree 3/1955 had a different view. They declared that the new amendments are worse, causing their tax liability to rise dramatically by 5% to 10% more than they used to pay. They added the following:

- These amendments were made to save the big fish in the market, we are now paying more than we used to although we are smaller enterprises.

- The new law discriminates against small businesses; we used to pay a lot less than 15%.
- The progressive tax rate is fairer than a flat rate tax.

The employees of the Tax Department had the same consensus using the reduction in tax rates as a reason why the amendments are better than Tax Decree 3/1955. A few employees had a different opinion:

- The Tax Law Amendments 2/2008 are a step forward towards coherent tax legislation modern enough to address modern economic and financial challenges. However the new amendments have not achieved that yet.
- The Tax Law Amendments 2/2008 should have included national companies as well as foreign companies, and they should have covered all taxing matters. However in some respects they are better than the Tax Decree 3/1955.

After a general agreement that Tax Amendments 2/2008 are better than the Tax Decree 3/1955, a series of tax law assessment questions followed:

♦ Would you say that the Tax Law Amendments 2/2008 eliminated the shortcomings of the Tax Decree 3/1955?

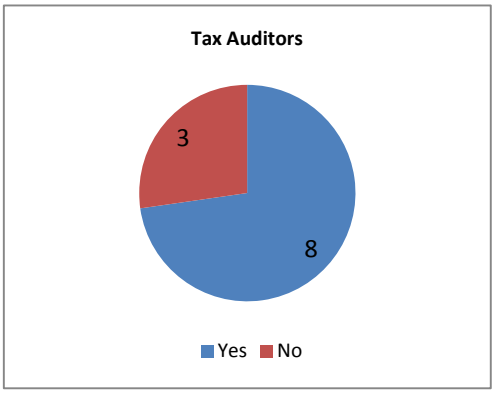



**Figure 7.4**

The Tax Auditors who answered 'Yes' to this question based their answer on the sole factor that the tax rate has been reduced to a single flat rate. Some of the

auditors mentioned the disadvantages which the new law has not eliminated: One of the main advantages was:

"foreign enterprises suffer from the broad authority of the tax department. If we want to object to a tax assessment the person dealing with our objection is the same tax inspector who made the assessment, and when we appeal his decision, the appeal is carried out by his superior".

This question also raised interesting results in terms of the answers of taxpayers and the employees of the Tax Department:

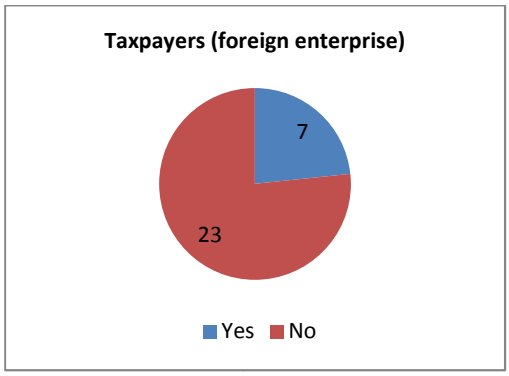



**Figure 7.5**

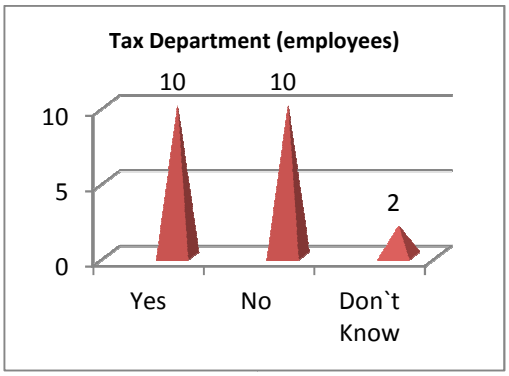



**Figure 7.6**

Most Taxpayers found that the Tax Law Amendments 2/2008 did not in fact eliminate any shortcomings of Tax Decree 3/1955. Some of the reasons mentioned were:

- Apart from the tax rate being reduced, no shortcomings have been eliminated.
- Although they have reduced the general tax rate, they have also reduced allowable head office expenses and allowable agent fees.
- The law is still a primitive one and one of the main disadvantages is the non existence of DTTs with many important countries.

Taxpayers who took more than just the lower tax rate into consideration agreed that the new law does not in fact eliminate previous shortcomings. The response of the employees of the Tax Department showed some employees agreed that shortcomings have been eliminated, and some did not. The former based their decision wholly on the lower tax rate, while some of those who disagreed stated:

- The new law has not improved anything other than reducing the tax rate and limiting forwarding losses to three years;
- The new law still contains a lot of inefficiencies, ambiguity and injustice.

♦ Have the Tax Law Amendments 2/2008, in your opinion, clarified the most debated issues in the Tax Decree 3/1955, such as the definition of taxpayer and the definition of agent?

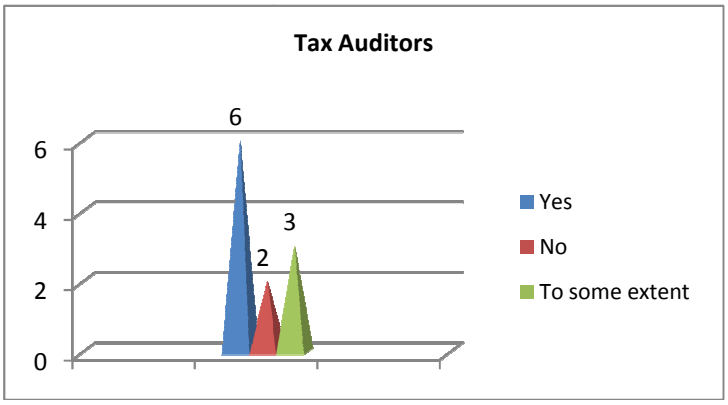



**Figure 7.7**

This question was important due to the somewhat ambiguous definitions of taxpayer and agent in both the Tax Decree 3/1955 and the Tax Law Amendments 2/2008. This has been discussed in length in chapter 4[697]. This question yielded interesting results in terms of the attitudes of the survey samples. Although it is very similar to the prior question in regard to assessing the efficiency of the Tax Law Amendments 2/2008, it offers more detail in terms of its focus on the

[697] See pp. 104 – 137.

meaning of taxpayer and agent. Although most Tax Auditors agreed that the amendments did in fact clarify the debated issues of taxpayer and agent, they based their opinion wholly on the fact that the Tax Law Amendments 2/2008 - unlike Tax Decree 3/1955 - explicitly excludes a distributor from the definition of an agent for the purpose of the 2008 Amendments.

On the whole, taxpayers believed that the new law does not in fact clarify the most debated issues in terms of defining taxpayers and agents, although the difference between foreign enterprises which answered 'No' and those which answered 'Not applicable' to this question is marginal. The reason why many taxpayers believed that this question did not apply to them may be attributed to one of the following reasons; first, many foreign enterprises were still unfamiliar with some details of the Tax Law Amendments 2/2008, such as definitions of terms. The Tax Law Amendments 2/2008 have not been widely distributed; also there exists poor correspondence between taxpayers and the Tax Department. Second, a good number of the foreign enterprises interviewed are not operating in Kuwait through an agent but through a 49% shareholding of national businesses, and thus have no practical knowledge of what constitutes an agent.

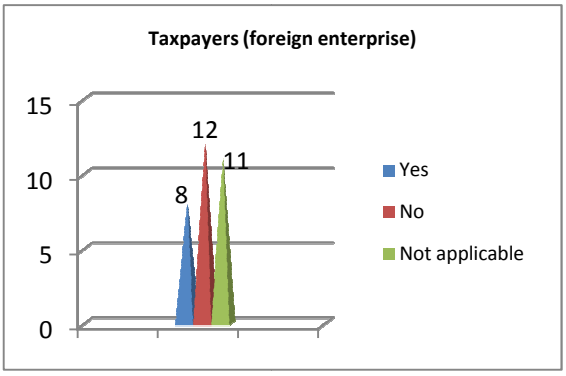



**Figure 7. 8**

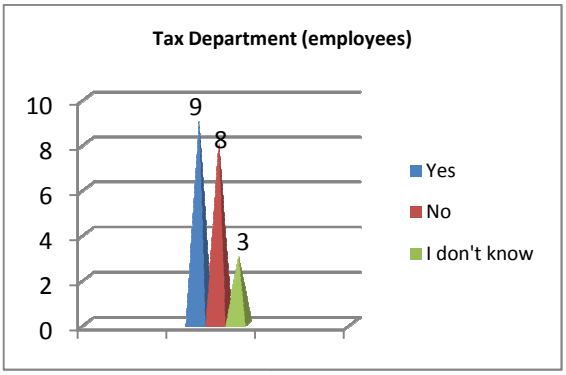



**Figure 7. 9**

In the Tax Department, the difference between those employees who answered 'Yes' and those who answered 'No' is very marginal, also three employees said they did not know the answer to this question, and one employee answered 'Yes' and added that Article 3 of Tax Law Amendments 2/2008 deals with definitions. It is in fact Article 2 of the 2008 amendments that deals with definitions.

♦ In your opinion, is the 15% rate of tax imposed by Tax Law Amendments 2/2008?

Too high ( )
Too low ( )
Reasonable ( )
Other, please specify ( )

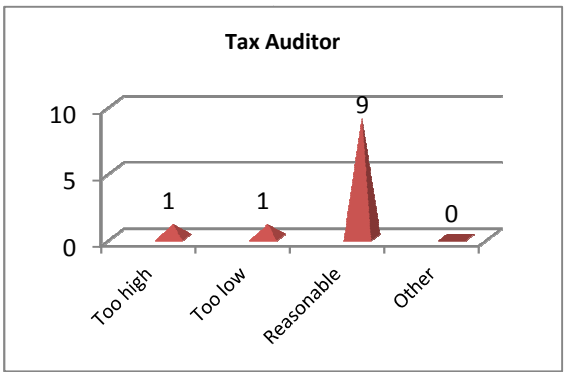



**Figure 7.10**

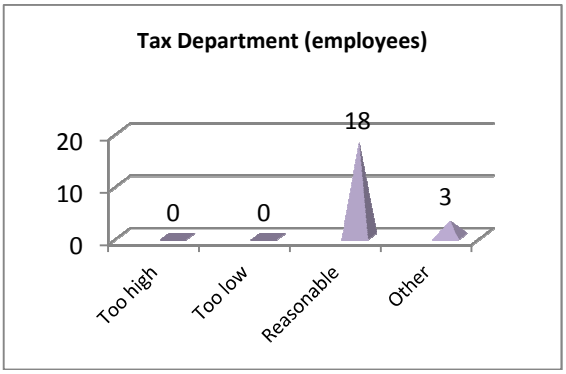


**Figure 7. 11**

There is a general consensus amongst Tax Auditors that the new tax rate is reasonable. Attitudes of the employees of the Tax Department were similar. Some respondents from the Tax Department who answered with 'Other' were supporters of a progressive tax, and made the following comments:

- A progressive tax is fairer and allows the state to collect more tax revenue from bigger companies, I think it should have been a progressive tax between 25% - 35%
- To have a progressive tax allows our fiscal system to be aligned with other international systems it should have been progressive 10% - 30%.

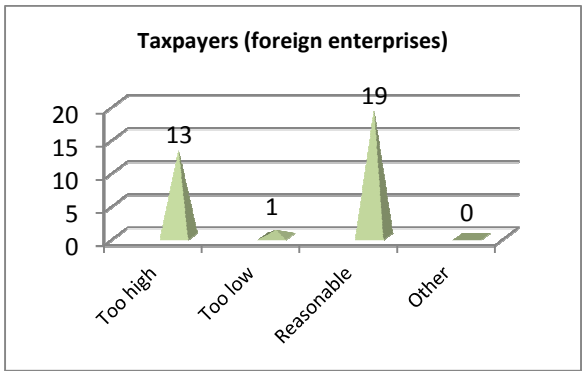


**Figure 7. 12**

Figure 7.12 shows a significant number of foreign enterprises believe that the new flat tax rate is too high. Small companies who paid 5% and 10% tax under the Tax Decree 3/1955 declared that the new tax rate was too high. Medium sized enterprises which paid between 20% and 35% tax, argued that despite the

decrease in the tax rate, other allowable expenses were also reduced which adds to their tax costs[698].

This question is effective in showing how the different survey samples had different views on an appropriate tax rate, or more importantly in the case of this thesis on its impact on foreign investment. It is certainly important not to underestimate start up companies and small and medium sized companies since these are the companies that are more likely to create new job opportunities and bring the latest technology and the knowhow to the State. The following question which was an extension to the prior question showed even more interesting results:

♦ Would you say that a single flat tax rate can be discouraging for a start up businesses (small size businesses) and that a reasonable progressive tax is better, more attractive for FDI? and why?

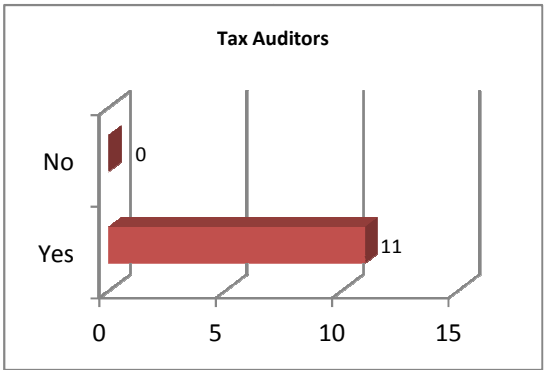



**Figure 7. 13**

[698] The reason there are 3 additional answers over the normal sample size of 30, is that three respondents provided two opinions, stating that the rate is reasonable internationally but still quite high domestically.

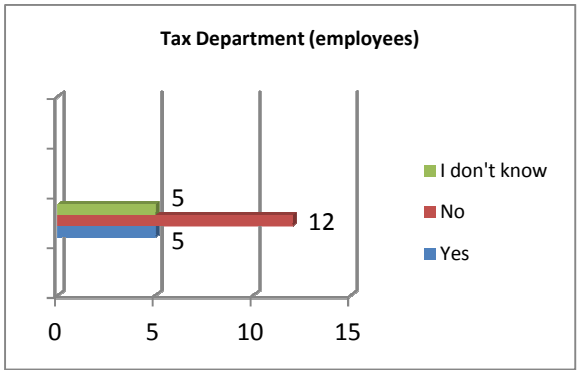



**Figure 7. 14**

`

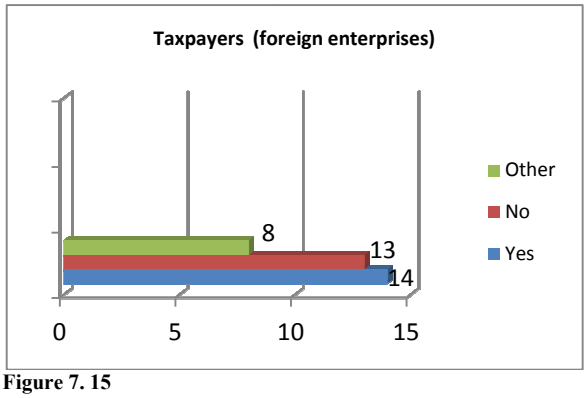



**Figure 7. 15**

Although the Tax Auditors agreed in response to previous questions that the tax rate was reasonable, they confirmed in their response to this question that a progressive tax may actually be fairer. However this view was not without reservation. Their answers included the following:

- Although a progressive tax can offer more fairness, we must acknowledge the fact that small businesses who used to pay 5% -10% don't constitute more than 1% - 2% of the Kuwaiti market, and are not in my opinion worth saving.
- Theoretically yes, a gradual tax is fairer, however in practical terms foreign businesses factor taxes into their pricing, thus if they want to end up with an after tax profit of K.D 100 then instead of pricing their product /service K.D 105, they would price it at K.D 115.

On the other hand, most employees of the Tax Department defended the reduced flat tax rate and claimed that it is lower than the rate applied in many developed and industrial countries.

This argument defeats the objective of the question as comparing Kuwait's tax rate with other developed countries is not the point, especially because other countries with higher tax rates than that of Kuwait might be offering other facilities for FDI which Kuwait does not. However it was the significant number of respondents who answered 'I don't know' that was unexpected. Such employees may be expected to have an opinion on this subject, not least because of their contact with smaller companies which have suffered from a tax rise. Finally in the case of the taxpayers, a number of foreign enterprises said "Yes, it is discouraging for smaller businesses" but a similar number stated 'No, it's not discouraging'. Those enterprises which did not say 'yes' or 'no' indicated:

- Even though the rate can be a bit damaging, the state puts the interest of the bigger companies first which is the right thing to do, the state will not favour small businesses unless they provide a vital service.
- Someone will have to pay more, if the smaller companies paid less, then the state has to raise taxes on the bigger companies and the state will not do that since it needs the larger businesses more.

Although foreign enterprises here are confirming that the increase in the tax rate may be discouraging for smaller businesses, they are also confirming that the State's strategy in attracting foreign businesses is likely to foresee larger businesses. There are 5 additional answers in this survey as 5 respondents answered 'yes' or 'no' then added an opinion to the 'other' category; some respondents provided:

- It is a slight change, but I wouldn't say it will damage the smaller companies
- As flat rate can have advantages and disadvantages for smaller and larger companies.

♦ How has the recent tax rate of 15%, in your opinion, affected foreign enterprises' behaviour in Kuwait? Would you say they will:

Continue doing business in Kuwait ( )
Expand the business ( )
Contract the business ( )
Do business elsewhere ( )
Other, please specify

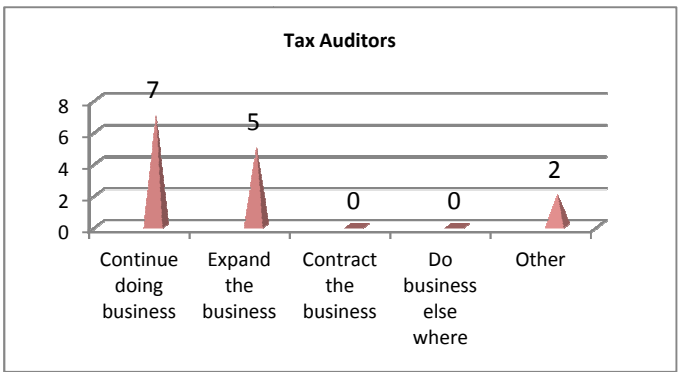



**Figure 7. 16**

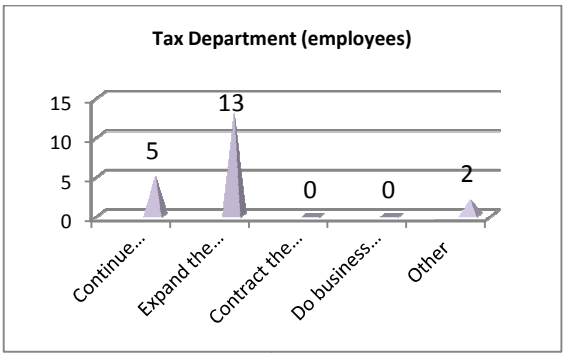



**Figure 7. 17**

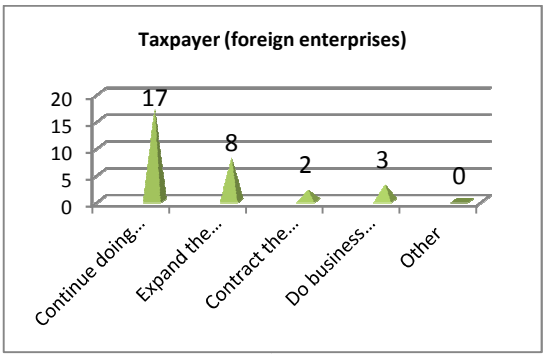



**Figure 7. 18**

This question has helped to emphasize the samples' opinion on whether or not a reduced tax rate affects foreign investors' decision-making when it comes to

investing in Kuwait. Figure 7.16 shows that the employees of the Tax Department believe that reducing taxes should work as an incentive for foreign enterprises to not only stay but expand their business activities in Kuwait, while this view was not shared by all the foreign enterprises. Also two Tax Auditors chose two answers for this question when they said that due to the tax reduction foreign enterprises: 'will continue to do business abroad' and will 'expand their businesses'. This, however, was not necessarily what others believed; Tax Auditors who did not agree that the reduction in the tax rate would encourage foreign business to continue doing business in Kuwait or expand their existent business stated:

- I don't think the change in the tax rate will change the behaviour of foreign enterprises in Kuwait, every company will accommodate according to its own benefit and interest since through a feasibility study all companies know in advance how much tax they will be liable to in the host country and thus include it in their costs.
- As for bigger corporations, the tax reduction has served as an incentive for them to expand their business in Kuwait; however the smaller business which used to pay less than 15% will suffer.

♦ Would you say that taxation is an important aspect which foreign investors consider when deciding to do business in Kuwait? If so, please provide explanation?

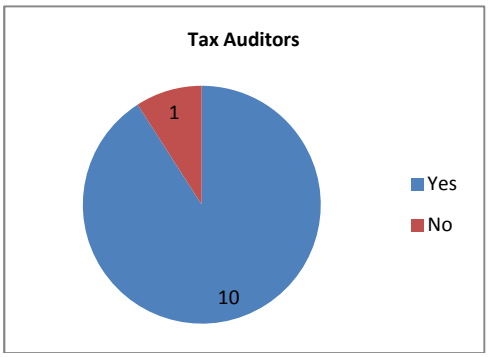



**Figure 7. 19**

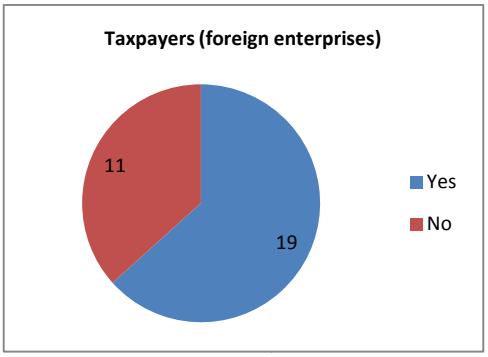



**Figure 7. 20**

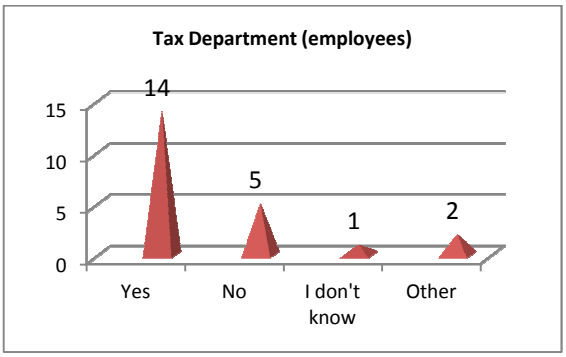



**Figure 7. 21**

Figure 7.19 shows that the Tax Auditors agreed that taxation is 'an important aspect' and that taxation is a priority for foreign businesses when deciding whether to invest in Kuwait; only one Tax Auditor disagreed with this. Although the majority of Taxpayers agreed that taxation is important, some of them stated:

- Taxes are not our main concern; to us other issues such as infrastructure and business opportunity come first.
- I need to think about my business first then think about how much tax I have to pay, as an elevator fitting company I can't have my office in Dubai (a tax free state) and fit elevators in Kuwait, I need to be here in Kuwait. I need my company to be based here.

Figure 7.21 reveals that the employees of the Tax Department agreed that taxation is 'an important aspect'. Some commented that other aspects such as political stability and judicial fairness can be more important for foreign investment.

♦ When making a decision to do business abroad which of the following do you think a company considers the most, please prioritize by number 1-7, with (1) being the most important and (7) being the least important:

Business opportunities
Low/High taxes
Labour
Infrastructure
Political stability
Tax incentives
Compliance costs
Other, please specify

Tax Auditors

| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|---|
| 1 | Business Opportunities | 10 | | | | | | |
| 2 | Political Stability | | 3 | 2 | 2 | | | |
| 3 | Infrastructure | | 2 | 5 | | | | |
| 4 | Low/High taxes | | 2 | 2 | 4 | | | |
| 5 | Tax Incentives | | 3 | | | 2 | 2 | |
| 6 | Labour | | | | | 3 | 4 | 2 |
| 7 | Compliance Costs | | | | | | 2 | 7 |

**Figure 7. 22**

In response to this question, Figure 7.22 shows that Tax Auditors put Business opportunities in the first place with ten votes, then came Political Stability with 3 votes as having the secondary importance. Infrastructure was placed in third place with five votes for its rating. Low and High Taxes, Tax Incentives, Labour and Compliance Costs followed, 'Other' priorities which some Tax Auditors said their corporate clients often mention included:

- Profitability, in addition to convenience and stability of business.
- The ability to carry business on directly without the need for a national agent.
- Economic development.
- Clarity of double tax treaties.
- Reducing corruption and bureaucracy.

Tax Department (employees)

| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|---|
| 1 | Political Stability | 11 | 4 | 4 | | | | |
| 2 | Low & High Taxes | | 10 | 2 | 2 | | | |
| 3 | Business Opportunities | | | 9 | 3 | 3 | | |
| 4 | Tax Incentives | | | | 10 | 4 | | |
| 6 | Infrastructure | | | | | | 7 | 4 |
| 7 | Compliance Costs | | | | | | 5 | 6 |
| 7 | Labour | | | | | | | 8 |

**Figure 7. 23**

The employees of the Tax Department rated Political Stability as the number one priority for foreign business investors with 11 votes. Low and High Taxes came in second with 10 votes recorded, for greater importance by the employees of the Tax Department than by the Tax Auditors. Business Opportunities were voted third. Tax incentives, Infrastructure, Compliance Costs and Labour were not regarded as primary factors. Other factors which is was felt foreign investors usually look for, were:

- Easier requirements to start up a business
- Easier requirements for moving capital and labour across the country.

Taxpayers (foreign enterprises)

| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|---|
| 1 | Business Opportunities | 22 | 7 | | | | | |
| 2 | Political Stability | | 25 | | | | | |
| 3 | Infrastructure | | 9 | 21 | | | | |
| 4 | Low & High Taxes | | | | 19 | 9 | | |
| 5 | Tax Incentives | | | | | 18 | 12 | |
| 6 | Labour | | | | | | 21 | 7 |
| 7 | Compliance Costs | | | | | | | 23 |

**Figure 7. 24**

Figure 7.24 shows that Taxpayers (foreign enterprises) were in agreement with the Tax Auditors in that Business Opportunities were the most important consideration when it comes to investing abroad. A significant number of these enterprises also place it as the second most important priority which emphasizes its importance. Political Stability was recorded by 25 votes as of secondary importance. Infrastructure which the employees of the Tax Department rated relatively lowly was an important priority for Taxpayers (foreign enterprises) as table 7.24 shows 9 companies voting it as the second most important consideration. Low and High Taxes for a good number of Taxpayers (foreign enterprises) played a relatively insignificant role. Further, the fact that compliance costs were accorded little significance suggests that Taxpayers (foreign enterprises) are not discouraged by high costs if business opportunities, stability and infrastructure exist. 'Other' priorities mentioned were:

- The bureaucracy slows down business and decision making; the requirements to start up a business should be easier.
- The abolition of agency rules.
- Bank loans should be facilitated for foreign investors.
- The culture should be welcoming for foreign businesses.

♦ If Kuwait was to give foreign investors an incentive to do business in Kuwait what should this incentive be in your opinion (please prioritize by numbers 1-3, with (1) being the most attractive incentive and (3) being the least attractive:

Tax holiday (  )
Applying national treatment (  )
Easier requirements for starting up a business (  )
Other, please explain (  )

Tax Auditors

| incentives: | 1 | 2 | 3 |
|---|---|---|---|
| Easier Requirements for starting up a business | 9 | 2 | |
| Applying National Treatment | | 5 | 6 |
| Tax Holiday | 2 | 4 | 5 |

**Figure 7. 25**

As seen above, most Tax Auditors regarded 'Easier requirements to start up a business' as the number one incentive. However, they were relatively evenly divided in their respective assessments of 'Applying National Treatment' and 'Tax holiday'.

When Tax Auditors were asked to give 'Other' suggestions on incentives for encouraging foreign investors to carry on business in Kuwait, their responses included:

- 100% ownership of foreign business.
- To create and allow more business opportunities.
- To sign more double tax treaties with more countries.
- Easier and faster procedures when it comes to work visas.
- Comprehensive tax laws.
- Abolishing agency rules.
- Nationalization of labour. A new requirement has been imposed by the Kuwaiti government to nationalize foreign companies' labour. It has caused more strain for those companies as Kuwaiti labour is more expensive, and not as productive.

Tax Department (employees)

| Incentives: | 1 | 2 | 3 |
|---|---|---|---|
| Easier Requirements for Starting up a business | 9 | 8 | 5 |
| Tax Holiday | 7 | 8 | 6 |
| Applying National Treatment | 6 | 5 | 11 |

**Figure 7. 26**

As Figure 7.26 shows employees of the Tax Department believed that 'Easier requirements to start up a business' is the first incentive - following the opinions expressed by the Tax Auditors. However, some prominence was also given to the

provision of Tax Holidays and the introduction of National Treatment, with the latter generally less favoured.

Taxpayers (foreign enterprises)

| Incentives: | 1 | 2 | 3 |
|---|---|---|---|
| Easier requirements for starting up a business | 17 | 8 | 5 |
| Tax Holiday | 10 | 14 | 6 |
| Applying National Treatment | 6 | 9 | 15 |

**Figure 7. 27**

As the above figure shows, the Taxpayers (foreign enterprises) closely followed the priorities identified by the Tax Auditors and the employees of the Tax Department, with 'Easier requirement to start a business' securing primary importance with 17 votes. A more marked preference for 'Tax holiday' rather than National Treatment was exhibited. 'Other' suggestions for incentives included:

- Eliminating the agency rules and the 51% national ownership of a foreign business.
- Easier work visa procedures.
- Eliminating the new offset programme which the Kuwaiti government has recently imposed on foreign businesses, obliging them to invest a percentage of their business value in Kuwait.

The following is a more open question which helps reveal attitudes towards the Tax Law Amendments 2/2008[699]:

♦ What changes - if any- would you suggest be made to Tax Law Amendments 2/2008?

[699] The purpose of this question was to allow each person to express their views and attitudes towards the amendments and how they can be improved. Such a survey as defined by Fink, is a system for collecting information from or about people to describe, compare, or explain their knowledge, attitudes, and behaviour. See Fink (note 694 supra).

Responses to this question varied and as the following Figures (7.28 – 7.30) included a range of suggestions. However, there was some consensus on the Amendments shortcomings with regards to the issue of clarity:

Tax Auditors

| Answers: | Number of responses that match that answer |
|---|---|
| General clarity in the provisions of the Amendments, especially in definition of taxable income, tax payer, and agent | 10 |
| Eliminating the concept of deemed profits | 2 |
| Eliminating the tax department's arbitration system on tax assessments objections and appeals, and referring tax objections and appeals to an independent judicial body. | 2 |
| Further reduction in the tax rates | 2 |
| Taxing national companies and individuals to achieve national treatment and fairness. | 2 |

**Figure 7. 28**

Figure 7.28 shows that there is a clear expression for demanding greater clarity by the Tax Auditors.

Tax Department (employees)

| Answers: | Number of responses that that match that answer |
|---|---|
| A more complete and comprehensive tax law which is applicable to national companies and individuals as well as foreign enterprises. | 6 |
| More clarity in terms of the meaning of the provisions | 2 |
| A wider tax base | 1 |
| To have a pre-tax period for foreign investors | 1 |
| More tax exemptions | 1 |
| A clear parameter for the companies compliance | 1 |
| Eliminating agency rules | 1 |
| None | 6 |
| I don't know | 3 |

**Figure 7. 29**

Figure 7.29 shows that greater clarity is supported to some extent, but there is greater support for a more comprehensive tax code that includes national companies and individuals.

Taxpayers (foreign enterprises)

| Answers: | Number of responses that that match that answer |
|---|---|
| Eliminating the agency rule and the 51% national ownership rule | 15 |
| Clarify the ambiguity in the Amendment's provisions | 8 |
| The tax rates should be progressive in order to achieve more fairness | 7 |
| A further tax decrease | 2 |
| A panel independent from the tax department to look into objections and appeals on tax assessments | 2 |
| A tax exemption for the first five years for foreign investors | 2 |
| The law should be more specific and should treat different industries differently | 2 |
| Clearer allowances and disallowances | 1 |
| An increase in the agent commission allowance, and the home office expenses allowance | 1 |

**Figure 7. 30**

Figure 7.30 reveals the strongest support was expressed by Taxpayers (foreign enterprises) for eliminating the agency and the 51% national ownership rules. However, there was also significant support for clarifying ambiguity in the Amendments and for progressive tax rates.

This next question was to test whether Adam Smith's four requirements for a good tax system: fairness, certainty, efficiency and convenience[700] were met by the Tax Law Amendments 2/2008[701].

♦ In regard to the Kuwaiti tax law, how would you describe it in terms of[702]:

1. Fairness

[700] See pp. 19-22.

[701] 'Clarity' was added as a fifth parameter due to the comments in relation to the previous question indicating a perceived lack of clarity in the Tax Law Amendments 2/2008.

[702] The meaning of some questions addressed to the survey sample may not always be direct or easy to understand and thus providing an explanation written or verbal is important in some cases. On meaning of questions Nuckols (1953) asked respondents to use their own words to describe what a question was asking. He also concluded that standardization of words does not automatically imply standardization of meaning. Belson (1981) did further work along this line by asking people in interviews what specific phrases meant in the context of survey questions. Ferber (1956) did the same thing for all respondents on an attitudinal question and found people readily expressing opinions about issues which they could not define. See Tanur, J. (1992), *Questions about Questions*: *Inquiries in the Cognitive Bases of a Survey*, Russell Sage Foundation, p. 50.

Fair ( ) Unfair ( ) In some aspects it is unfair ( ) I don't know ( )

2. Clarity

Clear ( ) Unclear ( ) In some aspects it is unclear ( ) I don't know ( )

3. Convenience (in regards to time and manner of payments):

Convenient ( ) Inconvenient ( ) In some aspects it is convenient ( ) I don't know ( )

4. Certainty (taxes should not be arbitrary, the time, manner, and quantity of taxes to be paid must be clear and plain for the taxpayer):

Certain ( ) Uncertain ( ) In some aspects it is uncertain ( ) I don't know ( )

5. Efficiency (the calculation of tax is simple and compliance is not costly):

Efficient ( ) Inefficient ( ) In some aspects it is inefficient ( ) I don't know ( )

**Tax Auditors**

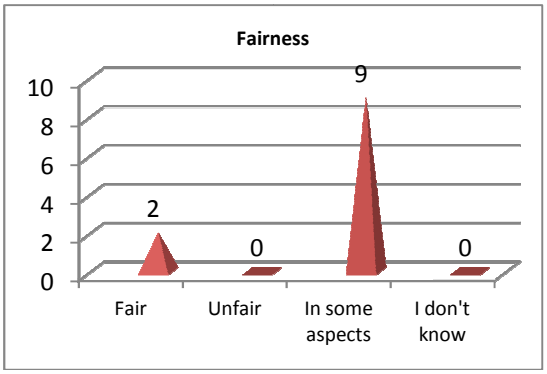



**Figure 7. 31**

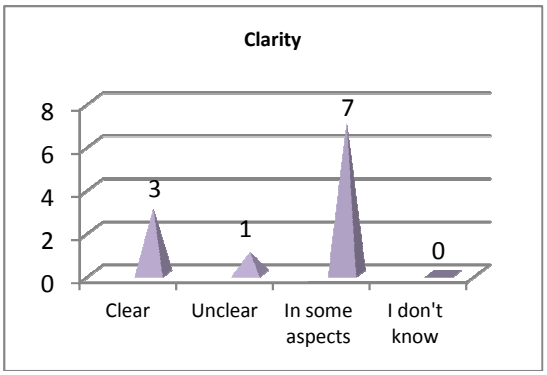



**Figure 7. 32**

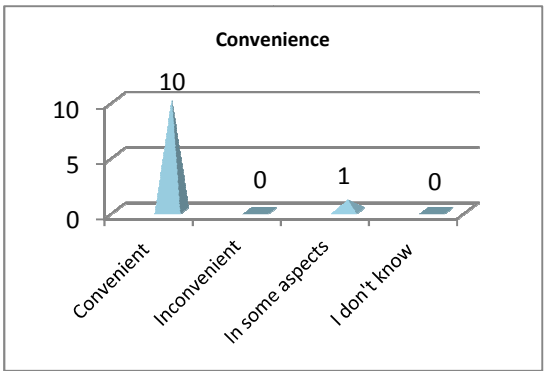


**Figure 7. 33**

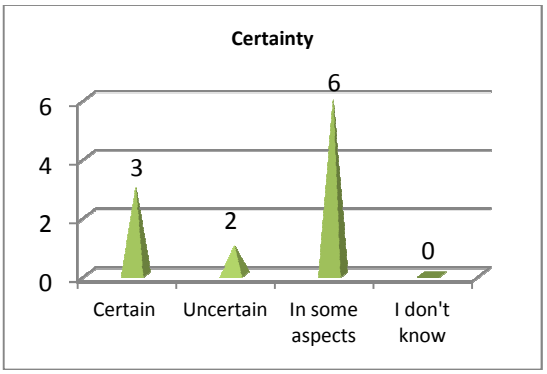


**Figure 7. 34**

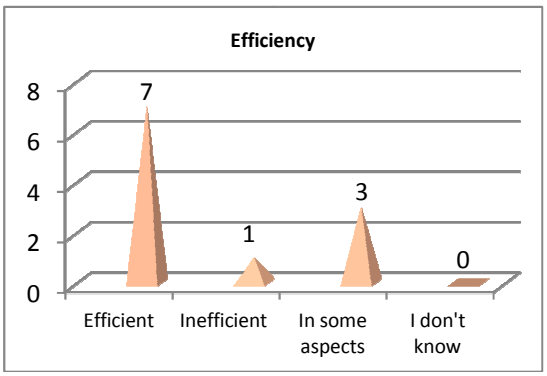


**Figure 7. 35**

From Figures 7.31 – 7.35 it shows that the majority of Tax Auditors agreed that the law is 'in some aspects' fair, clear, and certain. The majority of Tax Auditors confirmed that the law is convenient and efficient.

Tax Auditors who indicated that Kuwait's tax law was 'in some aspects unfair' provided the following explanations:

- Three respondents said that the law discriminates against foreign companies.
- Three respondents said that the law discriminates against smaller foreign companies.
- A respondent said that articles of the Amendments allow a wide interpretation which the Tax Department takes advantage of. Many of the articles are interpreted in favour of the Department not the taxpayer.
- Circular No. 43/2002 on deemed profits, whenever the Tax Department is not convinced with the accounts, or whenever we declare losses, we are assumed to have made a profit of 15% according to the 'Deemed Profits' Circular[703].

On 'Uncertainty' a number of Tax Auditors indicated specifically that the Tax Law Amendments 2/2008 are not certain in terms of allowances and disallowances. Some Tax Auditors also said that there was uncertainty in the following respects:

- The double tax treaties are not clear in their treatment of some aspects of taxation.
- The English translation of the law is vague.
- 25% of the tax issues are covered by the provisions of the Tax Law Amendments 2/2008 while 75% are dealt with by mere practice.

**The Tax Department**

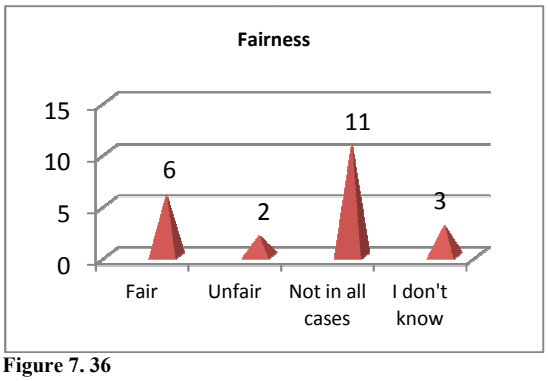



**Figure 7. 36**

[703] For more on 'Deemed Profits' see pp. 106-107.

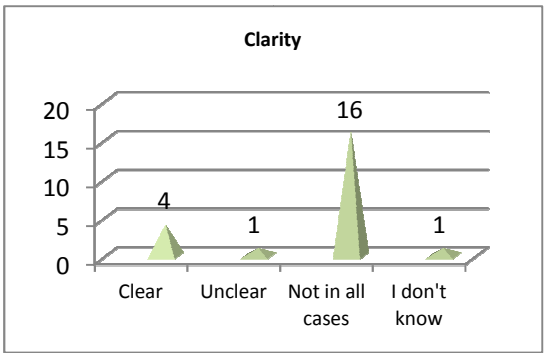



**Figure 7. 37**

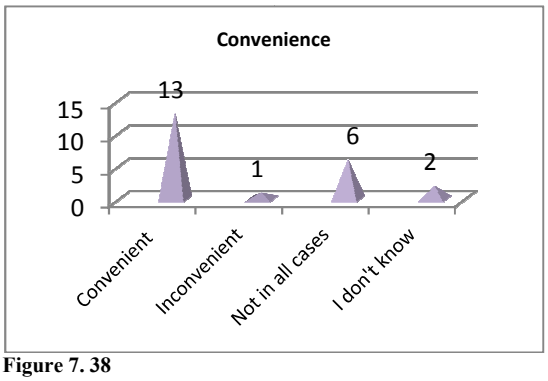



**Figure 7. 38**

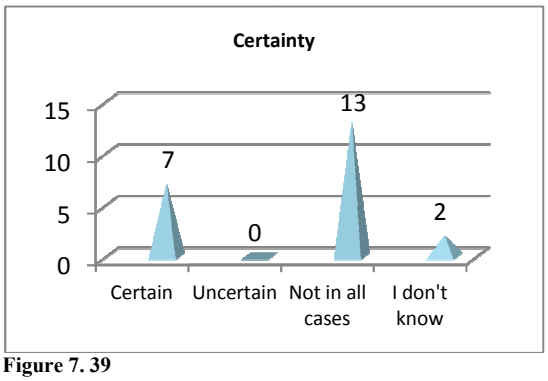



**Figure 7. 39**

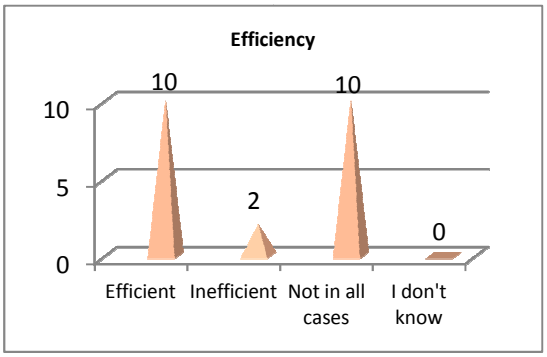



**Figure 7. 40**

The Figures show that there is a degree of uniformity in the employees of the Tax Department's responses. Half of the employees believed that Kuwait's Tax Law

was ‘not in all cases fair’, and only six of them thought it was ‘fair’. In terms of clarity again the vast majority thought that the law was ‘not in all cases clear’ while just a small number thought it was clear. Thirteen employees said the law was ‘convenient’, and the same number of employees thought the law was ‘not in all cases certain’. Ten employees believed that the law is ‘efficient’; however the same number thought it was ‘not efficient in all cases’.

Taxpayers (foreign enterprises)

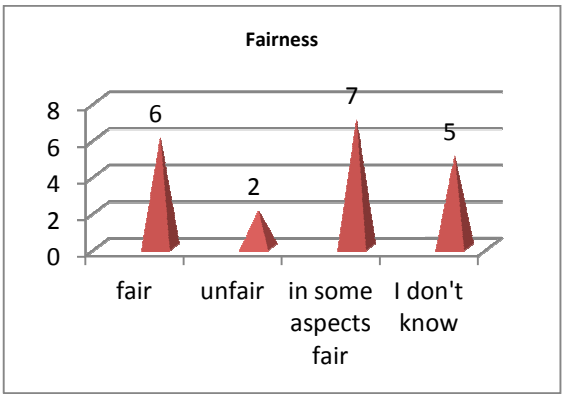



**Figure7.41**

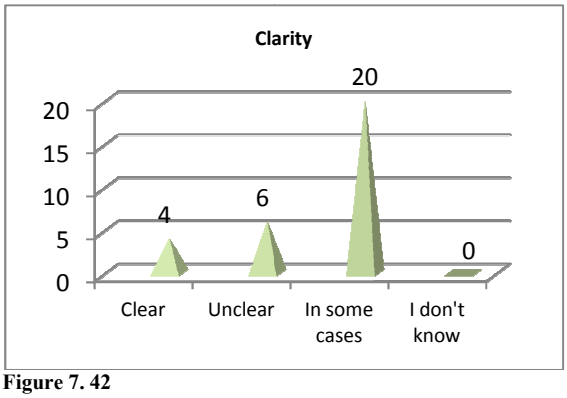



**Figure 7. 42**

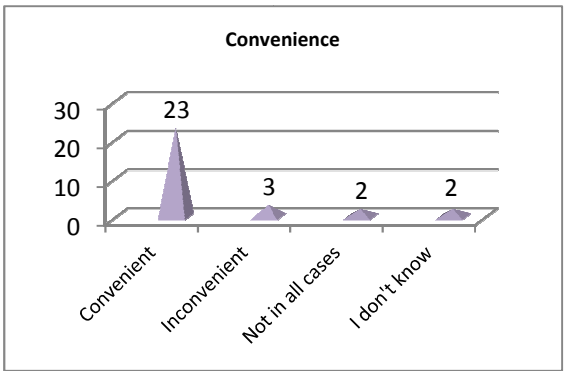



**Figure 7. 43**

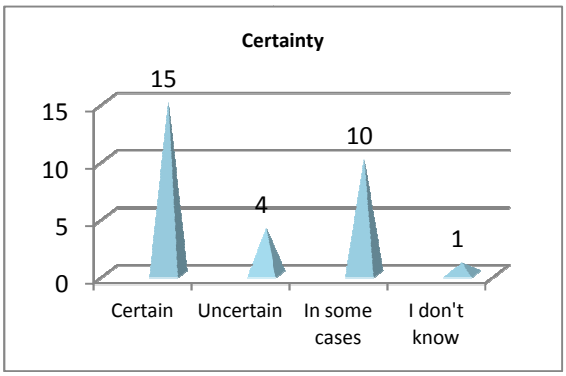



**Figure 7. 44**

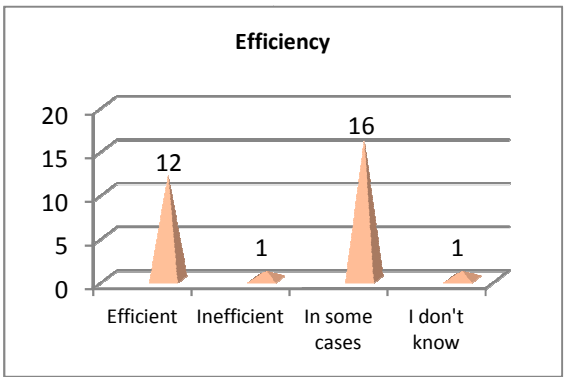



**Figure 7. 45**

The Figures above (7.41 – 7.45) show that the majority of taxpayers (foreign enterprises) believe that the law is 'in some cases' fair, clear and efficient. However, they also believe that the law is convenient and certain.

Further, the taxpayers (foreign enterprises) who believed that the law was 'not always fair' provided the following observations:

1. The objection and appeal process is unfair. There should be an independent judicial body. Such objections and appeals should not be decided by the Tax Department which is the current practice.
2. Discrimination against foreign companies.
3. Discriminating against smaller size companies
4. Allowable expenses for home office costs is only 1.5% which is considered too low.

The respondents who believed that the law was 'not always clear' provided the following explanations:

1. The 2008 Amendments are not clear on matters such as what constitutes an agent.
2. Lack of clarity in terms of allowances and disallowances.

The respondents who believed that the law was 'not always certain' provided the following:

1. The matter of arbitration causes uncertainty.
2. There is room for more improvement. The way the law is constructed causes uncertainty.
3. Our uncertainty arises when our auditors tell us that our costs will be allowed than when the tax inspector comes he disallows them.

The following questions consider the work of the Tax Department.

**7.4 Assessment of the Kuwaiti Tax Department [in the Ministry of Finance]**

The next set of questions assesses the Tax Department's performance in terms of tax collection, its efficiency and its attitudes toward towards taxpayers.

♦ Do you think that the Tax Department is efficient in collecting taxes?

Tax Auditors

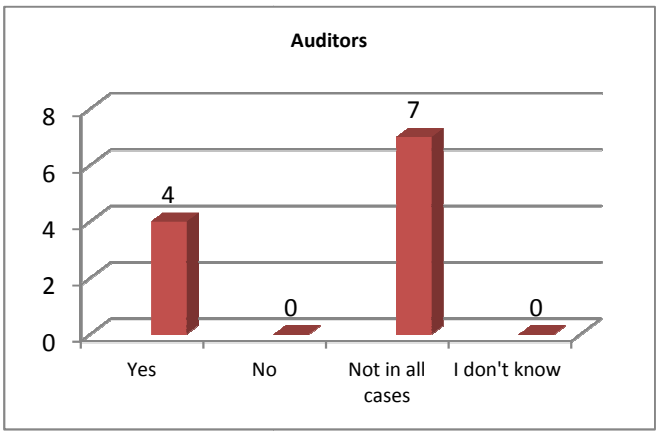



**Figure 7. 46**

Most Tax Auditors agreed that the Tax Department is not always efficient in collecting taxes. A couple of Tax Auditors gave the following reasons for this view:

- The Tax Department in Kuwait is relatively small. There aren't enough employees and the management is poor.
- All the procedures are very slow and usually postponed, e.g. we have requested a tax clearance four months ago and we are still waiting.

Tax Department (employees)

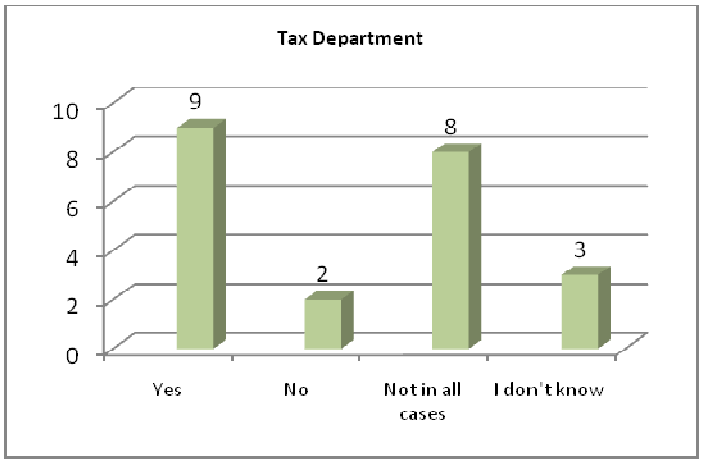



**Figure 7. 47**

As Figure 7.47 shows, the number of employees who thought that the Tax Department is efficient in collecting taxes is marginally higher than those who thought that the Department was not in all cases efficient, which indicates that not all employees believe that the Department is efficient in collecting taxes.

Because the questionnaire was distributed to the employees by their department's supervisor they were not asked specifically to write a justification for their response.

Taxpayers (foreign enterprises)

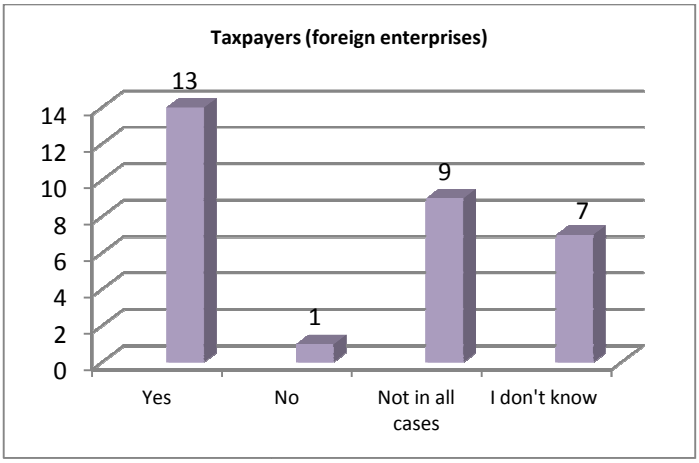



**Figure 7.48**

A majority of taxpayers (foreign enterprises) felt that the Department was in fact efficient in collecting taxes. However a significant minority believed that the Department was not always efficient. The following opinions were expressed:

- We are in constant disagreement with the Tax Department. Whenever we submit our records and they are unsure about our costs we are taxed upon deemed profits; it is not a fair procedure.
- The inspection procedures are very long and time consuming.
- It's 2009 and we are still waiting for the tax assessment of 2006. The inspectors are very slow.

♦ Do you feel that the Tax Department is fair in its tax assessments?

Tax Auditors

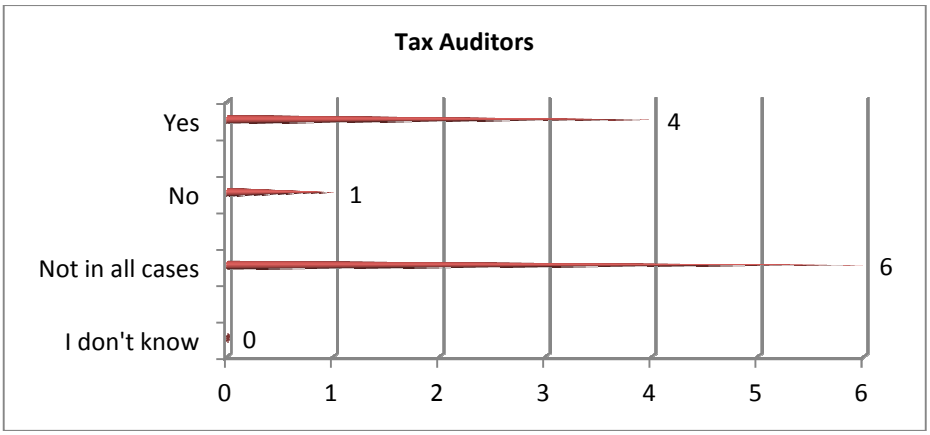



**Figure 7. 49**

A majority of Tax Auditors believed that the Tax Department is not always fair in their tax assessments. Some of the reasons given were:

- A number of Tax Auditors said that the decision making is arbitrary in the Tax Department.
- On various occasions the Tax Department would overlook our deductible expenses simply because they are unfamiliar with international accounting standards.
- The law is vague and allows broad interpretation and that is when the Tax Department takes advantage and interpretation is made in their favour.

Tax Department

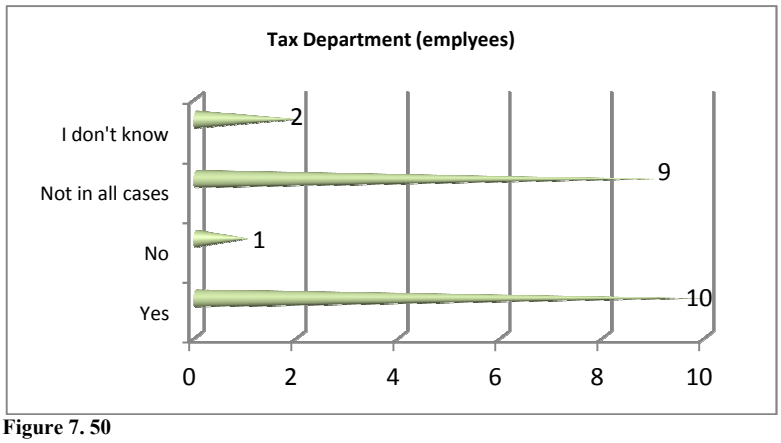



**Figure 7. 50**

The employees in the Tax Department were more or less evenly split in their responses; ten employees thought that the Tax Department is 'fair' in its assessment, and nine employees thought that the department is 'not always fair'.

Taxpayer (foreign enterprises)

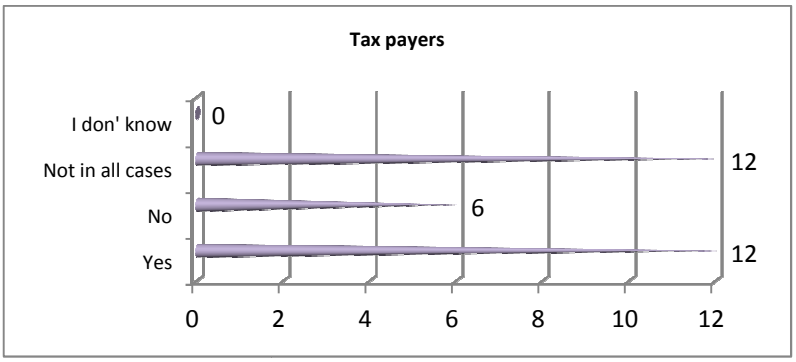



**Figure 7. 51**

The number of Taxpayers (foreign enterprises) who found that the Tax Department is fair in its assessments and those who felt it was 'not fair in all cases' was similarly evenly divided. Some taxpayers believe that the Tax Department might not always be fair in its tax assessments for a variety of reasons:

- We were subjected to unfair tax assessments many times before and were not given the opportunity to discuss them with the inspector.
- They add back depreciation, they don't accept accruals, and they put back expenses which in their own arbitrary opinion they decide are not deductible.
- They exaggerate when it comes to paperwork and documents. They ask us to submit irrelevant things and justify this by saying that they are 'supporting documents,
- Most of our expenses are not allowed.
- Deductible expenses differ from one inspector to another.
- Last year we had losses due to the drop in the US $ because the Kuwaiti Dinar was pegged to the US $ but the Tax Department refused to take our losses into consideration and taxed us upon deemed profits.

♦ How would you describe tax inspectors powers and authorities?

Too broad (  ) Reasonable (  ) In some cases broader than others (  ) I don't know (  )

Tax Auditors

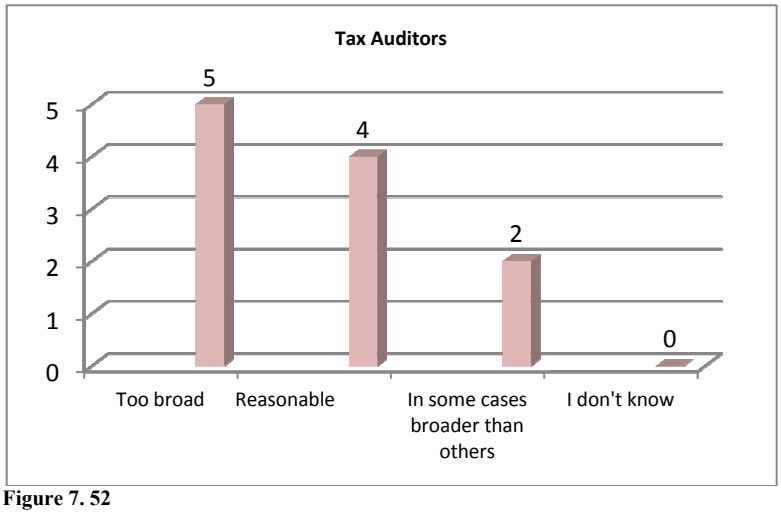



**Figure 7. 52**

Figure 7.52 shows that a significant number of Tax Auditors believed that the tax inspectors' authorities are too broad. The following reasons were cited in support of this:

- Because the law is vague and there are not fixed rules on their authority. This causes the authority issue to differ from one inspector to the other.
- They are given more powers than the law allows.

Tax Department (employees)

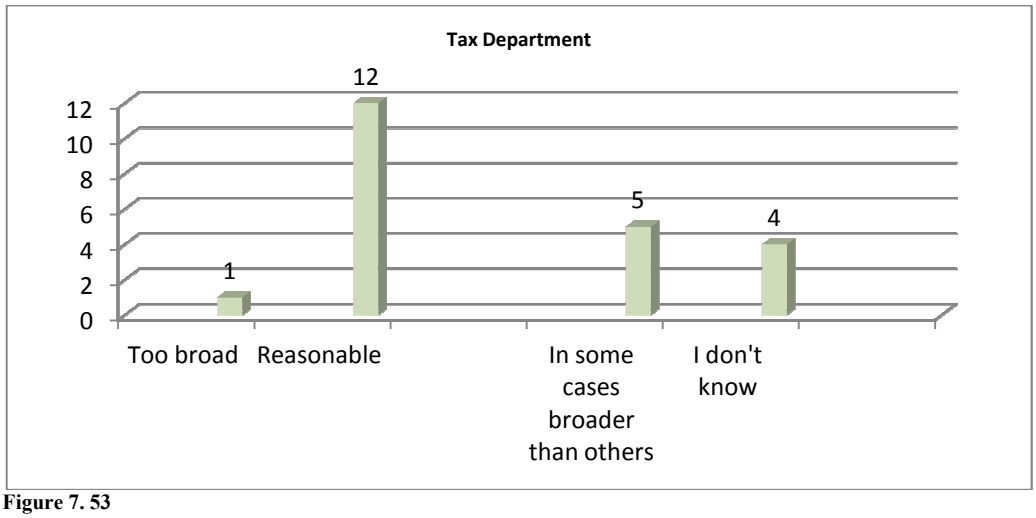



**Figure 7. 53**

Perhaps not surprisingly the majority of the Tax Department employees agreed that their powers are reasonable. A very small number of employees said that their powers were 'in some cases broader than others'.

Taxpayers (foreign enterprises)

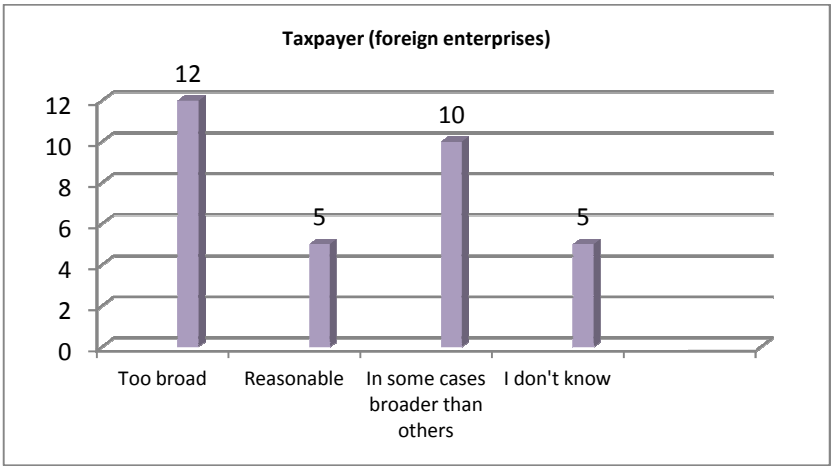



**Figure 7. 54**

12 taxpayers (foreign enterprises) felt that tax inspectors' authorities were too broad. Also 10 taxpayers recognized that in some cases inspectors' authorities are

broader than others. A few taxpayers felt that their positions might be explained by the following[704]:

- Vagueness in the law allows broad interpretation of an inspector's authority, and misuse of such authorities can occur.
- Connections have a strong influence; the stronger/bigger the company, the more willing the inspector is to bend the rules.
- They can decide what is deductible and what is not; this is not fair.
- Their authorities are not regulated or specified clearly.

♦ Are tax inspectors:

Well trained and educated (  )
Not well trained and educated (  )
Trained and educated to an extent (  )
I don't know (  )

Tax Auditors

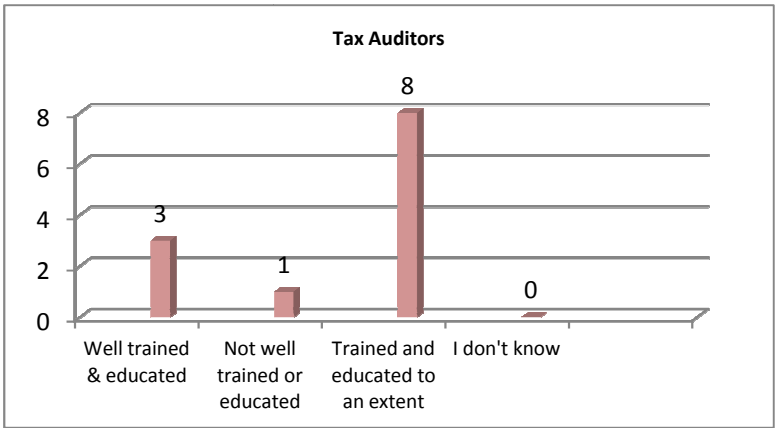



**Figure 7. 55**

Few Tax Auditors felt that tax inspectors were 'well trained and educated'. Whilst a clear majority believed that the tax inspectors were 'trained and educated to an extent' from which it might be intended that a better service could be provided with further training and education.

[704] It should be noted here that two respondents gave two answers to the same question, adding 2 more answers to the total of 30.

Tax Department

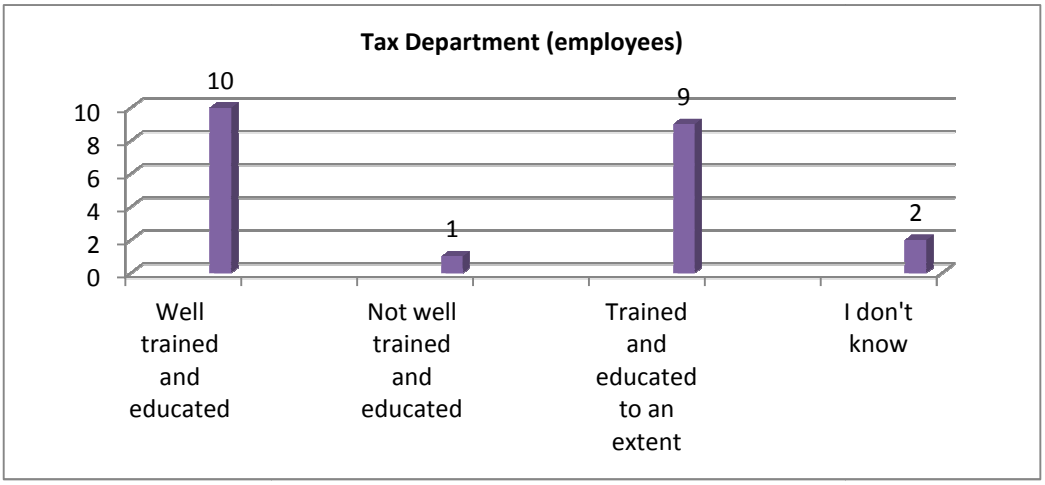



**Figure 7. 56**

It is not surprising, perhaps, to find more tax inspectors felt they are 'well trained and educated' than not, but it is interesting to note a significant number thought that they were 'trained and educated to an extent'.

Taxpayers (foreign enterprise)

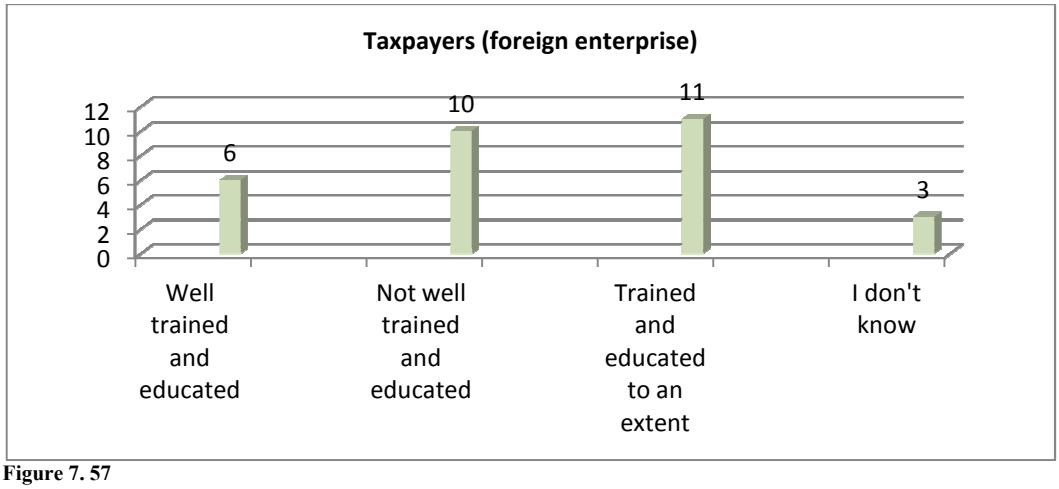



**Figure 7. 57**

Figure 7.57 shows that a clear majority of taxpayers (foreign enterprises) thought that the inspectors are either 'not well trained and educated' or only 'trained and

educated to a certain extent'. Two taxpayers (foreign enterprises) added the following comments:

- When we started paying taxes it took the inspector we were working with a whole year to do our assessment. We had no idea what were the allowances and disallowances, all the procedures were vague to us as taxpayers.
- Inspectors don't take their job seriously. Unexpectedly during the end of the financial year when our company tax records are due for tax assessments they are absent and there is never anyone else to take over their pending work. All we can do is wait.

The following two questions were addressed to Tax Auditors and Taxpayers (foreign enterprises) only.

♦ Have you ever experienced an unfair/unjust decision from tax inspectors?

Yes (  )  No (  )  In some cases (  )  I don't know (  )

Tax Auditors

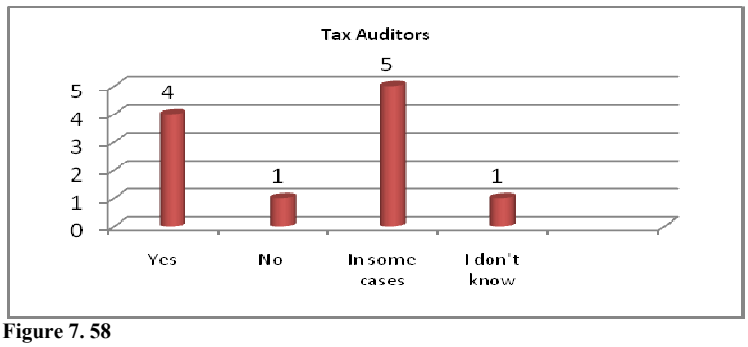



**Figure 7. 58**

A majority of Tax Auditors provided that they have 'in some cases' experienced unfair decisions from tax inspectors. However, no more specification was given on why or how this happens.

Taxpayers (foreign enterprises)

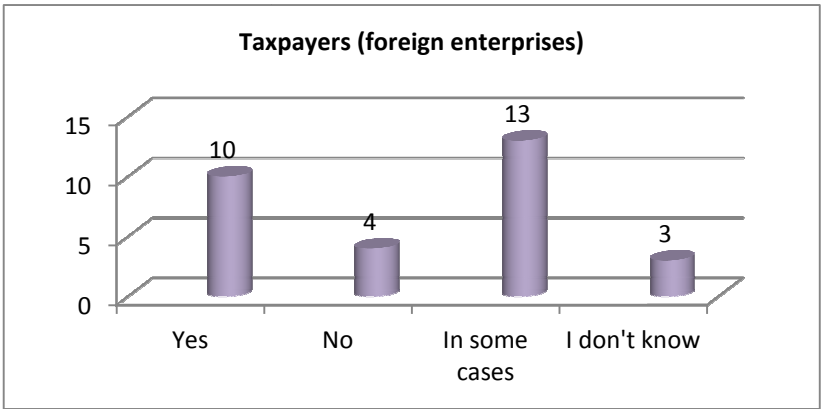



**Figure 7. 59**

A clear majority of taxpayers, perhaps not unexpectedly indicated that they have in their opinion experienced unjust decisions from tax inspectors.

♦ Has your objection to an inappropriate decision made by the inspector been:

Taken into consideration ( ) Disregarded ( ) In some cases taken into consideration ( ) I don't know ( )

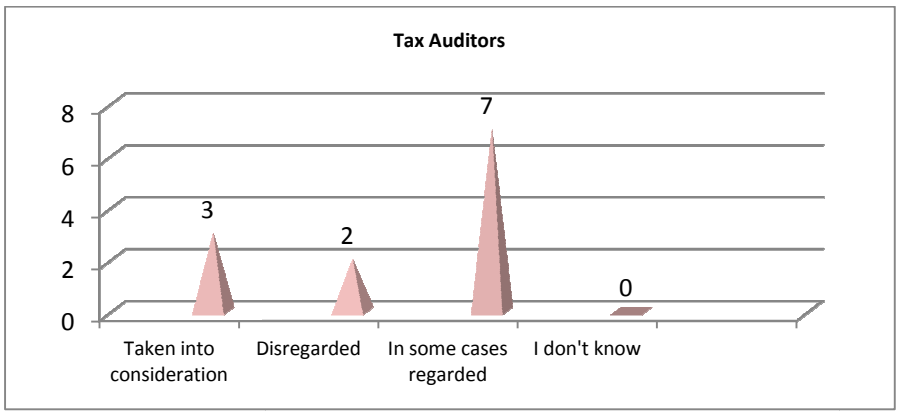



**Figure 7. 60**

The majority of Tax Auditors believed that the Tax Department only takes their objection into account on some occasions. One Auditor provided: "even if they do listen to our objections I know that they will eventually do what they want".

It should be noted here that two auditors provided two answers for the same question thus adding to the number of responses.

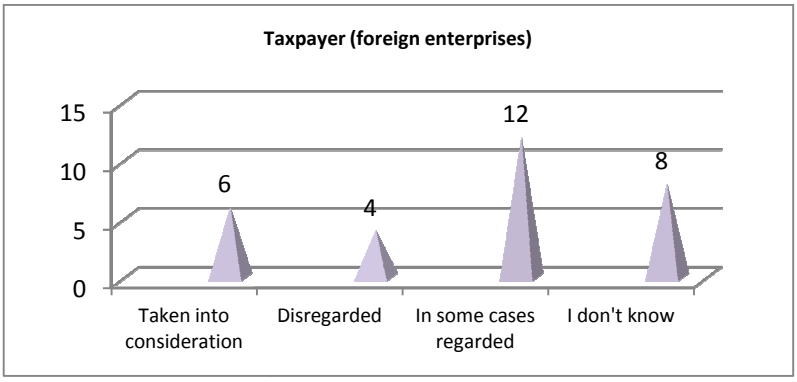



**Figure 7.61**

Most taxpayer respondents believed that their objections to the Tax Department were 'in some cases regarded'. A few believed that objections are 'disregarded', and a good number said their objections were 'taken into consideration'. An apparent oddity is the significant number of 'I don't knows' in this category, this may be explained by the fact that foreign enterprises rely on their auditors in tax matters, and thus are not directly involved in objections.

When this question was addressed to the employees of the Tax Department the language was modified as follows: When receiving an objection to a decision made by the Tax Department, would the Department:

Take it into consideration (  ) Disregard it (  ) In some cases taken into consideration (  ) I don't know (  )

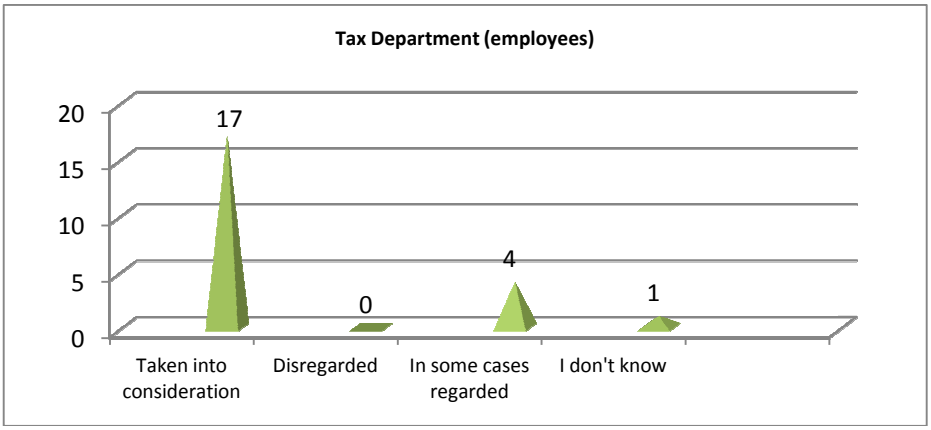



**Figure 7.62**

The findings in Figure 7.62 show the vast majority of the employees indicating that objections were 'taken into consideration'.

It should be noted that employees of the Tax Department were not asked to answer the following question.

♦ Would you say tax inspectors sometimes make 'arbitrary' allowances and disallowances?

Yes (  )  No (  )  Sometimes (  )  I don't know (  )

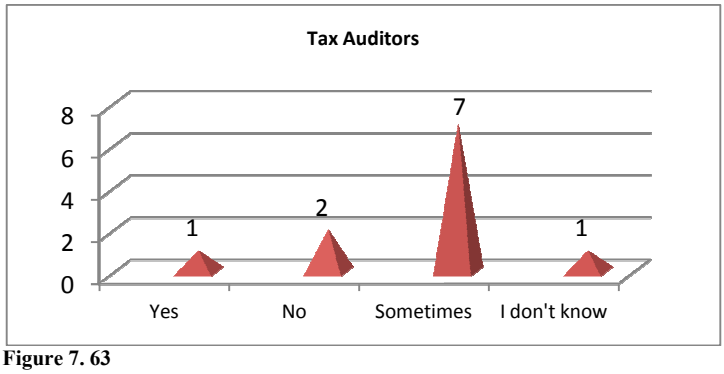



**Figure 7. 63**

Most auditors believe that tax inspectors sometimes make arbitrary allowances and disallowances, one auditor commented:

"Connections play a big role, there is corruption, if you are an important big company your allowances will be different than that of a smaller trivial company".

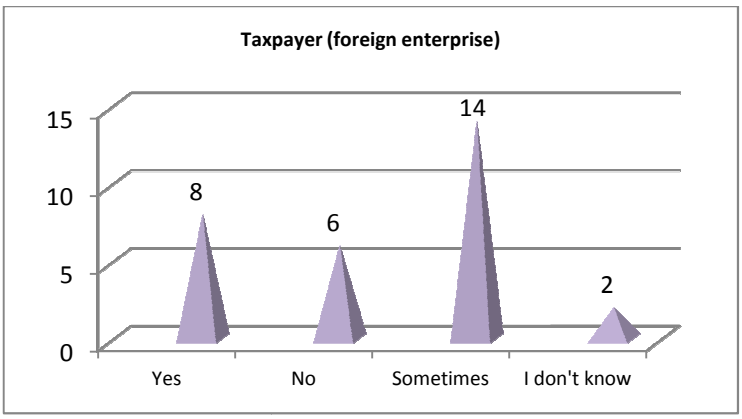



**Figure 7. 64**

Taxpayers confirmed that inspectors do sometimes make arbitrary allowances and disallowances.

♦ In terms of assessment, would you say that inspectors follow certain uniform rules and procedures according to the circulars of the law?

Uniform assessment (  ) Assessments vary from one payer to the other (  )
In some cases inspectors are arbitrary (  )  I don't know (  )

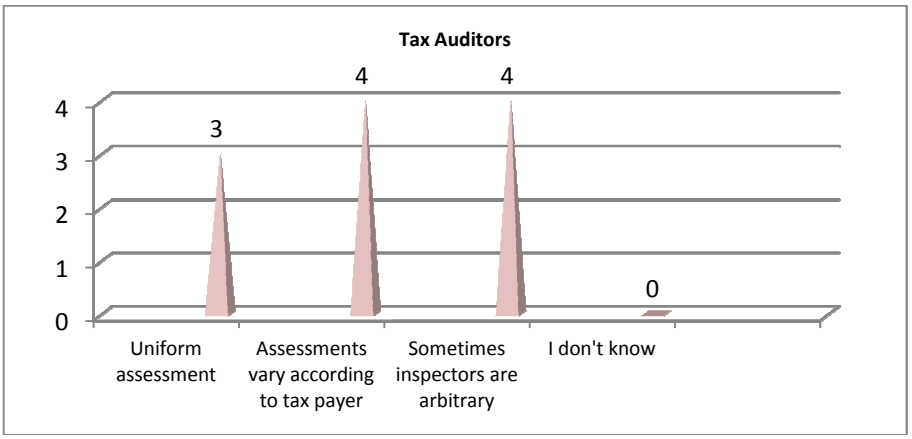



**Figure 7. 65**

Few Tax Auditors felt that tax inspectors followed uniform assessment practices when making an assessment. One auditor commented:

"I have worked with different inspectors and each has a different method. There are no uniform rules".

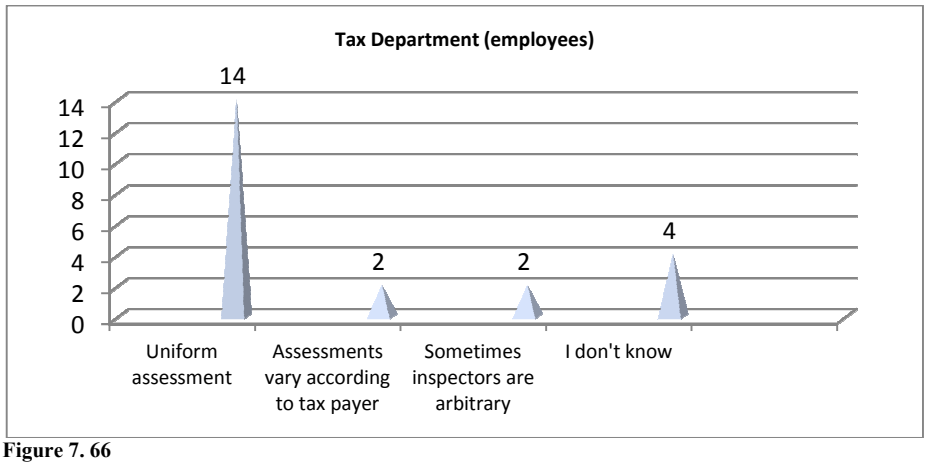



**Figure 7. 66**

Not surprisingly, Figure 7.66 shows that the Tax Department tax inspectors' carry out tax assessments in a uniform manner.

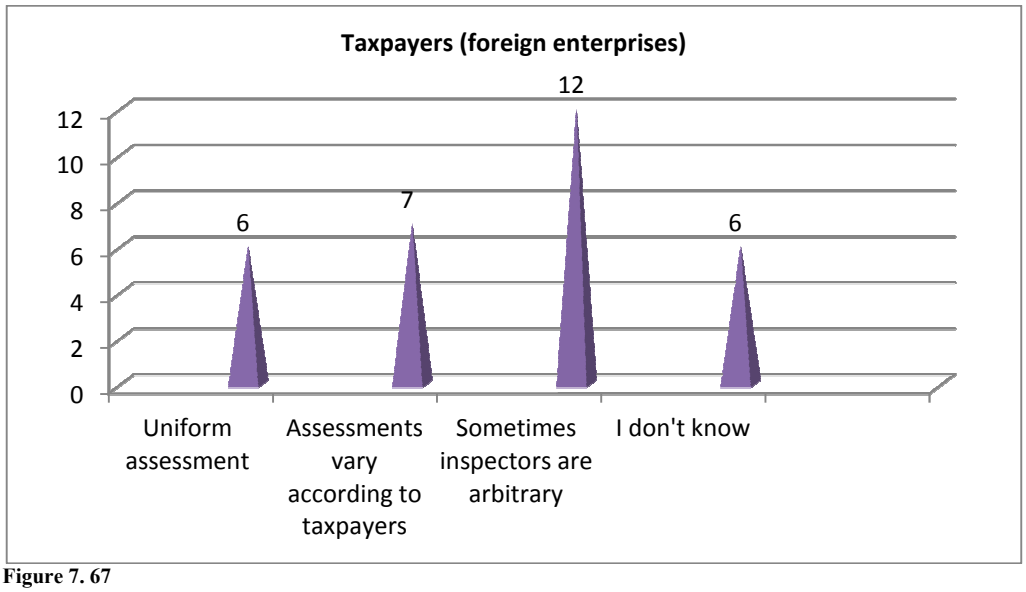



**Figure 7. 67**

Most taxpayers (foreign enterprises) agreed that tax inspectors are in some cases arbitrary. Also a significant number felt that tax inspectors' procedures vary from one taxpayer to the other when it comes to tax assessments, but this is not unexpected in view of the different nature of taxpayers' positions.

♦ Would you say that tax inspection procedures are efficient?

Yes ( ) No ( ) Not always ( ) I don't know ( )

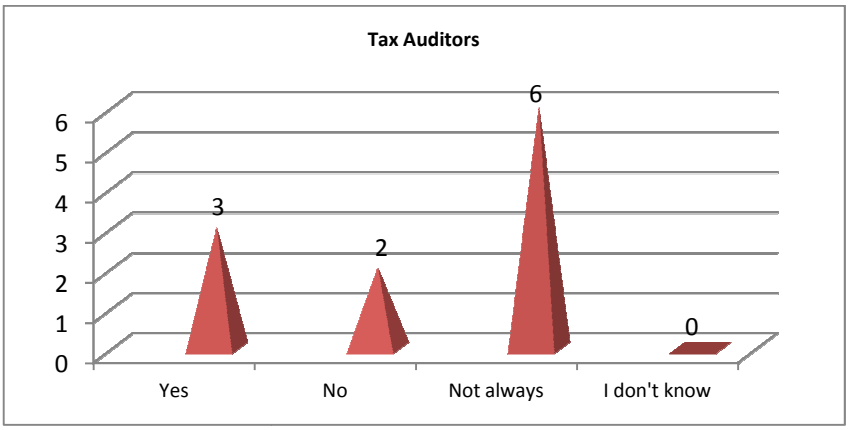



**Figure 7. 68**

A majority of Tax Auditors confirmed that inspection procedures are 'not always efficient'. The following observations were made:

- If a company does not have a permanent establishment in Kuwait we are always assessed according to a deemed profit rate which constitutes a problem for us.
- Although our 2007 inspection started in September we didn't hear from our inspector again until November that year.
- We have to change our accountancy standards to accommodate them, because they are not familiar with international accountancy standards.

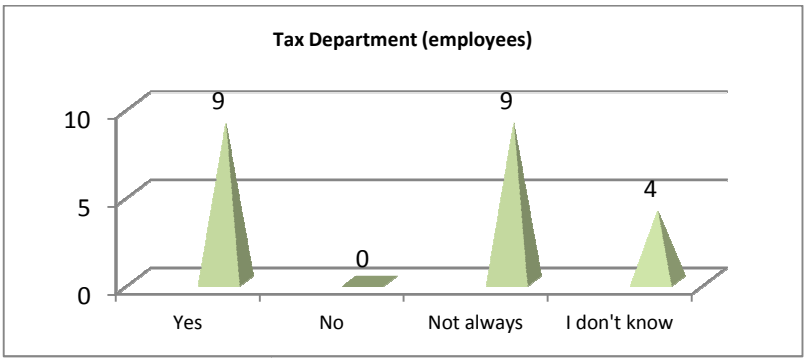



**Figure 7. 69**

The significant number of Tax Department employees who felt that their inspection procedures were 'efficient', was matched by those who recognized that tax inspection procedures are 'not always efficient'.

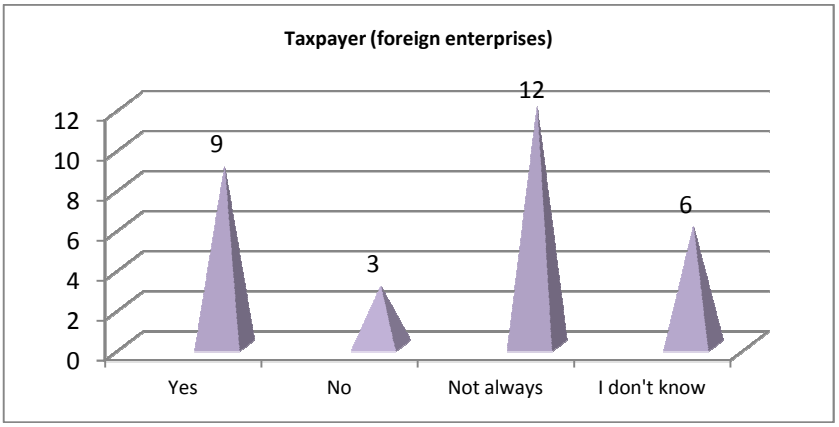



**Figure 7.70**

Figure 7.70 shows a fair spread of responses to this question, but nevertheless, 12 taxpayers said that tax inspection procedures are 'not always efficient'. The following comments were made by the taxpayers:

- Most inspectors take long leaves, especially during Ramadan, and all the work is postponed.
- We deal with an inspector, who suddenly disappears. We later find out from the Tax Department that he is on a two month leave. We are not allocated another inspector, so our file just stays pending.

The following question was only addressed to Tax Auditors and Taxpayers (foreign enterprises).

♦ In your opinion, are compliance costs too high for the taxpayer?

High costs ( ) Reasonable Costs ( ) Low costs ( ) I don't know ( )

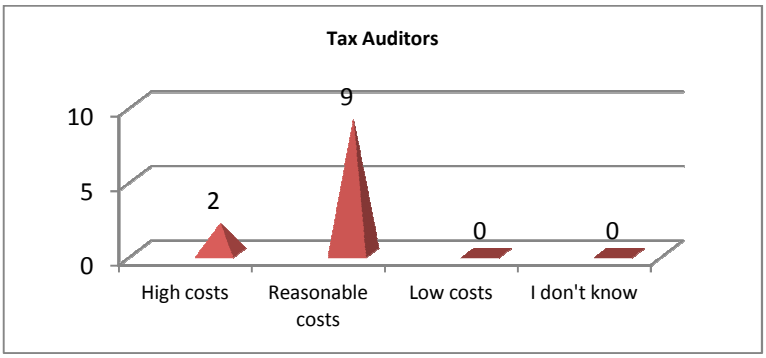



**Figure 7. 71**

A substantial majority of Tax Auditors believe that compliance costs are reasonable. One of the minority, who felt that compliance costs are high, added:

- Many companies complain that compliance costs are higher in Kuwait compared to other GCC countries, but we have to keep in mind that the cost of living in Kuwait is also the highest in the GCC.

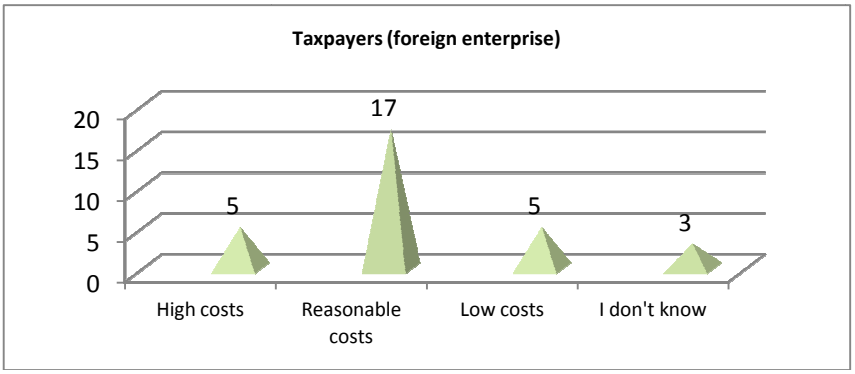



**Figure 7. 72**

Interestingly figure 7.72 shows that most taxpayers are in agreement with the substantial majority of Tax Auditors, with the majority responding that compliance costs are reasonable.

♦ How would you describe the objection and appeal process in the Tax Department?

Independent and objective ( ) Not independent or objective ( )
Not always independent and objective ( ) I don't know ( )

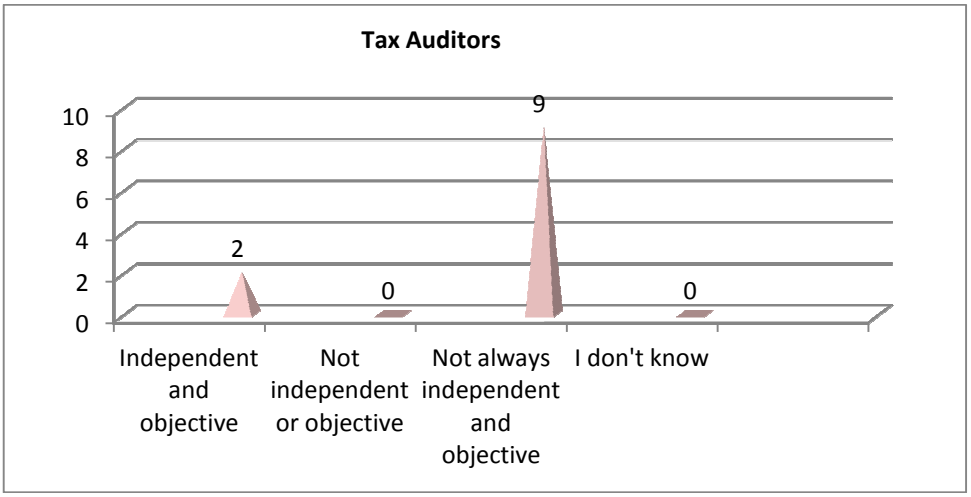



**Figure 7. 73**

The vast majority of Tax Auditors said that the objection and appeal process is 'not always independent and objective'. Some explained their reasons for taking this view:

- The arbitration panel looking into the objections and appeals is composed of the inspector whose assessment was challenged, and his superior, they can never be impartial.
- The appeal and objection is being looked at by the people who made the decisions themselves.
- In many complicated issues such as disputes on Double Tax Treaties, the Tax Department is not confident enough to make a decision so they refer it to the court.

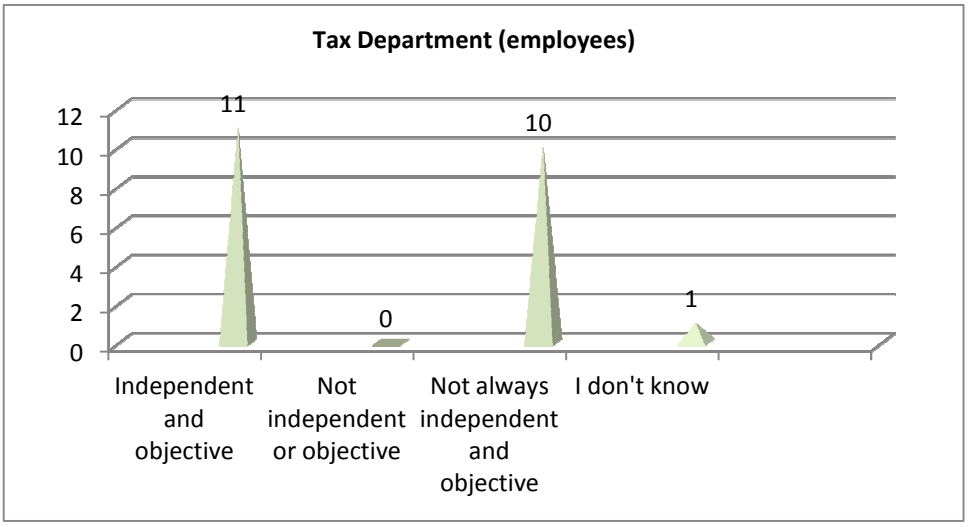



**Figure 7. 74**

Figure 7.74 shows again an interesting division of opinion with the employees of the Tax Department, with only a marginal difference between those who felt that the objection and appeal process was 'independent and objective' and those who believed it was not always so.

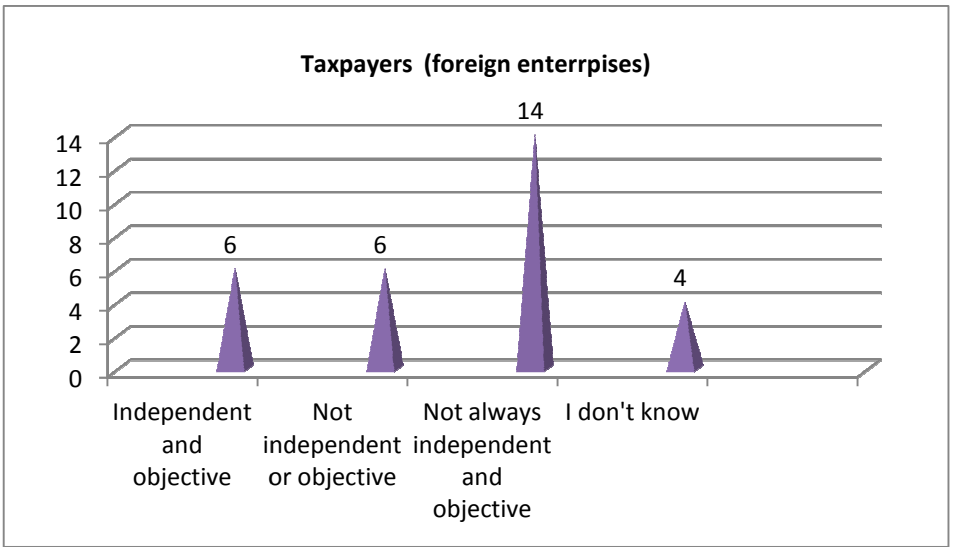



**Figure 7. 75**

Figure 7.75 reveals that there was amongst the taxpayers (foreign enterprises) strong support for the view that the objection and appeal process is 'Not always independent and objective'. Justifications for this view were similar to those expressed by the Tax Auditors, that there was a belief that the panel which looks into their objections and appeals is composed of the inspector who made the assessment (which they are appealing) and his superior and that for this reason the decision can never be neutral.

♦ When rejecting an objection or an appeal, does the tax department provide good reasoning for such a decision?

Provides reasoning (  ) Does not provide reasoning (  )
It doesn't always provide good reasoning (  ) I don't know (  )

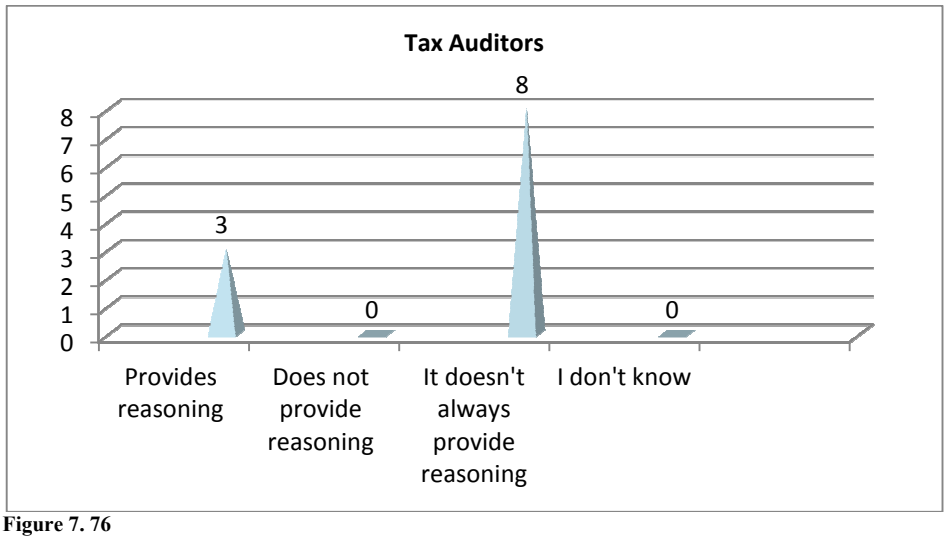



**Figure 7. 76**

The majority of Tax Auditors believed that the department 'doesn't always provide good reasoning' when rejecting an objection or an appeal. Some observations were as follows:

- They don't distinguish between one case and the other and they hold on to very trivial issues.
- They never provide reasoning. In one case we challenged why they did not allow labourers salaries (to be deducted) just because the salaries were paid by cash.

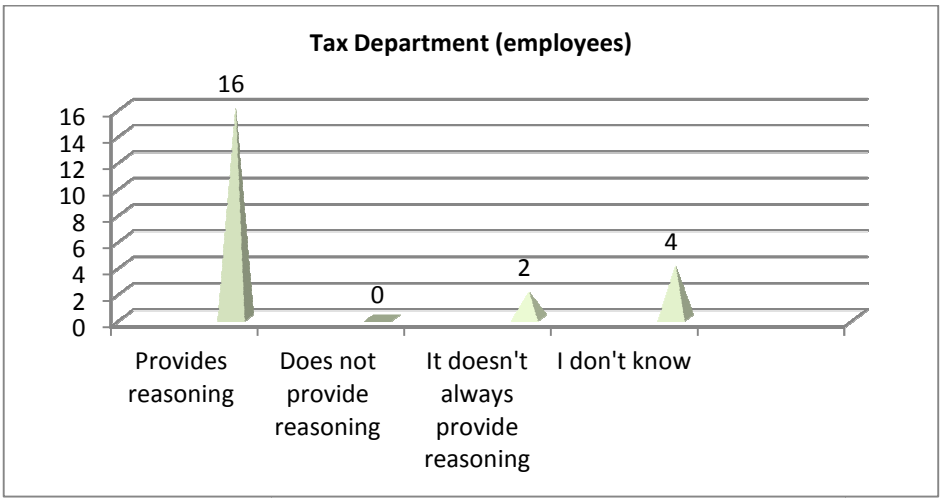



**Figure 7.77**

Figure 7.77 shows that employees of the Tax Department, as expected, believed that reasoning was provided when an objection or an appeal was rejected. It is

conceivable that the four employees who didn't know the answer to this question may not be involved in determining objections and appeals.

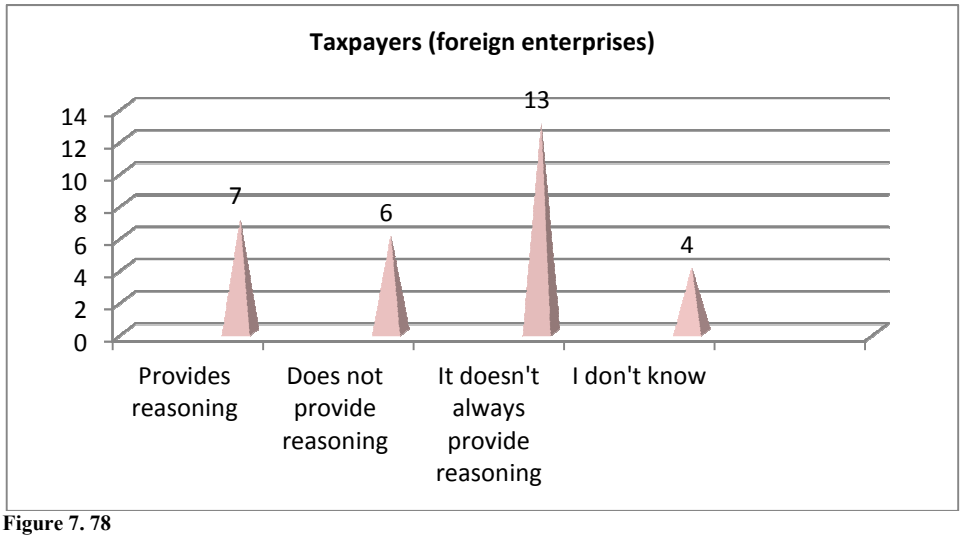



**Figure 7. 78**

Almost 50% of the taxpayers (foreign enterprises) responded that the Tax Department 'Does not always provide good reasoning' when rejecting an objection or an appeal. Some of the respondents who provided that the Tax Department 'Does not provide reasoning' added:

- They make ridiculous decisions without giving an explanation
- In all our appeals and objections they have never provided us with good reasoning.

This next question was addressed only to the Tax Auditors

♦ How would you as a tax consultant describe your relationship with the Tax Depsrtment?

Poor ( ) Fairly ( ) Good ( ) Excellent ( )

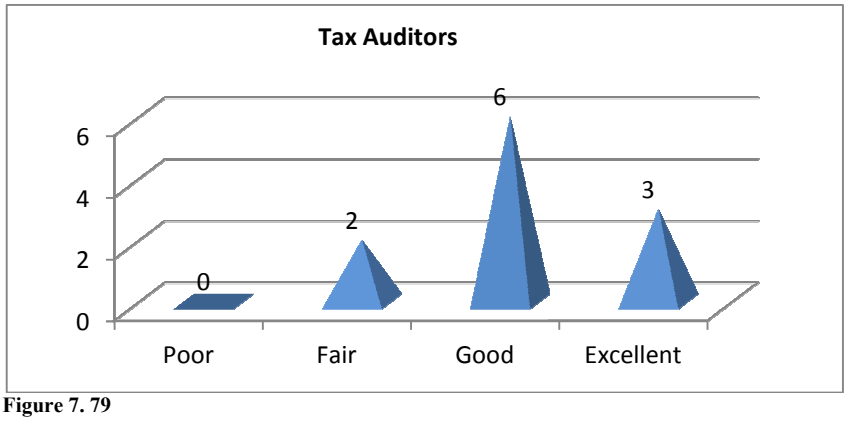


**Figure 7. 79**

Encouragingly, the vast majority of Tax Auditors felt they had an excellent or good relationship with the Tax Department.

**By way of conclusion to the questions relating to the workshops of the Tax Department this question was addressed to each sample.**

♦ How in your opinion can the Tax Department improve its services?

Tax Auditors:

arbitration, or self

ional accountancy
ystems.
is important.
s and inspection

Taxpayers (foreign enterprises)

1- We want the Department to interact more closely with companies. We want to talk to them and communicate with them.
2- Better deadline definition (they give us deadlines for tax assessments but they never comply).
3- The arbitration panel must be independent from the Department.
4- When they have doubts on our accounts there should be a chance to talk and discuss instead of taxing us according to deemed profits.
5- There is a language barrier. They don't speak English, and we don't speak Arabic.
6- Easier, faster inspection procedures.
7- Fairer treatment for taxpayers without discriminating against smaller companies by treating larger ones more favourably.

Tax Department (employees):

1- Developing the staff by offering courses and better training.
2- Increasing tax awareness in the country.
3- A more comprehensive tax law.
4- Independence of the Tax Department from the Ministry of Finance and less bureaucracy.
5- Better communication and correspondence with taxpayers and tax auditors by listening to their concerns and recommendations.
6- A tax magazine for the employees which provides the latest news on amendments, and changes on tax locally and internationally to improve their tax awareness.

It is interesting to see that all samples agree on very similar recommendations to improve the Tax Department's performance in Kuwait.

After assessing the tax department performance in collecting taxes and dealing with auditors and taxpayers, it is time to shed some light on how Kuwait can improve its taxing policies in order to attract more FDI.

### 7.5 Recommendations on how Kuwait can attract more Foreign Direct Investment

The third and last objective of this field study was to explore how the sample groups think the tax system could be improved in order for Kuwait to attract more FDI.

♦ What changes, if any, would you suggest be made to Tax Law Amendments 2/2008?

Tax Auditors:

1- More clarity to the law. It is very limited in its scope and should cover all issues related to taxation in Kuwait.

2- Clearer definitions in the law such as the definition of a taxpayer.
3- Abolishing deemed profits.
4- A more complete, coherent tax system and also proposing VAT.
5- A progressive tax rate is fairer generally, and for smaller businesses specifically.
6- Taxing national companies to avoid discrimination against foreign companies.

Tax Department (employees):

1- This tax law is very limited. There is a need for a more comprehensive, coherent law that covers all issues regarding taxation in Kuwait.
2- Eliminating discrimination against foreign companies by taxing national companies.
3- The tax base should be made wider, but there should also be a pre-tax period to encourage start-up companies.

Taxpayers (foreign enterprises):

1- The law is ambiguous, more clarity is crucial.
2- There needs to be periodical reviews on the law and its clauses and amendments in order to improve the law and the system as a whole.
3- Increase allowances for agent commission and head office expenses.
4- A progressive tax rate is fairer than a flat rate tax.
5- An independent panel to rule in tax objections and appeals, rather than the tax inspector in the Tax Department.
6- Giving start-up companies a tax holiday e.g. first five years of their business as an encouragement.

From the answers above, all samples call for very similar and in some cases identical reforms in order to improve Tax Law Amendments 2/2008.

♦ Can you say that Kuwait is an attractive environment for foreign investment? Why?

Tax Auditors

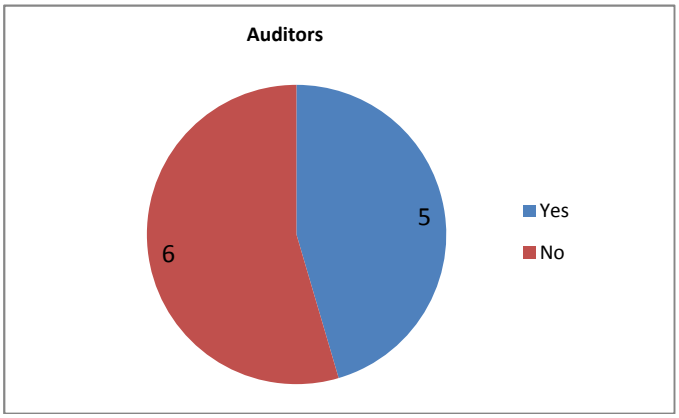



**Figure 7. 80**

This was a mixed response, but those who answered 'Yes' tended to stress that the new tax rate is very encouraging for foreign investment. Within those who answered 'No' the following non-tax related reasons were suggested:

- Kuwait's economy is in need of adequate infrastructure to grow, not just roads and buildings but also power centres, fully equipped facilitated harbours, and developed free trade zone areas.
- Due to the huge bureaucracy in the country the public sector which you must come in contact with when doing business in Kuwait (issuing trade permit, visa purposes, etc.) is very slow. This makes Kuwait unattractive for FDI.
- Too many long routine procedures to start up a business.

Tax Department (employees)

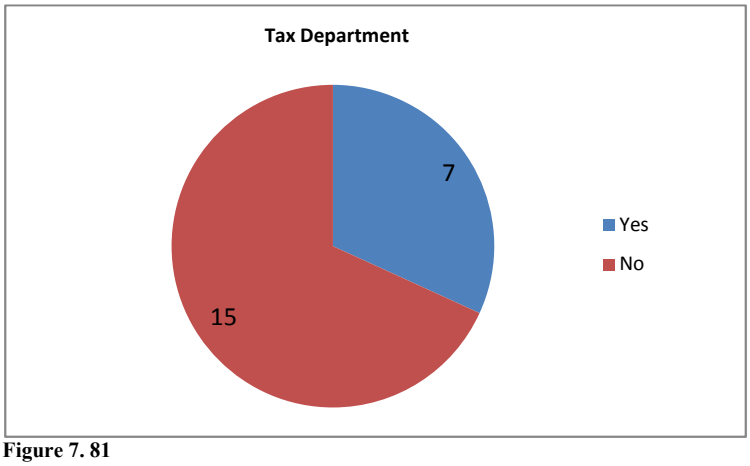



**Figure 7. 81**

Those who answered 'Yes' tended to draw attention to the reduced tax rate and also to Kuwait's strategic position on the world map which allows it to be a financial centre. Within the responses of those who answered 'No' the following observations were made:

- Commercial, investment, and tax laws need to be improved.
- Investment opportunities in Kuwait are strictly in oil sector.
- Due to the discrimination against foreign investment since national companies are exempt from tax.
- All development projects needed to attract FDI are put on hold.
- Poor infrastructure.
- Long complicated procedures and endless requirements.

Taxpayers (foreign enterprises)

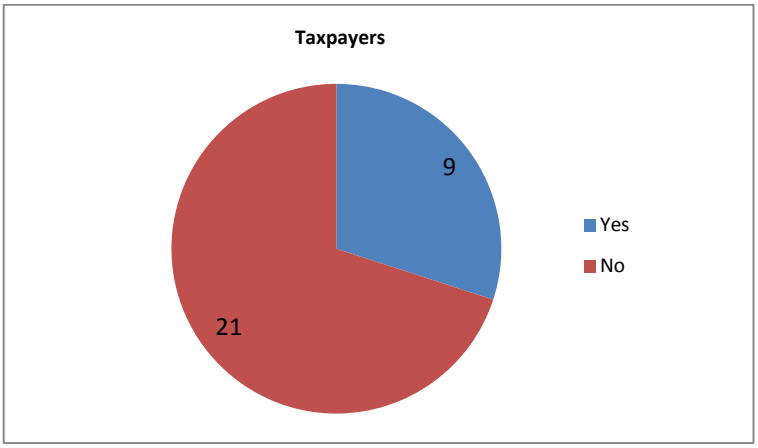



**Figure 7. 82**

Disturbingly, perhaps, almost 70% of taxpayers (foreign enterprise) felt that Kuwait is not an attractive environment for investment. Some of the reasons cited were as follows:

- Kuwait's business regulations are very restricting (agency and sponsorship rules), while other GCC countries are opening up for investment and abolishing barriers.
- It is supposed to be attractive but it is not due to the endless disputes between the government and Parliament. All development projects are shelved, and the continuous re-shuffling of the government is a hindrance to decision making.

- There are business opportunities but the requirement that a national must own 51% of the project makes these opportunities unattractive.
- The bureaucracy is huge, too many rules, and requirements and very long procedures.
- It is only attractive for oil companies.

Those who said 'Yes' mainly linked their answers to the new reduced tax rate.

♦ Foreign Direct Investment Law 8/2001 was found to encourage FDI in Kuwait by allowing foreign enterprises to own 100% of their businesses. What is in your opinion the most important shortfalls of the Kuwaiti Direct Foreign Investment Law 8/2001? And is it effective in encouraging FDI?

1. Tax Auditors

- The law imposes (almost) impossible requirements for foreign businesses to satisfy in order to enjoy the benefits and incentives it provides.
- The process of getting a license according to this law is long, and bureaucratic.
- The activities which this law allows foreign businesses to undertake are very limited.
- It's very vague in terms of what businesses are available for foreign investment and those that are not open for foreign investors to carry on in Kuwait.
- This law is effective in theory but not in practice, it has too many restrictions, with very complicated procedures and gives wide discretion for the Minister of Commerce, where no decision can be made without his (the Minister's) approval, and with the constant reshuffling of the government, decision making is shelved indefinitely. Some licenses take more than a year to be issued.

2. Tax Department (employees)

It should be mentioned here that 8 employees said they did not know this law, although the law has been in force since 2001. Also four employees answered 'No' it's not attractive without stating any reasons why they hold such views. Some employees did provide an opinion, some of these opinions were as follows:

- The Law states that there are specific business opportunities which are open for 100% foreign ownership; however, these restricted opportunities are not clarified in the law.
- There's a huge bureaucracy and very long procedures to get a license.

- Some tax employees said that the law is in fact encouraging and provided the following reasons:
- It gives tax exemptions up to ten years if the foreign company satisfies the requirements
- It provides some tax incentives.

3. Tax Payers (foreign enterprises)

Not all taxpayers in this sample knew about this law which can also indicate that the Foreign Direct Investment Bureau is not doing its best to promote the law and its objective of attracting more FDI, those tax payers who have heard of the law, or had experience trying to apply for incentives it offers provided the following opinions:

- It's useless it poses too many restrictions on foreign investors.
- The business activities which it allows 100% foreign ownership for are restricted to a few sectors.
- Too many conditions to satisfy.

♦ Can you confirm that foreign businesses entering Kuwait to invest usually have a common misconception that there are not any corporate income taxes in Kuwait, especially that national companies are not taxed? If yes, how can this be avoided?

1. Tax Auditors

All Tax Auditors provided that foreign entities do know about the tax imposed on foreign investment in Kuwait, so the first thing they enquire about before coming to invest in Kuwait is the tax rate and how the tax system works.

2. Tax Department (employees)

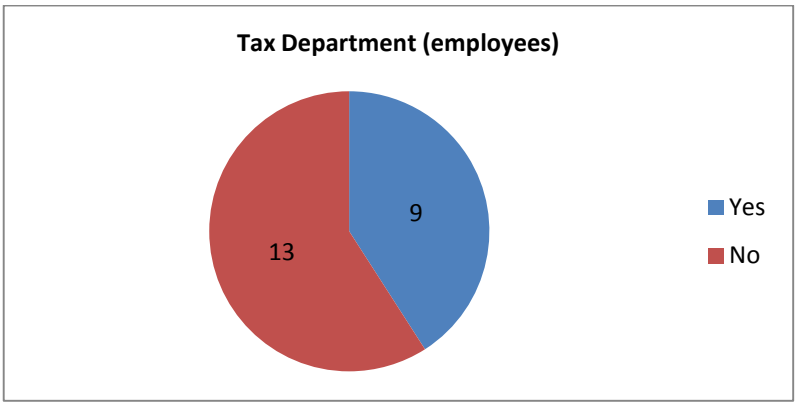



**Figure 7. 83**

As Figure 7.83 shows a majority of employees in the Tax Department felt that there was no misconception and added that most companies do research before embarking on an investment in another country. The minority of employees recognised that there might be a misconception and that there is no taxation upon companies possibly caused by non-taxing regimes of neighbouring countries Gulf countries such as Dubai.

Taxpayers (foreign enterprises)

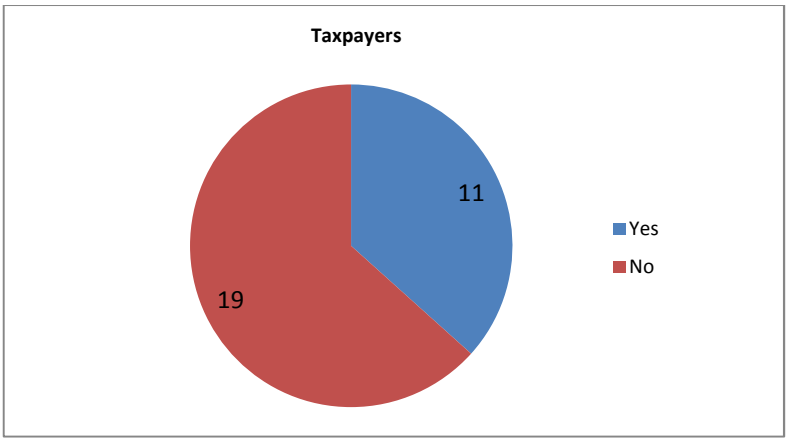



**Figure 7. 84**

A significant majority of taxpayers (foreign enterprises) said that there is no misconception and that foreign businesses are actually aware of the tax law and justified this by saying that all companies do feasibility tests before entering a new host country. Those who felt that there is a misconception, also indicated, in some cases, that it is the Tax Department's responsibility to increase the tax awareness. Some taxpayers said that tax regulations were referred to, and amendments on the Tax Department's web page were visited, however the web page is not updated and does not always have all the information they need.

**The objective of the following questions was to understand from the taxpayer's point of view what problems foreign investors face when working in Kuwait and what are their recommendations to make Kuwait more attractive for foreign investment, thus the following questions were addressed to the taxpayers only:**

♦ Kuwaiti Commercial Law states that a foreign business can only enter Kuwait through a Kuwaiti agent or to have a Kuwaiti own 51% of the business, how does this affect foreign businesses in Kuwait? Why?

Amongst the taxpayers (foreign enterprises) there was a consensus that such a rule is discouraging for foreign investment, with respondents commonly citing the following:

- I don't want a national agent to control my company. I want to be able to have full control over my business.
- Having an individual partner can cause many disputes.
- The rule can be very restricting, as the agent can be very controlling
- Because as a foreign company we pay agent commissions, our costs are always higher than national companies. Thus when we apply for a government bid, we are never really the lowest price so we never win the bid because our costs are higher.
- The agent doesn't help us (the foreign company) at all but we still have to pay him a commission.
- As an international company we have never seen this rule anywhere else other than in the Gulf.

- It can really be a barrier especially when the agent wants to get involved in the day to day decision making.
- When the agent is profit driven and unreliable it can really affect the company.
- We bring the business from abroad, we do everything to get off the ground and then a national who has contributed nothing comes and as soon as you start making profit they want to take over the business.

♦ What is your opinion on allowable expenses according to the Kuwaiti tax law e.g. head office expenses used to be (under the Tax Decree 3/1955) 3% now they are only 1.5%, would you say this is fair?

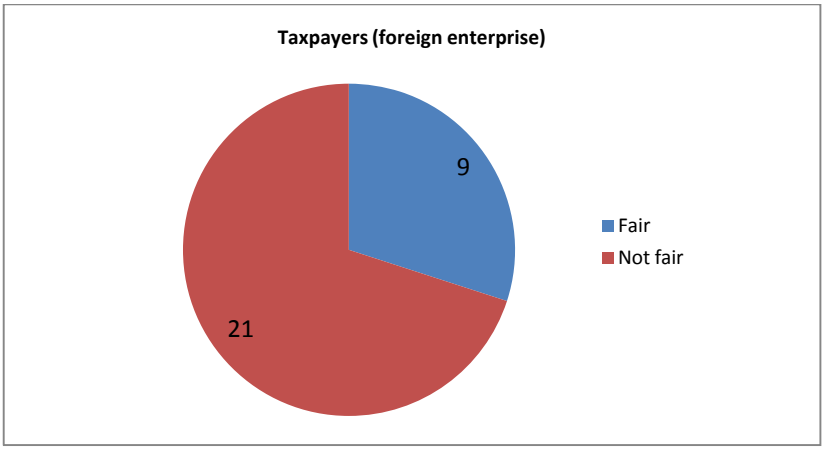



**Figure 7. 85**

70% of taxpayers indicated that a 1.5% allowance for head office expenses is not enough. Some of the reasons for this view were as follows:

- The amount of work we do at our home office is huge, even the previous 3% wasn't enough.
- It is not fair at all. An international company like us with 30% of our GP of general head office costs. If our GP was K.D 30,000 then our home office expenses are K.D 10,000 and we can only deduct from that 1.5%. In our opinion it should be at least 10%.
- The larger the company the higher their home office expenses.
- Sometimes when our contract is with the government we are asked to bring consultants and material from our home office. However, what I pay for this is not deducted from my home office expenses.

However, one of the taxpayers indicated that the decrease is fair and added the following:

- Even under the previous decree not all companies qualified for 3% home office allowance, we used to be given 2% only. However now, under the new tax rate we are saving 33% on our Corporate Income Tax, that's why we are not complaining about the decrease in home office allowance.

♦ If you as a foreign business can only own 49% of the company, while the other 51% is owned by a Kuwaiti national this means that the Kuwaiti owns the majority and thus can make business decisions. How has this affected your business?

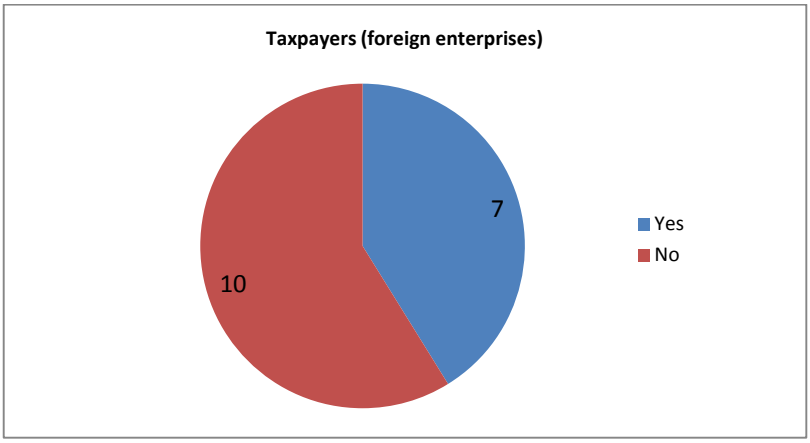



**Figure 7. 86**

The number of respondents to this question was restricted because not all foreign enterprises in the sample have Kuwaiti partners who hold 51% of the company's shares; some of them do business in Kuwait through an agent. Of those who responded, the following observations were made:

- 10 foreign enterprises said that their Kuwaiti partners are 'sleeping/ silent partners' and thus don't really interfere in the day-to-day decision making.
- 7 companies confirmed that they do 'struggle' with their national partners whose presence was regarded as inconvenient.

## 7.6 Conclusion

The results of this empirical study are most important, as foreign enterprises carrying on business in Kuwait specify the shortcomings of their experience of doing business in Kuwait and propose possible solutions to improve the fiscal and economic environment in the country. The expert advice of Tax Auditors and the opinions of the Tax Department employees and their suggestions are also extremely crucial for understanding the point of views of those who work closely with the Kuwaiti Tax Law and foreign investors in Kuwait.

The common problems which foreign enterprises face whilst doing business in Kuwait such as the restricting agency rules (and 51% national ownership), the bureaucracy, the shortcomings of services provided by the Tax Department, especially when it comes to addressing objections and appeals were stressed and emphasized repeatedly, not only by Taxpayers (foreign enterprises), but also by Tax Auditors and Tax Department employees who were aware of the struggles foreign enterprises face. The study also helped stress that contrary to what the Tax Department employees may believe, tax incentives and tax holidays are not as a highly prioritized by foreign investment when it comes to investing abroad as other elements such as the availability of business opportunities, political stability, infrastructure, judicial fairness, eliminating discrimination against foreign enterprises and national treatment. These common aspirations expressed by foreign enterprises especially and agreed upon by Tax Auditors and Tax Employees are helpful in terms of proposing possible tax reform that is suitable for Kuwait's fiscal and economic status, and useful for potential foreign investors

looking to do business in Kuwait, which is what the next concluding chapter of this thesis suggests.

# Chapter 8: Conclusions and Recommendations

Kuwait is a country with a population of 3.5 million and an annual population growth of 2.4%[705]; it has self-reported crude oil reserves of about 96 billion barrels; there are, however, claims that these reserves are over estimated and that the Kuwaiti oil reserves do not exceed half of the reported amount[706]. Kuwait's petroleum accounts for almost half of its GDP, 95% of export revenues, and 80% of government income. Kuwait's climate limits agricultural development[707], leaving it completely dependent on food imports which are in turn financed by oil exports. GDP of industry is 47.90% which consists primarily of petroleum and petrochemicals, plus FDI inflows that constitute no more than 0.1% of the country's GDP[708]. Kuwait does not implement taxes on individual income and only taxes foreign enterprises carrying on business within its jurisdiction.

As has been discussed in chapter one[709], this thesis aims to address the need for a second source of income for an oil dependant Kuwait and, with taxation being an infinite source of revenue, this thesis sets out to explore whether or not a reformed Kuwaiti tax system can serve as a possible solution, with a view that an improved, more welcoming fiscal system can assist Kuwait in becoming more attractive for

---

[705] UN data, Country profile, http://data.un.org/CountryProfile.aspx?crName=KUWAIT, [visited 8/3/2010].
[706] Howden, D. (2007), *World Oil Supplies are Set to Run out Faster than Expected,* The Independent, http://www.independent.co.uk/news/science/world-oil-supplies-are-set-to-run-out-faster-than-expected-warn-scientists-453068.html [visited 8/3/2011].
[707] GDP of agriculture is 0.40%.
[708] The Economist Intelligence Unit, Kuwait Fact Sheet, February 1st 2011, http://country.eiu.com/article.aspx?articleid=1197782704&Country=Kuwait&topic=Summary&subtopic=Fact+sheet&subsubtopic=Fact+sheet [visited 7/3/2011].
[709] See p. 1.

foreign investment and thus yield more tax revenues from FDI. However, there are a number of reservations and queries to attend to before engaging in a discussion on the status of the current Kuwaiti tax system, its shortfalls and how it can be improved.

Kuwait being a predominantly religious country, there would naturally be certain attitudes rooted in religious principles that can be in some cases problematic if such religious ideologies are fixed and intolerant to change.

The fact that Kuwait is an Islamic country where the majority of people pay Zakat has formed a strong belief amongst the Kuwaiti society that Zakat is a fairer system of redistribution than taxation simply because of its religious nature; this, coupled with the fact that the Kuwaiti people have not been taxed since the discovery of oil in 1938[710] led to poor awareness amongst Kuwaitis on the importance of the redistribution of wealth, and social responsibility. Due to this there was a need to assess Zakat and taxation from a theoretical point of view in order to reach the conclusion that Zakat - despite its many advantages - also has many limitations including its eight exclusive groups of beneficiaries[711] mentioned in the Qur'an. Its marginalizing of non-Muslims as Zakat is only known in the *Sunny* jurisprudence, thus non Muslims and Muslims following the *Shi'a* jurisprudence do not pay Zakat or receive its revenue, causing much discrepancy. Also such groups will reject paying Zakat if it were to be made obligatory in Kuwait since Zakat does not constitute a part of their religious

[710] See pp. 7-8.
[711] See pp. 15-17.

belief, and the fact that Zakat is still to this day voluntary in Kuwait for those who pay it allows a wide scope for avoidance and non-compliance.

Other shortcomings are also discussed in detail in Chapter 2[712] such as the non flexibility of Zakat, the progressivity of Zakat, and the wide discretion Zakat donors have when choosing their beneficiaries which can lead to the failure of Zakat revenues reaching the people who need them most. Thus Zakat alone is not a sufficient system of redistribution of wealth if it only aims at narrowing the gap between the rich and the poor as it currently does. A country such as Kuwait needs to secure a reliable source of income to finance the government's expenditure and the provision of public goods and services which Zakat does not cover.

However, an assessment of the theoretical background for taxation as a system of redistribution was not without its shortcomings. Although Western theories which call on taxation are convincing, such as Adam Smith's argument that as individuals we must contribute (in proportion to our abilities) towards the state in proportion to the revenue we as individuals could not have enjoyed or earned if it weren't for the protection of the state. Smith's theory, that there exists a contract between the people and the state, whereby the state provides us with services and we in turn pay for them is a plausible one, especially if we as people took into account that without roads and the infrastructure provided by the state we cannot practice our professions, work or business and without health services we would not be well enough to work or have healthy clients and consumers. However, implementing a fair tax system is not as straight-forward as the theory. When it

[712] See pp. 22-28.

comes to measuring the proportion which individuals are capable of contributing towards the state and whether this contribution should differ according to individual capability, taxation becomes more problematic in achieving social justice. Rawls's social primary goods approach is criticised for suggesting that fair redistribution is merely taking from the better off and giving such resources to the worse off without actually assessing whether the worse off have the ability to turn such resources into functionings. Rawls's theory is rivalled by Sen's capability approach which does not only look closely at individuals' resources but also to their opportunities and their freedom to achieve functionings. However, Sen's approach is also criticised as one that is not easy to monitor publically[713] as Norman Daniels puts it:

"countries pursue development, and external agencies assist or hinder them in this pursuit, they need to consider what policies to adopt; some policies will enhance the wellbeing of some people and some will enhance the wellbeing of others and some will enhance no one. Both the social primary goods approach and the capabilities approach complement each other and have advantages over each other and a redistribution scheme can be beneficial when it is drawn from both approaches"[714].

Another crucial question arises when suggesting tax reform in Kuwait is why is a country such as Kuwait so abundant in oil needing to consider a second source of income and should it consider tax reform?

Oil revenues became the main source of income in Kuwait since its discovery in 1938 to the extent that the Kuwaiti government saw no need for any further tax extraction. This significant change has had social, economic and political

[713] See pp. 41-47.
[714] Daniels, N. (2003) *Democratic Equality: Rawl's complex Eglittarianisim*, in Samuel Freeman (eds.) *The Cambridge Companion to Rawls* (Cambridge: Cambridge Press), pp.241 -277.

consequences. Socially it has shifted the Kuwaiti peoples' mentality completely from the necessity of tax. The feeling of social responsibility that had once existed between the Kuwaiti people to contribute to the state's expenditure has disappeared and the people of Kuwait have become completely dependent upon their government in terms of jobs and wages, housing, utility, health, and education.

Economically, depending on a highly volatile source of income such as oil also meant that Kuwait's economy fluctuated considerably; from an oil boom and revenue surplus throughout the 1970s to a severe economic stagnation in the 1980s where the price of oil fell by 51% and had significant effects upon the Kuwaiti economy causing a deficit in the Kuwaiti budget due to government's over spending. Poor social responsibility that had resulted from an extravagant welfare system stimulated the government of Kuwait to rethink about the possibility of introducing taxes back into the state.

Politically, the abundance of oil has led the ruling family in Kuwait to diminish tax extraction, however providing for the people also meant securing their alliance, and it leads to peoples' inability to hold their government accountable, when people cannot withdraw their financial support for their governments they cannot disapprove their governments' actions, unpopular policies or poor provision of goods and services.

Chapter 3 of this thesis, in addition to providing a historical background on Kuwait's economy prior to oil discovery[715] also sheds light on the economic, political and social downsides of oil dependency in general and oil dependency in

[715] See pp. 52-64.

Kuwait especially.[716] The Chapter also looks closely at the economic phenomenon, namely the 'Rentier State', an economic occurrence found in almost all oil dependent states including Kuwait[717] reaching a final conclusion on how crucial it is for Kuwait to move away from oil dependency[718].

Chapter 4 can be regarded as the heart of this thesis answering the following crucial questions; what is the current Kuwaiti tax system? And what are its shortfalls and its inefficiencies? This Chapter examines closely the previous Income Tax Decree 3/1955 and the 2008 Amendments.

The Kuwaiti government seems to have realized that in order to attract more FDI to the state the Income Tax Decree of 3/1955 needed to be amended; what the Kuwaiti government failed to do, however, is produce a comprehensive reform to its 1955 Decree. Thus in 2008 an amendment was introduced, however, only four amendments brought in 2008 can be considered significant; first, the explicit exemption of the national sole distributor who buys and transfers goods to his own account; secondly, the reduction of the tax rate imposed; thirdly, the reduction of some allowances; and finally the withholding of a 15% tax on foreign earned dividends whilst excluding trading profits. Also the decrease to the tax rate; from a progressive tax rate (ranging from 5% - 55%)[719] to a single flat 15% in the 2008 Amendments. Many of the 1955 Decree's shortcomings were left untreated, in terms of poor wording, discrimination against foreign enterprises,

[716] See pp. 76-88.
[717] See pp. 88-95.
[718] See pp. 94-97.
[719] See p. 109.

inefficiency and vagueness, unreformed and without improvement in the articles of the 2008 Amendments[720].

There is an opposition towards taxation from domestic Kuwaiti enterprises and especially from national distributing companies - sole agents for foreign goods - and franchisees. These enterprises are excluded from taxation under the current system. Both national distributors and franchisees lead profitable businesses, however, their initial reaction to the proposition of taxation is met with strong opposition explaining that the Kuwaiti government has adequate resources and must not extract taxes from national businesses, also claiming that national enterprises should be treated more favourably than foreign enterprises.

Although national distributors and franchisees continue to be excluded from tax in Kuwait, there is, however, a capacity within the current Kuwait tax system to include them in the tax base.

Sufficient connection must exist between the tax jurisdiction and (a) taxable person (tax subject) and (b) a taxable event (tax object) in order for tax liability to arise. The connecting factors are generally based on residency, nationality or the domicile of the tax payer for the tax subject, and on the source rules over income or gain for the tax object[721]. According to this a national distributor is connected to the state of Kuwait via nationality and source of income which constitutes him as a tax subject (due to nationality/domicile). Although this argument is outside the scope of this study, it is a crucial issue to address in future research.

---

[720] See pp. 136- 142.

[721] Rohatgi, R. (2005), *Basic International Taxation,* Second Edition, Vol. I: Principles, Richmond, p. 196.

Chapter 4 discusses at length when tax liability arises if a foreign enterprise carries on trade or business in Kuwait through a national agent[722]. However, the foreign principal gaining profits from selling goods in Kuwait through a national agent is to this day excluded. There exists, however, a capacity to tax the foreign principal gaining profits from selling his products in Kuwait through a national agent in the current tax law; Kuwait's fiscal system adopts the source of income connection rule, where an income or a gain is taxable in Kuwait as long as it has resulted from an activity that took place in Kuwait, this includes work carried out outside Kuwait (offshore activity) under a contract that involves an activity in Kuwait (onshore activity)[723]. Accordingly profits, fees, and incomes received by overseas foreign corporations due to an activity that took place in Kuwait should be taxed in Kuwait. Although this argument is outside the scope of this study, it is a crucial issue to address in future research.

Proposing tax reform in Kuwait as mentioned earlier[724] requires attending to some reservations and answering a number of queries. A crucial question to ask before undertaking fiscal reform is: does Kuwait have the freedom to reform its fiscal system or is it under any regional or international constraints? Chapter 5 argues that although Kuwait is a member of the Unified Economic Agreement (UEA) established in 1981 and amended in 2001 to which other Gulf countries are party, the UEA has imposed a Customs Union (CU)[725] upon its member states, to which

[722] See pp. 122-136.
[723] See pp. 101-102.
[724] See p. 304.
[725] See p. 165.

all member states have now complied, although Kuwait and other members states cannot reform their customs duties in a manner that contradicts with the UEA, Kuwait and other member states still have the freedom to reform other domestic taxes.

Kuwait has also been a member of the WTO since 1995 and although Kuwait abide by the WTO principles of Most Favourite Nation (MFN) or National Treatment (NT)[726] by excluding national enterprise and taxing foreign ones, however, this breach of the WTO obligations has not been challenged.

Clearing the ambiguity surrounding Kuwait's freedom to reform its domestic fiscal system in Chapter 5 yielded another question in regards to Double Taxation Treaties (DTTs). DTTs are international tax obligations Kuwait has with other states and when planning tax reform one cannot ignore the issue of double taxation and how it affects international commerce and its importance on multinationals' decision making. There is a particularly important reason to discuss Kuwait's approach in signing its DTTs in this thesis due to its objective in finding an initiative to attract more FDI to Kuwait. Kuwait's fiscal system focuses mainly on the taxation of the corporate income of foreign enterprises carrying on trade or business in Kuwait and with taxation on foreign enterprises being the main source of tax return in Kuwait, it is vital to shed light on how Kuwait relieves cross-border investment from double taxation.

[726] See pp. 159-160.

Chapter 6 looks in depth and compares the different methods available for eliminating double taxation: deduction, credit and exemption[727], and how to choose the optimal method of double taxation relief.

Although there are several Model Conventions for DTTs, the most popular ones referred to with much emphasis in Chapter 6 are the OECD and the UN Model Conventions and as an increasing number of countries compete to attract multinational companies through different fiscal incentives it is not surprising that tax treaties exhibit considerable heterogeneity, however, most treaties loosely follow the OECD or the UN Models.

With 48 DTTs Kuwait sometimes applies the OECD Model convention and sometimes the UN Model convention and in some cases deviates from both. A very close analysis is presented of how Kuwait's DTTs with other states treat crucial elements of international commerce i.e. Permanent Establishment (PE), when an Agent is considered a PE and thus raises tax liability, its treatment of business profits, dividends, interests and royalties, capital gains, non-discrimination provisions, exchange of information provisions, method of eliminating double taxation, and finally dispute settlement and mutual agreement procedures. Kuwait being a country that aims at attracting FDI has entered into some DTTs that are beneficial for its fiscal interest and some that are not. However, in the present era of global economic integration and interdependence of countries, states cannot shape their attitudes towards international investment without carefully considering external fiscal relations with other states. In some instances, a constraint on a country's freedom of fiscal action may be market led,

[727] See pp. 172-175.

for example a developing country may offer tax incentives to attract foreign direct investment not because it necessarily wishes to do so (as it is likely to lose tax revenue) but in order to compete with other countries which also offer incentives[728].

Understanding the behaviour of multinationals is key when aiming to attract more FDI. In order to transform the Kuwaiti fiscal system and make it more attractive for foreign investments there is a need to understand why companies invest? How they invest? And why they don't invest?

### a. Why do Companies Invest?

The most important reasons for investing are: (1) maintenance of markets for companies in the manufacturing field; (2) Availability of raw material for companies in the extractive field; (3) Expansion of existing operations within a particular county to meet greater need; (4) Development of foreign markets for present product lines; (5) Instigation of others desiring the company to operate within particular country; (6) Possibilities of unusually large profits[729].

1. Maintenance of Market:

[728] See Salter (note 686 supra).
[729] Barlow, E. R. and Wender, I. T. (1955), *Foreign Investment and Taxation*, Harvard Law School, pp.146 – 245.

The usual reason for beginning an assembly or manufacturing operations is to hold onto or maintain a market within the country that had already been established through exports. If a company starts selling in a particular country through export, then gradually increases the scope of the sales activity until it has a considerable marketing organization within the country, the natural progression would be next to manufacture, or at least local assembly, in the majority of cases however the shift from exports and local marketing to assembly or manufacture is not a result of a smooth transition; usually something, an outside factor or a crisis, makes it necessary for management to decide whether it is willing to assemble or manufacture. Among other factors that could make the decision to assemble or manufacture necessary are: (1) government activity[730]; (2) local competition; (3) inadequacy of local distribution; (4) marketing of related products[731].

2. Availability of Raw Materials

In the extractive field companies invest in those countries where the raw materials are available. A petroleum company will sink a large sum of money in exploration and development if there is some indication that oil is plentiful[732].

3. Expansion of Existing Operations

[730] This activity may take the form of import restrictions, tariffs, or exchange controls.
[731] When a country decides to assemble or manufacture a product in a country due to another relative product which the same company assembles of manufactures in that same country.
[732] See Barlow & Wender (note 729 supra).

It is common to begin an assembly or manufacturing operation in a country as a result of a decision to maintain a market after some outside factor has intervened, subsequent investment in that country is largely the result of expansion of existing operations[733].

4. Development of Foreign Markets for Present Product Lines

A few companies actually make a deliberate policy-level decision to embark on foreign operations. When companies develop products and services to the point where they experience a slow rate of growth by a marginal return from increasing pressure on their taxing lines, they must choose between developing new products and services or exploiting their products and services outside their residence state.

5. Instigation of Others

When restrictions are imposed within a particular country (i.e. the occasion of government activity), either the company's regular distributor or customers within the country may request that they be given permission to establish local manufacture or assembly operations on a licensing basis.

6. Possibilities of Unusually Large Profits

[733] *Id.*

A company typically does not consider various areas of the world in which investment might take place, find an opportunity for a product and make an investment. The high profit will be one of the factors involved in the decision, but not necessarily the compelling one[734].

**b. How do Companies Invest?**

In the field of manufacturing, companies make small initial investments in a country and expand subsequently from foreign earnings. Countries where large initial investments are not required in order to start operations for overseas companies are most likely to contain the greatest percentage of foreign investment. The question how foreign corporation invest is linked closely to the questions why companies invest; with three important considerations: (1) How are investment opportunities brought before management? (2) How are investment opportunities investigated? (3) How are investment decisions made?

1. How investment opportunities are brought before management

Due to a particular problem arising in the host country i.e. government restrictions have affected export operations, or the plant may have become too small in terms of the existing market, that the market can no longer be supplied, or a distributor may have failed to do an adequate job. Such problems or similar ones would be brought to the attention of the company's management; the management would

[734] See Barlow & Wender (note 729 supra).

then weigh investment propositions in terms of costs and profits and decide in favour of the most promising investment[735].

2. How investment opportunities are investigated

In most cases a formal report is prepared for management where projected operational costs are worked out in considerable detail, and estimated profits are calculated.

3. How investment decisions are made

These are made by the top-operating executive of the company, either the chairman of the board or the president. The company considers the overall situation when deciding on an investment, e.g. a decision on building a refinery in a particular place is tied in directly with the production and marketing operations. It may be worthwhile to build a refinery with a low rate return because it will favourably affect the marketing operations or will provide a greater outlet for the company's crude oil. In such a situation, it is difficult to decide just how profits should be divided between different parts of the business. In other words, it would be possible to price crude oil high into the refinery and low out of the refinery, so that the refinery makes little money, or by pricing crude oil low, take a large profit in the refinery. The profit could be realized on the crude end of the business, on the refinery or in the marketing[736].

### c. Why Companies Do Not Invest

[735] See Barlow & Wender (note 729 supra).
[736] See Barlow & Wender (note 729 supra).

The lack of interest and knowledge in foreign investment is the top reason why companies do not invest abroad, although other factors can hinder foreign investment: (1) the company does little exporting and therefore has not been brought into contact with foreign situation; (2) the products made by the company are so specialized that foreign countries do not provide a large enough market for a manufacturing investment; (3) management, money, and the technical personnel are needed for the resident state expansion; (4) the nature of the industry is such that a very large initial investment is required; (5) governments discourage private investment by foreigners in a particular industry[737].

Applying all the above knowledge of why and how corporations invest to the situation in Kuwait, did Kuwait provide foreign investors with enough incentive to enter its jurisdiction?

**Does Kuwait Attract FDI?**

Chapter 6 of this thesis discusses extensively Double Tax Treaties, their objectives and importance, it also looks in detail at Kuwait's DTTs with other countries, how such treaties treat foreign profits/incomes raised in Kuwait, and the incentives which these DTTs may provide for both parties. Chapter 7 also discusses the reduction in the tax rate which the Kuwait Tax Law Amendments 2/2008 offers to foreign enterprises doing business in Kuwait[738]; however, the question which remains to be answered here is how successful were such

[737] *Id.*
[738] See p.247.

concessions in attracting foreign investors? And how do they correspond with Kuwait's domestic tax policy, since it differs from that of other states.

### 1. Kuwait's treatment of dividends

Tax Law Amendments 2/2008 withhold a tax of 15% on dividends paid to foreign enterprises by national companies listed in KSE. The same Article in Tax Law Amendment 2/2008 exempts undistributed profits from tax; Article 2 (g) states:

"The term "income" means gains and profits of a body corporate derived from carrying on trade or business in Kuwait".[739]

"The profits of the incorporated entity resulting from trading operations within Kuwait Stock Exchange shall herby be exempted from the tax already imposed under this law, whether it has been executed directly or via portfolios and investment funds."[740]

Chapter 2 of the Tax Law Amendment bylaws also provides (exempts):

1. The incorporated body's profit resulting only from trades in Kuwait Stock Exchange Market, whether directly made or through investment portfolios or funds
2. The incomes realized by a natural person from practicing a trade or business in the state of Kuwait unless he proves that he is representing the share of an incorporated body

The legislator intended for the tax dividends paid to foreign companies by national companies to be liable for a 15% withholding tax whilst exempting trading profits; this is discussed in more detail in Chapter 4[741]. However, since Kuwait exempts individual income from taxation, the problem of the double taxing dividends, once at the company level, and another time in the hands of the beneficiary, will not occur here. Other issues will however rise: the first and most

[739] Article 2 (g) of the Tax Law Amendments 2/2008.
[740] Article 1 of the Tax Law Amendments 2/2008.
[741] See pp. 152 - 154.

obvious is the discrimination between national and foreign companies investing in KSE, where national companies are exempt on the dividends they receive when investing in KSE, causing a natural disincentive for foreign companies to invest. Second, foreign individuals (natural persons) receiving dividends in Kuwait are also exempt, which can cause avoidance if such foreign persons were trading in KSE for the interest of a foreign enterprise. And finally, how does withholding taxes upon dividends paid to foreign enterprises fit with the dividends treatment at the state of residence of the foreign beneficiary? Kuwait requires the national distributing company to withhold a 15% tax on the dividends it pays out to its foreign shareholders; this means that it's the shareholder (foreign company) that bears the tax burden on the dividends, not the distributing company. Also as has been discussed in chapter 6[742], Kuwait adopts the OECD treatment for dividends in most of its DTTs where the dividends are taxed in the beneficiary state of residence; the dividends can also be taxed in the host state with a limited tax rate provided in the treaty, which in Kuwait's cases varies between 5%, 10%, and 15%[743].

**Recommendations:**

a. If the home state imposes a 15% tax on the dividends the beneficiary earned in Kuwait, the taxes liability will be offset against the 15% tax withheld in Kuwait. However, in regards to home states that impose less on dividends e.g. 10% or 5% the difference is credited at the

[742] See pp. 197-201.
[743] See p. 200.

beneficiary's home state. The optimal situation would be to withhold a tax equal to that imposed in the home state or lower to create an incentive.

b. In its treaties with countries that retain the sole right to tax dividends paid out to their resident companies, Kuwait needs to re-negotiate its right to withhold tax on dividends at the source in order not to lose tax money to the state of residence. There is also the argument that companies don't necessarily need to pay dividends, even if firms needed to distribute profits, they could effectively do so by re-purchasing shares, however there is a view that there is an intrinsic value to dividends; through distribution of profits the firm proves to the shareholder who may not have full information about the profit ability of a firm that the firm is doing well.[744] Thus the source country where the distributing company is located should be entitled to tax such dividends.

c. In the case where Kuwait exempts foreign natural persons from withholding tax on dividends they earn in Kuwait, there is not much effect to this incentive if the resident state of the beneficiary (foreign natural person) taxes its residence on their foreign income, which is usually the case. The only way Kuwait can give effect to such incentive is to sign a "Tax-sparing" agreement with other member states. The proposed agreement will state that for the purpose of the resident state tax credit, the foreign natural person who had earned

[744] Slemrod, J. *(1999) Tax Policy in the Real World*, Cambridge University Press, pp.17-20.

dividends in the state of Kuwait and was exempted from tax in Kuwait, shall be treated in his state of residence as if he had in fact paid the tax that was "spared", or in other words be given a credit for the tax he had not paid[745].

d. The above recommendation should apply for trading profits earned by foreign companies investing in Kuwait, when foreign companies buy and sell shares in KSE their profits of such trading are exempt, such an incentive will not have effect unless met with a tax-sparing agreement between Kuwait and other foreign states.

## 2. Kuwait's Treatment of Interest

In Kuwait's DTTs with most Asian countries interest is taxed at home state. Interest can also be taxed at host state, however, host state tax in this case does not exceed 10%; other state's rates varied between 5%, 7% and 8% but none are higher than 10%[746].

### 1. Recommendations

a. Kuwait could renegotiate its treaties with countries that restrict the right to tax interests at the beneficiary state of residence, prohibiting Kuwait from the right to tax interest arising in its jurisdiction with a

[745] Richamn, P. (1963) *Taxation of Foreign Investment: An Economic Analysis*, Hopkins, p.55.
[746] See p. 203.

tax lower than that of the beneficiary state of residence e.g. 5% which can serve as an incentive for those companies and be credited in their state of residence.

b. In its' treaties with countries which allow interest taxing at host state, with a limit of 5% or 8% tax, Kuwait can renegotiate this rate, however keep it lower than the state of residence's rate in order for the beneficiary to be credited the difference.

**3. Kuwait's Treatment of Royalties**

Kuwait adopts the UN Model in most of its DTTs; taxing the payee of the royalties at the home state, however allowing the host state to tax with a limited rate[747]. Kuwait's DTTs with most states limit host state taxation on royalties with rates between 5%, 10%, 15%, 20%, and 30%[748].

**Recommendation**

Since Kuwait does not tax national companies and natural persons, the taxes paid for royalties arising in the above states will not be offset against anything, thus it is in Kuwait's best interest to renegotiate the royalty clause with countries that allow the source state to tax royalties up to 30% by bringing the rate down to 15%, this will serve as an incentive to invest for both contractors.

[747] See p.206.
[748] See p.206.

## 4. Suggesting Amendments to Kuwaiti Laws

The main focus of this thesis - from the beginning - was to reform the Kuwaiti tax policy in order to attract more foreign investment to Kuwait, however the empirical research[749] has shown that there's a lot that needs to be done, and foreign enterprises doing business in Kuwait have highlighted many issues which have slowed down and stood in the way of taking their enterprises further. The recommendations provided by foreign enterprises doing business in Kuwait on how to improve the existent legislation constitute much needed guidance on how to attract FDI[750].

### 4.1 The Kuwaiti Laws

1. Tax Law Amendments 2/2002

a. Discriminating Between National and Foreign Enterprises:

The discrimination between national and foreign enterprises was one of the main points raised by almost all of the foreign enterprises and Tax Auditors interviewed[751]. The Non-discrimination clause included in the OECD and UN Model Convention is one of the fundamental rules of international investment[752]. Although the Kuwaiti tax law does not explicitly exclude national companies from taxation, in practice it's only foreign enterprises that are liable to pay taxes

[749] See Chapter 7.
[750] See p. 291-292.
[751] See pp. 255-261 and 291-300.
[752] See pp. 217-223.

in Kuwait[753], for many investors this constitutes a disincentive to invest, and in some cases such as the US a barrier to sign a double taxation treaty with Kuwait.

b. Unclear provisions and ambiguous definitions:

Foreign businesses in Kuwait have criticised the Tax Law as being vague and ambiguous, almost all of the companies interviewed[754] provided that apart from the reduced tax rate which the new amendments brought no actual improvement has been made to the law in terms of clarifying the following debated issues:

- The definitions of agent and tax payer
- Tax inspector authorities
- Penalties in the event of failure to pay tax, or failure to pay on time
- Allowances and disallowances.

Simplicity is one of the main requirements of a tax policy. A tax law should be understood by the tax payer. If tax payers do not understand the working of a tax they may respond to it in an irrational way. The terms of a tax should be expressed clearly and precisely, the language as well as the content should be as straight forward as possible[755] .

c. Recommended additions:

- The first and most important recommendation is regarding the national agent rule which most foreign companies suffer from in terms of restricting their ownership of their own business and sharing the right to decision making[756], but worst of all demanding a higher agency commission than that specified in an agreement

[753] See pp. 110-111 and pp. 112-113.
[754] See pp. 241-246.
[755] Sanford, C.T. (1971), *Realistic Tax Reform*, Catto &Windus Ltd. London, p.9.
[756] See pp. 298-300.

between foreign business and national agent. Thus eliminating the agency rule helps make Kuwait a more attractive market.

- Most companies argued that the progressive rate the previous Tax Decree 3/1955 imposed provided more justice than the new 15% flat rate[757], especially for the smaller size companies that fell under the previous 5% and 10% rate.
- The authorities of the tax inspector should be regulated (according to the current practice there are no restrictions on tax inspector's authorities)[758].
- Most companies would like to see an increase in the recently decreased head office expenses and agent commissions[759].
- A separate and an independent panel from the tax department to look into tax objections and appeals[760].
- Tax holiday for the first few years (preferably 5 years) of the foreign business investment life in Kuwait[761].

2. The Kuwaiti Commercial Law No. 68/1980:

The Kuwaiti commercial law provides in Article 23 that no person other than a Kuwait can carry out business in Kuwait, unless they have one (or more) Kuwaiti partners, provided that the capital investment by the Kuwaiti is no less than 51% of the total capital of the treading firm. Article 24 of the same law states: "No foreign company may establish a branch or carry on trading activities in Kuwait except through a Kuwaiti agent".

a. Recommendations:

[757] See pp. 247-251.
[758] See pp. 271-274.
[759] See p. 292.
[760] See pp. 286 and 292.
[761] See p. 292.

- The elimination of the Kuwaiti National Sponsor rule, and the rule of foreign business being restricted to owning only 49% of their business while a Kuwaiti National has to own the other 51%. This recommendation has been on the top of the list with all of the foreign businesses interviewed[762].
- Easier requirements for starting up a business in the Kuwait commercial law[763].

3. The Kuwaiti Foreign Direct Investment Law No. 8/2001

The law and the foreign investment bureau has been discussed briefly in chapter 4[764] and mentioned again in Chapter 7[765]. It should be noted here that this law was found to enhance Kuwait's ability to attract FDI by allowing foreign enterprises working in Kuwait to own 100% of their businesses, and – under specific circumstances – providing foreign enterprises with a 3 – 10 year tax exemption. However, the law proved to be more successful in theory than in practice with endless bureaucratic requirements for foreign enterprises to fulfil in order to reap the benefits which the law offers.

a. Recommendations:

- To make the law accessible to more companies: the law aims to provide tax incentives for foreign investment in Kuwait, however with the law's current very challenging requirements, foreign enterprises have not been able to benefit from

[762] See p. 261 and pp. 298-300.
[763] See p. 259 and p. 294.
[764] See pp. 106-108.
[765] See pp. 295-296.

the incentives this law provides since it came into force in 2001, only 7 companies have been considered eligible.

- Better promotion of the law: a significant number of foreign enterprises working in Kuwait have provided that they are not familiar with the law or the benefits it aims to provide for foreign investors carrying on trade and business in Kuwait[766], thus most probably, potential foreign investors outside Kuwait are also unfamiliar with this law, which defeats its objective of attracting more foreign investment to the state.

Other countries have laws such as the Republic of Korea's enacted Promotion Act (FIPA) in 1998, an attempt to create a more liberalized and favourable business environment for foreign businesses and providing tax incentives to certain types of FDI. Under the FIPA, foreign businesses and investors who make advanced technology FDI in Korea are eligible for exemptions from individual and corporate income taxes for the first 7 years and 50% reductions for the next three years. In addition, foreign businesses and investors have been granted exemptions from a number of local taxes (i.e. acquisition tax, property tax, aggregate land tax, and registration tax) for a minimum of 5 years and 50% reductions for the next 3 years. Imported capital goods have also been made eligible for full or partial exemptions from custom duties, the special excise tax, and VAT[767].

However, the exemptions and special treatments given to promote specific economic objectives should not be so widely extended without the broadening of the tax base first. The already narrow tax base in most developing countries is eroded further by the provision of fiscal incentives in the form of tax preference and exemptions[768].To maximize the likelihood of beneficial results from tax concessions and to reduce the

[766] See p. 296.
[767] See Sanford, (note 755 supra).
[768] World Bank, (1991), *Lessons of Tax Reform*, World Bank, p.2.

damage that may be caused by poorly-designed and implemented incentives, countries should adhere to the following rules:

1. Keep it simple: incentives should be few in number and simple in structure as possible.
2. Keep records on who receives what concessions and at what cost is revenue forgone and also if the incentive is intended to achieve some particular objective, on the measurable results; in the absence of such information the incentive is simply not efficient.
3. Evaluate the numbers at regular intervals to determine whether the incentive is achieving results worth its estimated cost, and if it is not, eliminate it[769].

### 4.2 Reforming The Kuwaiti Tax Department

a. Recommendations:

- To have a judicial system (for tax objections and appeals) independent from the tax department (this is not the case at the moment, as the person who looks into tax assessment objections and appeals is the tax inspector who carried out the assessment and his supervisor) this recommendation was on the top of the list for all the foreign companies interviewed[770].
- The elimination of arbitration: all foreign enterprises interviewed have complained about how arbitrary tax inspectors are in terms of deductions, allowances and disallowances, and in inspection procedures[771]; both foreign

[769] Bird, R.M. (2008), *The BBLR Approach to the Tax Reform in Emerging Countries*, National Institute of Public Finance and Policy, New Delhi, pp. 7-8.
[770] See p. 261, 268, 278 and 287.
[771] See p. 281 and 290.

enterprises and Tax Auditors believe that tax inspectors and tax employees should have clear authorities, restricted and regulated by law, this helps eliminate uncertainty which is caused by the arbitrary decisions tax employees/inspectors make.

- Efficiency: although the majority of enterprises interviewed described the Kuwaiti Tax Department as efficient, they did criticise it's level of efficiency; in terms of inspectors not being available for inspection, or failing to inspect on the day of inspection set by them, not taking any of the company's comments on board, and finally not submitting the assessment to the subject enterprise on time[772].

**1)** Poor communication between foreign enterprises and inspectors, and the tax department in general due to language barriers.

**2)** The unfamiliarity of tax inspectors with international accounting standards can cause inspectors to fail to assess the foreign enterprises fairly.

**3)** The 'deemed profit' problem, most enterprises interviewed have on some occasion experienced the unfair 'deemed profit' treatment. The Tax Department has the authority under Circular 43/2002 to tax a foreign enterprise with a 15% tax even when the enterprise has shown losses if the enterprise did not submit a certain document, or did not show profits that financial year.

Reforming an existing tax system is not a straightforward process, adopting a fiscal regime proven successful in another jurisdiction will not always result in the same success if consideration was not given to the differences between the two jurisdictions, effectively, developed and developing states need their fiscal

[772] See pp. 270-275.

systems to operate in different ways and therefore will mould their reform in ways that will fit their fiscal needs most.

Developed and developing countries differ in their taxing strategies, the difference between industrial and developing countries is that the latter rely more heavily on corporate tax than on personal income tax. Personal income taxes are hard to collect in predominately rural economies or economies with large informal sectors, also personal income tax requires sophisticated tax administrations which developing countries lack[773]. In 1998 Korea's tax revenue had decreased significantly due to the recession, on the other hand a sharp increase in government spending was necessary, particularly to meet part of the cost of restructuring, unemployment benefits, and social safety nets. These naturally led to a huge fiscal deficit. To prevent an excessive deficit, the government raised tax rates on items that were believed to have been least affected by the economic crisis[774]. Thus among others, taxes on gasoline and diesel were raised, and the progressive taxation on interest income was switched to a proportional withholding tax. In addition to these, cigarettes became subject to VAT on top of the existing local tax. The government also curtailed tax exemptions and reductions. One notable example is the abolition of the VAT exemption on services supplied by professional service providers' e.g. lawyers, and accountants[775]. Broadening the base of the tax system should be a high priority when reforming the tax policy. In developing countries the tax base is often

[773] World Bank (note 768 supra).
[774] Yoo, I. (2000), *Experience with Tax Reform in the Republic of Korea*, Asia Pacific Development Journal, Vol. 7, No. 2, p. 82.
[775] *Id.*

narrow so governments must rely on relatively high tax rates to generate revenue (this used to be the case in Kuwait for foreign investments which used to pay taxes up to 55% on their income) the higher the rate, the greater the distortion in private economic activity and the greater the associated efficiency costs of taxation. In recent years the VAT has come into favour as an instrument for broadening the goods and services tax base in developing countries, as a desirable broadly based tax instrument, the VAT – particularly simplified versions of it – is suggested for most countries that do not already have one. The basic argument in favour of VAT is that, in light of its built-in-self enforcing mechanisms; it is a reliable generator of revenue and incurs relatively small efficiency losses. However since lower-income taxpayers tend to consume a higher proportion of their income than do middle and upper income taxpayers the VAT can be regressive. In an attempt to correct this the VAT is generally implemented with selected exemptions for commodity groups, such as unprocessed food, that are important items in the expenditure of the poor, and it is often supplemented by a set of luxury taxes on income-elastic consumption goods[776].

In addition to broadening the current tax base considering the possibility of future individual tax or VAT, Kuwait must understand the behaviour of foreign investment in order to have the means to attract more FDI.

Most Countries in Transition (CITs) governments have adopted a western-style tax structure with relative ease, yet have struggled with low rates of revenue mobilization and increasing rates of tax evasion[777]. It has slowly become clear that

[776] World Bank (note 768 supra).

[777] Go, D. S., (1994), *External Shocks, Adjustment Policies and Investment in a Developing Economy: Illustrations from a Forward-Looking CGE Model of the Philippines*, Journal of Development Economics 44(2): 229-61.

whether or not the tax reform effort ultimately succeeds in CITs will depend upon the upgrading of the tax administration system. Poor tax administration can be partly blamed for the poor revenue performance by CITs. Tax revenues in CITs plunged in years immediately following early reforms[778]. Tax systems are as good as their enforcement. Effective tax reform cannot be accomplished in isolation from the current capabilities of the tax administration system and taxpayers culture. The most serious mistake CITs collectively made was to focus primarily on modernizing tax policies and relegating tax administration and taxpayer issues to remote second place. Because the time required for these efforts to take effect was measured in years, the focus shifted to tax policy reform without considering the limited capacity of the tax administration. The results have been in many cases lagging collections and increased evasion[779].

**Are all Tax Concessions Welcome?**

Kuwait needs to simplify procedures, open the door to foreign investors in terms of infrastructure, and provide business opportunities and ensure political stability since those three requirements (business opportunities, infrastructure and political stability) were the most desirable conditions foreign enterprises look for in a host country. Foreign investors confirmed that those three conditions are more important than tax exemptions, tax holidays or increased allowances[780]. Although tax concessions and subsidies continue to play a role in the case of market failure,

---

[778] *Id.*
[779] Martinez-Vazquez J. and McNab, R. (1997), *Tax Reform in Transition Economies: Experience and Lessons*, Georgia State University, International Studies, pp. 5-6. http://aysps.gsu.edu/isp/files/ispwp0001.pdf. [visited 31/2/2011].
[780] See pp. 256-257, and p.259 and p.261.

in recent years fiscal experts have become more sceptical about using fiscal incentives in the form of tax expenditures to promote activities for the following reasons:

- Tax concessions erode the revenue base, the more tax concessions are granted, the higher the rates have be on the remaining tax bases to raise the requisite revenue[781].
- Many incentive schemes are a response to pressure groups rather than to needs that can be analytically justified. The resulting biases in favour of some sectors and projects can lead to inefficiency by altering the relative profitability of projects in the eyes of investors.
- Some incentive measures are ineffective, either because they are insufficient to override underlying economic forces, as with the incentives for decentralizing the locations of industries, or because they are offset by other domestic or foreign tax provisions.
- If tax incentives become a source of inequity, they make the tax burden uneven across taxpayers.
- Incentives schemes facilitate rent-seeking and arbitrage activities (legal ways of manipulating income so that it accrues to a low-tax entity) thereby making it difficult to administer taxes.

Mexico is one of the many countries that in recent years has responded to limiting the use of fiscal incentives. In the early 1980s, a fiscal incentive scheme was implemented by the Mexican government to promote investment. The programme

[781] World Bank, (note 768 supra).

had several objectives: increase employment, promote high-priority sectors of the economy, develop small industries, and to promote balanced regional growth. The incentives were given in the form of a tax credit based on a special certificate (CEPROFIS) that was used to pay the beneficiary's tax liabilities. During the three year period when CEPROFIS was implemented and promoted as the most important incentive, it was proven highly ineffective because the multiplicity of objectives weakened the signals that the government intended to send through the tax incentives. Thus due to its revenue costs and ineffectiveness the scheme was among the measures pruned to reduce the public sector deficit.[782]

**How Concessions can Affect International Investment**

The impact of tax policy on international competitiveness has not received much attention in tax reform analysis. It appears that developing countries are often engaged in wasteful tax competition by offering an increasing array of incentives to foreign investors, while not paying adequate attention to the tax regime that a potential investor faces in his home country. An investor from a country with a worldwide system of taxation can be taxed by the host country at the home country tax rate. Further, the host country must ensure that income is not shifted to low tax countries or tax havens through transfer pricing[783]. The theory of public finance and past experience from developed and developing countries show that the choices of tax structure and tax reform strategy can have significant effects on

[782] World Bank (note 768 supra).
[783] Khalilzadeh J. & Shah A, (1991), *Tax Reform in Developing Countries*, Finance and Development, p.45.

the overall economic performance of a country. The correlation coefficients between tax reform and measurements such as:

- The Timing of Tax Reform,
- The Preparation for Tax Reform,

(The average period of time allotted for preparation of legislation and preparation for implementation),

- Stability (stability in reforming tax legislation, not constant, rapid changes),
- The Tax Rates,
- Prevalence of Tax Holiday,
- and Complexity of the tax laws

are very important in determining success of the tax reform. States that have adopted effective tax reform strategies have not done that in isolation of other important pieces of economic reform. Also effective tax reform needs to be accompanied by overall liberalization, privatization, more competition and effectiveness of legislation fostering investment[784]. As additional measures to attract FDI in the Republic of Korea, the long protected real estate market in the country was completely opened to foreign investors in 1998 in an effort to attract large-scale foreign investment. The government also introduced a Foreign Investment Zone (FIZ) system. Foreign investment companies that receive the FIZ designation are eligible for government support and tax benefits. As for incentives provided to small and medium sized enterprises to stimulate employment and technology investment, they include tax exemptions on stock

[784] Martinez-Vasquez (note 779 supra).

options, tax credits, and exemptions on R&D, reduction of special excise tax on consumer electronic goods and automobiles, reduction of automobile tax, and reduction of capital gains tax[785]. In practice, the application of conventional fiscal analysis to developing countries is heavily constrained by the inadequacy of the data and information base, by administrative weaknesses and by insufficient political will[786]. Indeed the basic ingredients for an effective tax administration are: the political will to administer the tax system effectively, a clear strategy for achieving this goal and adequate resources for the task. The tax administration should be given an appropriate institutional form, adequately staffed with trained officials, with an organizational structure based on function or client groups. Computerization and appropriate use of modern information technology are important[787]. Experience from tax administration improvement suggests that the best approach to improving tax administration begins by assuming that the tax payer is a client not a thief to be caught. Studies on tax payer behaviour have shown that services to tax payers that facilitate reporting, filing, and paying taxes, or that impart education or information among citizens about their obligations under the tax laws, are often as or more cost-effective in securing compliance than measures (auditing, penalties) more directly designed to counter non-compliance. Simplifying procedures is also one of the main incentives for tax compliance; eliminating demands for superfluous information in tax returns and consolidating return and payment forms. Once procedures are simplified, the tax administration can then concentrate on its main tasks: facilitating compliance, monitoring and

[785] Yoo (note 774 supra).
[786] World Bank (note 768 supra).
[787] Zolt, E. M. and Bird, R.M. (2005), *Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, SSRN, p.47.

enforcing compliance, and controlling corruption[788]. Another major task is to control corruption amongst tax collectors. Corruption undermines confidence in the tax system, affects willingness to pay taxes, and reduces a country's capacity to finance government expenditures[789], no government can expect taxpayers to comply willingly if tax payers believe the tax structure is unfair or the revenue collected is not effectively used. Ideally tax collectors/inspectors should be professionally trained, promoted on the basis of merit, and judged by their adherence to the strictest standards of legality and morality. Temptation should be reduced by reducing direct contact between officials and tax payer, and increasing supervision when they do have such contact [790].

More revealing of this thesis is its direct contact with foreign enterprises doing business in Kuwait. Throughout Chapter 7 an empirical survey is carried out on foreign enterprises in Kuwait and various interviews and questionnaires undertaken with Tax Auditors, employees working in the Tax Department in addition to foreign enterprises carrying on work or business in Kuwait. The general attitude of the survey samples was that the 2008 Amendments did not add much improvement to Income Tax Decree 3/1955 other than the significant reduction in the tax rate[791]. Foreign enterprises have also stated their opinions on how Kuwait can improve its chances of becoming more attractive for FDI, where the majority wanted to see agency and 49% shareholding rules eliminated, such

---

[788] Bird (note 769 supra).
[789] Fjeldstad, O-H, (2005), *Corruption in Tax Administration: Lessons from Institutional Reforms in Uganda*, WP 2005:10, CMI Working Paper, Bergen, p. 11.
[790] Webber, C. & Wildavsky A., (1986) *A History of Taxation and Expenditure in the Western World*, New York, Simon and Shuster, pp. 312-313.
[791] See pp. 241-244.

rules prohibit foreign enterprises from carrying on business in Kuwait unless they (a) had a national agent, or (b) held no more than 49% of a company's shares while a national holds 51% of the company's shares. This recommendation topped the list of foreign enterprises in Kuwait as the above rules create a significant hindrance to FDI.

Clarifying the ambiguity in the Tax Law Amendments was also one of the main recommendations foreign enterprises had. Many foreign enterprises called for a panel which is separate from the Kuwaiti Tax Department to look into objections and appeals relating to tax assessments.

Most Taxpayers (foreign enterprises) who agreed that Kuwait is actually an attractive jurisdiction for foreign investment based their opinion on the reduction in the tax rate. However, disturbingly, perhaps, almost 70% of taxpayers in the survey samples used in Chapter 7 felt that Kuwait is not an attractive environment for investment. Some of the reasons cited were as follows:

- Kuwait's business regulations are very restricting (agency and sponsorship rules), while other GCC countries are opening up for investment and abolishing barriers.
- It is supposed to be attractive but it is not due to the endless disputes between the government and Parliament. All development projects are shelved, and the continuous re-shuffling of the government is a hindrance to decision making.
- There are business opportunities but the requirement that a national must own 51% of the project makes these opportunities unattractive.
- The bureaucracy is huge, too many rules, and requirements and very long procedures.
- It is only attractive for oil companies[792].

Tax payers (foreign enterprises) had the following specific recommendations to improve the 2008 Amendments:

[792] See pp. 292-294.

- The law is ambiguous, more clarity is crucial.
- There needs to be periodical reviews on the law and its clauses and amendments in order to improve the law and the system as a whole.
- Increase allowances for agent commission and head office expenses.
- A progressive tax rate is fairer than a flat rate tax.
- An independent panel to rule in tax objections and appeals, rather than the tax inspector in the Tax Department.
  Giving start-up companies a tax holiday e.g. first five years of their business as an encouragement.

Also, in terms of improving the Tax Department's services each survey sample had the following recommendations:

Taxpayers' (foreign enterprises) recommendations on improving the tax department:

- We want the Department to interact more closely with companies. We want to talk to them and communicate with them.
- Better deadline definition (they give us deadlines for tax assessments but they never comply).
- The arbitration panel must be independent from the Department.
- When they have doubts on our accounts there should be a chance to talk and discuss instead of taxing us according to deemed profits.
- There is a language barrier. They don't speak English, and we don't speak Arabic.
- Easier, faster inspection procedures.
- Fairer treatment for taxpayers without discriminating against smaller companies by treating larger ones more favourably.

Tax Auditors recommendations on how to improve the tax department;

- Tax law should cover all areas and not leave any room for arbitration, or self interpretation.
- Better qualified inspectors, by introducing them to international accountancy standards, and also exposing them to more advanced tax systems.
- The inspectors need to be more responsible; accountability is important.
- Simpler and easier compliance procedures, tax assessments and inspection procedures.
- An independent panel for tax objections and appeals.

Tax Department's recommendations on how to improve the tax department:

- Developing the staff by offering courses and better training.
- Increasing tax awareness in the country.
- A more comprehensive tax law.

- Independence of the Tax Department from the Ministry of Finance and less bureaucracy.
- Better communication and correspondence with taxpayers and tax auditors by listening to their concerns and recommendations.
- A tax magazine for the employees which provides the latest news on amendments, and changes on tax locally and internationally to improve their tax awareness.

Each chapter in this thesis has given rise to a crucial question in relation to the feasibility of tax reform in Kuwait and finally recommendations of how such tax reform can be carried out. There is much scope for taxing individual income in Kuwait and national companies especially when conforming to the WTO principles of MFN and NT, as has been mentioned in chapter 4 there is a capacity in the current tax system to tax national enterprises, however, in terms of taxing both individuals and national enterprises the Kuwaiti governments needs to provide fiscal awareness for the people and the domestic enterprises. As mentioned in chapter 2 it would not be realistic to argue that Zakat alone can serve as a sufficient system of redistribution of wealth in its current form, i.e. Zakat is currently voluntary in Kuwait allowing a significant chance of avoidance, and in its current inflexible form where all Zakat revenue is allocated to eight exclusive groups of poor and needy people mentioned in the Qur'an and not permitted towards the provision of public goods and services. The community based fiscal system which Kuwait is in crucial need for is one that focuses on convincing the Kuwaiti people that through tax extraction they can finance the provision of public goods and services and be able to hold their government liable to the level of such provisions of goods and services. It would be useful to merge Sen's capability approach with a system similar to Zakat, only one which allows

revenues to be spent on public goods, rather on just the worse off. With the capability approach which Sen endorses, resources will not only be extracted from the better off into the state and distributed between the worse off but there will also exist a significant measure of how to turn these resources into functionings that can benefit society as a whole. However, both this ambition of taxing the Kuwaiti people and national enterprises is outside the scope of this thesis but provide an interesting and relevant subject for future research.

What can be achieved in the short term in regards to the reformation of the Kuwaiti fiscal system is the cooperation between the Kuwaiti government and the Tax Department to take Taxpayers' recommendations mentioned above on board. Certainly relaxing the requirements and reducing the barriers for starting a business in Kuwait and allowing foreign investors more freedom to run their own enterprise without agency rules or the 49% rule can enhance Kuwait's ability to attract investment. Business opportunities and political stability also go a long way and in terms of the Tax Department; eliminating the concept of deemed profits, providing an arbitration panel which is separate from the Tax Department to look into the objections and appeals of tax assessments carried out by tax inspectors, and restricting the powers of tax inspectors to avoid arbitrary decisions, all contribute towards a fairer and more efficient Tax Department, as foreign enterprises prefer to be certain about their tax liability when investing in a foreign jurisdictions, this provides the feeling of commercial stability which foreign investment needs.

Poor tax administration as pointed out by Martinez[793] can be partly blamed for the poor revenue performance. Tax systems, he provides, are as good as their enforcement. Effective tax reform cannot be accomplished in isolation from the current capabilities of the tax administration system and taxpayers culture. The most serious mistake a country reforming its tax system can do is focus primarily on modernizing its tax policies and relegating tax administration and taxpayer issues to remote second place.

[793] Martinez-Vasques (note 779 supra).

# Bibliography

## Articles


- Aghnides, N. (2009) *Mohamedian Theory of Finance*. in Powell, R. (2009) *Zakat: Drawing Insight for Legal Theory and Economic Policy from Islamic Jurisprudence*, Seattle University, pp. 526-27.
- Al Hayyan, A. (2003) *The Kuwaiti Foreign Investment Law: Comments and Suggestions*, Arab Law Quarterly, p.328.
- Al Mazrooie, M. (2010), *The Process of the Customs Union of the Cooperation Council for the Arab States of the Gulf*, A Paper Produced for the GCC, Analysing the Development of Implementing the Customs Union in the GCC States from 2002-2010, pp. 8-10.
- Al Omar, F. (1997), *Bureaucracy State and Development in Kuwait and Arab Gulf States: A Comparative Study*, Institute of Policy Studies The Islamic Foundation, p. 76.
- Arnold, B. et al. (2002), *Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21Century. Bulletin for International Fiscal Documentation*, No. 56, pp.233-243.
- Altshuler, R. *et al.* (2000), *Repatriation Taxes, Repatriation Strategies and Multinational Financial Policy,*a paper prepared for the Trans-Atlantic Public Finance Seminar, Switzerland, p. 27.
- Al Twaijiri, M. (2007) *Customs Union: First Step towards GCC Integration*, Article Published in The Arab Times Daily News Paper, Kuwait, http://www.arabtimesonline.com, visited 20/7/2007.

- Azharuddin, M. (1998), *Role of Zakat in a Modern Economy with Reference to Bangladesh*, (cited in) Molla, R. (et al) (1988), *Frontiers and Mechanics of Islamic Economics*, University of Sokoto, Nigeria 68 – 155.
- Baaklini, A. et al, (1999), *Legislative Politics in hr Arab World, the Resurgence of Democratic Institutions of Domestic Institutions*, Lynne Rienner Publishers.
- Baker, P. (1986), *Kuwait: The Taxation of International Commercial Transactions*, Arab Law Quarterly, Vol. 1, No. 2, pp. 141-156.
- Bankman, J. and Griffith, T. (1987), *Social Welfare and the Rate Structure: A New Look at Progressive Taxation,* 75 California Law Review, pp. 1905-1908.
- Barthel, F. and Busse, M. *et al,* (2010), *The Impact of Double Taxation Treaties on Foreign Directed Investment: Evidence From Large Dyadic Panel Data,* Contemporary Economic Policy, Vol. 28, No. 3, pp. 366-377, July 2010.
- Basher, S. (2010), *Has the Oil Sector Decoupled from Oil Sector? A Case Study of the Gulf Cooperation Council Countries,* Department of Research in Qatar Central Bank, p.3.
- Benthall, J. (1999), *Financial Worship: The Quranic Injunction to Almsgiving*, The Journal of Royal Anthropological Institute, pp.27-42.
- Blonign, B.A. and Davies, R.B. (2004), *Do Bilateral Tax Treaties Promote Foreign Direct Investment?* U.S. FDI Activity, International Tax and Public Finance 11(5), pp. 601-622.
- Bradley, M. (2010), *The Invisible Handout, Smith, J.S. Mill and Marshall on Inequality and Progressm,* University of Maryland, p.1.
- Brighouse, H. and Unterhaulter, E. (2009) *Primary Goods Versus Capabilities: Defending the Good against the Equally Good?* in *Reflections on Rawls, An Assessment of his Legacy*, (Edit) by Shaun P. Young, (2009), Ashgate, pp.46-58.

- Brooks, K. (2007), *Tax Treaty Treatment of Royalty Payment from Low-Income countries: A Comparison of Canada and Australia's Policies,* e-Journal of Tax Research, Vol.5, No.2, pp.169-199.
- Crystal, J. (1973), Middle East Oil and Energy Crisis: Part Two, MERIP Report, 1973, No. 21, pp.34.
- Central Bank of Kuwait, (1981), *The Kuwaiti Economy in Ten Years 1969-1979 ,* Kuwait: Central Bank Press, p.150.
- Chalcraft, J. (2010), *Monarchy, Migration and Hegemony in the Arabian Peninsula,* LSE Global Governance, p. 18-20.
- Cordes, J. J. *et al*, (1999), *The Encyclopaedia of Taxation and Tax Policy,* The Urban Institute Press, p.45
- Coyne E.J. (1994), *An Articulated Analysis Model for FDI Attraction into developing Countries*, Florida: Nova Southeastern University, pp. 234-246.
- Davies, R. (2004), *Tax Treaties and Foreign Direct Investment: Potential versus Performance,* International Tax and Public Finance, 11, 776-802.
- Daniels, N. (2003) *Democratic Equality: Rawl's complex Eglittarianisim*, in Samuel Freeman (eds.) *The Cambridge Companion to Rawls* (Cambridge: Cambridge Press), pp.241 -277.
- Daya, A. (2009), *BP, Chevron Managers Leave Kuwait as Projects Delayed,* Bloomberg, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=avRG0YvHHPBk [visited 25/11/10].
- Degan, T. (2000), *The Tax Treaties Myth*, New York University, Journal of International Law and Politics, Summer 2000, pp. 939-996.

- Dehejia, R. and Dehejia, V. (1993), *Religion and Economic Activity in India: a Historical Perspective,* American Journal of Economics and sociology, Vol.52, Issue 2, p. 145-153.
- Desai, M. *et al*. (2001), *Repatriation Taxes and Dividends Distortion,* Bureau of Economic Analysis, U.S. Department of Commerce, p. 34.
- Ebrahim-Zadeh , C. (2003), *Dutch Disease: Too Much Wealth Managed Unwisely,* Finance and Development Vol. 40 (1), p. 50-51.
- Elkins, D. (2009), *Taxation and the Terms of Justice*, University of Toledo Law Review, Vol. 41, pp. 73-75.
- Fadel, M. (1996), *The Social Logic of Taqlid and the rise of Mukhtasar,* Islamic Law and Society, Vol.3, 193, p. 193.
- Fallon, G. M. (1993), *The Taxation of Companies and Individuals in Yemen,* Arab Law Quarterly, pp.37-41.
- Fearon, J.D. and Laitin, D. (2003), Ethnicity, Insurgency, and Civil War, American Political Science Review, 97 (1): 75-91.
- Fink, S. and Krapohl, S. (2010), *Assessing the Impact of Regional Integration: Do Regional Trade Institutions Shape Trade Patterns?,* Paper prepared for the PSA conference 2010, p. 5.
- Figueroa, A.H. (1992), *Comprehensive Tax Treaties in Double Taxation Treaties between Industrial and Developing Countries: OECD and UN* Models – *a Comparison*. Kluwer, pp. 9-13.
- Figlio, D. and Blonigen B. (2000), The Effects of Direct Foreign Investment on Local Communities, Journal of Urban Economics, Vol.48, Issue 2, pp. 338-363.
- Fjeldstad, O-H, (2005), *Corruption in Tax Administration: Lessons from Institutional Reforms in Uganda*, WP 2005:10, CMI Working Paper, Bergen, p. 11.

- Fleming P. and Zizzo, D. (2009), *Social Desirability, Approval and Public Good Contribution*, Social Science Research Network, p.10-14.
- Gerald, J. (1999), *Legal Aspects of Doing Business in Kuwait,* Arab Law Quarterly, Vol. 6, No. 4, p. 325.
- Ghabra, S. (1997), *Kuwait and the Dynamics of Socio-Economic Change*, Middle East Journal, Vol. 51, No.3, pp. 358.
- Go, D. S. (1994), *External Shocks, Adjustment Policies and Investment in a Developing Economy: Illustrations from a Forward-Looking CGE Model of the Philippines*, Journal of Development Economics 44(2): 229-61.
- Guiso, L. *et al*, (2002), *People's Opium? Religion and Economic Attitude*, Journal of Monetary Economics 50 (2003) 225-282.
- Gylfason, T. (2001), *Natural Resources, Education, and Economic Development*, European Economic Review, 45 (4-6): 847-59.
- Hargreaves, S. (2006), *Oil Surges Defying Expectations*, CNN, http://money.cnn.com/2006/09/27/markets/oil_eia/index.htm, [visited 25/11/10].
- Hallaq, W. B. (1984), *Was the Gate of Ijtihad Closed?* International Journal Middle East Studies, Vol. 16, pp. 3-14.
- Hassan, R. (2005), *Giving and Gaining: Philanthropy and Social Justice in Muslim Societies,* paper presented at a workshop at Flinder University 7-8 Nov.
- Herb, M. and Moore, P. W. (2000) *All in the Family: Absolution, Revolution, and Democracy in the Middle Eastern Monarchies*, The American Political Science Review, Vol.94, No.2,( June 2000), p. 478-479.
- Herb, M. (2002), *Does Rentierism Prevent Democracy?* Georgia University, p. 33-38.
- Herb, M. (2005), *TheTransition from Liberalized Autocracy? New Options for Promoting Democracy in the Arab World (The Case of Kuwait)*, Georgia State

University, a paper prepared for the USIP-Muslim World Initiative Working Group and Study Project:, p.14-16.

- Hodgson, M. (1985), *The Venture of Islam: Conscience and History in a World Civilization: The Classical Age of Islam: Volume 1,* The University of Chicago Press.
- Howden, D. (2007), *World Oil Supplies are Set to Run out Faster than Expected,* The Independent, http://www.independent.co.uk/news/science/world-oil-supplies-are-set-to-run-out-faster-than-expected-warn-scientists-453068.html , [visited 8/3/2011].
- Humpheys, M. (2005), *Natural Resources, Conflict and Conflict Resolution*, Journal of Conflict Resolution, 49:508-37.
- Janeba, E. (1995), *Corporate Income Tax Competition, Double Taxation Treaties and Foreign Direct Investment*, Journal of Public Economics 56 (2), pp. 311-325.
- Jehle, G. A. (1994), Zakat and Inequality: Some Evidence from Pakistan, 1994, Review of Income and Wealth, Series 40, Number 2, June, pp. 205-216.
- Kaboudan, M. (1984), *Oil Revenue and Kuwait's economy: An Economic Approach,* Middle East Economic Digest MEED, June, 20, 45-66.
- Kamar, B. and Naceur, S. (2007), *GCC Monetary Union and the Degree of Macroeconomic Policy Coordination*, IMF working paper, pp.25-28.
- Kassim, A. (1986), *Joint Venturing in Kuwait Company Law Explained,* Arab Law Quarterly, Vol.1, No.4, pp. 432-435.
- Kawach, N. (2010), *Tariff Rift Delays Block Customs Union,* Zawya, http://www.zawya.com , [visited 28/12/2010].
- Khalilzadeh J. and Shah, A. (1991), '*Tax Reform in Developing Countries'*, Finance and Development, p.45.

- Khalaf, S. and Hammoud, H. (1988), *The Emergence of the Oil Welfare State: The Case of Kuwait*, Dialectical Anthropology, Kluwer Academic Publishers, Vol. 12. 343-350.
- Khan, H., and Bashar, O. (2008), *Religion and Development are they Complimentary,* U21 Global Working Paper, p.5.
- Lockhart, L. (1947) *Outline of the History of Kuwait*, J. Royal Central Asian Soc., XXXIV (July-Oct. 1947), p. 262-274.
- Luft, G. (2006), *The Oil Crisis and its Impacts*, The Institute for the Analysis of Global Security (IAGS), p. 6-9.
- Mahjub, R. (2004), *Al Iqtisad Al Siyasi,* Vol. 1, pp. 191-192 (Arabic Reference).
- Martinez-Vazquez J. and McNab, R. (1997), *Tax Reform in Transition Economies: Experience and Lessons*, Georgia State University, International Studies, pp. 5-6. http://aysps.gsu.edu/isp/files/ispwp0001.pdf
- McCleary, R. (2008), *Religion and Economic Development*, Policy Review, p.148.
- Molla, R.I. Moten R.A. *et al*. (1988), *Frontiers and Mechanics of Islamic Economics*, University of Sokoto, Nigeria, pp. 73.
- Morrisset, J. and Pirnia, N. (2001), *How Tax Policy and Incentives Affect Foreign Direct Investment*, (FIAS) Foreign Investment Advisory Service, a Joint Service of the International Finance Corporation and the World Bank, 2001, p. 3.
- Moody, D. (2002), *Empirical Research Methods*, Monarch University, p.2, http://www.idi.ntnu.no
- Moore, M. (1998), *Death Without Taxes: Democracy, State Capacity, and Aid Dependence in the Fourth World*, (cited in) Robinson, M., and White, G. eds., (1998) *The Democratic Development State*, Oxford: Oxford University Press, pp. 84-128.

- Moore, P. and Salloukh, B. (2003), *Professional Associations, The State, and Fiscal Crisis in the Middle East*, University of Miami, p.17-19.
- Nechi, S. (2010), *Assessing Economic and Financial Cooperation and Integration Among the GCC Countries,* Jouranl of Buisness and Policy Research, Volume 5. Number 1. July 2010, p. 158.
- Arabian Oil and Gas.com, (2009), *Top 10 National Oil companies by Production,* http://www.arabianoilandgas.com/article-5460-top-10-national-oil-companies-by-production/1/print/ [visited 13/9/2009].
- Pillai R. And V. Kumar M., (1962), *The Political and Legal Status of Kuwait,* The International and Comparative Law Quarterly, Vol.11, No.1, pp.108-130.
- Pipes, D. (1982), *The Curse of Oil Wealth,* The Atlantic, http://www.danielpipes.org/163/the-curse-of-oil-wealth, [visited 2/7/ 2010].
- Raad, K. *edit*. (*2011), Materials on International and EU Tax Law,* OECD's Commentary on the New Article 7, IBFD, p. 1343.
- Radaelli, C. (1997), *The Politics of Corporate Taxation in the European Union*, Routledge Research in European Public Policy, London, pp. 112-134.
- Razari, H. (1983), *An Analysis of Iran's Oil Production Policy: a Welfare Maximization Approach,* Applied Economics, 14, 2, pp. 243-54.
- Rettab, B. and Istaitieh, A. (2007), *GCC Economic Integration in Focus with Special Reference to the UAE,* Chamber of Commerce and Industry, pp.19-20.
- Richardson, G. (2004), *Islamic Law and Zakat: Waqf Resources in Pakistan*, in *Islam and Social Policy*, Vanderbilt University Press, p.156.
- Rohatgi, R. (2005), *Basic International Taxation,* Second Edition, Vol. I: Principles, Richmond, p. 196.
- Rolfe R.J. et al. (1993), *Determinants of FDI Incentive Preferences of MNEs*, Journal of International Business Studies, 24(2), pp. 335-355.

- Ross, M. (2001), *Does Oil Hinder Democracy?* World Politics 53:(3), p.325-361.
- Ross, M. (2004), *Does Taxation Lead to Representation?* British Journal of Political Science, 34: 229-249.
- Ross, Michael L. (2004), *What do we Know about Natural Resources and Civil War?,* Journal of Peace Research, 41(3): 337-356.
- Roy, J. and Zarrouk, J. (2006), *Completing the GCC Customs Union*, The World Bank, pp.5- 6.
- Salih, K. (1991), *Kuwait: Political Consequences of Modernization, 1950-86,* Middle Eastern Studies, Vol.27, No.1, pp. 46-66.
- Salter, D. (2001) *Tax Constraints on Developing Countries and the Global Economic Recession*, cited in Faundez, J. and Tan, C. (2010) *International Economic Law, Globalization and Developing Countries*, Edward Elgar, pp.132-142.
- Samson, W. (2002), *History of Taxation* (cited in) Lymer, A. and Hasseldine, J. (eds.), *The International Taxation System*, Kluwer Academic Publishers, Boston, pp. 21-41.
- Shaheen, A. (2010), *GCC Countries Postpone Customs Union Move*, Gulfnews.com, p.1, http://gulfnews.com/business/general/gcc-countries-postpone-customs-union-move-1.678788, [visited 8/9/210].
- Shakow, D. and Shuldiner, R. (2000), *A Comprehensive Wealth Tax,* 35 Tax Law Review, pp. 499-578.
- Shehab, F. (1964), *Kuwait, a Super Affluent Society,* Foreign Affairs, Vol. 42: 461-474.
- Smith, B. (2004), *Oil Wealth and Regime Survival in the Developing World,* 1960-1999, American Journal of Political Science, 48 (2): 232-246.

- Standard Forum, (2009), Financial Standard Foundation, *Business Indicators, Kuwait,* http://www.estandardsforum.org/kuwait/business-indicators [visited 3/7/2009].
- Stauffer, T. (1987), *Income Measurement in Arab States,* in Beblawi H. and Luciani, G. (1987) *The Rentier State*, London: Croom Helm, pp. 48-60
- Suneja, V. (2002), *Policy Issues for Business,* SAGE publications, London, The Open University, p.2.
- Toumi, M. (2006), *Anti-avoidance and Harmful Tax Competition: from Unilateral to Multilateral Strategies,* in Lymer A. & Hasseldine, J. (eds.), (2006), *The International Tax System*, Kluwer, pp.83-105.
- Tretreault, M. A. (1991) *Autonomy, Necessity and the Small State: Ruling Kuwait in the Twentieth Century,* International Organization, Vol. 45, No. 4, (Autumn 1991) pp. 565-591.
- UNCTAD, (2004), *World Investment Report The Shift towards Services*, 2004, United Nations New York and Geneva, pp. 73-99.
- Yoo, I. (2000), *Experience with Tax Reform in the Republic of Korea*, Asia Pacific Development Journal, Vol. 7, No. 2, p. 82.
- Wells, L.T. (1986), *Investment Incentives: An unnecessary Debate*, CTC Reporter U.N. Centre on Transnational Corporations, New York, No 22, Autumn, pp. 58-60.
- Zaid, O. (2000), *The Appointment Qualifications of Muslim Accountants in the Middle Ages*, Accounting Education, 9 (4), pp. 329-342.
- Zolt, E. M. and Bird, R.M. (2005), *Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, SSRN, p.47.

## Books


- Abdul Rahman, A. (2002), *Zakat Accounting: Creating Business Wealth*, Akauntan Nasional, pp. 9-21.
- Al Bukhari, S. (1997), *The Translation of the Meanings of Sahih Al Bukhari,* Dar Assalam Publications, pp. 275-338, Translated by Dr. Mohammed M., Khan.
- Al Ghazali, A. H. (1975), *The Mysteries of Alms Giving*, Books Concern, translated by Nabin Faris, pp. 12-234.
- Al Farhan, R. (1960), *The Summary of the Kuwaiti History*, Cairo, Dar Al Orooba, pp. 55-65 (Arabic).
- *Al Muzaini, A. (1984), Zakat and Taxes in Kuwait: Past and Present, Dar El Salaseil, pp.16-20. (Arabic).*
- Al Na'im, A., A., (1996), *Toward and Islamic Reformation: Civil Liberties, Humane Rights and International Law,* Syracuse University Press, pp. 88-91.
- Al Sabah, Y.S.F. (1980), *The Oil Economy of Kuwait,* Kegan Paul International Ltd, London, pp. 39-59.
- Al Shamlan, S. (1959), *Min Tareekh AL Kuwait (Some of the Kuwaiti History),* Cairo, pp. 212-220, (Arabic).
- Al Tony, N. (2009), *Economic Diversification in the Arab World*, Arab Planning Institute, p.212.
- Anscombe, F. (1997), *The Ottoman Gulf: The Creation of Kuwait, Saudi Arabia, and Qatar* Columbia University Press, pp.113-132.
- Arnold, B. and McIntyre, M. (2002), *International Tax Primer*, Kluwer Law International, p.32.
- Auty, R. (1993), *Sustaining Development in Mineral Economies: The Resource Curse Thesis*, London: Routledge, pp. 154 – 160.

- Azharuddin, M., (1998), *Role of Zakat in a Modern Economy with Reference to Bangladesh*, (cited in) Molla, R., (et al) (1988), *Frontiers and Mechanics of Islamic Economics*, University of Sokoto, Nigeria.
- Baaklini, A. et al, (1999), *Legislative Politics in hr Arab World, the Resurgence of Democratic Institutions of Domestic Institutions*, Lynne Rienner Publishers, p. 178.
- Barlow, E. R. and Wender, I.T. (1955), *Foreign Investment and Taxation*, Harvard Law School, pp.146 – 245.
- Beblawi, H., Luciani, G., (1987) *The Rentier State*, London: Croom Helm, pp. 48-60.
- Bin Mohammed, A., (1993), *Zakat and Rural Development in Malaysia*, Berita Publishing: Kuala Lumpur, p. 13.
- Bird, R.M. (2008), *The BBLR Approach to the Tax Reform in Emerging Countries*, National Institute of Public Finance and Policy, New Delhi, pp. 7-8.
- Calder, N. (1993), *Studies of Early Muslim Jurisprudence*, Oxford University Press, pp. 45-65.
- Cordes, J. J. *et al*, *The Encyclopaedia of Taxation and Tax Policy,* The Urban Institute Press, p.50.
- Coulson, N. J. (2003), *A History of Islamic Law,* Edinburgh University Press, pp. 71-73.
- Crystal, J. (1992), *Kuwait: The Transformation of an Oil State,* Westview Press, Boulder, p.149.
- Dorenberg, R., (1997), '*International Taxation in a Nutshell'*, 3ed edition. St. Paul, West Publishing, and Blonigen, B., Davies, R., *The Effects of Bilateral Tax Treaties on US FDI Activity*, International Tax and Pubic Finance, p. 605.
- Fink, A. (2003), *The Survey Hand Book*, 2nd edition, SAGE Publications, p.35.

- Gillham, B. (2008), *Small Scale Social Survey Methods*, Continuum, p.8.
- Hallaq, W.,B. (1997), *A History of Islamic Legal Theories: An Introduction to Sunni Usul Al Fiqh*, Cambridge University Press, p. 43.
- Head, J. and Krever, R. (2009), *Tax Reform in the 21st Century*, Kluwer, p. 8.
- Hilmy, M. (1955), *Mizaniyat Al Dawla,* Nahda Misr, pp.73-75 (Arabic Reference) cited in Qardawi, Y. (1999), *Fiqh Az-Zakat: A Comparative Study*, Dar Al Taqwa, 628.
- Hobbes, T. (1651), *Leviathan,* Cambridge University Press, p. 238.
- Holmes, K. (2007), *International Tax Policy and Double Tax Treaties,* IBFD, p. 25.
- Housseini, Z., M., (1999), *Islam and Gender,* Princeton University Press, p.12.
- H.R.P. Dickson, (1856), *Kuwait and her Neighbours*, London: Allen & Unwin, pp. 270-276 and pp. 301-302.
- Humphreys, M. et al., (2007), *Escaping the Resource Curse*, Columbia University Press, pp. 1-4.
- Jacob, K. and El Malakh, R. (1981), *The Absorptive Capacity of Kuwait: Domestic and International Perspective,* Lexington Books, p. 113.
- Jeffery, R. (1999), *The Impact on State Sovereignty on Global Trade and International Taxation*, Kluwer, p. 63.
- Judith M. Et al., (1992), *Questions about Questions*, Russell Sage Foundation, p. 50.
- Kassis, E., H. (1983), *A Concordance of the QUR'AN,* University of California Press, p. 23.
- Kees Van Raad. edit, *2010/2011 Materials on International and EU Tax Law,* OECD's Commentary on the new Article 7, IBFD, p. 1343.

- Khazal, H. (1962) *Tarikh Al-Kuwiat Al Siyasi* (The Political History of Kuwait), Beirut, Dar al Kutub, Arabic (cited in) Ismael, J. S. (1993), *Kuwait: Dependency and Class in a Rentier State*, Gainsville: University Press of Florida, p.55.
- Locke, J. (1824), *Two Treaties of Government,* London, p. 220.
- Lucani, G. (1984), *Oil Companies and the Arab World,* Library of Congress Publications. p.146.
- Lymer, A. and Hasseldine, J. (2002), *The International Taxation System,* Kluwer, p.139.
- Mahdavi, H., (1970), *The Patterns and Problems of Economic Development in Rentier States: The Case of Iran, in Studies in the Economic History of the Middle East,* ed. M.A. Cook., Oxford University Press: London, p. 428.
- Mayer, A., E. (1986), *Islamization and Taxation in Pakistan, in Islamic Reassertion in Pakistan,* Syracuse: Syracuse University Press, p. 68.
- Mcleod, I. (2010), *Legal Theory,* Palgrave MacMillan, p. 171.
- Mill, J.S., (1848), *Principles of Political Economy,*The Great Mind Series, p. 805.
- Morse, G. and Williams, D. (2004), *Davies: Principles of Tax Law,* fifth edition, Thomson, p. 54.
- Murphy, L. and Nagel, T.(2002), *The Myth of Ownership*, *Taxes and Justice*, Oxford, p. 108.
- Musgrave, R. A. (1958), The Theory of Public Finance, New York: McGraw-Hill, p.312.
- Nozick, R. (1974), *Anarchy, State and Utopia*, New York (Basic Books), p. 185
- Parra, F. (2004), *Oil Politics: a Modern History of Petroleum,* LB Tauris London, pp.20-21.
- Pogge, T.W. (1998) *Realizing Rawls*, Cornell University Press, pp. 66-69.

- Pogge, T. W. (2002), *Can the Capabilities Approach be Justified,* Philosophical Topics 20/2 (2002): pp. 167-170.
- Prihatna, A., A., (2005), *Muslim Philanthropy: Potential and Reality of Zakat in Indonesia: Survey Results in Ten Cities,* Kota Depok: Pirmedia, pp. 60 – 70.
- Qardawi, Y., (1999), *Fiqh Az-Zakat: A Comparative Study*, Dar Al Taqwa, p. 550.
- Raad, K. edit, *2010/2011 Materials on International and EU Tax Law,* OECD's Commentary on the New Article 7, IBFD, p. 1343.
- Rawls, J. (1971) A *Theory of Justice* and *Political Liberalism,* Harvard University Press, p. 9.
- Reuber G. et al. (1973), *Private Foreign Investment in Development*, Clarendon Press for the OECD Development Centre, Oxford, 1973, p. 112-116.
- Richardson, G. (2004), *Islamic Law and Zakat: Waqf Resources in Pakistan*, in Islam and Social Policy, Vanderbilt University Press, p.156.
- Richamn, P. (1963)*'Taxation of Foreign Investment: An Economic Analysis'*, Hopkins, p.55.
- Roberts, G. And Fowler , D. (1995), *Built by Oil*, Ithaca press, 1995, pp 30-37.
- Rohatgi, R. (2005), *Basic International Taxation,* Second Edition, Vol. I: Principles, Richmond, p. 196.
- Rousseau, J. J. (1762), *The Social Contract,*Wordsworth edition, 1998, p.115.
- Sandel, M. (1982), *Liberalism and Limits of Justice*, Cambridge: Cambridge University Press, p.87.
- Sanford, C.T. (1971), *Realistic Tax Reform*, Catto &Windus Ltd. London, p.9.
- Sen, A. (2010), *The Idea of Justice*, Penguin, pp. 124-155.
- Senturk, O. (2007), *A comprehensive Guide to Zakat: charity in Islam*, The Light. p. 110.

- Siddiqi, S. A. (1992), *Public Finance in Islam*, (2nd edn.) Adam Publishers and Distributors, India, p. 113.
- Slemrod, J. *(1999) 'Tax Policy in the Real World'*, Cambridge University Press, pp.17-20.
- Smith, A. (1776), *An Inquiry into the Nature and Causes of the Wealth of Nations*, Clarendon Press 1976, Oxford, p. 1152.
- Stauffer, T. (1987), *Income Measurement in Arab States, cited in* Beblawi H., and Luciani G., eds., *The Rentier State,* New York: Croom Helm, p. 18.
- Tanur, J. (1992), *Questions about Questions*: *Inquiries in the Cognitive Bases of a Survey*, Russell Sage Foundation, p. 50.
- Tiley, J. (2008), *Revenue Law*, Hart Publishing, p. 114.
- Webber, C. and Wildavsky A., (1986) *A History of Taxation and Expenditure in the Western World*, New York, Simon and Shuster, pp. 312-313.
- World Bank, (1991), *Lessons of Tax Reform*, World Bank, p.2.
- Yates, D. A. (1996), *The Rentier State in Africa, Oil Rent Dependency and Neo-colonialism in the Republic of Gabon,* Africa World Press, pp. 11-15.
- Yin, R.K. (1994), *Case Study, Design and Methods*, 2nd edition Newbury Park, Sage Publications, p. 65.


## PhD Thesis


- Al Moqatei, M. (1987), *A Study of the Kuwaiti Constitutional Experience 1962-1986,* Ph.D Thesis, University of Warwick. pp. 24-28.
- Taqi, H. *Two Ethnicities,*(2010),*Three Generations: Phonological Variation and Change in Kuwait,* PhD Thesis, New Castle University, p. 211.

## Masters Dissertation


- Abdullah, N. (2005), *The Effect of Introducing Statutory Zakat in Kuwait,* MSc in Finance Accounting, University of West England, Bristol, pp. 1-54.
- Abulhasan, A. (2004), *Future Relations Between Kuwait Petroleum Corporation and the International Oil Companies: Success of Failure?* A Thesis of Master of Art in Law and Diplomacy, The Fletcher School, p.7-9.
- Al Roumi, Mohammed, (1981), *Kuwait and Malta British Imperial Policy*, Master Thesis, Malta University, pp. 134-156.


## Reports, Bulletins, Government Policies


- Al Bazie & Co. (Member of RSM International), 2009, *Taxation in Kuwait,* p.9.
- Al Khouri, R. (2008), *Kuwait: Rentierism Revisited*, Arab Reform Bulletin, http://www.carnegieendowment.org/arb/, [visited 11/11/2010].
- Association of International Life Office (2007), Bahrain Tax Facts, pp. 1-2.
- Ayittey, G.B.N. (2006), *Nigerea's Struggle with Corruption, Testimony*, U.S. House of Representatives, Washigton DC. http://www.globalsecurity.org/military/library/congress/2006_hr/060518_3-transcript.pdf, [visited 2/3/2009].
- Al Shall Economic Report, vol. 6. issue 44, November 4th 2010, http://www.alshall.com/admin/downloads/20101111041453-2-eng-report-44-10%20e.pdf. [visited 16/11/2010].

- Ernst & Young (2004), *World Wide Corporate Tax Guide*, p. 57.
- Ernst & Young, (2006) Middle East Tax Review, p. 2.
- Ernst & Young (2010), *Kuwait Taxation,* pp.8-10.
- Ernst & Young (2010), World Wide Corporate Tax Guide, 2010, p. 57.
- Ernst & Young, Middle East Tax Review, 2010, p. 2.
- Human Development Report http://hdr.undp.org/reports/global/2005, [visited 2/10/2009].
- IMF Working Paper, Leite, C. and Weidmann, J. (1999), *Does Mother Nature Corrupt?Natural Resources, Corruption, and Economic Growth. http://www.imf.org/external/pubs/ft/wp/1999/wp9985.pdf* ,[ visited 13/6/ 2008].
- IMF, April 2006, IMF Country Report No. 06/132, http://www.imf.org/external/pubs/ft/scr/2006/cr06132.pdf , [visited 28/4/2011].
- Kamar, B. and Naceur, S. (2007), *GCC Monetary Union and the Degree of Macroeconomic Policy Co-ordination,* IMF working paper, pp. 25-28.
- KAMCO Research, (2011), *Kuwait, Economic Outlook*, p.6 http://www.menafn.com/updates/research_center/Kuwait/Economic/kamco170211ee.pdf [visited 14/6/2011].
- KPMG's International Tax Centre (2006) *KPMG's Corporate Tax Rate Survey*, p.23.
- Kumar, R. (2004), *Taxation in Kuwait*, AL Bazie and Co. Auditing firm, pp. 1-34.
- Kumar, R. Albazie & Co. (2010), *Taxation in Kuwait,* Albazie & Co. Public Accountants (Member firm of RSM International), p.19-20.
- Kuwait, Ministry of Planning, a Report of the Main Characteristics of Inhabitants and Labour Force, April 1993, p.12.

- UNCTAD, (2004), *World Investment Report The Shift towards Services*, United Nations New York and Geneva, pp. 73-99.
- UNCTAD, (2009), Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows, p.1.
- UNCTAD, (2011), Global and Regional FDI Trends in 2010, p.5.


## Magazines and News Papers


- Al Ahram Weekly News Paper, 24th -30th January 2002.
- Al Qabas Daily News Paper, 19th May 2007.
- Kuwait Times Daily New Paper, 4th May 2009.
- Kuwait Times Daily New Paper, 11th July 2010.


## Websites


http://www.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf visited 13/ 4/2009, visited 4/8/2009.

http://www.oecd.org/dataoecd/59/30/38516170.pdf , visited 22/5/2010.

http://www.oecd.org/dataoecd/59/30/38516170.pdf, visited 1/9/2010.

http://www.oecd.org/daf/mai/pdf/ng/ng988r1e.pdf , visited 13/7/2011.

http://data.un.org/CountryProfile.aspx?crName=KUWAIT, visited 8/3/2010.

http://money.cnn.com/2006/09/27/markets/oil_eia/index.htm, visited 25/11/2010.

http://www.bloomberg.com/apps/news?pid=newsarchive&sid=avRG0YvHHPBk, visited 25/11/2010.

http://www.gccsg.org/eng/index.php?action=Sec-Show&ID=56, visited 5/9/2010.

http://www.gcc-sg.org/eng/index.php?action=Sec-Show&ID=84, visited 1/9/2010.

https://www.cia.gov/library/publications/the-world-factbook/geos/ku.html , visited 24/6/2010.

http://www.kuwaittimes.net/read_news.php?newsid=NjEzNDUxODEw , visited 8/11/2010.

http://www.opec.org/opec_web/en/press_room/896.htm , visited 1/7/2010.

http://gulfnews.com/business/general/gcc-countries-postpone-customs-union-move-1.678788, visited 8/9/210.

http://www.arabianoilandgas.com/article-5460-top-10-national-oil-companies-by-production/1/print/ , visited 13/9/2009.

http://www.defenceweb.co.za/index.php?option=com_content&view=article&id=16048:kuwait-in-crisis-as-ruling-family-splits-mps-rebel&catid=54:Governance&Itemid=118 , visited 15/6/2011.

http://country.eiu.com/article.aspx?articleid=1197782704&Country=Kuwait&topic=Summary&subtopic=Fact+sheet&subsubtopic=Fact+sheet ,visited 7/3/2011.

## Verse from the Qu'ran

Surat *Al Ahzab* 33:33.

Surat *Al An'am* 6:141.

Surat *Al Baqara* 2:267.

Surat *Al Maida* 5:12.

Surat *Al Nisa* 4:5.

Surat *Al Tawbah* 9:34.

Surat *Al Tawbah* 9:60.

Surat *Al Tawbah* 9:103.

Surat *Al Zariyat* 51:19.

## Personal Interviews

A personal interview with the director of Kuwait Tax Department, Mr. Fayez Al Jassar, March 12th 2009.