Qatar Financial Centre
Tax Manual (QTM)

مركـــز قطـــــر للمـــال
Qatar Financial Centre

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QFC Tax Manual (‘QTM’)

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The QFC Tax Department

Location

The Tax Department is located in QFC Tower 1.

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General Enquiries

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Website and Intranet

www.qfc.qa

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The QFC Tax Manual has been referenced in line with the QFC Tax Regulations. All "PARTS" tie into the relevant "Parts" of the QFC Tax Regulations for easy reference.

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INTRODUCTION

INTRO – 10 Overriding Principles

The QFC tax regime is based on the following principles which are reflected in the QFC tax law and support the strategic vision of the QFC.

- **Competitiveness**
  The size and scope of the fiscal burden in the QFC is comparable with competitor jurisdictions.
- **Compliance with international 'best practice'**
  Classification of the QFC as a tax haven or preferential tax regime would be detrimental to businesses locating to the QFC, therefore the regime aims to comply with OECD standards.
- **Simplicity**
  The operation of the tax law is as straightforward as possible.
- **Fairness**
  The tax law provides certainty of treatment and is transparent in its application and operation.
- **Relevance**
  The tax law is designed to be comprehensive in scope, thereby reducing uncertainty but without compromising simplicity.
- **Consistency**

The system was developed using a holistic approach, which should ensure that the complexities inherent in older tax systems developed and changed over many years are avoided and compliance costs are minimised.

- **Efficiency**

  The tax law is effective within the constraints imposed by competition, so that it generates the revenue required by the QFC.

- **Harmonisation**

  As far as possible, the QFC tax system is consistent with the mainstream Qatar Income Tax system, to minimise any tax distortions.

INTRO – 20 Secrecy

Officers of the Tax Department have a duty of confidentiality and secrecy. Part 3 of the Tax Rules (TAX3) outlines the secrecy rules. Disclosure of information to persons outside the Tax Department, including other QFC Employees, is only permitted in certain limited, defined circumstances which are specified at TAX3.2.

The duty of confidentiality is reinforced by Article 16 of the QFCA Regulations, which imposes a general duty of confidentiality on all QFCA employees.

It is important to understand that confidentiality is your personal responsibility and any action for breach of confidentiality may be taken against you personally.

INTRO – 80 Taxpayer Base

The Regulations and Rules apply to "all QFC Entities" (Article 2(2), and TAX 1.1). A "QFC Entity" is defined at Article 140 as "a body corporate, partnership, individual, unincorporated association, or trust which has been granted and continues to hold a QFC Licence." A QFC Licence is also defined at Article 140 as "a licence, approval or authorisation issued by the QFCA pursuant to Article 11.1 of the QFC Law." The tax base is therefore all QFC Licenced firms.

INTRO – 100 Tax Regulations: Commencement

Article 3 states that the commencement date of the Regulations is provided for in the issuing resolution. The issuing resolution stated that the Regulations became effective as of 1 January 2010. The Tax Rules are effective from the same date as the Regulations.

Updated Tax Regulations and Rules were enacted on 18th June 2014 and all changes introduced as part of the updated regulations and rules came into force on 18th June 2014, unless expressly stated otherwise. A list of changes and their enactment dates can be found at Appendix 4.

INTRO – 120 Language

In common with all other QFC law, the Tax Regulations and Rules are written in the English language.

PART 1 APPLICATION, COMMUNICATION & INTERPRETATION

1 – 1000+ QFC Tax Regulations and Tax Rules

The primary legislation for the QFC tax regime is the QFC Tax Regulations (No. 17 of the Year 2010), as amended. The Regulations are supported by the QFC Tax Rules (TAX).

1 – 1020 Tax Regulations

The Regulations, which may be cited as the "QFC Tax Regulations" (Article 1), are made under the authority of Article 9 of the QFC Law (Article 2(1)) and "define the scope, system, administration and computation of taxation of QFC Entities" as well as defining the powers of the Tax Department to "administer the QFC tax system, interpret the Regulations and collect tax" (Article 2(2)).

The Regulations are in 27 Parts.

1 – 1040 Tax Rules

The Rules, 15 in total, were made under the authority of Article 103 of the Regulations and "provide further detail in respect of the operation of the Tax Regulations" (TAX 1.2). They supplement the Regulations with regard to the operation of the tax system, providing detailed procedures for specific administrative features.

1 – 1060 QFC Tax Regime - Guidance Material

The main sources of guidance for the QFC tax system are the Regulations, the Rules and this Tax Manual. It should be remembered the manual is guidance material only and is not binding on the Tax Department or taxpayers, although the Tax Department may be expected to follow its own guidance.

1 – 1080 Taxpayers' Charter

The Taxpayers' Charter sets out taxpayers' rights and obligations and outlines the Tax Department's service standards. The Charter also gives guidance on how a taxpayer may make a complaint if dissatisfied with the way they have been treated by the Tax Department. The Taxpayers Charter can be found on the QFCA website.

1 – 1100 Practice Notes

The Tax Department may, under Article 94, issue practice notes setting out their interpretation of any aspect of the Regulations or Rules. Practice notes are binding on the Tax Department and made available to the public. They may also be found on our website.

1 – 1120 Rulings

The Tax Department may, under Article 93, give a written ruling to a QFC Entity setting out its position regarding the application of the Regulations and Rules with respect to an arrangement the QFC Entity proposes to enter into, or which it has already entered into. Such rulings are not published but are normally binding on the Tax Department. For further details on rulings see PART 18.

1 – 1140 Guide to Self-Assessment Return

The Tax Department has published a guide on completing a self-assessment return. This guide can be found on the QFCA website.

1 – 1160 QFC Tax Online

The Tax Department have specific tax pages on our website (www.qfc.qa). Posted on the tax pages of the website are copies to all tax related forms, copies of the tax Regulations and Rules, this manual, link to Qatar's DTA network and much more.

Online filing is dealt with separately at QTM19-2010.

1 – 1180 Complaints about the Tax Department

A QFC Entity or other customer may be unhappy with our service or the way they have been treated. Often a phone call will allow things to be put right quickly, but if not, the QFC Entity or other customer may wish to complain.

The Taxpayers Charter outlines how a complaint may be made.

If the complaint relates to a decision we have made, or failed to make, a QFC Entity may apply to the Regulatory Tribunal to have the decision reviewed.

1 – 1200 Appeals - Overview

The Regulations provide for a "dispute resolution process that is accessible, transparent and just" (Article 132). Most (but not all) of the decisions made by the Tax Department may be appealed.

Broadly, the first stage of the appeals procedure is an internal review. If the matter is not resolved by this review the appeal may be referred to the Qatar Financial Centre Regulatory Tribunal, and ultimately to the Qatar Financial Centre Civil and Commercial Court. The appellant may bypass the internal review and go directly to the QFC Regulatory Tribunal to ask for his appeal to be heard.

1 – 2000+ Interpretation

1 – 2000 Principles based Approach

When interpreting the Tax Regulations and Rules it is important that you bear in mind their design incorporates certain principles-based provisions. Any tax regime has to be 'rules-based' to a significant extent but significant principles-based elements have been incorporated in the QFC Tax regime.

The principles underlying the Tax Regulations are stated in the policy statements that are at the beginning of each Part of the QFC Tax Regulations (Parts 1, 17, 25, 26 and 27 excepted). The policy statements have been given the status of Articles, rather than merely headings, and so are integral parts of the tax law.

In addition to the policy statements, there are some specific instances where a principles based approach has been taken. For example, Article 46 allows the tax neutral treatment of reorganisations carried out for “bona fide commercial reasons” and the equalisation of the tax treatment of Islamic and conventional finance institutions and transactions (Part 11) also has a strong principles element.

Although there is no formal clearance mechanism, the ability to ask for a binding ruling (Part 18) should compensate for the lack of detailed rules in those complex situations where the lack of detailed rules may result in the tax treatment being unclear.

The Regulations do not contain a general anti-avoidance provision.

1 – 2020 General Interpretative Provisions

Article 152 sets out the interpretive rules for the Regulations and, by virtue of TAX 1.3, the Rules. Most of the interpretive provisions are self-explanatory and reflect the wording of the interpretation articles of other QFC Regulations.

You should note the following, in particular:

The Regulations and Rules are, per Article 152(3) “...to be interpreted in keeping with the spirit of the Regulations and with regard to the objective and purpose as well as the letter of the Regulations”.

It follows that you should not take a too literal approach to interpretation where the outcome does not favour the taxpayer and is in conflict with the intention stated in the relevant policy statement. Conversely, attempts to circumvent the intention of the Regulations by artificial schemes should be strongly resisted. The Rules are to be interpreted on the same basis as the Regulations (TAX 1.3).

The Regulations and Rules are to be interpreted as a whole when deriving the “object and purpose” of a particular provision (Article 152(4)). This means when seeking to discover the “object and purpose” of any provision you may look to any other part of the Regulations or Rules to cast light on the meaning of the provision being interpreted. Purposive interpretation is dealt with more fully below.

1 – 2040 Purposive Interpretation

The purposive approach to interpretation is explicitly set out in Article 152(3), which instructs you to interpret them in line with the spirit of the Regulations and the underlying purpose and objectives intended when drafted.

The first step when interpreting the regulations and rules should be to adopt the “Strictly literal approach”, which is to interpret the word of the QFC Tax Regulations and Rules as they are written, however you should also bear in mind the two following rules if this approach results in an outcome which is absurd or unfair.

1. The Golden Rule – if the literal approach results in an absurdity or inconsistency with the rest of the legislation then the grammatical and ordinary sense of the words may be modified so as to avoid that inconsistency, but no further.

2. The Mischief Rule – where words are ambiguous you should consider the mischief the legislations was enacted to remedy.

One difficulty in applying a purposive approach to the QFC tax regime lies in the lack of publicly available material available to establish the purpose of a particular provision. For example, there is no public record of parliamentary proceedings during which the provisions were debated. As the Tax Department drafted the legislation, all the policy papers from which purpose may be derived are within the custody of the Tax Department but are not in the public domain and as such taxpayers interpretation may differ from yours. However the policy statements that form part of the legislation will be a significant aid in determining purpose.

You should exercise great caution when proposing a purposive interpretation of the QFC tax law that results in a tax charge that could not be imposed under a literal interpretation. Generally speaking, ambiguities should be resolved in favour of the taxpayer.

1 – 2060 Other Interpretative Principles

When interpreting the Regulations and Rules, you should bear in mind the following principles of interpretation. It should be remembered statutory interpretation is a complex and evolving area, and the following does no more than touch on some of the principles (or canons) that are more commonly met when interpreting tax law.

- Regulations and Rules to be Read as a Whole

  The meaning of words can be understood from the words around them. This principle is sometimes described as "a word is known by the company it keeps." If a word is ambiguous its meaning may be derived from its use elsewhere in the Regulations and Rules.

- Words to be given their ordinary meaning

  Unless a word is defined in the Regulations (Article 153) or has an accepted meaning in tax law generally, is borrowed from other QFC legislation where it has an accepted meaning or has an accepted and specialised meaning at common law (i.e. is a term of art), then the word is to be given its ordinary meaning, derived from the dictionary.

- Ejusdem Generis

  The principle of Ejusdem Generis (of the same kind) may be stated as where general words follow an enumeration of persons or things, by words of a particular and specific meaning, such general words are not to be construed in their widest extent, but are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned. For example if a law referred to automobiles, trucks, tractors, motorcycles and other motor-powered vehicles, "vehicles" would not include airplanes, since the list is of land-based transportation. Generally it takes at least three words to form a genre or class.

1 – 2080 Use of Case Law

As the QFC tax law is relatively new there are, at the time of writing, no case law precedents. However the law has been modelled to a certain extent on existing legislation in other jurisdictions, such as the UK and Hong Kong. It follows that the case law from these (and other) jurisdictions may be useful with regard to the interpretation of the QFC Tax Law. Considerable caution is, however, required. Although the QFC tax law may bear similarities to the tax law in other jurisdictions it is not the same and, in any event, case law from abroad will only have persuasive value, at best, before the QFC appellate bodies.

There are similarities between the QFC and Qatar State tax regime. If a similar point or area has been decided by a decision in the State of Qatar Courts should be given a sympathetic hearing, although such decisions will, again, only have persuasive value, at best, before the QFC appellate bodies.

In time, as cases are taken before the QFC Regulatory Tribunal and QFC Civil and Commercial Court, the QFC tax regime will begin to build its own body of case law. An important point to remember when considering either case law from abroad or, in time, precedents from QFC tax cases is that the value of the cases is in establishing principles and not comparing fact with fact.

1 – 2100 Definitions

Article 153 provides statutory definitions for a number of words and phrases. Where a defined term is used in the Tax Rules, it has the same meaning as it has for the Regulations (TAX 1.4).

The meaning given by the defined terms only applies "where the context permits". However it is not anticipated the context of any of the defined terms will result in the meaning of the term in a particular Article having to be modified.

There is considerable overlap between the defined meaning for the purpose of the Tax Regulations and Rules and the meaning in the rest of the QFC legislation. You should not, however, assume the meanings are identical. For example, the term "QFC Entity" has a wider meaning for tax purposes than it does for the QFCA Rules (Article 3 of the QFCA Rules).

In addition to Article 153 various Articles contain their own definitions. For example Article 48(2) defines "arm's length conditions" in the context of transfer pricing and Article 57 defines "Control" for the purpose of the Regulations as a whole. The word will therefore have the meaning given to it by Article 57 in the definition of "connected person" in Article 153.

In this manual, unless specifically indicated or the context demands otherwise, the terms "profit" and "income" are regarded a synonymous.

PART 2(A) GENERAL SCHEME OF TAXATION, RESIDENCE AND THE CHARGE TO TAX

2 – 1000+ Corporation Tax

2 – 1000 General Scheme

Article 6 sets out the general scheme of taxation within the QFC. There is only one tax, corporation tax, which is levied on QFC Entities on their Local Source Profits (QTM2 – 5000). There is also only one category of Taxable Profits.

2 – 1020 Extent

All QFC Entities are within the charge to Corporation Tax. "QFC Entity" is defined broadly at Article 153 to embrace all Entities that have been granted, and continue to hold, a QFC Licence.

Corporation tax is a charge on profits (Article 9) and so is essentially a tax on the business profits earned by QFC licensed firms. Any Entity not holding a QFC Licence is not within the scope of the QFC tax regime and where A QFC Entity operates outside the terms of its QFC licence any profits (or losses) from such activity are not taxable (allowable) when calculating Taxable Profits of the QFC Entity. These profits and losses may instead be subject to the State tax regime.

The QFC Tax Regulations and Rules have been drafted to broadly follow accounting principles. The starting point for computing the tax liability is therefore the Accounting Profit (Article 15) see Part 3.

2 – 1040 Basis of Charge

The QFC tax system is source-based, that is tax is charged on a territorial basis. See QTM2 – 4000 below.

2 – 1060 Charge and the Rate

The charge is for an Accounting Period, at the standard rate, on every QFC Entity, in respect of the full amount of the Entities "Local Source Taxable Profits".

As the charge is on the "full amount" of profit, you should resist any argument income should be left out of Local Source Taxable Profits on the grounds of materiality, in an accounting sense.

The standard rate of tax is 10%. A concessionary zero rate may apply in respect of certain insurance activities (Part 13) and Qatari owned entities (Part 15), and certain bodies are, or may elect to be, tax exempt (Part 14).

2 – 1080 Local Source Taxable Profits

A QFC Entity arrives at its liability to tax by starting from its pre-tax accounting profit (Accounting Profit – Article 15, Part 3), making any specific tax adjustments in accordance with the Regulations (Chargeable Profits – Article 11, Part 4), eliminating any non-local source income and associated expenses (Article 20, QTM2 - 4000) to arrive at local source Chargeable Profits, and finally deducting any loss or group relief due to determine "Local Source Taxable Profits" to which the tax rate is applied.

2 – 1100 Example of Calculating Local Source Taxable Profits

A QFC Entity prepared its accounts for the year ended 31 December 2015 under IFRS. Profit per P&L – QR.1,500,000. The P&L also includes;

- General bad debt provision – QR.100,000
- Rental income from Dubai property – QR.300,000.
- Routine maintenance expenditure in respect of the Dubai property - QR.40,000
- Interest expense on Dubai property funding loan – QR.20,000

The QFC Entity also has unrelieved losses from the year ended 31 December 2014 of QR.30,000.

The computation will be as follows:

			QR
Accounting Profit (Article 15(1))			1,500,000
Adjustment under (Article 21(1))			100,000
			1,600,000
Exclude non-local source income (Article 20)		(300,000)	
Less expenses in earning non-local source income (Article 20)		60,000	
			(240,000)
Chargeable Profits (Article 11(1))			1,360,000
Less losses brought forward			(30,000)
Local Source taxable Profits (Article 11(2))			1,330,000
Corporation tax at 10%			133,000

2 – 1120 Currency of Tax Calculation

Taxable Profits and tax payable are to be calculated in Qatari Riyal (QR). The QFC Tax Return (Form QTD001) is to be completed in Qatari Riyals. However where accounts are prepared in another foreign currency the Chargeable Profit is to be calculated in the foreign currency and converted into Qatari Riyals. The same applies for tax losses.

Tax losses are to be computed in the same manner as chargeable profits (Article 12(5) & Article 27). It follows that any losses brought forward or group relief due to be deducted from chargeable profits in arriving at Taxable Profits will already have been converted into QR.

The basic rule (Article 12(2)) is that chargeable profits should be converted at the closing exchange rate on the last day of the accounting period during which the chargeable profits in question arose.

However, a QFC Entity may elect for the average rate over the accounting period in question to be used instead. The election is to be made in writing to the Tax Department within 6 months of the end of the accounting period in question (Article 12(4)). This is the only election in the Regulations where the Director of Tax is not permitted to extend the time limit (TAX13.4), so the time limit should be observed strictly.

Once an election to convert at the average rate has been made it applies to all future accounting periods (Article 12(4)). Upon acceptance we will is accepted you should write to the taxpayer confirming the election has been accepted and reminding him it applies for all subsequent accounting periods. If, in response, the taxpayer says he/she did not appreciate the permanence of the election then you may allow him to withdraw the election provided that the request to do so is made promptly (within 14 days) after the letter accepting the election is sent.

Later requests to withdraw an election should be refused. There is no statutory right to withdraw an election and consequently no right of appeal. A copy of all elections, and withdrawals, should be maintained in an establishment file maintained for the purpose.

The regulations are silent about which rate is to be used or the source of data. It is recommended to use the Financial Times website www.oanda.com. An enquiry should not be opened to challenge small differences between rates used by a taxpayer and published rates.

2 – 2000+ Residence

2 – 2000 Significance in a Territorial Tax Regime

Because the QFC tax system is territorial, or source-based the question of the residence status of a QFC Entity is far less significant than would be the case if the regime were residence, or worldwide, based. The charge to QFC tax depends mainly on the location of the source of profits, independent of the residence of the Entity.

The significance of residence is not, however, entirely absent from the QFC tax regime. By virtue of Article 13 a non-resident QFC Entity is chargeable (via Articles 9,10 and 11) only in respect of local source profits attributable to a permanent establishment (PE) of the Entity, in Qatar. There are two consequences.

1. Unless a non-resident QFC Entity is operating in Qatar through a PE, there is no charge to tax (see QTM2-3020).
2. Where there is a PE in Qatar, the charge to tax is based on the profits attributable to that PE, the basis of attribution being a "separate entity" approach (see QTM8-1000).

In addition to the slightly different treatment of resident and non-resident QFC Entities, retaining the concept of residence is consistent with Qatar's double tax agreements which are based on the OECD Model Tax Convention under which taxing rights are divided, in a number of instances, by reference to the residence of the taxpayer.

2 – 2020 Definition

Article 8 defines residence under two tests – (a) incorporation and (b) place of effective management. If a QFC Entity fulfils the conditions of either test it is resident in Qatar for QFC tax purposes.

The tests are related to "resident in Qatar" not "resident in the QFC." Although the QFC does have some characteristics of a "state within a state" the QFC is not separate from Qatar. In this context, Article 8 defines residence for the purpose of the QFC Tax Regulations only. Generally speaking for a firm to be resident for QFC tax purposes they have to be licensed by the QFC. If a non-resident entity is not licensed by the QFC but has its place of effective management in Qatar it will fall under the State tax system rather than the QFC.

The residence status of a taxpayer may also be determined by the terms of a double tax treaty (DTA) between Qatar and another country. Qatar's treaties are typically based on the OECD Model Tax Convention (MTC) and the residence Article is likely to be similar to

Article 4 of the MTC, containing a primary rule based on being liable to tax in one of the contracting States "by reason of … domicile, residence, place of management or any other criterion of a similar nature…" supplemented by a tie-breaker for dual resident persons other than individuals based on the place of effective management. The treaty tie breaker is likely to be relevant where a QFC Entity is resident in another country by reason of being incorporated in that country but is, for QFC tax purpose, resident in Qatar because its place of effective management is here. See Part 6 for more on STAs and residence.

2 – 2040 Incorporation Test

This test is straightforward. If a QFC Entity has been incorporated under the QFC Company, Limited Liability Partnership or Partnership Regulations, it is resident in Qatar for QFC tax purposes. It should be noted that companies that are within the QFC Special Company Regulations (Special Purpose Companies and Holding Companies) are incorporated under the QFC Company Regulations.

- ***Companies***

  A non-QFC company may apply under Article 110 of the Companies Regulations 2005 for its incorporation to be transferred from another jurisdiction to the QFC. The company will become resident from the date of continuation shown on the continuation certificate.

  A QFC company may apply to have its incorporation transferred to another jurisdiction under Article 115 of the Companies Regulations 2005. If the foreign jurisdiction accepts the transfer, the company is struck-off when the Companies Register Office receives the certificate or instrument of transfer from the foreign jurisdiction. The company is treated as non-resident from the date of striking-off (Article 8(1)).

  The date of transfer of incorporation (inwards or outwards) will most likely coincide with the QFC Entity beginning or ceasing to be tax resident in Qatar for QFC tax purposes, but not necessarily so. If the place of effective management is in Qatar before the transfer in, or after the transfer out, it will be that test, rather than the incorporation test that will determine when the company begins or ceases to be tax resident. See below for a more detailed discussion of the "place of effective management" test. See also Part 3 QTM3-2140 for details of the QFC tax consequences of a QFC Entity ceasing to be resident in Qatar (deemed disposals –Article 18).

- ***Limited Liability Partnerships***

  A Limited Liability Partnership (LLP) incorporated in the QFC under Article 9(1) of the Limited Liability Partnership Regulations 2005 will fulfil the incorporation test of Article 8(1)(a) from the date of incorporation.

- ***Limited Partnerships***

  A Limited Partnership incorporated in the QFC under Article 46 of the Partnership Regulations 2007 will fulfil the incorporation test of Article 8(1)(a) from the date of incorporation.

2 – 2060 Place of Effective Management Test – OECD Guidance

A QFC Entity is, by virtue of Article 8(1)(b), to be regarded as resident in Qatar if its place of effective management is in Qatar.

The term "place of effective management" is used in paragraph 3 of Article 4 of the OECD Model Tax Convention in determining the residence of an otherwise dual resident non-individual person (tie-breaker).

Paragraph 24 of the 2010 Commentary on the Model Tax Convention suggests the "place of effective management" is "the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made." Further, the commentary indicates that "All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

2 – 2080 Place of Effective Management Test – Other Guidance

The following, taken from the South African Revenue Service guidance, is a useful outline of the factors to be considered in determining the place of effective management-

"The concept of effective management is not the same as shareholder-control or control by the board of directors. Management focuses on the company's purpose and business and not on the shareholder function. In order to determine the meaning of "place of effective management", one should keep in mind that it is possible to distinguish between-

- *the place where central management and control is carried out by a board of directors;*

- *the place where executive directors or senior management execute and implement the policy and strategic decisions made by the board of directors and make and* *implement day-to-day/regular/operational management and business activities; and*

- *the place where the day-to-day business activities are carried out/conducted.*

The place of effective management is the place where the company is managed on a regular or day-to-day basis by the directors or senior managers of the company, irrespective of where the overriding control is exercised, or where the board of directors meets. Management by these directors or senior managers refers to the execution and implementation of policy and strategy decisions made by the board of directors. It can also be referred to as the place of implementation of the entity's overall group vision and objectives. Management structures, reporting lines and responsibilities vary from entity to entity, depending on the requirements of the entity, and no hard and fast rules exist. It is therefore not possible to lay down absolute guidelines in this regard.

If these management functions are executed at a single location, that location will be the place of effective management. This location might or might not correspond with the place from where the day-to-day business operations/activities are actually conducted from/carried out. If these management functions are not executed at a single location due to the fact that directors or senior managers manage via distance communication (e.g. telephone, internet, videoconferencing, etc.) the view is held that the place of effective management would best be reflected where the day-to-day operational management and commercial decisions taken by the senior managers are actually implemented, in other words, the place where the business operations/activities are actually carried out or conducted. If the nature of the entity is such that the business operations/activities are conducted from various locations, one needs to determine the place with the strongest economic nexus.

No definitive rule can be laid down in determining the place of effective management and all the relevant facts and circumstances such as those listed below must be examined on a case-by-case analysis.

- *Where the centre of top level management is located;*
- *Location of and functions performed at the headquarters;*
- *Where the business operations are actually conducted;*
- *Where controlling shareholders make key management and commercial decisions in relation to the company;*

- *Legal factors such as the place of incorporation, formation or establishment, the location of the registered office and public officer:*
- *Where the directors or senior managers or the designated manager, who are responsible for the day-to-day management, reside;*
- *The frequency of the meetings of the entity's directors or senior managers and where they take place;*
- *The experience and skills of the directors, managers, trustees or designated managers who purport to manage the entity;*
- *The actual activities and physical location of senior employees;*
- *The scale of onshore as opposed to offshore operations;*
- *The nature of powers conferred upon representatives of the entity, the manner in which those powers are exercised by the representatives and the purpose of conferring the powers to the representatives.*

The above list is not intended to be exhaustive or specific but serves merely as a guideline."

Further useful guidance is contained in the judgment in the UK Special Commissioners case of *Trevor Smallwood Trust v Revenue & Customs* [2008] UKSPC SPC00669.

When reviewing the residence status of a QFC Entity you should base your decision on a careful assessment of all relevant facts.

2 – 3000+ Taxation of Non-Residents

2 – 3000 The Basic Rule

The basic position is that for a non-resident QFC Entity, to be within the charge to tax it must operate through a permanent establishment (PE) in Qatar.

There is a parallel between Article 13(1) and Qatar's double tax treaties which are based on the OECD Model Tax Convention. Articles 7.1 and 7.2 of the OECD Model Convention say –

> *(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 on 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 purposes of this Article and Article [23 A] [23B], 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 engaged in the same or similar activities under the same or similar 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.*

You should remember that the exclusion of non-local source income and associated expenses (Article 20) applies equally to resident and non-resident QFC Entities. There is unlikely to be much, if any, difference between the profits attributable to a PE and the "local source" profits of that enterprise arrived at under general principles. However, the specific rules of Article 10(3) apply so that, for example, income from immovable property located outside Qatar will not be taxable.

2 – 3020 Permanent Establishment – Fixed Place of Business

Permanent Establishment (PE) is defined in Article 153 to have the same meaning as Article 5 of the OECD model tax convention (MTC) or any subsequent OECD meaning.

Under Article 5 of the OECD MTC, the basic definition in Article 5(1) being "...a fixed place of business through which the business of an enterprise is wholly or partly carried on."

For QFC tax purposes determining whether there is a PE should be straightforward. To obtain a QFC Licence an applicant has to demonstrate, inter alia, it will have a real business presence in Qatar e.g. QFC office, personnel etc. Any non-resident firms who do not have a QFC registered entity and operate in Qatar will fall under the State of Qatar tax regime and not the QFC.

If ever a QFC entity were to argue that their presence (normally a branch) does not constitute a PE further useful guidance may be found in the UK's HMRC International Manual. However, the OECD guidance and the UK material has no binding authority in Qatar and the material should be used to assist in your understanding of the principles behind the concept of a PE rather than directly quoted as binding authority in correspondence with taxpayers.

2 – 3040 Permanent Establishment – Agency

In addition to the OECD "fixed place of business" definition of a PE Article 5(5) deems a dependent agent to be a PE, in the following terms

> *"...where a person - other than an agent of an independent status... - is acting 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..."*

The difficulty in relation to the QFC tax regime is that where a dependent agent PE (which is itself a QFC Entity) exists, it is nevertheless the profits of the non-resident enterprise that are sought to be taxed through the PE (it is a PE of the non-resident entity, not of the agent). As the non-resident enterprise will normally not itself be a QFC Entity, we are unable to impose any charge on such a dependent agent PE.

There is a theoretical possibility that a non-resident enterprise that has a QFC Entity branch (a "fixed place of business PE") may appoint another QFC Entity in a dependent agent capacity. If the activities undertaken by the dependent agent are within the terms of the branch's QFC Licence, there may be a case for attributing such profits to the branch. If the business conducted by the dependent agent are outside those permitted under the branch's licence, there is no taxable position on the branch, in respect of any profits arising from such activities as, by virtue of Article 11(2), only profits arising from licensed activities are within the charge. In such cases the obligation of the QFC Tax Department will be to notify the Public Revenue & Taxes Department so they may review the circumstances and tax according to their own tax regulations.

2 – 3060 Permanent Establishment – Representative Office

If a dispute arises about the existence of a PE, this is likely to be on the grounds the activities are of a preparatory or auxiliary nature and although there is a fixed place of business in the QFC, the non-resident QFC Entity should not be regarded as having a PE in Qatar. Such arguments will probably be based on the OECD Model Convention definition of a PE, which specifically excludes, at Article 5(4)(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.”

A genuine rep office of, for example, a bank, would fall within this definition. However, it should be noted that the QFC Authority does not grant licences for ‘rep offices’ and therefore we will not accept that the operations of the QFC Entity in question are genuinely those of a rep office. It is our view that a QFC entity will be more than a rep office and its operations will therefore constitute a PE in Qatar. Where the operations of a QFC entity are very similar to a rep office the entity may wish to consider making an apportionment of profits to the QFC entity on a cost-plus basis (see Part 8 – Transfer Pricing)

2 – 3080 Permanent Establishment – The Law

Under Article 13(2) the Chargeable Profits to be attributed to a Permanent Establishment (PE) are-

> *“…the same as the Chargeable Profits it would have made if it were a distinct and separate entity, engaged in the same or similar activities under the same or similar conditions, dealing wholly independently with the enterprise of which it is a PE”*

Article 13(2) is worded in similar terms to Articles 7.1 and 7.2 of the OECD Model Tax Convention.

By virtue of Article 13(3) in attributing profits under Article 13(2) the PE is assumed to have the same credit rating as the enterprise of which it is a PE and, by virtue of Article 13(4), there shall be attributed to the PE such equity and loan capital as seems to the Tax Department to be just and reasonable (see Part 8 – Transfer Pricing). Article 13(5) then allows a deduction for interest on debt utilised by the PE relating to the activities carried on by the PE in Qatar.

2 – 3100 Recognition of Income

Various difficulties relating to the income to be recognised by a non-resident (generally a branch operation) are covered in detail at Part 9 - Partnerships.

The OECD Report on attribution of profits to permanent establishments can also be used as guidance when seeking to recognise income of a non-resident. This is dealt with in more detail in Part 8 – Transfer Pricing.

PART 2 (B) THE TERRITORIAL BASIS OF TAXATION

2 – 4000+ The Territorial Basis of Taxation - General

2 – 4000 Source and Residence Principles an Introduction

Two mainstream approaches have developed with regard to international taxation;

1. Worldwide (or residence based) - where jurisdictions tax residents on their income no matter where it arises, and

2. Territorial (or source based) - where jurisdictions tax only income which has its source within the territory.

On the international level, double tax Agreements (DTAs) seek to remove remaining potential conflicts and eliminate double taxation.

No jurisdiction applies a completely pure worldwide or a pure territorial basis. The scope of the charge to tax is restricted or extended to a greater or lesser extent. Worldwide systems generally tax non-residents on income sourced within their jurisdictions and countries with a source system tend to gradually extend the scope of their taxes by deeming certain types of income, especially passive income, to be sourced within their jurisdiction. In practice, then, the two systems tend to converge.

2 – 4020 The Extent of Territorial Jurisdictions

This section attempts to outline the main countries that have adopted a territorial basis in relation to corporate taxation. France is notable as the only OECD country adopting the territorial basis.

Historically, UK colonies had territorial systems, but they tended to move away from this basis after independence. For example, New Zealand and Australia both, historically, adopted a territorial basis but since independence have switched to a worldwide basis. The case precedence legacy in these jurisdictions is still of significance for territorial jurisdictions, such as Qatar.

In the Middle East, Jordan, Kuwait, Lebanon, Oman, Palestine, Qatar and Syria have adopted a territorial basis. The other GCC Countries (Bahrain, Saudi Arabia and the UAE) have limited tax regimes.

The Asian group of Hong Kong, Malaysia and Singapore are of interest because of their flourishing financial sectors. Of these countries Hong Kong's system is the purest. Malaysia taxes banks, insurance companies, shipping and air transport companies on a worldwide basis and Singapore taxes local source income plus, in the case of resident companies, foreign income remitted to Singapore. Such an extended territorial principle (local source plus remittances in the case of resident companies) may also be found in, for example, Ghana and Gibraltar. Other jurisdictions, such as Zambia, have local source income as the basic rule but also tax resident companies on profits carried on partly inside, and partly outside, Zambia.

The tax havens countries of Costa Rica, Panama and the Seychelles also have territorial systems.

2 – 4040 QFC Tax Regime

The QFC tax regime is territorial with a couple of categories of profit deemed to be local source and a very small number of categories of income deemed to not be local source.

An early report, commissioned to set the policy parameters of the QFC tax regime states, in the executive summary (2.1), *"The regime should be broadly territorial in scope, so non-local source income should in most cases not be subject to tax in the QFC."*

This approach was justified in the following terms (2005 report 3.4.6).

"As the existing Qatar Income Tax Law is broadly territorial in scope, the QFC should take the same approach, as to do otherwise would potentially have an adverse effect on the application of Qatar's existing double tax treaties in the Centre and the negotiation of future treaty benefits. Another factor supporting this view is that as the rate applicable in the QFC will be relatively low by international standards, the scope for the Centre to collect additional tax by taxing worldwide profits will be extremely limited. In most cases the foreign tax on such profits will be more than the QFC tax liability, so with credit relief the QFC will not collect incremental tax on such profits. In addition, on a practical note, a territorial basis of taxation should limit the need for complicated double taxation relief provisions to prevent the taxation of profits in more than one jurisdiction."

The report also recommended a minor extension of the territorial system –suggesting that non-local source interest income be taxed where the cash put on deposit was generated by activities carried out within the QFC. A distinction was made between "active" and "passive" interest income. Active income, such as that generated by a bank in the ordinary course of its business, would be subject to the normal source rules but there was a perceived risk that a QFC Entity could simply invest surplus funds, generated from QFC activities, out of Qatar and thereby avoid QFC tax on the interest. Such interest income would, it was argued, not be local source as the location of the bank where the funds are deposited will determine the source of the interest.

The recommendation that the tax base include some offshore “passive” interest was also partly to ensure that the treaty definition residence would not exclude QFC resident enterprises. The State Tax Law No. 21 of 2009 is similarly structured.

Article 2 States that *“an annual tax shall be imposed on the taxpayer’s taxable income derived from sources in the State during the previous taxable year.*

Notwithstanding the provisions of the previous paragraph, the tax shall be imposed on bank interest and returns realised outside the State provided that they are derived from amounts resulting from the activity of the taxpayer in the State…”

The above is useful when looking at the interpretation of the QFC Tax Regulations.

2 – 4060 Application of Double Tax Treaties

Qatar’s tax treaties are based on the OECD model tax convention. The convention applies to *“persons who are residents of one or both of the contracting states”* (Article 1 of the OECD model). Dual residence will be unusual, therefore in the main, treaty benefits will only be available to QFC Entities resident in Qatar.

2 – 4080 QFC Charging Provision

Article 10 of the Regulations is the relevant provision for charging tax on local source income. Article 10(1) states *“Taxable Profits are Local Source if they arise in or are derived from Qatar.”*

Article 10 (1A) deems profits which are derived from the provision of services for use outside Qatar to be non-Local Source taxable Profits if the conditions in Tax Rule 1A are met.

Article 10(2) lists specific inclusions which are deemed to be local source income and Article 10(3) lists specific exclusions from local source income. These are outlined below.

2 – 4100 Specific Exclusions from Local Source Income

2 – 4120 Immovable Property

The term “Immovable property” is not defined in the Tax Regulations. Immovable property is essentially land and all the permanent buildings and natural resources on or in it.

The OECD model tax convention which, at Article 6.1 gives taxing rights in respect of income from immovable property to the Contracting State where the property is situated. The commentary on Article 6 explains the taxing rights are attributed in this manner *“due to the fact that there is always a very close economic connection between the source of this income and the State of source.”*

Article 10(3)(a) of the Regulations follows the OECD model and excludes income from immovable property located outside of Qatar.

It is difficult to think of income from immoveable property outside Qatar that would, apart from Article 10(3)(a), be taxable as income, or profits, arising in or derived from Qatar. In most cases the location of the source of income from immovable property is likely to be obvious.

2 – 4140 Intangible Fixed Assets

The QFC previously restricted taxing rights with regard to profits from IP in that any such profits would only be local source if the IP was registered in Qatar. However there were a number of complications with defining what 'registered in Qatar' meant. The old Article 10(3)(b) was removed when the QFC tax regulations were updated in 2014.

Income from IFAs received after 18 June 2014 will be taxed in accordance with the updated regulations, and based upon core tax principles.

When determining whether income from Intellectual Property is local source (derived from Qatar) or non-local source (derived from outside Qatar), you should look at the whole picture. Consider who owns the IP rights, who the beneficial owner is. Royalties generally arise from a licence granting the right to use IP, therefore if the use of the asset takes place outside of Qatar royalty income associated with the use this will normally be non-local source income, likewise if the execution of the right to use takes place in Qatar the income will be local source. In practice this means that most overseas income earned by QFC licenced IP holding companies will be treated as non-local source income, however each case should be considered independently and all contracts relating to the IP and right to use scrutinised fully.

Article 12 of the OECD Model Tax Convention can be used for guidance. The main rule of Article 12 is that the taxing right in respect of royalties lies with the State where the Beneficial Owner resides. At Article 12.3 there is an exception to this basic rule, which states that where the Beneficial Owner has a PE in another State and the right or property to which the royalty (IP) income relates is connected with that PE then the taxing rights will be the location where the PE is situated.

2 – 4160 Permanent Establishments

Article 10(3)(b) of the Regulations excludes profits derived from a PE of a QFC Entity which is located outside of Qatar.

In practice the restriction of local source profits under Article 10(3)(b) may not be of great significance as the income from the overseas branch, constituting a PE (and not a mere representative office), of a QFC Entity incorporated in Qatar, will be unlikely to be “local source” under general principles.

An interesting position may arise if a QFC Entity operates a PE branch outside the QFC but within Qatar. Article 10(3)(b) will not apply as the PE is not outside Qatar. Such activity is highly unlikely, due to the QFC licensing rules but in the event of a QFC Entity operating through a PE branch in Qatar but outside the QFC, (probably thereby operating outside the terms of its QFC Licence), taxing rights in respect of the PE would lie with the State Tax Department.

2 – 5000+ The Territorial Basis of Taxation - Arising in or Derived from Qatar

2 – 5000 Principles

Hong Kong is a particularly useful tax jurisdiction to refer to when looking for guidance on the meaning of locality of source.

Hong Kong has a wealth of detailed guidance on the meaning of locality of source, including material from the Hong Kong Inland Revenue Department (IRD), a substantial body of case law, some of which dates back to the colonial era, plus useful commentary by both tax practitioners and academics.

Hong Kong is a thriving international financial centre, so the issues relating to locality of source that have arisen in the territory are of direct relevance to the QFC.

It should, however, be remembered that although the guidance may be useful, and the case law relevant to the QFC tax regime, the interpretive principles that have evolved in Hong Kong do not have binding precedent value in Qatar.

2 – 5020 The Imperial Source Cases

A study of the Hong Kong cases leads to a further useful body of case law. Historically a number of former UK colonies, including Australia, New Zealand, South Africa, Canada and India had a territorial basis of taxation. Some of the old case law decisions from these jurisdictions are still relevant today. In particular, there is a series of decisions by the UK Privy Council on the question of locality of source. In this guidance the old colonial cases are referred to as the "Imperial cases" and summaries of these cases can be found at Appendix 2.

2 – 5040 No Simple Rule of Law

The source of profit is a hard, practical matter of fact. Lord Bridge in *CIR v Hang Seng Bank Ltd* [1991] 1AC306 put it this way – "… the question of whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined."

As the question of source is a "question of fact" the courts will only overturn the decision of the fact finding tribunal if it finds there was no evidence on which it came to its conclusion, or the decision is perverse. The courts will not overturn the decision if they find the fact finding tribunal could reasonably have come to the decision they did, based on the evidence before them, even though the court hearing the case de novo may have come to a different conclusion.

It is expected, in relation to QFC tax appeals, that the appellate body (The QFC Civil and Commercial Court) will follow the same principles when considering a finding of the Regulatory Tribunal, the Court of first instance for QFC tax appeals.

2 – 5060 The Operations Test

Lord Bridge in the *Hang Seng* case observed "The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profits in question." This principle was applied and expanded by Lord Jauncey in the case of *CIR v HK-TVB International Ltd* [1992] 2AC397 where he said "…Lord Bridge's guiding principle could properly be expanded to read "one looks to see what the taxpayer has done and where he has done it'" and described the proper approach "…is to ascertain what were the operations which produced the relevant profits and where those operations took place".

2 – 5080 No Difference between "Arising In" and "Derived From"

The Privy Council held in *Hang Seng* that there is little, if any, difference between the terms "arising in" and "derived from". They may be regarded as synonymous.

2 – 5100 Only the Operations Directly Producing the Profit in Question are Relevant

The QFC approach in determining the source of profits will follow the *ING Barings Case*e meaning that enquiries should be directed towards the nature of the individual transactions producing the profits, and where they took place, rather than arguing profits are local source because the "heart and brains" of the business are in Qatar, based on a totality of facts argument.

2 – 5120 Agency Rule

A person will be seen as an agent for tax purposes as long as the transaction is carried out on a taxpayer's behalf and for the taxpayer's account on his instructions. It does not matter whether the taxpayer is acting on its own account with a view to profit or for the account of a client in return for a commission.

2 – 5140 Apportionment

In the 1929 Australian case of *The Commissioner of Taxation of Western Australia v D & W Murray Ltd* [1929] 42CLR332, the taxpayer purchased goods in the UK and sold them in Western Australia. The High Court considered an earlier case of *Commissioners of Taxes v Kirk* [1900] AC588 and determined in Murray that the law only required apportionment where value had been added in one jurisdiction and goods sold in another and the value added was the basis on which the apportionment was to be calculated. In

Murray the court decided no apportionment was required as no value had been added in the UK, the goods were merely acquired there.

The QFC will follow the value added approach to calculate any apportionment. This methodology is inherently sound in principle and readily capable of incorporating the techniques for resolving transfer pricing disputes. Subject to any strong evidence to the contrary, you should take this approach which it is considered apportionment is appropriate.

Where activities giving rise to a profit are carried on partly within and partly outside Qatar but the profit is inseparable, and apportionment therefore not appropriate/not possible, the locality will be determined by the acts more immediately responsible for the profit. This follows the principles set down in the cases of *Bank of India v CIR* [1988] 2HKTC503 and the Australian case *COT (NSW) v Hillsdon Watts ltd* [1936] 57CLR36.

2 – 5160 Where Decisions are made is Irrelevant

The place where day to day investment decisions are taken does not generally determine the locality of profits. It is a factor to be taken into account, but generally not the deciding factor.

2 – 6000+ The Territorial Basis of Taxation - Specific Types of Income

2 – 6000 Trading Income

The Imperial cases established the principle that, generally, a profit made by buying and selling goods is usually derived from the place where the goods are sold. A more expansive interpretation of "arising in or derived from" would lead to the position that the profits of a business carried on in the QFC are generally derived from Qatar, unless properly attributable to a permanent establishment (PE) outside Qatar. *HK-TVB* introduced the doctrine that it will only be in "rare cases" a firm carrying on business in Hong Kong can derive profits from outside Hong Kong. The operations test (QTM2 - 5060) establishes that the determining factor is the place where the contracts for purchase and sale are effected. "Effected" does not mean legally executed (booked) but contemplates the actual steps leading to the existence of the contracts including the negotiations and, in substance, conclusion and execution of the contracts. The old Australian and New Zealand cases show that at least a part of, if not the whole, of a profit made by buying and selling goods is derived from the place where the goods are sold. Although it is unlikely, in a QFC context, that a QFC Entity will derive profits from the sale of goods the view should be taken that the operations test is applicable to determine where contracts for purchase and sale are effected and if the place of sale is outside of Qatar, then apportionment may be appropriate.

2 – 6020 Income From Property

Both rental income and gains from the sale of property have their source where the property is located. In the QFC tax regime this approach is given statutory support by Article 10(2)(a) which says profits derived from immovable property located outside Qatar are not local source profits.

2 – 6040 Purchase and Sale of Listed Shares

The source of profits is the stock exchange where the shares in question are traded. This follows from the operations test, the transaction giving rise to the profit is the transaction of purchase and sale itself, any other activities are incidental or ancillary (see the *ING Barings* decision see Appendix 2).

2 – 6060 Purchase and Sale of Unlisted Securities

As for trading profits, the source of profits will be located where the contracts of purchase and sale are effected, "effected" having the wider meaning outlined at QTM2 – 6000 above.

2 – 6080 Service Fee Income

The source of profits is the place where the services giving rise to the fees are performed. In the case of an investment adviser, where the adviser's organisation and operations are located only in the QFC, profits derived from the management of clients funds are considered to have a Qatari source. This will include management and performance fees, rebates, commissions and discounts received from brokers in respect of securities transactions executed within Qatar on behalf of clients, (subject to effect of Article 82(9). However, following the *ING Barings* decision, where the source of rebates or commissions is the trading of securities on an exchange outside Qatar, such income may well, on the proper application of the "operations test" (QTM2-5060) not be local source. The crucial thing to remember here is that it is the operations that directly give rise to the profits in question that must be examined, and not secondary or ancillary operations. A "totality of facts" approach that seeks to attribute source to where the "heart and brains" of the business are located should not be adopted, but the immediate source of individual transactions examined instead.

Generally speaking where a QFC Entity with a principal place of business in Qatar earns fees or commissions from Qatari customers they will be liable to QFC tax. When the customer is outside of Qatar the place where the services giving rise to the fees, commissions etc. are performed will determine the source and apportionment may be appropriate.

Where the client is outside Qatar, the services giving rise to consultancy and advisory fees may be performed wholly or partly outside Qatar. The extent to which we consider that the fees 'arise in or are derived from' Qatar, and are thus taxable, will depend on the facts. If the QFC Entity is a branch, we will follow the guidance regarding attribution of profit to a permanent establishment at QTM2-3000+. Broadly this will involve identifying the key entrepreneurial risk taking and key people factors and attributing profit to the QFC permanent establishment accordingly. Where the QFC Entity is part of a group, the transfer pricing provisions of Part 8 of the Regulations may be relevant and it may be appropriate to arrive at the arm's length profit of the QFC Entity.

A QFC Entity may generate service income from, for example, accountancy, legal and recruitment services. Where the services are performed only in Qatar then we will regard all profits as arising in Qatar, even if some of the Entity's clients are off-shore unless Article 10 (1A) applies [see QTM2-8000].

Where a QFC Entity performs services partly in Qatar and partly abroad, an apportionment of profits may be necessary. We will take a common sense approach to such apportionments. For example, where a law firm acts for a client in Qatar but makes a single trip to Dubai for, say, a court hearing the profit arising from the services performed for that client will be regarded as having a Qatari source. If, however, a law firm has off-shore clients and spends a considerable amount of time out of Qatar performing services for such clients, part of the profit will not be local source and an apportionment, based on the facts, will be appropriate. In practice we will normally take the view that if the activities outside of Qatar are not sufficient to create a permanent establishment in the other State, all the income will have a Qatari source except where the deeming provision in Article 10 (1A) applies.

2 – 6100 Group Service Companies

A QFC Entity may render support services such as marketing and training to group companies located, say, throughout the Middle East region. Typically the services will be rendered substantially in Qatar and inter-group charges made on a cost plus basis. Such profits are regarded as arising wholly in Qatar although the deeming provision in Article 10 (1A) may apply to all or part of the QFC Entity's profits excluding them thereby from local source profits.

2 – 6120 Interest

Interest is a special class of income to which the general rules regarding source of profits cannot always be easily applied. For this reason, specific provisions have been incorporated into the QFC Tax Regulations to deal with the issue.

The specific provisions enacted recognise that interest received may be either 'passive' or 'active'. Passive interest is generally accepted as arising from the simple lending of money, for example, making a bank deposit. Active interest, on the other hand, refers to the receipt of interest income as an integral part of a business activity, for example interest received by a bank from loans to customers. The difference between the activities involved in earning passive and active interest means that different rules are generally applied in ascertaining the source of the respective categories of interest and the rules developed by the courts have been considered when formulating the statutory provisions incorporated into the Regulations.

For simplicity, the Tax Regulations distinguish between passive and active interest on the basis of the nature of the lender. In particular, passive interest income is defined to be interest income derived by a person other than a Financial Institution (Article 153). A 'financial institution' is also defined extensively in Article 153 and essentially means a person who carries on, in any jurisdiction, the business of banking, deposit-taking, provision of credit facilities, factoring of debts, trading or dealing in investments either as principal or an agent, insurance, reinsurance, asset management or any similar business or combination of businesses. It is appreciated that this definition will encompass taxpayers who might not otherwise consider themselves to be a 'financial institution'; nonetheless, the purpose of the definition is not to provide a common meaning of the term but to specify the types of businesses whose lending and depositing activities are likely to be undertaken as part of an active investment or financial business.

Notwithstanding the foregoing, it is important to note that "active interest income" is not a defined term and, in fact, is not used in the Regulations. Nonetheless, active interest income is effectively interest income which is not passive (which, therefore, means interest income derived by a financial institution) and this is subject to different rules for determining its source.

2 – 6140 Interest (Non -Financial Institutions)

The courts have not generally provided clear guidance as to defining the source of interest income. For example, the *Westminster Bank* case suggests a number of factors are relevant in determining the source of interest income, the most important of which are the residence of the debtor and the location of his assets. In this context 'residence of the debtor' is not a reference to tax residence but to jurisdiction for recovery.

Other factors include:

- The funds from which the interest is paid; Where the interest is paid;
- The place of performance of the contract and the method of payment;
- The competent jurisdiction for legal action and the proper law of contract; and
- The residence of any guarantor and the location of the security for the debt.

Similarly imprecise guidelines have been developed by courts in other jurisdictions; perhaps the most that can be said is that an analysis of all of the facts and circumstances of each particular case is required in order to determine the source of any particular item of interest income.

In order to avoid the inevitable uncertainty which arises from trying to apply the general guidelines arising from case law, the Regulations provide objective guidelines for determining the source of Passive Interest Income (i.e. interest income derived by a person other than a financial institution (as defined)). These provisions essentially determine the source of the passive interest income on the basis of (a) where the borrower is resident, or if (b) the borrowing was undertaken through a permanent establishment (PE) outside the jurisdiction of residence, the location of that PE.

More specifically, Article 10(2)(a) deems Passive Interest Income to be Local Source Taxable Profits. The purpose of this provision is to avoid any suggestion that such interest income should not be taxable on the grounds that it does not arise from the QFC Entity's business operations.

Article 10(3)(c), on the other hand, excludes Passive Interest Income from the charge to tax where the borrower (i.e. the person paying the interest) is not resident in Qatar, unless the borrowing is substantially undertaken through a PE of the borrower in Qatar, or the borrower is a Qatar resident but the borrowing is substantially undertaken through a PE of the borrower outside Qatar.

Key to applying these provisions will be ascertaining where the borrowing is substantially undertaken by the borrower. In our view, this is a question of the location of staff that evaluates the options and in substance makes the decisions regarding the borrowing, who are responsible for monitoring and effecting payments of principal and interest and who are responsible for liaising with the lender. As each business operates differently, there may be situations where other factors also need to be considered.

It is possible, but we believe it will be rare in practice, that the various activities referred to above are undertaken in two or more countries. However, in such circumstances, we will make a judgement as to which location is more immediately linked to the undertaking of the borrowing. In other words, we do not envisage that Passive Interest Income will need to be apportioned between two or more jurisdictions.

Each case will, of course, need to be considered against its own facts and circumstances. Where, however, a QFC Entity asserts that a loan to a Qatar resident was substantially undertaken by a non-Qatar PE of that borrower, we would expect sound documentation to be provided in support of the claim.

2 – 6160 Interest (Financial Institutions) & Examples

A Financial Institution is defined in Article 153. The definition is deliberately broader than the common usage of the term. This is because the term is aimed at identifying those types of businesses which are more likely to derive active interest income. The definition excludes, for any particular accounting period, a person whose activities, during that accounting period, are wholly within those permitted by a QFC Category 4 licence. These activities are arranging credit facilities or investment deals, investment advice, the provision of custody services and administering a collective investment fund. Therefore a QFC Entity whose activities, during an accounting period, are essentially advisory or arranging, but not providing, finance, is not within the definition of a 'financial institution' and the special rules described in this section do not apply for that accounting period. The rules for determining the source of interest received by such a QFC Entity for the relevant accounting period are therefore the 'passive interest' rules described above.

Financial Institutions are subject to special provisions because they typically derive active interest income. Case law in Hong Kong favours the view that in determining the source of active interest income an operations type test is appropriate; in other words, in determining the source of such income it is appropriate to look to the activities which are most directly responsible for the generation of that income and where those activities took place. Again, however, in an attempt to bring a higher level of certainty to taxpayers in the QFC, the Regulations incorporate some statutory rules for determining the source of interest income of a Financial Institution.

In particular, Article 10(2)(b) specifies the circumstances in which interest income received by or accrued to a Financial Institution is deemed taxable. The provision requires an analysis of where the loan was initiated by the financial Institution and where the risk of default is borne. Where the loan is both initiated in Qatar and the risk borne in Qatar, the interest will be deemed to be Local Source Taxable Profits. Conversely, if the loan initiation takes place outside Qatar and the risk is borne outside Qatar, the interest will not be deemed to be Local Source taxable Profits and will, therefore, not be taxable. The proviso to Article 10(2)(b) specifies that if the loan is initiated in Qatar but the risk borne elsewhere, or vice versa, only 50% of the relevant amounts will be deemed to be Local Source Taxable Profits.

For the purpose of interpreting Article 10(2)(b), "initiation" is taken as meaning the steps taken by or on behalf of the Financial Institution in bringing the loan into existence. Exactly what is involved with initiation will vary between institutions, but will typically involve marketing to potential clients, negotiating contractual terms, evaluating risk, granting approval, preparation of documentation, attending to security arrangements and arranging execution of documents. With regard to the last point, the actual signing is only considered to be a minor aspect of the overall initiation of a loan and a loan will not be considered initiated where it is signed if substantially all other activities in connection with the bringing of the loan into existence are undertaken elsewhere. In other words, if all substantive work is done in one location and then the agreements are simply signed and booked elsewhere, the loan will not be considered to be initiated in that booking location. As a consequence, it is important to note that a loan may be considered to be initiated in Qatar even if it is booked in a non-Qatar branch of the relevant institution.

It should be noted that the funding of a loan (i.e. the functions typically carried out by the Treasury function of a bank) are not considered to be part of the initiation of a loan.

On the other hand, the risk of default of a loan will typically be considered to lie in the jurisdiction in which the loan is booked (which would generally also be expected to be the location of the treasury function in respect of the loan). This is because it is the balance sheet of that branch which will normally reflect a loss from a default. Nonetheless, if guarantee, underwriting, credit default swap or similar formal arrangements are in place under which any loss from a default are transferred to another branch of the lending entity, the risk will not be considered borne by the booking location. Although a bank may have branches in many jurisdictions, it remains a single entity in law and, therefore, any default is in reality borne by the entire entity not just the branch in which it is recorded. Nonetheless, in deciding where a risk is borne we intend to look only to the location where the loan (i.e. the risk) is booked (unless underwriting, guarantee or similar formal arrangements are in place). The accounting treatment adopted will be influential in this case.

As a corollary to only taxing interest where the interest is, or is deemed to be, local source, Article 21(1)(f) only allows the write-off, as a bad debt, of a loan to be allowed for tax purposes when the corresponding interest was taxable.

The above analysis is illustrated with regard to a typical bank lending scenario. It is important to appreciate, however, that the provisions of Article 10(2)(b) apply to all interest earned by a Financial Institution, not just interest earned from traditional lending. Accordingly, the provisions apply to interest from passive bank deposits, bonds and other financial instruments and in applying these provisions to such income an appropriate interpretation of the term “initiation” needs to be applied. Although it is not possible to describe the practical interpretation of that term in all situations, the focus will clearly be on the steps involved in evaluating, making and monitoring the relevant investment.

Example 1

A loan is initiated and funds are lent directly by a funded QFC bank branch to a borrower in Qatar. The loan is ‘booked’ to the QFC branch and it is accepted it bears the risk of the loan. All the interest on the loan will be taxable on the QFC Entity.

Example 2

A loan to an off-shore entity is initiated by a QFC bank and booked in the accounts of its Qatar operations and is not subject to any guarantee, underwriting or similar arrangements. As the loan was initiated in Qatar and the risk borne in Qatar, the interest on the loan is fully taxable notwithstanding that the borrower is outside Qatar.

Example 3

Funds are lent directly to a borrower outside Qatar by an off-shore loan being initiated, negotiated, approved and documented outside Qatar by a company associated with a QFC bank. Although the loan is arranged outside Qatar by an associate, in legal terms the loan is made by the QFC bank and is reflected in the books of the QFC bank’s Qatar operations. The risk of default is not shifted to another branch or entity under any underwriting, guarantee or similar arrangements. Although the loan is booked, and the risk borne, in Qatar, clearly the initiation of the loan was outside Qatar. Accordingly, only 50% of the interest on the loan is subject to QFC taxation (proviso to Article 10(2)(b)).

Example 4

An off-shore loan is initiated by a company associated with a QFC bank outside of Qatar but on behalf of the QFC bank. The loan is recorded in the books of an overseas branch of the QFC bank and is not underwritten or guaranteed by the Qatar office of the QFC bank. As the loan was initiated outside Qatar and the risk is borne by a non-Qatar branch of the QFC bank, the interest is not subject to QFC taxation.

Example 5

A loan to an offshore borrower is initiated by a QFC bank in Qatar, but the loan is booked in an overseas branch of the QFC bank in the same location as the borrower. Nonetheless, the Qatar office of the QFC bank has, in return for a fee paid by the overseas branch, agreed to guarantee the loan in the event of a default. As the loan was initiated in Qatar and the risk is ultimately borne in Qatar, the whole of the interest is subject to QFC taxation notwithstanding that the borrower is outside Qatar and the loan is booked in a non-Qatar branch.

2 – 6180 Income Associated with Interest Income (Financial Institutions)

In addition to interest income, many financial institutions earn fees. Broadly speaking, these fees may be for the rendering of a service, or may be for assuming a risk.

A fee for assuming a risk would typically include, *inter alia*, a guarantee or underwriting fee, or a premium for entering into a credit default swap. We will treat the source of such risk related fees as the place where the risk being assumed is located.

Where a bank or other financial institution performs services in exchange for fees such as commissions, participation fees, arrangement fees, or commitment fees in connection with the provision of loan finance the facts will need to be established to determine where the services were provided that gave rise to the fees. All the factors regarding the initiation, negotiation and documenting of the loan will need to be considered as possibly being relevant depending on the particular facts of the case. Where the facts show that the services involved were performed partly within and partly outside Qatar, an apportionment is permissible based on the relative contribution of the services undertaken at the different locations, the aim being to make the apportionment on the basis of 'value added'. There is an analogy between the location of where services are performed and the determination of the key entrepreneurial risk-taking functions (KERT functions) in the attribution of the profits of a bank to a branch permanent establishment under the authorised OECD approach and the guidance on such attribution will be relevant in determining the source of a financial institution's service fee income.

Generally speaking where a QFC Entity with a principal place of business in Qatar earns fees or commissions from Qatari customers they will be liable to QFC tax. When the customer is outside of Qatar the place where the services giving rise to the fees, commissions etc. are performed will determine the source and apportionment may be appropriate.

For example, if a QFC bank arranges a loan for an off-shore client and charges the client a fee. The work undertaken (and value added as a result) to earn the fee took place partly in Qatar (say 60%) and partly offshore (say 40%). In these circumstances it would be appropriate to tax 60% of the commission fee to QFC tax. If, however all the work in arranging the loan were conducted in Qatar, then 100% of the fee would be subject to QFC tax.

2 – 7000+ The Territorial Basis of Taxation – Electronic Commerce

2 – 7000 Electronic Commerce – General

The general principles for determining source apply to e-commerce (EC). The operations test – what were the taxpayer's operations which produced the profit, and where did they take place – is the proper approach. The automation involved in EC reduces physical activity. A server may be used to link trading parties for a variety of purposes, for example to advertise products, to process on-line orders, to deliver digitalised products or services, or to process payments. All these activities may be automated and occur outside the QFC. However, the place where the automated server-based activities are carried out does not in itself determine the locality of source. They must be weighed against the core business operations required to conduct the EC transactions, which are usually carried out within a physical office (including operations arising from the need to automate, manage and control the virtual shop-front or back office). Tasks undertaken through a server are normally performed according to pre-designed application software – the server cannot function by itself and human control remains important in carrying on the overall business operations. Generally therefore it is the location of the physical business operation, rather than the server alone, that determines locality. The proper approach is to focus more on what and where the underlying physical operations were carried out rather than what is done electronically. The decided cases suggest it may be necessary to have regard to what a person's agent has done, and an agent may be a natural or legal person. However software or a server, no matter how advanced, cannot be an agent, nor can an Internet Service Provider, who merely operates a server under a web-site hosting arrangement.

As a general proposition, where the principal place of business operations of a company engaged in EC is in the QFC, profits will be local source, even if an intelligent server is located offshore. Conversely a business which has all of its operations outside the QFC apart from operating an intelligent server in the QFC, will not be liable to tax.

2 – 7020 Examples

Example 1: Trader

The business is financial publication sales from the QFC. There is a server outside the QFC that enables local and overseas customers to obtain details of publications and prices, process purchase orders and payments and allow downloading via the internet of publications in electronic format. Apart from the server functions, all the business operations – procurement of publications, supply of information for the server, storage of books, physical delivery, answering of customers' enquiries and operational control of virtual shop-front are carried out in the QFC. The profits of the business will all be onshore.

Example 2: Service Provider

A company operating in the QFC provides investment consultancy services. There is a server located outside the QFC which supplies details of services, answers enquiries, enables communications with potential and actual clients and accepts payments for services rendered. The company obtains projects from overseas clients through the server. Work relating to consultancy, including collecting and analysing data, undertaking research, preparing reports etc. is all done in the QFC. Final reports are sent via e-mail or uploaded onto server to be downloaded by the client. As the activities which in substance gave rise to the profits are carried out in the QFC the profits will be local source.

2 – 7040 Characterisation of Income

Characterisation of Income

The question of whether income from EC is in the nature of business profits income from the sale of goods, service income or royalty income is significant for the QFC tax regime. Firstly, royalty income is taxable in Qatar if the right to use the IP is effected in Qatar. Secondly taxing rights under DTA's differ according to how income is classified and thirdly the rules for determining locality of source differ for services (where the services are performed) and business profits from the sale of goods (operations test).

To give an example of the issues involved**,** the purchaser of a digitised image arguably is purchasing the **services** of the enterprise that purveyed the image over the Internet. Alternatively, the transaction might be viewed as the license to use an intangible, namely, the digitised image that is transmitted over the Internet. Finally, one might view the true nature of the transaction as the purchase of a photograph, economically identical to the purchase of an item of inventory. Obviously, the proper characterisation of a transaction will depend on its particular facts. The point is that the characterisation of transactions in EC, which have significant implications for the sourcing of income, is a task fraught with difficulties.

2 – 7060 Permanent Establishment

The concept of permanent establishment is of major importance in linking a non-resident corporation to the country in which the business of an enterprise is wholly or partly carried on.

A non-resident doing business in a foreign jurisdiction will be taxed in that jurisdiction to the extent that he carries out activities through a permanent establishment. The main advantage in qualifying an installation as being a permanent establishment is the possibility of this site being taxed the same manner as a resident corporation. The development of EC has led to a discussion among many countries of whether the permanent establishment concept remains workable. Traditionally, the concept required some presence in the country willing to impose tax. Today however, technology is changing the ways companies conduct business and it is no longer necessary to have a physical place of business in a country in order to sell products or services in that state.

The OECD issued their final report on the BEPS (Base Erosion and Profit Shifting) Project on 5th October 2015. As part of this report the digital economy and definition of PE were reviewed and changes suggested. At the time of writing the new provisions are still in the consideration stage but changes may be made in future to the QFC definition of PE in line with best practice.

Departing from the traditional concept of permanent establishment to the "new economy", the OECD released some comments related to the definition of permanent establishment in the context of electronic commerce.

In principle, a computer server, which is a piece of equipment, meets the fixed place of business requirement. For that reason, it may constitute a permanent establishment in the state where it is located, even though the server does not require human intervention.

Although a computer server is tangible personal property and has a physical location, it may be relocated. To constitute a permanent establishment, the server must remain in a certain location for a sufficient period of time.

In general websites are not taxable. In this way, a foreign enterprise will not be treated as having a permanent establishment simply because it carries on business through a website in the jurisdiction.

2 – 7080 Permanent Establishment – Some Issues

Some problems still subsist despite the OECD´s clarification of the definition of a permanent establishment in the context of e-commerce.

Servers are highly mobile and flexible in nature. A server may not need any geographic connection either to the source or to the residence country. Therefore e-business may own or lease a server located anywhere in the world or in space (even satellites are capable of constituting a server) and can conduct its business activities via this server in such a way as to ensure that their profits will either be taxed exclusively by the residence country or by some low tax jurisdiction.

Besides, many companies would find permanent establishments created in countries which they had no intention to have, because the server is located in a country other than the source state.

Another difficulty is determining the location of the server and the respective attribution of income to that server. In several cases web servers are interconnected and sometimes files initially stored on a specific server are cached to other servers. Moreover, it is usual to employ server arrays that enable a web site and its functions to be dispersed over many servers located in multiple jurisdictions. The server array may be used to direct congested internet traffic to different servers or applications for a single web site can which be loaded on different servers.

2 – 8000+ The Territorial Basis of Taxation – Treatment of profits from the provision of services for use outside Qatar

2 – 8000 Application of the Operations Test

Article 10 (1A) excludes from the scope of QFC corporation tax, profits from the provision of services for use outside Qatar, where the relevant activities and/or operations generating the profits were undertaken in Qatar.

The Operations Test [see QTM – 5060] continues to guide the interpretation of the local sourcing provisions. The deeming provision contained in Article 10 (1A) would be applicable only to profits which are derived from activities undertaken in Qatar where the conditions in Rule 1A are met [see QTM2 – 8160].

If any of the Rule 1A conditions are not met by a QFC entity, the relevant profits will be subject to the same tax treatment as they would ordinarily have been prior to the introduction of Article 10 (1A). In practice, this would generally result in the relevant profits being taxable in the QFC because the profit-generating activities and/or operations were located in Qatar.

2 – 8020: Article 10 (1A) – A Deeming Provision

Article 10 (1A) is a deeming provision in the Regulations. It does not introduce a specific tax exemption, and does not need a process to apply it.

A QFC Entity that has made a self-assessment that all or part of its profits falls under Article 10 (1A) is expected to reflect this in the relevant section of the tax return.

2 – 8040: Provision of Services in or from Qatar

"Services" is interpreted as including all the permitted activities that a QFC entity (other than an Authorised Firm) can undertake under the scope of its specific QFC license.

Article 10 (1A) would only apply if the relevant services have been provided by a QFC entity in or from Qatar.

The key objective of the requirement that the activities are undertaken by a QFC entity in Qatar is to increase the level of economic activity in Qatar, and to ensure that Article 10 (1A) is not misused by 'shell' or conduit entities in the QFC.

2 – 8060: For use outside Qatar

Article 10 (1A) is intended to apply where a QFC entity meeting the requirements of Rule 1.A [see QTM2 – 8160], provides services for the use, consumption, or benefit outside Qatar.

The concept of "use outside Qatar" is a question of fact and depends on the type of services provided and the purpose for which the services have been provided. A general "presumption" test would be applied in the first instance to assess whether the services provided by a QFC entity would fall under Article 10 (1A). The presumption will apply depending on whether or not the ultimate or end user is resident in Qatar:

a) Where the ultimate or end user of the services is a non-resident, the presumption is that Article 10 (1A) would, prima facie, be applicable (subject to the conditions in Rule 1A being met [see QTM2 – 8160]), unless the services have been provided for use in Qatar. This presumption would not apply if the non-resident is operating through a Permanent Establishment (PE), a subsidiary or an affiliate in Qatar; and

b) Where the ultimate or end user is a resident in Qatar, the presumption is that Article 10 (1A) would, prima facie, *not* be applicable, unless the services have been provided for use outside Qatar.

The term "resident" above is intended to refer to (a) a natural person who has a permanent home in Qatar, has been in Qatar for more than 183 consecutive or separate days during any 12 month period and/or has his or her centre of vital interests in Qatar;

or (b) a body corporate that is incorporated in Qatar, has its head office in Qatar and/or has its place of effective management in Qatar. A “non-resident” is a natural or legal person that is not resident in Qatar.

A subsidiary or an affiliate under (b) above is intended to refer to a Qatar incorporated body under the direct or indirect management and/or control of the non-resident who is claimed to be the end user of the services.

You will need to look beyond mere contracting arrangements to ensure that QFC entities are not contracting with non-residents simply to benefit of Article 10 (1A) when under the actual circumstances the relevant services are used by, consumed by, or benefit an ultimate or end user in Qatar.

2 – 8080: Examples

It may not be possible to exhaustively define the exact parameters of what constitutes “use of services outside Qatar”, however some examples are set out below:

a) Where a QFC entity contracts with a non-resident to provide the same with advisory, consultancy, IT support, intra-group management or other services from Qatar but for the purposes of the activities of the non-resident outside Qatar, this is a clear example of circumstances in which Article 10 (1A) would apply;

b) Where a QFC entity contracts with a non-resident to provide management/ consultancy services to its branch, subsidiary or related party in Qatar, Article 10 (1A) would not apply as the ultimate/ end user and/or “use” would be viewed as taking place in Qatar;

c) Where management, advisory or other services are provided by a QFC entity to a non-resident in relation to subject matter, asset, property, investment, business etc. in Qatar (“inbound advice”), Article 10 (1A) is unlikely to be applicable as the ultimate or end user and/or “use” would be viewed as taking place in Qatar. The intention is to prevent circumstances where QFC entities may opt to contract via related parties outside Qatar in order to get the benefit of Article 10 (1A);

Where a QFC entity contracts with, and provides services to, a resident in Qatar in relation to a project or subject matter outside Qatar (e.g. in relation to the activities of a non-resident subsidiary or foreign PE of the resident in Qatar i.e. “outbound advice”), Article 10 (1A) is likely to be applicable. If the QFC entity had contracted directly with the non-resident subsidiary or foreign PE, this would fall under the circumstances described in (a) above.

There may be patterns which do not fall into any of the above hypothetical circumstances. The general principles outlined above are a guide and each case should be considered on its merits.

2 – 8100: Profit Attribution

In line with the OECD's recommended approach under Action Point 5 of the Base Erosion and Profit Shifting (BEPS) project, Article 10 (1A) is only intended to be applicable to profits that are genuinely attributable to the relevant activities undertaken by the QFC entity in or from Qatar.

In considering the attribution of profits to a PE, the QFC tax department may use the principles set out in the OECD Report on the Attribution of Profits to a PE ("OECD Report") as guidance. The transfer pricing rules under the Regulations would continue to guide the attribution of profits to QFC entities that are not a PE [see QTM8-4000 and Part 8 Transfer Pricing].

Whether or not the relevant profits are attributable to activities undertaken in Qatar is a question of fact to be determined by ascertaining *what are the activities which generate the profits* and *where those activities are undertaken*. This is a somewhat similar to the Operations Test for determining the source of profits which focusses on the *activities which most directly generate the profits* [see QTM2-5060 and 'Local Source Income Guide'].

Once the income has been established as local source, it is then necessary to determine the quantum or margin attributable to Qatar. Accordingly, in order for the profits to be attributable to activities undertaken in Qatar, all core aspects of the profit generation should have taken place in Qatar. This can be evidenced (*inter alia)* by appropriately qualified and skilled personnel employed or acting on behalf of the QFC entity in Qatar and within the scope of the QFC entity's license. The focus in assessing profit attribution would be on the alignment of people functions to income generation.

In addition, in line with the OECD's recommendation in relation to Intellectual Property (IP) regimes, under BEPS Action Point 5, expenditure may in appropriate circumstances be used as a proxy for activity when considering the question of profit attribution (inappropriate circumstances could include passive activities/services which do not, by their nature, involve the provision of substantial activities, e.g. managing a digital platform). In other words, the proportion of costs of the QFC entity representing expenditure in Qatar may be considered as proper indication of the extent to which activities had been undertaken in the State. As with the approach under BEPs Action Point 5, however, expenses paid from Qatar to associated parties abroad would not be considered for this purpose.

This is confirmed by the OECD guidance provided in the 2017 progress report on Harmful Tax Practices. The report clarifies that applying the recommendations of transfer pricing-related action points of the BEPS project (Actions 8 to 10 and Action 13) would, to some extent, address the concern posed by the substantial activity requirement. This is because they ensure that profits attributed to an entity are in line with the level of core profit-generating activities undertaken by that entity. In addition, the report specifically refers to the number of full time employees and the amount of operating expenses incurred as an indication of the level of substantial activities undertaken.

Notwithstanding the above, it is useful to note that the OECD's analysis on the concept of profit attribution (in particular for non-IP regimes) is still evolving and that a flexible and common sense approach on profit attribution should be adopted based on the facts of each case. Should further guidelines be recommended by the OECD on profit attribution in the context of other regimes/ businesses in the future, additional guidance may be provided in this Manual.

2 – 8120: Administration – Independent professional advice

Whilst an independent profit attribution analysis or advice based on the OECD's authorized approach is not mandatory for the application of Article 10 (1A), professional independent advice obtained by a QFC entity from third party advisers will be viewed positively and could help substantiate that the QFC entity's profits (or a proportion thereof) are attributable to activities undertaken in Qatar.

If such advice has been commissioned by a QFC entity, the QFC entity should be encouraged to submit the relevant advice along with their annual tax returns. To the extent that an advice is claimed to have been obtained but has not been submitted along with a QFC entity's annual tax returns, you should request it from the QFC entity. The existence of such advice would be viewed positively, but it is important that you conduct your own analysis and reach your own conclusions as to the accuracy and correctness of the advice in the context of the QFC Tax Regulations.

2 – 8140: Apportionment

To the extent that services are provided for the benefit of both residents and non-residents in Qatar, the QFC entity would be expected to apportion its profits and losses accordingly e.g. on a time spent basis or based on the facts of a case.

Where the services generating the profits have been provided both from Qatar and outside of Qatar, an apportionment may, in some circumstances, be possible under the source rules with the latter category of profits being treated as non-local source income [see QTM2- 5140]. In any event, any profit attributable to services provided through a PE outside Qatar would already be excluded from the scope of tax under Article 10 (3) (C) [see QTM2- 4160]. If the services were provided from outside Qatar but not through an arrangement which amounted to a foreign PE, the source of the relevant profit in such circumstances would be determined by the acts responsible for the generation of profit. This profit may be local source. Nonetheless, although locally sourced, if some part of the profit is still attributable to services provided or undertaken outside Qatar, such portion would not attract the application of Article 10(1A). This is consistent with the OECD's general approach in the BEPS Action Point 5 report as well as the objective of extending the benefit of Article 10 (1A) only to profits attributable to activities undertaken in Qatar. The apportionment principles set out elsewhere in this Manual should be equally applicable [see QTM2- 5140].

2 – 8160: Conditions under Rule 1A of the QFC Tax Rules

It is important that a QFC entity seeking to apply Article 10 (1A) ensures that it meets all the conditions set out in Rule 1A for the Accounting Period in which Article 10 (1A) is intended to apply. The QFC entity is responsible for showing that the conditions have been met.

The Tax Rule 1A conditions are not intended to act as a substitute for the profit attribution approach outlined above [see QTM2 – 8100] i.e. the appropriate profit attribution will be assessed only *after* a QFC entity has met all the Rule 1A conditions.

a) The external audit requirement

Rule 1A (A) requires a QFC entity's accounts to be audited and reported on by an external auditor. In practice, this is already an existing requirement for QFC limited liability companies and LLPs. The condition extends an existing requirement to QFC entities taking the form of a branch in the QFC that are seeking to apply Article 10 (1A).

b) The three employees requirement

Under Rule 1A (C), a QFC entity is required to have at least three full time employees resident in Qatar on its payroll within the relevant Accounting Period. The employees would be expected to have residence permits sponsored by the QFC entity in question.

c) The 30% threshold requirement

In all instances, each requirement under Tax Rule 1A will have to be met before a QFC Entity can benefit from Article 10 (1A). To facilitate the assessment, you should, first look at whether the external audit and three employees' requirements are fulfilled before assessing if the 30% threshold requirement is also met.

Rule 1A (B) stipulates that at least 30% of the profits generated by a QFC entity should be attributable to the activities of the QFC entity in Qatar. In determining if the 30% threshold is met, the proportion of income which is self-assessed by the QFC Entity to be local source vs non-local source should be reviewed.

An example of how the 30% threshold may be met is set out below:

If a QFC entity derives profits of $100 which can be apportioned as set out in the table below:

Profit/ income ($)	10	20	70
Location of services & use	Services provided from or in Qatar, for use in Qatar	Services provided outside Qatar, for use in or outside Qatar	Services provided from or in Qatar, for use outside Qatar
QFC tax treatment	Subject to 10% QFC corporation tax (unless any other relevant exemptions or concessions apply under the QFC Tax Regulations)	Outside the scope of QFC taxation (on the assumption that these profits do not have a Qatar source)	Article. 10 (1A) may be applicable, if the conditions under Rule 1A are met

Article 10 (1A) could be applicable to the $70 of profit to the extent that the profit can be genuinely attributed to activities undertaken in Qatar.

Based on the hypothetical example above, the threshold would be assessed by looking at the following two categories of profit derived by the QFC entity: "services provided in or from Qatar, for use in Qatar" ($10) and "services provided in or from Qatar, for use outside Qatar" ($70). Hence, the QFC entity meets the requirement as it generates 80% of its income from activities **in** Qatar. However, whilst Article 10 (1A) may apply to the $70, the $10 would be subject to QFC corporation tax at 10% under the general local source income provision in Article 10 (1).

As stated above, the 30% threshold sets the parameter for circumstances where Article 10 (1A) may be applicable; it does not replace the need for actual profit attribution. A QFC entity that meets the 30% condition may apply Article 10 (1A) to its relevant income (in the hypothetical case above, this would be the $70), but will still be required to justify that such income is attributable to its activities in Qatar [see QTM2- 8100].

d) The anti-tax avoidance requirement

Rule 1A (D) allows the QFC Tax Department to negate the application of Article 10 (1A) by a QFC entity if it considers the sole or main purpose of the arrangement under which the services have been provided is the avoidance of tax under the QFC Tax Regulations.

An example of when this may be applicable would be in circumstances where the QFC entity enters into a contract with a non-resident related party, as a conduit, with the purpose of routing the services back for "use" by a related party resident in Qatar. The arrangement is entered into with the sole or main intention to avoid QFC corporation tax.

For the avoidance of doubt, for the purposes of Article 10 (1A), a decision to incorporate a QFC entity purely to benefit from the application of Article 10 (1A) should not, on its own, be viewed as evidence of an intention to avoid tax.

2 – 8180: Consequences of not meeting the conditions under Article 10 (1A) or Rule 1A

Where a QFC entity has applied the tax treatment under Article 10 (1A) to all or part of its profits but has not met all the conditions under Rule 1A in the relevant Accounting Period, the QFC entity's relevant profits will fall under Article 10 (1) of the QFC Tax Regulations. This means that such income is likely to be subject to QFC corporation tax at 10%, because it has arose in or was derived from to Qatar.

If a QFC entity is unable to demonstrate that it has met all the conditions under Rule 1A in the relevant Accounting Period, the relevant consequences and penalties under the QFC Tax Regulations would apply, including where the error has been made, negligently or fraudulently [see QTM19-2240], resulting in an incorrect return and/or a late or underpayment of tax.

2 – 8200: Effective date

Article 10 (1A) and Rule 1A were enacted into the QFC Tax Regulations and QFC Tax Rules respectively on 12 June 2017.

They will both consequently be applicable to Accounting Periods starting on or after 12 June 2017, to the extent that a QFC entity has generated profits which would fall under Article 10 (1A) and has met all the conditions under Rule 1A.

2 – 8220: Advanced Ruling

There may be situations where QFC taxpayers require greater certainty on the application of Article 10 (1A) to a particular set of facts. In such circumstances, a QFC taxpayer may apply for a binding advance ruling under Part 18 of the QFC Tax Regulations [see QTM-Part 18].

PART 3 ACCOUNTING PROFIT AND ACCOUNTING PERIODS

3 – 1000+ Accounting Profit

3 – 1000 Accounting Profit – General

"Accounting Profit" is a key term as it is the basis of calculating Chargeable Profits which, after the deduction of any losses and group relief to arrive at Taxable Profits, is the figure used to calculate tax due (see QTM2-1100). The difference between Accounting Profit and Chargeable Profit are the specific adjustments to be made in accordance with the Regulations – these are mainly contained in Part 4 of the Regulations (Computational Provisions – see Part 4 below).

The Accounting Profit is the pre-tax, pre-dividend profit of the QFC Entity reflected in its profit and loss account, or income statement, based on accounts prepared in accordance with generally accepted accounting principles (GAAP) and the laws of the QFC. Capital profits are included (Article 15(1)).

3 – 1020 Apportionment

Where the period of accounts covers more than one Accounting Period it will be necessary to apportion the Accounting Profit between two or more Accounting Periods. Article 15(7) gives statutory authority for such an apportionment to be made on a time basis, and this should normally be the basis adopted. However, in exceptional circumstances, where a QFC Entity demonstrates another basis of apportionment produces a more equitable result, that basis may be accepted. An example would be where, because of the conclusion of a significant deal late in the period of accounts, the profit arose predominantly in the later period and time apportionment would therefore not produce a just and reasonable result. The circumstances where the basis of apportionment has an impact on an Entity's overall tax liability will be comparatively rare – the availability of losses surrendered as group relief by a group member being a possibility. Where a significant tax advantage is to be gained by a non-linear apportionment, the request to deviate from the normal time apportionment should be reviewed critically, by way of an enquiry.

3 – 1040 Acceptable GAAP

The Policy Statement heading Part 3 of the Regulations (Article 14) reflects a preference for accounts drawn up under IFRS, but other GAAP are acceptable. To be consistent with other QFC Laws (e.g. Article 82 of the Company Regulations) UK and US GAAP are also acceptable (Article 15(2)).

In addition to the three main GAAP (IFRS, UK and US), accounts prepared in accordance with standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) may be accepted (Article 15(2)(b)).

3 – 1060 Other GAAP

Apart from the GAAP that are specifically authorised by Article 15(2), a QFC Entity may apply to use a different GAAP. As the most commonly used GAAP are authorised, the occasions when a QFC Entity applies to use a different GAAP should be rare, especially in view of the need for accounts to be prepared under IFRS, UK or US GAAP for compliance with the QFC Company Regulations (Article 82 of the Company Regulations). As an example, where a QFC Entity is a member of a group, and the GAAP used by its immediate parent is not authorised by Article 15(2), an application may be made under Article 15(3) to use a different GAAP.

An application for a GAAP outside those specifically authorised should be examined critically. Any application must be in writing and has to be made before the start of the Accounting Period to which it relates. In addition, the application must say why the QFC Entity wishes to adopt the particular GAAP as well as specifying the basis of accounting (Article 15(4)). An application must be dealt with within 60 days of receipt, and failure by the Tax Department to do so means that the application should be regarded as accepted (Article 15(5) and (6)). It is therefore important that applications are dealt with promptly so that an otherwise unacceptable election is not accepted by default.

There is no appeal to the Tax Department against a refusal to accept an alternative GAAP. If a QFC Entity, despite not being authorised to use a certain GAAP, submits a return with accounts drawn up under the unapproved GAAP, an enquiry should be opened and the differences in accounting treatment of transactions under the unapproved GAAP and IFRS, or other approved GAAP, fully explored. If the unapproved GAAP is more favourable, for tax purposes, than the results that would have been reflected using an approved GAAP, differences should be added back, pursuing through closure and appeal, if necessary.

3 – 1080 Change in Basis of Accounting

A QFC Entity may change its basis of accounting from one acceptable GAAP to another or, without changing the basis of accounting, change one or more of the accounting policies under which the accounts are prepared. In either case the change may give rise to a prior period adjustment which is carried to reserves, rather than the profit and loss account.

There is a risk that, without specific legislation, a change in accounting basis or policy may result in taxable profits or tax losses dropping out of account.

The problem is well illustrated by the facts of the UK case of *Pearce v Woodall-Duckham Ltd* [1978] 51TC271. This case will be persuasive but not binding on the QFC Tax Department. The company changed its method of valuing work in progress from an 'on-cost' basis to an 'accrued profit' basis in the 1969 accounts. It valued both the opening and the closing work-in-progress on the new basis and brought in the difference between the 1968 closing value and the 1969 opening value as 'surplus arising on change in valuation of contract work in progress at 31 December 1968'. The figure was not taken to the trading profit and loss account but shown in the company's profit and loss appropriation account under profit after taxation. It was common ground that both the old basis and the new basis were valid valuation methods for work in progress and that the change had been made for sound commercial reasons. It was held that the amount of the adjustment was taxable in 1969 as profits of that year.

The court went on to consider whether it was appropriate to tax that profit in 1969 or whether it fell out of charge to tax and decided *"The anticipated profit for work carried out prior to 1969 falls to be taxed in the year 1969, when it is first revealed and first brought into account".* The Court of Appeal upheld the decision.

The principle established by the *Pearce v Woodall-Duckham* case is given statutory authority by Article 16 of the QFC Tax Regulations. Where a change in accounting basis is adopted or where, without changing the accounting basis, one or more accounting policies are changed and the change gives rise to a prior year adjustment carried to reserves, the untaxed prior year adjustment is included, for the purposes of QFC taxation, in the Accounting Profit for the Accounting Period in which the change in basis is first adopted.

3 – 2000+ Accounting Periods

3 – 2000 Accounting Periods - General

The QFC tax regime is structured around Accounting Periods. The Regulations contain no concept of "tax year" or "year of assessment". Each QFC Entity is charged by reference to its Accounting Periods (AP), which may be of any length, up to a maximum of twelve months and begin and end on any date (see below for the exception to this rule for the first AP). A tax return is to be filed for an Accounting Period (Article 109) and both self-assessments (Article 112) and discovery assessments (Part 21) are to be made for an Accounting Period.

3 – 2020 Commencement

A new Accounting Period begins when a QFC Entity comes into the charge to tax or, in other cases, immediately after a previous Accounting Period ends without the QFC Entity then ceasing to be within the charge to tax (Article 17(1). A QFC Entity comes "within the charge to tax" when it commences activities within the terms of its QFC licence (Article 17(1)(a)). The date a QFC Entity commences activities within the terms of its licence will often not be the date on which the licence was granted. There is a distinction between preparing to carry on activities and actually commencing those activities. The distinction is important because not all expenses incurred before the first Accounting Period begins will be available for carry forward (see QTM5-1040).

As a general rule activities within the terms of a licence will not commence until the firm is in a position to provide the services which is its business to provide and actually does so or offers to do so.

The length of the setting up phase may vary and it can be particularly long where complex modern technology is involved. Once the business meets these criteria then it has commenced trading. The case of *Napier v Griffiths [1990] 63TC745* underlines that whether a business has commenced or not is a matter of fact. In the absence of any evidence to the contrary, the taxpayer was held to have commenced trading when he/she entered into his first contract of engagement.

3 – 2040 Extension of term of first Accounting Period

A QFC Entity may make a written application to the Tax Department before the tax return filing date to extend the period of its first accounting period beyond 12 months [Rule 8.1.3]. The extension should not be beyond 18 months. The ability to submit one tax return for the extended accounting period should be viewed as a reasonable request. The Tax Department should advise the QFC Entity of its decision in writing.

3 – 2060 Cessation of Accounting Period

The events that trigger the end of an Accounting Period are (Article 17(2) and 18(1)):

- The expiration of 12 months from the commencement of the Accounting Period
- An accounting date of the Entity
- The Entity becoming resident in Qatar
- The Entity ceasing to be resident in Qatar
- The Entity giving up its QFC licence or the licence being revoked
- The Entity ceasing to have any source of income within the terms of its QFC Licence
- The appointment of a liquidator at the commencement of a winding up under the Insolvency Regulations 2005.

The ending of an Accounting Period at the twelve month point, or an accounting date, are straightforward and should not present any difficulties.

An Entity is Resident in Qatar if it is incorporated in Qatar or its effective place of management is in Qatar (see QTM2-2000+). It follows that a LLC, for example, incorporated in Qatar will always be resident here. However, for companies not incorporated in Qatar, or for branches, partnerships etc., a change of residence status on a change in the place of effective management is quite possible. Such a change, whether from non-resident to resident, or vice versa, will trigger the end of an accounting period. The change in residence status may only become apparent when an enquiry is opened into a return. When this is the case the results for the original Accounting Period will need to be apportioned.

3 – 2080 Surrender or Revocation of QFC Licence

Where a QFC Entity gives up its licence, or its licence is revoked, it will no longer be within the definition of a QFC Entity as the definition stipulates (Article 153) that an Entity must continue to hold its QFC licence to be within the definition.

Cases may arise where a QFC Entity gives up or has its licence revoked but which subsequently receives income which may be attributable to activities either before or after the licence was surrendered or revoked. Where the activities took place before the licence was surrendered or revoked there may be scope for arguing such income should have been included in the Accounting Period before the licence was surrendered or revoked. There may also be situations (for example contingent payments) where accountancy principles support the view the receipt should not have been included in the post surrender or revocation Accounting Period. This is a difficult area. Decisions in the UK courts have tended to suggest less support for the accruals concept and prefer the modern accounting treatment which is to recognise the receipt as a current year item rather than by way of prior year adjustment. If the circumstances of a particular case suggest there may have deliberate exploitation of the “surrender or revocation” provision to avoid tax the papers should be submitted, with a full report of the relevant facts, to the Director of Tax.

Where a QFC Entity surrenders or has its licence revoked but continues to engage in activities within Qatar, any profits will be potentially within the State Tax Regime. If you become aware of any such situation a full report should be made to the Director of Tax so he/she may consider informing the State Tax Department of the situation under the terms of any Memorandum of Understanding between the two authorities.

3 – 2100 Cessation of Source and Dormancy

An Accounting Period ends when a QFC Entity ceases to have any source of income within the terms of its QFC Licence. A QFC Entity that has no source of income is not within the charge to tax, so when an Accounting Period ends as a result of the Entity ceasing to have a source, a new Accounting Period does not begin (Article 17(1)(b)). If a QFC Entity ceases to have a source of income but retains its QFC Licence, then it will be dormant until it either ceases to be a QFC Entity (by surrendering or having its licence revoked) or it recommences activity. If it recommences activity then it will come once again within the charge to tax and a new Accounting Period will begin (Article 17(1)(a)).

The point at which the winding down of a business amounts to a complete cessation of any source of income is a question of fact. Where funds remain in an interest bearing account and the interest is local source, then unless the amounts are trivial, the income should normally be regarded as a source within the terms of the Entity’s Licence, even though the interest is “passive” in nature. This view may be open to challenge and a common sense view should be taken, having regard to all the circumstances of the case.

3 – 2120 Appointment of a Liquidator

An Accounting Period ends on the appointment of a liquidator at the commencement of a winding up under the QFC Insolvency Regulations 2005 (Article 17(2)(e) and 18(1)(c)). Where a liquidator is appointed it is likely this will be followed, quite soon, by the final cessation of all sources of income and gains and/or the Entity ceasing to be a QFC Entity by surrendering or having its licence revoked. After a liquidator has been appointed all future correspondence, notices etc. should be addressed to the liquidator whom will, until the liquidation is finalised, be the representative of the Entity for tax purposes.

3 – 2140 Deemed Disposals

If a QFC Entity:

- Gives up or has its licence revoked;
- Ceases to be resident in Qatar, or;
- Appoints a liquidator at the commencement of a winding up under the Insolvency Regulations 2005,

it is to be treated as though, immediately before the occurrence of the first such event, it sold and immediately reacquired all of its assets and liabilities at their market value (Article 18(1)).

An accounting period ends when any of the above events occur (Article 17(2)(e)).

The purpose behind this provision is to crystallise unrealised gains or losses at a point that is likely to mark the end of an entities QFC Licensed existence.

The point of ceasing to be resident in Qatar is a little different as such an event may or may not mark the effective end of its QFC business operations. A QFC Entity that is resident in Qatar will cease to be resident if its place of effective management is no longer here. Such an event may occur without the Entity in any way ceasing operations. To cover this eventuality the Regulations provide that, on ceasing to be resident in Qatar the “sale and immediate reacquisition at market value” provision of Article18(2) does not apply in respect of any assets or liabilities retained in Qatar by a permanent establishment of the Entity (Article 18(3)). As the charge to tax on non-residents is only on the profits of a permanent establishment (Article 13) the provision effectively disapplies Article 18(2) to those assets and liabilities employed in its QFC business.

It is quite possible a QFC Entity may, for example, go into liquidation and at some later date (probably soon thereafter) give up or have its QFC Licence revoked. To account for such positions Article 18(4) ensures that the “sale and immediate reacquisition at market value” provision is applied only once to the same QFC Entity. However, where the provision has been disapplied in respect of assets and liabilities retained in a permanent establishment in Qatar, following a change of residence (see above) the “sale and immediate reacquisition at market value” provision is applied in respect of the retained assets and liabilities on the subsequent occurrence of any of the Article 18(1) events. It follows that the provisions may be applied more than once if an Entity’s residence status changes more than once (through repeated shifting of the place of effective management in and out of Qatar) and on each cessation of residence different assets or liabilities are not retained in the remaining Qatari permanent establishment. In practice this situation will be rare.

PART 4 COMPUTATIONAL PROVISIONS

4 – 1000 Computational Provisions Introduction

To arrive at Chargeable Profits (see Article 11(2)) the Accounting Profit arising from a QFC Entity's licenced activities are adjusted in accordance with the computational and other provisions in the Regulations. The charge to tax is on "local source taxable profits", taxable profits being Chargeable Profits, adjusted for losses and group relief (see QTM2 – 1000).

This part deals only with the computational provisions contained within Part 4 of the Regulations. You should refer to the relevant parts of this manual for other adjustments that may need to be made in arriving at Chargeable Profits, for example tax equalisation adjustments in the case of Islamic Financial Institutions (See QTM11 – 1020).

If none of the specific computational provisions of Part 4, or other Regulations that affect Chargeable Profit, apply in a particular case the Chargeable Profit of a QFC Entity will be the same as its Accounting Profit – that is the pre-tax, pre-dividend profit as reflected in the profit and loss account, or income statement, based on accounts prepared under acceptable GAAP (see Article 15).

The computational provisions of Part 4 consist of a general rule for permissible deductions, supplemented by specific allowances and restrictions. Article 21 sets out the deductions that are to be specifically disallowed. However, Articles 22-25 provide, in certain circumstances, for the deduction of amounts which would otherwise be prohibited by Article 21.

4 – 2000+ General Principles

4 – 2000 General Principles Overview

The QFC tax system is based on a territorial basis of taxation and local source profits are defined at Article 10 as profits "arising in or derived from Qatar" (See QTM2 – 1080). The charge to tax is on "local source taxable profits" (Article 9) and Taxable Profits are defined as Chargeable Profits as reduced by losses and group relief (Article 11).

The Policy Statement heading Part 4 (Article 19) sets out the general principles for determining deductions allowable for tax purposes.

Allowable deductions are those *"expenses, costs or other disbursements...that have been taken into account in arriving at the Accounting Profit of the QFC Entity for that Accounting Period and are incurred for the purpose of generating Local Source Profits or incurred in the operation of a business carried on for the purpose of generating such profits."*

The phrase "or incurred in the operation of a business carried on for the purpose of generating such [local source] profits" is intended to make it clear that allowable deductions are not restricted to expenses etc. that are incurred *directly* in generating local source profits. The phrase does not mean that *all* expenses incurred in the operation of a business carried on for the purpose of generating local source profits are allowable.

Article 20 makes it clear the tax base includes all net (after allowable deductions) local source income. It follows any non-local source income and expenditure relating, directly or indirectly, to the generation of non-local source income should be excluded from the tax computation.

4 – 2020 Apportionment of Expenditure

Article 19 indicates that expenses, costs or other disbursements may be deducted *to the extent* that they are incurred for the purpose of generating local source profits or incurred in the operation of a business carried on for the purpose of generating such profits. Accordingly expenses may need to be apportioned when they are incurred only partly for an allowable purpose.

Article 21(2) deals with the apportionment of expenditure between local source and non-local source income - such apportionment is to be made on a "just and reasonable" basis.

What constitutes a "just and reasonable basis" will depend on the circumstances of the particular case. Some expenditure is clearly specific in nature and relates directly to either local or non-local source income. A firm should be able to demonstrate, by producing appropriate evidence, that a particular item of expenditure was incurred wholly or mainly for generating local or non-local source income. Once specific expenditure has been allocated, a "just and reasonable" allocation of the remaining non-specific and other overhead expenditure (including any interest expenses) should be carried out. A good starting point will often be the ratio of local to non-local source income. For example if 90% of gross income is local source and 10% non-local, a reasonable disallowance of, for example, property rental expenses incurred in generating total profits may be 10%.

The link between local source profits and local source income is to be found within Article 20.

Where the accounts or computations show, in a particular case, the proportion of non-local source income is significant, the apportionment of expenditure should be carefully reviewed. Trivial adjustments should not be pursued. Evidence is essential and you may have to demonstrate to the Tribunal, at the conclusion of an enquiry that your figures are "just and reasonable" based on the evidence obtained. Factors such as time spent, resources consumed, costs incurred etc. may all be relevant in this context.

4 – 2040 Meaning of "For the Purpose"

Article 19 allows deductions to the extent they are incurred "for the purpose" of generating local source profits, or incurred in the operation of a business carried on "for the purpose" of generating such profit.

In considering "purpose" in the context of Article 19 it is the QFC Entity's immediate purpose and not some remoter or supposedly underlying purpose that is important. It is not sufficient that the expenditure results in an advantage for the Entity; the direct and immediate purpose of the expenditure is what matters. It is purpose and not motive that counts. This is illustrated by the case of *Marshall Richards Machine Tool Co Ltd v Jewitt* [1956] 36TC511 where Upjohn J, when discussing the payment made by a UK company to help its American subsidiary meet its obligations, said "That is exactly what the payment was for, and it was not laid out in any sense at all to advance the trade of the parent company. Of course, that was the motive, but it was not the purpose of the payment."

"Purpose" is not a metaphor which personifies the business, ascribing to it human aims and objectives such as underlying motive, it is concerned with the actual, direct and immediate purpose for which the person carrying on the business makes the expenditure.

In the UK case of *Smith's Potato Estates Ltd v Bolland* [1948] 30TC267 the company incurred legal and accountancy expenses in connection with a successful Excess Profits Tax appeal. Lord Porter explained the costs were not allowable because they were not incurred to earn the profits of the trade but for the purpose of ascertaining the quantum for assessment. This case illustrates what is known as the "capacity test". Therefore if an expense is incurred by a QFC Entity in some capacity other than generating local source profits the expense will not be deductible. In the *Smiths's Potato Estates* case the legal and accountancy costs were incurred in the capacity of a taxpayer, and not in the capacity of a trader.

It is the purpose of the expenditure, therefore, and not the result with which we are concerned.

4 – 2060 Meaning of "incurred"

Article 19 permits the deduction of expenses, costs and other disbursements "incurred" and similarly Article 20 refers to expenses "incurred." It could be argued this wording introduces a timing test for tax purposes that overrules accountancy principles. This point was considered in the UK case of *Threlfall v Jones* [1993] 66TC77 by the Court of Appeal where the argument for an overriding principle was rejected. Following this case you should not argue there is an overriding principle overruling accountancy principles and it follows expenditure should be allowed for tax purposes at the time it is recognised in the accounts. If, exceptionally, a QFC Entity argues the wording of Article 19 introduces a timing test and seeks a deduction for a period different from that established by accounting principles, you should resist, citing the *Threlfall v Jones* case to support your view.

Article 21(1)(a) specifically disallows items of expenditure that are "not actually incurred" or not supported by documentary evidence. When considering whether expenses have been incurred documentary evidence will be key. The aim is to ensure "deemed" payments between group entities are not allowed for tax purposes and also to ensure only expense which can be proven to have been incurred by the QFC entity and not a group entity are allowed.

4 – 2080 Timing

The time at which expenditure is recognised for tax purposes will generally be determined by the accountancy principles under which the QFC Entity's accounts are prepared. Outside of the specific provisions of Articles 22- 24 (see below) there is no general tax rule that overrides the accountancy treatment. In some situations, the correct application of Generally Accepted Accountancy Principles (GAAP) permits an expense to be either wholly charged in the year incurred or spread over a longer period, for example, development expenditure where there is a reasonable certainty that it will give rise to revenue in the future.

The relevant GAAP should be referred to where the treatment of expenditure, including provisions, appears to give rise to a possible timing advantage. If there is doubt that the correct treatment has been followed, and the amount involved is significant, an enquiry should be opened to investigate the position fully.

4 – 2100 Provisions and Contingent Liabilities

Provisions and contingent liabilities are dealt with under International Accounting Standard (IAS)37. The basis of IAS37 is that a provision is a liability of uncertain timing or amount. The definition of liability is given by the standard as *'a present obligation of an entity to transfer economic benefits as a result of past transactions or events'*. Mere anticipation of future expenditure, however probable and no matter how detailed the estimates, is not enough, in the absence of an obligation at the balance sheet date.

IAS37 lays down a complete code prescribing when provisions must be made, and when they must not and also lays down rules for the quantification of provisions.

IAS37 does not allow the recognition of contingent liabilities, but such liabilities may be disclosed by way of a note.

IAS37 does not apply to trade creditors, accruals, adjustments to the carrying value of assets such as stock provisions, bad debt provisions and provisions for depreciation, insurance company provisions arising from contracts with policyholders or provisions which are specifically addressed by other accounting standards.

Provisions of a general nature, including general bad debt provisions, are specifically disallowed by Article 21(1)(g) (see QTM4 - 3020)

4 – 2120 Establishing the Facts

If the admissibility for tax purposes of an item of expenditure is disputed it is essential you obtain and consider all the evidence, which might include contemporaneous documents, agreements, notes of meetings and other records or documentation. In many cases a face to face meeting may be the quickest way to establish the admissibility of the disputed expenditure.

4 – 3000+ Specific Rules

4 – 3000 Introduction

In addition to the general principles regarding deductions in Articles 19 and 20 (see above) specific computational provisions are to be found at Articles 21-25.

Article 21 provides a list of disallowable deductions, and Articles 22-25 provide rules regarding the admissibility of specific items.

4 – 3020 Deductions Not Allowable

Article 21 provides a list of specific items of expenditure which, subject to other provisions, may not be deducted in computing chargeable profits.

The items of expenditure that are not allowable by virtue of Article 21 are:

- Expenses not actually incurred or not supported by documentary evidence (QTM4-2060)

- Depreciation of tangible fixed assets, except as provided by Article 22 (QTM4-4000+)
- Fines or penalties imposed by the Tax Department or any other government agency, in Qatar or overseas (QTM4-6000)
- Any costs connected with unlawful acts (QTM.4-6020)
- Amortisation of intangible fixed assets, except as provided for by Article 24 (QTM4-5000+)
- Waivers of debt between Connected Persons (QTM4 - 6040)
- General bad debt or any other provisions of a general nature (QTM4 - 6060)
- Share-based remuneration, except as provided for by Article 25 (QTM4 - 6080)
- Any distributions of profits (QTM4-6100)
- Overseas corporation tax, except as provided for by Article 40 (QTM4-6120)
- Any expenditure incurred generating income that is exempt from tax under the Regulations (QTM4-6140)
- Expenditure incurred in connection with obtaining or seeking to obtain a QFC Licence (QTM4-6160)
- Charitable donations in excess of 5% of the Chargeable Profits of the QFC Entity (QTM.4-6180)

4 – 4000+ Depreciation of Tangible Fixed Assets

4 – 4000 General

Any deduction for the depreciation of tangible fixed assets is initially disallowed by Article 21(1)(b) but Articles 22 and 23 then permit a deduction, subject to certain restrictions.

Article 22(1) allows a deduction for the depreciation or other impairment of a tangible fixed asset, equal to the depreciation charged in the Entity's accounts, provided that the assets have been acquired for the purposes of its licensed activity. The provision is, importantly, subject to Articles 22(2) and Article 23 (see below). Article 22(3) caps the total tax deduction for depreciation, over one or a number of accounting periods, to the original cost of the asset.

4 – 4020 Acquired For the Purpose of Licensed Activity

To qualify for a deduction under Article 22(1) the asset in question must have been acquired for the purpose of the QFC Entity's licenced activity. The provision does not refer to use of the asset, nor does it suggest the asset must be used solely in connection with the licensed activity.

A deduction for depreciation may therefore be available, under Article 22(1), in respect of assets before they are bought into use and for assets used only partly for the purpose of the QFC Entity's licenced activity.

Depreciation is a non-cash disbursement and Article 19 limits deductions to the extent expenditure, including disbursements, is incurred for the purpose of generating local source profits (see QTM4-2060). It follows that where an asset is used only partly for the purpose of generating local source profits, depreciation, like any other expense, may be apportioned (Article 21(2)). The basis of apportionment under Article 21(2) is a "just and reasonable" basis, which will normally reflect the ratio of the licenced activity to other use. If however, on the facts, another basis of apportionment gives a result that is more just or reasonable, that basis should be adopted (See QTM4-2020 for guidance on what is meant by "just and reasonable").

Assets acquired before a licence is received may still be regarded as having been acquired for the purpose of the licenced activity. However any depreciation charged between acquiring the asset and a QFC Entity coming into charge to corporation tax, by commencing licensed activity, will not be allowable. If a taxpayer acquires an asset before obtaining their QFC licence, but does not start to depreciate it until it was brought into use in the activities carried out after the licence was obtained, this treatment should normally be accepted.

If an asset is acquired but never brought into use before being disposed of, there may be an argument that it was not acquired for the purpose of its licenced activity (see QTM4-2040 above for the meaning of the phrase "for the purpose of..."). You should not seek to deny a deduction solely on the grounds the asset was not used and the full facts should be carefully examined.

4 – 4040 Depreciation Charged in the Accounts

Article 22(1) allows as a deduction the depreciation charged in the QFC Entity's accounts. Where the depreciation charge has not been calculated in accordance with GAAP then Article 22(2) restricts the deduction to the amount that would have been charged under GAAP.

It will be unusual to find that accounts prepared in accordance with GAAP (as defined by Article 15(2)) contain a depreciation charge that has been calculated on a basis not in accordance with GAAP. It is possible for this to happen by, for example, depreciation not in accordance with GAAP being included without attention being drawn to the fact on grounds of materiality, or the audit certificate being qualified to note the deviation from GAAP. In such circumstances Article 22(2) restricts the tax deduction to the amount that would have been charged, had the calculation been made in accordance with GAAP. If the difference between the GAAP calculation and the basis adopted is not material for the purpose of GAAP, but is considered significant for tax purposes, then an argument that the accounts charge is in accordance with GAAP (and should stand for tax purposes) should be countered by the fact the charge to tax is on the "full amount" of local source taxable profits (Article 9(1) and QTM2-1080 on corporation tax rate and charge) and this overrides the accounting concept of materiality.

The requirements of the QFC Regulatory Authority, the CRO together with the requirements of Article 15 will make it highly unlikely that a QFC Entity's return for an accounting period will be supported by accounts that have not been prepared in accordance with GAAP. If you do meet this situation, perhaps most likely in the case of a branch or a partnership not formed in Qatar, it may be necessary to adjust the results, by way of an enquiry, to reflect the depreciation charge that would have been made under GAAP.

4 – 4060 Depreciation Restricted to Original Cost

In order to prevent an excessive deduction for depreciation Article 22(3) provides that the total tax deduction for the depreciation of an asset must not exceed the original cost of the asset.

Without this provision the total depreciation in respect of an individual asset might exceed cost on the basis of a revaluation during the lifetime of the asset or as a result of the QFC Entity acquiring the asset for more than original cost.

"Original cost" is defined in Article 22(5) as the lower of the cost incurred by the QFC Entity in acquiring the asset and the market value of the asset at the time it was acquired by the QFC Entity. "Market value" is defined by Article 153 as, "the price an asset might reasonably be expected to fetch on a sale in the open market."

The cost incurred by the QFC Entity in acquiring the asset includes capitalised incidental acquisition costs.

The comparison is between the cost incurred by the QFC Entity in acquiring the asset and the open market value at that time, not at the time the asset was originally acquired by, for example, another group company. The open market value should include incidental costs of acquisition, to the extent these have been capitalised and included in the cost of the asset in the balance sheet of the QFC Entity.

Valuation can be a complex matter requiring professional qualifications. If you need to ascertain the open market value of a fixed asset the case papers should be referred to the

Director of Tax to consider employing the services of a firm of specialised valuers. If the open market value of an asset appears to be a material question in an enquiry you should consider asking the taxpayer to obtain an independent professional valuation to support their figure. The Tax Department will not bear the cost of such a valuation – it represents part of normal tax compliance costs, but if the request is unreasonable, the QFC may have to consider making reimbursement if a formal complaint is upheld. Challenges to the open market value of an asset should only be made where a significant amount of tax (or losses) appear to be at stake.

In addition to limiting depreciation in revaluation situations, the main purpose of Article 22(3) is to prevent a QFC Entity obtaining an excessive deduction for depreciation on an asset transferred from a related party at over-value.

Where it is suspected an asset has been transferred at a substantial overvalue the position should be challenged by way of an enquiry during the accounting period when the transfer takes place, even though the Article 22(3) restriction may have no effect on the profits or losses for that period.

The Article 22(3) restriction is on *total* depreciation of an individual tangible fixed asset. This may result in having to track the position over several accounting periods.

Where a transfer at overvalue is identified, as a result of an enquiry or otherwise, a prominent forward note should be made to track the accumulated depreciation, so that the adjustment required is not lost sight of. Similarly, where the accounts show an upward revaluation of a tangible fixed asset has been made, a prominent forward note should be made.

4 – 4080 Reversal of Depreciation

As a corollary to the restriction of depreciation to original cost (above) Article 22(4) ensures that on the reversal of depreciation, for example when an asset is sold, the tax charge is limited to the original cost, and not a re-valued, or over-valued amount.

For example, suppose an asset with an open market value of QR 200,000 is acquired for QR 500,000 and written down to QR 50,000 in the books of the QFC Entity. The depreciation for tax purposes will have been restricted to QR 200,000. If the asset is sold on the open market for QR 300,000, the QR 450,000 depreciation will be written back to the profit and loss account. The tax charge on this write back should, however, be restricted to the QR 200,000 depreciation allowed for tax purposes.

4 – 4100 Specified Classes of Assets – Article 23

Article 23 limits the allowable depreciation charge to 5% per annum of original cost in respect of:

- Aircraft
- Ships
- Industrial buildings and offices
- Infrastructure assets including but not limited to roads, bridges and port facilities.

The charge is on a per annum basis, so if an accounting period is less than 12 months the restriction should be applied pro-rata. For example if an office cost QR 10m and the accounting period is 9 months the maximum allowable depreciation charge will be QR10m x 5% x 9/12 = QR375,000.

The classes of assets are not specifically defined, although there should normally be little difficulty in determining whether an asset is, for example, an aircraft or a ship etc.

The position may not always be clear, for example, is a helicopter an aircraft, a hovercraft or an oil rig a ship? Because the terms are not defined the meaning to be given to each of the assets within Article 23 is the ordinary everyday meaning. For example, an oil rig, because it is fixed to the sea bed, should not be regarded as a ship.

The term "industrial building" may also cause problems. The general approach should be to regard a building or structure used directly in manufacturing or a technically productive enterprise as an industrial building. Take a warehouse for example. A warehouse used in the business of storing goods would not be an industrial building whereas a warehouse used by a manufacturer to store finished products before delivery to customers is an industrial building. As the meaning of "industrial building" is connected to the use to which the building is put, situations may arise where a building is only partly used for, say, manufacturing and partly used for other purposes, such as a showroom. In such cases the restriction should be calculated on an apportioned basis.

For example if a QFC Entity owns a building costing QR70m, depreciated in the accounts at 10%, which is used 70% for manufacturing and 30% as a showroom, the annual depreciation should be restricted to (QR70m x 70% x 5%) + (70m x 30% x 10%) = QR4.55m.

It is not anticipated the meaning of the word "office" should create any particular problems.

Where there is a change in use of a building from an industrial building or office to some other purpose, or vice versa, (for example, an office block converted into a hotel) the restriction should be applied/disapplied in the accounting period of change, with the restriction for the accounting period of change being pro-rated.

A common sense approach should be taken where the conversion of a building covers more than one accounting period, the general approach being, on the basis that in cases of doubt the benefit should be given to the taxpayer, that the restriction is disapplied at the beginning of a conversion to a use that will no longer require a restriction (e.g. an office to a hotel) and applied at the end of the conversion to a use that will require a restriction (e.g. a hotel to an office).

In the case of a building under construction the approach should be to restrict the depreciation if the intended use of the completed building is clearly as an industrial building or office. If the building is not used for such purpose on completion, the restriction should be disapplied as soon as it is known the intended use has changed.

To be considered an industrial building, and subject to the Article 23 5% limitation, a building does not have to be used in a manufacturing or similar business carried on directly by the QFC Entity. It is highly unlikely that a QFC Entity will itself conduct activities in a building that would be regarded as an industrial building. The restriction may, however, arise where a QFC Entity owns a building that it leases as part of its licensed activity. In such circumstances it is the use to which the building is put by the tenant that will be relevant.

When considering infrastructure assets (Article 23(1)(d)), application of the *'ejusdem generis principle'* (see QTM1-2060) means the restriction should be limited to assets that are roads, bridges or port facilities, or assets of a similar kind.

4 – 4120 Specified Classes of Assets – Article 23(2)

Article 23(2) provides that where depreciation has been limited to 5% per annum of original cost and in a subsequent accounting period the depreciation charged in the accounts in respect of that same asset is less than 5% of original cost then a deduction for depreciation is allowed at the annual rate of 5% of original cost, providing that:

a) The asset is still owned by the QFC entity and is being used for the purpose of its licensed activity,
b) The total accumulated tax deduction does not exceed original cost, and
c) The total accumulated tax deduction does not exceed the total accumulated depreciation on the asset

This provision covers the situation where the depreciation charged in the accounts writes the asset down to the point where the annual charge is less than 5% of original cost. It should be remembered, in this context, that the restriction under Article 23 is to the depreciation charged in the accounts (Article 22(1)).

For example if a QFC Entity acquires an office for QR 30m which it writes down in its accounts at 20% on a straight line basis (not likely under GAAP, but figure used for illustrative purposes). After 5 years the asset will be written down to nil and no further depreciation will be charged to the profit and loss account. However as, for tax purposes, the depreciation will have been limited to 5% p.a., only 5 years x 5% x 30m = QR7.5m will have been allowed. Article 23(2) allows depreciation to continue to be given at the rate of 5% p.a. (in this example QR 30m x 5% = QR1.5m p.a.) provided the conditions in Article 23(2)(a-c) are met.

It should be noted Article 23(2)(a) introduces an "in use" condition. Strictly this means if, exceptionally, an asset under construction, or an asset completed but not used is depreciated to below 5% of original cost then no depreciation may be allowed for tax purposes. However a broad view should be taken regarding, for example, periods of temporary disuse.

The restriction is by reference to original cost.

Articles 23(2)(b) and (c) ensure that where a tax deduction is given after the depreciation charged in the accounts is less than 5% of original cost, the total tax deduction is not allowed to exceed either original cost (Article23(2)(b)) or the total accumulated depreciation of that particular asset (Article 23(2)(c)).

4 – 4140 Record Keeping

Where depreciation is restricted under Article 22 or 23 then a clear record of the depreciation allowed for tax purposes against specific assets should be maintained in the permanent notes folder of the QFC Entity concerned and a forward note made to ensure the position regarding restricted depreciation of assets is not lost sight of.

4 – 5000+ Intangible Fixed Assets

4 – 5000 General

A deduction for the amortisation of intangible fixed assets is prohibited by Article 21(1)(e), subject to Article 24.

Amortisation, similar to depreciation, recognises the consumption, expiration, obsolescence or other decline in the value of an intangible fixed asset as a result of use or the passage of time.

IAS 38(8) defines an intangible asset as an identifiable non-monetary asset without physical substance. Under this definition goodwill is not regarded as an intangible asset as it is not "identifiable". Under IFRS goodwill may be impaired but is not amortised, an impairment loss carried to profit and loss account in accordance with IFRS, will be allowable in full for tax purposes.

A useful list of the type of assets included within the scope of "intangible assets" may be found in IFRS 3(IE) and includes marketing, customer, artistic, contract-based and technology based assets.

4 – 5020 Allowable Amortisation

Article 24(1) allows a QFC Entity to deduct the amortisation of intangible fixed assets, acquired for the purpose of its licensed activity, of the amount charged in its accounts.

When considering the phrase "acquired for the purpose of its licensed activity" the same principles apply as in relation to tangible fixed assets, for which guidance is given at QTM4 - 2040 above.

4 – 5040 Restriction of Allowable Amortisation

The amortisation to be allowed in the case of internal intangible fixed assets is restricted broadly by reference to the income generated from the asset. Practice Note 1 considers this position in further detail.

An internal intangible fixed asset is defined as any intangible fixed asset acquired from a connected person (Article 24(3)). For the meaning of "connected person" see below.

The restriction of allowable amortisation of internal intangible fixed assets is to limit the admissible amortisation to the *"…amount of taxable income generated from charges for the use, licence or exploitation of the asset."*

The restriction is based on "taxable income." Although not defined the phrase should be taken to mean the amount of income taken into account in arriving at the chargeable profits (see Part 1 of this manual) of the QFC Entity for the accounting period in question. Non-local source income will therefore be excluded.

It should be noted the provision is restrictive, not permissive. So if, for example a QFC Entity received taxable royalties of QR10m from a patent acquired from a connected person, which was amortised in the Entity's accounts to the extent of QR1m, the allowable deduction will be QR1m, not QR10m. On the other hand if the taxable royalty income was only QR 700,000 then Article 24(2) restricts the deduction from the accounts charge of QR1m to the income generated of QR700,000.

4 –5060 Meaning of Connected Person

In addition to its use in Article 24(3) the term "Connected Person" is used in connection with the waiver of bad debts (Article 21(1)(f)) and in relation to Transfer Pricing at Article 57(4) and Part 8 of this manual).

Article 153 defines "Connected Person" as *"…a Company is connected with another Company if the same Person has control of both, or a Person has control of one and Persons connected with him, or he and Persons connected with him, have control of the other."*

Article 153 also brings within the scope of "Connected Persons" those persons whom are connected by virtue of the definition of "Connected Person" in Part 8 (Transfer Pricing) at Article 57(4).

In brief, a person may control a company by virtue of his shareholding or if the affairs of a company are conducted in accordance with his wishes. Control of a company may be indirect. So if, for example, company A has a 100% subsidiary B which, in turn, has a 100% subsidiary C, A will control C as A is able to exercise indirect control over the affairs of C by virtue of its shares in B.

The above means that in a group, where (for the sake of simplicity) all subsidiaries are directly at least 51% owned by fellow group members, all the companies in the group will be connected to each other.

Company connection goes beyond the group situation when individuals are taken into account. For example if individual A controls both companies B and C, which are otherwise unconnected, B and C will be connected through A's control. Further if company B is controlled by individual A and company C is controlled by a person, or persons, connected to A, such as his or her relative or relatives, then the companies B and C will be connected.

If a company is a member of a partnership comprising other companies or other companies and individuals, the company will be connected with the partners (corporate and individual) by virtue of Article 57(4)(b).

Lastly, if individual A controls company B and that individual (A) together with persons connected to him, such as his relatives, control company C, then companies B and C will be connected.

The above examples are not exhaustive, although they do cover the most likely situations. You should refer to Articles 57(4) and the definition of connected person in Article 140 if it is necessary to consider if a company is connected with another company in circumstances outside those described above.

4 – 6000+ Other Deductions Not Allowed

4 – 6000 Financial sanctions

Financial sanctions which are imposed by the Tax Department, or fines and penalties imposed by any other government agency whether in Qatar or overseas are not allowed as a deduction in arriving at a taxpayer's chargeable profits (Article 21(1)(c)).

4 – 6020 Costs Connected with Unlawful Acts

Any costs connected with unlawful acts of the taxpayer, whether in Qatar or overseas, are not allowed as a deduction in arriving at chargeable profits (Article 21(1)(c)). The provision ensures that the QFC does not subsidise a taxpayer's unlawful acts.

An unlawful act is behaviour that is not authorised by law; commission of or participation in an activity that violates criminal or civil law. It follows the range of disallowance will cover minor breaches of the civil code, such as speeding fines, to payments that are in themselves criminal, such as the payment of a bribe to win a contract. You should only raise the possible application of Article 21(1)(d) if you find clear signs that it may be relevant.

Raising the possibility of a disallowance for the taxpayer may mean you are suggesting they may have committed a crime. This should not present a difficulty where the courts have already found the payer guilty of an appropriate offence.

Alternatively, legal advice may be provided which states that the payment in question was not unlawful. If so, ask to see both the request for advice and the advice itself. Either or both should set out the facts on which the advice is based. You should then normally close your enquiry if the legal advice is unequivocal and apparently of good standing.

However, the technical position may be much less clear cut where the unlawful act, if there is one, has not come to the attention of the courts and there is no other conclusive legal advice. You should therefore refer to the Director of Tax for advice at an early stage.

Sometimes, however, the taxpayer's inability to provide satisfactory evidence about the nature of payments, or the payee's name and address, may be a sufficient reason for seeking a disallowance.

4 – 6040 Debt Waivers Between Connected Persons

If a QFC Entity waives a debt due to a Connected Person, and the waiver is carried to the Entity's profit and loss account (because, for instance, the debt was on revenue account) Article 21(1)(f) prohibits any deduction for QFC tax purposes. "Connected Person".

4 – 6060 General Bad Debt or any Other Provisions of a General Nature

Under IFRS (and other GAAP, for instance UK GAAP) general provisions are not permitted. Under IFRS, bad debts are dealt with by way of "impairment" rather than provision, but again no general impairment reserve is permissible. It follows that general bad debt, stock (inventory) or other provisions of a general nature should be relatively uncommon.

A profit and loss account charge relating to a provision that is general in nature is inadmissible for the purposes of QFC tax by virtue of Article 21(1)(g).

A bank will make a general provision for loans that are believed to be bad or doubtful at the accounting date but have not been individually identified. They are usually quantified by reference to historical data as well as economic, sector and political information rather than information about the individual debtor. The movement in the general bad debt provision is taken to the profit and loss account in the same way as specific provisions. On the basis that the provision made by banks for bad or doubtful loans has been calculated with sufficient accuracy we may allow a deduction in the same way as is allowable for specific provisions.

The taxation of insurance companies, including the treatment of provisions, is dealt with at Part 13 of the Regulations (see Part 13 of this manual). General provisions are specifically disallowed at Article 76(2) along with equalisation and catastrophe reserves.

4 – 6080 Share Based Remuneration

Neither the State nor the QFC impose any tax on the remuneration of QFC employees. Share based remuneration received by QFC employee's is therefore not taxed as income. Such remuneration may be treated as an ordinary expense of the business, taken to the profit and loss account or income statement in accordance with GAAP and may, under specified circumstances, be allowed as a deductible expenses for QFC tax purposes.

Share based remuneration granted to employees which is recorded in a taxpayer's accounts in accordance with acceptable GAAP is deductible as an expense provided the conditions outlined in Article 25 are met. Remuneration of employees of QFC entities which is linked to the share price performance of shares listed on a recognised stock exchange is allowed as a deduction for an accounting period if:

1) It is charged in the profit and loss account of the QFC entity; and
2) It is charged in the profit and loss account of the consolidated accounts of the quoted parent company

Both conditions must be met for the remuneration to be allowed as a deduction. In conformity with Article 15, the accounts of the QFC entity must be prepared in accordance with acceptable GAAP. The parent company of the QFC entity may or may not also be a QFC entity and it should be noted the parent company must be a quoted company.

Types of Share Based Remuneration

"Share based remuneration" includes, but is not limited to:

- Share option grants or exercise
- Share awards
- Payments to employee benefit trusts or affiliates
- Share option scheme set-up and administration costs

Recognised Stock Exchange

The phrase "listed on a recognised stock exchange" is not defined anywhere in the Regulations or elsewhere in QFC Law, and no known authoritative list of recognised stock exchanges is published by the Government of Qatar.

It has been decided, the list of recognised stock exchanges published by the UK HMRC should be regarded as a useful guide to those stock exchanges that should be regarded as "recognised."

HMRC provide a definition of recognised stock exchange on their website together with tables of recognised exchanges (http://www.hmrc.gov.uk/fid/rse.htm).

The Qatar Exchange (previously the Doha Securities Market, (DSM)) should be regarded as "recognised."

4 – 6100 Distributions

Article 21(1)(i) prohibits any deduction in respect of distributions of profits. The definition of accounting profit (Article 15) specifies pre-dividend profit and as distributions will not normally be charged to the profit and loss account "above the line" the provision in Article 21(1)(i) is, to some extent, precautionary.

"Distribution" is defined in Article 153 as, *"any dividend paid by a Company, including a capital dividend, or anything distributed out of assets of a Company in respect of shares and securities in the Company."*

A distribution arising from the purchase, by a company, of its own shares (see Article 44(1)(c) and QTM7-4060) is also disallowable.

4 – 6120 Overseas Corporation Tax

Relief from double taxation is given by the provisions of Part 6 of the Regulations. Broadly relief is given unilaterally or under the terms of a double tax treaty. Normally relief is given by credit against tax payable, but a taxpayer may elect (where, for example, there are losses) to have relief given as an expense deduction (see Article 40 and QTM6-3040). Article 21(1)(j), by prohibiting a deduction for overseas corporation tax, except as provided for by Article 40, ensures that relief is not given twice – once as deduction in arriving at profits and secondly by way of treaty or unilateral relief. The provision also prevents the deduction of overseas corporation tax that does not qualify for treaty or unilateral relief.

The prohibition should not be regarded as applying only to overseas taxes that are specifically called "corporation tax." A deduction should be denied to the payment of taxes that are essentially similar to corporation tax, such as income tax on corporate profits or, in the case of a QFC Entity that is, for example, a partnership, overseas income tax.

4 – 6140 Expenditure Incurred in Generating Exempt Income

A distinction is to be drawn between a taxable QFC Entity whose income, in a particular accounting period, consists wholly or partly of income that is exempt from tax under the Regulations and a QFC Entity that is itself exempt from tax.

This section deals with income that is exempt. See Part 13 (QTM13-1000+ Insurance) for the apportionment of profits in the case of an insurance company chargeable partly at the concessionary rate (on profits from reinsurance) and partly at the standard rate (on other profits).

Where an Entity is tax exempt, there is no question of any losses being utilised, for example by way of group relief or for carry forward against future taxable profits (Article 82(8)). Exempt Entities are those that elect for special exempt status under Part 14 (see QTM14-1000+), which may include an Islamic Finance SPV (Article 70 and QTM11-5120), and the Government of Qatar (Article 151). Because an exempt entity cannot create a tax loss, there is no need to specifically disallow expenses incurred in generating the income – rather, for any given accounting period, all profits are non-taxable in full and all losses are fully non-allowable.

A QFC Entity that is not exempt from tax may earn income that is exempt, for instance-

- Transactions under Article 44(1) (Reduction in share capital) – any QFC entity carrying out, receiving proceeds or generating a profit and loss account credit in respect of such transactions is exempt from tax on that transaction (see Part 7 Reorganisations and Reconstructions)
- The gain arising on the disposal of a qualifying shareholding (Article 72 and Part 12 of this manual)
- Dividends received (Article 150)

Where a QFC Entity is in receipt of exempt income, Article 21(1)(k) prohibits a deduction in respect of expenditure incurred in generating that income. It should be noted the income and expenditure do not need to relate to the same accounting period, so that expenditure incurred in generating exempt income that is received in a future or past accounting period is disallowable in the same way as expenditure incurred in generating exempt income received in the same accounting period as the expense was incurred.

Some expenditure will relate directly to the generation of exempt income and some will relate only partly to such income. Where apportionment is necessary this should be on a “just and reasonable” basis, along the same lines as apportioning expenditure between local and non-local source income (see Article 21(2)).

4 – 6160 Expenditure Incurred in Obtaining a QFC Licence

Article 21(1)(m) disallows any expenditure incurred in connection with obtaining or seeking to obtain a QFC Licence. This section was not originally required as these costs would have been incurred before a QFC Entity commenced trading. However following the introduction of Article 21(3) (Part 5 of this manual on losses) which allows a deduction for pre trading expenses the restriction in Article 21(1)(m) is now required.

4 – 6180 Charitable Donations in excess of 5% of Chargeable Profits

Article 21(4) restricts the deduction of donations made by a QFC Entity to a registered charity in an Accounting Period to 5% of the Chargeable Profits (as calculated prior to the deduction of the donations and in accordance with the principles outlines earlier in this manual.

Generally donations are not an expense incurred “for the purpose” of the business, however they are allowed on the basis the business can afford to make the donation and the fact that it is for a good cause. The limitation in Article 21 means that for those entities who make low or no profits and cannot afford (in business terms) to make charitable donations the amount will be restricted. For loss making entities any charitable donations are likely to be disallowed for tax purposes. Entities making low profits will need to take care when making charitable donations.

4 – 6200 Leases

The Regulations do not provide any specific rules on the taxation of leasing transactions.

A lease is an agreement under which the lessor grants to the lessee the right to use an asset for a defined period of time in exchange for a stated rental payment. From an economic point of view, lease agreements can be broadly divided into two types (recognising that some agreements may fall into a grey area between the two): financial lease (or finance lease) and operating lease. A finance lease is one under which the risks and benefits inherent in the ownership of the asset over its lifetime are transferred to the lessee, while the legal title to the asset remains with the lessor. The agreement may provide for purchase of the property by the lessee upon expiration of the lease term. An operating lease is any lease other than a finance lease, i.e. one where the risks and benefits incident to ownership (and the legal title) remain largely with the lessor. An example of an operating lease is one for a very short term, e.g. one week.

The following tax treatment, which follows the accounting treatment, should be applied to leases:

	Lessee		**Lessor**

Operating Lease	Deductions are allowable for operating lease rentals for use of the asset, which are paid to the lessor		Lessors receiving rental income from a lessee for the use of an asset should include this income in their accounting profits
Finance Lease	Deductions will be allowable for depreciation of the finance lease asset and interest charges associated with the finance lease, paid to the lessor		Lessor receives interest income from the lessee and this income should be included in the lessor's accounting profits. The lessor will not be allowed deductions for depreciation of the finance lease asset.

PART 5 LOSS RELIEF (including Group Relief)

5 – 1000+ Loss relief - General Overview

5 – 1000 General Overview

Part 5 of the Regulations deals with loss and group relief.

Losses may be carried forward, without limit of time, to set off against profits of succeeding accounting periods. Losses cannot be carried back. As there is only one class of taxable profits, loss streaming is unnecessary, with one exception (Article 29 – transfer of losses without a change in ownership – see transfer of licensed activity below at QTM5-3000+).

The transfer of losses between QFC Entities under common control, and on the incorporation of a business is facilitated. An anti-avoidance provision is included in order to deter loss-buying.

Group relief is available between QFC Entities that are members of the same group. Relief is given only for the accounting period in which the loss is incurred – excess group relief may not be claimed and carried forward by a claimant company. Group Relief is restricted when a company joins or leaves a group.

Relief for losses brought forward is normally given in priority to group relief, although a company may elect for group relief to be given first.

5 – 1020 Computation of Losses

Tax losses are to be calculated *'… on the same basis as Chargeable Profits'* (Article 26).

The phrase *'Tax loss'* is used in the Regulations to distinguish a tax adjusted loss, available for relief, from an accounting or other loss.

Because tax losses are computed in the same way as Chargeable Profits, it follows that no relief is available in respect of any loss arising from a non-licensed activity (Article 11(2). If a QFC Entity does carry on an unlicensed activity and submits accounts for its whole operation, it will be necessary to separate out the results of the non-licensed part of the business, apportioning income and expenditure where necessary. The apportionment should be on the basis of the facts of the case.

As the charge to tax is on Local Source Taxable Profits (Article 9 – QTM2-1000) any tax losses must 'arise in or are derived from Qatar' in the same way as profits. In other words the territorial basis, discussed at Part 2 of this manual, applies equally to the calculation of tax losses as it does to taxable profits.

Both profits and losses are computed in relation to accounting periods. For a loss to qualify for relief as a tax loss it must arise in an accounting period. Accounting periods discussed in Part 3 of this manual. It follows that losses which arise before a QFC Entity commences activities within the terms of its QFC licence (Article 17(1)(a)) do not qualify as tax losses. However, see below for pre-trading expenditure. Any losses arising after a QFC Entity ceases to have a source of income within the terms of its QFC licence (Article 12(2)(c)) – for example on cessation or during a period of dormancy - also do not qualify as tax losses.

The principles of attributing profit to a non-resident QFC Entity (see Article 13 and QTM2-2000+ of this manual) apply equally to profits and losses so that, broadly speaking, the losses of a branch in Qatar are computed on the basis the branch is a separate enterprise dealing at arm's length with the enterprise of which it is a part.

5 – 1040 Relief for pre trading expenditure

A QFC Entity comes within the charge to tax by commencing activities within the terms of its QFC Licence. As noted above, per Article 17(1)(a) this means losses incurred before an entity commences activities do not qualify as tax losses. Article 21(3) provides that expenditure incurred by a QFC Entity in Qatar prior to the granting of its QFC Licence, or the commencement of activities within the terms of its QFC Licence, shall be deemed to have been incurred by the entity on the first day of its first accounting period under the QFC Tax Regulations.

These expenses have to have been reflected in the accounts of the QFC Entity. Furthermore the words "incurred in Qatar" restrict the deductions available. Essentially these words are included to prevent deductions for expenses incurred by other members of the group and charged to the QFC Entity once it has been established. Incurred in Qatar means that the provider of the service or supply was based in Qatar, not that the QFC Entity paid for them in Qatar. Examples of expenses that should be allowed include rental of office space in Qatar, salaries of locally based employees, services provided by locally based consultants, telephone charges, utilities. Examples of expenses that would not be allowed include management charges from overseas Head Office, employees based overseas, offshore consultancy services. charges from overseas service centres. Costs incurred in obtaining the QFC Licence should also be disallowed, see Article 21(1)(m) and QTM4-6160 above).

5 – 1060 Restrictions on Relief

The carry forward or surrender as group relief of losses is restricted in the situations outlined below.

Relief is not to be given more than once in respect of the same loss (Article 27) so, for example, a tax loss may not be both carried forward and surrendered as group relief.

Losses arising during the period of the tax holiday, which ended on 31 December 2009, are not available for carry forward by virtue of Article 28(3).

Article 30 prevents the carry forward of losses where there has been both a change in ownership and a major change in the nature of the Licensed Activities carried on by a QFC Entity. This provision is an anti-avoidance measure designed to prevent loss-buying and is discussed fully at QTM5-4000+ below.

Any QFC Entity taxable at the concessionary rate (captive insurers, profits from reinsurance and Qatari owned entities) may not carry forward, or surrender as group relief, any losses arising in any accounting period in respect of which the concessionary rate applies as Part 5 is specifically disapplied by Article 90 (Part 15 of this manual).

A QFC Entity which elects under Part 14 for special exempt status may not carry forward, or surrender as group relief, any losses arising in any Accounting Period in respect of which such an election is in force (Article 82(8). Because an Entity that has claimed special exempt status for an Accounting Period has no Chargeable Profits for that Accounting Period, it may not make a group relief claim (Article 32(1)).

Exempt Entities (as the Regulations stand at present, just the Government of Qatar, exempt under Article 151) do not have Accounting Periods or Chargeable Profits, so an exempt entity may not surrender or claim losses by way of group relief.

The participation exemption provisions of Part 12 of the Tax Regulations (and Part 12 of this manual) include a rule that any loss arising on the disposal of a 'Qualifying Shareholding' is not available for carry forward or group relief.

Group relief is only available to companies in the same group. Group relief is restricted where the surrendering and claimant companies are not in the same group throughout the whole of the surrendering company's Accounting Period (Article 35 – see QTM5 – 5000+ below).

5 – 1080 Discovery Determinations

Discovery assessments may, broadly, be made when the QFC discovers there is a loss of tax and the relevant enquiry window for that tax return has closed. Discovery determinations may be made when it is discovered a return that affects or may affect another Accounting Period, or the liability of another QFC Entity, is incorrect (Article 128(2)).

Where it is discovered a return has overstated the amount of losses available for carry forward under Article 28, this will potentially affect the tax liability of future accounting periods. In these circumstance a discovery determination should be made under Article 128(2)(a) which has the effect of reducing the losses available to the figure in the determination. If excessive relief for one or more future accounting periods has already been given, the excessive relief may be clawed back by either opening an enquiry into the return for the relevant Accounting Period (subject to time limits) or by raising a discovery assessment under Article 128.

If it is discovered excessive group relief has been surrendered and the enquiry time limit for the surrendering company has passed, then a discovery determination may be made under Article 128(2)(b) which has the effect of reducing the losses available for surrender to the figure in the determination. The consequences for claimant companies, is dealt with by TAX 9.5 .

5 – 2000+ Carry Forward of Losses

5 – 2000 General

Article 28 provides for the carry forward of tax losses against Chargeable Profits arising in future Accounting Periods, without limit of time, provided the QFC Entity continues to have a source of income within the terms of its QFC licence.

This condition of continuing to have a source of income means that a QFC Entity may not carry losses across a period of dormancy. In this context 'dormant' means ceasing to have *any* source of income within the terms of an entity's QFC licence, not merely that the income from a continuing source becomes negligible. Dormancy will also mean there is a cessation of (or break in, if the dormancy is temporary) accounting periods, as on ceasing to have any source of income, an accounting period ends without a new one beginning (Article 17 - see QTM3-2000+). It follows that when a QFC Entity re-commences profitable activity within the terms of its QFC licence after a period of dormancy, no relief is available for losses incurred when the period of dormancy began.

Relief for losses carried forward does not have to be claimed. Relief is mandatory and losses are set off, so far as possible, against the Chargeable Profits of the next Accounting Period before being carried forward to a later period (Article 28(2)).

See above for the interaction of losses available for carry forward and discovery assessments and Article 128(2) for the making of discovery determinations.

The amount of loss available for carry forward will be reduced by any surrendered losses as group relief. For the interaction of losses carried forward and group relief see QTM5-5160 below.

5 – 2020 Apportionment

It will sometimes be necessary to apportion either the results shown by a QFC Entity's accounts to different Accounting Periods or to apportion the tax loss arising in an actual accounting period between deemed Accounting Periods. Normally apportionment should be made on a time basis. Exceptionally, if a QFC Entity produces convincing evidence, such as monthly management accounts, to show a time basis of apportionment does not produce a just result, you may accept an alternative apportionment, based on the facts of the case.

5 – 3000+ Transfer of Licensed Activity Without a Change in Ownership

5 – 3000 Introduction

Article 29 deals with company reconstructions and, broadly speaking, allows losses to be transferred when a business is transferred from one QFC entity to another QFC entity and both are under common ownership, defined as a Person with at least a 51% interest in both the predecessor QFC entity and the successor QFC entity.

Although Article 29 refers to the transfer of a licensed activity between two QFC Entities in common ownership (i.e. is not, prima facie, restricted to companies), as '51% interest' is defined in terms of Ordinary Share Capital, a strict reading of Article 29 means that it applies only to company to company transfers ('company', in this context, excludes a LLP). By concession, you may accept that Article 29 should apply to a transfer other than a company to company transfer, provided all other conditions are met, the relevant facts are obtained and you consider that the claim has merit and tax avoidance is not an obvious objective.

5 – 3020 Conditions and Effect

For losses to be transferred under Article 29, **all** the following conditions must be met:

- A QFC Entity (the 'predecessor') must cease carrying on a licensed activity.
- Another QFC Entity (the 'successor') must begin to carry on the **same** licensed activity.
- The predecessor and successor must be in common ownership (see QTM5-3140 below) at the time of the transfer, and remain in common ownership for at least six months from that date.

Where all the conditions are met, the predecessor's tax losses unutilised at the date of transfer become available to the successor (and no longer available to the predecessor), as losses brought forward under Article 28 at the date of transfer. The losses are only available for carry forward against future profits from the transferred activity (Article 29(3)), and are not available to be set against profits from any other activity carried on by the successor, or for surrender as group relief. No claim is required and the transfer of losses is mandatory where the conditions are met.

5 – 3040 Cessation of Licensed Activity

Article 29 is written in terms of the transfer of a 'Licensed Activity' which is defined at Article 153 as *'The activities a QFC Entity is permitted to carry on under the terms of its QFC Licence.'*

Article 29 will normally apply in a group situation where the business carried out by one group member is transferred in its entirety to another newly formed group member as part of a scheme of reconstruction. The application of Article 29 in such cases will be straightforward.

Article 29 does, however, cover a range of possible situations. It may not always be a straightforward matter to determine whether the predecessor has ceased to carry on a licensed activity or whether the successor has begun to carry on a licensed activity previously carried on by the predecessor.

Difficulties may arise when only part only of the activity carried on by the predecessor is transferred, and/or the successor is already carrying on a licensed activity at the time of the transfer. Questions of cessation and succession (see below) can be complex.

With respect to the predecessor, our view is that Article 29 applies when the whole of a distinct type of business activity is transferred, but not when only part of such a business is transferred. For example, suppose the Licensed Activity of an insurance company is 'insurance of whatsoever nature' and the QFC Entity in question carries on both general and life insurance. We would accept the transfer, in its entirety, of either the life or general insurance business as being within Article 29. However, if part of either business (say the Middle East part of a MENA business) was transferred we would not accept that there has been a cessation of a Licensed Activity.

Individual cases should be decided on their own facts and a common sense approach taken.

5 – 3060 Commencement of Licensed Activity

As well as the predecessor having to cease carrying on a licensed activity, the successor has to begin to carry on that same activity. Often there will be no doubt that the Licensed Activity transferred is carried on by the successor, for example where the whole of a Licensed Activity is transferred to a newly set up fellow subsidiary whose only activity is the business previously carried on by the predecessor.

Where the successor is already actively operating it may not always be clear that the successor has 'begun to carry on' the licensed activity carried on by the predecessor. Where for example a QFC Entity carrying on a life insurance business transferred that activity to a QFC company in common ownership which had been conducting a general insurance business for some time, there would be no doubt the successor began, on the transfer, to carry on the business previously undertaken by the predecessor and Article 29 will apply.

The position may not be so clear in other situations. For example take a QFC Entity carrying on the banking activity of little more than a rep office, making investment recommendations but passing the actual business on to another group member to complete deals, provide funding etc. If that business is transferred to a fellow group member carrying out a fully-fledged wholesale banking operation, then can it be said the successor is carrying on the predecessor's licensed activity? The licensed activity carried on by the predecessor may no longer be carried on in any identifiable form by the successor so there is a strong argument the successor has not begun to carry on the licensed activity of the predecessor and Article 29 does not apply.

Article 29 is broadly modelled on the UK corporation tax equivalent (Part 22, Chapter 1 of CTA 2010) and if difficult issues arise in relation to succession the HMRC guidance at CTM06000, available on the HMRC website, may usefully be referred to for further guidance. The leading UK cases on succession are *Rolls Royce Motors Ltd v Bamford (*(1976) 51 TC 319) and *Falmer Jeans Ltd v Rodin (HMIT)(* [1990] BTC 193).

5 – 3080 Predecessors Losses Transferred.

Often when Article 29 applies, an Accounting Period of the predecessor will end if it ceases to carry on its entire licensed activity, that activity being transferred to the successor (Article 17(2)(c)). Also, where the licensed activity transferred also marks the commencement of the sole licensed activity of the successor the transfer date will also be the beginning of an Accounting Period of the successor (Article 17(1)(a)). In these circumstances the unrelieved losses at the date of transfer will be treated as losses available for relief to the successor under Article 28 at the date of transfer.

However, where the predecessor is carrying on more than one activity, and only one of those activities is transferred, the transfer may not coincide with the end of an Accounting Period and the results for the activity transferred may or may not have been accounted for separately. It may thus sometimes be necessary to separate out the losses attributable to the transferred activity. A common sense approach should be taken and a high degree of precision should not be insisted upon. Examine all the facts, especially any evidence produced by the QFC Entity to support their claim of the quantum of losses available for transfer. Evidence such as monthly management accounts, comparison of the volume, profitability etc. of the different licensed activities should be considered.

Where the transfer does not coincide with the beginning of an Accounting Period of the successor, you should not argue that the transferred losses are not available for the Accounting Period during which the transfer took place, but bear in mind that losses are streamed, that is they are only available against profits from the licensed activity transferred (see Article 29(3) and below).

5 – 3100 Losses Available to Successor.

Losses transferred to a successor under Article 29 are only available for set off against the successor's chargeable profits arising from the licensed activity transferred (Article 29(3). This is the only situation in the Regulations where losses are 'streamed.'

Losses are streamed to prevent taxpayers exploiting Article 29 to utilise a predecessor's loss in situations where it is not intended that relief should be available. For example, take two companies, A and B, which are in the same group and carrying on different, licensed activities. They may utilise each other's losses via group relief. Suppose, however, company A has accumulated unrelieved losses at the time company B joins the group. Those losses are available for carry forward against A's profits under Article 28 but may not be surrendered to B as group relief as losses may only be surrendered as group relief for the Accounting Period during which the losses are incurred (QTM5-5120). But, if the licensed activity that gave rise to the accumulated unrelieved losses is transferred from A to B when B is a member of the group, A's accumulated losses would, apart from Article 29(3), be available for set off against all of B's future profits. Article 29(3) restricts relief with respect to losses transferred under Article 29 by allowing such losses only to be set off against future profits generated by the licensed activity transferred. This approach is, in practice, modified when the successor is already carrying on a licensed activity of the same nature as the predecessor (see below).

Where the successor was not carrying on any activity before the transfer, Article 29(3) will be of no effect unless the successor, after the transfer, commences a new, different licensed activity, in which case any unutilised losses transferred will not be available to set against profits arising from the new activity.

Where the successor is already carrying on a licensed activity, at the time of transfer, our approach depends on the nature of that activity. If the licensed activity already carried on by the successor is the same as the activity transferred, then you may accept transferred losses may be set against the profits of the combined (existing & transferred) business – no attempt should be made to analyse the results to arrive at the profit relating to the activity transferred. However, where the successor is carrying on a different licensed activity the results *will* need to be analysed to isolate any profit attributable to the transferred licensed activity so that the transferred losses are only (under Article 29(3)) set off against profits arising from the activity transferred.

The principles outlined above have been illustrated in the next section. These examples by no means exhaust the situations where the operation of Article 29(3) may be in point. For example they do not cover situations where A is carrying more than one licensed activity, and the whole of A's business is not transferred to B. When considering restricting loss relief on the basis that Article 29(3) applies it should be remembered the main purpose of Article 29(3) is to prevent taxpayers from exploiting Article 29 by transferring a licensed activity to utilise otherwise unavailable tax losses. Although there is no need to establish any avoidance motive to restrict losses under Article 29, loss streaming should not be imposed too rigorously where its operation is borderline, and it is clear the transfer of licensed activity was commercially, rather than tax, driven.

Loss streaming can give rise to situations where the order of set off between streamed and other losses can affect liability. The order of set off, derived from Article 28(2), is that losses should be set off against profits of an earlier period before they are set off for a later period. The principle of setting off 'older losses first' will usually give the taxpayer the most advantageous treatment with respect to streamed losses – see example 5 below.

There may be exceptional circumstances where the successor has accumulated unrelieved losses at the date of transfer and, strictly, it may be necessary at some point after the transfer to determine which losses arose first – the successor's accumulated losses at the date of transfer or the losses transferred by the predecessor? Article 29 merely indicates the transferred losses shall be treated as losses carried forward at the date of transfer, but does not deem that they arose on that date. Strictly it is necessary to determine which of the losses arose first – the successor's existing losses or the losses transferred in. In practice, in the unlikely event you are faced with such a situation, the treatment which is most favourable to the taxpayer should be adopted, unless it is considered the transfer has been engineered wholly or mainly to gain a tax advantage, in which case the possibility of applying the strict statutory position should be considered.

5 – 3120 Losses Available to Successor - Examples.

In the following examples it is assumed all the conditions for relief under Article 29 to be given (e.g. the 51% common ownership test) are met. The examples are intended primarily to illustrate the operation of loss streaming (Article 29(3)).

In all the examples Company A, the predecessor, is carrying on the licensed activity of a general insurer. On 01/01/12 that activity is transferred, in its entirety, to a fellow group member, Company B. Company A's unrelieved tax losses at the transfer date (01/01/12) are QR150,000.

1. Simple transfer

B is inactive until A's trade is transferred.

B will be able to continue to set the transferred losses (QR150,000) against future profits, under Article 28, just as if the operation had been continued by A.

Article 29(3) is of no application.

2. Simple transfer followed by new activity

On 01/01/15, B commences a life insurance business. Unrelieved losses at 01/01/15 are QR100,000 as QR50,000 of the transferred losses have been set against the profits from the general insurance business arising between 01/01/12 and 31/12/14. During the year to 31/12/2015 the general business produces a profit of QR10,000 and the life business a profit of QR30,000. The general business profit will be covered by the transferred losses, leaving a balance of QR90,000 (QR100,000 – QR10,000) available for carry forward against future profits from the general insurance business. Article 29(3) prevents any of the transferred loss being set off against profits from the life business, which will be taxed in full.

3. Transfer to company already conducting a licensed activity (1)

At the time of transfer B is already carrying on a profitable life insurance business. During the year to 31/12/12 B's profit is QR70,000 of which QR20,000 may be attributed to the transferred general business, the balance of QR50,000 being attributable to the life business. Article 29(3) operates to restrict the set off of the transferred losses only against the transferred general insurance business profits. The general insurance business profit of QR20,000 will therefore be covered by transferred losses, leaving a balance of (QR150,000 – QR20,000) QR130,000 available for carry forward against future profits from the general business. Relief against the profits from the life insurance business (QR50,000) is prohibited by Article 29(3) and they will be taxed in full.

4. Transfer to company already conducting a licensed activity (2)

At the time of transfer B is carrying on a profitable insurance operation, both general and life. It is accepted that B 'began to carry on' A's licensed activity at the time of transfer (i.e. that B succeeded to A's licensed activity). During the year to 31/12/12 B's profit is QR70,000, QR20,000 of which may be attributed to the general insurance business, the balance of QR50,000 is attributable to the life insurance business. When considering the operation of Article 29(3) you should not attempt to apportion the general insurance profit (QR20,000) between the general insurance business transferred and the general insurance business already being carried on by B at the transfer date. Consequently the general insurance business profit of QR20,000 will be covered by transferred losses, leaving a balance of (QR150,000 – QR20,000) QR130,000 available for carry forward against future profits from the combined general insurance business. The profits from the life insurance business (QR50,000) will be taxed in full, as in example (3), above.

5. Application of Article 29(3) – order of priority of loss set off

At the time of transfer B is carrying on a profitable insurance operation, both general and life. It is accepted that B 'began to carry on' A's licensed activity at the time of transfer (i.e. that B succeeded to A's licensed activity).

B's results, before loss relief, are as follows:

(loss transferred from A's general insurance activity on 01/01/12 = QR150,000)

Year ended 31/12/12:	General Insurance Business	Loss QR 100,000

	Life Insurance Business	Profit QR10,000
Year ended 31/12/13:	General Insurance Business	Profit QR70,000
	Life Insurance Business	Profit QR 15,000
Year ended 31/12/14:	General Insurance Business	Profit QR20,000
	Life Insurance Business	Profit QR200,000

Year ended 31/12/12

For the year to 31/12/12 the transferred losses may not be set against the life business profits (Article 29(3)) but the general insurance business loss for the year ended 31/12/12 will be set against the life insurance profit arising in that year. The computation will be:-

Life profits QR10,000 less general business loss y/e 31/12/12 QR10,000 = NIL

Losses forward QR240,000 (QR150,000 transferred loss plus QR90,000 general business loss y/e 31/12/12).

Year ended 31/12/13

The question of the order of priority of loss set off comes into focus when the treatment of losses forward is considered for the year ended 31/12/13. There are two alternatives, each with a different outcome - (A) give priority to transferred losses or (B) give priority to post-transfer losses. Article 29(3) prevents the transferred losses being set against the life insurance profits for the year to 31/12/13. The question is 'should the general insurance profits of QR70,000 arising in the year to 31/12/13 be covered by the losses transferred on 01/01/12 or by the unutilised general insurance business losses incurred in the year ended 31/12/12?'

In any event unrelieved losses at 01/01/13 stand at QR240,000, the total profits of QR85,000 arising in the year ended 31/12/13 are covered by losses forward from the year ended 31/12/12 and there is a balance of unrelieved losses of QR155,000 available for carry forward at the 31/12/13.

A - Give priority to losses transferred:

In this case the general insurance profits for the year to 31/12/13 are covered by the losses transferred on 01/01/12. Unrelieved losses at 31/12/13 (155,000) will be made up of QR80,000 losses transferred (QR150,000 less QR70,000 set against general insurance business loss for the year ended 31/12/13) and QR75,000 losses arising during the year to 31/12/12 (QR90,000 less QR15,000 used to cover the life insurance profits for the year ended 31/12/13).

B – Give priority to later losses:

In this case the general insurance profits for the year to 31/12/13 are covered by the losses arising during the year ended 31/12/12. Unrelieved losses at 31/12/13 (155,000) will be made up of all of the QR150,000 losses transferred and QR5,000 losses arising during the year to 31/12/12 (QR90,000 less QR15,000 used to cover life insurance profits for the year ended 31/12/13 and less QR70,000 used to cover the general insurance profits for the year ended 31/12/13).

Year ended 31/12/14

The consequence of the different order of set off becomes apparent when looking at the position for the year to 31/12/14:

Losses forward are QR155,000 and depending on the order of set off comprise either-

A QR80,000 losses transferred on 01/01/12 and QR75,000 losses arising during the year to 31/12/12 if priority given to transferred losses for the year ended 31/12/12.

OR

B QR150,000 losses transferred on 01/01/12 and QR5,000 losses arising during the year to 31/12/12 if priority given to losses arising in the year to 31/12/12.

The results for the year to 31/12/14 are:

General Insurance Business	Profit QR20,000
Life Insurance Business	Profit QR200,000

A – Give priority to loss transferred

QR20,000 of the transferred losses will be available for set off against the general insurance business profits of QR20,000 arising during the year ended 31/12/14 and the QR60,000 balance of transferred losses (QR80,000 less QR20,000 used in year ended

31/12/14) will be available for carry forward. Loss streaming prevents any of the transferred losses being set against life insurance business profits.

All of the QR75,000 losses brought forward from the year to 31/12/12 will be set off against the life insurance business profits for the year to 31/12/14, leaving profits of QR125,000 in charge and losses forward (all transferred losses) of QR60,000.

B-Give priority to later losses

Although the general insurance business profits of QR20,000 will be covered by transferred losses, leaving a balance of QR130,000 (QR150,000 – QR20,000) available for carry forward, there are only QR5,000 losses from the year ended 31/12/12 available for set off against the life insurance business profits for the year ended 31/12/12 leaving QR195,000 in charge.

In summary:

A – priority to transferred losses:		**B – priority to later losses:**	
Losses brought forward	QR155,000	Losses brought forward	QR155,000
Profits y/e 31/12/14	QR220,000	Profits year ended 31/12/14	QR220,000
Loss Relief	QR95,000	Loss Relief	QR25,000
Taxable	QR125,000	Taxable	QR195,000
Losses carried forward	QR60,000	Losses carried forward	QR130,000

As explained above, Article 28(2) indicates earlier losses are to be set off before later losses and, consequently, ‘A’ rather than ‘B’ applies. This treatment favours the taxpayer as it minimises the impact of loss streaming.

5 – 3140 51% Interest test

For Article 29 to apply, a person with a 51% interest in the predecessor must also hold a 51% interest in the successor at the time of the transfer of the licensed activity, and that person must continue to hold a 51% interest in the successor for at least six months after the date of transfer (Article 29(1)). In other words the predecessor and successor must be in, and remain in (for a period of six months), common ownership.

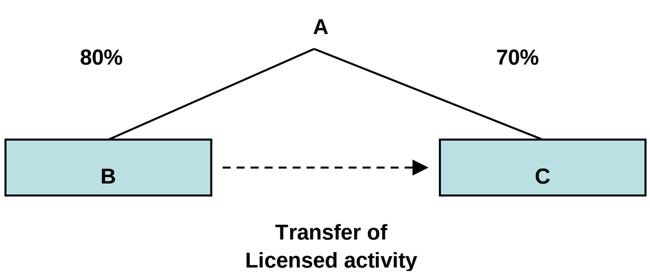
A ‘Person’ is defined by Article 153 as including, *“…a natural or legal person, body corporate or body unincorporate, including any partnership.”* It follows that Article 29 applies to transfers between QFC entities which are associated with one another via having a common owner, as well as groups.

A ‘51% Interest’ for a company is defined at Article 153 as *“in relation to a company a Person has a 51% interest in a QFC Entity that is a company if more than 50% of the Ordinary Share Capital of the QFC Entity is held, directly or indirectly, by that Person.”* The term “Ordinary Share Capital” is defined as *“…all the issued share capital of a Company other than capital which only gives a right to a fixed rate dividend.”*

A “51% Interest” for an LLP is defined at Article 153 as “in relation to an LLP, a Person has a 51% interest in a QFC Entity that is an LLC if that Person beneficially owns more than (i) 50% of the LLP assets; or (ii) 50% of the income earning rights in the LLP.”

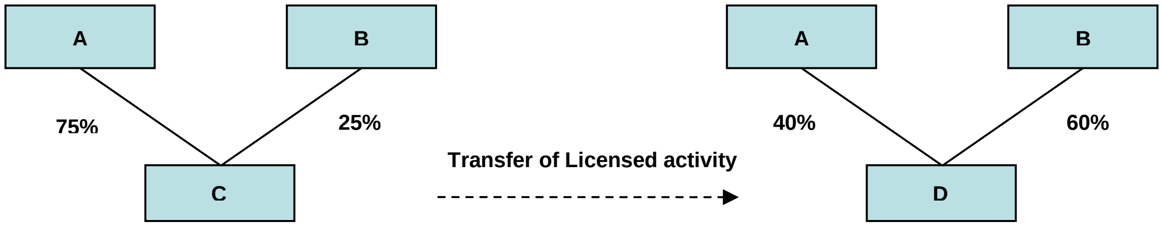
The ownership test is relatively straightforward, and complications are only likely to arise when the relevant shares are held indirectly. In the following examples, both the predecessor and successor are QFC LLCs.

Example 1 – Direct ownership test met

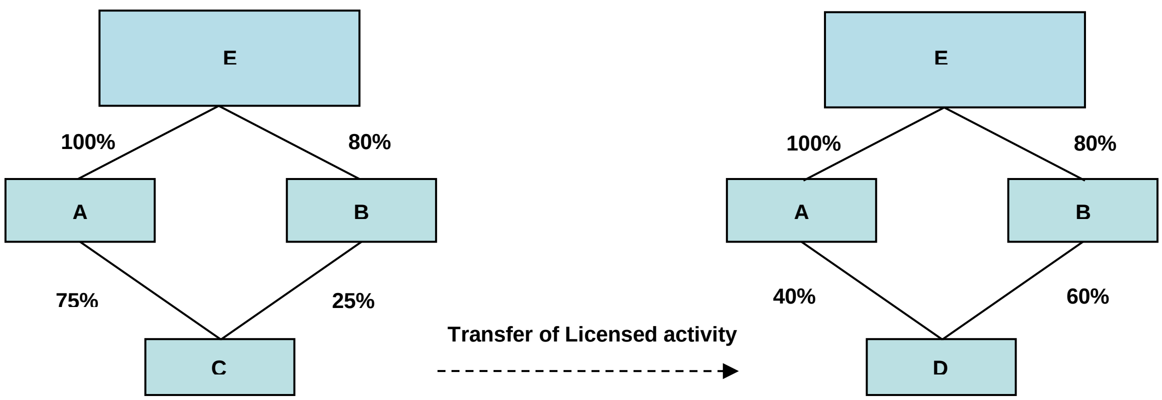


A, an individual, holds an 80% interest in B (the predecessor) and a 70% interest in C (the successor). On the transfer of the licensed activity from B to C, Article 29 will apply as the 51% test is met via the direct holding of shares.

Example 2 – Direct ownership test not met

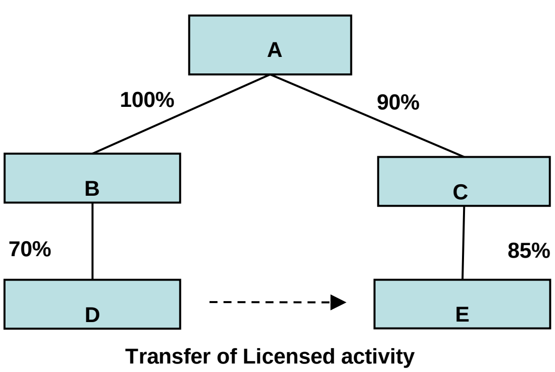


Independent Companies A and B own 75% and 25% of C (the predecessor), respectively. The licensed activity is then transferred to D (the successor). As neither A nor B have a 51% interest in C and D, Article 29 will not apply. However if another Company ‘E’ held an interest in both A and B so that he/she controlled (by holding 51% or more of the share capital of both A and B) C and D indirectly, Article 29 would apply (see diagram, below).



Example 3 – Indirect ownership test met

Common ownership can be established by indirect holdings:



A has an indirect 70% interest in D, via B, and an indirect 76.5% (85% x 90%) interest in E, via C. Article 29 will thus apply.

5 - 3160 6 Months Test

The 51% interest test must be met at the time the licensed activity is transferred and the person meeting the test must maintain a 51% interest in the successor for at least 6 months (Article 29(1)).

Without the 6 month requirement Article 29 is open to potential abuse by using it to transfer losses to unconnected companies. Suppose company A, a QFC Entity that has a loss making division, and a wholly unconnected QFC Entity B would like to acquire A's loss making division business, along with its tax losses. If the licensed activity of the loss making division were simply transferred to B the 51% interest would not be met and Article 29 would not apply. However if A transfers the loss making Activity to C, a wholly owned subsidiary of A, not carrying on any activity (the extent to which this is possible within the QFC may be limited) and then sells the shares in C to B, then as Article 29 applies to the transfer of activity and losses from A to C, B will acquire C along with its tax losses. B may then arrange C's activity to be transferred to B within Article 29. Such loss buying transactions are not uncommon, and are usually characterised by the sale of the subsidiary shortly, sometimes in a matter of days, after the transfer of the activity and losses. To discourage such transactions Article 29 includes the rule the successor must continue to fulfil the 51% interest test for a minimum of six months from the date they begin to carry on the licensed activity.

The 'loss-buying provision' contained in Article 30 (see QTM5-4000+) may, in some circumstances, also be used to counter such abuse.

5 – 4000+ Disallowance of Tax Losses on a Change of Ownership

5 – 4000 Introduction

Article 30 is intended to counter 'loss-buying', where a person buys a QFC Entity wholly or partly for its unused losses rather than solely for the inherent value of its business or assets. The new owner usually introduces a new activity into the Entity. Thus, but for Article 30, the Entity would keep its entitlement to relief for losses brought forward.

Article 30 applies where **either:**

- within an 'ownership period' there is both (a) a change in ownership of a QFC Entity **and** a major change in the nature or conduct of the Entity's Licensed Activities;

or

- there is a change in ownership at a time when the QFC Entity's Licensed Activities have become negligible.

When Article 30 applies, accumulated unrelieved losses as at the date of change of ownership cease to be available for set off against future profits. An accounting period is deemed to end on the date the change of ownership occurs, if the change of ownership date does not coincide with the end of an accounting period (Articles 30(1) and (3)).

5 – 4020 Identifying Cases

A loss buying exercise will normally be identifiable by two main features:

- the purchase of a QFC Entity which has significant unused Article 28 losses.
- a dying business brought back to life and/or the making of important changes to Licensed Activities.

Although Article 30 is anti-avoidance legislation, there is no 'motive test'. Businesses have to be flexible to keep up with market conditions and improve efficiency. A new owner may be expected to assess the business and bring in new ideas and people. But if these changes go beyond what may be described as the organic growth of the business, Article 30 may apply, regardless of the fact that there was no tax avoidance motive behind the acquisition of the business.

As the ownership change period runs from one year before to two years after the change in ownership it will often be more informative to review the accounts covering the whole ownership period. However, regard should be had to the enquiry window and the discovery position.

If a taxpayer asks for an advance ruling (see Part 18 of the regulations and this manual) in relation to Article 30, caution should be exercised. If a ruling is given before the ownership period has ended, it should be qualified to make it clear the ruling is contingent on a review of the facts at the end of the ownership period as it may be inappropriate to give an advance assurance about legislation which envisages a three year period of review, before the end of that period.

5 – 4040 Change of Ownership - Companies

There is a change of ownership of a company where, within any 12 month review period either:

- a single person acquires more than half the ordinary share capital of the company (Article 31(1)(a));

  or

- two or more persons each acquire 10% or more of the ordinary share capital of the company, and those holdings together amount to more than half of the ordinary share capital of the company (Article 31(1)(b)).

The 12 month review period (Article 31(4)) is designed to enable acquisitions over that period, rather than on a single date, to be reviewed, and also permits a gradual acquisition over a longer period to fall outside the 'change of ownership' definition. So, for example, the acquisition of 30% followed by a further 25% nine months later would amount to a change of ownership whereas the acquisition of 20%, followed by a further 20% six months later, followed by a further 15% eight months after that would not be regarded as a change of ownership because there is no 12 month period during which more than 50% of the ordinary share capital was acquired.

For there to be a change of ownership under the second bullet point above (Article 31(1)(b)), the persons acquiring the shares do not need to be connected with each other. However, the 12 month review period is to be applied to the position of the company, not the position of the individual shareholders. For example, suppose individuals A, B and C each acquire a 20% holding of company D within a 12 month period. There will have been a change of ownership of Company D under Article 31(1)(b).

However, now suppose A already had a 15% holding which he/she acquired on 1 June 2010 and he/she then acquires a further 5% on 1 October 2010. B acquires 20% on 1 March 2011 and C acquires 20% on 1 August 2011. There is no change in ownership under Article 31(1)(b) as there was no 50% plus acquisition within any 12 month period. If, however A had acquired his 15% holding after 1 August 2010, there would have been a change of ownership as A, B and C together acquired more than 50% (and each acquired more than 10%) in a 12 month period.

Note that it is possible for more than 50% of a company's shares to change hands without there being a change of ownership as defined by Article 31(1)(b), through the acquisition by a number of persons, each of whose holdings is less than 10%.

5 – 4060 Change of Ownership – Companies - Indirect Ownership

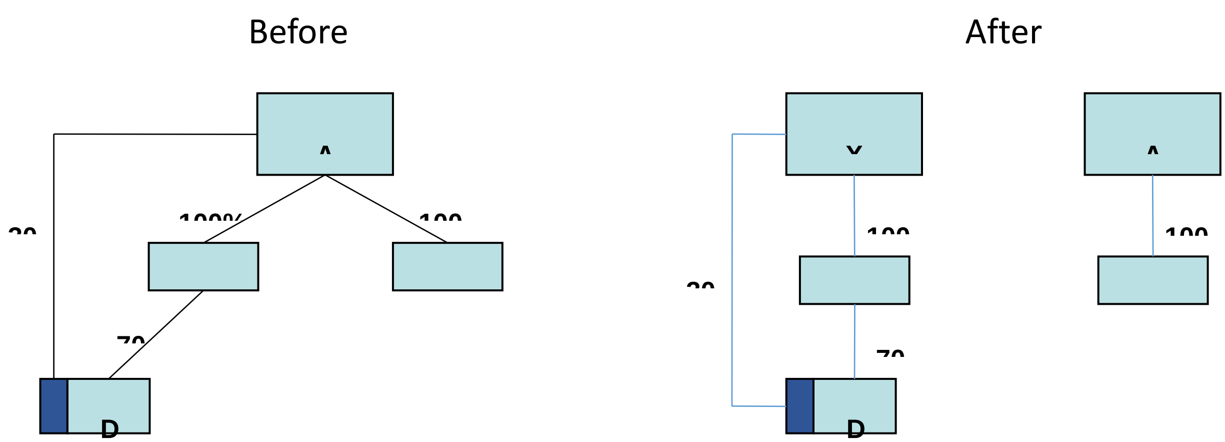
Article 31(2) provides that 'ownership' of a company includes both direct and indirect ownership of ordinary share capital.

Indirect but no direct change in ownership

The example below illustrates the type of situation where the ‘indirect’ holding provision of Article 31(2) may be relevant:

- A is the 100% parent of B and C.
- B owns 70% of the shares in D and A owns the other 30%.
- D has substantial losses brought forward which are wanted by the X group who will however not be able to use them unless a major change is made to D's Licensed Activities.
- X buys A's 100% shareholding in B and A's 30% shareholding in D.

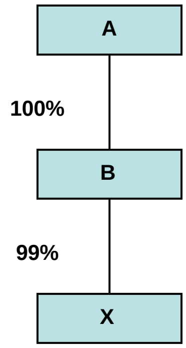
There is no **direct** change in ownership of D (X only acquired 30% of D’s shares). Yet there is a change in ownership of D for the purposes of Article 30 because Article 31(2) deems X to have acquired B's 70% holding in D. The position is summarised in the diagram below:



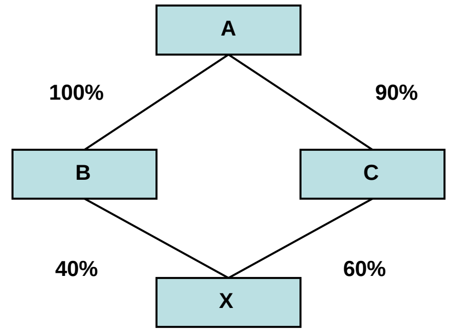
Direct but no indirect change in ownership

A change of ownership should not be regarded as having occurred where there is a change in the direct holding, so as to potentially trigger Article 31, but there is no such change in control when indirect holdings are considered. This is illustrated by the following example:

1)



2)



1) Company A indirectly owns more than half of the ordinary share capital of X.

2) The direct ownership of X changes, as C now owns 60% of the ordinary share capital. However, as C is a 90% subsidiary of A, A continues to indirectly own more than half of the ordinary share capital of X. The direct change in ownership of X may be disregarded for the purposes of Article 31 as it remains an indirect 51% subsidiary of A throughout.

Although it is necessary to be aware that changes of ownership may be quite complex (as illustrated above) it is unlikely that, in practice, such situations will often be encountered and whether or not a change of ownership has occurred will usually be clear and undisputed.

5 – 4080 Change of Ownership – Partnerships

There is a change of ownership of a partnership where the beneficial ownership of at least half of the partnership assets or income earning rights changes hands within any 12 month period (Articles 31(3) and (4)).

Ownership is defined in Article 153 to mean beneficial ownership.

'Beneficial Ownership' is not a straightforward legal concept and in cases of dispute advice should be sought from the Legal Department. A beneficial owner is the person who enjoys the benefits of ownership, regardless of whose name the title is in. Broadly speaking you should attribute to the beneficial owner (rather than the legal owner), assets or income earning rights held by:

- nominees
- agents
- bare trustees (that is, where the person is absolutely entitled to property held by trustees),

- receivers, liquidators or trustees in bankruptcy
- mortgages or charge holders or any other persons entitled to the asset by way of security,

It will normally be quite clear where there has been a change of ownership in a partnership. In less straightforward cases, where the change in beneficial ownership of the assets or income rights are manifold or complex, you will need to establish all the facts and carefully review the relevant documentation – the partnership agreement being the key document.

Remember that a review of changes to beneficial ownership is restricted to any twelve month period, and the principles for considering changes in share ownership, modified to relate to changes in beneficial ownership of partnership assets or profit share (rather than ownership of ordinary share capital) outlined in QTM5-4040 should be followed, adapted as necessary.

Changes of ownership in relation to limited partnerships may pose problems, as may changes in ownership of large LLPs. However it should be remembered that for Article 30 to apply, as well as a change of ownership there must be a major change in the nature or conduct of the partnership's licensed activities or a change of ownership of a 'dying' partnership (that is one whose activities have become negligible). It is unlikely that large LLPs or LPs will be involved in a loss buying exercise.

5 – 4100 Meaning of "Major Change"

Article 30 only applies where, if the change of ownership conditions are met, there is also a *'…major change in the nature or conduct of the Licenced Activities…'* of the QFC Entity in question, within the period commencing one year before and ending two years after, the date of the change of ownership.

A major change in the nature of Licenced Activities includes a major change in the contents of the QFC Entity's Licence (Article 30(5)).

In some situations it will be obvious there has been a major change in the nature or conduct of a QFC entity's licenced activities. A change in activity from, say, general insurance to life insurance would certainly constitute a major change. Other situations may not be so clear cut. Although you need not prove a tax-avoidance motive, it should be remembered the purpose of Article 30 is to discourage artificial arrangements put in place to take advantage of the loss relief provisions. In borderline cases, where the arrangements appear to be commercial and the amount of losses available is not large, the benefit of the doubt should be given to the taxpayer. Some examples of situations that should and that should not be regarded as a 'major change' are given below.

A major change in the *nature* of the licenced activities means a major change in the substance of the activities. A major change in the *conduct* of the licenced activities means a major change in the way those activities are being carried out. To constitute a 'major change' the change must be more than significant, although it does not necessarily have to be fundamental. In addition, a change can be a major one even if it is the result of a gradual process which began before the ownership change period.

Whether or not there is a major change in the nature or conduct of the licenced activities is a question of fact, to be determined from the circumstances of each case. It can occur, inter alia, by virtue of a major change in:

1. The type of commodities or financial instruments dealt in, or the nature of investments held; or

2. The services or facilities provided; or

3. The type of customers; or

4. The outlets or markets.

In addition, consideration should be given to changes in other factors such as the location of the entity's business premises, the identity of the entity's suppliers, management, or staff, the entity's method of providing services, or pricing policies - to the extent that these factors indicate that a major change has occurred.

A major change should not be regarded as having occurred when all that happens is that a QFC entity makes changes to increase its efficiency, or makes changes which are needed to keep pace with developing technology or methodology in the industry concerned, or with developing management techniques. Such changes may be regarded as a normal part of the organic growth of the entity's business.

Examples where a change would not of itself be regarded as a major change:

- An entity trading and dealing in one type of precious metal, switches to trading and dealing in another type of precious metal. *(Not a major change in the type of commodity dealt in).*

- An entity offering both general insurance and life insurance (of which general insurance forms the greater part of the entity's business), concentrates solely on general insurance. *(A rationalisation of product range, without a major change in the type of service).*

- An entity whose business consists of making and holding investments in Qatari quoted shares and securities makes changes to its portfolio of quoted shares and securities. *(Not a major change in the nature of investments held).*

Examples where a major change would be regarded as occurring

- An entity offering insurance services switches to offering reinsurance services. *(A major change in the type of service offered).*

- An entity providing retail banking services switches to offering money and asset management services. *(A major change in the type of service offered).*

- An entity trading and dealing in precious metals switches to trading and dealing in stocks and bonds. *(A major change in the type of product dealt in).*

- An entity switches from investing in quoted shares to investing in real property for rent. *(A major change in the nature of investments held)*

5 – 4120 Activities Becoming Negligible

Article 30(1)(b) prevents the carry forward of losses where there is a change of ownership at any time after the scale of a QFC Entity's activities have become negligible, and before any significant revival of those activities. The intention here is to prevent the losses of a 'dying' business being acquired by a new owner who then revives those activities. This may arise where an Entity with a 'dying' business claims it is still holding itself out for business, so still has a 'source of income', and losses under Article 28 thereby continue to be carried forward. If the Entity becomes totally dormant, so it no longer has any source of income, losses will cease to be available for carry forward by virtue of Article 28(1) so Article 30 need not be invoked.

The deterrent effect of Article 30(1)(b) should result in its application being a rarity.

5 – 4140 Computing Losses to be Disallowed

Where Article 30 applies and the change of ownership coincides with the ending of an actual accounting period of the QFC Entity, the position is simple. Accumulated Article 28 losses at the end of the accounting period cease to be available for carry forward.

Where the change of ownership occurs part-way through an accounting period Article 30(3) deems an accounting period to end on the date of the change of ownership. This means the results before and after the change will have to be apportioned. The apportionment is to be made on a time basis, unless the QFC entity can demonstrate this produces an unjust result, in which case a different basis may be used to produce a result which appears, to the Tax Department, to be just and reasonable (Article 30(4)). Evidence, such as monthly management accounts, should be obtained where a taxpayer claims a time basis of apportionment produces an unjust result. It should be noted the time apportionment basis may only be varied when a taxpayer claims it produces an unjust result for him. The Tax Department may not vary the time basis because they feel that basis produces an unreasonably favourable result for the taxpayer.

5 - 5000+ Group Relief

5 – 5000 Group Relief - Introduction

Losses arising in an accounting period may be surrendered by one company or LLP and claimed by another member of the same group during its corresponding accounting period. Relief is given by setting the loss surrendered against the claimant's chargeable profits for the corresponding accounting period. Losses brought forward are not available for surrender. Where the accounting periods of the claimant and surrendering companies do not coincide rules are provided to determine the corresponding accounting period (see examples at QTM5-5120 below). Provision is also made to cover the situation where a company joins or leaves a group (see QTM5-5180).

The Tax Rules (TAX) provide rules at TAX 9 for the interaction between group relief claims/surrenders and the self-assessment tax return.

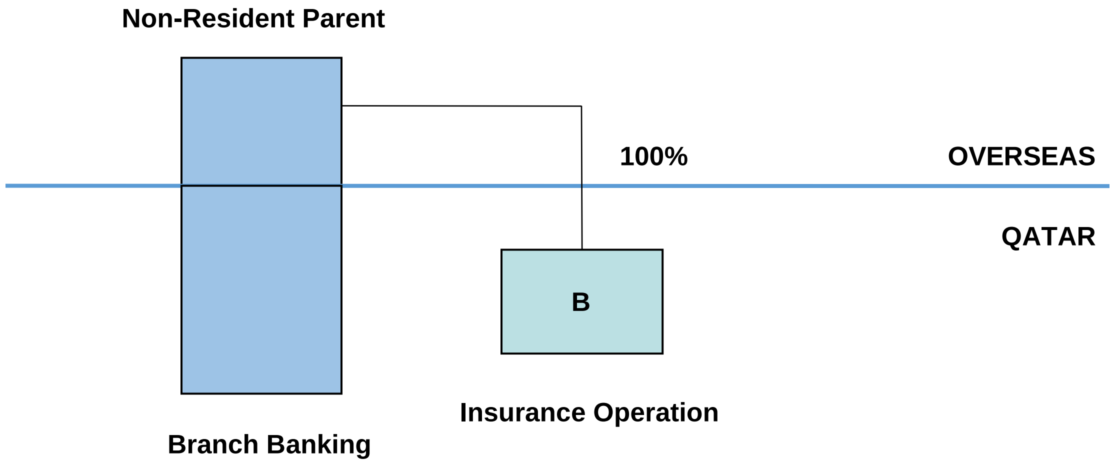
Because group relief is limited to QFC Entities, group relief claims and surrenders will normally be straightforward and will be unlikely to involve complications such as multiple claims and surrenders for different accounting periods between large numbers of group members.

5 – 5020 A QFC Group

To qualify for group relief both the surrendering and claimant companies must be QFC entities and members of the same group (Article 32(2)). The meaning of a 'group' is given by Article 34.

The basic definition of a group is that two companies are members of the same group if one is a 75% subsidiary of the other, or both are 75% subsidiaries of a third company or an LLP (Article 34(1)). There is no need for the third company to be a QFC Entity so that, for example, fellow QFC subsidiaries of a non-QFC parent are (provided the 75% test is met) members of the same group.

As there is no residency requirement for group relief, it is also available to branches which are QFC entities, provided that they fall within the definition of a member of a group. This situation may occur where, for example, a non-resident establishes, say, a banking operation in the QFC via a branch and an insurance operation via a subsidiary, as illustrated below.



5 – 5040 What is a 75%Subsidiary?

The test for determining whether a company is member of a group is the 75% subsidiary test of Article 34(1). The main rule for determining whether or not that test is met is by examining the ownership, direct or indirect, of the ordinary share capital of the company (Article 34(2)). Ordinary share capital is defined at Article 140 as all issued share capital, apart from that which only gives a right to a fixed rate dividend (preference shares).

It will normally be clear that two companies are members of a group. The share capital in QFC company A will often be at least 75% (often 100%) directly owned by QFC company B, or at least 75% (again, often 100%) of the share capital of A and B will be directly held by Company C. It is not necessary for C to be a QFC Entity in order for QFC companies A & B to be able to surrender/claim losses as group relief, however company C will not be able to do so unless it is also a QFC Entity.

'Ownership' in relation to both direct and indirect should be interpreted as beneficial ownership. See QTM5-4080 for an outline of the meaning of 'beneficial ownership'.

The ownership test of Article 34(2) is a continuing, rather than a once and for all test. If the shareholding of a group member changes so that it is no longer a 75% subsidiary (as defined by Article 34) then the company ceases, at that time, to be a group member.

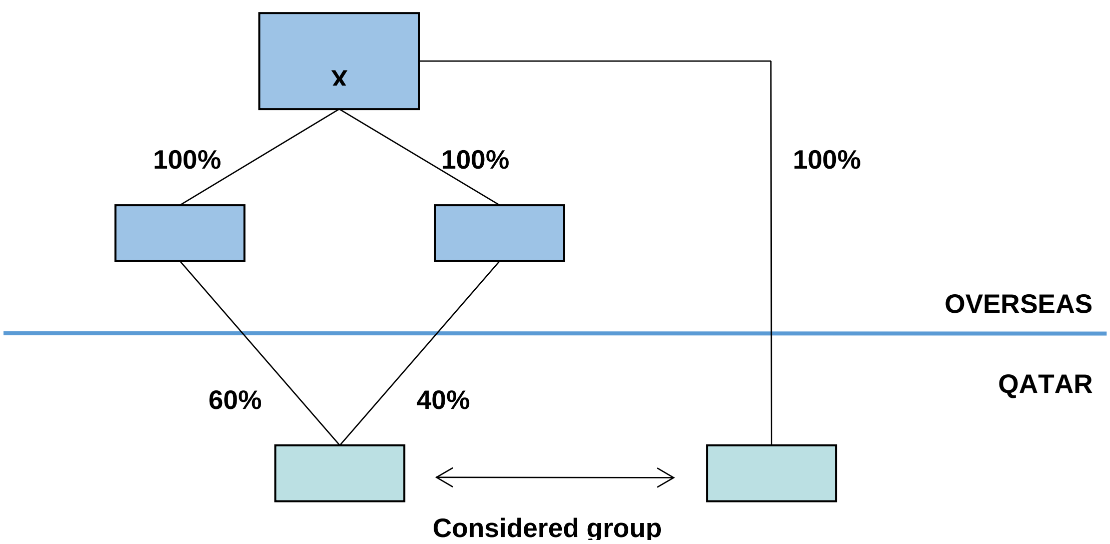
In addition to the ownership test (Article 34(2)) to qualify as a group member a company must also meet the conditions of Article 34(3). Under Article 34(3) it will not qualify as a 75% subsidiary unless its parent is beneficially entitled to at least 75% of (a) profits available for distribution *and* (b) assets on a winding up. This is an anti-avoidance provision.

An LLP has to meet the conditions of Articles 34(5) and 34(6). An LLP is a 75% Subsidiary of another Company or LLP if and so long as (a) not less than 75% of the assets of the LLP; and (b) not less than 75% of the income earning rights in the LLP, are beneficially owned by that other Company or LLP. Also an LLP shall not be treated as a 75% Subsidiary of another Company or LLP unless that Company or LLP is (a) beneficially entitled to not less than 75% of any profits available for Distributions to holders of an LLP interest, as applicable, in the subsidiary LLP; and (b) beneficially entitled to not less than 75% of any assets of the subsidiary LLP available to holders of an LLP interest, as applicable, in the subsidiary LLP on a winding up.

5 – 5060 Ownership and Indirect Holdings

In considering the ownership test of Article 34(2) regard should be had to indirect, as well as direct, holdings.

If, for example, a QFC Entity is held 60:40 by two unrelated companies, it is not a 75% subsidiary of either. If, however, each of those two companies is 100% owned by a common parent, then the QFC Entity will be an indirect 75% subsidiary of that parent and may be grouped with other QFC 75% direct or indirect subsidiaries of the same parent, as illustrated below



When considering Article 34(3) in the above situation, company X should be regarded as the 'parent' when the testing rights to profit distribution and assets on a winding up.

More complex situations are possible in relation to both the ownership test of Article 34(2) and the distribution/winding-up tests of Article 34(3). However it is thought unlikely that such complexities will be met in relation to QFC Entities. If this assumption proves to be incorrect, this part of the manual will be expanded to encompass the situations met in practice.

5 – 5080 Potential Avoidance

In addition to passing the ownership test (Article 34(2)) before one company may be regarded as a 75% subsidiary of another, it must also satisfy the dual condition of Article 34(3) that is the parent must be beneficially entitled to at least 75% of both distributable profits ***and*** assets available to equity holders on a winding up.

Where the ownership test is met through indirect ownership, when considering whether the Article 34(3) tests are met you may 'look through' immediate shareholdings and treat the company further up the group chain, by which the 75% ownership test was met, as the 'parent.' See the example used for indirect ownership above.

The purpose of Article 34(3) is to prevent entitlements to profits, or entitlement to assets available for distribution on a winding-up, being manipulated to let a subsidiary surrender group relief to another company which is in the same group, where the parent company has the appearance of being its parent, but is not its true economic parent. The apparent parent may group itself artificially with a subsidiary, in an attempt to receive group relief which the true economic parent cannot take advantage of. The company selling group relief and the company buying it will then share the benefit of the tax saved between them.

It will not normally be necessary to test for the possible application of Article 34(3) in simple group situations, for example where:

- the subsidiary company has only one class of issued share capital which does not carry any unusual rights, and
- any loans are clearly normal commercial loans.

If a detailed examination is required reference should be made to the documents regulating the company and its share capital, for instance:

- the Memorandum and Articles of Association,
- special resolutions concerning alterations in share capital, and
- documents relating to loans made to the company.

The purpose of such an examination is to determine different equity holders' entitlements to:

- profits, and/or
- assets on winding-up.

As well as manipulating shareholdings to artificially bring a company within the definition of a group for group relief purposes, groups may also try other tactics to exploit the relief by, for example, entering certain arrangements. The kind of arrangement that may be encountered is where a loss-making company attaches one of its subsidiaries to a profitable group for long enough for the second group to benefit from the subsidiary's losses on a major investment project but with a prior arrangement or undertaking that the subsidiary will then revert to the original (and real) parent.

If such arrangements, or any other situation where it is considered group relief may be being artificially exploited, are encountered a report detailing all the relevant facts, together with the case papers, should be submitted to the Director of Tax.

5 – 5100 Shares Held on Trading Account

When considering the 75% subsidiary tests any shares held on trading account are to be disregarded (Article 34(4)). This condition is unlikely to be met often but it excludes, for example, shares held by a dealer.

5 – 5120 Corresponding Accounting Periods

Where the Accounting Periods of the claimant and surrendering companies coincide, the whole of the loss incurred during that accounting period may be surrendered. The whole of the loss does not, however, have to be surrendered – part may be surrendered and part carried forward. Losses may also be surrendered or claimed by more than one group member.

Where the accounting periods of the claimant and surrendering companies do not coincide, the amount of group relief that may be surrendered and claimed is arrived at by applying a fraction to the tax loss of the surrendering company and the Chargeable Profits of the claimant company.

A *'Corresponding Accounting Period'* is defined by Article 33 as any Accounting Period of the claimant company falling wholly or partly within an Accounting Period of the surrendering company. It follows that group relief is only available where the Accounting Period of the claimant and surrendering companies overlap. The length in common is designated 'A', the length of the accounting period of the surrendering company 'B' and the length of the corresponding claimant company 'C'.

The amount of the tax loss that may be surrendered for the accounting period of the surrendering company is reduced by A/B and the chargeable profits against which group relief may be claimed for the claimant company's corresponding accounting period is reduced by A/C.

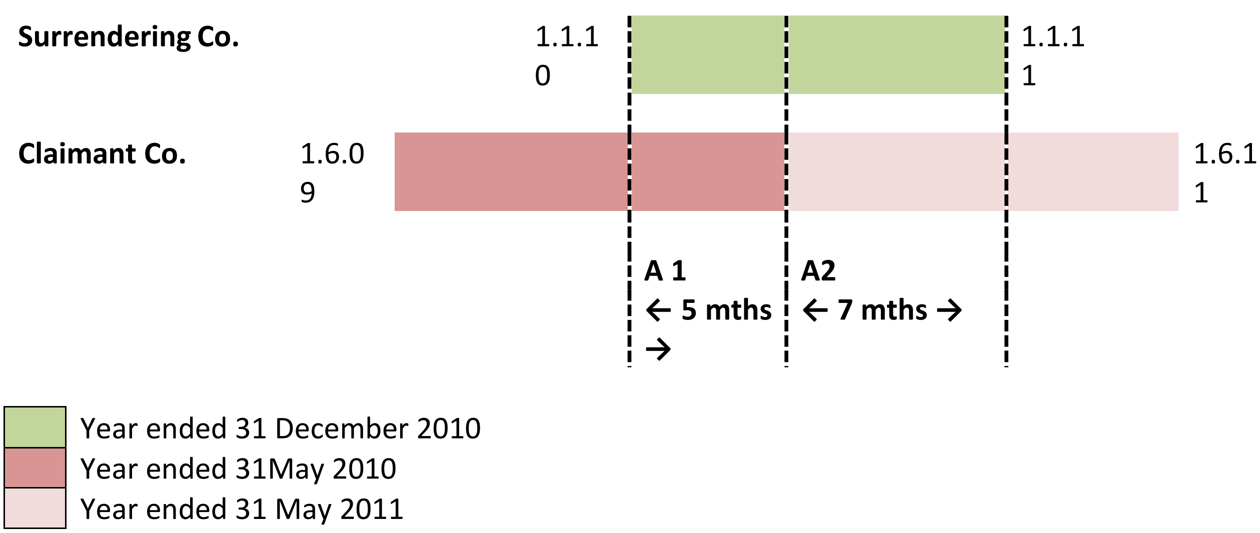
For any Accounting Period of the surrendering company, where the accounting period of the claimant company does not coincide with the surrendering company's accounting period, there may be more than one corresponding accounting period.

The apportionments required are illustrated by the examples below.

5 – 5120 Corresponding Accounting Periods - Examples

Example 1

A surrendering company has tax losses of QR100,000 for its Accounting Period (AP) for the year ended 31 December 2010. The claimant company's yearend is 31 May. The claimant company's APs for both the year to 31 May 2010 and 2011 'correspond' to the surrendering company's AP for the year to 31 December 2010.



If the claimant company has chargeable profits for the year ended 31 May 2010 of QR300,000 and for the year ended 31 May 2011 of QR500,000 it may claim group relief for each of these APs, as follows:

(a) Year ended 31 May 2010

A1 = period in common = 5 months
B = AP of surrendering company = 12 months
C = AP of corresponding period of claimant company = 12 Months

Maximum tax loss that may be surrendered:

100,000 x 5/12 = 41,667

Maximum chargeable profits against which tax loss may be set:

300,000 x 5/12 = 125,000

Group relief may be claimed in the figure 41,667 for the AP ending on 31 May 2010.

(b) Year ended 31 May 2011

A2 = period in common = 7 months
B = AP of surrendering company = 12 months
C = AP of corresponding period of claimant company = 12 Months

Maximum tax loss that may be surrendered:

100,000 x 7/12 = 58,333

Maximum chargeable profits against which tax loss may be set:

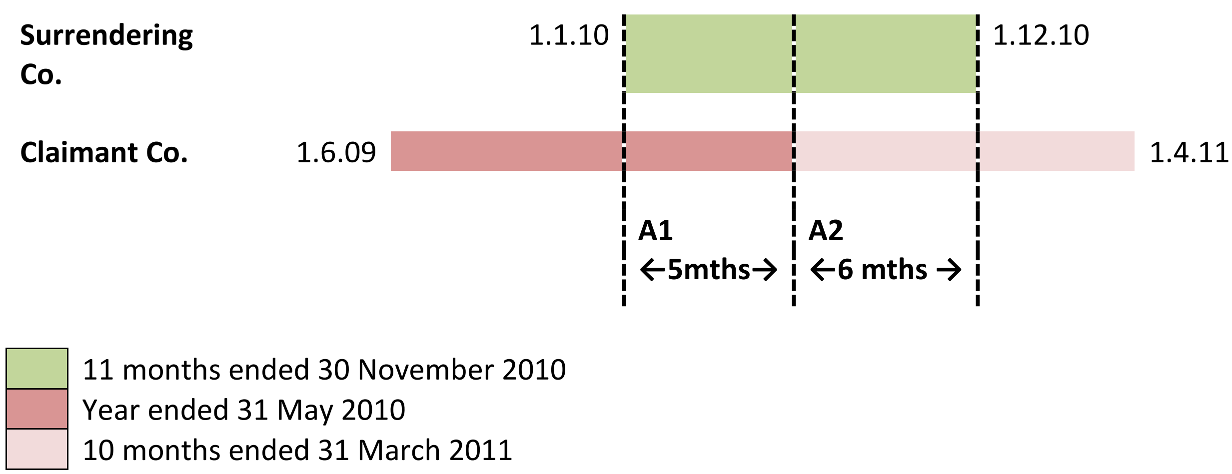
500,000 x 7/12 = 291,667

Group relief may be claimed in the figure 58,333 for the AP ending on 31 May 2011.

Because the claimant company has sufficient chargeable profits the formula simply divides the tax loss of the surrendering company between the accounting periods of the claimant company, in proportion to the length of the overlap and the whole of the loss (100,000 = 41,667 + 58,333) may be claimed as group relief.

Example 2

The surrendering company has tax losses of QR100,000 for its Accounting Period (AP) for the 11 months ended 30 November 2010. The claimant company's accounts are drawn up for the year ended 31 May 2010 and the 10 months ended 31 March 2011. Both the AP for the year to 31 May 2010 and for the 10 months to 31 March 2011 'correspond' to the surrendering company's AP ending on 30 November 2010.



If the claimant company has chargeable profits for the year ended 31 May 2010 of QR150,000 and for the period ended 31 March 2011 of QR80,000 it may claim group relief for each of these APs, as follows:

<u>(a) Year ended 31 May 2010</u>

A1 = period in common = 5 months
B = AP of surrendering company = 11 months
C = AP of corresponding period of claimant company = 12 months

Maximum tax loss that may be surrendered:

100,000 x 5/11 = 45,454

Maximum chargeable profits against which tax loss may be set:

150,000 x 5/12 = 62,500

Group relief may be claimed in the figure 45,454 for the AP ending on 31 May 2010.

(b) Period ended 31 March 2011

A2 = period in common = 6 months
B = AP of surrendering company = 11 months
C = AP of corresponding period of claimant company = 10 months

Maximum tax loss that may be surrendered:

100,000 x 6/11 = 54,546

Maximum chargeable profits against which tax loss may be set:

80,000 x 6/10 = 48,000

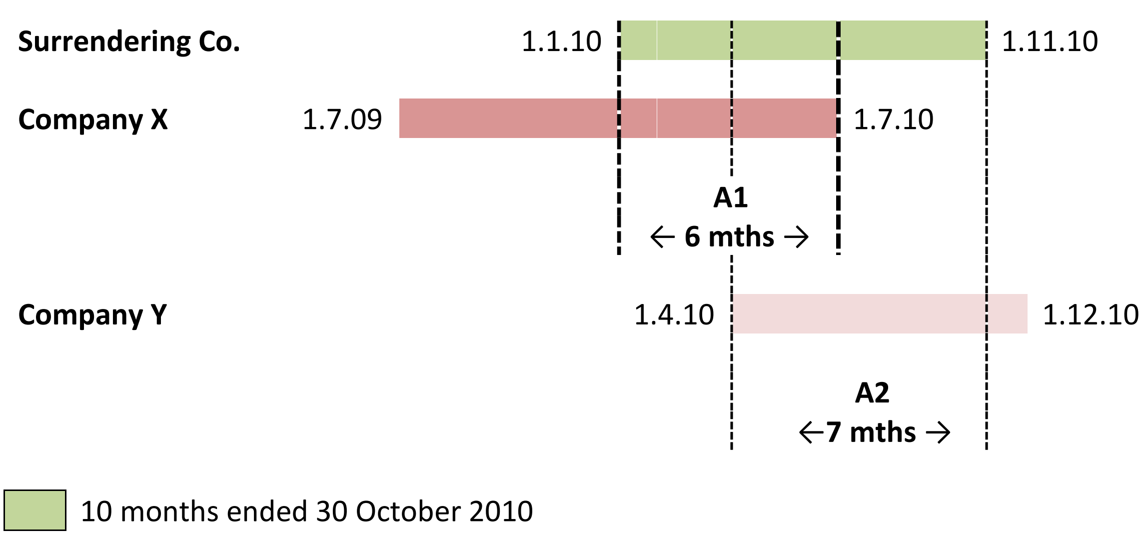
Group relief may be claimed in the restricted figure 48,000 for the AP ending on 31 March 2011.

The surrendering company will be able to carry forward (or surrender to another group member) the balance of its tax losses, amounting to (100,000 – [45,454+48,000]) = 6,546.

Example 3

The surrendering company has tax losses of QR100,000 for its Accounting Period (AP) for the 10 months ended 30 October 2010.

Claimant company 'X' has chargeable profits of QR150,000 for its AP of 12 months ending on 30 June 2010 and Claimant company 'Y' has chargeable profits of QR70,000 for its 8 month AP ending on 30 November 2010.



Year ended 30 June 2010
8 months ended 30 November 2010

The maximum that may be surrendered to Company 'X' is

A1 = period in common = 6 months
B= AP of surrendering company = 10 months

100,000 x 6/10 = 60,000

The maximum that may be surrendered to Company 'Y' is

A2 = period in common = 7 months
B= AP of surrendering company = 10 months

100,000 x 7/10 = 70,000

The Maximum chargeable profits of Company 'X' against which tax loss may be set are:

C = AP of corresponding period of claimant company = 12 months

150,000 x 6/12 = 75,000

The Maximum chargeable profits of Company 'Y' against which tax loss may be set are:
C = AP of corresponding period of claimant company = 8 months

70,000 x 7/8 = 61,250

The surrendering company may surrender the whole of its loss (QR100,000) and is free to choose how to divide the losses between 'X' and 'Y'. In the case of company 'X' the limiting factor is 60,000 – the maximum that may be surrendered to 'X'. In the case of company 'Y' the limiting factor is 61,250 – the maximum that may be claimed by 'Y'. The total amount surrendered cannot, however, exceed the surrendering company's tax losses of 100,000.

5 – 5140 Payment for Group Relief

If a claimant company makes payment to a surrendering company for losses surrendered, under an agreement between the two companies, then any payment up to the amount of the loss surrendered (rather than the amount of relief in terms of tax) is to be ignored for tax purposes when computing the losses of the surrendering company or the profits of the claimant company (Article 32(6)).

5 – 5160 Interaction with Losses Brought Forward

Group relief is normally given after any relief has been given in respect of losses brought forward under Article 28 (Article 32(3)). However, a company may elect (in writing to the Tax Department within 18 months of the end of the Accounting Period to which the election relates) for group relief for an Accounting Period to be given in priority to losses brought forward (Article 32(4)). Late elections may be considered (TAX 13.4). Group relief must be claimed but relief for losses brought forward under Article 28 is automatic and mandatory, a QFC entity may not choose not to utilise losses brought forward for any particular Accounting Period.

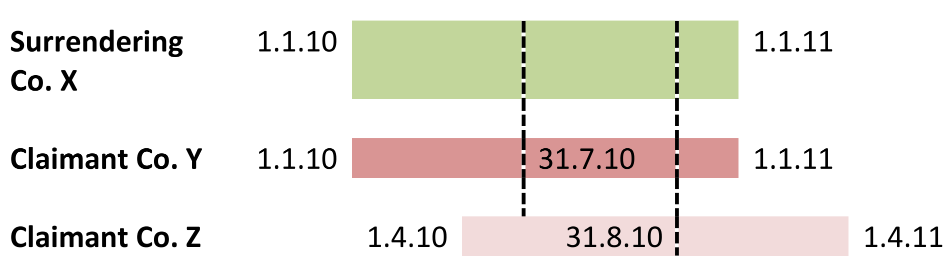
5 – 5180 Companies Joining or Leaving a Group

Both the surrendering and claimant company must be members of the same group throughout the whole of the surrendering company's Accounting Period and the whole of the claimant company's corresponding Accounting Period (Article 35(1)).

When a company joins or leaves a group, then on that occasion (unless a true Accounting Period ends or begins on that date) an Accounting Period is deemed to end/begin for the purposes of group relief (Article 35(2)). Profits and losses are to be apportioned between the deemed Accounting Periods on a time basis (Article 35(3)). Exceptionally, if a QFC Entity produces convincing evidence, such as monthly management accounts, to show a time basis of apportionment does not produce a just result, you may accept an alternative apportionment, based on the facts of the case.

Example

Surrendering company 'X' has an Accounting Period of 12 months to 31 December 2010 and tax losses for that Accounting Period of QR100,000. A claimant company 'Y' has chargeable profits of QR50,000 for its 12 month Accounting Period ending on 31 December 2010, but the company ('Y') leaves the group on 31 July 2010. Company 'Z' has chargeable profits of QR70,000 for its Accounting Period of 12 months to 31 March 2011 and joins the group on 1 September 2010.



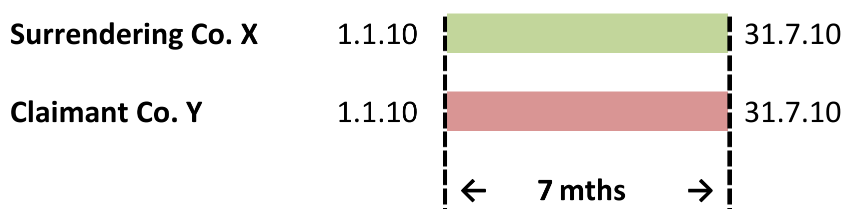
Year ended 31 December 2010
Year ended 31 December 2010 – Company Y leaves group on 31 July 2010
Year ended 31 March 2011 – Company Z joins group on 1 September 2010

'X' has deemed accounting periods and time-apportioned tax losses as follows:

7 months to 31 July 2010 (01/01/2010 to date 'Y' leaves): 7/12 x 100,000 = 58,333
1 month to 31 August 2010 (date 'Z' joins): 1/12 x 100,000 = 8,333
4 months to 31 December 2010 (to end of accounting period): 4/12 x 100,000 = 33,334

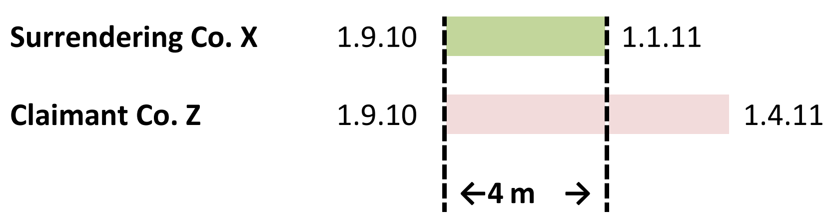
Company 'Y' will have deemed accounting periods and time-apportioned chargeable profits as follows:

7 months to 31 July 2010 (date leaves group): 7/12 x 50,000 = 29,167
5 months to 31 December 2010: 5/12 x 50,000 = 20,833



Company 'Z' will have deemed accounting periods and time-apportioned chargeable profits as follows:

5 months to 31 August 2010 (date joins group): 5/12 x 70,000 = 29,167
7 months to 31 March 2011: 7/12 x 70,000 = 40,833



'X' may surrender to 'Y' maximum group relief of 58,333 as 'X' and 'Y' are both members of the same group throughout the whole of the deemed 7 month accounting period to 31 July 2010. However, the maximum group relief that may be claimed by 'Y' is **29,167**.

‘X’ may surrender to ‘Z’ maximum group relief of 33,334 as ‘X’ and ‘Z’ are both members of the same group throughout the whole of the deemed 4 month accounting period to 31 December 2010. The maximum group relief that may be claimed by ‘Z’ is 40,833 x 4/7 as there is only a 4 month corresponding period. Z may therefore only claim up to **23,333**.

If both ‘Y’ and ‘Z’ claim the maximum possible amounts, ‘X’s’ accounting period for the year ended 31 December will reflect tax losses of QR100,000 less group relief surrendered (29,167 + 23,333) 52,500 and the balance of loss (47,500) is available for carry forward.

The accounting period of ‘Y’ for the year ended 31 December 2010 will reflect chargeable profits of 50,000, less group relief of 29,167, net **20,833**.

The accounting period of ‘Z’ for the year ended 31 March 2011 will reflect chargeable profits of 70,000, less group relief of 23,333, net **46,667**.

It should be noted that the deemed accounting periods are used only for calculating the maximum group relief available for surrender/claim and do not change the actual accounting periods for the purposes of self-assessment, the filing date for returns etc.

5 – 5200 Surrenders and Claims - Procedures

The procedures for claiming and surrendering group relief, in the context of self-assessment, are dealt with in TAX 9 (Article 32(5)). The procedural rules are, of necessity, somewhat complex as they need to cater for a wide range of possible circumstances. Normally the position will be quite straightforward – the tax returns of the claimant and surrendering companies will reflect the group relief position correctly and there will be no need to enquire into, or amend, the return of either company.

5 – 5220 Claims – General

Group relief has to be claimed (Article 32(5)). TAX 9.1.1 indicates that the claim must be made in the tax return (or amended return) for the accounting period of claim and must be specified and quantified at the time it is made (TAX 9.1.3). ‘Quantified’ means the claim must be expressed in figures, rather than a formula. ‘Company A claims group relief of QR100,000 from company B’ is acceptable but ‘Company A claims sufficient group relief from company B to reduce its profits to QR50,000’ is not. The claim must also specify the name of the surrendering company. A completed self-assessment return, with the group relief claim section fully completed will fulfil the criteria of a valid claim.

A claim to group relief need not be for the full amount available for surrender (TAX 9.1.4) and equally a surrendering company need not surrender all its available losses to a claimant company.

5 – 5240 Claims - Consent

A claim to group relief is ineffective without the written consent of the surrendering company, which is to be given before or at the same time the claim is made (TAX 9.1.5). A surrender notice must show the names of both the claimant and surrendering company, the amount of the loss being surrendered and the accounting period of the surrendering company. A completed self-assessment return, with the group relief surrender section fully completed will fulfil the criteria of a valid surrender notice, however (unlike a claim) it is not necessary for a consent notice to be included in a return and any written notice fulfilling the conditions of TAX 9.2.1 will constitute a validly made consent notice.

5 – 5260 Amending Claims

A claim to group relief may not be amended (TAX 9.1.2). Instead a claim must be withdrawn and replaced by the claimant company making an amended return. The time limit for making and withdrawing claims is dealt with by TAX 9.4 (See time limits below).

5 – 5280 Amending Consent

If a surrendering company changes its mind about the amount of group relief it is prepared to surrender to a claimant company then the consent notice must be withdrawn and replaced by another notice (TAX 9.2.2). The new notice of consent must be accompanied by a notice from the claimant company signifying it agrees to the new consent notice and, at the same time, the claimant company must amend its return to reflect the revised amount surrendered. The obligation for consent to be given by the claimant company does not apply when the surrender is withdrawn because the amount available for surrender is reduced (See TAX 9.5). The time limits detailed at TAX 9.4 effectively constrain the time within which a surrendering company may change its mind about the losses it wishes to surrender.

5 – 5300 Amendment of Returns

Where a notice of consent (including a replacement notice under TAX 9.2.2 is given after the claimant company has filed a return for the accounting period of claim, the claimant company must amend its self-assessment return for that period, to reflect the consent notice (TAX 9.3.1). The normal time limit for amending a return is extended, if necessary, to allow such an amendment (TAX 9.3.3).

If a surrendering company decides to surrender losses in respect of which relief has already been given for a subsequent accounting period(s) under Article 28, the surrendering company must amend its return for that period(s) at the same time the notice of consent is given (TAX 9.3.2). The normal time limit for amending a return is extended, if necessary, to allow such an amendment (TAX9.3.3). This may happen where, for example, the surrendering company's accounting period ends almost 12 months after the claimant company's corresponding accounting period, and the claimant company's filing date is extended.

5 – 5320 Time limits

The normal time limit for making or withdrawing a group relief claim is 12 months after the filing date (not the date the return was actually filed) for the accounting period of claim (TAX 9.4.1(A)).

If an enquiry is opened into the claimant's return the time limit is extended to 30 days after the enquiry is completed (TAX 9.4.1(B)), that is 30 days after a closure notice is issued under Article 112. This rule is modified when either the Tax Department amend the return under Article 112 at the conclusion of an enquiry, or an appeal is made against such an amendment. In such cases the time limit is extended to 30 days after the notice of amendment is issued or 30 days after the appeal is finally determined (TAX 9.4.1(C) and (D)). If an appeal is taken before the QFC Regulatory Tribunal or QFC Court it should not be regarded as finally determined until the decision of the Tribunal/Court is handed down.

The Tax Department have a general discretion to extend the time limit for the making/withdrawing of group relief claims. This discretion should be used cautiously and generally you should only allow a late claim where you are convinced, on the facts of the case, that there was a reasonable excuse for not making the claim/withdrawal in time and it was made thereafter without unreasonable delay. There is no appeal against a refusal to admit a group relief late claim/withdrawal.

Where a claim is made or withdrawn under TAX 9.4.1 (B) – (D) the normal time limit for amending a return is extended to allow the claim/withdrawal under TAX 9.4.1. The time limit is extended only for the purpose of the group relief claim/withdrawal and only to the extent necessary to make the claim/withdrawal (TAX 9.4.2).

5 – 5340 Amount Available for Surrender Reduced

The amount of losses a company has available to surrender may be reduced after a valid notice of consent has been given. This may happen for a number of reasons, including a company amending its own return, or the Tax Department amending a return at the conclusion of an enquiry.

In these circumstances the surrendering company is obliged to withdraw, within 30 days, the notice(s) of consent to bring the total amount surrendered within the new amount available for surrender. The surrendering company must send notices of withdrawal, and any new consent notices, to both the Tax Department and the affected claimant companies (TAX 9.5.1 - 9.5.3). The claimant company must amend its return to reflect the withdrawal and any new consent notices (TAX 9.5.5). Where the amount available for surrender is reduced the claimant company need not, as is normally the case consent to the amendment (TAX 9.2.2).

Examples

Surrendering company ‘S’ returns losses of QR100,000 for the accounting period year ended 31 December 2010 on 1 May 2011. Following an enquiry, the return is amended by the Tax Department, on 1 June 2012, to reflect revised losses of QR20,000

Example 1

Claimant Company ‘A’ has chargeable profits of QR200,000 for the 12 month accounting period ending on 31 December 2010 and it claims, by way of group relief, all of company ‘S’ losses.

Following the amendment made at the conclusion of the enquiry, company ‘S’ must withdraw its consent notice for the surrender of the QR100,000, notifying both the Tax Department and company ‘A’. Company ‘S’ may (but is not obliged to) give a new notice of consent in respect of its revised losses. Company ‘A’ must revise its return to reflect the position. Company ‘A’ does not have to consent to the change in losses surrendered in order for it to be effective (see above and TAX 9.2.2).

Example 2

Suppose the company ‘S’ loss of QR100,000 was originally surrendered as follows: QR50,000 to company ‘A’, QR40,000 to company ‘B’ and QR10,000 to company ‘C.’ Following the reduction in the amount available for surrender to QR20,000 Company ‘S’ will have to withdraw consent notices so as to reduce the total amount surrendered to less than the new amount available for surrender, and may give one or more new notices of consent (TAX 9.5.2). This result may be achieved in a number of ways, two of which are given by way of illustration:

Option 1

Company ‘S’ withdraws consent from companies ‘A’ and ‘B’. It will then have a total of QR10,000 of losses that it may surrender to companies ‘A’ and/or ‘B’ by way of a fresh notice. Companies ‘A’ and ‘B’ will have to amend their returns accordingly. Company ‘C’ will be unaffected as it is unnecessary to withdraw consent in respect of company ‘C’ to bring the total available for surrender down to the reduced amount.

Option 2

Company ‘S’ withdraws consent from companies ‘A’, ‘B’ and ‘C’. It will then have QR20,000 of losses that it may surrender to companies ‘A’, ‘B’ and/or ‘C’ by way of a fresh notice. Companies ‘A’, ‘B’ and ‘C’ will have to amend their returns accordingly.

If a surrendering company does not withdraw consent following a reduction of the amount available, the Tax Department may issue directions (to the surrendering company and each affected claimant company) which have the same effect as a consent withdrawal notice(s) (TAX 9.5.4). Where such directions are issued the claimant company(s) must amend their return accordingly (TAX 9.5.5). You should consider issuing directions as soon as the 30 day time limit for the surrendering company to withdraw consent (TAX 9.5.2) has passed.

PART 6 DOUBLE TAXATION RELIEF

6 – 1000+ Introduction

Part 6 of the QFC Tax Regulations deals with double taxation relief. Provision is made for both relief under double tax treaties and also unilaterally. The tax credit method is the normal method of giving unilateral relief but there is also an option for admissible overseas taxes to be treated as an expense deduction.

6 – 2000+ Double Tax Treaties

6 – 2000 General

Article 37 makes it clear that where Qatar has entered into a double tax agreement (DTA) with another country, the provisions of that agreement shall apply in preference to any similar domestic legislation. However it is generally accepted that a DTA cannot create new taxing obligations.

Qatar’s DTAs are negotiated by the Government of Qatar (through the Ministry of Finance and the Public Revenue and Taxes Department) and are generally based on the OECD Model Tax Convention (MTC).

You will need to check the relevant double tax agreement in question however in general, the agreements between Qatar and its treaty partners apply to existing taxes and subsequently enacted taxes of a similar nature, in accordance with a sub-Article identical to, or substantially the same as, Article 2.4 of the MTC:

"The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws."

The competent authority at present is the Director of the State Tax Department and the DTAs will apply to QFC corporation tax. QFC tax is "substantially similar" to the State tax.

As Qatar's DTAs apply, in the case of Qatar, to 'taxes on income' or 'taxes on income or profit' any DTAs signed after QFC tax is enacted will apply to QFC tax, as well as State tax as QFC tax is clearly a tax on 'income' or 'profit'.

Following the publication of the OECD's report into BEPS and their recommend to changes to the current MTC (largely around the inclusion of a Limitation of Benefits Clause similar to that in most USA treaties to prevent double non-taxation) we may see Qatar having to renegotiate several of its DTAs. The QFCA Tax Department may have a role to play in future treaty negotiations.

6 – 2020 DTA Network

The Government of Qatar is actively expanding its treaty network and in addition to concluding several treaties, many more are in various stages of negotiation. Copies of most treaties entered into by Qatar are available via the Tax Treaty Database on our website (www.qfc.qa).

Qatar's treaties generally closely follow the OECD model tax convention (MTC). When considering if relief is due under the terms of a particular agreement it is important to refer to the exact terms of the agreement itself.

6 – 2040 The OECD MTC

Some features of the MTC generally present in Qatar's DTAs and which may be relevant to QFC taxation, are described below:-

Article 4 - Residence

The treaty tie-breaker for a dual resident QFC Entity is normally its place of effective management (see Part 2 Residence at QTM2-2000+).

Article 5 – Permanent Establishment

The treaty definition of a permanent establishment (PE) in Qatar's DTAs is normally identical to the MTC definition. The QFC definition of a permanent establishment is itself based on Article 5 of the MTC (see Part 2 Taxation of non-residents at QTM2-3000+). It is therefore most unlikely a situation will arise where there is, or is not, a PE under the QFC Tax Regulations but there is not, or is, a PE under any particular DTA.

Article 6 - Immovable Property

The QFC source rules deem income from immovable property situated outside of Qatar not to be local source income (see Part 2 Territorial basis of taxation at QTM2-4120), which follows Article 6 of the MTC.

Article 7 – Business Profits

Article 13 of the QFC Tax Regulations charges non-resident QFC Entities on profits attributable to a permanent establishment of the entity in Qatar, the measure of profit being based on the profit the PE would have made if it were a *"distinct and separate entity… dealing wholly independently with the enterprise of which it is a PE."* This is identical to the approach contained within Article 7(2) of the MTC (2008 Edition). See QTM2-3000+ for the principles to be adopted in attributing profits to a PE. The guidance follows the *'Authorised OECD Approach'*.

Article 9 – Associated Enterprises

The QFC transfer pricing provisions of Part 8 are based on the arm's length principle and are in harmony with Article 9 of the MTC.

Article 10 –Dividends

Primary taxing rights are given to the State of residence of the payee (MTC Article 10(1)). However the source state has secondary taxing rights and may impose withholding taxes (MTC Article 10(2)).

As the QFC tax regime contains no withholding tax provisions, the main impact, from a QFC perspective, of the dividend Article in Qatar's DTAs is likely to be to limit the rate of WHT (nil under some of Qatar's DTAs) that other States apply in respect of dividends paid to QFC Entities.

Where the beneficial owner of a dividend is a resident of one of the Contracting States and carries on a business in the other Contracting State (in which the dividend arises) through a PE, Article 7 (business profits) rather than Article 5 applies (MTC Article 10(4)).

Article 150 exempts the receipt of dividends from tax under the QFC Tax Regulations. For Accounting Periods that straddle 18th June 2014 it will be necessary for taxpayers to split the type of dividend received as prior to this date only specific dividends were exempt under the QFC Tax Regulations.

Neither the QFC nor the State Tax regime presently imposes any withholding taxes on dividends paid abroad.

Article 11 – Interest

Article 11 of the MTC gives primary taxing right to the country of residence of the payee. However the country in which the interest arises may charge a withholding tax of up to 10%.

Article 11(5) of the MTC deems interest to arise in a Contracting State if the payer is a resident of that State. This rule is modified where the payer (wherever resident) has a permanent establishment (PE) in a Contracting State and the indebtedness on which the interest is paid arose in connection with that PE and the PE bears the interest charge. In these circumstances then the interest is deemed to arise in the Contracting State where the PE is located.

Where the beneficial owner of the interest is a resident of one of the Contracting States and carries on a business in the other Contracting State (in which the interest arises) through a PE, Article 7 (business profits) rather than Article 5 applies (MTC, Article 11(5)).

The interest Article of a Qatari DTA may be exploited by third country 'treaty shoppers' whom wish to take advantage of Qatar's treaty network to gain a tax advantage. The Qatar/UK treaty in Articles 11(2)/(3) contains specific provisions, suggested by the UK, to limit or eliminate the extent to which the treaty may be used for treaty shopping. See, in this context Part 6 specifically QTM6-2060 Treaty abuse below.

Article 12 – Royalties

The main MTC Article 12 rule is that where royalties arise in one Contracting State that are beneficially owned by a resident of the other Contracting State, the taxing rights lie with the State where the beneficial owner is resident.

The basic rule is modified where the beneficial owner of a Royalty, resident of one of the Contracting States, carries on business through a permanent establishment (PE) in the other State where the royalties arise, and the rights or property in respect of which the royalty is paid is effectively connected with the PE. In such cases the business profits Article 7 applies rather than Article 12.

Article 12 will give Qatar taxing rights when the beneficial owner is resident. See QTM2-4140 for more information.

Article 13 – Capital Gains

Article 13 of the MTC sets out the taxing rights in relation to capital gains.

In practice this Article is likely to be of limited application as there is no specific QFC capital gains tax. However the Article may sometimes be in point as the scope of QFC corporation tax includes capital gains taken to a QFC Entity's profit and loss account under the GAAP used to prepare the QFC Entity's accounts.

Article 23 B – Tax Credit

The method, in all of Qatar's DTAs for relieving double taxation is based on the credit method contained in Article 23B of the MTC, as opposed to the exemption method of Article 23A.

The basis of the credit method is that the State of residence of the taxpayer (State R) retains its right to tax the income in question but allows a deduction in respect of tax due in the State of Source (State S) on that income (States R and S are the treaty partners – neither is a third State). The deduction is known as a 'tax credit'.

A characteristic of the credit method is that State R is never obliged to allow a deduction of more than the tax due in State S on the income in question.

Qatar's DTAs do not provide for 'tax sparing' or credit for underlying tax.

Article 26 – Exchange of Information

Generally, Qatar's treaties follow the MTC with regard to exchange of information. Significantly, more recent treaties incorporate the 2005 OECD wording which signifies Qatar subscribes fully to OECD principles regarding transparency and exchange of information.

In 2011 Qatar successfully completed an OECD Global Forum phase 1 review of its regulatory and legal framework in relation to transparency and exchange of information for tax purposes. A phase 2 review (practical application of matters covered in phase 1) was undertaken in 2012 and Qatar was awarded a score of 'largely compliant'. This is the second highest score available and the main reason for Qatar not obtaining the highest score possible was due to the limited number of exchange of information requests received during the review period.

6 – 2060 Treaty Abuse

DTAs are used by tax planners, sometimes to seek to gain a tax advantage that was not intended by the treaty partners.

A good example of such planning is 'treaty shopping' often by the use of conduit companies which have no real business presence in a jurisdiction but which funds pass through to obtain the desired advantageous result.

Example

Suppose under the terms of a Qatar/UK treaty interest under the MTC Article 11 equivalent could be paid to Qatar from the UK gross.

Take the case of a State A resident company X Ltd wishing to borrow $1 million from a wealthy Middle East lender Y with whom it is unconnected. Company X intends to use the money to set up a wholly owned subsidiary company abroad. Y will lend only on terms that he/she pays no State A tax. X cannot afford to borrow unless it gets relief on the interest. State A's domestic law does not permit both of these things at the same time. To secure the desired result X forms a Qatari subsidiary Q. Y lends the $1 million to Q, and Q lends it on to X making a small profit on the interest rate. The (hypothetical) tax treaty between State A and Qatar may well allow the interest paid by X to Q to be paid in full and the Qatar tax regime allows company Q to pay the interest on to Y without deduction of Qatari tax because there is no withholding tax on interest.

Treaties negotiated by Qatar may, increasingly, contain anti-treaty shopping clauses, inserted at the behest of the treaty partner. These may be of a general nature, denying treaty benefits where the main or one of the main purposes of the transactions behind the claim to treaty relief was obtaining a tax advantage. Treaty partners may also negotiate the insertion of specific anti-treaty shopping clauses, such as the treaty rate of withholding tax on interest only applying where the payee has a real business presence in Qatar. The domestic legislation of treaty partners may also contain treaty over-ride anti-avoidance provisions to negate the effect of the treaty in relation to certain specific transactions.

6 – 2080 Treaty Relief

As noted above, Qatar's DTAs invariably adopt the tax credit method of relieving double taxation in Qatar (MTC Article 23B) rather than the exemption method of Article 23A. The specific treaty should be referred to, together with the most recent OECD commentary, to determine the amount of relief, if any, that is due.

Treaty relief is given, in terms of tax, against QFC tax payable. Where the amount of credit due exceeds the QFC tax payable, there is no provision for carrying forward or otherwise relieving the excess. The option of claiming an expense deduction is strictly, on the wording of Article 40 (see below), not available in respect of a tax credit under a DTA but you should consider any request for an expense deduction in respect of treaty relief sympathetically, especially as it is unlikely large amounts of tax will be at stake.

The amount of credit relief is limited, under Article 23B(1) of the MTC to the lesser of the foreign tax paid or the QFC tax payable on the same income before any tax credit relief.

Before giving relief you should be satisfied that the foreign tax has been paid and it relates to the same income included in the QFC tax charge. Normally the taxpayer should be able to obtain a certificate from the foreign tax authority but any good evidence of payment may be accepted.

6 – 3000+ Unilateral Relief

6 – 3000 General

Articles 38-40 of the QFC Tax Regulations deal with unilateral tax credit relief. Broadly, where foreign tax is suffered on income chargeable to QFC tax, the foreign tax may be allowed as a credit against the QFC tax due (Article 38).

Unilateral relief is only available where there is no double tax agreement between Qatar and the country in which the foreign tax charge arose, and for the avoidance of doubt Article 37(2) states that a credit is not available under Article 38 if any credit is available under a Double Tax Agreement. However unilateral relief may be available in respect of a tax (within the definition of Article 38(2)) that is not specifically covered by the DTA. For example a DTA between Qatar and another country may cover federal but not local income taxes. Unilateral relief, in this case, may be available in respect of the local income tax.

Article 39 deals with the computation of the foreign tax available for credit relief. The relief, which does not have to be claimed, is only available to QFC Entities resident in Qatar under Article 8 (Article 38(3)). This means, for example, a QFC Entity branch of a non-Qatari enterprise is not entitled to unilateral relief.

An option is available to treat allowable foreign tax as a deductible expense.

6 – 3020 Claiming Unilateral Relief

Article 38(1) of the QFC Tax Regulations authorises tax credit relief for 'tax paid under the law of any other country than Qatar' as a 'credit against corporation tax'.

The scope of relief is limited by Article 38(2) which defines 'tax paid' in Article 38(1) as only including (a) income and corporation taxes paid on income in the other country and computed by reference to that income and (b) withholding taxes paid in respect of such income in the other country. This means, for example, indirect taxes such as VAT are not within the scope of unilateral relief.

Article 39(1) defines the foreign income in respect of which a unilateral tax credit is to be given as the full amount of that income, i.e. not that income as reduced by the foreign tax borne. Article 39(2) effectively limits the credit to the lesser of (a) the foreign tax paid or (b) the QFC tax payable on the same income before any tax credit relief.

For example, suppose foreign tax has been deducted in another country on income of QR100,000 equivalent at 20%. i.e. QR 20,000. Unilateral relief will be restricted to QR10,000 (QR100,000 @10%) - the QFC tax chargeable on the same income.

The relief is given, in terms of tax, against QFC tax payable. Where the amount of credit due exceeds the QFC tax payable, there is no provision for carrying forward or otherwise relieving the excess. However see below with regard to electing for a deduction expense in respect of admissible foreign tax.

Before giving relief you should be satisfied that the foreign tax has been paid and it relates to the same income included in the QFC tax charge. Normally the taxpayer should be able to obtain a certificate from the foreign tax authority but any good evidence of payment may be accepted.

6 – 3040 Expense Deduction

Where an election is made under Article 40 for overseas tax to be treated as a deducible expense the election will apply with respect to <u>all</u> tax paid on <u>any</u> sources of overseas income. It is therefore an "all or nothing" election, part unilateral relief and part expense deduction is not allowed.

It may happen that unilateral relief (or treaty relief) cannot be given, or not given in full, because the QFC Entity does not have sufficient tax in charge. This situation will most often arise when the QFC Entity returns a loss for the accounting period in question. It is open to the QFC Entity to, instead of setting the foreign tax off as a credit against QFC tax payable, elect to treat the foreign tax as a deduction in arriving at chargeable profits/tax losses for the period. The loss, enhanced by the deduction, will then be available for carry forward or surrender as group relief under part 5 of the Regulations (QTM5-5000+). To benefit from such treatment, for any accounting period, the QFC Entity must make a written election within 18 months from the end of that accounting period.

If an election is made for an expense deduction, relief may be given for the full amount of foreign tax paid in respect of the income being doubly taxed in Qatar – the deduction need not be restricted to the QFC tax payable on the income in respect of which the foreign tax was paid.

A late election may be considered (TAX 13.4 and see QTM–TR-2020). You should normally only accept a late election when you are satisfied there was a reasonable excuse for not making the election on time, and it was made thereafter without unreasonable delay.

PART 7 REORGANISATIONS AND RECONSTRUCTIONS

7 – 1000+ Reorganisations and Reconstructions

7 – 1000 Introduction

Part 7 of the Regulations covers reorganisations and reconstructions. The QFC tax system has been designed to support commercially driven reorganisations or reconstructions required by a QFC entity in undertaking its business in Qatar.

As a general policy, QFC tax is intended to be charged on the commercial profits of a QFC entity's business as they arise. However, a taxable gain or profit may crystallise solely as a result of a reorganisation or reconstruction - for example on the intra-group transfer of assets or on the incorporation of a business. Imposing a tax charge on the 'paper' gains or profits arising from such transactions would be an unwelcome deterrent and a barrier to a QFC entity's ability to operate and structure its business in an optimal commercial manner.

In support of this policy, the QFC tax regime provides that certain specified reorganisations and reconstructions are treated in a tax neutral manner.

Articles 42 - 45 cover the following transactions:

- Intra-group transfers of assets (Article 42 and QTM7-2000+)
- Replacement of business assets, or 'roll-over relief' (Article 43 and QTM7-3000+)
- Reduction in share capital (Article 44 and QTM7-4000+)

- Incorporation of a business (Article 45 and QTM7-5000+)

In addition to the above specified transactions, Article 46 (QTM7-6000+) provides relief on a discretionary basis for other reorganisations or reconstructions. To qualify for the favourable tax treatment the reorganisation or reconstruction has to be carried out for bona-fide commercial reasons, rather than to gain a tax advantage.

7 – 1020 Disposals and Acquisitions

Questions such as the date of disposal and acquisition, or whether there has been a disposal of an asset should not normally arise. The Regulations do not attempt to set out a full code with regard to the acquisition or disposal of assets, and the accountancy treatment should be followed, taking a broad, common sense approach where the accountancy treatment may require modification in applying the specific provisions of Part 7. For example, the date of disposal of an asset is the date of acquisition by the person acquiring it. You may regard a disposal having taken place where a capital sum is received in respect of an asset, for example from insurance proceeds when an asset is lost or destroyed. The date of disposal will normally be the date an unconditional contract for the sale/acquisition is made. Where a conditional contract has 'conditions precedent', that is conditions that must be satisfied before the contract becomes legally binding, the date of disposal will be the date on which all such conditions are satisfied. In the case of a capital sum derived from assets, the date of disposal should be taken as the date on which the capital sum is received.

7 – 2000+ Intra-Group Transfer of Assets

7 – 2000 Introduction

Article 42 covers the transfer of assets between group companies. The article allows assets to be moved around a group without incurring a tax charge. Such transfers are treated on a no gain/no loss basis for tax purposes.

Article 34 describes when, for QFC tax purposes, companies are to be regarded as members of the same group. To qualify for relief under Article 42, both the transferor and the transferee must, as well as being members of the same group, both be QFC entities.

Where all the conditions required for the relief are met, the relief applies automatically; no claim is required and an entity may not elect for the relief to be dis-applied.

7 – 2020 No gain/No loss

Article 42(1) provides that where an asset is transferred from one group member, Company A, to another, Company B, then they are treated as if the asset was acquired by

Company B for a consideration of such an amount that would secure that neither a gain nor a loss would accrue to Company A on the disposal.

Example 1

Companies A and B are members of the same group. Company A acquires a property from Company X (an unconnected third party) on 1 January 2012 for QR500,000. On 1 September 2013 it sells the property to Company B for a consideration of QR750,000. Company A's accounts for the accounting period covering the transaction will show a profit/gain of QR250,000 arising on the sale of the property. However, for tax purposes, the transaction is treated as though the transfer value is such that no gain or loss has taken place upon transfer i.e. A is regarded as selling the property and B is regarded as purchasing the property for a consideration of QR500,000.

The no gain/no loss rule determines, for tax purposes, both the sale and purchase price and the effect is to defer the gain (or loss) by substituting the purchase price paid by Company B with the original cost paid for acquiring the asset by Company A. The deferred gain (or loss) will be realised when the asset is sold outside the group, or a taxable gain (or loss) otherwise crystallises (see below). For example, assuming Company B sells the asset for QR 900,000 to an unconnected third party on 1 January 2015 a taxable gain of QR 400,000 will become chargeable on Company B (QR 900,000 – QR 500,000).

7 – 2040 Conditions

There are three main conditions which must be satisfied in order for a gain to be deferred on an intra-group transfer of assets under Article 42.

1. **Disposal of an asset:**

   There must be a disposal of an asset. 'Disposal' is not defined in the Regulations and therefore the word takes its ordinary meaning. You should generally accept there has been a disposal when the beneficial ownership of an asset has been transferred, and there has been a corresponding acquisition of the beneficial ownership by another group company. A disposal includes a part-disposal. For example, a QFC entity owns a plot of land and disposes only part of that land to another group entity there will have been a disposal of an asset within Article 42(1). In the case of a part disposal the accounting treatment would normally attribute acquisition costs on a pro-rata basis and this treatment may be accepted for tax purposes.

2. **Disposal to a group member:**

Article 42(1) provides that the disposal must be made from one QFC entity to another, at a time when both companies are members of the same group. "Group" is defined at Article 34 (see QTM5-5020).

3. Continued Membership of the Same Group for at Least 12 months:

Even if conditions 1 and 2 above are satisfied, relief is not due if the two QFC entities cease to be members of the same group within 12 months of the disposal of the asset (Article 42(2)). This rule is intended to discourage a company avoiding a tax charge on the sale of an asset by transferring the asset to a subsidiary and shortly thereafter selling the shares in that subsidiary. The potential for avoiding a tax charge arises because of the QFC participation exemption (QTM12-1000). Broadly, Part 12 exempts a tax charge on the disposal of the shares in a group company, provided the company has been in the group for at least 6 months.

Example 1

Suppose Company A has an asset with a large potential taxable gain it wishes to dispose of to an unconnected third party, Company C. A straight sale from A to C will result in A's gain being charged to QFC tax. However, if A sets up a new QFC subsidiary, Company B, at least six months before the intended sale, and transfers the asset to B in exchange for shares, then the gain on the transfer to B will be on a no gain no loss basis because the conditions of Article 42(1) will be met. The value of the shares in B will reflect the open market value of the underlying asset transferred but when these are sold to C, the gain arising will, prima facie, be exempt under the participation exemption. Company A will thus have avoided an otherwise taxable gain.

The success of such a scheme may be frustrated in a number of ways. Firstly, because of the QFC licensing requirements, it is not possible to simply set up a QFC 'shell' company for use in an avoidance scheme – all companies have to go through a rigorous licensing process, including the submission of a business plan etc. Secondly, the participation exemption does not apply when the shares sold were held wholly or mainly with a view to resale (Article 72(2)(c) –see QTM12-1020). In the example given above it could be argued that Company A held the shares in Company B solely with a view to their subsequent sale to Company C. Finally, in addition to the participation exemption qualification that the shares have to be held for at least six months before the sale, Article 42(2) negates the no gain/no loss transfer if Company B leaves the group within 12 months of the transfer.

The above factors should make the use of a combination of the participation exemption and Article 42 to avoid an otherwise chargeable gain unlikely. You should, however, remain vigilant when examining accounts and computations for possible variations designed to exploit the intra-group relief provisions. If an asset with a significant potentially taxable gain is transferred out of a group to a third party without attracting a charge to tax the facts should be examined critically, by way of an enquiry into the relevant return.

It should be noted that for Article 42(2) to apply the company has to leave the group, as defined by Article 34. If a group company ceases to be a QFC Entity (but is still a group member as defined by Article 34) within 12 months of an Article 42 transfer, the mere fact of it ceasing to be a QFC entity will not trigger an Article 42(2) charge.

7 – 2060 Crystallising the Gain

An asset can be moved around a group many times without incurring a tax charge via sequential applications of Article 42. The potential gain is deferred during its period of ownership by the group, and generally speaking, the gain does not crystallise until the asset finally leaves the group. However Article 42(2) dis-applies Article 42 when the transferor and transferee cease to be members of the same group within 12 months of the transfer.

A gain may crystallise in 2 main ways:

1. **Deemed disposal where companies cease being members of same group within 12 months**

   As noted above, where a disposal has been afforded Article 42(1) treatment but the transferee and transferor cease to be members of the same group within a period of 12 months after the disposal, the disposal of the asset is treated as having taken place at open market value at the date of disposal (Article 42(2)). The gain is chargeable on the transferor who should also make the tax payment.

2. **Disposal to an unconnected third party**

   Where an asset, that has been transferred from group Company A to group Company B is then subsequently sold to a third unconnected party the deferred gain crystallises, as in the example at QTM7-2020.

The usual case will be that the gain will not crystallise until the asset leaves the group. However, it should be noted that it is possible for a gain to crystallise, in full or in part, without the asset being sold outside the group. For example, revaluation of assets to reverse a downward adjustment written-off to the Profit and Loss account in an earlier accounting period, may result in a profit and loss charge without there being a third party disposal.

7 – 2080 Records to be Maintained

Whenever the acquisition cost of an asset is reduced by a deferred gain you should make a prominent permanent note in the taxpayers file identifying the asset involved, the date it was acquired, the acquisition cost and the amount of the deferred gain reducing that cost for tax purposes.

A similar note should also be made in the file for the transferor, in case the companies cease to be members of the same group in the 12 months following the transfer.

7 – 3000+ Replacement of Business Assets

7 – 3000 Introduction

Article 43 covers the replacement of business assets. Relief from an immediate tax charge is provided where a QFC entity disposes of specified assets and the consideration for the disposal is used to acquire, in full or in part, other specified business assets. The classes of assets qualifying for relief are buildings or land, goodwill, patents, copyrights or any other form of intellectual property. The assets must have been used, wholly or partly, for the purposes of generating local source income.

The relief is intended to allow businesses to modernise, expand and relocate without loss of capital to an immediate tax charge that would otherwise arise when a business asset is sold. The effect of the relief is that the gain on disposal of an old asset is deferred by setting it against the acquisition cost of the new asset(s). The relief is known as 'roll-over relief' as the gain on disposal of the old asset is 'rolled-over' against the cost of the new asset.

Roll-over relief must be claimed. There are time limits within which reinvestment must occur and rules for giving limited relief where the disposal proceeds are not fully reinvested or the assets have not been fully used to generate local source income. These are outlined in detail below.

7 – 3020 No Gain/No Loss

Article 43(1)(a) provides that the consideration for the disposal of the old assets is treated on a no gain/no loss basis and Article 43(1)(b) reduces the consideration for the acquisition of the new assets, for tax purposes, by the amount of the deferred gain, or increases the cost of the new asset by the deferred loss (see below for details regarding roll-over relief and losses). Relief is restricted when the asset has not been fully used throughout its period of ownership in generating local source income or when the proceeds from the sale of the old asset are not fully reinvested.

The straightforward application of roll-over relief may be illustrated as follows (it is assumed all the conditions for full roll-over relief to be given are met):

Company A owns a building which it acquired on 1 January 2010 for QR100,000. On 1 January 2011 it sells the building for QR150,000 and in February 2011 it acquires a plot of land for QR300,000. The company claims roll-over relief.

The consideration for the sale of the old asset is treated, for tax purposes, as being QR100,000 (no gain/no loss).

For tax purposes, the consideration for the land acquired (QR300,000) is reduced by the difference between the actual consideration for the disposal of the old asset (QR150,000) and the amount Company A is treated as having received under Article 43(1)(a) (QR100,000). The consideration is therefore reduced by QR50,000 to QR250,000. Put simply, the gain is not taxed when the old asset is sold but instead the acquisition cost of the new asset is reduced by the deferred gain. With a reduced base cost for the new asset any subsequent gain made on the sale of that new asset will therefore be higher, thus taking into account the gain rolled over.

7 – 3040 Losses

When an asset is disposed of for a loss a QFC Entity will not normally claim roll-over relief as it will wish to utilise the loss, either in the accounting period it arose (against other profits, or to surrender as group relief) or carry it forward against future profits. There may, however, be circumstances where it will be to a group's advantage for a group member to claim roll-over relief when it disposes of an asset at a loss so it may maximise the availability of losses to the group by either (a) maximising the potential to surrender losses as group relief (see example 1 below), or (b) transferring the rolled-over loss to another group company by making an intra-group transfer under Article 42 after claiming roll-over relief (see example 2 below).

Although Article 43(1)(b) talks of the consideration for the new asset being 'reduced', in practice you may accept a roll-over claim in relation to an asset sold at a loss *increasing* the deemed cost of the new asset.

Example 1 – Maximising Group Relief

Company Y and Company Z are both members of the same QFC group and both have 31 December year ends. Company Z is a currently operating at a loss, but is expected to become profitable next year. Company Y expects to be in a loss position for some considerable time.

On 1 September 2012 Company Y sells a building which it acquired on 1 April 2011 for QR350,000. Due to a slump in real estate prices, Company Y sells the building for QR280,000, incurring a loss of QR70,000. On 1 November 2012 Y buys a new building for QR300,000.

On making a roll-over relief claim, the disposal of the old building is treated for tax purposes as being QR350,000, ensuring neither a gain nor loss accrues to Company Y on the disposal. The consideration for acquiring the new building is *increased* by QR70,000 to QR370,000 being the difference between the actual consideration for the disposal of the old building (QR280,000) and the deemed disposal consideration (QR350,000). The loss is thus rolled-over into the new asset.

If Company Y sells the new building for (say) QR300,000 during the year ended 31 December 2013 the loss of QR70,000 crystallises and will be available for surrender, in that accounting period, as group relief to company Z. Without the roll-over relief claim the loss would only have been available to Y for carry forward.

Example 2 – Roll-over claim followed by intra-group transfer.

The facts regarding the sale of the building, acquisition of the new building and roll-over relief claim are the same as in example 1. The new building has a deemed acquisition cost of QR370,000 compared to an actual cost of QR300,000. If, instead of selling the new building Company Y immediately transfers it to Company Z then, because of the operation of Article 42 (see QTM7-2000+), the new building will be transferred 'with the loss' i.e. at the deemed acquisition cost of QR370,000 irrespective of the market value of the asset at the transfer date. If Company Z subsequently sells the new building for less than its deemed acquisition cost (say, as in example 1, a sale during the year to 31 December 2013 for QR300,000) it will be able to use the loss on the disposal in that accounting period (or surrender it to any third group member as group relief) or carry it forward against future profits.

7 – 3060 Conditions

Roll-over relief must be claimed (Article 43(1) and QTM-TR-3000+ regarding claims generally). In order for the claim to succeed, the QFC entity must be able to show that the conditions detailed below for asset use are satisfied.

7 – 3080 Asset Use

Roll-over relief is only due when both the old and new assets have been used for the purposes of generating local source income (Article 43(2)(a)). For the meaning of 'local source income' see Part 2 of this manual.

Where an old asset has not been used for the purposes of generating local source income for the whole of its period of ownership, or has not been wholly used for such purposes, Article 43(4) provides that only partial relief is available based on an apportionment of the disposal consideration. *'Ownership'* should be taken to mean beneficial ownership.

You should review the ownership period of the asset and compare the 'qualifying' period or proportion of use to the total period of ownership. Relief is computed as if there were two assets – one representing the 'qualifying' element (in respect of which roll-over relief is given in full), and in the other representing the 'non-qualifying' element (in respect of which the gain is fully taxed).

It will be reasonably easy to determine the qualifying and non-qualifying periods when an asset has been wholly used to generate local source income but for only part of its period of ownership. However, it may not be so easy to determine the extent to which an asset has been used to generate local source income in a business generating both local and non-local source income. A good starting point will be the ratio, as reflected by the QFC Entities tax returns, of local to non-local source income over the entire period of ownership. In some cases there may be valid arguments (either way) that this ratio does not truly reflect qualifying to non-qualifying use. An asset may have been used wholly, or not used at all, (or anywhere in between) to generate the local source element of a mixed business.

The proportion of qualifying to non-qualifying use is a question of fact and you may need to establish the relevant facts by means of an enquiry. You should not attempt to be too precise, especially if (as may often be the case) the tax effect of agreeing one ratio as compared to another, will be relatively small.

Examples

In the following examples a qualifying asset (the old asset) costing QR100,000 is purchased on 1 January 2010, sold for QR300,000 on 1 January 2015 and is replaced by another qualifying asset (the new asset) costing QR700,000 on 1 January 2016. The gain on disposal of the old asset is QR200,000.

If full roll-over relief was available the whole of the gain on the old asset (QR200,000) would be deferred, reducing the tax cost of the new asset by that amount to (QR700,000 – QR200,000) QR500,000.

Example 1 – Asset used fully to generate local source income but only for part of period of ownership

The asset is fully used to generate local source income for the period 1 January 2010 until 1 January 2013 and thereafter is wholly used to generate non-local source income.

The qualifying period is 60% (3 years out of 5). Therefore 60% of the gain (QR120,000) will be rolled over giving a tax cost of the new asset of (QR700,000 – QR120,000) QR580,000. The balance of the gain (QR80,000) will fall to be taxed in the accounting period covering the date of disposal of the old asset – 1 January 2015.

Example 2 – Asset is used partially to generate local source income for whole of period of ownership

The asset is used to the extent of 40% to generate local source income over the whole period of ownership.

The qualifying element is 40% so that proportion of the gain (QR80,000) will be rolled over giving a tax cost of the new asset of (QR700,000 – QR80,000) QR620,000. The balance of the gain (QR120,000) will fall to be taxed in the accounting period covering the date of disposal of the old asset – 1 January 2015.

Example 3 – Asset is used partially to generate local source income and only for part of the period of ownership

The asset is wholly used to generate local source income for the year to 31 December 2010 and during the year to 31 December 2011 it is used 20% to generate local source income. For the year to 31 December 2012 the asset is not used in the business at all and during the year to 31 December 2013 it is used 90% to generate local source income up to 30 August when it used 100% to generate local source income. During the final year of ownership the extent to which the asset is used to generate local source income is 70% for the first six months and 85% for the final half of the year.

The qualifying use is:

Year 1: 100%

Year 2: 20%

Year 3: 0%

Year 4: (90% x 8/12) + (100% x 4/12) = 93.3%

Year 5: (70% x 6/12) + (85% x 6/12) = 77.5%

The overall qualifying use is therefore (100/5) + (20/5) + (0/5) + (93.3/5) + (77.5/5) = 58.16%

Consequently (100% - 58.16%) 41.84% of the gain or QR83,680 is chargeable in the accounting period covering the date of disposal – 1 January 2015. The balance (58.16% = QR116,320) of the gain may be rolled over giving a tax cost of the new asset of QR700,000 – QR116,320 = QR 583,680.

For roll-over relief to apply the new asset must have been used for the purpose of generating local source income (Article 43(2)(a)). There is no restriction about the extent to which the new asset must be used to generate local source income, nor the period of time over which the asset must be so used. However, both these factors will be relevant when the new asset is sold or, if a further roll-over relief claim is made.

7 – 3100 Qualifying Assets

Both the old and the new assets must fall within one of the following classes for roll-over relief to be granted:

- a building, part of a building or land;
- goodwill;
- patents, copyrights or any other form of intellectual property

The word 'building' is not defined in the Regulations, and therefore takes its ordinary meaning.

The old and new assets need not fall within the same class. Therefore, for example, a disposal of a building and the acquisition of goodwill prima facie qualify for relief.

7 – 3120 Consideration not Fully Reinvested

For full roll-over relief to be given, the whole of the consideration received for the disposal of the old assets must be used in acquiring new assets. Where the consideration is not fully utilised to acquire new assets, only partial relief is given, by increasing the consideration under Article 43(1)(a) by the amount not used to acquire new assets (Article 43(3)).

For example, Company Y acquires an asset on 1 January 2009 for QR2,000 which it sells on 1 January 2012 for QR7,000. The consideration for the disposal is treated under Article 41(1)(a) as being QR2,000 for tax purposes (i.e. no gain, no loss). Company Y then buys a new asset on 1 April 2012 for QR3,000 but does not use the remaining QR4,000 of the proceeds to purchase new assets. The Article 41(1)(a) consideration for the disposal of the old asset of QR2,000 must be increased by the QR4,000 not reinvested, giving total consideration of QR6,000. This has two consequences, firstly the consideration for the disposal of the old asset is now QR6,000, which leaves a gain of QR4,000 (equal to the amount not reinvested) taxable and, secondly, the cost of the new asset is reduced by QR1,000, the balance of the gain, to QR2,000.

Where the amount of the disposal proceeds not reinvested exceeds the gain, roll-over relief will not be available and the gain will be wholly chargeable due to the operation of Article 43(3).

7 – 3140 More than One New Asset Acquired

The consideration for the disposal of the old asset may be used to acquire more than one new specified business asset. The total cost of new assets acquired within the qualifying period may fall short of or exceed the disposal proceeds. You should accept the taxpayer's allocation of proceeds against new asset investment, but the allocation must be against specific assets. Also, the allocation does not change the limit of relief available against individual assets, as illustrated below (example 1).

Example 1

An asset costing QR1m is sold for QR1.5m and the following assets acquired, all the conditions for roll-over relief being fulfilled.

Asset 1 cost QR0.8m

Asset 2 cost QR0.9m

Total cost QR1.7m

The whole of the gain of QR0.5m may be rolled over against the new assets as more than the total disposal proceeds of QR1.5m have been reinvested. However the total gain may not be rolled over against either asset 1 or 2 individually, the ceilings being:

Asset 1 - 0.8/1.5 x 0.5 = QR266,667

Asset 2 – 0.9/1.5 x 0.5 = QR300,000

Within the above limits the gain of QR0.5m may be allocated to each asset as the taxpayer chooses (the total must not, of course, exceed QR0.5m).

Where the disposal proceeds are not fully reinvested, similar considerations apply, as illustrated below (example 2).

Example 2

An asset costing QR 600,000 is sold for QR1.5m and the following assets acquired, all the conditions for roll-over relief being fulfilled.

Asset 1 cost	QR0.8m
Asset 2 cost	QR0.2m
Total cost	QR1.0m

Because only QR1m of the disposal proceeds has been reinvested part of the gain will be charged and part will be rolled over as follows:

Total gain - QR0.9m

Amount to be charged - Deemed consideration of QR 1.1m (QR 600,000 cost on NG/NL basis + QR 500,000 consideration not rolled over) – QR 600,000 cost = QR 500,000 gain to be charged

Amount to be rolled over – QR 900,000 gain – QR 500,000 gain charged = QR 400,000 gain to be rolled over

However the total gain available for relief (QR400,000) may not be rolled over against either asset 1 or 2 individually, but must be apportioned as follows:

Asset 1 - 0.8/1.0 x 400,000 = QR 320,000

Asset 2 – 0.2/1.0 x 400,000 = QR 80,000

7 – 3160 Time Limits

The acquisition of new assets must take place within the period beginning 6 months before and ending 2 years after the disposal of the old assets. There is no provision to extend these time limits.

It should be noted that the new assets can be acquired before the old assets are disposed of.

7 – 3180 Making a Claim

Roll-over relief must be claimed (Article 43(1)). A claim cannot be made until the new assets have been acquired. Where a claim cannot be made due to new assets not yet being acquired, the gains accruing on the disposal of the old assets should be included in the taxpayer's self-assessment tax return for the accounting period covering the disposal. The return can be amended at a later date if a valid claim to relief is subsequently received.

See QTM-TR-3000+ for more information regarding claims generally. Claims should normally be included in a return (or amended return) but if such inclusion is not possible, claims may be made outside a return. The normal time limit for making a claim is up to 3 years after the end of the accounting period to which the claim relates (TAX 13.2.1).

A claim must be quantified at the time it is made (TAX 13.1.2). This means the claim must be specific in relation to both the old and new assets and the amount of relief (that is the reduction in the otherwise taxable gain) claimed. You will need the following information to determine a claim:

- Details of the asset disposed of, the date of disposal and consideration received
- The taxable gain (before relief) arising on the disposal
- Details of each asset acquired against which the gain is to be rolled over, including the purchase date and acquisition cost
- Confirmation the new asset(s) have been used for the purpose of generating local source income
- Where the old asset was not wholly used for generating local source income during the whole of its period of ownership, full details of periods of non-qualifying use

If a claim does not include sufficient information to make any sort of quantification (for example 'we wish to set the gain off against new assets to be acquired at some future date') the claim may be rejected as not having been validly made. In other circumstances you may need to enquire into the claim (via an enquiry into the return or, in the case of a claim outside a return into the claim itself), to obtain more details or to check the validity of the information given when the claim was made.

7 – 3200 Records to be Maintained

Whenever the acquisition cost of a new asset is reduced by a deferred gain you should make a prominent permanent note in the taxpayer's file identifying the asset involved, the date it was acquired, the acquisition cost and the amount of the deferred gain reducing that cost for tax purposes.

7 – 4000+ Reduction in Share Capital

7 – 4000 Introduction

Article 44(1) sets out the main internal reorganisations a company may undertake to reduce the amount of its share capital or to reduce shareholders' liability in respect of shares which are not fully paid up. A company will generally undertake such an internal reorganisation because either; (a) excess cash is held for which the company has no use and decides to return it to shareholders, (b) capital has been lost or is no longer represented by assets or (c) the company wishes to boost its earnings per share.

Article 44 applies where:

a) liability in respect of unpaid share capital is reduced or extinguished;
b) paid up share capital that has been lost or is not represented by assets is cancelled; or
c) the company redeems or purchases its own shares.

The tax treatment, specified in Article 44(2), is to treat any proceeds, or profit and loss credit generated from such transactions, as exempt from tax. In other words, internal reorganisations of the type covered by Article 44(1) do not give rise to a tax charge. It is worth mentioning that in many cases the transactions will not, in any event, result in income or a profit and loss account credit, which would otherwise be chargeable to tax. Consequently the section will only be of application in fairly limited circumstances.

The types of transactions enumerated in Article 44(1) are specifically authorised, provided certain conditions are fulfilled, by the QFC Companies Regulations 2005 at Article 30 (reduction in share capital) and Articles 31 and 32 (redemption or purchase of own shares).

The section below looks at each of the different reorganisations set out at Article 41(1)(a)-(c) separately.

7 – 4020 Article 44(1)(a) - Extinguishing the Liability on Shares not Fully Paid Up

Although shares are normally issued on terms requiring full payment on subscription, shares are sometimes issued on the basis of a proportion of the price being paid on subscription, the balance being payable later. The difference between the issue price and the price paid is referred to as uncalled capital and represents potential cash which a company is able to call up from shareholders. If the uncalled capital is reduced this will benefit shareholders but may have an adverse effect on creditors as the uncalled capital will no longer be available (or, in the case of a partial reduction, not so fully available). If uncalled capital is extinguished, the shares are regarded as fully paid. If uncalled capital is reduced the extent to which the shares are regarded as paid up will be correspondingly adjusted. Journal entries are not required and it is therefore highly unlikely such a reorganisation will give rise to a profit & loss account credit.

For example, suppose a company issues 1,000,000 QR10 shares, asking for only QR6 on subscription.

The balance sheet will show:

Share Capital: 1,000,000 shares issued at QR10 per share (QR6 paid):	QR 6,000,000

Now suppose (a) uncalled capital of QR4 per share is extinguished or (b) reduced to QR1 per share.

The balance sheet will now show:

(a) Share Capital: 1,000,000 shares (fully paid):	QR 6,000,000
(b) Share Capital: 1,000,000 shares issued at QR10 per share, reduced to QR7 per share (QR6 paid):	QR 6,000,000

7 – 4040 Article 44(1)(b) - Cancellation of Paid Up Capital

The situation may arise where, for example, a company has a large amount of accumulated losses and/or some of its assets are overvalued or overstated (or fictitious). This situation will result in an erosion of its paid up share capital. A company in such a position may decide to reorganise, aiming to start afresh to regain profitability, adjusting unrepresented assets, writing off accumulated losses by reducing its paid up capital and issuing additional shares to fund its future plans.

It is primarily the ordinary shareholders who will bear the largest amount of reduction in capital, although debenture and preference shareholders (as well as creditors) may also have to take a share of the loss.

Where the share capital is cancelled to reduce losses, the reduction is effectively set against the losses to reduce them by the amount of the cancellation. Similarly, in the case of overstated assets, the credit from the cancellation is used to absorb the write-down in the value of the assets

In the course of this reduction of share capital, the company's total issued share capital will be reduced to a designated amount such that the resulting issued share capital can be made equal to the underlying net asset value of the company whereas the accumulated losses will be removed permanently.

It is unlikely that the cancellation of paid up capital will give rise to income, or a profit & loss account credit that would otherwise be taxable, but if such income or credit does arise, perhaps on a cancellation in excess of that needed to eliminate losses or undervalued assets, any such amount will be exempted from tax by Article 44(2).

7 – 4060 Article 44(1)(c) - Redemption or Purchase of Own Shares

Under the QFC Companies Regulations 2005 any shares redeemed or purchased are immediately cancelled. A redemption or repurchase does not, however, reduce the company's authorised share capital. For a redemption or purchase of own shares to be valid it must be approved by shareholders, the shares in question must be fully paid and the consideration must be paid in cash, and not deferred.

Normally a redemption or POS will not impact the profit and loss account and therefore not affect the tax liability of the company in question.

There may, however be situations where a profit and loss charge does arise, for instance where shares are repurchased at a discount compared to their nominal value; this will create a distributable profit. The effect of Article 44(2) is to permit the company to exclude any such profit from the computation of its tax liability. An amount paid by a company, over the nominal value of the shares redeemed or purchased may be treated as a distribution of profits. The general rule is that, for QFC tax purposes, distributions are not allowable deductions (see Article 21(1)(h) and QTM4-6100 distributions). Article 44 does not override this rule as it applies only to proceeds received or profit and loss account credits.

For the avoidance of doubt, gains made on the purchase of own debt at a discount **are** taxable.

7 – 5000+ Incorporation of a business

7 – 5000 Introduction

Article 45 gives relief for taxable gains arising when the business of a QFC entity that is not a company is transferred to a company or an LLP in exchange for shares or interests as applicable. This may happen where a business such as a LLP, general or limited partnership incorporates to form an LLC. Sole traders are also covered by this relief, although it is highly unlikely the QFC will grant a licence to a business operating as a sole trader. It is envisaged that the most likely scenarios will be a general or limited partnership incorporating to form an LLC, or where an existing or newly licensed QFC LLC takes over a partnership. It is not a requirement that the recipient company is newly incorporated or wholly owned by the owners of the business transferred. The company may already be carrying on a business and the transferor may be only a minority shareholder after the transfer.

Article 45 allows a QFC entity that is not a company to incorporate its business without incurring a tax charge at that point on gains that may arise as a result of the disposal of its assets. The article applies when a QFC entity, that is not a company, transfers to a QFC entity, that is a company or LLP, a business as a going concern, together with the whole or substantially the whole of the assets of the business (excluding cash), and the business is transferred wholly in exchange for shares in the company or interests in the LLP (Article 45(1)).

Similar to the other specific reorganisations and reconstructions covered by Part 7, the aim of incorporation relief is to defer any charge to tax on gains that may arise as a result of incorporation. The relief works by treating the reorganisation on a no gain/no loss basis, and the consideration for the transfer is treated as being of such an amount that would secure no gain or loss accrues to the QFC entity on the disposal (Article 45(2)).

In order to prevent abuse of incorporation relief, Article 45(4) dis-applies the relief if ownership of more than 50% of the newly issued shares changes within 12 months of the transfer of the business. In such circumstances the no gain/no loss treatment given to the assets is replaced by treating the transaction as if it had taken place at market value (Article 45(3)), with the possibility of an increased tax charge as a result of the transaction.

Article 45(5) allows losses incurred by the business before incorporation to be carried forward by the QFC entity that is a company after incorporation.

Article 45(6) provides that the consideration for the issuance of new shares in Article 45(1) shall be deemed to be for a consideration equal to the market value of the business transferred on the date of the transfer.

Incorporation relief is given automatically in all cases where the conditions of Article 45 are satisfied, without the need for a claim.

7 – 5020 Conditions - Transfer of a 'business'

The first condition of incorporation relief is that there must be a transfer of a business. There is no legal definition of the word 'business' in the Tax Regulations, and so the word generally takes its ordinary meaning. However it is improbable that we would interpret 'business' as including passive holdings of investments or an investment property – particularly if the business was not set up for the purposes of making investments.

The word 'business' has been the subject of much debate in many tax cases. The most useful authority on what is meant by business can be found in the following statement made by Lord Diplock in the case of American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue [1978] 3 All ER 1185:

"in the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business… The carrying on of 'business' no doubt, usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business the activity may be intermittent with long intervals of quiescence in between."

Lord Diplock also interestingly remarked in the case of Town Investments Ltd v Department of the Environment [1978] AC 359 that, *"[the word business is] an etymological chameleon; it suits its meaning to the context in which it is found."*

The meaning of the word 'business' was also considered in the 1998 case of Jowett v O'Neill & Brennan Construction Ltd [1998] BTC 133. In that case, a company ceased trading and placed its accumulated profits in a bank deposit account from which it received deposit account interest in the year in question, and this was the company's sole asset. It was significant in this case that the company was set up to carry on a trade rather than for making investments. Park J acknowledged that whilst the normal conclusion when a company lays out its assets and earns an income return is that it is carrying on a business, there will, as a matter of law, be exceptional cases where the facts indicated that no business is being carried on by the company. Park J pointed out that in this case it was the exception rather than the rule that a company is not carrying on a business when it puts its money on deposit.

Lastly, in the case of HMRC v Salaried Persons Postal Loans Limited [2006] EWHC 763 the word 'business' was considered in the context of a company whose only financial activity was receiving a rental cheque twice yearly. As the company had ceased trading in 1995, this rental income was its only source of income. HMRC appealed to the High Court against the Special Commissioner's decision that the company was not carrying on a business, and the High Court refused HMRC's appeal. In its defence, the company argued, inter alia, that there should not be a difference in principle between a passive receipt of bank deposit interest (as in American Leaf Blending) and the almost equally passive receipt of rental income.

The above cases may be helpful in establishing whether a particular activity does constitute a business, although fundamentally it comes down to a question of fact and common sense. The difficulty in establishing whether there is a business is alleviated by the fact that in the case of a QFC entity incorporating, it will usually be the case that the licensed activity of the business will be transferred. This should serve as a clear indication that a business has been transferred. To qualify for the relief, a QFC entity must transfer its entire business. For example, if a QFC entity is licensed to carry on both general and life insurance, it will be insufficient to transfer only the general or the life insurance business.

7 – 5040 Conditions: Transfer as a 'going concern'

The business must be transferred as a going concern. The phrase 'going concern' indicates that something more than just a collection of assets must be transferred.

The meaning of the term 'going concern' was addressed by Sugarman J in the Australian case of Re Electricity Commission (Balmain Electric Light Company Purchase) Act 1950 [1957] SR (NSW) 100, at p131:

"To describe an undertaking as a 'going concern' imports no more than that, at the point of time to which the description applies, its doors are open for business; that is then active and operating, and perhaps also that is has all the plant etc. which is necessary to keep it in operation, as distinct from its being only an inert aggregation of plant".

The business must be a going concern at the time of transfer. This was noted in the case of CIR v Gordon (64TC173) where the Court added the limitation that a business could not be described as a going concern at the time of the transfer if the transferor had taken steps before that date to prevent the transferee company from carrying on the business without interruption as it wished after the transfer. This covers situations where for example, the transferor imposes a restrictive covenant on the transferee, or the transferor withholds client lists.

The transfer of the business as a going concern also includes the transfer of the business's licenced activities. If the licenced activity is continued by the company after transfer, then we would consider that the business has been transferred as a going concern.

7 – 5080 Conditions: 'Assets of the business'

Article 45(1) provides that the business must be transferred with the whole, or substantially the whole of the assets of the business, other than cash. Cash includes any sums held by the business in a deposit or current account. Assets include tangible and intangible assets, as well as any goodwill.

The assets of the business will usually be all of the assets legally owned by the business, although this may not always be the case. It is possible that an asset not recorded on the business's balance sheet may still be a 'business asset'. For example an asset owned by a partner, but used wholly by the partnership business, such as an office or a vehicle will be a 'business asset.' A business asset may be defined as any asset used wholly or partly for the purposes of the business.

Off-balance sheet assets such as leases or forms of off-balance sheet financing such as assets and liabilities in a partially owned SPV may also be business assets.

The transferor and transferee will often, but not always, be associated for transfer pricing purposes (see Article 56 and QTM8-2220) for definition of 'associated persons'). If the parties are associated and you feel that an attempt is being made to substantially undervalue the assets being transferred, the transfer pricing provisions of Part 8 may be used to substitute the arm's length price.

7 – 5100 Conditions: 'Substantially the whole of the assets of the business'

Article 45(1) requires that the whole or substantially the whole of the assets of the business (excluding cash) must be transferred as part of the incorporation. What is meant by 'substantially the whole' will depend to a large extent on the specific facts of each business. The article does not provide a specific threshold which must be passed for it to be accepted that substantially the whole of the assets have been transferred. Generally speaking, you should take the position that the condition has been satisfied where at least 80% - 85% of the assets have been transferred.

It is important to note that the relief applies in full if at least substantially the whole of the assets have been transferred. Unlike roll-over relief which requires apportionment where there has not been full reinvestment in new assets (see QTM7-3080), incorporation relief does not require such apportionment where some of the assets have not been transferred.

7 – 5120 Conditions: Transfer 'wholly in exchange for shares'

The consideration for the transfer of the business and its assets must be wholly in the form of shares or interests in an LLP. It follows that if a proprietor's or partner's capital account is transferred and converted into a loan account with the company or LLP, relief is not due as such conversion will be equivalent to cash.

The transfer of the business and its assets must occur before or at the same time as the issuing of the new shares or interests. Article 45 will not apply where the issue of shares or interests is made before (even if shortly before) the transfer of the business it is not always possible for this to happen at the same time as the transfer of the business. The share issue may be delayed due to administrative and legal procedures that must first be complied with, e.g. the authorised capital of the company may have to be increased. Although Article 45 does not include a time limit within which the shares must be issued, the shares should be issued fairly promptly after the reason for the delay has disappeared for you to be satisfied they are being issued in consideration for the business that has been transferred.

If cash consideration is left on loan account and is satisfied by the issue of shares or interests under a later agreement, the conditions for the relief to apply will not be met.

7 - 5140 Conditions: Restriction on the relief – change in ownership of shares

Where the ownership of more than 50% of the newly issued shares changes within 12 months of the date of transfer, then the transfer is treated as taking place at market value on the date the business was transferred to the company (Article 45(4)). Market value is defined in Article 153 as the price an asset might reasonably be expected to fetch on a sale in the open market. Article 45(4) prevents a taxpayer from trying to avoid tax by transferring its business to a new company, taking advantage of incorporation relief, and then promptly selling all its shares to a 3rd party and avoiding the liability to tax that would arise when the assets carrying the gains are eventually disposed of by the company.

For Article 45(4) to apply the change in ownership of the new shares does not have to be to a single shareholder or in one transfer. The test is met if the total ownership of more than 50% of the shares changes over the 12 month period following the transfer of the business (rather than the date of the issue of the new shares, if later).

Where Article 45(4) applies the transferor should amend its return for the period covering the transfer. If you become aware the Article applies, but the return is not amended, you should open an enquiry and recompute the liability for that accounting period based on a transfer of assets at market value.

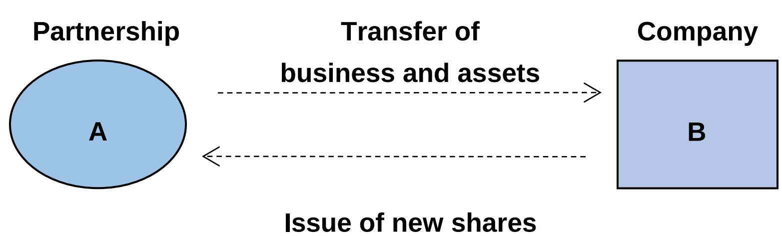
7 – 5160 Computation of the relief

Where Article 45 applies, the consideration for the transfer is to be treated as being of such an amount to secure neither a gain nor loss accruing to the transferor on the disposal (Article 45(3)).

Effect is given to the no gain/no loss rule by not taxing the gains that would otherwise crystallise on the transfer, but instead deferring them against the assets being transferred.

The gain is effectively 'rolled-over' (as in intra-group asset transfers discussed above) into the assets being transferred, and will be taxed when the assets are sold by the company. The consideration for the new shares or interests will however be the market value of the assets transferred at the date of transfer, Article 45(6).

Example



A is a QFC general partnership that incorporates for commercial reasons. They set up a new QFC company B, and transfer the whole of the business and all its assets to B. They also transfer A's only asset, a piece of land which was acquired 3 years ago for QR100,000 and has a market value of QR365,000 at the date of transfer. In return, B issues shares worth QR365,000 (the purchase cost of the assets) to the partners of A as consideration for the transfer. The base cost of the shares going forward will therefore be QR 365,000, the market value of the assets at the date of transfer. In the absence of Article 45, A would be liable to pay tax on the gain of QR265,000 which would arise when the land was sold to B.

However, Article 45 requires that the transaction be treated on a no gain/no loss basis. To achieve that, for tax purposes the acquisition cost of the assets by B is reduced by the amount of the gain from QR365,000 to QR100,000. Correspondingly, the consideration received by A is reduced by the amount of the gain from QR365,000 to QR100,000. As the original purchase cost of the land is equal to the consideration received for the land on incorporation, no gains arise at this time on A.

Two years after the transfer of the business, B sells the land for the open market value of QR500,000. As the acquisition cost of the land for tax purposes is QR100,000 rather than QR365,000, a gain of QR400,000 arises when the land is sold, which is taxed. The QR400,000 gain reflects the deferred gain of QR265,000 at the time of incorporation, as well as the accumulated gain of QR135,000 which has accrued during the period of B's ownership of the land.

7 – 5180 Loss relief

Article 45(5) allows loss relief to continue following the incorporation of a business. Any unutilised tax losses before the transfer are available to the transferee company following the transfer, as though they were losses carried forward under Article 28 (Carry Forward of Tax Losses) at the date of transfer.

Article 45 is more favourable than Article 29, which allows loss relief where there has been a transfer of a licenced activity from one company to another, without a change in ownership (QTM5-3000+) as it does not require a common ownership test to be met or for losses to be streamed and only set off against chargeable profits of the same licenced activity. Unutilised losses carried forward following the incorporation of a business can be carried forward by the new company without restriction. It should also be noted that a 'market value' recomputation where 50% of the new shares are sold within 12 months of the transfer date does not affect the availability of losses transferred.

7 – 5200 Records to be Maintained

Whenever the acquisition cost of assets is reduced by a deferred gain on incorporation you should make a prominent permanent note in the taxpayers file identifying the assets involved, the date they were acquired, the acquisition costs and the amount of the deferred gains reducing those costs for tax purposes.

A similar note should also be made in the file for the transferor, in case more than 50% of the new shares are sold within 12 months and the transfer is to be treated as having taken place at market value (Article 45(4)).

7 – 6000+ Bona Fide Commercial Reorganisations and Reconstructions

7 – 6000 Introduction

The broad intention of the QFC tax regime is to tax accounting profits and gains as they arise in the ordinary course of a QFC entity's business. Reorganisations and reconstructions may crystallise profits or gains that would not have been taxed had the reorganisation or reconstruction not have taken place. Articles 42-45 deal with some common situations where a tax charge may be mitigated or deferred. However there are many other situations where similar treatment may be justified but to provide detailed rules to cover all potential situations would make Part 7 of the Tax Regulations long and overly complex. Instead a principles based approach has been adopted which gives the Tax Department limited discretion to treat any reorganisation or reconstruction in a tax neutral manner, so long as the conditions set out within Article 46 are met. If a transaction or series of transactions are of a kind that should potentially be afforded Article 46 treatment, and you are satisfied the motive for undertaking the transaction(s) was commercially and not tax driven, then an application by the QFC Entity for tax neutral treatment should be granted. Further details, including the type of transaction(s) that may be considered for the favourable Article 46 treatment, and the basis on which a decision whether or not to exercise your discretion should be based is contained in QTM7-6100. All decisions regarding applications under Article 46 must be authorised by the Director of Tax.

7 – 6020 Establishment File

When an application is made under Article 46, an entry should be made in the Establishment File. A record should be made of the name and TIN of the applicant, the date of application, the relevant accounting period and an outline of the nature of the transaction(s) subject to the application. A note of the date of the decision and whether the application was granted or not should also be recorded and a copy of the letter notifying the QFC Entity of the decision, which should be signed personally by the Director of Tax, should also be kept within the Establishment File. Details of any appeal relating to the application (see QTM22-1000+ appeals) should also be recorded, and a note made of the eventual outcome. The Establishment File may be used as a starting point to determine if any precedents have been set, or broadly similar circumstances considered, when examining a new application.

7 – 6040 Type of Transaction(s)

The term 'reorganisation or reconstruction' is not defined by the Regulations. The type of transactions that may give rise to an application under Article 46 includes, but is not limited to the following overlapping broad categories:-

- Business combinations within IFRS 3
- Mergers and demergers
- Schemes of reconstruction or amalgamation, including the capitalisation of debt
- Share exchanges
- Inward domestication (the incorporation, within the QFC, of a branch)

7 – 6060 Nature of the Relief

Where an application under Article 46 is successful, the transaction(s) constituting the reorganisation or reconstruction are to be treated so that no charge to tax arises in respect of the reorganisation or reconstruction. This does not mean that the transaction(s) are to be exempted from tax and often Article 46 treatment will result in the deferral of a tax charge. However, the scope of Article 46 is not restricted to deferment. The intention is that, in cases where an application succeeds, the reorganisation or reconstruction should not in itself give rise to a tax charge. There may be situations where a tax charge arises out of a reconstruction or reorganisation that we would normally not seek to tax at all. In such cases the tax charge will be exempted rather than deferred.

Because Article 46 is a principles based provision, it is not possible to be precise about the nature or extent of the relief to be granted in all situations where the Article applies. The intention of the legislation should be borne in mind (that is a reorganisation or reconstruction should not, in and by itself, normally give rise to a tax charge) and relief granted in a manner that is equitable to the taxpayer and the QFC and also consistent with the overarching policy objective. It should be remembered the policy objectives relate to the taxation of asset related gains and the intention of the legislation is not to permit the exemption or deferral of trading profits.

As the number of Article 46 applications considered by the Tax Department grows, this will result an increasing number of precedents covering different situations. The Establishment File will contain an outline of all previous Article 46 applications and whenever a new application is received the Establishment File should be checked to see if any useful precedents exist.

7 – 6080 Bona Fide Reasons

In order for an application to succeed you must be satisfied the reorganisation or reconstruction under consideration was carried out for bona fide commercial reasons (Article 46(1)(a)) and the obtaining of a tax advantage must not have been the main, or one of the main, objects of the transaction(s) (Article 46(1)(b)).

If the transaction(s) was not carried out for bona fide commercial reasons it is quite likely obtaining a tax advantage was the motivation for structuring the transaction(s) in the particular, non-commercial, manner. A reconstruction or reorganisation may be undertaken in a non-commercial manner for non-tax reasons, perhaps to benefit the directors of a director/shareholder controlled company or, in the case of a partnership, for reasons connected with the private interests of one or more partners. In such cases favourable Article 46 treatment should be refused, even if no tax avoidance motive is detected or proved, as *both* the conditions of Article 46(1)(a) and (b) must be met for an application to succeed.

It is not possible to precisely define ‘bona fide commercial reasons.’ An application should not be refused because you think the transaction(s) were commercially unwise –if the motive for undertaking the transaction(s) was genuinely commercial then the test may be accepted as met, irrespective of the outcome.

Establishing either a non-commercial or tax avoidance motive is notoriously difficult and an application should only be challenged where it is considered granting the application would give a tax advantage in circumstances that obviously go against the policy objectives of the legislation. The amount of tax at stake should be taken into account but if an important point of principle is involved an application should be refused even if little tax is in issue.

As a general rule you should only challenge on the grounds of non-commerciality and/or obtaining a tax advantage where one or more of the steps in a reorganisation or reconstruction have been inserted to obtain the desired tax result without any apparent commercial reason or justification. It is this element of artificiality in the arrangement that is the key to identifying situations that should be challenged.

Both the conditions of Article 46(1)(a) and (b) have to be met. As mentioned above, it is possible for an application to fail on the ‘bona fide commercial reasons’ test without having to prove a tax advantage motive. When considering whether obtaining a tax advantage was the main, or one of the main, reasons for the transaction(s) you should not take too narrow a view. If tax reasons are a significant part of the reason why a reorganisation or reconstruction is undertaken then so long as the reorganisation was commercial, you should not deny an application if the tax advantage was the result of normal tax planning. It is very difficult to say where the line between acceptable tax planning and objectionable avoidance lies but, as mentioned above, the insertion of one or more steps in a series of transactions that appear to have no commercial justification would indicate a degree of artificiality suggesting gaining a tax advantage was the, or one of the, main objects of the transaction(s). In particular, any transactions that converts taxable income, including interest income, into capital and deferral or exemption in respect of that capital is sought, should be regarded as, prima facie, unacceptable avoidance and the relevant Article 46 application refused.

7 – 6100 Operation of Discretion

Relief under Article 46 is discretionary. However this does not mean relief can be refused without good reason. The tax treatment sought by an applicant will be reflected in their self-assessment return for the accounting period(s) covering the reorganisation or reconstruction. If it is considered an application should be refused then an enquiry into the relevant return(s) will have to be opened. Where an advance ruling has been given in relation to the reorganisation or reconstruction an application can only be refused if there is a significant variance between the facts given in support of the original ruling application and the actual transaction undertaken.

On closure of an enquiry the taxpayer will have the right of appeal (see QTM22-1000). The appeals body may not be persuaded if, at an appeal hearing, it is merely asserted that the relief is at the discretion of the Tax Department and that we declined to exercise that discretion, there is no direct appeal against that decision so the appeal against the closure notice should be dismissed. Although the Tax Department does not have a burden of proof to show that the transaction(s) were not commercial and/or that there was a strong tax advantage motive, the tribunal may reasonably expect the Tax Department to fully explain the reasons why they came to their decision not to allow the relief. However if a taxpayer refuses or fails to provide the information reasonably required to enable you to come to a reasoned decision, then refusal of the application will be appropriate.

7 – 6120 Procedure

The procedure for making an application under Regulation 46 is contained in TAX 14 (Article 46(2)).

Tax 14 sets out that an application under Article 46 should be made in the return for the accounting period during which the reorganisation or reconstruction occurred and must contain the following information:

- full particulars of the transaction or transactions constituting the reorganisation or reconstruction;
- the date that the transaction or transactions constituting the reorganisation or reconstruction took place;
- copies of all relevant documents with the relevant parts or passages identified;
- the applicant's opinion of the tax consequences of the reorganisation or reconstruction, together with the reasons why it is considered those consequences should not apply, and the tax neutral treatment of Article 46 apply instead;
- the applicant's explanation of any particular point(s) of difficulty regarding the application; and

- details of the provisions of the Tax Regulations and these rules the applicant considers are relevant to the application.

The information required is largely self-explanatory. Where you consider an application does not provide sufficient information to enable you to come to a reasoned decision, and the QFC Entity is not forthcoming in providing additional information, then unless the application is obviously incomplete (in which case the application may be refused on those grounds alone) it will be more effective to attempt to obtain the additional information via an enquiry into the relevant return, using the information powers contained in Article 125 (see Part 23).

7 – 6140 Advance Rulings

A QFC Entity may request an advance ruling under Part 18 in relation to the Article 46 treatment of a proposed reorganisation or reconstruction. The procedure for making advance rulings is dealt with in detail at QTM18-2140. Before giving a ruling it is important to ensure that all the relevant information is obtained and, as usual, the ruling (if favourable) will be subject to the transaction(s) being carried out exactly as described. When the return (and Article 46 application) for the accounting period(s) covering the transaction(s) is received you should check, by way of opening an enquiry if necessary, that the transaction(s) were executed as detailed in the ruling application. If there is a significant variance between the facts given in support of the ruling application and the actual transaction(s), the ruling will be invalid and the Article 46 application should be considered by reference to the actual transaction(s) carried out, disregarding the advance ruling.

7 – 6160 Records to be Maintained

Whenever the acquisition cost of an asset is reduced by a deferred gain you should make a prominent permanent note in the taxpayers file identifying the asset involved, the date it was acquired, the acquisition cost and the amount of the deferred gain reducing that cost for tax purposes.

PART 8 TRANSFER PRICING & THIN CAPITALISATION

8 – 1000+ Introduction

Part 8 of the QFC Tax Regulations deals with the tax treatment of transactions between associated persons. Broadly speaking, Part 8 deals with transfer pricing and thin capitalisation. The legislation has been influenced by the UK's transfer pricing provisions. Guidance on the UK legislation may be found in HMRC's on-line International Manual. The UK guidance material and publications such as the OECD Transfer Pricing Guidelines and the commentary on both the OECD and UN Model Tax Conventions are useful sources in the interpretation and practical application of Part 8.

It is important to recognise that Part 8 applies whenever profits are reduced (losses increased) because transactions between associates are not at arm's length. There is no need to establish a tax avoidance motive before applying Part 8 which is relevant even when the transfer price has been set at other than an arm's length price for purely commercial reasons.

8 – 1020 Policy Statement

Article 47 is the introductory statement confirming that Part 8 of the QFC Tax Regulations provides the transfer pricing rules which apply to transactions between QFC entities and associated persons. Associated persons for these purposes are defined in Article 56 (see QTM8-2220 below)

The transfer pricing policy requires the chargeable profits and tax losses of a QFC entity to be calculated for the purposes of the QFC Tax Regulations on the arm's length basis and is intended to counter tax loss generated by pricing in commercial or financial relations that are not on an arm's length basis.

8 – 2000+ Transfer Pricing

8 – 2000 What is Transfer Pricing?

Where the parties to a transaction are connected the terms of the transaction will not be governed purely by market forces and where the parties are under common ownership the price related to a transaction will merely determine how the common owner's funds, profits or financial resources are transferred or shifted from one company to the other.

The transfer price is the price charged in a transaction. Where connected parties transact with each other there is not always the need or the incentive to charge prices that they would have done had they been dealing at arm's length. As a result the level of their profits may differ, by accident or design, from what would have arisen if they had undertaken the same transactions with unconnected parties.

The transfer pricing issue mainly arises in cross border transactions between two companies who are part of the same group. Large multinational enterprises and their advisors are well aware of the opportunities to manipulate transfer prices. Tax authorities around the world are increasingly aware that the transfer pricing of transactions between connected parties can affect their tax yield. This is particularly so where the parties to a transaction are subject to different tax rules and rates.

8 – 2020 Basic Rule of Transfer Pricing

Article 48 provides the basic rule for the application of the transfer pricing regulations.

The transfer pricing regulations apply when, by means of a transaction or series of transactions, the chargeable profits to be computed for the purposes of the QFC Tax Regulations are reduced below the amount that would have been achieved on an arm's length basis as a result of non-arm's length conditions made or imposed between associated persons.

The reduction of chargeable profits in question includes a reduction of the chargeable profits to nil or an accrual or increase of a tax loss, and the reference to increase in chargeable profits in Article 51(1) includes a reduction in a tax loss whether to a smaller amount or nil.

Part 8 of the QFC Tax Regulations has a one way adjustment approach and will only be applied where the resulting transfer pricing adjustment would be an increase in the amount of chargeable profits or a reduction in tax losses.

Example 1 – One way adjustment approach

Company Q, a QFC entity, receives services from Company X which is tax resident overseas. The arm's length value of the services provided by Company X is QAR 1M.

Scenario A

The actual service fee paid by Company Q, a QFC entity, to Company X is QAR 1.2M. The fee paid by Company Q therefore exceeds the arm's length amount. As a result, a transfer pricing adjustment needs to be made in Company Q's tax return, to reduce the amount of allowable expenditure by the excess amount of QAR 0.2M to the arm's length price of QAR 1M, thus resulting in an increase in the chargeable profits of Company Q.

Scenario B

The actual service fee paid by Company Q to Company X is QAR 0.8M. The fee paid by Company Q is therefore less than the arm's length amount. Due to the one way effect of the transfer pricing regulations, no additional deduction may be claimed to increase the allowable expenditure to the arm's length level of QAR 1M.

8 – 2040 Arm's Length Conditions

Article 48(2) provides that the arm's length conditions are the conditions that would have been made or imposed if the persons were not associated with each other.

For the purposes of administration of Part 8, the QFC Tax Department intend that the arm's length conditions are to be construed in a manner consistent with the authoritative statement of the arm's length principle in the Associated Enterprise Article of the OECD

Model Tax Convention on Income and Capital, in order that Part 8 shall be applied on the basis of international standards.

The legislation also applies to cases where no conditions would have been made or imposed between non-associated persons, as a result of which the transactions or series of transactions may need to be re-characterised or disregarded for transfer pricing purposes.

Transactions between non-associated persons may need to be taken into account when looking at the conditions made or imposed between two associated persons by means of a series of transactions. Further guidance is contained at QTM8-2280.

8 – 2060 Computation on the arm's length basis

Article 48(3) provides the statutory basis for adjusting the chargeable profits of the QFC entity.

Where the conditions made or imposed between associated persons are not on an arm's length basis, and as a result the chargeable profits of the QFC entity are reduced to an amount less than the amount that would be achieved under arm's length conditions, the QFC Tax Regulations require the computation of the chargeable profits of the QFC entity as if the arm's length conditions had been made or imposed.

Although the QFC Tax Regulations came into effect on 1 January 2010, the computation of chargeable profits of QFC entities may be reduced as a result of non-arm's length conditions made or imposed prior to that date. Therefore, Article 48(5) has the effect of substituting the non-arm's length conditions with the arm's length conditions no matter when the conditions were made or imposed, giving effect to the arm's length principle to chargeable profits of QFC entities for any subsequent accounting periods.

8 – 2080 Loans

Article 49 applies where the conditions between associated persons include the making of a loan. Thin capitalisation is within the scope of Article 49 (see QTM8-3000+).

Whereas the arm's length conditions shall be construed after taking into account all factors, Article 49(2) identifies certain additional specific factors to be taken into account where the conditions include the making of a loan.

The specific factors set out in Article 49(2) are as follows:

- the appropriate level or extent of the borrowing person's overall indebtedness;
- whether the loan would have been made at all at arm's length;

- the amount which would have been lent at arm's length;
- the rate of interest and other terms which would have been agreed at arm's length.

The fact that the provision of loans is not generally part of the business of the associated person shall be disregarded for these purposes.

When determining what the arm's length conditions in respect of the loan would have been, no account shall be taken of any guarantee in respect of the loan provided by a person associated with the borrower, and a guarantee for these purposes is to be widely interpreted, including but not limited to the arrangements described in Article 49(5). This ensures that the amount of the loan, the interest rate and other terms and conditions are to be determined as if no guarantee had been provided by any associated person. It should be noted that there is no need to establish a tax avoidance motive in applying the transfer pricing provisions to loans.

8 – 2100 Guarantees

Article 50 extends the application of the transfer pricing rule to a loan from a third party which is guaranteed by an associated person. Such an arrangement constitutes a series of transactions for transfer pricing purposes. Where the series of transactions includes the receipt of a loan by one of the associated persons and the provision of a guarantee by another associated person, the conditions of the loan may not reflect the conditions which would exist at arm's length.

Similar to Article 49(2), the arm's length conditions shall be construed after taking into account all factors, but Article 50(2) identifies the following additional specific factors to be taken into account where Article 50 applies:

- whether the guarantee would have been provided at all at arm's length;
- the amount that would have been guaranteed at arm's length;
- the consideration for the guarantee and other terms which would have been agreed at arm's length.

The fact that the provision of guarantees is not generally part of the business of the associated person shall be disregarded for these purposes.

In determining the arm's length conditions, any guarantee provided by an associated person shall be disregarded in relation to the following considerations:

- the appropriate level or extent of the borrowing person's overall indebtedness;

- whether the making of a loan, or a loan of a particular amount, would have been made at all at arm's length; and
- the rate of interest and other terms that might be expected to be applicable in any particular case to such a transaction.

As in Article 49, this ensures that the amount of the loan, the interest rate and other terms and conditions are to be determined as if the guarantee had not been provided.

A guarantee for these purposes is intended to be widely interpreted, including but not limited to the arrangements described in Article 49(5).

8 – 2120 Compensating Adjustment Claims

Compensating adjustments are a means of reducing double taxation between associated QFC entities where the chargeable profits of one QFC entity have been increased to reflect the arm's length conditions.

Under Article 51, the QFC entity whose chargeable profits in an accounting period were reduced by the actual conditions, and that has been subject to a substitution of the arm's length amount of chargeable profits, is referred to as the "first taxpayer".

Where the corresponding chargeable profits of an associated QFC entity, referred to in Article 51 as "the second taxpayer", have been increased by the same actual conditions, and the first taxpayer has been subject to a substitution of the arm's length amount of chargeable profits, the second taxpayer may make a compensating adjustment claim to have its chargeable profits computed as if the arm's length conditions had been made or imposed instead of the actual conditions.

Article 48(4) confirms that reference to increase in chargeable profits in Article 51(1) includes a reduction in a tax loss, whether to a smaller amount or nil.

Such a claim must be made in writing by the second taxpayer to the Tax Department.

A compensating adjustment may only be made where the chargeable profits of the second taxpayer which exceed the arm's length profits, by reason of the actual conditions, would be taken into account in computing the chargeable profits of the second taxpayer for an accounting period. The effect of this is that only profits that would otherwise be subject to double taxation are relieved under a compensating adjustment for the second taxpayer.

It follows that consideration needs to be given as to whether the actual conditions have resulted in an increase in the chargeable profits of the second taxpayer.

No claim may be made by the second taxpayer unless the computations of both the associated persons have been prepared on a consistent basis and unless the first taxpayer has:

- made a tax return for the same accounting period on arm's length basis; or

- received a relevant notice (see QTM8-2360) from the QFC Tax Department determining an amended amount of chargeable profit to be brought into account on an arm's length basis.

Any claim must be made within three years of the date on which that return is made or relevant notice of determination given, or within such longer time that the QFC Tax Department may allow.

Where a compensating adjustment claim has been made by the second taxpayer in relation to a return on the arm's length basis made by the first taxpayer, and subsequently the first taxpayer is given a relevant notice taking account of a determination in accordance with Part 8 (Transfer Pricing), the second taxpayer shall be entitled to make an amendment to the compensating adjustment claim to give effect to the relief corresponding to the determination contained within the relevant notice, provided the conditions of Article 51 are otherwise met. Such an amendment to the claim must be made within three years of the date of the relevant notice. In effect this means that if a transfer pricing adjustment for the first taxpayer is increased following an enquiry, the second taxpayer may, within the time allowed, put in a supplementary claim in respect of the increase.

Example 2 – Compensating Adjustment Claims

Assume that both Company A and Company B are QFC entities and Company A provides services to Company B at an actual price of QAR 0.6M when the arm's length price would be QAR 1M.

The positions of Companies A and B are as follows:

- Company A needs to make a transfer pricing adjustment equal to the difference between the consideration received and the arm's length price (QAR 1M – QAR 0.6M = QAR 0.4M).
- Company B is able to claim a compensating adjustment to reduce its taxable profits (or increase its allowable losses) by the same amount (i.e. QAR 0.4M).

The impact of the compensating adjustment claim is to eliminate the double taxation that would otherwise arise as a result of the requirement for Company A to make a transfer pricing adjustment.

8 – 2140 Compensating Adjustment for Guarantor

Article 52 applies where an associated person ('the borrower') has received a loan which is guaranteed by another associated person ('the guarantor') and the liabilities under the loan are to be reduced, in accordance with the arm's length conditions, in computing the chargeable profits of the borrower.

In such a case, the guarantor may make a claim to the Tax Department to the effect that the guarantor, to the extent of the disallowed liability, be treated as if it had received the loan, owned the liabilities under the terms of the loan and had paid any interest or other amounts under the terms of the loan.

By virtue of Article 52(3), where the borrower's liabilities under the loan are the subject of two or more guarantees, the sum of the compensating adjustments claimed by the guarantors must not exceed the total reduction of the liabilities under Article 52(1).

No claim may be made by the guarantor unless the borrowing person has:

- made a tax return for the same accounting period on an arm's length basis; or

- received a relevant notice (see QTM8-2360) from the QFC Tax Department determining an amended amount of chargeable profit to be brought into account on an arm's length basis.

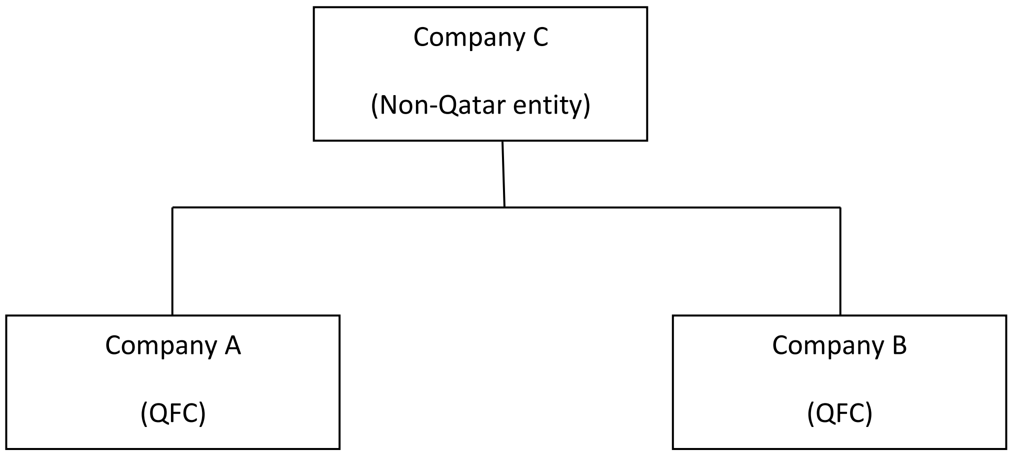
Any claim must be made within three years of the date on which that return is made or relevant notice of determination given, or within such longer time that the QFC Tax Department may allow.

Where a compensating adjustment claim has been made by the guarantor in relation to a tax return on the arm's length basis made by the borrower, and subsequently the borrower is given a relevant notice taking account of a determination in accordance with Part 8 (Transfer Pricing), the guarantor shall be entitled to make an amendment of the compensating adjustment claim to give effect to the relief corresponding to the determination contained within the relevant notice, provided the conditions of Article 52 are otherwise met. Such an amendment to the claim must be made within three years of the date of the relevant notice. In effect this means that if a transfer pricing adjustment for the borrower is increased following an enquiry, the guarantor may, within the time allowed, put in a supplementary claim in respect of the increase.

A guarantee for these purposes is intended to be widely interpreted, including but not limited to the arrangements described in Article 49(5).

Example 3 – Guarantor Compensating Adjustments

Consider the following group, comprising Companies A, B and C:



Company A receives a loan from associated non-QFC Company C for the amount of $100M at an interest rate of 10%. On an arm's length analysis, Company A has borrowing capacity of $60M (i.e. $60M is the maximum amount that an independent entity would lend to Company A on freely negotiated commercial terms).

As a result, and subject to any other considerations such as the rate of interest and other considerations, interest on the remaining $40M would be disallowed within Company A's tax computation.

Unlike in Example 2, a conventional compensating adjustment is not available in this case, as the lender (Company C) does not hold a QFC license and is therefore not subject to QFC taxation. However, if there is:

- either a formal guarantee in place between Company B and Company C or the behaviour of the parties indicates that an implicit guarantee has been provided by Company B; and

- Company B has the arm's length borrowing capacity to bear the interest expense on all or part of the remaining $40M

then Company B as guarantor may claim a guarantor compensating adjustment to reduce the level of its taxable profits or increase the level of its allowable losses. The level of guarantor adjustment would be up to the interest on any part of the remaining $40M that it could be demonstrated Company B would be able to borrow on an arm's length basis.

8 – 2160 Balancing Payments

Article 53 applies where the first taxpayer in Article 51(1)(b), whose chargeable profits in an accounting period were reduced by the actual conditions, receives one or more balancing payments from the second taxpayer for the sole or main reason that the chargeable profits of the first taxpayer have been adjusted in accordance with the arm's length conditions.

Provided those balancing payments do not in aggregate exceed the amount of the available compensating adjustment, those payments shall not be taken into account when computing the chargeable profits or tax losses of either person.

The available compensating adjustment is the difference between the chargeable profit or tax loss of the second taxpayer computed on the basis of:

- the actual conditions and

- the arm's length conditions.

Example – Balancing Payments

In Example 2, Company A is taxed as if it received QAR 1M but has in fact received only QAR 0.6M. Equally, although Company B is able to benefit from a compensating adjustment and be treated for tax purposes as though it has paid QAR 1M, it has in fact paid only QAR 0.6M.

As a result, the QFC regulations allow for a 'balancing payment' to be made by Company B to Company A of an amount up to (and not more than) the available compensating adjustment of QAR 0.4M. Company B would not obtain tax relief in relation to such a payment and no tax liability would arise upon receipt by Company A.

8 – 2180 Balancing Payments by Guarantor

Article 54 applies where:

- an associated person ('the borrower') has received a loan which is guaranteed by one or more associated persons ('the guarantor(s)');
- the liabilities under the loan are to be reduced, in accordance with the arm's length conditions, in computing the chargeable profits of the borrower; and
- the borrower receives one or more balancing payments from the guarantor(s) for the sole or main reason that:

- the chargeable profits of the borrower have been adjusted in accordance with the arm's length conditions instead of the actual conditions; or
- a compensating adjustment has been given to the guarantor under Article 52.

Provided those balancing payments do not in aggregate exceed the amount of the reductions to the interest or other amounts for the borrower made in accordance with the arm's length computation in Article 52(1)(c), those payments shall not be taken into account when computing the chargeable profits or tax losses of the borrower or the guarantor(s).

8 – 2200 Effect on Double Taxation Relief

Compensating adjustments allowed under Article 51 may affect the amount of credit relief available to a claimant for overseas tax under the double taxation relief articles because the amount of chargeable profits for the claimant will have been reduced by the compensating adjustment.

Where such a compensating adjustment has been made, and the claimant has been given credit for overseas tax, the calculation of the amount of the credit may need to be revised to exclude any amount of overseas tax which would not have been paid or payable had the computation of the income to which the compensating adjustment relates been made on an arm's length basis.

Similarly, the amount of income in respect of which the claimant is or may be given credit relief for overseas tax shall be determined on an arm's length basis, so that no relief would be given in respect of income in excess of the arm's length chargeable profit as adjusted by a compensating adjustment claim.

8 – 2220 Meaning of Associated Persons

For the purpose of the transfer pricing rules, persons are associated when one of the following relationships exists:

- one person controls the other, either directly or indirectly;
- both persons are controlled by the same person or persons.

'Control' for these purposes is defined in Article 57.

For the purposes of the QFC Tax Regulations, a 'person' is defined in Article 153 as including, in addition to a natural person, a body of persons corporate or unincorporate, and any partnership.

8 – 2240 Meaning of Control

The definition of ‘control’ is set out in Article 57.

In relation to a company, a person controls the company if they have the power, through the holding of shares or voting rights in that company or by virtue of any powers conferred by the Articles of Association or any other document regulating that company, to secure that the affairs of the company are conducted in accordance with their wishes.

In relation to a partnership, ‘control’ is defined as the right to a share of more than half of the assets or income of the partnership.

Furthermore, a person who exercises control over the affairs of a company or partnership, or who is able to exercise or is entitled to acquire direct or indirect control over the company or partnership shall be taken to have control of that company or partnership.

The legislation deems a person (‘the potential controller’) to have indirect control of a company or partnership if he would be taken to be directly controlling the company or partnership if the rights and powers attributed to the potential controller included the rights and powers of persons connected with the potential controller.

‘Connected’ is defined in Article 57(4). Two persons are connected if:

- one of them is an individual and the other is his spouse, a relative of his or of his spouse, or the spouse of such a relative;
- the first person is in partnership with the second person or is the spouse or relative of the second person; or
- one of them is the trustee of a settlement and the other is either a settlor of that settlement or a person connected with the settlor.

Article 57(5) defines ‘relative’ as a brother, sister, ancestor or lineal descendent, including a step-child.

‘Settlement’ is defined in Article 153. Settlor is defined as ‘in relation to a settlement, means any person by whom the settlement was made.’

8 – 2260 Appeals Procedure

Article 58 provides specific rules on appeals to be heard by the QFC Regulatory Tribunal in relation to transfer pricing matters.

This Article should be read in conjunction with Part 22 of the QFC Tax Regulations which provides more details on the appeals procedure.

Where the matter is not resolved by internal review the appeal may be referred to the Regulatory Tribunal.

A complication regarding transfer pricing appeals is that the outcome may affect the tax liability of more than one taxpayer. For example, suppose a transfer price for services is set between two QFC associates and the Tax Department seek to increase the profits of one taxpayer (the first taxpayer) on the grounds the price is in excess of the arm's length price. If a dispute arises and is subject of an appeal to be heard by the Regulatory Tribunal the outcome will affect not just the profits of the first taxpayer, but the amount of compensating adjustment that may potentially be claimed by the other (second) taxpayer. Thus where a transfer pricing dispute is heard by the Tribunal, Article 58(a) provides each person between whom the actual conditions were made or imposed are entitled to appear before and be heard by the Tribunal, or to make representations to them in writing.

An appeal by a taxpayer against the decision of the Tax Department may involve more issues than transfer pricing. The details of the other issues under appeal should not, on the grounds of taxpayer confidentiality, be revealed to any other taxpayer affected by the transfer pricing dispute. Accordingly Article 58(b) provides that the Regulatory Tribunal shall determine any questions on the application of the transfer pricing rules in Part 8 separately from any other questions in the appeal. Article 58(c) provides that their determination on the transfer pricing question shall have effect on any QFC entity that is one of the persons between whom the actual conditions were made or imposed.

8 – 2280 Transaction or Series of Transactions

In order for Part 8 to apply, conditions have to be made or imposed by means of a transaction or a series of transactions.

The definition of 'transaction', in Article 59(1)(a), is wide and includes arrangements, understandings and mutual practices whether or not they are, or are intended to be, legally enforceable.

A series of transactions is also widely defined in Article 59 and can include transactions entered into in pursuance of, or in relation to, the same arrangement. This would mean that, for example, regular transactions under an agreement would constitute a series of transactions.

Article 59(d) outlines certain matters which, even where present, do not prevent the conditions being treated as a series of transactions by means of which conditions have been made or imposed between any two persons. These matters are:

- that there is no transaction to which both those persons are parties;
- that the parties to any arrangement in pursuance of which the transactions in the series are entered into do not include one or both of those persons; and
- that there is one or more of the transactions in the series to which neither of those is a party.

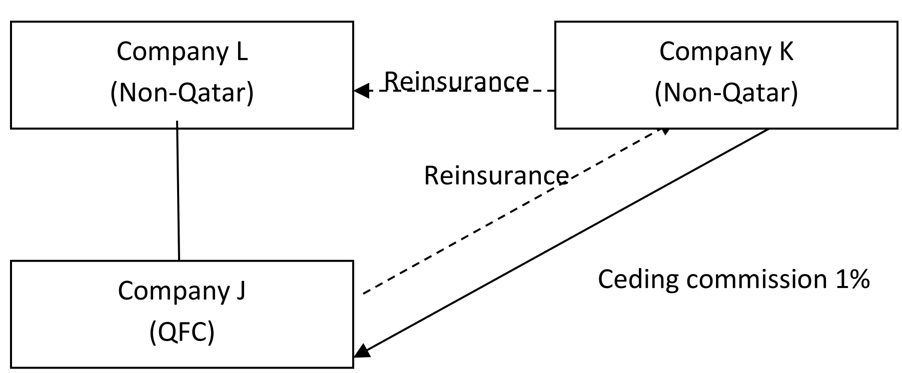
Clearly it is not necessary for all transactions in a series to take place between the associated persons. It is possible to have transactions in a series in which a third party is involved or to which neither associated person is a party. It is also possible to have a situation where there are no transactions in the series to which both persons (the 'any two persons' identified in Article 59(d)) are party.

Consideration also needs to be given to whether transactions with a third party would constitute a series of transactions, for example a third party may enter into contracts to provide commercial or financial services to two persons which are associated with each other. The arrangements may or may not constitute a series of transactions, depending on the facts and understandings between the parties.

In the definition of 'transaction', 'arrangement' means any scheme or arrangement of any kind, whether or not it is, or is intended to be, legally enforceable.

Example 1 – Series of Transactions

Company J, a QFC entity, operates an insurance business but reinsures a proportion of the insurance book to an overseas third party reinsurer, Company K, for a ceding commission of 1% on the understanding that the third party will retrocede the same insurance risk to Company L, a company that is in the same group as Company J but resident outside Qatar.



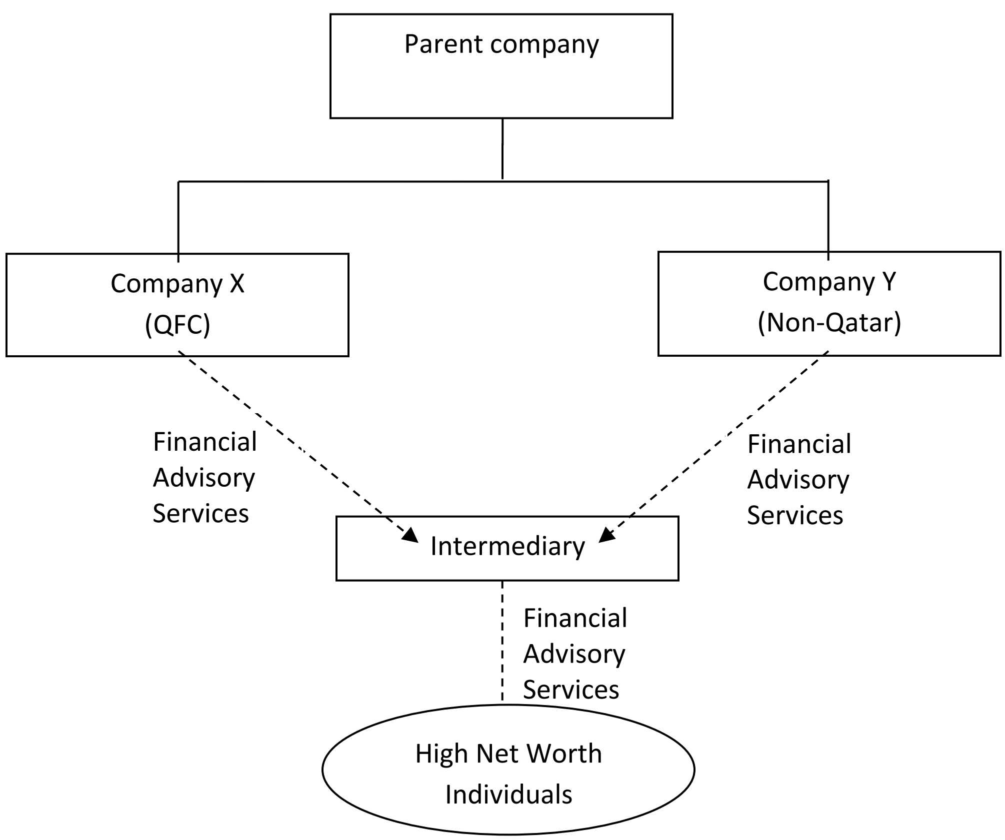
On analysis, it is established that the arm's length ceding commission for Company J would be a rate higher than 1%, and that:

- Company J has received less than the arm's length commission;
- Company K has received an arm's length reward;
- Company L has achieved in excess of the amount which it might receive at arm's length.

The Regulations require an increase in the chargeable profits of Company J to reflect the commissions it would receive at arm's length because the actual conditions between the Associated Persons has resulted in a reduction of the profits of Company J to a level below the arm's length amount.

Example 2 – Series of Transactions

Company X, a QFC incorporated and tax resident company, and Company Y, a company incorporated and tax resident in an overseas territory, are associated persons jointly delivering specialised independent financial advisory services to high net worth individuals through a third party intermediary.



The clients pay an agreed fee per annum for the services provided and, regardless of the relative levels of contribution by Company X and Company Y in delivering these services, 50% of this fee, net of any amounts retained by the intermediary, is paid to Company X and 50% is paid to Company Y.

In this example, Company X and Company Y both deliver services to external clients and receive fees from these clients. However, the provision of services by each of these companies represents the actual conditions made between two associated persons given effect by a series of transactions, and the transfer pricing Regulations apply to the sharing of fees between Company X and Company Y.

If a functional and economic analysis of the activities of each company revealed that Company X consistently delivered a more valuable service than Company Y, it is possible that at arm's length Company X would receive a greater proportion of the fee, and therefore a transfer pricing adjustment would be required when preparing the tax return of Company X.

8 – 2300 Rebuttable Assumption

Article 59(3) of the QFC Tax Regulations presents the assumption that different conditions or no conditions would have been imposed in relation to commercial or financial relations between associated persons instead of the actual conditions, placing the onus on the QFC entity to establish that the actual conditions are consistent with the arm's length conditions.

In the case of a compensating adjustment claim under Article 51(1) it shall be for the claimant to show that the claim satisfies the conditions for the claim.

8 – 2320 Giving Effect to Any Adjustment

If, as a result of the application of Part 8, an adjustment is required to be made, such adjustment may be made by way of a discharge or repayment of tax by modification of any assessment or otherwise.

8 – 2340 Relevant Activities

The term 'relevant activities' is referred to in Article 58 (Appeals). For Article 58 to apply, the two persons between whom conditions are made or imposed must each be within the charge to QFC tax in respect of profits arising from the 'relevant activities'. The 'relevant activities' are defined in Article 59(5) as those activities of an associated person comprising the activities in the course of which, or with respect to which, the conditions are made or imposed.

However, activities that are carried on either separately from the activities in the course of which, or with respect to which, the conditions are made or imposed, or activities for a different part of that person's business, will not fall within the 'relevant activities' for these purposes.

8 – 2360 Relevant Notice

A relevant notice for the purposes of the transfer pricing rule in part 8 is one of the following:

- a closure notice under Article 124 in relation to a filed or amended tax return, including a partnership tax return;
- a notice of a discovery assessment under Article 128(1); or
- a notice of a discovery determination under Article 128(2).

8 – 3000+ Thin Capitalisation

8 – 3000 What is Thin Capitalisation?

A QFC taxpayer is thinly capitalised when it has excessive debt in relation to its arm's length borrowing capacity, leading to the possibility of excessive interest deductions. An important parallel consideration is whether the rate of interest is one which would have been obtained at arm's length.

The arm's length borrowing capacity of a QFC taxpayer is the amount of debt which it could and would have taken on, as a stand-alone entity, from an independent lender.

An analysis of the capitalisation of a QFC entity for these purposes extends to the terms and conditions of lending such as the interest rate, the amount and duration of loan, repayment terms, etc. (Article 49(2)).

It is therefore important to recognise that the amount of interest payable may be in excess of the arm's length amount for one or a combination of reasons.

8 – 3020 Why Thin Capitalisation is an Issue

There is an important distinction in tax treatment between debt finance and equity, in that (subject to other regulations) interest on debt is generally deductible in calculating taxable profits, whereas dividends are not.

When a QFC entity borrows from (or with the support of) associated persons, decisions regarding funding structure may not be driven by commercial considerations alone, as is the case with unrelated parties operating under arm's length conditions. The special relationship between the parties involved might allow them to construct the finance in a manner not available to a borrower at arm's length or with funding risks which an independent borrower would avoid.

In particular, as a result of the differences in tax treatment between interest and dividends, a group may seek to structure its funding such that a QFC entity incurs a greater than arm's length level of interest expense in order to reduce its QFC tax liability.

It is the possibility of excessive deductions for interest which the QFC legislation on thin capitalisation seeks to counteract by limiting interest deductions to those which a QFC borrower could and would have incurred at arm's length.

If a QFC entity is only able to take on excessive borrowing because it either borrows from an associated person or borrows from third parties on the strength of the support of an associated person, for example in the form of guarantees, it is regarded as thinly capitalised. In such cases, the Transfer Pricing Regulations in Part 8 apply to limit the deductible interest for tax purposes to the interest costs that would be incurred at arm's length, including interest at above an arm's length rate.

8 – 3040 When Might a QFC Entity be Thinly Capitalised?

In considering whether a QFC entity is thinly capitalised it is necessary to compare the interest expense, both in relation to the rate of interest and the amount borrowed, resulting from the actual borrowing conditions with those which would be incurred under arm's length borrowing conditions.

The key areas to be considered are:

- the amount that a lender would have advanced, i.e. what the borrower could have borrowed;
- the amount that the borrower, acting in the best interests of its own business, would have borrowed;
- the interest rate and other terms and conditions.

The amount that a lender would have advanced, and thus the amount a QFC entity could have borrowed, is affected by a number of factors, some of which are considered below.

An analysis of whether the QFC entity would, at arm's length, have borrowed at all or would have done so on the same terms and conditions as the actual terms and conditions requires consideration of what would have occurred in the absence of the special relationship between the lender and borrower. For these purposes, it is useful to consider alternative third party options which may have been available at the time of the transaction, such as cheaper funding and/or on better terms, and also whether the borrower would have entered into any debt transaction at all on an arm's length basis. For example a QFC Entity's balance sheet may be so negative it is reasonable to conclude, on a standalone basis, that an independent lender would not be prepared to make any advance.

In summary, therefore, the application of the arm's length principle requires a judgement of the facts and circumstances to establish what would have happened at arm's length, including whether the QFC entity would have borrowed at all and the terms on which the QFC entity:

- could and would have borrowed under arm's length conditions;
- from a third party lender unconnected with the borrower;

- without guarantees or other similar forms of financial arrangements involving associated persons.

A QFC entity may be thinly capitalised as a result of some or all of the following factors:

- it has borrowed an amount of interest-bearing debt greater than it could borrow at arm's length without related transactions such as guarantees or back to back lending arrangements;
- the interest charged is in excess of the arm's length rate for the debt, having regard to the conditions which would exist at arm's length;
- the duration of the debt is greater than would be the case at arm's length; or
- repayment or other terms are more disadvantageous than could be obtained in an arm's length arrangement.

In assessing whether borrowing is on arm's length terms, it is essential to consider all the terms and conditions of the lending.

8 – 3060 The Borrowing Unit

Under the application of the arm's length principle, the borrowing capacity of the QFC entity needs to be evaluated on the basis that it is a separate enterprise distinct from the financial strength of the group of which it may be a part. The arm's length borrowing capacity of the borrower is therefore the debt which it could and would, as an independent enterprise, have borrowed from an independent lender.

In determining the ability of the QFC entity to borrow at arm's length, the question arises as to whether the value of the following should be taken into account in evaluating its financial strength:

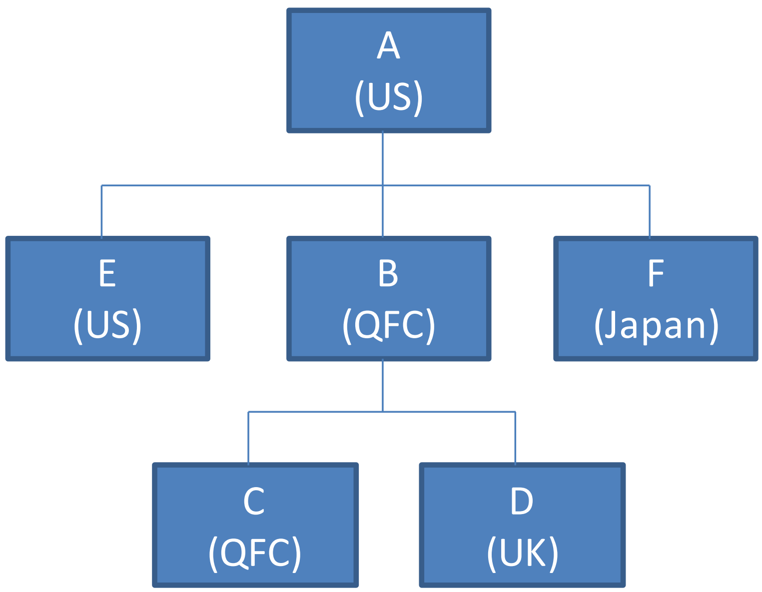
- subsidiaries of the QFC entity; and
- other group entities or associated persons.

It is recognised that, even on a standalone basis, negotiations with a third party lender would involve an assessment of the financial strength of the borrower that would take into account the income, assets and liabilities within the borrower's subsidiaries. In broad terms, this will be based on the strength (or otherwise) of the borrower's consolidated balance sheet and profit and loss account, subject to analysis of the facts underlying the figures on the face of those accounts.

Therefore, an analysis of the financial strength of the borrower for thin capitalisation purposes should include the income, assets and liabilities of the borrower's subsidiaries, but not the parent. This grouping is known as the 'borrowing unit'.

Other group entities or associated persons that do not form part of the financial assets of the QFC entity are to be disregarded in accordance with the separate enterprise principle as they would not form part of the assets of the QFC entity under the arm's length conditions. Furthermore, in determining the borrowing capacity of a QFC entity, no account is taken of any guarantees, explicit or implicit, from associated persons (Article 50 – see QTM8-2220).

Consider a group made up of companies ABCDEF, which has the group structure indicated below:



In assessing the borrowing capacity of the QFC Entity B, in addition to B's income, assets and liabilities, it would be necessary to consider the income, assets and liabilities of entities C and D, which are subsidiaries of B. The fact that one of these entities (D) is a non-QFC entity does not affect this analysis. However, the income, assets and liabilities of the ultimate parent (A), and companies E and F would not be included as they do not form part of the borrowing unit on the separate enterprise principle.

In assessing the borrowing capacity of C (also a QFC entity), only the income, assets and liabilities of C itself should be considered.

8 – 3080 Establishing the Value of Subsidiaries

A practical approach should be taken when considering the borrowing capacity of the borrowing unit where this includes subsidiaries.

If consolidated accounts are not drawn up as a matter of course, consolidated figures may be requested. There may be no obligation on the borrower to produce audited consolidated accounts, so properly drawn up schedules reflecting the consolidated position will be acceptable.

There may be subsidiaries that need to be excluded, e.g. companies with a dividend block which a lender might not recognise as assets against which they would wish to lend. There may also be companies that need to be excluded from consolidation and dealt with according to their own characteristics, e.g. finance companies with a higher proportion of debt than ordinary trading companies.

The question of the borrowing capacity of the borrowing unit will be considered pragmatically and on a case by case basis where there are aspects giving rise to uncertainty.

8 – 3100 Financial Ratios

The debt / equity ratio, or gearing, of a QFC Entity is regarded as the key ratio in determining whether that Entity is thinly capitalised. Other ratios may be relevant and may be used by a taxpayer to support his view that despite the gearing being higher than we regard as acceptable (See QTM8-7000 for the safe harbour limits) the Entity should not be regarded as being thinly capitalised.

Financial ratios are often used by lenders in arm's length loan transactions to measure the borrowing capacity of a potential borrower. In particular, a lender is concerned with a borrower's ability to:

- satisfy its obligations to make periodic interest payments on the amounts loaned; and
- discharge the debt based on an agreed repayment schedule.

Typically, arm's length lenders consider both:

- projected financial ratios at the time of granting a loan, which form part of a lender's assessment as to whether and how much to lend to the potential borrower; and

- actual financial ratios during the term of the loan. This is important as a lender often requires a borrower to maintain financial ratios at certain levels during the term of the loan, with a default being triggered if these levels are not met.

Whilst the ratios that are used to assess borrowing capacity can vary within certain industry sectors, the guidance below summarises the ratios that are typically of most relevance for a conventional trading or service business. Different considerations may apply in relation to the financial services industry.

8 – 3120 Using EBITDA

The Debt / Earnings before interest, tax, depreciation and amortisation (EBITDA) ratio is commonly considered within arm's length loan agreements and measures a borrower's ability to meet financial obligations arising from its borrowing. Specifically, by comparing debt with EBITDA, an approximation of cash flow, it is possible to gain an indication of both the borrower's ability to service its debt and how long, hypothetically, it would take the borrower to repay the debt.

In calculating Debt / EBITDA ratio, the debt that will be of most interest is long-term debt, which is by definition the debt it is expected will take some time to pay off. It may not be apparent in the balance sheet of a QFC entity whether debt is long-term or short-term, and an enquiry to obtain an analysis of borrowings may be necessary.

Agreements drawn up by third-party lenders will often define debt in a very specific way, although it is less likely that agreements between related parties will be so detailed. For example, the term 'borrowings' might be defined to include any combination of the following:

- money borrowed or raised, including capitalised interest;

- any liability under any bond, note, debenture, loan stock, redeemable preference share capital or other instrument or security;

- any liability for acceptance, documentary credits or discounted instruments;

- any liability for the acquisition cost of assets or services payable on deferred payment terms where the period of deferment is more than 90 days (except trading credit where the liability can reasonably be regarded as the subject of a bona fide dispute);

- any liability under debt purchase, factoring and similar agreements and capital amounts owed under financial leases, hire purchase or conditional sale arrangements;

- any liability under any guarantee or indemnity (except product warranties); and
- any liability under any foreign exchange or interest rate contract net of liabilities owed by the counterparty.

As a general rule, if it is likely that a third-party lender would take an item into account when considering the ability of the borrower to service the loan, it should be included in the calculation of debt when calculating a Debt / EBITDA ratio for thin capitalisation purposes. Payments in connection with shares and interest free loans are, however, excluded from such consideration.

In measuring EBITDA, it is typical to adjust for significant cash obligations that are not measured within EBITDA, such as material capital expenditure commitments. An alternative approach which can be appropriate in cases where the level of capital expenditure incurred is generally consistent from one year to the next is to consider the ratio of Debt to Earnings Before Interest and Amortisation (EBITA) rather than Debt to EBITDA - as in such cases the depreciation charge included within the accounts is likely to fairly closely approximate the capital expenditure incurred.

8 – 3140 Debt / Equity Ratios

The Debt / Equity ratio measures the overall gearing or leverage of a business and the term “leveraging” refers to the process of increasing this ratio. A QFC entity within a multinational group that has a high Debt / Equity ratio compared to the typical level for companies within the same business sector may have borrowed in excess of the arm’s length level of debt.

In calculating Debt / Equity, the same comments as provided above for Debt / EBITDA are relevant for the purposes of establishing an appropriate debt figure.

As for equity, for thin capitalisation purposes, the equity of a QFC entity includes issued share capital, any share premium account, interest free loans, the retained profits of the company and substantiated reserves. Similarly the existence of negative reserves will reduce equity for these purposes. However, there may be shares that have the characteristics of debt and which should be treated as such.

As mentioned above the debt / equity ratio is regarded as the key ratio in relation to thin capitalisation. The perceived importance of this ratio is such that the Tax Department has set safe-harbours based on debt / equity ratios (See QTM8-7000).

8 – 3160 Cash flow and Interest Cover

The cash flow position of a borrower, i.e. the level of cash generated through a borrower's activities and how this compares with the interest payments that need to be made on a loan, is of particular relevance to an arm's length lender. This is because a lender is primarily interested in the ability of a borrower to service debt, not with accounting adjustments, and a cash flow measure demonstrates that ability without the distortion potentially caused by accounting policies.

An interest cover ratio provides a calculation of the number of times the profits of a QFC entity can cover its interest expense and, under arm's length circumstances, interest cover is frequently recognised as providing a suitably reliable approximate measure of a borrower's ability to pay interest and other costs associated with borrowing. In cases where interest cover is used, however, it is important to have a good understanding of the accounting policies used in order to appreciate any material distinctions between the accounting profit and the business' cash flow position.

The basic calculation of interest cover is as follows:

$$\text{Interest cover} = \frac{\text{Earnings before interest and tax (EBIT)}}{\text{Interest payable}}$$

Variations on interest cover can involve using either EBITA or EBITDA in the numerator of the above ratio rather than EBIT.

Where a QFC entity does not prepare a consolidated cash-flow statement, for example because it is part of a larger group, then an interest cover ratio based on the operating profit shown by the Profit & Loss account may be considered an acceptable substitute.

8 – 3180 Example of Ratio Calculations

Company A has the following profit and loss and balance sheet information for the year ending 31 December 2014:

Profit & Loss (YE 31 December 2014)	**QAR M**
Turnover	100
Cost of sales	70
Gross profit	30
Other operating expenses	15

EBITDA	15
Depreciation and amortisation	5
EBIT	10
Interest payable	3
Profit before tax	7
Balance Sheet (as at 31 December 2014)	**QAR M**
Cash	20
Trade debtors	20
Fixed assets	40
Total assets	**80**
Trade creditors	5
Bank overdraft	10
Intra-group loan	25
Total liabilities	**40**
Paid-in capital	1
Cumulative profit/loss	39
Total shareholders' funds	**40**

Company A's Debt / EBITDA ratio can be calculated as:

Debt = Bank overdraft + Intra-group loan
= 10 + 25
= 35

EBITDA = 15

Debt / EBITDA = 35 / 15
= 2.33

Company A's Debt / Equity ratio as at 31 December 2014 can be calculated as:

Debt = Bank overdraft + Intra-group loan
= 10 + 25
= 35

Equity = Total shareholders' funds
= 40

Debt / Equity = 35 / 40
= 0.875

Company A's interest cover ratio can be calculated as:

EBIT	=	10
Interest payable	=	3
Interest cover	=	3.33

8 – 3200 Guarantees

Guarantees can be used to support the borrowing capacity of a QFC entity and may distort the terms on which the entity may borrow. For example the parent of a QFC entity may provide a guarantee in relation to a loan to the entity from a group treasury company or an unrelated bank.

With the additional comfort offered to the lender by a guarantor, the lender might provide a loan on more advantageous terms than the borrower could have obtained independently, because the guarantee will reduce the risk to the lender. The guarantor would of course have to demonstrate that it could make good its pledge, and perhaps provide security in relation to its commitment. With the guarantee in place, the lender should have greater and more immediate success in recovering its assets by exercising its rights under the guarantee.

The effect of a guarantee on loan terms is varied. For example, guarantees may help secure:

- a greater amount of debt;
- an increase in duration of the loan;
- less demanding covenants on the borrower; or
- a lower interest rate than would otherwise be incurred by the borrower.

Any of these may have implications for the transfer pricing of the transaction e.g. a larger loan may be obtainable, but it may be more than the borrower would be able or willing to take on at arm's length.

Article 50 of the QFC Tax Regulations disregards the existence of a guarantee when determining the arm's length conditions.

Guidance on what represents a guarantee for these purposes may be found at QTM8-2100.

For many groups, honouring the debts of subsidiaries and wider affiliates is a matter of maintaining their own credit reputation to avoid undermining the group credit rating and therefore its ability to raise finance in the future. Informal arrangements of this type will fall within the definition of guarantee, and would be termed “implicit guarantees”.

The wide definition of guarantee recognises the possibility that whilst a guarantee may not be formally documented, the behaviour of the parties indicates that a guarantee exists. Implicit guarantees can be difficult to evaluate, since their terms are not explicitly stated and motivation may be mixed and obscure.

Disregarding the effect of any guarantees establishes the amount the borrower would have been able to borrow in its own right, at arm’s length, and the terms on which it would have done so.

However, it is important to note that although an explicit or implicit guarantee may be found to exist, it does not necessarily follow that the guarantee has added to the ability of the QFC entity to borrow at arm’s length, as there may be cases where the QFC entity borrowings may meet the arm’s length conditions test without the existence of the guarantee. Alternatively it may be evident that the guarantee could only be met by drawing on the assets of the QFC entity and that the guarantor has no further assets available to it, leading to the conclusion that the guarantee does not add to the borrowing ability of the QFC entity. Each case will need to be considered on the basis of its own facts and circumstances.

Example

See the ABCDEF group example at QTM8-3060, and assume that C has been provided a $100M loan by an unrelated US based bank. A review of the loan agreement in place with the bank does not indicate the existence of any guarantee from A. However, a separate exchange of letters between A and the bank in question makes clear that, in the event of C being unable to satisfy its commitments to pay interest and repay principal, A would instead agree to make these payments.

As a result, it is clear that the loan is subject to a guarantee from A and is thus subject to the transfer pricing legislation. It is therefore necessary to consider whether any part of the interest expense incurred by C needs to be disallowed on the grounds of being non arm’s length.

An arm’s length analysis of C’s borrowing capacity indicates that C would be able to borrow $60M based on its own income, assets, liabilities and that the remaining $40M is only likely to have been lent at arm’s length as a result of the presence of the guarantee from A. As a result, it will be necessary for interest on $40M of the $100M loan to be disallowed within C’s tax return.

8 – 3220 Pricing Intra-Group Loans

When considering intra-group loans, there are two elements which determine the quantum of the interest deduction being claimed and thus need to be considered for transfer pricing purposes:

- the level of borrowing; and
- the pricing of the loan or loans (essentially the interest rate).

The previous sections of this chapter have focused primarily on the level of borrowing. However, the pricing of a loan is also important and should not be neglected.

The role of credit ratings

Credit ratings can fulfil a valuable role when seeking to apply the transfer pricing methods outlined within the OECD Transfer Pricing Guidelines for Multinationals and Tax Administrations to the specific circumstances of intra-group loans.

A credit rating represents an attempt by an independent party (usually a rating agency) to provide an accurate and standardised assessment of a subject's credit risk, i.e. the ability of the subject to meet its financial obligations on a timely basis. This might include consideration of:

- the likelihood of default in relation to a specific financial obligation (usually a bond or other financial instrument);
- the general creditworthiness of the subject; and
- the ability of the country (or countries) in which the subject conducts its business to provide a secure environment for investment.

The credit rating of a borrower typically has a very significant influence on the interest rate that the borrower would be charged if it were to borrow on an arm's length basis, although it should be recognised that credit ratings affect both the interest rate and the quantum of borrowing. Therefore, if an intra-group borrower has a credit rating, this is likely to provide an appropriate starting point for evaluating an arm's length interest rate on the intra-group loan. It is then often possible to apply the Comparable Uncontrolled Price (CUP) method to evaluate an appropriate interest rate, using publicly available information on corporate bond yields at the same or similar ratings and with the same or similar maturity and currency characteristics.

The role of credit rating tools

In practice, it is often the case that a credit rating only exists for the parent of a multinational group and not for individual subsidiary entities.

In such cases, consideration can be given to the use of synthetic credit rating tools, which are available for licence from a number of the major credit ratings agencies. These tools enable an approximate credit rating to be derived for an entity based on its industry sector, location and financial information and ratios and it is important for appropriate tools to be selected to reflect the specific circumstances of the borrower in question. It is also important to ensure that that appropriate consolidated financial information for the borrowing unit (as described previously) is used when calculating financial ratios and values.

Once a synthetic rating is derived, this can be used as a basis for evaluating an arm's length interest rate in a similar manner as an actual credit rating, however consideration will also have to be given as to the quantum of the loan being provided.

8 – 4000+ Types of QFC Entity for Transfer Pricing and Thin Capitalisation

8 – 4000 Branches

In considering the attribution of profits to the permanent establishment the QFC Tax Department will be influenced by the principles set out in the OECD Report on the Attribution of Profits to Permanent Establishments ("the OECD Report").

Under Article 13 of the QFC Tax Regulations QFC branches are taxed on the profits attributable to the branch, as a permanent establishment (PE), in Qatar. The authorised OECD approach to attributing profits to a PE is to first perform a functional and factual analysis of the operations of the PE and then to apply the transfer pricing guidelines by analogy. It follows when attributing profits to a QFC PE the principles outlined above may be helpful when looking at the relationship between the branch and its head office and dealings between the branch and any associates. However the OECD guidance should not be allowed to undermine the basic intent behind the article, and there should be attributed to the branch such equity and loan capital as appears to the Tax Department to be just and reasonable (Article 13(4)). This provision should be used as far as possible to ensure equality of treatment for thin capitalisation purposes between branches and LLC's.

A QFC branch is assumed to have the same credit rating as the enterprise of which it is a branch (Article 13(3)).

8 – 4020 Banking entities

All companies require capital to fund their capital expenditure and business activities, for example to fund premises, machinery or working capital. Equity capital may be raised by issuing ordinary shares, or loan capital raised by issuing debt securities, or capital may be built up through retained profits.

Banks are exceptional because they trade in money, rather than just supplying goods or services in return for money, and as a result they rely on access to capital as the core asset of their trading activities as well as needing funding for capital expenditure purposes. In its simplest form a bank makes a profit by borrowing money from investors and customers and either lending it to others or trading in financial instruments. Banks also provide fee-earning services such as merger and acquisition services and arranging finance provided by other lenders.

To protect the interests of customers and investors, banks throughout the world are subject to regulatory standards designed to make sure they have a solid base of capital available at all times to meet their customers' demands. Recommendations in relation to such international regulatory standards on capital requirements are prescribed primarily by organisations such as the Basel Committee on Banking Supervision and local banking regulators. In principle, capital needs to be sufficient to act as a buffer against future losses, leaving a bank room to recover or to organise an orderly winding down of its business. There is no doubt that there is a worldwide trend towards requiring greater levels of regulatory capital.

The level and type of capital of banks (and certain other financial institutions) is therefore prescribed in a manner quite different to that of other businesses. The commercial reality is that the amount and type of capital that banks hold has a direct impact on their overall profitability since regulatory capital has an economic cost to the bank. There is therefore a tension between maximising profit and meeting capital adequacy standards.

The QFC Tax Regulations effectively require that the Chargeable Profits reflect the amount that would be achieved by an independent regulated bank under the arm's length conditions. Therefore, the profits may need to be adjusted to disallow an amount of interest on debt to compute the Chargeable Profits. Such an adjustment is a computational one for tax purposes and is not intended to affect the way in which the company or permanent establishment may conduct or fund its actual business.

Banks are considered in more detail at QTM8-5000+ below.

8 – 4040 Insurers

Insurance companies are required by regulators to maintain sufficient capital to protect policy holders. The principles for quantifying the capital adequacy of an insurance company are complex and are not addressed in detail in this guidance as the practical application of the arm's length conditions will, to a considerable extent, be determined by the regulatory requirements.

In summary, a QFC entity needs to ensure that the value of its attributable assets exceeds the aggregate of its liabilities and its technical provisions determined by the relevant regulatory requirements.

QFC entities may carry on insurance activities through a resident company or a permanent establishment. In the case of a permanent establishment, Article 13 of the QFC Tax Regulations requires that the profits to be attributed to a QFC permanent establishment be those that the permanent establishment would make if it were:

- a distinct and separate entity;
- undertaking the same or similar activities;
- under the same or similar conditions, and
- dealing wholly independently with the enterprise of which it is a permanent establishment.

Article 10(3)(c) of the QFC Tax Regulations ensures that the profits attributable to permanent establishments outside Qatar are excluded from the QFC entity Chargeable Profits. It is therefore necessary, to determine the amount of QFC Chargeable Profits, to apply the principles of permanent establishment profit attribution in circumstances where a QFC resident company carries on business outside Qatar through a permanent establishment.

In the case of a permanent establishment engaged in insurance business, the hypothesis that the profits of the permanent establishment are the same as those of an independent enterprise requires the assumption that the permanent establishment has assets of the same type and amount that would be held by an independent enterprise engaged in the same or similar activities under the same or similar conditions.

In considering the attribution of profits to the permanent establishment, including attribution of assets and the return on allocated or attributable investment assets, the QFC Tax Department will be influenced by the principles set out in Parts I and IV of the

OECD Report on the Attribution of Profits to Permanent Establishments ("the OECD Report").

Insurance companies are considered in more detail at QTM8-6000+ below.

8 – 5000+ Banks

8 – 5000 Overview of Banks Resident in Qatar

A QFC entity is regarded as thinly capitalised, and subject to an adjustment under Part 8 of the QFC Tax Regulations if it incurs interest charges in excess of the amount that would be incurred at arm's length. Determining an appropriate level of capital for a banking QFC entity, whether a company or permanent establishment, is essential for the purposes of ensuring that the Chargeable Profits reflect the amount which would be achieved at arm's length.

A company may be thinly capitalised if:

- it is obtaining non-equity finance either from, or with the support of, associated persons;
- at a greater amount and/or at a greater cost than it could or would on an arm's length basis.

An analysis of the level of equity capital a group company that is a QFC entity engaged in banking activities would need to hold is therefore an essential starting point when identifying whether the subsidiary's cost of borrowings from associated persons is excessive from an arm's length perspective. Any adjustment to taxable profits would then take the form of a disallowance of the element of interest costs that exceeds the interest that would be incurred under arm's length conditions.

Under article 10(3)(c) of the QFC Tax Regulations ensures the profits attributable to permanent establishments outside Qatar are excluded from Chargeable Profits. Where a resident QFC entity has a permanent establishment outside of Qatar it is therefore necessary to apply the principles of permanent establishment profit attribution to determine the profits of the foreign permanent establishment, such profits being excluded from the QFC Chargeable Profits.

8 – 5020 Bank Branches

The Chargeable Profits attributed to a permanent establishment of a non-resident QFC entity are those that it would have made if it were:

- a distinct and separate entity;

- undertaking the same or similar activities;
- under the same or similar conditions; and
- dealing wholly independently with the enterprise of which it is a permanent establishment.

The approach to determining the capitalisation of a QFC entity permanent establishment is described in the following sections, which should be read in conjunction with QTM8-4000+.

8 – 5040 Determining an Appropriate Level of Capital - Overview

This section considers an internationally recognised process for identifying an appropriate level of capital, and calculating any required tax adjustments, for a QFC entity, whether a Qatar resident company or a QFC permanent establishment of a non-resident entity, in terms of five distinct steps:

- Step 1 - Determine the assets attributable;
- Step 2 - Risk weight those assets;
- Step 3 - Determine the equity capital that the QFC entity would require if it were an independent regulated enterprise engaged in the same or similar activities under the same or similar conditions;
- Step 4 - Determine the loan capital that such an enterprise would have had if it had the equity capital determined under step 3; and
- Step 5 – Use the findings from Steps 3 and 4 to determine the required tax adjustments.

Each of these steps is discussed further in the following sections.

8 – 5060 Step 1: Attributing the Assets

The amount of capital required by a QFC entity will depend on the size and nature of its activities and the assets from which it derives its profits.

Whether the QFC entity is a Qatar resident or non-resident entity, the assets attributable to it may not correspond to the assets shown on its balance sheet (or balance sheet prepared for tax purposes).

In considering the attribution of assets to QFC entities, the QFC Tax Department will give consideration to the principles in the guidance produced by The Basel Committee on Banking Supervision ('the Basel Accords') and in *The OECD Report on the Attribution of Profits to Permanent Establishments*.

8 – 5080 Step 2: Risk Weighting the Assets – Use of the Basel Accords

Banks do not require the same amount of capital in relation to each of their assets and the amount of capital required can vary greatly depending on the nature and risk profile of the asset. It is therefore necessary to apply an appropriate risk weighting to each class of asset. Unless there is evidence to the contrary, the QFC Tax Department will assume a 100% risk weighting of all assets.

For example, the Basel II framework, the second of the Basel Accords, specifies an approach to the risk weighting of assets that is recognised internationally and forms the basis of banking regulations in a considerable number of jurisdictions. This framework puts considerable emphasis on the role of banks' internal systems for the purposes of assessing risks and puts forward a detailed set of minimum requirements designed to ensure the integrity of those internal risk assessments.

The Basel II framework is comprised of three pillars:

- Pillar 1 provides for calculation of the capital adequacy requirement to support credit, market and operational risk;
- Pillar 2 provides for the review process required to ensure compliance with the Pillar 1 requirement, and the identification of risk not covered under Pillar 1 and the provision of capital to support it; and
- Pillar 3 provides for enhanced disclosure and market discipline.

The third of the Basel Accords, Basel III, was developed in response to deficiencies in financial regulation and both strengthens bank capital requirements and introduces new regulatory requirements on bank liquidity and bank leverage.

The Basel Accords or, depending on the location of the regulator of the bank concerned, another reasonable regulatory measure of capital requirement may be used as the starting point for establishing an appropriate level of capital for a QFC entity, and since such guidance is extensive it is neither repeated nor summarised here, since banks will have maintained their own approaches to capital adequacy for regulatory purposes. Guidance provided by the QFC Regulatory Authority will, of course, be most relevant.

In some circumstances, it may be appropriate to consider whether the QFC entity would have a capital structure similar to the bank as a whole, whereas in other circumstances the operations of the QFC entity will be sufficiently different from the global operations of the group to mean that such a structure would not be appropriate.

8 – 5100 Step 3: Determining the Equity Capital

Under the Basel Accords, the capital used by a bank to support its activities is placed in three categories – Tier 1, Tier 2 and Tier 3. The Basel II framework requires a bank to maintain specific ratios of capital relative to its risk weighted assets, both in terms of total capital and also in terms of Tier 1 capital.

While Tier 1 will consist largely of equity capital and Tiers 2 and 3 largely of loan capital, each tier, and the extent to which items within each tier will be regarded as equity or loan capital for QFC tax purposes, is considered further below.

Tier 1 capital

Tier 1 capital takes two forms:

1. **Issued capital -** the majority of the capital will be issued share capital;
2. **Internally generated capital -** this can include certain general and other reserves created by appropriations of retained earnings, share premium, other surpluses and retained profits.

Tier 2 Capital

A number of items fall within this category of capital, including subordinated term debt and convertible subordinated bonds. Both of these will be regarded as 'loan capital' for QFC tax purposes, subject to the limitations of applying the arm's length conditions for the QFC entity. However, dated preferred shares or perpetual cumulative preferred shares falling within Tier 2 will generally be regarded as 'equity capital'.

Tier 2 capital may also include certain reserves, such as those arising from the revaluation of tangible fixed assets and fixed asset investments. So, to the extent that such reserves or provisions could fall to be included in Tier 2 capital, they may effectively be treated as equity when considering the capitalisation of a QFC entity.

The QFC Tax Department will treat as loan capital any item for which an interest deduction is claimed.

Tier 3 Capital

Tier 3 capital is used to support trading book activities and essentially consists of short-term subordinated debt. Any such debt will be loan capital for QFC tax purposes.

<u>The arm's length level of equity capital</u>

Most banks operate with levels of equity capital in excess of the levels required under regulatory capital adequacy requirements and the amount of this excess varies depending on a number of commercial factors. Thus, whilst the required regulatory equity capital provides a valid starting point, the amount of equity capital held at arm's length would be over and above this level.

In quantifying an arm's length level of capital, there are a number of factors that could be taken into account, including in particular the ratio of equity capital held by banks undertaking the same type of activities under similar circumstances. (See QTM8-7000+ – Safe Harbours).

It may be the case that the activities of a QFC entity are more or less risky than those of the bank (or banking group) as a whole, thus meaning that the QFC entity needs to give consideration to what capital it would hold at arm's length by reference to comparable banking operations carried on at arm's length in similar circumstances rather than adopt the capital ratio of either the head office or the group.

8 – 5120 Step 4: Determining the Loan Capital

Loan capital in this context is the amount of interest-bearing capital within Tiers 1, 2 and 3 of a bank's regulatory capital.

The arm's length level of loan capital will be dependent on the overall regulatory capital required and will reflect the fact that (as noted above) most banks operate with levels of capital in excess of those required under regulatory capital adequacy requirements, thus meaning that, just as with equity capital, the level of loan capital is normally in excess of the minimum required for regulatory purposes.

As with equity capital, it may be the case that the activities of a QFC entity are more or less risky than those of the bank (or banking group) as a whole, thus meaning that the QFC entity needs to give consideration to what loan capital it would hold at arm's length by reference to comparable banking operations carried on at arm's length in similar circumstances rather than adopt the capital ratio of either the head office or the group.

8 – 5140 Step 5: Determining the Required Tax Adjustments

Having established the equity and loan capital that a QFC entity would require under arm's length circumstances, it is necessary to arrive at the deductibility for tax purposes of the costs of such capital for the purposes of the computing any appropriate tax adjustments. As far as the equity capital is concerned this will be nil.

The rate of interest to be applied to the total amount of loan capital will also need to be considered, and this will depend on a number of factors that would exist in arm's length conditions, including the functional currency, the hypothetical mix of loan capital and if appropriate, the nature of, and rate of interest on, loan capital held by the banking group.

The arm's length funding cost reached as described above should then be compared with the actual funding costs incurred by, or attributed to, the QFC entity. If the arm's length cost of funding for the appropriate mix of equity and loan capital is lower than the amount incurred by, or attributed to, the QFC entity, an adjustment will be required to ensure that only the amount of interest which would be incurred at arm's length is deducted in computing the Chargeable Profits of the QFC entity.

Example

A QFC entity permanent establishment of a non-resident bank is funded by its head office with:

- Short terms loans of QR.8,000M at an interest cost of 5%
- A ten year subordinated loan (Tier 2) of QR.500M at an interest cost of 7%, and
- An interest-free allotment of capital (Tier 1) of QR.750M.

1. For illustration purposes, suppose the analysis of the arm's length conditions concludes that the permanent establishment would hold regulatory capital of QR.2,000M, made up of equity capital of QR.1,500M and loan capital of QR.500M.
2. In this case, it is assumed that interest on the short term loans is wholly incurred for business purposes of the QFC entity.
3. The appropriate interest rate for attributed loan capital is determined to be 6%.
4. The funding to be treated as attributable equity and loan capital is agreed as the QR.750M allotted equity, the QR.500M ten-year loan and QR.750M of the short-term loans.
5. QAR 750M of the short terms loans will need to be recharacterised as Tier 1 capital.
6. The interest of the remainder on the short term loans would ordinarily continue to be deductible while funding the business of the QFC entity.

The costs of equity and loan capital deductible in accordance with the arm's length conditions will be:

Type of capital	Amount of capital	Interest rate	Deductible
Equity capital	QR 1,500M	0%	0
Loan capital	QR 500M	6%	QR 30M
		Total	QR 30M

The funding that will be displaced by this attributed capital will be:

Type of funding	Amount of funding	Interest rate	Original interest
Allotted capital	QR 750M	0%	0
Short-term loan (treated as equity capital)	QR 750M	5%	QR 37.5M
10-year loan (interest rate to be restricted)	QR 500M	7%	QR 35M
		Total	QR 72.5M

Therefore, the funding costs to be disallowed in computing the Chargeable Profits would be QR.42.5M (QR.72.5M – QR.30M).

8 – 5160 Frequency of Calculations

Frequency of calculations

Although a banking regulator may require frequent reports of a bank's capital for monitoring purposes, a pragmatic basis of calculation for tax purposes is required rather than a replication of the reporting requirements of financial regulators.

Therefore, the QFC Tax Regulations set no standard as to how frequently calculations should be performed within an accounting period beyond the general requirement that the Chargeable Profits be computed on an arm's length basis.

The frequency of the capital attribution calculations will depend on the facts in a particular case, but in the vast majority of cases the QFC Tax Department is not expecting this tax calculation to be performed on a daily or weekly basis unless such calculations are already performed and readily available. The frequency should be governed by what is reasonably required to ensure an accurate computation of Chargeable Profits. The starting point will always be to look at the position shown in the closing balance sheet.

8 – 6000+ Insurers

8 – 6000 Overview of Insurers Resident in Qatar

Insurance companies are required by regulators to maintain sufficient capital to protect policy holders. The principles for quantifying the capital adequacy of an insurance company are complex and are not addressed in detail in this guidance as the practical application of the arm's length conditions will, to a considerable extent, be determined by the regulatory requirements.

In summary, a QFC entity needs to ensure that the value of its attributable assets exceeds the aggregate of its liabilities and its technical provisions determined by the relevant regulatory requirements.

8 – 6020 Insurance Branches

QFC entities may carry on insurance activities through a resident company or a permanent establishment. In the case of a permanent establishment, Article 13 of the QFC Tax Regulations requires that the profits to be attributed to a QFC permanent establishment be those that the permanent establishment would make if it were:

- a distinct and separate entity;
- undertaking the same or similar activities;
- under the same or similar conditions, and
- dealing wholly independently with the enterprise of which it is a permanent establishment.

Article 10(3)(c) of the QFC Tax Regulations ensures that the profits attributable to permanent establishments outside Qatar are excluded from the QFC entity Chargeable Profits. It is therefore necessary, to determine the amount of QFC Chargeable Profits, to apply the principles of permanent establishment profit attribution in circumstances where a QFC resident company carries on business outside Qatar through a permanent establishment.

In the case of a permanent establishment engaged in insurance business, the hypothesis that the profits of the permanent establishment are the same as those of an independent enterprise requires the assumption that the permanent establishment has assets of the same type and amount that would be held by an independent enterprise engaged in the same or similar activities under the same or similar conditions.

In considering the attribution of profits to the permanent establishment, including attribution of assets and the return on allocated or attributable investment assets, the QFC Tax Department will be influenced by the principles set out in Parts I and IV of the OECD Report on the Attribution of Profits to Permanent Establishments ("the OECD Report").

8 – 6040 Attribution of Profits to a PE

This section considers the OECD guidance on the attribution of profits to a Permanent Establishment in relation to insurance companies. In order to identify an appropriate level of capital, and calculate any required tax adjustments, for a QFC entity, whether a Qatar resident company or a QFC permanent establishment of a non-resident entity, you should consider the three topics below;

- Attribution of Assets
- Investment yield
- Internal Reinsurance

8 – 6060 Attribution of Assets

Assets are required to support the insurance risk assumed. Two approaches to asset attribution are adopted as Authorised OECD Approaches within the OECD Report:

- the capital allocation approach, and
- the thin capitalisation (or adjusted regulatory minimum) approach.

Each of these Authorised OECD Approaches are discussed further below.

In some circumstances, the QFC Tax Department may consider the application of the third method described in the OECD Report, the quasi thin capitalisation approach based on the regulatory minimum amounts, as a potential domestic safe harbour for QFC entities.

However the attribution of investment assets to a PE is not an exact science, and the particular facts are likely to give rise to a range of arm's length results for the attributable investment assets rather than a single figure. The QFC Tax Department will be looking to the taxpayer to make a reasonable allocation, based on the facts of their case, and will expect the taxpayer to be able to support the allocation adopted.

Capital allocation approach

Two principles underlie the capital allocation approach:

- the investment assets support the business of the whole entity;
- the sum of the investment assets attributable to parts of the enterprise equates to the total investment assets, rather than the regulatory minimum;

Generally the allocation of assets should be in proportion to the insurance risk assumed by each part of the enterprise, without however allocating excessive surplus assets to any PE.

Diversification benefits are recognised as potentially reducing the total sum of the entity's total investment assets to be allocated.

Allocation keys or proxy methods for the allocation of assets may be used where these are just and reasonable. Suitable allocation keys might be based on technical provisions, premiums or regulatory parameters such as solvency margins, depending on the facts and circumstances. The QFC Tax Department will however be looking for taxpayers to apply any agreed methodology on a consistent basis.

Thin capitalisation (or adjusted regulatory minimum) approach

The thin capitalisation approach seeks to determine the investment assets required by reference to the assets which would be required by an independent enterprise with similar activities, assets and risks in similar conditions. This involves undertaking a comparability analysis, having regard to:

- the capital of the enterprise as a whole;
- the minimum amount of capital the host regulator would require for an enterprise carrying on similar activities in similar conditions.

8 – 6080 Investment Yield

In arriving at the arm's length profits of the QFC entity it is necessary to attribute an investment yield to the assets held by, or attributable to, the QFC entity.

Two approaches are discussed within the OECD Report - the 'top-down' and 'bottom-up' approaches, each of which are summarised below. The approaches attempt to estimate the return on investment assets, and as always flexibility and due regard to the facts and circumstances are needed.

'Top-down' approach

To the extent that the amount of investment assets attributable to the QFC entity exceeds the amount of investment assets actually held in Qatar, additional assets will have been attributed to the QFC entity. The ‘top-down’ approach applies to those additional assets a return equal to the rate of return earned on all investment assets (‘uncommitted assets’) held by the company that are not required to be held in trusteed accounts in other countries to support business in that territory, having due regard to those assets which do not give rise to income. The facts and circumstances should be taken into account, for example taking account of underperforming assets or currency inflation, and it may be possible to identify the yield on those categories of the company’s uncommitted investment assets that are most appropriate to attribute with the QFC entity.

‘Bottom-up’ approach

The ‘bottom-up’ approach assumes that the rate of return earned on investment assets held in Qatar by the QFC entity, or attributed to the QFC entity, is also earned by the additional ‘uncommitted’ investment assets that are to be attributed to the QFC entity.

8 – 6100 Internal Reinsurance

Insurance companies commonly buy reinsurance from both unrelated and associated enterprises in order to manage their insurance and investment risk. The question of internal reinsurance of risks by the permanent establishment as 'cedant' with another part of the entity as 'reinsurer' is problematic.

Under the Authorised OECD Approach in the OECD Report, no dealing that internally transfers insurance contracts or associated insurance risk is recognised unless it can be demonstrated that another part of the enterprise has performed the relevant key entrepreneurial risk-taking function. The general assumption of the Authorised OECD Approach is that the risk management function of deciding whether to reinsure contracts held by an enterprise, after insured risks have been assumed, is not a key entrepreneurial risk-taking function and would not result in economic ownership of the insurance contracts to be transferred within the enterprise.

On the other hand, if

- a QFC entity enters into contracts, whether in Qatar or in another territory through a permanent establishment, which on a separate enterprise basis it would not have been able to enter into, or not to the same extent; and

- it is acting essentially as a fronting operation for insurance business which is economically owned by another part of the enterprise

the passing of those contracts by way of such an internal dealing may be recognised, subject to an arm’s length reward being given to the fronting functions performed.

In the large majority of cases, the risk management function of deciding whether to reinsure externally or retain risks assumed by the permanent establishment will not give rise to an internal reinsurance dealing, although functions performed by specialists located in another territory should be rewarded in accordance with the arm's length principle.

In considering the arm's length conditions, QFC entities will need to give special considerations to the effects of external and internal (if appropriate) reinsurance on allocation of premiums paid, the allocation of recoveries and the need for provisions and surplus.

8 – 6120 Resolving Differences

Alternative asset attribution and investment yield approaches may lead to international differences and the prospect of double taxation. Generally, the principles of profit attribution in the OECD Report should be applied with some flexibility to produce the most appropriate application of the arm's length principle in the circumstances based on all the facts relevant to the case, and in some instances it may be necessary to enter into the Mutual Agreement Procedure (MAP) under the relevant treaty to resolve differences between jurisdictions which may lead to double taxation. MAP procedures are dealt with by the Director of the PRTD, as Qatar's competent authority.

8 – 7000+ Safe Harbours

8 – 7000 QFC Debt to Equity Safe Harbour Ratios

QFC Entities are required to comply with the transfer pricing tax requirements as set out in Part 8 of the QFC Tax Regulations. However establishing the correct transfer price for goods or services, or the arm's length interest deduction in relation to loans is more of an art than a science. Furthermore the process of obtaining information on comparables and undertaking a transfer pricing study or benchmark exercise is costly and time consuming.

The QFC Tax Department have therefore decided to provide support and a degree of certainty for taxpayers by publishing non-binding debt to equity safe harbour rules in circumstances where Article 49 Applies which is mainly where related party debt is used to fund a QFC Entity. An analysis of the ratios used in countries where guidance is provided at Appendix 3. Following the comprehensive review it was considered to be appropriate to allow a higher ratio for Financial Institutions (as defined in Article 153) to reflect the particular nature of their businesses. The ratios acceptable to the QFC Tax Department are as follows:

Institution:	Debt:Equity Ratio
Non-Financial	**2:1**
Financial	**4:1**

These safe harbour debt to equity ratios are non-statutory and are non-binding on either the taxpayer or the Tax Department. However except in exceptional circumstances, most likely where the avoidance of tax is perceived as a motive in using the ratios, the Tax Department would be expected to accept their use when considering whether to open an enquiry into a return. The safe harbour ratios relates only to the quantum of the loan, not the interest rate.

8 – 7020 Calculating the debt to equity

The ratio should normally be calculated using the closing balance sheet of the entity, but an average ratio throughout the accounting period may be used where this is applied on a consistent basis over time.

If an independent entity had a negative balance sheet it would require shareholders funding in order to reverse the negative equity position. Any entity operating with a negative balance sheet for more than one year is unlikely to be signed off by auditors as a going concern. Therefore, where a QFC entity has a negative balance sheet it will be necessary to offset all loans against the negative reserves to bring the entity into a nil debt/equity position. Once the nil position has been computed any remaining debt and interest charged thereon will be subject to the debt/equity safe harbour ratios. Any interest paid on debt offset against reserves will not be allowed for tax purposes.

When offsetting loans against negative reserves you should do so in a manner which is favourable to the taxpayer, for example by offsetting any debt which is interest free first, before using debt which is subject to interest payments.

It is accepted that some QFC Entities may require a higher level of certainty in their tax affairs than that provided by the safe harbour ratios. It is open to those Entities to apply for an advance ruling from the Tax Department to obtain that certainty.

8 – 7040 Rulings

A ruling in relation to the application of the safe harbour ratios should be a relatively straightforward process, subject to payment of the application fee of QR6,000. The ruling would generally be applicable for a period of 2 or 3 years.

A ruling may also be requested in respect of the application of other areas of the transfer pricing regulations, for example the suitability of the use of a Group transfer pricing policy or the appropriate mark up to be applied to inter-company services. This application will however have to include support and justification for the particular pricing policy adopted. It will also have to include all the information set out in section 7 of the Tax Rules. In effect the Rulings procedure maybe used to obtain an advance pricing agreement (APA).

The safe harbour guidance applies for accounting periods beginning on or after 1 January 2012. The Tax Department do not consider there are any grounds for reopening settled cases agreed on a basis different from that set out above.

8 – 8000+ Maintenance of Records for Transfer Pricing Purposes

8 – 8000 General

The general regulations regarding the maintenance and preservation of records apply to an entity that is required to make a tax return for a period.

Part 18 of the QFC Tax Regulations enables the QFC to specify in the Tax Rules the books of account and other records to be maintained and preserved by QFC entities. The QFC Tax Department has published Tax Rule 6 to specify both the records to be maintained by a QFC entity which is required to file a return under Article 109, and the retention period for those records.

When a QFC entity makes a tax return, it needs to apply the Transfer Pricing Regulations to transactions falling within the scope of Part 8 of the QFC Tax Regulations and will therefore need to maintain records establishing that the Chargeable Profits have been computed on the arm’s length basis as required by Article 48 of the QFC Tax Regulations.

The compliance costs of maintaining such records is not intended to be disproportionate, and the QFC entity should prepare and retain such documentation as is reasonable given the nature, size and complexity (or otherwise) of the business, or of the relevant transaction or series of transactions, in order to achieve the purpose of establishing that the Chargeable Profits have been computed on the arm’s length basis.

It is likely that a multinational enterprise operating under a QFC licence will already have transfer pricing documentation either for global policy purposes or to meet the tax compliance requirements of the associated persons with which the QFC entity is transacting. It is therefore expected that such documentation could be adapted efficiently to support the tax return for the QFC entity without a disproportionate compliance burden.

Transfer pricing documentation in relation to a period covered by a tax return will therefore consist of a mixture of the records described in Tax Rule 6.3(a), the supporting documents described in Tax Rule 6.3(b) and evidence demonstrating that the computation has been made on the arm's length basis.

If a taxpayer fails to maintain adequate records to support the pricing of transactions with associates, or claims in his return that no adjustment is required under Part 8 of the Tax Regulations without being able to substantiate that claim then there may be a liability to a penalty for failure to maintain adequate records (Article 108) or for making an incorrect return (Article 119(4)).

8 – 8020 Types of records

There are four classes of records or evidence that will need to be considered:

- Primary accounting records
- Tax adjustment records
- Records of transactions with associated businesses
- Evidence to demonstrate an arm's length result

Primary accounting records

These are the records of transactions occurring in the course of business activities that the QFC entity enters into its accounting system. These records are needed to produce accounts, including a balance sheet and a statement of profit or loss, and it is expected that such records would be maintained for normal commercial accounting purposes.

These primary accounting records include the results of the relevant actual transactions which may or may not reflect the arm's length conditions.

Tax adjustment records

These are the records that identify adjustments to profits made by a QFC entity in order to compute the Chargeable Profits in accordance with the tax regulations, including the recording of adjustment of actual results to the results which would be achieved under the arm's length conditions.

Records of transactions with associated businesses

These are the records in which a QFC entity identifies transactions to which the transfer pricing regulations apply.

Evidence to demonstrate an arm's length result

This is the evidence that demonstrates that the Chargeable Profits are those which would be achieved under the arm's length conditions. The extent of this evidence will depend on the nature, size and complexity (or otherwise) of the business or transactions conducted with associated persons.

In simple cases it may be clear that a simple analysis of the comparability of the transaction with a transaction between third parties is sufficient for these purposes whereas a QFC entity that engages in a complex range of transactions or services with associated persons may be expected to maintain comprehensive transfer pricing documentation consistent with international standards. Such comprehensive documentation, which may in any case also be maintained in order to meet the documentation requirements of other territories, would be expected to include the following:

- A functional analysis
- A list of the transactions to which the transfer pricing regulations apply
    - The source and effect of the relevant legislation
    - The transfer pricing methodology selected
    - The basis on which the transfer pricing methodology has been applied, for example confirming the profit level indicator used in the transactional net margin method
    - Identification of the comparable companies or transactions
    - The arm's length results or range of results, if appropriate
    - Consideration of where the results of the tested party are within the range
    - The conclusion

8 – 8040 When Records and Evidence Need to Come into Existence

Primary accounting records will generally be created at the time the information is entered into the business accounting system. Such records therefore exist before a tax return is made for the period in question.

Tax adjustment records would not need to be created at the same time as primary accounting records, but would need to be created before a tax return is made for the period in question.

The records identifying transactions to which the transfer pricing regulations apply and evidence to demonstrate an arm's length result would need to be made available to the QFC Tax Department in response to a request for such information.

Although the QFC entity would need to compute its Chargeable Profits in the tax return on the basis of appropriate evidence, at the time the return was made the material recording that evidence for transfer pricing purposes would not necessarily exist in a form that could be made available to the QFC Tax Department. Indeed, if the information was not requested, the evidence may never exist in such a form.

It is clear that, in order to comply with Tax Rule 6, evidence that the Chargeable Profits are consistent with the arm's length conditions should be in existence in some form before the tax return is finalised.

If a taxpayer has undertaken a transfer pricing study, properly benchmarked against valid comparables, the existence and presentation of such a study to the Tax Department will be a significant factor in deciding if an enquiry into a return is necessary.

8 – 9000+ Transfer Pricing Methodologies

8 – 9000 Overview

International transfer pricing standards have established that there are various methods for establishing the arm's length conditions. In considering the transfer pricing methods adopted by QFC entities, the QFC Tax Department will apply the Transfer Pricing Regulations in a manner which is intended to ensure consistency with the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

The *OECD Transfer Pricing Guidelines* describe methods that are divided into traditional methods and transactional methods, all requiring the exercise of judgement on the part of both the tax administration and taxpayer. While the QFC Tax Department is prepared to consider any reasonable method for establishing the arm's length conditions, it is expected that the method applied by the QFC entity will be the most appropriate method, having taken account of the benefit to the QFC entity of the transaction when establishing the arm's length conditions and the amount that a QFC entity would pay to a third party in relation to the transaction.

The following paragraphs provide an introduction to the transfer pricing methodologies.

Central to the application of the arm's length principle in transfer pricing is the concept of comparability. Whatever methodology is employed to establish an arm's length price, it will involve to varying extents the identification of transactions between third parties which have a degree of comparability with the transactions being tested and an assessment of how any differences might affect the price that would be paid between independent parties. Comparability factors are covered at Part9 – Partnerships below.

8 – 9020 Comparable Uncontrolled Price (CUP)

In the circumstances where it is possible to identify a comparable uncontrolled transaction, the comparable uncontrolled price ('CUP') is the most accurate of transfer pricing methods. The CUP method simply compares the price in the transaction within the Transfer Pricing Regulations with the price in a comparable uncontrolled transaction. If there is a difference in the price, the price in the uncontrolled transaction may need to be applied.

An uncontrolled transaction may be considered to be comparable to a controlled transaction if:

- There are no differences between the transactions being compared, or between the persons entering into the transactions, which could materially affect the price charged in the open market; and
- Where there are minor differences, reasonably accurate adjustments could be made to eliminate their effect.

Where a comparable uncontrolled transaction is available as evidence, the CUP method is likely to be the preferred method of applying the arm's length principle due to its high level of reliability.

However, identifying comparable uncontrolled transactions can sometimes be difficult in practice.

8 – 9040 Resale Minus

The Resale Minus method is intended to reflect how parties engaged in distribution set their prices in practice, and it is not commonly applied to the provision of financial or professional services. This method is particularly useful where a company purchases goods from a connected party that are intended for distribution.

The Resale Minus method begins with the price at which a product, purchased from an associated person, is resold to an independent person. The resale price is then reduced by an appropriate gross margin (the "resale price margin") representing the amount out of which the reseller would seek to cover its selling and other operating expenses and make a profit, taking account of the functions performed, assets used and risks assumed. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of goods and products between the associated persons.

8 – 9060 Cost Plus

The cost plus method is the third of the traditional transactional methods and may be applied to the provision of both goods and services.

The starting point is the costs incurred by the supplier of the goods or services. A mark-up should be added to this to give the supplier a profit appropriate to the functions performed and the market conditions.

The profit margin should be calculated by reference to the profit the supplier would earn in comparable uncontrolled transactions or the mark up that would have been earned in comparable transactions by independent persons.

It is critical to the application of this method to give careful consideration to the level and types of costs incurred in the provision of the goods or services to which the margin (mark-up) should be applied. This is particularly important when looking for comparable persons, whom may classify costs in different ways in their accounts - some at operating expense level, some at gross expense level. Thus, although in principle the cost plus methodology should compare margins at the gross profit level, it is recognised that there may be practical difficulties in so doing.

8 – 9080 Transactional Profit Split

The profit split method is, along with the transactional net margin method, one of the two transactional profit methods.

The method can offer a solution for complex trading relationships involving highly integrated operations, where it is sometimes difficult to evaluate those transactions separately. In some circumstances independent entities might set up a form of partnership or joint venture and agree to share the profit (or the loss) from their combined trade, in certain proportions.

The profit split method attempts to eliminate the effect of a control relationship on profits accruing to each connected party by determining the division of profits that independent persons would have expected to realise from engaging in the transactions.

The profits should be split on an economically valid basis - one that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length without the use of hindsight.

The following two common forms of computing the profit split are described below:

- The contribution analysis
- The residual analysis.

When determining a profit split on the basis of a **contribution analysis**, the combined profits from the controlled transactions made by all the entities involved in earning those profits are split on the basis of the relative value of the functions that each carries out. This requires careful consideration of the overall business and key value drivers. The economic importance of the functions carried out by each party in earning the profits should be considered. For example, consideration should be given to whether it was the intrinsic nature of the product or service that generated the profits or whether it was the success of the marketing activity that generated sales.

When determining a profit split on the basis of a **residual analysis** (also known as the residual profit split), the combined profit of the overall trade made by the connected parties is again considered. Firstly, each participant is allocated sufficient reward to provide it with a basic return appropriate to the functions carried out by reference to similar types of transactions undertaken by independent persons. Secondly, any profit (or loss) left after the allocation of basic returns would be split as appropriate between the parties based on an analysis of how this residual (entrepreneurial) profit would have been split between unrelated entities on the basis of high value assets and functions, including any contributions of intangible property and the relative bargaining positions of each party.

In either analysis it is essential for the taxpayer to provide a valid commercial analysis of the transactions, including value drivers.

8 – 9100 Transactional Net Margin Method (TNMM)

The transactional net margin method is the second of the transactional profit methods used for establishing the arm's length price. This method focuses on establishing the arm's length net profit margin as opposed to the more common gross profit margin sought by the 'traditional' methods of CUP, resale minus and cost plus.

The TNMM compares the profitability of the tested party with the profitability of comparable companies. Considering that the TNMM focuses on overall profitability and not strictly on individual transactions, it does not require a high degree of comparability between products, but rather requires similarity in terms of functions performed, risks taken and assets engaged. The TNMM thus applies a one-sided analysis, aiming to determine whether one of the two related transacting parties has achieved a level of profitability consistent with that achieved by independent companies performing broadly similar functions and assuming broadly similar risks.

The application of the TNMM should begin by comparing the net margin which the tested party makes from a controlled transaction with the net margin it makes from an uncontrolled one. Where there are no transactions with third parties, the net margin which would have been made by an independent person in a comparable transaction may serve as a guide. It may be possible to adjust results for minor functional differences.

Using this method for determining/verifying the arm's length mark-up on services is common practice due to the abundance of publicly available financial information, which includes data on total operating costs, especially where other methods would not be more appropriate.

It should be noted that with the TNMM, the net profit indicator of a company can be influenced by a range of factors that may have no effect, or a minimal effect, on gross margins or the actual price of a transaction, making the comparison between the tested party and another entity challenging if the latter is not affected by the same factors.

In recognition of the challenges outlined above, it is important to take into account a range of results when using TNMM as the range of results may mitigate unquantifiable differences between the tested party and independent companies carrying out comparable transactions.

8 – 9120 Intra-Group Services

In establishing the arm's length price in respect of intra-group services, the method and level of the margin depends on the nature and complexity of the service. The cost plus basis may be an appropriate approach where the activities performed are of relatively low value or low risk-bearing to the business as a whole.

It is important, in determining whether cost plus is an appropriate methodology to apply in the pricing of a particular transaction, to consider the risk allocation between the parties, beginning with an analysis of the contractual risk allocation and whether the actual conduct of the parties conforms to the contractual terms and obligations.

It should then be established whether the actual risk allocation, either under the contractual arrangements or that indicated by the actual conduct of the parties where the latter differs, is one that would have occurred between comparable independent parties at arm's length. This may include consideration of which party has greater control over the risks, analysis of the financial capacity of the party to which the risk has been contractually assigned to actually bear that risk and a search for comparables demonstrating similar risk allocations in arm's length conditions.

The cost base

If cost plus is selected as the appropriate transfer pricing method to arrive at the arm's length price, it is important to ensure that all the relevant costs are included in the cost base when determining the price(s) charged.

Difficulties can arise in considering the cost base of a partnership when applying cost-related transfer pricing methods. For example, in applying the net operating margin method to a partnership, the benchmarking data will be derived from the operating results of companies, net of directors' remuneration. In order to accurately determine the anticipated operating margin of a partnership it may be necessary to impute an arm's length cost for senior personnel as if the partnership were a company.

Parts 9 and 10 of the QFC Tax Regulations provide that, in computing the Chargeable Profits of a general, limited or limited liability partnership, a deduction in respect of remuneration paid to Members shall be allowed up to a maximum of 50% of the Chargeable Profits of the accounting period, as calculated prior to the deduction of Partners' remuneration.

Where the method for a QFC entity that is a partnership is to be applied by reference to its costs, the QFC Tax Department will ordinarily accept an imputation of Members' remuneration costs amounting to 50% of the Chargeable Profits of the accounting period, as calculated prior to the deduction of members' remuneration, in order to compute the arm's length operating margin.

8 – 11000+ Comparables

8 – 11000 Overview

Application of the arm's length conditions to transactions between associated persons relies on comparing the related party transaction with identical or similar transactions carried out between either the tested party and a third party, or between independent persons.

Therefore the aim is to find, to the extent possible, a comparable uncontrolled price ('CUP') to compare the terms of the related party transaction with an identical transaction carried out with, or between, independent persons.

The resale minus and cost plus methods look to compare transactions at the gross margin level, whilst the transactional net margin method ('TNMM') requires comparison of the net margins of comparable companies. It may be easier to locate comparables at the level of the TNMM data.

In some cases, it may be possible to make adjustments to eliminate differences in order to improve comparability.

Some of the factors that should be taken into account in a comparability analysis are set out below, though the list is not intended to be exhaustive:

1. The characteristics of the property or services

- For tangible goods this will include physical features, quality, reliability, volume and availability of supply.
- For the provision of services, the nature and extent of those services.
- For intangible property, the type of the property (patent, trademark, etc.), the form of the transaction (licence, sale, etc.), the duration and degree of protection and the anticipated benefits.

2. Functional analysis

- Compare the functions undertaken by the parties being tested
- Compare the economic substance of the functions.
- Take account of physical assets used in the business (e.g. technology) and also intangible assets such as brand names.
- The risks assumed by each party are important, including financial risk and regulatory compliance.

3. The contractual terms of the transactions

It is important to consider a transaction from the perspectives of all parties, looking at the functions undertaken and the risks borne by the parties to it, as any material differences in function and risk will affect the price.

4. Economic circumstances

Prices vary across different markets even for the same goods or services. To compare transactions you may need to consider whether the following factors (among others) are comparable:

- Geographic location
- Size of the market
- The extent of competition in the markets
- The relative competitive positions of the buyers and sellers (including their relative bargaining power)
- Availability of substitute goods and services
- Levels of supply and demand
- Purchasing power
- Government regulations
- Costs of productions (e.g. costs of local labour and raw materials)

5. Business strategies

Business strategies such as innovation and new product development, degree of diversification, risk aversion, likely political changes, labour laws, etc. may also need to be considered in the analysis.

Market penetration schemes or market expansion schemes can be particularly problematic as pricing structures and levels of marketing expenditure will differ, so it is important to establish who is bearing the costs, and who at arm's length would be bearing the costs, of a market penetration scheme and for how long.

8 – 11020 Internal Comparables

The best source of comparables may be within the group itself. A large group will have contracts and trading relationships with many customers, suppliers, contractors, etc. Compare the prices, terms and conditions of transactions with affiliates with the prices, terms and conditions of transactions with independents.

A search for internal comparables is sometimes overlooked by groups when they are considering their transfer pricing policy and compiling documentation to demonstrate that the pricing is at arm's length. If the transfer pricing documentation makes no mention of internal comparables, it may be appropriate to establish what work has actually been done to find out if there are any.

The facts might lead to the conclusion that similar transactions with associated persons should be compared with the conditions existing in the internal comparables.

8 – 11040 QFC or Global Companies

The taxpayer may produce comparables which are located in different geographical areas. It is important to regard the market serviced by the tested party when searching for comparables. If a search produces say 12 comparable companies, 8 of which are based in the QFC, it may make sense to consider those 8 companies in isolation in the first instance.

If there are no QFC or regional comparables, or these companies are found to be insufficiently comparable, it would be necessary to consider using comparables from other countries, and the analysis would need to take into account whether territorial differences lead to market differences in a particular case.

8 – 11060 Commercial Databases

The most common way to search for comparable companies is to use a commercial database. These take information from a variety of publicly-available sources and present them in a user friendly format. The basis of any economic analysis constructed to support the cost plus, resale minus and transactional net margin method ('TNMM') methodologies will need a review of comparables using a commercial database.

In reviewing data obtained from commercial databases, consideration should be given to factors such as the following:

- Accounts can be presented in a number of ways under various accounting standards, for example there can be different approaches for deciding how gross profit is calculated
- Some companies that are independent, according to the databases, are in fact owned by overseas parents
- Business descriptions are obtained from the accounts and may lack clarity
- Companies are classified by industry codes and may be described by more than one industry code
- The company may have been allocated an inappropriate industry code
- The databases are most useful for comparing net operating profits. They can be used to obtain gross operating profits for comparison, but it may be difficult to establish exactly how the gross profit has been calculated in each case and whether expenses have been taken to gross costs or operating costs.

8 – 11080 Selecting and Discarding Comparables

The following provides guidance for preparing or reviewing comparable search analyses:

1. There should be a clear audit trail of the search and reasons for selection or rejection.

2. A search model will generally start out with a wide net and produce a lot of companies, the majority of which will not be comparable. Further searches can then be refined, producing, hopefully, narrower ranges of companies, which are more likely to be comparable.

3. The number of years' data analysed will vary depending on facts and circumstances. The database itself may provide a limited sample of data for various reasons. Ideally the analysis should consider at least 3 years' accounts information for each potentially comparable company. This allows for variations in the economic cycle. The analysis need not be limited to companies with the same accounting date.

4. Small companies should be avoided as the comparability of the results may be distorted by the forms in which the directors, who may well be shareholders, take remuneration.

5. Avoid companies that are part of a group as group companies are potentially subject to distortions in financial results arising from their own intercompany pricing policies.

6. Search for comparable companies whose turnover is broadly at the same level as the tested entity or within a reasonable range.

7. Consistently loss-making companies should be discarded as such losses are likely to derive from specific economic factors.

8 – 11100 Adjusting Potential Comparables

It is essential to establish the level and degree at which the comparability analysis is to be applied, e.g.:

- Comparing a single transaction, e.g. the sale price, and terms of sale of a particular product

- Comparing a bundle of transactions, e.g. a licence agreement, a contract for services, a distribution agreement, etc.

- Comparing results of independent companies at the gross margin level

- Comparing results of independent companies at the net margin level

- Comparing results of independent companies by reference to some other measure, such as return on capital, ratio of costs to gross margin, etc.

The QFC is most likely to use its own analysis from commercial databases to review royalty rates, inter-company charges and interest rates.

It should be recognised that slight differences between companies can be adjusted for. However, it is unlikely that significant differences can be taken into account in a meaningful manner.

8 – 11120 Range and Number of Comparable Results

Calculating an arm's length price is not an exact science in the same way that pricing between independents is rarely predicated on exact science. While it is possible on occasion to fix an exact price, in the vast majority of cases any transfer pricing model will produce a range of possible results.

Many transfer pricing analyses will involve comparing either the gross margins, or more likely, the net margins of a number of comparable companies. If the results of the tested party fall within an acceptable comparable range, no adjustment should be made. If the results of the tested party fall outside an acceptable range, adjustments should be made to replace the actual conditions with the arm's length conditions.

There is no set number of comparables that is necessary. The number will depend on the particular facts of the case under consideration. From the outset the task is to look for closely comparable companies and to construct a model based on those companies.

The focus should be on establishing which companies chosen are truly comparable. It does not matter if only one company is found to be carrying on virtually the same activities as the company, dealing in the same type of products, in similar quantities, in the same type of market. A range of results from two good comparables is much better than a range encompassing two good and twelve questionable comparables.

8 – 11140 Use of the Data and Deciding Where the Transfer Price Should be Set

A transfer pricing analysis will invariably produce a number of comparable companies and the results are usually summarised as an interquartile range.

The interquartile range, discarding the results of the bottom quarter and top quarter of the results in order to refine the data by removing the outlying result, is commonly used.

The median is the mid-point of the interquartile range and will generally produce a different result to the average of the range being considered.

The reliability of the comparability analysis should be taken into account in deciding where, in a range, the transfer price should be set. If all companies in the range are considered highly comparable, it could be argued that any point in the range satisfies the arm's length principle.

However, if comparability defects remain, the use of measures of central tendency such as the median, mean or weighted average etc. may be useful in deciding where to set the transfer price. In all cases, selecting the appropriate measure of central tendency maximises the likelihood that the adjusted price falls within the true arm's length range.

Inevitably, judgement and common sense need to be exercised to determine the arm's length results.

PART 9 GENERAL PARTNERSHIPS AND LIMITED PARTNERSHIPS

9 – 1000+ Introduction to QFC Partnerships (GP, LP and LLP)

Various types of partnership entities may be formed under QFC law, or may obtain a QFC Licence as a branch of a partnership formed outside the QFC, including partnerships formed under the (non-QFC) law of Qatar.

The taxation of partnerships within the QFC is a difficult area. Problems arise both from general considerations of partnership taxation, particularly international aspects, and the fact there is no personal income tax within the QFC or generally in Qatar.

A widely accepted definition of a partnership is *'the relationship which subsists between persons carrying on a business in common with a view of profit.'*

The partners or members of a partnership may be individual or corporate or a mixture of both.

Under QFC law only a Limited Liability Partnership (LLP) (see Part 10 below) has a separate legal personality. This means for a General Partnership (GP) or a Limited Partnership (LP), remuneration paid to partners (in their capacity as partners) is, strictly, a profit share. As QFC tax is essentially a tax on business profits GP's and LP's would be disadvantaged over other forms of business entity, such as an LLC, if no deduction for partners' remuneration were allowed in arriving at taxable profits.

In the absence of a personal income tax both in the QFC and in Qatar it would be incongruous to tax partnership profits on individual members so the approach is to treat, for QFC tax purposes, all partnerships as taxable entities. This is achieved by including within the definition of 'QFC Entity' (the charge to tax is on all QFC Entities –Article 9) all partnerships holding a QFC Licence.

The overall approach to the problem of partners' remuneration is to allow, for tax purposes, remuneration up to a maximum of 50% of the chargeable profits (before partners' remuneration) for any accounting period (Articles 62(4) and 65(1) and see QTM9-3020 and QTM10-1020). Significant difficulties have been experienced in determining the partners to which this disallowance should apply.

9 – 1020 Overseas Issues

Because the partnership is itself the taxable entity, residency questions not determined by the place of incorporation of a partnership will turn on the place of effective management of the partnership (see QTM9-2000).

The fact that the QFC tax charge is on the partnership means problems related to mixed residency partnerships, where some members are resident in Qatar and others are not, are minimised as the members residency status is irrelevant in determining partnership liability.

A QFC licence may be granted to partnerships formed outside the QFC. Such partnerships may be formed in Qatar or abroad. All non-QFC Partnerships are required to register with the Companies Registration Office (CRO) as a branch in order to obtain a QFC Licence (Article 45(1) of the QFC LLP Regulations 2005 and Article 75(1) of the QFC Partnership Regulations 2007). All QFC LLPs and LPs must also register with the CRO and although registration of GPs is not mandatory (Article 36 of the QFC Partnership Regulations 2007) in practice it is understood a QFC licence will not be issued unless an applicant entity is registered with the CRO.

Although, for tax purposes, all partnerships are treated as if they had legal personality, it is thought that foreign tax authorities will regard all QFC partnerships as fiscally transparent (see QTM9-2020). It is not thought that QFC partnerships, including LLPs, have the characteristics of a company and this should result in any non-resident members, where appropriate, obtaining double tax relief in their home jurisdiction for the QFC tax paid on their share of profits as they arise, as opposed to when they are distributed or remitted. Article 62(1), which attributes tax paid by the partnership to the members in accordance with their profit share is intended to support such treatment.

9 – 1040 Approach to Taxation

The approach to partnership taxation within the QFC is to tax the partnership, as opposed to the partners, on profits arising. The rules for computing chargeable profits generally apply to partnerships just as they do for any other QFC Entity. The charge is thus on local source accounting profits as adjusted by specific tax rules. As for other non-resident QFC Entities, a non-resident partnership is taxed on the local source profits attributable to a permanent establishment of the (partnership) entity in Qatar. The only 'special' partnership rules relate to members' remuneration (see QTM9-3000+).

9 – 1060 Recognition of Income

The majority of partnerships established in the QFC have licences to carry on some form of advisory/consultancy business, and the QFC Entity is generally structured as a branch of an overseas partnership. For services the source rules in the QFC look at where the services are performed. Where a QFC partnership provides services to Qatar based clients, and all the work is carried on in Qatar, the accounting treatment and the source rules will generally match. However difficulties arise where Qatar based employees work overseas, and overseas employees work in Qatar. A number of partnerships have configured their accounting systems to record income based on an employee's home base and not where the work was carried out. This may be a convenient arrangement for a global accounting system but is not in accordance with QFC Tax Regulations. Firms should be advised to make an adjustment in their tax returns, backing out overseas work and including work carried on in Qatar by overseas employees.

It is not however the intention to require adjustments to be made where any differences identified above are likely to be small. The QFC Local Source Income Guide [September 2010] already states that "Where a QFC Entity performs services partly in Qatar and partly abroad, an apportionment of profits may be necessary. We will take a common sense approach to such apportionments. For example, where a law firm acts for a client in Qatar but makes a single trip to Dubai for say, a court hearing the profit arising from the services performed for that client will be regarded as having a Qatari source." A similar piece of work carried on in Qatar on behalf of the partnership by an overseas employee could also be ignored for the purposes of QFC taxation. The difficulty is determining what is 'small'. Unfortunately every case will be different and will ultimately have to be assessed on the particular set of facts.

9 - 1080 Types of Partnerships

QFC Law provides for the establishment and registration of three different types of partnership – a general partnership (GP), a limited partnership (LP) and a limited liability partnership (LLP) (QTM10-1000+). General and limited partnerships (QTM9-3000+) are governed by the QFC Partnership Regulations 2007 (QFC Regulation No. 13) and limited liability partnerships are subject to the QFC Limited Liability Partnerships Regulations 2005 (QFC Regulation No. 7).

9 – 1100 Branches of non QFC Partnerships

To obtain a QFC Licence a partnership need not have been formed under QFC law but may be a branch of a partnership incorporated or otherwise established outside the QFC.

Article 61 states that Part 9 of the QFC Tax Regulations relates to GPs and LPs established or registered under the Partnerships Regulations 2007. Therefore the restriction on partners' remuneration under Article 62(4) applies both to QFC established GPs and LPs and to branches of non-QFC GPs and LPs which are registered in the QFC under the Partnership Regulations 2007. A QFC branch of a non-QFC GP or LP is required to register with the CRO under Article 75 & 76 of the Partnership regulations 2007.

Similarly, Article 64 states that Part 10 of the QFC Tax Regulations relates to LLPs established or registered under the LLP Regulations 2005. Therefore the restriction on members' remuneration under Article 65 applies both to QFC established LLPs and to branches of non-QFC LLPs which are registered in the QFC under the LLP Regulations 2005. A QFC branch of a non-QFC LLP is required to register with the CRO under Article 45 & 46 of the LLP Regulations 2005.

Partnerships formed under (non-QFC) Qatari Law are broadly similar in form to the QFC GP or LP but there would appear to be no equivalent to an LLP. The governing law is the Commercial Companies Law (Law No.5 of the year 2002). A Partnership Company formed under Articles 19-43 is broadly equivalent to a QFC GP whereas a Joint Partnership Company (Articles 44-51) and a Limited Share Partnership Company (Articles 206 -224) are both broadly equivalent to a QFC LP.

9 – 1120 Joint Venture Partnerships

QFC Law does not provide for any special joint venture company. Joint venture arrangements may take several forms and unless a separate legal entity is established the results will be reflected in the accounts of the parties to the venture. Where a separate entity is established for the venture this may take the form of a partnership or a company. The tax treatment will be the same as for any other company or partnership.

Qatari company law provides for a Joint Venture Company (Articles 52 -60 of the Qatar Commercial Companies law). This is an unincorporated Entity without legal persona and if such an entity obtained a QFC licence it would be regarded as a general partnership.

9 – 2000+ Factors Affecting All Partnerships

9 – 2000 Residence

As the QFC tax charge is levied on the partnership, rather than individual partners, it is the residency of the partnership itself that is important. Article 8(a) provides that any partnership incorporated under the QFC Partnership Regulations or LLP Regulations is, by definition, resident in Qatar. For other partnerships the residency status will, by virtue of Article 8(b) turn on the place of effective management. Broadly, this means that QFC partnerships will all be resident in Qatar but only those non-QFC partnerships which have their place of effective management in Qatar will be so resident.

See QTM2-2060 for a detailed discussion of the meaning of 'place of effective management.' In essence, the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. In deciding the location of the place of effective management of a firm with both Qatari and overseas partners, you should usually regard as significant such factors as the comparative seniority of the partners in age and experience (a simple head count will not be appropriate), the extent of their interests in the firm, the source and control of the finance, the places of decision on policy and major transactions, the places and locations of partners' meetings and what was done at those meetings. The place of meetings incidentally is not a conclusive factor any more than it is for companies. The nature of the business done at the meeting is important.

Where a partnership is found to be non-resident then the chargeable profits will be those attributable to a Permanent Establishment (PE) of the partnership, in Qatar. The approach to determining whether a PE exists and the profits to be attributed to a PE are fully discussed at QTM2-4000+.

9 – 2020 Double Taxation Relief

Members of a QFC partnership may not be tax resident in Qatar. The question may thus arise regarding the members' entitlement to relief from double taxation in their jurisdiction of residence. Such relief may be given under the terms of a double tax agreement or unilaterally. In this context, from the member's perspective, it may be important how the foreign tax authority view the relevant partnership within the QFC. In essence the foreign tax authority is likely to consider whether the QFC partnership is fiscally transparent (analogous to a partnership) and the member may be regarded as having been taxed on business profits or fiscally opaque (analogous to a company) and the member should be regarded as having received, and been taxed on, a dividend.

In approaching this issue the foreign tax authority will look for indicators as to whether the QFC partnership carries on the business itself or whether the members do so jointly; and whether the profits accrue directly to the members or whether they accrue to the QFC partnership which then distributes them to the members. These conclusions should help the foreign tax authority decide whether the members of the QFC partnership are carrying on business solely or in partnership and, if so, whether the income is immediately derived by the member from the carrying on of that business.

Whether or not tax is borne by the partnership or the partners, under the QFC Regulations it is attributed to the partners in accordance with their profit shares (Article 62(1)). This provision should assist individual non-resident partners obtain double tax relief from their home jurisdiction in respect of tax, levied by that jurisdiction, on their profits from the partnership within the QFC.

Complications may arise in the case of dual residence partnerships but it is perhaps unlikely that a QFC partnership would be regarded as resident outside of Qatar or a partnership formed under the laws of a foreign jurisdiction be regarded as resident in Qatar. These instructions may have to be expanded if, in practice, problems arise from dual residency or other international issues, such as a foreign tax authority regarding some QFC partnerships as being fiscally opaque.

9 – 2040 Tax Return

Because a partnership is a taxable person, it has to make a tax return in its own right (Article 110(1)). The return must show how the partnership profit is split between the partners/members (Article 110(2)) and that division is binding, should the partners become liable to pay tax. In practice this will be shown in supporting papers submitted with the return. Where a QFC Entity is itself a member of a partnership its self-assessment return must include a statement of the entity's share of the partnership profit or loss (Article 110(3)). Such a share will however only be taxed/relieved once (Article 110(4)).

9 – 2060 Payment of Tax

Within the QFC tax is chargeable on, and payable by, a partnership as opposed to the partners being liable on their share of the profits. However, in the case of general and limited partnerships if tax is outstanding for more than six months it may be collected from the partners in the same proportion as their profit share (Article 62(2)). The partnership remains jointly liable for the debt with each partner (Article 62(3)).

In the case of a GP or LP, whether or not tax is borne by the partnership or the partners themselves it is attributed to the partners in accordance with their profit shares (Article 62(1)). This provision should assist individual non-resident partners obtain double tax relief from their home jurisdiction in respect of tax, levied by that jurisdiction, on their profits from the partnership within the QFC (see QTM9-2020).

In this context a partner remains personally liable for a tax debt incurred while he/she was a partner, even after he/she ceases to be a member of the partnership.

The specific tax rules in relation to partnerships should be regarded as overriding, in respect of tax debts, the provision in the Partnership Regulations (Articles 24 and 42) that makes a general partner jointly and severally liable for all of the partnership debts and other liabilities.

9 – 3000+ General Partnerships and Limited Partnerships

9 – 3000 Overview

The QFC Partnership Regulations provide for the establishment and registration of general partnerships (GPs) and limited partnerships (LPs) within the QFC. A LP is a partnership comprising of at least one general partner and at least one limited partner, whereas a GP is defined as any QFC partnership which is not an LP or an LLP.

General Partnerships (GPs)

GPs are comprised of general partners only, each of whom has unlimited liability and is personally liable, jointly and severally with the other partners for the whole amount of any partnership debts or other partnership liabilities incurred while he/she is a partner. However, the QFC Tax Regulations modify, in an important manner, the application of joint and several liability with respect to tax debts – see QTM9-2060 above.

Traditionally, GPs were favoured by smaller businesses and the professions. However some very substantial businesses have retained their partnership structure and many professional firms now operate through LLPs due to the limited liability of members such vehicles offer.

A GP need not be established by way of a written agreement, although it will be very unusual for a QFC partnership not to have a written partnership agreement. In the absence of a partnership agreement the QFC Partnership Regulations provide default rules, which also apply where a written agreement is not comprehensive.

Limited Partnerships (LPs)

LPs comprise at least one limited partner and one general partner. Limited partners are not liable for any partnership debts or other partnership liabilities but do stand to lose their capital contribution. Limited partners may not take part in the management of the partnership business or affairs (Article 38 of the Partnership Regulations).

Article 39 of the Partnership Regulations sets out the specific ‘permitted activities’ that limited partners are allowed to engage in. The permitted activities include activities such as variation of the partnership agreement, deciding whether to veto a class of investment, taking part in a decision about whether the general nature of the partnership agreement should change etc. Permitted activities do not include partaking in the day to day management of the partnership business. If a limited partner breaches the rules with regard to management or permitted activities, he/she loses his/her limited liability protection (Article 41 of the Partnership Regulations).

General partners are allowed to manage the partnership and are potentially fully responsible for partnership debts and other liabilities (see QTM9-2060 regarding tax debts). The general partner will often be corporate so the liability is effectively limited to that of the capital contribution of the corporate (general) partner.

The partners in a GP or LP need not be individuals and may be corporate, or a mixture of both. A general partnership or limited partnership cannot itself be a partner in another partnership because of the lack of legal personality of a GP or LP.

As noted above, although GPs need not have a written partnership agreement (although they normally will), an LP must submit a written partnership agreement to the Companies Registration Office on registration. The partnership agreement will set out various governance matters of the partnership including how profits are to be shared, how capital is to be contributed, how accounting records are to be maintained, etc. Where the partnership agreement is not comprehensive, the Partnership Regulations contain "*Default Rules*." For example, if the partnership agreement does not specify how profits and losses are to be shared, the Default Rule in Article 16 of the Partnership Regulations provides that the partners are entitled to share any partnership profits, and are liable to bear any partnership losses, in equal proportions. You should follow this convention in attributing taxable profits to individual partners in the absence of a partnership agreement.

You should always obtain a copy of any GP or LP partnership agreement, which should be retained in the partnership file as a permanent note.

9 – 3020 Partners' Remuneration

The introductory section at QTM9-1020 discusses the problem, in general terms, of partnership remuneration. The overarching QFC taxation policy objective is to tax the profits of a QFC Entity on a similar basis, no matter what type of legal entity the business is conducted through. In order to achieve this objective it follows that a reasonable amount of partner's remuneration (if a partner is working in the business) should be deducted in arriving at the taxable profits of a GP or LP so that the tax charge is equal to what it would have been had the business been conducted through, for example, an LLC where director's remuneration is deductible in arriving at taxable profits. Article 62 restricts the maximum deduction in respect of partner's remuneration to 50% of the chargeable profits, before the deduction of any partners' remuneration, and the amount must also be considered just and reasonable by the Tax Department. A common sense approach should be taken in arriving at the amount of partners' remuneration to be deducted in arriving at taxable profits. The 50% is a maximum deduction and where that maximum is claimed the facts should be reviewed critically to ensure the amount claimed is reasonable. Inevitably there is a high degree of subjectivity in arriving at a reasonable deduction for remuneration and you should challenge the position by way of enquiry only where there are prima facie grounds for considering the deduction claimed is excessive. You should accept, subject to the 50% cap, a deduction for remuneration that is commensurate with the duties undertaken and at the rate payable on an arm's length basis by comparable employers.

It should be noted Article 17(2) of the Partnership Regulations contains a default rule to the effect that if the written partnership agreement contains no provision for partner's remuneration, there is by default no entitlement for remuneration for acting in the partnership business. As we are allowing the deduction of a profit share to achieve equitable treatment it should not be argued the deduction for tax purposes should be restricted to what is provided for in the partnership agreement and, in the absence of such an agreement, give no deduction following the default rule of Article 17(2) of the QFC Partnership Regulations.

The provisions of Article 62(4) also apply to 'disguised partners' and the impact of this on the body of partners to who the disallowance is discussed in QTM9-3060 below.

The 50% restriction also applies to branches of GPs and LPs (see QTM9-1100).

9 – 3040 Types of Partner

The 50% restriction in Article 62 and Article 65 applies to remuneration paid to partners/members who are considered to be "full" or "equity" partners (or who display all the characteristics of an equity partner) and who are therefore entitled to share in the profits and losses of the partnership. The restriction is not intended to apply to remuneration paid to partners who are "salaried" partners. For these purposes it is necessary to distinguish between various categories of partner.

Full/Equity partner

A full or equity partner is a person who shares in the profits, losses, management and risk of the partnership fully. A partner in an LLP is referred to as a 'member' and in most respects a member will enjoy the same status as a full/equity partner and will be treated as such. Profits earned by the partnership are allocated between the partners in a manner as decided by the partners. The profit sharing basis is often set out in the partnership or member's agreement. There are many ways in which profit can be allocated between partners and the relevant agreement should be requested if further information is required. For example, there is often an agreement whereby the residual profits are to be allocated based on certain pre-determined percentages however there will first be a prior allocation of profit which might represent:

- a notional salary for each working day
- a notional amount of interest in relation to the working capital provided
- a reward for performance above certain targets and
- a reward for risk

It should be noted that the salary allocation is "notional" only and represents an allocation of the partnership's profit. It does not mean that the partner is an employee and paid a salary.

The 50% restriction in Article 62 and Article 65 applies to remuneration paid to "full" or "equity" partners.

Limited partner

The status of a limited partner is governed by the Partnership Regulations 2007. A limited partner has limited liability provided they act in accordance with Article 38 of Partnership Regulations 2007. A limited Partner must not take part in the management of the partnership business or affairs. If a limited partner carries out activities beyond those permitted then they may prejudice their limited liability protection. For the purposes of Article 62 a limited partner is treated in the same way as an equity partner and therefore subject to the 50% restriction where relevant.

General partner

A general partner is a person who is a partner in a Limited Partnership but not a Limited partner. A general partner therefore has unlimited liability. For the purposes of Article 62 a general partner is treated in the same way as an equity partner and therefore subject to the 50% restriction where relevant.

Salaried Partner

The term 'salaried partner' is often used interchangeably with the term 'fixed share' partner (see below). A salaried partner may be a partner who is 'held out' as a partner to the general public but who is, in reality, treated as an employee of the partnership and paid a salary. Remuneration paid to employees of partnerships is not caught by the restriction in Article 62 or 65 therefore the restriction will not apply to partners who are true salaried partners. It may sometimes be hard to determine the status of a partner as a salaried partner.

Regardless of title, the correct status of a partner (whether salaried or full equity) is a question of fact. It will depend on the terms, conditions and arrangements under which a partner or member undertakes their activities. There are several factors which are often used to distinguish between a full/equity partner and an employee. The presence or absence of one or more of these factors is not determinative in deciding whether a person is a partner or not. For example, it is not unusual in recent times for employees to have a remuneration which is determined in some way by reference to a firm's profits, this does not necessarily make them a full equity partner.

The definition of a full equity partner is someone who would typically participate in some or all of the following:

- share in profits and losses of the partnership
- be a party to the partnership agreement
- participate in the management of the business
- subscribe capital to the partnership

The issues involved in deciding whether a person is a full/equity partner or an employee are complex and a detailed review of the position is not covered here however several cases which may provide further information include two UK cases, *Horner v Hasted (1995) 67 TC 439*, and *Mr M Tiffin v Lester Aldridge LLP (2011)*. Reference should also be made to QTM9-3060 which considers disguised partners and the factors which could undermine a claim that a partner is salaried and not equity.

Fixed share Partner

Certain partnerships may have partners who only have a fixed share of profit, for example an annual QR 500,000 share of the partnership's profits. The term "fixed share partner" is often used interchangeably with "salaried partner" and therefore the position of the person should be considered very carefully. In determining a person's status, and therefore the applicability or not of Article 62/65, it is necessary to consider all of the rights and responsibilities attaching to that person's position within the partnership.

9 – 3060 Disguised Partners and Members

The restriction on the deductibility of remuneration paid to Partners of GPs and LPs (QTM9-3020) and to Members of LLPs (QTM10-1020) also includes Disguised Partners

(Article 62(5)) and Disguised Members (Article 65(3)). A Disguised Partner is a Person who performs services for a GP and LP partnership and receives remuneration, and a Disguised Member is a person who performs services for an LLP and receives remuneration (Article 153).

The intention behind the original Partnership provisions enacted in 2010 was to bring the taxation treatment of Partnerships closer to that of LLC's by allowing a deduction for the remuneration of partners working in the partnership business, but applying a cap on the deduction to reflect that part of any payments reflected a distribution of the profits of the partnership. Whilst the provisions were meant to be permissive, to ensure partnerships obtained a tax deduction for expenses they might not otherwise be entitled to, the experience of the Tax Department to date is that in practice the deductions being claimed by partnerships did not always reflect the spirit of the law.

The definition of 'disguised' partner or member is therefore deliberately very wide and could be interpreted as including all employees. Whilst it is certainly not the intention to apply a disallowance to the remuneration of genuine employees it is the intention to apply a disallowance to a wider group of partners than was previously possible. The target group remains those partners who are sharing in the profits of the partnerships rather than those who are effectively salaried partners, with an entitlement to a bonus based on performance. QTM9-3040 considers the tax treatment of remuneration paid to different categories of partners. However the analysis is not simply to define a partners status according to the categories below but to use the 'disguised partner' definition, together with the requirement for any remuneration to be 'just and reasonable' to address some of the more difficult areas of abuse, and in particular:

- Partnership agreements dressed up as employment agreements,
- Temporary change of status during period in Qatar,
- Excessive remuneration in Qatar, particularly where a large part of remuneration is based on profits of worldwide partnership,
- Service contracts from related entities.

There may of course be circumstances where elements of the above are reasonable, for example the permanent retirement of an individual from a partnership who then takes up employment in Qatar. As always each case must be reviewed on its particular circumstances and fact pattern.

PART 10 LIMITED LIABILITY PARTNERSHIPS

10 – 1000+ Introduction

A limited liability partnership (LLP) formed under the QFC LLP Regulations is a corporate entity with a legal personality separate from that of its members (Articles 6 and 7 of the QFC LLP Regulations). Although a QFC LLP has legal personality and is a corporate entity for the purposes of QFC Law it is considered likely that it will be regarded as fiscally transparent by foreign tax jurisdictions in relation to double tax relief. This is because a QFC LLP, despite its legal personality and corporate status, still retains the key characteristics of a partnership. It consists of members carrying on a business in common with a view to profit, the members all acting as agents of the partnership (Article 13 of the QFC LLP Regulations) and entitled to a profit share as profits arise (Article 18 of the LLP Regulations) rather than a profit distribution by way of a dividend or analogous payment.

An LLP is similar to a general partnership but the liability of a member of an LLP for the LLP's debts is restricted to their capital contribution unless they are negligent in relation to the work carried out for a client.

10 – 1020 Members' Remuneration

Because an LLP has a separate legal personality from its members it is possible for the members to be paid remuneration in respect of acting in the business or management of an LLP. It should be noted that Article 18 of the LLP Regulations prohibits any remuneration being paid to members unless this is specifically provided for in the partnership agreement.

Article 65(1) limits the deduction in respect to remuneration paid to members, for any accounting period, to 50% of the (pre-remuneration) chargeable profits for that accounting period.

Because of the capacity for an LLP to pay remuneration to its members you should resist an argument a profit share should be attributed to members in the absence of any actual payment of remuneration. You should apply the same considerations as for GP's and LP's when considering if remuneration paid to a member of an LLP is excessive (See QTM9-3020).

The provisions of Article 65(1) also apply to 'disguised members', and the impact of this is discussed at QTM9-3060 above.

The 50% restriction also applies to branches of LLPs (see QTM9-1100).

PART 11 ISLAMIC FINANCE

11 – 1000+ Islamic Finance – General

11 – 1000 Introduction

Part 11 of the Regulations covers the taxation of Islamic Financial Institutions (IFIs) and Islamic finance transactions. One of the policies of the QFC is to support the development of Islamic financial services in Qatar. In support of this policy, the overarching aim of the QFC tax regime is to ensure that the tax treatment of IFIs and Islamic finance transactions is not less advantageous than that of conventional alternatives. This is achieved by making a tax adjustment available for IFIs and Islamic finance transactions, when certain conditions are satisfied, and also by allowing a deduction for funding costs in the case of IFIs.

Islamic finance is governed by Islamic law (Shari'a), and its practical application through the development of Islamic economics. The most distinguishing features of Islamic finance are; (1) interest, or the payment of fees for the use of money (riba) is prohibited, (2) a fundamental belief in the sharing of profit and risk (mudarabah) and (3) investing in businesses that provide certain goods or services (e.g. gambling, pork, alcohol) is forbidden (haraam).

Many traditional or conventional financial institutions (e.g. Citigroup and HSBC) are now offering Islamic finance products and Islamic banking services via 'Islamic windows'. Such firms are required to comply with Shari'a with respect to their Islamic finance business which will often mean ensuring complete segregation of funds (between Islamic and non-Islamic business) and the appointment of a Shari'a supervisory board.

11 – 1020 Differences between Islamic Accounting and Conventional Accounting

The fundamental differences between Islamic and conventional financing result in significant differences between Islamic and conventional accounting. Conventional accounting is focused on the identification, recording, classification, interpreting and communication of economic events to stakeholders, to permit users to make informed decisions. Islamic accounting is based on providing information (not necessarily limited to financial data) to stakeholders of an entity which will enable them to ensure that the entity is continuously operating within the bounds of Shari'a, and delivering on its socio-economic objectives. The accounts of an IFI are likely to differ significantly from those of a firm using conventional accounting. For example, it is possible that in addition to the profit and loss statement, balance sheet and cash flow statement, the accounts for an IFI will also include a value-added statement, disclosures about the social performance activities of the firm, and detailed accounts for its zakat fund, qard (interest-free loans) and charitable contributions.

Zakat is payable on genuinely owned productive surplus assets that have been possessed for a full year. For the purposes of zakat, assets are valued at the selling price at the time the zakat is due. The zakat valuation is therefore parallel to the concept of continuously contemporary accounting (CoCoA), or current cash equivalent. The rules for zakat are inconsistent with GAAP and problems arise with the valuation of inventories, the valuation of accounts receivable and the concept of conservatism. For zakat, inventories should be valued at selling price, not the lower of cost or net realisable value. Zakat does not permit a general bad debt reserve, or provision for doubtful debts. Given two possible valuations of an asset, whereas the Anglo-American accountant would choose the lower, a Muslim accountant would be careful not to understate assets or overstate liabilities as paying zakat is a most important religious duty.

11 – 1040 Unique features of Islamic accounting

There will be differences between the accounts of an IFI and that of a conventional entity based on the fact that Shari'a prohibits interest and practices that use the prediction of the future. The following are forbidden in Islamic financing:

- The use of interest-bearing bonds and preference shares
- The use of interest in leasing transactions, notes receivable and notes payable
- The use of the net present value and other such 'predictions' are likely to be disallowed
- Hedging against currency fluctuations.

Any money lent in Islam will be either purely to help another person, foregoing any notion of profit, or on the basis of sharing in any profit or loss incurred by the borrower.

Islam treats money and commodities differently. Since money has no intrinsic value, but is only a medium of exchange, monetary exchanges must be at par. Any excess in a spot transaction is without consideration and is not allowed in Shari'a. Any excess in a credit transaction, where money is exchanged for money, will be against nothing but time and is also not allowed. Commodities however have intrinsic utility and the owner is at liberty to sell them at whatever price he/she wants.

11 – 2000+ Financial Models in Islamic Finance

11 – 2000 Overview

The modern beginnings of Islamic finance were based on conventional banking products. However, over the years Islamic finance has expanded and diversified to include a wide range of different products and services which are alternatives to their traditional financing counterparts, including insurance and private equity. The form of these Islamic alternatives varies slightly from country to country, but there are some common basic models. In order to understand how IFIs and Islamic finance transactions may produce different profits or losses to their conventional finance alternatives, it is useful to have an understanding of the most common Islamic financial models. These models are outlined in the following sections and are broadly based on two financing methods. The first is dependent on profit-and-loss sharing and includes mudarabah and musharakah. In the profit-and-loss sharing models the return is not fixed in advance and is dependent on the ultimate outcome of the business. The second type of model is trade based and involves the sale of goods and services on credit and leads to the indebtedness of the party purchasing those goods. This type of financing includes murabahah, ijarah, salam and istisna. The return to the financier in these modes is a part of the price. Islamic bonds (sukuk*)* are generally based on one of the two basic models, or a combination of the two.

Further Islamic Finance models can be found in Part 13 of this guidance relating to Takaful Insurance businesses (see QTM13-2000+).

11 – 2020 Profit-and Loss Sharing Mudarabah

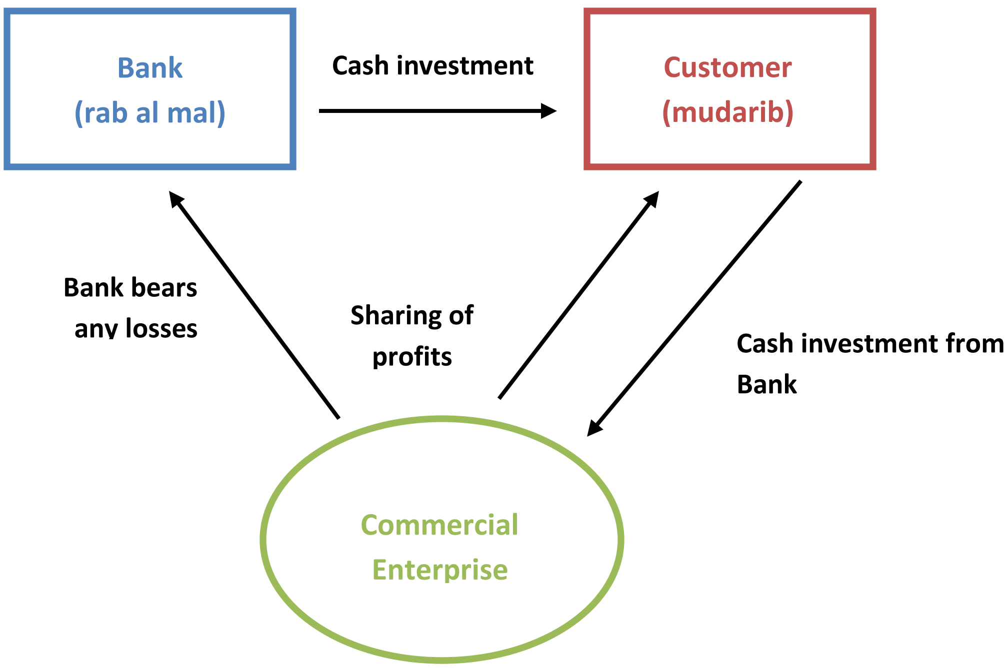
Mudarabah is a special type of investment partnership arrangement whereby one party (the investor 'rab al mal'), provides capital to another party (the 'mudarib', the investment manager or entrepreneur) in order to undertake a business or investment activity. The investment comes from the rab al mal, and the mudarib invests the funds in a project or portfolio in exchange for a pre-agreed profit share. Losses are born solely by the rab al mal, but the mudarib loses the opportunity cost of his labour, which failed to generate any income for him. The mudarib cannot suffer a financial loss as he/she did not make a capital investment to the enterprise and the mudarib cannot claim any periodical salary, fee or remuneration for the work done by him for the mudarabah

The rab al mal has no right to participate in the management of the mudarabah. A mudarabah is similar to a diversified pool of assets held in a discretionary asset management portfolio.

The rab al mal may specify a particular business for the mudarib (restricted mudarabah or al mudarabah al muqayyadah). Alternatively the rab al mal may leave it open for the mudarib to undertake whatever business he/she wishes (unrestricted mudarabah or al mudarabah al mutlaqah).

As a method of finance offered by Islamic banks, on the liabilities side, depositors serve as the rab al mal and the bank as the mudarib. Mudarabah deposits can be general (al mudarabah al mutlaqah), entering a common pool, or restricted to a certain project or line of business (al mudarabah al muqayyadah). On the assets side the bank serves as the rab al mal and the entrepreneur as the mudarib. The mudarib is often allowed to mix the mudarabah capital with his own funds. In this case profit may be distributed in accordance with the agreed ratio, but any loss must be borne in proportion to the capital provided by each of them.

An example of a mudarabah on the assets side:

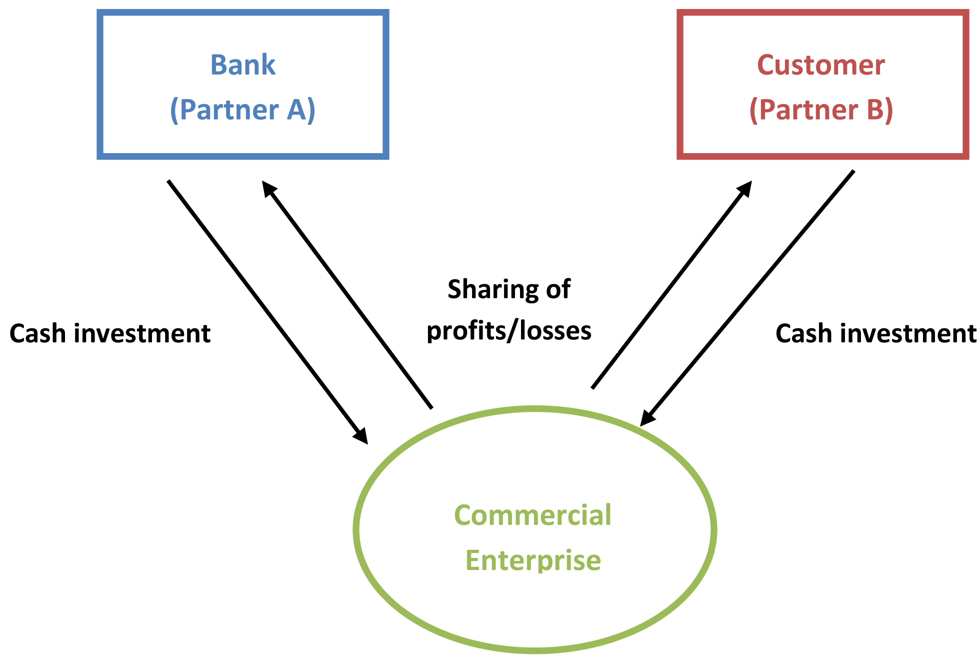


11 – 2040 Profit-and Loss Sharing Musharakah

Musharakah comes from the Arabic word 'shirkah' which means 'sharing'. Musharakah is a contractual arrangement between two or more parties through a mutual contract, who contribute capital to a joint enterprise or venture and divide the net profit and loss pro-rata. The partners may contribute funds, not necessarily equally, and the contributions may be used to buy equal units representing currency and called shares. The assets of musharakah are jointly owned in proportion to the contribution of each partner.

Musharakah is often used for investment projects, letters of credit and the purchase of real estate or property. All providers of capital are entitled to participate in the management of the business, but are not necessarily required to do so.

Profit can be divisible unequally and need not be in proportion to the capital invested. The profit of a non-working or sleeping partner cannot exceed the ratio their investment bears to the total capital. However, in the case of loss, each partner suffers the loss exactly according to the ratio of his investment.



Another form of musharakah is diminishing musharakah. In this type of arrangement the bank/financier and the customer participate either in the joint ownership of a property or an equipment, or in a joint commercial enterprise. The share of the financier is further divided into a number of units, and the customer purchases the units of the financier's share at an agreed price and according to an agreed schedule until all the units of the financier are purchased by him, so as to make him the sole owner of the property or commercial enterprise. Diminishing musharakah is used mostly in house financing.

11 – 2060 Combination of Musharakah and Mudarabah

Under a mudarabah contract the mudarib (investment manager or entrepreneur) does not normally invest any money, which all comes from the rab al mal (IFI). However, the mudarib may want to invest some of his own money in the commercial enterprise. In these circumstances mudarabah and musharakah may be combined.

For example suppose an IFI invested QR10m in a project and the entrepreneur (mudarib) adds QR5m from his own pocket, with the IFI's permission.

The mudarib may allocate for himself a certain percentage of profit on account as his investment as a sharik (partner) and another percentage for his management work as a mudarib. In the example above the normal basis for allocation would be that the mudarib would take one third of the actual profit on account of his investment, and the remaining two thirds would be allocated equally between the IFI and the mudarib. A different allocation may be agreed but the sleeping partner may not get a greater proportion than that represented by his investment. In the above example that means the IFI cannot receive more than two thirds of the total profit as he/she has invested two thirds of the total capital.

11 – 2080 Musharakah and Mudarabah in Project Financing

Musharakah or mudarabah (or a combination of both) can be easily adopted in the context of project funding. If the IFI is financing the whole project, a mudarabah arrangement will be appropriate. If investment comes from both sides, the form of musharakah combined with mudarabah can be adopted. If the IFI wants to withdraw from the project whilst the other party wishes to continue, the manager or entrepreneur can buy the IFI's share at an agreed price. The IFI will get back his investment plus a profit (if the venture has been profitable).

The manager or entrepreneur can continue with the project, either on his own, or by selling the IFI's share to another financier. Some IFI's do not want to remain a partner in a project throughout its whole life and so will sell their share to the other project partners, as above. If liquidity prevents the sale all at one time, the IFI's share can be divided into units and each unit sold at intervals.

11 – 2100 Other Uses of Musharakah and Mudarabah

Musharakah and mudarabah can also be used to finance single transactions, fulfilling the day to day needs of small traders as well as financing imports and exports via letters of credit. Musharakah may also be used to finance the working capital of a business; IFI's often opening a running account for business customers.

11 – 2120 Securitisation of Musharakah

Musharakah can be securitised, especially in the case of large projects. Each subscriber may be given a musharakah certificate representing his proportionate ownership of the assets. Once the project has started and has acquired substantial non-liquid assets, the musharakah certificates can be treated as negotiable instruments and can be traded on the secondary market. However, such trading is not allowed when the assets of the musharakah are in liquid form (the excess above par of a musharakah certificate where the assets are liquid would be riba). There is some difference of opinion amongst Shari'a scholars regarding the trading of musharakah certificates when the assets are a mixture of liquid and non-liquid. Most scholars say trading is allowed if the value of the non-liquid assets represents more than 50% of the value of the total assets.

11 – 3000+ Trade Based Islamic Financial Models

11 – 3000 Murabaha (Cost plus)

'Murabaha' is a term of Islamic Fiqh (jurisprudence) and refers to a particular kind of sale where a seller agrees with a purchaser to provide a specific asset at a certain profit added to his cost. The basic characteristic of a murabaha transaction is that the seller discloses his actual cost in acquiring the asset, and then adds some profit. The profit may be a lump sum or a percentage of cost. All the expenses incurred by the seller in acquiring the asset, like freight, customs duty etc., are included in the cost and murabaha is only valid when the exact cost can be ascertained. Payment may be at spot, or over a period of time.

IFI's have added some concepts to the basic meaning of murabaha in developing it as a means of financing. Murabaha is not a loan with interest; it is the sale of an asset for a deferred price which includes an agreed profit added to the cost. Murabaha may only be used to finance the actual purchase of specific assets, and not for other purposes, such as paying for assets already acquired or to fund general running costs. The IFI must have owned the asset before selling it to a customer. According to Shari'a it is best if the IFI purchases the asset and keeps in his own possession (or purchase through a third person appointed as his agent) before sale to the customer. However it is permissible for the IFI to make the customer his agent for the purchase so that his possession of the asset is initially as trustee, with ownership vesting in the IFI, with full ownership to the customer being transferred later. Although the sale cannot take place until the asset is in the possession of the seller, the IFI can promise to sell before the asset is in his possession.

The stages of a typical murabaha between an Islamic bank and a customer are as follows:

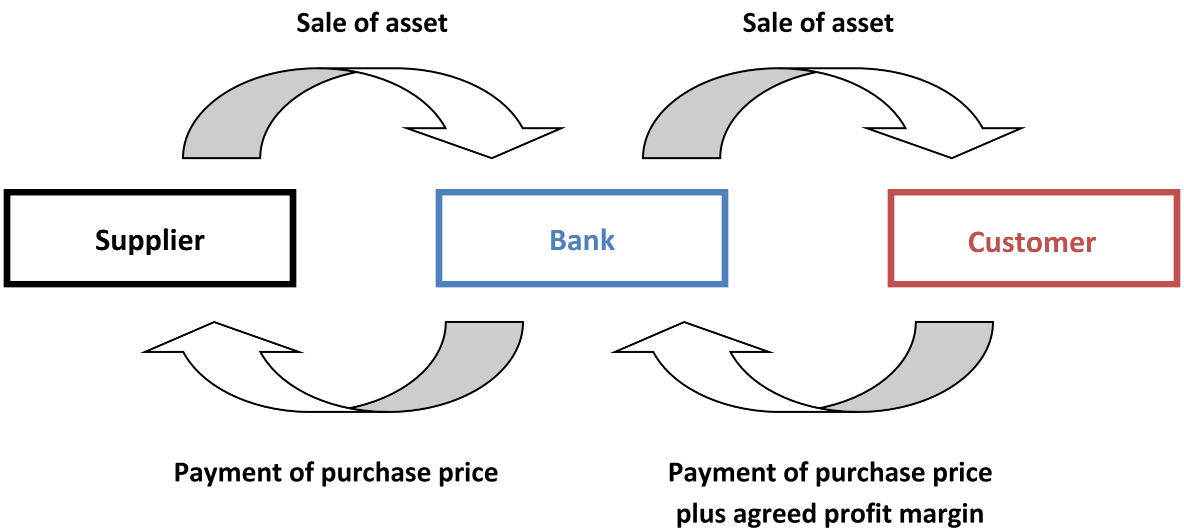
- The IFI and the customer sign an overall agreement whereby the institution promises to sell and the customer promises to buy the assets, payment being over an agreed period with an agreed profit ratio added to the cost. The agreement may specify the limit up to which the facility may be availed.

- When a specific asset is required by the customer, the IFI appoints him as his agent for purchasing the asset on its behalf, and an agency agreement is signed by both parties.

- The customer purchases the asset on behalf of the IFI and takes possession as agent of the IFI.

- The customer informs the IFI he/she has purchased the asset on the IFI's behalf, and at the same time makes an offer to purchase it from the IFI.

- The IFI accepts the offer and the sale is concluded whereby the ownership of the asset is transferred to the customer.



A murabaha arrangement is normally comprised of three separate agreements – a promise to buy (see below), an agency contract and the actual murabaha agreement.

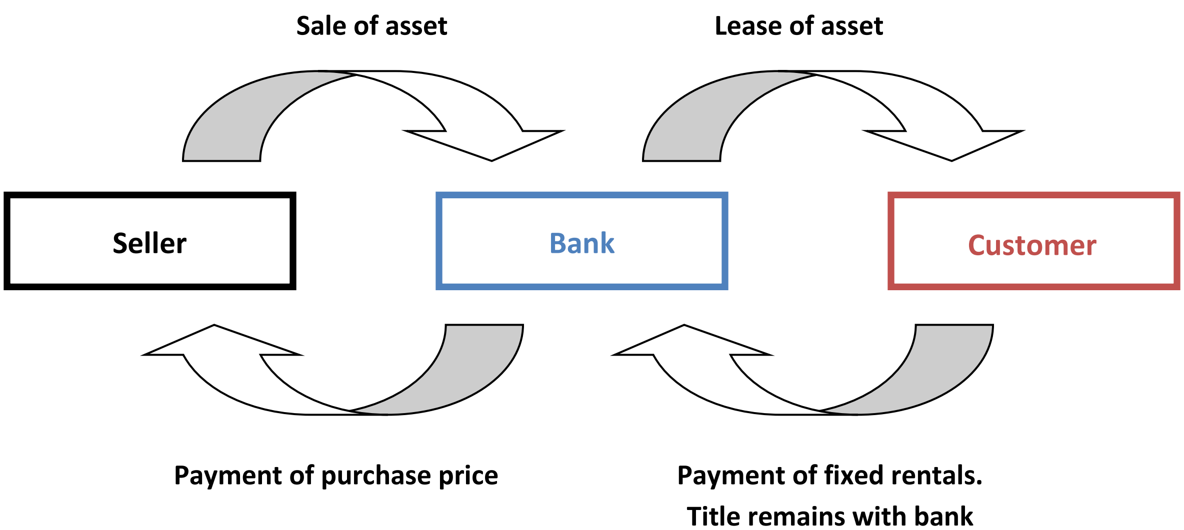
For murabaha to be valid the asset must be purchased from a third party – the purchase of the asset from the customer under a buy-back agreement is not permitted. The IFI may ask the customer to furnish a security for the prompt payment of the deferred price. The security can include the sold asset itself. The IFI may also ask the customer to sign a bill of exchange or promissory note, but only after the sale to the customer has taken place as it is only then that the debtor/creditor relationship is established. If the customer defaults, the price cannot be increased but the agreement may provide for a payment to be made to the IFI for charitable purposes. The IFI is bound to spend such payments for charitable purposes, on behalf of the buyer. The IFI may also ask the customer for a guarantee from a third party. Murabaha arrangements cannot be 'rolled-over' and no rebate may be given for early repayment, although the IFI may, at its own option forego some part of the price without making it a pre-condition in the agreement. Murabaha transactions cannot be securitised for creating a negotiable instrument to be purchased and sold in a secondary market, although a mixed portfolio consisting of a number of transactions like musharakah, leasing and murabaha may issue negotiable certificates subject to certain conditions.

The potential problem of a customer refusing to purchase an asset acquired by the IFI is circumvented by the IFI asking the customer to sign a promise to purchase the asset when it is acquired by the IFI. This is a unilateral promise from the customer, not a bilateral contract of forward sale. This promise may be enforced, according to Shari'a, by the courts of law.

In practice many IFI's financing by way of murabaha determine their profit or mark up using LIBOR plus as a benchmark.

11 – 3020 Ijara (Leases)

Ijara means to give something on rent. In the context of Islamic finance 'ijara' relates to the usufructs (right to use) of assets and property. Ijara means to transfer usufruct in exchange for a rent and is analogous to 'leasing'. Ijara is used both as a form of investment and financing.



An Ijara agreement with an IFI is similar to a finance lease with a conventional bank but, to be Shari'a compliant, there are differences. An ijara agreement must differ substantially from an interest bearing loan – substituting 'rent' for 'interest' and 'leased asset' for 'mortgage' is not enough. The necessary differences between contemporary financial leasing and leasing allowed under Shari'a are indicated below.

Although a forward sale is not allowed under Shari'a, ijara can be effected for a future date, so long as the rent does not become payable before the asset is delivered to the lessee. Under a finance lease the lessee normally purchases the asset on behalf of the lessor who pays the supplier directly or via the lessee. In some finance leases, the lease commences when the price is paid by the lessor, irrespective of whether or not the lessee has effected payment to the supplier and taken delivery of the asset. Consequently, rent under a conventional finance lease may become due before the lessee takes delivery of the asset. This is not allowed under Shari'a where rent should not be paid before the asset is delivered.

To comply with Shari'a the lessor must pay all the expenses incurred in purchasing the asset including, if relevant, importation costs. These expenses may, of course, be taken into account when fixing the rentals, but any agreement, as is found in conventional finance leases, that the lessee should bear such costs will not conform to Shari'a.

In contrast to a conventional finance lease, the lessee under ijara cannot be made responsible for a loss caused by factors beyond his control. Under Shari'a there cannot be a penalty for the late payment of rent, but the lessee may be asked to undertake that if he/she fails to pay the rent on time he/she will pay a certain amount to a charitable fund maintained by the lessor.

Some other clauses in conventional finance leases, such as the lessor having an unfettered right to terminate the lease or the balance of rent being payable on termination, even termination by the lessor, are not found in ijara. Insurance of the asset should, under ijara, be at the expense of the lessor, not the lessee, as in a conventional finance lease.

A conventional finance lease normally provides, explicitly or implicitly, for ownership of the asset to be transferred to the lessee at the end of the lease for a zero or nominal sum, provided all rent has been paid. This condition is not in accordance with Shari'a as under Shari'a one transaction cannot be tied up with another transaction so as to make one the precondition for the other. However the lessor may sign a separate unilateral promise to gift or sell the asset to the lessee at the end of the lease. This arrangement is called ijara wa iqtina and is widely used by IFI's. The promise must be unilateral and recorded in a separate document.

The lessor may sub-lease the asset with the lessor's permission, but there are different views whether, if the sub-leasing is at a profit, the profit may be retained or must be donated to charity. The Lessor may sell the property but may not assign the lease whilst maintaining ownership of the property. The ability for the lessor to sell the asset means there is good potential for the securitisation of ijara. An ijarah certificate will represent the holder's proportionate ownership of the leased asset and he/she will assume the rights and obligations of the owner/lessor to that extent. Ijara certificates can be traded and negotiated freely in the market and can serve as an instrument readily convertible into cash. Ijara certificates may help the liquidity management problems faced by IFI's. It should be noted that the ijara certificates must represent real ownership of the assets and not merely the right to receive rent.

11 – 3040 Parallel Salam

Salam is a sale where the seller undertakes to supply specific goods at a future date for an advanced price, fully paid at spot. Salam arose to meet the need of small farmers who needed money to grow crops and feed their family up to the time of harvest. Salam is an exception to the general rule which prohibits forward sales, and is therefore subject to some strict Shari'a conditions. The price must be paid in full when the sale is effected. Salam can be effected in commodities only where the quality and quantity can be specified exactly and cannot be effected on a particular commodity or on the product of a particular field or farm (eg wheat from a particular field). The quality and quantity of the commodity along with the exact date and place of delivery must be clearly specified.

In the context of IFI's the problem with Salam is that the IFI will receive delivery of the commodity. There is a view that IFI's will have to develop special cells for dealing in commodities, but there are two other ways of dealing with this issue.

After purchasing a commodity by way of Salam, the IFI may sell it through a parallel contract of Salam for the same date of delivery. The price in the second transaction is likely to be higher because the period is shorter, the difference between the two prices being the profit earned by the bank. This approach will enable IFI's to manage their short term financing portfolios. If a parallel contract is not feasible an IFI may obtain a promise to purchase from a third party, the promise being unilateral from the expected buyer. Being merely a promise the buyers will not have to pay the price in advance and therefore a higher price may be fixed and as soon as the commodity is received by the IFI it will be sold to the third party at a pre-agreed price, according to the terms of the promise.

For parallel Salam to be valid the two contracts must be independent and not tied up so that the rights and obligations of one are in any way dependent on the rights and obligations of the other. Parallel Salam is only allowed with a third party. The seller in the first contract cannot be the buyer in the second contract or it will be a buy-back contract which is not permissible in Shari'a.

11 – 3060 Istisna

Istisna is another kind of sale where a commodity is transacted before it exists. However istisna is connected with manufacturing, rather than agriculture and it means to order a manufacturer to produce a specific commodity, using his own materials, for the buyer. The price must be fixed by agreement and the commodity to be manufactured must be fully specified. The contract may be cancelled by either party before the manufacturer starts work, but it may not be cancelled unilaterally once work has commenced. It is not essential for the date of delivery to be specified, but the purchaser may fix a maximum time for delivery, which means if the manufacturer delays, the buyer is not bound to accept the goods and pay the price. An istisna contract may contain a penalty clause in the case of delay, usually calculated on a daily basis.

Istisna may be used by IFI's to provide financing and is widely used in the housing sector. If a customer has land, his financier may undertake to construct a house on the land on the basis of Istisna, and if he/she needs also to purchase land, the financier may undertake to build a house on a specified plot. As it is not necessary in istisna for the price to be paid in advance, or at the time of delivery, the time of payment may be fixed in whatever manner the parties wish, including instalment arrangements. Also, it is not necessary the financier constructs the house himself but he/she can enter into a parallel contract of istisna with a third party or may hire the services of a contractor (not the client). If payment is by instalments, the financier may retain the title deeds as security.

Istisna may be used for project financing, for example for the building of a bridge or highway. Modern BOT (Buy, Operate and Transfer) agreements may also be formalised on the basis of istisna.

11 – 3080 Sukuk (Islamic bonds)

Sukuk is the plural of the Arabic 'Sakk' which means 'legal instrument, deed, cheque'. Sukuk are financial certificates and are the Islamic equivalent of conventional bonds. Sukuk grant the investor a share of an asset along with the cash flows and risk commensurate with such ownership. Unlike with conventional bonds, sukuk are fixed-income securities that do not bear interest. While a conventional bond is a promise to repay a loan, sukuk constitute partial ownership in either a debt (Sukuk Murabaha), an asset (Sukuk Al Ijara), a project (Sukuk Al Istisna), a business (Sukuk Al Musharakah), or an investment (Sukuk Al Istithmar). A more diversified form of the sukuk has also emerged called the hybrid or mixed asset sukuk. In a hybrid sukuk, the underlying pool of assets can comprise of istisna, murabaha receivables as well as ijara. Having a portfolio of assets comprising of different classes allows for a greater mobilisation of funds.

Sukuk holders claim an undivided beneficial ownership in the underlying assets. As a consequence of this, sukuk holders are entitled to share in the revenues generated by the sukuk assets, as well as being entitled to share in the proceeds of the realisation of the sukuk assets.

Sukuk representing tangible assets or proportionate ownership of a business or investment portfolio are tradable on the secondary market (i.e. sukuk of ijara or musharakah/mudarabah). Sukuk representing receivables of cash or goods are non-tradable (i.e. sukuk of salam or murabaha).

Sukuk are amongst the best ways of financing large enterprises that are beyond the ability of a single party to finance and also provide an ideal means for investors wishing to deploy streams of capital which may be liquidated by trading on the secondary market. Sukuk also represent an excellent way for managing the liquidity of IFI's and are a means for the equitable distribution of wealth.

The standard form of sukuk involves a Special Purpose Vehicle acquiring an asset either from or on behalf of a company. The company then leases the asset from the SPV, making periodical rent payments (Sukuk Al Ijara). The SPV is funded by investors acquiring participation certificates, the Sukuk, in the SPV. The investor then receives over time his share of the profits of the SPV.

The SPV may be a Special Purpose Company registered with the QFC, established specifically for the project. The Tax Regulations include provisions for the establishment of tax exempt SPVs in support of such transactions (see Article 70).

To make sukuk competitive with conventional bonds many sukuk issues are endowed with the same characteristics as conventional bonds. Generally sukuk represent ownership shares in assets whereas conventional bonds document interest bearing debt. There has been a proliferation of sukuk issues based on a mix of ijarah, istisna and murabaha contracts undertaken by IFI's that are packaged and sold to customers who hope to obtain a return from these operations. The inclusion of murabahah contracts into such sukuk, however, brings into question the issue of the sale of debt which is prohibited by Shari'a. Most sukuk issues distribute profits at a fixed percentage based on LIBOR. Any excess is paid to the manager as a reward for effective management and the manager promises to meet any shortfall as an interest free loan to the holders, the loan being recovered by the manager from profits in excess of the interest rate in subsequent periods or from lowering the cost of repurchasing the assets when the sukuk are redeemed. Also, virtually all sukuk guarantee the return of principal at maturity. This is achieved by a binding promise from the issuer or manager to repurchase the sukuk assets at the price they were originally purchased by the sukuk holders, regardless of their market value at redemption.

11 – 3100 Qard Hassan (Good loan)

Qard Hassan is a loan that is extended on a goodwill basis, where the debtor is only required to repay the amount borrowed (i.e. no added interest). The debtor may, however, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without making a promise to do so), as a token of appreciation to the creditor.

11 – 3120 Wakalah (Agency)

Wakalah is a deposit product in which the profit is derived from a specific investment. This deposit product is based on the Shari'a principle of Wakalah and refers to a contract between two parties, i.e. the owner of the capital (Muwakil) and the Bank (Wakil). The investor, who is the owner of the capital, places a specified sum of money with the Bank, which acts as the Wakil in investing the funds in specific investment activities of the Bank with the objective of making profits. The profits from the venture are shared between the customer and the Wakil in agreed proportions. Wakalah is widely seen in Takaful.

11 – 4000+ Governance and Accounting Standards

11 – 4000 The Islamic Financial Services Board (IFSB)

The IFSB is based in Kuala Lumpur and serves as an international standard-setting body of regulatory and supervisory agencies that have vested interest in ensuring the soundness and stability of the Islamic financial services industry, which is defined broadly to include banking, capital markets and insurance. In advancing this mission, the IFSB promotes the development of a prudent and transparent Islamic financial services industry through introducing new, or adapting existing international standards consistent with Shari'a principles, and recommend them for adoption.

As at 1 January 2014, the IFSB had issued 15 standards, 5 guidance notes and one technical note.

To this end, the work of the IFSB complements that of the Basel Committee on Banking Supervision, International Organisation of Securities Commissions and the International Association of Insurance Supervisors.

The QFCRA is an associate member of the IFSB.

11 – 4020 Accounting and Auditing Organisation for Islamic Financial Institutions

(AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Shari'a standards for Islamic financial institutions and the Islamic financing and banking industry. Professional qualification programs (notably CIPA, the Shari'a Adviser and Auditor "CSAA", and the corporate compliance program) are presented now by AAOIFI in its efforts to enhance the industry's human resources base and governance structures.

AAOIFI was established in accordance with the Agreement of Association which was signed by Islamic financial institutions on 26 February, 1990 in Algiers. It was registered on 27 March, 1991 in the State of Bahrain.

As an independent international organisation, AAOIFI is supported by institutional members (200 members from 40 countries, so far) including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide.

AAOIFI has gained assuring support for the implementation of its standards, which are now adopted in the Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan and Syria. The relevant authorities in Australia, Indonesia, Malaysia, Pakistan, Kingdom of Saudi Arabia, and South Africa have issued guidelines that are based on AAOIFI's standards and pronouncements.

As at January 2014 AAOIFI had issued 88 Shari'a, accounting, governance and ethics standard for IFIs.

AAOIFI develops alternative Islamic standards when:

(a) The equivalent IFRS cannot be adopted in whole by the IFIs (e.g. Ijara standard vs IAS 17)
(b) The IASB has no IFRS to cover the specific Islamic banking and finance practices (e.g. Mudarabah, Musharakah, Salam and Istisna).

When certain IFRS can be adopted, then either AAOIFI does not develop a standard, or it develops and adapts the relevant IFRS.

11 – 4040 The QFCRA

General Rulebook (GENE) requires QFC IFI's to prepare and maintain all financial accounts and statements in accordance with the accounting standards of AAOIFI (GENE 9.3.2) and requires QFC Authorised Firms which operate an Islamic window to prepare and maintain financial accounts and statements, in respect of its Islamic financial business, in accordance with AAOIFI FAS 18 (Gene 9.3.3). FAS 18 requires disclosure in respect of co-mingling of funds and disclosure regarding the sources and application of funds.

The Islamic Finance Rulebook (ISFI) imposes further requirements on QFC IFI's and Authorised Firms operating an Islamic window. All such firms must have an appropriate endorsement on their QFC licence (ISFI 2) and comply with additional specific requirements applicable to Islamic funds. These specific requirements are that a Shari'a supervisory board must be appointed that complies with certain minimum requirements, there must be systems and controls to ensure the business to be operated in accordance with Shari's is so operated and that there is an internal review process to ensure the firm complies with the fatwas and rulings of the Shari'a board (ISFI 6). In addition there are specific regulatory requirements regarding disclosure (ISFI 3) and capital requirements (PIIB 3).

Article 15(2)(b) allows QFC entities to submit, for tax purposes, accounts prepared in accordance with standards issued by AAOIFI.

11 – 5000+ Islamic Finance & Taxation

11 – 5000 General Taxation Issues

Because Islamic Finance transactions are structured differently from conventional transactions, there will be differences in the reported results. One of the main differences will arise from the absence of interest from Islamic transactions, a profit share often being substituted for interest. If no special measures were in put in place in the QFC tax regime, then tax issues may have been a serious disincentive for the promotion and development of Islamic finance in the QFC and Qatar. For example if an Islamic bank distributes profit on its borrowings, rather than paying interest, the unavailability of a tax deduction for profit distribution would make the Islamic bank unable to compete 'on a level playing field' with a conventional bank which will get a tax deduction on interest paid in respect of its borrowings.

Some jurisdictions, notably the Malaysia and the UK, have introduced specific legislation the purpose of which is to ensure Shari'a compliant products are taxed in a way that is neither more nor less advantageous than equivalent banking products.

11 – 5020 The QFC approach

The aim of Part 11 of the QFC Tax Regulations is to ensure that an Islamic Financial Institution (IFI), or a QFC Entity entering into an Islamic finance transaction with an IFI, is not at a tax disadvantage. However, to support the QFC's broader aim of promoting Islamic Finance in the QFC and Qatar any tax advantage an IFI (or a QFC Entity entering into an Islamic finance transaction with an IFI) may secure is not cancelled.

A principles based approach has been adopted, rather than attempting to draw up a set of detailed rules aimed at creating tax equalisation for the different types of Islamic finance models described at QTM11-2000+. It is believed this principles based approach to the taxation of Islamic finance is unique.

The Regulations contain provisions regarding the taxation of IFI's themselves (Article 67) the funding costs of an IFI (Article 68) and transactions by a QFC Entity with an IFI (Article

69). In addition, an SPV established to support or facilitate an Islamic financial transaction may elect for special exempt status (Article 70). All of these Articles are discussed in further detail below.

11 – 5040 Article 67 – Taxation of IFIs

The chargeable profits of an Islamic financial institution (IFI) are to be computed in the same manner as a conventional financial institution (Article 67(1)).

An IFI is defined as an Authorised firm whose entire business operations are conducted in accordance with Shari'a and a conventional financial institution is defined as any other financial institution (Article 140). A 'financial institution' is defined by the QFC Interpretation and Application Rulebook (INAP) as a 'regulated or unregulated entity, whose activities are primarily financial in nature'.

An IFI may, if the conditions detailed below are met, claim for any accounting period a 'tax adjustment'. The tax adjustment reduces chargeable profits or increases the tax loss for the accounting period of claim to the figure that would have been returned had either (a) the accounts been prepared under IFRS or (b) the transaction(s) had been structured as a conventional finance transaction(s). A tax adjustment may create a loss.

A conventional finance transaction is defined as any transaction that is not an Islamic finance transaction, which in turn is defined as a financial transaction conducted in accordance with Shari'a (Article 140).

The conditions to be fulfilled for an IFI to claim a tax adjustment are that (a) the profit returned based on the accounts prepared under AAOIFI is materially higher (in the case of a loss, the loss is materially smaller) than would have been the case had the return been based on accounts prepared under IFRS (Article 67(4)); or (b) the chargeable profit/allowable loss arising from a Islamic finance transaction (or series of transactions) is materially higher/lower than would have been the case had the transaction(s) been structured as a conventional finance transaction (Article 67(4)(b)).

'Material' in this context means more than 5% (Article 67(5)).

The onus is on the taxpayer to show that the conditions for making a claim are met, and also to quantify the amount of the tax adjustment due.

When examining a claim under Article 67 you should not get too involved in detail and keep in mind the broad overall aim of the legislation. However, if you are not satisfied the claim is accurate an enquiry should be opened to challenge the position.

The provisions of Article 67 may be regarded as applying to a conventional financial institution operating an Islamic window, as if its Islamic finance business were being carried on by a separate Islamic finance institution.

Where, as may often be the case, a tax adjustment is claimed that arises from a timing difference, the adjustment may be clawed back when the timing difference is reversed (Article 67(7)). Where an adjustment is made for a timing difference a prominent forward note should be made on the taxpayers file so that the claw back is not overlooked.

See QTM11-5080 for the interaction between Articles 67 and 68 (funding costs of an IFI).

Example

Company A an IFI prepares accounts under AAOIFI and for the year ended 31 December 2012 showed an accounting profit of QR 1.5M. Had the accounts been prepared under IFRS the accounting profit would have been QR 1.2M as a bad debt provision of QR 300k would be included in the IFRS accounts. The provision is made up of QR 180k specific bad debts and QR 120 general bad debts.

	AAOIFI QR'000	IFRS QR'000	Difference
Accounting Profit	1,500	1,200	20%
Tax Adjustment – General bad debts disallowed	-	120	
Chargeable Profit	1,500	1,320	12%

The accounting profit is 20% higher in Company A and the Chargeable Profits 12% higher. Article 67 will therefore apply and a tax adjustment can be claimed to reduce the Chargeable Profits from QR 1.5M to QR 1.32M.

11 – 5060 Article 68 - Funding costs of IFIs

Banks and other financial institutions like any other business require capital to support their activities, for example to acquire premises. Such capital might be raised as equity capital by issuing ordinary shares or as loan capital by the issue of bonds.

Banks trade in money, rather than goods in return for money. As a result, as well as needing funds for capital purposes, they rely on access to funds in the form of money as an integral part of their trading activities. Banks do, of course, also offer fee-earning services such as merger and acquisition services, but at its simplest they make a profit by borrowing money at interest from third parties and lending it to others at higher rates of interest. That money comes both from investors and customers who place funds with the banks.

To protect the interests of customers, banks are subject to regulatory standards designed to make sure they have a solid base of capital available at all times to meet their customers' demands. That capital requirement needs to be sufficient to act as a buffer against future, unidentified, even quite improbable losses, while still leaving a bank room to recover or to organise an orderly winding down of its business.

The level and type of capital of banks (and certain other financial institutions) is, therefore, prescribed in a way that the capital of other concerns is not. In practice, banks normally hold capital in excess of that required by the regulator. Banks aim to maximise their profits by conducting the maximum amount of lending and dealing business that is possible without infringing the capital adequacy requirement they have been set. This means that they cannot borrow every Riyal they use in their business; they must have a certain amount of regulatory capital. Part of that amount, which will be at least equal to and normally in excess of the minimum amount of equity capital required by the regulator, is 'free' to the bank, since the bank is not paying interest to borrow it. The bank's profit on this proportion of its capital will be much higher than its usual margin between the return on lending and its costs of borrowing. Therefore, the amount of the bank's regulatory capital, particularly equity capital, has a direct effect on the profits it makes.

Because of the Shari'a prohibition of the payment of interest Islamic banks and other IFI's will be funded differently from conventional banks. An Islamic IFI is likely to be funded by a mix of equity, customer deposits and inter-bank lending (on the Islamic inter-bank money market), just as any other bank. However, instead of paying interest to customers and on customer deposits and money market lending, the bank will pay a profit share under a murabaha, mudarabah, wakalah or similar type of arrangement.

11 – 5080 Article 68 - Tax Adjustment

Article 68 seeks to equalise the tax treatment of IFI's and conventional financial institutions with respect to funding costs. The approach is to determine the deduction that would be allowable for funding costs if the IFI were a conventional financial institution. That amount is then compared with the IFI's actual tax allowable funding cost and where the notional conventional funding costs are greater, a deduction, in arriving at chargeable profits is given for the difference.

The equalisation deduction is called the ‘equivalent funding amount’ (Article 68(1)). The actual tax allowable funding costs of the IFI is called the ‘actual funding amount’ (Article 68(3)). The equivalent funding amount is then defined as the difference between the funding costs that would be tax deductible if the IFI were a conventional financial institution and the actual funding amount (Article 68(2)). ‘Funding costs’ are defined as the cost of servicing debt obligations, excluding capital repayments (Article 68(4)).

In arriving at the ‘equivalent funding amount’ the arm’s length transfer pricing principles of Part 8 are specifically applied (Article 68(5)).

One of the key issues will be determining what level of ‘free capital’ should be notionally attributed to the IFI in arriving at the equivalent funding amount. In this context the approach to be taken is analogous to arriving at the free capital to be attributed to a bank’s PE under the OECD authorised approach (see QTM8-4000+, and in particular QTM8-5020).

Article 68 may be applied to a conventional financial institution operating an Islamic window. Where a QFC Entity is operating an Islamic window, they are obliged to segregate funds between their Islamic and non-Islamic business.

For many IFI’s there will be a potential deduction under both Articles 67 and 68. There can be no double allowance, and the general approach is for funding costs to be considered first and then if there is still an excess profit, or a timing difference, this may be dealt with under Article 67. It should be noted that the deduction does not have to be claimed, but is an entitlement (Article 68(1)). The tax computations of an IFI should therefore include whatever Article 68 deduction is considered by the IFI to be appropriate. When examining a return which includes an Article 67 deduction you should not get too involved in detail and keep in mind the broad overall aim of the legislation. However, if you are not satisfied the deduction is accurate an enquiry should be opened to challenge the position.

Example

Company A an IFI prepares accounts under AAOIFI and for the year ended 31 December 2012 showed an accounting profit of QR 1.5M. The Bank is funded by an QR 8M loan from various sources and the “actual funding amount” paid and included in the AAOIFI financial statements amounts to QR 100,000.

A Transfer Pricing Study has been completed and it shows that the arm’s length interest rate for conventional banks who are funded in a similar way is 2%. Conventional banks would therefore be entitled to a higher funding charge that is allowed under AAOIFI.

Company A can make a claim under Article 68 and claim a tax deduction for the equivalent funding amount of QR 60,000 being the difference between the funding amount allowed for conventional banks (QR 160,000) and the actual funding amount (QR 100,000).

Company A will therefore be taxed on profits of QR 1.44M not QR 1.5M.

11 – 5100 Article 69 – Taxation of Islamic Finance Transactions

Article 69 covers the situation where a QFC Entity enters an 'Islamic financial transaction' with an IFI. An Islamic financial transaction is defined as a financial transaction conducted in accordance with Shari'a (Article 140). Article 69 is most likely to come into effect when a QFC Entity that is not an IFI enters a transaction of the type described at QTM11-2000+ with an IFI. It may also apply to IFI to IFI transactions but any tax adjustments as a result of such transactions are more likely to be dealt with under Articles 67 and/or 68.

If a QFC Entity can show that their liability to QFC tax is accelerated or, over the period of the transaction, is greater than would have been the case if the transaction had been conventionally structured, their liability to tax may be adjusted to equalise the position.

An adjustment under Article 69 has to be claimed by the QFC Entity and the adjustment is made in terms of tax (an adjustment to the self-assessment) not in terms of profit. The onus is on the taxpayer to satisfy the Tax Department an adjustment is due.

The adjustment is not restricted to a single accounting period and can be given in respect of timing as well as quantum. For example if a QFC Entity shows that by entering an Islamic financial transaction it would pay (but for Article 69) an amount of tax QR X in accounting period (AP) 1 which, had the transaction been conventional, would have been evenly spread over accounting periods 1-5, then Article 69 will operate to reduce the tax liability in AP 1 by QR (4/5 x X) but the self-assessment for each of the AP's 2-5 will need to be increased by QR (1/5 x X).

If the tax liability over the period of the Islamic financial transaction is greater than would have been the case had the transaction been conventional then the self-assessment may be reduced so that the liability is the same as it would have been if the transaction had been conventional. For example if a QFC Entity enters an Islamic financial transaction that lasts less than a complete AP and if the transaction had been conventional, QR X less tax would have been payable (but for Article 69), the self-assessment may be reduced by QR X.

If there is a combination of more tax being paid and a timing difference, then the adjustments should be made accordingly. For example suppose a QFC Entity shows that by entering an Islamic financial transaction it would pay (but for Article 69) an amount of tax QR X in accounting period (AP) 1 but, had the transaction been conventional, it would have paid QR Y (where Y is less than X) evenly spread over accounting periods 1-5. The adjustment required to equalise the Islamic/conventional liability will be to reduce the self-assessment for AP 1 by QR (X- Y/5) and to increase the liability for AP's 2-5 by QR (Y/5).

When examining a claim under Article 70 you should not get too involved in detail and keep in mind the broad overall aim of the legislation. However, if you are not satisfied the claim is accurate an enquiry should be opened to challenge the position.

The Director of Tax must approve any claim under Article 69(2) and a permanent record of all claims made, the decision on the claim and the approval of that decision by the Director of Tax should be recorded in an establishment file maintained for that purpose. Any appeal (see below) against a decision, with a note of the eventual outcome of the appeal should also be recorded in the Establishment file. (Master File).

Effect is given to a claim under Article 69 by adjusting the self-assessment for the relevant accounting period. A taxpayer may appeal against the Tax Departments refusal to accept a taxpayers claim, or to accept it in full by either appealing against the notice of an amendment to a self-assessment made as a result of the claim, or appealing against the closure notice at the end of an enquiry into the claim.

You should make a prominent forward note of any adjustments to be made to future liabilities as a result of a claim under Article 69.

11 – 5120 Article 70 - Islamic Finance and Special Purpose Companies

Under Article 70, any special purpose company (SPC) that is established for the purposes of supporting or facilitating and Islamic finance transaction may elect for Special Exempt Status under Part 14 of the Regulations. You are most likely to see such an SPC as part of a sukuk issue (see QTM11-3080

PART 12 PARTICIPATION EXEMPTIONS

12 – 1000+ Introduction

Part 12 of the Tax Regulations provides a participation exemption for capital gains in respect of 'qualifying shareholdings'. The basic concept behind a participation exemption is to reduce economic double taxation. Provided a QFC Entity has at least a 10% holding in a company then, generally, any gains arising on the sale of such a holding are exempt from QFC Tax. As a general rule the Participation Exemption will follow the beneficial ownership of the shares. It is rare for the beneficial ownership of shares to be different to the legal owner, however in case where this does arise the full facts of why this has arisen should be reviewed and the exemption allowed based on the facts of the case in question.

The presence of a participation exemption for capital gains is an important factor in relation to the location of choice of holding companies. Dividends are exempt by virtue of Article 150(1). A number of holding companies may also be entitled to the benefits available from Part 14 of the Tax Regulations.

12 – 1020 Qualifying Shareholding

To benefit from the participation exemption a QFC Entity must have a 'qualifying shareholding' in the company in respect of which the gain arises. A qualifying shareholding is defined by Article 72(2) as a holding meeting all of the following conditions:

- The holding by the QFC Entity is at least 10% of the ordinary share capital of the company (Article 72(2)(a));
- That 10% plus holding has been held by the QFC Entity, or another company in the same group, for at least 6 months (Article 72(2)(b)); and
- The shares have not been held on trading account (Article 72(2)(c)).

'Ordinary Share Capital' is defined by Article 153 as 'all the issued share capital of a company other than capital which only gives a right to a fixed rate dividend'

'Group' is defined by Article 34 (see QTM5-5020) and, broadly speaking, two companies are members of the same group if one is a 75% subsidiary of the other or both are 75% subsidiaries of a third company.

To qualify for the participation exemption it is not necessary that the company giving rise to the gain should be a QFC Entity. Also, when considering group holdings in relation to the six month holding condition, it is not necessary for other group members to be QFC Entities.

It will be unusual that a holding that would otherwise qualify for the exemption to fail on the grounds the shares were held on trading account (the statutory words are 'wholly or mainly with a view to resale'). This condition is only likely to be relevant to QFC Entities that are dealing in large volumes of shares as part of their day to day business. Where you consider an otherwise qualifying holding may fail solely because of this condition, the papers should be submitted to the Director of Tax for consideration. Your submission should set out all the relevant facts and also explain why you consider the company may not qualify for the exemption.

12 – 1040 Consequences of Exemption Applying

Where the conditions of Article 72 are met, the relevant dividends or gains will be automatically exempt – there is no need for the QFC Entity to make a claim for the exemption to apply, but the taxpayers return should reflect any adjustment made to the accounting profit as a result of an entitlement to a participation exemption.

Any gains arising from the disposal of a qualifying holding are exempt from QFC tax, however any losses arising from such a holding are not available for loss relief (Article 72(1)).

12 – 1060 Exemption Ceasing to Apply

As soon as a holding drops below the 10% level required by Article 72(2)(a) the QFC Entity will lose the benefit of the participation exemption. Any gains arising, in respect of the shares in question will then be within the charge to tax (subject, of course, to other provisions within the Regulations) and losses arising will, be allowable (again, subject to other provisions within the Regulations

PART 13 INSURANCE

13 – 1000+ Introduction

Part 13 of the Tax Regulations deals specifically with the taxation of insurance companies within the QFC. In broad terms, insurance companies are taxed on their accounting profit like any other QFC Entity. Captive insurance and reinsurance business can apply to be taxed at the zero concessionary rate and there are special rules for Takaful (Shari'a complaint insurance).

Part 13 covers all QFC insurers, which are defined in Article 142 by reference to the QFC Financial Services Regulations. 'Insurer' means a person carrying on the regulated activity of effecting or carrying out a contract of insurance as *principal* (Schedule 3, part 2 of the QFC Financial Services Regulations). Insurance brokers are therefore outside the scope of Part 13.

The rationale for allowing captive insurance or re-insurance to be taxed at the 0% concessionary rate is connected with the wider business aims of the QFC – if tax were levied on such entities they would most likely not locate in the QFC and so a favourable tax regime is an essential part of attracting such insurers to Qatar.

13 – 1020 Tax on Accounting Profit

Subject to some specific rules regarding provisions (see Article 77 and QTM13-1060) and cessation of business (see Article 82 and QTM13-1080) insurers are taxed on their accounting profits, as determined by accounts drawn up under acceptable GAAP and adjusted under the same rules applying to taxpayers generally.

The funded basis of accounting is not permitted (Article 75). Fund accounting is a method of accounting which emphasises accountability rather than profitability and is more commonly used by non-profit organisations.

The general trend worldwide has been to move away from the funded basis of accounting to more conventional accounting giving a "just and fair view" of the company's assets, liabilities, financial position and profit or loss. IFRS 4 applies to virtually all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds. It does not apply to other assets and liabilities of an insurer, such as financial assets and financial liabilities within the scope of IAS 39 (Financial Instruments).

13 – 1040 The Taxation of Life Insurance

Life insurance is used as a vehicle for investment as well as to provide cover in respect of a loss. A life insurance company thus holds funds on behalf of policyholders. Worldwide, the tax treatment on life insurance companies is remarkably diverse and depends, in part, whether the insurer is perceived as representing policyholders, or as a company transacting business for profit, or both.

Pure insurance is the pooling of risks and is a zero game for the insured population as a whole, after allowing for expenses, underwriting profit and interim reserving for fluctuations. If the insurance term is short the reserve build up will be small and investment earnings on reserves will not be a major factor. In these circumstances it is appropriate to tax the insurance company like a normal trading company. The charge is on the excess of total income over total expenses with an allowance for provisioning. Income includes premiums and expenses includes claims. General insurance is, broadly speaking, dealt with in this manner. Because claims are allowable to the insurer and not taxed on the policyholder, the benefits derived by policyholders from the insurer's investment activities are not taxed. As long as, overall, claims do not exceed premiums by much, this is not a problem.

However as soon as a life insurer enters the savings market to any extent the addition of investment earnings to policyholders benefits becomes significant and unless some additional tax is imposed to deal with the investment income attributable to policyholders, life insurers gain an unreasonable advantage over other savings media. Generally investors pay tax on the fruits of their investment, when the benefit arises. If the fruits of a saving medium are taxed appropriately in the investor's hands, the taxation of the institution providing the service is straightforward – it is taxed on the residual profits after the investors have been paid and reserves would be built up out of taxed profits.

There are various complicating factors that prevent a ready solution to taxing life insurance companies including:

- All the elements of risk pooling are present, as in general insurance, but the savings element is greater and often dominant, bringing life insurance into completion with other savings media and favoured tax treatment is seen as unacceptable. In practice, with many life products, disentangling the risk and investment element is very difficult

- Taxing policyholders on the benefits they receive, when they receive them is not practical when benefits are deferred until maturity or a claim is made.

- The net increase in value of a policy will be made up of different types of investment earnings (eg dividends, interest, etc.) which will not be taxed uniformly.

- A high proportion of life insurance business is associated with retirement funding instruments which are rightly untaxed in the institutions hands, but the profits made from conducting this business should still be taxed.

- The differential between the corporate and personal income tax rates can put life insurers at a significant disadvantage compared with other savings institutions.

- The corporate profit and policy holder elements are difficult to separate clearly.

- The long term nature of life insurance and the variety of actuarial valuation basis makes it very difficult to determine corporate profits.

The solutions adopted in respect of the above (and other) problems in taxing life insurance companies by tax authorities around the world have been varied and tend to be highly complex in nature.

In the context of the QFC tax regime, it was not thought beneficial to introduce complex rules. By not allowing a funded basis of accounting insurance companies will have to submit a set of accounts that reflect their profit or loss for the year. In addition investment income is to be taxed on the company as it arises (Article 75(3)). There will, of course, be no income tax on investment income of policyholders in Qatar but the taxation of investment income in the hands of the insurer, the allowance of claims (including the investment element) paid in full and the low tax rate should not put a life insurer operating in Qatar at any significant tax disadvantage over other savings institutions.

13 – 1060 Provisions

Article 76(1) allows insurers to deduct a specific provision established in respect of a present obligation arising from a past event. It follows that the outstanding claims reserve (claims made but not settled and claims incurred but not reported [IBNR]) will be allowable, subject to it being properly calculated.

Any general provisions and any claims equalisation or catastrophe reserves are not allowable for QFC tax purposes. The equalisation and catastrophe reserves are a form of profit smoothing to spread profit more evenly over time. IFRS 4 prohibits equalisation and catastrophe reserves.

13 – 1080 Cessation

Article 82 provides a special rule where an insurer ceases to effect contracts of insurance – that is ceases to write new policies. Normally a business would cease (and fall out of the charge to tax) at or about the time its selling activity ceases, or it ceases to provide services. The problem with insurers is that they will have a liability in respect of existing policies that will continue to exist until all liabilities in respect of those policies have been met. During this period, which is known in the insurance industry as ‘run-off’, all the reliefs and allowances available under the QFC Tax Regulations remain available to the insurer. For example, group relief (see QTM5-5000+) will continue to be available in respect of losses incurred during the run-off period. In practice, an insurer will often sell his run-off business to a company specialising in acquiring and managing run-off portfolios.

13 – 2000+ Takaful

13 – 2000 Introduction

Takaful is an Islamic insurance concept which is compliant with Shari’a principles. "Takaful" is derived from the Arabic word "Kafala" which means to guarantee; to help; to take care of one's needs. At its core, risk is shared collectively by a group of participants who, by paying contributions to a common fund, agree to jointly guarantee themselves against loss or damage to any one of them as defined in the pact or agreement.

Takaful is based on shared responsibility, solidarity and mutual cooperation. In particular, it is based on two main Shari’a principles: "Ta'awuni" (mutual assistance) and "Tabarru" (voluntary contribution). The basic fundamentals underlying the Takaful concept are very similar to co-operative and mutual principles, to the extent that the co-operative and mutual model is one that has been accepted under Shari'a.

For Takaful programs to be financially sound over the long term, as well as to provide incentive to Takaful insurers to develop and promulgate these programs to provide Shari'a compliant alternatives to conventional insurance, Takaful operators must, to some degree, be rewarded through profit in a more traditional sense. However profits are not the end goal of the operation.

A Shari'a Supervisory Board supervises the business activity of Takaful companies. The board is made up of recognised Islamic scholars, who ensure the company's operational model, profit distribution policies, product design and investment guidelines comply with Islamic principles. An important function of the Supervisory Board is to decide whether company's new products and operations comply with Shari'a.

It is the generally accepted view of Muslim jurists that conventional insurance does not conform to the requirements of Shari'a as it contains the following three elements:

- **Al-Gharar:** This refers to 'unknown' or 'uncertain' factors in a conventional insurance contract. In conventional insurance, it is not made known to the policyholders how profits are distributed or in what the funds are invested. In a Takaful operation which is based on the Mudharabah concept, the distribution of profits to the operators and the participants in the contract are clearly outlined.

- **Al-Maisir:** Gambling. In conventional insurance, the policyholder stands to lose all the premiums paid if the risk does not occur. On the other hand he/she stands to get more should a misfortune happen whilst paying a small amount of premium. In Takaful, if the risk does not occur, the participant is entitled to get back the contribution that he /she has paid. Should the risk occur he/she will be paid from the amount of his premium and from the pool of funds 'donated' by other participants.

- **Al-Riba:** Investment in traditional fixed income securities, and other related practices of a conventional insurance companies contravene the rules of Shari'a. In a Takaful operation there are limitations on acceptable investments (i.e. no investments in gambling, pork, alcohol, etc.). Investment in sukuk and stocks are permitted.

13 – 2020 General Characteristics of Takaful Companies

There is not one preferred model for Takaful insurers. Shari'a scholars generally agree on certain fundamental components that are required to be present in any Takaful company, however operational differences are tolerated so long as there is no contradiction to any essential Shari'a principles.

The fundamental principles of Takaful are:

- Policyholders co-operate among themselves for their common good.
- Every policyholder pays his subscriptions to help those that need assistance.
- Losses are divided and liabilities spread according to the community pooling system
- Uncertainty is eliminated in respect of subscription and compensation
- It does not derive advantage at the cost of others.

Takaful insurers have certain unique characteristics and, in addition to the establishment of a Shari'a board and the restriction on investments, these are (a) the establishment of two separate funds and (b) the solidarity/equal surplus distribution principles.

The two funds are a Takaful (or policyholders') fund and an operator's (or shareholders) fund. The Takaful fund operates under pure cooperative principles, in a very similar way to a conventional mutual insurance entity. Underwriting deficits and surpluses are accrued over time within this fund, to which the operator has no direct recourse. The Takaful fund is effectively ring-fenced and protected from default of the operator's fund. Management expenses and seed capital are borne by the operator's fund, where the main income takes the form of either a predefined management fee (to cover costs) or a share of investment returns and underwriting results (or a combination of both).

Given that the Takaful fund is seen as a pool of risks managed under solidarity principles, it is not meant to accumulate surpluses at levels excessively higher than those strictly needed to protect the fund from volatile results and to support further growth. Likewise, any fees or profit shares received by the operator should be just sufficient to cover management and capital costs while keeping the company running as a going concern. In the case of financial distress of the Takaful fund, the operator is committed to provide it with an interest free loan, Qard Hasan, for however long it is deemed necessary – providing an additional layer of financial security for the participants.

The surplus distribution structure is expected to be managed carefully and in a balanced way, so that neither policyholders nor the operator make excessive profits at the expense of the other party.

Takaful 'Windows'

Many conventional insurance and reinsurance companies, in countries as diverse as UK, Singapore, Thailand, Australia, Sri Lanka, Ghana, Niger, Lebanon, Indonesia and Brunei offer Takaful products through operating a Takaful 'window'.

13 – 2040 Regulatory Requirements

Takaful Entities and operators of Takaful windows are subject to the QFCRA Prudential Insurance Rulebook (PINS). PINS 6 contains the record keeping and other requirements specifically applicable to Takaful business, including the requirements for maintaining (and segregating) Takaful funds, loans from a Takaful fund and policies relating to the distribution of a surplus or funding a deficit in a Takaful fund. Takaful business is also subject to the QFCRA Islamic Finance Rulebook (ISFI) and in particular disclosure has to be in accordance with AAOIFI FAS 12 and the policy for the distribution of a surplus or deficit has to be in accordance with FAS 13.

13 - 2060 Taxation of Takaful Entities and 'Windows'

Article 77 provides for the taxation of Takaful within the QFC. The treatment applies to any insurer authorised under the Islamic Finance Rulebook to operate as an Islamic financial institution or conduct Islamic financial business by operating an Islamic window. Insurers falling within the Article 77(1) definition are known as Takaful entity's and the rule is that a Takaful entity shall set off the net surplus or deficit attributable to Takaful business for an accounting period against its chargeable profits for that accounting period. The effect of this provision is to exclude from chargeable profits the gain or surplus arising in respect of the policyholders fund and to charge to tax the profit (relieve the loss) arising to the operator of the fund.

13 – 3000+ Takaful Models

13 – 3000 Ta'awuni

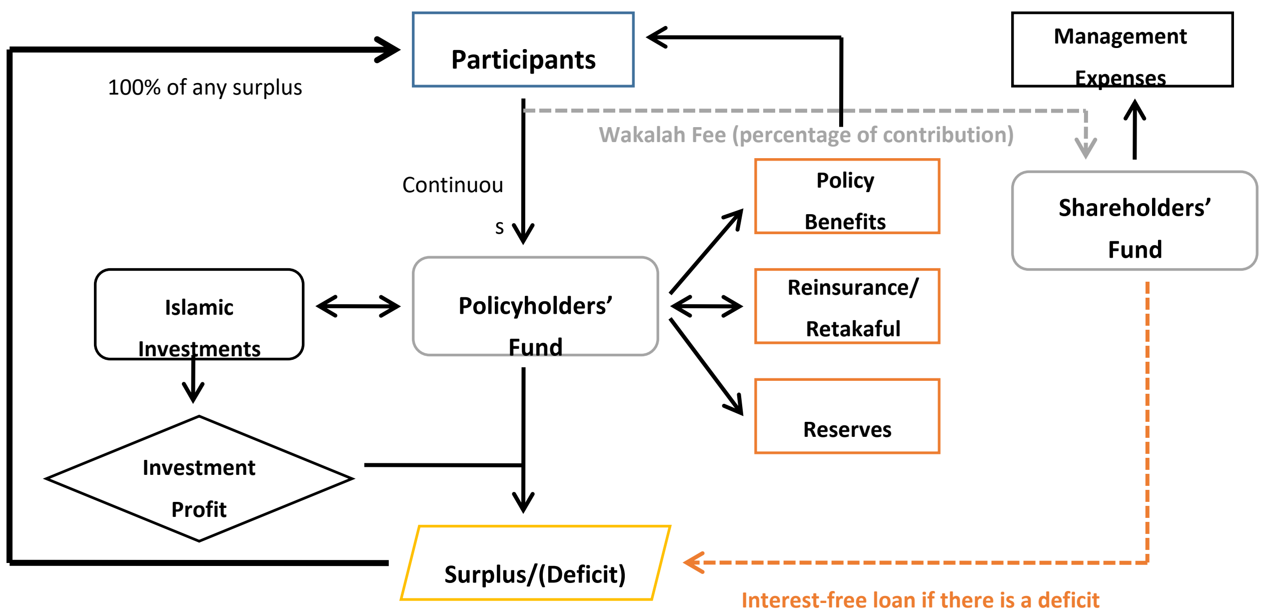
Ta'awuni (mutual assistance) practices the concept of pure Mudharabah (profit sharing) in daily transactions, where it encourages the Islamic values of brotherhood, unity, solidarity and mutual cooperation. In the pure Mudharabah concept the Takaful company and the participant share the direct investment income, while the participant is entitled to 100% of the surplus, with no deduction made prior to the distribution.

Two basic models Al Mudharabah, Al Wakalah are derived from the Ta'awuni concept. In reality there are many variations of these models but they basically follow one of two conceptual frameworks.

The Al Mudharabah model is found mainly in the Far East, Al Wakalah is the dominant model in the Middle East and Waqf is found in Pakistan and South Africa.

13 – 3020 Wakalah

Wakalah is a contract of agency prevalent in the Middle East. Under the contract, the policyholders appoint a representative, the Takaful operator (a 'Wakil') to perform the administrative aspects of the Takaful operation. In particular, the Takaful operator ensures that the operation is run in the most efficient, productive and professional manner for the benefit of the members. The Takaful operator earns a fee of a fixed amount for services performed on behalf of the participants, and does not participate or share in any underwriting results (as these belong to the participants as surplus or deficit). The operator may also, in some circumstances, charge a funds management fee and a performance incentive fee.

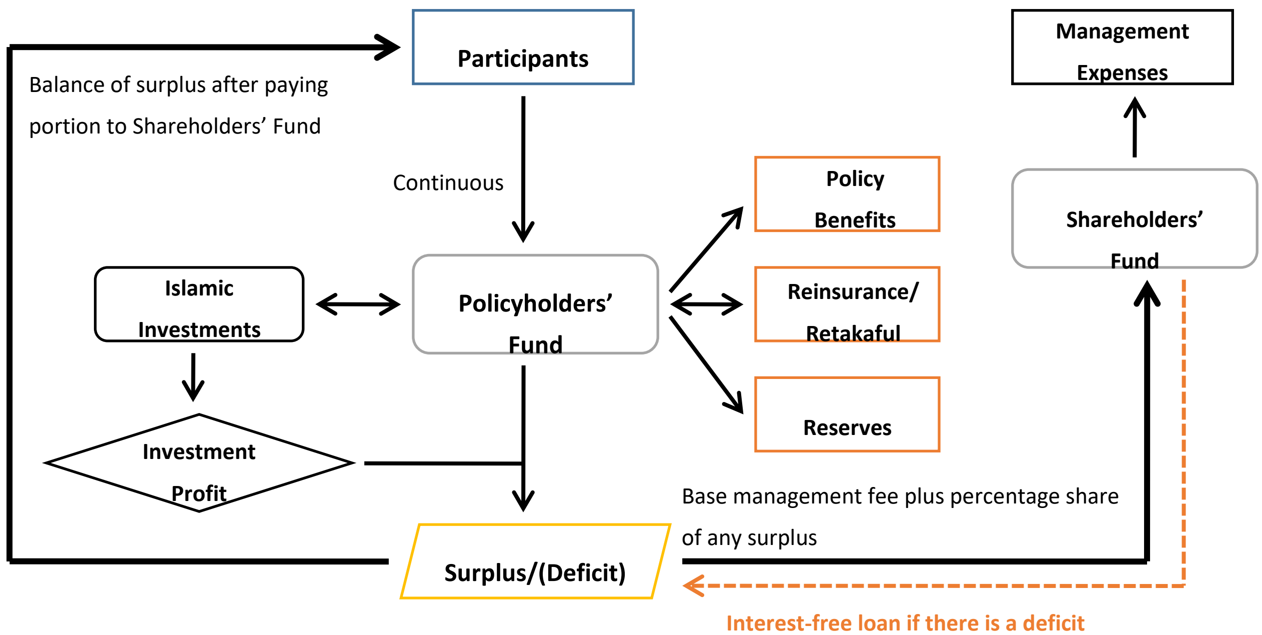


13 – 3040 Mudarabah

Mudarabah is a trust financing/profit sharing model, prevalent in Malaysia. It is an investment partnership whereby the investors/policyholders (called the 'Rab Al-Maal') provide capital to the Takaful operator (called the 'Mudarib') in the form of Takaful contributions (premiums) in order to undertake a business or investment activity. The contract between the two parties specifies how the profit (surplus) from the operations of the Takaful managed by the Takaful operator is to be shared. The profits are thus shared on a pre-agreed ratio, which may be in the ration 5:5. 6:4. 7:3 etc. However losses are borne only by the investors. The Mudarib stands to lose only his share of the expected income.

The investor has no right to interfere in the management of the business, but he/she can specify conditions that would ensure better management of his money. In this way Mudarabah is sometimes referred to as a sleeping partnership.

In order to eliminate the element of uncertainty (Al-Gharar) in the Takaful contract, the concept of Tabarru is incorporated. A participant agrees to relinquish as Tabarru a certain proportion of his Takaful instalments that he/she agrees or undertakes to pay thus enabling him to fulfil his obligation of mutual help and joint guarantee should any of his fellow participants suffer a defined loss.



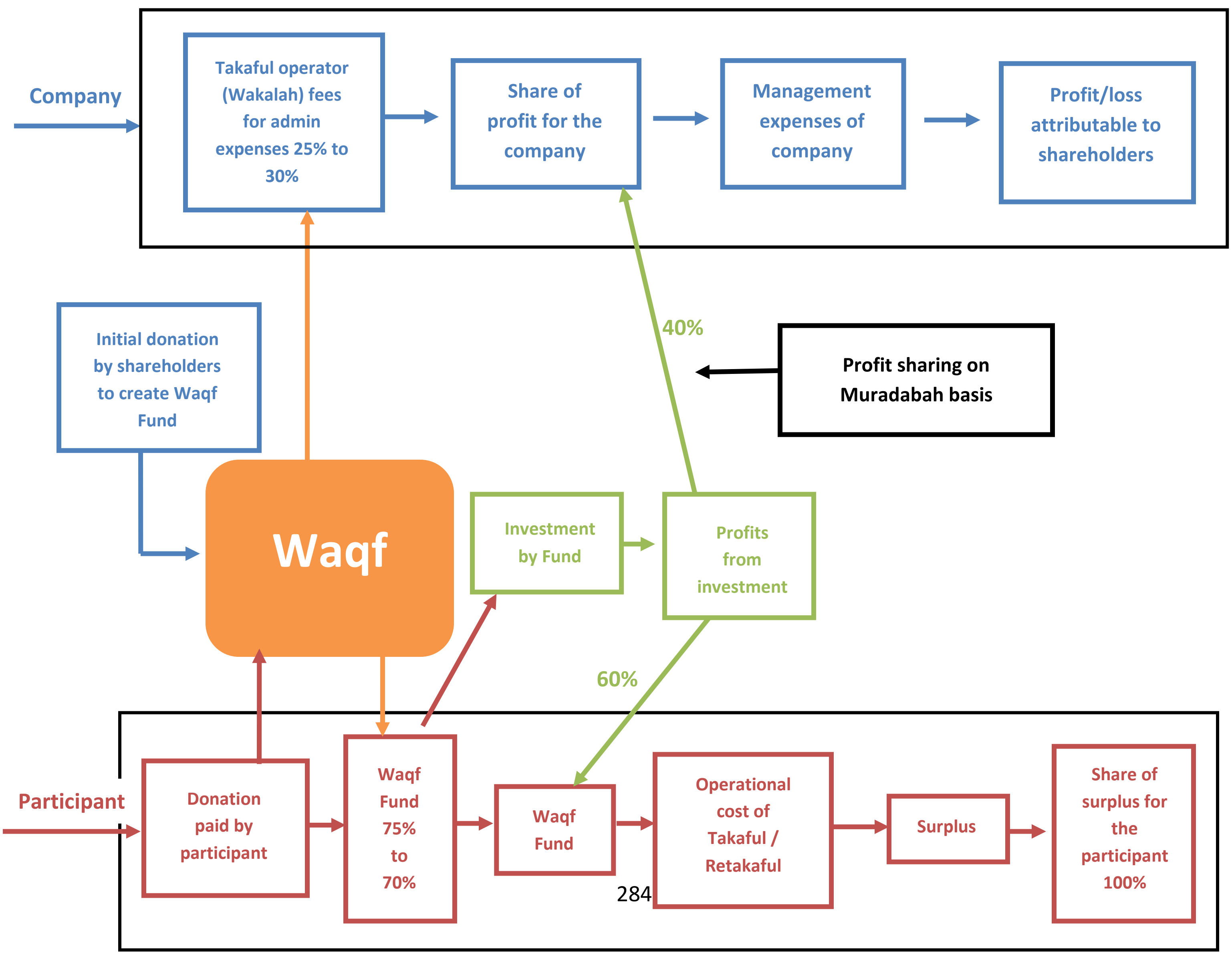
13 – 3060 Waqf

A pure Waqf model operates as a social/governmental enterprise, and programmes are operated on a non-profit basis. Any surplus or profit is not owned directly by either the insurer or the participants, and there is no mechanism to distribute surplus funds which, in effect, are retained by the insurer to support the participant community. This model, with a single surplus fund, is most like a conventional mutual insurance model.

A variation of the Waqf model, known as the Wakala-Waqf model, was developed in Pakistan. The scholars who formulated this model felt that there should be a separate legal entity on whose behalf the Takaful operator should act as an agent (Wakil) and were inspired by the Islamic institution of Waqf or Perpetual Endowment to serve the purpose.

The Waqf fund is created by the shareholders of the Takaful company who contribute the seed capital. This seed capital must remain as Waqf and cannot be used for claims, though it may be utilised for investments. The contributions received are also a part of this fund and the combined amount may be used for investment, with the profits earned being deposited into the same fund. Losses to the participants are paid by the company from the same fund while operational expenses incurred for providing the service are also met from it. Here, both the Takaful operator and the participants share a relationship through the Waqf. Since the Takaful operator will manage the enterprise on behalf of the Waqf it is entitled to a Wakala or agency fee. The participants are also governed by the Waqf rules, so that whatever claims they have, they get by virtue of being a member of that Waqf.

The following diagram illustrates how the Wakalah-Waqf model may operate. The percentages used are for illustrative purposes only.



13 – 3080 Retakaful

Recent times have seen the emergence of Retakaful as a viable and Shari'a-compliant alternative to Reinsurance. Just as Reinsurance allows insurance companies to achieve greater capacity and balance by the geographical spread of risk, Retakaful companies operate in a similar manner. A few years ago, there existed only a handful of Retakaful firms and only one or two of them were rated. Thus they could provide only a very limited capacity, prompting the Shari'a scholars of the day to permit Takaful firms to resort to conventional reinsurers as a provisional measure.

Most of the leading Reinsurance companies like Munich Re, Hanover Re and Swiss Re have set up Retakaful facilities. The German Reinsurers Munich Re and Hanover Re have set up Retakaful offices in Kuala Lumpur and Bahrain respectively while the Japanese Reinsurers Mitsui Sumitomo and Tokyo Marine have set up in Singapore.

Retakaful does not, in principle, differ from Takaful operations. The Shari'a principles applying to Takaful apply to Retakaful operations as well. The difference, if any, is that in the Retakaful operations, the participants are Takaful operators instead of individual participants. It is argued that the current practice of insurance business has shown that a Takaful ceding company cannot do without Retakaful facility. Therefore, there is a need for Takaful operators to split risks by way of establishing Retakaful operators. By doing so, they share their risks with Retakaful companies. The Retakaful operator, on the other hand, assumes the responsibility of managing and investing the premiums of Takaful operators on the basis of Profit and Loss Sharing.

The lack of full Retakaful capacity has been a factor influencing the growth of Takaful products generally.

13 – 4000+ Other Types of Insurers

13 – 4000 Captive Insurance

Imposing a tax charge on captive insurers would likely be a strong disincentive to them setting up in the QFC as opposed to, say, Bahrain or Dubai or operating from well-established captive domiciles further afield such as Bermuda, The Cayman Islands or Vermont. Against this background it was decided to allow captive insurance companies to elect to be taxed at a special zero concessionary rate. The reason a zero rate was chosen, instead of exempting captives was to ensure captive insurers are 'liable to tax' (albeit at a zero rate) for the purposes of double taxation agreements.

A Captive Insurer may elect under Article 88 to be taxed at the Concessionary Rate (for details of the election see QTM15-1040).In summary the impact of the election is that the Captive will be taxed at the Concessionary Rate of 0%, and the election will apply for a period of 4 years. The election cannot be revoked once made, it can only expire. It will need to be renewed after the 4 year period. A separate Concessionary Rate Charge will apply which is payable 6 months after the end of the first accounting period to which the election is to apply.

The QFC licensing rules permit the setting up of pure captives and variations such a rent-a-captives and protected cell companies. A QFC Captive Insurer is defined, at Article 153, as having 'the meaning given in the QFC Captive Insurance Business Rules 2011'. In practice this means that if the QFRCA has regulated an entity as a Captive Insurer then it will also be a Captive Insurer for the purposes of QFC taxation. Generally this will be a subsidiary company, the main business of which consists wholly or mainly of insuring the risks of its parent or other group company. In this context see, also QTM14-4000 which discusses the exemption of 'Alternate Risk Vehicles' under Article 86, where only 75% of the risk management activities must be intra-group.

13 – 4020 Reinsurance

The QFC Tax Regulations allow reinsurance companies to elect to apply the concessionary rate of tax to their reinsurance profits i.e. 0%. For details of the concessionary rate see Part 15**)**. In the case of a mixed business, the profits are to be split between the reinsurance business (zero rate) and other business (standard rate) on a 'just and reasonable' basis (Article 92(1)). See QTM4-2020 for guidance on the meaning of 'just and reasonable'.

When the concessionary zero rate applies, loss and group relief are not available. In the case of a mixed business loss and group relief are available to the non-reinsurance element, but not to the reinsurance element and this includes netting any losses of the reinsurance element against the profits of other business for the same accounting period.

The investment income of a reinsurance business includes its investment income related to that business and such income will also be subject to the concessionary rate (Article 88(3)). In a mixed business it will be necessary to determine the element of investment income that is attributable to the reinsurance activity. The apportionment should be made on a 'just and reasonable' basis (see above).

Reinsurance Business is defined at Article 153 as 'the business of entering into and managing Contracts of Reinsurance' and a 'contract of reinsurance' is defined as a ‘contract of insurance covering all or part of a risk to which a person is exposed under a contract of insurance.

Reinsurance includes retakaful (see above).

PART 14 SPECIAL EXEMPTIONS

14 – 1000+ Introduction

Under Part 14 of the Regulations, to support the QFC’s strategic aims, certain QFC Entitiesmay elect to be exempt from QFC tax. The Entities that are potentially exempt are, broadly speaking, certain investment funds, alternative risk vehicles and listed companies. In addition, distributions paid by certain exempt funds are also exempt in the hands of the recipients.

Exempt status is granted upon election on an accounting period by accounting period basis, provided that certain conditions are met (see QTM 14 – 1080). The loss and group relief provisions of Part 5 of the QFC Tax Regulations are disapplied if an entity successfully elects for special exempt status (Article 82(8)).

14 – 1020 Exempt Entities

Article 82(1) permits a QFC Entity that is one of the exempt vehicles listed in Article 82(3) or a firm that is listed on the Qatar Stock Exchange or another approved public market in Qatar to elect for the special exempt status. A QFC Entity that elects for this status is exempt from tax under the Regulations for the accounting period to which the election relates, provided that the conditions set forth in Article 86A are met.

Exempt vehicles are defined at Article 82(3) as:

(a) Registered funds as defined by Article 83 (see QTM14-2100);

(b) A special investment fund as defined in Article 84(see QTM14-2200+);

(c) A special funding company as defined in Article 85(see QTM14-3000+);

(d) An alternative risk vehicle as defined in Article 86(see QTM14-4000); or

14 – 1040 Consequences of Making an Election.

When an election under Article 82 is accepted, the taxpayer will be exempt from QFC tax for the accounting period for which the election is made. In addition, any dividends received by a taxpayer from another taxpayer that has elected for exempt status under Article 82(3)(a) (registered funds) or Article 82(3)(b) (special investment funds) are also exempt from QFC tax.

Where a QFC Entity has made an election for an accounting period under Article 82, the loss and group relief provisions of Part 5 are disapplied. This means any losses incurred by a taxpayer whilst an election is in force are not available for carry forward or to be surrendered as group relief. An exempt taxpayer may not claim group relief. If, exceptionally, a QFC Entity has accumulated losses before electing for exempt status andthen is exempt for a period before not electing (or not being entitled to elect for) exemptstatus, the losses available for carry forward before the period of exemption are availablefor relief under Article 28 against post exemption profits.

14 – 1060 Making an Election

An election for special exempt status has to be made to the Tax Department in writing within 6 months of the end of the accounting period to which it applies (Article 82(5)). The time limit for making an election coincides with the normal filing date for the accounting period and the return has a 'tick box' for making an election under Article 82.A late election may be accepted by the Director of Tax if he/she is satisfied there was reasonable cause why the election could not be made in time and it was made thereafterwithout undue delay (TAX 13.4).

It should be noted that an election for special exempt status is not 'once and for all' but must be made in respect of each accounting period for which it is to apply.

An election for special exempt status will be deemed to be approved if no rejection is notified to the taxpayer. You may only refuse to accept an election if either (a) the QFC Entity is not within the scope of Part 14 – i.e. it is not a listed company or one of the vehicles listed in Article 82(3), or (b) one or more of the conditions provided for in Article 86A is not met (see QTM 14 – 1080).

All potential refusals to accept an election should be referred to the Director of Tax for a decision. The submission should provide full details of the reason(s) you consider grantingan election is inappropriate. Where you recommend an election should be refusedbecause you do not consider the QFC Entity is a qualifying vehicle/Entity you should set out in detail all the relevant facts and your reasons for forming the view, based on those facts, that the taxpayer does not qualify. Similarly, where you consider an election should be refused because the conditions of Article 86A are not met, you should identify the relevant facts and explain in detail why you consider those facts lead you to believe the condition(s) is/are not met.

There is no appeal against a refusal to accept an election under Article 82, per se. However if a QFC Entity submits a return on the basis they are entitled to make an election you will have to open an enquiry to challenge that view and the taxpayer will have the right of appeal against your closure of that enquiry so, in effect, your decision will be open to appeal.

14 – 1080 Conditions for approving the election

Article 86A.1. lists the conditions of validity of an election under Article 82. You must ensure that these conditions are met before approving the election. The conditions are as follows:

a) Adequate number of employees

The QFC Entity must have an adequate number of full-time employees with appropriate qualifications to perform their professional responsibilities. The employees must be resident in Qatar.

There is no definition of the term "adequate" in the regulations or in the OECD or EU materials on economic substance requirements. The term should be understood to have its ordinary meaning in the English language i.e. "enough or satisfactory for a particular purpose". The assessment of the adequacy criterion will, therefore, be fact-driven and made on a case-by-case basis. What is adequate for a specific entity will be dependent on the business activity (size, type, etc.) and other particular circumstances of that entity. Considering the importance of this criterion in meeting the economic substance requirements as laid down in the OECD directives on BEPS Action 5 and its alignment with QFCA's strategic objectives, you should carefully consider all the relevant factors and circumstances to make a fair determination as to whether or not the criterion is met. You should also adopt a pragmatic approach in making this assessment, as the intention is not to require an entity to engage more employees or incur more costs than it really needs. The test here is whether or not the number of employees is commensurate with the entity's level of business activity. Consequently, it is not required that the number of employees remains constant. It may decrease or increase depending on the variations in the entity's level of activities.

The computation of the number of employees should, first, consider the number of employees having full-time employment contract with the QFC Entity. However, considering that the number of employees should be commensurate with the level of core activities and this level may change over time, the assessment should also consider other forms of employment, including part time. Hence, the computation should be based on the time worked by all the employees, including directors if they are involved in executing the Core Income Generating Activity (CIGA, see QTM 14-1080 (c)) in Qatar.

You should consider the amount of time each employee worked during the accounting period, whether he/she has spent all or only part of his/her time working with the concerned entity. For employees who have not worked on a full time basis or have worked only part of the accounting period, the computation will be made on Full Time Equivalent (FTE) basis i.e. as a fraction of a FTE, with the assumption that a standard working week is 35 hours.

If the entity outsources, contracts or delegates some or all of its CIGA, then the resources of the service provider in Qatar will be taken into consideration in the same way as for the entity's employees (see QTM 14-1080 (c1)).

The number of employees on the tax return should reflect only the employees with whom the QFC has an employment contract. The computation to demonstrate the adequacy of the number of employees should be made in the tax computation document.

It is important to note that the entity should keep appropriate documentation to demonstrate the adequacy of the number of employees and their qualifications. Documentation can include employment contracts, resumes, timesheets, academic or professional qualifications, etc.

b) Adequate amount of operating expenses

The QFC Entity must incur an adequate amount of operating expenditures to undertake its activities in Qatar. As mentioned in relation to employees, there is no definition or prescribed amount of what is adequate, as this will depend on the particular facts and circumstances of each entity. The only requirement here is that the amount is proportionate to the level of activity of the QFC Entity in Qatar.

In assessing this criterion, you should, first, consider the total amount of operating expenses of the QFC entity. It must be commensurate with the level of its income generating activities in Qatar. You should also consider how much of these expenses is incurred in Qatar and how much is incurred outside Qatar. Cases where there is a predominance of expenses incurred outside Qatar and/or expenses due/paid to related parties should be identified and examined closely as they may indicate that the entity does not incur an adequate amount of expenses and does not have an adequate level of economic substance in Qatar.

In considering expenses with related parties, you should have reasonable assurance that these expenses are at arm's length.

The entity is expected to maintain proper records to substantiate the expenses incurred and demonstrate their adequacy.

c) Core Income Generating Activities carried out in Qatar

The QFC Entity must ensure that its Core Income Generating Activities (CIGA) are carried out in Qatar. CIGA refer to the key essential and valuable activities that generate the income of the entity. More details on the definition of CIGA can be found in QTM 15 – 1050 (a).

The requirement applies only to CIGA. The election can still be valid even if all the other activities of support nature such as IT, HR, finance, etc. are performed outside Qatar. Further, the requirement is not that the QFC Entity carries on itself all the CIGA but rather that the latter are carried out in Qatar. Hence, the entity may outsource some of the CIGA to a service provider who must perform them in Qatar (see QTM 14-1080 (c1)).

Where the CIGA consist in, or involve, making decisions, then the person or persons making these decisions (or the majority thereof if they are several) is/are expected to be present in Qatar at the time when the decisions are made, otherwise the decisions may not be considered to be made in Qatar. However, you should take a reasonable approach in assessing this matter. If only isolated decisions are taken outside Qatar and all the other decisions and CIGA are undertaken in Qatar such that they clearly outweigh the decisions taken outside Qatar, then the criterion may still be considered to be met.

It is important that the QFC Entity maintains proper documentation to substantiate that CIGA are carried out in Qatar. Such documentation may include evidence that the entity has an adequate number of qualified employees and incurs an adequate level of operating expenses (see QTM 14-1080 (a) and (b)) as well as contracts or agreements with local service providers, if any, etc.

c.1.) Outsourcing

Outsourcing CIGA is allowed provided that the outsourced activities are carried out in Qatar. The QFC Entity must ensure (and be able to demonstrate) that it has adequate supervision and control over the outsourced activities (see QTM 15 – 1050 (b) for more details). Outsourcing includes contracting or delegating activities to third or to related parties.

For the purposes of assessing the economic substance of the QFC Entity, the resources used by the service provider will be taken into consideration. Hence, the employees used by the service provider will be counted (on FTE basis) to determine the number of employees of the QFC Entity and demonstrate its adequacy. However, the QFC Entity must ensure that there is no double counting of these resources in cases where the service provider performs CIGA for other entities as well. It is expected that the QFC Entity provides details of the resources used by the service provider in the tax computation.

d) Monitoring

The monitoring of the implementation of the conditions of Article 86.A. should start with reviewing the information provided in the tax return and the tax computation. You should particularly focus on the amount of operating expenses and the number of employees and review their adequacy as envisaged in QTM 14-1080 (a) and (b). You should also ask for further information, if needed, to make a determination as to whether or not the conditions are met. If the conditions are not met the election should be rejected (see QTM 14-1060).

Qualifying QFC Entities may request a ruling to obtain confirmation that they qualify for the exemption (see QTM 18 – 2000+). In this case, you should request all the information and supporting documentation to check that the conditions are met before recommending the issuance of the ruling.

14 – 2000+ Investment Funds

Article 82 allows registered funds and special investment funds to elect for the special exempt status. It is important to note that this election is not subject to the conditions of Article 86A.1. However, under Article 86.A.3. the Tax Department may reject the election if they consider that the sole or main purpose of the vehicle is the avoidance of tax under the Regulations.

You should, therefore, consider whether or not the sole or main purpose of the exempt vehicle is the avoidance of QFC tax. If the sole or main purpose of the vehicle is the avoidance of tax in another country, the election should be reviewed critically in light of the international tax obligations of the State of Qatar and the QFCA's strategy to not facilitate tax avoidance.

14 – 2100 Registered Funds

A registered fund is an exempt vehicle (Article 82(3)(a)) so a QFC Entity that is a registered fund may elect for exempt status under Article 82. A registered fund is defined by Article 83 as a QFC Scheme or a Private Placement Scheme. A QFC Scheme has the meaning given by Rule 1.2.6 of the Collective Investment Scheme Rules 2010. A Private Placement Scheme has the meaning given by Rule 1.1.4 of the Private Placement Scheme Rules 2010.

Any distributions paid out of the profits arising whilst a registered fund is exempt are themselves exempt from QFC tax in the hands of the recipient. This will, of course, only be relevant when the payee is a QFC Entity.

14 – 2200 Special Investment Funds

14 – 2220 Overview

A special investment fund is an exempt vehicle (Article 82(3)(b)) so a QFC Entity that is a special investment fund may elect for exempt status under Article 82. A special investment fund is defined by Article 84 as a QFC Entity that is (a) not a Registered Fund within Article 83, (b) is managed by an Approved QFC Entity and (c) is established for oneof the permitted activities listed in Article 84(2). The permitted activities are (a) private equity investments, (b) venture capital investments, (c) making investments, including investments in property or (d) making investments on behalf of a Single Family.

An Approved QFC Entity is defined in Article 84(3) as 'a Person permitted to manage the special investment fund under an approval, an authority or a licence (however described)given by the QFC Authority under the QFC Law.

Any distributions paid out of the profits arising whilst a special investment fund is exemptare themselves exempt from QFC tax in the hands of the recipient. This will, of course, only be relevant when the payee is a QFC Entity.

14 – 2240 Property

The QFC has not developed specific rules covering the establishment of Real Estate Investment Trusts (REIT's) or similar property investment vehicles. However to the extentthat they are established either under existing or new regulations it is considered that Article 82(2)(c) will have the effect of making most of those investment vehicles exempt from tax in the QFC, subject to it being managed by an Approved QFC Entity (Article 82(1)(b)).

14 – 2260 Single Family

The QFC legal environment includes specific regulations providing for the establishment of a Single Family Office within the QFC (The QFC Regulations no. 16 – QFC Single Family Office Regulations "SOR"). A Special Investment Fund making investments on behalf of aSingle Family is exempt from QFC taxation, Article 84(2)(d). A 90% Qatari owned Investment Vehicle established as an LLC may separately be able to elect for the concessionary rate of taxation (zero) to apply (see Part 15).

14 – 3000+ Special Funding Companies

14 – 3000 Overview

A special funding company is an exempt vehicle (Article 82(3)(c)) so a QFC Entity that is aspecial funding company may elect for exempt status under Article 82.

A special funding company is defined by Article 85(1) as a company carrying on one or more of the activities listed below and no other activity, apart from any activity incidentalto such activities-

(a) acquiring, holding and managing financial assets forming the whole or partof the security for a funding arrangement;
(b) acting as a guarantor in respect of loan relationships, derivative contracts,finance leases or other liabilities of other Companies where the whole, orsubstantially the whole, of the Company's rights in respect of the guarantee form the whole or part of the security for the funding arrangement;
(c) acquiring, holding and managing financial assets forming the whole or partof the security for a funding arrangement entered into by another specialfunding company;
(d) entering into and being a party to a creditor relationship with another special funding company.
(e) in relation to a Special Purpose Company, any of those activities listed in Article 9.1(a) to (d) of the Special Company Regulations;
(f) in relation to a Holding Company, any of the activities listed in Article20.1(a) to (f) of the Special Company Regulations.

Activities covered by (a) to (d) above concern activities carried on either as part of or connected to a "funding arrangement" and will normally be QFC Entities that were not enacted under the QFC Special Company Regulations. Situations covering entities enactedunder the QFC Special Company Regulations (SPC's and Holdco's) are discussed below.

A "funding arrangement" is defined as any arrangement for the raising of funds, or the creation of any form of debt instrument (Article 85(2)).

14 – 3020 Special Purpose Companies

The activities that can be carried on by a Special Purpose Company [SPC] are defined in the QFC Special Company Regulations, Article 9, which states that 'A Special Purpose

Company may only be established for the purpose of a Transaction. Subject to the termsof its Licence, a Special Purpose Company may only carry on one or more of the followingactivities:

(a) the acquisition (by way of leasing, title transfer, risk transfer or otherwise), the holding and the disposal of any asset (tangible or intangible, including but not limited to receivables, shares, real or personal rights, interests, options or privileges of any kind whatsoever in, over or in respect of any such asset);

(b) the obtaining of any type of financing (banking or capital markets), the granting of any type of security interest, the provision of any indemnity or similar support or the entering into any type of loan or hedging arrangements, including to secure the repayment of any money borrowed, raised or owed or any other obligation of or binding on the Special Purpose Company by mortgage, charge, standard security, lien or other security upon the whole or any part of the Special Purpose Company's property or assets (whether present or future), including its uncalled capital;

(c) the financing of the Initiator or any other Person;

(d) the carrying out of any of the following activities:

i. to act as trust administrator or agent for any participant in a Transaction;

ii. to enter into arrangements or grant licences in respect of intellectual property rights, know-how, confidential information or trade secrets;

iii. to issue any shares or enter into any agreements which provide for the issue or allotment of, or grant any Person the right to call for the issue or allotment of, any share or loan capital; and

iv. to subscribe for, purchase, or otherwise acquire, hold, sell, deal with and dispose of, place and underwrite shares, stocks, debentures, debenture stocks, bonds, sukuks, obligations or securities issued or guaranteed by any other Entity or any government or authority, municipal, local or otherwise, including in the State or overseas;’

The activity must be part of a Transaction which is defined as ‘a transaction or series of connected transactions’.

Activities falling within Article 9.1(a) to (d) above are exempt from QFC taxation.
Note that the tax exemption does not include items in Article 9.1(e) and (f) of the Special Company Regulations which potentially have a very wide application.

14 – 3040 Holding Company

The Holding Company activities that can benefit from the QFC tax exemption are definedin Article 20.1(a) to (f) of the Special Company Regulations, which states that 'Subject to the terms of its Licence, a Holding Company may only carry on any one or more of thefollowing activities:

(a) owning and maintaining one or more Subsidiary;

(b) granting any type of security interest over its assets (tangible or intangible, including but not limited to receivables, shares, real or personal rights, interests, options or privileges of any kind whatsoever in, over or in respect of any such asset) for its own benefit or for the benefit of any Entity within the Holding Company Group;

(c) providing an indemnity, guarantee or similar support to any third party for its own benefit or for the benefit of any Entity within the Holding Company Group;

(d) the acquisition, holding or disposal of any interest in any asset whether tangible or intangible for its own benefit or for the benefit of any Entity within the Holding Company Group;

(e) providing any type of loan or other form of financing to any Entity within the Holding Company Group;

(f) any activities which are ancillary to the activities set out under (a) to (e) above; '

Note that this does not cover any activities under Article 20.1(g) which would, subject to the nature of the income earned, be subject to QFC taxation at the standard rate.

Article 86.A. requires that Core Income Generating Activities are carried out in Qatar, even in the case of holding companies. However, the application of this requirement to pure holding companies i.e. those that only hold equity participations and only earn dividends and capital gains, involves a certain degree of flexibility under the standard (i.e. directives of BEPS Action 5). The requirement will be considered to be met if the holding companies comply with applicable corporate law filing requirements and has the premises and people needed to hold and manage the participation.

For other holding companies i.e. those holding a variety of assets and earning different types of income (e.g. interest, rents, royalties, etc.), the core income generating activities that are associated with the income streams earned by the holding companies must be undertaken in Qatar.

14 – 4000+ Special Exemptions

14 – 4000 Alternative Risk Vehicles

An alternative risk vehicle is an exempt vehicle (Article 82(3)(d)) so a QFC Entity that is analternative risk vehicle may elect for exempt status under Article 82.

An alternative risk vehicle is defined by Article 86(1) as a QFC Entity established for the purpose of managing risk, but which is not a captive insurance company. In addition, at least 75% of the risk management activities must relate to members of the same group to which the alternative risk vehicle belongs.

Alternative risk financing is the use of products and solutions which have grown out of the convergence of the banking and insurance industries. The products and solutions include captives, catastrophe bonds (cat bonds) as well as finite risk products such as lossportfolio transfers and adverse development covers.

A Loss Portfolio Transfer (LPT) is an example of a finite risk product and is a means of transferring outstanding claims from one insurer to another insurer. LPTs essentially capitalise the time value of loss reserves and are a form of retrospective reinsurance. The premium is the net present value of the outstanding claims plus a loading made up of expenses, risk capital, and margins, and will include a level of profit that may be assessed explicitly or implicitly within the margins. The motives for the ceding company are risk reduction and possible certainty, administrative savings, and often a simplification of the structure. The motives for the accepting company are eventual profit, arising from its claims handling expertise; its negotiating advantage, particularly if it is involved with similar portfolios; and liquidity, as real monies are transferred with the liabilities. LPTs arealso made within companies in the same group. The motives for an intragroup LPT are the ring-fencing of old liabilities, the tidying up of the business, profit-taking, and tax advantages, in situations where losses can be offset against profits.

14-5000 Other exemptions

There are a number of other exemptions provided by way of Concessionary Statement of

Practice (CSOP) issued on the basis of an approval from QFCA board. These include:

14-5020 Exemption of not-for-profit entities

The CSOP on not-for-profit QFC entities exempts from tax QFC entities the purpose of which does not include generating profits or other assets for distribution to shareholders,partners, members or the like.

Specifically, the CSOP identifies the following entities as qualifying for the exemption:

- A Business Council;
- A Chamber of Commerce; or
- Any other QFC-registered entity that the QFCA Board may approve from time totime as such an entity.

All other entities, including professional associations and other types of LLC(G)s remain subject to tax.

14-5040 Exemption of QFC Entities involved with FIFA Competitions in Qatar

As part of its bid to host the FIFA World Cup Qatar 2022, the State of Qatar provided a commitment to exempt from tax entities that are involved in the organisation of FIFA competitions in Qatar.

To give effect to this commitment, QFCA issued a CSOP on 01 December 2019 granting QFC entities that are involved in the organization of FIFA competitions an exemption fromcorporation tax.

(a) Eligible Entities

The following entities are eligible for the exemption:

- FIFA Subsidiaries: These are legal entities in which FIFA owns at least 50% (fifty percent) of their capital or voting interest. They may be resident or non-resident in Qatar. An example of such firms is FIFA World Cup Qatar 2022 LLC. Any legal entity in which FIFA World Cup Qatar 2022 LLC wholly owns the capital or voting interest will also qualify.

  FIFA Subsidiaries are entitled to an exemption from corporation tax under the QFCTax Regulations. The exemption is not time bound or competition/event-related.In other words, a QFC Entity that is a FIFA subsidiary will be exempt from tax for an indefinite period of time regardless of the nature of permitted activities carriedon.

- FIFA Service Providers, FIFA Host Broadcasters and LOC Entities: All these are defined in the CSOP and are eligible for an exemption from corporation tax in relation to taxable profits that are derived from activities carried on for the purposes of the eligible events (see (b) below).
  Accordingly, profits from activities that are not carried on for the purposes of theeligible events shall remain subject to tax.

The onus of proof is on the entity claiming the exemption i.e. it is up to this entity to prove that the revenues reported as qualifying for the exemption are derived from activities conducted for the purposes of the eligible events. The determination of whether or not an activity is carried on for the purposes of the eligible events will be a matter of fact and shall be considered on a case-by-case basis. However, it is expected that the contract or agreement under which the activity is performed would provide a reasonable basis to make such a determination. Hence, for FIFA Service Providers, for instance, the hospitality services and the other goods and services (the costs of which are borne by FIFA) should be easily identifiable. The contract/arrangement with FIFA should allow a straightforward determination of these goods and services as well as the revenuesrelated thereto.

The same should apply to FIFA Host Broadcasters, as these will be “licensed or appointed” by FIFA under a contract or agreement. Profits under such contracts or agreements will most likely be eligible for the exemption.

Similarly, for LOC Entities, the contracts under which the qualifying activities are carried on should provide a sufficient proof that these activities are conducted forthe purposes of the eligible events. Revenues under these contracts will likely qualify for the exemption.

As a matter of principle, the QFC entity that claims the exemption will be required to provide a copy of the contract or agreement under which the qualifying activities are carried out. However, where the entity claims the benefit of the exemption as a Host Broadcaster or a Service Provider (as defined in the CSOP) without having a direct contractual relationship with FIFA i.e. it has been appointed or licensed by a FIFA’s licensee or appointee, you should check that theactivity of the QFC entity (as defined in the contract it has with the FIFA’s appointee or licensee) falls within the scope of work of the contract between FIFAand the FIFA appointee and licensee and that their amount ties with the value of that latter contract.

You will have access to the information of the contract between FIFA and FIFA’s appointee or licensee as per the process to be agreed between FIFA and the QFC Tax Department.

Where a QFC entity carries on both qualifying and non-qualifying activities, the exemption shall apply only to profits from qualifying activities. These profits shall be determined based on the accounts. Where it is not possible to determine the profits based on the accounts, the profits shall be determined on a "just and reasonable" basis (See QTM4-2020 for guidance on what is meant by "just and reasonable").

(b) Eligible events

Under the CSOP, the exemption of FIFA Service Providers, FIFA Host Broadcasters and LOCEntities applies only to profits derived from activities carried on for the purposes of the following eligible events:

- The Competitions, which include the FIFA World Cup Qatar 2022 as well as any other prior FIFA test events hosted in Qatar, including but not limited to the FIFA Club World Cup and Pan-Arab Tournament; and
- Other events or activities directly or indirectly related to the Competitions and officially organised, sanctioned or endorsed by, or under the auspices of, FIFA, Qatar 2022 Local Organising Committee LLC, FIFA World Cup Qatar 2022 LLC or Qatar Football Association. Examples include:
    - the FIFA Congress, banquets, opening, closing, award and other ceremonies, the preliminary draw, the final draw and any other draws, anymascot launch and other launch activities;
    - any seminars, meetings, conferences, workshops and press conferences;
    - any official public viewing or other fan-related events;
    - any cultural activities, in particular concerts, exhibitions, displays, shows or other expressions of culture;
    - any events, activities, projects and/or programmes for social and human development as well as environmental protection, other corporate social responsibility, humanitarian or similar charity projects;
    - any football matches and training sessions; and
    - any other activities that FIFA considers relevant for the staging, organization, preparation, marketing, promotion or winding-up of the Competitions.

The key criterion in identifying the eligible events other than the Competitions is that theyare organised, sanctioned or endorsed by or under the auspices of FIFA, Qatar 2022 LocalOrganising Committee LLC, FIFA World Cup Qatar 2022 LLC or Qatar Football Association.A proof of the involvement of any of these entities as envisaged above should be presented to demonstrate that the event is an eligible one. Examples of proof include contracts, agreements, letters or statements signed/issued by these entities confirming that the event is organised, sanctioned or endorsed by them.

(c) Scope of the exemption

The CSOP is issued under the QFC Tax Regulations. Accordingly, the exemption applies only to corporation tax imposed under the QFC Tax Regulations. As this tax is the only taxcurrently imposed in the QFC, the commitment of the State of Qatar to exempt qualifyingentities from all taxes is fulfilled in the QFC.

The exemption concerns only the obligation to pay tax and the penalties and charges related thereto. It does not extend to the other obligations provided for under the QFC Tax Regulations such as the obligation to file a tax return or provide information or documents to the tax department or to the penalties related thereto.

The exemption also applies to the ruling fees provided for under Rule 7 of the QFC Tax Rules. Accordingly, ruling fees that are paid as part of the process of submitting on the portal a ruling request related to the application of the exemption under the CSOP will berefunded.

In relation to VAT, appropriate measures will be taken, should the tax be introduced, to ensure that qualifying entities are exempt from VAT in relation to qualifying activities.

(d) Conditions of the exemption

The CSOP requires that the following conditions be met to grant the exemption:

i. the eligible entity is a validly established QFC entity that operates within theterms of its license and that has genuine economic substance in Qatar;

ii. the eligible entity does not undertake regulated activities without appropriateauthorization from QFCRA;

iii. the eligible entity applies for, and the QFC Tax Department grants, an advance ruling under Article 105 of the QFC Tax Regulations confirming the exempt statusof the eligible Entity;

iv. the eligible entity is included in the list provided by FIFA to the QFC Tax Department on an ongoing basis of entities that are eligible for the exemption;

v. the sole or main purpose of the eligible entity is not the avoidance of Tax; and

vi. the QFC Tax Department is satisfied that granting the exemption is not in breachof international tax principles as set out in the OECD's BEPS Project minimum standards.

Where any of these conditions is not met, the exemption shall be denied, and the tax shallbecome due as of the date on which the condition or conditions become(s) no longer satisfied. There will be no withdrawal of the exemption for the period during which the conditions were met.

The existence of genuine economic substance in condition (i) above will be considered in light of the guidance on economic substance requirements to be issued by the Ministry of Finance and/or the General Tax Authority as part of the fulfillment of the State of Qatar's obligations under BEPS action 5. The key criteria to be considered include whetheror not the eligible entity has a registered office in Qatar and an appropriate number of qualified employees that are resident in Qatar, incurs an appropriate level of operating expenses and carries on, or arranges to carry on, the key income generating activities in Qatar.

(e) Administration

The CSOP does not expressly stipulate that the exemption is granted by way of election, as in the case of exemptions provided for under Part 14 of the QFC Tax Regulations. However, this does not mean that the exemption applies automatically. Eligible entities who are not included in the list of eligible entities to be sent by FIFA to the QFC Tax Department from time to time or who do not submit a ruling will not benefit from the exemption.

The exemption applies to accounting periods starting on or after 1 December 2018.

14-5060 Exemption of QFC Entities involved with defence and security contracts

The QFC Tax Regulations and Rules do not provide for any concessionary treatment for defence and security contracts with the Ministry of Defence (MoD), Ministry of Interior (MoI) or other security or defence agencies in the State. This contrasts with the treatment of companies in the State involved in similar contracts, as they are eligible for an exemption from tax under law 6 of 1991.

To level the playing field for QFC Entities operating in the defence and security sector, the Tax Department issued a Concessionary Statement of Practice (CSOP), based on an approval from QFCA board in its meeting of 01 December 2020, to the effect of exempting QFC Entities on profits from contracts with MoD, MoI or other defence or security agencies in the State, provided that certain conditions are met.

(a) Eligible entities

The CSOP provides for an exemption from corporation tax under the QFC Tax Regulations of profits derived from defence and security contracts that have a strategic and/or confidential nature carried out for the benefit of the MoD, MoI or any other competent defence or security agencies in the State.

Therefore, the exemption applies (subject to the conditions set out in QTM 14-5060 (c) to QFC Entities that carry on activities and/or provide services under a contract of a strategic and/or confidential nature that benefits to MoD, MoI or other competent security and defence agencies in the State.

It is important to note that the CSOP does not require that the contract be directly signed with MoD, MoI or the defence or security agency. As long as the contract is recognized by these ministries and agency as being carried out in their benefit, as envisaged in QTM 14-5060 (c) (ii), the QFC Entity may, prime facie, benefit from the exemption even if the contract is concluded with a contractor of these ministries and agency.

(b) Eligible profits

The exemption applies only to profits derived from qualifying contracts. In other words, if the QFC Entity has multiple contracts, some of them qualify for the exemption and some others do not, the exemption shall apply only to profits arising from the qualifying contracts.

As in the case of the CSOP on FIFA competitions (see QTM 14-5040), qualifying profits shall be determined on the basis of the accounts. Where the accounts do not allow such determination, the profits shall be determined on a "just and reasonable" basis (See QTM 4-2020).

You should pay particular attention to the allocation of costs between qualifying activities and non-qualifying ones.

(c) Conditions of exemption

The QFC Entity must meet the following conditions to be eligible for the exemption:

i. Validly licensed Entity

The Entity must be validly established in the QFC and must operate within the terms of its license. In the unlikely event that the Entity carries on activities that are not covered by the license, you should not accept the exemption of the profits derived from these activities and you should immediately alert monitoring team.

This shall apply in all cases where a concessionary treatment applies and the QFC Entity operates beyond its license.

ii. Qualifying contract

To substantiate the qualifying nature of the contract, the Entity must present a letter from MoD, MoI or other competent defence or security agencies in the State confirming that:

the Entity has a contract for the benefit of the mentioned ministries or agencies; and the said contract has a strategic and/or confidential nature.

Only letters issued by the above-mentioned ministries and agencies and specifically referring to the QFC Entity being involved in the execution of the contract can be accepted. The letter, to be addressed to QFCA Tax Department, must confirm the strategic and/or confidential nature of the contract and specify the period of the same (commencement and end dates).

iii. Core Income Generating Activities (CIGA) undertaken in Qatar

The Entity must carry out (or arrange to carry out) its CIGA under the contract on in Qatar. Non-core activities may be performed outside Qatar. See QTM 14 – 1080 (c) for more details.

iv. Adequate number of employees

The Entity must employ on a full-time basis an adequate number of qualified employees that are resident in Qatar. This number may not be less than five.

In the computation of this minimum, only qualified employees that have a full-time employment contract with the QFC Entity and that are resident in Qatar are considered. In the assessment of the adequacy test, the other forms of employment (including part time) may be considered. See QTM 14 – 1080 (a) for more details.

v. Adequate amount of operating expenses

The Entity must incur an adequate amount of operating expenses. This amount may not be less than USD 1,000,000 per Accounting Period.

In the computation of this minimum, only operating expenses that are incurred in Qatar are considered. For the assessment of the adequacy test, see QTM 14 – 1080 (b) for more details.

vi. Advance ruling

The Entity must obtain an advance ruling under Article 105 of the Tax Regulations confirming their exempt status. Prior to issuing the ruling, you should check and be satisfied that the Entity meets all the requirements to benefit from the exemption.

If an Entity submits a tax return on the basis that they are exempt under the CSOP without obtaining an advance ruling, you should open an enquiry to deny the exemption and charge the applicable tax and penalties.

vii. Audited accounts

The Entity must have their accounts audited by an approved auditor. This requirement applies to all QFC Entities, including branches.

No tax avoidance or breach of international standards.

The exemption may not be granted if the sole or main purpose of the Entity is the avoidance of Tax or the exemption would result in breaching international tax principles as set out in the BEPS Project minimum standards, including the directives of Action 5 on economic substance requirements.

viii. Administration

The fact that the CSOP does not specifically provide that the exemption applies upon election does not mean that it automatically applies to all QFC Entities that meet the economic substance requirements (see QTM 14-5040 (e)).

You should check that all the requirements (including obtaining a tax ruling) are met before allowing the exemption to apply for a specific Accounting Period.

You should also keep monitoring the activities of the QFC Entity to ensure that the requirements remain fulfilled. This monitoring will start with the information provided in the tax return and computation of tax and can extend to requesting additional information or opening an enquiry. See QTM 14-1080 (d) and QTM 15-1075.

PART 15 CONCESSIONARY RATE

15 – 1000+ Introduction

Part 15 of the Tax Regulations provides for a concessionary rate of tax to apply to the chargeable profits of a QFC Entity in certain circumstances. Article 88(1) provides that it shall apply to:

(a) a Qatari Owned QFC Entity (see QTM15-1060)

(b) a QFC Captive Insurer (see QTM13-4000)

(c) a Reinsurer (see QTM13-4020)

(d) an Investment Manager (see QTM15-1070)

The Concessionary Rate is currently set at 0% (Article 90(1)) and any QFC Entity electing for this rate will be required to pay a Concessionary Rate Charge.

15 – 1020 Implementation of the new rules

The QFC Tax Regulations are updated on different occasions. To avoid crossover periods for firms with Accounting Periods straddling the date the new regulations came into force the Tax Department has published notices for all taxpayers outlining the timing of when the new provisions or changes to the QFC Tax Regulations will come into force. For the concessionary rate the implementation is as follows;

(ii) for Qatari owned QFC Entities the new rules will apply to all new firms set up on or after 18 June 2014,

(iii) for QFC Captive Insurers and existing reinsurance firms the new concessionary rate rules will apply to their first Accounting Period commencing on or after 18 June 2014.

(iv) For Investment Managers the new rules apply to their first Accounting Period commencing on or after 18 July 2019.

15 – 1040 Election to Apply

In order to benefit from the Concessionary Rate a QFC Entity must make an election to the QFC Tax Department within 6 months from the end of the first accounting period to which the election is to apply. The election will then remain in force in respect of the three subsequent accounting periods. For example: a QFC Entity with a year end of 31 December 2015 submits an election on 25 June 2016 for the concessionary rate to apply. The election will be valid for the period 1 January 2015 to 31 December 2018.

The election is only valid if the QFC Entity has also paid the Concessionary Rate Charge, Article 88(5) (QTM15-1080).

The election cannot be revoked once made and will remain valid for the four year term of the election.

The procedural aspects of making a claim are covered in QTM-TR-3140. However, you should generally accept a claim made as part of the annual tax return submission, provided the return is filed on time and required fee paid at the same time.

Where a QFC Entity is taxed at the Concessionary rate the loss provisions in Part 5 will not apply.

15 – 1050 Conditions of validity of the election

The election will not be valid if the Core Income Generating Activities are not carried out in Qatar or the sole or main purpose of the election was the avoidance of tax under the QFC tax regulations, Article 88(10).

(a) **Core Income Generating Activities**

Core Income Generating Activities (CIGA) is a concept introduced by the 2015 BEPS Action 5 final report, titled “Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance” (the report) as part of the substantial activity requirement.

Under these requirements, a taxpayer may benefit from a preferential regime only to the extent that they undertook the core activities that generated the income covered by the preferential regime in the jurisdiction that offers the same. The CIGA should be undertaken with an adequate number of qualified full-time personnel residents in Qatar to perform these activities and with an adequate level of operating expenses.

Qatar has joined the BEPS Inclusive Framework and committed to implement the four minimum standards of the BEPS project (Actions 5, 6, 13 and 14). The requirements of Action 5 are, therefore, applicable in the QFC.

Accordingly, QFC Entities benefiting from a concessionary treatment, including the Concessionary Rate, are required to meet the substantial activity requirement and to carry out the CIGA in Qatar.

CIGA are defined in the report as follows:

- For Captive Insurers (see QTM13-4000) and Reinsurers (see QTM13-4020), CIGA include predicting and calculating risk, insuring or re-insuring against risk, and providing client services; and
- For Investment Managers (see QTM15-1070), CIGA include taking decisions on the holding and selling of investments; calculating risks and reserves; taking decisions on currency or interest fluctuations and hedging positions; and preparing relevant regulatory or other reports for government authorities and investors.

The report also provides definition of CIGA for all other geographically mobile activities that are in the scope of the Forum on Harmful Tax Practices (FHTP) work. These include: headquarters, distribution and service centers, financing and leasing, banking, shipping, holding companies.

Where a QFC Entity carries on any of these activities and benefits from a concessionary treatment, you should ensure that the corresponding CIGA (as defined in the report) are carried out in Qatar.

Carrying on CIGA in Qatar presupposes that the QFC entity has an adequate number of qualified personnel residents in Qatar to perform these activities and incurs an adequate level of operating expenses. This is part of the economic substance requirement of Action 5. When examining the tax return and financial statements of a QFC Entity that benefits from a concessionary treatment you should ensure that all these requirements are met (see QTM15 – 1075).

(b) Outsourcing

The FHTP requires that all core income generating activities are performed within the jurisdiction offering the preferential regime regardless whether they are outsourced or performed by the taxpayers themselves.

Accordingly, if any of the CIGA is outsourced by a QFC Entity benefiting from a concessionary treatment, you need to ensure that the outsourced activities are carried out in Qatar. Otherwise, the requirement on CIGA will not be met, and the election will not be valid.

Furthermore, the QFC Entity should have the capacity to properly supervise and control the work of the service provider. The employees of the service provider can then be counted for the purpose of identifying the employees of the QFC Entity used to fulfil the substantial activities requirement. However, you will need to perform further verification to ensure that only the portion of full-time equivalent employee directly used in the service of the QFC Entity is counted. This is intended to prevent the engagement of the same service provider by multiple companies in order to circumvent the requirement to have an adequate level of activities in Qatar.

The requirement above applies only to CIGA. In other words, non-core activities may be outsourced to service providers outside Qatar. Such activities include, for instance, back office functions, IT, payroll, legal services, etc.

15 – 1060 Qatari Owned QFC Entity

Article 89(1) defines the conditions for a QFC Entity to be treated as Qatar owned for the purposes of Article 88(1)(a). These are:

(a) at least 90% of the Ordinary Share Capital of the LLC is beneficially owned, directly or indirectly, by Persons who are Qatari Nationals;

(b) Persons who are Qatari Nationals are beneficially entitled to at least 90% of any profits of the LLC available for Distribution to equity holders of the LLC;

(c) Persons who are Qatari Nationals are beneficially entitled to at least 90% of any of the assets of the LLC available to equity holders on a winding up of the LLC

(d) Is not an Authorised Firm.

Qatari nationals is defined in Article 153 as ’individuals holding, or entitled to hold, a Qatari passport’.

It should be noted that this election is not open to all Qatari owned businesses. It only applies to LLC’s and non-Authorised Firms. Authorised Firm is defined in Article 153 as ‘a

Person that has been granted, and continues to hold, an Authorisation in accordance with Part 5 of the Financial Services Regulations'.

15 – 1070 Investment Managers

Article 88(6) allows Investment Managers to elect for the zero per cent concessionary rate provided they meet a number of requirements.

An Investment Manager is a QFC Entity that carries on one or more of the Qualifying Investment Activities, which are the following:

- managing investments as defined in the QFC Financial Services Regulations Schedule 3, Part 2;
- operating a collective investment fund as defined in the QFC Financial Services Regulations Schedule 3, Part 2;
- operating a Special Investment Fund; or
- managing a Special Investment Fund;

To qualify for the election, the Investment Manager must:

a) be duly authorized to carry on the Qualifying Investment Activities;
b) employ on a full-time basis an adequate number of qualified investment professionals that are resident in Qatar each earning a total monthly salary (including fringe benefits) of at least QAR 15,000 per month, provided that this number shall not be less than three;
c) have assets under management of a value of not less than QAR 150 million;
d) incur an adequate amount of operating expenses, which shall not be less than QAR 1,000,000 per Accounting Period; and
e) have the accounts audited and reported on by an external auditor.

These requirements must be met in each of the Accounting Periods for which the election is to be exercised. The Concessionary Rate shall not be granted in an Accounting Period, if during that Accounting Period, any of the requirements is not met. The standard rate will apply to the total amount of Taxable Profits of that Accounting Period.

The investment professionals must be based in Qatar. They are expected to carry on the CIGA. You need therefore to check the profile, roles and responsibilities of the QFC Entity's investment professionals to ensure that they are able to perform the actions and take the decisions expected from an investment manager. Their number must be adequate to the level of activity of the QFC Entity and may not be less than 3 full time employees.

If you have evidence that all or part of the CIGA are carried out outside Qatar, the election shall be invalidated and the QFC entity becomes taxable at the standard rate.

If the outsourcing is made to a service provider in Qatar, you need to understand the volume of work provided by the service provider to the QFC Entity in terms of full time equivalent (FTE) resources. These resources will be added to the full-time employees of the QFC Entity (which may not be less than 3) to assess whether or not the QFC entity has an adequate number of employees.

15 – 1075 Monitoring

As in the case of election for special exempt status (see QTM 14 – 1080), the Tax Department will monitor compliance with the conditions of validity of the election for the concessionary rate.

The monitoring should start with reviewing the information provided in the tax return and the tax computation. When examining the tax return and the financial statements of the QFC Entity, you need to check the following:

- the QFC Entity opted for the Concessionary Rate (by ticking the proper box in the return)
- the QFC Entity provides a clear statement that CIGA were carried out in Qatar
- where all or part of the CIGA is outsourced to a service provider in Qatar, the QFC Entity identifies the service provider and provides the details of the contract or arrangement under which the services are provided.

You should particularly focus on the condition that CIGA have been performed in Qatar. To this effect, you will need to check the amount of operating expenses and the number of employees and review their adequacy (see QTM 14-1080 (a) and (b)). You should also ask for further information, if needed, to make a determination as to whether or not the CIGA have been carried out in Qatar through an adequate number of qualified employees and with an adequate level of operating expenses. If these conditions are not met the election should be rejected. A recommendation to this effect should be submitted to the Director of Tax with a detailed presentation of the reasons why the election is to be denied (see QTM 14-1060).

If, despite the denial of the election, the QFC files a return on the basis that the concessionary applies to them, you should open an enquiry to deny the concessionary rate and apply the standard tax rate.

15 – 1080 Concessionary Rate Charge

Any QFC Entity electing for the Concessionary Rate will be required to pay the Concessionary Rate Charge which is based on the share capital of the entity at the end of the first accounting period to which the election is to apply, the "relevant time" (Article 91(2)). For an entity with a share capital of QR1,500,000 or less the charge is QR10,000 and for an entity with a share capital in excess of QR1,500,000 the charge will be QR20,000 (Article 91(1)).

For Branches the Concessionary Rate charge will be based on the share capital of the non-resident QFC Entity of which the QFC Branch is a part of. This is likely to result in the larger charge applying for branches. Where it is felt that by using the share capital of the non-resident results in the higher charge applying when an LLC of the same size as the branch would have qualified for the lower charge consideration should be given to the QFCRA capital requirements for LLC's, Captive Insurers and Reinsurance companies.

Where the QFCRA capital requirements are such that the lower charge would arise and using the non-resident share capital as a starting point a reasonable attribution of share capital to the Branch can be done to determine if the lower charge is reasonable in the circumstances.

In addition to the above for entities that carry out both insurance and reinsurance businesses it may be necessary to apportion the share capital, however this will only be necessary where the lower rate charge would apply if the share capital is apportioned between the two trades.

QFCRA Base Capital Requirements as at October 2015;

Captive Insurer	From $150,000 to $1million depending on class.
Reinsurance	$20million

The Concessionary Rate Charge is payable 6 months after the end of the first accounting period for which the concessionary rate applies, Article 92(1).

15 – 1100 Apportionment of Chargeable Profits

There may be circumstances where the profits of an entity are partly liable to tax at the standard rate and partly liable at the concessionary rate. In these circumstances it is expected that he accounts allow a clear segregation between activities that are taxable at the standard rate and those that are taxable at the Concessionary Rate (or exempt). The accounts should allow determination of revenues and the tracking of expenses, at least those related to the CIGA, to the corresponding profits.

Where such tracking is not possible, the profits should be apportioned on a just and reasonable basis. Determination of revenues is expected to be straightforward. You may rely on contracts, time sheets of fee earners etc. to ascertain them. Expenses related to CIGA are also expected to be determined reasonably easily based on time sheets. Non CIGA related expenses may be determined on a reasonable allocation key, which would depend on the nature of the expense. For example, payroll expenses may be allocated on the basis of headcount; IT related expenses may be allocated on the basis of the number of users or machines etc.

Attention should be paid to the basis of apportionment of expenses to ensure that an excessive amount of expenses are not allocated against income taxable at the standard rate.

PART 16 TAX CREDITS

16 – 1000+ Credit for Tax Losses

Part 16 of the QFC Tax Regulations introduces a new and innovative arrangement whereby firms establishing within the QFC, and which fall within the list of entities entitled to benefit from the scheme, can claim a cash reimbursement for tax losses incurred in the first two accounting periods of operation. There a number of conditions to be met to claim the loss and not all losses can be reclaimed. Article 96 sets out the process for making a claim for reimbursement. There are additional anti avoidance provisions to ensure that the scheme is not abused in a way that would allow credits to be claimed where they should not be due. This section looks at all of the above areas in detail.

16 – 1020 The Basic Scheme

In order for a QFC Entity to benefit from the tax loss credit scheme it must meet the following conditions:

(v) it must be an LLC,

(vi) it must carry on a Licensed Activity (ie the activity under its QFC licence),

(vii) it must have at least 3 employees,

(viii) it meets all the conditions in Tax 15 (QTM16-1120),

(ix) it has not elected for exempt status (Part 14) or for its profits to be taxed at the concessionary rate (Part 15).

This credit was not available under the old QFC Tax Regulations and only came into force on 18 June 2014, when the new/updated regulations were approved. As such the concession is only available to firms meeting all of the necessary criteria who were set up on or after 18 June 2014.

16 – 1040 Reimbursable Tax Losses

The Reimbursable Tax losses are calculated in the same manner as tax losses in accordance with Article 27, with the additional condition that no deduction will be available in respect of the following items:

(a) expenses not incurred in the State. This is similar to the requirement in Article 21(3) for expenditure to be incurred in Qatar (QTM5-1040),

(b) depreciation of tangible fixed assets,

(c) amortisation of intangible fixed assets,

(d) interest incurred on indebtedness, and

(e) any distribution.

The costs incurred in (a) to (d) can still be included in the calculation of losses available for carry forward or for surrender by way of group relief. Care is need to ensure that losses are not claimed twice as losses available for either group relief or carry forward will be reduced by the amount of the reimbursable tax loss (Article 98).

Example

Below are the results for a QFC LLC set up on 7 November 2014, which commenced to trade on 1 December 2014 and submitted a claim (and was granted) for their first AP to run from 1 December 2014 to 31 December 2015 (13months).

	13 month AP 31 December 2015 QR'000	**y/e 31 December 2016 QR'000**
Revenue	1,000	2,000
Expenses		
Rent	(400)	(500)
Salaries	(720)	(1,200)
Depreciation	(50)	(50)
Costs paid to Head Office in DIFC for set up	(180)	
Cost of Sales	(450)	(750)
Net Loss	**(800)**	**(500)**

The Initial Accounting Period is 13 months and a net loss of QR.800,000 has been realised. However, this includes QR.50,000 relating to depreciation and QR.180,000 of expenses not incurred in Qatar. As such the maximum loss available for the tax loss credit is

QR.570,000 (800-180-50). The QR.180,000 incurred by the Head Office for set up are unlikely to be allowed as these do not relate to local source income and are therefore disallowed, leaving losses of QR.50,000 arising from depreciation available to carry forward.

In the Successive Accounting Period a net loss of QR.500,000 has arisen. The maximum loss available for the tax credit claim will be QR.450,000 (i.e. excluding the depreciation expense). The depreciation expense will be added to the losses brought forward from the Initial AP (QR.50,000), resulting in losses of QR.100,000 to carry forward at 31 December 2016.

16 – 1060 Reimbursable Accounting Period

The period over which reimbursable losses can accrue is called the reimbursable accounting period and includes the first accounting period of the QFC Entity under the tax regulations, the "initial accounting period", and the accounting period immediately after the initial accounting period, the "succeeding accounting period" (Article 153). The Initial Accounting Period could include an extended accounting period under TAX8.1.3 of up to 18 months so a reimbursable accounting period could be as long as 30 months.

16 – 1080 Payment of Reimbursable Tax Losses - Claim

In order to receive a payment in respect of its reimbursable tax losses a QFC Entity must submit a claim to the Tax Department within six months of the end of the reimbursable accounting period to which the loss relates. This will generally be done as part of the firm's annual tax return filing. Firms who apply for an extension to their normal filing date (See QTM19-2100) or file their return late will need to adhere to the six month deadline, if the claim is received outside of this timeframe it should be rejected.

We will aim to pay the tax credit within six months of the date the Entity files its tax return including the loss (Article 96(3)) or submits the tax loss credit claim. There is no sanction on the Tax Department for paying the credit late, however the credit is offered as an incentive to set up in the QFC and to assist in early period cash flow so you should ensure that the payment of the credit is not unreasonably delayed.

There may be circumstances where the tax return has not been agreed, but it has been determined that there are sufficient reimbursable tax losses to make either a part or full payment of the credit. In those circumstances the payment can be made prior to the agreement of the return, assuming there are no other reasons to delay payment.

16 – 1100 Restriction to Elect for Special Exempt Status or Concessionary Rate

Article 100 provides that once a QFC Entity has received payment of a reimbursable tax loss then it is not able to elect for either special exempt status or for the concessionary rate in any of the three accounting periods following the reimbursable accounting period, ie the initial and subsequent accounting periods in which the tax loss was claimed.

The credit has been designed to encourage firms that are likely to be taxpayers in the future to set up in the QFC, not firms that would normally elect to pay no tax. If a taxpayer who would ordinarily qualify for special exempt status or to be taxable at the concessionary rate, does not elect for either of those provisions to apply any future election by them for either exempt status or the concessionary rate should be reviewed carefully. If it is felt the sole reason for not electing for these provisions was to claim the tax credit you should consider whether the anti-avoidance provisions in Article 99 apply and whether a refund of the tax credit claimed is due.

16 – 1120 Anti-Avoidance Provisions

Article 99 incorporates a "disqualifying purpose" test into the provisions of Part 16. Where arrangements have been entered into wholly or mainly for a disqualifying purpose then they should be ignored for the purposes of determining the amount of the reimbursable tax loss. A disqualifying purpose is any arrangement entered into by a QFC Entity in order to obtain a credit it was not entitled to, or obtain a credit greater than it would otherwise have been entitled to.

This is a new provision and so there is no experience of the type of arrangements that might be entered into, but Article 99(2) defines arrangements as including 'any action, scheme, agreement or understanding.' Certainly any claims should be reviewed to ensure costs have not been brought forward into earlier accounting periods, or that expenses not incurred in Qatar have been routed through a Qatari entity to try and claim it was 'incurred in the State'.

16 – 1140 Limit on Amount of Claim

The amount of tax credit resulting from a claim for a reimbursable loss is the lower of:

(x) 8% of the reimbursable loss for the reimbursable accounting period, or

(xi) QR200,000.

The percentage in (i) above may be amended by the Director of Taxation in the future by way of publication of a public notice, (TAX15.1.2(A)).

16 – 1180 Qualifying QFC Entities

An LLC may only make a claim if it falls within the list of QFC Entities entitled to benefit from Part 16 of the Tax Regulations published by the Tax Department by way of a public notice (TAX15.1.1). This list may be updated by the Director of Taxation from time to time.

The current list issued by the Director of Tax in January 2015 includes all non-regulated activities.

16 – 2000 Tax Credit – Web Summit Entities

In an effort to attract foreign direct investment into the State of Qatar and ensure the success of the Web Summit held in Doha on 26 – 29 February 2024, QFCA has acted as the main registering platform for startups participating in the Summit, and granted certain incentives to startups licensed with the QFCA. The key incentive consists of a tax credit in relation to business-related expenses, whereby a qualifying QFC entity (see QTM 16 – 2020 below) would be entitled to a refund of expenses equal to the tax liability due for the concerned Accounting Period, as detailed below. The incentive will be granted for a period of five years following the licence date.

16 – 2020 Qualifying Entities

The incentive will only be available to firms who satisfy **all** of the following conditions:

a. The QFC Entity must have registered to attend and attended the Web Summit,
b. The QFC Entity must not be a Connected Person (see QTM4 – 5060) to an entity already incorporated in the QFC that carries on the same or similar activity,
c. The startup's business model must be innovative and must embed technology as a main component, and
d. The startup's business model must be scalable and have significant growth potential.

Condition (a) above will be determined by the licensing team at the point the QFC Entity is licensed.

Condition (c) may seem somewhat subjective, as there is no clear definition of what an innovative business model is and to what extent technology should be embedded therein to be considered as the main component. While firms are expected to demonstrate that they are introducing new ideas, methods, designs etc. to the marketplace using technology as the driving force to deliver new products/services, you may need to exercise a certain level of judgement as to these aspects. In some cases, this will be straightforward. For Fintech Firms, for instance, it will generally be clear that the business model is innovative (considering the level of development of the sector in Qatar) and that technology is the main component in that model. In other cases, however, you will need to look further into the operations of the firm (for example, review the firm's website, social media, etc.), the sector in which it operates, the competition, etc. (you may have access to these in the firm's license application/business case) to determine whether or not condition (c) is met.

Like condition (c), condition (d) is also somewhat subjective, and the firm is expected to demonstrate that it is met. When assessing the firm's submission to determine whether or not the activities of the firm are scalable, factors such as market size, position vis a vis the competition, access to funding and steps taken to market the technology should be considered. If the firm provided projections as part of their licence application these should also be considered.

While looking into all these conditions (possibly best through an enquiry), you are expected to adopt a reasonable approach and take into account the policy objective of the measure and all the relevant facts and circumstances of the case. In case of doubt, the issue should be discussed with the Director of Tax at an early stage.

Economic Substance

All Qualifying Entities are required to have economic substance in Qatar. Specifically, this requires each entity to have (i) an adequate number of qualified employees who are resident in Qatar, (ii) incur an adequate amount of operational expenses in Qatar and (iii) carry on the core income generating activities from Qatar.

When determining these criteria look to QTM14 – 1080 for guidance, however bear in mind that Web Sumit firms are new start-ups and therefore having a single employee and a low level of opex at the outset may be adequate for that business until it expands.

16 – 2040 Computation of Tax

Qualifying entities remain taxable under the QFC Tax Regulations. All standard rules regarding the computation of taxable profits and the administrative requirements shall apply.

The Tax Return and Tax Computation of a qualifying entity should be prepared in the same manner as all other QFC entities.

Upon filing the Tax Return a qualifying entity will identify itself as a Web Summit firm and will be allowed to make the relevant tax adjustment in the Tax Return (Box 62 – Unilateral Tax Relief) after the taxable profit is determined.

16 – 2060 Qualifying Expenses and Computation of Expense Refund

Upon calculation of the Taxable Profits, a Qualifying Entity will compute the refund due in respect of qualifying expenses (see QTM16 – 2080).

The refund due on qualifying expenses will be limited to the tax due.

Example 1:

QFC firm A has Turnover of QR400,000, qualifying expenses of QR150,000 for the year ended 31 December 2025. The Taxable profit of Firm A is QR.250,000 and tax due on this is QR.25,000. The firm can claim QR.25,000 tax credit from qualifying expenses of QR.150,000.

	QR
Income	400,000
Expenses	(150,000)
Taxable Profits	250,000

10 % Tax	25,000
Unilateral Tax Relief (from expenses of 150,000)	(25,000)
Tax payable	**Nil**

Where the tax due exceeds the qualifying expenses, the firm may carry the excess tax due to the next period such that the current year's tax payable remains nil. In the following year, the firm may deduct the qualifying expenses of that year from the aggregate amount of: (i) the tax due brought forward from last year, and (ii) the current year's tax due. Firms will be required to file a detailed Tax Computation showing qualifying expenses, the current year's tax due and the tax due carry forward.

While this is a peculiar and highly unlikely case (i.e. the amount of tax due exceeds the amount of expenses), it is still relevant to address it as, mathematically, it is possible and could occur.

Example 2:

Qualifying Firm B has turnover of QR.3.8million and expenses of QR.200,000 in the period ended 31 December 2025. Tax due on the profit of QR.3.6million is QR.360,000. The qualifying expenses of QR.200,000 are insufficient to cover the amount of tax liability and reduce the tax due to nil. In this case, the excess amount of tax due of QR.160,000 is carried over to 2026 and the tax liability for 2025 would remain nil.

2025 Figures	**Actual**	**Tax Computation**	**Tax Return**
Income	3,800,000	3,800,000	3,800,000
Expenses	(200,000)	(200,000)	(200,000)
Taxable Profits	3,600,000	3,600,000	3,600,000
10 % Tax	360,000	360,000	360,000
Unilateral Tax Relief (from expenses of 200,000)	(200,000)	(360,000)	(360,000)
Tax payable	**160,000**	**nil**	**nil**
Carry forward to 2026		**160,000**	

In 2026, the above Firm B has turnover of QR.2.4m and qualifying expenses of QR.1.8m. The offset would be as follows:

2026 Figures	Actual	Tax Computation	Tax Return
Income	2,400,000	2,400,000	2,400,000
Expenses	(1,800,000)	(1,800,000)	(1,800,000)
Taxable Profits	600,000	600,000	600,000
10 % Tax	60,000	60,000	60,000
2025 tax due b/fwd		160,000	
Unilateral Tax Relief (from expenses of 1.8m)	(60,000)	(220,000)	(60,000)
Tax payable	**nil**	**nil**	**nil**
Carry forward to 2026		**nil**	

Where a firm has a carry forward after the fifth year, that excess will be carried forward to their sixth Accounting Period and paid in that year. In the above example, if Firm B was licensed in 2024 and the figures noted above for 2025 instead arose in 2028 (the firms fifth year). The total tax due in the sixth year (2029) would be QR.220,000 (60,000 from 2029 plus QR160,000 brought forward from 2028).

Where a firm has losses in the sixth year, but tax due brought forward as a result of an excess of tax liability over qualifying expenses, the firm will still be required to pay the tax due brought forward regardless of the loss status of that year; the reason being that the tax liability arose as a result of an insufficient amount of qualifying expenses, and as a matter of principle, firms should not be compensated at an amount that exceeds what they have incurred as business expenses.

As to the losses of the sixth year, they may be carried forward in the normal manner.

Example 3:

Let's take the data of example 2 and assume that Firm B was registered at the 2024 Web Summit, had tax due of QR.160,000 brought forward in 2029 (sixth year), but made a loss of QR.500,000 in 2029. The firm would be required to pay tax due of QR.160,000 by 30 June 2030, but the firm would also be allowed to carry forward QR.500,000 of losses to the next accounting period (y/e 31 December 2030) as normal.

16 – 2080 Qualifying Expenses

Qualifying expenses are those expenses incurred by the firm in the ordinary course of business and required to generate local source income. Expenses not allowed under any article of the Tax Regulations will not be qualifying expenses for the purposes of this incentive.

Apportionment of qualifying expenses will be required during the Accounting Period where the five-year incentive time limit expires. In such cases the QFC will follow a just and reasonable basis for the apportionment of chargeable profits and expenses. (See QTM4 – 2020 and QTM15 – 1100).

Firms may choose to apply an apportionment method based on a timing split, or they may opt for an actual basis based on the date income and expenses were earnt/incurred. Either should be accepted.

Example 4:

Firm XY was licensed on 15 May 2024. Their chosen year end is 31 December. The firm's incentive will expire on 14 May 2029. Qualifying expenses and taxable profits arising during period 1 Jan 2029 to 14 May 2029 will be entitled to the tax credit, whereas taxable profits arising from 15 May 2029 to 31 December 2029 will not be entitled to the credit. Firm XY has operating expenses (which are all qualifying expenses) of QR.500,000 during the year ended 31 December 2029 and Revenue of QR.1,200,000. Using the apportionment method the firm would split the taxable profits as below with tax payable of QR.43,918 due after applying the tax credit.

2029 Figures	**Actual**	**1 Jan 29 – 14 May 29**	**15 May 29 – 31 Dec 29**
		136 Days	**229 days**
Income	1,200,000	447,123	752,877
Expenses	(500,000)	(186,301)	(313,699)
Taxable Profits	700,000	260,822	439,178
Tax at 10%		26,082	43,918
Unilateral Tax Relief (from expenses of QR186k)		(26,082)	
Tax payable		**nil**	**43,918**

16 – 2100 Timing

The incentive period is five years from the registration and licence date of the qualifying QFC entity. This is regardless of the Accounting Period chosen or commencement date (see QTM3-2020). This is likely to result in apportionment of expenses in the sixth accounting period.

Example 5:

Qualifying Firm C was licensed on 1 March 2024 with a chosen financial year end of 31 December. Firm C remained inactive (dormant) until 1 October 2027. The incentive for Firm C expires on 28 February 2029. Firm C can apply the incentive for the period 1 October 2027 – 31 December 2027, 1 January 2028 – 31 December 2028 and for the period 1 January 2029 to 28 February 2029 as part of the year ended 31 December 2029.

16 – 2120 Limitation of Benefits

The Web Summit incentive is designed to foster innovation and provide a conducive business environment for start-up businesses in Qatar. Therefore, where achieving this policy objective is not envisaged, the incentive should not be available. Hence, the following anti-abuse conditions apply:

(i) The credit cannot be combined with any other concessionary treatment provided for under the QFC Tax Regulations (including exemptions and the concessionary rate),

(ii) Where, following incorporation, a change is made to the ownership or scope of licence of the QFC Entity, such that it becomes Connected to an existing QFC entity carrying on similar activities to, or the same activities as, the existing QFC entity, then the former will no longer be treated as a qualifying entity and will not be entitled to the incentive, and

(iii) Where a qualifying QFC entity applying for the incentive or any Person Connected therewith carries out arrangements, the main purpose of which is to benefit from the incentive in an abusive way, then the credit will be denied.

When considering whether an arrangement is abusive, officers must bear in mind the purpose behind the incentive while considering: (i) whether or not the arrangement in question is consistent with the policy objective of the incentive, (ii) the reasonableness of the arrangement and, (iii) whether it includes contrived, unnecessary or abnormal steps.

Part 17 THE QFCA TAX DEPARTMENT

17 – 1000+ Establishment of the QFCA Tax Department

The QFCA Tax Department is established by the QFCA (Article 101(1)) and is headed by the QFCA Director of Tax, who is appointed by the QFCA CEO and Director-General. The Director of Tax is responsible for administration of the Tax Regulations and the management of the Tax Department (Articles 101(2) and (3).

17 – 1020 Supervision of the Tax Department

The Tax Department is subject to the supervision of the QFCA (Article 101(4)). The QFCA Board delegated, under Article 6.3 of the QFC Law, certain powers and functions relating to taxation to the QFCA Executive. The effect of the delegation order is to give the Director of Tax decision making power in all matters relating to the administration of corporation tax, apart from a few powers which the Board have reserved to themselves. In addition, the delegation order specifies certain powers should only be exercised with the consent of the QFCA CEO and Director-General, and after consultation with the QFC Business Development and Legal Departments. The delegated powers and functions are set out in further detail in a tax delegation matrix which is reviewed and updated as necessary.

17 – 1040 Delegation within the Tax Department

The Director of Tax may, under Article 102, delegate to any Officer of the Tax Department any duties, powers and functions conferred or imposed upon him/her, with the exception of the power of delegation itself and the power to authorise an Officer to examine a person (Article 138(1b))

PART 18 RULINGS BY TAX DEPARTMENT

18 – 1000+ Rulings and Practice Notes

18 – 1000 Introduction

The QFC tax system is founded on the principles that the law should be as clear as possible and that taxpayers should have a high degree of certainty regarding the tax consequences of transactions they enter into. To support these principles the Regulations contain an advance rulings regime and also allow the Tax Department to issue practice notes.

A taxpayer may apply for an advance ruling up to two months before the filing date of the relevant return and may be pre or post transaction. Provided there has been full disclosure we are bound by the rulings we make. A ruling relates to specific transactions entered into by a particular taxpayer and are not published.

Where we feel it would be helpful to publicise our understanding of how the law operates in a certain area, or where a taxpayer asks for clarification of how, in general terms, we consider the law applies, we may issue a practice note. A practice note sets out our interpretation of a particular aspect, or aspects, of the Regulations or Tax Rules and is binding upon us.

The legislation is contained in Part 18 of the Regulations and the procedural aspects for advanced rulings may be found at TAX 7.

18 – 2000+ Rulings

18 – 2000 Scope

A taxpayer may apply for a ruling in respect of an 'arrangement' (Article 105(1)). The term 'arrangement' is not defined but the meaning is wide, and should be regarded as including any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable). The applicant must be able to explain what he/she considers the tax consequences of the arrangement are and why he/she considers those consequences prevail (TAX 7.1(D) and see QTM18-2120). This requirement prevents a ruling being sought in terms that are too general. It is intended that a taxpayer should be able to seek a ruling with regard to matters such as whether specific items of income are taxable, the admissibility of expenses through to agreement of an entity's transfer pricing policy, akin to an advance pricing agreement.

18 – 2020 Tax Avoidance

You may decline to give a ruling if you consider an arrangement constitutes, or is part of, an avoidance scheme (Article 105(2)). This is a subjective judgement and you should only refuse to give a ruling where there are strong grounds for considering that the ruling relates to an avoidance scheme, such as the presence of artificial or non-commercial steps in a series of transactions. If you consider a ruling request may relate to an avoidance scheme, the papers should be referred to the Director of Tax and you should not decline to give a ruling without the Director's authority. There is no appeal against a decision not to give a ruling, but if you do the advance ruling fee should be repaid (see QTM18-2100).

18 – 2040 Frivolous or Vexatious Applications and Applications that do not Involve Genuine Doubt or Difficulty.

You may refuse to give an advance ruling if the application is frivolous or vexatious or does not involve genuine points of doubt or difficulty (Article 105(2)). It will be very unusual, given the nature of the QFC taxpayer base, to receive rulings applications that fall within these categories. The part of Article 105(2) dealing with such applications is thus largely precautionary. The terms 'frivolous' and 'vexatious' are not defined in the Regulations but the phrase 'frivolous or vexatious' has a well-established track record in striking out legal proceedings. In general, a proceeding can be declared frivolous or vexatious only if no reasonable person could properly treat it as bona fide. Adopting this meaning, you should only refuse to give a ruling on the grounds the application is frivolous or vexatious if you consider no reasonable person could regard the application as having been made in good faith.

Dictionary definitions of frivolous refer to "trifling; not serious" and an application will fall into this category if the relevant issues of are of a very minor nature and would not warrant any action at all or any action required would be disproportionate. An example would be an advance ruling request for a trifling amount where there was no general point of principle involved. The fact that a QR6,000 fee has to be paid for an advance ruling should eliminate frivolous requests.

Dictionary definitions of vexatious refer to “causing annoyance or worry”. A rulings application may be regarded as vexatious if it is *designed* to subject the Tax Department to inconvenience, harassment or expense.

It will be most unusual to receive a ruling request that does not contain genuine points of doubt or difficulty but it may apply if a taxpayer attempts to use the rulings procedure to obtain information or the Tax Department view on matters that are not appropriate to a ruling, for example proposed legislative or procedural changes.

The Director of Tax must approve any refusal to give a ruling on the grounds the application is frivolous or vexatious or does not involve genuine points of doubt or difficulty. Where a ruling is so refused the advance ruling fee should be repaid.

18 – 2060 Binding on the Tax Department.

Rulings are generally binding on the Tax Department, but not on the taxpayer. To have binding force, the taxpayer must have made a full disclosure of the transaction(s) and the transaction(s) must, in all material aspects, have proceeded as described in the application. In addition, in respect of a pre-transaction ruling, the ruling is only binding if the proposed transaction(s) has been carried out within twelve months of the ruling being made (Articles 105(4) and (5)).

18 – 2080 Time Limit.

There is no statutory time limit in respect of pre-transaction rulings but a post-transaction ruling must be made within 60 days of the filing date for the return for the accounting period during which the transaction(s) were executed. This time limit is intended to prevent the Tax Department being obliged to give a ruling where the return for the accounting period in which the transactions took place has been, or should have been, filed and it is therefore more appropriate for any discussion regarding the tax treatment to arise from an enquiry into the return, which may be opened if the Tax Department feel the correct tax treatment of the transaction(s) in question is not reflected in the return. It makes little sense for a ruling to be given, guiding a taxpayer as to how a return should be made, if that return has already been, or is due to be, filed. Because rulings are intended to clarify the tax position in advance of the submission of a return, you should decline to give a pre-transaction ruling where the application is made within 30 days of the end of the accounting period to which the transaction(s) relate.

18 – 2100 Fee

There is a fee of QR 6,000 that must be paid in full before a ruling is given. The fee is refundable if the Tax Department fail to or decline to give a ruling (TAX 7.3). As well as compensating for the work necessary to give a ruling the fee should also inhibit rulings requests that are trivial or frivolous (see QTM18-2040).

18 – 2120 Information to Support a Ruling Application

General

A ruling may only be sought by QFC Entities. An application has to contain certain information contained in TAX 7.1 (and for post-transaction rulings, supplemented by TAX 7.2 – see QTM18-2040) detailed below, and cannot be framed in general terms. However when considering a rulings application, it should be remembered the underlying principle is to provide the taxpayer with as much clarity and certainty as possible and the conditions at TAX 7.1 and 7.2 should not be interpreted too rigidly if you are convinced the application represents a complete disclosure and is generally sound.

The detailed information to be provided with all rulings is (TAX 7.1):

(a) The Name and TIN of the applicant

(b) Full particulars of the arrangement in respect of which a ruling is sought

(c) Copies of all documents relevant to the ruling, identifying the relevant passages within those documents

(d) A statement of the applicant's opinion of the tax consequences of the arrangement, with reasons why the applicant is of that opinion.

(e) The applicant's explanation of the particular point, or points, of difficulty that gave rise to the ruling application

(f) Details of the provisions in the Regulations or Rules that the applicant feels are relevant to the application

(g) Details of any case law or practice notes that the applicant considers are relevant to the application.

Post-Transaction Rulings

Where the application for a ruling relates to transactions that have already taken place, in addition to the information detailed at QTM18-2120, the applicant must also provide the following information (Tax 7.2):

(a) The date(s) on which the transactions relevant to the application took place

(b) Identification of the particular aspect(s) of the transactions in respect of which a ruling is being requested

(c) Certification that to the best of the applicant's knowledge and belief there has been full and accurate disclosure.

18 – 2140 Procedures

Advance rulings are a key part of the Tax Department's policy of providing an efficient and transparent service to taxpayers and providing them with as much certainty as possible. It follows advance rulings requests should be given high priority. Our published aim is to respond to a ruling within 30 days of receipt. Sometimes this may not be possible because, for example, of pressure of work or because of the complexity of the application or because further information is required before a ruling may be given. Where it is not possible to deal with a ruling within 30 days you should write to the taxpayer explaining the position and also letting him know by when you expect to be able to issue the ruling.

Whenever a ruling request is received an entry must be made in the Advance Rulings Establishment File. This Establishment file must also be used to record the outcome of the application and a copy of the ruling itself should also be filed there. The Director of Tax must approve all advance rulings, and a copy of that approval recorded in the Advance Rulings Establishment file.

The process for handling, and where appropriate repaying, advance rulings fees are dealt with in the Tax Workbench Guide.

18 – 2160 Form of Ruling

There is no prescribed form for a ruling but a ruling should always be given in writing, addressed to the taxpayer or any agent authorised to act on the taxpayer's behalf. The wording of the letter giving a ruling should be as clear and as comprehensive as possible. The letter should describe or identify precisely the arrangement in respect of which the ruling is being given and also identify the relevant accounting period(s). The ruling letter should also specify the relevant legislation and set out in clear terms the interpretation of that legislation, as it applies to the particular facts of the ruling. A ruling should not be used to express broad or general matters of interpretation – such matters are proper to a practice note (see QTM18-3000+).

18 – 3000+ Practice Notes

18 – 3000 General

Where we feel it would be helpful to publicise our understanding of how the law operates in a certain area, or where a taxpayer asks for clarification of how in general terms, we consider the law applies, we may issue a practice note. A practice note sets out our interpretation of a particular aspect, or aspects, of the Regulations or Tax Rules and is binding upon us, but not on taxpayers (Article 106). However the binding nature of a practice note comes to an end if the Tax Department revoke the note (Article 106(2)). A practice note may give our interpretation of any aspect of the Tax regulations or Rules. A practice note may also indicate that we intend, in certain specified circumstances, to apply the law in a way that is more favourable to the taxpayer than would be the case if it were applied strictly. A practice note may not, however, introduce any new obligation or burden on a taxpayer that is not supported by the law.

Practice notes are to be made public and may be published freely, as well as being posted on the QFC website.

18 – 3020 Procedures

The process of researching and formulating a practice note should be fully documented and recorded in a precedent file opened for the purpose. This file should be a sub-file of the Practice Note Establishment file which must be used to record the procedural aspects of the issue of practice notes. Where a practice note merely clarifies the interpretation of some aspect of the Tax Regulations or Rules, or is concerned purely with administrative matters, its issue may be authorised by the Director of Tax. Where however, the practice note in effect changes Tax Department policy by, for example, changing our existing interpretation of some aspect of the Tax Regulations or rules, or by introducing some concessionary practice, then you should, via the Director of Tax, consult with the QFC Group Chief Legal Officer (GCLO). Such consultation should also be undertaken where the practice note involves matters of uncertainty regarding the interpretation of QFC tax law. The practice note establishment file should contain a copy of all such consultations with the GCLO.

18 – 3040 Effective Date

A practice note is binding from the date it is made public. This means the Tax Department are not bound by a practice note with respect to transactions taking place before the note was issued, even though the return covering the transactions may not be filed until after the practice note was issued. Similarly, when a practice note is revoked it ceases to be binding on the tax Department from the date of the public notice revoking the note.

18 – 3060 Concessionary Statements of Practice

The Tax Department may at any time issue a concessionary statement of practice setting out that they will treat Persons as if they were entitled to (a) a reduction in a liability to tax, or (b) any other concession relating to tax, to which they are not, or may not be, entitled in accordance with the QFC Tax Regulations (Article 101(6)). This provision should under no circumstances be used to provide one QFC taxpayer with a tax treatment more advantageous than a second QFC taxpayer. The intention behind this provision is to allow the QFC Tax Department to:

(ii) deal with a situation where the drafting and/or interpretation of an Article in the QFC Tax Regulations is not in line with the original intention of the Article, or

(iii) deal with a situation where other areas of QFC law has changed and impacts on the QFC Tax Regulations, or the QFC law change is not specifically covered by the current QFC Tax Regulations.

Situations where the QFC Tax Department is merely clarifying its understanding of how the law works in certain areas should be dealt with by the issuance of a Practice note (QTM18-3000).

A Concessionary Statement of Practice can never impose an additional tax liability on a taxpayer, but can only provide for a reduction or other concession in respect of QFC taxation. It should always be approved by the Director of Tax.

PART 19 RECORDS AND RETURNS

19 – 1000+ Obligation to Maintain and Preserve Records

19 – 1000 General

Article 108 provides the authority for the tax rulebook (TAX) to specify the books of account and other records that are to be maintained and preserved by taxpayers.

TAX 6 deals with taxpayers obligations with regard to the maintenance and preservation of records. TAX 6 applies to every QFC Entity required to file a return for an accounting period.

19 – 1020 Records to be Maintained

TAX 6.1 obliges taxpayers to maintain whatever records are necessary to enable it to file a ‘correct and complete’ return. TAX 6.3 extends this general rule by specifying the records to be maintained (and preserved) under Tax 6 includes records of all sums of money received or expended, all sales and purchases of goods and services and other transactions and the assets and liabilities of the QFC entity. In addition supporting documents relating to the records must be maintained (and preserved) including (but not limited to) accounts, books of account, deeds, contracts, vouchers and receipts. The records must be sufficient to show and explain all transactions and to disclose with reasonable accuracy the financial position of the QFC Entity at any time.

19 – 1040 Preservation of Records

The records to be maintained under TAX 6 must be kept for six years from the end of the accounting period to which they relate or (if later) the completion of any enquiry into the return for the accounting period to which the records relate.

19 – 1060 Copies

To comply with TAX 6, normally the original records and supporting documents have to be preserved. However, Tax 6.4 states that the preservation of the 'information contained in the records' will satisfy the requirements of TAX 6. The rule is principally designed to allow the preservation of records in an electronic format. Where records are maintained in an electronic format, a copy of any document forming part of the electronic records (such as a print out of an electronically stored document) is admissible in evidence before the Regulatory Tribunal, in the same way as the original record.

19 – 1080 Penalties

Article 108(2) provides for a penalty, not exceeding QR 20,000, to be imposed on a QFC Entity failing to comply with TAX 6. As TAX 6 imposes record keeping requirements for each accounting period, a penalty may be charged for each accounting period where there has been a failure. In practice a penalty under TAX 6 should be reserved for the most blatant failures. When an enquiry reveals inadequate records have been maintained, that fact will usually be a factor in determining the level of mitigation of a tax geared penalty for making an incorrect return under Article 119. A penalty under this rule may also be considered where, for example, there has been a serious failure to maintain records but there has been no loss of tax due to the presence of losses. Any penalty charged under TAX 6 must be authorised by the Director of Tax and a copy of the authorisation kept in the Establishment file maintained for that purpose.

19 – 1200 Interaction with other QFC Law

LLC's, branches and partnerships are all obliged to maintain proper accounting records under QFC Regulations. For LLC's, company branches, LLP's, LP's and GP's registered with the QFC Companies Register Office (CRO) the records to be maintained are stipulated as follows:

'Every [entity] shall keep proper accounting records with respect to all sums of money received and expended by the [entity] and all sales and purchases of goods and services and other transactions by the [entity] and the assets and liabilities of the [entity]. Such records shall be sufficient to show and explain all transactions by the [entity] and must be such as to:

(A) disclose with reasonable accuracy the financial position of the [entity] at any time; and

(B) enable the [directors/partners/members] to ensure that any accounts prepared by the [entity] comply with the requirement of these Regulations.'

These provisions overlap substantially with the requirements of TAX 6 and TAX 6.3(A) reflects the above wording (apart from (B)). It follows the record keeping requirements of the Tax Department are very closely aligned to the requirements of the QFC generally.

The QFC legislation imposing the above requirements is as follows:

LLC:	Article 79 of the Companies Regulations
Company Branch:	Article 123 of the Companies Regulations
Partnership Branch:	Article 81 of the Partnership Regulations
LLP:	Article 32 of the LLP Regulations
LP's:	Article 62 of the Partnership Regulations
CRO registered GP's:	Article 62 (as applied by Article 36) of the Partnership Regulations

The QFC record keeping requirements for a General Partnership not registered with the CRO are contained in Article 20 of the Partnership Regulations which obliges partners to ensure proper accounting records are kept of transactions affecting the partnership and of which the other partners would reasonably expect to be kept. In practice, as the QFRA expect all General Partnerships to register with the CRO, the rather wider requirements will apply for all GP's which are, in any event, subject to the more extensive record keeping rule of TAX 6.

19 – 1220 Where Records are to be Kept

TAX 6 is silent on where records are to be kept. We are of the view we do not want to insist, for tax purposes, records are located at any particular place, so long as complete records are maintained and preserved and are made available for inspection or copying, should the need arise in connection with an enquiry.

However other QFC law specifies where certain records are to be located and also sets out the length of time for which records are to be retained. It should be noted that where TAX 6 provides that records are to be maintained for a period longer than provided for in other QFC law, the TAX time limit prevails. So, for example, although Article 80 of the Companies Regulations provides that the records of an LLC should be maintained for 6 years from the date to which they relate, if there is an open enquiry into an accounting period, the relevant records for that accounting period must not be destroyed until the enquiry is closed, even if closure takes place more than 6 years after the accounting period end (TAX 6.2(B)).

For an LLC, LLP or LP, records are to be kept at the registered office and preserved for six years (Article 80 of the Companies Regulations, Article 32 (2) of the LLP Regulations and Article 62 of the Partnership Regulations).

For branches and CRO registered GP's records are to be kept at the principal place of business of the branch or GP and preserved for six years (Article 123 of the Companies Regulations, Article 81 of the Partnership Regulations and Article 62 (as applied by Article 63) of the Partnership Regulations).

19 – 2000+ Returns

19 – 2000 Obligation to File a Return

The basic obligation to file a QFC tax return is imposed by Article 109(1). The obligation to file is on every QFC Entity for each of its accounting periods. There is no requirement that a QFC Entity should be served a return in order for the obligation to file to apply.

The obligation to file a return is not removed if, for example, a taxpayer makes losses, is in liquidation, is exempt or has been granted special exempt status.

It should also be noted that a return must be filed for each accounting period, even if the accounting period is short – for example if a taxpayer draws up financial statements covering a 13 month period then, as an accounting period may not exceed 12 months (see QTM3-2000+), two returns must be filed, one for the first 12 months and one for the remaining month. The one exception to this is in relation to the first accounting period of a QFC Entity (QTM3-2040).

19-2010 Online Filing

From 1 January 2016 all QFC Entities will be required to file their returns using the online QFC Portal. Hard copy returns will no longer be accepted and any hard copy forms received will be returned.

All references in the law and this manual to "submission" and "filing" regarding annual tax return forms and amended returns relate to online submission and filing.

19 – 2020 The Return Form

Article 115(1)(a) indicates the Tax Department is to prescribe the form of a return and having prescribed such a form, it must be used by taxpayers when filing a return. Form

QTD001 V2, having been duly prescribed is the form to be used by all taxpayers when making a return. The return form QTD001 V2 is available to be downloaded from the QFC website and is the layout used on the QFC online filing portal.

19 – 2040 Documents etc. Submitted With Return

Article 115(1)(b) permits the Tax Department to require that a return must be accompanied by such 'information, accounts, statements and reports as may be reasonably required' to ascertain the taxpayers liability or losses. Any documents submitted with the return become part of the return itself.

Normally you should expect a return to be accompanied by accounts covering the period of the return and tax computations linking the accounts to the returned figures. For online filing the system allows pdf documents to be attached to the return being submitted. If a return is filed without the accounts or computations then, in principle, you could refuse to accept a hard copy submission of the return on the grounds it is incomplete. In practice, however, it is probably more effective to accept the return and open an enquiry, seeking the missing documentation under an Article 125 information notice as that provision contains more effective sanctions for failure to comply than the sanctions for late filing. If a return is submitted using the online portal this will be the main way to obtain the required documentation.

19 – 2060 Signature and Declaration

Every return must be signed by the 'Representative' of the QFC Entity filing the return and must also contain a declaration, the form of which is provided for within the return, that the return is, to the best of the Representatives knowledge and belief, correct and complete.

When firms file their return online there may not be a signed return. The online portal has been designed in such a way that prior to submission there is a check box stating that the person submitting the return is authorised to do so. Therefore where a return is submitted online you should presume that the "Representative" has submitted the return. Where a return is submitted by a tax agent on behalf of a taxpayer the tax agent will likely hold a copy of the signed hard copy return.

The 'Representative' of a QFC Entity is defined by Article 153 and is normally the Entity's representative under QFC Law, as follows:

Type of Entity	Representative
LLC	Company Secretary appointed under Article 60 of the Company Regulations, 2005

LLP	Principal Representative appointed under Article 40 of the LLP Regulations 2005
Branch	Principal Representative appointed under Article 117(2)(A) of the Company Regulations, 2005
All other Entities	Person appointed under relevant QFC law to represent the Entity.

Although a return should normally be signed by the Representative, as defined above, in exceptional circumstances you may accept a return signed by another person competent to represent the Entity, e.g. a director in the case of an LLC, where you are convinced it is impossible or impractical for the return to be signed by the defined Representative. This might happen when, for example, the Representative is absent from work due illness.

19 – 2080 Return Filing Date

A return is due to be filed 6 months from the end of the accounting period for which it is made. (Article 111(1)). The date a return is actually filed is the date the return is received by the tax Department and not the date it was, for example, posted. Most QFC returns will be received by hand, by courier or via online filing. See QTM19-3000+ regarding late filing and below regarding extension of the filing date.

19 – 2100 Extension of Return Filing Date

The date on which a return for an accounting period is to be filed is normally six months after the end of the accounting period to which the return relates (see Article 111).

If a return is filed late this does not affect the due and payable date (see Article 140(1), TAX 8.1.3. A late payment charge in respect of late payment of tax (see Article 143) always runs from the due and payable date (not the date the return was filed) to the date the tax is paid.

TAX 8 permits the filing date to be extended by a maximum of 120 days. QFC firms may apply for an extension either by making a written application to the Tax Department or via the online tax portal. Any extension request has to be made **before** the normal filing date (six months from the end of the accounting period) and must show 'reasonable cause' as to why the return may not be filed on time.

The Tax Department must notify the taxpayer of their decision regarding an application extension. Your notification to the taxpayer (or their agent) can be via hard copy letter or email. You also need to ensure the approval, or rejection is recorded on the Tax Portal. There is no right of appeal against the Tax Department's decision not to extend the normal filing date but an appeal may be made against a notice of a financial sanction issued for the late filing of a return.

Multiple applications for an extension may be made, but the maximum extension is to 120 days after the original due date. All applications must be made before the normal due date. For example if a QFC Entity has a year-end of 31st December its normal due date will be the following 30 June. If the firm writes on 1 May 2012 saying it seeks an extension of the filing date for the return for the year to 31 December 2011 to 1 August 2012, this may be accepted. If the firm writes again on 10 June 2012 asking for that date to be further extended to 1 September 2012 that extension may also be accepted (provided in both cases there is reasonable cause for the delay). However if the first extension had been granted and the firm wrote on 2 July 2012 seeking a further extension, that request is out of time, and may not be considered, as it is made after the normal due date.

An extension may be granted on such 'terms and conditions' as the Tax Department consider to be appropriate. It may, for example, be a condition for granting an extension that other aspects of a taxpayer's affairs such as outstanding payments or replies to correspondence, are also brought up to date and when granting an extension you should review the taxpayer's affairs generally to see if it would be useful (as well as reasonable) to make the extension conditional or to impose specific terms.

When considering whether there is 'reasonable cause' for late filing the phrase 'reasonable cause' should be taken as meaning a cause which would prompt an ordinarily intelligent man to act under similar circumstances as the taxpayer did in not being able to file his tax return on time. 'Reasonable cause' is very like 'reasonable excuse' in meaning and includes reasons such as death or serious illness of key personnel or a member of their immediate family, unavoidable absence of the taxpayer and destruction of taxpayer's business records by fire or other casualty.

You should remember the only consequence of extending a filing date is a change in the date on which a late filing financial sanction under Article 119 (see QTM19-3000+) becomes chargeable.

19 – 2120 Return to include Self-Assessment

Every return is to include a self-assessment of liability (Article 112). The return form itself provides for this self-assessment which is a simple statement of Local Source Taxable Profits chargeable at the standard rate, less adjustments to be made in terms of tax. There is also provision to specify any profits chargeable at the concessionary zero rate and a check box to be checked by exempt entities. The details of the self-assessment are recorded on the QFC Tax Portal and form the assessment for the relevant accounting period.

19 – 2140 Amended Return

A taxpayer may amend a return by notice to the Tax Department (Article 116(1)). More than one amendment may be made but the overall time limit for making amendments is 12 months from the filing date. The filing date is six months from the end of the accounting period for which the return is being made. It follows that the time limit for amending a return is 18 months after the end of the relevant accounting period. It should be noted that filing a return late does not alter the filing date, or consequently the amendment time limit. Also, the extension of the filing date under TAX 8 does not extend the time limit for amending a return.

Article 116(3) enables the Tax Department to specify the form a notice amending a return should take and also to specify what information and statements should accompany the notice. At present the Tax Department has not specified either the form of an amendment notice or the information etc. that must accompany the notice. In practice you may accept an amendment where the taxpayer submits online a further return for the same accounting period, making it clear he/she is wishing to amend the earlier return, or where he/she writes asking that the return be amended in a specific manner. In the latter case the amended figures may be noted on the return and it is not necessary to insist on the completion of a further return. Verbal amendments are not acceptable. You may ask for whatever information or documents you feel are necessary to support the amendment, but if you wish to test or challenge the figures you should open an enquiry into the amended return.

19 – 2160 Partnership Returns and Amended Returns

The QFC tax regime regards all partnerships as taxable entities (See Part 9). Article 110(1) makes it clear it is the partnership, rather than the individual partners or members, that is required to file a return under Article 109. A partnership return must be signed by the Representative of the partnership (Article 109(2)), as defined by Article 153.

A partnership return must also contain an allocation of Taxable Profits between the partners and the profit share thus shown is binding on them with regard to attributing liability to pay tax, under Article 62(2) and (3) that is not paid by the partnership six months after the due date.

The same principles for amending a partnership return apply in the same way as for any other return. Article 116(2) indicates a partnership return may be amended by the partnership representative.

19 – 2180 QFC Entity as a Member of a Partnership.

Although probably unlikely to be seen often, if at all, it is possible a QFC Entity may itself be a *member* of a partnership, as opposed to itself *being* a partnership. This may happen where, for example, an existing QFC Entity enters into a partnership with a company. If a QFC Entity is a member of a partnership Article 98(2) stipulates its return must include its share of any profit or loss arising from the partnership. Where the accounting period of the QFC Entity and the partnership to which it belongs do not coincide, an apportionment will be necessary so that the return reflects the partnership profits or losses for the accounting period of the return. Where the partnership entered into by a QFC Entity is itself a QFC Entity (for example a QFC Entity entering into a partnership with a company that is licenced as a separate QFC Entity) Article 110(4) ensures profits are not taxed or losses relieved more than once.

19 – 2200 Acknowledgement of Return.

Every return or amended return received (Article 117) should be acknowledged by the Tax Department within 30 days of receipt. A copy of the acknowledgement, for both the original return and any amendment, should be retained with the return in the taxpayers file.

In practice where a return is submitted using the online Portal the acknowledgement will be via an automatic email notification to the taxpayer (or tax agent). If a return is submitted via hard copy the acknowledgement will be via stamping and signing of a cover letter returned to the taxpayer or tax agent.

19 – 2220 Obvious Errors or Omissions

Article 118 allows the Tax Department to correct obvious errors or omissions in a return by amending the return and issuing a notice to the taxpayer detailing the changes to the return that have been made. The corrections should, if possible, be made before the return is recorded on the Tax Portal when a hard copy return is received. This is not possible where a return is submitted online and you will need to notify the taxpayer that you intend to amend their return and detail the changes. The taxpayer is not obliged to accept the Tax Department's correction, and if the taxpayer indicates that he/she does not accept your corrections then the amendment to the original return should be cancelled. You may then need to consider opening an enquiry if you consider the return is incorrect. A correction may also be made where a taxpayer amends his return.

A correction may only be made within four months of the return or, as the case may be, the amended return being filed (Article 118(2)).

The errors that may be corrected include errors or omissions of principle, arithmetical mistakes and other errors or omissions (Article 118(1)).

Examples of obvious errors include arithmetical errors or the carry forward of the wrong figure from one box to another.

If you need to contact the taxpayer where an entry is illegible or it is impossible to decide what the correct entry should be you may contact the taxpayer or agent, but you must make it clear that the query is designed to allow you to process the return on the basis of the figures supplied and does no more than clarify unclear handwriting or incorrect arithmetic. Any information supplied by the taxpayer or agent may be used to repair an obvious error, including additional information on the return.

If you have any difficulty clarifying or identifying an error you should accept the taxpayer's figure, and consider if it is necessary to open an enquiry.

19 – 2240 Incorrect Returns

Article 119(9) imposes a financial sanction of up to 100% of the tax understated where an incorrect return is filed fraudulently or negligently or where the taxpayer discovers his return is incorrect and does not remedy the error without unreasonable delay.

19 – 2245 How to determine fraud and/or negligence

Fraud

When considering whether a taxpayers actions are fraudulent, it should be clear that there has been a deliberate or intentional action taken by the taxpayer with the purpose of producing an inaccurate result. Deliberate action will also include instances where a person consciously or intentionally chooses not to take an action in order to find out and/or apply the correct result. Examples of deliberate actions include; knowingly failing to record all sales, deliberately describing transactions inaccurately, deliberately failing to take action that the taxpayer know is necessary to ensure a return is accurate, providing documentation to the QFC Tax Department which is known to be incorrect.

The level of fraudulent behaviour and, therefore, the level of penalty to be charged will depend on whether or not there is deliberate inaccuracy in the return and sophisticated efforts to conceal it. Penalties should be higher where such effort exists.

The act of concealment may include; creating false documents such as invoices, minutes of meetings, contracts, etc. backdating or postdating contracts or invoices, , destroying books and records, diverting takings into undisclosed bank accounts, describing expenditure as business related when it is a personal expense, creating sales records that deliberately understate the value of the goods sold. This is not an exhaustive list but provides a guide with regard to concealment.

Negligence

Negligence is where a taxpayer has not taken reasonable care to ensure that their affairs are in order.

Reasonable care should take into account the particular circumstances of the taxpayer. For example, the level of knowledge or expertise expected from a small unrepresented owner managed business will not be the same as that expected from a firm that is part of a global business.

Also, it is reasonable to expect a person who encounters a transaction or event that they are not familiar with to find out about the correct tax treatment, or seek and follow appropriate advice. For example, there will be no negligence where a difference of interpretation of the tax regulations results in an incorrect tax submission, and the taxpayer can be shown to have taken professional advice and acted on the basis of that advice.

When determining negligence there is no question of whether or not the taxpayer knew about the inaccuracy when they submitted the return. If they did, it would be fraud as it would be deliberate behaviour.

19 – 2250 How to determine unreasonable delay

Where reasonable care has been taken by the taxpayer but the return was incorrect (i.e. the return is not incorrect because of fraud or negligence), and the taxpayer knew about it and failed to remedy the error(s) without unreasonable delay, a penalty can still be charged under Article 119(9)(b). The determination of whether or not a delay is unreasonable will be subjective and based on individual circumstances of each case.

Generally, delay will be unreasonable if the period of the delay is longer than what would be taken by a normal person in similar circumstances. A reasonable time is an amount of time which is necessary for a reasonable person to correct the inaccuracy as soon as circumstances permit. Each case will be different and the steps taken by the taxpayer from discovering the error to correcting it should be reviewed and considered.

Unreasonable delays can include instances where taxpayers become aware of an inaccuracy but do not take steps to remedy the error until prompted to do so by the QFC Tax Department or the error is corrected by the QFC Tax Department.

The degree of complexity of the error should be taken into consideration in determining whether or not an unreasonable delay occurred. Hence, taking a prolonged period of time to correct a simple error would be a case of unreasonable delay (simple errors will be expected to take less time to correct than complex errors).

19 – 2255 Calculating a penalty under Article 119(9)

When calculating the penalty due under Article 119(9)(a) and (b) the penalty should start at 100%. The following table should then be used to determine how much the penalty should be reduced taking into account the specific circumstances of the case.

Penalty under 119(9)(a)

Disclosure	
	Where full disclosure is made before QFC would have any reason to be aware of the error reduction in penalty can be up to 40%. Where full disclosure is made only after an enquiry is opened the reduction in penalty will be less than 40%. The reduction in the penalty will be higher if full disclosure is made early on during the enquiry than if it is made only made towards the end of the enquiry
Co-operation	Taxpayers need to demonstrate a willingness to co-operate with any questions or document requests made by the QFC Tax Department in connection with an enquiry. The penalty can be reduced by up to 40% for good co-operation. Good co-operation includes providing information quickly, agreeing to enquiry meetings, answering questions fully and correctly. Unprompted disclosures will be viewed as an indication of good cooperation.

	If there are delays providing information, misleading answers provided or obstructions to the enquiry evident, the reduction will be small or there will be no reduction at all.
Seriousness	Depending on the level of seriousness of the case, the penalty can be reduced by up to 30%. The reduction in the penalty will be higher in less serious cases than in more serious ones. To determine the level of seriousness, look at the reasons errors arose, the length of time the errors arose and the amount of money involved. Incorrect returns arising out of negligence (where the taxpayer was unaware of the inaccuracy) will be reduced by more than cases where inaccuracy is a result of fraudulent behaviour. When considering fraudulent behaviour consider the efforts made to conceal the error. Sophisticated efforts indicate a higher level of seriousness.

Penalty under 119(9)(b)

Complexity	When charging a penalty for unreasonable delay, the complexity of the inaccuracy should be taken into account. If correction of the inaccuracy is likely to require assistance from a professional or tax advice, then the inaccuracy would be regarded as complex and the delay reasonably required to correct it would be longer. In complex cases, the penalty can be reduced by up to 30%. Where complexity is low and delays (beyond what would be reasonably expected to correct the error) have arisen, the penalty will be reduced by a lower amount or not be reduced at all.
Steps taken	The steps taken by the taxpayer once they became aware of the inaccuracy should be looked at. If they have taken significant steps to remedy the inaccuracy , the penalty can be reduced by up to 30%. Where they become aware of an inaccuracy and do nothing or little to correct it, the reduction in penalty will be lower or nil.

Timeframe	Consider the time between the taxpayer becoming aware of the inaccuracy and the date on which they corrected the same (if at all). Depending on the delay beyond the time frame a reasonable person would need to correct the inaccuracy (taking into account its complexity), the penalty can be reduced by up to 20%. The shorter the delay the higher reduction.
Seriousness	Depending on the level of seriousness of the case, the penalty can be reduced by up to 30%. The reduction in the penalty will be higher in less serious cases than in more serious ones. To determine the level of seriousness, consider the amount of money involved and whether or not the QFC Tax Department made a taxpayer aware of an inaccuracy. If the QFC Tax Department make the taxpayer aware of the inaccuracy but they do nothing to correct it, little or no reduction in the penalty should be given.

Example

Company QFC submits a Tax Return for y/e 31 December 2015 with reasonable care on 30 June 2016. They submit a Tax Return for y/e 31 December 2016 on 30 June 2017 with reasonable care and prepared on the same basis as the y/e 31 December 2015.

The QFC raised an enquiry into the y/e 31 December 2015 on 1 March 2017 and closed the enquiry on 1 September 2017. An inaccuracy was found during the enquiry and the 2015 Return was amended as part of the enquiry. The QFC Tax Department upon closure of the enquiry on 1 September 2017 advised Company QFC that they would be required to amend their tax return for 2016 as the same inaccuracy arose in that year.

The QFC Tax Department raised an enquiry into the year ended 31 December 2016 on 15 June 2018 in order to correct the inaccuracy identified as part of the 2015 enquiry.

There should be no penalty charged in respect of the Tax Return for the year ended 31 December 2015. The return was submitted with reasonable care and amended as part of an initial enquiry.

The Tax Return for the year ended 31 December 2016 was submitted at the time with reasonable care, however on 1 September 2017 the taxpayer became aware of the inaccuracy of the 2016 Return.

- Complexity – the inaccuracy was identified during the 2015 enquiry and amended in that return, the assumption being that to amend the 2016 return the taxpayer need only follow the same correction as has been done in 2015. Likely that the complexity is low.
- Steps taken by the taxpayer – if the inaccuracy was clear and nothing has been done to correct the 2016 Return, or to prevent in arising in future years no reduction to the penalty will be given.
- Timeframe – in this example the taxpayer had 9.5 months to correct the 2016 Return. The whole 2015 enquiry and correction took only 6 months. It is reasonable to expect that a taxpayer would be able to correct the inaccuracy within 1 -2 months. The taxpayer made a delay of more than 7 months than what they would reasonably need. No reduction should be given.
- Seriousness – The taxpayer was made aware the inaccuracy by the QFC Tax Department and, yet, they fail to amend the 2016 Return and correct the inaccuracy, which meant that the QFC Tax Department had to raise a formal enquiry prior to the enquiry window deadline of 30 June 2018.

In this case little to no reduction in the Article 119(9)(b) penalty would arise.

19 – 2260 Determinations of Tax Payable in Absence of a Return

TAX 8.2 empowers the Tax Department to determine the tax payable by a QFC Entity, for any accounting period, where no return is filed on or before the filing date. The determination is to be made to the best of the Tax Department's 'knowledge and belief' (TAX 8.2.1 and 8.2.2). When deciding on the quantum of a determination, there is necessarily an element of subjectivity involved in the process. However the quantum should be based on all the available facts and a reasonable approach should be taken. You must not determine the quantum on the basis of a mere unfounded suspicion or irrational conviction.

The power to make a determination is only to be exercised with the approval of the Director of Tax and all such approvals should be recorded in an establishment file maintained for that purpose.

If it is unclear what the accounting periods of a taxpayer are, then TAX 8.2.3 permits a determination to be made on the basis of accounting periods as determined by the Tax Department.

A determination issued under TAX 8.2 is made in terms of tax payable and must be served on the QFC Entity and state the amount of the determination, the accounting period and the date of issue (TAX 8.2.5).

Normally a determination should not be considered until the return is very late (12 months) and you are considering a tax related penalty under TAX 10.2. You may consider making a determination earlier if you are aware the QFC Entity has ceased business or may be surrendering its licence or the QFCRA are considering revoking the Entity's licence. A determination for an accounting period cannot be made more than 5 years after the filing date for the return for that accounting period.

The quantum of the determination should be based on the history of the taxpayer and all other relevant available information. Remember that a determination may not be appealed but it is automatically displaced when a self-assessment is made (TAX 8.3 and QTM19-3060).

If you make a determination and the taxpayer can demonstrate either (a) there is no accounting period ending within or at the end of the period of the determination, or (b) it has in fact filed a return for the accounting period covered by the determination, or (c) no return is yet due for the period covered by the determination, the determination is of no effect and should be reduced to nil (TAX 8.2.7).

A determination has the same effect, for the purpose of the payment of tax and interest on overdue tax, as a self-assessment for the accounting period made by the QFC Entity.

19 – 3000+ Late Filing Financial Sanctions

19 – 3000 General

Article 119(1) provides for a fixed financial sanction of QAR 3,000 where a QFC Entity fails to file within 60 days of the filing date, or the filing date as extended by TAX 8, with further sanctions if the return is still overdue or there is a history of failure to submit returns on time.

Article 119(4) provides for a tax geared financial sanction (in addition to any initial financial sanction under Article 119(2)) where a QFC Entity fails to file within 12 months of the filing date, or the filing date as extended by TAX 8, whichever is the later.

19 – 3020 Fixed Rate Financial Sanction

Where a taxpayer fails to file his return on time – that is by the filing date (6 months after the end of the accounting period) or the filing date as extended (see QTM19-2100) a fixed penalty of QR 3,000 is chargeable so long as the return is delivered within 60 days of the filing date. It should be noted the amount of the sanction is not variable, i.e. it is not 'up to QR 3,000' but is QR 3,000 or nothing. If the return is more than 60 days late then the financial sanction is increased to QR 6,000. See QTM19-3040 for the possible waiver of a late filing fixed financial sanction in individual cases.

The financial sanctions are further increased where there is a history of failure on the part of the taxpayer to submit his tax return on time. Where the conditions below are met the penalties in 119(2) are increased from QR 3,000 to QR 5,000 and from QR 6,000 to QR 10,000 respectively. The conditions are:

(xii) the QFC Entity is within the charge to tax under these Regulations for three consecutive Accounting Periods;

(xiii) the QFC Entity is obliged to file a return for each of those Accounting Periods under Article 109;

(xiv) the QFC Entity was liable to a penalty under Article 119(1) in respect of the first two of those Accounting Periods; and

(xv) the QFC Entity is liable to a penalty under Article 119(1) in respect of the third Accounting Period.

In practice we would hope that there would not be many circumstances where additional penalties under Article 119(3) would need to be applied. If a taxpayer has been late with two returns then the reasons for the delay should be investigated as it may be a symptom of more serious problems.

19 – 3040 Waiver

Article 119(8) provides for the waiver of a fixed financial sanction for failing to file a tax return on time where the QFC Entity, on making an application to the Tax Department in writing, establishes there was a reasonable excuse for not filing on time, and that excuse persisted throughout the period of default, that is from the filing date (as extended) to the date the return was actually filed. The sanction is either waived in full, or not at all – it cannot be partially waived.

There will be occasions when a taxpayer genuinely tries to meet his filing obligation but fails because of unforeseen misfortune. Provided there is a reasonable excuse for the failure, you may waive the initial late filing financial sanction. The taxpayer must remedy the failure as soon as can reasonably be expected after the excuse has ended.

The Regulations do not define 'reasonable excuse' and you should consider all claims on their merits.

Honesty of purpose is a preliminary condition that a taxpayer always needs to fulfil. You also need to take into account the circumstances of the person making the claim. You need to establish all the relevant facts, including:

- the circumstances which led to the failure to submit the return in time,
- the extent to which appropriate preliminary work such as preparation of accounts had been put in hand before the excuse prevented further progress,
- whether the necessary steps were taken to remedy the failure after the excuse had ended.

The following is a guide to, though not an exhaustive list of, the circumstances that might amount to a reasonable excuse.

- One individual runs the QFC Entity and he/she (or an immediate family member) dies or suffers a sudden and serious illness close to the filing date. Alternatively, the individual has a prolonged and serious illness throughout much of the return period.
- Unavoidable and unexpected absence abroad of the responsible individual close to the deadline because of business commitments or domestic emergency.
- Accidental destruction of the records through fire or flood.
- Exceptional postal delays due to a strike by postal workers or other civil disruption.

A taxpayer may appeal against a fixed late filing financial sanction. Normally such appeals will involve disputes as to whether or not there was a reasonable excuse for late filing, which is a question of fact.

19 – 3060 Tax Related Financial Sanction

Article 119(4) provides that where a taxpayer is very late, more than 12 months, in filing then he/she is liable to a tax-related financial sanction, in addition to any fixed financial sanction for late filing (see Article 119(2)). The tax-related financial sanction is the higher of QR 10,000 or 10% of any unpaid tax, if the return is delivered within 18 months after the filing date, and the higher of QR 20,000 or 20% of any unpaid tax, in any other case. This penalty is in addition to any flat-rate financial sanction. Even though a return has not been filed, the full amount of tax due for the accounting period may not be outstanding 12 months after the filing date (as extended) as the taxpayer may have made a payment on account of his liability for that accounting period. Overpayments from other accounting periods that have not been repaid to the taxpayer should not be regarded as reducing the liability for the accounting period in question.

It will not normally be possible to determine the tax unpaid 12 months after the filing date (as extended) until the return for the filing period is actually filed. It follows that a tax related late filing financial sanction determination will not normally be made until the return has been filed. However where a determination of tax payable in the absence of a return is made (see QTM19-2260) you may regard the tax charged by that determination (less any tax actually paid for the accounting period) as the tax unpaid 12 months after the filing date (as extended) and raise a tax related financial sanction determination on that basis. If, as is likely, the taxpayer appeals the financial sanction, it should be possible to determine that appeal by agreement on the basis of the liability shown by the actual return, when that is eventually filed.

PART 20 ENQUIRIES

20 – 1000+ Enquiries into Tax Return

20 – 1000 Notices

All returns are to be fully reviewed and risk assessed within the first 6 months of receipt. A second risk assessment should be undertaken on all returns by a second tax officer of the Tax Department. The tax officers will mark the file as one of the following;

- RED – Enquiry to be raised
- Amber – Allow enquiry window to expire
- Green – consider issuing Notice of No Intention To Enquire

A Notice of No Intention to Enquiry under Article 121(4) should only be issued where you are confident that no enquiry will need to be raised at a later date into that return. Consideration should be given to whether a ruling exists, the complexity of the taxpayers affairs and the detail provided by the taxpayer with their return.

20 – 1020 Opening an Enquiry

Where a decision is made for an enquiry to be raised a formal notice, in writing, should be issued to the Representative of the QFC Entity and a copy sent to their tax agent (if they have one). An enquiry can only be opened once both risk assessments have been undertaken. A Notice to Enquire should be in a prescribed format and the template letter should be used and amended to suit the specifics of each enquiry.

20 – 1040 Time Limits

Article 121(2) sets out the time limits for opening an enquiry. Opening an enquiry is subject to a strict time frame. Enquiries can only be opened within 12 months of the filing deadline, unless a return was submitted late, or at a later agreed filing deadline following an extension approval. If a return was submitted late or filed later due to having a filing extension granted, the enquiry deadline will be 12 months from the date the return was received. Where a return is amended within the allowed timeframe (see Article 116 and QTM19-2140) the time limit will be 12 months from the date the amended return was received.

The time limits should be adhered to strictly. All Self-Assessment Notices should contain a date of receipt and it is from this date the 12 month deadline will run. If the notice of enquiry is issued even 1 day after the deadline has passed it should not be accepted by the taxpayer. The Tax Department must therefore ensure the Enquiry Log is kept up to date and a record of all enquiry deadlines recorded and diary notes made to open enquiries ahead of the filing deadlines.

Following the implementation of the Tax Portal the taxpayer will receive an email notification that an enquiry has been opened. You should however, continue to issue hard copy letters at this stage and use the online facility as an enquiry monitoring system only.

20 – 1060 Amendment During an Enquiry

The Tax Department can amend a tax return even before an enquiry if closed. Any notice of amendment should be in writing.

In practice, any amendments required to a return arising as a result of the enquiry will normally be dealt with at the closure of the enquiry, however where significant tax is at stake or loss credit refund due , you can make an amendment under Article 123 and request immediate payment of additional tax due.

Taxpayers are able to appeal any notice issued under Article 123. If you receive such an appeal the changes and collection of tax should be held over until the enquiry is closed.

20 – 1080 Completion and Closure of Enquiry

Once an enquiry has been concluded a formal notice of completion should be issued in writing to the taxpayer, and a copy sent to their tax advisor (if relevant). The Closure Notice should outline what (if any) changes have been agreed. Standard letter templates should be used and amended according to the specifics of the case. The online Tax Portal will automatically issue an email notification when an enquiry is closed, however this does not replace the written notice. Care should be taken to ensure the system and letter are issued/updated on the same date.

The taxpayer has 60 days to appeal against a Closure Notice.

20 – 1100 Taxpayers Right to Request Closure of an Enquiry

Article 124(3) affords taxpayers the right to appeal an enquiry and request for immediate closure. This will commonly be used where a taxpayer feels that there is no reason for the enquiry to continue and that they have addressed all points raised by the Tax Department. Whilst we do not anticipate this happening often, care should be taken in all enquiries to ensure that; (a) all correspondence is dealt with on a timely basis (i.e. a reply sent within 30 days of receipt) and (b) that all areas under enquiry are justified and queries warranted.

20 – 1020 Notice to Produce Documents and/or Information

Where the Tax Department request documents or information as part of an enquiry and a taxpayer fails to produce these in a timely manner a charge can be raised under Article 125 for QR 1,000 initial penalty and then up to QR 1,000 per day.

A penalty under Article 125 should only be raised after the taxpayer has been given sufficient time to produce the information requested and has failed to do so. The daily rate of 'up to' QR 1,000 per day is designed to encourage taxpayers to send the information in a timely manner, it is not to penalise them.

Reduction of the daily penalty should follow the below guidelines;

	Reduction guidance
Frequency	If this is the first time the taxpayer has been issued an Article 125 Notice during the current enquiry a reduction of 25% should be applied. If the taxpayer has previously been issued with an Article 125 Notice within the previous three years, even where the deadline for that notice was met, no reduction for frequency should be applied.
Timing	The following reductions should apply where documents and information are provided in full after the deadline;

	• 1 - 7 days late – 50% • 8 – 14 days late – 30% • 15 – 30 days late – 10%
Responsibility of delay	Where the reasons for the delay in submission of documents and information are largely beyond the QFC Entity's control or influence (and evidence to support this is submitted) a reduction of 25% should be applied. The "reasonable person" test will be applied when determining whether the delay was within the control of the QFC Entity and what steps they took to ensure the deadline was met.

PART 21 ASSESSMENTS

21 – 1000+ Introduction

The Self-Assessment tax regime in the QFC means that taxpayers calculate their own tax position each year and report this to the Tax Department via the prescribed tax return form and with relevant accompanying documents (see QTM19-2000+ and QTM19-2040).

The Self-Assessment system means that upon submission (or process of the tax return if a hard copy is filed) an Assessment is automatically generated based on the taxpayers calculation. Should the Tax Department disagree or require further clarification on the taxpayers calculation of taxable profits/losses an enquiry would be opened (see Part 20).

Where the enquiry window has closed (see QTM20-1040 for time limits) the Tax Department can issue an Assessment under Article 128.

21 – 2000+ Types of Assessment

There are 2 types of Assessment;

- Discovery Assessment, and
- Discovery Determination

21 – 2020 Discovery Assessment

Where the Tax Department discover (after the enquiry deadline has passed) that an amount which should have been assessed to tax was not, or that relief has been given which was, or is now excessive, they can raise a Discovery Assessment under Article 128 to collect unpaid tax or reclaim excessive credit claimed (i.e. Tax Loss Credit Relief – Part 16).

Discovery Assessments, will normally be required where an enquiry into a later year brings to light an issue that was present in earlier years, but the necessary information was not made available to the Tax Department or they could not have known about the error based on the information made available to them at that time.

The Tax Regulations require necessary documents and information to be submitted with the annual tax return (See QTM19-2040). Taxpayers should ensure that any computations or additional information provided contains relevant disclosures of any contentious tax issues.

When raising an Assessment under Article 128(1) you must ensure that at the time of assessing the return we could not have reasonably been expected to be aware of the issue at stake. If the information was disclosed on the return or tax computation but no enquiry raised you cannot raise an assessment under Article 128(1).

21 – 2040 Discovery Determination

A Discovery Determination will arise where the Tax Department discovers that a return has incorrectly stated an amount that affects the tax due by that taxpayer or the tax liability of another taxpayer (in the case of Group Relief).

As with Discovery Assessments a Discovery Determination will normally result from an enquiry into a later year which brings to light information that affects prior years and that information was not available when the earlier years return was assessed.

21 – 2060 Time limits

An Assessment can only be made within 6 years of the end of the Accounting Period to which it relates. For example for a year ended 31 December 2010, the last date for an Assessment is 31 December 2016. For a Discovery Assessment to reclaim overpaid tax credit relief the time limit is 20 years after the end of the AP in which the loss credit claim was made.

An Assessment under Article 128 can be done so via the Tax Portal and the taxpayer will receive immediate notification of the Assessment. You should also issue written notification to the taxpayer outlining the details of the Assessment. The taxpayer has 60 days to appeal against the Assessment.

21 – 2080 Error Or Mistake

Where a taxpayer discovers that they have overpaid tax in an earlier year, but the amendment window has passed, they may apply to the Tax Department, in writing, requesting the original assessment be updated to reflect the correction.

Upon receipt of an Error or Mistake Claim you should review all of the facts and reasons why the error has arisen. A favourable stance should be taken to allow for genuine errors or mistakes. However, if the claim is in fact an amendment unconnected with an error or mistake then it should be rejected. For example, a taxpayer used a thin cap ratio of 2:1 in the years ended 31 December 2010 – 2012, however following the issue of our safe harbour limits they now use a thin cap ratio of 4:1 in the year ended 31 December 2013 onwards. Any error or mistake claim received (outside of the amendment deadline) will not be accepted as there was no error or mistake at the time the original returns were submitted. (See QTM-TR-3000+ for more details on Claims).

PART 22 APPEALS

22 – 1000 General

Taxpayers have the right of appeal against many decisions made by the Tax Department. The main areas where appeals may arise are;

- Against late filing penalties (see QTM19-3000+)
- Against enquiry closure notices (see QTM20-1080)
- Against Discovery Assessments or Determinations (see Part 21)
- Against financial sanctions (see Part 25)

Appeals cannot be made against refusal to grant an extension to the filing deadline, determinations issued in the absence of a return (see Article 109(3) and QTM19-2260) or refusal to grant a ruling.

22 – 1020 Procedure

Taxpayers have 60 days from the date of either an amendment to a return or a notice being issued (i.e. a Closure Notice or Notice of Discovery Assessment) to appeal.

Once the Tax Department receives the appeal the Director of Tax should be notified and the appeal must be dealt with by a tax officer not involved in the original case. The chosen officer will review the case file and details of the appeal. Once complete the Director of Tax will be consulted and a decision made on whether to accept or reject the appeal in full or in part.

This step is not mandatory and a taxpayer can request that the appeal go directly to The Regulatory Tribunal. Once referred to The Regulatory Tribunal the records should be updated to reflect that there is a case pending.

The internal review should be conducted on a non-bias basis, however consideration should be given to the quality of the QFC case and whether this will be successful if passed to The Regulatory Tribunal. It will generally be more favourable to come to an agreement with a taxpayer over an area of dispute, however where the interpretation of the law is in question and the view of the Tax Department and taxpayer differ, a decision in the court could assist as it will provide a clear answer and precedent for future interpretation of that area of law.

22 – 1030 Appeal Format and Referral Procedure

All appeals to the QFC Tax Department or Regulatory Tribunal should be made in accordance with Article 10.5 of the QFC Regulatory Tribunal Regulations and Procedural Rules. The appeal notice must state;

- Full name and address of the Appellant (including postal address, telephone, fax and email details)
- The decision the Appellant wishes to challenge
- The basis on which the Regulatory Tribunal is alleged to have jurisdiction (i.e. the Article of law the appeal is being made under),
- The grounds on which the Appellant seeks to challenge the decision
- The remedies which the Appellant seeks, and
- Any other information or documentary evidence relevant to the appeal.

Where an appeal is sent to the Tax Department instead of directly to the Regulatory Tribunal and the taxpayer indicated clearly in the appeal letter that they want the appeal to be forwarded onto the Regulatory Tribunal the QFC Tax Department should ensure the appeal is forwarded on within 60 days of receipt. The taxpayer should be notified once the appeal has been referred.

The QFC Tax Department has 28 days from the date the appeal is received (from the taxpayer not the date it is referred to the Regulatory Tribunal) to provide a full response to the Regulatory Tribunal in accordance with Article 12 of the Regulatory Tribunal Regulations and Procedure Rules. A copy of the QFC response to the appeal also needs to be provided to the taxpayer (Appellant).

22 – 1040 Late Appeals

Generally late appeals should not be accepted, unless the taxpayer has a very good reason for the delay. A taxpayer can appeal a rejection to a late appeal during which the “reasonable excuse” it likely to be examined. An appeal against a refusal of a late appeal will not be subject to the Tax Department internal review, but directly by the tribunal court.

PART 23 INFORMATION POWERS

This section has not been made publicly available.

PART 24 PAYMENT AND RECOVERY

24 – 1000 Due and Payable Dates

Where the payment deadline is not stipulated in the Tax Regulations any notice requiring payment is due and payable within 30 days after issue. If payment has not been received within 30 days you should issue a reminder notice to the taxpayer that payment was due.

If a taxpayer has outstanding liabilities due to the Tax Department you should refrain from issuing any Advance Ruling, Tax Registration Card (or renewal therefore) or authorising de-registration before the amount owed has been paid in full.

24 – 1020 Late Payment of Tax Charge

This is more commonly referred to as the 'Late Payment Charge' (LPC). This charge only arises on unpaid tax due and accrues on a daily basis increasing the longer the tax remains unpaid.

Where during the course of an enquiry areas are agreed upon and additional tax due as a result you should consider advising the taxpayer to make a payment of tax on account towards the additional tax due to prevent further daily charges arising.

24 – 1040 Compensation for Overpayment of Tax

Similar to a late payment charge, where a taxpayer has overpaid tax they will be entitled to compensation for having overpaid tax. The compensation payment will be calculated from the date the tax was due to the date the refund is made. The application of this should be fairly straightforward. On occasion taxpayers may request that overpayments of tax be held on account and offset against future tax liabilities.

If the taxpayer choses to hold the amount on account any compensation due should be calculated from the due date of the tax to the date the refund was offered but refused by the taxpayer. No further compensation will be allowed while the amount is held on account to offset against future liabilities.

24 – 1060 Overpayment of Tax Credit

It is possible that a Reimbursable Tax Credit (see Part 16) may be repayable to the Tax Department. For example the taxpayer may amend their return to remove the claim, or following an enquiry it may be found that the level of the claim was excessive. Where the taxpayer is required to refund overpaid tax the 30 day deadline noted above will apply.

PART 25 FINANCIAL SANCTIONS

Article 148 allows the Tax Department to impose the financial sanctions noted in the Tax Regulations and Rules. It should be read in conjunction with all other Articles in the Tax Regulations and Rules which specify the appropriate financial sanction applicable to the specific circumstances.

Article 148(7) allows the Tax Department discretion to mitigate partly or wholly or entirely any financial sanction chargeable under the QFC Tax Regulations. Financial Sanctions are clearly identified as such in the regulations and described as "financial sanctions". This discretion does not extend to other charges levied under the QFC Tax Regulations. Approval must be sought from the Director of Tax before a financial sanction can be mitigated.

PART 26 EXEMPTIONS

26 – 1000 Statutory Exemptions

Apart from the 'Special Exemptions' provisions of Part 14 of the Regulations there are two further exemptions in Part 26 of the Regulations.

Article 150 exempts from QFC tax all dividends, interest and returns from public treasury bonds.

Article 151 exempts the Government of Qatar itself from tax. It should be accepted that the term the 'Government of Qatar' includes a company where the Government is the sole shareholder. However where there is any holding by non-governmental individuals or bodies, the QFC exemption may not apply. If you receive a claim a QFC Entity should benefit from the Article 151 exemption, but there is some doubt that it is a wholly owned Government body, a full report of the facts should be made immediately to the Director of Tax for further consideration.

26 – 1020 Sovereign Immunity

The QFC recognises the principle of international law known as sovereign immunity whereby one sovereign state does not seek to apply its domestic laws to another sovereign state. In accordance with this principle, the QFC regard as immune from tax any QFC Entity beneficially owned by the head of state or the government of a foreign sovereign state recognised by Qatar. If a QFC Entity claims sovereign immunity but there is some doubt that it falls within the exemption, a full report of the facts should be made immediately to the Director of Tax for further consideration.

TAX RULES

TR – 1000+ Claims and Elections

TR – 1000 Introduction

The Regulations provide that certain reliefs must be claimed by the taxpayer before being given. The Regulations also provide that certain favourable tax treatments will only be given where the taxpayer makes an election for such treatment. Claims allow a taxpayer to tell the Tax Department they consider they are entitled to a particular tax relief whereas elections allow a taxpayer to choose a particular way of having their affairs treated for tax purposes.

This part of the manual deals with the procedural aspects of claims and elections, the technical aspects are dealt with in the sections of the manual dealing with the subject matter of the claim or election.

TR – 2000+ Elections

TR – 2000 General

Where the Regulations provide for the making of an election, the procedure (in writing, to the Tax Department within a certain time limit) is set out within the section dealing with the election itself. Apart from provision for late elections the Regulations and Rules contain no other specific provisions about elections.

The elections that may be made under the Regulations are set out below together with a brief description of the tax treatment that may be elected for, the conditions for a valid election to be made and a cross-reference to the part of this guide where more detailed technical information may be found.

Article 12(3) – Election for average exchange rate to apply when calculating chargeable profits for an accounting period.

This election is to be made in writing to the Tax Department within 6 months of the first accounting period to which it is to apply. The tax return has a 'check box' to enable the election to be made. The election is irrevocable, i.e. once it has been made; the election applies to all subsequent accounting periods. It is the only election not covered by the late elections provision of TAX 13.4. See QTM2-1120 for more details.

Article 32(4) – Election for group relief to be set off in priority to losses brought forward.

This election is to be made in writing to the Tax Department within 18 months of the end of the accounting period to which it relates. The tax return has a 'check box' (box 22) to enable the election to be made. The election is valid only for the accounting period in respect of which it is made. The normal order of set-off is for losses to be set-off in priority to group relief, but the election allows the order to be reversed, which will be beneficial to a taxpayer when the total of losses forward and group relief exceeds the chargeable profits for an accounting period. See QTM5-5160 for more details.

Article 40 – Election for overseas tax to be treated as a deductible expense.

This election is to be made in writing to the Tax Department within 18 months of the end of the accounting period to which it relates. It will be to the taxpayers benefit to elect for this treatment where unilateral relief cannot be given because of losses – giving DTR as an expense will increase losses available for carry forward. The election is valid only for the accounting period for which it is made. See QTM6-3040 for more details.

Article 70 – Election for special exempt status to apply to an Islamic finance SPV.

Article 70 does not provide for a separate election but brings an SPV established to support or facilitate an Islamic Finance Transaction within the type of entities that may elect for 'special exempt status' (see note on Article 82, below). The procedure and time limit for making an election for an Islamic SPV to be given 'special exempt status' is consequently governed by Article 84. See QTM11-5120 and Part 14.

Article 88 – Election for QFC Entity to be charged at the standard rate.

Article 88 provides for Qatari owned entities, reinsurers and captives to be charged at the concessionary zero rate. The election is to be made in writing to the Tax Department within 6 months of the end of the first accounting period for which it is to apply and once the election is made, it will remain in force for the three subsequent accounting periods. See Part 15 for more details.

Article 82 – Election for special exempt status.

A QFC Entity that falls within Article 82(3) may elect for special exempt status. The election is to be made within six months of the accounting period for which it is to apply and is valid only for the accounting period for which it is made. An election may be refused if the Tax Department consider the QFC Entity making the election is being used solely or mainly for the avoidance of QFC tax. The tax return includes a 'check-box' (box 11) to enable the election to be made. See Part 14 for more details.

TR – 2020 Late Elections

TAX 13.4 specifies that a late election for most of the elections that can be made under the QFC Tax Regulations may be accepted if the Director of Tax is satisfied that there was a reasonable cause why the election was not made on time and it was made thereafter without unreasonable delay.

The only election that may not be made late is for the currency of the accounts to be converted in to Qatari Riyal at the average exchange rate for the accounting period of the election (Article 12(3) and QTM2-1120).

All late election applications should be recorded in the establishment file maintained for that purpose. The establishment file should show, for each application, a summary of the details of the late election, the date the late election was received and a note of the Director of Tax's decision, signed by the Director. There is no specific form for making a late election application and any written indication a taxpayer wishes to make an election out of time, including the (late) filing of a return with an election check box checked, should be regarded as an application.

TR – 2040 Late Elections – Factors

When considering a late election there are two factors the Director of Tax should take into account – is there a valid reason why the election was not made on time and, if so, was the election made thereafter without unreasonable delay?

Each application should be considered on its own facts. A reasonable cause will only be present where an exceptional event beyond the control of the taxpayer prevented the election being made on time. For example the loss of records through fire, flood or theft or the serious illness of key personnel may constitute a reasonable cause.

When the circumstances giving grounds for the delay are removed, then the election must then be made without further delay. So, for example, if the illness of a key director prevented an election being made on time, a late election should not be accepted if the election was not made until weeks or months after his recovery.

TR – 3000+ Claims

TR – 3000 General

The Tax Regulations provide for a claim to be made in six circumstances. The relevant section of this manual provides technical details regarding each type of claim, whereas this part is mainly concerned with the procedural aspects of making claims.

Claims may be made, under the Tax Regulations as follows:

Article 32 – Claim to Group Relief

Group relief is dealt with at QTM5-5000+. Procedural rules for making group relief claims are contained in TAX 9. The procedures for making group relief claims thus differ from the procedures for making claims generally. Details of the procedures for making group relief claims, which cover both the claimant and surrendering companies, may be found at QTM5-5200.

Article 43 – Replacement of Business Assets

Article 43 provides for a tax charge to be deferred when certain business assets are replaced (rollover relief). The technical aspects of the relief, which has to be claimed, are dealt with at QTM7-3000+.

Article 51 – Compensating Adjustment Claim and Article 52 - Compensating Adjustment Claim - Guarantor.

These transfer pricing compensating adjustment reliefs (see QTM8-2120 for technical details) must both be claimed.

Articles 67 and 69 – Tax Adjustments - Islamic Financial Institutions and Islamic Financial Transactions.

These tax adjustments are designed to give equality of tax treatment between transactions carried out on the basis of Islamic and conventional finance principles and they must be claimed. The technical aspects of the adjustments are dealt with at Part 11.

TR – 3020 Repayment of Tax

In addition to the claims set out above, a repayment to tax must be claimed and the procedures and time limits for making a repayment claim are the same as for other claims (TAX 10.1)

TR – 3040 Claims – The General Rule

The general rule is that a claim must, if it can be, be made by inclusion in a return (TAX 13.1.3). The return form has spaces to enable all the claims available under the Regulations to be made. If it is decided to make a claim after a return has been filed, but within the time limit for amending the return (12 months after the filing date), then the claim is to be made by way of an amendment to the return (TAX 13.1.4).

TR – 3060 Claims Made Outside a Return

It may not always be possible to include a claim in a return or an amended return. Examples include a claim that is made in time but outside the time limit for amending a return (the normal claim time limit is 3 years after the end of the relevant accounting period and a return can normally be amended only up to 18 months after the end of the relevant accounting period) or a claim that is made before the filing date for the accounting period in question (for example, a claim to roll-over relief for a particular accounting period could be made before the filing date for that period). A claim will also be made outside a return when, at the end of an enquiry, a claim is admitted out of time on the raising of a discovery assessment (TAX 13.2.2)

TR – 3080 Claims Must be Quantified

Where a claim is made within or outside a return, including a claim to repayment of tax, the claim has to be quantified at the time it is made (TAX 13.1.2). This means the amount of the claim must be determined with reasonable accuracy. For example, if a claim is made for roll-over relief (QTM7-3000+) then a claim in the form 'we wish to claim to defer the gain of QR100,000 arising on the disposal of asset A which was sold on 1 June 2015 for QR1,000,000 against asset B purchased for QR1,200,000 on 1 November 2015, both A and B being qualifying assets' would be acceptable whereas 'we wish to claim to defer the gain of QR100,000 arising on the disposal of asset A which was sold on 1 June 2015 for QR1,000,000 against unspecified assets to be purchased at various future unspecified dates' would not be acceptable.

There may be circumstances where it is not possible to specify the amount of the claim with complete accuracy at the time it is made. For example where an Islamic tax adjustment is being claimed there may be some factors that have to be negotiated and agreed between the taxpayer and the Tax Department before the claim can be settled. In these circumstances a claim could be accepted even though it contains an element of estimation. However the basic principle is that the claim should be quantified as far as possible and not be a pure estimate.

If a claim, whether included in a return or not, is felt not to constitute a valid claim on the grounds the amount of the claim has not been adequately quantified, you should challenge the claim by opening an enquiry, either into the return or into the claim directly where the claim does not from part of a return (see TAX 13.3.3).

TR – 3100 Time Limits

The normal time limit for a claim to be made is three years after the end of the accounting period to which the claim relates (TAX13.2.1). The normal time limits are overridden in the case of transfer pricing compensating adjustment claims where the time limit for making a claim to a corresponding adjustment is 3 years from the date the return for the relevant accounting period is filed or such longer time as the Tax Department may allow. (Articles 51(4) and 52(4) and see QTM8-2120 and QTM8-2140). Compensating adjustment claims are the only claims where the statutory time limit may be extended at the discretion of the Tax Department. For other claims the time limit should be applied strictly. However where it is felt there is a reasonable excuse for a claim being made marginally late the papers should be submitted to the Director of Tax to consider allowing a late claim by concession. A note of the granting of any such concessionary treatment should be in the appropriate claims establishment file.

Where a discovery assessment is raised at the end of an enquiry to assess understated profits then Tax 13.2.2 extends the time limit for making a claim to one year after the discovery assessment was raised. This provision means a taxpayer is not denied the advantage of being able to make a claim simply because he/she has concealed profits. The extent of the claim should however only extend to the additional profits being assessed. Tax 13.2.2, by referring to a claim that may only be allowed because of the making of a discovery assessment, means that the making of such a discovery assessment is not a doorway to extending the time limit generally for claims in respect of profits, or losses, originally returned. Only a claim that affects the additional profits assessed may be admitted.

TR – 3120 Enquiries

Claims are subject to the self-assessment enquiry regime. If the claim is included in a return, then the claim forms part of the return and an enquiry into the claim may be made as an enquiry, or part of an enquiry into a return. The normal rules, procedures etc. regarding enquiries apply. Where a claim is not made in a return TAX13.3.3 applies the enquiry regime, with any necessary modifications, to the claim. A common sense approach should be taken when modifying the enquiry regime to enquire into a claim made outside a return and the taxpayer should be afforded all the protections provided by the enquiry regime.

TR – 3140 Form of Claim

Where a claim is included in a return the return form itself will include space to make the claim. Any inclusion in the return or in the supporting documents submitted as part of the return of information making it clear it is wished to make a claim should be accepted. See, however, QTM.TR-3080 about the need for a claim to be quantified. If you are not satisfied the benefits of a claim may be fully given, based on the information provided in the return, including supporting documents, you should open an enquiry to challenge the claim or to obtain further information.

Where a claim is not included in a return TAX 13.3 gives the Tax Department the power to determine the form in which a claim is to be made, the information and documents that are to accompany the claim and provision is also made for the claim to be accompanied by a declaration by the claimant to the effect all the particulars given in the claim form are, to the best of his knowledge and belief, correctly stated (TAX 13.3.1 and 13.3.2).

Where a claim cannot be included in a return, any letter or other clear indication that a taxpayer wishes to make a claim should be accepted. Where the claimant does not provide sufficient information to enable you to determine the claim then you may ask for further information and supporting documents under TAX 13.3.2. If, however, the correspondence becomes protracted or if you have reason to doubt the validity of the claim or the quantum of the claim, you should formally open an enquiry under TAX 13.3.3 by issuing an enquiry notice.

TR – 3160 Error or Mistake

Where a taxpayer has made a claim, whether within a return or otherwise, and he/she subsequently discovers that an error or mistake has been made in the claim, he/she may make a supplementary claim (TAX 13.1.5). It should be noted that there must have been an 'error or mistake' in the original claim, not merely a change of mind. Also the supplementary claim must be made within the time allowed for the original claim - the error or mistake provision does not extend the time limits for making a claim (TAX 13.1.5). Where a claim is made by being included in a return, there is some overlap between the provisions of Article 130 and TAX 13.1.5. In particular you should not, where a claim has been included in a return, deny a taxpayer the more generous time limit provided for in Article 130 (six years).

TR – 3180 Appeals

Although there are no specific appeal rights relating directly to claims or elections, in practice a taxpayer has appeal rights where the Tax Department decide a claim or election is not due, is not due in full or the consequences of making a claim or election are different from what the taxpayer considers them to be.

In the case of elections, the taxpayer will submit his return on the basis of the consequences he/she considers flow from the election he/she has made – for example if the election is for profits to be translated at the average exchange rate over the period then the tax computations submitted with the return for that period will reflect that treatment. If you consider the election has not been validly made, or that the average exchange rate used is wrong then you should open an enquiry and the taxpayer will have the right of appeal against the notice closing the enquiry. The same principle will apply to claims made within a return. In the case of a claim made outside a return TAX 13.3.3 applies the enquiry regime (with necessary modifications) to such claims and at the conclusion of an enquiry into a claim made outside a return (the means by which you are able to question, test or challenge such a claim) you will be required to issue a closure notice, against which the taxpayer will have full appeal rights.

APPENDIX 1 – About the QFC

ABOUT THE QFC

Foreword

Tax is an important consideration for international businesses and in developing its tax regime the Qatar Financial Centre (QFC) has taken an approach which is unique for financial centres in the region, adopting a low tax rate and a transparent, efficient administrative process. The QFC is not a tax haven, instead it has been set up as a location in which companies can operate onshore in Qatar, regionally and globally.

In developing the QFC tax regime the business community was widely consulted to ensure that the regime achieved a fair balance between its fiscal objectives and the needs of licensed firms. The result is a class-leading regime which creates an internationally competitive environment, supporting and stimulating business activities.

Tax within the QFC was first levied in 2010 and new Regulations were enacted on 18 June 2014. The regime will be developed over the coming years to continue to impose a stable, transparent and fair tax. Guidance material and practice notes will be published to aid transparency.

The Qatar Financial Centre

In March 2005 the State of Qatar enacted Law No. (7) (QFC Law) to establish the QFC. The QFC formally opened on 1 May 2005. The QFC was established to attract international financial institutions and multinational corporations to establish business in international banking, financial services, insurance and reinsurance, captive insurance, asset management, corporate head office functions and related activities within Qatar.

Over the last 10 years the QFC has widened the scope of licensed activities firms can undertake and this in turn has increased the number of non-regulated firms setting up in the QFC.

The QFCA and the QFCRA

The QFC is organised into four authorities, the QFC Authority (QFCA), the QFC Regulatory Authority (QFCRA), Qatar Financial Centre Civil and Commercial Court and the Qatar Financial Centre Regulatory Tribunal. These entities are independent of each other and from the Government of Qatar, however the latter two fall under the Qatar International Court and Dispute Resolution Centre (QICDRC).

The QFCA is responsible for the development, operation and administration of the QFC. The QFCA is governed by the QFCA Board, which is chaired by the Minister of Finance. One of the QFCA's most important roles is to approve and issue licenses to entities wishing to establish a presence in the QFC. Businesses undertaking financial services also require authorisation from the QFCRA. The Tax Department is established by the QFCA under Article 6 of the QFC Law.

Under Article 9 of the QFC Law both the QFCA and the QFCRA can, to achieve their objectives, submit Regulations for enactment to the Minister, and both have Rule making powers.

The QFC also provides a mechanism for dispute resolution, including tax appeals.

QFC Legislation

The QFC has its own law (Regulations and Rules), distinct from the laws of the State. In addition to the Tax Regulations and Rules the QFC laws include Regulations enacted in respect of Financial Services, Companies, LLP's Partnerships, Trusts, Special Companies, Single Family Offices, Anti-Money Laundering, Contracts, Data Protection, Insolvency, Employment and Immigration. The QFC legislative framework is of an international standard of the kind that multi-national businesses are familiar with.

BACKGROUND TO THE QFC TAX REGIME

Developing the QFC Tax Regime

The strategic vision for the QFC includes the adoption of a modern, efficient tax system with a low but meaningful tax rate. It is considered such a regime will be preferred by entrant businesses to one under which significant fixed fees or taxes based on turnover are the primary source of revenue.

Taxation is not yet highly developed in the Middle East, particularly in the GCC states. Some states are tax free, and others charge tax only on foreign businesses. The GCC states generally do not subject the wages or salaries of employees to tax.

The QFC tax regime is transparent, and the taxes paid should normally be creditable in other jurisdictions and hence, for many businesses, do not represent an incremental cost of doing business in the QFC.

An Onshore Centre

The QFC is not a free-zone or an offshore centre and the tax regime is designed to ensure that it is not labelled as an offshore tax haven by international fiscal organisations. The robustness and transparency of the regime, together with openness to effective exchange of information has resulted in the Organisation for Economic Cooperation and Development (OECD) not regarding the QFC tax regime as being 'harmful'. The QFC does not seek to undermine fair competition or to be a haven for secrecy.

Qatar is a member of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. In 2010 Qatar was subject to an OECD Phase 1 peer review of its legal and regulatory framework. The QFCA Tax Department assisted the State Tax Department by providing information about the QFC's legal and regulatory framework and took part in the peer review process.

A Phase 1 peer review assesses a jurisdictions legal and regulatory framework against the following elements:

1. Availability of information

2. Access to information

3. Exchanging information

The Phase 1 peer review for Qatar (including the QFC) confirmed that Qatar's legal and regulatory framework fully meets the OECD standards.

A Phase 2 peer review focuses on the effectiveness of exchange of information. Qatar's Phase 2 peer review was completed in the summer of 2013 with Qatar being awarded the second highest possible mark (largely compliant). The main reason for not achieving the highest mark (compliant) was due to the low number of exchange of information requests received during the peer review period. In due course, when Qatar has more exchange of information on request experience, it is intended to request a supplementary phase 2 report with a view to upgrading the overall rating to 'compliant'. In the future Qatar will be subject to a phase 3 review (which will focus on beneficial ownership information) as well as being involved in the OECD automatic exchange of information project.

QFC LAW

Taxation

Article 17 of the QFC Law, provides the vires for the QFC to charge tax on entities established in the QFC and limits the scope of the State tax law in relation to QFC entities.

APPENDIX 2 - The Territorial Basis of Taxation - Case Law

CIR v Hong Kong & Whampoa Dock Co. Ltd [1960] 1HKTC85 (Apportionment)

This case concerned a ship salvage operation. A vessel was damaged outside Hong Kong waters and was repaired, re-floated and towed into Hong Kong by the taxpayer. It was argued that as the operations were almost wholly outside Hong Kong, the profits were not taxable.

The view was taken that as s.14 (Hong Kong charging section containing the words "arising in or derived from") does not explicitly provide for apportionment the court could not apportion where some profit arose within and some without Hong Kong. The court adopted the test derived from the Australian case *COT (NSW) v Hillsdon Watts ltd* [1937] 57CLR36 – where profits cannot be dissected and separate parts attributed to different places locality "…must be determined by considerations which fasten upon the acts more immediately responsible for the receipt of profits". It was held that where payment made for services is of no importance. Because almost the entire services which gave rise to the profits were performed outside Hong Kong the profit did not arise in or was derived from Hong Kong.

CIR v International Wood Products Ltd [1971] 1HKTC551 (Operations Test)

The appellant company was the agent for two overseas principals for the sale of logs. It appointed sub-agents outside Hong Kong to make sales. Orders and payments were sent directly to the overseas principals. The company received commission from the principals and passed sub-commission on to its sub-agents. The courts found that the source of commission was the place where the services were rendered to earn the commission – in this case the work done by the sub-agents outside Hong Kong – even though some ancillary services were done within Hong Kong. It was held the profits were therefore not local source and not assessable.

***Sinolink Overseas Ltd v CIR* [1985] 2HKTC127 (Operations Test)**

The company purchased plywood for sale in Hong Kong and China. There was no office in China but one in Hong Kong. Chinese sales were concluded in China by a director fully empowered to sign contracts. After conclusion of sales contracts the company sent purchase orders to overseas manufacturers. Company argued there were two businesses – one in Hong Kong and one in China.

The operations test was applied. It was found that it was the activities of the Hong Kong office that produced profits because (1) the business setting and purchase/sale logistics were all in Hong Kong (2) the purchases were managed and arranged in Hong Kong (3) although the Chinese sales were concluded in China the profit should be regarded as arising from both the purchase and sale. The fact sales were concluded in China could not on its own make the sales from Chinese sales non-taxable and (4) all post-contract activities and management work was done in Hong Kong. On the totality of the above factors it was concluded all profits (whether from Hong Kong or China) were local source and taxable.

This decision was very controversial and its significance has been falling since the case of *CIR v Magna Industrial Company Ltd* [1997] HKLRD 173.

Commentators have frequently argued that the decision in *Sinolink* may be viewed as a departure from the traditional source rule which, in the case of a merchandising trade, indicates that the most important if not the critical factor in determining the source of profits is the place where the contracts of sale were made. However a Board of Review decision shows that in practice it may be difficult to escape the approach adopted in the *Sinolink* case. A local company bought aluminum from a Taiwanese supplier and resold it to a Japanese buyer. In reaching its decision that the appellant's profits arose from a source in Hong Kong, the Board applied, point by point, the analysis of Hunter J in *Sinolink* by looking at the places where the following activities were carried out: pre-contract preparation and management, making of the contract of purchase, making of the contract of sale and post-contract performance and management. Although the first two activities took place in Taiwan, the remaining two were undertaken in Hong Kong and this was sufficient for the Board to conclude that the appellant's profits were chargeable to tax in Hong Kong.

The operations test focuses upon identifying those activities which substantially give rise to the gross profits derived from individual transactions and then ascertaining where those activities took place. In accordance with this test, the Inland Revenue Department historically accepted that operations with substantial connections outside Hong Kong (such as those of a typical trading operation based in Hong Kong but dealing with foreign sellers and buyers) did not give rise to taxable profits in Hong Kong. In the majority of cases, this test seems to have worked acceptably but, particularly in the trading area, more recent cases have expanded the perceived ambit of the operations test and introduced an unsatisfactory level of uncertainty. The *Sinolink* case was the first major indication of future difficulties in applying the operations test. When the case was decided, it attracted widespread attention because it subjected to profits tax the profits of a so-called "China trader". In *Sinolink* the company, whose business was controlled in Hong Kong and which had no branch operation outside Hong Kong, sent agents to the PRC to conclude sales contracts. Notwithstanding that the agents had full authority to contract and did conclude contracts in the PRC, all of the company's profits were held by the High Court to be subject to tax in Hong Kong. It appears that considerable emphasis was placed by the Court upon the fact that the company's headquarters and sole place of business were in Hong Kong, even though this was not previously determinative in deciding the issue of source of profits. As a result of the *Sinolink* case the IRD made a more concerted attempt to tax profits derived from offshore operations by Hong Kong entities. The trend continued, supported by the Privy Council decision in *CIR v HK-TVB International Ltd* [1992] 3HKTC468. It remains to be seen the extent to which the decision in *ING Baring Securities (Hong Kong) Limited v CIR* [2007] FACV No.19 of 2006 reverses this trend.

Bank of India v CIR [1988] 2HKTC503 (Apportionment)

The Bank carried on business in Hong Kong and was active in trade financing via discounting foreign bills of exchange, originating from international trade. The drawers of bills were Hong Kong companies who were suppliers of goods. Drawees were importers resident outside Hong Kong. The Bank was the payee. On a customers' application, the bank discounted bills and paid proceeds to customers in Hong Kong. The collection of the value of the bill on maturity was performed overseas by banks agent. The banks profit was the difference between cost of bills and proceeds on maturity. It was held that the operations from which the profit arose took place in Hong Kong and the profits were therefore taxable as local source.

Exxon Chemical International Supply SA v CIR [1989] 3HKTC57

The taxpayer was a wholly owned subsidiary of a USA multi-national enterprise, carrying on business in Hong Kong and the Bahamas. In the course of its Hong Kong business the taxpayer purchased goods from one group member and sold to another at a profit. The Courts held it was "necessary first to determine how profit derived and secondly where derived". In this case the profit was derived from the mark-up on sales. The taxpayer obtained orders for goods in Hong Kong and the order with the seller, to meet the buyer's requirements, was placed in Hong Kong – this was the foundation of the transaction generating the profit and was derived from activities in Hong Kong. Income arose on the delivery of the goods – but that was the income of those responsible for getting goods from Houston to Singapore. The only income of the taxpayer was the "turn" between the selling and buying prices. The taxpayer did not engage in, outside Hong Kong, any activity with a view to profit. It was held to be immaterial that the subject of the transaction (effected by the taxpayer accepting the order from the buyer matched, at a profit, by its own order placed with the seller) was a load of oil additive destined for transhipment from the USA to Singapore. The business was transacted in Hong Kong and the profits were local source.

***CIR v Hang Seng Bank Ltd* [1991] 1AC 306 (Operations Test)**

This case concerned a Hong Kong bank making profits from the purchase and sale of securities outside Hong Kong.

The primary IRD argument was that the business of the bank was one and indivisible - that business was carried on in Hong Kong and all the relevant operations which resulted in the profits in question being earned were directed from Hong Kong and owed their success to the expertise of officers of the bank employed in Hong Kong. No overseas branch was involved and the funds used in the purchase of certificates of deposit were part of the assets of the bank arising from the carrying on of the bank's business in Hong Kong. For these reasons the profits accruing from overseas trading in certificates of deposit cannot be looked at in isolation; they were mere components of the profits of an entire business and those profits, as a whole, arose in and derived from Hong Kong.

In refuting the IRD argument Lord Bridge observed the structure of the charging section presupposes profits of a business carried on in Hong Kong may accrue from different sources – some within and some without Hong Kong. If the IRD argument was correct the "arising in or derived from" provision would be otiose as it would be sufficient to show the profits were earned by a business carried on in Hong Kong to make them taxable there. In the course of the hearing counsel for IRD submitted that the "arising in or derived from" provision only excludes from liability the profit earned by a "fully fledged" overseas branch of a Hong Kong bank "which takes in its own deposits, makes its own loans and investments and generally runs its own banking business subject to the overall direction of its head office in Hong Kong." This argument was rejected on the grounds restricting the scope of "arising in or derived from Hong Kong" to excluding the profits of an independent business carried on overseas would reduce the effect of the provision to negligible significance. The same result could be secured, without statutory assistance, by ensuring the separate business of the overseas branch was carried on by a different or subsidiary company.

Lord Bridge continued by saying that in determining locality of source the gross profit arising from individual transactions must be examined. The "Broad guiding principle" was stated by Lord Bridge as "… one must look to see what the taxpayer has done to earn the relevant profits". This was later expanded in the *HK-TVB* case to "one looks to see what the taxpayer has done and where he has done it." The profits arose from trading certificates of deposit, and as a general principle trading income arises where the activities take place from which the income can be said to arise. In this case the trading activities were the buying and selling of the certificates overseas, so the profit arose overseas. The fact the funds used to finance the transactions came from Hong Kong did not mean the profits arising from the overseas investment of those moneys must likewise derive from Hong Kong. The source of income being taxed was not the source of funds invested by the bank but the activities of the bank and the property of the bank from which the profits arose. The profit making activity was the buying and selling of the certificates and not the decision making process or any other activity in Hong Kong. Otherwise a taxpayer trading in real estate or securities outside Hong Kong would be liable to tax in Hong Kong if the decisions were made in Hong Kong, the operations based in Hong Kong or the funds used once originated in Hong Kong. There is no such worldwide income concept in the Hong Kong tax law.

The IRD put forward a secondary argument that if the profits were not assessable in full, they were at least assessable in part, the split being based on management costs, the relative importance of what was done inside and outside Hong Kong or on a 50:50 basis. Although Lord Bridge held the profits in the *Hang Seng* case were derived entirely from the places where the sales were effected (outside Hong Kong) and were therefore not taxable at all he also said that the statute implicitly requires the apportionment of profits in some circumstances. The example was given of goods sold outside Hong Kong which were manufactured and finished partly in Hong Kong and partly overseas. In such cases, the absence of a specific provision for apportionment would not obviate the necessity to apportion the gross profit on sale as having arisen partly in Hong Kong and partly outside Hong Kong. Lord Bridge gave little guidance on the circumstances in which apportionment is required or, when it is required, how it is to be calculated. In the two decades since *Hang Seng* these two questions have given rise to much debate and speculation and remain almost entirely unresolved.

CIR v HK-TVB International Ltd [1992] 3HKTC468 (Operations Test)

The company licensed films produced by its parent. The company had exclusive rights to broadcast and export parent's TV films and programs outside Hong Kong and to grant sub-licenses. Negotiations with customers usually took place outside Hong Kong. Contracts were signed by customers overseas but taken to Hong Kong for completion. It was held by the Privy Council that the profits were assessable as the operations producing the profit - the acquisition of the exclusive right to grant sub-licenses together with the relevant films and the grant of the sublicenses together with the provision of the film by contracts with individual customers – were carried out in Hong Kong.

This case is the origin of the so called “rare case” doctrine. Lord Jauncey observing “...it can only be in rare cases that a taxpayer with a principal place of business in Hong Kong can earn profits which are not chargeable...”

*CIR v Euro Tech (Far East) Ltd* [1995] 4HKTC30 (Operations Test)

This case concerned the Hong Kong incorporated subsidiary of a UK parent. The business was marketing/trading electronic equipment purchased from the UK parent and other group companies. The taxpayer had distribution agreements with Korean and Singapore companies. Orders were received from the distributor companies and sent to the UK parent who shipped the goods direct to the distributors. The profit earned by the Hong Kong company were held to be assessable. It was held that it was the bridging operations in Hong Kong between the UK and the two overseas buyers, that gave rise to the profit. “If a taxpayer has a principal place of business in Hong Kong, it is likely that it is in Hong Kong that he earns his profits. It will be difficult for such a taxpayer to demonstrate that the profits were earned outside Hong Kong”. Reference was made to Lord Jauncey’s dicta in *HK- TVB* and the so-called “rare case” doctrine.

CIR v Orion Caribbean Ltd [1996] 4HKTC432 (No Simple Rule of Law)

The point at issue was the source of interest income. The company received deposits from its off-shore holding company and lent the money on to persons outside Hong Kong. In deciding the source of the interest income the Board of Review looked to the observation, given by way of example, in *Hang Seng* that where profit is earned by lending money, source will be place where money is lent (provision of credit test). The Board concluded the taxpayer in this case had lent money, and as it did so offshore the interest was not local source.

In the Court of Appeal, finding for the taxpayer, there is a useful exposition of the application of the broad guiding principle. In some situations profits earned are earned by effecting a transaction (eg *Hang Seng* - and the present case) in others the performance of an operation (eg *HK-TVB*). In every case one must look to the nature of the transaction, operation or activity that generates the profit – one then looks to see where the transaction was effected, operation performed or activity carried on. Whether the profit is from a transaction, operation or activity will depend on the facts. In *Hang Seng* the source was a series of transactions effected offshore. In *HK- TVB* the source was the operation carried on in Hong Kong. In this case it was concluded what the taxpayer did to earn profit it did outside Hong Kong at the various places where the money was lent – the transaction which generates profit in the case of an offshore loan is the making available of the money from which the interest arises – in this case outside Hong Kong.

The Privy Council (deciding for IRD) held the interest income from loan syndicates derived by the taxpayer (incorporated in Cayman Islands) arose from a Hong Kong source. The loans on which interest was paid to the taxpayer were administered from Hong Kong. The borrowing to fund the taxpayer's loan commitments was carried out in Hong Kong and elsewhere by group companies. The funds were all placed with the taxpayer in a bank account outside Hong Kong. There was an agreement between the taxpayer and its Hong Kong parent whereby the parent agreed to perform various services for the taxpayer including credit analysis of potential borrowers, administration and accounting and management of the taxpayer's cash deposits. The taxpayer employed no staff in the Cayman Islands but held meetings there. Its main business was to consider and approve loan participations recommended by its Hong Kong parent. In all cases the taxpayer provided funds to ultimate borrowers, all outside Hong Kong. The taxpayer accepted (on appeal) it carried on a business in Hong Kong - its Hong Kong parent entered into loan syndication commitments in Hong Kong as its agent. The Privy Council approved the provision of credit test for simple loans of money but on the facts of this case applied the operations test – the business of the company was borrowing of money for on-lending at a profit. That profit was held to arise from business transacted in Hong Kong as it was earned by the taxpayer by allowing itself (as part of a tax avoidance scheme) to be interposed between the lender of funds (the Hong Kong parent) that were raised or provided in Hong Kong and the ultimate borrowers under loan agreements negotiated, approved and serviced by the Hong Kong parent.

CIR v Magna Industrial Company Ltd [1997] 1HKLRD173 (operations linked to profit)

The taxpayer secured industrial products from a wholly owned subsidiary and sold them to overseas customers. The subsidiary acquired the products from overseas suppliers and warehoused them in its own name in Hong Kong. The taxpayer set up a network of independent agents authorised to enter sales orders in the countries in which they operated. The agents sent orders to the taxpayer in Hong Kong for processing. Taxpayer bought goods from its subsidiary, shipped them to customers and collected the sales money. Held by the Board of Review that the purchase activity was that of the subsidiary and the sales were effected by independent overseas agents with authority to bind taxpayer to specific orders – therefore the profits derived outside Hong Kong. Court observed "Clearly everything must be weighed by a Board when reaching its factual decision as to the true source of the profit. We must look at the totality of the facts and find out what the taxpayer did to earn the profit…Obviously the question where the goods were bought and sold is important. But there are other questions: For example: How were the goods procured and stored? How were the sales solicited? How were the orders processed? How were the goods shipped? How was the financing arranged? How was payment effected?”

This case is in direct contrast to IRD guidance on locality of profits (DPIN 21) which indicates if contract of purchase or sale is effected in Hong Kong then the profit arises in Hong Kong.

CIR v Indosuez W I Carr Securities Limited [2002] 1HKLRD308 (apportionment)

Hong Kong and overseas clients appointed the taxpayer to buy/sell stocks listed on overseas markets. The taxpayer instructed overseas brokers to execute the purchases/sales. The Hong Kong and overseas clients paid the taxpayer commission. The point at issue was whether the commission was wholly taxable in Hong Kong. It was not disputed the commission received by the taxpayers from overseas clients was not taxable but the question was whether the commission from Hong Kong clients was taxable. The Court of First Instance held it is possible to apportion the commission income. Their decision relies on the “totality of facts” approach and they remitted the case back to the Board of Review who apportioned 50:50. Taxpayer requested a Judicial Review, which was decided in January 2006 and IRD were successful (profits wholly taxable in Hong Kong).

The case then went to the High Court who found that, with regard to orders placed by overseas clients on exchanges outside Hong Kong, the Board of Review did not find that brokers were agents of the taxpayer (making the acts of broker performed overseas the acts of taxpayer) but found the taxpayer engaged overseas group offices as its agents to liaise with clients, process, handle and manage the orders and provide primary research material. As a result the Board found that profits generated from overseas clients arose substantially offshore. For Hong Kong customers the profits derived from operations within and outside Hong Kong, but the greater element was in Hong Kong - building and maintaining client relationship, quality research and advice, effective reliable service and projecting image of repute and reliability. The actual execution of orders on overseas exchanges were not the acts of the taxpayer. The court would have liked to apportion 60:40 (60 to Hong Kong) but considered it had no authority to apportion so looked to predominant source, which was Hong Kong.

In reviewing the law the court indicated that it is important to focus on what the taxpayer, rather than anyone else, has done.

On remittance (BOR D79/03) the Board confirmed its view that profits in respect of overseas clients was offshore, but for Hong Kong profits, as substantial sales and research functions were performed in Hong Kong (but client orders managed and executed overseas), a 50:50 apportionment was required. There was a further judicial review by the High Court followed by a Court of Appeal hearing where judgment was made against the taxpayer. The taxpayer appealed to the Court of Final Appeal but in April 2009 the parties agreed, with the consent of the Court of Final Appeal, to settle on the Basis of the Board of Review decision mentioned above, that is on the basis of a 50:50 apportionment.

Kwong Mile Services Ltd v CIR [2004] 7HKCFAR 278

The taxpayer carried on business in Hong Kong and realised profit from a property development in the PRC. Profit arose from underwriting the sale of the PRC property in Hong Kong. Taxpayer agreed to underwrite the sale of units in the figure of $84m up to 30 June 1992. If, before then, the developer received more than $84m the developer would pay the difference to the taxpayer. If the developer received less than $84m the taxpayer would have to pay the difference to the developer and take up the unsold units. The taxpayer advertised the units in Hong Kong and secured purchasers in Hong Kong. The purchasers had to sign, in Hong Kong, a "pre-contract provisional agreement" with the developer. These purchasers then went to mainland to sign a "pre-contract formal agreement" with developer. The taxpayer was not a party to these agreements. The sale was a success and the developer got more than $84m and consequently the excess was paid to the taxpayer. Court of Appeal held it was the underwriting of the sale that gave rise to profit and as the underwriting was substantially carried out in Hong Kong, the net profit derived from Hong Kong and was therefore taxable.

This case is useful in that it contains a thorough analysis of the role of the appellate court, the fact/law distinction and the circumstances where the Courts may overturn a finding by the fact finding body (in Hong Kong, the Board of Review).

Kim Eng Securities (Hong Kong) Ltd v CIR [2006] FACV N0.11 of 2006

KES Hong Kong, was a Hong Kong incorporated stockbroker and a member of the Hong Kong stock exchange, whom earned brokerage income from the execution by group companies and independent brokers on overseas stock exchanges – Singapore, Malaysia, Philippines etc. Before the courts it was agreed the Singaporean transactions were typical. KES Singapore and KES Hong Kong formed part of a corporate group controlled by a Singaporean holding company. Singapore stockbrokers were required to charge customers a minimum commission, which could be reduced by up to 50% (a rebate) for sharing with foreign stockbrokers that referred customers to a Singapore stockbroker. KES Hong Kong was interposed between KES Singapore and the customer, and as KES Hong Kong was regarded as a foreign stockbroker by the Singapore Stock Exchange, KES

Singapore could give KES Hong Kong a rebate of up to 50% of the minimum commission, allowing KES Hong Kong to charge overseas customers a lower commission and retain a competitive edge. Overseas customers dealt directly with employees of KES Singapore, authorised to act on behalf of KES Hong Kong in receiving payments and operating KES Hong Kong's bank account in Singapore. The account executives of KES Singapore who sourced the overseas customers continued to provide them with information and research material. KES Hong Kong's activities in Hong Kong included opening accounts for overseas customers, sending trade confirmations and bought and sold notes to customers, billing customers and following up on settlement.

The point at issue was whether net commission or brokerage derived from the execution of trade on overseas stock exchanges for overseas customers, plus three other types of income derived from margin accounts, were sourced in Hong Kong. The other three types of income were commissions charged for margin accounts inactive for 90 days (contango commission), commitment fees and interest income.

The taxpayer argued the brokerage was derived outside Hong Kong under the operations test – the effective cause of earning the net commission was the execution of trades on overseas exchanges for overseas customers performed by overseas stockbrokers. KES Hong Kong performed no activities in Hong Kong to earn the commission - KES Hong Kong was in a passive role when the trades were executed successfully by KES Singapore on the Singapore Stock exchange. Activities in Hong Kong were merely ancillary in nature – not the crucial operations that produced the income in question. *Wardley* should, it was argued, be overruled as the acts of agents (overseas stockbrokers) in that case were ignored. In respect of the three types of income from margin accounts it was argued the source of income was outside Hong Kong as both the place of borrowing and place of lending were outside Hong Kong.

The IRD argued, when looking at the brokerage, the arrangement between KES Hong Kong, KES Singapore and overseas customers could be characterised as a "sharing of fees" and the net effect of the transactions was KES Singapore would get 50% of the minimum commission and leave the rebate to be shared between KES Hong Kong and the overseas customer. It was thus crucial KES Hong Kong was interposed to bring the complementary needs of the overseas customers to KES Singapore. KES Hong Kong earned its actual share of commission for its work done in Hong Kong, while KES Singapore earned its own income for work done abroad. With regard to the margin accounts - contango and commitment fee should have the same source as interest income – it arose because of KES Hong Kong's ability to provide margin financing to its customers which was not possible without the interposition of KES Hong Kong, in Hong Kong.

In coming to their decision, the court held that the cornerstone of taxpayer's argument was that it executed orders on foreign exchanges albeit via agents outside Hong Kong (Singapore broker was acting on instructions given by customer and was acting for customer, not as an agent of taxpayer). The entire argument was constructed on the question – should the acts of agent be viewed as the acts of the principal? Bokhary J explained it is not always appropriate to look at the acts of an agent - "such a complete identification is usually regarded as inappropriate". The judge did not agree *Wardley* ignored the agency concept. The importance of the taxpayer's activities in Hong Kong was stressed – these actions made the customer a customer of a stockbroker outside Hong Kong and it was these activities that generated commission for KES Hong Kong. The execution of customers' orders preceded the paperwork making them customers of the taxpayer. KES Hong Kong made its profit under contractual arrangement separate and distinct from the contract under which commission on the share transaction became payable. This was a "dressing up" arrangement, for which KES Hong Kong earned income for arrangements orchestrated and implemented in Hong Kong and therefore the source of income was Hong Kong.

Lord Scott of Foscote considered KES Singapore was not an agent of KES Hong Kong as KES Singapore acted on instructions from customers, not KES Hong Kong. Therefore it was not necessary to examine the acts of KES Singapore and the source was in Hong Kong as KES Hong Kong did nothing outside Hong Kong.

With regard to the margin accounts, the cause of earning income was the margin facilities being opened and kept by KES Hong Kong in Hong Kong and the source was therefore in Hong Kong.

Apportionment was not considered appropriate as it was considered the income arose only from a Hong Kong source, not a mixed source.

Bokhary J considered an overseas broker can be agent of a Hong Kong broker but also introduced a new rule – in certain circumstances the acts of an agent need not be taken into account in determining source. This makes an already complex position with regard to agents even more so. In *Orion Caribbean* it was decided an agent relationship could be established by reference to the activities of an agent despite the presence of an express agreement to deny such a relationship. The terms of a written agreement may not, therefore, be conclusive.

Bokhary J emphasised that the execution of a customer's order on a foreign exchange had always preceded the paperwork making that customer KES Hong Kong's customer for that transaction, but then reached an apparently contradictory conclusion that the paramount activities generating brokerage was "making the customer a customer of a stockbroker (KES Singapore) outside the country..." in Hong Kong as opposed to the actual execution of the transactions in Singapore.

Kim Eng is very similar to *Wardley* – a rebate commission earned by Hong Kong stockbroker from overseas stockbroker. In *Wardley* the judges did not consider whether the overseas stockbroker was an agent of a Hong Kong stockbroker – perhaps the main reason why taxpayer did not succeed. It is unclear why Bokhary J did not accept the agency concept was ignored in *Wardley*.

Lord Scott of Foscote's approach was that KES Singapore was not an agent of KES Hong Kong, a position consistent with the decision of the court of first instance in *Indosuez.* In that case it was held the overseas stockbroker was acting as an agent of the Hong Kong stockbroker. In *Kim Eng,* by contrast, it was the customers who gave instructions directly to overseas stockbrokers, so overseas stockbrokers simply acting on behalf of customers, rather than Hong Kong stockbroker, and therefore agents of customers.

ING Baring Securities (Hong Kong) Limited v CIR [2007] FACV No.19 of 2006 (Operations Test)

Taxpayer was part of the Barings Group (global securities sub-group). The Hong Kong incorporated company primarily acted as an agent in securities dealings. At issue were commissions, placement and marketing income derived from securities traded on stock exchanges outside Hong Kong.

Commission income was earned by successfully executing client orders on overseas stock exchanges. Clients would approach sales desk of Barings in resident country. Orders were channeled to the taxpayer and executed on a stock exchange via a broker (whom may or may not have been a Barings entity). Client paid commission to taxpayer and taxpayer paid brokers commission, the net commission retained being the profit.

Placement income was the commission on the successful allotment of shares on IPO/new listing on exchanges outside Hong Kong. Customers applied for IPO/listing shares through taxpayer and other Barings companies. Taxpayer consolidated orders and transmitted them to a Barings company where the IPO/listing was located. The taxpayer received commission for successful placement of issued securities.

Marketing income arose from Barings group policy which required commission to be split between the party executing the transaction and the party introducing the client. If the taxpayer introduced a client to another group company operating in a foreign market and the client traded in that market through a group company, the taxpayer got a share of the commission earned from the transactions executed by the other group company.

The Court of Final Appeal applied the "operations test" and ruled unanimously in favour of the taxpayer. The crucial step in earning commission was executing transactions for sale and purchase and these took place outside Hong Kong. Income was not earned unless and until transactions were performed outside Hong Kong. The place where the taxpayers business was administered or where the commercial decisions were taken was not determinative. The same applied to placement income which was derived from commissions received on successful allotment of shares outside Hong Kong. With regard to introduction fees, it was held the introduction itself did not result in the commission payment, which was only paid after the trading transaction (on overseas exchange) took place, so this income also arose offshore.

The Courts stressed that in applying the operations test it is the activities of the taxpayer –not anyone else (such as the Barings group as a whole) that needed to be examined.

The operations test is the guiding principle. The totality of facts approach (which places a compliance burden on taxpayer) can no longer be supported by the Court. The agency rule was clarified –a taxpayer is no longer required to identify whether profits are derived as a result of transactions performed by the taxpayer or his agent in a full legal sense. For tax purposes a person will be seen as an agent as long as a transaction is carried out on the taxpayer's behalf, for the taxpayer's account, and on the taxpayer's instructions – it does not matter whether the taxpayer is acting on his own account or for the account of a client in return for a commission.

Kim Eng and *Barings* may be usefully compared and contrasted. In *Kim Eng* the court ruled the acts of an agent, in some circumstances, do not need to be taken into account in determining the source of income of the principal. The Court of Final Appeal distinguished *Barings* from *Kim Eng* by saying the critical factor in *Kim Eng* was that the transactions giving rise to the profit only took place **after** the trading in securities in Singapore were completed by other group entities. The commission income in *Kim Eng* was not earned from transactions in Singapore (which had already taken place) but for taking part in the "dressing-up arrangement" orchestrated and implemented in Hong Kong.

CIR v Li & Fung (Trading) Ltd [2012] CCV 8/2011

The taxpayer, a Hong Kong company, provided services to its overseas customers in connection with the sourcing of products from suppliers (manufacturers) outside Hong Kong and overseeing the manufacturing process for quality control purposes. Both the customers and suppliers were unrelated to the taxpayer. Upon delivery of the goods the taxpayer was paid a commission of 6% of the total freight on board (FOB) value of the customers export sales. The taxpayer entered into contracts with its overseas affiliates under which the latter performed the sourcing and oversight services for the taxpayer outside Hong Kong, the taxpayer paying 4% of the FOB value of the customers' export sales in consideration for these services. The taxpayer entered agency agreements with its customers for the services described above as a result of the efforts of its senior, Hong Kong based, staff.

The taxpayer argued the commission earned on orders from overseas customers handled by affiliates outside of Hong Kong were not Hong Kong sourced, the IRD considered such profits were local source. The IRD argued before the Review Board that the taxpayer operated a 'supply chain management business' and earned the 2% net commission from managing its own and its affiliates activities. Before the Court of the First Instance the IRD argued the Board had erred in not apportioning the 6% gross profit which was, in its view, earned by the taxpayer both in Hong Kong and overseas. Both the Board and Court of First Instance ruled for the taxpayer, finding the source of the commission income was offshore and not taxable. In essence the Court agreed with the Board's approach of applying the principle established in the *ING Baring* case for determining source, it being the services performed by the taxpayer's overseas affiliates as the relevant profit producing activities, supporting also the Board's view that the activities performed by senior management in Hong Kong were 'antecedent'.

The IRD before the Court of Appeal argued that as the services performed by the taxpayer in Hong Kong were part of the services giving rise to the commission income in the agency agreements between the taxpayer and its customers, those activities were not antecedent or incidental but part of the profit producing transactions and that the case should be remitted to the Board to apportion part of the taxpayers profits as attributable to the services performed in Hong Kong.

The Court of Appeal rejected the IRD's argument. They held the argument for remission was based on a new argument, not put before the Review Board so remission was inappropriate. The Board's decision correctly analysed the source cases and correctly applied the principles established in *ING Baring*, namely one has to focus on 'establishing the geographic location of the taxpayer's profit producing transactions themselves as distinct from activities antecedent or incidental to those transactions'. There is an important distinction between the taxpayer managing its business in Hong Kong and performing its profit producing activities, via the services rendered by its overseas affiliates, outside of Hong Kong, only the latter is relevant in determining the source of the taxpayer's profit. On this basis the Court of Appeal held that all the profit making activities were performed outside Hong Kong and the income in question was therefore not local source.

The case underlines the important distinction between activities that are commercially essential to the operation and profitability of a taxpayer and activities that provide the legal test for ascertaining the source of profits. It was concluded the taxpayer derived its profits from the provision of sourcing services based on the terms of the standard agency agreement between the taxpayer and its customers. Once it is established the income is in the nature of service fee income, the relevant activities in determining source are the performance of those services. Other activities performed by senior management in Hong Kong, no matter how important to the operation of the taxpayer's business operations are 'antecedent or incidental' as far as determining source is concerned.

APPENDIX 3 - Safe Harbour Ratio Review

Table of ratios

Country	Limitation	Comments
Australia	Debt:Equity 1.5:1	In 2002, Australia's thin capitalisation regime changed substantially, bringing in lengthy and complex legislation. • A 'safe harbour' debt amount has been introduced, with an alternative "arm's length" test which can potentially increase the permissible interest • Exceptions made for certain financial businesses - authorised deposit takers • Interest in excess of the prescribed level is denied as a deduction. However, it is fully deductible if the company satisfies the arm's length test. The safe harbour limit was reduced from 3:1 to 1.5:1 in Australia's 2013 budget The Australian Tax Office has a well-organised and accessible website, with good search facilities.
Germany	Limit to deductibility of	The legislation was substantially revised in 2008

	interest (30% of income)	- Interest deductibility is limited to 30% of taxable income before interest, taxes on income, depreciation and amortisation. - There are exceptions for low interest expense, and where interest paid to any one shareholder falls within limits. - Previously Germany had a widely available safe harbour: a debt:equity ratio of 1.5:1
France	Interest limitation by ref to third party rates Arm's length measure for interest rate Debt:equity 1.5:1 25% interest: operating income ratio	A new system was applied from January 2007, applying limitations between related parties, and bringing in the arm's length measure. Interest rate limitations: - deduction limited to an average of rates charged by lending institutions, or - the interest rate that the debtor company could have obtained from a third-party lender and Debt-based limitations: - overall indebtedness (debt:equity ratio), and Disallowed interest can be carried forward indefinitely at group level, but will be reduced annually by 5% from the second year after the expense was incurred. There is no differentiation between types of companies. Companies are considered on a standalone basis. Certain financial businesses and transactions are excluded.

Japan	3:1	Japanese thin capitalisation rules were revised in 2006. A debt:equity safe harbour rule applies to foreign-owned corporations The 2006 rules extend this to third parties where foreign corporations guarantee the borrowing
Egypt	4:1	For all sectors.
China	Financial 5:1 Non-Financial 2:1	China introduced thin capitalisation legislation for the first time late in 2008. • Two safe harbour ratios have been set, one for financial industry enterprises, one for non-financial. • If these ratios are breached, it appears that the taxpayer will still have the opportunity to try to demonstrate that the transaction is still consistent with the arm's length principle.
USA	1.5:1	The US "earnings stripping rules" currently include a restriction on interest paid by a corporation to related persons, if the corporation has: • A debt-to-equity ratio exceeding 1.5:1, and • A net interest expense exceeding 50% of the company's adjusted taxable income. This is likely to be tightened, probably to 25%

APPENDIX 4 – Implementation of revised QFC Tax Regulations

Article reference and summary of changes	Implementation
Article 10 The exclusion of profits from intangible fixed assets has been removed, thus any profit from Intellectual	 This change will apply for all accounting periods commencing after 18th June 2014.

Property, patents, trademarks etc. are not excluded from "Local Source Income".	
Article 17 and Tax Rule 8.1 We are now allowing entities to write and request their first Accounting Period (AP) to be up to 18 months. This change was made to ensure when there is a long AP we can give an extension to the whole AP not just the last period.	This change will apply from 18th June 2014 and will affect new entities. For existing entities where their first AP straddles the 18th June 2014 they may apply for the long AP authorization.
Article 21(4) Donations were previously allowed. We have updated the law to restrict the level of allowable donations based on the profitability of the QFC entity.	This change will apply for all accounting periods commencing after 18th June 2014.
Article 62 and Article 65 A "Disguised Partner"/"Disguised Member" definition has been introduced, which will affect "salaries" paid to Partners.	This change should apply for all accounting periods commencing after 18th June 2014. A separate guidance note will be published to help explain how this new rule will work in practice.
Article 85 Additional activities have been added to the special funding company rules.	For existing entities that have an accounting period straddling 18 June 2014 they may apply for the exemption. Article 82(6) will apply and we must receive their application within 6 months of the end of their AP to which the exemption applies.
Part 15 – Concessionary Rate **For Qatari owned businesses** there is a new 0% concessionary rate application available.	This new provision will apply to accounting periods commencing after 18th June 2014.

Captive insurers will continue to be required to apply for the 0% concessionary rate to apply, however going forward a fee will be applicable. **For reinsurance companies** the 0% concessionary rate previously applied automatically, under the new regulations reinsurance companies will be required to apply for the 0% concessionary rate to apply and will also be required to pay a fee upon application.	This change will apply for all accounting periods commencing after 18th June 2014. This change will apply for all accounting periods commencing after 18th June 2014.
Part 17 – Tax Credit Introduces a new tax credit for losses in specific industries. (Further announcements to follow).	This new provision will apply to accounting periods commencing after 18th June 2014.
Article 119 Penalties - several penalty amounts and limits have been increased and changes made to late filing penalty system.	We have allowed a grace period before new penalties are introduced. All new penalties will be applied from 1 January 2015.
Article 150 All income from dividends is exempt under the new regulations.	For entities with an accounting period straddling the 18th June, all dividends received after 18 June 2014 will be exempt. Any received before that date will be taxable under the old tax regulations.
TAX RULES	

TAX7.3 – The Ruling fee has increased from QR.3,000 to QR.6,000.	All ruling applications received after 18th June 2014 will be required to pay the new fees.