Family Businesses, Private Wealth and Taxes

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As the saying goes, nothing in life is certain but death and taxes. Even though many people believe that there are no taxes imposed in the Middle East, the truth is that there are and family businesses and private wealth owners are no exception.

In this article, we will highlight some of the tax issues that family businesses and wealth owners/managers may face in their daily operations.

Pinning down the concepts

There is no statutory definition of family businesses or private wealth in the region. Most people tend to use both concepts interchangeably, but there are some differences.

In general, a family business means a joint undertaking – conducted either through a corporate vehicle or an unincorporated form in which two or more family members are involved and the majority of its ownership or control lies within a family.

Conversely, private wealth usually relates to assets owned by private individuals. These assets, which may be jointly owned by family members or not, are not normally used with a view to furthering an economic activity.

Taking into account this division, we will discuss the direct and indirect tax implications of each.

Direct taxes

Concerning direct taxes, even though taxation imposed on natural persons is limited throughout the Gulf Cooperation Council ('**GCC**') countries, in certain cases business income may be taxable. However, personal tax implications are likely to be most relevant when dealing with cross-border matters. For instance, inadequate tax planning may result in withholding taxes or in higher withholding taxes in the foreign country where the income originates. This concern is all the more important after the signing of the OECD's Multilateral Instrument or 'BEPS Package' by Saudi Arabia ('**KSA**'), Kuwait, the United Arab Emirates ('**UAE**') and Qatar. Although not ratified, once in force the BEPS Package will give the tax authorities of foreign countries more ways of taxing the income originating in their territories. The BEPS Package deals with and elaborates on tax concepts such as substance, principal purpose, legitimate tax planning, etc. Therefore, family businesses and private wealth owners and managers in the Middle East are recommended to revisit their existing arrangements (e.g. cross-border nominee arrangements, fiduciary structures, contracts for the granting of IP rights, asset-holding vehicles, etc.) and determine whether they are in line with the upcoming best international standards.

Finally, a highly challenging and interesting matter for tax purposes is the relocation of the tax residence of individuals, either for persons moving into or outside the Middle East. In this regard, it is important to analyse the tax regime to which the individual will be subjected and any special regimes which may be applicable. In this regard, it is critical to know whether: any exit tax is triggered; the scope of the double tax treaty network of the new residence country; and the challenges encountered when requesting a tax residence certificate, both on paper and in practice.

With regard to corporate taxes, family businesses may also find themselves incurring income tax liabilities in KSA, Qatar, Oman and Kuwait in respect of their business operations. For instance, it is not uncommon for family businesses to enter into joint ventures on large construction projects, which may give rise to permanent establishment issues in some jurisdictions. Also, family changes, especially succession and marital ones, may result in the family business being subject to tax or more tax than it was before.

When restructuring the family business, special attention must be paid to any taxation arising, for instance as capital gains. It is important to examine whether relief from tax is available, either under domestic intra-group provisions or a double tax treaty. It is not uncommon that these points are not always carefully considered. However, depending on the circumstances and the specific transaction, it may be even more important to determine whether the purchasing entity may be entitled to utilise any tax credits that the target company has accrued in previous years. These factors, which play a key role when agreeing on the transaction price, should be taken into account at the time of negotiation or even earlier.

Special attention should also be paid to transactions between related parties. Whilst it is true that the tax authorities in countries like KSA and Qatar can already assess whether transactions have been carried out on an arm's length basis, the introduction of detailed transfer pricing regulations, first in KSA, but other GCC countries may follow, implies a major step in this field. It will be particularly interesting to see, amongst other matters, how the tax authorities will treat the secondary adjustment in practice, especially in light of the upcoming double tax treaty between KSA and the UAE.

Finally, where any of the members of the family is a GCC national and depending on the country concerned, Zakat considerations should also be borne in mind.

Indirect tax implications

In relation to indirect taxes, value added tax ('VAT') is currently fully rolled out in KSA and in the UAE, but it is in its infancy in Bahrain. The most frequent issue that family businesses face is determining whether they qualify as a taxable person for VAT purposes and are thus required to register for VAT. Even though sorting through the VAT implications under the existing arrangements is not always an easy task, there are multiple cases where the family business, or the family members themselves, meet the mandatory registration requirements. For example, this would be the case where several family members jointly own office buildings and lease them for consideration above the mandatory registration threshold. If proper advice is not sought and protective steps are not taken, the family members may be found not to comply with the VAT laws and consequently be putting themselves at risk of tax audits and penalties.

Other matters that are relevant from a VAT perspective include, for instance, the financing of the family business. In the past, intra-group loans and other financial instruments were not always accurately recorded and little attention was paid to which entity should be providing finance. With the advent of VAT, there is room for VAT optimisation that can and should be explored.

In respect of private wealth, holding companies, foundations, charities and other similar entities are often employed for different purposes, such as asset protection, succession planning, efficient investment structuring or pursuant to privacy considerations. It is a common misunderstanding that these kinds of entities do not fall within the VAT system. The answer, as in most cases when dealing with tax matters, is that it depends on each particular case.

In relation to VAT, the most common challenge lies in determining whether the restructuring gives rise to any VAT implications. It is often the case that the contracting parties expect the transaction not to be subject to VAT, but in certain instances the correct VAT treatment falls foul of the parties' initial thoughts. The most prominent example is the transfer of business assets, which only fall outside the scope of VAT if they qualify as a business transfer under the relevant VAT provisions.

Other elements to consider include reviewing whether the new structure is optimal from a VAT recovery point of view and whether it triggers any cashflow impact or relevant compliance costs.

Finally, while tax-efficiency considerations sometimes carry a significant weight at the time of planning any structure, they are not the only ones. Civil, inheritance, commercial and regulatory implications, to name a few, often play a key role in tailoring the best possible solution. This is why it is critical for clients to be well advised, by a full service law firm, of any overriding legal restriction that may defeat the purpose of the overall transaction.

Final remarks

Taxes are not complicated; they are only a matter of discipline. Whilst taxes in the Middle East are quantitatively and qualitatively limited when compared to other jurisdictions, there are several laws imposing tax obligations on family businesses that need to be carefully considered.

In addition, setting up and maintaining tax efficient private wealth structures requires both initial analysis and regular health checks, particularly in light of the fast-evolving tax environment in the GCC.

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