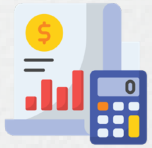
Profits in Losses: Treatment of tax losses in GCC

INTRODUCTION

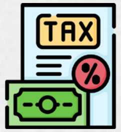
Companies face business risks every day, which are part of operating in the segment or industry in which the company resides. Companies deal with business risks regularly, which are the potential factors and events in their industry that can affect how well they do and how much money they make.

In any business, loss occurs when the expenses incurred by the company are more than the revenue generated. The losses could occur as a result of internal factors, such as poor utilization of assets, unproductive working capital, personnel issues or external factors such as natural disasters, economic downturns, or regulatory changes.

CONCEPT OF ACCOUNTING LOSS VS TAX LOSS



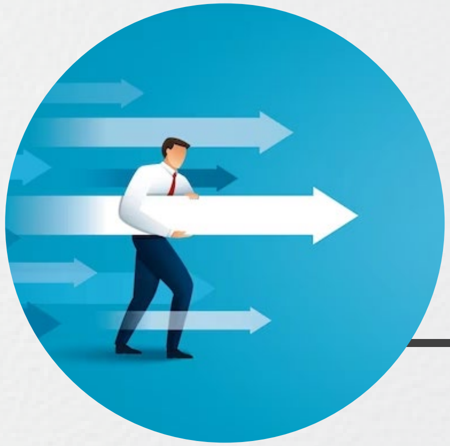
A net accounting loss is when total expenses (including taxes, fees, interest, and depreciation) exceed the income or revenue produced for a given period in the financial statements.



Taxable income often differs from accounting profit due to various adjustments made for tax computation. These adjustments include adding back certain non-tax-deductible expenses, deducting certain payments, and accounting for any tax credits or reliefs available under the tax law.

Thus, a tax loss occurs when total expenses are greater than total revenues under the tax reporting rules of the applicable government jurisdiction. A tax loss reduces an entity's tax liability.

When a person or corporation earns more costs or deductions than revenue in a specific tax year, they may be allowed to claim a tax loss under several tax systems. Depending on the particular state's tax rules and regulations, tax losses may be utilized to reduce taxable income in forthcoming or prior tax years. Generally, this is referred to as either carry-forward or carry-back of tax losses.



Suppose a taxpayer or corporation has a tax loss in a given year but cannot wholly offset their taxable income for that year. In that case, they may carry over the unutilized portion of the loss to subsequent tax years under a loss carry-forward; this means that they can deduct the loss from their taxable income in the next few years, thus reducing their tax obligation for future years. Conversely, loss carry-back is the approach that allows a taxpayer to offset revenue from a prior year with a current-year tax loss, which can lead to a tax refund for the past years.

The amount of a loss that may be carried forward or carried back in the same financial year is also subject to limitations set by the tax rules of specific nations. There also exist restrictions on the kinds of losses that can be carried forward or back.

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Illustration:

Following illustration explains the calculation and tax loss set-off mechanism:

Particulars	Year 1 (Amount in $ '000)	Year 2 (Amount in $ '000)
Accounting profit/(loss) as per financial statements	(1000)	300
Add/(Less): Tax law adjustments	500	100
Final Taxable Income	**(500)**	**400**
B/f loss of earlier year/s set off to a maximum of up to available income	Nil	(400)
Balance Income	(500)	Nil
Tax on income @9%	**Nil**	**Nil**
Loss to be carried forward for set off to subsequent years	(500)	(100)

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Illustration:

In the above example, the Company has a net loss of $500,000 in the first year. However, in the subsequent year, the company generated a taxable profit of $400,000. Since a loss occurred in the previous year, by the concept of tax loss carry-forward, it can utilize the carried forward loss to offset the tax liability in the current year. Here, the loss from the previous year can be applied in the present year to reduce the taxable income.

Hence, in the present example, the taxable income for the current year will be Nil after setting off the past year loss. Now, the remaining $100,000 can be carried forward and utilized in future years if the Company continues to generate taxable income.

Notably, different jurisdictions may have different tax regulations governing how tax losses are treated. The particular guidelines, restrictions, and steps for using tax losses should be evaluated depending on the tax regulations, as applicable.

TAX LOSSES- COMPARATIVE ANALYSIS OF GCC

Particulars	Tax Losses
UAE	Tax losses can be utilized, subject to specific conditions to offset against future periods' taxable income, limited to a maximum of 75% of the taxable income for each subsequent period. Any unused tax losses are carried forward indefinitely and applied against taxable income in future tax periods. Tax losses can be carried forward without any restrictions if the same individual or group of individuals maintains ownership of at least 50% of the entity with the losses. However, if there is a change in ownership exceeding 50%, the tax losses can still be carried forward as long as there are no significant alterations in the nature or operation of the entity's business. Tax losses incurred by one UAE group company can be utilized to offset the taxable income of another UAE group company, provided there is common ownership of 75% or more and certain additional criteria are satisfied. It is important to note that tax loss transfers are not permitted from companies that are exempt from taxation or that benefit from the 0% Free Zone Corporate Tax regime. Carry-back of tax losses is not permitted in UAE.
Bahrain	Unutilized losses may be carried forward indefinitely for subsequent tax periods, and these losses can be deducted up to an amount equivalent to the net income. At present, companies (local and foreign) that operate in the oil and gas sector or in the extraction or processing of fossil fuels are only taxable and hence eligible to set off tax losses for the income generated from such activities only. However, carry-back of losses is not allowed. On 23 May 2023, the Bahrain Minister of Finance and National Economy confirmed the introduction of Corporate Income Tax (CIT) in Bahrain during the weekly parliamentary session. Accordingly, tax loss treatment is expected to undergo a change and may become at par with the provisions of other GCC countries.
Kuwait	In Kuwaiti tax law, losses may be carried forward for a maximum period of three years, provided that the following situations do not arise in the fiscal year following the period in which the loss was incurred: • The tax declaration does not include any revenue from the business activities of the taxpayer in Kuwait. • There is a change in the legal structure of the taxpayer. • An entity of the taxpayer has merged with another entity. • There is liquidation or ceasing of the activities of the taxpayer in Kuwait. However, carry-back of losses is not permitted.

Particulars	Tax Losses
Oman	Carrying forward of losses is limited to five years, except for companies that incurred losses during a mandatory tax-exempt period, where the net losses may be carried forward indefinitely for offset against future profits. Carry-back of losses is not allowed.
Qatar	Under the State of Qatar tax regime, losses can be carried forward and set off against profits for up to five years. However, the carry-back of losses is not permitted. Under the Qatar Financial Centre (QFC) tax regime, losses may be carried forward for as long as the QFC entity continues to have a source of income within the terms of its license. Losses arising from a tax-exempt or non-taxable source of income cannot be deducted.
Saudi Arabia	Tax losses may be carried forward indefinitely, subject to a maximum offset each year of 25% of the annual taxable profits, as reported in the tax return. Corporations may carry forward losses, irrespective of whether there has been a change in ownership or control, provided they continue to perform the same activity. Also, a transfer of assets within a group of companies is not considered as a change in ownership or control. Carry-back of losses is not allowed.

CONCLUDING REMARKS

Allowing tax losses to be carried forward or backwards is a notion designed to aid companies and people through difficult financial times. It considers that not every year will be profitable and contributes to ensuring taxes are assessed based on long-term financial performance rather than transient changes.

However, companies must maintain accurate records for claiming these tax losses, since the tax authorities frequently demand thorough evidence of the losses incurred and the methods applied to those losses to offset taxable income.

If transactions with the related parties and connected persons are not at arm’s length, then the transfer pricing adjustments could be triggered, and tax losses may not be available for set-off or carry-forward. Further, the introduction of anti-abuse rules in various tax laws empowers the Tax Authority in a country to deny tax benefits of transactions or arrangements that do not have any commercial substance, and the primary purpose of such a transaction is achieving a tax benefit.

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