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OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	Qatar's Foreign source income (FSIE) regime (QA004) – Final description and assessment

STANDSTILL REVIEW PROCESS (SEPTEMBER 2021)

Qatar committed to reform its FSIE regime within a timeline that will permit adoption of the necessary legislation by the end of 2022. Qatar also committed not to availing of any grandfathering, as requested by the COCG.

The Code of Conduct Group meeting of 21 September 2021 acknowledged the commitment of Qatar. This conclusion was endorsed by the ECOFIN Council on 5 October 2021.

Annex 1: Assessment of the QA004 regime

ANNEX 1

Assessment of the QA004 regime (standstill)

Assessment of FSIE regime

	1a	1b	2a	2b	3	4	5
Qatar– FSIE	V	?	V	?	V	X	V

V: Harmful; X not harmful

Gateway criterion – Significantly lower level of taxation:

"*Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code*"

Qatar imposes income tax at a general 10% rate on business activity income[1]. Income tax is levied on income of resident and non-resident persons derived from sources located in Qatar. Income from foreign sources is not subject to tax, except in the following two cases:

(i) Inbound interest and bank earnings, which result from income derived from business activity in Qatar and
(ii) Inbound commissions from agency, brokerage or commercial representation agreements concluded abroad but related to business activity carried out in Qatar.

The tax base is self-assessed on an annual basis; income considered foreign sourced and thus exempt is not declared in the tax return.

[1] Income tax is imposed according to Law 24/2018 (Income Tax Law and hereinafter "ITL") as interpreted in the Council of Ministers' Decision 39/2019 (Executive Regulations and hereinafter "ER"). ITL repealed and replaced Law 21/2009, without significant changes as regards the FSIE regime.

As regards the determination of the source of the income, pursuant to the legislative framework, income from bank interest is treated as sourced in Qatar if the relevant business activity is performed there. This sourcing rule is extended to other types of income, active and passive, via administrative doctrine. As a result, income linked to operations organised, controlled or managed in Qatar is deemed Qatari-sourced while income linked to a PE or complete commercial cycle in another jurisdiction is deemed foreign sourced and exempt from tax in Qatar. In the absence of PE or a complete commercial cycle abroad, the entire income is presumed Qatari-sourced.

The ITL provides that income tax is levied on income from Qatar sources at a general rate of 10% while no tax is levied on foreign source income.

As the Code of Conduct looks at the effects that tax legislation may have on the location of business activities in general terms, a full tax exemption may be regarded as one of the reasons for a business to establish in one jurisdiction over another. In this sense, the provisions are relevant for the Code.

The Code of Conduct uses a broad term ('*tax measures*') to describe what should be assessed under its criteria. This definition is not limited to specific pieces of legislation nor does it circumscribe the meaning of what should be intended as a 'tax measure'. In the specific case of the measures of the ITL, it is relevant to take into account the general tax system to understand if the legislation provides for a significantly lower level of taxation. This is the case here, as certain types of income with foreign source are exempted from taxation.

The provisions are therefore potentially harmful and should be evaluated under the Code.

Criteria 1 and 2 – Targeting non-residents and Ring-fencing

"*whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents*"

"*whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base*"

The exemption from taxation of foreign source income applies only in respect of transactions carried out with non-residents and it does not affect the national tax base. Such exemption is by its nature targeted to non-residents and ring-fenced. We would therefore propose a tick ("V" – harmful) for criteria 1.a and 2.a.

On Criteria 1.b and 2.b more information should be gathered from Qatar to make an assessment. No statistics are currently available on the taxpayers benefitting from FSIE or the amount of exempt income. This is because income deemed foreign sourced by the taxpayers is not included in the income tax returns. The tax authority is setting up a new electronic tax reporting system, which would require the declaration of income deemed foreign sourced. However, it is encountering delays due to the COVID19 crisis. We would propose a question mark ("?" – Insufficient information under the criterion) for criteria 1.b and 2.b.

Criterion 3 – Substance:

"*whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages*"

According to the standard practice for criterion 3, a measure is found harmful under this criterion if there are no specific requirements with regard to real economic activities. According to the guidance on FSIE regimes, an evaluation shall focus primarily on passive income and namely if there are conditions or safeguards to prevent ring-fencing and lack of substance. Exemption of passive income without clear conditions (e.g. explicit link to some real activity in the jurisdiction) would be found to contravene the principles of the Code. With regard to active income, the guidance requires to consider if and how it is taxed and in particular if the domestic PE definition is in line with the OECD Model Tax Convention.

Requirements for passive income

The ITL does not distinguish between active and passive income. Passive income deemed foreign-sourced is therefore exempt from tax in Qatar, and the exemption covers interest, bank earnings and commissions in certain circumstances. There are no other conditions in this respect and namely there are no economic substance requirements in place[2].

As explained above (see under 1), according to administrative doctrine, passive income is considered foreign sourced if it is linked to a PE or complete commercial cycle in another jurisdiction. This is not provided in the ITL but arises from a *lato sensu* interpretation of the legal provision specifically for bank interest in administrative doctrine. The source of passive income is determined by the taxpayer in the annual tax return.

[2] Qatar is currently in the process of introducing economic substance requirements in connection with its three preferential regimes under scrutiny by the FHTP (Qatar Finance Centre, Qatar Science and Technology Park Free Zone and Qatar Free Zones). However, such requirements apply only within the limited scope of the specific preferential regimes.

Anti-avoidance rules

Qatar applies a general anti-avoidance rule (GAAR), providing that a benefit under the ITL or a tax convention shall not be granted if it is reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in the benefit.

In addition, specific anti-avoidance provisions target the risks of circumvention and abuse of the Qatari PE status by foreign enterprises.

Conclusion

Passive income from foreign source is taxable in Qatar to the extent that it is linked to business activity in Qatar. Contrary to this, it is not taxable in Qatar if it is linked to a foreign PE or complete commercial cycle abroad. However, this is not explicit in ITL but established by administrative doctrine that interprets *lato sensu* the ITL. This may imply a discretion by the authorities that have to make the final determination. In addition, for the exemption to apply, no specific conditions are required to be met by the taxpayer (e.g. regarding evidence of taxation abroad and/or connection with a real activity in Qatar) other than the self-assessment.

While there are general and specific anti-avoidance rules in place in Qatar, these are general or targeted to different situations. Hence, they are not sufficient to tackle the specific risks of double non-taxation and lack of substantial activities in Qatar linked to exempt income as above. Therefore, we propose a tick ("V" – harmful) for this criterion.

Criterion 4 – Internationally accepted principles:

"*whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD*"

Permanent Establishment

According to ITL, "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. It includes especially: a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of exploration, extraction and exploitation of natural resources.

While the PE definition is based on the OECD Model, it also endorses certain concepts of the UN Model, e.g. that provision of services can constitute a PE and that delivery is not of preparatory/auxiliary nature.

Except for the foreign PE case, active income can be deemed foreign-sourced and hence exempt from tax in Qatar (in absence of a foreign PE) if it is derived from a complete commercial cycle abroad.

The concept of "complete commercial cycle" (or full business cycle) started applying in Qatar on 11 December 2019. A complete commercial cycle exists where a person has a series of commercial or industrial operations in a specific jurisdiction outside Qatar, which are coherent, directed to specific goal and detachable, due to their nature or way of performance, from the operations in Qatar. This implies that a foreign enterprise without a PE in Qatar is still taxable in Qatar if it carries out operations constituting a complete commercial cycle, for all income linked to these operations. Conversely, a Qatari enterprise is not taxable in Qatar on (active) income from operations forming a complete commercial cycle in another jurisdiction (regardless of whether these operations would not qualify as foreign PE). Whether the relevant income is taxable in the other jurisdiction is not a relevant factor.

The concept of complete commercial cycle is close to the PE one and widely accepted in domestic legislation and practice of several countries worldwide, including EU Member States. It also applies in a proportionate manner (to residents for the exemption of foreign sourced income and equally to non-residents for the taxation of domestically sourced income). In this light, it can be considered aligned with the international standard.

The measures do not contain other elements that would be relevant from the point of view of internationally accepted principles as referred to in criterion 4 of paragraph B of the Code. In addition, Qatar has confirmed that transfer pricing rules are based on the arm's length principle and has signed and ratified the MLI. We have therefore proposed a cross ("X" – Not harmful).

Criterion 5 – Transparency:

"*whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way*"

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

As explained under point 2 above, Qatar's administrative doctrine endorses a *lato sensu* interpretation of the provisions of the ITL on what is Qatari-sourced income. Such interpretation is not incorporated in the ITL itself. A system of self-assessment applies, where income deemed foreign sourced by the taxpayer is not reflected in the tax return, without further requirements. The determination of the source lies ultimately with the tax authority in the context of its audit activity. In this respect, Qatar did not indicate any specific evidence required to be produced by the taxpayer to substantiate the determination of the income source or the payment of tax abroad on the relevant income. Because of the discrepancy between the ITL and the administrative doctrine and the fact that there is no clear procedure for the determination of the source, we propose a tick ("V" – harmful) for this criterion.

Overall Assessment

In light of the above, Qatar's FSIE regime is considered overall harmful.