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**REPORT**

# **Taxation and the GCC States**

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At a time when the states of the Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE) - are enjoying a period of relatively high oil prices and are rated highly in international surveys for their low taxation levels,<sup>[1]</sup> it might seem strange for them to consider introducing various kinds of taxation. Indeed, the principal domestic role of each GCC state during the oil era has arguably been the provision of benefits to their populations rather than the extraction of taxes.<sup>[2]</sup> However, a number of interconnecting domestic and external factors have brought the issue of taxation into sharper focus:

1. Domestic public welfare provision is increasingly absorbing GCC energy export revenues.
2. Future energy export volumes could be under threat as domestic energy consumption absorbs increasing levels of oil production.
3. Increasing numbers of bilateral and/or regional Free Trade Agreements are reducing revenues from trade-related taxation.
4. Partially as a consequence of economic globalization, since the late 1990s international institutions have recommended GCC states implement taxation policies.

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1 See, for example, Sara Hassan “Gulf states take the lead in tax regime rankings” *Global Insight*, Lexington, Massachusetts, 18 December 2009. The rankings compiled by the World Bank, the International Finance Corporation, and PricewaterhouseCoopers placed Qatar second, the UAE fourth, Saudi Arabia seventh, Oman eighth, Kuwait eleventh, and Bahrain thirteenth.

2 See, for example, F. Gregory Gause III *Oil Monarchies: Domestic and Security Challenges in the Arab Gulf* (1994, Council on Foreign Relations Press).

The first section of this paper takes an historical overview of the issue of taxation over the last two decades and more. It shows that although the issue has become important in recent years, it is one the GCC states have repeatedly sought to address in response to fluctuating oil prices and repeatedly encountered opposition to its implementation. By the late 1990s however, international institutions added their voices to what previously been an issue influenced mainly by domestic and/or regional factors. The second section addresses the case for taxation, taking into consideration points raised in the historical overview and those listed above, before addressing the issues surrounding the proposed introduction of VAT. The third section deals with aspects relating to the administration and collection of taxes, looking primarily at the UAE’s efforts to introduce VAT. The fourth section examines the distribution of revenues from taxation, taking the recently introduced Bahraini foreign labour tax as an example and the potential for its implementation elsewhere in the GCC region. In addition to making recommendations, the concluding section notes the changing international, regional, and domestic environments the taxation issue has been set against and how these changes have influenced and will continue to influence it in future.

## 1. Historical Overview

The issue of taxation in the GCC states is by no means a new one, with efforts to introduce direct or indirect taxation dating back to the late 1980s. Before then Kuwait and Saudi Arabia already had various tax policies – Kuwait introduced a corporate tax in 1955, and Saudi Arabia had an income tax on foreigners until 1975. Saudi Arabia suspended this tax in 1975 due to the scale of its oil revenues and the need to recruit large numbers of foreign workers to help develop its economy and infrastructure. However, in 1988 the Saudi

government sought to reintroduce income tax on foreign workers to offset declining oil revenues. In addition the tax would have potentially allowed for the replacement of foreigners who chose to leave with Saudis, thereby helping to address rising levels of local unemployment. The result was a threatened large-scale expatriate exodus which would have severely affected the kingdom's capacity to function, particularly in its health and banking sectors. This was combined with strong pressure from Saudi business and tribal leaders who opposed it on the grounds that they were not consulted and/or that it was incompatible with local culture.<sup>[3]</sup> <sup>[4]</sup> Within days King Fahd withdrew the proposal.<sup>[5]</sup> Bahrain<sup>[6]</sup> and the UAE<sup>[7]</sup> had considered emulating the Saudi proposal on income tax in 1988 but, following events in the kingdom, they also withdrew their plans.

Although opposition to income tax in Saudi Arabia was most striking from expatriate and local business leaders, the issue also touched upon local socio-political culture. A 1985 report on the Bahraini economy noted the government

had considered levying personal or corporate taxes but at the time it was, “an idea which all the peoples of the area regard as dangerously socialist and thoroughly un-Arabian.”<sup>[8]</sup> When Saudi Arabia proposed introducing income tax in 1988, one report noted divisions amongst Saudi tribes over the issue. The Anazah and Shammar tribes were reportedly opposed while the Sudairi tribe remained neutral. King Fahd was from the Sudairi tribe by maternal lineage as are several senior princes, including Prince Sultan (now Crown Prince and Defence Minister) and Prince Nayef (now Second Deputy Prime Minister and Interior Minister). The then Crown Prince Abdullah, now King Abdullah, is from the Shammar by maternal lineage. In 1988 one Shammar leader described the idea of inviting people to work in the kingdom and then paying back some of their wages as, “not being in the line of Islamic traditions.”<sup>[9]</sup> This point also serves to illustrate the linkages between tribes and state in Saudi Arabia and the collegiate nature of decision making in the kingdom.

In the early 1990s, GCC ministers reportedly studied the feasibility of introducing VAT and corporate tax as part of their economic reforms.<sup>[10]</sup> Oman introduced a corporate tax in 1994 with exemptions later added for certain sectors and projects.<sup>[11]</sup> Nevertheless,

8 Michael Field “Survey of Bahrain: Economy: Spending to be cut in budgetary squeeze”, *Financial Times*, London, 22 July 1985.

9 Zafar op.cit.

10 “Gulf states may introduce Value Added Tax”, *Moneyclips* (Middle East Newsfile), 2 October 1992, quoting a report from the Arabic newspaper *Al Hayat*; and “Gulf states plan corporate tax?”, *Times of Oman*, Oman, 27 March 1995, via *Moneyclips*.

11 Exemptions were granted to companies, “...whose main activity is in industry, agriculture, fishing or other important economic sectors...” See “Royal Decree exempts some industries from paying tax”, *Times of Oman*, Oman, 29 December 1995, via *Moneyclips*.

3 See, for example, Finn Barre “Saudis move to tax foreign workers”, *Financial Times*, London, 4 January 1988; and Nicholas Beeston “Expatriate exodus likely as Saudis revive tax”, *The Times*, London, 5 January 1988.

4 Said Zafar “Against Saudis’ grain to tax foreigners”, *The Financial Post*, Toronto, 25 April 1988.

5 For further reporting of the plan’s withdrawal, see, for example, Finn Barre and Richard Johns “Saudi plan to tax foreigners abandoned”, *Financial Times*, London, 6 January 1988; Finn Barre “Saudi expatriates breathe a collective sigh of relief: The tax prospects for a long sheltered community”, *Financial Times*, London, 7 January 1988; and Amit Roy “Why Fahd freed expats from their tax blues: Saudi Arabia”, *The Sunday Times*, London, 10 January 1988.

6 “Bahrain rules out income tax”, *Reuters*, via *The New Straits Times*, Kuala Lumpur, 29 January 1988. The Bahrain Finance Minister added that should such a tax ever be necessary it would apply to locals and expatriates.

7 Michael Field “Survey of United Arab Emirates: Prosperity holds up – Weakening oil prices have not yet hit the economy”, *Financial Times*, London, 24 March 1988.

despite the continuing relatively low price of oil, many GCC states remained wary of implementing taxes for fear of upsetting international and domestic businesses and investors.<sup>[12]</sup> A 1992 report on the Bahraini economy illustrated the wider regional situation when it noted: “Some modest - and heavily disguised - attempts have been introduced to boost tax revenues, but more direct methods, such as an income tax, are deemed to be politically impossible.”<sup>[13]</sup>

However, towards the end of the 1990s and thereafter international organisations also began publicly encouraging the GCC to implement taxation policies. In 1997 the United Nations Economic and Social Commission for West Asia’s annual report noted, “significant scope [in the GCC states]...to eliminate tariff exemptions, expand excise taxes, and introduce a selective tax on luxury goods...In addition, tax revenues could be increased by expanding the scope and coverage of the current income taxes.”<sup>[14]</sup> In the case of Qatar, a 1998 report by credit ratings agency Moody’s recommended: “If oil prices remain soft, the government will need to respond with corrective fiscal measures in order to contain unsustainably high budget deficits.” At the time Qatar had no form of corporate taxation and subsidised the utility, health and education sectors.<sup>[15]</sup> In 2000, the

Kuwaiti Finance Minister declared Kuwaitis would have to get used to the idea of an income tax. However, along with other measures aimed at reforming the Kuwait economy, the proposal met fierce opposition in the country’s parliament,<sup>[16]</sup> even though some Kuwaitis said they would not mind paying taxes if services improved as a result.<sup>[17]</sup> Also in 2000, in an attempt to attract increased foreign investment, Saudi Arabia<sup>[18]</sup> and Oman<sup>[19]</sup> announced tax reductions on foreign businesses.

In 2001 an IMF report argued GCC states could no longer rely on oil sales, and recommended they cut spending and implement income tax, corporate tax, consumption tax and value added tax.<sup>[20]</sup> On a country-specific basis, IMF consultations noted Kuwait’s efforts to reform its corporate income tax law whilst recommending, “the introduction of a broad based consumption tax, and the levying of excises on luxury items.”<sup>[21]</sup> The IMF recommended Saudi Arabia begin, “moving ahead with steps to mobilize non-oil revenues through improvements in tax administration, early introduction of indirect taxes, and consolidation of various fees and charges”<sup>[22]</sup> In Qatar, the IMF, “encouraged the authorities to reduce the budget’s dependence on oil receipts through the gradual introduction

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12 Nadim Kawash “Tax fears dog Gulf economic reforms”, *Agence France Presse*, 3 April 1995.

13 Roger Matthews “Survey of Bahrain: Economic changes add to the strain of adaptation – The prospects for political change”, *Financial Times*, London, 14 July 1992.

14 Nadim Kawash “Gulf states should boost taxes to balance budget: UN report”, *Agence France Presse*, 27 February 1997.

15 “Qatar needs to bring in taxes: Moody’s”, *Agence France Presse*, 17 September 1998.

16 “Kuwait: It’s Time for Income Taxes”, *The Associated Press*, 4 January 2000.

17 “Kuwait: Fees, Future Taxes Scaring Away Expats?”, *Kuwait Times*, Kuwait, 19 April 2000.

18 “Saudi slashes taxes on foreign businesses”, *Agence France Presse*, 15 April 2000.

19 “Oman set to amend tax laws”, *Gulf Daily News*, Bahrain, 21 August 2000.

20 “Gulf leaders to review IMF call for taxes as oil income dwindles”, *Agence France Presse*, 30 December 2001.

21 “IMF Concludes Article IV Consultation with Kuwait”, Public Information Notice (PIN) No. 01/60, 29 June 2001, International Monetary Fund, Washington D.C.

22 “IMF Concludes 2001 Article IV Consultation with Saudi Arabia”, Public Information Notice (PIN) No. 01/119, 7 November 2001, International Monetary Fund, Washington D.C.

of a modern tax system, based on a range of taxes on consumption and profits, to replace and broaden existing sources of non-oil revenue.”<sup>[23]</sup> Recommendations for the UAE included adopting, “a broad-based modern tax system with a view to reducing fiscal vulnerability...expand taxes in line with policies...already in place in other members of the GCC, and consider implementing a broad low-rate consumption tax on services, while local governments should introduce a property tax. Several Directors encouraged the authorities to avail themselves of Fund technical assistance for tax reform and institution building.”<sup>[24]</sup> Recommendations for Oman included, “adopting, in the short run, excise taxes on luxury goods and services, and a simple property tax to replace the current scheme of taxation of rental agreements. Over the medium term, and in coordination with other GCC countries, the adoption of a broad-based value-added tax on imports and locally produced goods and services...together with the introduction of personal income taxes.”<sup>[25]</sup> In the case of Bahrain, the IMF recommended, “adopting a broad-based consumption tax (preferably, a value-added tax)...in the context of a future coordinated tax regime under the Gulf Cooperation Council (GCC).”<sup>[26]</sup>

What we can see from the IMF’s general and country-specific recommendations is an effort to encourage the introduction of indirect and direct taxation in states where they were previously either

minimal or absent altogether; expansion of taxation schemes in states where they were already present; and an effort to use existing schemes as an inducement to encourage regional taxation schemes under the auspices of the Gulf Cooperation Council.

In 2002 and 2003, the Saudi Shura Council proposed introducing income tax on foreign workers except (in the 2002 proposal) on those workers from countries with which Saudi Arabia had double taxation agreements.<sup>[27]</sup> However, the reaction by expatriates and local business leaders in the kingdom was such that the idea was shelved. Significantly when the issue was raised again in 2003 the Shura Council passed a resolution declaring it was inappropriate to levy taxes on non-Saudis regardless of their pay levels.<sup>[28]</sup> In addition to the possibility of foreign workers leaving and loss of foreign investment, considerations for the Shura Council included the implicit threat of Saudi capital leaving the kingdom and the transparency of government finances.<sup>[29]</sup>

On the one hand, because Saudi Arabia was planning to introduce income tax, other member states could have followed its lead. As in 1988, had Saudi Arabia

23 “IMF Concludes 2002 Article IV Consultation with Qatar”, Public Information Notice (PIN) No. 02/99, 10 September 2002, International Monetary Fund, Washington D.C.  
 24 “IMF Concludes 2002 Article IV Consultation with the United Arab Emirates”, Public Information Notice (PIN) No. 03/30, 11 March 2003, International Monetary Fund, Washington D.C.  
 25 “IMF urges Oman to levy personal income tax”, *Agence France Presse*, 1 November 2003.  
 26 “IMF Concludes 2004 Article IV Consultation with the Kingdom of Bahrain”, Public Information Notice (PIN) No. 04/96, 24 August 2004, International Monetary Fund, Washington D.C.

27 See “Saudi Arabia considers income tax for expats”, *Agence France Presse*, 7 April 2002; “Saudi Arabia: Income tax elements based on zakat”, *Middle East Economic Digest*, London and Dubai, 19 April 2002; and N. Janardhan “Saudi income tax plan scares Gulf expatriates”, *Inter Press Service*, 10 May 2002.  
 28 “Saudi Shura Council rejects income tax on foreigners”, *Agence France Presse*, 12 January 2003.  
 29 Steffen Hertog “Segmented Clientelism: The Political Economy of Saudi Economic Reform Efforts” in Paul Aarts and Gerd Nonneman (Eds.) *Saudi Arabia In The Balance: Political Economy, Society, Foreign Affairs* (2005, Hurst & Company), p.136 and n.47.

successfully implemented its tax plans, other GCC states could have followed suit. On the other hand, there were concerns in Saudi Arabia that other GCC states might have sought to exploit the kingdom's tax changes by promoting their own economies as comparatively tax free.<sup>[30]</sup> This indicates that, whilst the debate was similar to 1988, other GCC economies such as Qatar and the UAE had grown sufficiently to deliver a greater degree of political and economic autonomy from Saudi Arabia compared to their relative positions in the late 1980s. By implication an unpopular taxation programme in Saudi Arabia might have resulted in a flight of Saudi capital to its neighbours.

To offset falling oil revenues, in 2003 Oman imposed a road tax and raised petrol prices. This raises a point regarding Oman's ability to implement new taxes whilst other GCC states experienced difficulties. We have seen that in 1994 Oman implemented a corporate tax. A possible explanation is that in the early to mid-1990s Oman was faced with a domestic economic situation that raised the need for taxation revenues. Yet Bahrain was also in a difficult economic position at the time and did not implement taxation policies. Another explanation may relate to Omani decision making. According to a 2004 study, in comparison with some of its GCC neighbours the ruling Al Sa'id family of Oman is relatively small, numbering fewer than one hundred members, and Oman's ruler, Sultan Qaboos Al Sa'id stands 'at the apex' of decision making. At his accession in 1970 and during the Sultanate's state-building efforts thereafter, resources from oil flowed to the Omani state whilst a weak

30 Janardhan op.cit.

business class left him with considerable power, along with a few Omani merchant families who had gained control of economic policy.<sup>[31]</sup> In consequence, Omani decision making faces potentially fewer oppositional hurdles than elsewhere in the region.

In August 2004, Saudi Arabia again cut tax on foreign companies and investors (from 30% to 20%) to attract foreign investment.<sup>[32]</sup> The IMF in 2003 had suggested that the UAE implement a Value Added Tax system and, in 2005 the UAE asked the Fund to help it do so.<sup>[33]</sup> In a historic move intended to increase foreign investment, the Kuwaiti parliament cut the 1955 corporate tax rate from 55% to 15% in 2007,<sup>[34]</sup> a measure that had been sought for several years. The head of Kuwait's parliamentary finance and economic affairs panel told reporters that the 1955 law had been hindering the flow of foreign investment into the emirate but added that, rather than any extra money that might accrue from foreign investment, it was the expertise and technology that came with it that Kuwait most needed.<sup>[35]</sup>

Standard Chartered's chief global economist argued in 2008 that Qatar could slowly move into a tax regime to diversify its income, and that imposition of VAT at a rate of 3-5% in Qatar would not be inflationary.<sup>[36]</sup> At the time Qatari

31 Francis Owtram *A Modern History of Oman: Formation of the State since 1920* (2004, I.B. Tauris), pp.201-203.

32 Simon Briault "Saudi Arabia slashes corporate tax burden for multinationals", *International Tax Review*, September 2004, Vol.15 Issue 8.

33 "UAE, IMF tax guidance", *Middle East Financial Newswire*, 8 August 2005; and Nader Habibi "UAE Leaders Serious About Value-Added Tax", *World Markets Analysis*, 8 August 2005.

34 Diana Elias "Parliament approves bill substantially lowering taxes on foreign company profits", *The Associated Press*, 26 December 2007.

35 Omar Hasan "Kuwait to cut tax for foreign firms", *Agence France Presse*, 26 December 2007.

36 "Qatar urged to move into tax regime to help expand income", *Gulf Times*, Qatar, 5 June 2008.

inflation was running at 15%.<sup>[37]</sup> A year later Qatar cut corporate tax on foreign companies from 35% to 10%. Along with cuts by Kuwait, Saudi Arabia and Oman earlier in the decade, competitive corporate tax rates had become a feature as GCC states vied with each other for foreign investment.<sup>[38]</sup>

In October 2009, the Bahrain parliamentary chairman proposed placing a tax on foreign investors setting up large-scale projects. However, the parliamentary committee amended the proposal to include Bahraini and GCC investors to avoid contravening World Trade Organization regulations. Concerns were also expressed that a tax solely on foreign investors might deter future investment.<sup>[39]</sup> A month later the Chairman of the Bahrain Chamber of Commerce claimed taxation was inevitable, whilst stressing such measures would be designed to avoid hurting poorer sectors of Bahraini society.<sup>[40]</sup> In its 2009 consultation with Oman, published in February 2010, the IMF recommended the Sultanate, “analyze the costs and benefits associated with the unilateral implementation of a VAT if neighbouring countries continue to delay the introduction of a VAT at the regional level.”<sup>[41]</sup> Three months

37 See “Qatar: Statistical Appendix”, March 2010, IMF Country Report No.10/62, International Monetary Fund, Washington D.C.; and “Qatar: Economic Structure”, *EIU ViewsWire*, Economist Intelligence Unit, New York, 14 July 2010.

38 Jack Grocott “The race is on as Gulf states use lower rates to compete for foreign investors”, *International Tax Review* July 2009, Vol.20 Issue 6 pp.6-7; “Corporate tax law issued”, *Gulf Times*, Qatar, 18 November 2009; and Robin Wigglesworth and Simeon Kerr “Qatar formalises tax changes”, *Financial Times*, London, 18 November 2009.

39 See Mohammed Al A’Ali and Arthur Macdonald “Investors could be taxed soon”, *Gulf Daily News*, Bahrain, 11 October 2009; and “Bahrain economy: Investment tax mooted”, *EIU ViewsWire*, Economist Intelligence Unit, New York, 28 October 2009.

40 Arthur Macdonald “Tax inevitable to meet Bahrain’s expenditure”, *Gulf Daily News*, Bahrain, 6 November 2009.

41 “IMF Executive Board Concludes 2009 Article

later Ehtisham Ahmad, the taxation advisor to the UAE Prime Minister’s Office, argued that a proposed 2012 deadline for implementing VAT across the GCC states was very tight.<sup>[42]</sup>

The IMF’s recommendation to Oman and Ehtisham Ahmad’s comments illustrate the conflicting pressures to implement taxation in the GCC states. On the one hand, the IMF recommended Oman introduce VAT, if necessary without waiting for other states. Given where VAT was closest to implementation, the IMF was clearly referring to the UAE as much as Bahrain, Kuwait, Qatar or Saudi Arabia. On the other hand, the UAE’s taxation advisor, himself a former IMF representative to Pakistan, was urging a more realistic approach to the timeframe for GCC-wide implementation, arguably reflecting the state of readiness to proceed in both the wider region as well as the UAE itself.

## 2. The case for tax

We can see from the above that the possibility of introducing various forms of taxation in the GCC states is not a new phenomenon. With growing populations and expanding economies the GCC states face increasing difficulties in funding the scale of public welfare provision and public sector jobs to which their populations have long been accustomed. The issue was highlighted following a recent debate on privatisation in the Kuwait parliament when an MP said Kuwait, “sells oil to pay salaries. In the future we may not be able to do that.”<sup>[43]</sup>

IV Consultation with Oman”, Public Information Notice (PIN) No. 10/21 17 February 2010, International Monetary Fund, Washington D.C.

42 Karen Rimo-Listana “Jury is still out on VAT’s viability in UAE”, *Emirates Business* 24/7, Dubai, 2 May 2010.

43 Omar Hasan “Kuwait MPs pass privatisation

Kuwait is by no means unique in facing this predicament. Table 1 illustrates the situation by providing a thirty year overview of GDP and population for the GCC states.

Bahrain stands out as the most obvious high consumer in relation to production, chiefly because of its low production levels – in 2009 the figure was 48,500 barrels per day.<sup>[44]</sup> However,

		1985	1990	1995	2000	2005	2010	2015
<b>Bahrain</b>	GDP	3.66	4.53	5.85	7.97	13.46	22.36	29.86
	Population	0.41	0.48	0.58	0.67	0.73	1.06	1.17
<b>Kuwait</b>	GDP	21.54	18.29	27.19	37.72	80.80	135.06	186.18
	Population	1.70	2.13	1.57	2.21	2.99	3.60	3.98
<b>Oman</b>	GDP	10.40	11.69	13.80	19.45	30.91	62.25	87.45
	Population	1.50	1.63	2.09	2.40	2.50	3.06	3.55
<b>Qatar</b>	GDP	6.27	7.36	8.14	17.76	42.46	110.84	183.62
	Population	0.34	0.46	0.52	0.60	0.79	1.35	2.34
<b>Saudi Arabia</b>	GDP	103.89	116.78	42.46	188.69	315.76	438.01	644.97
	Population	11.89	15.18	18.13	20.47	23.11	26.10	29.02
<b>UAE</b>	GDP	27.35	35.99	40.73	70.22	134.17	252.74	372.12
	Population	1.38	1.84	2.41	2.99	4.10	5.05	5.69

*Source: IMF World Economic Outlook Database, April 2010, International Monetary Fund, Washington D.C.*

GCC states need to find additional sources of revenue as they diversify their economies. In

Saudi Arabia the world’s largest oil producer - 9.7 million barrels per day in 2009<sup>[45]</sup> - consumed

	2001	2003	2005	2007	2009
<b>Bahrain</b>	48.6	52.3	64.2	86.5	80.3
<b>Kuwait</b>	12.9	13.1	12.3	12.6	12.8
<b>Oman</b>	6.1	7.1	9.2	11.5	10.3
<b>Qatar</b>	6.3	7.8	7.7	9.5	11.7
<b>Saudi Arabia</b>	17.5	17.6	17.7	21.6	24.9
<b>UAE</b>	13.0	12.5	13.2	16.0	15.5

*Source: EIA International Energy Production and Consumption Statistics, Energy Information Administration, Washington D.C. Percentages based on author’s calculations.*

Bahrain and Oman this issue is compounded by declining oil and gas reserves. Moreover, in varying degree it affects all GCC states due to increased domestic oil consumption. Table 2 illustrates the problem of growing domestic consumption

20-25% of its production over the last three years. This presents a growing challenge to economic policymakers as increasing levels of Saudi oil production are directed towards power

law, exclude energy production”, *Agence France Presse*, 12 May 2010.

44 EIA International Energy Production Statistics, Energy Information Administration, Washington D.C.  
45 Ibid.

generation, particularly in the summer months despite Saudi assurances that near-term export commitments would be met.<sup>[46]</sup> However, in a rare public statement on the issue, the head of Saudi Aramco warned that, without greater domestic efficiency, the kingdom could lose up to 3 million barrels per day from export availability by 2028,<sup>[47]</sup> while some forecasts reportedly envisage Saudi Arabia becoming a net oil importer by 2040.<sup>[48]</sup>

Additional factors for GCC states in considering the introduction of new taxation stem from their economies' increasing exposure to aspects of globalisation. These include the growing numbers of bilateral and/or regional Free Trade Agreements (FTAs) concluded in recent years such as the Bahrain-US or GCC-Singapore FTAs, and those still in negotiation such as the GCC-EU or GCC-China FTAs. Conditions of these agreements include the abolition of tariffs and other trade-related duties. Using the example of Dubai, Table 3 illustrates how customs duties and taxes related to trade and port operations

form

an important part of annual revenues. Given that many concluded and pending FTAs are with the GCC states' most important trading partners and/or regions, revenues from trade-related taxes will need to be found elsewhere. A further issue concerns the increasing calls by international organisations and agencies for the GCC states to implement various forms of taxation. Such calls began when oil revenues were relatively low and budgetary pressures were a frequent problem for at least some GCC states. However, even with the rise in oil revenues since that period the calls to implement taxation have persisted.

Most recently indirect taxation appears to have become the favoured option, particularly VAT, offering the option of spreading the tax burden between local and foreign populations/companies. However,

**Table 3: Customs revenues as percentages of total Dubai Revenues (\$ millions)**

	2003	2004	2005	2006	2007
<b>Total Dubai Revenues</b>	2735.2	3260.9	4600.9	5530.6	6970.8
<b>Dubai Customs<sup>a</sup></b>	16.9	17.5	17.1	19.6	23.1

*Source:* United Arab Emirates: Statistical Appendix", April 2009, IMF Country Report No.09/120, International Monetary Fund, Washington D.C., p.18. IMF figures are quoted in UAE Dhiraams. Author's conversions into dollars are at \$1=Dh3.6732. Percentages based on author's calculations.  
<sup>a</sup> The IMF notes this includes all revenues associated with trade and port operations, including customs duties.

46 See, for example, Judy Hua "Saudi Arabia aims to raise use of crude for power", *Reuters India*, 7 April 2010.

47 Andrew England and Abeer Allam "Saudi oil chief fears domestic risk to exports", *Financial Times*, London, 26 April 2010.

48 "Saudi Arabia economy: Crude erosion", *EIU ViewsWire*, Economist Intelligence Unit, New York, 1 March 2010. The EIU report casts doubt on this forecast but adds that Saudi Arabia nevertheless needs to urgently review its energy strategy.

indirect taxation rates need careful monitoring to ensure investors are not driven away. Any indirect taxation such as VAT must also avoid hurting the poor. One study of VAT in Papua New Guinea found that, by using household survey data to identify items mainly consumed by poorer households, these items could be exempted

from VAT, thereby reducing the impact on more vulnerable sectors of society.<sup>[49]</sup> In the high income GCC states, economic planners have examined the merits of placing higher VAT levels on luxury goods rather than those used by low and middle-income consumers.<sup>[50]</sup>

Another consideration is whether taxes such as VAT will be inflationary. In 2008, when Dubai announced it wanted to implement VAT to replace lost customs receipts<sup>[51]</sup> the IMF Middle East director warned the inflationary environment at the time would be exacerbated by the introduction of VAT and suggested delaying its implementation until inflation lowered.<sup>[52]</sup> As Table 4 shows, by 2008 inflation had become an increasingly evident problem in Kuwait, Oman, Qatar and the UAE. However, between 2008 and 2009 inflation dropped sharply in countries most affected. It is unlikely the tax will be operational before 2013 and, as we can see, inflation is already much lower and

forecast to remain so until at least 2015.

Perhaps the most important argument in favour of VAT is its strengthening effect on state revenues, particularly if oil prices should fall again. However, offsetting shortfalls in the GCC states where oil revenue forms a significant component in state income may require a high value on the VAT, and more than the 3-5% range often mentioned. Therefore, if VAT were introduced in the initial range of 3-5%, a sharp or prolonged fall in oil prices may mean VAT having to rise higher than the initially projected levels.<sup>[53]</sup> Depending upon its timing such an increase could deter other GCC states from emulating the project. Indeed it is arguable that the UAE is being used to test the effectiveness of VAT and its success or failure could substantially influence its implementation in other GCC states.

The case for taxation in the GCC states has been advanced by repeated recommendations from international organizations such as the IMF. This can be viewed as a part of the economic

	2008	2009	2010	2011	2015
<b>Bahrain</b>	3.533	2.785	2.000	2.000	2.000
<b>Kuwait</b>	10.500	4.678	4.463	4.026	3.530
<b>Oman</b>	12.611	3.537	3.886	2.903	1.545
<b>Qatar</b>	15.049	-4.865	1.033	3.024	4.000
<b>Saudi Arabia</b>	9.871	5.057	5.200	5.000	3.000
<b>UAE</b>	11.544	1.008	2.229	3.015	3.173

*Source:* IMF World Economic Outlook Database, April 2010, International Monetary Fund, Washington D.C.

49 John Gibson “Indirect tax reform and the poor in Papua New Guinea”, *Pacific Economic Bulletin* 1998 Vol.13 No.2 p.13.

50 James Gavin “Learning the value of VAT”, *Middle East Economic Digest*, London and Dubai, 8 August 2008.

51 Dominic Dudley “Increasing the tax burden”, *Middle East Economic Digest*, London and Dubai, 6 June 2008.

52 Ali Khalil “Tax-free UAE on course to introduce VAT in Gulf”, *Agence France Presse*, 29 May 2008.

globalization process. However, the extent to which states act on such recommendations stems much more from domestic factors – be they political in the sense of the ease with which

53 “UAE: VAT – Analyzing the impact”, *Emerging Markets Monitor*, 9 June 2008, <http://www.emergingmarketsmonitor.com>.

recommendations to implement taxation can feasibly be introduced, or economic to the extent which taxation is a necessary requirement to bolster state revenues. A 2007 study of taxation in developing countries concluded: “A good tax system is one that fits both the social institutions as well as other specific determinants of distribution and economic growth in each country.”<sup>[54]</sup> Whilst states may need outside assistance to advise on the best tax policies, according to a 2008 study, the role of foreign advisors in helping developing countries with taxation policies is changing. They may bring important analytical skills and experience from elsewhere in the world but their role in decision making is now much reduced, with greater emphasis placed upon local decision makers who can gear taxation policies to the various requirements and sensitivities of the local environment.<sup>[55]</sup> In the case of the UAE, we have seen how in 2002 the IMF offered to assist the federation in implementing a taxation programme, and a former IMF advisor to the government of Pakistan, Ehtisham Ahmad, has since been appointed by the Prime Minister’s Office to devise a VAT programme for the country. Ultimately

however, it will be the UAE government, at federal and emirate levels, taking into account local political and economic circumstances, that makes the final policy decisions.

An additional factor is that economic globalization can affect the type of taxation states introduce. The regional competition for foreign investment means several GCC states have cut their corporate tax rates. Table 5 illustrates the ability of GCC states to attract foreign direct investment over the past decade, and how even in apparently attractive economies, enduring high levels of investment flows are by no means guaranteed.

A 2001 study concluded that in an increasingly competitive and globalized economy, states vying for foreign direct investment may have to place greater reliance on indirect taxation including those on consumption rather than taxes on income, profits and assets.<sup>[56]</sup>

### 3. Administration and collection

An important component in the introduction of taxation is the extent to which a state is

	1995-2005 Annual Average	2006	2007	2008	2009
<b>Bahrain</b>	594	2915	1756	1794	257
<b>Kuwait</b>	49	122	116	-51	145
<b>Oman</b>	200	1597	3332	2359	2211
<b>Qatar</b>	619	3500	4700	4107	8722
<b>Saudi Arabia</b>	1534	17140	22821	38151	35514
<b>UAE</b>	2487	12806	14187	13700	4003

*Source:* United Nations Conference on Trade And Development (UNCTAD) “World Investment Report 2010”, <http://www.unctad.org/wir>

54 Reuven Avi-Yonah and Yoram Margalioth “Taxation in developing countries: some recent support and challenges to the conventional view”, *Virginia Tax Review* 2007 Vol.27 No.1 p.20.

55 Roy W. Bahl and Richard M. Bird “Tax Policy in Developing Countries: Looking Back—and Forward”, *National Tax Journal* 2008 Vol.LXI No.2 p.289.

56 Mukul G. Asher and Ramkishen S. Rajan “Globalization and Tax Systems: Implications for Developing Countries with Particular Reference to Southeast Asia”, *ASEAN Economic Bulletin* 2001 Vol.18 No.1 p.135.

able to implement the necessary functions of administration and collection. The UAE will probably be the first GCC state to implement VAT, and a 2008 report on the issue noted concerns, over the UAE's institutional infrastructure, and its capacity to adequately manage the introduction of a new tax system. Dubai Customs, which is leading the project, has insisted that the infrastructure will be in place by the end of the year, ready to be rolled out to the other Emirates as necessary. However, given the apparent lack of statistical capacity that already exists in the UAE...we remain sceptical. Furthermore, much of the burden will fall on businesses, which will be required to file tax returns more frequently and to more meticulous standards. Small businesses (those with revenues under \$1million) will likely be exempt but even many larger firms in the UAE, particularly family-owned firms, currently have rather opaque financial reporting practices. In the longer term, VAT could lead to more transparent reporting practices and better financial regulation, but we expect some teething problems in the early stages.<sup>[57]</sup>

According to a taxation specialist in the region, the problem has been exacerbated by reforms outpacing administrative changes. In consequence, changes are required in the tax administration structure, training of tax administrative staff, and proper accounting.<sup>[58]</sup> By October 2009 when the UAE's 2010 budget was announced, there was still no provision made for VAT. One

57 "UAE: VAT – Analyzing the impact", op.cit.

58 Sunil Kumar Singh "GCC needs a uniform tax structure", *Emirates Business* 24/7, Dubai, 25 March 2010. The article quotes the recommendations of Sherif El Kilany, managing partner in taxation services at Ernst & Young Middle East.

reason given by the UAE Ministry of Finance was: "the necessity to provide infrastructure to complete the VAT application, especially at local level, such as setting up a federal authority for tax collection."<sup>[59]</sup> This point was repeated by the Chairman of the Dubai Economic Council in April 2010 when he said the UAE would not benefit from VAT because, "such a project needs institutional readiness."<sup>[60]</sup> Given that the UAE is a federation of seven emirates this is no small undertaking.

As a 2005 study of the UAE noted in comparing Abu Dhabi and Dubai: "Dubai's strong commercial traditions coupled with its comparatively modest oil wealth have facilitated and spurred a more rapid and wholesale diversification of the economy especially in the non-oil related trade sector. Conversely, Abu Dhabi's non-commercial foundations and its massive oil wealth have engendered a more oil-focused development strategy."<sup>[61]</sup> However, in the years since this study Abu Dhabi has begun implementing a non-oil economic strategy utilising the liquidity provided by its oil revenues and sovereign wealth fund.<sup>[62]</sup> Dubai may well utilise its administrative experience and institutional resources from handling customs revenues to administer a new tax such as VAT. Some emirates in the federation may be more prepared than others for the various administrative requirements of implementing new taxation. Table 6 illustrates the contributions of each emirate to the UAE's GDP. Aside from Abu Dhabi and Dubai, the smaller emirates of the UAE remain heavily reliant upon the larger.

59 Abdel Hai Mohamed "VAT ruled out in zero-deficit budget for 2010", *Emirates Business* 24/7, Dubai, 27 October 2009.

60 "VAT will not benefit UAE: Juma Al Majid", *Emirates Business* 24/7, Dubai, 28 April 2010.

61 Christopher M. Davidson *The United Arab Emirates: A Study in Survival* (2005, Lynne Rienner Publishers), p.159.

62 Christopher M. Davidson "Abu Dhabi's new economy: oil, investment and domestic development", *Middle East Policy* June 2009 Vol.16 No.2.

There is also potential for inter-emirate disagreements over taxation administration and collection. Davidson notes: “while the federation has certainly strengthened in recent years with the

**Table 6: Percentage contribution of each emirate to UAE GDP**

	2003	2005	2007
<b>Abu Dhabi</b>	59.6	59.0	54.8
<b>Dubai</b>	25.4	28.9	31.0
<b>Sharjah</b>	9.0	7.4	9.4
<b>Ajman</b>	1.6	1.2	1.3
<b>Umm al Qaiwan</b>	0.6	0.4	0.4
<b>Ras Al Khaimah</b>	2.4	1.9	1.9
<b>Fujairah</b>	1.4	1.2	1.2

*Source:* United Arab Emirates Statistical Appendix, April 2009, IMF Country Report No.09/120, International Monetary Fund, Washington D.C. Percentages based on author’s calculations.

greater incorporation of Dubai, it is nevertheless still more accurate to consider the UAE as something of a loose confederation, with its relatively autonomous and at times uncoordinated emirate-level powers continuing to shape the state’s development.”<sup>[63]</sup> Dubai’s international connections are arguably as numerous as those it has with the other six emirates.<sup>[64]</sup> These issues raise questions about the extent of consensus throughout the UAE on taxation. Local media

reporting on the VAT issue, particularly in 2009-2010, appears to highlight an absence of consensus at business and perhaps governmental level.

One additional noteworthy development concerns the growth of Qatar’s corporate tax revenues. Qatar cut its corporate tax rate in 2009 to 10% making it one of the most competitive in the GCC region. Table 7 illustrates that, from modest levels, by 2008/2009 corporate tax revenues accounted for an estimated 10.4% of Qatari government revenues.

This could be explained by Qatar’s growing appeal to foreign investors as the Qatari economy experienced rapid growth throughout this period. However, when Qatar altered its corporate tax rate in 2009 local media emphasised the penalties for late filing of returns, providing false information, or attempts to evade the tax, with tighter penalties promised in case of frequent violation of the law by companies.<sup>[65]</sup> Qatar thereby demonstrated its willingness to make its economy more attractive to foreign investors by means of a low corporate tax rate whilst emphasising its determination to enforce it. This also raises a

**Table 7: Corporate tax as percentage of total Qatari Government Revenue (\$ million)**

	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9*
<b>Total Qatar Revenue</b>	8092.6	8440.2	15129.8	18047.8	23646.7	32364.3	38727.0
<b>Business corporate income tax</b>	0.6	3.5	2.8	0.7	5.3	7.6	10.4

*Source:* United Arab Emirates Statistical Appendix, April 2009, IMF Country Report No.09/120, International Monetary Fund, Washington D.C. Percentages based on author’s calculations. \* IMF Estimate

63 Davidson *The United Arab Emirates...* op.cit. pp.238-239.

64 John W. Fox, Nada Mourtada-Sabbah and Mohammed al-Mutawa “The Arab Gulf region: Traditionalism globalized or globalization traditionalized?” in John W. Fox, Nada Mourtada-Sabbah and Mohammed al-Mutawa (Eds.) *Globalization and the Gulf* (2006, Routledge), p.49; and Roula Khalaf “Long-term test of unity for UAE federation”, *Financial Times*, London, 29 June 2010.

point for the wider region. With greater focus on administration, collection and disclosure it may be possible to increase revenue from existing taxes, as well as from the introduction of new ones. One regional taxation expert has argued that despite a short-term reduction

65 “Corporate tax law issued” *Gulf Times*, op.cit.

in revenues due to corporate tax cuts, in the longer term both tax receipts and transparency will increase. For example, when Egypt cut tax rates in 2005, revenues rose and the number of taxpayers doubled.<sup>[66]</sup>

#### 4. Distribution of revenues

In 2008 Bahrain introduced a tax levied on businesses for every foreign worker they employed. The purpose of the tax was to raise the cost of employing foreign workers, thereby encouraging the private sector to employ more Bahrainis. The tax is collected by an agency run by the Labour Market Regulatory Authority, and the proceeds are used to train Bahrainis for the workplace, create jobs, and supplement local employee wages in their first year. Thus far, the scheme has raised around BD90 million (\$238 million) and there are hopes it will train up to 19,000 Bahrainis on low incomes.<sup>[67]</sup>

The Bahrain tax experiment could be replicated elsewhere in the GCC region and indeed the scheme is being closely observed by Bahrain's neighbours.<sup>[68]</sup> In Saudi Arabia for example, rising population levels have put increasing pressure on state resources and public sector job creation capacities. By 2008 only 16% of Saudi nationals were employed in the private sector.<sup>[69]</sup> Growing

66 Grocott op.cit. pp.6-7. The report quotes Howard Hull, international tax partner at Ernst & Young in Dubai.

67 "Bahrain's labour market: Bridging the Gulf", *The Economist*, London, 16 January 2010; Frederik Richter "Bahrain reforms raising cost of foreign labour", *Reuters India*, 19 January 2010; and Rebecca Torr "'Death' of business mourned", *Gulf Daily News*, Bahrain, 26 May 2010.

68 "Bahrain's labour market: Bridging the Gulf" op.cit.

69 "From Job Substitution to Job Creation: Addressing the Labour Market Challenges in the GCC Countries – Lessons from Saudi Arabia", *Gulf One Research Bulletin*, June 2010, Gulf One Investment Bank, Jeddah,

local unemployment in the kingdom is frequently attributed to educational standards that do not give Saudis the necessary skills for employment.<sup>[70]</sup> Whilst educational reforms are a potential medium to long-term solution, in the short term additional training could be funded by employers via schemes similar to that in Bahrain. Bahraini officials have noted that the foreign labour tax scheme will require around five years to assess its effectiveness, and precedes a plan to place formal caps on the number of foreign workers in each sector of the Bahraini economy. The potential for this scheme to be applied elsewhere in the region is particularly compelling when set against a 2005 estimate of 12.8 million foreign workers in the GCC states.<sup>[71]</sup> Given the expansion of GCC economies in the years since this estimate it is safe to conclude the figure is now considerably higher.

#### 5. Conclusions

The issue of taxation in the GCC states is not a new phenomenon. However, over more than twenty years, the issue has been played out within a changing domestic, regional and international landscape. At the global level, we could cite the ending of the Cold War, the multifaceted aspects and speed of the economic globalization process, and the increased influence of international organisations in implementing economic norms which include taxation. At the regional level, the greatly increased economic capacity and consequent autonomy of a number of GCC states such as Qatar and the UAE compared to Saudi Arabia mean that the regional GCC arrangement has to take account of changes in the economic, and therefore political, landscape.

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Saudi Arabia, p.10.

70 See, for example, Asma Alsharif "Saudi Arabia struggles to curb rising unemployment", *Reuters Africa*, 10 June 2010; and Ulf Laessing "Saudi population seen rising on skilled labour need", *Reuters Africa*, 10 June 2010.

71 "From Job Substitution to Job Creation..." op.cit. p.6.

At the domestic level, new generations of leadership in Bahrain, Qatar, and the UAE have brought changing perspectives and dynamics to the process of economic development. Another important consideration is that the relationship between rulers and ruled has not remained static. A 2005 study noted that while the Saudi state was grappling with a long period of low oil prices from the early 1980s onwards, the Saudi private sector, previously dependent on the state for its resources, “mutated into a national bourgeoisie whose financial assets outstrip those of the government, whose capabilities are remarkable [and] whose assertiveness is clearly increasing. [To] the extent that it will not get what it wants from the Saudi system, it will get it from neighbouring countries: the game of competition in governance is very clearly on.”<sup>[72]</sup> In the case of the UAE, Davidson notes a struggle for the future of Emirati development between reformers and conservatives within the country’s political and economic elite. Reformers seek new ways to maintain the state’s economic role via non-oil diversification, while conservatives seek to perpetuate reliance on oil wealth. Issues such as foreign property ownership and foreign investment have become part of this struggle between reformers and conservatives.<sup>[73]</sup> It would be safe to conclude that the issue of taxation falls very much within this struggle for future economic policy direction, and that the situation highlighted by the case of the UAE is one being played out in varying degrees within many if not all the GCC states. Thus the taxation issue sits on a changing politico-economic balance which raises the question: what is any new taxation for?

#### Does it underpin state revenues in periods of

72 Giacomo Luciani “From Private Sector To National Bourgeoisie: Saudi Arabian Business” in Paul Aarts and Gerd Nonneman (Eds.) *Saudi Arabia In The Balance: Political Economy, Society, Foreign Affairs* (2005, Hurst & Company), pp.180-181.

73 Davidson *The United Arab Emirates...* op.cit. p.239.

fluctuating oil prices and/or augment state revenues when faced with increased domestic demand for public welfare provision and public sector jobs? Does it raise the prospect of providing greater local socio-economic opportunities as is the aim of the Bahraini foreign labour tax? Or does it offset lost customs revenue following the conclusion of bilateral and/or regional free trade agreements? Taxation is an instrument that can and is already serving a multiplicity of purposes in the GCC region. As such it forms another component in the political-economic arrangement at state and regional levels. If successful, the UAE test case with VAT could be implemented elsewhere. Whilst rates of 3-5% have been mentioned for VAT in the UAE, would it be practical to implement a standard GCC-wide rate of VAT? Given that each of the six economies has different characteristics this could present problems. Another factor concerns the difficulties already experienced with another major pan-regional project – the single currency. This probably means implementing a regional taxation plan will take time.<sup>[74]</sup> Conversely, in the absence of a regional taxation arrangement, as shown with corporate tax rate variations, GCC states may adjust other taxation rates as a form of regional economic competition to attract foreign capital and/or companies and indeed their regional counterparts. Therefore, regional-level or state-level taxation schemes are not without potential difficulties. As Bahl and Bird note, “tax policy is usually heavily shaped by past decisions and frequently

74 In a May 2010 interview, the GCC Secretary General said it was unlikely the region’s single currency would be launched before 2015, with the UAE and Oman unlikely to join until after the currency was already operational. See Martin Dokoupil and Souhail Karam “Gulf single currency unlikely in next 5 years – GCC head”, *Reuters India*, 26 May 2010.

overtaken by current events. Economic, administrative, political, and social realities have always shaped tax policy decisions and constrained what could be done.”<sup>[75]</sup>

Direct taxation such as personal income tax seems less likely in the short-term because income tax payers would become a party to the taxation-representation argument, whereby their own incomes contribute to state funds and thus they have a stake in its policy-making. As a 1999 report noted: “Tax on citizens is more than just a source of revenue; it is an inextricable link to the public and its voice.”<sup>[76]</sup> Even in Kuwait, where a parliamentary democracy is already extant and Kuwaiti officials have periodically raised the issue of income tax, it seems unlikely in the near future. However, a successfully implemented and managed indirect tax system led by the example of the UAE may, in the long-term, provide reassurance to those with longstanding objections. As this project has already been delayed until at least 2013, the question of direct taxation in the GCC states is probably years away and even then only in states with favourable environments. Once taxes are operational, the issue of their legitimacy comes into play because ultimately tax reform requires a degree of social consensus that such policies are in the collective interest.<sup>[77]</sup> The longer they are functioning and seen to be functioning well, the taxation issue could become less charged and less associated with the imposition of

75 Bahl and Bird op.cit. pp.283-284.

76 Michael Gordon “No representation without taxation”, *The Middle East*, March 1999 Issue No.288 pp.19-21.

77 Jonathan Di John “The Political Economy of Taxation and Tax Reform in Developing Countries” *UNU-WIDER Research Paper No.2006/74*, July 2006, (United Nations University – World Institute for Development Economics Research), pp.20-21.

policies incompatible with local culture.

Future policy recommendations regarding taxation include:

1. Taking steps to ensure existing or proposed taxation programmes are effectively administered at every stage. This is particularly important for the role played by administration and collection in the legitimacy of taxation. If, in future, direct taxes were to be implemented in GCC states the legitimacy and effectiveness of administration and collection would be crucial because of the voluntary nature of direct taxation.<sup>[78]</sup>
2. Businesses already present in the region or planning to begin operations there should receive the necessary information about present forms of taxation and any changes to be implemented.<sup>[79]</sup>
3. Actively encouraging a culture of financial transparency and disclosure. Greater state-level transparency would give a valuable lead for others to follow.<sup>[80]</sup>
4. Stating the case for tax. States should place strong public emphasis on the linkage between taxation and expenditure. Helping populations and businesses understand their purpose would help legitimise existing or proposed tax

78 Schwarz, Rolf “The political economy of state-formation in the Arab Middle East: Rentier states, economic reform, and democratization”, *Review of International Political Economy* 2008 Vol.15 No.4 pp.599–621.

79 A recent report noted that many businesses remain unaware of numerous changes to taxation policies in the GCC and across the Middle East. See “GCC tax changes go largely unnoticed” *CPI Financial*, Dubai, 22 July 2010.

80 One example of improving levels of state-level financial transparency concerns the region’s Sovereign Wealth Funds (SWFs). Less than five years ago, with little if any public disclosure on the subject, it was difficult to ascertain the direction or destination of Gulf SWF investments. However, more recently the Kuwait Investment Authority and the Abu Dhabi Investment Authority among others have made public some of their investment destinations and future intentions.

programmes.<sup>[81]</sup>

5. Demonstrating explicit links between taxation programmes and resulting benefits.<sup>[82]</sup>

The Bahraini foreign labour tax scheme provides an example, where taxation has been implemented to directly benefit unemployed Bahrainis. Also, when the issue of possible income taxation in Kuwait arose in 2000, some Kuwaitis said they would not mind paying if it meant services improved.<sup>[83]</sup> Therefore, emphasising demonstrable benefits accruing from taxation may make it easier to justify their implementation.

6. Taxation should be perceived as fair, meaning a broad base of taxpayers and fewer exemptions<sup>[84]</sup> other than for poorer sectors of society.

7. Inflation and VAT. The issue of inflation and VAT is very much a reflection of the economy within which it is operating. Kuwait, Oman, Qatar, and the UAE were already grappling with high levels of inflation in 2008 when IMF officials recommended postponing implementing VAT in the UAE. Thus, a relatively low inflationary environment, such as that forecast until at least 2015 in GCC states, would be less likely to be exacerbated by the introduction of VAT. Generally, VAT only seems to raise inflation in its first year of implementation so long as rates remain constant in later years.<sup>[85]</sup>

8. If in future the GCC implemented a common tax system, to ensure fairness in the distribution of revenues, a similar system to

that implemented in India could be used, whereby the Indian government appoints a Finance Commission comprising members from all the States which meets every three years to decide the criteria for revenue allocation.

One of the enduring appeals of the GCC states to outside investors, expatriates and tourists is their relatively tax-free environment. A 2008 report on VAT in the GCC states noted: “The real significance of such initiatives is the steady erosion of the region’s hallowed tax-free status. The reality is that as the six-member bloc becomes more deeply entwined in the global economy, its ability to steer its own course will be circumscribed. Once introduced, VAT is likely to be here to stay - and consumers and retailers alike will have to get used to it.”<sup>[86]</sup> As with its reasons for application, the consequences of taxation once applied will also be numerous and varied.

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86 Gavin “Learning the value of VAT” op.cit.

81 Max Everest-Phillips “State-Building Taxation for Developing Countries: Principles for Reform”, *Development Policy Review* 2010 Vol.28 No.1 p.93.

82 Ibid p.93.

83 “Kuwait: Fees, Future Taxes Scaring Away Expats?” *Kuwait Times* op.cit.

84 Everest-Phillips op.cit. p.94.

85 Dudley “Increasing the tax burden” op.cit.

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The main purpose of the Centre is to conduct empirical research focused on key economic and financial developments in the Middle East and North Africa (MENA) region, with special emphasis on the Gulf region. This region includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates, countries that form the Gulf Cooperation Council.

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