



A.T.A.I.C  
Association of Tax Administrators of Islamic Countries



Iranian National Tax  
Administration

FINAL REPORT  
2<sup>nd</sup> ATAIC TECHNICAL CONFERENCE  
TEHRAN - I R A N



Iranian National Tax  
Administration



ATAIC



مؤامرن كئفر انئرفئف مءمء مقاماء  
مالباءء كئشورءءاءء اسلامء

المؤامرنءئفئفءئف لءمءع السلاءاء الضمراءببء للبلاءء الاسلامبء

2<sup>nd</sup> ATAIC TECHNICAL CONFERENCE

# FINAL REPORT

TEHRAN - I R A N - 2 0 0 5



**Final report**  
**Second Technical Conference of ATAIC**  
**Tehran 2005**



## Some Verses from the Holy Quran

فَإِنْ تَابُوا وَأَقَامُوا الصَّلَاةَ وَآتَوُا الزَّكَاةَ فَإِخْوَانُكُمْ فِي الدِّينِ وَنُفَصِّلُ الْآيَاتِ لِقَوْمٍ يَعْلَمُونَ

But (even so), if they repent, establish regular prayers, and practice regular charity they are your brethren in faith: (thus) do we explain the signs in detail, for those who understand.

إِنَّمَا الصَّدَقَاتُ لِلْفُقَرَاءِ وَالْمَسْكِينِ وَالْعَامِلِينَ عَلَيْهَا وَالْمُؤَلَّفَةِ قُلُوبُهُمْ وَفِي الرِّقَابِ وَالْغَارِمِينَ وَفِي سَبِيلِ اللَّهِ وَابْنِ السَّبِيلِ فَرِيضَةً مِّنَ اللَّهِ وَاللَّهُ عَلِيمٌ حَكِيمٌ

Alms are for the poor and the needy, and those employed to administer these (funds); for those whose hearts have been (recently) reconciled (to Truth); for those in bondage and in debt; in the cause of Allah. And for the wayfarer: (thus is it) ordained by Allah, and Allah is full of knowledge and wisdom.

وَجَاهِدُوا فِي اللَّهِ حَقَّ جِهَادِهِ هُوَ اجْتَبَاكُمْ وَمَا جَعَلَ عَلَيْكُمْ فِي الدِّينِ مِنْ حَرَجٍ مِلَّةَ أَبِيكُمْ إِبْرَاهِيمَ هُوَ سَمَّاكُمُ الْمُسْلِمِينَ مِنْ قَبْلُ وَفِي هَذَا لِيَكُونَ الرَّسُولُ شَهِيدًا عَلَيْكُمْ وَتَكُونُوا شُهَدَاءَ عَلَى النَّاسِ فَأَقِيمُوا الصَّلَاةَ وَآتُوا الزَّكَاةَ وَاعْتَصِمُوا بِاللَّهِ هُوَ مَوْلَاكُمْ فَنِعْمَ الْمَوْلَى وَنِعْمَ النَّصِيرُ

And strive in His cause as ye ought to strive, (with sincerity and under discipline). He has chosen you, and has imposed no difficulties on you in religion; it is the cult of your father Ibrahim. It is He who has named you Muslims, both before and in this (Revelation); that the Messenger may be a witness for you, and ye be witnesses for mankind! So establish regular prayer, give regular charity, and hold fast to Allah. He is your protector – the best to protect and the best to help!

وَجَعَلَنِي مُبَارَكًا أَيْنَ مَا كُنْتُ وَأَوْصَانِي بِالصَّلَاةِ وَالزَّكَاةِ مَا دُمْتُ حَيًّا

And He hath made me blessed wheresoever I be, and hath enjoined on me prayer and charity as long as I live;

خُذْ مِنْ أَمْوَالِهِمْ صَدَقَةً تُطَهِّرُهُمْ وَتُزَكِّيهِمْ بِهَا وَصَلِّ عَلَيْهِمْ إِنَّ صَلَاتَكَ سَكَنٌ لَهُمْ وَاللَّهُ سَمِيعٌ عَلِيمٌ

Of their goods, take alms, that so Thou mightest purify and sanctify them; and pray on their behalf. Verily Thy prayers are a source of security for them: and Allah is One who heareth and knoweth.

**Final report**  
**Second Technical Conference of ATAIC**  
**Tehran 2005**

**AN INTRODUCTION**

**TO**

**"A T A I C"**

## **Association of Tax Authorities of the Islamic Countries (A T A I C)**

### **Introduction**

To involve Moslem countries in the development of new tax systems in the modern borderless world was the main logic for the formation of the Association of Tax Authorities of Islamic Countries.

The ATAIC was first established and launched in Putrajaya, Malaysia on 15 October 2003. The representatives of Islamic countries were invited to participate in the preparatory meetings of ATAIC during 13 - 14 October 2003, prior to this launch.

Issues such as administration, collection and distribution of tax and Zakat

accordingly, are the main subjects to be dealt with by the ATAIC.

### **Goals and Objectives**

The Association mainly aims at the improvement of tax and Zakat policies and administrations in all aspects within Islamic member countries in order to meet the challenges of the rapidly changing world.

ATAIC also aims at the provision of an annual forum to exchange experiences on tax and Zakat, and development of appropriate strategies to adapt to the new technological changes. Promotion of integrated Islamic tax policies and improvement of the administrative and executive structure of taxation and Zakat systems, are some other significant objectives.

### **Activities**

In order to adapt the tax systems with the economic developments, properly remove obstacles and confront global challenges, the ATAIC members will draw up necessary measures in line with the policies adopted by the Islamic countries' representatives at ATAIC meetings.

Included in the agenda of the ATAIC annual programs are the following important activities:

- Holding of annual meetings to discuss tax policies,
- Organizing seminars, workshops and training courses in order to consider approaches towards establishing modern administrative systems,
- Expansion of cooperation among regional and international organizations

in order to provide technical assistance, loans and financial facilities for research in the field of executive and administrative structure and organization of taxation systems in member countries, and

- Providing for easy access to information within the Islamic countries regarding development in advanced taxation systems.

### **The ATAIC Formation**

The agreement for the formation of ATAIC was signed by the representatives of eleven Islamic countries at the meetings held in 2003 (13–15 October). Based on the ATAIC agreement, an annual technical meeting should be held once a year in one of the member countries.

## **The 1<sup>st</sup> ATAIC Technical Conference 2004**

The First ATAIC Technical Conference was held in Putrajaya, Malaysia in 2004 (4-7 October). Sixteen Islamic Countries were the members of ATAIC, out of which eleven attended the first conference. Topics of discussion at that conference included:

- 1) Taxpayer Services-Improvement in Tax Administration towards Better Services to Taxpayer,
- 2) The Role of Zakat in Development of the Muslim Ummah and Modernization Strategies in Collection and Distribution.

**ATAIC Member Countries  
October 2004**

- |                      |                |
|----------------------|----------------|
| 1) Bangladesh        | 9) Malaysia    |
| 2) Brunei Darussalam | 10) Morocco    |
| 3) Egypt             | 11) Pakistan   |
| 4) Indonesia         | 12) Qatar      |
| 5) Iran              | 13) Senegal    |
| 6) Jordan            | 14) Sudan      |
| 7) Kuwait            | 15) Tajikistan |
| 8) Lebanon           | 16) Yemen      |

## **The 2<sup>nd</sup> ATAIC Technical Conference 2005**

The main objective of the ATAIC Technical Conferences is to provide for the meeting of tax administrators and policy makers from Islamic countries in order to share their knowledge and experiences regarding taxation and related matters.

Following the first ATAIC Technical Conference during October 2004 in Putrajaya, Malaysia, the Islamic Republic of Iran was the host to the second ATAIC Technical Conference 2005 in Tehran from November 29 to December 2, 2005. Active participation of all tax authorities from Islamic countries and observers from international tax organizations made our conference as fruitful as possible for the Islamic world.

Participants discussed the following topics at the conference, 2005:

*Topic 1: Tax Issues in Cross-Border Transactions.*

*Topic 2: Value Added Tax (VAT) - Practice and Implementation.*

Presentations on the specific topics and related issues considered as fundamental steps towards the development of Islamic economic thoughts among Moslem tax scholars and administrators.

Islamic Republic of Iran warmly welcomes any response, suggestion or proposal in this regard. For further details, you can communicate with the Conference Secretariat at the following:

State Tax Organization,  
26, Dadman, Blvd,  
Shahrak-e-Ghods,  
Tehran-Iran  
Tel: +98 (21) 88099136  
Tel: +98 (21) 88579207  
Fax: +98 (21) 88579208  
E-mail: [ATAIC@storg.ir](mailto:ATAIC@storg.ir)

**THE AGREEMENT  
OF  
FOUNDING MEMBERSHIP**

**MALAYSIA  
OCTOBER 2003**

**THE COUNTRIES ACCEPTED  
THE INVITATION OF THE  
ISLAMIC REPUBLIC OF IRAN**

**TO THE  
SECOND TECHNICAL CONFERENCE  
2005**

# **PARTICIPATING COUNTRIES**

## **THE SECOND A T A I C TECHNICAL CONFERENCE 2005**

## **Countries and Delegations**

### **AFGHANISTAN**

**1. Mr. Mohammad Bashir Sadid**

*General Director for Large Taxpayers Unit*

### **AZERBAIJAN**

**1. Mr. Ilgar Akbarli**

*Head of the International Relations Department*

**2. Mr. Hamid Zeynalov**

*First Deputy Head of the Tax Policy and Strategic Research Main Department*

**3. Mr. Adil Aliyev**

*Chief State Tax Inspector of the Division of Audit Enterprises with Special Tax Regime*

**4. Mr. Riyad Huseynov**

*Senior State Tax Inspector of the International Relations Department*

**BRUNEI (DARUSSALAM)**

**1. Mr. Pg Hj Mumin Bin Plw Pg Hj Yussof**

*Director of Special Duties*

**2. Mrs. Chairani Binti Haji Sulaiman**

*Acting Senior Taxation / Finance Officer*

**COMOROS**

**1. Mr. Abderemane Said**

*Agent Fisc/ Recouvrement*

**COTE D'IVOIRE (IVORY COAST)**

**1. Mr. Ouattara Sie Abou**

*Director*

**2. Mr. Dali-Okpo Nougbo Albert**

*Tax Investigator*

**INDONESIA**

**1. Mr. Hasan Rachmany**

*Head of Bali Regional Tax Office*

**2. Ms Catur Rini Widosari**

*Deputy Director for VAT on Services*

**3. Mr. Harry Yusuf Adegdaha Laksana**

*Section Chief for Corporate Income Tax*

**4. Mr. Dany Hamdan Karim**

*Chief for Tax Audit at State Owned Companies*

## **IRAQ**

**1. Mr. Talib M. Jaber Ab-Juala**

*General Director for Taxation*

## **JORDAN**

**1. Mr. Refat Abdelhameed Obeidat**

*Head of Tax Policy*

**2. Mr. Hussein Moh'd Almoumani**

*Director of Audit*

## **KUWAIT**

**1. Mr. Fawzi S. Al-Qassar**

*Assistant Undersecretary for Financial Taxes Affairs*

**2. Mr. Nabil Al-Abduljalil**

*Director*

**3. Mr. Abdul Aziz Al-Sallal**

*Controller of International Treaties*

**4. Mr. Yousif N. Kh. Hamada**

*Controller of Tax Liability & Follow-Up*

**5. Mr. Mohammed-Al-Essa**

*Controller of Tax Claims*

## **MALAYSIA**

**1. Mr. (Tan Sri Dato') Zainol Abidin Bin Abd. Rashid**

*Chief Executive Officer / Director General of IRBM*

**2. Mr. Azhar Husin**

*Senior Assistant Director*

**3. MDM. Mardziah Binti Musir**

*Senior Assistant Director*

**4. Mr. Mohd Jaafar Bin Embong**

*Senior Assistant Director, Research, Development & Consultation Division*

**5. Mr. Zulkiflee Bin Md Tahir**

*Director of Non-Resident Branch*

**6. MDM. Nor Hiszan Binti A. Hamid**

*Assistant Director, International Tax Department*

**7. Mr. Mohd Zakri Bin Hj. Hussin**

*Director General of Department of Waqf, Zakat & Haj*

**8. Mr. (Y.Bhg. Dato' Hj.) Abdul Rahim. Bin. Abu Bakar**

*Chairman*

**9. Mr. Mohd Rais Hj. Alias**

*General Manager*

**10. Mrs. Dato' Kamariah Bt. Hussain**

*Chairman of Tax Panel Review*

**11. Mr. Paddy Bin Abd. Halim**

*Senior Assistant Director of Customs*

**12. Mrs. (Datuk) Aziyah Bahauddin**

*Undersecretary, Tax Analysis Division*

**13. Mr. MD Taufiq Bin MD. Ralip**

*Assistant Secretary*

**14. Mr. Nik Abdul Aziz Bin Nik Yahya**

*Advisor to Embassy of Malaysia in the Islamic Republic of Iran*

**MOROCCO**

**1. Mr. Brahim Kettani**

*Director of the Legislation Studies & International Cooperation*

**2. Mr. Omar Al Madani**

*Head of International Cooperation Unit*

**PAKISTAN**

**1. Mr. Salman Nabi**

*Senior Member of Direct Taxes*

**2. Mr. Muhammad Faiyaz Khan**

*Chief (Direct Taxes Policy)*

**QATAR**

**1. Mr. Yousef A. Bilal**

*Public Revenues & Taxes Department*

**2. Mr. Meteab M. Al Kubaisi**

*Tax Assessor*

**3. Mr. Abdul Rahman Al-Mannai**

*Survey & Follow-up Section*

4. **Mr. Ahmed Yousef Al-Ammari**  
*Public Revenues & Taxes Department*

#### **SAUDI ARABIA**

1. **Mr. Sami A. Al-Juhani**  
*Sector Director General*
2. **Mr. Mansour S. Al-Wabli**  
*Legal Accountant*
3. **Mr. Abdulaziz A. Al-Traifi**  
*Revenue Analyst*

#### **SENEGAL**

1. **Mr. Assane Dianko**  
*Director General (=Directeur Générale Des Impôts Et Des Domaines)*

#### **SIERRA LEONE**

1. **Mr. Ousman Barrie**  
*Deputy Commissioner –General*
2. **Mr. Allieu Sesay**  
*Head of Revenue & Tax Policy Division*

#### **SUDAN**

1. **Mr. Elsayied Osman Elsayed**  
*Deputy Undersecretary*

**2. Mr. Adil Abdel Moniem Abdelrazig Idres**

*Director of Taxation Chamber*

**TUNISIA**

**1. Mr. Friaa Nouredine**

*Manager of Tax Claim*

**TURKEY**

**1. Mr. Aydin Kiratli**

*Head of the Department of Revenue Administration*

**2. Mr. Mustafa Güneş**

*Head of the Group of Revenue Administration*

**YEMEN**

**1. Mr. Ahmed Ghaleb**

*Deputy Chairman*

**2. Mr. Ahmed Rajeh**

*General Manager of Controlling & Inspection*

**3. Mr. Yahya Mohamed Al-Osta**

*General Manager of Legal Department*

**SECOND TECHNICAL  
CONFERENCE PROGRAM**

**TEHRAN-IRAN  
NOVEMBER 29 – DECEMBER 2  
2005**

## 2<sup>nd</sup> ATAIC TECHNICAL CONFERENCE 2005

### 29 NOVEMBER- 2 DECEMBER TEHRAN - IRAN

#### *Conference Schedule*

Date	Time	Venue	Agenda
Monday, Nov. 28, 2005	All the day.	Main Hall of the Hotel	Arrival of delegations and registration.
<b><i>Opening Ceremony of the Second ATAIC Technical Conference</i></b>			
Tuesday, Nov. 29, 2005	9:00		- Arrive of the foreign delegation and the formal guests.
	9:05		- Arrival of the high-ranking guests.
	9:15		- Recitation of some verses of the Holy Quran.
	9:30		- Lecture by Mr. Datto Zeinol Abedin, the chairman of the First ATAIC Technical Conference.
	9:45	Alborz Hall	- Greeting by Dr. Arabmazar, the chairman of the Second ATAIC Technical Conference, the President of State Tax Organization.
	10:00		- Lecture by H.E. Dr. Ahmadinejad, the Respectful President of the Islamic Republic of Iran.
	10:20		- Lecture by Dr. Danesh Jafari, the Respectful Minister of Finance and Economic Affairs.
<b><i>Opening Ceremony of the Second ATAIC Technical Conference by the High Ranking Authorities</i></b>			
	10:30		- Refreshments.
	10:30	Alborz Hall	- Press conference by high-ranking authorities.
	11:00		- The end of the opening ceremony.
<b><i>Beginning of the Second ATAIC Technical Conference</i></b>			
	11:00	Alborz Hall	- Announcement of the opening ceremony by the chairman of the ATAIC Second Technical Conference, introduction of the Working Groups (WGs).
	11:35		- Prayers and lunch.
	12:50	Amir Kabir Hall	- Meeting of Heads of Delegations.
	13:50	Aras/Damavand Hall	- Beginning of meeting of the WGs of topics 1 & 2.
	15:20		- Prayers and Refreshments.
	15:50		- Meetings of the WG continued.

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17:10

- End of working sessions.

*Continued*

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## 2<sup>nd</sup> ATAIC TECHNICAL CONFERENCE 2005

29 NOVEMBER- 2 DECEMBER  
TEHRAN - IRAN

### *Conference Schedule*

<b>Date</b>	<b>Time</b>	<b>Venue</b>	<b>Agenda</b>
Wednesday, Nov. 30, 2005	9:00 10:30 10:45 11:35 12:50 15:20 15:50 17:10	Aras/Damavand Hall	- Meeting of WGs. - Refreshments/group photos. - WGs meetings continued. - Prayers and Lunch. - WGs meeting continued. - Prayers and refreshments. - WGs meetings continued. - End of meetings.
Thursday, December 1, 2005	9:00 10:30 10:45 11:35 14:00	Aras/Damavand Hall	- WGs meeting continued. - Refreshments. - Summing up of the reports. - Prayers and lunch. - Cultural and social visits.
Friday, December 2 2005	9:00 10:30 10:45 11:00 11:20 11:35 11:35	Alborz Hall	- Reports of WGs meetings. - Refreshments. - Recitation of some verses of the Holy Quran. - Concluding meeting with the participation of all the members (closing ceremony). - Expression of gratitude to the host. - Lecture by the Chairman of the 2 <sup>nd</sup> Technical Conference. - End of the Technical Conference. - Prayers and lunch.

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## Proposed Agenda Heads of Delegation Meetings

<i>Date</i>	<i>Time</i>	<i>Venue</i>	<i>Hall</i>
Tuesday 29 Nov. 2005	14:00	Iranian Center for International Conferences (I.C.I.C)	Amirkabir
<b><i>AGENDA</i></b>			
1) Opening Remarks by the new ATAIC Chairman			
2) Appointment of the Chairpersons and Rapporteurs of each Working Group			
3) Conference Program <ul style="list-style-type: none"> <li>• <i>Briefing by the Chairman of the ATAIC</i></li> </ul>			
4) Report of HOD Meeting of the 1 <sup>st</sup> ATAIC Technical Conference 2004, held in Putrajaya, Malaysia on 7 October 2004			
5) Report of the new Membership and Introduction of new Member Countries			

6) 3<sup>rd</sup> ATAIC Technical Conference 2006

- *Host Country*
- *Date and Venue*
- *Discussion Topics*

7) Other Matters Arising

# **OPENING CEREMONY**

**TUESDAY  
NOVEMBER 29  
2005**

**"Alborz Hall"**

*In the Name of the Most High*

## **ATAIC 2<sup>nd</sup> Technical Conference**

### **Opening Ceremony**

The second ATAIC Technical Conference was opened on Tuesday, November 29, 2005.

Sixty participants from twenty-two countries had attended the conference. The respected guests from the embassies, universities, parliament, and the government organizations and institutions were present in the conference.

First, some verses of the holly Quran were recited.

After announcement of the program by the host of the ceremony, the representative of Malaysia, Tan Sri Dato' Zainol Abidin bin Abd. Rashid, the Chairman of the First Technical Conference was invited to deliver his speech. Mr. Zainol Abidin, began expressing his thanks and appreciation for all ATAIC member countries for having made the 1<sup>st</sup> ATAIC Technical Conference 2004 in Malaysia a success. Then he referred to some of the 1<sup>st</sup> Technical Conference's important results including pursuit of common goals and sharing experiences for better organization.

He referred to arrangement of seminars, workshops and training courses on Tax and Zakat issues. In order to meet the challenges of the rapidly

changing world, he believed that such courses helped the ATAIC countries to further improve tax and Zakat administrations within their countries. At the end of his speech Mr. Zainol Abidin invited the participants to work together and convert this gathering into an effective communication channel for consolidated cooperation and fraternal ties among members of ATAIC.

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Then H.E. Dr. Danesh Jafari the Minister of Economic Affairs and Finance delivered his speech. Thanking the respected participants in the 2<sup>nd</sup> Technical Conference, H.E. Mr. Minister expressed hope that the ATAIC member countries would take great steps towards materialization of invaluable goals of the Association. Referring to new tax structures, Mr. Minister mentioned that the tax system of the Islamic countries should be reorganized to provide for sufficient financing sources to meet budgetary needs and to attempt to prevent destruction of tax sources due to tax evasion and tax avoidance or inefficiency of the executive system. In this regard, H.E. Dr. Danesh Jafari referred to identification of tax capacities, introduction of new taxes and promotion of information and executive systems at the national & international levels, which should be observed by the policy makers. To reach this goal, cooperation between Islamic and non-Islamic countries is required.

According to H.E. Mr. Danesh Jafari without an efficient private sector, growth of tax revenues may not be achieved, since the government usually cannot collect tax from its sub-organizations. In his speech H.E. Mr. Minister referred to the adoption of open strategies fore interaction with other international economic systems which can be taken into consideration

by the ATAIC members, in order to create the required environment to achieve the predicted goals.

H.E. Mr. Minister believes that the combination of scientific, technical, financial and economic capacities of Muslim nations all over the world, and complying with the economic obligations of the Islamic rules in different aspects particularly Islamic public finance will benefit both the Islamic states as well as the entire society.

At the end of his speech H.E. Dr. Danesh Jafari expressed hope that the efforts of the participants in this conference would result in the optimum use of economic and financial sources. This result should be deemed as thanks to God's blessings.

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The session was continued by the speech of the new chairman of the ATAIC, Dr. Aliakbar Arabmazar.

Mr. Chairman as the President of the State Tax Organization started his speech lauding the late Imam Khomeini (RA) and the martyrs of the Islamic Revolution. He also praised the leader and wished him good health. Dr. Arabmazar then welcomed the honorable guest, H.E. Dr. Danesh Jafari, the Minister of Economic Affairs & Finance, and the respected guests to the 2<sup>nd</sup> ATAIC Technical Conference.

In his speech, Dr. Aliakbar Arabmazar referred to the main components of the structural reform in the Iranian taxation system. These included: evolution in the tax system during the Third and Fourth Development Plan with the aim of reducing dependence of budget on oil revenues, establishment of the new tax organization and designing new administrative structure, revising of the Direct Taxes Act, amending the

structure of numerous charges in Indirect Taxes, efforts aimed at preparing the grounds for the implementation of VAT system, fundamental reforms in the information system and providing the program of the integrated mechanized tax systems, the government policy of financing the current expenditures out of non oil revenues, transparent and logical structure of economic activities, expansion of international economic co-operation. After the opening session, the members were divided into two working groups:

1-Tax issues in Cross-Border Transactions

2- Value Added Tax, Practice & Implementation

In the afternoon the two workshops officially opened. All the participants who had been divided into two groups according to their interests and experiences attended the workshops, in order to express their opinions on the Conference topics.

## **ADDRESS BY**

**Tan Sri Dato' Zainol Abidin bin Abd.**

**Rashid**

**Chief Executive Officer/Director General of**

**IRBM**

**CHAIRMAN OF THE ATAIC  
1st TECHNICAL CONFERENCE**

## **His Excellencies, Ambassadors of ATAIC Member Countries, Distinguished Guests**

### **Ladies and Gentlemen**

Assalamualaikum warahmatullahi wabarakatuh and a very good morning  
I am delighted to be here today at this 2<sup>nd</sup> ATAIC Technical Conference 2005, to pursue and continue making ATAIC an effective forum for exchange of ideas and information through the annual conference held among its members. It is particularly pleasing to see that our efforts in the formation of ATAIC for the benefits of the Muslim Ummah have begun to gather momentum.

### **Ladies and Gentlemen,**

Before I proceed, please allow me to take this opportunity to record my sincere thanks and appreciation to all ATAIC member countries, for making the 1<sup>st</sup> ATAIC Technical Conference 2004 in Malaysia a success. I am proud that this support and cooperation has facilitated the role entrusted to us and indeed I believe will augur well for the future well being of this Organization.

It is my sincere and earnest hope that the friendship and close cooperation, nurtured at the 1<sup>st</sup> ATAIC Technical Conference 2004 in Putrajaya, Malaysia, will continue to flourish in the tranquil ambience of this beautiful country of Iran.

The 1<sup>st</sup> ATAIC Technical Conference 2004 held at Putrajaya Convention Centre, Malaysia from the 4<sup>th</sup> to 7<sup>th</sup> October 2004 had indeed accomplished

our objectives, particularly in pursuing our common goal of working together, sharing our experiences and tapping the vast potential within us for the betterment of our Organization.

One of the objectives of the ATAIC is to organize seminars, workshops and training courses on aspects of Tax/Zakat organization in order to meet the challenges of a rapidly changing world.

In this regard please allow me to take this opportunity to congratulate Pakistan for having initiated the 1<sup>st</sup> ATAIC international course especially designed for our member countries. The two-week course on "Tax Analysis and Revenue Forecasting" conducted at the Directorate General of Income Tax Training and Research Centre in Lahore from April 25 to May 6, 2005 benefited 31 participants from seven (7) member countries. They were from Brunei Darussalam, Indonesia, Iran, Malaysia, Pakistan, Sudan and Yemen.

I strongly believe this course and other activities carried out by ATAIC will not only benefit the participants but also help to promote the improvement of tax and zakat administrations within the member countries.

I would like to take this opportunity to record my deepest appreciation to all of you for your invaluable support in making the ATAIC a reality.

The idea for the formation of the ATAIC was first mooted to Inland Revenue Board of Malaysia in the year 2003 by the then Prime Minister of Malaysia, Tan Dr. Mahathir Mohamed. And on October 15, 2003 he himself formally launched the ATAIC during the 10<sup>th</sup> Session of the Organization of Islamic Conference (OIC) Summit held in Putrajaya,

Malaysia. From a humble beginning of eleven (11) members, we should be proud that the membership of ATAIC has grown to seventeen (17) today. I am very confident that many more will join us as we progress in the pursuit of hope and excellence for the fraternity of this Organization.

Let us work together and make this gathering an effective communication channel to further strengthen cooperation and fraternal ties among member countries of ATAIC.

On that note, it is with great pleasure; I congratulate the President of the State Tax Organization, Tehran, Islamic Republic of Iran and his team of dedicated conference organizers for hosting the 2<sup>nd</sup> ATAIC Technical Conference 2005.

*I wish everyone a fruitful and successful conference.*

*I conclude with Wassalamualaikum warahmatullahi wabarakatuh.*

*Thank you.*

**ADDRESS BY**

**H.E. Dr. Danesh Jafari**

**MINISTER OF ECONOMIC AFFAIRS  
AND FINANCE**

**THE HONORABLE GUEST  
TO THE 2<sup>ND</sup> TECHNICAL CONFERENCE**

**In the Name of Allah  
The Compassionate, The Merciful**

الْحَمْدُ لِلَّهِ الَّذِي هَدَانَا لِهَذَا وَمَا كُنَّا لِنَهْتَدِيَ لَوْلَا أَنْ هَدَانَا اللَّهُ

Praise belongs to Allah, who has led us to this position, and we were not among the righteous, if Allah had not put us on this way.

Assalamualaikum warahmatullah

Dear Guests and Audience,

Respected Sisters and Brethren,

Senior Tax and Custom Officials of the Islamic Countries,

Scholars and Experts of the Islamic economics

Distinguished guests to the 2<sup>nd</sup> Technical Conference of the ATAIC

At first, I take this opportunity to warmly welcome your presence in the Islamic Iran, and it is such a great pleasure for us to host the respected scholars, experts and distinguished tax authorities of the Islamic countries, in the 2<sup>nd</sup> Technical Conference.

I would like to express my thanks to all Iranian and foreign guests, who with their active participation in this conference, contribute to further enrichment of the Association.

God willing, we can take great steps to achieve the invaluable goals of the Association, during the meetings of the Technical Conference.

Dear Audience!

Confirming the viewpoints expressed in the speeches of Dr. Zainol Abidin and Dr. Arabmazar on the role of ATAIC in expanding scientific, technical and professional tax collaboration among Islamic countries, and the other points brought up by them. I have no doubt that, this gathering will provide the proper arrangements required for cooperation and common understanding of national and international tax issues among the Islamic countries.

It is hoped that, this new desirable atmosphere for exchange of views among tax policy makers and intellectuals of the Islamic economics from the Islamic countries, will lead to the creation and consolidation of new structures and provision of new administrative orders in the other economic fields.

Certainly, in order to control the process of economic, social and cultural development, with respect to moral ideals inherent in the rules of our religion, and with regard to removing the gap between the poor and rich countries, definitely, scientific planning of the Islamic governments and technical, financial and technological support for the economic sectors will be required.

The patterns of the Islamic economics and management, which constitute the rules and concepts governing the economy, and the new findings in the international management, can be used to remedy the above problems.

The principles and fundamentals of the holy religion of Islam, respecting the private ownership, and free trade, have explicitly and implicitly determined the social obligations of the governments. The resultant of these two facts indicate: for properly fulfilling the above mentioned obligations, the government's serious considerations for providing the needed financial sources are required. Also the facts make reference to the special consideration needed to design the type of tax structure that will best provide for extensive support to productive economic activities.

In other words, the Islamic countries should make their efforts to reduce the leakage of tax revenues due to tax evasion, tax avoidance, or inefficiency of the executive and enforcement systems, while they should attempt to design the type of tax structures that provide sufficient sources to support the increasing budgetary needs.

Comprehensive planning includes accurate identification of tax capacities, introduction of new taxes, implementation and operation of

information systems at the national level, and also bilateral cooperation between Islamic and non-Islamic countries, at the global level.

Since the government is not able to tax its sub organizations, hence, without participation of an efficient and capable private sector, the growth of tax revenues will not be possible.

So, the policies for increasing tax revenues, and the policies for empowering the private sector, are deemed as two different sides of one coin.

Countries with considerable non-tax revenues, such as oil revenues in their total budget, normally provide the grounds for government's greater involvement in the economy. These countries should try to use these types of revenues to increase investments, particularly investment by the private investors.

The Islamic Republic of Iran has prepared a comprehensive plan for empowering the private sector and consequently avoiding the enlargement of the government.

The predicted general solution is that, wherever the private sector is prepared to undertake the task, the government should stop interfering.

It is expected that by the end of the next development plan, all the government's current expenditures, be financed out of non oil revenues.

The initial requirements have been made for further involvement by the private sector in the activities previously under government monopoly.

There have been provided many programs to accelerate privatization of the government owned companies.

Under the title of the "justice shares", a considerable portion of the shares, belonging to the government owned companies, will be provided to the public, and repaid out of the annual dividends. In order to motivate regional development, another program provided by the government is to apply tax relief.

Redirecting the banking facilities to the less developed regions and subsidizing part of banking interests, is another government program for regional development.

Expansion of trade transactions among Islamic countries can also lead to implementation of development plans in a shorter time, along with implementation of the national programs for increasing of tax revenues. Preferred tariffs together with other incentives can help the Islamic countries to reach these goals.

It is hoped that common approaches to immediate access to these goals, be provided to the Islamic countries, through annual ATAIC Conferences.

As two specific cases, "poverty" and "discrimination" in distributing income, or income inequality, which in any form or at any level, are ugly features, should not exist in the Islamic societies. To redirect the budgetary systems of the governments, in general, and the taxation systems of the

countries, in particular, towards "economic justice" and "tax equity", concerning different income groups and different business groups should be taken into consideration as the significant priorities, and the essential elements for economic development and social welfare of the countries.

Certainly, I do believe that this Technical Conference can provide appropriate opportunities for national, intra-national, and international cooperation among the Islamic specialists and researchers towards conducting in-depth studies and researches in the field of Islamic issues, while it is helpful in designing new patterns for international and regional cooperation among different Islamic associations and groups, regarding tax issues.

Adoption of open strategies for interaction with the other international economic systems can be seriously taken into serious consideration, by the ATAIC member countries, in order to provide the required environment to achieve the above-mentioned goals.

As a whole, it seems that, the new era of intellectuals' exchange of views concerning the economic issues has been emerged in the world of Islam.

The considerable share of Islamic countries in the global economy and the increasing economic power of these countries who benefit from the same fundamentals and patterns of the Islamic economics is promising the rise of a clear horizon, which can be deemed as the perspective of the their future economies thank God.

We do believe that the scientific, technical, financial, and economic capacities of the world Muslim nations, alongside with fulfillment economic obligations, in compliance with the Islamic rules in different aspects, in particular, the principles of public finance in the Islamic economics, will result in the Islamic Ummah's prosperity as well as welfare for humanity.

At the end, while wishing a very pleasant stay for all dear guests of the ATAIC, and thanking your patience, I would like to call on all dear participants to rely on the blessings of God,

وَذَكِّرْ فَإِنَّ الذِّكْرَ تَنْفَعُ الْمُؤْمِنِينَ

Hopefully, reliance on God's blessings helps us to achieve higher levels of the scientific and technical goals pursued by the conference. The optimum use of economic and financial resources will be regarded as our gratitude to God for His blessings.

# **ADDRESS BY**

**Dr. Aliakbar Arabmazar**

**PRESIDENT OF THE  
STATE TAX ORGANIZATION**

**CHAIRMAN OF THE ATAIC  
2<sup>ND</sup> TECHNICAL CONFERENCE**

## **In the Name of Allah, the Compassionate, the Merciful**

Assalamualaikum warahmatullah

With best regards to the victorious souls of Imam Khomeini and martyrs of the Islamic revolution we begin. Expressing hope for the well being and longevity of the supreme Leader of the Islamic Republic of Iran, I hereby appreciate the presence of all the honorable participants. Respectful Islamic Republic of Iran cabinet members, the honorable MPs, respectable ambassadors to Tehran of member countries of the Organization of Islamic Countries and the Islamic Development Bank, as well as other dignified guests of the Second ATAIC Technical Conference, you are warmly welcomed.

First, I deem it necessary to express my gratitude to the founders of the ATAIC, the ATAIC official members and the tax authorities of the Islamic countries for their heartfelt presence which has paved the way for the promotion of the conference.

Furthermore, I would like to sincerely thank all the scholars, researchers and politico-economic authorities of the ATAIC member countries and the helpful hands that made this event possible. Your warm presence glorified our conference and I am thankful to you.

Dear Participants,

Distinguished Guests and all You Dignitaries,

As you are already aware,

Globalization and the extension of the economic, social, and cultural developments specifically in the developing countries have necessitated adoption of special steps by the governments of these countries. These steps they should take in the way of reforms, reconstruction, and development of their financial systems in order to provide feasibly for the increasing expenses of the management of the changes. In this way, the reform and development of the tax system in all the aspects is rightfully considered as an integral part of the development of the financial system of the governments.

The Islamic Republic of Iran began making changes in its tax system during the third and forth economic, social and cultural development plans aimed at reducing dependency of the public budget on oil revenues. Some of the main changes recently made in the Iranian tax system include the establishment of the State Tax Organization (STO) under a new structure,

conducting fundamental amendments in the direct taxes laws and regulations, and bringing modification to numerous duties in the indirect taxes. Preparation for the introduction of VAT and specially making basic reforms in the data system and tax execution affairs in the framework of the integrated tax system, form some of the other steps being taken which shall expose our tax system to a new stage of development and change.

The Islamic Republic of Iran government's approach towards these changes is to finance total current expenditures from the non-oil revenues. Modification, clarification, rationalization and promotion of the structure of the economy, creation of necessary links with the international economic system and provision of necessary backgrounds to further expand these links based on the twenty year outlook of the nation and the 4<sup>th</sup> development plan are some of the objectives concerning these changes.

By concluding agreements of avoidance of double taxation, the IRI aims at the promotion of its interaction and participation in the international tax system to a desirable level. Some factors have provided a desirable background for the further development of international cooperation in all aspects of tax related issues for the IRI. They include; foreign policy overall approach based on the expansion of the international politico-economic interactions, and the role of strategic economy in the region and the world, specially the potential as well as actual capabilities of the economy of the Islamic Republic of Iran.

The undeniable fact of increasing growth in the regional, interregional and global cross-border transactions and the variety of issues existing in this regard particularly in the tax related aspects, require new tax strategies to be taken by the countries as an integral principle of the international tax system.

Although the economic aspects of the cross-border transactions are apparently much wider than the tax related issues, the significance of the tax aspects of the above mentioned transactions transpires, taking into account the following important points:

First, the desirable planning of tax structures in regard with these cross-border transactions is potentially an encouraging factor in their expansion and in turn, leads to the expansion of economic relations and international trade. Conversely, ambiguity, deficiency and disorder in the said structure actually impede the expansion of these transactions.

Second a proper structure for tax on cross-border transactions results in an additional tax base and an increase in the revenues of governments. A less than desirable tax structure or a defection in the bilateral or multilateral regulation of these taxes not only brings about their loss in the public budgets, but also places the states' budget balances in a position less tolerable than the assumed situation of a world free of such transactions. The existing problems in regard with transfer pricing make one of the examples of such deviances.

Finally, a disharmony in the statement of the situation of taxes on the cross-border transactions is one of the basic factors of deviance in the competitive powers of the economic factors at the national and international levels.

Undoubtedly, compared with developed countries, the developing countries need to pay more attention to cross-border transactions due to three reasons: 1) A need for the potential taxes resulting from the international economic activities; 2) the necessity to absorb foreign investments; and 3) considerations regarding the increase of competitiveness of the factors of production.

With this approach, the State Tax Organization of the Islamic Republic of Iran is aimed at taking steps in this regard through to the technical and scientific cooperation with the countries of the world, specially the countries with which common principles are shared. In this arena, two main topics namely *Taxes on Cross Border Transaction* and *VAT* were determined for the Second ATAIC Technical Conference that in addition to national aspects, also contain international aspects.

Resolution of problems related to double taxation, speculative tax behaviors (cross-border tax arbitrage), transfer pricing, and exchange of information are some of the significant factors that despite the progress in the international tax system in these regards, require new provisions. In addition, the ever-increasing international transactions in different aspects, and the existing links between the international economic factors may lead

to a situation that the issues and questions related to taxes on cross-border transactions are not merely resolvable in the framework of bilateral relations, and new arrangements are required to be made in the area of international economy.

A structured study of VAT, which despite its relatively long history, is still regarded as a new tax model in the global economy, is required at the national level and also in regard with international trade.

I hope that enjoying the blessing of the Almighty Allah, the Second ATAIC Technical Conference, not only gains its main objectives, but also opens new horizons for the Islamic countries to play more effective roles in the development of national and international tax systems. All this may happen relying on the scientific and research potentials of the Moslem scholars and the interchange of ideas between tax authorities of the Islamic countries.

*Wassalamualaikum warahmatullahi wabarakatuh*

**THE TOPIC OF THE PAPERS  
PRESENTED TO THE ATAIC  
2<sup>ND</sup> TECHNICAL CONFERENCE**

**TEHRAN-IRAN**

**2005**

## **The Papers Presented to the Second Technical Conference**

The Papers Presented by the Islamic countries' delegations to the conference secretariat for the Second Technical Conference:

### ***Islamic Government of Afghanistan***

- ▶ Topic 1- The Taxation System of Afghanistan

### ***Republic of Azerbaijan***

- ▶ Topic 1- Tax Issues in Cross-Border Transactions
- ▶ Topic 2- Value Added Tax (VAT), Practice and Implementation

### ***State of Brunei Darussalam***

- ▶ Topic 1- Tax Issues in Cross Border Transactions

### ***Republic of Indonesia***

- ▶ Topic 1- Tax Issues in Cross-Border Transactions

- ▶ Topic 2-Value Added Tax (VAT), Practice and Implementation (VAT in Indonesia: Practice and Implementation)

### ***Islamic Republic of Iran***

- ▶ Topic 1-Tax Issues in Cross-Border Transactions
- ▶ Topic 2-Value Added Tax (VAT), Practice and Implementation

### ***State of Kuwait***

- ▶ Topic 1-Tax Issues in Cross Border Transactions
- ▶ Effect of the Tax Legislation Principle on the Cross Border Transactions

### ***Malaysia***

- ▶ Topic 1-Tax Issues in Cross Border Transactions

### ***Kingdom of Morocco***

- ▶ Topic 1-Tax Issues in Cross Border Transactions
- ▶ Topic 2-Value Added Tax (VAT), Practice and Implementation (Practice and implementation in Morocco)

### ***Government of Pakistan***

- ▶ Topic 1- Tax Issues in Cross Border Transactions

### ***Republic of Senegal***

- ▶ Topic 1- Tax Issues in Cross Border Transactions

- ▶ Topic 2- Value Added Tax (VAT), Practice and Implementation

***Republic of the Sudan***

- ▶ Topic 1- Tax Issues in Cross Border Transactions
- ▶ Topic 2- Value Added Tax (VAT), Practice and Implementation

***Republic of Yemen***

- ▶ Topic 1- Value Added Tax (VAT), Practice and Implementation in Yemen

**TOPIC (1)**

**TAX ISSUES IN CROSS-BORDER  
TRANSACTIONS**

**NOVEMBER 29 to DECEMBER 2  
2005**

**"Outline"**

## **Tax Issues in Cross-Border Transactions**

### ***TOPIC OUTLINE***

#### **A. Overview**

- The relevant provisions under your domestic tax legislation regarding cross-border transactions
- The role of Agreements (Tax Treaties) for the avoidance of double taxation and the prevention of fiscal evasion in cross-border transactions for your country (if any)

#### **B. Tax Issues**

##### ***- Determination of profits under your domestic tax legislation***

- Allocation of expenses
- Basis of allocation
- Issues of expenses disputed by taxpayers

##### ***- Withholding tax***

- Whether or not your country has withholding tax on certain types of income, e.g. dividend, interest and royalties
- Issues on interpretation and implementation of tax treaties in your country

**C. How does your country resolve tax issues/disputes in cross-border transactions?**

- Current procedures?
- Court decisions?

**D. Conclusion**

- Your country's approach in managing issues on cross-border transactions
- Future directions to overcome issues
- The level of assistance you need from member countries

***TOPIC SCOPE***

This topic is to gather information regarding your country's tax policies on cross-border-transactions. The topic should cover the scope and level of inbound and outbound investments taking place in your country and abroad.

At the operational level, it should also highlight tax issues pertaining to withholding taxes, business operations and other transactions that require administrative measures.

In short, the topic will indicate the problems/issues of capital importing countries especially involving foreign direct investments and your own residents investing abroad.

If you have a tax treaty, whether it plays any significant role in the above mentioned issues and problems.

**WORKING GROUP REPORT**

**ON**

**TOPIC (1)**

**TAX ISSUES IN CROSS BORDER  
TRANSACTIONS**

**"Aras Hall"**

## Participants

**Chairperson:** *Mr. Salman Nabi*

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**Rapporteur:** *MDM. Mardziah Musir*

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<i>32. Mdm. Monireh Kazemi</i>	<i>IRAN</i>

## **Working Group Report and Resolutions**

### **1. Introduction**

The purpose of this topic is to share experiences and various approaches by member countries in addressing tax issues and cross border transactions. The ultimate objective of these approaches is to resolve issues pertaining to cross border transactions faced by member countries.

### **2. Background**

Many member countries have their own anti-avoidance provisions regarding cross border transactions. Some countries have special tax treatment for certain categories of industries such as oil, gas, mining, sea and air transport, insurance and banking. Penalties are also imposed as a deterrent to discourage non-compliance.

Settlement of tax disputes is made through negotiations, concessions or legal means. Unfortunately, the problems in cross border transactions have become more complex and these can have serious consequences to the revenue of the affected countries. Thus, there is a need for member countries to have new approaches in auditing and investigating techniques, to amend the existing legislation or create new provision to address the problems and issues that might arise to curb tax evasion and tax avoidance.

### **3. Tax Issues**

Cross border price manipulation by companies can be profitable in countries where each country has a different tax system and varying tax rates. Issues not specifically tackled under the provisions of the tax law are addressed through circulars and instructions by the relevant tax authority.

#### ***3.1. Domestic law provisions relating to cross border transactions***

Most member countries have enacted laws and regulations pertaining to cross border transaction issues such as the determination of profit, allocation of expenses, imposition of withholding taxes and the resolution of tax dispute. Cases that cannot be resolved by the tax authority are resolved through legal means.

Domestic provisions are used to overcome issues of cross border transactions relating to the following:

- Arm's length principle

- Transfer pricing
- Thin capitalization
- Permanent establishment
- International treaties on avoidance of double taxation
- Advance ruling for non-residents

Anti-avoidance provisions in many member countries regulate transfer pricing practices. This provision will be invoked to disregard transaction if evasion of tax is discovered in order to protect the affected country's revenue. However, many of these provisions are not specifically catered for any specific circumstances.

### ***3.2. The role of double tax agreement in cross border transactions***

The main consideration of double tax agreement is to promote the elimination of double taxation and prevention of fiscal evasion. It is also used to encourage the inflow of capital and growth of trading activities.

Double tax agreement gives the contracting parties the right to tax and the granting of credit for the foreign tax paid. It also provides a more effective relief as compared to unilateral relief measures.

Double tax agreement acts as means to better information gathering on tax issues through the exchange of information. Where there is a conflict between the domestic law and the tax treaty, the former will prevail.

### ***3.3. Determination of profits under domestic tax legislation***

In most member countries the outgoing and expenses are deductible if incurred in the production of income. Transaction between interrelated

companies is expected to be conducted at arm's length. Some countries will accept any reasonable method of allocation of expenses computed by taxpayer as long as it is based on the arms-length principle.

#### ***3.4. Situations due to which tax disputes arise in cross border transactions***

Tax disputes in cross border transactions may arise due to the following factors:

- Deductions allowable do not depend on the actual reimbursements of such expenditure by their Permanent Establishment.
- Examination and verification of claims made locally and abroad.
- Interrelated company transactions may not be at market value or at arm's length.
- Amount of charged fees may not commensurate with the amount of services rendered.
- Expenses are not wholly and exclusively incurred in the production of income.

#### ***3.5. Dispute resolutions mechanisms***

Tax disputes are resolved through the following methods:

- Cases are settled arbitrarily based on estimates or mark-up, negotiated and compromised between taxpayer and tax officers.
- Settlement is made through the enforcement of tax treaties.
- Legal remedies-appeals to special Commissioners and High Court.

#### ***3.6. Other issues***

Data collection or information gathering is an important factor that should be considered due to the following:

- Poor data collection will not produce sufficient evidence to justify the action taken by the tax authorities in settlement of disputes in the court of law.
- No proper mechanism in data collection to develop sufficient database on taxpayers and business profile, profit margin, industrial cost ratios and averages, etc. which impede the process of enforcing anti-avoidance provisions.
- Effective data collection will enable tax authority to use them in analyzing the comparables to determine the profit more effectively.

#### **4. Future Direction / Recommendations**

Recommendations made by member countries are as follows:

- Greater cooperation and networking among member tax administrators through ATAIC, CATA, SGATAR, etc.
- Creation of data warehousing through gathering of information on tax matters and factors of production such as payers, market variables, cost, profit margin, etc.
- Training of human resources in latest techniques in auditing, investigation and in specialized fields such as forensic accounting, forensic computer and criminal investigation. This will enable tax authority to have an efficient and knowledgeable work force.

- Producing periodical magazines by the ATAIC secretariat to provide the latest news in taxation issues and activities to member countries.
- Member countries are encouraged to conclude Double Tax Agreements among themselves.
- Structure of the system for participating countries should be unified.
- Creating a conducive environment and transparent tax system to widen the tax base and to encourage tax compliance.
- International tax forum to oversee the tax issues.
- Tax harmonization. Harmonization will lead to a simpler and more efficient tax system for it will mean one administration, one tax and one rate.
- Developed countries should sacrifice a portion of their tax on behalf of the developing countries.

## **5. Conclusion**

The continued expansion of global markets, improvements in telecommunications and transportation, a worldwide focus on globalization and the internet has made doing business across international boundaries the rule rather than the exception. This results in domestic and international transactions becoming increasingly indistinguishable with respect to administrative burdens, transaction cost and procedures.

All member countries are in consensus with regard to cooperation to facilitate exchange of information and to work together towards better networking in resolving issues pertaining to cross border transactions.

Note:

The detail papers furnished by respective members are attached together with the final report.

**TOPIC (2)**

**VALUE ADDED TAX (VAT)**

**PRACTICE  
AND IMPLEMENTATION**

**NOVEMBER 29 TO DECEMBER 2**

**"Outline"**

# Value Added Tax (VAT) Practice and Implementation

## *TOPIC OUTLINE*

### **A. Overview**

- Background of the VAT Introduction in Your Country  
*As a tool of economic reforms, while adhering to the principles of efficiency, simplicity and equity, VAT should provide the impetus and the momentum of growth and increased revenues.*
- Legislative Framework and Administrative Procedures

### **B. Issues**

- *Taxation*

- Scope and definition
- The tax base, the tax rates, categories of taxpayers and coverage of product and services as well as exemptions

**- Administration**

- Taxing authorities (Tax & Customs Administration, other organizations powers and jurisdiction)
- Taxpayer identification and registration
- Audits and refunds
- Skills promotion; and
- Procedural guidelines for administration

**- Compliance**

- Public readiness for VAT implementation
- Educating people, publicity and media role
- Challenges of self-assessment and record-keeping
- Penalties for tax avoidance and evasion

**C. Conclusion**

- Future directions, guidelines for success in an ever changing political, economic and social environment

***TOPIC SCOPE***

The purpose of this topic is to invite discussions among member countries regarding the policies, practices and implementation of VAT in their respective countries. It shall naturally contain the conceptual as well as the legislative framework of VAT and the underlying principles. Issues of VAT compliance and administration, especially with regard to the sensitive issues of refunds, penalties, audits and record-keeping shall also be tackled. Effectiveness and the efficiency of this system in the context of the current economic, political and social challenges emerging at the national as well as the international level shall also be the main focus.

**WORKING GROUP REPORT**

**ON**

**TOPIC (2)**

**VALUE ADDED TAX (VAT)  
PRACTICE AND  
IMPLEMENTATION**

**"Damavand Hall"**

## Participants

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**Reporteur:** *Mr. Paddy bin Abd Halim* MALAYSIA

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## **Working Group Report and Resolutions**

### **1. Introduction**

The 2<sup>nd</sup> ATAIC Technical Conference Working Group for Topic 2 has been assigned to discuss the practice and implementation of Value Added Tax (VAT) by various participating member countries with the objective of enriching the tax administrations competency and knowledge on various issues.

### **2. Background**

2.1. Value Added Tax is designed to tax final consumption and is applied throughout the distribution chain of the supply of goods and services. In the Chairman's opening remarks, he emphasized that VAT is a complex tax where the economic, social and legal peculiarities will inevitably influence the structure and features of a country's VAT system resulting in diverse

practice and implementation throughout the world. The diversity is manifested in the form of different rates, threshold or thresholds and exemptions.

2.2. The question of whether multiple rates are necessary for the various reasons and are dictated by a country's economic circumstances is also a difficult one to answer. International practice deems a single standard rate to be ideal.

2.3. It is noted that members of this working group are at various stages of implementation of the VAT. There are countries that had already implemented the VAT for more than 20 years and on the other hand, there are a few who are in the formative stage. A few member countries were selected to present their experiences and the current practice of the implementation of VAT.

### **3. Issues**

#### ***3.1. Determination of tax rate and threshold***

3.1.1. Member countries discussed, at length, the methods or bases that were used to determine the tax rate and threshold, with regard to the various economic and social situations of each country. A member country suggested taking cognizance of international standards in order to reach the most suitable tax rate and threshold. Another member country remarked that the management and audit capacity is a very important factor to

determine the rate and threshold. The use of IT would greatly assist the implementation and control of VAT. The number of potential VAT taxpayers and the ability of the taxpayers that can reasonably comply with the tax requirements are additionally crucial elements in the determination of the rate and threshold.

3.1.2. A number of member countries are moving towards a reduction of multiple rates to a single standard rate or at most two rates. A single standard rate is much preferred by most tax authorities for the efficient administration of the tax. More importantly, and with no doubt, it is less problematic for the taxpayer.

3.1.3. It is also recommended that countries apply a low single standard tax rate at start-up for the obvious reasons and gradually increase the rate as time and situation warrants.

### ***3.2. Public awareness***

3.2.1. A member country had expressed concern over the need for adequate public awareness of its implementation of VAT because it has a low tax rate on income for companies, while its people are comfortable with their position in an oil producing country. The host country explained that it is of utmost importance to allow the people realize that existing system of revenue collection may not be reliable, particularly in oil producing countries. Oil revenues may not be stable enough for tax and budget planning.

3.2.2. Publicity programs using the electronic media (television, radio & internet) and print media, as well as public consultations and conferences should impress upon the people the need for a more efficient tax administration and the importance of the public to have a share of the national financial burden. There is also a need to show accountability of the money paid as tax.

3.2.3. In addition to adequate and effective publicity, a low tax rate will have a significant impact on public acceptance.

### ***3.3. Audits and control***

3.3.1. VAT is a tax implemented by way of self assessment. The need for strong and efficient audit program is paramount for combating fraud and minimizing revenue leakages. Risk analysis methods must be used to optimize manpower and to minimize taxpayer inconvenience. It is also to avoid requiring every return to be audited before refunds are made.

3.3.2. Double invoicing and fictitious invoices are also major concerns. It was suggested that tax administrators serially print and sell the tax invoices for monitoring and control purposes and to enforce tax compliance. However, there is a need to allow some element of trust between businesses and the tax administration since VAT is conceptually self assessing.

3.3.3. Legislation should provide for adequate and justifiable penalties in order to maintain compliance.

### ***3.4. Exemptions***

3.4.1. There are conceptual differences in applying the exemptions of the tax. In some countries, the exemptions are applied to goods or services whereas others may exempt based on turnover or on the ability of the taxpayer.

3.4.2. Member countries accept that VAT should have as minimum exemptions as possible so as not to disrupt the tax incidence in the distribution chain. This is especially important where there is a common market shared by bordering countries. Steps are being taken by members to harmonize and reduce the exemptions.

### ***3.5. Taxpayer identification and registration***

Members consulted with each other on the methods and bases to determine the taxpayer registration number for control and payment purposes. A member country practiced even and odd taxpayer numbers for the duration of time to submit returns. A few members practice the single tax identification number for various tax paying purposes. It has been shown that it leads to higher compliance.

### ***3.6. Taxing Islamic banking***

Much time was allowed for discussing this topic. There were different opinions for taxing Islamic banking. It is widely accepted that financial services are exempted and that equal tax treatment should be applied to both conventional and Islamic banking. Further discussions would be necessary to address this subject.

### ***3.7. Internet sales and E-commerce***

There were questions on how to tax internet sales and trading via E-commerce. Member countries have not yet been faced with any major problems in this area. As such, there is not much focus on this matter. However, members acknowledged that this is the future problem in trading and the tax systems must have provisions to address this issue.

## **4. Challenges**

4.1. Member countries that are going to implement the VAT are faced with the challenge to provide for a simple, efficient and acceptable tax. Tax rules and regulations should be as simple as possible. Member countries planning to introduce the VAT should undertake anti-inflationary measures.

4.2. Member countries that have already implemented the tax are striving to reduce the exemptions, harmonize or reduce altogether multiple rates into a single tax rate and to improve compliance.

4.3. In both situations there is a fine balance in establishing tax policy so that revenue for the country is not compromised. The taxpayers require transparency in their business interactions with the tax authorities, and require appeals to be promptly and judiciously heard.

## **5. Conclusion**

Members of this meeting benefited from the vast experiences of the member countries who had already implemented the VAT. In the closing session, the Chairperson thanked the members for their active participation and praised the host country, in particular, members of the ATAIC Secretariat.

**THE ABSTRACTS OF THE  
PAPERS**

**ON**

**TOPIC (1)**

**SECOND TECHNICAL CONFERENCE  
TEHRAN-IRAN**

**2005**

## **Introduction**

The first meeting of the working group started on 29 November 2005. In that session respectful delegations from Azerbaijan, Brunei Darussalam, Indonesia, Iran, Iraq, Kuwait, Malaysia, Morocco, Pakistan, Qatar, Saudi Arabia, Senegal, Sierra Leone, Sudan, Tunisia, Turkey and Yemen had participated. The chairperson of the session was Mr. Salman Nabi from Pakistan.

At first, he gave a brief explanation about Pakistan's tax system. Then he requested the participants to express their views about the cross-border transactions based on the tax laws of their respective countries.

During 3 days from November 29 to December 1, the participants from Azerbaijan, Indonesia, Iran, Kuwait, Morocco, Sudan, Pakistan and Yemen provided papers on topic one.

The most important points introduced by each participant were as follows:

- Taxable resident and non-resident persons
- Different tax bases in different tax systems
- The efforts made by each country to attract Foreign Direct Investment
- The latest reforms which have been practiced
- Different tax exemptions regarding foreign companies
- The number of tax treaties ratified or under ratification
- The ratio of tax revenues to GDP
- Difficulties regarding transfer pricing
- Consideration of problems regarding tax treaties for both sides, taxpayers and tax authorities
- The importance of Zakat and the measures drawn up (regulated) to collect it

At the end, the members reached consensus on the following points:

- Due to the importance of Zakat, relevant courses should be taught at elementary schools. In this way the importance of Zakat will be kept in their minds for ever.
- In order to have efficient and knowledgeable staff, training should be expanded.

- A periodical magazine to be published by the ATAIC secretariat, to provide the latest tax information, and ATAIC activities to the members.
- Exchange of information regarding tax issues.
- To encourage the members to conclude agreements on the avoidance of double taxation among themselves as soon as possible.
- To introduce mutual agreements regarding cross-border transactions to be implemented by the members.

The following notes selected from the papers presented and discussed during the conference, may be regarded as the main points.

## **AFGHANISTAN**

In 1919, the Ministry of Finance was established in Afghanistan. In the years 1944, 1956, 1973 and 1988, different reforms were provided. However, in 2004, the income tax law was adjusted, consisting of 35 Articles. According to these adjustments, the individual income up to 150000 Afghani is subject to tax at the rate of 10% and the amount excess of that is subject to tax at the rate of 20%.

All companies (domestic and non-domestic) are liable to tax on their net income at the rate of 20%. They are also liable to tax for their profitable transaction at the rate of 2%. The strategy of collecting tax is based on the self-assessment system. For this purpose the following steps have been taken by the Ministry of Finance:

Increasing tax compliance of taxpayers through continuous training and providing information, establishment of an effective information system to control activities of different sectors, identifying the cases on tax evasion as well as identifying the cases where tax is to be refunded, applying the identification number for transactions according to the income tax law, establishment of Large Tax Unit, amendment to the tariffs and customs administration regulations, creating an effective system to control earnings and expenses of the companies, using new

technology in almost 50% of the offices, adopting new reforms in the administrative structures.

The new reforms have provided new facilities for the taxpayers.

The process of reform implementation is very fast.

Another concern is the Avoidance of Double Taxation. The Ministry of Finance has provided certain rules regarding this issue. But problems can be solved better through concluding new tax treaties.

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## **AZERBAIJAN**

A non-resident enterprise operating in the Republic of Azerbaijan through its permanent establishment shall pay tax on its profit, i.e. on gross income generated from Azeri sources in relation with the permanent establishment, less the amount of expenses incurred.

The gross income of a non-resident enterprise not connected with the permanent establishment, shall be taxed at the source of payment without expenses being deducted.

A non-resident enterprise generating income through the transfer of property not connected with the permanent establishment shall pay tax on the gross income received from an Azerbaijani source during the calendar year. This tax shall be paid after deducting the expenses.

An enterprise's profit shall be taxed at the rate of 24% in Azerbaijan Republic. Interests paid by resident or non-resident's permanent establishment or on behalf of such establishment with the exception of

interests paid on credits (loans), *deposits (accounts)* of resident-banks or permanent establishment of non-resident banks shall be taxed at the source of payment at a rate of 10%.

The rent and royalty paid by the resident or permanent establishment of non-resident in the Azerbaijan Republic shall be taxed at the source of payment at the rate of 14%.

Gross income of a non-resident derived from an Azerbaijani source which is not attributable to the permanent establishment of the non-resident located in the territory of the Republic of Azerbaijan shall be subject to taxation at the source of payment without deduction of costs at the source of payment at the following rates:

- Dividends - 10%
- Interests - 10%
- Leasing payments, including payments on financial leasing operations of resident-enterprise or entrepreneur, as well as insurance payments under risk insurance or reinsurance agreements - 4 %
- Payments by a resident enterprise for telecommunication or transport services, for international communications or shipments between the Republic of Azerbaijan and other states - 6%
- Rent payment and royalty- 14%
- The income from services as well as income received from the Azeri source, except for the employment income - 10 %;

### ***Production Sharing Agreements***

There are special tax regimes for institutions and companies working on the basis of joint venture, such as pipeline agreements or foreign

subcontractors in Azerbaijan Republic operating in the field of hydrocarbon production, pay tax according to the agreements ranging (from 5% to 8%).

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## **BRUNEI DARUSSALAM**

### **Current Provisions**

The Brunei Darussalam Income Tax Act was introduced in 1949 according to which a territorial scope is the basis of income taxation in Brunei Darussalam where the income of any person accruing in, derived from, or received in Brunei Darussalam is taxed in Brunei Darussalam. This is stated by section 8 of the Income Tax Act which reads as follows:

"Subject to the provisions of this Act, income tax shall be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person accruing in, derived from, or received in Brunei Darussalam."

In the scheme of taxation where it involves cross-border transactions, it is vital to determine the taxing procedures within the country and this depends on the source of income.

### **Tax Treaties**

The problem of double taxation will arise, if tax is levied on the same item of income or capital under the laws of the governments of the respective countries. Hence, DTA provides certainty on the taxing rights of the contractual practices, and helps the investors to better assess their potential tax liabilities on economic activities, and provides an extra incentive for

cross-border business. The rate of tax on dividends, interest and royalties depends on the agreement with the respective contracting states. However, currently, Brunei Darussalam does not tax dividends, interest and royalties. Up to now, Brunei Darussalam has signed four DTAs, concluded five negotiations and negotiates with few other countries. The Government of Brunei Darussalam is making new arrangements through signing tax treaties with other countries in order to reduce or completely avoid double taxation and prevent fiscal evasion.

### **Tax Issues**

Cross-border transactions include the purchase and sale of tangible as well as intangibles. Interrelated sales and purchases may occur between the related companies whether through a permanent establishment or branch or associate company located within Brunei or other parts of the world where prices may vary.

### **Determination of profits under Domestic Tax Legislation**

Profits are determined after all expenses, Zakat and taxes are accounted for. Income tax shall be payable at the specified rates provided the income is derived from, or accrued in Brunei Darussalam in accordance with the provisions specified in section 8 of the Income Tax Act.

Only income that is derived from or accrued in Brunei Darussalam shall be taxable at the specified rate i.e. 30%.

### **Allocation of Expenses**

Audited financial statements of an enterprise will be used to determine the profit attributable to its branch for a particular year of assessment. As agreements are made between the Head Office and its branch, this raises the issue concerning the reliability of its accounts.

#### **Basis of Allocation**

The adjusted income shall be determined after allocation of any outgoing and expenses of a business that is wholly and exclusively incurred for the income gained, and these expenses are not prohibited under section 12 of the Income Tax Act.

#### **Transfer pricing**

Interrelated companies' transactions are analyzed especially in the transfer pricing area. The price change between the companies must correspond with the market value or arm's length. The arm's length price will have to be determined, if doubt arises. However, in practice, it is often difficult to decide what the arm's length price is. At the moment, transfer pricing issue is not widely practiced in Brunei Darussalam.

#### **Withholding Tax**

Brunei Darussalam has only stipulated provisions for withholding tax on interest income. Under section 37 of the Income Tax Act, whereby if any person pays interest due to a non-resident, he shall be liable to pay a withholding tax of 20%.

#### ***Exchange of Information***

Brunei Darussalam can exchange information with other countries if there is a binding agreement with those countries i.e. DTA. However, the information to be exchanged is limited only to the tax related issues covered by the Agreement.

In conclusion, issues regarding allocation of expenses, withholding tax, interpretation and implementation of tax treaties need to be identified and resolved in order to achieve smooth borderless transactions. We hope that through this conference, we will be able to learn more about cross-border transactions so that we can apply our knowledge to set up our own procedures and guidelines.

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## **INDONESIA**

The process of globalization, along with the government's foreign investment policy has motivated foreign enterprises to do business in Indonesia.

Foreign investors may set up their business by forming subsidiaries or branches / permanent establishments in Indonesia. The increased global cross-border transactions, give rise to a number of tax issues, one among others is how to determine profits in cross-border transactions. Such issue has also been faced by the Indonesian tax administration. When the foreign enterprise establishes a subsidiary in Indonesia, the subsidiary will be treated as a resident taxpayer. Accordingly, it will be fully subject to the Indonesian tax laws. Whilst the foreign enterprise carries on business in

Indonesia through a permanent establishment, the permanent establishment will be treated as a nonresident taxpayer and is therefore taxed only on Indonesian source income, however, in fulfilling its tax obligation, it is treated as a resident taxpayer; thus, the permanent establishment is obliged to fulfill all its tax obligations under Indonesian tax laws. Consequently, the applicable tax rates, deductions, and withholding tax are the same as apply to resident taxpayers. The issue may arise as how to determine the profits attributable to the permanent establishment.

Profits attributable to the permanent establishment resulting from its businesses or activities and from its owned or controlled properties shall be subject to income tax in Indonesia. The taxable income of permanent establishment shall also include income of its head office from businesses or activities, sales of goods, or furnishing services in Indonesia which are similar to those undertaken by the permanent establishment in Indonesia, and income from dividend, interest, royalty, lease of property received or accrued by its head office provided that the properties or activities giving rise to the aforesaid income are effectively connected with the permanent establishment.

In determining profits of a permanent establishment, there shall be allowed as deductions, the expenses related to income derived by the permanent establishment, expenses related to income of its head office from the same businesses or activities in Indonesia, and expenses related to income of its head office which are effectively connected with the permanent establishment may be deducted in the hands of the permanent establishment. The permanent establishment can also claim the administrative expenses incurred by its head office, however, the allowable

amount shall not exceed a proportionate part based on the ratio of the permanent establishment's turnover, to that of the head office as a whole. In calculating profits of the permanent establishment there shall not be allowed as deductions, payments to its head office of royalties or other payments paid in respect of the use of properties, patents, or other rights; payments in respect of management services or other services; and interests in return for money lent, except in banking business. Conversely, those payments received by the permanent establishment from its head office will not be included in taxable object of the permanent establishment, except interest in banking business. The reason behind this provision is that basically a permanent establishment and its head office are considered as a single entity, therefore, payments made by the permanent establishment to its head office, such as royalties on the use of head office's property, compensation for services and interest in return for money lent, are considered as a flow of funds within one company. Therefore, under this provision, those payments made by a permanent establishment to its head office are not deductible from the income of the permanent establishment.

After deducting the allowable expenses, the income of the permanent establishment will be taxed at the general tax rates up to 30%. In addition to the above, the permanent establishment will be subject to additional tax, often referred to as branch profits tax of 20% or a rate of relevant tax treaties, except where the profit is re-invested in Indonesia. The branch profits tax is imposed on net profits after tax.

Basically the concept of a permanent establishment under the Indonesian Tax Act is almost similar to the concept of that under the model tax treaty whereby basically the term permanent establishment means a

fixed place of business through which the business of an enterprise is wholly or partly carried on. The significant difference is that under the ITA to constitute a permanent establishment from a building site or construction, assembly, or installation is not required to meet a time threshold whilst under model tax treaty those activities will constitute the permanent establishment only if it sufficiently meets certain duration. Accordingly, under Indonesian tax law the permanent establishment will start to exist from the date when a foreign contractor begins his works in Indonesia.

The other difference is that under the ITA a representative office of a foreign company is deemed to be the permanent establishment in Indonesia, and its profit will be subject to tax in Indonesia. Even though the trade representative may not be directly involved in selling goods from his home country, his presence in Indonesia is deemed to contribute to the sale. Therefore, sales from its head office are attributable to the permanent establishment. While under the tax treaty, a representative office will not be deemed to be a permanent establishment insofar as it solely engages in activities governed by paragraph 4 of Article 5 of the model tax treaty.

To this date Indonesia has signed 55 tax treaties, 49 of which have been taken into effect. The Indonesian position with regard to the provisions of permanent establishment in treaty negotiation is that Indonesia adopts United Nations Model Double Taxation Convention, but modified in accordance with Indonesian tax laws. Indonesia maintains that the term permanent establishment shall also include a warehouse or premises used as sales outlet. In addition, Indonesia wishes to preserve that the persons who manufacture or process goods or merchandise for the

foreign enterprise, (which does belong to the foreign enterprise) will be treated as a dependent agent; thus the foreign enterprise is deemed to have a permanent establishment in Indonesia.

With regard to furnishing services, most treaties that Indonesia has concluded, provide that furnishing services will constitute the permanent establishment, if it is conducted for more than a specific period of time. The time threshold for determination of the permanent establishment from this activity varies from one treaty to another. Some treaties provide that income in respect of services may be taxed in source country at a certain rate, usually referred to as gross method. There is only one treaty, which waives the right of source country to tax income from furnishing services, namely tax treaty between Indonesia and Japan.

All Indonesia's tax treaties contain a Business Profits Article, which generally provide that the profits of an enterprise resident in one country shall be taxable only in that country, unless the enterprise carries on business through a permanent establishment in the other country. In most treaties that Indonesia has concluded, not only income attributable to the permanent establishment is subject to tax, but also income derived by its head office from sale of goods and business activities, which are similar to those undertaken by the permanent establishment is subject to tax.

As mentioned above, profits of permanent establishment will be subject to general tax rates up to 30% and a branch profit tax at a rate provided in tax treaty, except for companies operating oil, gas, and other mining industries under production sharing contract and contract of work, the rate of which shall be in accordance with Indonesian income tax law.

Under Indonesian income tax law, basically the items of allowable

expenses of a permanent establishment shall be all expenses related to the business activity which taking into consideration that such expenses are necessary to earn, collect, and preserve income of the permanent establishment. This criterion is intended to assure that the expenses claimed as deductions in determining taxable income are those expenses, which are relevant, referable and necessary for carrying out the business. In other words, the allowable expenses are all necessary and ordinary expenses.

The issue may arise as to the allocation of the expenses incurred by the head office for the purpose of the permanent establishment. Since income attributable to the permanent establishment shall include income of its head office from sales of goods or business activities in Indonesia which are similar to those undertaken by the permanent establishment in Indonesia, and income from dividend, interest and royalty received or accrued by its head office provided that the properties or activities giving rise to the aforesaid income are effectively connected with a permanent establishment; thus, all expenses related to those incomes are allowed as deductions. The question may arise whether the particular expense incurred at a head office can truly be considered as an expense incurred for the purpose of the permanent establishment, and what amount is allowed; Indonesia does not have a special regulation to address this issue. The allocation of those expenses shall be on the basis of the fact and circumstances that the expense is necessarily incurred in earning, collecting, and preserving income of the permanent establishment. In case of administrative expenses incurred at the head office, the allocation of such expenses will be based on the actual amount so incurred but shall not exceed a proportionate part based on the ratio of the permanent

establishment turnover to that of the head office as a whole.

The permanent establishment is required to submit the consolidated financial statement from its head office, which consists of the whole business activities around the world for the year concerned as an attachment of its income tax return. The consolidated financial statement must be audited by public accountant and disclose the details of turn over or business activities of enterprise and the amount of administrative expenses.

The potential issue that may also arise pertains to certain expenses, such as interest, or royalty, or commission paid by the permanent establishment to its head office in return for money lent or patent rights licenses or exercise of services by its head office to the permanent establishment. In this case, under the Indonesian income tax law those payments shall not be allowed as deductions in computing the profits of the permanent establishment.

In general, withholding taxes are imposed on certain payments made to resident taxpayers, including the permanent establishment in Indonesia and non-resident taxpayers.

Certain income paid or payable by resident corporate taxpayers, including the permanent establishment to other resident taxpayers or the permanent establishment is subject to withholding tax at the rate of 15% if the income is in the form of dividends, interest, royalties, gifts and rewards, rentals, and fees for technical management, and certain other services.

Interest paid or payable to a bank is exempted from withholding tax. The term bank includes a bank incorporated as an Indonesian legal entity as well as branch of a foreign bank in Indonesia.

Certain income paid or payable by resident taxpayers, including the permanent establishment to non-resident taxpayers is subject to withholding tax at the rate of 20% if the income is in the form of dividends, interest, premiums, discounts, swap premiums and compensation in accordance with a loan guarantee, royalties, rentals and other income connected with the use of property, compensation for services, employment activities, gifts and rewards, pensions and other periodic payments. The tax treaties concluded by Indonesia provide under certain conditions, for exemption of withholding tax and reductions in the withholding tax rate.

Under a turnkey project, a contractor is required to build the construction of buildings, such as factory or similar facility, to be ready to be used or ready for operation. When the facility is ready to be used or ready for operation, it is handed over to the purchaser. The international tax problems occur when a facility is to be constructed in one country by a contractor resident of another country. The turnkey project usually consists of construction work activities, including architectural and engineering services, procurement (purchase of capital goods), technical assistance, and commissioning. The construction will constitute the permanent establishment if it meets certain duration of time. The latter activities, however, sometimes are done before the actual construction work starts and often outside the country in which the construction site is situated.

The question may arise as to what portion of profits of the turnkey project is properly attributable to the permanent establishment and thus taxable in the country in which it is situated. Some countries tend to tax the whole price of contract as a taxable income, however, other countries tax only the income in consideration of the construction work which is actually

attributable to a permanent establishment since some works have been completed before a permanent establishment starts to exist in the residence country or outside the country of which the permanent establishment is situated.

The increased global cross-border transactions in Indonesia have created a number of tax issues, which must be tackled by Indonesian tax administration, particularly tax issues in determination of profits in cross-border transactions. This issue has been a challenge to Indonesian tax administration for years since the domestic laws and the administrative practices sometimes are not well equipped to address such issues.

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## **IRAN**

### ***Direct Taxes Act, Foreign Persons, "An Overview"***

#### **Introduction**

The first comprehensive Direct Taxes Act (DTA) was ratified in 1966. Following emergence different technical impediments in the enactment of the law, several amendments were made to the Act.

However, in 1987, the revised DTA was passed by the parliament, taking into account the fundamental socio-economic changes during the first decade of the Islamic revolution, in order to make required adjustment to meet taxpayers' expectations.

The main objective of the essential changes made to the Direct Taxes Act was to direct investments to the deprived areas, and provide investment incentives for the production sectors. Consequently, this tax policy served to boost economic efficiency in certain sectors of the economy, and higher level of tax revenues.

The second post-Revolution decade actually proved to be the era of economic reconstruction. During this period, public and private sectors both were involved in the reconstruction of the economy.

With the aim of removing the bottlenecks and meeting the society's expectations, in particular the owners of the economic firms (active in different sectors of the economy), new changes in the tax regulations were required. So, the tax policy makers attempted to reorganize the administrative structure of the tax collection system and designed new rules and regulations to revise the taxation structure of the system. The following are the main objectives of the new amendments made to the Direct Taxes Act, ratified in 2002 by the parliament.

- Encouraging entrepreneurs, investors and businessmen to broaden the scope of private economic activities
- Encouraging investment in the productive sectors (including industrial and mining sectors and export of manufactured goods)
- Reforming the administrative structure of the taxation system
- Reviewing tax regulations, creating higher levels of tax equity among different income groups and among different business groups with the same level of income.
- Introducing new technological changes to promote the self-assessment system with regard to different categories of taxpayers.

- Introducing modern approaches in imposing tax and levies
- Applying new techniques and procedures in collecting tax and levies, in order to increase Taxpayers satisfactions.

#### **Direct Taxes Act, New Strategies:**

- Tax base expansion through elimination and adjustment of tax exemptions
- Tax base expansion by imposing new consumption-based tax i.e. value added tax
- Attempts towards identifying tax resources, and prevention of tax evasion by developing the tax information system and concluding treaties for the avoidance of double taxation
- To promote self-assessment system
- To enforce effective legal executive penalties in order to confront the official offences and tax evasions.

#### **Direct Taxes Act, the reform milestones**

The following can be regarded as the reform milestones, taken into consideration when regulating the new amendments to the Direct Taxes Act:

- Adjustment of tax exemptions' structure
- Providing tax exemptions for the economic firms active in the productive sectors (including industrial and mining sectors)
- Providing tax exemptions for the expansion and completion of the enterprises active in mining and industrial sectors
- Elimination of inefficient tax resources
- Adjustment of the tax rate structure

- Harmonizing and increasing the threshold level regarding different categories of taxpayers (salary earners, self employed business people, etc)
- Modifying the salary tax structure to meet the changes of the Consumer Price Index and the essential needs of the economy
- Introducing different structures of tax rates for real persons, and legal persons.
- Assessment of taxable income of foreign legal persons according to their legal books
- Adjustment of acceptable expenditures, i.e. research and development expenditures.
- Reforming the administrative structure of the taxation system.
- Introducing new approach in examining financial statements and taking into consideration the technical views of certified accountants.

### **Direct Taxes Act, Foreign Persons**

The foreign persons who would like to invest in the territory of the Islamic Republic of Iran, or establish a company or a branch or representative office,

or, the foreign real persons who would like to run business in the economic activities and earn income by providing services, ***both will be treated similar to the Iranian citizens as stipulated in the Direct Taxes Act.***

### **Paragraph 5 to Article 1:**

*Every non-Iranian person (whether real or legal) with regard to his/its incomes earned in Iran, as well as in respect of the incomes derived by*

*such person from Iranian sources for grant of licenses and other rights, or for the provision of training and technical assistance and also for the transfer of cinematographic films (whether the latter income is received as the price or the fee for the screening of the films or under any other titles).*

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According to the Direct Taxes Act, the total income derived from agricultural sector is exempted from tax, whether the owner of the income is Iranian or foreigner.

### **Article 81**

*"The income derived from all activities in the field of agriculture; animal rearing; stockbreeding; fish farming; bee-keeping; poultry husbandry; hunting and fishing; sericulture; revival of pastures and forests, horticulture of any type and palm trees, is exempt from payment of taxes. The government is obligated to undertake appropriate studies and investigations in the field of all agricultural operations and on those branches of such activities in respect of which the tax exemption status is to be continued, and to prepare the relevant bill of law not later than the end of the term of the third economic, social and cultural development plan of the Islamic Republic of Iran and submit the same to the Islamic Consultative Assembly\*."*

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### **Foreign Real Persons**

A foreign person, who provides business as a real person or establishes a productive unit in the different sectors of industry, mining,

distribution and services will be subject to tax at the same rate as the Iranian real person, and will benefit the same exemptions and allowances.

A foreign real person who provides his workforce as the employee of an Iranian enterprise is subject to salary tax after deduction of the basic exemption (the threshold)

This threshold is subject to annual changes according to the economic changes, occurred during the development process.

For the fiscal year 2005-2006, the basic exemption is roughly US\$ 2500.

A foreign person's annual salary of up to Rials 42,000,000 will be taxed at the rate of 10% and the amount in excess of Rials 42,000,000 will be taxed at the rates stipulated in Article 131 (the same as the Iranian salary earner).

The following persons are exempted from the salary tax in the Islamic Republic of Iran.

#### **Article 91**

*The salary income shall be exempt from taxation in the following cases:*

*(1) Heads and members of foreign diplomatic missions in Iran and heads and members of the extraordinary delegations of foreign states with regard to the salary income received by them from their respective governments subject to reciprocal treatment, and also the heads and members of delegations of the United Nations Organization and its specialized agencies in Iran in respect of the salary income received by them from the said organization and agencies, provided that they are not nationals of the Islamic Republic of Iran;*

*(2) Heads and members of foreign consular missions in Iran and also the staff of the cultural institutions of foreign states with regard to the salary income received by them from their respective governments, subject to reciprocal treatment;*

*(3) Foreign experts sent to Iran with the consent of the government of the Islamic Republic of Iran under technical, economic, scientific and cultural gratuitous assistance programs of foreign states or international institutions, with regard to the salaries received by such experts from their respective governments or the said international institutions;*

*(4) Local employees of the Islamic Republic of Iran's embassies, consulates and missions abroad in connection with the salary income received by them from the government of the Islamic Republic of Iran, provided that they are not citizens of the Islamic Republic of Iran and subject to reciprocal treatment;*

*(5) Retirement pension, survivors pension, regular annuities, termination of employment payments, dismissal compensation, payments for buying-out of services, pensions and annuities paid to the heirs, service them allowance and the salary of the period of unused leave payable to salary receivers at the time of becoming retired or disabled.*

*(6) Service-related travel expenditure and allowance.*

*(7) Deleted.*

*(8) Accommodation provided on site of the factory or workshop for the benefit of workers and low price employer-provided houses outside the factory or workshop that are used by workers.*

*(9) Compensation received from insurers with regard to physical injury, medical treatment, and the like;*

*(10) New year bonus\* or year-end bonus\* up to one twelfth of the tax exemption envisaged under Article 84 of this Act.*

*(11) Employer-provided houses put at the disposal of civil servants by virtue of a legal permission or according to special regulations.*

*(12) Payments made by the employer, directly or through the relevant employer, to a physician or hospital for the treatment of his employees and persons who are dependent on them, where such payments are substantiated by demonstrative evidence and documents;*

*(13) Non-cash benefits paid to members of the armed forces of the Islamic Republic of Iran, whether belonging to the military or disciplinary branches, and the salary of employees subject to employment law of the Intelligence Ministry, and also the salary income of the disabled of Islamic Revolution and imposed war and freed prisoners of war.*

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Besides, the foreign persons who are employed in the less developed regions will enjoy the allowances stipulated in Article 92.

### **Article 92**

*50% of the salary tax of the employees working in less developed regions, as per the list prepared by the State Organization of Management and Planning, shall be spared.*

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## **Foreign Legal Persons**

### **Article 107**

*The taxable income of foreign legal persons and enterprises residing abroad shall be assessed as follows:*

*(a) In case of contracting business in Iran with regard to all types of work in the fields of construction, installations and technical installations, including procurement and setting up of the same, and also in the fields of transportation, preparation of design for buildings and installations, topography, drawing, supervision and technical calculations, provision of training and technical assistance, transfer of technology and other services, the taxable income in all cases will be 12% of total annual receipts.*

*(b) In case of income derived from Iran for granting of licenses and other rights or transfer of cinematographic films, whether the latter income is received as the price or the fee for the screening of the films, or under any other titles, the taxable income shall consist of 20% to 40% of all payments received by them during a tax year. The applicable coefficients for determination of taxable income in each of the cases mentioned in this paragraph shall be determined on the basis of the proposal of the Ministry of Economic Affairs and Finance and approval of the Council of Ministers. Those making the said payments or the payments mentioned in paragraph "a" of this article, shall be required to withhold, from each payment, the applicable tax by taking into account the total payments made from the beginning of the year up to the date of each relevant payment. They should remit the withheld amounts, within ten days, to the tax affairs office local to their residence. Otherwise, the receivers shall be jointly and severally liable for payment of the basic tax and other payments related thereto.*

*(c) As for the operation of capital and other activities performed by the aforesaid legal persons and enterprises in Iran through the agencies such as branches, representatives, agents and the like, the regulations of Article 106 of this Act shall apply.*

**Note (1)** *In cases where the contract operations subject to paragraphs (a) and (b) of this article are wholly or partly assigned to Iranian legal entities as contractors, those making payments to such Iranian contractors should withhold 2.5% of each payment as their on account tax and remit it, within thirty days from the date of payment, to the account to be determined by the State Organization of Tax Affairs.*

**Note (2)** *If the relevant employer of the contract subject to paragraph (a) of this article is a ministry, a government institution, a state company or a municipality, then that part of the contract price which is used for purchase of supplies and equipment from domestic or foreign sources shall be exempt from taxation, provided the amounts relevant to those supplies and equipment are included, apart from other items, in the contract or in its further amendments or supplements.*

**Note (3)** *Branches and agents of foreign companies and banks in Iran that are engaged in gathering information or finding markets in Iran for their parent entities, without having the right to make transactions, and receive remuneration from them against their expenditures, shall not be subject to taxation in respect of such remuneration.*

*Note (4) In cases where foreign contractors assign, wholly or partly, the contract subject to paragraph (a) of this article to Iranian legal entities as subcontractors, any part of the receipts of the main contractor in respect of the supplies and equipment that are mentioned in the first hand contract but purchased by the subcontractor, will be exempt from taxation.*

*Note (5) The taxable income of the activities subject to paragraph (a) of Article 107 hereof, the contracts of which will be concluded from the beginning of the year 1382 (March 20, 2003) onwards, shall be assessed according to the provisions of Article 106 of this Act. The rule of this Note shall not apply to the remaining part of the activities of the contracts concluded before the year 1382 (March 20, 2003).*

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With regard to Foreign Juridical Persons, the determination of taxable income is usually based on the specific source of earned income.

Tax examination procedure and taxable income determination are usually the same for the Iranian and foreign persons.

According to Article 106 the legal person's taxable income is determined and examined based on the information of the legal books.

Other incomes earned by the person will be added to the base, and the expenses and depreciation costs will be deducted to reach the taxable income.

The earned income, previously taxed at a flat rate, will be deducted from the taxable income.

In general, the foreign legal persons who are taxable persons will be classified into the following categories:

***1. The legal persons, who run activities directly, or via their representative offices such as branch offices or representative offices or agent offices.***

Normally, the tax examination procedure for this group is the same as the Iranian legal persons. In fact the foreign legal persons are obliged to submit their tax returns in due times providing legal books (including the journals and ledger books), documents and evidences for their income and expenses occurred during the year.

The district tax unit determines the taxable income by examining the books and taking into consideration the stated income and expenses and applying the rate of 25% to the taxable income.

***2. The legal persons, who earn income from Iran through contract agreements in Iran, or from granting licenses and other rights, or transferring know-how and providing technical assistance or providing cinematographic films.***

In this case the taxable income of the foreign persons will be examined in two ways, according to the rules stipulated in Article 107,

*(a) In case of contracting business in Iran with regard to all types of work in the fields of construction, installations and technical installations, including procurement and setting up of the same, and also in the fields of transportation, preparation of design for buildings and installations, topography, drawing, supervision and technical calculations, provision of training and technical assistance, transfer of technology and other services, the taxable income in all cases will be 12% of total annual receipts.*

*(b) In case of income derived from Iran for grant of licenses and other rights or transfer of cinematographic films, whether the latter income is received as the price or the fee for the screening of the films, or under any other titles, the taxable income shall consist of 20% to 40% of all payments received by them during a tax year. The applicable coefficients for determination of taxable income in each of the cases mentioned in this paragraph shall be determined on the basis of the proposal of the Ministry of Economic Affairs and Finance and approval of the Council of Ministers. Those making the said payment or the payments mentioned in paragraph "a" of this Article, shall be required to withhold, from each payment, the applicable tax by taking into account the total payments made from the beginning of the year up to the date of each relevant payment. They should remit the withheld amounts, within ten days, to the tax affairs office local to their residence. Otherwise, the receivers shall be jointly and severally liable for payment of the basic tax and other payments related thereto.*

*(c) As for the operation of capital and other activities performed by the aforesaid legal persons and enterprises in Iran through the agencies such as branches, representatives, agents and the like, the regulations of Article 106 of this Act shall apply. The determination of the taxable income for a legal person has been stipulated in Article 106:*

**\*\*\***

### **Article 106**

*The taxable income of legal persons shall be assessed through examination of statutory books of accounts, according to the provisions of Article 94 and paragraph "A" of Article 95 of the present Act (except those types of incomes for which another method of assessment is stipulated herein). The*

*cases mentioned under Article 97 of this Act shall be subject to ex officio assessment.*

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## **Foreign persons, their rights and obligations**

### **1- Exemptions**

As mentioned before, in order to encourage investment and create employment in the productive sectors of the economy, there have been stipulated various exemptions in the new amendment of the Direct Taxes Act (2002), with the same treatment towards Iranian and foreign persons.

- Exemption of stated taxable income earned from activities in the productive unites of industries and mines up to 80% for the period of four years for developed regions, and up to 100% for a period of ten years for the less developed regions, with regard to the provisions stipulated in the Act (Article 105).
- Annual exemption for tourist establishments up to 50% of the due tax.
- Exemption of the income earned from training and educational activities of the private schools and private higher education institutions.
- Exemption of the income of the institutions intended for nursing the disabled people.
- Exemption of the income of sport clubs.

- 50% of the tax related to stated profit of expansion, reconstruction, completion or establishment of the industrial and mining productive units.
- The income earned from publishing and journalistic, cultural and art activities totally is exempted.
- 100% of total income earned from the export of manufactured products and agricultural produce and processed products.
- 50% of the total income earned from export of other commodities.
- 100% of the total income earned from goods imported to Iran on transit.
- Scientific awards and scholarships.
- The income of granting patent and exploration rights.
- Income derived from R & D.
- The profit or prize awarded to the bank accounts by the Iranian banks and non-bank credit institutions.
- The interest paid to the foreign banks by the Iranian banks on overdrafts and time deposits subject to reciprocal treatment.

## **2- The acceptable expenditures**

### **Article 148**

*The expenditures that are described hereunder and meet the conditions stated in the above Article will be acceptable in tax computation:*

*(1) The purchase price of the sold goods or the purchase price of materials used in the sold goods and services;*

*(2) Personnel costs proportional to the services of employees and on the basis of the enterprise's employment regulations, including:*

- (a) Basic salaries or wages and regularly recurring benefits, whether in cash or in kind (the benefits in kind at their cost to the employer);*
- (b) Irregular non-recurring benefits, whether in cash or in kind, such as foodstuffs, productivity allowance, bonus\*, New year bonus\*, overtime pay and travel expenditure and allowance. The limits of travel expenditure and allowance paid to directors, inspectors and employees traveling abroad to provide for the relevant enterprise's needs, shall be determined under the regulations that will be foreseen by the Ministry of Economic Affairs and Finance and the State Organization of Management and Planning, and will be approved by the Council of Ministers;*
- c) Health and treatment expenses and payments for health and life insurance of employees, or for insuring them against accidents arising out of work;*
- d) Retirement pension, survivors pension and termination of employment payments in accordance with the enterprise's employment provisions, dismissal compensation and payments for buying-out of services according to the enacted laws and in respect of that amount of such payments that exceeds the relevant reserve account;*
- e) Payments to the Social Security Organization in accordance with the relevant regulations and also an amount up to 3% of the paid annual salaries, as the employees' savings, in accordance with the regulations to be prepared by the State Organization of Tax Affairs and approved by the Minister of Economic Affairs and Finance; and*

*f) Funds reserved for financing the retirement pension, survivors pension, termination of employment payments, dismissal compensation and payments for buying-out of services of the enterprise's employees, not exceeding the amount of the latest monthly salaries and wages and the balance resulted from the adjustment of the previous years salaries. This rule shall apply to the reserves deposited in bank accounts so far, as well.*

*(3) The rent paid for the enterprise's premises in case of being rented. The amount of rental shall be determined on the basis of the official deed\* (if any), otherwise within the normal range;*

*(4) Rental of enterprise's machinery and equipment in case of being rented;*

*(5) Costs of fuel, electricity, lighting, water and communications;*

*(6) Funds paid in respect of various kinds of insurance relating to the operations and assets of the enterprise;*

*(7) Royalties paid, as well as duties, levies and taxes paid to municipalities, ministries, government institutions and their affiliates in connection with the activities of the enterprise (except for the income tax and its appendants and other taxes that the enterprise is obligated, under the provisions of this Act, to withhold from its payments to other persons and remit it, as well as the fines paid to the government and municipalities);*

*(8) Research, experiment and education expenses, purchase of books, periodicals and compact disks, marketing, advertising and exhibition expenses, if such expenditures pertain to the activity of the enterprise, and on the basis of the regulations to be proposed by the State Organization of Tax Affairs and approved by the Minister of Economic Affairs.*

*(9) Expenditures related to the indemnification of damages caused by the operation of assets of the enterprise, provided that:*

*First, the occurrence of the damages is ascertained;*  
*Second, the type and extent of the damages are determined; and*  
*Third, no other party is responsible for indemnification thereof under the provisions of the existing laws or agreements, or-at any event – the damage is not otherwise recovered.*

*Regulations concerning realization of the above three conditions shall be approved by the Minister of Economic Affairs and Finance in accordance with the proposal of the State Organization of Tax Affairs.*

*(10) Cultural, sport and welfare expenditures paid in respect of workers to the Ministry of Labor and Social Affairs, up to a maximum amount of IRR 10,000 per each worker;*

*(11) Reserves against doubtful receivables provided that:*

*First, the receivables are connected with the enterprise's business;*  
*Second, they are, most probably, not recoverable; and Third, the reserve is administered under a special heading in the enterprise's books of accounts until the claim is recovered or it is ascertained, that the claim cannot be recovered.*

*Regulations concerning this paragraph will be approved by the Minister of Economic Affairs and Finance on the basis of the proposal of the State Organization of Tax Affairs.*

*(12) Losses of real and legal persons, if ascertained by examination of their statutory books of accounts and in conformity with the regulations, can be carried forward and be offset against the income of subsequent year or years.*

*(13) Small expenses incurred in connection with the premises of the enterprise, if such expenses are customarily born by the tenant and the place of business is rented;*

*(14) Expenses incurred for maintenance and upkeep of the premises, if the place of business is owned by the enterprise;*

*(15) Transportation expenses;*

*(16) Expenses related to transportation of employees, entertainment and warehousing;*

*(17) Fees paid in proportion to the services rendered such as commission, brokerage, legal fees, consultation fees, conference fees, auditors fees and fees for administrative, financial and inspection services, expenses related to software and design and setting up of systems needed for the enterprise, expenditures for other specialized services pertaining to the activities of the enterprise and the fee of the legal inspector;*

*(18) Fees paid or allocated to banks, cooperative funds and authorized non-bank credit institutions for the purpose of carrying out the enterprise's operations;*

*(19) Price of office supplies and office equipment that are usually consumed within one year;*

*(20) Cost of repair and maintenance of machinery and work equipment and also the cost of replacement of spare parts, provided that it would not be considered as a basic repair;*

*(21) Abortive mine exploration expenditures;*

*(22) Membership and subscription fees paid in connection with the business of the enterprise;*

*(23) Bad debts in excess of the reserve for doubtful receivables and if it is proved by the taxpayer to be unrecoverable;*

*(24) Currency exchange losses computed in accordance with accepted accountancy practice, provided it is applied consistently from year to year by the taxpayer;*

*(25) Normal wastage of production;*

*(26) Reserve of payable acceptable expenses related to the assessment year;*

*(27) Acceptable expenses related to previous years, the payment or allocation of which is realized in the tax year under examination; and*

*(28) Expenses related to purchase of books and other cultural and artistic goods for employees and their dependants, up to a maximum amount equal to 5% of the exemption threshold of Article 84 hereof in respect of each individual.*

*Note (1) The expenses that are not mentioned in the present Article, but are considered to be related to the earning of the enterprise's income, shall be accepted as deductible expenses on the basis of the proposal of the State Organization of Tax Affairs and approval of the Minister of Economic Affairs and Finance.*

*Note (2) Directors and owners of a legal person's capital shall be considered as the enterprise's employees, in case they are engaged in salaried positions of the enterprise. In the enterprises other than legal persons, however, the salary and fringe benefits paid to the owner of enterprise and his spouse and children who are dependent on him, shall not be considered as acceptable expenses, except for service-related travel*

*expenditure and allowance, which shall be subject to paragraph (b) (2) of this Article.*

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### **3- Incentives and fines**

- In the case of non-payment of the tax in due times, a fine equal to 2.5% of the stated tax (per each month) is imposed.
- If the taxpayer does not submit the tax return or balance sheet and profit and loss statement, a fine equal to 40% of the due tax, will be imposed.
- If the taxpayer does not provide legal books and documents and evidences, a fine equal to 20% of due tax will be imposed.
- In the case of salary, 2% of the paid salaries will be imposed as fine, if the taxpayer does not provide the list of employees.
- In the case of contracting agreements, 1% of the total amount of the contract, will be imposed as a fine, if the contractor does not provide the contract.

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### **The Taxation System, Future Perspective**

In order to follow the reform program the following steps have been taken into consideration:

- Informing the public & promoting the culture
- Establishing tax information site, and providing bilingual laws & regulations, bylaws & instructions, and tax forms via international network.

- Promoting the self-assessments system in order to increase the efficiency of the administrative management of the tax collection system, to increase the public satisfaction with the tax organization.
- Re-engineering the organizational structure and improvement of operational procedures to increase the efficiency of the taxation system.
- To provide advanced information technology, and introduce modern technological innovations, in order to mechanize the operational process, and to increase the efficiency of the tax system throughout the country.

*M. Alizadeh Ahvazi*

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OECD Tax convention has provided paragraph 2 of Article 9, to eliminate double taxation in transfer pricing cases. According to this paragraph, tax administration may be requested for corresponding adjustment as described in paragraph 2 of Article 9. In this paper adjustment of transfer pricing and difficulties that arise in this regard will be discussed.

### **1- Understanding of transfer pricing**

Transfer pricing is the pricing of inter-company transactions, which concerns virtually all transactions between a parent company and its subsidiaries and between affiliates within a transnational group. The

transfer pricing process determines the amount of income that each party earns from that transaction.

Without special rules, transnational groups would be able to manipulate the prices charged in intra-group transactions in order to minimize taxable profit in higher tax countries and maximize them in countries imposing lower, or no taxes consequently.

Almost all developed countries, and many less-developed countries have some sort of provisions in their tax codes giving their tax authorities the power to examine the price charged in transaction between related persons and to substitute for the price actually charged, an amount that represents the price that would have been charged in transaction between unrelated persons.

## **2- Transfer pricing transactions**

All transactions between members of a transnational corporation group are potentially reviewable, not only supplies of materials, components and finished products but also payments for intangibles such as management fees, intellectual property, royalties, interest on loan, payments for technical assistance and know-how, and other similar transactions.

There are essentially two types of situations related to transfer pricing:

1. Those which involve only two countries.
2. Those which involve three or more countries.

In the bilateral type of cases, goods and services supplied from the country with the-higher tax rate will tend to be under priced, and those supplied to the higher -tax country may be overpriced.

Normally, only the authorities of the country, with higher tax rate will have the interest to making an adjustment to the prices fixed by the parties, and countries with relatively low tax rates generally have little to fear from that type of transaction, which has a lower tax rate. A typical example can be where goods or services are sold to an affiliate located in a tax heaven country and resold to another member of the TNC group. In this multilateral case, taxable profits may be reduced in both the real host country and home country, and will be transferred to an intermediate country where they will pay little or no tax. In this type of case, both countries will have an interest in making an adjustment.

### **3- Transfer pricing adjustment**

The right to make transfer pricing adjustment is recognized in Article 9 of the OECD Model Treaty, and the OECD has published Guidelines, illustrating how transfer pricing rules should be applied. Most OECD member countries have adopted transfer pricing legislation, or have adopted their existing legislation to conform to the Guidelines, some conforming more closely than others.

The Guidelines prescribe the application of an "arm's length" test to what is essentially transaction-based approach. However, a variety of methods may be used in order to determine this hypothetical arm's length price in particular:

- the comparable uncontrolled price method (CUP);
- the cost plus method;
- the resale-price method;
- the profit-split method;

the comparable profits method (CP);  
the transaction net margin (TNM) method;  
the rate of return method;  
the berry ratio.

The starting point under the Guidelines is the CUP method. This method seeks to compare the transfer price under review with that charged in comparable arm's length transactions.

Where comparable arm's length transactions do not exist, as might be the case with sale of components of a product, that is, unique to the TNC group, or, especially, the licensing of patent or trade mark rights, other methods are suggested by which a fair market price may be estimated.

#### **4- Problems Arising from OECD Guidelines Issues**

Many meetings have been held by OECD for solving the problems arise as a result of transfer pricing and Guideline Issues, so far. Moreover so many forums have been held by EU Commission and others on taxation, but still problems have remained. Problems can be categorized as below:

##### ***a- Problems faced by taxpayers***

-The affected taxpayers are normally excluded from competent authority deliberation or, in any event, have no official or guaranteed states in such deliberations.

The procedure usually dose not produce an entirely satisfactory result. Although the competent authorities usually do reach agreement, there is no guarantee that they will solve the problems.

-Double taxation conventions establish no procedural rules or time limits for competent authority proceedings, and specify no method for their implementation.

-There are numerous procedural conflicts between competent authority and domestic examination and appeal rules.

-Delays in reaching a conclusion of competent authority proceedings can be very long, and are of concern to business.

-Even if the competent authorities do eliminate double taxation, the taxpayer may not be neutral as to how this is achieved. It may still be disadvantageous to the taxpayers concerned; who are not themselves parties to the negotiation or agreement.

***b- Problems arise at policy and practical levels***

-Policymakers may need to reconcile their legitimate right to tax the profit of the taxpayers in a way to avoid double or multiple taxation

- The tax administration may face difficulties to collect pertinent data from outside of their jurisdiction.

-The competent authority decision may not conform to national or treaty law, and may be influenced by extraneous factors such as other pending competent cases.

***c- Problems regarding arm's length principle***

Current OECD international guidelines are based on the arm's length principle that a transfer price should be the same as if two companies involved were indeed two independent, not part of the same corporate structure .The arm's length principle (ALP), is found in article 9 of the

OECD Model Tax convention and is the framework for the bilateral treaties between OECD countries. The OECD Transfer pricing Guideline provides a framework for setting such matters by providing considerable details as to how to apply the arm's length principle, but all of this assumes the best possible world, where tax authorities and MNEs (and other taxpayers) work together in good faith yet transfer pricing has gained wider attention among government and non-government organizations. OECD has spent so much effort on developing its transfer pricing guidelines, but applying transfer pricing rules based on arm's length principle is not easy, even with the help of OECD's Guidelines. It is always impossible and certainly time consuming to find comparable market transaction to set an acceptable transfer price. A computer chip subsidiary in a developing country might be the only one of its kind locally.

***d- Problems regarding shift of profits into low tax jurisdiction***

Even if MNEs carry out little business activity in a certain jurisdiction, there could be another risk, which is shift of profit into a low tax jurisdiction. This leads to trade as well as tax distortion.

**5- Conclusion**

When companies operate in countries around the world, they share ideas, products, and services every day. Sharing these types of activities can be considered price worthy and in the world of taxation can be recognized as transfer pricing. Regarding different types of transfer pricing and different methods to adjust and calculate it, sometimes the subject

seems very complicated. Questions like how to apportion intellectual capital and R&D between jurisdictions have become contentious.

Applying transfer pricing rules on cross-border of physical product, managerial and technical services shared by the company's international operation, international financial transaction, specialized knowledge e.g. surveying techniques in oil, gas, and other areas, would make it difficult to reach agreement on the form of a formula, particularly between parent companies in wealthy countries and subsidiaries in poorer countries.

So in order to meet the new challenges related to transfer pricing and also prevent wasting valuable resources of the Islamic Countries, we should not merely on bilateral agreements, introduced by OECD or other international organizations. We hope the ATAIC members take necessary actions in line with rapid changes of the economic conditions and international taxation system.

*Monireh Kazemi*

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## **KUWAIT**

Tax is imposed on the net income, after deduction of the costs and expenses incurred by the taxpayer.

Any foreign established company whose head office is located abroad but pursues activity or work in Kuwait is subject to the Kuwaiti income tax for the income realized from the activity pursued in Kuwait.

However, there are exceptions exempting foreign companies from the application of the principle of regionalism as stipulated in the following laws:

- The law of Arabic and foreign aviation companies in accordance with the principle of reciprocity.
- Free Zones Law.
- Law licensing the establishment of lease and investment companies.
- Foreign Investor's Law.

The application of the principle of regionalism on the foreign companies leads to double taxation as the income resulting from these companies activities in Kuwait is subject to double taxation. The first one upon the imposition of the Kuwaiti Income Tax as the source of this income is Kuwait and the second one upon the imposition of the tax on the same income in the State where the head office of the foreign company is located pursuant to the principle of international income. The international double taxation may hinder the movement of foreign investments in the State of Kuwait and therefore, this problem is overcome by concluding certain agreements to avoid double taxation with a number of countries.

The Kuwaiti tax legislation was limited to establish companies subject to the income tax and the ones registered abroad that pursue a certain trade or work in Kuwait, whether directly or through an agent.

At the beginning, the taxpayer submits a statement on the income tax on or prior to the fifteenth day of the fourth month that follows the taxable period, provided that his income in any taxable period exceeds 5250 Dinars.

Upon calculation of the income, the following costs may be deducted:

- The costs realized upon the sale of goods or services rendered relating to the pursuit of the work or trade in Kuwait.
- The costs accumulated on the taxpayer and paid thereby during the taxable period (like the expenses relating to management, general expenses, wages and benefits for the services).
- The depreciations as stated in the Income Tax Decree.
- The losses incurred during the taxable period concerning the pursuit of a work or trade in Kuwait.

***Expenses paid abroad:***

As this type of expenses is difficult to audit (for instance the salaries paid abroad), a dispute may arise with the taxpayer concerning acceptance of the expenses however, a certain percentage of these expenses is often excluded according to the nature of the company activity in comparison with similar cases.

***Cost of materials:***

The Tax Department specified, through the internal circulars, several percentages for the acceptance of this type of costs.

***Expenses distributed on the years of the project:***

There are certain expenses that the companies request to be accepted in the first year of the project; however, the Tax Department distributes these expenses on the years of the projects; these expenses include:

Pre-operation costs, Training programs costs, Assets purchase costs

***Subcontractors' expenses:***

This type of expenses is not applicable in case the company withholds 5% of the contract amount on the subcontractors, in application of the ministerial resolution in this respect.

The role of avoidance of double taxation agreements is evident in the realization of the following objectives:

1. Providing discounts or tax exemptions for the income derived from foreign investments.
2. Protecting these investments from any other or additional taxes that may be imposed during the agreement period.
3. Exchange of information and experiences with the advanced countries in the tax field and preventing tax evasion.
4. Promoting and developing economic and political relations with the world countries.

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## **MALAYSIA**

### **1. Introduction**

Growing market globalization and significant increases in cross-border trade are among the challenges, tax authorities around the world face today. Governments face complex problems in taxing such transactions of multinational enterprises. One major tax issue involves the determination of profits in cross-border transactions. Malaysia is not

spared from tackling this issue which involves multinational resident companies operating worldwide and non-resident companies conducting business in the country.

Currently the globalization of business activities is accelerating. Operating entities of multinational corporations increasingly rely on each other for goods and services. . These are further compounded where constant developments and innovations are in progress. The problems on cross border transactions become more complex with the accelerated IT revolution and rapid emergence of e-commerce. These developments have revolutionized the manner business transactions are conducted by both small and large organizations. Such cross-border transactions dominate world trade flows that can create serious tax consequences which will affect national tax revenues.

## **1.1. Current Provisions**

1.1.1. Income tax in Malaysia is territorial. Tax is imposed on income that has a Malaysian source. Malaysia includes the territories of the Federation of Malaysia, the territorial waters of Malaysia, and any area over which Malaysia has sovereign rights to explore and exploit natural resources. Under the Exclusive Economic Zone Act 1984, the offshore area of Malaysia extends up to 200 nautical miles from the Malaysian coast. The Income Tax Act 1967 (ITA 1967) would therefore include jurisdiction over persons working offshore within the exclusive economic zone of Malaysia.

1.1.2. Income that is remitted to Malaysia by a non- resident is wholly exempt. Only income derived from Malaysia is subject to tax.

Foreign source of income received by residents in Malaysia (except banks, insurance, sea and air transport) is exempt from tax. Banking, insurance, sea and air transport companies are taxed on a world income basis.

1.1.3. Malaysia is practicing the self-assessment system of taxation. It was introduced in 2001 for companies. This system was introduced to other categories of taxpayers on a staggered basis. In 2005, the system has fully covered all categories of taxpayers.

1.1.4. Currently, the corporate tax rate for companies stands at 28%. The chargeable income of an individual who is a resident is taxed on a graduated scale from 0% to 28%. However, a non-resident individual is taxed at a fixed rate of 28% on all types of income.

1.1.5. A non-resident is also subjected to withholding tax on income such as interest (15%), royalty (10%) and remuneration of a public entertainer (15%).

1.1.6. Certain incomes received by a non-resident constitute special classes of income is subject to tax under Section 4A of the ITA, 1967. These incomes such as technical fees, installation fees and rental of moveable property are subject to 10% withholding tax.

## **1.2. Agreements (Tax Treaties)**

1.2.1. Double taxation arises where two or more tax administrations take different positions to tax the same item of income or capital which has its source within their boundaries. Many countries also tax their residents on foreign-source income either on arising or remittance basis:

Double taxation acts as a hindrance to the free flow of investment funds and the movement of labor between countries. Consequently, the governments of many countries have made arrangements through tax treaties to reduce or to completely avoid double taxation and the prevention of fiscal evasion.

1.2.2. The main consideration of a taxation agreement is to promote the elimination of double taxation. Other considerations are to encourage the inflow of capital and growth of trading activities. To achieve these, fiscal incentives and tax sparing credits are given.

To attract investments, Malaysia provides tax incentives and relief by way of tax sparing. Average Foreign Direct Investment in approved projects in Malaysia for 1999-2004 is RM15.22 billion. Malaysia's average inbound and outbound investments for the period 2000-2004 are RM35.926 billion and RM 16.92 billion respectively.

1.2.3. The objectives of a Malaysian DTA are:

- To create a favorable climate for both inbound and outbound investments,
- To make Malaysia's special tax incentives fully effective for taxpayers of capital exporting countries,

- To obtain a more effective relief from double taxation compared to relief gained under unilateral measures and
- To prevent evasion and avoidance of tax through exchange of information.

1.2.4. Section 132 of the ITA 1967 empowers the Minister of Finance to make provisions by Order (done by notification in the Government Gazette), the authority to enter negotiations with the government of any territory outside Malaysia. Malaysia at present has effectively signed double taxation agreements with 55 countries which are largely based on the OECD model.

Section 132 of the ITA 1967 reads as follows:

- (1) If the Minister by statutory Order declares that;
    - (a) Arrangements specified in the Order, have been made by the Government with the Government of any territory outside Malaysia with a view to afford relief from double taxation in relation to tax under this Act and any foreign tax of that territory; and
    - (b) It is expedient that those arrangements should have effect, then, so long as the Order remains in force, those arrangements shall have effect in relation to tax under this Act notwithstanding anything in any written law.
- Thus, when there is a conflict between the provisions of a tax treaty and the provisions of domestic law, the former will prevail.

## **2. Tax Issues**

Cross-border transactions extend to the purchase and sales of tangibles as well as intangibles. In countries where there are different tax systems and varying rates of tax, cross - border price manipulation by multinationals can be profitable practice for generating maximum income with minimum tax incidence.

Interrelated sales and purchase may occur between the related companies whether through a permanent establishment or branch or associate company located within Malaysia or another part of the world. Prices may vary. For tax purposes, each company under the legislation is considered as having a separate entity. Normally, the profits so determined by each individual enterprise would be the same profits that one would expect to be determined by the ordinary processes of good business accountancy. There would be no doubt that evasion of tax could be practiced by undisclosed channeling of profits away from a permanent establishment. In Malaysia, Sections 140 and 141(1) of the ITA 1967, would be invoked to disregard such transactions, if they are discovered.

### **2.1. Allocation of Expenses**

2.1.1. In a great majority of cases, the audited trading accounts of the enterprise will be used to ascertain the profit attributable to the branch for the year of assessment concerned. This raises the question as to what extent such accounts should be relied upon when they are based on agreements made between the Head Office and its Branch in Malaysia. Generally, the trading accounts of the Head Office and that of the branch

are prepared symmetrically according to such agreement and if they reflect the functions performed by the different parts of the enterprise, then, these trading accounts could be accepted. On the other hand, where trading accounts are prepared based on internal agreements, the accounts that have been prepared would reflect, to a certain extent, the 'artificial' arrangement rather than actual real economic transactions/functions of the different parts of the enterprise. Such accounts will be disregarded.

## **2.2. Basis of Allocation**

2.2.1. In determining the adjusted income from a source for the basis period, there shall be allowed outgoings and expenses of a business whether resident or non - resident, that is wholly and exclusively incurred in the production of gross income. Such provisions are provided under Sections 33 and 39 of the ITA 1967.

2.2.2. In practice, the Inland Revenue Board would accept any reasonable method of allocation of expenses computed by the taxpayer or his agent as long as it is based on the arm's length principle. Due care would be taken in handling the cases of such enterprises to ascertain that no transfer of bad debts or assets or liabilities be made into the account of the associate company or the permanent establishment concerned.

## **2.3. Administrative Expenses**

2.3.1. In the case of general administrative expenditure incurred by the Head Office of the enterprise, if it is charged to the branch or the permanent establishment, a proportionate amount would normally be

allowed based on turnover, commission, deposits, or total working capital depending on the nature of the business. The method of allocation of expenses adopted is also expected to be consistently adhered to.

2.3.2. Malaysia follows the principle that the nature of the Head Office expenses which are allowable as deduction as calculated in arriving at the amount in reference to the Malaysian branch or permanent establishment in Malaysia is generally limited to those that are wholly and exclusively incurred.

## **2.4. Payments for Intangible Assets**

2.4.1. Cross-Border payments for use of intangible assets and special types of services involving multinationals and holding companies are quite common. Generally, expenditure related to the acquisition of a source of income or capital assets would be of a capital nature while expenditures relating to the performance of profit earning operations would be of revenue nature.

2.4.2. As for special kind of services, under Section 4A of the ITA 1967, the services might have been done performed overseas or in Malaysia. The charges made are borne directly or indirectly by the Malaysian enterprise and the payments are deductible against income derived or accruing in Malaysia.

2.4.3. Payments made to non-residents for services performed in Malaysia will be subjected to withholding tax provisions.

## **2.5. Payments Made by Specific Industries**

2.5.1. (a) With regard to banking, there is no specific ruling on the type and amount of Head Office expenses to be allowed.

In practice, the percentage of turnover or deposits or staff costs plus other related expenses are acceptable. The following are the types of Head Office expenses generally allowed:

- i. Management and administrative expenses;
- ii. Advertisement and marketing costs;
- iii. Professional and consultancy costs;
- iv. Accounting and auditing costs.

(b) Deduction of interest as an expense is governed by the provisions of Sections 33(1) (a) and 33(2) of the ITA 1967. The principle to be applied on whether or not interest is deductible involves determining the purpose for which the principal amount of the loan has been applied. Cross-Border loans between related companies are quite rampant. It has to be distinguished whether such loans are for the working capital of the Malaysian enterprise or for the purpose of securing investments in Malaysia. To be deductible, the interest must be wholly and exclusively incurred in the production of gross income.

2.5.2. In life and general insurance business, specific tax legislations provide for taxing resident and non-resident companies respectively. The main difference between taxation of a resident and non-resident insurance company lies in the scope of charge and the deduction of Head Office expenses. Resident companies are taxed on world income while non-

resident companies are taxed only on income derived from Malaysia. The specific provision on the taxation of resident and non-resident insurance companies spells out the formula in working out the portion of Head Office and management expenses to be allowed as a deduction against the aggregate income of the insurance business.

2.5.3. In the case of non-resident and resident contractors who are involved in contracted projects overseas, outgoings and expenses incurred are deductible only if they are wholly and exclusively incurred in the production of gross income.

2.5.4. To encourage more local construction companies to explore opportunities outside Malaysia and to induce them to remit income earned abroad back to Malaysia, with effect from Year of Assessment 1990, the legislation exempts 50% of the income of a company resident in Malaysia derived from a construction project carried on outside Malaysia. The rate was increased to 70% from Year of Assessment 1994. In addition dividends issued out of the exempt income will be tax-exempt in the hands of shareholders. However, with effect from Year of Assessment 1995, all remittances are fully exempted.

2.5.5. As for non-resident shipping or aircraft operators, the provisions of section 54 (2) deem the profits arising from the outward shipment of passengers, mail, livestock and goods from Malaysia to be derived from Malaysia. Section 54 (4) then provides the basis for measuring the

profits that are attributable to Malaysia. There are two methods provided by law:

***(a) The ratio-certificate method***

According to this, a certificate has to be submitted to the Director General and the following requirements apply:

- (i) The certificate must be one issued by the Revenue Authority of the country of residence of the operator.
- (ii) The said Revenue Authority must compute and assess the full profits of the non- resident operator.

From his shipping or airline business;

- (iii) The basis on which the computation and assessment is made by the foreign Revenue Authority must not be substantially different from the basis adopted by the Director General;
- (iv) The certificate must state the total sums received or received in respect of the carriage of passengers, mail, livestock and goods, the adjusted profits (or losses) as computed for income tax purposes (before adjustments in respect of capital allowances) and the capital allowances for tax purposes.

The Inland Revenue Board, Malaysia (IRBM) applies the following formula to ascertain the proportion of adjusted profits (losses) that are applicable to Malaysia:

$$\frac{\text{Adjusted world profit (loss)}}{\text{Gross world shipping or Airline earnings}} \times \text{Gross shipping or airline earnings from outward shipments from Malaysia}$$

(As shown by the certificate)

In the same manner the capital allowances applicable to Malaysia are computed thus:

<u>Total world capital allowances</u>	x	Gross shipping or airline
Gross world shipping or		earnings from outward
airline earnings		shipments from Malaysia
(As shown by the certificate)		

The income assessable in Malaysia is then arrived at by subtracting the capital allowances applicable to Malaysia from the adjusted profits applicable in Malaysia.

***(b) The "arbitrary" method***

Under this method, an assessment is made on an arbitrary proportion of the amounts received or receivable from the carriage of passengers, livestock, mails or goods shipped out from Malaysia. The present rate fixed is 5% of the gross amounts from outward shipments from Malaysia. The amount so arrived at is taxed at a flat rate of 28%.

In practice, the IRBM will accept the ratio certificates that are forwarded by the ship owners or airline operators. In the absence of the said certificate, the arbitrary method is applied.

2.5.6. To stimulate the nation's economic growth, the development of several new growth sectors has been intensified. Multinational companies which set up Operational Headquarters in Malaysia (OHQ), approved by the Minister, will be taxed at a reduced rate of 10% on income derived from Malaysia. Furthermore, non-fiscal incentives are given whereby they

will be allowed to employ based on expertise, skills requirements and needs of the company.

(a) Operational Headquarters are allowed to borrow freely in foreign currency/invest in foreign securities to fund their treasury and fund management operations for their related companies outside Malaysia. However, OHQs are not allowed to lend or raise funds in any currency in Malaysia on behalf of related companies outside Malaysia.

(b) Operational Headquarters will be allowed to use professional services of a foreign firm provided such services are not available locally.

2.5.7.(a) The legislation does not provide for capital gains (with the exception of certain real property transactions) nor does it provide for relief for capital losses. In principle, the relief in term of capital allowances on fixed assets is given to a person who incurs the qualifying plant expenditure. In this context, the qualifying costs of plants or machinery can be influenced by differences arising in currency exchange whereby the devaluation or evaluation of currency will be added or deducted from the qualifying plant expenditure.

(b) For plant or machinery which had been used outside Malaysia and is brought into use for the purpose of a business in Malaysia, the qualifying expenditure of the plant or machinery will be taken to be the market value or the net book value, whichever is the lower, on the day it was brought into Malaysia. Only annual allowances will be given on the qualifying expenditure.

(c) Transfer of plant and machinery to the Head Office is not considered as a disposal considering that the Head Office and its Malaysian branch are of a related entity and such disposal is subject to control. The disposal value is deemed to be the residual value of the Malaysian Branch where such disposal suffers no gain and no loss.

## **2.6. Expenses Disputed by Taxpayers**

2.6.1. The deduction allowable to the Malaysian branch for any of the expenses attributed to the enterprise does not depend upon the actual reimbursement of such expenditure by the Malaysia branch. The difficulty arises in making a distinction between the circumstances of the case where a cost incurred by the enterprise should not be considered as an expense of the Malaysian branch and the relevant expense should be considered on the basis of arm's length principle.

2.6.2. As for contractors, the examination and verification of claims made by the non-resident companies can be difficult because each project is unique and most of them are involved in huge contracts or turnkey projects in Malaysia. The expenses claimed might have been incurred abroad. Being multinational companies, books and supporting documents to the accounts are not kept in Malaysia.

2.6.3. (a) For ship owners or airline operators it is up to the taxpayer to satisfy the IRBM that the method or basis of computing profits in his home country is not substantially different from that used in Malaysia. For this purpose it may be necessary to provide the IRBM with a detailed

computation of the non-resident's tax liability in his home country, a copy of the accounts supporting the computation, details of any special tax provisions relating and airline operations, such as special allowances, subsidies, exemptions, etc.

(b) Section 54(4) of the ITA 1967, specifically excludes from the liability to tax of a non-resident shipping and airline operator on transshipment of goods, passengers, etc. including casual calls made in Malaysia. When a call was made, the arbitrary method of taxation of the shipping operator would have been applied. Under Sec. 54(6) of the ITA, 1967 a call is considered as casual if apart from this call, there were no other calls at Malaysia ports by the operator in the 24 months preceding that call. If this can be established, then the arbitrary tax will be refunded.

2.6.4. The ITA 1967, empowers the IRBM to examine international transactions in order to protect Malaysia's revenue. With the implementation of self assessment system, tax audit will become the major activity of the Inland Revenue Board and this tax provision has to be enforced.

2.6.5. Interrelated-company transactions are scrutinized especially in the transfer pricing area. The price charged between controlled companies must be at market value or arm's length. Where doubt arises the arm's length price will have to be determined.

In practice however, it is often difficult to determine what the arm's length price is. The determination of the open market value of goods and services

sold between related entities are often fraught with difficulties due to the absence of comparables in the market and different nature of operations of each entity, etc.

2.6.6. In examining services and intangibles provided by related companies, attention is paid as to whether in actual fact such services are being rendered. If the result is in the negative the expense charged will automatically be disallowed. If services are rendered, then the basis of allocating the cost will be scrutinized. Details of services provided and queries whether the charges commensurate with the amount of the services rendered and whether they are being charged at arm's length will be raised. The details of the costs charged would be examined and those which are not justifiable when weighed against the services provided, will be disallowed or restricted.

2.6.7. However, the IRBM officers find it difficult to evaluate cross border pricing of the taxpayer. Tedious queries and examination on the records are required to ascertain whether taxpayer's pricing is in order. Information may only be furnished upon request by the IRBM and this has proven to be time consuming and costly.

2.6.8. The Malaysian tax law requires taxpayers to keep proper accounts and records of transactions, be it local or international and all records that relate to any business in Malaysia shall be kept and retained in Malaysia. However, multinational companies often keep their accounts and records

in their Head Office/Regional Office. Request for them is met either with very slow or negative response.

## **2.7. Withholding Tax**

### **2.7.1. Deduction of Tax from contract payments**

(a) As more non-resident contractors and foreign employees are coming to Malaysia for development projects, the Government has introduced provisions in the ITA 1967, to improve their compliance as follows:

(i) 10% withholding tax is to be deducted from all payments made to a non-resident contractor in respect of services under a contract.

(ii) 3% of the service portion of the contract payments in respect of tax of employees of the non-resident contractor.

Remittance of tax should be made within one month after paying or crediting such contract payment.

(b) Where the payer fails to pay the due amount that amount which he fails to pay shall be increased by an amount equal to ten percent of the contract payment liable to deduction of tax and the total sum shall be a debt due from him to the Government. Furthermore, no deduction of the expenses will be allowed to the payer in arriving at the adjusted income for the year of assessment concerned.

(c) However, this withholding tax is not a final tax. Upon submission of the relevant returns to the Inland Revenue Board, the non-resident or his agent in Malaysia can claim a refund of the overpaid tax withheld, if any.

### 2.7.2. Deduction of Tax from interest or royalty in certain cases

(a) In the case of intangible rights, cross-border transactions include payments for patents, know-how, inventions, trademarks, brand names, copyrights, registered designs, franchises, licenses, literary and artistic property rights, and other similar items, which are valued for their intellectual or intangible content. Intangibles such as trademarks and trade names are normally referred to as marketing intangibles; while intangibles such as patents, which are created through risky and costly R & O, are classified as trade intangibles.

(b) The legislation provides for the withholding tax from interest and royalties paid or credited by Malaysian businesses to a non-resident company, partnership or any other body of persons which does not carry on a business in Malaysia. In practice, the withholding tax to be remitted to the Inland Revenue Board is at the rate of 10%.

(c) When the payer fails to pay the amount due from this, that amount which he fails to pay shall be increased by an amount equal to 10% of the royalty liable to deduction of tax and the amount shall be a debt due from him to the Government. However, the rate of tax applicable on royalty is subject to the provisions contained in Malaysian double taxation agreements which provide for reduced rates or exemptions.

### 2.7.3. Deduction of Tax from Special Classes of Income

(a) The ITA 1967, provides for tax to be withheld on payments made to non-resident persons in respect of:

(i) amount paid in consideration of services rendered by the person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from such person;

(ii) amount paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; or

(iii) rents or other payments not being payments of film rentals, made under any agreement or arrangement for the use of any moveable property.

(b) The withholding tax rate is a flat 10% of the gross amount payable. The payer must within one month after the date of payment/crediting of the contract remit the withholding tax (whether deducted or not) to IRBM.

(c) Where the payer fails to pay withholding tax or pays withholding tax late, he is imposed an increase in tax of an amount equal to ten percent of the payment subjected to withholding tax deduction.

Should the payer fail to pay withholding tax and/or increase in tax imposed on him, this deduction is not allowed against his business income.

(d) The tax in this respect is the final tax. However, if the recipient has a place of business in Malaysia (PE) he may submit a return and by concession claim the relief on the withholding tax suffered though income of such nature may not be considered as a business source.

## **2.8. Interpretation and Implementation of Tax Treaties**

Tax treaties entail two major issues namely interpretation and implementation of "Fees for Technical Services" and the application of "Exchange of Information".

### 2.8.1 Fees for Technical Services

(a) Section 4A of the Income Tax Act 1967, which is a provision on special classes of income that came into effect from 21.1.1983. It was introduced subsequent to the decision of DGIR v Euro Medical Industries Ltd. (EIL) [1983]2MLJ57. The issue for determination in EIL was whether the assessments were correctly made having regard to the Double Taxation Relief (United Kingdom) Order 1973 and section 4 of the Income Tax Act.

(b) Payments under Section 4A are not to be considered as business income and the permanent establishment concept cannot therefore apply.

### 2.8.2 Exchange of Information

Exchange of information clauses contained in double taxation treaties between two Contracting States are utilized for obtaining information on taxpayers or any relevant information not available in the other country. The information will provide administrative assistance for the purpose of ascertaining facts in relation to which the rules of the convention are to be applied:

(a) The competent authorities of the two Contracting States are permitted to exchange such information as is necessary for carrying out two purposes, firstly, for carrying out the provisions of the agreement, and secondly, for carrying out the domestic laws of the Contracting States concerning the taxes covered by the agreement.

(b) Exchange of information is not limited to information necessary for the implementation of the agreement, nor is it limited to information concerning the taxation of residents of the two Contracting States - information concerning non-residents may also be exchanged. The information to be exchanged is, however, limited to those covered by the agreement.

(c) The information exchanged is to be treated as confidential in the receiving state. It is not to be disclosed to any person other than those, including a court, concerned with the enforcement, assessment, collection of taxes or determination of tax appeals.

### 2.8.3. Banks and Financial Institutions

(a) In most countries, banks and similar institutions have obligations as to confidentiality in relation to clients, based on specific legislation or on the civil contract existing between the bank and the client. In Malaysia, tax authorities are bound by the provisions of section 97 of the Banking and Financial Institutions Act 1989 (BAFIA).

(b) As the Malaysian banking authorities are bound by BAFIA, tax authority could not supply such information to her treaty partner.

### **3. Settlement on Tax Issues/Disputes**

Transactions between related parties are expected to be conducted at arm's length principle. In cases uncovered and proved to be otherwise, the Director General of the IRBM has the power to make the necessary adjustments.

3.1. Malaysia has neither specific transfer pricing legislation nor does she have any specific bilateral or multilateral transfer pricing agreement with any country. However the ITA 1967, has provisions which regulate transfer pricing practices. These provisions include the main anti-avoidance provisions in Sections 140 and 141 of the ITA.

The Director General is given wide powers in the ITA 1967, to examine international transactions in order to protect Malaysia's revenue. The IRBM also provides regulations and rulings to tax officers in dealing with cross-border transactions. One such example is the Transfer Pricing Guidelines which was issued on 2 July 2003.

The IRBM faces difficulties in arriving at the arm's length price due to lack of comparables, unavailability of necessary information for cost or functional analysis, etc. Cases are settled arbitrarily based on estimates or mark-up negotiated and compromised between taxpayers and the tax officers.

Settlement on tax disputes can be made through the enforcement of tax treaties. Under the Mutual Agreement Procedure article, a resident of one country who considers that the actions of either country have imposed or will impose taxation on him which is not within the scope of the treaty may make a representation to the competent authority in his country of residence. The competent authority will endeavor to resolve the problem through Mutual Agreement Procedures. In Malaysia, the competent authority is the Director General and his representatives.

### **3.2. Legal Remedy**

#### **3.2.1. Appeals to Special Commissioners**

Where tax disputes become impossible to resolve at the level of the Director General, the taxpayer may, after serving the notice of objection (having expired after six months), request the former in writing, to send the appeal to the Special Commissioners. The Director General must forward the appeal to the Special Commissioners within three months.

The onus is on the taxpayer to prove the assessment is erroneous (on the ground that it is excessive, incorrectly assessed or incorrectly increased), notwithstanding the fact that it is on estimate made by the Director General.

#### **3.2.2. High Court**

The taxpayer or the Director General of the IRBM, if dissatisfied with the decision made by the Special Commissioners as being erroneous in law or of mixed law and fact, may by notice;

Require the Commissioners to state a case of an appeal to the High Court. The High Court will determine any question of law arising on a stated case

and may confirm, increase, reduce or annul any assessment determined by the Commissioners.

Decisions by the High Court are open to appeal to the Court of Appeal and then to the Federal Court. There is no right of appeal against decision of the High Court on a question of fact.

#### **4. Conclusion**

Cross-Border transactions are seen to be the most important taxation issue. Many countries in the world are trying to resolve it by various approaches. In Malaysia, these approaches include arbitration, negotiation, enforcement (field audit and/or desk audit) and the application of double taxation agreements.

The Self Assessment System of taxation requires the IRBM to mobilize for cement activities effectively. To ensure greater compliance amongst taxpayers, several actions have been taken by the IRBM:

(a) Educating taxpayers, tax agents and the public on current tax issues and programs.

(b) Training tax officers in specialized fields such as forensic counting, forensic computer, and financial investigative techniques in auditing and criminal investigation.

(c) Street surveys

(d) Greater cooperation and networking among member tax administrators through ATAIC, CATA, SGATAR, etc.

(e) Creation of data warehousing on compilation of information on taxpayers, market variables, costs, profits, etc.

(f) Amending tax law to suit current needs in taxation. An international joint effort seems to be the key solution in addressing the problem of cross-border transactions. Malaysia should develop means for better information gathering. Higher level of cooperation among member countries is needed in matters like knowledge sharing, experiences on important international tax issues and information on tax schemes. By participating internationally, Malaysia's efforts in addressing the issues will be enhanced.

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## **MOROCCO**

In Morocco, the following persons are liable to taxation:

- Individuals who have usual residence in Morocco, for their global income of Moroccan or foreign sources;
- Individuals whose main residence is not in Morocco but derive their global income from Morocco;
- Individuals who derive their income or gains, whether they have their usual residence in Morocco or not, and for which the right to tax is given to Morocco through a tax treaty for the avoidance of

double taxation.

Moroccan taxation laws stipulate that an individual is considered having a usual residence in Morocco when he/she owns a permanent residence, a centre of its vital interests.

Civil servants who are sent abroad in the course of their function or on a mission are considered as permanent residents of Morocco, provided that their personal income is not exempted in the host country.

With respect to companies, the following companies are subjected to corporate tax in Morocco:

- Companies regardless of their form or purpose, except for partnerships and joint ventures that have opted not to be subjected to such a tax, defacto companies and transparent real estate companies;
- Public institutions with industrial and commercial purpose, as well as any other legal entities performing profitable activities;

Companies, whether they have or not their head office in Morocco, are liable to tax on their global income and profits:

- that are related to their properties, activities and profit making transactions performed in Morocco, even occasionally;
- for which the right to tax has been granted to Morocco in application of provisions of a tax treaty for the avoidance of double taxation.

Moreover, foreign companies, whose their head offices is not located in Morocco, are subjected to tax on some gross income (royalties, interests, brokerage commissions, remunerations for all kinds of services), except when these gross incomes have been derived from work or services performed by the foreign companies' branch or permanent establishment in Morocco; in such a case, this income is liable to tax therein.

In a context of globalization and internationalization of business transactions, double taxation arises, whenever trading, financial or other operations involve more than one tax jurisdiction.

With regard to the General Income Tax, Moroccan tax laws allow a deduction of the foreign tax paid on an item of the global income. The granting of this deduction is subject to form and content conditions on a reciprocal basis provided for in a tax treaty for the avoidance of double taxation.

In the Moroccan tax treaty practice, exclusive taxation is generally granted to:

- The country where the place of effective management is located regarding profits of shipping and air transport as well as for capital gains from the alienation of ships and aircrafts;
- The country of residence for private pensions;
- The recipient's country of income and capital, as a general rule in all cases where the taxation has not been specifically granted to another State.

The contracting State, which does not have the exclusive right to tax, should exempt the above-mentioned income and capital, either integrally or in a way to take into account the exempted income or capital in determining the effective tax rate, in order to respect the tax table progressively.

As part of foreign investments incentive, particularly direct investments, Morocco does respect the principle of non-discrimination both in its national legislation and in its international tax treaties network.

In Morocco, taxable profits of companies are computed according to very

accurate tax rules which highly contribute to the Moroccan tax system's transparency.

The fiscal result for each accounting period is the excess of earnings minus operating expenses engaged for the need of the taxable activity.

Based on specific tax rules, the fiscal result is obtained from the accounting result adjusted according to the tax rules particularly through the deduction of non taxable earnings and the reintegration of the non deductible expenses.

The coordination centers, tax base represents 10% of their operating expenses to which is added, if any, the result of non ordinary transactions.

For individuals, the accounting year must correspond to the civil year, unlike companies.

The deductibility of foreign head offices' expenses is one of the most disputed issues in Morocco. Tax disputes arising from this issue shows to what extent countries like Morocco find it difficult to control the reality of fees and expenses stated by foreign companies and to protect their tax base from shrinking.

Another aspect of recurrent tax issues is the withholding tax on revenues and remunerations derived from work, services or various services carried out or rendered in Morocco.

Moroccan tax law provides for a withholding taxation at source of income like salaries, dividends, royalties, remunerations, interests and varied commissions. Therefore, salaries paid to temporary or permanent employees should be subjected to a withholding tax by the employer in Morocco, according to the General Income Tax progressive scale.

Companies settled in Morocco, serving dividends to individuals or legal

entities, resident or non resident, are also liable to a withholding tax of 10%.

Interests are also subjected to a withholding tax of:

- 20% or 30% in full discharge of any tax if resident taxpayers do not disclose their identity; and
- 10% for non residents.

Royalties, payment for technical assistance or for personnel services or equipment in lease, as well as payment to artists, to sportsmen and to foreign individuals, for any services, are subject to withholding tax of 10%. However, withholding taxes are balanced by international tax treaties which specify reduced tax rates.

With regards to dividends, Morocco has signed tax treaties providing for their taxation in the state of source, at a lower rate ranging between 10% and 15%.

For foreign direct investments, dividends paid by a Moroccan resident company to a foreign company residing in the other contracting state are charged a reduced withholding tax rate ranging from 5% to 10% provided that the foreign company holds, directly at least, 10% to 25% of the distributing company's capital.

Interests are liable to a withholding tax of 10% however, governments of contracting states or their central banks, as well as other public financial institutions benefit from an exemption of interests accrued on their deposited funds.

According to tax treaties concluded by Morocco, the following are liable to a withholding tax of 10% royalties on

- Copyrights;

- Patents;
- Trademarks;
- Information relating to industrial, commercial or scientific experiences;
- Economic and technical studies;
- Technical assistance.

With respect to royalties, the implementation of international tax treaties raises many interpretation and application issues.

Indeed, the very large scope of the withholding tax on royalties and other assimilated remunerations provided for the domestic tax law does not always fit with the very narrow definition of "royalties" as it appears in international tax treaties. The reason that prompts taxpayers to contest the validity of the withholding tax and to wonder whether it is considered as royalties, remuneration for technical assistance or transfer of know-how, is their difficulty to differentiate between all of these.

The situation gets more complicated when the same operation encompasses all these services (know-how, professional services and technical assistance).

Morocco has adopted a legal and pragmatic approach towards taxation management of cross-border transactions.

Morocco is reviewing its previous tax treaties for the avoidance of double taxation in order to update them according to new developments in its domestic and its States partners' laws, in the OECD and UN convention models and according to changes in Morocco and the partner countries' conventional policies.

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## **PAKISTAN**

A new Income Tax Law was necessary to achieve simplification, consolidation, rearrangement to incorporate the tax reform measures, especially aimed at encouraging voluntary tax compliance backed by strong audit. It was in this background that the Income Tax Ordinance 2001 was promulgated. The new law contains the concepts and methodology in line with the latest concepts, principles and objectives of the tax systems prevailing in the most of the developed and developing economies all over the world. Besides, the Income Tax Ordinance 2001, contains many internationally acknowledged and prevailing concepts, like Arms Length Principle, Transfer Pricing, Thin Capitalization, Permanent Establishment, International Tax Treaties for Avoidance of Double Taxation and Prevention of Fiscal Evasion Principles relating to associates, re-characterization of transactions and advance ruling, etc.

### ***The treaties provide for:***

- (a) Relief from the tax payable under Income Tax Ordinance;
- (b) The determination of the Pakistan-source income of non-resident persons;
- (c) where all the operations of a business are not carried on within Pakistan, the determination of the income attributable to operations carried on within and outside Pakistan, or the income chargeable to tax in Pakistan in the hands of non -resident persons, including their agents, branches, and permanent establishments in Pakistan;

(d) The determination of the income to be attributed to any resident persons having a special relationship with a non-resident person;

(e) The exchange of information for the prevention of fiscal evasion or avoidance of Taxes on income chargeable under Income Tax Ordinance and under the corresponding laws in force in that other country.

Income and expenses are basically governed by the principle of methods of accounting applied by the taxpayers. Accounts are maintained either on cash basis or on mercantile basis and are subject to corresponding treatment under the Income Tax Ordinance 2001, and the rules made thereunder.

In 1979, there were only seven kinds of payments/transactions subject to withholding taxes. Subsequently, withholding tax regime was expanded to include as much as 25 transactions on which income tax was being withheld.

There is Presumptive Tax Regime, which is a self-contained regime within the withholding taxes, where the withholding taxes on transactions are treated as final discharge of tax liability of the taxpayers and hence a final disposal of the case. It therefore, tended to encourage the simplification of the tax system at the cost of documentation of economy. The Income Tax Ordinance 2001, on the one hand emphasizes simplification of the tax system through introduction of the concept/scheme of Universal Self-Assessment (USAS), customer's facilitation, simplification of language of the statute and consonance with the international tax systems but on the other hand the concept of withholding taxes has gradually been limited and at present there are fifteen types of transactions on which withholding taxes are applicable. Under the Income

Tax Ordinance 2001 the following types of transactions are subject to withholding taxes:

- |                              |                                    |
|------------------------------|------------------------------------|
| 1. Imports                   | 2. Salary                          |
| 3. Dividends                 | 4. Profit on debt                  |
| 5. Payments to non-residents | 6. Payments for goods and services |
| 7. Exports                   | 8. Income from property            |
| 9. Prizes and winnings       | 10. Petroleum products             |

Besides the above withholding taxes chapter XII of the Income Tax Ordinance imposes withholding taxes on certain transactions, which have been kept in transitional phase. These transactions include the following:

1. Brokerage and Commission
2. Collection of tax by a stock exchange registered in Pakistan
3. Transport Business
4. Electricity Consumption
5. Telephone users

Since these have been kept under the heading "transitional", it therefore, signifies that the legislature may think over the deletion of these transactions from imposition of withholding taxes in future.

To avoid tax disputes in cross-border transactions, the two countries normally resort to tax treaties on Avoidance of Double Taxation and Prevention of Fiscal Evasion. Income Tax Ordinance 2001, provides for signing such treaties under section 107 and the disputes on cross-border transactions are resolved under these treaties, which provide for such mechanism i.e. Mutual Agreement Procedure under which the tax competent authorities of both the contracting states resolve such issues through correspondence or face to face negotiations.

In this situation one party to the transaction is based outside the jurisdiction of the other party.

### ***Based Taxation Income***

The income is either subjected to tax on the basis of the source of income or on the basis of worldwide income of their residence. Timing differences in recognition of income and expenses between particular tax systems can complicate the issue further i.e. some countries allow interest paid as an expense on an accrual basis, while others only tax interest income on a receipt basis.

Just as some people suffer statelessness and some have the privilege of dual nationality due to conflict in the laws of nationality, similarly same taxpayer on the same income, one on a source basis and other on residence basis is charged to tax. The type of double taxation that results is known as "juridical double taxation", since two states claim a taxing jurisdiction over the same taxpayer and income. Disputes arising from such situation can be properly tackled with the assistance of double taxation agreements.

Jurisdictional Asymmetry-Cross-Border compliance becomes difficult by different tax burdens on income imposed by the domestic laws of the different states. The tax rates imposed by a country need to be comparative to other countries so that no tax havens exist for those who find such havens for tax evasion. These tax evaders normally canalize their profits to a country where they will not be effectively taxed or taxed very lightly. When their profits cannot be sheltered from normal rates of tax, they steer back their profits to home jurisdiction in order to generate cash for funding dividends to shareholders. Countries offer special tax regimes that can be

exploited by non-residents. Usually, the non-resident has to set-up a local subsidiary to access such benefits, which may, in part, depend on negotiating a case, specific agreement or ruling with the tax authority. Such countries are typically not generally regarded as tax havens and transactions with them are less likely to attract attention. They often have extensive DTA networks, which facilitate their use in tax planning. Such countries may be referred to as quasi-havens. Where there are unabsorbed losses or tax allowances/exemptions that can be exploited. Variance in ways of giving double taxation relief between the tax systems of different countries, also provide a good abode to tax evaders to minimize effective taxation of their income.

***Techniques employed in the cross-border transactions for tax evasion:***

Setting transfer prices to determine where profits arise, exploiting tax-deductible interest flows (and other financing costs) by means of thin capitalization and financial avoidance, diverting part of a trading activity in a country to a claimed non-locally taxable entity (probably exploiting DTA provisions on permanent establishments "PEs"), investing capital via havens, or special tax regime entities in quasi-havens, manipulation of intellectual property and royalties (including fragmentation).

Pakistan's approach in managing issues on cross-border transactions is progressive. It is aimed at providing conducive environment for external stakeholders. Latest initiative i.e. pronouncement of advance rulings is a revolutionary step, which provides creditability to the tax regime. The modern concept of facilitating non-resident taxpayers has been introduced

to obtain an authoritative ruling of binding nature in respect of any transaction to which Pakistani Income Tax Law applies.

It is provided that a non-resident taxpayer who makes an application to the Central Board of Revenue for an advance ruling must make a full and true disclosure of the nature of all aspects of the transaction in the application. When this is done, the commissioner's position regarding the relevant provisions of the ordinance applicable to the transaction, in all its material respects will be issued to the taxpayers as an advance ruling by the Central Board of Revenue. This ruling will be binding on the Commissioner even though it may be inconsistent with any circular. However, such advance ruling will not be binding if the law prevalent at the time of ruling is changed subsequently in respect of the transaction entered into or proposed by the non- resident person.

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## **SUDAN**

In general, direct taxes in Sudan are imposed on incomes annually:

- (a) Derived from Sudan in the case of a resident or non-resident person.
- (b) Derived from outside of Sudan for resident persons. The 1986 income tax law recognizes a resident person, as the person who resides in Sudan for more than one hundred eighty-three days in the base year proceeding the assessment year.
  - The highest rate for business profit tax is 35% for companies and individuals.

- 10% tax rate for industry.
- The highest rate for personal income tax from wages and salaries is 20%.
- Dividends and interests are exempted from any kind of tax and there is no withholding tax in this area.
- Royalties derived from Sudan are taxed by 35% for non- resident persons. In the case of a prevailing and valid double taxation avoidance agreement with the respective countries, royalties are taxed according to what is agreed upon in these agreements. Usually the tax rate is 10% to 15% of the amount of the royalty.

Sudan has concluded about twenty eight double taxation avoidance agreements with different countries, and these agreements are of great importance in dealing with cross-border transactions specially in determining the personal scope of the persons and the tax covered and the status of a resident person for tax purposes.

The Permanent Establishment is a main factor for taxing cross-border transactions, and the agreements help in defining and determining the Permanent Establishment.

The agreement also helps in allocating the profits and deducting the expenses incurred for Permanent Establishment according to what is agreed upon between the contracting states.

Direct taxes, business profit tax in particular should be taxed where the income is derived and the transaction is incurred, and in this respect defining the permanent establishment and its duration to be considered as Permanent Establishment is essential.

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**SELECTED PAPERS  
ON  
VALUE ADDED TAX**

**2<sup>ND</sup> TECHNICAL CONFERENCE  
TEHRAN-IRAN  
2005**

## **MOROCCO PRESENTATION**

### **Value Added Tax Practice and Implementation**

**Ladies and Gentlemen,**

It is with a great pleasure that I am taking part in the 2<sup>nd</sup> Technical Conference of the Association of Tax Authorities of Islamic Countries, especially as it devotes a part of its work to the topic of Value Added Tax. This meeting adds to the ongoing work undertaken in Morocco on the reform of this tax, to modernize it, to fully make it play its financial role and to promote its economic neutrality.

The current Moroccan VAT is the result of a long process the origin of which goes back to the fifties. Indeed it was in 1948 that Morocco, then under the French protectorate, adopted a tax on transactions (sales tax), a

relatively simplistic form of expenses taxation, which was evolved into a tax on products and services (TPS), following independence in 1961.

In 1986, within the framework of a total tax reform the TPS disappeared, leaving room for the VAT in its current form, which has met the great principles governing the mechanism of this type of tax all over the world: payment of tax in installments and compensation at the borders. It is characterized by the:

- Homogenization of taxation of all categories of expenses, overcoming the duality of the TPS which juxtaposed two taxes:
  - a) a tax on products that could be more or less assimilated to the VAT
  - b) and a tax on services which presented the disadvantage of being cumulative.
- Widening of the scope of the wholesale trade while the TPS was not extended beyond the factory limits.
- Extension of the right of deduction to almost all other taxes burdening the cost price upstream (some exclusions still remain).
- Cutting down the number of tax rates from eleven (11) to five (5).

Since 1986, the Moroccan legislator has introduced several adjustments in order to adapt the VAT to changes in the Moroccan socioeconomic context.

These changes mainly included:

- Reclassification of certain activities with regards to the rate;
- Introduction of new exemptions;
- Abolition of the upper rate of 30%
- Standardization of procedures with those governing other taxes;
- Strengthening of taxpayer's guarantees.

## **I- The VAT Economic Scope**

### **1- Scope**

#### ***a- Taxable transaction:***

The VAT applies to industrial or handicraft activities, to provision of services, to some independent personal services and to the sale of goods by traders whose turnover reaches a threshold of 2,000,000 Dirham (USD 200,000.). The VAT applies to imports.

Agricultural activities and a great deal of the distribution sector are outside the scope of VAT, while other transactions are exempted from VAT.

In certain cases, persons performing activities outside the scope of VAT or who are exempted from it, without entitlement to deduction, may opt for their liability.

#### ***b- Exemptions***

There are two sets of exemptions according to their impact on the cost price and the taxpayer's treasury:

- Exemptions without entitlement to deduction: the taxpayer sells net of tax and buys his inputs VAT invoiced, without being able to recover it. These exemptions concern some products and services such as basic goods, services rendered by small manufacturers and service providers whose turnover does not exceed Dhs 180,000. (USD 18,000.).
- Exemption with entitlement to deduction: the taxable person sells net of tax and buys his input VAT invoiced, which will be recovered through a deduction or a refund. In Morocco, exemptions with entitlement to deduction do not relate solely to export or

international transport activities but also concern a broad range of products and services sold locally.

## **2- Tax Base Rules**

### ***a- Taxable event***

Locally, the taxable event is the receipt of payment for the sold goods and merchandise, services rendered and work carried out. However, the option to adopt the invoice-based VAT system is permitted.

In the case of settlement of goods and services by way of compensation or exchange or in case of delivery to oneself of movable properties or constructions, the taxable event is the moment of delivery of merchandise or goods or the completion of work.

In case of import, the taxable event is the moment when goods cross the border (customs clearance).

### ***b- Taxable base***

The taxable base encompasses:

- Value of goods, work and services;
- Expenses relating to sales
- Incidental revenue
- Additional sum to the price
- Duties and tax (other than VAT)
- Financial products.

### ***c- Tax rates***

There are four VAT rates:

- Standard rate of 20%
- Rate of 14%, with entitlement to deduction applies to electricity, transport, building and construction activities... and without entitlement to deduction (insurance brokerage transactions)
- Reduced rate of 10% applies to hotel and catering industries
- Reduced rate of 7% with entitlement to deduction (sales and delivery of water, energy, gas, petroleum oils and educational stationery,...) and without right to deduction (large consumer goods).

#### ***d- Deduction***

A taxpayer is allowed to offset against output VAT, the input VAT on purchase of merchandise, consumables, services, overhead expenses and equipment.

Credit situations generated in particular by the differential of rate do not give rise to a refund except with respect to exports and to activities subject to a zero rate.

Finally, for transparency purpose payment of purchases, work or services amounting to Dhs 10,000 (\$ 1,000) must be settled by crossed non-negotiable cheque, bill of exchange, magnetic means of payment or by bank transfer, otherwise, their entitlement to deduction will be cut by 50%.

### **3- Tax System Regimes**

Two tax regimes are prescribed:

- the monthly return system is compulsory for taxable persons whose taxable turnover during the pervious year has been Dhs 1,000,000 (USD 100,000) or more will be added for any person without a

permanent establishment in Morocco who engages in taxable transactions;

- quarterly return system is intended to new taxable persons and to those whose turnover is less than the above mentioned threshold limit.

There is no presumptive return system.

#### **4- Taxable Persons' Rights and Obligations**

Taxpayers are compelled to keep the accounts, as well as to fill a monthly or quarterly tax return and pay the tax due at the same time.

In this respect, in order to allow the Tax Authorities to perform control under favorable conditions, any individual or legal entity must submit to the right of disclosure.

If taxpayers have some obligations, they also benefit from guarantees. In particular, those relating to the possibilities of appeal:

- administrative appeal.
- appeal of an assessment resulting from a tax audit.

##### ***a- Administrative appeal***

Taxpayers initiate the administrative phase by lodging an appeal before the General Tax Director, within a six month period from the date of the issuance tax bill. If taxpayers receive no response or unfavorable decision, they may begin the legal phase by lodging an appeal before the competent court.

***b- Appeal following a tax audit***

This kind of recourse is initiated when a taxpayer disputes an assessment resulting from a tax audit, and this, by filing an appeal with arbitration committees (Local Committee of Taxation, National Committee of Tax Appeal) and if the dispute is not settled, he may then file an appeal with the court.

If the Appellant still disagrees with the decision of the National Committee of Tax Appeal, he/she may take the matter to the court within 60 days from the date of receipt of the decision.

The local committee of taxation is a board of arbitration with regional competence, chaired by a judge and composed of representative of taxpayers and representative of the Tax Administration.

The appeal before the local committee grants a stay against recovery of the tax.

The National Committee of Tax Appeal has a national competence, it is directly placed under the authority of the Prime Minister and is divided into three sub-commissions each composed of: one judge (president), two taxpayers' representatives chosen from among 100 people from the business circles and two civil servants seconded to this Committee to represent the Tax Administration. It is empowered to deal with issues relating to facts but has no authority to make decisions on issues involving the interpretation of law.

After the decision of the National Committee of the Tax Appeal is made, the final tax to be recovered is enforced.

## **5- Sanctions**

VAT sanctions have undergone some amendments within the framework of the harmonization of the main tax laws. The sanctions in force, take the form of tax sanctions (surcharges and penalties for late filing of return, fines), penal sanctions and sanctions relating to the right of control and disclosure.

### ***a- Tax sanctions***

- Surcharge for failure to fill tax return, late or inadequate filing: 15% of the unpaid tax;
- Penalty for late payment: 10% of the amount due, in addition to surcharges delay of 5% for the first month and of 0.5% for the subsequent months of delay;
- Fine for late filing of tax return not comprising a tax to be paid nor credit of tax: Dhs 5500 (USD 50) if the tax returns comprise a credit of tax, it is reduced by 15%;
- Fine for late filing of rata tax return;
- Fine for fraud: Dhs 100 (USD 100).

### ***b- Penal sanctions***

Are subject to a fine ranging from Dhs 5,000 to 50,000 (USD 500 to 5000), persons who:

- issue fictitious invoices;
- produce false or fictitious book entries;
- carry out sales on regular basis without issuing invoices;
- withdraw or destroy legally required accounting recounting records;

- Conceal the whole or part of the company's assets or increase their liabilities to organize insolvency.

In case of a second offence, within a five years period following conviction with a fine, the contravener is sentenced to one to three months imprisonment, term.

***c- Sanctions for infringements of the provisions relating to the presentation of book records and to the right of control and communication***

A fine of Dhs 2000 (USD 200) and possibly a daily fine of Dhs 100 (USD 10) per day for delays of up to Dhs 1000 (USD 100)

## **II- Management of the VAT**

### **1- Tax base**

Concerning tax management and the organization of tax services, the General Tax Administration has moved from "professions" oriented structure to "users" oriented structure. The simplification of taxpayers' procedures has been its main focus, assisting the Tax Administration to implement several organizational projects aiming at the improvement of its management methods and its relationship with the users. This restructuring has been carried out through the following three steps:

- A functional restructuring had initially removed the partitioning of the administration by merging services (direct taxes, tax on turnover, registration and stamps) into a configuration around three main functions: tax base, control and litigation.

- A second step came to strengthen the decentralization by creating 18 polyvalent regional and prefectural departments with wide attributions as regards delegation of powers and management of human resources;
- Then, the reorganization, which started four years ago has allowed to:
  - Strengthen the decentralization by granting a greater autonomy of decision to regional and prefectural directors;
  - Implement a proximity management by creating specific entities in charge of large companies, small and medium enterprises (professional) and individuals (private individuals).

Thus, for the cities of Rabat and Casablanca, the setting up of special entities dedicated to large companies facilitated customized services to companies whose turnover exceeds 50 million Dirham (USD 5 million), to companies of the financial sector and to permanent establishment of foreign companies.

Along with this reorganization, the single tax identification number (VAT/ Corporate Tax, VAT General Income Tax) has been introduced according to the legal type of the taxpayer, in order to enable him to have a single interlocutor in the General Tax Administration for all taxes he is liable to.

The improvement of the tax yield resulting from this new reorganization has led to better tax behavior of taxpayers and to a greater effectiveness of the Tax Administration. Indeed, profiting from the proximity and the existence of a unique tax information source, a taxpayer is informed in a complete and interactive manner.

With respect to the Administration, a large program of computerization and modernization of management methods is being processed in order to ensure greater control over the taxpayers' fiscal situation.

## **2- Tax Collection**

Until the year 2003, collection of VAT was carried out by the tax collection offices reporting to the General Treasury Department of the Kingdom.

As of the year 2004, the General Tax Administration has been entrusted with the task of collecting the VAT. This measure is part of actions aiming at a better processing of taxpayers' files, in particular through:

- a better reaction in terms of dunning and regularizing late taxpayers;
- rationalization of refund management;
- centralization of accounting operations and date capture;
- controlling and following up of tax returns;
- reduction in the number of litigation files due to the time required for transmission of information between tax collection offices and the General Tax Administration (for instance: issuing of tax on the basis of an estimated assessment in spite of the tax return being deposited at the tax collector's office).

## **3- Information System**

The processing of the VAT through the information system is completely decentralized at the regional level.

It comprises:

- identification and registration of new taxpayers by giving them a single tax identification number according to the taxpayer's legal form;
- date capture drawn from periodical returns-monthly or quarterly.

***a- Identification data***

The main identification details processed are:

- Identification number;
- Last and first name or corporate name;
- Type of taxpayer;
- Mailing address;
- Nationality;
- Beginning of activities;
- Tax regime;
- Business license tax number

***b- Periodical tax return data***

The information elements processed are:

- Turnover broken down depending on whether the transaction is taxable, exempted or outside the scope of the VAT and according to the different rates applied (tax base, tax due);
- Deductions relating to fixed and current assets. The data processed relates to the rate, VAT invoiced and deductible VAT;
- VAT due;
- Credit of VAT;
- Amount paid and references of payment.

The information system also enables practice of control by an automatic edition of listings regarding late taxpayers of underpaid tax, which are forwarded to tax managers for validation before the system issues the regularization rolls.

The progress made with regard to VAT management has been reinforced by the adoption in 2005 of the electronic tax return system, electronic payment of VAT and electronic services from which it is expected to achieve a better rationalization of VAT management and the improvement of services rendered to the taxpayers.

### **III- Projects in Progress**

The Tax Administration has carried on through the VAT reform by adopting some measures in order to achieve its goals in terms of yield, modernization and tax simplification.

These measures are scheduled to be implemented over a period of 3 years (2005-2007) and focus on the following issues:

- Reduction of exemptions;
- Cutting down the variety of rates;
- Improvement of VAT refunding;
- Modernization of the management system.

#### **1- Reduction of exemptions**

This goal is achieved through banning any new exemption, extending the liability at a reduced rate to currently exempted goods and services, and the application of a zero rate to exports and international transport activities.

Also, in order to allow the decision makers to measure the budgetary impact of the exemptions and to make strategic choices between budgetary expenditures and tax expenditures, estimates of tax expenditures were prepared to accompany for the first time the bill of the budget law 2006.02.13

## **2- Cutting down the number of rates**

The adoption of different VAT rates to achieve certain socio-economic goals has shown its limits, particularly:

- The existence of structural tax credits that penalize companies;
- The burden of management for the Administration.

The simplification of the rates structure along with the reduction of exemptions is today the focus point of reflection on the VAT reform, in accordance with the best practice at the international level which supports the use of a single rate, in addition to the rate zero exclusively applicable to exports and international transport activities.

The transition towards this system may be achieved through the adoption of two rates: one set between 7% and 10% and the second between 18% and 20%.

## **3- Improvement of VAT refunding**

Some thoughts have been initiated around the possible generalization of VAT refunding to ensure economic and financial neutrality of the tax.

That implies two major prerequisites:

- Broadening the VAT tax base to all sectors;
- Modernization of the refunding management.

In order to achieve more proximity with taxpayers and to relieve their treasury, the VAT refunding has been entirely decentralized as of the last quarter of 2005, entrusting regional directors with extended powers. Moreover, the period for the processing of refunding files has been brought down to 4 months as from the date the request is deposited.

## **Conclusion**

### ***Ladies and Gentlemen,***

The VAT reform is gaining more importance for the mobilization of tax revenues considering the opening policy in favor of partnerships and free trade agreements.

The constraints of tariffs dismantling coupled with the dwindling of receipts from privatization implies the reinforcement of the Moroccan Tax Authority's role in the mobilization of the necessary resources for funding the State budget.

Indeed, efforts for mobilization of resources with respect to direct taxes continue to be deployed but considering the VAT intrinsic dynamism, this tax proves to be more suitable to raise the required receipts to offset customs taxation drops resulting from the opening of the borders.

The widening of the tax base underlies the necessity to pay more attention to the reform of national taxes, in particular the VAT which is a general tax on consumption and which optimal outcomes would allow to achieve the mobilization of additional domestic tax revenues as well as tax transition.

## **SENEGAL PRESENTATION**

**Mr. Assane Dianko**

*Directeur Generale Des Impots Et Des Domaines*

































## **IRAN PRESENTATION**

### **Value Added Tax- Practice and Implementation**

*When we talk about tax, we are dealing with people's culture and feelings. Bear in mind that experimental studies and theoretical bases indicate just of reality.*

#### **Summary:**

Before the spreading of Value Added Tax in the world's countries, tax on sales was the main source of the governments, cost funding. Of course this type of taxation was practiced without considering the value added made in each procedure of product and service turnover. So the countries local economies encountered serious confusion due to this cascading feature (excess taxation).

Vertical integration of industrial enterprises was endeavored just for decreasing tax liability and burden. In other words, this caused intensification of monopolies.

Financial authorities were looking for a new tax system through which they could be able to reduce distortion and on the other hand provide for increased public income.

After the Second World War, the introduction of Value Added Tax system in European and some of the Latin American countries brought about a new prospect of fiscal approach for many world countries. Tax authorities gradually found out that implementation of Value Added Tax with related technical complications, could help them to achieve their economic goals.

Value Added Tax system has been introduced in around 136 countries and almost contributes more than 25 percent of total tax revenues.

But, in Islamic Republic of Iran, taxation system and macro economic variables were highly influenced by the 1978 revolution and the Iraqi imposed war in the early post-revolution era, and due to the establishment of a new governmental system, tax revenues showed a negative growth. But in the subsequent years they displayed a positive growth rate. During these years, this reality that oil revenue is not a reliable source for the achievement of economic goals and national independence has occupied the minds of the state authorities and tax as the most important source of revenue has been included in the government planning.

Tax revenues forecast in the government budget particularly in the Islamic Republic of Iran economic, social and cultural development plans raise the question whether limited potential capacities in Iran tax system which is

based on direct taxes especially corporations, wages and salaries; could materialize such an increment or not?

The ratio of Islamic Republic of Iran's tax revenues to GDP has not been more than 7.5% up to this date.

Introduction of VAT in Iran with shifting the tax system from an income based to consumption based, one together with the expansion of tax capacity (changing potential capacity to actual) has managed to reduce the taxpayers liabilities and if VAT comes effectively into force, it can increase tax revenues. On the other hand, disappointments in investment fields would be replaced by incentive. Also, most of the transactions which are hidden from the state tax organization and income tax system would be identified and tax system totally developed.

In this connection, during the last two decades, Iranian experts with the assistance of World Bank and IMF economists and consultants have conducted comprehensive studies about possibility of VAT introduction and implementation in Iran. Also in order to succeed in this case and take advantage of others' experiences, in addition to records study, educational visits to some of the countries which practice VAT system, have been made.

The Islamic Republic of Iran VAT bill has been regulated in 6 chapters and 42 articles. Currently, the parliament representatives are studying the bill in order to present it to the open session of the parliament.

For the purpose of compiling, publicity and per paring the ground for implementation, VAT project office has been established under Tax Revenues Vice- Minister of Economic Affairs and Finance since 2001. This

office is obviously under control of State Tax Organization after its commencement.

In this article in addition to describing principals and primary steps for introduction and implementation of this type of tax which is one of the subjects proposed in the Second ATAIC Technical Conference in Tehran-Iran 2005; the author has tried to present the performance of VAT project office team in Iran and current circumstances to the extent possible.

*Elena Babaei*

## **YEMEN PRESENTATION**

**Mr. Ahmed Ghaleb**  
*Vice-Chairman*

**Mr. Ahmed Rajeh**  
*General Manager of Controlling & Inspection*

**Mr. Yahya Mohamed Al-Osta**  
*General Manager of Legal Department*

































**HEADS OF DELEGATIONS  
MEETINGS**

**2ND TECHNICAL CONFERENCE  
TEHRAN-IRAN  
2005**

**"Amirkabir Hall"**

## **Heads of Delegations Meetings**

The Heads of delegations meetings of the Second Technical Conference 2005 were held in I.C.I.C, Tehran on November 29, November 30, and December 2.

All heads of delegations were present at the meetings. The representatives of the member countries from Malaysia, Iran, Kuwait, Senegal, Sudan, Yemen, Indonesia, Brunei, Comoros, Jordan, Morocco, Pakistan, Qatar, and Sierra Leone discussed issues related to managing and holding of the Technical Conferences. H.E. Dr. Aliakbar Arabmazar, the President of the State Tax Organization of Iran, and the new chairman of ATAIC chaired the meetings.

## **Tuesday Afternoon, November 29**

At the beginning, H.E. Dr. Aliakbar Arabmazar, the President of the State Tax Organization delivered the opening remarks. Then he proposed the new Chairpersons and Rapporteur of each working group: (Tax Issues in Cross-Border Transactions, and Value Added Tax, Practice and Implementation). The new chairman of the ATAIC announced the conference program and explained the procedure of the workshops.

The participant from Sierra Leone, Mr. Ousman Barrie requested to become a member of ATAIC. The membership of this country was approved by all the members of the ATAIC.

Referring to the agenda of the heads of delegations meeting, the new chairman asked about Sudan decision for hosting the next conference in 2006. But the representative of Sudan, Mr. Ahmed Adam Salim Mohamed apologized and elaborated on reasons for Sudan's lack of preparedness for year 2006. He referred to some internal changes in the political administration in his country.

By the end of this meeting, Mr. Salman Nabi, the head of Pakistani delegation was nominated as the chairperson of the working group on topic (1). Then in reply to Mr. chairman, H.E Dr. Arabmazar, Mr. Kettani head of Morocco delegation accepted chairmanship of the working group on topic (2).

### **Wednesday Evening, November 30**

The second meeting of heads of delegations was held on Wednesday evening, November 30.

In the meeting, Dr. Arabmazar as the chairman of the 2nd Technical Conference of ATAIC asked the participants to nominate the host country for the year 2006.

The head of Kuwaiti delegation, Mr. Fawzi S. Al-Qassar proposed his country to host the technical conference, in 2007.

The head of Indonesian delegation, Mr. Hasan Rachmany proposed Indonesia to host the 4<sup>th</sup> Technical Conference, in 2008.

Then, Tan Sri Dato' Zainol Abidin, the head of delegation from Malaysia explained the procedure for holding the Technical Conferences with minimum expenditures.

By the end of this meeting, the chairman of the first technical conference, Tan Sri Dato' Zainol Abidin assigned the ATAIC chairmanship to Dr. Arabmazar, the new chairman of ATAIC. The ATAIC flag and the 2003 agreement of the founders were delivered to the new chairman of ATAIC.

## **Friday Afternoon, December 2**

In the third meeting of the heads of delegations, the representative of Malaysia, Tan Sri Dato' Zainol Abidin delivered the report of the CATA Technical conference and CIOTA meeting (August 29 to September 3, 2005) and proposed acceptance of CIOTA membership.

Then, Mr. Salman Nabi the head of Pakistan delegation asked the other participants to express their views concerning for holding of the 1<sup>st</sup> training meeting for heads of ATAIC in Lahore, Pakistan by the Central Board of Revenue, in December 2005 (26-28).

The date was not approved by the delegates because of its coincidence with the peak of tourist season.

Thanking the member countries for their active participation, the new chairman of ATAIC announced that Islamic country of Comoros had applied for being a member of ATAIC.

The membership of Comoros was approved by the ATAIC members, present at the meeting.

Then Dr. Arabmazar drew the attention of participants to the topics to be put to discussion in future conference including: the topics for the 3<sup>rd</sup> conference, the host country for the 3<sup>rd</sup> conference and the date and the ATAIC logo.

At the end of the meeting, the chairman of the ATAIC, Dr. Aliakbar Arabmazar, President of the State Tax Organization asked the participants to inform the ATAIC secretariat in Tehran, of their decision for the holding of the 3<sup>rd</sup> conference within two months. And, he suggested that for the

prospect conferences, the topics to be selected in line with the subject of the other Islamic conferences.

Then, he wished all the participants a happy visit during their stay in Iran, and expressed hope for closer coordination and cooperation among ATAIC member countries in future.

1. The membership of two new participants, namely Sierra Leone and Comoros was approved by all the members of ATAIC.
2. Three topics 1- direct taxes, 2- tax-issues on cross-border transactions and 3- Zakat were proposed to be discussed in future conferences. Also arrangement of annual technical conferences, on the 3 topics.
3. Zakat, as an Islamic tax common among the Islamic countries to be discussed regularly at the annual conferences. In fact Zakat discussion is the only characteristic which distinguishes the Islamic conference from other conferences.
4. Efficiently collecting and administering Zakat will provide an efficient and valuable fund for financing the poor, providing opportunities for promotion of skills among the people.
5. The procedure for selecting and proposing topics for discussion may freely be performed with regard to the possibilities of the host country. But at least one topic should be selected in line with the topics mainly concerned and proposed by the other Islamic conferences.
6. Within two months, the member countries will consider the possibility of being the host country for 2006 and announce their decision to the secretariat.

## **The Islamic Countries**

### **Overview**

57 countries are the members of the Organization of the Islamic Conference.

We can classify the countries with majority Muslim populations to four categories:

First, the countries with per capita income ranging from USD 600 to 2200

Second category, the countries with per capita income ranging from USD 2200 to 5700

Third category, with per capita income ranging from USD 5700 to 7700

And the fourth category, with per capita income ranging from USD 7700 to 25200

The total population of the sixty Islamic countries is estimated at 1,497,300,000 and the total Muslim population is estimated at 1,217,800,000.

The first group containing the poorest, constitutes 40% of the total Muslim population, with lowest per capita income ranging from 600 to 2200 \$ dollars, enjoy only 15.98% of total income gained in the Islamic world.

The second group which constitutes 40% of the total Muslim population, with P.C.I. ranging from 2200 to 5700 dollars enjoys only 37.54% of total income yield in the Muslim world.

The third group who are just 10% of total Muslim population, with the per capita income ranging from 5700 to 7700 US dollars, own 19.59% of total income yield in the Muslim world.

But 26.89% of total income yield in the Muslim world belongs to the top 10% of Muslim population, with P.C.I. ranging from 7700 to 25200 dollars (Tables 1 and 2).

Unfortunately, the gap between these different income groups will be increasing while the underdeveloped countries suffer from the lack of capital to invest.

However, in comparing the per capita income of the developing countries with the developed ones, we can reach to the fact that the highest range of per capita income in Muslim countries is nearly close to the lowest per capita income in the developed world (Table 3).

As it is seen for the lowest 40% of the EU countries, the P.C.I ranges from 7135 to 27700 dollars and the next 40% of EU countries enjoy P.C.I ranging from 27700 to 29500 dollars (Table 4).

Meanwhile, we can see only two EU Countries, containing 10% of the total EU population, with per capita income of about 29000 US dollars.

According to this survey, the top 10% of the total population of EU benefit per capita income ranging from 29600 to 58900 dollars. In other words, the lowest 40% of EU population has 31.25% of total income derived in EU countries also the next 40% of EU population has 44.93% of income yield in EU countries. The third category who is only 10% of the EU population owns 11.58% of total yield income and the top 10% of EU population (including Luxembourg, Denmark, Ireland, Austria, Belgium and United Kingdom) take 12.24% of total yield income.

As a result, the inequality is much higher in the Muslim world compared to EU countries.

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# **THE TABLES**















**FINDINGS & ACHIEVEMENTS**  
**OF THE**  
**2<sup>ND</sup> TECHNICAL CONFERENCE**  
**TEHRAN-IRAN**  
**2005**

## **General View**

The First Technical Conference of ATAIC was held in Malaysia in October 2004. Eleven Islamic countries participated in that conference.

However, in 2005 the Second Technical Conference was held in Iran with more than sixty participants from twenty-two countries.

The increase in the number of delegations attending the Second Technical Conference from 11 to 22 countries, does indicate the need for expansion of economic and fiscal cooperation among Islamic countries.

With regard to the interaction of economic and cultural relations, in fact the common cultural values and social structures of the Islamic Countries necessitate regular exchange of ideas regarding socio-economic problems.

Since the Islamic countries do believe in the same religion and the same shariya, the exchange of information on economic and fiscal issues will be facilitated through holding of such a forum.

On the one hand, the unpleasant reality of the existing gap between potential tax and the collected tax revenue in the developing countries, usually leads to inefficiency and economic distortion.

On the other hand, the current conditions of the international systems, and the process of globalization with its negative impacts on the developing economies will lead into the vulnerability of the developing Muslim countries.

In fact, financing the government expenditures out of the tax revenues and applying new techniques in the administrative systems of collecting revenues and gradually decreasing the impact of globalization on the economy required adoption of the strategy of converging and integrating the fiscal policies and economic relations among Islamic countries. Adoption of optimum tax policies, imposing appropriate laws and regulations, promoting tax culture and tax compliance and to improve the tax structure, require new arrangements for voluntary tax payment, adoption of new approaches, and more interactions among Islamic countries.

Promoting the system of controlling, taking serious actions against tax avoidance and preventing tax evasion which can be considered as the important steps to achieve the above goals, will be facilitated through continuous fiscal-economic cooperation among the Islamic countries.

The activities of members of ATAIC to expand their relations regarding fiscal issues and exchanging ideas and experiences on tax systems, may lead to the improvement of their fiscal systems. This improvement would be in line with the world progress. Achieving advanced technology and increasing the social welfare of the economy with regard to the equity

principle and the stability of economic sources and consequently the growth of the government revenues, will increase the capital needed for investment domestically.

To direct the taxation system of the Islamic world towards economic equity, with regard to different income groups and different business groups is one of the important priorities which should be considered as one of the significant obligations to promote the economic welfare of the economy.

Clearly, one of the most important obligations of the Islamic governments is to promote the economic welfare of the Muslim nations. So, the tax systems of the Islamic countries should be restructured to comply with (observing) the rules of economic equity stipulated in the concepts and principles of the Islamic economics.

To achieve economic equity within the country and between the countries, (regarding different income groups and different business groups), requires adoption of tax policies based on Islamic rules.

The Technical Conferences of ATAIC usually follow the important issues coherent in the Islamic concepts to regulate the economic activities and design the action plans to develop fiscal systems.

Obviously, such a gathering provides the framework for cooperation and mutual understanding, regarding the national and international issues of the Islamic countries. This atmosphere for exchange of ideas among tax policy-makers and the economists from the Islamic countries, may hopefully lead to new structures and arrangements in the other fields of economy.

The scientific Islamic thought, which particularly does exist in the Islamic countries around the world, shall be deemed as invaluable and fruitful asset for economic welfare of the society.

As mentioned earlier, improvement of Tax and Zakat administrations within member countries is the main objective of the Association of Tax Authorities of Islamic Countries. So, the development of administrative framework and the organizational structure of the underdeveloped and developing economies should be reviewed taking into consideration the principles and the concepts of the Islamic economics.

In fact, the Islamic countries, may contribute to the financial development of the developing world, through promotion of their fiscal systems and expansion of economic and financial cooperation, applying the rules and guidelines of Islamic economics.

Hopefully, the Technical Conferences of "ATAIC" provide opportunities for exchange of ideas and viewpoints among Muslim scholars and scientists to redirect the tax policies and administrations of the Islamic countries in a way to achieve the advanced objectives of Islam in future.

Open strategies towards interactions with other international economic systems may be taken by the ATAIC member countries, in order to create an atmosphere required for expansion of cross-border transactions. In this regard, the tax issues and problems that arise in these countries can be discussed and resolved at the meetings which will be held with the participation of the Muslim tax policy makers.

In the Tehran Conference, all the representatives of the Islamic countries attempted to participate in the discussions actively to present their views on the improvement of the tax policies and administrations. The

following is the abstract of the papers, focused mainly on the issues discussed throughout the conference.

## **Closing Ceremony , Concluding Remarks Friday, December 2, 2005**

**The closing ceremony was glorified by recitation of verses of the holy Quran.**

**First of all the two chairpersons were invited to deliver their speeches about the results and achievements of the workshops.**

At the beginning, Mr. Kettani, from Morocco, the chairperson and the speaker of the working group of Value Added Tax, reported the achievements on the topic, discussed by the participants during the workshop.

He believed that, it had been a very useful workshop and they had very deep and fruitful deliberation from the technical points of view. Very good questions were discussed, and also good points were mentioned and considered on the topic of value added tax.

Then, he thanked Iranian delegation for the opportunity they had provided and also he thanked other member countries for sharing their experiences. He mentioned that the member countries might need some reforms according to the papers distributed.

In this topic, practice and implementation of value added tax was to be discussed by the participating countries, with the objective of increasing the tax administration efficiency, and up-to-date knowledge on the various aspects of the issue. Mr. Kettani referred to VAT as a complex tax system. The economic, social and legal conditions would inevitably influence the structure and the characteristic of VAT system of the countries. The diversity is manifested in the form of different trades, thresholds and exemptions. It was noted that members of the working group were at various stages of implementation of the VAT. There are countries that have already implemented the VAT for more than 20 years and on the other hand there are few who are going through the formative stages. Member countries discussed the methods of all bases for determining the tax rate and threshold, regarding the various economic and social situations.

***Suggestions on suitable tax rate and threshold:***

- Management and audit capacity, as very important factor for determining the rate and threshold.
- The vital role of Information Technology for the implementation and control of VAT.
- The application of standard tax rate at the beginning and gradual increase of the rate, as time and situation change.
- Adequate public awareness about VAT.

- To optimize manpower, risk analysis method is preferred.
- Serial tax invoices for monitoring and controlling, purposes, and to increase tax compliance to be provided by tax administration.
- Determination of the rate and threshold, as crucial factor for increasing the number of potential VAT taxpayers and the ability of the taxpayers to comply.
- Eliminating multiple rates and adopting a single standard rate or at most two rates, preferred by the tax authorities, and also less problematic for the taxpayers.

***Audit and control:***

VAT as a self-assessment system, facilitates implementation.

- Strong and efficient audit program, to combat fraud and minimize revenue leakages.
- Double invoicing and fictitious invoices concerned as the major issue.
- Harmonizing exemptions and decreasing the number of exempted goods and services.

A few member countries practice the single tax identification number for various tax paying purposes.

Member countries believe that in introducing VAT, the anti-inflationary measures should be undertaken.

In the conclusion the chairperson, Mr. Kettani thanked all active participants, and the host country in particular and member of ATAIC secretariat.

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Then the representative of Pakistan, Mr. Salman Nabi, Chairperson and the speaker of the working group (1) reported the achievements on topic 1- cross border transactions. He shared some of the ideas, views and comments elaborated in the working group 1, with the audience.

He explained about the presentations made by participating countries, which had been structured on the five parameters given by the secretariat.

Mr. Salman Nabi mentioned that, the first presentation was made by Indonesia. It was about some basic regulations contained in their domestic legislations about cross-border transactions, such as permanent establishment, and determination of profits. The second report had been elaborated by Saudi Arabia. They have undertaken the restructuring reforms and there have been many achievements. With regard to foreign trade, new amendments have been made in the year 2004. Two important recommendations were introduced by Saudi delegation. One, they would like to be allowed to audit the account of the companies branches located outside their jurisdiction, and two, they were serious about the way companies allocate research and development expenditures to increase their profit.

Mr. Salman Nabi confirmed that, the point has been very serious for our countries. They ought to know how the expenditures on research and development would be allocated by the developed world in a particular year.

Then he referred to Sudanese delegation's elaboration on their domestic tax laws and their treaties, the Malaysian presentation on cross-border

transactions and equal treatments toward foreign investors and domestic investors.

Mr. Salman Nabi mentioned the system of taxation explained by Kuwait delegation, and also the detailed presentations provided by the Iranian delegation.

He referred to Mr. Jaber, the representative of Iraq who had elaborated on reduction of tax in his country.

Then he explained the presentation of Brunei delegation, where there is no personal taxation; and very good structured paper represented by Azerbaijan delegation.

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The next speech in the closing ceremony was delivered by Mr. Zeinol Abidin, Director General of Inland Revenue Board of Malaysia. In his remarks, he thanked Dr. Aliakbar Arabmazar, the President of the State Tax Organization, and Madam Hosseini-Sadr, the adviser to the President and the organizer of the conference.

Dr. Zeinol Abidin, who had attended the CATA conference, added "I am here to report ATAIC 's attendants of the 26 CATA Technical Conference and CIOTA meeting held in Ottawa, Canada, from August 29 to September 3, 2005".

"CATA is the common work association of tax authorities and one of the largest organizations of tax administration in the world with 46 member states, former colonies of Britain". He proposed ATAIC to accept the membership of CIOTA.

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Then Mr. AliAkbar Arabmazar, the President of the State Tax Organization was invited to deliver his remarks. He thanked all participants specially the heads of delegations from Islamic countries, heads of working groups and also those who presented lectures and actively participated in the deliberations and working groups. He mentioned that the results of the conference would be published and forwarded to all the members and the secretariat would be responsible to inform the member countries about the coming news.

At the end of the closing ceremony, the new chairman of ATAIC, Dr. Aliakbar Arabmazar expressed his thanks and appreciations to all the participants from the Islamic countries:

*"I would like to thank all participants specially the heads of delegations from Islamic countries and also heads of working groups and those who have presented lectures and actively participated in the deliberations and working groups who in fact, enriched this conference scientifically.*

*As you are already aware, two subjects have been taken into consideration in this conference. First, Value Added Tax and second, Cross-Border Transactions. Exchanging our experiences and also using the global experiences on these two subjects became possible, through this conference.*

*Although, I was not able to take part in all sessions, according to the reports which were presented at the beginning by the heads of working groups, and also the reports on the working groups' progress presented by the secretariat, it is noticeable that all participants had willingly been*

*present in the meetings. The fruitful speeches have been elaborated by the representatives of the Islamic countries.*

*The most important subject which has not yet been answered is the decision on the venue of next conference. In the meetings of the heads of delegations, it was decided that the member countries on returning home, consult with their officials about the issue. I am so hopeful that in the next two months, we will reach a very good result.*

*Surely, the secretariat will inform all the member countries about the decisions.*

*All of you are aware that, the world today is developing very fast and also all of the world countries, especially developed states have developed through cooperation.*

*With regard to the common values, the Islamic countries, will definitely achieve their actual position in the global economy, through expansion of their relations and cooperation.*

*In this general description, the position of the ATAIC, I mean the Association of Tax Authorities of Islamic Countries is clarified.*

*Therefore, the objective behind establishment of the Association and the strategy of development and the continuation of its work, has been clearly expressed in the following verse of the holy Quran:*

وَشَاوِرْهُمْ فِي الْأَمْرِ فَإِذَا عَزَمْتَ فَتَوَكَّلْ عَلَى اللَّهِ إِنَّ اللَّهَ يُحِبُّ الْمُتَوَكِّلِينَ

*And take counsel with them in the affair, so when you have decided, then place your trust in God, surely God loves those who trust (3:159)*

*It is necessary for all the Islamic countries to consult and to coordinate their affairs, and undoubtedly, with regard to their internal conditions and policies act wisely.*

*The organization of ATAIC is new. However, with regard to the potential capabilities of member countries and other Islamic countries, we can expect a prospering and bright future for it. Hence, we ought to try to contribute to the promotion of the activities of the ATAIC. We shouldn't limit our contacts to the annual conferences. I hope these contacts and meetings be continued during the year. These scientific and consultative associations not only help to promote the efficiency of our tax organizations but also strengthen the Islamic countries, relationships and constant friendly relationship.*

*I announce the preparedness of the secretariat and the State Tax Organization for pursuing the decisions and the findings of the conference to achieve the goals of ATAIC.*

*At the end I would like to acknowledge the endeavors by the members of the first Secretariat of ATAIC in Kuala Lumpur, and the second Secretariat of ATAIC in Tehran, especially one who has done great efforts to the ATAIC Ms. Hosseini Sadr. Her efforts have been so useful for the progress, of works.*

*I hope all brothers and sisters return to their countries with a good memory from Iran.*

*I hope to see you again in the Third Technical Conference of ATAIC".*

**Declaration of the Second Technical Conference of ATAIC  
Tehran – Iran  
29 November – 2 December 2005**

The participants in the 2<sup>nd</sup> ATAIC Technical Conference, hosted by the Islamic republic of Iran and organized by the State Tax Organization, with the participation of the tax authorities of 22 Islamic Countries, Afghanistan, Azerbaijan, Brunei Darussalam, Comoros, Ivory Coast, Indonesia, Iraq, Jordan, Kuwait, Malaysia, Morocco, Pakistan, Qatar, Saudi Arabia, Senegal, Sierra Leone, Sudan, Syria, Tunisia, Turkey, Yemen, and the Islamic Republic of Iran which took place in Tehran-Iran from November 29 to December 2, 2005,

**Profoundly** concerned with the tax laws & regulations, with regard to introducing and establishing the new VAT system and the tax issues and problems of the cross-border transactions,

**Recognize** that consideration and discussion of the Islamic tax is the fundamental logic of the formation of ATAIC,

**And are interested** in putting into action the decisions made at the technical conferences and observing the values commonly shared by the Islamic societies,

**Hereby agree that:**

1. The activities of the "ATAIC" should be promoted and expanded throughout the Islamic world to develop the network of ATAIC.

2. In order to exchange information on the tax systems of the Islamic countries, to introduce new approaches and to apply advanced technologies, the annual meetings should be held regularly in one of the member Countries
3. In order to provide the grounds for implementing the final decisions made by the tax authorities of the Islamic countries, the ATAIC action plan should be formulated and approved by the member countries
4. In order to provide up-to-date information to the member countries, on the administration of tax and Zakat within the Islamic countries, the secretariats responsible for ATAIC affairs in each country should coordinate and facilitate the exchange of information among the member countries and establish Data Bank for ATAIC members to receive the required information.
5. In order to develop the human resources of the tax administrations, and to promote the skills and knowledge of the tax officials, of the Islamic countries, special training courses, in particular, courses for the training of trainers in one of the member countries with high levels of proficiency and skills, should be arranged regularly.
6. In order to create the ground for exchange of ideas on tax and Zakat issues, and to provide solutions to the critical problems arising at the time of enforcement of the newly adopted regulations, internally and externally, the technical conferences should be held annually in one of the member countries.
7. Zakat, as an Islamic tax, common in the Islamic countries and as the only characteristic which makes the Islamic conferences distinguishable

from the other conferences, should be discussed regularly at the annual conferences.

## **The Member Countries of the ATAIC Including New Members**

- |                |                      |
|----------------|----------------------|
| 1) Bangladesh  | 2) Brunei Darussalam |
| 3) Comoros     | 4) Egypt             |
| 5) Indonesia   | 6) Iran              |
| 7) Iraq        | 8) Jordan            |
| 9) Kuwait      | 10) Lebanon          |
| 11) Malaysia   | 12) Morocco          |
| 13) Pakistan   | 14) Qatar            |
| 15) Senegal    | 16) Sudan            |
| 17) Tajikistan | 18) Yemen            |
| 19) Guyana     | 20) Sierra Leone     |

**Please Sign and Forward to Tehran ATAIC Secretariat  
Country, Organization, Name, Designation, Signature**

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# **THE NEW CHAIRMAN OF ATAIC**

**Dr. Aliakbar Arabmazar**

**PRESIDENT OF THE  
STATE TAX ORGANIZATION**

**Dr. ALIAKBAR ARABMAZAR**  
*President of the State Tax Organization*

Professor, School of Economics and Political Sciences, Shahid Beheshti University, Tehran, Iran

Ph.D., System Science, Michigan State University, U.S.A., 1983

M.Sc., Operations Research, Michigan State University, U.S.A., 1980

M.A., Economics, Michigan State University, U.S.A., 1980

B.A., Business Administration, Tehran Business College, 1977

Vice Minister for Taxation, Ministry of Economic Affairs and Finance, Oct. 1997-Sep.2001, President State Tax Organization

Vice Minister for International Affairs, Ministry of Economic Affairs and Finance, April and Finance, April 1996-September 1997

Advisor to the President and Director – General of Macro Economic Bureau, Planning and Budget Organization, 1995-1996.

## **ANNEXES**

- 1- Reviewed Logo**
- 1- The Background of the ATAIC**
- 2- The Guiding Principles of the  
ATAIC**
- 3- The OIC Member States**
- 4- Selected Pictures and Photos,  
Tehran Conference 2005**

## **The Concept of Design for Association Logo**

## **Background of the ATAIC**

A need for an appropriate grouping that can best represent the interests of Islamic countries on tax and Zakat issues

### **OBJECTIVE OF ATAIC**

To provide a forum for Tax/Zakat administration of member countries

### **ACTIVITIES**

- Exchange of ideas and experiences
- Organizing seminars, workshops and training courses on aspects of Tax/Zakat administration
- Collecting, analyzing and disseminating information on Tax/Zakat issues

### **ACTIVITIES**

- Provide technical assistance and research facilities in the field of tax administration
- Functional cooperation between and among Islamic countries
- Keeping abreast with development of tax related regimes in non-Islamic countries and regional tax associations

### **ATAIC, ANOTHER MILESTONE**

- Networking and functional cooperation among Islamic countries

- Modernization and uniformity of Zakat administration and collection (including review of current philosophy)
- Addressing issues of common interest facing the faith and the Ummah on tax system and Zakat

#### **THE NEED TO ESTABLISH ATAIC**

Reasons for establishment:

- Impact of Globalization
- Current Trends

#### **THE PROPOSED STRUCTURE**

**Initial – An Informal Structure:**

(Along the line of SGATAR)

- Rotation of main activities among members
  - Host country will undertake the administrative and secretariat work
- prospect – A Permanent Secretariat

#### **THE PROPOSED MEMBERSHIP**

Open to all member countries of the OIC and other Islamic countries

#### **FUNDING**

Initially, fund disbursements may be restricted to only technical activities undertaken by a host member country

#### **ENHANCEMENT OF ZAKAT ADMINISTRATION**

- Modernization of Zakat administration

- Role of income tax administrators in Zakat collection
- Integration of income tax and Zakat collection
- Exchange of information
- Greater awareness on Zakat and Zakat administration

#### **BENEFITS TO MEMBERS**

- Keeping abreast on developments of Tax/Zakat matters
- Strengthening of fraternal ties among Tax/Zakat policy makers and administrators
- Developing new methods and approaches on Zakat administration

A mechanism to:

- Learn best practice by member countries through seminars, workshops and training courses;
- Promote understanding among member countries towards the common purpose of improving Tax/Zakat administration.

#### **THE OFFICIAL LAUNCH OF ATAIC**

*Place:* The OIC Summit  
Kuala Lumpur  
Malaysia

*Date:* 11-18, OCTOBER 2003

#### **THE WAY FORWARD**

##### **Short term**

- To form Pro tem Committee

- To draft the ATAIC Constitution
- To organize the First ATAIC Technical Conference

**Mid term**

- To increase number of memberships
- To continue with membership drive
- To conduct workshops in selected member countries

**Long - term**

- A more structured and permanent secretariat
- To conduct research, develop, process and disseminate information and to provide insight in the field of international and comparative taxation/Zakat

# **ATAIC**

## **Guiding Principles**

### **1. ESTABLISHMENT AND NAME**

The Association of Tax Authorities of Islamic Countries (hereafter referred to as the Association) is hereby established.

### **2. OBJECTIVE AND ACTIVITIES**

The purpose of the Association is to facilitate the improvement of tax and Zakat policies and administrations in all their aspects within member Islamic countries in order to meet the challenges of a rapidly changing world. To this end the activities of the Association may include:

- Holding meetings including an Annual Technical Meeting in related Tax/Zakat issues for the exchange of ideas and experiences,
- Organizing seminars, workshops and training courses on aspects of Tax/Zakat organization,
- Collecting, analyzing and disseminating information on Tax/Zakat issues,
- Providing directly or in collaboration with, and generally facilitating the work of, bilateral and multilateral agencies that provide technical assistance and research facilities in the field of tax administration,

- Generally carrying out functions related to overall improvement of the capabilities of Tax/Zakat administration through functional cooperation between and among Islamic countries,
- Keeping abreast all member Islamic countries with development of tax and related regimes in non-Islamic countries as well as activities of regional tax associations.

### **3. CHAIRMANSHIP**

The host country of an Annual Technical Meeting shall assume the Chairmanship of the Association until the next Annual Technical Meeting.

### **4. SECRETARIAT**

Chairmanship of the Association may establish a secretariat with such staff as may be determined in order to facilitate the fraternity of the Association.

### **5. MEMBERSHIP**

- Membership shall be opened to all Islamic countries subject to application rules hereinafter indicated:
  - ▶ Application for membership may be made through the Chairmanship of the Association for circulation to other members for their official responses

- ▶ Chairmanship of the Association may undertake summation of responses for consideration of the Association
- ▶ Consensus/Mushawarah shall be the guiding rule in determination of status of membership application

## **6. ANNUAL TECHNICAL MEETING**

- An Annual Technical Meeting is to be held once a year on a rotation basis among members.
- The Annual Technical Meeting will discuss at least two topics one of which will be a choice of the host country and the other to be agreed among members.
- The host country shall meet and bear the costs of organization other than airfares and accommodation.

## **7. INTERIM ARRANGEMENTS**

The Chairman and members of the pro tem Committee elected by the Meeting at which this Guiding Principles is adopted shall carry out such duties and functions deemed necessary to further realize the formation of this Association.

*Secretariat to be contacted in 2005-2006:*

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