Recent Pillar Two Developments

Middle East Updates | **January 2025**

Kuwait implements Pillar Two from 1 January 2025

The Government of Kuwait has released the law for the implementation of the **Top-up Tax (the "Law")**, which marks a significant milestone in the evolution of Kuwait's tax framework. The Top-up Tax takes the form of a Domestic Minimum Top-up Tax ("DMTT"), and will apply to MNEs that are in scope of Pillar Two. The tax will be imposed in cases where the MNE's effective tax rate ("ETR") in Kuwait is below 15%.

The Top-up Tax (hereafter referred to as "DMTT"), is effective for financial years starting on or after 1 January 2025. Notably, the DMTT will only apply to MNEs with global consolidated revenues (in at least two of the preceding four fiscal years) of at least EUR 750m, including MNEs headquartered in and outside Kuwait. The Law will not apply to local businesses with no operations outside Kuwait (*see other exclusions below*).

The specifics on the DMTT, including details on the calculation methodology, scope and conditions for Covered Taxes, accounting standard, and payment mechanisms are expected to be issued in the Executive Regulations, which are required to be issued by 30 June 2025. It is envisaged that the DMTT will be in accordance with the OECD Global Anti-Base Erosion ("GloBE") Model Rules.

There is no clarity on whether Kuwait will also introduce an Income Inclusion Rule and/or Undertaxed Profits Rule (the other charging mechanisms under the GloBE rules).

In addition, MNEs subject to the DMTT will no longer be liable for Kuwait tax in relation to the following:

- Corporate Income Tax, as per Decree No. 3 of 1955;
- Corporate Income Tax on Operations in the Neutral Zone, as per Income Tax Law No. 23 of 1961;
- Paragraph 1 of Article 12, and paragraph 2 of Article 14 of the Law to Support and Encouragement of National Manpower Employment in Non-Governmental Entities (also referred to as 'National Labor Support Tax'), as per Law No. 19 of 2000;
- Zakat and Contribution of Public and Closed Shareholding Companies in the State's Budget, under Law No. (46) of 2006.

MNEs will need to consider the impact of the Law on their existing Kuwait tax profiles and compliance obligations.

The DMTT is a key tax development for MNEs in Kuwait, and while all the specifics on the tax are yet to be issued, we have outlined below certain key features of the DMTT, including some of our initial reactions and key takeaways.

Key features of the DMTT

Issue	**Comment**
Scope of the rules	The DMTT introduces a jurisdictional-level Top-up Tax on Kuwaiti Constituent Entities ("CEs") and Joint Ventures of an MNE Group, ensuring that profits of such groups are subject to a minimum ETR of 15%. Specifically, the tax would apply where the effective tax rate is below 15%, in respect to the aggregated results of Kuwaiti CEs or Joint Ventures of an MNE Group. It is currently unclear if Kuwait will also introduce the complementary Income Inclusion Rule ("IIR") or Undertaxed Profits Rule as prescribed by the GloBE Model Rules. **Constituent Entities** are entities or permanent establishments that are consolidated for purposes of the MNE Group's Consolidated Financial Statements ("CFS"). **Joint Ventures** are entities that the Ultimate Parent (i.e. the entity that prepares the MNE Group's CFS) directly or indirectly holds 50% or more of the ownership interests and are equity accounted for in the MNE Group's CFS.

Key features of the DMTT

<table>
<tr><th>Issue</th><th>Comment</th></tr>
<tr><td>Excluded Entities</td><td>The Law excludes the below entities from the DMTT:

Government entities;
Non-profit organizations;
International organizations;
Pension funds;
Investment funds that are Ultimate Parent Entities (“UPEs”); and
Real estate investment vehicles that are UPEs.

The conditions for eligibility of the above exclusions are expected to be clarified in the Executive Regulations. Important to note that in accordance with the GloBE Model Rules, while Excluded Entities are not treated as CEs of the MNE Group, the revenue of such entities should be considered in determining whether the revenue threshold of EUR 750m or more is met by the MNE Group.</td></tr>
<tr><td>Calculation of the DMTT</td><td>The Law does not provide details on the calculation aspects of the DMTT. These are expected to be issued under the Executive Regulations.

However, the Law does include the Substance-based Income Exclusion, and also excludes specific types of income, such as dividends, capital gains, and income from international shipping activities. The rules and conditions for these exclusions will be issued under the Executive Regulations.

Assuming the DMTT will be aligned with the GloBE Model Rules, the below would be envisaged as the calculation mechanism:
<table>
<tr><td>Step 1: Calculate the CE Income and Adjusted Covered Taxes for each Kuwait CE and aggregate</td><td>(1) Aggregate CE Income = Sum of all adjusted income for all non-excluded entities in Kuwait</td><td>(2) Aggregate Adjusted Covered Taxes = Sum of Adjusted Taxes for all non-excluded entities in Kuwait</td></tr>
<tr><td>Step 2: Calculate the ETR for Kuwait</td><td colspan="2">(3) ETR = (2) / (1) X 100</td></tr>
<tr><td>Step 3: Calculate the Top-up Tax percentage for Kuwait</td><td colspan="2">(4) Top-up Tax percentage = 15% - (3)</td></tr>
<tr><td>Step 4: Calculate the Substance-based Income Exclusion</td><td colspan="2">(5) Substance-based Income Exclusion = 5% to 9.6% of the sum of eligible payroll costs for all entities in Kuwait + 5% to 7.6% of the sum of eligible tangible assets for all entities in Kuwait</td></tr>
<tr><td>Step 5: Calculate Top-up Tax</td><td colspan="2">(6) Jurisdictional Top-up Tax = (4) X [(1) - (5)]</td></tr>
<tr><td>Step 6: Determine Additional Current Tax / Permanent Difference Tax liability</td><td colspan="2">(7) Determine (if any) whether additional current tax and/or permanent difference tax liability arises due to certain criteria being met, e.g. restatement of financial statements or non-GloBE permanent differences</td></tr>
<tr><td>Step 7: Determine the total DMTT liability</td><td colspan="2">(8) Kuwait total DMTT liability =
(6) + (7)</td></tr>
</table>
If the DMTT follows the GloBE Model Rules, Joint Ventures (and their subsidiaries) as well as Minority-Owned Constituent Entities (and their subsidiaries) will calculate their DMTT liability separately from Constituent Entities in Kuwait. Minority-Owned Constituent Entities as entities that are consolidated but in which the UPE has a 30% or less ownership interest.

While not specifically mentioned in the Law, the expectation is that all Constituent Entities are jointly liable for their DMTT liability, while Joint Ventures’ liability is limited to the DMTT on their respective profits (including their subsidiaries).</td></tr>
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Key features of the DMTT

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<tr><td>Safe harbours and exclusions</td><td>The Law provides for the following safe harbours and exclusions:

de minimis safe harbour - the Top-up Tax is considered nil where the aggregate average revenue in Kuwait is below EUR 10m and the average DMTT Income or Loss does not exceed EUR 1m for the current and two prior fiscal years.
simplified calculations safe harbour - the details will be issued in the Executive Regulations.
the transitional Country-by-Country Reporting (“CbCR”) Safe Harbour - for fiscal years beginning on or before 31 December 2026 and excluding fiscal years ending after 30 June 2028, the Top-up Tax due may be considered nil if any of the simplified tests are met, i.e. De Minimis Test, ETR Test or Routine Profit Test. A Qualified CbCR is required to access this safe harbour.
initial phase of international activity exclusion - the Top-up Tax is considered nil if:

the MNE Group operates in no more than six jurisdictions and holds Eligible Tangible Assets below EUR 50m outside its “reference jurisdiction”, i.e. the jurisdiction which holds the highest amount of tangible assets; and
No interest in the Kuwaiti CEs / Joint Ventures is owned by a parent entity in the group which applies the IIR.

This exclusion only applies for five years from when the MNE Group becomes subject to Pillar Two.
</td></tr>
<tr><td>Registration</td><td>In scope CEs and Joint Ventures will be required to register with the Kuwait Tax Authorities within nine months from the effective date of the Law (by 30 September 2025).

In addition, CEs and Joint Ventures that become in scope at a later date are required to register within 120 days from becoming subject to the Law.

Failure to comply will result in an administrative penalty of KWD 3,000. Details on the registration process and forms are expected to be issued under the Executive Regulations.</td></tr>
<tr><td>Tax filing and payment</td><td>In scope CEs and Joint Ventures will be required to submit a tax return in respect to the DMTT, including audited financial statements from an audit office accredited by the Kuwait Ministry of Finance within 15 months from the end of the tax period. Any taxes due will also be paid by the return submission deadline.

Details on the format of the tax return and payment mechanism are expected to be issued via the Executive Regulations. The 15 months timeline aligns with those adopted by most jurisdictions. There is no clarity on whether a single filing entity will be designated, in case of multiple CEs.

Subject to further details in the Executive Regulations, an advance payment system may also apply for the DMTT in line with the requirements in certain other jurisdictions.

Penalties for non-filing or late filing of DMTT returns are significant and range from 5% to 25% of the tax payable.

Penalties for filing an incorrect DMTT return could apply at 25% of the unpaid tax.

In addition, a fine of 1% of the value of unpaid amounts will apply to every 30 days (or part thereof) from the legal deadline of payment.

The Law also provides for certain other administrative penalties and for criminal penalties for tax evasion of up to three years and/or fines of up to three times the amount of evaded tax. This is increased to five times when the offense is repeated.</td></tr>
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Key features of the DMTT

Record keeping requirements	Groups will be required to maintain the necessary records, documents and financial information used in determining their DMTT liability for a period of 10 years from the date of the start of the relevant tax period.
Statute of limitations	The Law prescribes a period of 10 years from the date of submission of the tax return (or from the filing deadline if the return is not submitted) for the tax authorities to claim any unpaid DMTT liability.
Tax residency	The Law defines a tax resident entity as an entity that either (i) is established in the country, or (i) has its place of effective management in the country. The newly introduced concept of tax residency is important as it determines the location of the entity for the purposes of the DMTT. Groups will need to consider how the Law will interact with the tax residency provisions under double tax treaties once the Executive Regulations are issued.
Definition of permanent establishment (“PE”)	The Law provides a detailed definition, broadly aligned with Article 5 of the OECD Model Tax Convention, on what constitutes a PE for DMTT purposes. The Law clarifies the specific criteria and conditions under which an entity’s activities in Kuwait would be considered a PE and subject to the DMTT. In addition, the Law includes provision that would establish a PE if the Kuwait sourced income of the main entity is exempt from tax in the foreign jurisdiction. Groups will need to consider their current operations to determine whether any Kuwaiti operations trigger a PE under the Law, and how the rules will interact with the PE provisions under double tax treaties once the Executive Regulations are issued.
General anti-avoidance rules (GAAR)	The Law also contains the framework provisions for comprehensive GAAR rules for transactions for which the main purpose or one of the main purposes is to reduce, postpone or exempt from tax, without real or commercial reasons for undertaking the transaction. The Executive Regulations will provide further details on the application of this provision.
Transfer pricing	The Law prescribe that transactions between related entities must adhere to the arm’s length criterion. While the exact specifics have been left to the Executive Regulations, groups will need to reassess their current global and domestic transfer pricing policies in light of these changes.

Further to the above, Kuwait’s DMTT will need to undergo the transitional qualification by the Inclusive Framework before it can be confirmed as a Qualified DMTT, with a peer review process within two years of the Law coming into effect. A similar process will be required to confirm if the Qualified DMTT meets the standards for a QDMTT Safe Harbour. Subject to the details in the Executive Regulations, our current reading of the Law indicates that it is meant to be both a Qualified DMTT and also meet the Safe Harbour criteria. However, the final position will be confirmed based on the Executive Regulations and the outcome of the peer review process.

Must-Do Immediate Next Steps

To comply with the Law, MNE Groups will need to take several immediate steps to assess whether they are in scope, complete the required disclosures for financial year 2024, register if needed, and plan for both interim and year-end compliance requirements. This also includes reviewing their transfer pricing policies and ensuring timely compliance throughout the year. While the Law is expected to be aligned with the GloBE Model Rules, affected MNE Groups should stay alert for ongoing updates, as the Kuwaiti Government will release the Executive Regulations giving clarity to the rules, in addition to explanatory guides, clarifications, and illustrative evidence necessary for implementing the Law. We have outlined some of the immediate steps that must be taken to ensure compliance with the Law.

- **Assessment:** Determine whether the MNE Group is in scope of DMTT including undertaking an impact assessment and, if required, a data and systems gap assessment, to understand the impact (financial and otherwise), whether any safe harbours or exclusions are available, if it needs to register and, if relevant, the steps it needs to undertake to be able to meet its DMTT compliance, reporting and payment obligations, as well as any related financial statement disclosures. This will involve engaging with the broader business functions (finance, legal, tax, investment teams, etc.) within the group to ensure they understand the impact of the DMTT, and the need for internal stakeholder buy-in and attention to tackle it.

- **Financial Year 2024 Disclosure Requirements:** Affected MNE Groups must ensure compliance with IAS 12 requirements relating to Pillar Two disclosures. At a minimum, in-scope MNE Groups will need to disclose an assessment of their Pillar Two profile, including the Law for FY25 purposes. See more in relation to Pillar Two accounting disclosures here.

- **DMTT Registration:** If you are in scope of the DMTT, you must complete the registration with the Kuwait tax administration within the prescribed deadline. Penalties may be imposed for failure to register in a timely manner.

- **Use Assessment for Compliance Planning and Execution:** Based on your impact assessment and data and systems gap assessment, plan for:

    - **Interim Financial Reporting: Interim financial statement disclosures and / or provisions, if required, for the first quarter of 2025.**

    - **Year-End Roadmap: Create a roadmap to ensure end-of-year compliance for tax and financial statement purposes.**

        - This will include not only determining the year-end DMTT tax liability and DMTT filing requirements, but also determining the timing of the DMTT filing, especially in situations where the MNE Group may be in a refund position.

        - In addition, MNE Groups will need to consider the processes to be able to determine and provision for DMTT liabilities to ensure compliance with their statutory financial reporting obligations.

- **Qualified CbCR:** Ensure that CbCR meets the ‘qualifying’ requirements in order to access the reliefs under the transitional CbCR Safe Harbour.

- **Transfer pricing policies:** Map your group’s intercompany transactions, review and update transfer pricing policies to ensure compliance with the Arm’s Length principle. Groups will need to potentially consider their transfer pricing compliance obligations, including the potential for CbCR reporting becoming mandatory as part of the forthcoming Executive Regulations.

Contact Us

MNE Groups operating in Kuwait should plan ahead and prepare for the upcoming compliance requirements. Our team is working on impact assessments, readiness, and implementation and compliance support, such as systems and process updates for a variety of businesses in the region in the context of the Pillar Two rules including DMTTs, and will be happy to support you. Please contact us for further assistance.

Stay tuned for any further updates!

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