An invitation investors cannot afford to miss

As the Middle East prepares to do more business with foreign businesses, Andrew Robinson of KPMG looks at the recent developments paving the way in the GCC.

European businesses have long held the view that the Middle East market should not be overlooked but have found the political instability, different legal systems and investment regulations, which protect locally-owned businesses, a discouragement to investing properly in the region.

We will look at the recent developments taking place in the investment, accounting and taxation fields of the Gulf Co-operation Council (GCC) states, which include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates.

Although each country is different in so many ways, in terms of current developments, the general theme is similar: encouraging foreign investment to help diversify these oil and gas based economies. The methods include:

- relaxation of rules in which foreigners were only allowed minority ownership in local companies;
- long property leases or foreign ownership of land and property;
- developing the free trade zone concepts;
- enhance facilities and infrastructure;
- revised tax structures;
- privatising state monopolies;
- harmonising import tariffs across the GCC; and
- membership of the World Trade Organisation (WTO).

Some of the more significant developments are explained below.

Majority ownership

UAE – Dubai Internet City

Dubai has gone hi-tech with the establishment of Dubai Internet City which is attracting serious investors from around the globe. His Highness General Sheikh Mohammad Bin Rashid Al Maktoum,

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Crown Prince of Dubai and the UAE Defence Minister said: "The mission of Dubai Internet City is to create an infrastructure, environment and attitude that will enable New Economy companies to operate locally, regionally and globally out of Dubai with significant competitive advantages. The attitude dimension in our mission is an important element. It means approaching our customers and business constituents with a view to solving their problems."

Dubai Internet City is believed to be the first free trade zone to enable e-business-related companies to operate globally out of Dubai. Known as the Dubai Technology, Electronic Commerce and Media Free Zone, it is financially and administratively independent. This is a clear indication of the government's commitment on this project. The following business and activities can be carried out in the Dubai Internet City:

Andrew Robinson

- design, development, use and maintenance of all processes relevant to information technology;
- business of e-commerce;
- telecommunications and media services;
- provision of services through the internet or through any other medium, including banking, financial services, insurance, education, call centres, marketing operations, information and recreation services;
- import, export, storage, assembly and packing of products manufactured outside or within the free zone; and
- warehousing, logistics, distribution and re-distribution services.

Free Zone establishments and their employees will be exempt from all taxes and excluded from any restriction on repatriation and transfer of capital, profits or wages in any currency to any place outside the Free Zone for a period of 50 years, which may be renewed.

More than 200 businesses have already committed to Dubai Internet City, including some of the world's biggest technology players.

Certainly the publicity and initial rush to be "a part of the future" has resulted in a significant boost of confidence for the economy of Dubai. But the challenge is to ensure the momentum is continued and, with the commitment of the Government of Dubai, the prospects are encouraging.

Qatar – a new Foreign Capital Investment Law

A new foreign investment law, introduced on 25 November 2000, outlined the foreign investment (business) activities in Qatar. It allows foreign participation in business activities in most areas, except banking, insurance, commercial agency and real estate.

The encouraging development in the new law is the possibility of an increase in foreign ownership in business in Qatar from the previous maximum of 49% up to 100% in the following designated business sectors:

- agriculture;
- manufacturing;
- health;
- education;
- tourism;
- projects which develop and utilise natural resources;
- power; and
- mining.

There is no automatic exemption from 49% limitation on foreign investments. The Minister of Finance, Economy and Commerce is the relevant authority to approve foreign investments in excess of 49%.

The new law also provides certain incentives to the above projects to attract foreign investments in the designated business sectors outlined in the law:

- projects would be allocated land under long-term lease contracts up to 50 years, with a renewable option;
- tax holidays for periods of up to 10 years;
- exemption from customs duty on certain imports; and
- no restrictions on repatriation of profits from projects.

Oman – strategic investment

Oman has been rationalising its laws to encourage foreign investment. It recently announced that foreign ownership of up to 70% would be allowed in certain strategic and semi-strategic sectors, including petroleum and petrochemical industries and industries focusing on exports such as textiles.

There are also proposals to allow 100% foreign investment by 2003 in banking and insurance, and by 2005, in the telecommunications sectors.

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Bahrain - industrial free zone

Bahrain plans to continue developing free zones with a recently announced industrial free zone, which, once approved, would provide efficient service for both national and foreign investors. Boosting commercial activities as part of an overall development programme is on top of the priority list in the new era of changes now sweeping Bahrain.

Wholly-owned foreign companies are allowed where the company is setting up an industrial, service or distribution (offshore) company.

World Trade Organisation (WTO)

Saudia Arabia

Saudi Arabia, the only Gulf Arab state still outside the WTO, is making progress in its bid to join the world body. The world's largest producer and exporter of oil, it has been trying to join for years but has struggled to meet WTO criteria on the liberalisation of its trade. The Kingdom sees membership of the WTO, which administers rules agreed by all member countries, as a way of diversifying its oil-led economy. It has taken several steps towards this, issuing a new investment law that allows foreigners for the first time to own projects and related property.

Oman and Bahrain

Oman and Bahrain are members of the WTO and have recently made significant moves to curtail monopolistic trade activities such as the amendment to the sole agency laws. Before, a third party needed the relevant agent's consent to import-branded goods into Bahrain, for example, and was obligated to pay a commission of 5% (of the value of imports) to the agent. After the amendment, anyone can now import goods into Bahrain without consent of the agent – the commission of 5% is payable only if the goods are not imported from the manufacturer of those branded goods.

Privatisation

Oman – taking the lead

Oman has taken the lead among the GCC states in devising and implementing a privatisation policy. In 1996, it became the first Gulf state to turn exclusively to the private sector to build, own, operate and transfer (BOOT) a key power project. The government has recently announced three other build, own and operate (BOO) power projects for the private sector. In the next five years, it also hopes to privatise much of the power generation, electricity transmission and distribution.

A recent successful example of a joint venture between the government and private investors was the successful commencement in November 1998 of the $250m container transshipment port in Salalah in Southern Oman. Other sectors attracting the government's attention for privatisation include telecommunications, air transport, sewage and water.

Kuwait – moving towards privatisation

The government of Kuwait aims to pass key draft reform laws through parliament by the end of June, which will open the doors to privatisation as early as 2003. State finances have improved sharply over the past 22 months, with soaring budget surpluses due to higher world oil prices and increased liquidity from Iraqi cash flowing in from 1990/91 Gulf crisis compensation funds. However, the economy remains sluggish and the cabinet has been discussing steps to implement long-promised reforms, cut non-development spending and boost the private sector.

Kuwait is preparing to seek advice from the World Bank and international consultancies to lay the groundwork for eventual privatisation of heavily subsidised services such as water, electricity and fixed telephones.

Offsets group

The UAE Offsets Group (UOG) Programme has resulted in 21 joint ventures and a combined capital of roughly AED2bn, according to a UOG official. The projects in partnership with

international defence contractors range from shipbuilding, fish farming and financial services to agriculture, medical waste management, training and business centres.

The implementation of the programme is not the UOG's only responsibility, however. In the past three years, its role has matured into that of a development agency and a venture capital organisation. It is also working as a think-tank and assisting the government to develop and implement new projects on a fast-track basis. The group has also come up with initiatives designed to complement the hydrocarbons sector and add more value to the local and regional economies

Unifying import tariffs

Preferential tariffs

Saudi Arabia has this year eased regulations to allow imports of goods from fellow Gulf states under preferential tariffs, moving towards a unified Gulf market, and has scrapped the requirement that imports must be made by firms owned by Gulf citizens in order to qualify for preferential treatment in the GCC's tariff regime. Instead, it has decided that products imported into the Kingdom from fellow GCC members must have at least 40% local added value to enjoy preferential tariffs.

The decision was taken as part of a long-held goal of freeing up regional commerce and creating a trade bloc among the Arab states. For European investors it also means that goods produced by a wholly-owned European branch in any GCC state could also enjoy these preferential tariffs if it meets the 40% local added value test.

Saudi Arabia has been modifying legislation to attract foreign investments. Last July, authorities began issuing licenses for foreign investments and some 91 permits were issued up until April this year, worth more than $8bn.

Accounting standards

IAS compliance

Regulators in Kuwait, Bahrain and Oman have taken steps to monitor compliance with IAS 39 on financial instruments which is now effective. For example, in Oman the Capital Market Authority (CMA) is requesting public companies releasing their 2001 first quarter results to furnish an audit report specifically addressing compliance with the IAS 39.

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The Saudi Arabian Accounting Standards mainly follow the US GAAP. But in the rest of the GCC local commercial laws are silent about the application of accounting standards by reporting companies, with the exception of banks, which adopt International Accounting Standards (IASs) in accordance with the requirements of the relevant central bank.

Discrepancies

However, the relevant economic departments look to auditors to encourage their clients to adopt IASs. Thus, most big businesses in the region either follow US GAAP or IASs. Occasionally, this does give rise to differences between the locally reported results of the business and those reported to the investor in accordance with the investors accounting policies. As the European accounting standards converge towards IAS there, differences are expected to diminish.

Taxation

Reduced taxation in Oman

Oman has cut tax rates from 50% to 30% for foreign companies and local companies where foreign investment exceeds 70%. All other companies are now subject to a maximum tax rate of 12%. It is the only state of the GCC to impose taxation on local companies. As with the other states, there is no personal taxation in Oman.

Double tax agreements

All GCC states have concluded, or are in discussions regarding, double taxation treaties with a number of countries, including the UK, France and Italy.

Capital gains

A recent issue that has become the subject of much discussions and litigation is whether income by way of dividends and profits arising from sale of shares are liable to tax. There is some ambiguity on this matter as the tax laws are not explicit. In Qatar, while there are no guidelines available, it is considered that profits from the sale of business will attract the same tax rates as are applicable to business income, and that overseas income can be subject to tax in the region if the overseas income is related to sources in Qatar.

In Oman, the tax authorities have, however, accepted that capital gains arising from sale of businesses are not liable to tax so long as the business was not originally acquired by payment of a goodwill which was claimed as a tax deduction. It has also acknowledged that income arising overseas is not liable to tax.

Future investment

Stabilitiy

The Gulf States need to attract more foreign direct investment and this can only be done by demonstrating that the region is politically stable, which is priority number one for investors who see it as a single entity for investment, according to Horst Kohler, Managing Director of the IMF. Whilst perhaps more work needs to be done in this regard we can see from the above analysis that the economic measures being taken will contribute to further investment in the region. ■

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