

THE UNIVERSITY OF HULL

"Kuwait's Tax Reformation, Its Alternatives And Impact  
On A Developing Accounting Profession"

Being a Thesis Submitted for the Degree  
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*" Abstract "*

Since the discovery of oil, Kuwait has witnessed a vast economic transition which has boosted a significant welfare state. However, in recent years the situation has changed, influencing the state budget and financial resources. The search for sources of income other than oil gave rise to the possibility of imposing taxes in a hitherto tax-free country. The 1955 tax law was applied only to foreign enterprises operating in Kuwait, and since then few attempts have been undertaken to reform it.

The purpose of this study is to examine the tax alternatives available to Kuwait, which could increase state revenues, and reduce the level of inequality among the population resulting from the government land purchasing programme adopted in the early sixties. It also aims, through an empirical investigation, to reveal the potential impact of tax reformation on the development of the emerging accounting profession in Kuwait.

The determination of the most appropriate tax policy for Kuwait necessitates the examination of the views of those parties most concerned, who are defined in this study as the public, foreign investors, and accounting practitioners. Accordingly, questionnaires were designed, tested, distributed and analysed to reveal attitudes

towards tax reformation. In addition, interviews with concerned persons in the country, including tax legislators, officials, and authors, were conducted, so as to further examine these attitudes and other aspects of tax introduction. Based on the findings of this investigation as well as the traditional literature survey, appropriate reforms are suggested, including reformation in the legislative, administrative, and technical considerations of the tax introduction.

Moreover, recommendations concerning the development of the accounting profession to accommodate the new tax era are also made, including better organisation of the profession, and its contribution to taxation in Kuwait.

*In The Name Of ALLAH, Most Gracious, Most Merciful*

*I Would like to dedicate this thesis*

*To My*

*Mother & Father*

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## INTRODUCTION

### 1> *Nature Of The Problem*

The present study concerns Kuwait's developing economy, of which, the mere mention conjures up to many, images of oil and tremendous wealth. Most of the general literature on developing economies is either irrelevant or inapplicable to Kuwait. All previous works presume a shortage of capital or lack of necessary funds for economic growth, and an imbalance between public finance (budget allocation) and the ability to save.

About 5 years ago this surmise would not have been of much significance to Kuwait and many of its fellow oil exporting states in the gulf, because they were not confronted with such problems. Nowadays, Kuwait's economic atmosphere is totally different at both the international and national levels, than it was a few years ago. How to deploy the requisite capital to obtain maximum future benefits had been the basic problem which challenged the Kuwaiti government. Instead, the problem of financing investment and resources allocation has arisen in the last few fiscal years. Consequently, the possibility of using tax as an alternative source of finance, materialised in the Kuwaiti government's plans.

Few attempts have been undertaken to reform the tax system of Kuwait, and none of these attempts have been successful. The search, however, continues for an appropriate tax policy. Therefore, this study is to assist in this search.

## 2> *Statement Of The Problem*

The controversy over tax reformation has distorted the calls to rationalise and plan the present tax legislation. This legislation has been in force for more than 30 years, since 1955. Neither effective tax studies nor methodological tax planning have yet been conducted, despite the considerable urgency attached by the government to this issue.

The situation has been exacerbated by the great inequality among the population, represented by the high Gini coefficient of 0.47 measured in 1972/73 (see chapter 3). This inequality has been increased by the government's oil revenue distribution policy in the early seventies, which was implemented by means of a land purchase programme and reserving certain occupations for nationals.

The process of tax policy formulation requires further analysis and scrutiny. The present study is an attempt to investigate anew financial resource in Kuwait's economic, political and social setting. The thesis is also concerned with the evaluation of the impact of the introduction of tax on the developing accounting profession. Further, tax as an instrument for redistributing national wealth and altering the economic framework of the country is investigated.

Financial budgeting in general, and tax formulation in particular have been entirely left to the government and little responsibility has been assumed by the professions concerned. The development of the profession itself largely

depends on moves by the government. Tax reformation could contribute significantly to the advancement of the accounting system as a whole, in addition to the important measures required to regulate the profession.

The accounting profession is a major element in the achievement of a successful tax system, to the extent that an inadequately correlated accounting structure could result in significant distortions in the application of tax legislation. This interaction between the accounting profession and taxation could be employed to the advantage of both elements, if promptly investigated and planned in Kuwait.

### *3> Objectives*

The introduction of taxes in Kuwait is a complex subject which has not yet been explored. With few studies conducted on this issue, the purpose of this particular study is to define the tax criteria most applicable to Kuwait and develop an appropriate tax policy, including the tax packages and organisational structure of the tax administration.

There is no existing study which summarises the current tax position in the country and the role of the accounting profession in its enforcement. Indeed, few studies world-wide have been devoted to such a goal. Many accounting firms in Kuwait have totally abandoned tax services and devoted themselves exclusively to the traditional kinds of accounting and auditing work. Such

practitioners need to be aware of their role in tax introduction and the feasibility or otherwise of its implementation. In addition, concerned parties, such as administrative officials, accountants and lawyers, should contribute to its enforcement.

This study also aims to shed light on the forecasting of taxable capacity, including the suggestion of a tax policy most applicable to Kuwait. In making this analysis the researcher will formulate an operational definition of the tax formula in Kuwait which could be relevant to the other Gulf states also.

In summary, then, the study's objectives in order of priority are as follows:

- 1> To investigate attitudes towards tax introduction in Kuwait;
- 2> To suggest tax reformation methodology and procedures;
- 3> To identify means to establish a capable tax authority;
- 4> To discuss the role of the accounting profession in this reformation and its responsibilities of enforcement.

#### 4> *Procedures & Research Methodology*

The methodology used in this research is a combination of traditional library search together with the use of the questionnaire technique. The library search will review current trends in the area of taxation, and its interaction with the accounting profession.

A literature survey on regional policy has been carried out emphasising major issues arising from attempts

to impose income tax in Kuwait during the last 10 years. The survey begins with the background to economic development and public welfare. It then moves on to look at the effects on investment of various tax policies from the early, simple policies to more recent financial budgeting. A review of all pertinent cases is also employed. On the basis of this literature survey, an attempt is made to devise an ideal tax system and the relevant financial budgeting rules.

Traditional analysis is the method of analysis most useful in matters of argument such as tax reforms. An assessment of the current position such as this, probably does not lend itself to such methods as well as does a presentation of opposing views. A straight-forward historical account is of limited use, because a study such as the present one is to some extent both an ongoing, and evolutionary one. The sensitivity of the issue and the importance of its outcome require wider contribution than from the history alone. The literature review and description of past experiences in Kuwait cannot provide a complete picture of the problem.

Before gathering evidence to achieve the objectives, the question must be addressed of who is involved in the introduction of tax and the means by which information is exchanged. The decision was made to consider the 3 selected samples as the parties most concerned. A review of the questionnaire results revealed that this decision was



appropriate and the obtained results were indicative.

In particular, through the use of questionnaires, the study attempted to determine the attitudes toward tax introduction in Kuwait of 3 concerned parties, namely; the public, foreign investors, and accountants in the accounting firms. The questionnaires also illuminated the extent of contemporary tax practice by accounting firms. Respondents were selected in the Kuwaiti metropolitan area, regardless of whether they are in favour of or against tax.

Questionnaires distributed to accountants, foreign investors, and the public in general, attempted to determine the type and extent of tax introduction desired by all parties. It is hoped that the suggestions presented here will reflect the attitudes actually prevailing in Kuwait.

The data collected by means of questionnaires were then statistically analysed and tested against some assumed premises. In an attempt to provide supporting and supplementary information, interviews were conducted with some respondents and other concerned persons.

Because some of the data gathered does not meet the requirements of parametric statistical analysis, the experimental hypotheses were tested using non-parametric statistical tests. Chi square comparison was used to test for significant variables affecting the attitudes of the public toward tax introduction.

The study included also, a thorough review of the limited literature, and an analysis of the tax proposals and attitudes toward tax introduction. The views of

government personnel as well as other parties were sought and investigated, and all of these sources discussed in relation to the actual state of tax introduction.

In addition to the ordinary methods of obtaining information, government publications and pertinent legislation were obtained and analysed. Examples of such records are indicated below:

- 1> Ministry of Finance publications and pronouncements.
- 2> Unpublished materials from the Microfilm Centre of the Ministry of Finance.
- 3> Unpublished studies conducted by the Ministry of Commerce.
- 4> Explanatory memos and official correspondence from the library of the Oil Ministry.
- 5> Relevant official memorandums of Kuwait Airways with regard to double tax agreements and double tax relief.
- 6> Various articles and comments from the Information Centre of the daily 'Al-Watan' newspaper.

5> *Importance Of The Study*

This study analyses in full the history of Kuwait's tax system, which has recently proved to be one of the most pressing issues in the financial budget of Kuwait state. Interest in Kuwaiti taxation arose more than twenty four years ago in 1963, when a commission from the International Bank for Reconstruction and Development recommended that a generic tax law should be imposed in Kuwait.

Many parties were actively involved in the search for appropriate tax legislation in Kuwait during the long

negotiations which have continued over the past three decades. Kuwait's Ministry of Finance was determined to secure the best financial and legislative terms possible, while various groups have negotiated for their own vested interests.

Events in Kuwait have been interrelated with and parallel to oil price recessions and the Gulf War, which necessitated further budget restrictions on both revenue and public expenditure. Further, the collapse of Kuwait's Stock Exchange drew the government deeper into deficit implications. These events gave rise to the search for financial sources of public revenue other than oil. Moreover, it necessitated the issue of accounting and auditing regulations within the financial sector.

It has never been possible to devise a perfect tax system, and demonstrate completely its reform, size, and effect. What this analysis can hope to do is to give the best available picture of tax reform, and the tax administration at this point. It does not, however, attempt to explore the economic, legal and social aspects of the subject in great depth.

The issue of tax system reformation in Kuwait is one which requires imperative technical and empirical research. Accordingly, this study attempted to define the packages and parties of the tax system, and to determine, through the examination of tax-related subjects and empirical data, an appropriate strategy for Kuwaiti taxation.

## 6> *Limitations*

The topic under investigation is made more complex by the huge amount of tax and tax-accounting data that have to be dealt with. Further work is needed here as the concentration in this study is on Kuwait's tax reformation and its influence on the accounting profession, for which there are few relevant sources of information.

Overall, two obstacles are confronted which necessitate careful analysis and multiple testing. These preclusions are:

1> The sources quoted are such as to provide in most cases information in much greater detail than is possible in a thesis of this type and size, dealing with a number of factors related to a specific area ( tax reformation avenues and its impact on the accounting profession).

2> Major limitations derive from obstacles affecting data gathering. The following are material examples of these limitations:

- A. Politicisation of information.
- B. Lack of freedom from bias.
- C. Unavailability of sufficient useful data.
- D. Inconsistency.
- E. Confidentiality.

In addition to the above hindrances, the little consistent information available was not in the English language, or was out of date. This problem has been proportionally lessened by liberal translation, and by updating Arabic data as far as was possible.

At the same time the researcher is aware of his inadequacy for the task of tax reformation. To address the

subject of tax formulation and tax accounting when one's authority in the field is yet to be established is an act of temerity. However, as stated above, the sensitivity and importance of the issue leave no room for postponement, albeit that the attempt is made by a non-authorized person. The researcher's professional interests and enthusiasm, together with the significance and attraction of the subject, have considerably lessened such difficulty. Above all, the researcher is impelled by his commitment and debt to his country to compete against such difficulties.

#### 7> *Hypotheses*

In the process of constructing, testing, accepting or rejecting of hypotheses in this thesis, two criteria will be considered. These are relevance and predictive ability. Relevance in this context implies close association between factors included in a hypothesis and the results produced. In other words, the objectivity of the reformation as well as its applicability is the most relevant element that should be included in the study of Kuwait's taxation. Other factors with little or no relevance are excluded or marginally dealt with, for instance, the political or the economic implications of the tax reformation.

As for predictive ability, the study is based on specific considerations under which the predictions are made. In particular, predictions are based on future inputs, such as that taxation will soon be introduced in Kuwait. They also apply to Kuwait taxation as a phenomenon

which has occurred though no observations on it have yet been made.

The validity of the preliminary hypothesis -the tax objectives- is subject to examination from different viewpoints, and verifications are made to clarify whether it is accepted, rejected or ought to be replaced. This hypothesis is replaced with a more comprehensive hypothesis, e.g. a combination of tax objectives behind the reformation of tax and the obstacles confronting its change: economic, political, administrative, etc. This approach has provided results more closely applicable to the observations in Kuwait.

The subject under investigation is founded on a set of beliefs about society. Its claim is to involve the objectives, interests and attitudes of the people. These factors can only be sustained within the context of the underlying assumptions - assumptions about what is being investigated and why, and to whom information is being made available and for what purposes.

In this research, experimental methods such as questionnaires and relevant statistical analysis are employed, in addition to the traditional research methods, such as the literature survey and the descriptive analysis. A concerted effort has been made to comply with this method, which in its turn contributes to the conclusions eventually reached.

8> *Use Of Abbreviations*

For the purpose of brevity and simplicity, the following terms are frequently used to indicate:

AB :- The Audit Bureau.

AICPA:- American Institute of Certified Public Accountants.

CEAR :- Committee For The Establishment of Accounting Rules.

DC :- Developing Countries.

FGA :- Future Generations Account.

GCC :- Gulf Co-operation Council.

IBRD :- International Bank For Reconstruction and Development.

ICAEW:- Institute of Chartered Accountants in England and Wales.

IMF :- International Monetary Fund.

KD :- Kuwait Currency (The Dinar = £ 2.120 ).

KOC :- Kuwait Oil Company.

KSAA :- Kuwait Society of Accountants and Auditors.

LDC'S:- Less Developed Countries.

OPEC :- Organisation of The Petroleum Exporting Countries.

RC :- The Accounting Registration Committee.

VAT :- Value Added Tax.

### 9> *Organisation Of The Study*

This study is presented in 12 chapters. Following this introduction, chapter one describes the economic background of Kuwait including the public sector and the financial budgeting of the state, covering the period before oil discovery and after the oil boom in the country. As a background to our discussion, this chapter also analyses the rationale of taxation in Kuwait and its potential effects.

In particular, the question of fiscal deficit, limited resources and budgeting limitations is discussed in this chapter. Attention is also focused on the argument about the redistribution of wealth, the current income distribution measures in Kuwait, and the policies designed to reduce inequality.

The first part of chapter two relates to the tax act of Kuwait and a discussion of other relevant laws. This discussion begins with the taxes before and after the oil boom. Moreover, Kuwaiti tax legislation and related commercial provisions are discussed, as are the merits and disadvantages of the 1981 tax proposal. In order to illustrate the significance of this study, an analysis of the tax laws of the Gulf States is given. The new era of taxation in the country is also described.

Chapter three deals with the measures of tax capacity and administration effort in Kuwait. This section is presented after a theoretical discussion of the ideal tax structure and review of arguments regarding tax objectives. The tax capacity and revenue stability measures as applied



to Kuwait, are also discussed.

Chapter Four contains a descriptive analysis of the status and deficiencies of Kuwaiti accounting, and the government auditing system. Recommendations for its regulation and improvement are also made.

The role of accountancy in tax enforcement and tax impact on the accounting profession is examined in chapter five of this study. There has been very little literature specifically examining this subject, but relevant historical evidence is discussed in this chapter.

Chapter six discusses the attitudes, criticisms, and improvements suggested by the public sample with reference to the introduction of tax in Kuwait. It also contains the statistical analysis of replies to the public questionnaire and the hypothetical testing.

Chapter seven deals with the attitudes of foreign investors toward tax introduction. Emphasis is placed on the difficulties that confront them in Kuwait, and their evaluation of the incentives provided within the present tax legislation. Further, their views regarding the implications of tax on their investments are also revealed.

Chapter eight outlines the perceptions of accountants toward taxation in Kuwait, and their role in its enforcement. It also examines their evaluation of the current tax legislation and administration. Specifically, this chapter investigates the contribution of accountants and the accounting firms and other institutions to tax reformation.

The regional aspects of taxes are then introduced through an examination of the tax legislation of some neighbouring countries. Taxes in Saudi Arabia, Egypt, and Jordan are examined in chapter nine. Useful tax experiences of other countries are also examined in order to provide some guidance in the process of tax legislation formulation.

Chapter ten summarises indirect taxes in Kuwait and their applicability to Kuwait. The elasticity assessment of the present indirect tax including import duties is introduced and statistically analysed. The nature, types and use of indirect taxes including value added tax are then discussed as these may be included in the tax policy. The scope and validity of VAT is also examined.

Based on the research findings, a proposed general tax formula for gradual employment by Kuwait's Ministry Of Finance is developed in chapter eleven. Further, the optimal design of Kuwait's Tax Authority is indicated in this section, and the provisions of its establishment are discussed as an essential objective of the theme.

The findings of this study are given in chapter twelve. They confirm the request for legislation, tax administration and pertinent accounting procedures as a priority in the fiscal plans of the Kuwaiti Government. This chapter also contains a summary of the research and its recommendations. The final part of this chapter is devoted to the limitations of the study and suggestions for further research.

*Chapter One*  
*"Economic Development"*

**1.1 The Background to Economic Development**

Kuwait is a small country situated at the north western angle of the Arabian Gulf with a land area of 18,000 square kilometres and a population approaching 1.8 million in 1987. It is bounded by Iraq on the north and west, by Saudi Arabia on the south and by the Arabian Gulf on the east. The land is a flat, sandy desert broken by shallow depressions and low hills.

Before the eighteenth century Kuwait was a nominal settlement of the "Anaiza" tribe who ruled the area and established modern Kuwait later on. At that time and prior to the oil boom, Kuwait's major economic activities were pearling and fishing as well as small-scale trading. Throughout the nineteenth century Kuwait was a mid-point of Gulf trading patterns and cargo that commenced with various commodities bought at Basra - Iraq - which were then traded down the Gulf coast either for money or other goods.

In December, 1939 Kuwait Oil Company (KOC) was established by the Gulf Oil Corporation and The Anglo-Persian Oil Company (which later became British Petroleum).<sup>(1)</sup> After long negotiations, an agreement was reached between the Kuwaiti ruler (Sheikh Ahmed Al-Jabir) and the British Government represented by the Anglo Persian Oil Company. KOC had an initial capital of £50,000, was to have 3 directors from each party and to remain a British

company until 1975 when it was nationalised by the Kuwait government.

On signature of that agreement the Sheikh was granted 475,000 rupees, approximately £70,545. At that time the Indian rupee was the prevailing currency and equalled 0.075 of the present currency, the Dinar. In addition, the concession included the payment of 3 rupees per ton - won and saved - or 95,000 rupees (about £14,108) per annum, whichever was the larger, until oil was declared obtainable in commercial quantities. Subsequently, the concession was altered to 250,000 rupees (£37,129) per annum or the 3 rupees per ton royalty whichever was the greater plus, in lieu of all taxes and dues, 4 Annas (6p) per ton of oil on which royalties were payable.<sup>(2)</sup>

The original concession was first amended in 1951, when an Income Tax was imposed on the KOC's profits. The tax was computed in such a way that, together with the royalty payments, provided the Kuwaiti Government with revenues equal to half of the KOC's profits on oil exports. In that same year the company's concession was also extended by seventy five years to 2026. Further amendments to the concession were negotiated from that point. One of the most notable changes was the relinquishment of over half of the original concession area in 1962. This area then came under the control of the Kuwait National Petroleum Company (KNPC).<sup>(3)</sup>

In fact, Kuwait's modern economy was founded in 1946

when the first oil shipment was exported. The country's growth since then has largely mirrored the smooth swift exploitation of its vast oil reserves. Within a span of no more than fifteen years its population came to enjoy living standards normally considered the prerogative of the most developed among the Industrialised countries.<sup>(4)</sup> The pattern of growth that Kuwait has experienced since 1946, the development of its infrastructure, institutions and the welfare system that has evolved are unparalleled in modern history.

This chapter is thus devoted to a brief analysis of the main features of Kuwait's economic growth covering the expansion of the fiscal system and budgeting to reach the current financial position, focusing special attention on the development of Financial Resources and Public expenditure.

## 1.2 Foundation of The Kuwait Economy

Oil was not only the leading sector after 1946, but it was quickly substituted for many of the country's traditional activities, particularly pearling, seafaring and fishing. The swiftness with which oil exports acquired a predominant role was essentially due to the small size of the economy (estimated GNP in 1975 was less than \$5 billion) and the rapid increase in oil revenues.<sup>(5)</sup> Table 1.1 illustrates the growth of oil production and government oil revenues during the period of 1946-1987. As the table shows, oil production growth was subject to noticeable

TABLE 1.1

Growth of Oil Production and Revenues, 1946 - 1989

Year	Crude Oil Production		Government Oil Revenues	
	(Million US Barrels)	(Annual Increase %)	(Million \$US)	(Annual Increase%)
1946	5.9	-	0.76	-
1947	16.2	174.0	2.07	172.3
1948	46.5	187.0	5.95	187.4
1949	89.9	98.0	11.52	93.6
1950	125.7	39.0	16.09	39.6
1951	204.9	63.0	18.00	11.8
1952	273.4	33.0	57.00	216.6
1953	314.6	15.0	169.00	195.6
1954	349.7	11.0	194.20	14.9
1955	402.7	15.0	281.70	45.0
1956	405.5	0.6	293.70	4.2
1957	424.8	4.7	308.00	4.8
1958	522.4	23.0	356.00	15.5
1959	525.9	0.6	419.40	17.8
1960	619.1	17.7	445.80	6.3
1961	633.3	2.2	467.40	4.8
1962	714.6	12.8	484.40	3.6
1963	765.2	7.0	513.80	5.7
1964	842.2	10.0	554.40	7.9
1965	861.5	2.3	567.50	2.4
1966	907.2	5.3	598.30	5.4
1967	912.4	0.6	648.80	8.4
1968	956.6	4.8	736.70	13.6
1969	1011.7	5.8	690.20	-6.3
1970	1090.6	7.8	784.00	13.6
1971	1116.4	2.4	963.00	22.8
1972	1201.6	7.6	1650.00	71.3
1973	1102.5	-0.8	1795.20	8.8
1974	929.3	-15.7	7094.90	295.2
1975	760.7	-18.2	8641.20	21.8
1976	785.2	3.2	9802.80	13.4
1977	718.0	-8.5	8963.10	-8.0
1978	776.9	8.2	9555.48	6.6
1979	911.0	17.26	11537.18	20.73
1980	1467.2	61.03	21385.8	85.36
1981	1017.0	(30.06)	15874.47	(25.77)
1982	731.0	(28.12)	9950.76	(37.31)

- Cont. 2 -

Year	Crude Oil Production		Government Oil Revenues	
	(Million US Barrels)	(Annual Increase %)	(Million \$US)	(Annual Increase%)
1983	912.0	24.76	8404.56	(15.53)
1984	885.0	2.96	10524.96	25.22
1985	861.0	(2.71)	8137.05	(22.68)
1986	1200.0	39.37	7090.71	(12.85)
1987	1100.0	(8.33)	6196.42	(12.61)
1988*	1124.0	2.18	6331.61	2.91

\* Estimates

- Sources:- Khouja M. and Sadler P., "The Economy of Kuwait" London, 1978. P. 26.
- Central Bank of Kuwait, "The Kuwaiti Economy 1980 - 1984" Bulletin, 1984.
  - MEED, Kuwait- Special Report, April 1988, P.24.
  - Ministry of Planning, Annual Statistical Abstract, Edition XXIV, 1987.

fluctuations after the year 1973, mainly due to external factors such as the Arab-Israeli war and collapses in oil prices, especially in the early eighties.

The Kuwaiti economy, like that of some other developing countries, is excessively dependent on a single commodity- oil. The average contribution of the oil sector (including gas production) to GDP was over 66%. Table 1.2 shows the annual oil sector contribution to total state revenue. Clearly, during the last 5 to 6 years the contribution of oil revenue to national income has changed in relation to other sources of income. Additionally, the Kuwaiti economy was and still is, exceedingly vulnerable to factors beyond its control, associated with the international oil market's fluctuating prices.

In response to the falling price of oil, the Kuwaiti government adopted a severe conservationist strategy regarding its oil production. In April 1972 a reduction in crude oil production of 860,000 barrels per day was set after a peak production level of 3.86 million barrels per day early in that year. Two years afterwards a 2 million barrels per day limit was reached as an application of that policy.

Perhaps the motivation behind the conservationist policy was the inability of the domestic economy to absorb all revenues arising out of crude oil production.<sup>(6)</sup> During 1970-1977 when oil prices were extremely high, Kuwait produced 3 times as much oil as it needed for development expenditure. Thus, even though Kuwait's spending and



TABLE 1.2

Sectorial Contribution to GDP (a)

1970/71 - 1984/85 (b)

(in million KDs)

Year	(1) Oil Sector	(2) Non-Oil Sector	(3) GDP	-in percent-	
				(1)/(3)	(2)/(3)
1970/71	736	348	1084	67.9	32.1
1971/72	949	468	1417	67.0	33.0
1972/73	947	634	1581	59.9	40.1
1973/74	1447	665	2112	68.5	31.5
1974/75	2660	790	3450	77.1	22.9
1975/76	2295	984	3279	70.1	29.9
1976/77	2417	1372	3789	60.6	39.4
1977/78	2313	1614	3927	58.9	41.1
1978/79	2533	1655	4188	60.5	39.5
1979/80	4560	1781	6431	72.3	27.7
1980/81	5059.2	2388	7447.2	67.9	32.1
1981/82	4117.8	2620	6737.8	61.11	38.89
1982/83	2805.0	3192.2	5997.7	46.76	53.24
1983/84	3086.3	3329	6415.3	48.10	51.90
1984/85	2902.0	3522.9	6424.8	45.16	54.84
1985/86	2801.9	3133.1	5935.0	47.20	52.79
1986/87	1655.6	3324.4	4980.0	33.24	66.75
1987/88	1776.2	3473.8	5250.0	33.83	66.67

(a) In market prices.

(b) The non-oil sectors are the following: Agriculture and fishing; Manufacturing; Electricity; Gas and Water; Construction; Trade; Finance and Real Estate; Transport and Communication; Taxes and Other.

Sources:- Andary S. A., "Surplus Saving and the case for a regional market in Kuwait" a Ph.D. Thesis University of Aberdeen 1982.

- Ministry of Planning, An Analytical Study of the National Accounts of the Kuwait Economy 1970/71-1975/76; + Annual Statistical Abstract, C.S.O., ed. XXIV, 1987.

- Central Bank of Kuwait, Quarterly Economic Bulletin, 1984.

investment ability has progressively risen (illustrated in Table 1.3 column 3), over 75% of its actual production was more than the requisite development expenditure ( 22% of Actual production would cover domestic consumption plus development employment- Table 1.3, column 8).

In other words, the gap between Kuwait oil production during the seven year period 1970-1977 and the requisite oil production for development and consumption (shown in Figure 1.1) gave rise to Kuwait's tremendous savings surplus. However, Kuwait oil production in the period 1980-1989 showed a general downward trend, after peaking in 1979 at 2.5 million barrels/day. This was in line with the shrinking world demand for oil in general, and for OPEC oil in particular as well as Kuwait's obligation to comply with the OPEC quota and prices.

Eventually, Kuwait's oil revenues dropped sharply in the years 1981-1984 by 30%, 17%, 8% and 3% respectively. Income Tax and royalties received from the Arabian Oil Company (A.O.C.), which produce oil in the south fields on a sharing basis with the Kuwaiti Government, have also declined by 45% and 70% in 1982 and 1987 respectively.

In the early eighties, Kuwait oil revenues fell noticeably, from KD 4443.2 million in 1980 to KD 2397.6 million in 1984 (54%), apparently because of the drop in world demand for oil.\*

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\* Although world oil demand diminished by 33.4%, 32.3% and 27% during the years 1980, 81, and 82 respectively,

TABLE 1.3

Kuwait: Crude-Oil Production versus Production Necessary to Cover Development Expenditure and Domestic Consumption, 1970-1977.

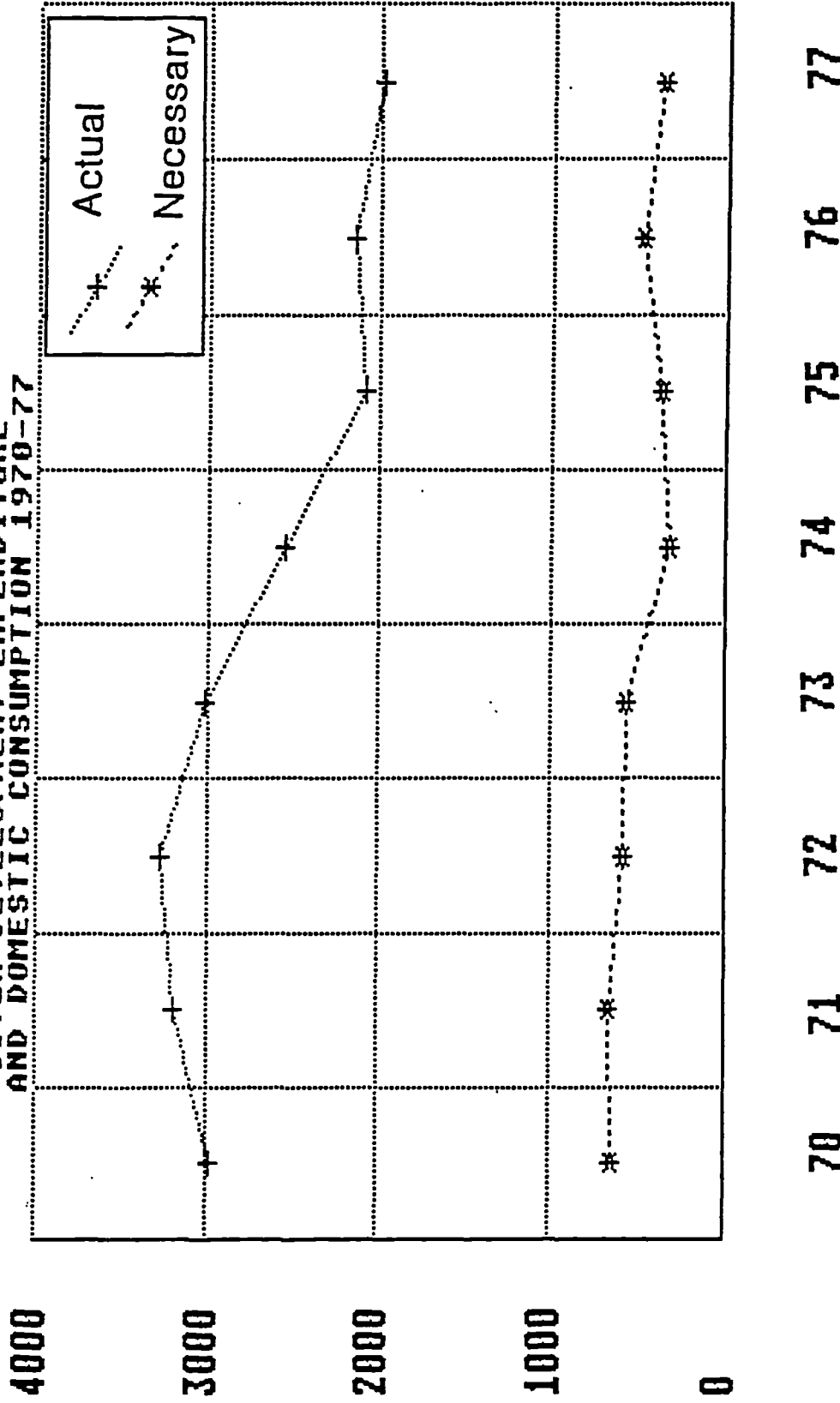
(1) Year	(2) Revenue per Barrel (US Dollars)	(3) Development Expenditure (Million US Dollars)	(4) Exports Necessa- ry to cover Development Expenditure (1,000 b/d)	(5) Domestic Consumption (1,000 b/d)*	(6) Production Necessary to Cover Develop- ment Expendi- ture & Domestic Consumption (1,000 b/d)	(7) Actual Production (1,000 b/d)	(8) Production Necessary to Cover Development & Domestic Consumption as a Percentage of Actual Production
1970	0.771	134.1	476.5	158.0	634.5	2,989.6	21.2
1971	0.846	142.4	461.2	195.7	656.9	3,196.7	20.5
1972	1.212	187.3	422.2	148.3	570.5	3,283.0	17.4
1973	1.668	238.0	390.9	167.3	558.2	3,020.4	18.5
1974	7.313	385.1	144.3	177.9	322.2	2,546.1	12.7
1975	8.929	562.1	172.5	187.7	360.2	2,084.2	17.3
1976	8.717	1,286.9	403.4	75.9	479.3	2,145.4	22.3
1977	12.863	1,355.0	288.6	70.2	358.8	1,969.0	18.2

\*Balance of production minus exports plus imports.

Source: OPEC Review 3, No. 1 (March 1979).

Figure - 1.1

**KUWAIT CRUDE OIL PRODUCTION TO  
COVER DEVELOPMENT EXPENDITURE  
AND DOMESTIC CONSUMPTION 1970-77**



SOURCE OPEC REVIEW 3:1 MAR '79



As a result of this and other consequences which had a severe impact on the budget, such as the Al-Manakh stock market crisis in 1982 and the current economic recession, serious questions were raised as to whether the government should investigate other sources of revenue. This exploration led to various financial proposals parallel with oil revenues. Taxes are arguably one of the most possible and attainable alternative sources of revenue.

### 1.3 The Present Financial Position

At present the Kuwait economy is passing through a critical stage that necessitates the adoption of new significant tax policies. Domestic and foreign outlays are being further restricted by the budget deficit.

Kuwaiti public expenditure continued to increase at annual rates amounting to 6.5% and 11.1% respectively in the period 1980-1984, regardless of the massive drop in oil receipts. Additionally, while the eight-year Gulf war between Iraq and Iran continued to absorb the financial resources of the Gulf states in general, Kuwait's overall final consumption value exceeded non-oil GDP (at current price) in 1986 by 55%. It should be remembered that this percentage had been 27.9% in 1980 and only 11% in 1975.

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- Kuwait oil production rose by 28% to 1.05 mn. bbl/d, due to the relatively increased demand for OPEC oil. Cuts in OPEC member's quotas in November 1984 were responsible for this increased demand to meet the challenge of the US oil price cut by \$5. Kuwait share of production cuts was over 100,000 bbl/day - from 1.05 mn to 900,000. (Central Bank of Kuwait, The Kuwaiti Economy. 1984).

The balance of payments also recorded a decline of 63% in its current account during 1983, after reaching a maximum surplus in 1980 of KD 4.1 Billion. This surplus fell to KD 3.8 Billion in 1981, KD 1.4 billion and 1.5 Billion in 1982 and 1983 respectively. In the last two years this account, however, has shown some sign of recovery (KD 1.7 billion in 1986), but it is still below the figures earlier in the decade.

On the other hand, the investment account (which includes all foreign assets in the State General Reserve and Reserve for Future Generations, plus the Kuwaiti Petroleum Corporations investments) has recorded a decline in 1981 dropping from the peak of KD 2.8 billion in 1980 to KD 1.1 billion in 1986. This account in fact continued to fall showing an inflow of KD 417 million (credit) in 1983, as illustrated in table 1.4.

Adding to the above problems, the total GDP growth rate (at current prices) fell from 7% in 1983 to only 0.1% in 1984, while the growth rate of the GDP for the oil sector fell by 6% between 1983 and 1984. These percentages have further declined in the last two budgets (e.g., GDP growth rate of 1986 was -16%). The absence of a strong manufacturing industry, well-structured banking systems and effective management are the major contributors to this instability in the rates of domestic growth.

Foremost among the regrettable economic factors was the fall in the Al-Manakh stock market in Summer 1982.

TABLE 1.4  
Kuwait Total Balance of Payments  
(Millions Dinars)

Description	1980		1981		1982		1983		1984		1985		1986	
	CR	DB	CR	DB	CR	DB	CR	DB	CR	DB	CR	DB	CR	DB
1. Goods & Services (Net)	4563		4304		1842		1941		2022		1921		2158	
2. Unrequited Transfers	427		463		438		450		373		473		368	
3. Total Current Account (1+2)	4136		3841		1404		1491		1649		1448		1790	
4. Nonmonetary Capital	251		100		404		376		511		121		398	
5. Government Investment Account.	2805		2214		1277		417		1680		572		887	
6. Other Net	798		1449		34		1823		525		586		493	
TOTAL (3+4+5+6)	282		78		565		291		17		169		12	
7. Reserves (Central Bank of Kuwait).	282		78		565		291		17		169		12	

@) This decline is a direct result of the following. 1) K.D. 450 million decrease in C.B. deposits with foreign banks. 2) Increase of C.B. foreign liability. 3) Increase in C.B. treasury bills. 4) Increase in IMF reserve by K.D. 63 million.

Source: - Central Bank of Kuwait, The Kuwaiti Economy, 1980 - 1989.

- Annual Statistical Abstract, XXIV, Ministry of Planning, 1987, P. 276.

Several consequences arose directly from Al-Manakh, ranging from the undermining of several productive or potentially productive sectors to a high level of outstanding debt on both institutional and private accounts. Evans stressed that;

"Not only did the stock exchange affect the Kuwaiti economic structure, but it was also affected by it ... The result was that the prosperity of Al-Manakh was the direct result of the recession in the local Kuwaiti stock market" (7)

Nevertheless, people in Kuwait had blind confidence in the state to overcome the dilemma. This belief is traceable to the precedent set in 1977 when the government spent KD 155 million to avert the crisis. However, there were always fears of a considerable financial collapse. In May 1982, about four months before the second crisis, the aggregate value of post-dated cheques issued amounted to KD 3,500 million; together with premiums of KD 1,225 million, the outstanding total was KD 4,725 million. It created a situation impossible to control. One of the US and western papers which published reports on the crisis, the Washington Post, published an article on 24.11.82 under the heading, "The collapse of the Kuwaiti Stock Exchange of a turnover of US \$90 billion". (8)

The damage to the Kuwait economy, arising in particular from diminishing oil revenues in addition to the grave effects of the Gulf stock exchange crash, was so serious that towards the end of 1985 the government was obliged to call in a joint team from the world bank and the International Monetary Fund (IMF) to study, together



with local Kuwaiti experts, the deterioration of the economy and to suggest a plan for reconstruction. Beginning their task in December, members of the combined team set themselves two objectives; to determine priorities for non-oil sectors, and to work out means to direct government spending so as to achieve maximum economic prosperity.<sup>(9)</sup> In the meantime, short-term acute issues, such as total private debt arising from post-dated cheques, and the sharp decline in public spending, remained largely unresolved.

Regarding Kuwait's public finance, a significant proportion of oil revenues is still used in domestic public expenditure to finance government programmes of public welfare. Community services are still provided in Kuwait free of charge or at nominal fees. Realisation of high living standards, social welfare, health, education, housing and other services placed a heavy burden on the state budget in association with the above mentioned factors.

According to available data in table (1.5), Public revenues in the period 1980/81 - 1986/87 showed a continued downward trend, dropping at rates ranging from 2.9% to 32.1%. Increased income from investment successfully contributed to total state revenue in the first quarter of this decade. However, in the fiscal year of 1983/84 it fell by 22.2%. Consequently, the relative weight of this income within public revenues declined to 29%. Other domestic sources of revenue (Taxes, Custom duties, various fees and revenues from public services

TABLE 1.5

Total Public Revenues and Expenditure  
(Million Dinars)

Particulars	1980/81		1981/82		1982/83		1983/84		1984/85		1985/86		1986/87	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
1. Revenue from	5403.2	100	4349.2	100	4223.7	100	4439.1	100	4201.2	100	3732.0		4092.6	
Oil	4434.2	69.3	2764.1	63.5	2334.6	55.3	2923.6	65.9	2912.6	69.3	2060.1	55.2	1653.3	40.4
Investment Income (a)	1743.9	27.2	1364.0	31.4	1657.1	39.2	1288.6	29.0	985.1	23.4	1387.0	37.2	2180.0	53.3
Other:-	225.1	3.5	221.1	5.1	232.0	5.5	226.9	5.1	303.5	7.2	284.9	7.6	259.3	6.3
Taxes	77.9		99.6		92.6		75.9		131.5		107.4		77.5	
Non-Tax Income	147.2		121.5		139.4		151.0		172.0		177.5		181.9	
2. Public Expenditure	3377.9		3783.0		3732.0		3660.3		3567.6		4998.0		5918.3	
- domestic expenditure (b)	3115.8		3538.2		3502.3		3475.3		3355.8		4030.0		4125.6	
3. Gross Surplus (1-2)	3025.3		566.2		491.7		778.9		633.6		(298)		(1825.7)	

(a) Income from Investment consist of: State General reserve Account + future generations reserve account.

(b) These are ordinary state expenditure such as domestic current expenditure, wages & salaries, commodity & services, transfers & unclassified payments, land purchases, development expenditure, transport means, and others.

Source: - Central Bank of Kuwait, The Kuwaiti Economy 1980 - 1984.

- Ministry of planning, central statistics department, (Statistical Bulletin) 1985.

- Annual Statistical Abstract, Ministry of Planning, 1987.

rendered by government agencies) constituted an extremely small proportion of total revenues, not exceeding 5.5%.\*

### 1.3.1 Public Expenditure

Remarkably, one of the principal features of Kuwaiti public expenditure is its reliance on oil revenues as the main source of finance (nearly 68% in the last five fiscal budgets). Therefore, the stability and growth of public expenditure is excessively dominated by the performance of oil revenues. Since other revenue items contribute only a small proportion of state finance (e.g., taxes contribute only 6%) the major driving force of Kuwaiti public expenditure is the dependent variable of oil. The rapid increase in oil revenues during the past decade, promoted a considerable rise in public expenditure approaching about KD 3.5 billion in 1980/81 - a growth of 39.4%. Following a 12% rise in the fiscal year of 1981, a reduction in public expenditure by KD 300 thousand occurred in 1984, representing the first budget cuts. However, the KD 3567.6 million budget expenditure of 1984 was a 6% increase over the allocation for the previous fiscal year. Recently, budgeted outlays reflected an 11% spending cut to KD 3053 million (1987). Not surprisingly, this is the highest drop in actual spending in the recent period.

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\* Tax revenue in other countries finance a very considerable portion of public expenditure (i.e. in Switzerland and Norway more than 90%, 88% in France, 83% in Austria, and over 60% in some oil countries such as Venezuela, Nigeria, Indonesia, Singapore, Tunisia and the Ivory Coast).

Current expenditure has been particularly affected by the belt-tightening policy, with total disbursements in 1988 estimated at KD 2.066 billion, a drop of 13% from the previous year. Development expenditure, initially targeted at some 13% below the budget figure for 1985/86, is believed actually to have shown a modest 1.9% increase over the previous year's KD 564 million. On the other hand, disbursements for land purchases are estimated to have remained virtually unchanged from the 1987 level of KD 160 million.

Analysis of table 1.6 shows that a budget deficit has become an unwelcome fact over the last 2 years. The first real deficit in Kuwait recent history was in the 1986 fiscal budget, when it was KD 750 million. A year later, the strictly-defined deficit reached a peak of KD 1169 million, and will probably reach a stable plateau of around KD 1.1 billion in the last two years of this decade. The gross surplus in the table (item 4) is derived by adding foreign transfers (foreign budget) to domestic revenues to finance all claims after honouring domestic expenditure. Central Bank figures indicate that foreign budget (transfer and expenditure) accounts were 10% of current expenditure and 25% of capital expenditure. The public expenditure growth rate has been kept down at 12% in 1981/82, 9.9%, and 11% in 1986, 87 respectively.

It is worth mentioning that most of the public expenditure represents domestic disposals, which rose from

TABLE 1.6

Integral Fiscal Budget  
1975/76 - 1986/87 - (KD Million)

	175/76	176/77	177/78	178/79	179/80	84/85	85/86	86/87
1. Domestic Budget								
Revenue (a)	103	106	134	140	164	249.9	284.9	259.3
Expenditure (b)	861	958	1188	1200	1707	3355.8	3431.5	3052.9
Deficit	(758)	(852)	(1054)	(1060)	(1543)	(3105.9)	(3146.5)	(2793.5)
2. Foreign Budget								
Revenues (c)	3857	2928	2963	3558	6795	3602.1	2787.0	2051.4
Expenditure	226	350	468	482	526	211.8	401.3	421.4
Surplus	3631	2578	2495	3076	6269	3390.3	2385.7	1624.5
3. Domestic Budget								
Deficit financing (from foreign budget surplus)	758	852	1054	1060	1543	3105.9	3146.5	2793.5
4. Gross (d) Surplus	2873	1726	1441	2016	4726	284.4	(760.8)	(1169)

(a) Customs Duties and Income from utilities.

(b) Domestic Expenditure consists of the following items: Current (wages and general); land purchases; development; local loans and contributions to government financial institution. (c) Oil and foreign investment income.

(d) The gross surplus finances the principal item, namely, local and foreign reserve funds, and very minor items, namely, government deposits with the central bank, government deposits with commercial banks and changes in cash balance.

Source: - Andary S.A., "Surplus saving and the case for a regional financial market in Kuwait" a Ph.D. Thesis, University of Aberdeen, Feb 1982, P271.

- Central Bank of Kuwait, The Kuwait Economy 1980-84 (various tables).

91.2% in 1979/80 to 94.9% in 1983/84. Despite this, and considering the drop in the past 2 years in domestic revenue employment, the growth rate of domestic proposals remained higher than the non-oil GDP growth rate in 1979/80 - 1983/84. At current prices, an average (annual) rate of 9.4% was recorded for the former, and 8% annual rate for the latter. This emphasises the expansion in public expenditure albeit the narrow productive base of domestic expenditure to the GDP (from 32.8% to 47.2% within the period 1979/80 - 1983/84 at current prices).

Expenditure items have tended to rise over the past 5 years (direct development expenditure 1%, current expenditure 47%, wages and salaries 57.5%, commodity and service requirements 40%, domestic transfers and unclassified payments 37.2%). Miscellaneous outlays and domestic transfers, which consisted mainly of government subsidies to certain basic commodities and services, in addition to social aid, have also increased noticeably, from KD 18.9 million in 1979/80 to KD 117.8 million in 1982/83 - a rise of 523%.

Though subsidization is one of the policies through which government has sought to relieve the burden of cost-of-living, it becomes - in the absence of a taxation system - a means for the distribution of part of the oil wealth, the economic and social consequences of which are by no means negligible. (10)

Other applications of Kuwait budget revenues include a 10% annual transfer of total revenues to the future

generations reserve account as per Law No. 106 for 1976, and a yearly portion is earmarked for the capital of Kuwait's Fund for Arab Economic Development.

In the fiscal year 1984/85 the government adopted a policy of rationalising public expenditure and reforming the standard of performance in government administration. First, the policy was symbolised by a diminutive increase (about 3.5%) in outlays for wages and salaries. Secondly, action was taken to reduce the allocations of commodity and services requirements by 14.8%. Similarly, only 0.6% rise has been granted for transport and equipment.

Although there are unlikely to be any sharp increases or decreases in spending, but the trend is certainly heading toward an increase. In this respect, the government in 1988 has successfully introduced issues of bills and bonds to finance "what is generally accepted to be an accounting deficit in the budget".<sup>(11)</sup>

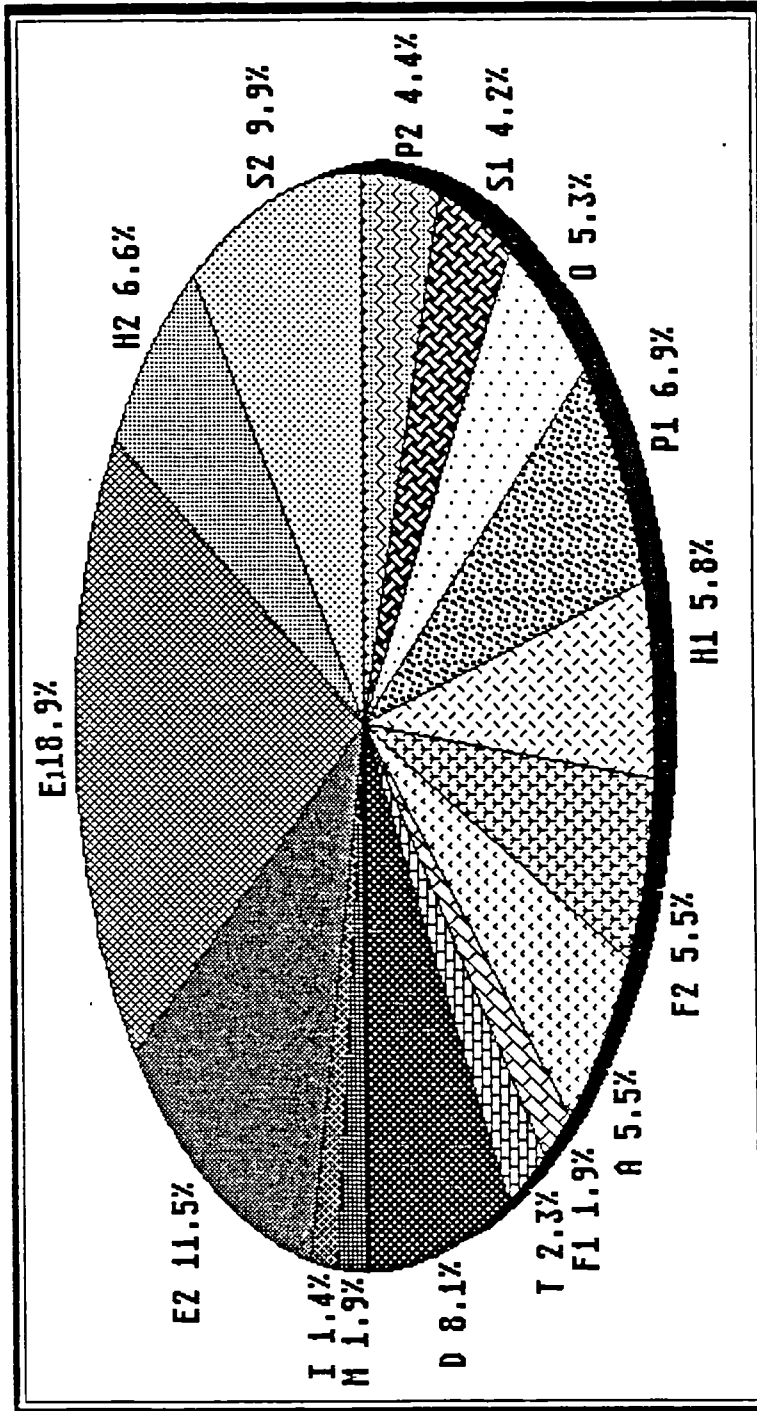
Diagram 1.2 illustrates in percentage terms the main allocations of the 1985/86 budget to the various government departments (electricity & water 18.9%, education 11.5%, social affairs 9.9%, defence 8.1%, housing 5.8%).

### 1.3.2 Per Capita Income

An illuminating picture of the modern status of Kuwait may be derived from an examination of the major economic developments enjoyed since 1946. Social welfare, for example has shown vast improvement and a rapid rate of expansion. Kuwait enjoyed one of the highest per capita

Diagram 1.2

KUWAIT EXPENDITURE ALLOCATION TO VARIOUS GOVERNMENT DEPARTMENTS



- |      |                             |      |                         |
|------|-----------------------------|------|-------------------------|
| (M)  | MINING AND QUARRYING        | (A)  | ADMINISTRATIVE SERVICES |
| (O)  | OTHER SERVICES              | (D)  | DEFENCE                 |
| (P1) | PUBLIC UTILITIES            | (E1) | ELECTRICITY AND WATER   |
| (P2) | PUBLIC PROPERTIES           | (E2) | EDUCATIONAL SERVICES    |
| (S1) | SECURITY AND JUSTICE        | (F1) | FINANCIAL SERVICES      |
| (S2) | SOCIAL AND RELATED SERVICES | (F2) | FOREIGN LIABILITIES     |
| (T)  | TRANSPORT AND COMMUNICATION | (H1) | HOUSING                 |
|      |                             | (H2) | HEALTH SERVICES         |
|      |                             | (I)  | INFORMATION SERVICES    |

SOURCER: MINISTRY OF INFORMATION "KUWAIT FACTS AND FIGURES" (1986), P85



incomes of all countries in the early and mid seventies.

The average per capita share of gross national product (GNP) - at current prices, amounted to KD 5484 in 1980, a 13.4% decline over 1979. Furthermore, it dropped to KD 5064, 4630, 4548, 4032, and 3775 respectively through the years from 1982 to 1986.

Owing to the oil production reduction in 1984, per capita share of GDP dropped to KD 3967. However, because the Kuwaiti currency (Dinar) is one of the most stable in the world and since the government subsidise basic commodities and provides several public services free of charge or at nominal rates, the people of Kuwait still enjoy a high standard of living.

### 1.3.3 Internal Rate of Inflation

Kuwait's inflation rate is very low and has declined in the past few years. Expressed in figures relative to the cost of living, a mere 1.2% inflation level was recorded in 1984 against 4.7% and 7.8% in 1983 and 1982 respectively.

Furthermore, the 1987 inflation rate was 0.7% (which compares with 0.5% in 1986), as the figures of the UN's International Labour Organisation indicated.

Compared with the 12% inflation rate of industrial countries in the early eighties, inflation in Kuwait is extremely low. GNP's negative growth rates in the industrial countries -especially in the US- peaked in 1982, and decelerated in the early years of the decade (down from 12% 1980, to 5% 1984). Consequently, the export price index

in these countries fell at annual rates ranging between 3.2% and 3.8% during the period 1981-1983 and at 2.3% in September 1984.

The heavy dependence of the Kuwaiti economy on imports, and the decline in the industrial countries export prices stimulated a positive development for consumer imports in Kuwait. Food prices dropped by 0.1% in 1984, clothing and footwear by 0.6%, and other commodities and services by 3.9% for the same year. Rates for medical and educational services rates were stable in 1983 while other rates increased considerably (transport and communication by 1.1%, beverages and tobacco 1.5%, household equipment and services 2.3%, and for housing services by 4.5%).

Greatly affected by government policies in granting a wide range of subsidies to improve the standard of living of those on fixed or limited incomes, the domestic rate of inflation eventually decreased. Government subsidy in 1986 totalled over KD 45 million, an increase of 24% over 1985. This increase was allocated for commodities and foodstuffs to prevent price escalation. In addition, substantial housing subsidies have been granted by the Kuwaiti government in the last few years. These subsidies took the form of provision of ready-built houses for limited income groups, a monthly housing allowance for eligible families, building loans, a grant to newly married couples (half of which is exempt from repayment), and social assistance to

needy families which amounted to KD 9 million in 1984.\*

#### 1.4 Rapid Wealth Distribution

##### 1.4.1 Land Purchasing Programme

After the first drop in oil shipments, Kuwait policy makers had to adopt an economic strategy enabling them to maintain their mandate and to stabilise political power. National income was channelled through the fiscal system in order to make a trade-off between freedom of action in the economic arena and the distribution of income. This was implemented through the purchase of private land at very high prices. The government would claim that these lands were needed for public projects (housing, infrastructural projects, public utilities), and thus land owners would be highly compensated in return.

The attitude of the government was apparent not only in the establishment of the welfare system but also in its determination to distribute national wealth among the Kuwaiti population. The purchase of land was considered the simplest and quickest method for achieving this objective. Thus a total of more than KD 1 Billion (£2.4 Billion) was disbursed through the land acquisition programme during 1952-1975. The government distributed by this means about one quarter of its total oil revenues during the period from 1946 to 1971.<sup>(12)</sup>

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\* Several other public services are provided free of charge to all nationals and expatriates (i.e., education, water, fuel services, provision of electricity). Also, many commodities essential to some industries are exempt from tax while local production is subsidised.

Indeed it was crucial to accomplish this task alongside vital national mobilisation. However, due to the lack of adequate modern organisation and effective planning, this task was increasingly vulnerable. In fact, this wealth distribution programme - implemented in the sixties - has been criticised as an indiscriminate and an inequitable way of distributing oil revenues. Andary indicated that;

"Indeed the early stages of social mobilisation and economic modernisation generate pressures for a general transformation of the political elite. For these pressures to lead to viable forms of political participation requires both the rapid deployment of apparatus for sharing of political and economic power and the institutionalisation of socio-economic pressure groups. From the outset, rulers in Kuwait realised that success in accommodating these demands on the political system would reduce the social tensions of the oil era. In consequence their overriding objective, was to distribute the gains from oil rapidly among their constituents and specifically among the merchant class, the most effective pressure group existing at the time". (13)

Mercantilism, it should be recalled, was a feature of Kuwait society long before the advent of the oil era. The discovery of oil and subsequently the flow of oil wealth, in an economy that had very little else to offer in tangible production, did very little more than to accentuate the position of the merchant class in the society. For only through international trade could the growing needs of the affluent society be catered for; and with the upsurge in trading, the traditional merchant families prospered and gained more political leverage. (14)

Huge sums were spent on land purchase via an "eager

beaver" policy. The government would pay far in excess of what land was worth. The government would then sell back the acquired - unrequired - surplus of purchased land and recover only a fraction of its acquisition cost.

#### 1.4.2 The Scheme's Advantages and Disadvantages

Wealth was soon quickly spread among Kuwaitis, ensuring the success of the wealth distribution programme. In addition, economic activity was stimulated, particularly in such sectors such as housing, trade, and small scale industry.<sup>(15)</sup> Above all, the policy absorbed what the government might have seen as the threat of the powerful and ambitious merchant class.

Nevertheless, the wealth distribution programme of the sixties had a number of undesirable consequences. These included:

[1] The degree of inequality among the Kuwaiti population, which favours native Kuwaitis above non-Kuwaitis. It is estimated that the top 10% of Kuwaiti households received more than 40% of total income.<sup>(16)</sup>

Considerably higher income rates are enjoyed by Kuwaiti families than those of non-Kuwaitis (illustrated in Table 1.7). This was a direct consequence of the government objective of native control over economic activity. Moreover, other governmental policies such as preference for nationals in public sector employment - discussed below- and higher salaries for nationals (decree 7/1960 and amendments up to decree 1/1979) led to

considerable inequalities among the population.\*

It is estimated that a middle class Kuwaiti family receives approximately KD 225 per month compared with slightly more than KD 150 for a similar non-Kuwaiti family. In addition, only 44.3% of the Kuwaiti families earn less than KD 200 per month, whereas more than 65% of the non-Kuwaiti families realise a far lower income than this level.\*\*

The figures in Table 1.7 have been aggravated by the recent rise in the cost of living, particularly with regard to rents and prices of consumer goods. A recent study showed that the average wage of expatriates is KD 239 (£550) per month, a little more than half that of Kuwaitis. Also, since rents average about KD 150 (£345) a month, little is left for other necessary expenses, let alone for the savings which attracted most expatriates at the outset.

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\* A number of regulations were imposed as part of this policy (e.g., Restricting non-Kuwaitis from operating certain business unless they have a Kuwaiti partner with 51% share of capital or a Kuwaiti sponsor who receives a fixed fee or a share of net profit; granting paying jobs for nationals; several employment provisions for Kuwaitis).. See Najjar, I. (1969) and Andary S. (1982).

\*\* The earned income of Kuwait nationals is higher than that of non-Kuwaitis based on the following facts:

1. Most non-Kuwaitis are employed as labourers who are lower paid;
2. The receipt of unearned income (rents and dividends) by Kuwaitis which does not accrue to non-Kuwaitis because of restrictions on ownership of property and company shares;
3. More and better allowances for Kuwaitis;
4. Government subsidies to the indigenous work force such as a monthly housing welfare allowance... The Ministry of Information, Kuwait Facts & Figures, 1986.

TABLE 1.7  
Structure of Family Income - 1972/73

Monthly Family Income in (KD)	Kuwaiti		Non-Kuwaiti		Total	
	House - Holds (%)	Share of Income (%)	House - Holds (%)	Share of Income (%)	House - Holds (%)	Share of Income (%)
Less than 50	5.7	0.5	5.5	1.1	5.4	0.8
50-69	3.0	0.5	7.5	2.2	5.7	1.3
70-99	4.0	1.0	14.6	6.0	10.3	3.2
100-149	13.6	4.9	20.9	12.6	17.9	8.4
150-199	18.7	9.2	16.1	13.8	17.2	11.3
200-249	12.8	7.9	10.3	11.2	11.3	9.4
250-299	9.4	7.2	7.6	10.2	8.4	8.5
300-399	10.3	10.0	8.1	13.8	9.0	11.7
400-599	11.5	15.4	6.5	15.1	8.5	15.2
600-999	5.8	11.8	2.2	7.8	3.6	10.0
1000 and more	5.5	31.6	0.7	6.2	2.7	20.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Source:- Khouja and Sadler, "The Economy of Kuwait", Macmillan Press 1979, p.46

- Annual Statistical Abstract, Kuwait Ministry of Planning, 1977.

For all that, these difficulties are not encountered by all expatriates. Those at the top of the wage scale including the westerns, earn much more than the average, and often enjoy free or subsidised company housing. Many of those at the bottom live in free or highly subsidised work camps, while maids and servants, who earn an average KD 34 (£78) a month, nearly all live in their employer's premises.

Strong desires to revise the income distribution pattern have resulted in the introduction of welfare benefits, though there seems to be clear evidence that a significant degree of inequality would remain.

The development of this pattern of income distribution since 1946 is attributed to: (A) differences in levels of education, (B) differences in social background, (C) the presence of market imperfections in the economy with major barriers to entry in many business activities, (D) lack of a appropriate fiscal and public policies, and (E) the land purchase programme which while succeeding in spreading the wealth tended to accentuate the pre-oil income disparity.<sup>(17)</sup>

[2] Direct income transfers account for large sums of money in the private sector. Thus, and due to lack of solid investment opportunities in the country, considerable funds were channelled abroad to acquire overseas assets. Consequently, the programme failed to revitalise all sections of the economy; though there was some stimulation of certain industries such as housing and small-scale



trade, essential industrial and financial enterprises were not properly activated.

The scheme was criticised by the world bank (the International Bank for Reconstruction and Development (IBRD- Mission's Report, 1965) for being indiscriminate and unsystematic. (18)

Jassem AL-Saadoun, the Kuwaiti economist, who is regarded as something of a heretic by the local business and political establishment, has recommended that the government terminate this programme as it "keeps the price of land at an artificially high level". (19)

Land acquisition, for instance, was unjustified in terms of the ambiguous procedures of land selection and appreciation involved. The Commission of Land Acquisition in Kuwait published details of acquired land by area and not by value, nor did it explain the assessment method adopted.\*

[3] The programme was politically directed towards socio-bureaucratic stability. From 1967 to 1978 the land acquisition budget was enlarged in response to the actions of pressure groups, particularly the merchants.

An increase of more than KD 61 million was allocated for land acquisition during a seven-year period, (1972-1978), that is 266% expansion in this expenditure, whereas the sale of government surplus land rose by only KD 1.1 million during the same period (Table 1.8).

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\* The commission publications are found in Al-Kuwait Al-Yawm Nos. 1155-1158, 1211, 1213, 1238, 1293 and 1294. See Andary S., (1982) p. 85.

TABLE 1.8

Public acquisition and Sale of Land  
in Million KD

	72/73	73/74	74/75	75/76	76/77	77/78	78/79
Land Acquisition	23.2	25.1	135.0	89.2	166.4	129.2	85.0
Land Sale	1.1	1.9	4.0	18.9	4.7	4.0	2.2

Source:- Andary S. A., op. cit. (1982) p.84

Thus between 1972/73, the average income from the sale of government land was 4.7% of the land purchase expenditure as estimated from Table 1.8.

In fact, Andary in his research emphasised the influence of the merchant class in the land acquisition scheme;

"The transfers of the scheme ( land acquisition scheme ) were expanded both in relative and in-absolute terms from 7 percent (1967-1974) to 9 percent of total budgetary expenditure (1975-1978). The increase in these transfers is primarily a growthmanship - oriented policy to maintain the value of the redistributed assets. If growth is considered to be a function of social stability; that is to say; in so doing, the government accommodates the demands of the pressure groups on the political system". (20)

Accordingly, with the political impetus for the income distribution plan, some attention was paid to other income distribution channels such as economic and social infrastructural projects including free health, subsidised utilities, power and water desalination plants, and other transport services.

In spite of the considerable usefulness of these tactics to the public and to the improvement of the welfare system, however, their effect did not transcend the inequality in the income distribution process.

The achievement of any meaningful equitable distribution would necessitate the use of secondary redistribution through a tax system. Moreover, redistributive policies are sufficiently important to generate an internal growth market. One reason why the government has so far avoided the imposition of taxes,

such as wealth or income taxes, is its recognition that pressure groups would oppose their introduction, fearing the possible erosion of their economic power. More importantly oil is the major source of revenue, which accrues to the government far in excess of government budgetary needs. (21)

Therefore, there is an increasing body of opinion that a taxation system in Kuwait would serve two main purposes; 1) Financing the governmental budget; 2) Income redistribution.

Alongside with equitable budgetary expenditure, a tax system may fulfil the above objectives. Eventually, under the present circumstances, budgetary prospects are to be focused on certain issues, particularly the new area of public financing in the state of Kuwait.

### 1.5 Population Growth & Diversification

The 1985 population census indicated a decline in the annual growth rate of Kuwait population to 4.5% for the intercensal years 1980-1985, compared with 6.4% between the 1975-1980 censuses. The 1985 census figures indicate that the rate of population growth for Kuwaitis remained unchanged at 3.7% per annum, compared with a decline in that of the non-Kuwaiti population from 8.7% between 1975 and 1980, to 5.1%, as illustrated in Table 1.9.

It is said that Kuwaitis are a minority in their own country. According to the 1985 census, Kuwaitis form only 40% of the total population of 1.7 million, which comprises

TABLE 1.9

Population Rate of Growth \*

Year	Kuwaiti	Non-Kuwaiti	Average
1957 - 1961	8.6%	13.6%	11.0%
1961 - 1965	8.7%	14.4%	10.9%
1965 - 1970	9.5%	9.6%	9.6%
1970 - 1975	6.3%	5.9%	6.1%
1975 - 1980	3.7%	8.7%	6.4%
1980 - 1985	3.7%	5.1%	4.5%

\* With the exception of the period between 1970-1975 censuses, the rate of growth for non-Kuwaitis since 1957 was higher than that for Kuwaitis. This is a crucial factor in Kuwait population increase.

Source: - Ministry of Information, Kuwait Facts and Figures, 1986, p.28.

680,000 Kuwaitis and 1.02 million non-Kuwaitis. It is expected also, that total population will rise to 2.1 million by 1990, and to 3 million by the year 2000.

Although the era of booming oil revenues has started to slacken, attempts are continuing to strengthen the economic base and to maintain high growth rates. There are still development projects under way which cannot be implemented without regular inflows of expatriate labour. Consequently, foreign immigration to Kuwait, and the consequent high rates of population growth, will continue to play a fundamental role in bridging the gap between manpower demand and supply in the foreseeable future. Table 1.10 shows the seven official population censuses conducted since 1957.

In addition to Kuwaitis, there are expatriates from 120 different countries living in Kuwait. Data analysis of the 1980 general population census shows that Kuwaitis represented 41.7% of the total population, 42.3% were from other Arab countries (mainly Palestine and Jordan), 15% from Asian Countries and only 1% from African, European and American Countries.

#### **1.6 Employment Reinforcement for Kuwaitis**

Unlike other problems of developing countries, unemployment is of minor importance in Kuwait. Overall, unemployment was estimated at less than 2% in 1975, most of the unemployed were non-Kuwaitis. In fact, provision of employment for nationals was another effect of the income

TABLE 1.10

"Official Population Census 1957-1985"

Year	Nationality	Male	Female	Total	Average population per sq. Km
1957	Kuwaiti	59,157	54,468	113,622	7
	non-Kuwaiti	72,904	19,947	922,851	6
TOTAL		132,058	74,415	206,473	13
1961	Kuwaiti	84,461	77,448	161,909	10
	non-Kuwaiti	116,246	43,466	159,712	10
TOTAL		200,707	120,914	321,621	20
1965	Kuwaiti	112,569	107,490	220,059	14
	non-Kuwaiti	173,743	73,537	247,280	15
TOTAL		286,312	181,027	467,339	29
1970	Kuwaiti	175,513	171,883	347,396	21
	non-Kuwaiti	244,368	146,898	391,266	23
TOTAL		419,887	318,781	738,662	44
1975	Kuwaiti	236,600	235,488	472,088	27
	non-Kuwaiti	307,168	215,581	522,749	29
TOTAL		543,768	451,669	994,837	56
1980	Kuwaiti	280,649	284,964	565,613	33
	non-Kuwaiti	495,990	296,349	792,339	47
TOTAL		776,639	581,313	1,357,952	80
1985	Kuwaiti	338,796	342,492	681,288	40
	non-Kuwaiti	626,501	389,512	1,061,013	60
TOTAL		965,297	732,004	1,697,301	100

Source:- Central Statistical Office, Annual Statistical Abstract, 1987 (Kuwait : Ministry of Planning).

distribution policy adopted by the Kuwaiti government. More than 54% of public sector employees are Kuwaitis, concentrated in administrative positions. The public sector has more than 52% of the total work force in Kuwait, and a high proportion of it is found in government services (e.g., administration, social and defence services).

The second important feature in this respect, is the political motive behind the creation of employment for nationals, whereby their costs (wages and allowances) are not matched in terms of improved national productivity.

The fact is that the policy's political rationale supersedes its distributive function. In Kuwait, and certainly in all other Gulf states, public sector employment is not only the most important available means for granting employment to nationals, but it is the root of political stability. Since power is not and cannot be neutral, it is considered preferable that it should be in the hands of nationals rather than expatriates. Here lies the intrinsic rationale for the state provisions of public sector employment to nationals. (22)

Reading through the Stanford Research Institute Report, nationals obtain the higher positions in the public sector and possibly receive more than they produce. The report states in page V-6:-

"By international standards (the Kuwaiti) receives too much for doing too little ... it is the degree of the divorce between income and effort that dominates the situation". (23)

With the increasing wage rates in the private sector



in comparison with the public sector, an increasing number of Kuwaitis have been opting for more challenging and lucrative non-government jobs. Self-employment among Kuwaitis has also expanded in recent years, accounting for over 10% of the Kuwaiti work force in 1975.<sup>(24)</sup>

To recapitulate, the nationalisation of jobs, "Kuwaitisation", the job-price differential and the social opportunity cost were, until a couple of years ago, the main features of the government employment policy. However, with the recent change in picturing the economy as a Limited - affluent - one, unemployment in the Keynesian sense will soon be reported even among Kuwaitis. Therefore, the 2.3% recent unemployment rate measured among Kuwaitis (Table 1.11) does not accurately reflect the position.

Finally, Kuwaitis are reluctant to accept low paid or unattractive jobs, and most families receive more than one source of income. In this respect employment would constitute a vital element in measuring income for tax declaration.

#### 1.6.1 Labour Force Structure

Within the period 1946-1957 an average 9% labour force growth was a flourishing indicator. Over 16% annual rise in the following eight years was stimulated to meet the requirements of the oil industry and rapid construction projects. In 1965 the total labour force in Kuwait reached 184,297, of which the majority were employed in oil-related industries and infrastructure plans. Ten years later, this

TABLE 1.11 Labour Classification by Economic Activity (1985 Census)

	Kuwaitis			Non-Kuwaitis			Total	%
	M	F	T	M	F	T		
Agriculture & Fishing	2,715	66	2,781	9,799	52	9,851	12,632	1.9
Mining & Quarrying	2,468	43	2,511	4,233	289	4,522	7,033	1.0
Manufacturing Industries	4,552	140	4,692	45,262	1,135	46,397	51,089	7.7
Electricity, Gas and Water	1,510	54	1,564	5,887	15	5,902	7,466	1.1
Construction	1,435	27	1,462	121,534	1,160	122,694	124,156	18.8
Wholesale & Retail Trade	5,932	144	6,070	66,524	3,331	69,855	75,931	11.5
Transport, Storage and Communications	6,812	849	7,661	28,224	1,320	29,544	37,205	5.6
Finance & Insurance	3,175	693	3,868	13,868	2,611	16,479	6,523	3.0
Government and other services	70,504	22,441	92,945	138,371	95,413	233,784	326,729	49.5
Total Employment	98,594	24,422	123,016	423,402	105,077	528,479	660,495	98.5
Unemployment	2,504	346	2,850	2,948	1,999	4,947	7,797	1.5
Active Labour Force	101,607	24,803	126,410	436,650	107,325	543,975	670,385	100.0
Unemployment rate (%)	2.5	1.4	2.3	0.7	1.9	0.9	1.5	

Source: - Kuwait Annual Statistical Abstract, 1987.

- Kouja, and Sadler, op. cit. (1979) p.43.

number reached 304,582, of which Kuwaitis represented about 30% and non Kuwaitis 70%. As compared with the early sixties, labour force growth was slowing down in the early seventies due to the slower growth of the economy and to the tightened restrictions on entry into the country.

A significant number of policies were implemented to maintain national control over the work force in Kuwait from the mid-sixties to the late seventies. A series of decrees were enacted to control the flow of expatriates, for example the nationality and commercial laws which were intended to discourage the permanent settlement of expatriates. Expatriates in general were not allowed to own land or shares, and without the support of a national sponsor, immigrants could not obtain work permits.

However, two distinctions should be made with respect to expatriate labour. First, the relationship between the home government and the Kuwaiti government was of major importance in determining how various expatriate groups are treated (for instance, Arab nationals are given priority, after nationals, over other nationalities in public sector employment). Secondly, there is a distinction between short-term immigrants (South Koreans & Indians) and those who come in the hope of remaining in Kuwait indefinitely (20.5% are Palestinians).<sup>(25)</sup>

In addition, following these overall policies of national control, income distribution and employment provision, Kuwaitis had greater opportunities to acquire higher surplus savings than others in Kuwait, and so to

become the influential group in this field. The manifest impact of such and other concerns has been:

1> The relatively small percentage of national labour participation in recent years (40% in 1960's to less than 30.6% in 1975). Eventually, a large portion of foreign labour had to be imported to meet the needs of development. However, this has created certain dilemmas for the government.\*

2> The high percentage of younger men who postpone joining the labour force, particularly among Kuwaitis. A percentage of 42 was recorded in 1975 of such economically inactive people, of which more than 58% were Kuwaitis. Major forces behind this situation are the increased aspiration for higher education, the relative dependence on family sources of income, and the attitude towards production or manual work, especially among younger men.

A recent study by Sayigh has come to the conclusion that the Kuwaiti labour force contains a category rarely encountered in labour statistics: people who have no desire to work and no need to do so, since the bulk of this category belong to a more affluent class. The percentage of inactive people in Kuwait rose to 60.5% in 1965, and the revision of some labour provisions appears to be necessary.\*\*

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\* The government had to tighten several procedures to control labour inflow particularly from South Asia, which is considered a totally different society. (Social behaviour, Safety procedures, the impact of imported goods on local industry).

\*\* Sayigh included in his definition all people over 11

3> A high proportion of women in Kuwait are discouraged from seeking employment. In 1957, a very small percentage (2.5% of total population) of women participated in the labour force. Moreover, of the 3.2% total female labour force in 1975 only 7.8% were Kuwaitis. Social and cultural factors were the main obstacles to their employment.

4> It seems that high employment ratios are concentrated around trade and construction in addition to governmental services, as indicated in Table 1.12 below.

The table confirms the most striking fact that, although oil -including mining- is the leading sector in contribution to the gross domestic product, it is practically the smallest sector in employment. (26)

## 1.7 Commerce & Industry

### 1.7.1 Foreign Investment

In contrast with those of other Gulf states, Kuwait's domestic financial markets have been rapidly linked with international activities supported by a vigorous private involvement. Kuwait's government has succeeded in liberalising the economy in the sense that no exchange control nor any restrictions have been enforced on capital movement. Also, very limited taxes (mostly tariff duties) have been levied. This, in conjunction with the rapid

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- years old. He further estimated only the male population which consequently reduced the percentage to 6.7 (if the premise is valid) among 15-60 year old Kuwaitis in 1965. (See Y.A. Sayigh, "The Economics of the Arab world Development since 1945" London, Groom Helm, 1978, p.96).

TABLE 1.12

Gross domestic product and employment, by Economic Activity, 1985 - 1986 - (Percent)

Economic Activity	Employment			% of GDP	
	Non-Kuwait	Kuwaiti	Total	1985	1986
Agriculture	1.0	0.4	1.9	0.7	1.1
Mining & Quarrying	0.4	0.4	1.0	51.0	37.3
Manufacturing	4.6	0.7	7.7	6.4	11.2
Electricity, Gas & Water	0.6	0.2	1.1	2.6	1.9
Construction	12.1	0.2	18.8	3.3	3.2
Trade & Restaurants	6.9	0.9	11.5	9.4	10.4
Transport, Storage & Communication	3.0	1.1	5.6	4.1	5.1
Financial & Insurance Services	1.6	0.6	3.0	8.4	5.1
Other Services (mostly government)	23.0	13.6	49.5	19.3	24.1

Source: - EL- Mallakh and Atta, "Absorptive capacity of Kuwait" Lexington books, 1981, p. 91.

- Central statistical office (Kuwait) annual statistical abstract, October 1987, pp. 144, 266.

growth of oil revenues, facilitated the establishment and the harmonisation of the financial sector in the early sixties.\*

A remarkable saving surplus was accumulated by the Government over the past two decades, making the country a very important source of capital funds. A high proportion of this was invested abroad and kept as the second major source of national income. Furthermore, for the generation of future benefits, Kuwait's foreign investment is widely diversified including long and short term investments. Cash balances, foreign assets, and other deployment operations (mainly in North America and Europe) are typical representations of Kuwait's foreign portfolio.

In the absence of adequate information on Kuwait's foreign portfolio and its capital investment, further discussion of this subject would be inadvisable. Kuwait's foreign investments are considered matters of national secrecy to the extent that even members of parliament are not kept informed of their details and specifications.

The Future Generation Accounts (FGA) on the other hand, was formalised in 1976 by Act No. 106/76, which restricted any type of withdrawal from it. On the day of

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\* The Kuwaiti Government seek to grant a sustained level of income as well as public welfare over the future years. Since Kuwait enjoys a plentiful source of income, 3 public investment companies were established to employ the growing account surpluses in the seventies. This decision was provoked by the limited domestic absorptive capacity, which deviated the need for deployment of local fund by the government. During 1983 and 1984 the investment companies invested a significant part of their funds overseas. Their foreign assets in 1984 constituted around 55% of their total assets, as against 53% in 1983.

establishment, 50% of state-retained revenues were transferred to FGA, in addition to a yearly non-negotiable 10% ratio of public revenues. Kuwait's foreign investment is the major source for finance for this account.

The total balance of FGA reached KD 3.6 billion (£8 bn.) in 1977/78 fiscal year, then increased to KD 4.2 billion (£9.6 bn.) in 1979. Within the last five years this account has increased at an annual rate of 16%.

### 1.7.2 Banking Sector

In addition to the Central Bank of Kuwait, the domestic financial sector comprises seven commercial banks and the Kuwait Finance House, which is a bank operated in accordance with Islamic Law. Apart from the local banks, there are 28 investment companies operating in Kuwait subject to Central Bank supervision, and 79 exchange companies of which 18 are under the control of the Central Bank.

An investigation of the figures in Table 1.13, reveals that the growth rate of commercial bank operations continued to fall at 7% (1984) and at 2% (1986) per annum. Their consolidated balance sheet rose by 60% between 1980 and 1986. However, it is worth mentioning that the increase of 88.9% in commercial bank's credit facilities has reflected the "Al-Manakh" stock market crisis during the past 4 years.

In addition to commercial banks, there are three specialist banks which provide services complementary to the commercial bank medium and long term financing.



TABLE 1.13

Summary of the Banking and Financial Systems  
Transactions During the Period (1979-1986)  
(Million K.D.'s)

Particulars	1979	1980	1981	1982	1983	1984	1985	1986
First : Central Bank Total Balance Sheet	1014.3	1424.1	1479.4	2039.6	1923.9	2007.1	2098.0	2355.0
Second : Commercial Banks								
1. No. of Banks	7	7	7	7	7	7	7	7
2. No. of Operating Branches	107	114	116	132	144	153	167	179
3. Consolidated Balance Sheet	3788.9	4896.5	6320.3	7392.6	7689.3	8225.7	9052.6	9302.4
4. Claims on the Private Sector - of which (Credit Facilities)	2118.3 1917.5	2671.4 2418.6	3453.6 3172.8	4292.5 3897.3	4752.7 3844.3	5045.4 4108.9	5065.6 4198.5	5156.1 4330.0
5. Reserve (Cash & with CBK)	143.4	221.7	321.6	626.0	372.5	323.0	329.9	288.0
6. Net Foreign Assets	614.7	745.7	981.3	721.0	750.7	946.9	873.9	965.0
7. Private Sector Deposits	2073.9	2606.2	3583.0	3835.3	4027.1	4171.8	4116.5	4224.6
8. Capital and Reserves (Shareholders Equities)	267.7	336.9	411.0	576.9	664.4	823.3	831.6	889.3
9. Govt. Deposits.	149.0	171.3	211.0	393.8	362.5	387.8	385.8	226.6
10. Interbank Transactions	449.6	749.6	1279.3	1773.3	2308.4	1331.0	1605.7	1757.9
11. Total Domestic Assets	2874.9	769.0	5353.5	6895.2	7693.1	7078.3	6820.2	7123.4
12. Bank Aggregate Balance sheet.	4293.5	649.1	7599.0	9146.2	9994.2	9585.9	9052.6	9302.4

Source: - Central Bank of Kuwait, "The Kuwaiti Economy" 1984, p. 63.

- Annual Statistical Abstract, Ministry of Planning, 1987, P. 280.

At the end of 1985, their total aggregate balance sheet rose by 5.6% against 7.7% in 1984. This growth came mainly from domestic loans which rose by 6.8% and domestic investments which also increased by 10.7%.<sup>(27)</sup>

### 1.7.3 Manufacturing Industry

Despite its 9 years increasing contribution to GDP from KD 75 million in 1974 to KD 219.5 million in 1985, industry in Kuwait still plays only a modest role in the economy. In 1983, it accounted for only 3.6% of GNP.<sup>(28)</sup> The government is committed to the formulation of a comprehensive strategy for further industrial development.\*

It is worth mentioning that the recommendation made by the Kuwaiti Industrial Development Committee (the state authority responsible for industrial development) to re-activate the economy resulted in a resolution by the council of ministers allowing an increase of customs duties on 15 imported articles of a similar nature to locally manufactured products to 30% for the forth-coming three years.<sup>(29)</sup> This was in conjunction with new tax regulations on selected goods such as luxury items.

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\* The industrial sector receives special support from the government through the provision of generous incentives, inducements and exemptions (soft interest rates of a yearly 5%, long term loans nominal rents on long term industrial areas, the allocation of 167,000 square metres for new industrial developments, and low priced electrical power). Also, tariffs are imposed on imported competing goods and local manufactured goods are allowed a 10% preference over the lowest imported prices of goods of comparable quality.

## 1.8 Concluding Remarks

Ever since its foundation, Kuwait has been subject to drastic changes. Such changes stemmed from two major sources: firstly Kuwait's exposure to the sudden boom of oil revenues and consequent extreme shift in its public expenditure; secondly, changes in the political scene and traditional life style. This setting within which the country found itself, brought about fast changes. Kuwait had to face the new area of state development, not to mention the need for government to divert some of its available resources to cope with the requirements of challenging growth plans.

Since the early sixties, the Kuwaiti economy has witnessed a remarkable development and growth rates by most standards. Both GNP and GDP have grown by more than 10 percent annually accompanied by financial stability which has brought a real growth in per capita income and a better standard of living. However, the picture has been changing rapidly since the early eighties in terms of provincial budgeting and public expenditure. In addition to the sharp decline in oil prices, and the catastrophic aftermath of the stock exchange collapse, the Government adopted an un-rational treasury bill issue policy in recent years, which made the situation more complicated. In practice, there were no buyers of the bills outside the banking institutions, which raises doubts concerning the investing public's confidence in the Government.

In fact, underallocation of bills is quite common, although the real figures for this are never published. The central bank -according to bankers-, floods the market with liquidity immediately before an issue in an attempt to announce huge over-subscriptions. Thus, while overnight rates are driven down, rates are left to rise again after the issue has been allocated.<sup>(30)</sup>

This pace of economic development and growth was accompanied, as is to be expected, by certain transformations in various aspects of the economy, which may be summarised as follows;

- 1) As stated previously, and rightly noted by many others, the oil sector revenue dominated and still dominates the financing of the budget. The relative importance of other sectors was reduced except for foreign investment, though foreign investment growth was insufficient to direct the pace of economic development.
- 2) These factors gave rise to a financial sector unrestricted by taxes (particularly in public expenditure).

Furthermore, Kuwait experienced financial imbalance as a result of the inadequacy of domestically generated revenues which eventually led to greater dependence on the performance of oil.

- 3) During the past decade, the country in fact received increasing inflows from the oil sector, which made it possible to achieve an enormous savings surplus. Indeed, one could argue that with such levels of savings, the government overcame all its problems, stabilising its

political power and dealing with pressure groups, especially the merchants.

The striking feature is that through the implementation of this policy, a great disparity in incomes came about as a result of the wealth distribution programme, which led to an unrealistically high standard of living, even among the native lower class. Despite the scarcity of reliable and pertinent data, a Gini Coefficient of 0.47 in Kuwait for 1972/73 fiscal year, reveals the inequality of income distribution. Even though Kuwait had one of the highest per capita income levels, still a sizeable percentile of income recipients hold the top portion of total income.<sup>(31)</sup>

4) It should be stressed that foreign resource inflows are not likely to continue indefinitely, nor can oil revenues. On the one hand they are dependent on the political situation which is itself volatile. On the other hand, the main objective here is to provide sound plans in the development process, so that further progress becomes automatic and self-sustaining.

Facing the problems described earlier, Kuwait recently has called for an effective implementation of taxation and public debt as an available financial instrument to direct its fiscal plans.

The purpose of this study is to evaluate the validity and accounting implications of Kuwait's taxation policies. This will necessitate the examination of both current tax laws and prospective tax project plans.

## NOTES

- (1) For a more detailed historical account of the Oil Industry in Kuwait, See Ragaei El Mallakh, " Economic Development and Regional Co-operation: Kuwait " (Chicago: University of Chicago Press. 1968) chapter 2.
- (2) The final agreement was signed after very keen negotiations between the two parties which lasted for more than 20 years. - More discussion is found in Bilovich Y., "Great Power and Corporate rivalry in Kuwait 1912-1934"; "Ph.D. Thesis University of London 1982.
- (3) El-Mallakh R., Atta J. K., "The absorptive capacity of Kuwait" Toronto 1981, p.12.
- (4) Khouja M. W. and Sadler P. G. "The Economy of Kuwait", London 1979, P.25.
- (5) Income and Public revenue estimates are based on information from an article by Fakhir Shehab, "Kuwait: A Super Affluent Society"; Foreign affairs, vol. 42 pp. 461-74 (April 1964) El-Mallakh, op. cit. pp. 25.
- (6) Several factors contribute to the implications of such policy. First, the increased bargaining position of OPEC in 1972 (Kuwait and Saudi Arabia shared the responsibility of the derived difference in world demand and supply of oil). Second, the huge estimated sums of reserves (almost 67 billion barrels in 1977). Third, to keep up with the high prices stream of oil at the time. Last, the limited size of Kuwait absorptive capacity of relevant revenues. For further details see, El-Mallakh and Atta, "The absorptive capacity of Kuwait", Op. Cit., p.19.
- (7) Kathy Evans, "Souk Al-Manakh problems edges towards banking doorstep"; Financial Times (Supplement, Arab Banking 10), 15.10.84
- (8) For a comprehensive study of this crisis, see Fida Darwiche, "The Gulf Stock Exchange Crash, The rise and fall of the Souk Al-Manakh", Croom Helm, Kent 1986.
- (9) Ibid., p. 154.
- (10) Central Bank of Kuwait, "The Kuwaiti Economy, 1980-1984"; Dar Al-Seyassah Press (Kuwait). 1984 p.50.
- (11) MEED, "Kuwait: Special Report"; 22 April, 1988, p.23
- (12) Khouja and Sadler, op. cit., p.44.

- (13) Andary S. A., "Surplus Saving and the case for the regional financial market in Kuwait"; a Ph.D. Thesis, University of Aberdeen, Feb. 1982, p. 81.
- (14) Ibid., p.81.
- (15) Khouja and Sadler, op. cit., p. 45.
- (16) Ibid., p. 45, also see Al-Saadoun, "Factors Contributing to equality of income distribution in Kuwait"; Journal of the Gulf and Arabian Peninsula, Vol. 3, No. 12, p. 83 (October 1977).
- (17) Andary S. A., op. cit., p. 85.
- (18) Ibid., p. 85-86.
- (19) The Financial Times, "Kuwait: Special Report"; 22 February, 1988, pp. 15-18.
- (20) Andary S. A.,op. cit., pp. 85-86.
- (21) Ibid., p. 87.
- (22) Ibid., p. 88.
- (23) Stanford Research Institute's Report (1974), p. V-6, also see Andary S. A., Op. Cit. (1982) p. 90.
- (24) Khouja and Sadler, op. cit., p. 77.
- (25) Andary S. A., Op. Cit., p. 95.
- (26) Ragaei El Mallakh, "Economic Development and Regional Co-operation: Kuwait"; (Chicago: University of Chicago Press, 1968), p. 16.
- (27) Central Bank of Kuwait, "The Kuwaiti Economy", 1984, Op. Cit., p. 61.
- (28) Kuwait Ministry of Information, "Kuwait: Facts and Figures 1986"; Op. Cit. p. 115.
- (29) Ibid., p. 115, and refer to the state five year development plan (1986-1990). "Kuwait Ministry of Planning, 1986".
- (30) The Economist Intelligence Unit, "Kuwait: Country Report", London, No. 4, 1988, p. 8.
- (31) Khouja and Sadler, op. cit., p. 45.

*Chapter Two*  
*"Tax Laws of Kuwait"*

2.1 Introduction

The aim of this chapter is to review the historical background to the taxation system in Kuwait before the oil boom, after which the current tax regulations will be reviewed and extensively analysed from different perspectives. From an understanding of the present tax system, it will be possible to assess the current problem of taxation in Kuwait.

Eventually, to overcome the marked shortcomings of the 1955 tax act, several attempts were made to introduce a new tax bill to replace the previous one.

However, the subject was novel and it would have affected all the classes - particularly the governing class - who have developed a taste for luxury; thus it was unlikely to win much support unless a convincing case could be made. That would necessitate stressing the vital need for public responsibility as well as the rationalisation of public spending. Unfortunately, an effective case was not made, as a result of which the latest tax reform was rejected in 1981. Therefore, this chapter will contain the following sections; 1> Taxes in Kuwait before and after the oil boom including the present tax Act No. 3 for 1955. 2> Assessment of the 1981 tax paper and relevant regulations; 3> Finally, tax as an emerging financial source in Kuwait.



## 2.2 The Pre-Oil Taxes of Kuwait

Taxation is a relatively new concept in Kuwait, even though it was known early this century. The taxation system at that time was very simple and in its infancy. Customs duties were imposed by the merchants themselves at a starting rate of 1% ad valorem, and were intended to assist the government at that time.

In 1831, Stocqucher A. a European tourist, visited Kuwait and described it as " a town ruled by a Prince (Sheikh) but for any military forces, who was collecting a 2 per cent taxes on all imports".<sup>(1)</sup> Another traveller, Pelly, stated that Kuwait did not impose any type of taxes except for what was paid by the merchants, which reached 20,000 Riyals per annum. Afterwards, customs duties were levied at a rate of 2% - on the complacency of the merchants and the wealthy people.<sup>(2)</sup>

Kuwait's financial reputation soon grew, but its tax system still consisted of a 10% tax on pearling profits, customs duties and guarding fees. Likewise, there were taxes on sales of property and shop rentals, both at 33%. In 1930, the municipality of Kuwait classified properties into four classes and imposed, on the basis of this classification, a progressive tax on houses.<sup>(3)</sup> The first class was to pay 24 rupees a year, the second 12 rupees, the third 6 rupees, and the fourth 3.6 rupees. However, due to several difficulties in levying the tax (including the high cost of employing tax collectors), it was cancelled only a year after its imposition.

In 1932, a substitute tax on all types of commercial and industrial shops was decided. During the 1930's and 1940's, because of changes in the need for funds, the scope and rates of these taxes were subject to continuous fluctuation.<sup>(4)</sup>

Furthermore, a site tax was added to these imposts, which was 50 Rupees (75 files or 32 pennies) then reduced to 10 rupees, per 100 sq. feet, and an excise tax of 2% on building materials.

Over all, the pre-oil taxes were very simple and the associated system was rudimentary. For instance, pearling income taxes were characterised by the following:<sup>(5)</sup>

1. A fixed, uniform tax rate was levied on every pearl diver in each pearling season;
2. The tax inspector and collector at the same time was a designated official, who had the duty of recording, declaring and collecting taxes;
3. Few tax exemptions were granted;
4. Pearling tax was a direct proportional income tax;
5. It was only applied on Kuwaitis only;
6. The payment, timing, and the manner of taxes were subject to certain conditions and were not arbitrary; This made them generally intelligible and liability was traceable with some degree of certainty.
7. Despite all the above, the equity of that tax system could be questioned as it did not affect all classes. Also, the annual revenue was not easily adjustable to meet annual demand. Finally, dislocations were created by the frequent modifications of rates and imposts which occurred.

In 1946 crude oil exports started and replaced all these taxes as the major income source of Kuwait. Seven years later, Kuwait Municipality terminated most of the

taxes and imposts known previously.\*

### 2.3 Tax laws in The Period Since Oil Shipments

The coming of oil in Kuwait had a significant influence on the shape of imposts after 1938. The Burgan field, which was to become the principal source of Kuwait's crude oil, was discovered at that time, but the well was plugged in 1942 due to the outbreak of world war II. Drilling was resumed in 1945 and the first commercial oil shipments began in 1946, giving the government the requisite funds to abolish most of the taxes.

As discussed in chapter 1, Kuwait Oil Company (KOC) used to pay the ruler, in accordance with the first Kuwait oil concession agreement of 1934, a royalty of 90 US cents plus a tax-exemption fee of 70 cents per ton of crude oil produced.<sup>(6)</sup>

The first corporation income tax law in Kuwait was introduced in 1951 as an artificial tax law to be used only by the Kuwait oil company's concessionaires ( Gulf and Anglo-Iranian or British Petroleum later) on the basis of a claim for double taxation relief from USA and U.K. income tax authorities.<sup>(7)</sup> Four years later a royalty of 12.5% of the posted oil prices was agreed on between the Kuwaiti government and KOC. This was also to represent payment in advance of the 50% income tax.<sup>(8)</sup>

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\* Most of these imposts were charged as fees or rents (shops rent, shopping licenses, transportation fees; - etc.) see AL-Jassim N. A., "Kuwait Municipality in Fifty Years"; Kuwait, 1984.

The 1951 income tax law was the first act to organise imposts in a cohesive legal plan. The act was based on a unified income tax and had specified taxpayers (the oil concessionaires with KOC.). However, the law was abolished four years later, and the scanty data available on it is outside the scope of the present study.

### 2.3.1 Income Tax Decree No. 3 for 1955

From 1955 till the present time, act No.3 has been the only tax law applied in Kuwait. It was based on the British oil income tax at the time of its introduction. This year is not without significance because in 1955 no commercial legislation existed in Kuwait. Thus terms used in the tax law were defined substantively.

The literal translation of the act might have been an advantage over tax laws in many countries, where disputes may arise about the question of whether the tax law has created its own definition of a concept (i.e., companies subject to tax), or whether it has adapted a meaning expressed in other legislation. Unfortunately, this ideal situation, from the legal standpoint, was nullified after the introduction of the company law of 1960 in Kuwait.<sup>(9)</sup>

The act contained 14 articles and 3 appendices covering the system's profit computation, exemptions, deductions, allowances and relief for losses. The decree was issued on 10th October 1955 to replace the 1951 tax law. Several amendments were introduced to the law, the most notable being Act. No. 26 for 1967 (pertaining to the

collection of tax accruing on certain petroleum companies), and Act No. 34 for 1970 (income tax and advanced payment operation).

Despite the poor promulgation of the act, its ambiguity, and the absence of adequate judgements regarding its scope, the act is still effective in Kuwait as well as other Gulf states (Bahrain, Oman, Qatar, and the United Arab Emirates).<sup>(10)</sup>

Basically, the act and its further amendments were designed to provide a legal framework for the imposts on oil companies operating in Kuwait. Accordingly, these companies would avoid double taxation, in Kuwait and in their home countries. However, the act was in general formed to stress the impact of imposts of an extensive income tax decree, and not only to enable oil companies to avoid double taxation. Consequently, it was applied on several firms other than oil companies.<sup>(11)</sup>

Nevertheless, ambiguity arose with respect to the field of applicability of the law. According to article 1 of the decree on income tax "a tax is imposed on every body corporate, wheresoever incorporated, carrying on trade or business in Kuwait". The decree itself provides that the term includes any body corporate carrying on trade or business in Kuwait either directly or through an agent, and also includes any body corporate carrying on trade or business in Kuwait as an agent for others. The director of finance and income tax however, has issued an interpretation of the term "body corporate" stating that

it signifies an association formed and registered under the laws of any country or state which is recognised as having a legal existence entirely separate from that of its individual members. In 1955 the term could only be applied to foreign companies, for no commercial company legislation existed in Kuwait. However, after the enactment of the the 1960 company law, the position of Kuwaiti companies created thereunder became unclear, especially if the shares of the company established and registered in Kuwait were owned partly by Kuwaiti nationals and partly by foreign nationals. (12)

The government, however, paid no attention to the conflict that resulted from the enforcement of the company law, nor did the problem assume much importance due to the relative abundance of oil revenues. Uncertainty surrounded the application of the act in the cases of partly foreign and partly Kuwaiti owned enterprises. (13)

"It was certainly not intended that the introduction of a commercial law would create an indirect tax burden on Kuwaiti nationals who owned all the shares of a Kuwaiti company. On the other hand, if a Kuwaiti company was not considered " a body corporate" then foreign shareholders would be released from a tax burden, a result clearly not intended by the decree on income tax. In practice the problem has often been solved by imposing corporate income tax on the profits of a Kuwaiti company only insofar as they are attributable to foreign shareholders". (14)

"Taxation in Kuwait is limited, in broad terms, to foreign corporations. There is no income tax on individuals, nor generally upon Kuwaiti corporations. In line with the policy of most modern

states only foreign corporations (with separate legal existence from their individual members) that carry on business or trade in Kuwait are liable to Kuwait taxation" (15)

In fact, this is not surprising, since Act No. 3 was intended to be applied on foreign companies operating in Kuwait. Moreover, there is no constraint on imposing income tax on Kuwaiti-formed companies as well as foreign firms according to the act's articles.

In general, the taxation of a company's income will be reflected in the sums available for dividend distribution. Further, it is unjustified to impose taxes on individuals in their capacity as shareholders, while exempting those who operate private businesses. (16)

For the most part, the application of the law proved to be ineffective and yielded little revenue. This was mainly due to the government's failure to investigate the profits of many foreign partners. Also, it was easy for any corporate body subject to the law to evade tax by claiming that income for the taxable period did not exceed the exemption level. (17)

Table 2.1 indicates tax revenues for the last 25 years. Later in this chapter the act will be more thoroughly assessed.

#### **2.3.1.1 The Structure of The Act**

The act consisted of 14 articles and 3 appendices, in addition to five major amendments and following pertinent orders. Article 1 defined those liable to tax, which

Table 2.1

Tax Revenues Since 1962/63 To 1985/86  
(KD)

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YEAR	AMOUNT	Increase (Decrease)	% of Increase (Decrease)
1962/63	321409	-	-
1963/64	189741	(131668)	(41%)
1964/65	257638	67897	36%
1965/66	176045	(81593)	(32%)
1966/67	295010	118965	68%
1967/68	210754	(84256)	(29%)
1968/69	543697	332943	158%
1969/70	137465	(406232)	(75%)
1970/71	339447	201982	147%
1971/72	44670	(294777)	(87%)
1972/73	150248	105578	236%
1973/74	72718	(77530)	(52%)
1974/75	16905	(55813)	(77%)
1975/76	19525	2620	15%
1976/77	140670	121145	620%
1977/78	319241	188571	110%
1978/79	707931	378690	115%
1979/80	1146769	438838	62%
1980/81	1117717	(29052)	(3%)
1981/82	1147065	29348	3%
1982/83	3589968	2442903	213%
1983/84	3325978	(263990)	(7%)
1984/85	15254150	11928272	358%
1985/86	12000000	(3254250)	(21%)

\* No. of taxable companies = 470 company

\* No. of tax inspectors = 8

- Source : Tax Department, Ministry of Finance, Kuwait, 1986.



included all companies that had trade or business in Kuwait directly or through an agent "on every corporate body, wheresoever incorporated...".<sup>(18)</sup> Sections (a), (b) and (c) of the article specified the appropriate determination of income, and consequently the bracket into which the income of the body corporate for the taxable period would fall.

Article 2 explained some terms used in the act such as the taxpayer, taxable period, the director, the body corporate, and income. Above all, section (i) of the article revealed that tax rates applied to taxable income in the following percentages [Table 2.2];

Table 2.2

Rates of Income Tax In Kuwait  
Decree No. 3 For 1955  
(KD)

On Income Exceeding	But not more than	Rate %
5,250	18,750	5
18,750	37,500	10
37,500	56,250	15
56,250	75,000	20
75,000	112,500	25
112,500	150,000	30
150,000	225,000	35
225,000	300,000	40
300,000	375,000	45
375,000 .... and more		50
-----		
Amendment (1970),	375,000 and more	55

Source: - Tax department, Ministry of Finance, Kuwait.  
- "Tax laws of Kuwait", Decree No. 3 for 1955,  
Graham & Trotman limited, London, 1979.

The above progressive rates are ranged from 5 to 50 per cent, however the upper limit was increased to 55% in conformity with the OPEC agreement of December 1970, which

again shows the close relationship between income tax and the oil sector. (19)

Allowances that were permitted to be deducted in the computation of income were listed under article 3.

Depreciation rates were;

Office and buildings.....	4%
Plant, machinery and equipment.....	10%
Transport equipment.....	25-33%

The residual value of an asset after depreciation or depletion was determined according to article 4 as the original cost of the property increased by the amount of all expenditure chargeable to capital account and decreased by losses and allowances mentioned in article 3. On the other hand, the taxable period in respect of which income tax was imposed was determined in article 5, as the accounting period used by the taxpayer in keeping its records. Therefore, income was computed in accordance with the method of commercial accounting regularly employed by the taxpayer in keeping its records (Article 6).

The provision of relief in the event of loss was stated under article 7. Losses could be carried forward and set against income for the following taxable period. This relief could be claimed in the first subsequent taxable period. If it was not claimed then, it was carried forward the next taxable period and so on.\*

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\* One of the main criticism of the act is that article 7 did not clearly lay down a limit (either in years or in total sums) for the carrying forward of losses.

The tax is payable in four equal instalments (Article 8). In practice, however, the tax department often expects to receive the full amount of tax due when the declaration is filed.<sup>(20)</sup> A fine is payable of 1% of the outstanding tax for each 30 days following the tax due date, unless there is a reasonable cause for the delay.

In the absence of any proof to the contrary, the income tax declaration is presumed to be correct and the amount of tax shown is presumed to be final if an accountant who is a member of an internationally recognised firm certifies that the declaration conforms with the company's records, which are supposed to be correct and fairly reflect the taxpayer's income (Article 9).\*

Once a taxpayer's final tax liability has been settled, he is given a tax clearance certificate (Article 10). Confidentiality of taxpayer's records is to be respected, and declaration shall not be open to examination or inspection by any person other than governmental officials (Article 11). Article 12 stated the consequences of falsifying tax declarations. Anyone convicted of an offence against this decree shall be liable to a fine or imprisonment, or both. If a dispute between the administration of this law and a taxpayer arises, then

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\* The director of income tax is required to issue on an annual basis a list of at least two international accounting firms which are approved by him (article 9). This has proved effective in preventing tax evasion in later years, but there are still some loopholes in the act that can be exploited by the accounting firms to the maximum benefit of their clients.

either party may be referred to the courts for adjudication, or they may agree to submit the dispute to arbitration (Article 13).<sup>(21)</sup>

Finally, article 14 had abolished the enforcement of the income tax decree of 1951, and instead substituted it with Act. No. 3 for 1955. Also, an interpretation of the terms "Body corporate" and "Agent" were declared.

The three attached appendices to the act provided further interpretation of the expressions stated in the act (A), the income calculation of a collective partnership (B), and some forms of declaration and the relevant exemption claims (C).<sup>(22)</sup>

#### 2.3.1.2 Computation of Profit

Kuwait income tax applies the global income concept, that is all income from different sources is pooled in a single total for each taxpayer and subject to a single progressive rate. Taxable income is defined as the gains and profits of a corporate entity derived from carrying on trade or business in Kuwait. Accordingly, capital gains are considered to be part of income.

Article 2 of the act (Section i) exemplified taxable activities as follows:-

1. Dealing in immovable property, goods, or rights attached to such property in Kuwait, and maintaining a permanent office in Kuwait where contracts are executed;
2. Operating manufacturing, industrial or commercial activities in Kuwait;
3. Letting of any property in Kuwait;
4. Rendering services within Kuwait.

The mere purchase of property or goods in Kuwait is not considered to constitute a taxable activity. In addition, only income having its source in Kuwait is taxable, and must have been derived from local activities. However, activities which are carried on partly inside and partly outside Kuwait may be considered as wholly derived from a source in Kuwait, unless the two types of activity are sufficiently separated.<sup>(23)</sup> Income from contracts under which part of the technical, research or design work is done outside Kuwait is processed as wholly from a Kuwaiti source.

#### 2.3.1.3 Exemptions

Act No. 3 for 1955 did not provide any specific exemptions, but income that has been already taxed shall not be taxed again. For that reason, some writers believe that Kuwait income tax law is insignificant for the promotion of regional industrial investment. There is no specific tax incentive to promote successful projects in the industrial sector or to encourage national industrial investment. On the contrary, the only incentive in the manufacturing sector is for foreign investors, which are exempted from all taxes for ten years (Industry Act 1965). Hence the act is not applied to any Kuwaiti enterprise as long as it is registered in Kuwait.<sup>(24)</sup>

" There is no tax incentive (AL-Mejren, 1984, state) in Kuwait because all enterprises whether industrial, services or financial, are exempted from taxes. However, the only tax incentive offered to industry in Kuwait is the one which is directed toward foreign interests in the manufacturing sector. These

foreign interests are exempted from all taxes for ten years (Industry Act of 1965)." (25)

However, a high rate of income tax (55%) is applied at KD 375,000 net income after the exemption period, which may also be considered to be discouraging to foreign investment. (26)

#### 2.3.1.4 Deductions

According to the tax law, taxable income is assessed after deduction of several items. These deductions include;

1. The cost of goods sold and services rendered;
2. Expenses incurred in connection with operating the business in Kuwait (administrative costs, overheads, wages, insurance funds and pensions..etc.);
3. Reasonable depreciation expenses (discussed below);
4. Amortisation expenses (10% p.a. for 10 years life projects or more, and spreading over the remaining years for abandoned projects);
5. Uncompensated losses (debts, damages, etc.);
6. Interest on loans connected with activities in Kuwait;
7. Foreign exchange losses;
8. Proven payments to subcontractors may be deducted.

#### 2.3.1.5 Depreciation and Loss Relief Allowances

In calculating income, a reasonable amount may be deducted from taxable income for depreciation expenses. The straight line basis is the most common method for tax

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\* With regard to incurred expenses, the law does not prescribe any specific amounts of head office and general administrative expenses to be allocated to the Kuwaiti operations (branch accounts). Head office expenses which are related directly to activities in Kuwait may be deducted at cost. However, the tax administration generally limits the deduction to 3.5% of the total revenue from activities in Kuwait... see I.B.F.D., 1986, p. 36.

purposes and is generally computed on an annual basis. Higher rates can be used if deemed justifiable by the income tax department, otherwise the following rates should be applied;<sup>(27)</sup>

- Buildings, roads.....	4% p.a.
- Plant, machinery and equipment.....	10% p.a.
- Office furniture & equipment.....	15% p.a.
- Carts.....	20% p.a.
- lorries, aircrafts.....	25% p.a.
- Cars.....	33.5% p.a.

There are no indications in the Act of the amortisation of intangibles like goodwill. Thus it is unlikely that this and similar expenses would be deductible. Likewise, deductions for capital losses on disposal of fixed assets are not allowed.

In the same fashion, losses incurred in a trade or other business carried on in Kuwait may be carried forward and set off against the first available profits of the trade or business in which they were incurred. Relief is given as far as possible in the first year following that in which the loss concerned arose, and if it can not be given then, carried forward to the next year and so on.<sup>(28)</sup>

Although losses may not be carried back, a loss from one activity may be set off against a profit from another in a given year, because each taxpayer makes one income tax declaration for all his taxable activities in the year.\*

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\* There is no requirement in the commercial company's law to produce consolidated financial statements, but the taxpayer must aggregate the results of all his various business interests in Kuwait to determine his total taxable income.

The tax inspector has wide discretion in allowing or disallowing losses and depreciation, but in the main the provisions are recognisable as being based on standard accounting procedures.

### 2.3.2 Review of Other Imposts

Kuwait tax law No.3 is the only direct tax in the country and there are no taxes whatsoever on individual income except for the social insurance premium. Both the employer and the employee pay on a monthly basis a total premium of 15% of the employee's salary to the Authority of Social Insurance. The employer contribute 10% and the employee pay the other 5% of the premium. In addition, a 4% standard rate of customs duty is imposed on the CIF value of imported goods.

Since 1955 a few amendments or other tax laws have been appended to Act No. 3. These issues are listed below;

1. Income tax law of Kuwait No. 23 of 1961 (In the specified zone)...

This law was promulgated in July 1961, to regulate income tax in the neutral zone.\* The law is identical with Act No.3 for 1955 except for two dissimilarities;

- a. Tax rates: it has only 2 tax rate;

Income (KD)	Rate(%)
=====	=====
500,000	20
over 500,000	57

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\* Kuwait shares its south and south-west border (155 Miles) with Saudi Arabia. The southern part, however is shared with Saudi Arabia on an equal benefits basis, thus it is called the "Neutral Zone".



In addition, tax rates according to law No. 23 are applied on income brackets rather than on aggregated income as is the case with tax law No. 3. That is to say, there are two income brackets: up to KD 500,000, and over KD 500,000. In the case of decree No. 3, income was aggregated into taxable slices, which were subject to progressive taxation.

b. Loss relief: According to this law losses may not be carried forward or backward and set off against the first available profit. In other words, losses are to be included in the profit & loss account for the year in which they occur, and loss relief can not be claimed in other years. Losses therefore are the burden of the company concerned, which is a disincentive to regional investments, particularly in industry.

The first paragraph of the act (Article 1) identified the taxables as all companies operating in the neutral zone. Separate declarations should be filed with the tax department by taxpayers liable to the provision of both acts No. 3 and No. 23.<sup>(29)</sup>

2. Income tax law No. 22 for 1961..

This law was introduced before law No. 23 of the same year and had the same objectives as law No. 23, except that law 23 added 3 islands to the specified taxable area.

3. Law No. 2 of 1962..

The government issued this law in April 1962 to impose a 100% customs tax (ad valorem) on imported liquefied petroleum gas.

4. Law No. 26 for 1967 (pertaining to the collection of tax accruing on British petroleum (BP) and Gulf Kuwait Company (GKC)).

In addition to royalties, the Kuwaiti government decided to impose taxes on BP and GKC. This was carried out on July 2, 1967 through tax law No. 26. The two companies agreed to pay income tax in advance of the year in which production takes place and profit is realised.\*<sup>(30)</sup>

5. Law No. 24 of 1970 (Appended to law NO. 26 of 1967)..

This law is an amendment to law No. 26 with regard to the application of the latter on all operating oil companies in the country (to which law No. 26 was not made applicable).

6. Tax law No. 34 of 1970...

An additional 5% tax was added by this law, on every establishment subject to Kuwait income tax decree No. 3 of 1955. The extra 5% tax is liable only on annual income exceeding KD 375,000.

### 2.3.3 Pertinent Resolutions, Orders, and Laws

In addition to the laws described above, various orders, circulars and resolutions have been issued with respect to Kuwait's tax laws, particularly decree No. 3. The essential issues are the following;

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\* The later agreement was signed under law No. 26 of 1967 (The collection of the advance payment and transfer to the state treasury)..law No. 26 of 1967, Tax Department, Ministry of Finance and Petroleum, Kuwait, 1967.

1. Decree No. 41 of 1960..(The Endorsement of Kuwait Currency)..

The Kuwaiti currency -Dinar- came into existence in 1960 and was worth 1000 fillis (75 fillis = 1 Rupee - the previous tender). Thus the income tax decree's values were converted accordingly ( 1 Dinar = £ 2.2 approximately).

2. Appendix to income tax law No. 8 of 1967..(Amendments to decree No. 3 of 1955)..

This appendix states that the expenses mentioned under article 3 of the decree are not inclusive of all deductible expenses. Furthermore, new expenses of oil companies were allowed to be included in the deductions.

3. Law No. 108 of 1967.. (Foreign Airlines tax exemptions).

Foreign airline companies were exempted from paying taxes in Kuwait according to this law. This treatment was based on signed airline treaties.

4. Circular No. 16 of 1979..(Tax Certificates)..

In this ministerial circular, the Ministry of Finance prevented all other ministries and governmental authorities from paying the last dues of their contracts with taxable companies except upon the submission of a tax declaration certificate. These certificates were obtained from the tax administration at the Ministry of Finance.

5. Order No. 5 of 1980.. (Head offices administrative expenses)..

The order controlled the allowable administrative expenses of a foreign company's head office to be added to their accounts of operations in Kuwait. The allowable percentages were 3.5 in respect of contracting companies or

their branches, and 2 for foreign companies with shares in Kuwaiti companies.

6. Circular No. 17 for 1983..(Declaration requirements)..

The Ministry required a list of statements to be submitted along with tax declarations. These statements are;

- a. Current financial statements (Balance sheet / Profit & Loss account / Cash flow statement).
- b. A statement of fixed assets showing:
  - 1> Date of purchase
  - 2> Values
  - 3> Depreciation rates
  - 4> Depreciation charges
  - 5> Any additions to assets
  - 6> Disposals
- c. An inclusive statement of sub-contractors.
- d. The inventory list of the year (quantity & values).
- e. Contracts in progress affirmations.
- f. The closing trial balance.
- g. The last payment certificate issued by the project owner.
- h. Detailed policies schedules of insurance companies.

7. Resolution No. 103 for 1983..(Re-exporting of equipment)..

Foreign companies operating in Kuwait are prohibited from re-exporting their plant, machinery and equipment under the enforcement of this resolution. Only by submitting an income tax clearance certificate, can the companies concerned re-export their equipment.

8. Ministerial order No. 44 for 1985..(Informing about contractors)..

By this order the Ministry of Finance resolved that establishments, authorities and companies must inform the ministry (income tax control) of their contractors and sub-contractors. Moreover, the final payment due to the contractor -which should be no less than 5% of the total contract value-, is to be withheld until the contractor has settled his tax liability. Otherwise, the tax department

will disallow all payments made to sub-contractors that are not reported to the department when inspecting the relevant tax declaration.

9. Resolution No. 206 for 1985..(Commercial records and books)..

According to the terms of this resolution, every body corporate subject to income tax decree No. 3 should keep the following;

- a. General journal (including cash transactions).
- b. Inventory sheet.
- c. General ledger.
- d. Expenses analysis journal.
- e. Stock records.

Moreover, companies are permitted to use computers for the preparation of their financial statements provided that they have informed the ministry in advance. Tax declaration which do not comply with this resolution will be rejected by the tax department.

#### **2.3.4 Kuwaiti Commercial & Industrial Laws**

In 1960, Commercial Companies law No. 15 was published in the official Gazette. Basically, the structure of the law was borrowed from the neighbouring states.

In each part of the five divisions of the law, a classification of a commercial company was defined;<sup>(31)</sup>

1. General Partnership (Solidarity Company);
2. Limited partnership (Simple and Limited by Shares);
3. Joint Venture;
4. Corporation;
5. Limited Liability.

#### 2.3.4.1 Law Of Commerce

In 1961, Kuwait law of commerce No. 2 was published in the official Gazette, consisting of an introductory chapter and five books. These Books are;

1. Commercial business and the application of Mercantilism (Commercial acts, Merchants, Commercial houses);
2. General obligations (effects, features, transfer, sources, and termination of obligation);
3. General provisions of commercial contracts (sale, transport, commission agency, brokerage, current accounts, etc.).
4. Commercial papers (Bill of exchange, Bill to order, the Check);
5. Bankruptcy (declaration, effects, administration, termination, creditors affairs).

#### 2.3.4.2 The Industrial Law

Law No. 6 of 1965 enables the minister of commerce to grant approved new industries certain benefits and privileges. These benefits include low-cost land; ten year exemption from any existing or future taxes; exemptions from custom duties (base rate 4% ad valorem) on machinery, spare parts and raw materials; and the imposition of restrictive import tariffs.

The Industrial Development Committee at the Ministry of Trade and Commerce can grant these incentives to new and existing industries. Collectively, free use of industrial land, financial assistance for research and feasibility, and preference in government purchasing can be conferred, if necessary, to appropriate establishments.

### 2.3.5 Gulf State's Tax Laws

In one way or another, tax legislation in the Gulf area is related to oil production and to royalties imposed on oil companies operating in the region.

Basically, the tax laws established in the Gulf states was intended to be applied only on oil companies. However, the situation came to be regarded as too discriminatory. As one author pointed out:

"The original intention was to limit the taxation to companies producing petroleum from the ground, but the home countries saw this as too discriminatory to be acceptable as income tax, and the laws were thus extended to include "every body corporate, wheresoever incorporated, carrying on trade or business." (32)

The expression, "Carrying on business" usually includes business carried out by means of an agent, so the concept of residence is not a consideration.

In later periods, tax agreements between oil companies and the Gulf states have been amended gradually. Percentages have been increased, discounts have been abolished, royalties have been re-introduced, and participation agreements have become common. However, the basic form of taxation has not changed. Tax is chargeable on a sliding scale which rises in most cases to 50%. Losses may generally be carried forward with no maximum period defined, and tax laws generally provide for disputes to be settled by arbitration. (33)

Prior to a concise examination of the tax laws of each state, two major points should be made at this juncture.

First, the only true tax-free areas in all fields other than petroleum production are Bahrain and Fujairah (UAE), since those states were not subject to precisely the same fiscal pressures as the other jurisdictions, and their tax laws were never extended to cover businesses other than oil companies.

Secondly, non-oil corporations tax liabilities in the other Gulf states receive varying treatment, from punctilious collection to complete and long-standing non-enforcement. While there is some comfort in Kuwait in the existence of a five year limitation period, under the civil code, for the collection of back taxes, there is no such limitation period in the rest of the area. Thus the risk of long retroactive assessment is a real one. (34)

A variety of exemptions are available in the Gulf states and these exemptions are granted by law only to foreign licensed businesses. However, their requirements are frequently changed depending on the kind of investment each state wishes to attract. At present, the most sought after investment is of plant and expertise, not capital.

Also, it should be noted that Kuwait's tax policy is anomalous in comparison with those of the other Gulf states. Kuwait's constitution requires that no one shall be exempted from payment of taxes except in circumstances set out in law. Nevertheless, the aftermath of the promulgation of decree No.3 of 1955, and later on the advent of the Kuwaiti Commercial Companies law of 1960 raised the question of whether or not to tax Kuwaiti-



established corporations. "By a stroke of the pen corporations could be formed which, as carrying on business in Kuwait, were immediately liable for corporation tax. In practice tax has not been collected on the Kuwaiti elements in such corporations." (35)

#### Saudi Arabia..

Saudi Arabia had a corporation tax until 1975, when it was abolished on the ground that Saudi corporations and shareholders pay the religious "Zakat", not income tax.\*

Before that, income taxes were collected on a similar basis to those of other Gulf states (coming earlier than in the other states, in 1950). Taxes in Saudi Arabia will be further discussed in chapter 9.

#### Bahrain..

One of the most notable attractions of Bahrain's taxation policy is its free port. The only impositions in Bahrain are governmental charges and legal documents requirements (notarial fees, registrations and governmental paper's stamp duties). Oil producers are the only taxpayers in Bahrain, despite the many attempts to produce further legislation. Bahrain tax legislation came in during 1955.

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\* Zakat is one of the five imperative religious obligations of all Muslims. It is levied on money, investment, animals, agriculture, trade and business. All money that is put aside and not used for a whole lunar year, has a Zakat of 2.5% levied on it. Similarly, 10 percent is levied on income from investments and 2.5% from personal income (salaries and wages).. see Gambling and Karim, "Islam and social accounting" Journal of Business Finance & Accounting" Vol. 13, No. 1, 1986, p.43.

**Qatar..**

Resembling the tax laws of Kuwait, the tax laws of Qatar have been imposed on oil companies since 1955. However, where a body corporate carries on business through an agent, no tax liability arises where the agent himself is not a body corporate. Furthermore, the application of the tax law and the collection of due taxes is conducted on normal basis.

**The United Arab Emirates..**

Since the country is divided into provisional states, the central government is enabled to levy a federal income tax. Every state has its own tax legislation, but no steps have yet been taken to unify the tax laws of the Emirates. In Abu Dhabi, for instance, the basic tax law was passed in 1965, and taxes are collected in certain cases, but not as a general rule. In Fujairah, on the other hand, tax laws were passed in 1966, which apply only to oil producers. The other five states introduced taxes either in 1968 or in 1969, and collection or exemption depends upon the dictates of the individual rulers.

**Oman..**

Wholly Omani-owned companies do not pay tax under decree No. 21 of 1975, nor do companies engaged in industry, agriculture or fishing. These statutory exemptions appear to have been left intact by the Companies Income Tax law, which repealed the 1971 law (exemptions from the 1971 law were exceptionally provided at the

Sultan's discretion in the interests of the sultanate). (36)

However, under the 1981 law all types of companies and also joint ventures in Oman attract tax, as also does any resident establishment supported by a foreign firm such as manufacturing premises, seat of management branch office, etc. (37)

#### 2.4 An Evaluation of Kuwait Tax Laws

The foremost criteria that come to mind when evaluating any tax system are the objectives of the taxes themselves, for whatever comes afterwards will be based upon those specified objectives. Clearly Kuwaiti tax law at the present time is totally inadequate for the current stage of development, and tax objectives have been entirely eroded. Decree No. 3 of 1955 was introduced on the basis of the absolute advantage of the oil companies operating in Kuwait at that time. In order to avoid heavy taxes in their home countries, oil companies operating in the Gulf area adopted the notion of local imposts that are fully credited in the tax scheme of the home country. The contrast was between lenient, negotiable tax rates and a rigid, well organised tax structure. Of course, the first choice was considered preferable to the second.

It can be argued that tax imposition in Kuwait was introduced largely for that reason, and not for revenue raising or any other fiscal budget purpose. In fact, it is believed that the act itself was written in English then poorly translated into Arabic, which created the impression

that the oil companies had been thoroughly involved in its draft formulation. (38)

Not only was the decree ambiguous, legally inaccurate, imperfect in its definitions, couched in generalised terms, and full of shortcomings, but also it was not followed by an explanatory memorandum. Thus, many amendments and ministerial orders were issued to overcome these loopholes in the act. Despite these, several bodies have stressed the inadequacy of the act in various respects. The International Bank for Reconstruction and Development (IBRD) commission to Kuwait in 1961, for example, recommended a reform of Kuwait tax laws. Further in their criticism of the act they stated:

"The IBRD missions of 1961 and 1963 wondered why a mutually agreeable agreement could not be worked out with the oil companies which would give the government latitude in adjusting income tax rates applicable to other foreign investments in Kuwait". (39)

Others, however, suggested that the remedy was, at least in part, in the hands of the tax administration.

"The income tax decree is very short and general, and uncertainty exists on many points. The director of income tax is authorised to make administrative ruling, but this authority has been infrequently exercised, so it is advisable to ask the income tax department for its opinion on doubtful matters. The income tax department does not, however, normally give binding rulings on particular transactions in advance". (40)

Also,

"In practice, however, few rulings have been issued and since the income tax law is either silent or unclear about a number of issues, the current interpretation of the income

tax department should be regularly sought" (41)

Among several shortcomings in the law, the following are the most widely criticised: (42)

1> The decree's articles were unclear and partly misleading. Article 7, for instance, provided loss relief for eligible taxables. However, this relief was stated in such broad terms that it was open to abuse by those seeking to evade tax. The article states "Any relief under this article shall be given as far as possible in the first subsequent taxable period within the said following taxable periods and so far as it cannot be so given then in the next taxable period and so on". The last three words, "and so on", meant that potentially, endless exemption into the future was granted for any taxable as long as it could cover its losses, even if these losses were 20 or 30 years old. Eventually, such provision would not only affect the tax collection for some years, but would also allow uncompetitive companies to stay in the market by claiming loss relief.

Despite the fact that foreign investors are attracted by the high profit margin, the government could on the basis of double tax treaties, provide the following incentives to promote foreign investment flow into the state;

- 1) Exemptions from import controls for specific industries;
- 2) Tax credits for any foreign tax liability;
- 3) Less official administrative procedures;
- 4) Cash subsidies for industrial projects;
- 5) Credit facilities at competitive interests rates.

Furthermore, the treatment of the loss carry forward could also be used within these incentives, which could be based on two criteria. First, the number of years that

such relief could be claimed for previous losses either be restricted to a certain number (e.g., 3 years), or to a percentage of losses to be recovered (e.g., 70-80%), which ever occurs first. Second, a net present value approach could be allowed to enable taxables to equate for their previous losses in terms of their cash flow effect (at the time of tax declaration).

Moreover, the determination of taxable income has always been a major source of disagreements between taxables and the tax department (see chapter 7). The decree was couched in very general terms, and made little reference to most of the areas of dispute, such as overheads of headquarters (the % allowed to be included in the branch's profit & loss account), the treatment of goodwill amortisation, capital gains, royalties and patents, the share in profits of a subsidiary company, as well as other disputed legal proceedings.

As far as accounting practice is concerned, the decree states " Income shall be computed as provided by this decree and in accordance with the method of commercial accounting regularly employed by the taxpayer in keeping its records". This regulation is also rather loose, and resulted in further wide-ranging disputes as to what type of accounting method was to be employed in keeping records and determining income, and why. The article was sufficiently vague as to allow taxables to accommodate the accounting method employed to best suit their own interests.

Depreciation, for example, was calculated on different bases within the same period showing inconsistency in the accounting method applied. Similarly, the adoption of the accrual basis in one accounting period, and the cash base in the following one (without reasonable cause) resulted in long disputes between the tax department and taxables. While both parties sought to justify their views, the decree provided no clear answer.

2> Since the decree was basically formed in accordance with the oil companies taxation, it is at present unable to solve many inquiries regarding the taxation of non-oil companies. The historical relationship between the Kuwaiti Government represented by the Ministry of Finance & Economy, and the two oil companies (BP of Kuwait, and Kuwait Gulf), had provided the impetus for promulgation of decree No. 3 of 1955, and most of the following tax laws (i.e., law 23 of 1961, ministerial order 103 of 1983). In fact, the memorandum to law 34 of 1970 states; "After negotiation between the Kuwaiti Government and both BP of Kuwait and Kuwait Gulf oil companies, a 5% increase in income tax has been agreed as declared in decree 3/1955".

In addition, some of the expressions used in the decree are relevant only to the oil industry, for example, "expenses of exploration, drilling, or development of petroleum or other hydrocarbon properties ..etc." [(Article 3, (b))]. These expenses are only encountered by oil companies and cannot be equated with other costs encountered by non-oil companies.

The legal procedures followed to settle disputes between the tax department and taxables gave further indication of the multinational perspective, influencing the decree, for example the possibility of arbitration if settlement could not be solved between the two parties by an elementary committee, and the representation procedures ought to be followed in cases of claims through an agent.

3> Kuwait tax legislation can not cope with modern development requirements, particularly in the area of tax incentives. As previously stated (2.3.1.1 Exemptions), the decree contributed almost nothing to the promotion of local industry, nor did it provide incentives for establishing a manufacturing base in the country, with or without the collaboration of foreign investors. The only tax incentive offered to such investors in industry was ten-year total tax exemption. However, this exemption was granted under the provision of the Industry Act of 1965, and decree No. 3 made no reference to it.

4> Tax declaration procedures are not properly governed in terms of declaration filing, inspecting, penalties, and further disputes. Tax declarations, for example, were to be submitted within the first 3 months following the taxable period (Article 8). An extension to this date could be granted by the tax director. However, the decree provided no maximum limit to such extension which was left entirely to the discretion of the tax director. Furthermore, a penalty on every 30 days delay was to be enforced (1% of



taxable income). However, if the result of the operation was a loss rather than profit, this penalty could not be enforced. Thus the tax department had no effective means of forcing the concerned taxable to submit tax declarations. The decree provided no solution to the problem, which has frequently arises in recent years.

Similarly, according to article 13 of the decree, disputes could be referred to arbitration with the consent of both parties, if an adjudication could not be reached. Even though such proceedings might be legally justified, in tax affairs, the state sovereignty is involved, necessitating the final decision to be made by an appeal court rather than an arbitration (which is likely to acquire international dimensions). A system of a lower court and an appeal court could better serve the legal purpose without raising the sensitive issue of state sovereignty.

5> The ambiguity of the act is compounded by failure to supply further detail in an explanatory memorandum. The interpretation and enforcement of the decree's article were left solely to the tax department, which in many cases caused long disputes with the taxables regarding their taxable income, for example. Long and endless disputes have been attributed to the wide interpretation of the word "income" [(Article 2,(h)] as used in the decree. The tax department insists that "income" include all profits generated within Kuwait regardless of their source. While on the other hand, taxables argue that "income" as stated

in the decree includes only "operating profits" and excludes profits earned from capital gains, or from transfer pricing. The decree, was unfortunately silent on these matters.

- 6> Many loopholes in the act prevent the tax department from sufficiently performing its duties, such as;
- a. Deducting customs duties from the tax liability rather than allowing such imposts as expenses deducted from total income;
  - b. The tax department's authority and responsibilities were not specifically identified in the act;
  - c. Penalties, disputes, allowable expenses and other legal actions that negated the effect of the decree were totally uncertain;
  - d. Taxable companies were not forced by the act to keep financial records on a regular basis, nor were they obliged to attach their current trial balance alongside the tax declaration.

Moreover, the tax department is not the only government authority to admit the impracticability of the tax decree. The Central Auditing Bureau of Kuwait also stressed on several occasions the need for reform of Kuwaiti tax laws. Since one of the principal aims of the Auditing Bureau is to audit the performance of the budget revenue sources and the application of public funds, a continuous monitoring of taxes has been conducted and reported in the bureau's yearly reports during the last 17 years. In line with this objective, the Auditing Bureau has evaluated the efficiency of the tax department's records of accountable taxes. The effects of that assessment will be discussed as part of the tax administration appraisal later in this chapter. However, the following is a sample of comments

from the annual Auditing Bureau reports (1978 to 1985) with respect to the tax decree No.3 of 1955; (43)

"The decree is entirely in-applicable for enforcement at present - structurally and economically ..."

(A.B./ Rep. 1984, P.14)

"Apart from its failings -the decree- did not limit the loss relief (carrying forward allowance) to an identified period. It was open for both faithful and incompetent taxables..."

(A.B./ Rep. 1979, P.6)

"As for asset's sales and other used property, there is no indication, whatsoever, of the applicable depreciation rates to be employed in such cases..."

(A.B./ Rep. 1980, P.7)

".. For a regular procedure, the act is formally confusing in the sense that it does not specify the accepted tax declaration procedures, nor the legal courses of action..."

(A.B./ Rep. 1981, P.3)

More recently, many queries have been taken up in the correspondence between the Auditing Bureau and the tax department. Examples of such queries include the percentages of administrative expenses allowable as tax deductible expenses, the volume of financial data required for tax inspection, penalties and final tax dues, and other disputes regarding the application of accounting principles.

In general, the income tax decree was not perfectly structured and lacks a logical sequence such as is found in most recognised tax laws. That is to say, the decree should have stated the taxables, then taxable income

measurement, allowable expenses, exemptions, tax collection, and legal disputes respectively. Also, it is noticeable that, the subsequent orders and tax laws are either amendments or appendices to the decree, despite all the shortcomings of the decree's basic structure. More than 27 years has passed since the decree was promulgated, and it is more than time to substitute it with a new tax law that will overcome all the defects of the current tax law. (44)

## 2.5 The Tax Administration

Kuwaiti tax administration is regulated under the supervision of the general accounting department of the Ministry of Finance. It is not, fully independent as the tax department's actual director is a third ranked manager (senior accountant); the formal director of the tax department is the Minister of Finance.

There are 8 tax inspectors working in the department for 7 hours a day (40 hours a week), most of whom have a bachelor degree in accounting. However, there are more than 470 taxable companies which have to file a tax declaration every year and to be inspected, while the number of inspectors has remained static. In other words, each inspector has to closely examine almost 59 company declarations within 12 months. Doubtless, such a work load will affect the quality of the inspection, in addition to which taxable companies seek the reduction of their tax liability by tax avoidance and evasion. Naturally these multinational establishments have numerous operations to be

checked yearly, which puts more pressure on the tax inspector who has to be accurate in his assessment to the greatest possible extent. Accounting consulting organisations and public auditing bureau are no exception from the current evasion methods, especially as Kuwait has no formal accounting regulations nor has it any professional code of ethics. For these reason, it is possible for these accounting and auditing bureau to pursue their client's interests - reducing the tax liability- by manipulation of accounting income measurements. Depreciation expenses for a single asset, for example, may be calculated according to several methods and rates within a given period.

Together with the above, general corruption has also contributed to the low productivity of the tax department. Extra afternoon jobs are held by 5 tax department staff thus taking up time, efforts and interest that could otherwise be applied to more effective tax control.\*

Owing to these and other factors, the likelihood of increasing the value of collected taxes has been reduced, even though a significant percentage increase of tax receipts was recorded in the previous two years (see Table 2.1). Likewise, in spite of the obvious increase in the number of taxables and the related tax activity, the vast majority of those taxables are still either not covered or improperly assessed. The percentages of the tax collection (Table 2.3) reveal the efficiency of the tax department's

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\* Kuwait's working hours are from 7 am. till 1 pm. and the afternoon jobs (extra) are usually from 4 pm. to 9 pm.

TABLE 2.3

## Kuwait Tax Department Collection Evaluation

- (000) KD - \*

(1) Fiscal Year	(2) Tax Revenues	(3)** Un- Collected Taxes	(4) Total due tax of the year =(2)+(3)	(5) % Of tax Collection =(2)/(4)	(6) % Increase (decrease) of collection n-1 =(5)-(5)
78/79	319.2	1,822.3	2,141.5	15%	---
79/80	1,146.8	1,283.4	2,430.2	47%	32%
80/81	1,117.7	0.837	1,118.5	99%	52%
81/82	1,147	0.304	1,147	<> 100%	1.0%
82/83	3,590	3,282	6,872	52%	(48%)
83/84	3,326	3,557.5	6,883.5	48%	(52%)

\* Figures are approximated to KD 1,000.

\*\* Taxes ought to be collected (as estimated by the Audit Bureau).

- Among the multiple reasons for the low tax collection ratio in the later years are :-

1. The exaggeration of depreciation rates, head office expenses, legal and doubtful debts allocations, insurance premiums, fiscal losses, administrative costs and rewards, etc.
2. The lenient approach of the tax administration to enforce penalties and the tardy procedures for collecting fines already due.
3. The mis-interpretation of the ambiguous decree's articles with respect to taxables, agents, contractors and income determination.
4. Governmental routines and many other legal actions.

- Source: The Accounting & Auditing Bureau, various annual reports, Kuwait.

performance. One could attribute the declining collection ratios of recent years mainly to the administrative efforts and other factors listed in table 2.3, and above all, to the deficiency of the tax decree. However, in 1981 and 82 the ratio reached its highest levels at 99% and 100% respectively, which might reflect the government's growing interest in the tax system and the prevailing environment of the 1981 proposed tax bill which will shortly be discussed in some detail.

Furthermore, while tax revenues contribute less than 2.5% of total public revenues in Kuwait, and only 33% of domestic revenues, direct taxes made up 69% of total imposts (customs duties formed the remaining 31%). Thus, when total government revenues are taken into account the contribution of direct taxes is much less impressive. For example, tax revenues in 1976/77 contributed about 4% of total revenues, and their share in total government revenues thereafter was not significantly better. In no single year did domestic tax revenues cover even 10% of domestic expenditure.

Although, the deficiency of the tax system in administrating direct taxes has been a shortcoming of the tax department's performance, the political power of the different pressure groups may also have been a major obstacle to tax administration. Perhaps the 1981 tax proposal and the consideration of introduction of a land gain tax to lessen land speculation and to divert such resources to more productive avenues, are the most evident

examples. Moreover, the availability of foreign resources may also be considered a hindrance in the sense that it created built-in inflexibility in the tax system and led to the relaxation of tax efforts on the part of the government.

As mentioned previously, the large number of companies subject to the tax decree which are scattered all over the country is a stumbling block to efficient tax administration. The Kuwaiti tax department has only one office at the Ministry of Finance which was responsible for more than 500 tax units in 1986. It is worth noting also, that the tax department has only recently been organised, until then, it was only a sub-department consisting of fewer than 6 tax inspectors under the control of the Ministry of Finance's budgeting department.

Overall, several reasons have contributed to the unsatisfactory position of the tax administration in Kuwait. These are the following obstacles:

1. The absence of a suitable and organised tax law as discussed earlier;
2. The tax department's staffing has been static during the past seven years, despite the actual increase in the tax base - the number of the taxpayers. The problem would have been worse had the tax decree been strictly enforced on all foreign and indigenous corporations. The result of the present situation is the accumulation of cases to be assessed and large amounts of overdue taxes either



unclaimed or not given adequate follow-up. Further, the number of objections and appeals are relatively high, and usually take 20-25 months to be judged.

Unfortunately, till now no research has been undertaken on the ways and means of improving Kuwait's tax administration performance, as it is the case in most developing countries. It is vital, that certain changes in the tax structure of Kuwait - which by now is out of date - should be sought, and there is still much that should be done to improve the administration machinery. An improvement in Kuwait's administrative procedures and tax collecting performance could be achieved by the following and similar means:-

- a. On-the-job training programmes, conferences, seminars, etc.;
- b. An increase in the manpower resource of the department, particularly with a talented and experienced staff;
- c. Special calls for various improvements in the government's daily routines and governmental authorities' co-operation;
- d. Increased taxpayer knowledge of the law by means of educational programmes, publication of taxpayer's guides, etc.;
- e. A clear instruction requiring the auditing offices to submit a copy of their report on the accounts of their clients to the tax department;
- f. Standardisation of the tax declaration procedures and pertinent accounting practices;
- g. The establishment of certain legal actions coupled with some covering penalties in cases of fraud or withholding tax information;
- h. New instructions compelling taxables with certain paid-up capital to furnish legal accounts to the income tax department;
- i. Simultaneous, implementation of these and similar

appliances by restructuring the income tax law so that it will be more amenable to enforcement.

3. There has been increasing tax evasion among taxables by both legal and illegal means. Withholding information or making false declarations, the establishment of wholly owned subsidiaries as sub-contractors in order to transfer cash and expenses, re-exporting productive - fully depreciated - equipment and exaggerating overheads are some examples of the means of evasion prevailing in Kuwait.

It is difficult to find hard evidence of this evasion, but it has been widely accepted that it occurs. An examination of the orders, resolutions, and circulars issued by the Ministry of Finance & Economy during the last 7 years clearly indicates that the intention was to eliminate the scope for evasion which was available to the taxables. For example, resolution No. 206 for 1985, order No. 44 for 1985, and resolution No. 103 for 1983 were all enforced to put an end to the "tricky" channels of evasion such as re-exporting productive -fully depreciated- equipment, and transferring profits to owned subsidiaries as subcontractors.

Of course, the tax department has more evidence of evasion than other governmental departments, but the officials are either handicapped by the out-dated tax decree or by official (or unofficial) secrecy and general pressure. In fact this situation has led to the belief that "tax evasion is the basic rule and providing correct information is the exception". (45)

Similarly, one can safely argue that the existence of pressure groups, prominent Kuwaiti shareholders in foreign establishments, political power centres and so on, is a major obstacle against a proper implementation of the income tax.

4. The structure of the Kuwaiti economy itself perhaps could be considered one of the contributing factors to the low performance of direct taxes. Kuwait's heavy dependence on oil revenues may have caused low significance to be ascribed to other sources of public revenue. This, until recently, weakened governmental concerns with tax enforcement, as revealed by the lack of coherence among the tax department and other governmental ministries and authorities.

5. Many loopholes in the tax decree No. 3 itself contributed to these factors, particularly the powers conferred on the tax assessor in the process of income tax law implementation in article 10. Article 3, also, had put a ceiling of 50% (amended to 55%, by law 34 of 1970) on the income tax schedule. The law has given the higher income groups a clear advantage, as compared to other countries where the upper limit of income tax is in excess of 50%.\* (46)

Furthermore, the tax system is believed to be inadequate and with very limited effect on investments and

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\* In several countries the upper limits of the marginal tax rates were, Syria 70%, Lebanon 42%, Iraq 70%, Egypt 95%, Britain 60%, France 70%, Germany (Federal Republic) 90%, Japan 85%... UN "Taxes and Fiscal Policy in Developing Nations", UN. Publication Office, 1975, p. 204. Also see.. Kay & King "The British Tax System", Oxford University Press, 1983.

the industrial sector in the form of tax incentives. The extent to which tax concessions and allowances are provided has aggravated the problem. This also, has limited the tax administration's power to control and efficiently reach some of the taxables operating in the industrial sector.

Over all, the above discussion clearly demonstrates that the Kuwaiti tax system - administration & law - has failed to provide even a small share of total government revenues, despite its potential which far exceeds the present collection (Table 2.3). Consequently, Kuwaiti officials have been motivated to improve the tax system. Thus, in 1981 a new tax bill was introduced which was intended to abolish tax decree No. 3. However, that tax proposal was rejected.

## 2.6 The 1981 Tax Proposal

As far as the proposed tax scheme in 1981 was concerned, a committee had been formed to investigate three main avenues of the propounded tax plan at that time.\*

The first option was to retain tax decree No. 3, but to clearly include the Kuwaiti establishments as taxables on an equal basis with foreign corporations. Second was the introduction of a new structured tax act that would totally abolish tax decree No. 3. The new tax law would state that individuals as well as corporations were subject

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\* The committee was formed of representatives from; the tax department, The Auditing Bureau, The Government Legislation Authority, and also representatives from the Ministries of, Finance, Planning, Commerce & Industry, and Ministry of Oil.

to taxation. This option was based mainly on the social equity ground that citizens should bear some responsibilities in the community, as they benefit from the rights of citizenship. Finally, the third possibility was to impose compulsory Zakat (the third Islamic pillar) on Muslims and to levy similar taxes on non-Muslims.

However, the committee found that the political and social climate was unsuited to the imposition of income tax on individuals by either means, compulsory or voluntary. Therefore, the decision was focused on the first choice, with the suggested amendments to apply the decree to Kuwaiti corporations. The committee anticipated, however, that such an approach would affect local private investment, since it would have an adverse affect on the desire to invest locally by Kuwaitis. In other words, Kuwaiti businessmen would search for a tax free investment, and if this was not available locally, they would be prepared to invest abroad in order to avoid taxes. (47)

These were the factors to be considered by the committee preparing the income tax formula. Their solution was to implement a progressive "brackets" tax rate on the one hand, and to raise the tax exemption level, especially for companies that contributed to the national economy, on the other. The tax project stated that all types of corporations, companies, and establishments (whether owned by Kuwaitis or non-Kuwaitis) were to be subject to income tax. The project, later that year, was rejected on submission to the council of Ministers.

### 2.6.1 Review of the Scheme's Components

The 1981 tax plan came in eight chapters totalling 51 articles, arranged in as follows;

Chapter =====	Subject =====	No. of Articles =====
1	The Taxables	4
2	Profit subject to taxes	7
3	Tax rates	2
4	The Exemptions	3
5	Tax Assessment	7
6	Disputes & Settlement	8
7	Penalties	5
8	General Provisions	15

The first article of the proposal stated that tax was to be;

"..Imposed on all profits of a company that is operating in Kuwait, whatever its function or its legal status, national or foreign, without exception." (48)

Because tax was to be imposed on all types of business activity carried out by local business entities, the project was regional, that is to say, it would operate in Kuwait. 'National companies' included all types of shareholding and corporation firms, while 'foreign taxables' meant all non-Kuwaiti establishments. On the other hand, foreign revenues of taxables were not subject to taxation as long as their sources were beyond Kuwait borders.

The second chapter of the plan (Article 5) defined the taxable period for a company as its financial year. Article 6 specified taxable income to include all sources of income aggregated in totals. Revenues included profits from sales of property, exploiting revenues and services or from any other technical advice. Taxable income was to

be calculated on the excess of the company's revenues over its expenses, in addition to any ordinary profits, extra ordinary and capital gains profits. However, only essential costs for the company's activities were tax deductible. These expenses were:

- a. Taxes, duties, and allowable returns;
- b. Real consumptions (allowable depreciation);
- c. Social insurance pensions;
- d. Un-compensated losses;
- e. Insurance premiums;
- f. Total (absolute) bad debts allocations;
- g. A reasonable percentage of head quarter's expenses;

The plan also limited the carry forward relief to a maximum of 5 consecutive years (Article 11), and granted permission to deduct technical reserves from taxable income as long as these reserves were computed back in the next year's taxable income.

As for chapter 3, it mainly consisted of the income tax thresholds and the appropriate tax rates to be applied. Table 2.4 shows these rates below;

Table 2.4

- The Proposal Tax Rates -

	Total Income (slices) KD. =====	Rate (%) =====
1.	0 - 50,000	-
2.	First 100,000	5
3.	Following 100,000	7
4.	Following 250,000	10
5.	Following 500,000	12
6.	Following 1,500,000	15
7.	Following 2,500,000	17
8.	Over the above	20

- Source: "Tax proposal of 1981", Ministry of Finance, Kuwait.

The proposal excluded any benefits gained by the taxable company as a result of its share or association with another company subject to income tax (Article 13). Additionally, the first KD 50,000 of net profit is exempted, as well as the personal profits gained from exercising private professions within the limits of that type of revenue. Further exemptions were subject to the decisions of the Minister of Finance.

Chapter five of the plan set forth tax assessment arrangements, which bound every taxable to submit a tax declaration to the tax department during the last four months of its financial year (Article 17). Unless all tax payments and the relative tax differences were settled, taxables would be liable for those payments. If the company subject to income tax did not keep regular accounts, the tax administration would have the right to eliminate the profits, determine the tax owed, and give notice to the company concerned.

A detailed legal presentation of tax disputes and other settlement matters was given in chapter six, articles 24 to 31. An elementary committee was to deal with all disputes; if unsuccessful, then an appeal committee formed by the Minister of Finance would judge the case, whose decision would be final.

The scheme's penalties were set out in chapter 7 in the following stages;-

a. Delay in tax payment (limits KD 500 - 5000);



- b. Refusal to submit tax declaration and preventing legal inspection (KD 1000 - 10,000 );
- c. Legal fraud or preparing false accounts (1 year imprisonment or KD 1000 fine or both).

Finally, chapter eight explained general terms and provisions such as tax inspector's rights of access to documents and books, the tax liability consideration over debts of a company subject to income tax, tax evasion devices, and the tax administration's right to seize assets if needed, etc. It is also worth mentioning that article 49 of the plan abolished the enforcement of tax decree No.3, including every stipulation contradicting the provisions of the plan.

#### 2.6.2 The Plan Assessment

In general, the proposal has overcome the many difficulties and pitfalls of tax decree No.3, though it effaced the valid advantages of the decree over the plan. These missing advantages would have had a great effect on tax revenue if the plan had been adopted. The plan income tax thresholds and the relevant tax rates were the weakest part of the proposal, not to mention the irrationality of exemptions, the plan's generalisation, and the bias of the scheme. The following points reveal the major disadvantages of the plan:-

- 1) The proposal still lacked comprehensive tax terms such as to include all income sources of a company subject to the tax law inside and outside the Kuwaiti region as long as the company operated within Kuwait and the income was

disclosed in their financial statements. This action would enhance Kuwait's tax negotiations with the rest of the world, as well as limiting the possibility of double taxation. Moreover, many principles of modern taxation would be gradually gained from international tax practices and agreements. At present the Kuwaiti tax administration badly lacks such assistance.

2) Part of the old problem, is the question of whether to tax income of all sorts including personal income as one of the most attractive taxables in Kuwait. The question remained unanswered by the plan. The appointed committee sought to avoid possible conflict with pressure groups and the influential classes which have the controlling interest in most small business. Perhaps this is the reason behind the exclusion of income tax on the individual, from the alternatives available to the committee. Consequently, there is no other negative incentive such as the exclusion of individuals and similar personal establishments (such as single partnership or joint venture companies), which would later on swamp the Kuwaiti economy with companies of limited capital and short-term objectives, which would not be taxed.

In fact, the committee's remedy for such a possibility was well beyond the real dimensions of the problem. Increasing the upper limit of the exemption, and changing income tax thresholds was not the proper treatment, since it would apply only to corporations (common shareholding, partnership, etc.) and not to family

or private businesses (which account for a large number of Kuwaiti establishments). (49)

Furthermore, the proposal is inequitable since both types of company (private - shareholding) have an independent entity, or an equal legal ground. One conclusion which can be drawn here, is that the plan favoured the wealthy and upper classes, since they are the only people capable of establishing their own (un-taxed) companies. In contrast, shareholders, creditors, and partners (most of whom are from the middle and lower classes) bear the tax burden alone, even though they are represented by a stand alone entity similar to a private company's entity. This point still needs clarification in the law. (50)

3) Several items need to be identified by an added article so as to terminate the endless disputes with regards to some definitions and interpretations which have occurred in the past. Income, sources of income, business activity, allowable depreciation and other explications of similar terms need to be stated.

4) As for exempted companies, it would be more appropriate to state that "the director of the income tax department has the right to exempt applicable companies" without restricting exemptions to national companies only (Article 12 & 15). It may be in the country's interest to exempt foreign companies also, as these taxables have the new technology, inventions and modern industrialisation which are most sought after by Kuwait.

5) Compared with the rates in income tax decree No.3, the proposed tax rates were so low as to severely restrict revenues. The proposal also raised the upper exemption level to KD 50,000. Additionally, the income tax thresholds are widely spaced and the rise in tax rates is not commensurate with the increase in taxable income. Therefore, most taxables would either be exempted due to the high exemption level (KD 50,000) or subject to very low tax rates. According to tax decree No.3, a 55% tax rate was applied on income over KD 375,000, while within the plan an income exceeding KD 250,000 was subject to only 10% income tax -the third threshold. (51)

The following example shows the effect of this change on tax revenues:

- Suppose that the taxable income is KD 400,000, then income tax under the decree No.3 and the proposal would be as follows;

A> The Decree:

=====			
Taxable income (KD)	*	Rate	= Income tax
-----			
400,000	*	55%	= 220,000

B> The Proposal:

=====			
/-----\ {Counter} \-----/	Taxable income (KD)	*	Rate = Income tax
-----			
50,000	The First 50,000	*	0% = 0
150,000	The First 100,000	*	5% = 5,000
250,000	The second 100,000	*	7% = 7,000
400,000	Residual 150,000	*	10% = 15,000
			=====
TOTAL			27,000

A total of KD 193,000 would be lost from tax revenues

by application of the proposal (220,000 - 27,000), i.e. an 88% reduction in the tax yield.

6) Finally, the legal penalties stated in the proposal were not comprehensive enough to cover collusion between foreign companies (subject to tax) and national exempted establishments in order to avoid taxes on the ground of shared benefits, for instance, by making false contracts; exaggerated invoice values, and claims for non-existent or false projects are also possible areas of tax evasion. The present tax practice faces such occurrences regularly. This situation requires severe penalties to prevent such damaging fraud. However, the proposal was too weak to furnish the tax administration with the legal permission to trace and control the relevant activities of national companies colluding with foreign taxables.

### 2.6.3 Un-resolved Shortcomings

Although the proposal was designed to overcome the many defects of tax decree No.3, it had its own inadequacies, either remaining from the decree or created in 1981. The main shortcomings are as follows:

1) Both tax laws were vague regarding the position of Kuwaiti private establishments in the sense that no clear definition was given of their business entities and whether they were subject to income tax, whatever the definition is.

2) The proposal and the decree stated that " taxable income is the excess of revenues over expenses". While

this might be true, in practice the actual taxable income was always the figure determined by the tax administration based on their unreliable inspections. Therefore, disputes in the past have always been caused by this point of conflict between the tax administration and taxables. It is impossible to list all the potential revenue and expense items under an article, but the tax law should at least provide a list of recurring and general types of revenue and expenses in an attached appendix or through the law's explanatory memorandum.

Similarly, clear cut pronouncements followed by plain interpretations of many aspects of the tax scheme are very essential. These interpretations include taxable income, revenue sources, differences between taxable period and the accounting period, capital gains, extra-ordinary profits and allowable expenses for tax purposes.

3) The treatment of the accounting allocations and other reserves was not covered in either the decree or the proposal. This issue has been left to the judgement of the director of the income tax department. In addition, percentages of like allocations (intangibles amortisation) are unrestricted in both laws, and even though the proposal limited the allowance for head office expenses to a maximum of 10%, this also was at the discretion of the tax department. Bad debts and doubtful allowances and tax liability allowance are also left unsolved in both tax laws.

4) The loss relief under the decree's application was one

of its biggest loopholes, thus it has been the most attractive area for tax evasion in the past 20 years. However, the proposal contributed very little to this dilemma by restricting the carried-forward loss relief to a maximum of 5 years. For a developing country like Kuwait, a period of 5 years in a very profitable market for foreign investors is too long. The period is more than enough to recover previous losses, which it may act as an incentive for weak and unreliable establishments to stay in the market. If, however, investigation were to prove that losses are of commercial nature and the company under investigation is economically useful and contributes to the national output, then exemptions or even longer periods of loss-relief privilege could be approved for it.

Another factor which prevailed in the past concerning loss carry forward was the unlimited ceiling of loss relief within an unlimited period of time. In some cases such relief was misused and repeatedly claimed during a period of 7 years. (52)

5) In cases of liquidation or suspension of operations of a taxable, neither laws made provisions for the treatment and the aftermath of these situations. Foreign companies commonly suspended their operations for a time in order to mislead the tax administration, while their investment was continued by means of an agent or a national partner. Unfortunately, the proposal took no account of this matter, and the problem remains unresolved.

6) Article 42 of the proposal permitted an additional

assessment in cases of doubtful or false declaration due to the lack of sufficient books or documents to pursue an assessment. However, as in the decree, no specific identifications of such records were given, nor were the amount and accountability of these books clarified. The plan only refer to books specified by the tax administration, which leaves scope for misunderstanding.

7) From the legal standpoint also, there is a lack of formal procedures to be followed in disputes under both laws. These procedures are intended for solving the long standing cases and the regular disputes between the tax administration and taxables, which take a very long time to settle and hinder the tax department from carrying out its duties.

Article 31 for instance, states that "the tax administration could have reconciliation at any time... conducted by a conciliation committee". However, there is room for discussion regarding the procedures that have been taken since the formation of the elementary committee and following the appeal committee. Are there any priorities to be implemented with reference to every committee ? What are the formalities of charges and further expenses during the first days of the trial ? How are the taxes due to be determined for the duration of such committees ? The liability of proving claims is on whom ?. These and other legal settlements have to be clarified to avoid disputes of the type common in the past.



8) The tax administration in Kuwait is still growing, and requires more support from the government to establish itself (authority to enforce penalties and or, co-operation with other departments in this respect). Further, the tax department needs comprehensive technical execution procedures in order to facilitate its performance (e.g. procedures related to tax declaration investigation and certification, training programmes, establishment of effective co-ordination with international organisations). However, both tax laws in Kuwait have neglected this subject in their legislation and in their appendices, memorandums and subsequent orders. At least a provision in the law that authorises the director of the income tax department to modernise the department would be desirable. This could include the adoption of an automative filing system, more staff recruitment, conduct of related seminars and symposiums, and support for research along with other useful programmes.

## 2.7 The New Era

In reviewing the dilemma of the tax system in Kuwait, and evaluating the two tax experiences of the past 20 years in Kuwait's fiscal policy, two main questions arise. These questions are;

1. Does Kuwait need a tax system in the first place ?
2. If so, What sort of taxes are most appropriate to Kuwait ?

Briefly, there are two schools of thought current in Kuwait with respect to the introduction of taxes. While

the first has succeeded in dominating the fiscal policies of Kuwait for a time, the second is more rationally based and bodes better for the future. Thus it has begun to dominate in the last few years, leading to belief in its supremacy and eventual prevalence.

The first school of thought is totally against the idea of imposing tax in Kuwait of any type. Its members appeal for the abolition of tax decree No.3 on the ground that oil revenues are sufficient to cover all public expenditure. Their argument is justified thus:

- 1> Kuwait's oil revenues far surpass domestic expenditure so taxes are unnecessary. This state will continue throughout the twentieth century, after which taxes may be conveniently formulated in a different manner.
- 2> Revenues from taxes do not and will not justify the expense of their collection, particularly, if one considers that there is no comparison between tax revenues and oil revenues or foreign investment revenues within the government budget.
- 3> Most of the tax burden is being transferred either to the government or to consumers. This is due to the fact that 95% of the taxables (subject to decree No.3) are foreign companies which have several contracts directly or indirectly with the government.
- 4> Economically, taxing foreign companies increases their project's costs or their product's prices. If these price increases exceed a certain level, then an inflated economy will certainly be the result as is the case in open economies.

5> There are other considerations to be taken into account when taxing foreign and multinational companies, such as the advanced technology and the know-how that may be lost if those companies abandon their operations in Kuwait. Together, these companies provide experience and employed capital too valuable to risk.

6> Finally, Kuwait's foreign investment is subject to taxes in the base country, just as foreign investment in Kuwait is subject to income tax decree No.3. Whether Kuwaiti investments are taxed or not, these investments will be taxed abroad as long as Kuwait has no tax treaties with other states. Since this is the case in Kuwait, no value is attached to a tax system in Kuwait unless based on tax treaties.

Tax supporters, on the other hand, have called for a new tax system to include income tax as well as corporation taxes (tax decree No.3 is to be substituted by a new tax bill). Furthermore, they argue that sacrifice and responsibility sharing are necessary concomitants to the privileges and rights associated with being a Kuwaiti. It is time to rationalise our expenses as individuals before we demand such action from the government towards public expenditure.

In summary, the arguments of this group run thus:

1> Sooner or later the oil boom will diminish and consequently other sources of finance must be sought. Thus, it is wise to prepare for the inevitable rather than

be taken by surprise.

2> The comparison between tax revenues and oil revenues will always weigh the latter over the former. However, tax revenues in Kuwait have been enough to establish the foundation of a tax administration in the past twenty years, and would be still more gainful if the law were strictly enforced. Moreover, although oil is considered the main source of public revenues, while taxes rank fourth in Kuwaiti budgeting, but this position will become different in the future.

3> All investors in Kuwait have known its tax base since the early years of its imposition, and their investment decision have not been unduly affected by the taxes in Kuwait. In fact, an effective tax law in Kuwait (decree No.3) has been found to benefit foreign investors in Kuwait, in that it enables them to avoid double taxation. Certainly, taxes are computed in their project's estimations, so little scope remains for them to increase their prices on that basis. Even if this were to happen, the government has the power and the policies to control inflation, and taxes represent one of these effective policies. In the past, however, Kuwait has had very low inflation rates, and a rapid inflation increase is certainly not expected in Kuwait in the near future.

4> As for the technology and know-how, it is clear that foreign companies are under some restrictions by their home countries to introduce such things unless otherwise permitted. Also, most of their investments are

concentrated around limited areas of the industry such as the production of semi-finished goods, sale of finished products, or provision of services. Secrecy surrounding advanced technology also in some cases prevents its transfer to other states, while competition plays a significant role in keeping the know-how and relevant manufacturing methods within certain borders.

5> Generally, tax treaties between two countries will enhance the arrangement of investment and pertinent tax treatment in both countries. To gain a powerful position in such negotiations, Kuwait ought to form its own tax system in order to claim effectively for similar tax conduct regarding its foreign investment.

It appears from the above discussion, that Kuwait can not depend on one diminishing source of revenue, though it now supports its economy almost entirely from that source. (see chapter 1). Even if the budget can be computed with a surplus for years, this state will not persist for ever. The past 3 years have proved that a deficit is a possible outcome in Kuwait, thus appropriate action must be taken. In April 1982, the price of petrol was doubled, and that of diesel increased by six times locally. The government is also expected to cut back many subsidies and reduce others (e.g., electricity and water).

The problem, however, with Kuwait's new, more stringent policies is that they are set in the wrong direction, or they may have come too late. The economy has

already been spoilt by an over-generous government. An attempt to take over-harsh steps could aggravate the situation. It has been stated before that;

"Fiscal policies alone will not be enough to cover all saving steps and development progress. To direct the flow of money within their economies, the governments may also have to take un-popular steps to increase economic regulation and extend tax regimes in almost taxless Arabia" (53)

Also;

"Since achieving full independence in 1961, Kuwait attached special importance to planning due to the particular problems it face. Firstly, it depends on one source of income... Secondly, it suffers from a feeble absorptive capacity... Thirdly, the lack of most instruments necessary for the effective implementation of an economic policy: No public debt, Minimal taxation, rigid interest rates and lack of financial instruments. This has both long and short-term implications." (54)

Kuwait might be the country least affected by cuts in oil price as its development commitments are modest and the government now gets as much income from its investments as it does from oil. However the realities in the future may turn out to be rather different. No country is free of the revenue constraint when faced with increasing demands on expenditure, as the 1973 study of the United States budget, undertaken by the Brooking Institute, revealed. The central finding was;

"...Economic growth can no longer be counted to provide the federal government with additional revenue every year to finance new programmes... and that revenue would not catch up with the government spending under the existing programmes...Until 1977 the needed revenue could come from additional taxes but the congress will not prefer that" (55)

Others, on the other hand, oppose tax introduction

and instead propose more spending cuts in health and education as argued by Mr. J. Saadoun;

"..The government instead of borrowing from the local market, should reduce spending on health and education. Perhaps, it is the ultimate heresy in Kuwait, by suggesting that the government should introduce personal income tax". (56)

There are risks associated with heavy reliance on a single natural resource for national income, export receipts, and budgetary revenues in Kuwait, although the foreseeable future of the oil market is strong. With 65% total dependence on oil, Kuwait would have no economic base if the oil sector were to experience some disruption. Only by diversification into the industrial and financial sector, in addition to the employment of fiscal policies such as a comprehensive tax system, can Kuwait secure it's future. (57)

Finally, the government has recently realised this fact, accordingly it has adopted several fiscal policies to rationalise public expenditure and to impose charges and fees of various types.

".. A KD 2 (\$7.10) airport tax will be introduced on 1 April (1989). The tax will be paid by all departing air travellers except state guests, diplomats, children under 12, transit passengers and deportees. It is expected to generate about KD 2.25 million (\$8 million) a year from the estimated 1.5 million people leaving the airport." (58)

In line with these policies, the government has earnestly sought tax reformation. Unfortunately, this task was not related to adopted tax objectives, which, in the

researcher's opinion, should include the following:-

- 1- To increase domestic revenues;
- 2- To reduce the inequalities in wealth and income;
- 3- To provide encouraging incentives for private investments;
- 4- To maintain a stable economy in the face of long-run inflationary pressures.

## 2.8 Concluding Remarks

In this chapter, emphasis was made on the effectiveness of the tax law. This law was found inadequate, and the corporate tax has failed to achieve any of its macro objectives, if indeed it has any. This was probably a result of two main factors:-

1. Deficiencies in the legislation itself.
2. The tax administration's weakness.

This might also have been aggravated by political pressures as well as by characteristics of the economy. National corporations were granted a total tax exemption, while other foreign companies were generously conceded unjustified allowances coupled with a limitation on the income tax base. The tax administration has so far been unable to reach and properly assess a wide range of taxpayers, a result mainly of the government failure to back it up either morally or physically in terms of developing its staff capabilities, equipment, and more incentives to recruit highly qualified people.

Other fruitful points of discussion, which will be studied in the coming chapters, include measures of better administration and preventing evasion of the tax laws.



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*Chapter Three*  
*"Literature Review"*

**Introduction**

The proper scope and role of tax administration in achieving a successful tax system is an essential aspect of tax reformation. The function of tax management is not only to administer the enforcement of tax, but also to accentuate the formulation of sound tax objectives in terms of their effectiveness and applicability.

This chapter is an attempt to discuss the literature on the ideal tax structure and its applicability to developing countries. Specifically, measures of the tax capacity, tax effort, and instability of revenues in Kuwait are analysed. The final part of this chapter is an empirical investigation of the tax administration's efficiency.

**3.1 Functions & Objectives of Taxes in Developing Countries**

The literature on public finance recognises several functions of taxation, the most important being:

- 1> A method of paying for social goods;
- 2> A means for the promotion of economic growth;
- 3> A path by which income and wealth may be re-distributed in what is considered to be a fair manner;
- 4> A system for achieving short-term stability. (1)

A government in pursuance of its economic growth plans, may wish to use the tax system to promote the increase of the overall level of savings in households. At the same time, its priorities of social justice may require the transfer of income and wealth from high income

households, in which the propensity to save is high, to low income households where the propensity to save is low. These decisions should be made on the political level rather than the administrative one. The result of attempting to reconcile contradictory objectives, however, can often be unnecessary complication of tax legislation.<sup>(2)</sup>

Generally speaking, almost all tax objectives can be defined within re-distributive, stabilitive, and promotive functions. Curtailing consumption, freeing resources for governmental services or capital formation, whilst maintaining an administratively and politically feasible economy are examples of the stability sought by a tax policy. Re-allocating resources from low-benefit investments to those of greater benefit and providing incentives to alter economic behaviour in such a way as to facilitate economic growth (i.e., incentives to save) are on the other hand, promotive tax functions. Hence the distributive attribute of a tax system lies in its ability to prevent inequalities of income from growing and improve the existing distribution through the transfer of funds by the government.

It is worth mentioning that, the above functions are linked sequentially. The first function is essential since the consumption and investment patterns of those who have the investible surplus may tend to be inimical to economic growth. By taxing this surplus the government can then channel it to a high priority investment. Alternatively,

the reinvestment of such funds would fulfil a re-distributive role depending on the form of this channelling (social benefits, health services, etc.), and its main beneficiaries (the public, private industries, etc.).

More important is the wider role of taxes in supporting government budgeting and in enabling a country to finance its necessary public expenditure. This has always been a major issue in the fiscal budgeting of developing countries while in developed countries such matters are determined in the first place by the setting of the tax objectives.

"..The developing country tends to gear its expenditure programmes to the expected revenue, while in the case of developed countries the tax policy tends to accept the level of expenditures as its revenue goal. This is possible because of the abundant tax revenues and possibility for borrowing.." (3)

Therefore, it is generally recognised that in a developing country like Kuwait domestically generated saving plays a vital role in both public and private finance. Nevertheless, such domestic resources form a small percentage of GNP for several reasons. Particularly notable in Kuwait is the marginal propensity to consume which is high enough to leave nothing but a relatively small share of income available for capital formation.

In this respect, we can ascertain one of the main objectives required of a tax plan in similar countries. As professor Nurkse puts it, "I believe that public finance assumes a new significance in the face of the problem of capital formation in under-developed countries".(4)

If this were the situation in a developed economy, then an appropriate fiscal policy would be adopted for lessening the interference of taxation with the incentives to channel those savings into productive investment.<sup>(5)</sup> In contrast, governments in developing countries are called upon to interfere in this economic circle, on the assumption that they assume wider functions than those of developed countries by providing infrastructural investments, and because of the low contribution of the private sector in investments like health, education, etc. To ensure a state of steady growth, a governmental plan of public financing plays a vital role in mobilising sufficient resources for this objective; this could be maintained by a concordant tax system.

"..Here taxation is an important instrument -as Heller put it forth;- to break out of this [vicious] circle, apart from foreign aid, calls for vigorous taxation and government development programmes.." (6)

Now it is widely accepted that fiscal policy in developing countries has essentially to be concerned with allocating more resources for investment and restraining consumption. This task can be achieved by taxation means and could be broken down into the following elements: .

- 1> Public financing of social overhead investment;
- 2> Injecting surplus capital into fruitful projects;
- 3> Providing the necessary incentives for the private sector to carry out its own investment.<sup>(7)</sup>

### 3.2 Ideal Tax Structure

Two centuries ago, economists were searching for an

optimal tax system, many of them looking for inspiration to the classic work of Adam Smith and his canons of taxation.<sup>(8)</sup> Those canons were:

- 1> The ability to pay;
- 2> Certainty of taxes;
- 3> Convenience of collection;
- 4> Neutrality or imposing a minimum burden on the taxpayer.

First, the question of justice and fairness calls for equality of treatment both horizontally and vertically. Horizontally, a prime requisite is to ensure that people in similar circumstances are treated alike. Vertically, equity calls for different treatment of people in unequal circumstances related to society's evaluation of various states of well being.<sup>(9)</sup> For Adam Smith, equality lay in taxpayers contributing "in proportion to the revenue they respectively enjoy".<sup>(10)</sup> On the other hand later writers have used equality (as a synonym with equity) to indicate the equality of sacrifices (i.e., utility). These sacrifices may in turn be defined as equal absolute, equal proportional or equal marginal sacrifices.<sup>(11)</sup> As a guide to fiscal policy, however, this value of utility is limited by the difficulty of estimating the shape of such utility schedules. Other factors have also added to this difficulty, e.g. non-utility considerations such as political affairs, the existence of unofficial (black) markets, tax evasion and the importance of power objectives at upper levels of income.<sup>(12)</sup>

Moreover, the "ability" criterion has always been correlated with the benefit received approach in the quest



for a justifiable tax structure. Everyone should contribute in this respect to the government in order to sustain the goods and services received.<sup>(13)</sup> However, as an exception, individuals with limited financial resources should be exempted from such payment in order that they may not suffer from the imposition of too heavy a burden, even though they do gain some benefit from government.<sup>(14)</sup>

Generally, the principle of ability to pay is more accepted and defended than the benefit approach in the search for equity. It is commonly believed that net income rather than gross income is a reasonably satisfactory measure of the ability to pay tax.<sup>(15)</sup>

As far as certainty is concerned, there is a call for greater stability in the structure of the tax system, rather than it being used as a tool of short-term economic management. In U.K. for instance, the Meade committee has stated that:

"..An essential need is to put a stop to this bewildering process of altering each element in the tax structure as soon as the taxpayer gets used to it and arranges his affairs appropriately. Uncertainty and lack of confidence in the stability of present arrangements are serious impediments to the national effort to improve our economic performance.." (16)

In relation to neutrality, the burden of a tax -at its minimum- should equal at least the revenue collected from this tax, otherwise it is said to have an "excess burden" or efficiency cost attached to it. When the funds are transferred from the taxpayer, whether individual or corporate, not only is his spending power reduced, but also

his economic decisions may be distorted. For example, his views about relative prices may be affected, leading to the substitution of one form of consumption or activity for another.<sup>(17)</sup>

In the world of business, this distortion may arise when firms are forced to allocate resources in any different way from that which they would have adopted in the absence of the tax. It is widely believed that no tax system can ever be truly neutral.<sup>(18)</sup> Other views held by some writers are that at a given level of tax revenue it is possible to minimise the distortion by use of the fiscal policy or a mix of rates. Thus, there have been arguments for the substitution of one form of tax by another form, e.g., expenditure tax in place of personal tax, and cash-flow tax in lieu of corporate income tax.<sup>(19)</sup>

In addition, assurance should be available beforehand that the administration and compliance cost will be low enough to be compatible with other objectives. An understanding of the tax administration by the taxpayer is as vital as the efficiency of administration; a proposition which is increasingly demanded in developing countries.<sup>(20)</sup>

Overall, these and other attributes of the so-called optimal tax structure necessitate the abandonment of all but the pure revenue objectives of fiscal policy.<sup>(21)</sup> Logically, it is a difficult task to set a tax frame without having conflicting objectives. For example, in order to fulfil the equity criterion, one has to consider

the complexity of the tax administration at this stage, which in turn raises the question of the administrative and compliance cost of assessing and collecting taxes.<sup>(22)</sup> When such conflict arises, a simultaneous treatment of these objectives according to their priorities is the proper way to overcome such problems, as well as to minimise, to the greatest extent possible the spillover negative effects that may arise.

### 3.3 Tax Policy & Inequality

Taxation as an income redistribution device is accepted as a vital objective of any tax policy, although different views have been expressed about the effects of redistribution of income on the rate of economic development. H. C. Johnson (1964) wrote:

"The extent or importance of this conflict (between economic efficiency and social justice) is likely to vary according to the state of economic development. The more advanced the country is, the less likely its economic growth will be affected.. it would, therefore seem unwise for a country anxious to enjoy growth to insist too strongly on politics of insuring economic equality".<sup>(23)</sup>

Such view, however, have been empirically tested and the assumption that only high income groups are the real savers has been challenged. For example, family budget studies in Brazil indicate that the poor do in fact save.<sup>(24)</sup> Economic development policies in many developing countries have had adverse effects in this regard, and consequently gave rise to this conflict, reflected in the figures (e.g., extensive imports resulted in inflationary pressures, and capital

intensive techniques produced a Marxist reserve army).\*

While there's obviously a need for these differing views on the subject to be resolved, this is beyond the scope of the present study.

Moreover, it is recognised that the achievement of an acceptable level of economic development does not necessarily bring with it the desired degree of equal distribution of the fruits of such development. (25)

As a device of income and wealth redistribution, the function of fiscal policy in developing countries is largely one of attempting to attain that degree of income redistribution through taxation and government expenditure, in other words, to balance the "humanitarian interest in sharing economic well-being more equally against the efficiency interest - an incentive for more economic efforts". (26)

However, not everyone is convinced of the efficacy of taxes as a fiscal tool for redistributing income in developing countries. Mahbub Ul Haq of the World Bank is a relatively recent critic, referring to the prevalence of "a misguided faith in the fiscal system of developing countries and a fairly naive understanding of the inter-play of economic and political institutions". (27)

However, more optimistic indications have been seen in recent studies, showing a collection of more than 20% of GNP

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\* Similar results have also been derived in different manner in Pakistan and Nigeria.. see Salama Abdin A. "Sources of Finances For Economic Development in The - Sudan" Un-published Ph.d. thesis, University college of north Wales, 1975, pp. 167-170.

in taxes in some developing countries (i.e., Tunisia 20.7%, Congo 23.4%, Guinea 20.6%, and Brazil 20.6% of GNP).<sup>(28)</sup>

Eventually, this would give substantial scope for the use of taxes as a redistribution device in these and other developing countries, though, caution should be exercised due to the many differences among countries, particularly in the developing regions.\*

### 3.3.1 Redistribution of Income in Kuwait

Despite the huge oil revenues collected in Kuwait since the early 1960's, there has been little attempt to pass on the benefit to all sections of the population. One example is the government's introduction, towards the end of the last decade, of a Social Insurance Programme (SIP) which proved incapable of meeting its objectives. This programme was legislated in 1976 when the Government established the Public Institution for Social Security. The institution is entitled to a 15% contribution from every employee's salary. In fact, the employee contributes 5% of his salary, while the employer is required to pay the remaining 10%. The funds of the institution are to be invested in order to provide every employee with a life pension at the age of retirement.

Unfortunately, this programme was not totally useful in this respect.<sup>(29)</sup> As stated by Al-Houmoud M.,

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\* Gross country studies did not provide hard evidence of the ineffectiveness of such fiscal instruments as a mean of income redistribution.. See Bird R., "Readings on Taxation in Developing Countries", Johns Hopkins Press, Baltimore, 1964. P. 3.

"..This redistribution effect is less important in the Kuwait system than in other systems. This arises partly from the fact that proportional benefits are a fixed percentage of previous earnings -without any adjustments or modifications in favour of the lower earning group-, which limit the redistribution of income between individuals at different levels of income by providing larger benefits for those with higher income upon their retirement.." (30)

Moreover, in view of Kuwait's undeveloped tax system this programme should have been accentuated for better redistribution, though such has not yet been the case.

Kuwait reached its highest per capita income in the seventies, though this dropped gradually from KD 4748 in 1981 to KD 4140 in 1983. It still forms a high share of GNP distributions, irrespective of the fairness of such distributions. Due to the absence of direct taxation, in addition to the principle of free enterprise, the Kuwaiti economy has not yet achieved a pattern of income distribution commensurate with the high level of per capita income, resulting in a long-standing and significant degree of inequality. It is unfortunate that during 1980-1988, no amendment to the SIP has been initiated to correct the anomaly in the distribution of income. (31)

Figures from the 1972/73 family income structure -Table 1.7- show that the top 6.3% of the households received about 30% of total income compared with only 25% of income received by over 56% of households.

"..The degree of inequality is also greater among the Kuwaiti segments of the population that it is among non-Kuwaitis. It is estimated that the top 10% of Kuwaiti households receive more than 40%

of total income received by this group of families compared with about 30% in the case of non-Kuwaiti families.." (32)

The 1972/73 family income structure data are the only figures available to date, but taking into consideration the recent rise in the cost of living, the above anomalies would certainly be aggravated. Also, there is clear evidence that a significant degree of inequality would remain despite any improvement to the social security system to incorporate welfare benefits as a pattern of income distribution. The land purchase programme in turn contributed to spreading wealth and tended also to accentuate the pre-oil disparity in income. (33)

Without resorting to direct taxation or attempting to change the free enterprise orientation of the economy, the government has aimed to help satisfy almost all basic needs of the population: services and commodities such as public health, education, public works and road maintenance, building materials, fresh meat, and many sorts of food have been provided free of charge, or heavily subsidised. (34)

Even so, such procedures were limited by oil revenue constraints and by the fact that income distribution as one of the priorities of fiscal policy has been restricted to the expenditure side of the budget only.

### 3.3.2 Income Distribution Measurements

The nature of the data on Kuwait necessitates the use of simple techniques of income distribution measurement. Others however can be found in Sen 1973, Karvis 1960, and

Kuznets 1963. The obtained information will be graphically expressed according to Lorenz curve.\* This representation will show the distribution of income among the population segments. Also, from the curve a Gini coefficient could be computed- that is the ratio of the area bounded by the Lorenz curve and the diagonal to the area of the triangle. This Gini ratio would be zero at perfect equality, whilst at perfect inequality the value of the ratio would be one. In addition, other advanced approaches can be used to further analyse income distribution (i.e., the degree of income divergences from average national income, and functional distribution of income, etc.). However as mentioned earlier, these approaches demand more data than is currently available on Kuwait.

### 3.3.3 The Case of Kuwait

Prior to this study, there has been an attempt to measure income distribution in 1973 conducted by the Ministry of Planning in Kuwait. In their findings, a .47 Gini coefficient was reported for the period 1972/73. This is a relatively high ratio reflecting the degree of inequality in a small economy like Kuwait. Chart 3.1 shows that ratio based upon the Lorenz curve graph.

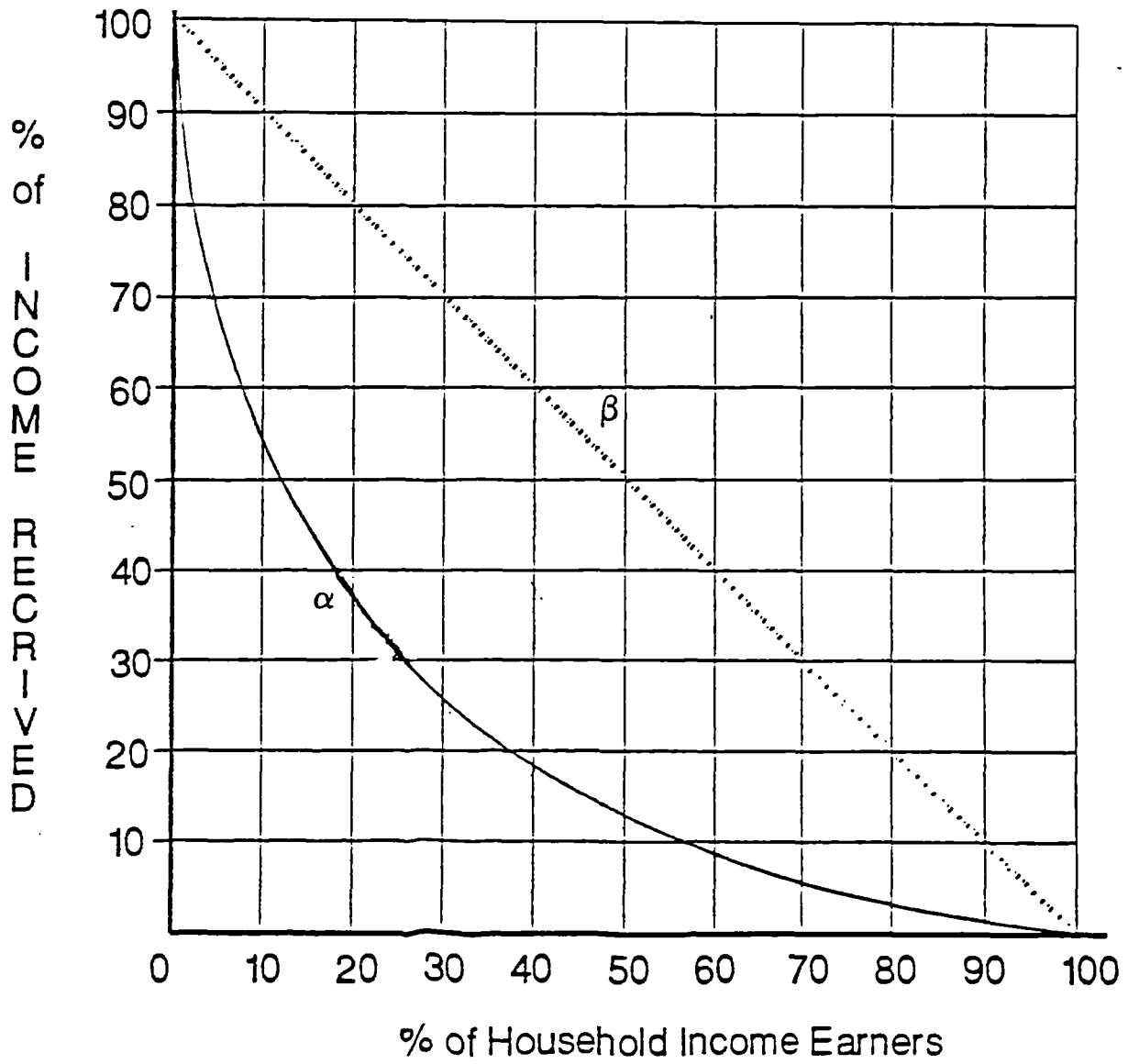
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\* The curve is obtained by plotting cumulative percentage of households or other income or wealth recipients units along the horizontal axis and cumulative percentage of income (or wealth) along the vertical axis. Perfect equality would result if the curve coincides with a 45 line, while straight lines indicate perfect inequality. The curve however, usually falls somewhere between these two extremes.. see Simon J. and Nobes, "The Economics of Taxation", Philip Allen, 2nd. ed. (Oxford, 1983), also see Salama A., 1975, pp. 175-180.



GRAPH 3.1

LORENZ CURVE FOR KUWAIT INCOME DISTRIBUTION...  
1972/73



$\alpha$  Lorenz Curve.  
 $\beta$  Base Line.

These findings may provide a good basis for studying tax incidence in Kuwait as well as providing ideas on how the budget plans could be used to improve the situation of the poorest 20% of income recipients. Other suggestions may include a plan to reduce the share of the richest 10% who earn more than 40% of total income.

However it is questionable whether the 1973 data are as reliable and comprehensive as is desirable. For example, the data were collected on a household basis rather than on an individual one which is more appropriate. Also, the data refers to the level of income in a single year, which is not a bona fide indicator of the long term standard of living. In addition, the responses to some questions were so very poor that expenditure data were used for constructing income tables in some cases.

It is essential that the Ministry of Planning undertakes a new survey on income distribution in Kuwait, based on individual income, using the latest methods of data collection and processing. These figures should be available at the earliest stages of the planning of a tax system.

The graphic delineation of the 1972/73 data is basically derived from the calculations in Table 3.1 below, showing that 70 per cent of the population earn about 34 per cent of the total income. The next 10% earn about 14% of total income. It is also noticeable from the table that the share of the poorest 25% is proportionally low compared to the total received by all earners. The poorest 30% of

Table 3.1

## Income Distribution in Kuwait -1972\73

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Class	Class Mark	Proportionate frequency of income earners	Cumulative proportionate frequency of %	Total Income 2 * 3 KD	Proportionate Frequency of income earned %	Cumulative proportionate frequency of income earned %
0-50	25	0.8	1.0	20	0.001	0.001
50-100	75	4.5	5.5	337.5	0.006	0.007
100-200	150	19.7	25.2	2955	0.05	0.057
200-400	300	29.6	54.8	8880	0.15	0.207
400-600	500	15.2	70.0	7600	0.13	0.337
600-1000	800	10.0	80.0	8000	0.14	0.477
1000- more	1500	20.0	100.0	30000	0.51	0.987
TOTAL		99.8		57792.5		

Sources:-

- 1> Ministry of Planning, Annual Statistical Abstract, Ed. 10, 1972/73.
- 2> Khouja M. and Sadler P.G., op.cit., p. 46.
- 3> Salama R. A., op.cit., p. 178.

the population also earn less than 20% of the total income, while the top 50% of total income is obtained by 20% of the population.

### 3.4 Taxable Capacity

The elusive quest of taxable capacity has occupied a considerable space in the literature and has raised a substantial amount of discussion both at conceptual and empirical levels. Because taxes are seen to impose a burden on the people, inquiry has attempted to determine the maximum possible burden that can be imposed in a country at any given period of time.

It may be impossible to apply the same measurement of taxable capacity in every country, since there is no clear-cut definition or unified formula for its calculation. In fact, this concept is obtained from the priorities of public expenditure in a country and the relevant -real- proceeds devoted to those priorities.

The object is to obtain the funding requirement with the minimum amount of objection from the taxpayers. Unless the allocations of tax proceeds are specified, the burdensome aspect of taxation as well as the tax acceptance could be challenged.<sup>(35)</sup>

A United Nations study has concluded, "There is no categorical answer to the question where the optimum level of taxation lies".<sup>(36)</sup>

Generally, the measurement of tax capacity is a form of approximation that should be undertaken with extreme

care, for this concept is influenced by various factors which may or may not be measurable. Hence, The essential aim is to minimise (if not to overcome) the adverse effects of those taxes which place an unfair burden on one group of taxpayers only.

In this respect, two approaches dominate the literature on tax capacity measurement.

Firstly, Kaldor's and Chelliah's method assumes that taxation imposes no social or political burden on the community. Tax capacity is calculated on the basis of a broad definition of the "difference between the national output and subsistence consumption which allows the population to maintain its labour capacity".<sup>(37)</sup>

In view of this interpretation, an argument arose as to the possibility of measuring such surplus over the subsistence level of consumption. This task becomes difficult, if not impossible, in the case of a developing country. Chelliah himself stated that:

"While to equate the surplus over subsistence consumption with maximum taxable capacity leads us nowhere, a rough measure of the size of the mobilised surplus in relation to the GNP can serve as a basis for judging the scope for, and possibility of additional taxation".<sup>(38)</sup>

Following Bahl's definition of tax capacity, the second dynamic approach of measuring it, is referred to as "the tax ratio that would result if a country applied to its tax bases a set of (average) effective rates on those bases. These rates are computed as net regression coefficient".<sup>(39)</sup>

The presumption here is based on a given tax base approximated by variables reflecting the main characteristics of the economy which affect the tax ratio. On the one hand, the estimated tax ratio represents the minimum taxable capacity in the economy given its major characteristics. On the other hand, the factors that determine the stability or instability of tax revenues, among other factors, are assumed to be the same factors which affect tax capacity.

Due to the difficulty of accurately measuring economic surplus in order to get a measure of maximum tax capacity, the second method, or what came to be called "the effort approach" is used to approximate the minimum tax capacity in the economy.

However, due to the lack of a precise tax base, tax ratios and a policy of taxation in a real sense, the measurement of Kuwait's tax capacity within the boundaries and limitations of the effort approach is wholly unreliable. Hence, the application of the tax policy itself has varied from continuous enforcement to prolonged negligence, which leads us to question the validity of its rationale and fairness.

#### **3.4.1 The Minimum Level of Tax in Kuwait**

The Kuwaiti tax situation might lead to the employment of the first approach in order to obtain some indications of taxable capacity. Even though the method may suffer from inadequacy because of its simplicity and weakness in

some areas, the tax policy implications derived from such measurements are more relevant than the figures themselves (as was indicated) to the future instability of government revenues. These revenues, which characterise part of the government budget, will be measured to add to the empirical knowledge of the nature of Kuwait's tax system. However, it seems almost an impossible task to calculate taxable capacity with non-constant variables, e.g. the surplus level: therefore it will be assumed that the available subsistence consumption is the sought level- that is the optimal labour capacity. Accordingly, the difference between national output and consumption level will indicate the least level of taxation- the minimum effort- as shown in Table 3.2 below.

Table 3.2

**The Minimum Level of Taxation 1981/86**  
KD (000)

YEAR	National Output	Consumption Level	Tax Level	Tax Proceeds	Net
81/82	3,008	2,813	--	1.147	+
82/83	2,602	3,248	(646.0)	3.589	(642.4)
83/84	3,175	3,023	--	3.235	+
84/85	2,744	3,204	(460.0)	15.254	(444.7)
85/86	3,116	3,330	(214.0)	12.070	(201.9)

- Source: Ministry of Planning, Annual Statistical Abstract, XXIII, 1986, pp. 225-229.

Obviously, the validity of the above assumption can be questioned theoretically and mathematically, but the scope for an additional level of taxes is proved to exceed the current tax revenues. The last column in table 3.2 raises the question of whether the revenues were sufficient to finance the community's essential needs, particularly in the fiscal years of 1982, 84, 85 respectively. The minimum level of tax burden on the population in 1985 exceeded KD 200 million, which is well above the revenues actually received from this source.

Overall, these remarks stimulate inquiry into the possibility of implementing a wider-ranging tax policy in the future plan, for less than 7.2% of the lower level of taxation (15/200) has been earned within the past 6 years tax experience in Kuwait.

### 3.5 Instability of Tax Revenues

One of the main areas of importance to tax policy makers in Kuwait is identification of the instability level of tax revenues. The previous local experience with tax proceeds was marked by disruptions in this part of governmental revenue, particularly in the early years of this decade. This identification would, among other things, allow for policy implications to be taken into consideration in the planning of government expenditure: a steady and reliable provision of public expenditure is to a large extent dependent on an equally steady flow of public funds.



Although the steps to measure tax revenue instability are of a derivative nature, since it is affected by all related factors, the main influence in this respect is the tax effort. The effort put into tax enforcement is clearly seen in the sums collected in tax since 1979 compared with those before, as well as the recent increase in government attention to the reorganisation of the tax policy. In addition, Kuwaiti planners have recently been concerned about instability in foreign resources. While they realise the importance of limited domestic resources, the implications of an equal instability in government domestic resources, though limited in nature, have not yet been addressed.

### 3.5.1 Instability Measures

Several methods of measuring revenue instability have been discussed in the literature. Some have used the log variance (log J) and the variance of the first differences.<sup>(40)</sup> Others have applied a statistical index (the inverse of the standard error of natural log of taxes -R- regressed on time -T-).<sup>(41)</sup>

However, here we shall use the coefficient of variations for two reasons: [1] The rudimentary nature of available data with reference to the Kuwait tax system, [2] In order to show the average contribution of the tax revenue sub-categories to total domestic revenue, as follows:

$$X_{(T)} = \frac{R}{\bar{M}} \times 100$$

Where,

X<sub>(T)</sub> = The instability index of Kuwait tax revenues over the 1976-1985 period,

R = Is the standard error- correcting for all domestic government revenues,

$\bar{M}$  = Mean tax revenue of 1976-1985.

Here, R is used to correct for other factors affecting the instability of the index- tax effort, budget controls, trends, etc.

### 3.5.2 Empirical Testing

As indicated in table 3.3, the instability of tax revenues has ranged from 6.7% for excise duties to 61.2% of revenue from oil company taxes.

TABLE 3.3

#### Estimated Indices of Tax Revenue Instability, 1976/1985

Sources	X <sub>(T)</sub> -%
- Non-oil companies taxes	47.5
- Oil companies taxes	61.2
- Registration fees *	39.1
- Customs	46.3
- Excise	6.7
- Miscellaneous	21.4

\* These fees include administrative charges, stamp duty, service charges, and other surcharges.

Normally, a high instability in income tax and customs is to be expected, especially in the given period in which the enforcement of tax decree No. 3 of 1955 has been relatively rigorous, and because of external factors like the Gulf War and the recent establishment of ports down the West Gulf Coast. These proportionally high indices should be viewed with some concern, because they are seen as the prospective future resources of government revenues. Allowing for the importance of other domestic revenues, the instability in the tax revenues is certain to result in considerable instability in government domestic revenues.

On the other hand, the low instability of excise - 6.7%- reflects the narrow range of produced excisable commodities in addition to the limited coverage of the excise system in general.

All in all, a fresh look into the Kuwaiti tax system is essential for the continuation of development plans, particularly as regards more effective enforcement of the law and its tax collection. This will necessitate co-ordination among the different categories of the tax system, i.e., oil taxes and royalties, customs and excise imposts.

### 3.6 Tax Effort

One theme which appears again and again in the tax survey is the importance of tax administration. No documentation on the fiscal problems of developing countries would be complete without an explicit treatment of tax administration, the quality of which is usually an

overriding constraint on the possibility of changing a country's tax system.

Moreover, one major element in determining the tax capacity of a country is measurement of the influence of changes in the tax administration (tax effort) on that capacity. This task has been approached by two methods. The first was developed by the International Monetary Fund (IMF), and is based on an analysis of certain explanatory variables considered to be the major determinants of taxable capacity in less developed countries. Accordingly, on this ground, they estimated the taxable capacity for LDC's. The tax effort index of a given country was considered to be the ratio of its actual tax collection to the estimation of tax capacity. (42)

A second approach of measuring tax effort has been suggested by Bird: that is, the appreciation of the tax system behaviour of a given country over time. (43) Such behaviour has two components: Automatic (tax elasticity) and Discretionary (tax buoyancy). The former reflects tax behaviour in the sense that it is a characteristic of the existing tax structure at one point in time. The latter, on the other hand, include the changes in the tax administration and may be interpreted as tax effort.

"More precisely, one measure of the tax effort may be the buoyancy of the tax system (its historical ex post elasticity) less the automatic component due to change in the tax base. Effort thus defined would then measure the political and administrative efforts to increase effective rates or the coverage (base) of the tax system made during the period under examination." (44)

### 3.6.1 Estimate of Kuwait's Tax Effort

There has been no previous attempt to estimate tax effort nor to predict tax ratios in Kuwait. The alternative approach here is to measure the actual tax ratio for the period of 1976-1985, then applying the IMF equation to it to obtain the average tax effort (predicted) in Kuwait as follows:

$$F_i = T_i / C_i$$

Where,

$$\begin{aligned} F_i &= \text{The tax effort corresponding to tax } , \\ T_i &= \text{Actual Ratio of tax } , \\ C_i &= \text{The capacity of tax } , \end{aligned}$$

The application of this crude measurement of tax effort on the 1976-85 data shows a low tax ratio (Table 3.4) and consequently it will yield a low tax effort, particularly if compared with the ratios of other developing countries within the IMF index. It is certainly very low if compared with similar ratios in developed countries. However, in general tax ratios in developing countries -measured as actual tax collection over GNP- are remarkably low.

"A typical developing country, for example may collect less than 15% of GNP compared to 25% of GNP for a typical developed country. This divergence may be greater if social security contributions are considered. Inclusion of these may raise the tax ratio of developed countries to 32%" (45)

Moreover, the same factors that determine taxable capacity are theoretically used as indicators of development to explain tax ratio in developing countries.

TABLE 3.4

## Estimated Tax Ratios, 1976/85

<sup>2</sup>  
 KD (000) \*  
 -----

YEAR	C <sub>i</sub>	ACTUAL TAX	TAX RATIO
76/77	1751	.140	.008
77/78	1807.4	.319	.017
78/79	2033.3	.707	.034
79/80	2243.4	1.146	.051
80/81	2247	1.117	.049
81/82	2528.5	1.147	.045
82/83	2244.7	3.589	.015
83/84	3175.4	3.325	.010
84/85	2744.7	15.254	.055
85/86	3116	12.070	.038

\* 1976-1979 at 1976 prices.

\* 1980-1986 at current prices.

- Source:- Central Bank of Kuwait, The Economy 1980-84.

- Ministry of Planning, Central Statistics Office, Annual Statistical Abstract XXIII, 1986, pp. 225-230.

Such factors include per capita income, the level of industrialisation, openness of the economy, degree of monetisation, price level increases, the rate of population growth, the mining and mineral share, etc. (46)

At all events, due to the lack of relevant data on tax capacity, and because of the unreliability of any results based on such data, tax effort may not be proceeded significantly in Kuwait. In addition to the low contribution of tax revenues in the GNP, and the virtual non-existence of a tax base- for it has witnessed variable enforcement since 1969- any tax ratio will be irrelevant and unjustifiable. Moreover, the above factors which determine taxable capacity should be thoroughly analysed, for not all of them are included in such measurement. For example the demand for public expenditure would be excluded.

An advanced statistical approach based on a regression analysis is most suitable for this task. As a similar model was tested by Lotz and Morss, these factors would be further transformed into logarithmic and semi-logarithmic forms to see if any significant changes in the regression equations would be produced. (47)

It is also important to consider the substantial unrealised tax potential that exists in Kuwait, i.e., the non-monetary (subsistence) sector. In this respect also, the monetisation ratio would have to be represented as an extra factor in the above regression method to evaluate the tax efforts.

"..Indeed, the integration of the non-monetary sector into the market economy does not only lead to higher tax ratio through its favourable effects on exports and per capita income- as implied by the IMF studies. Monetisation makes all transactions measurable, easier to administer, and therefore, taxable" (48)

It is not only the legal component that is important, but also the capabilities and the financial feasibility of the law that determine its shape and ratios. The need for precision grows in importance both as the rates climb upwards and as the base broadens with variable capacity and efforts. If taxes are to be imposed on income, for example, a favourite device of the twentieth century, twentieth century measurements as well as administration and ratios have to be considered first. The most sensible course of action in Kuwait may thus be, firstly to strengthen both the existing tax administration machinery and the related tax laws.

### 3.7 Concluding Remarks

Some measures were taken to evaluate the distribution of income in Kuwait. It was found that there is a large gap between the upper and lower classes of the population. The degree of inequality in the economy is further accentuated by the high Gini coefficient of 0.47 as was found in 1972/73.

One problem encountered with reference to Kuwait's tax capacity, is the measurement of the economic surplus and accordingly the maximum base of taxation. This problem is certainly worth considering by the tax department. Tax revenue instability, on the other hand, has a vital impact



on the reformed tax policy as it indicate the tax areas most elastic to external or internal factors. Those taxes with high ratios of revenue instability should be considered in the coming tax policy, as they represent optimal sources of public revenue.

Moreover, tax collection in Kuwait was found to be low (about 3%) in comparison with those of other developing countries. This ratio is also well below the standard ratio found in any developed country. Improvement in the performance of the tax department is to be considered a priority in Kuwait's tax reformation, and many courses could be adopted in this respect (as shall be discussed in chapter 11).

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*Chapter Four*  
*"Accounting in Kuwait"*

**4.1 Introduction**

An understanding of the prevailing problems of the accounting profession should not be the final aim of any scholar whose objective is the advancement of the country's accounting. Within the framework of a normative model, hypotheses should be created as to what should exist. Accordingly, These hypotheses can be tested to ascertain whether what is postulated is true.<sup>(1)</sup>

Within a normative model, the history of accounting in Kuwait and its three distinguishable phases is presented in this chapter followed by a discussion on the local accounting bodies, needs, and constraints. Finally, accounting future role in public policy is investigated.

**4.2 Historical Background**

The need for accounting arose as an inevitable consequence of the oil discovery in 1938 and the following economic growth patterns and increasingly complex businesses demands. Several factors stimulated the need for a basic accounting system to fulfil various tasks, the principal of which were book-keeping and financial reporting. In addition to the vast changes in commercial, economic and social activities due to the abundant oil revenues, the flow of new foreign skills, and the influence of neighbouring countries' regulations were the major

incentives for the emergence of an accounting profession.

The role of the expanding economy on the evolution of accounting has been observed by Shuaib A.:

"The need for accounting information emerged with the changes in the economic and commercial activities in Kuwait. With the formation of corporations and the separation of management and ownership, the demand for better accounting increased. Management needs accounting information for intelligent decisions in formulating it's policies and in directing its operations. Furthermore, investors, creditors and government agencies are interested in financial positions and results of operations of enterprises in the country." (2)

The absence of an effective accounting profession forced the government to bear full responsibility for regulating the practice of accounting and auditing.

Malallah has indicated that:

"the profession's failure to establish accounting and auditing standards as well as rules of conduct, had led the government to provide rules and standards in addition to the needed reporting disclosure regulations". (3)

Even so, this did not significantly contribute to the advancement of the local profession, since government achievements did not correspond to the needs in this respect.

Some writers have gone so far as to state that it was, the accountants dissatisfaction with government performance which led to the establishment of the Kuwait Society of Accountants and Auditors (KSAA) in 1973.<sup>(4)</sup> Others believe that KSAA's focus is primarily political and administrative rather than purely professional.

Since 1962 the Ministry of Finance & Economy (3 years

later Ministry of Commerce) representing the government, has issued 3 major laws regulating the accounting profession in Kuwait. These laws are:

- 1) Law No. 6 of 1962,
- 2) Law No. 3 for 1965 [amendment to law No. 6];
- 3) and Law No. 5 of 1981.

In addition there has been other legislation directly affecting the local accounting system such as:

- A. Commercial companies law No. 15 of 1960 (legal financial reporting requirement + Auditor appointment).
- B. Law No. 2 of 1961 (requirements for commercial business books).
- C. Tax law No. 3 for 1955 (income derivations, depreciation allocation, etc. - see chapter 2).

#### 4.3 Stages Of Accountancy Development in Kuwait

Accounting development may be classified in three main phases as follows:

##### 4.3.1 The Embryonic Stage 1946-1962

During the oil boom in the country in the early 40's, business enterprises expanded at varying rates. Government projects and expenditure gradually increased, contributing to the formation of high-yielding private investments. These events created an urgent need for accounting to cope with this great economic diversification. As is the case with developing countries, accounting began by performing the task of book-keeping and recording liability and ownership. The accounting regulations at that time were imported from neighbouring and other Arab countries.<sup>(5)</sup> Accountants, were among those newcomers who brought the

professional standards of their homelands and, more importantly, their experiences and practices.

Little record is available of the nature and development of accounting at this stage, but in his empirical survey, Malallah found that the first accounting firm in Kuwait was established in 1946 after the first oil shipment, while the first law to regulate the accounting practice was enacted in 1962 (law No. 6).<sup>(6)</sup>

#### 4.3.2 The Intermediate Stage 1962-1981

There was general agreement on the need to improve the structure of accounting practice. The government's first step was to accord the Ministry of Finance and Economy the authority to issue professional accountants with the licenses required to practice as registered accountants. This privilege was furnished through law No. 6 of 1962 (Article 1 & 2).<sup>(7)</sup> Among the twenty nine articles contained in law No. 6, the first two articles require qualified applicants to register at the Ministry's Auditors register.

Overall, the law was inadequate to regulate the profession though it was the first attempt to organise the accounting system of the country in general, and accounting practice in particular.

In 1965 the government amended law No. 6 of 1962 by issuing law No. 3 for 1965, which permitted accountants to participate in operating auditing bureau on a combined liability basis. As for matters relating to the conduct of



the profession, the law was totally silent.

This situation continued for another 8 years, when the Kuwaiti Society of Audit and Accounting (KSAA) was established by the government in response to the needs and pressures of accounting. The number of KSAA members is increasing, rising from around 150 registered accountants in 1981 to over 300 accountants in the mid eighties. This may be attributed to the requirement of law No. 6 (Article 3), that a person must be registered with an accepted professional body in order to qualify for a license.

Despite these successes, in the 14 years since the establishment of KSAA, its performance has been very limited. This is not surprising in view of the lack of co-ordination with official entities, co-operative plans, and sufficiently educated members.<sup>(8)</sup>

As far as accounting educational plans during this stage are concerned, the first programme of this kind commenced in 1963 at the secondary school of commerce. It was a 4 year-course in bookkeeping and other related topics leading to certification. Twelve years afterwards, Ministry of Education established a new commercial institute for further studies in accounting for high school graduates.<sup>(9)</sup>

Accounting education at the university level in Kuwait has a fairly short tradition. In 1967 the Faculty of Commerce and Economics introduced the accounting discipline of 120 credit hours.

To sum up the features of this stage, it may be seen that even though some attempts were made by the government

to advance the profession as a whole, they were inadequate and not accorded sufficient priority.

#### 4.3.3 The Beginning of Progress 1981-....

This stage has been marked by some achievement, beginning with the establishment of the accounting rules committee (CEAR) earlier this decade and the progressive attitudes towards rationalising accounting regulations. KSAA, moreover, has also begun to work effectively for the target planned 10 years ago, that is to set local accounting rules. A proposal has been submitted by KSAA to the Ministry of Commerce and Industry as part of a professional evaluation exercise more than a year ago. In addition, KSAA participated in the organisation of an international conference in December 1984 on the subject of the role of accounting information in investment decisions and expenditure rationalisation.

Another feature of this period of progress was the formation of CEAR in 1981 by the Ministry of Commerce & Industry. The purpose of this committee was to improve accounting practice locally as well as to set the required accounting rules.<sup>(10)</sup> Indeed, this event in particular was first and foremost, a significant indication of the government's desire to improve the accounting system, as it assigned a member of KSAA to be a delegate in this committee. Secondly, it reflected the mutual understanding and co-operation between the government, the major decision maker in this matter, and the professional

bodies. Similarly, Malallah indicated that;

"While it was possible for the government to enact new regulations on its own without consulting the profession as was the case in 1962, it was obvious that the government was seeking improvement in accounting practices rather than just adding more regulations. [another change].. was the mutual understanding between the government and the profession that public accounting practices had matured enough to surpass the era of loose regulations." (11)

CEAR was formed of 5 representatives, 3 from the Ministry of Commerce and the other two from KSAA and Kuwait University. Its objectives were:

1. To develop a code of ethics;
2. To set standardised financial reporting rules;
3. To establish minimum disclosure requirements;
4. To review periodically existing rules and accounting procedures;
5. To research and study means of improvement.

Unfortunately, the committee did not publish a report until December 1986, when 3 accounting guides were issued. These guides were: 1) Financial data disclosure, 2) Accounting for Investments, 3) Estate Accounting . This committee was affected by government routine and the ineffective planning measures of its meetings. Malallah, for example, stated that:

"The CEAR has been charged with responsibilities beyond the capability of its members. The majority of its members lack the needed knowledge and experience to achieve the desired goals." (12)

The other committee, The Registration Committee (RC) was designed to evaluate the credentials and of those applying for a professional license. The Ministry of

Commerce founded this committee, comprising 3 of its staff and 2 members of KSAA. Except for affirming that any applicant conformed with the set requirements, RC did not play any part in the enhancement of accounting rules.

Another noticeable feature of this phase is the increasing role of accounting firms -especially the multinationals- in inputting a wide range of experiences, and practices. However, these firms have harmful consequences as observed by Enthoven:

"..In many [developing] countries, foreign accounting firms operate. They tend to follow foreign accounting and auditing pronouncements, which may not help develop useful local standards. In general, accounting firms are not involved adequately in social and economic programmes, nor do they assist sufficiently in fulfilling the accounting needs of smaller firms either directly or through development institutions." (13)

The number of accounting firms operating in Kuwait has increased dramatically within a period of 10 years (6 in 1972 to 21 in 1984). All big 8 accounting firms have representative in Kuwait, of which, Ernst & Whinney is the oldest. (14) Despite this phenomenon, law No. 5 of 1981 has limited accounting and auditing practices to Kuwaiti qualified accountants only, to be effective as from January 1986.

Another discouraging fact found by Malallah in his research was that in his estimation, only 7% of the accountants in the accounting firms were Kuwaitis. Almost all of these large firms have adopted professional rules and codes despite the lack of such regulations in Kuwait. while only 53% of the small accounting firms did so. (15)

Not only is there a possibility of losing the experience and training programmes of these firms, but also, practical opportunities for new accounting graduates to work for these firms will be jeopardised.

As for the educational programme, the range of topics taught has broadened as the number of lecturers in the Department of Accountancy of Kuwait university has increased to 21 within 6 years. However, the programme itself has not been entirely effective due to the lack of locally written accounting text books and other relevant literature, as well as the extensive concentration on the theoretical background of accountancy rather than on the practical area of the profession, which is where the present need lies. (16)

Similar shortcomings could be noted in respect of the disclosure of accounting policies in Kuwait. Even though most financial statements prepared in Kuwait make disclosures of their accounting policies, unfortunately, quality and quantity are not uniform, and the standard is generally poor.

" It is common to encounter statements of policies merely stating that the financial statements have been prepared on the historical cost basis and giving a few details concerning the fixed asset depreciation rates." (17)

The current trend, however, is dependent on the auditors of the enterprise. Whereas large firms normally have their own professionally qualified accountants to decide on such matters, most locally-based preparers of

financial statements rely on their auditors to select the appropriate policies. (18)

The need for accounting as a financial reporting function has become more acute during the last 5 years, particularly at the time of the AL-Manakh market collapse in summer 1982. Private investors began to turn to accounting to provide informative, reliable, and timely financial reports to avoid another crisis.

This issue has also been taken up by the government resulting in further supervision of accounting firms.

"Lately, following the AL-Manakh crisis, the accounting firms have been subjected to some supervision from the government. However, they remain themselves largely responsible for the standard of auditing and the quality of their work." (19)

Objectively, in the light of this state:

"The Ministry of Commerce and Industry has specified a format for the presentation of the balance sheet and the profit and loss account. This format [however], is not always followed... In 1984, the Ministry issued a draft revision of the specified format. Auditors were asked to comment on the draft format, and it may be issued as mandatory for all accountants to follow." (20)

On the subject of the national accounting function in Kuwait, regrettably the information derived from micro accounting is not yet counted in the compilation of national accounts. Also, such important figures are not adequately included in national planning and national accounting statistics, a role that is widely recognised. Morgenstern indicated that business accounts comprise a

large portion of the information required to construct national accounts.<sup>(21)</sup> This premise has been confirmed by others: the American Accounting Association for example, has pointed out that a considerable proportion of the macro-accounting data base contains micro-accounting data which is of grave importance.<sup>(22)</sup>

Within this consideration, it seems that the reliability of national accounts depends to a great extent on the accuracy and relevance of micro accounts. The published national accounts of Kuwait, however, are far from being informative and thus obviously are inadequate for governmental purposes, including the construction of national accounting statistics.<sup>(23)</sup> Douban has concluded:

"..It should be noted that the financial statements of public and joint-venture companies in Kuwait are not prepared and published in a uniform basis... Additionally, no detailed disclosure requirements have been established by Ministry of Commerce & Industry in Kuwait." (24)

"Now it is the proper time [in Kuwait] to study the possibilities of linking the published accounts of companies, particularly those of public and joint-venture nature, with national accounts so that the information output of the former become part of the information inputs to the latter.." (25)

All in all, these events are hoped to speed up the plans for accounting regulation. Certainly, overcoming these deficiencies cannot be through the importation of USA or U.K. accounting principles. Among the authors who confirm this notion, Briston and Russell, have recently argued that:

"..There is very little point in encouraging developing countries, whose

major economic entities are public enterprises and subsidiaries of multinational companies and in which the government wishes to play a positive role in the planning and control of the economy, to adopt an accountancy system which evolved in the context of a laissez-faire economy and which places the needs of private sector shareholders above those of the government." (26)

Briston further criticises the spread of western accounting, to developing countries. He concludes:

"..Each country has its own political, social, economic and cultural characteristics and it is highly probable that the goals and thus the information needs of the managers of the economy will differ from one country to another. As a consequence, each country should be encouraged not to standardise the structure and specifications of its information system, but to create a system appropriate to its own needs." (27)

While others recommended the adoption of the international accounting standards instead:

"Enterprises in Kuwait should consider carefully the selection of the accounting policies which best suit their business and organisation structure. Once selected, these policies should be applied on a consistent basis. Any departure from these policies should be disclosed. In fact, there should be greater compliance with IASC standards which, in our opinion, are more relevant to Kuwait than either U.K. or US standards." (28)

Further, an urgent need for establishing the basis of the accounting practices in the country is widely asserted.

In his 1978 article, Shuaib mentioned this need:

"..It is at this stage that the accounting profession has a tremendous opportunity to help speed the process and to establish itself in society as the protector of the public interest.."

[And]

"..To be effective, professional accounting groups must be better organised and be more



concerned with the identification and standardisation of accounting practices... The accounting profession [also] should establish an acceptable list of accounting principles and auditing procedures in the country." (29)

These standards are the foundation of a true profession:

"Accounting and auditing standards are a requirement for the development of a financial accounting profession; these standards are necessary for determining the appropriateness of accounting and reporting practices. Accounting and auditing standards are the foundations of the practice of the accounting profession; hence, they should be the initial concern of a professional organisation in a developing country." (30)

Examining the history of accounting in Kuwait and its slow development, we may conclude that the profession has not yet come of age. However, the latest observations indicate that perhaps attitudes are now changing in the direction of the development of sound accounting practices, even though the pronounced plans are still far from being successfully executed, or are misdirected. Banning non-Kuwaitis from auditing practice, for instance, is not a prescription for a reliable auditing service, for those auditors will be replaced by relatively inexperienced Kuwaitis. Without doubt such constraints will harm the growing profession, as noted in other countries.\*

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\* Private accounting firms are generally multinationals whose operations consist of training on diversified practices and professional employment, which is likely to lead to an emphasis in such areas..see Briston R. J. and El Ashker A. A., " The Egyptian accounting system- a case study in western influence", International journal of Accounting, Education and Research, Vol. 20, No. 1, Spring 1985.

#### 4.4 Constraints on Accounting Regulation in Kuwait

It would seem useful to analyse the hindrances that preclude an organised accounting system in Kuwait according to the bodies concerned;

##### 4.4.1 The Government

1> Despite past government efforts and continued support of the profession, still its performance is inadequate to build a compulsory system of financial reporting within specified categories.

2> Government routines and lengthy procedures are often a discouraging factor in establishing a responsible accounting body: CEAR, for example, devoted more than 6 years to a goal that had not been documented nor been prepared for in advance.

3> Funds and financial facilities assigned for training research and further studies in local accounting are not adequate to the need. During the last 13 years, only one piece of official research has been published by the Ministry of Commerce & Industry.

##### 4.4.2 The Profession

In the search for a solid and well-organised accounting profession, finding an active professional body of Kuwaiti accountants is of paramount importance. Such a body according to Enthoven, can speed up the establishment of an organised profession:

" The development of the accounting profession in the developing areas can be greatly accelerated and enhanced with the

existence of a machinery through which organised and co-operative effort can be undertaken. This machinery is provided most effectively by a professional accounting organisation. A professional organisation is imperative for elevating the status of accountants for establishing and maintaining high standard of conduct and practice, and for disseminating information of common interest to all accountants. It is a vehicle through which its members could accomplish on a co-operative basis, what could not be accomplished by individuals or firms acting alone." (31)

1> The main predicament that the profession faces in Kuwait is that it lacks the following: (32)

- A) Generally accepted accounting principles, auditing rules as well as code of ethics which should be "Kuwaiti made".
- B) Practically and academically qualified practitioners, especially in the indigenous group of auditors.
- C) Lack of provisional disclosure requirements of financial reports, similar to that known in regulated professions for the use of investors and the public.
- D) Effective operational standards as well as effective ethical codes.
- E) "Guide lines on the important subjects of personal relationships, social pressure, and owning stocks in a client's company (the concept of Independence)."
- F) Poor communication channels and co-operation among the professionals themselves.

2> There has been insufficient integration among the private sector, professional accountants and other parties to obtain feed-back responses regarding business needs and professional limitations.

3> Poor organisation and co-ordination by KSAA as the direct voice of the profession with other entities has meant, for example, that there is almost no communication between accountants in the public sector and those working in the private sector at the enterprise level.

4> Other services provided by the profession, like consultancy services, foreign investment advice and price changes derivations are undervalued by users and the public. Poor public relations are responsible for this state.

#### 4.4.3 The Academic Institutions

The ineffectiveness of this important body may be seen on two levels: the educational level and profession development level.

##### 4.4.3.1 The Educational Level

The accounting educational programme has been deficient for the following reasons:

- A) The lack of locally-written accounting text books and other relevant literature.
- B) The inadequacy of translated accounting text books from advanced nations.
- C) The lack of accounting education research and development (empirical work).
- D) Emphasis on the theoretical ground of accounting theory rather than the application of such theory in reality.
- E) Failure to consider the auditing function.
- G) Graduation based on the number of accounting graduates needed to meet the market demand rather than on the quality of the graduate.

##### 4.4.3.2 Professional Development

- A) Funds and research on profession development have been entirely inadequate.
- B) Practical training courses were not provided.
- C) lack of co-operation of accountancy educators in professional activities (technical assistance).
- D) A shortage of guidelines for certificate applicants.

E) Poor participation from the private sector.

#### 4.5 The Audit Bureau

##### 4.5.1 Establishment & Objectives

The constitution of Kuwait decrees:

".. There shall shall be established by law a commission for the financial control. It shall assist both the government and the national assembly in collecting the state revenues and expending of funds within the limited budget allocations".

The Constitution, Article [151].

Accordingly, in 1964 law No. 30 was enacted establishing the Kuwaiti Audit Bureau (A.B.). The A.B. is an independent agency reporting directly to the national assembly. A.B.'s main objective is to locate the financial deviations in the governmental budget and take the appropriate action.

"Through performance of its control activity, the Audit Bureau has concentrated on the creation of a full conviction in the audited bodies that A.B. is not looking for errors or deviations, but aims primarily at the maintenance of public interests by safeguarding public funds and efficiently utilising them for the aspects they have been allocated for." (33)

The audit bureau controls only government departments ministries, public agencies, and companies in which the state holds a share of not less than 50% of their capital. However the A.B has no control whatsoever, over private and foreign bodies nor over accounting firms.

In performing its functions, A.B. follows two types of financial control;

- 1) Prior control ( inspecting tenders and propositions and verifying their earmarked allocations).
- 2) Subsequent control (the subsequent examination of financial commitment).

When A.B. finds an error or a financial deviation, it notifies the authority concerned requiring it to correct the matter quickly; otherwise the error is noted and reported by the A.B. to the national assembly and the head of state.

#### 4.5.2 Evaluation of A.B. Performance

In connection with A. B., Ministry of Finance & Economy issues circulations regarding the execution of the budget to other governmental bodies, that should coincide with the directions of A.B. The bureau also offers advice on the best accounting system to follow.<sup>(34)</sup> However, poor co-ordination and very few communication channels are maintained between A.B. and accounting professional firms and KSAA. Although A.B. has organised multiple seminars, training courses, and technical programmes, accounting as a control system has dominated most of these activities, while cost accounting and government accounting accounted for the remainder.

Twenty five years have passed since the establishment of A.B., but it has not contributed significantly to the Kuwaiti accounting profession. It might be that the basic aims of the audit bureau have limited its scope to realise effective control over public funds and not to be involved in the status of the accounting profession.

#### 4.6 Accounting and Kuwait's Public Policy

Public policy is often discussed in terms of government's actions. The budget, for example, is the core of the public policy-making process. Derived from accounting-related information, the budget is considered a very vital financial statement. Dye, goes so far as to , argue that "the budget is the single most important policy statement of any government."<sup>(35)</sup> Others consider it the central of the state planning.<sup>(36)</sup>

Even though budgeting is a mixture of economic and political attitudes, a finely tuned accounting system is also a basic component.<sup>(37)</sup> It forms a multi-task element in this mixture, for which it is supposed to provide the compiled information (micro and macro levels) and control.

Unlike other disciplines, accounting has been thought of as separate and distinct from public policy issues. This distinction between accounting and budgeting systems exists in most countries, especially within the emerging nations. Recent studies, in fact, by Pohlman and Daniker showed that such separation is noted even in the accounting and budgeting systems in the federal government of the United States, where it should be more compatible than is the present case.<sup>(38)</sup> Also, the few investigated areas have been largely confined to the effects and roles of accounting techniques on economic modes.<sup>(39)</sup>

Developing countries, particularly, are confronted with the difficulty of defining this important relationship

between accounting and public policy. This definition includes designing the integrated system, processing, using and then controlling the national information system of all government sectors. Even though these nations, as reported by Linowes D., the advisor to the department of US state and the United Nations, have accorded accounting an important role in their central planning process, this recognition is not quite sufficient. (40)

He concluded that: "The scope of accounting must be broadened by the leaders of the accounting professions in the newly emerging countries if national goals of industrial and agricultural development are to be obtained within the target dates." (41)

The governments of these nations have realised that only through legislation can a promising accounting profession emerge, since their accounting systems are either inadequate or lack a generally accepted body of accounting rules. If national goals are to be met, local accounting professions have to assume the appropriate responsibilities for the development of suitable accounting information to serve national planning needs. (42)

As far as Kuwait is concerned, accounting profession contribution in this respect is obsolete, and the concerned bodies frequently work at cross purposes. This clearly shown through the lack of reliable accounting information, which is not employed in the fiscal planning any way.

Perhaps the most obvious example that to illustrate the position is the matter of timing. The national fiscal year ends on June 30. The year-end closing process means



that reliable accounting data should be available sufficiently in advance to be included in the annual plans. However, in most cases, financial statements and other sectorial data are published in November or December, six months afterwards, while other accounts are deferred and information is published too late to be of benefit to the users. By the very nature of the budget accounts, most decisions leading up to the submission of the budget must be made on the basis of preliminary accounting data or, more likely, estimates that may have little or no basis in the accounting system. This means that much of the presumed accuracy, reliability and thus, the usefulness of these accounting data is lost.

Another problem lies in the structure of accounting data available in Kuwait. Traditionally, appropriation accounts have been used as the basic unit of the budget. Over the years, the accounting structure has been geared to this. However, recently a wide variety of decision units are becoming necessary (especially by the parliament), and these are not reflected in the accounting structure. Below the appropriation level, accounting data may either be estimated again -losing the presumption of accuracy and reliability, or simply may not be available. For instance, a programme may be funded through an appropriation account, which in turn, funds several programmes.

A framework of data integration is currently necessary for the process of budgeting at the Ministry of Finance &

Economy. This should also include prior examination of public policy decision-making and an appropriate information system including accounting be structured to mesh with those decisions.

#### 4.7 Concluding Remarks

This chapter has stressed the need for a regulated accountancy profession in Kuwait and a certain degree of compatibility between micro accounting data, methods and the national accounts outputs in Kuwait.

This will only come about if there are organised bodies capable of directing such a long-term policy. Thus, it is perhaps necessary for government to take the lead in resolving the deficiencies of accounting regulations in Kuwait, beginning with full co-operation with KSAA, accounting firms and the professional in order to draw up a suitable framework for Kuwait's accountancy.

Finally, of grave importance to the subject of tax reform and its relevance to the accounting system in Kuwait is the question of whether accounting will be subordinated to tax-ordained accounting principles ? What are the pitfalls confronting the practice of tax accounting, which the fledgeling accounting profession must anticipate ? How can the accounting profession tailor accounting practices to accommodate the budget plans and professional requirements ? These questions, it is hoped will be answered at least in part, through the empirical path of this study.

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## Chapter Five

### *"The Impact of Taxation on Accounting"*

#### 5.1 Introduction

This study begins by detailing the close historical and evolutionary association between taxation and accounting.

The impact of taxation on accounting is a subtle issue involving a broad range of aspects. There are, in fact, multiple effects which may be identified, but the major influences of taxes on accounting are our main concern here.

These influences are described as follows;

- 1> Direct effect: that is the direct influence stimulated by the consequences of the tax authorities involvement in accounting standards setting.
- 2> Economic leverage; the effect of fiscal policy on investment consumption decisions, on borrowing, etc.).
- 3> The impact of taxes on the decision making of managements, investors, share holders, etc.

The goals of fiscal policy, which are basically to raise revenues and to stabilise economic activities, do not always conform to the objectives of accounting standards-setting bodies, which seek fair presentation of corporate results within a reasonable economic framework . Such conformity has been sought to the extent of reducing auditing costs to fulfil it, which represents a very narrow focus on the part of the accounting profession.<sup>(1)</sup>

Despite the fact that taxation nowadays is widely seen as one of the many accountancy specialisations, the origins of accounting can be traced to the early existence and development of taxation forms.<sup>(2)</sup>

As far as the modern history is concerned, an examination of the two most obvious experiences, namely the U.K. and the U.S.A. experiences, helps to reveal the close association between tax and accounting.

## 5.2 The U.K. Experience

"Income taxation is as old as civilisation", states Chatfield.<sup>(3)</sup> The history of British taxation is also an old one and has a long connection with accounting and accountants in particular. Nevertheless, the modern tax history of the U.K. dates from the Napoleonic wars between France and England, when a general income tax was imposed first in France in 1793 and later in England in 1799 in order to finance the war; both countries imposed a 10% income tax at that time.<sup>(4)</sup> This action had a great influence on accounting and accountants.

Taxation had surely secured more employment opportunities for accountants than before, as Ba-Eissa further explains:

"The imposition of tax laws led to more employment of accountants, both as experts to design and prepare adequate records and accounts of business financial affairs and transactions, and as professionals performing tax services which included preparation of tax returns and also consultation on taxation matters." (5)

Accountants were called upon by corporations, partnerships, and even traders to assist them in preparing their accounts as well as keeping records. Sidebotham points out that;

"Many more people keep adequate records of their financial affairs because of taxation rules than would otherwise be the case. Sole traders and partnerships have frequently employed

accountants not because they appreciated at the outset the value of accurate records for their own sake, but solely because of the need to submit taxation returns. Taxation legislation has both encouraged better record keeping in small firms, and given a stimulus to the growth of the accounting profession." (6)

In particular, taxpayers sought the aid of accountants to act as their representatives in dealing with the increasingly heavy tax burden, and the growing complexity of tax legislation.<sup>(7)</sup> Stacey asserts that;

"Legislation regulating trade, industry and commerce often brings more work for the accountants. In particular, taxation and the problems arising from it have been a constant source of addition to the accountant's work. Some even assert that accountants have a vested interest in taxation work of all kind. Perhaps the adjective -vested interest- is a little unhappy but, of course, accountants have the same kind of vested interest in their metier as doctors have in illness and disease and clergymen in sin". (8)

Another indirect but effective impact of tax on the development of accountancy in the U.K. was found in the collaboration -initiated by tax subjects- between accountants and lawyers. This collaboration arose from the accepted processing of most accounting work in solicitors' offices in Britain during the eighteenth century.<sup>(9)</sup> Some scholars of this century have affirmed the benefits of this co-ordination to the extent that accountants and lawyers complement each other's role in tax cases.<sup>(10)</sup> One of the first British practitioners Cooper once said:

"...Our friends, the solicitors, not only bring us our work, but they guide us through it and point out to us its pitfalls, and when we stumble into them they help us out." (11)

Jeal also shared this view and considered the legal



aspect of taxation as a significant factor in the development of professional accounting.

"The infant profession has been encouraged rather than crushed by British jurists".(12)

As happened with the 18th century war taxes, the package of taxes imposed during the first and second world wars in the 20th century, also brought more recognition to the profession. Such taxes were sufficiently complex and punitive to cause both taxpayers and the government to seek the assistance of professionals who could help in reducing the burden of taxes for taxpayers, and in properly levying taxes for the government.(13) Furthermore, accountants were considered as experts and often referred to in settling tax disputes in addition to arguments and difficult cases. More importantly, some professional accountants were called upon and appointed members of a board of referees set up by the 1915 Finance Act to adjudicate in difficult cases.(14) Taxation work became an essential aspect of professional accountancy. After gaining the public acceptance and recognition, the accounting profession required a range of specialisations in order to form an integrated profession. Tax services, in this respect, could be considered as the second trend on which accountancy was developed. In 1968, the Economist stated;

"The practising accountant now has three growth fields of activity. Taxation, auditing and management accounting consultancy." (15)

In 1930 the Institute of Taxation was founded as a specialist organisation for those professionally engaged in taxation, the majority of whom were accountants (others were

lawyers, in banks or other commercial concerns, etc.). Glover strongly indicated that:

"for some accountants this may in future supersede their formal accountancy qualification. A case has been reported of a practitioner who has apparently relinquished his status as a chartered accountant and relies on his Taxation Institute membership as a qualification for practising". (16)

In 1942, a Committee for Taxation and Financial Relations affairs (TFRC) was established by ICAEW. Its role was to consider matters affecting taxation and the financial relationship of the business community with the Inland Revenue and other government departments.

Although TFRC was not solely concerned with tax, as the name may indicate, however the accountancy profession in U.K. has benefited from this committee in three ways;

First, through this committee an effective liaison between practising and non-practising accountants was formed.

Secondly, the committee's contribution led to the Institute's greater concern in vital subjects such as setting accounting principles, rather than concentrating extensively on administrative and disciplinary matters.

Thirdly, its establishment opened the door for more contributions in the accounting research field. In fact, the committee's recommendations and encouragements led 7 years later in 1949, to a change of its name, to the Taxation and Research Committee (TRC) in 1949. (17)

As far as the effect of tax on accounting principles is concerned, the development of accounting rules has been

closely correlated to tax accounting as it requires a rather comprehensive and detailed regulations. Emphasising this advantage, Werntz further indicated;

"..There are embodied in tax procedure well-established means for placing disputed [accounting] issues before the appropriate tribunals for final decisions... In contrast, the instances in which matters of financial accounting have come before the courts are rare, indeed." (18)

In most of these cases, opinions rendered to tax enforcement were a valuable part of the discussion on financial accounting, since it was related to interests of parties, in terms of the amount of money is disputed.<sup>(19)</sup> While, on the other hand, accounting principles setting was rarely encountered within the judicial system as it has little effect on other parties except accountants. The history of tax disputes in England is rich in such cases where the decision was founded on special tax considerations that were not matched with the rules of financial accounting. This has provided the motive for accountants to further standardise their profession.

One example was the Whimster & Co. case in 1921.<sup>(20)</sup> Based on the the accounts of this company, they had credited the amount they would have to pay according to their hiring agreement (on time charter). However, there was some difference between the rates they actually had paid, and the low rates which were prevailing afterwards (because of the depression in the shipping industry. Since, such difference between these sums was not a proper deduction in computing

profits for tax purposes (taxable accounting), it was not considered a real loss as it was reported in the accounts (accounting income). Regardless of this conservative approach adopted by the company, the incurred loss was not allowed by the tax commissioners. This reflected the influence taxation had on accounting, despite the close association between taxable accounting and accounting for financial reporting.

This situation has even produced some distortion in that the tax laws overdid some accounting principles and distorted financial reporting techniques to determine taxable income, which sometimes seemed inconsistent with accounting income concepts such as the accrual method.

The effect of tax accounting was such to pose substantial accounting problems to the accountant, which lead this profession to be more concerned with its set of rules than ever because of the associated tax consequences. The E E C Quarries Ltd. case in 1975 is another example of such distortion.<sup>(21)</sup> E E C planning expenditure was not considered of a revenue nature even though it was incurred for such purpose. The accountancy evidence was not sufficient enough to allow such expenditure to be deducted from taxable income, as the planning intentions were not to generate profits, but some subsequent operations would. Thus, the decision was not taken in favour of the accounting approach followed by the company, i.e., to write it off against profits. This cost was not deducted from the taxable figure, despite that it was incurred and reported in the financial statement of E E C.

Moreover, for tax purposes, expenses were sometimes

regarded in a different manner from the accounting treatment of these expenses. The case of Odeon Associated Theatres Ltd. in 1971 can be cited here in support of such argument. (22)

For the taxman, expenses have to be accrued in the process of earning income, otherwise they would not be allowed for tax deduction. If they were not of a capital nature (gains), accounting proof has to be furnished to make their deduction eligible. Certainly, this proof requires the existence of sound accounting principles for proof to be based on in cases of expenses classification disputes. Herein lies the significant influence of tax on setting generally accepted accounting principles. This has materialised, at least in part, within the current regulation of the accounting profession in Britain.

There is ample evidence that tax accounting requirements and decisions have had a direct influence on financial accounting practice, especially after the war. (23)

"Conservatism might cause him [the accountant] to lean somewhat toward a liberal provision against revenues, and a minimum reduction in connection with anticipated losses...no one could be held responsible for that because of the tax requirements" (24)

In a recent study by Deane, the conclusion was reached that: "taxation is an area of primary concern to certified and chartered accountants in private practice".\*

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\* Although his study was conducted in a limited geographical area, the findings were very significant. For example he found that; 1> The average accountant in private practice spends about one quarter of his time on tax related work. 2> The accountant is the major

Nevertheless, if the scope and significance of work stimulated from tax legislations in Britain is compared with that of other countries like the United States of America, it would seem that taxation in Britain has had a less influential role than in some other countries. In Britain, for instance, tax assessments are made by the tax authorities, while in the United States accountants are authorised to practice tax self-assessment.\* Obviously, tax services in the latter case will be more widespread and significantly affect accountants' work.

From the above discussion we may conclude that accountancy in U.K. has been based heavily on the tax structure. Since the early imposition of taxes, almost two centuries ago, accountancy as a profession has attracted more staff, especially to control and administer taxes.

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- professional user of tax information in the private sector.  
3> Almost every accountant in private practice has a significant tax component to his work; even the minimal reported involvement of 10% far outweighs the importance of taxation to the average accountant in industry or commerce. 4> The existence of "Tax Specialists" in a firm necessarily suggests that the firm has reached a certain minimum size (e.g., The large firms- especially internationals - are all chartered, while certified practitioners tend to be smaller)...see Deane K. D., "Tax information and accountants, a study of generation, flow and use of tax information by one professional group", op. cit., pp. 97-104.

\* It is noteworthy to mention that tax services are the second largest area of professional services in Britain, while auditing is the first area. Also, accountancy firms in Britain do more tax and liquidation work than US firms, due to the legal dominance of such issues in US, while in U.K. they are largely in the hands of accountants, see.. Seidler I. J., "A comparison of the economic and social status of the accountancy profession in G.B. and the USA", in Dimensions in Accounting, eds. S Chesler, A. Matias and S. Pullara, (New Jersey General Learning Press, 1972), pp. 238-242.

### 5.3 The U.S.A. Experience

In the United States, as in Britain, tax introduction had a very influential impact on accounting development early this century. In this regard, Chatfield states:

" The accountancy profession became an essential part of American economic life during the years 1900-1930, mainly as a result of income tax and the dependence of businesses on outside sources of capital". (25)

Chatfield further considers tax rules in United States as the American equivalent of the legal codes which regulate accountancy in France, Germany and Sweden. (26)

Demand on accountants in United States has increased rapidly since the first two decades of this century, and it has continued to increase with a record peak during the two world wars. Obviously, that increase was basically caused by the heavy wartime excess-profits tax and the rise in income tax rates as evidenced by the large volume of tax services and practices that dominated the accounting profession services in the US. Businessmen, individuals and corporations sought accountants assistance in preparing their financial records, preparing their accounts, filling their tax returns and representing them in disputes with tax authority. (27)

Peloubet claims that income tax work influence on accountants was the greatest factor:

"There seems, from a purely historical point of view, to be little doubt that the passage of the income tax statutes, the increasingly high rates of taxation, and the large increase in the number of taxpayers have provided a volume of work for accountants which is very much greater than that provided by any other development.

Many of the smallest enterprises -gas stations, small retail stores, farms and ranches- now have an imperative need for accounting services which never existed, or at least never was recognised until the enterprises or their owner became federal taxpayers." (28)

It was, therefore, more profitable and convenient for accountants and other book-keepers in industry to leave their jobs and set up offices as public accountants, in order to take advantage of the ever increasing demand for tax services. Carey further explains this trend:(29)

"...Many revenue agents saw that there was more money in working for taxpayers than for the government, and they too became public accountants, (hereafter)... Large numbers of these practitioners became C.P.A in order to enhance their status..." (30)

Furthermore, the accountancy profession in the US benefited much from tax reform in that;(31)

- 1> It created a useful collaboration between the federal government and public accountants who had enhanced their image by being in the mainstream of the social reform movement through municipal and corporate audits.
- 2> It asserted the definite need for accounting services.

The preceding benefits are supported by many examples in the history of professional accountancy in the US. In 1946, for example, the American tax authority (Inland Revenue Services-IRS) changed its policy favouring straight line depreciation and allowed the use of 150% declining balance. The approval of this method for federal tax purposes was dependent on its use for reporting purposes also. In 1954, however, following the amendment of the income tax code, accelerated depreciation methods for tax purposes only were



allowed. (32) In his study, Firmin concludes;

"...In no case did any company official or certified public accountant interviewed state that either the declining balance method or the sum of the years digits method was inherently a better method of allocating plant and equipment costs than the straight line method... The one single factor governing the decision to adopt either of the newly permitted 'liberalised' methods of depreciation seems to have been its advantage as a mean of postponing the impact of the federal income tax..." (33)

A mutual influence between taxation and accounting can be observed through the increasing dialogue between the US Treasury Department and the accounting standards-setting bodies in the early fifties. The subject of tax accounting, for example, was one of the major issues in that dialogue. The tax committee of the AICPA council reported in 1945 that;

"The committee has adopted, as one of its primary projects, a complete study of accounting for tax purposes, with a view to recommending legislation and administrative action which will eliminate, or at least greatly reduce, the increasing wide gap between generally accepted accounting principles and accounting procedures recognised for tax purposes by ruling and court decisions, which has manifested itself particularly in such matters as prepaid income, deductions for accrued taxes and reserves." (34)

Five years later the institute's council adopted another resolution, renewing the "non-partisan" committee proposal and pointing out the added expenses and uncertainties about tax liabilities caused by the lack of conformity between tax laws and GAAP. The same proposal was called for in 1952 after several negotiations and dialogues with the treasury, but the committee was not established until one year later in 1953. It was a special

committee established by the executive committee of the Congress, that consisted of four members of the accounting procedures committee as well as three from the committee on federal taxation. The special committee objective was "to draft recommendations which would reduce present deviations in tax accounting from GAAP".(35)

A short time afterwards, the committee produced a report which was sufficiently persuasive to result in amendment of the tax code, despite some opposition from the treasury department permitting recognition of expense reserves as current deductions for tax purposes, and deferring tax on prepaid income until the provision of the goods or services. In this regard, Carey stated that;

"..These provisions were hailed as a long step toward reconciliation of tax accounting with GAAP." (36)

The disparity between the two authorities on subjects related to tax and accounting continued for years. Another obvious example was the treatment of investment tax credit (ITC). President Nixon recommended that congress revive ITC in 1971, while AICPA asked treasury officials to urge the administration to refrain from expressing its views on the proper accounting treatment of ITC. After receiving a letter from the treasury promising neutrality, AICPA, APB and SEC prepared and issued an exposure draft reasserting the 1962 treatment of the credit. However;

"Partly in response to industry pressures, the treasury revised its neutrality stand and advised the senate that it strongly supported a continuation of the optimal accounting treatment of the credit and would support a legislative resolution of this matter. Notwithstanding the

eleventh-hour pleas of institute leaders, Congress amended the tax bill, which later became law, to allow taxpayers to their preferred method of accounting for the credit. In the face of this Congressional dictum, the APB withdrew its exposure draft and issued a statement deploring Congressional involvement in the establishment of accounting principles". (37)

The last-in, first-out method (lifo) of costing inventories became law in 1938 in USA. The circumstances of its introduction were similar to other issues related to the conformity of tax laws with accounting. The provision of lifo required the taxpayer to use the same method in keeping records for purposes other than tax.<sup>(38)</sup> External reports were required by this first provision of its kind to conform with income tax provision as a prerequisite for the use of the income tax method. It was clear that lifo provision was fully motivated by taxation, which in turn affected the accounting practices as well as the economy as a whole. This has been explained by Aharoni;

"In view of the conformity between tax and accounting authorities regarding the inventory method, it seems that the adoption of lifo has been mainly tax motivated in an economy of constant inflation." (39)

It is generally agreed that accountability is one of the prime objective of financial reporting. Since the early development of the accounting profession, this role of accounting has been recognised and was even established in early Mesopotamia.<sup>(40)</sup> Even though fiscal policy and accounting policy emerged at the same time in history as major economic events, they were not developed in parallel steps.<sup>(41)</sup> During war time the federal government had to

raise more funds to meet its obligations, and did so entirely from tax sources. Tax rates dramatically increased in 1916-17, 1942 and 1951, corresponding to the first and second world wars and the Korean war respectively. On the other hand, major consideration was given to accounting practices in 1933 following the 1929 depression, when companies were first required to provide "full and fair disclosure".<sup>(42)</sup> More than 4 decades later, and more specifically in 1971, the US treasury department announced a study to "set forth more specifically the circumstances under which a new tax accounting method may be used by a taxpayer only if (also) used for financial accounting and reporting".<sup>(43)</sup> Before that announcement, taxpayers had been permitted to change accounting methods for tax purposes, if the new methods were used in all reports and for all other purposes. The AICPA board of directors - formerly the executive committee- supported by the AAA executive committee (and after a long debate with the profession) opposed such enforced conformity of tax accounting with financial accounting and advised the treasury of its views.<sup>(44)</sup>

From the above examples, one can conclude that taxation and fiscal policy in general has had a great impact on the development of accounting -the profession in particular- in the USA since the commencement of this century. This impact was emphasised through different channels (e.g. accounting practices, accounting for tax purposes and related methods of computing income, lobbying for the change in accounting

standards, etc.) however in most cases the cause behind the resultant conflicts was the lack of congruence between accounting standards, objectives and the concerned bodies on one side, and tax laws, and fiscal policies objectives on the other. Also, the influence was by no means one-sided, but it should be borne in mind that a mutual influence between taxation and accounting has certainly arisen and offers scope for further research and investigation.

#### 5.4 A Mutual Influence

##### 5.4.1 The Literature

The literature on the influence of taxation on accounting is rather limited and consists of very brief statements of opinion on this matter. The relationship is considered here as one of simultaneous and mutual influence, which in the researcher's view should be considered by any scholar due to the rooted assumptions, and techniques that combine the two arts (e.g., the impact of accounting numbers on fiscal policy decision-making). This approach, albeit more complicated, may provide a better insight into the net effect of taxation on accounting.

Not only does taxation contribute to the shaping of accounting, but also accounting can affect taxation and the formulation of its structure. Enthoven observed that;

"...An accounting profession can help the tax structure formulation by out-lining the best tax alternatives and pointing out inequities, loopholes and distortions; but its main contribution will be in designing better accounting information systems (inclusive of fundamentals) and regulations." (45)

Therefore, Enthoven himself adopted the belief that forming the tax structure should be a responsibility of the accounting bodies as well as the tax administration;

"From the viewpoint of accounting, tax administration tends to be more concrete and more easily identifiable with accounting than the tax structure, although in our opinion accounting and the accounting bodies, also have a bearing on the formulation of the structure itself." (46)

It has been shown in the previous sections that in both ancient and recent times, taxation has affected accounting development. However, accountancy is now returning the favour by servicing tax policies, to the extent that failure in achieving tax objectives is sometimes ascribed to the absence of the appropriate accounting measurements. Accountancy's importance to a tax is great, and in some respects may be considered a 'must' as Mueller indicated;

"Whether an income, property, sales, or other tax is involved, the fairness of its assessment depends to a large degree on the reliability and the uniformity of the financial records on which the assessment is based. In Other words, a degree of accounting uniformity is almost a 'must' for tax accounting." (47)

Evidence of this may be observed in modern history, where a need for a conformity between tax accounting and financial accounting has appeared. In the US, as discussed earlier, tax legislation was the driving-force behind the development of accounting to determine taxable income. However, at that time accounting-tax integration was lacking, due to the absence of financial accounting uniformity, which has required the subsequent creation of separate but uniform tax accounting rules through a series of internal revenue

acts supplemented by extensive sets of regulations.<sup>(48)</sup>

Uniformity of financial accounting and the related adoption of a tax based accounting system is widely applied now in many countries other than the US. A direct relationship between financial accounting and tax accounting exists now in most the Scandinavian and South American states. In those countries, certain tax accounting procedures and allowances are only recognised if they are fully applied to financial accounting. The case is more noticeable in Sweden which more than any other country has based its accounting practices and concepts to a large extent on a macro-economic basis. In this regard, accounting is of major importance, especially if we know that accounting and taxation principles directly reflect Sweden's national economic policies.<sup>(49)</sup> This aspect of the accounting function will facilitate rapid compliance with tax legislation for it is ready to be adopted for tax purposes.

Indeed, the implementation of a tax policy is aided by high standards of accounting and the development of public accounting firms. The scope of taxes and their potential revenues depend primarily on record-keeping by taxpayers, tax administration accounting systems and procedures in addition to other variables.<sup>(50)</sup> Addressing his words to Colonel R. Montgomery (president of AICPA), president F. Roosevelt wrote fifty years ago that, "innumerable influences had made an effective accounting system an essential to the continued life of businesses and public policy".<sup>(51)</sup> Asserting these

views, Enthoven states;

" Accounting plays an important role in improving the set-up of both the tax administration and the taxpayers, enabling more equitable and effective tax policies and procedures to be executed. Furthermore, accounting is able to assist in appraising the best forms of taxation to achieve the necessary objectives." (52)

It is worth noting that tax accounting and financial accounting are strongly related to each other from a macro accounting view. It could be argued, therefore, that taxation requirements are one phase of the national economic system, for accounting is also oriented to the implications of national policies. Hence, tax accounting legislation completes and serves the objectives of financial accounting and vice versa. It follows then, that changes in the basis of tax accounting will have a certain subsequent effect on the financial accounting system.

From what has been said in the preceding paragraphs, it would appear appropriate to describe the accounting system in a country as one of the prime components of its tax structure. An efficient tax administration, for instance, needs first a systematic accounting set-up to be adhered to along with an effective internal organisation of the accounting system. "This whole basic phase cannot be omitted".<sup>(53)</sup> This burden of establishing a balanced tax structure based on supportive accounting is a shared responsibility of accounting institutes as well as the tax administration.



#### 5.4.2 In Developing Countries

Tax formulation reflects, besides the degree of economic development of the country, the condition of the accounting system for tax purposes in that country. The more advanced the stage reached in enforcing modern tax, the higher should be the level of tax accounting and relevant administrative set-up. It is, therefore, not surprising that developing countries have many difficulties in developing their tax structure to the stage of introducing a well-monitored taxation on income and wealth. Professor Enthoven writing on this links says;

" Taxation on income and wealth still faces major stumbling blocks in developing countries, largely due to the absence of even minimum administrative accounting conditions..." (54)

Evidence of this is clearly observable in the continued reluctance of many developing countries to introduce direct rather than indirect taxation (sales, imports, customs, etc.), which is easier to administer and often forms over 50% of tax revenues in such countries.

Developing countries need additional scrutiny and care when establishing an accounting system for tax purposes. This is all the more advisable in view of the fact that accounting practices and principles are more valid when a country moves to a higher level of economic welfare and development. Perhaps accuracy in selecting the appropriate taxes to suit the level of economic development of a country is as important as the formulation of tax accounting that will maintain an effective tax strategy. Due has asserted that

among the variables that lead to a successful tax structure, are the existence of;

"a high standard of accounting and the development of public accounting firms".(55)

The optimal form of administrative accounting practices for tax purposes depends not only upon accounting regulations, but also upon the follow-up and support of effective professional bodies. Enthoven has called for accounting institutes within and outside a country to provide such assistance. He argued that:

" Accounting institutes, from outside the country and within, can help implement better tax administration and accounting procedures, and design more uniform methods for processing and reporting fiscal information, whereby close co-ordination between business, social and government accounting would be desired." (56)

Another factor that is observed in developing countries with respect to accounting links with taxation is the public recognition of accountancy, which is, compared with that in developed nations, at a very low level. In the US and Britain, accountants have wider relations with individuals, groups, and the public in general than is the case in developing countries. It is not even necessary for individuals to be in business to have such relations, for accountants in the US and U.K. render more tax services (tax returns, consultancy, representations and appeals, etc.) than occurs in a typical developing state.

In order to achieve the planned objectives of taxation in developing countries, a well designed tax structure and an effective tax administration must first be secured. These

important aspects, rely to a great extent on the availability of a developing accountancy field. Tax administration usually involves the assessment, collection, recording and verification of taxable amounts. All these functions may be viewed as accounting-based. Herein, lies the importance of a sound accounting system for tax purposes.

#### 5.5 Concluding Remarks

The philosophy of tax accounting has emerged from the dual correlation between tax and accounting, despite the fact that fiscal policies and taxation in particular are only one aspect of accountancy development. Throughout history tax has initiated major accounting functions for it has given the word "accountability" its reference and vitality. Since its inception accountancy has developed under the supervision and encouragement of taxation. Later on, taxation became significantly dependent on accounting support to secure the "accountability" needs of taxation. In this respect, the two arts merged together to form "Taxable Accountancy" or "Accounting For Tax Purposes", which represents the other side of the dual effect 'coin'.

## NOTES

1. Accounting authorities try to establish sound and clearly determined rules of auditing including the resolving of ambiguous interpretation of any issue. APB and the Treasury in USA, for example, had many debates concerning this matter that signifies the conflicts in the objectives of fiscal policy makers (revenue raising even through dual interpretation of financial statements), and the objectives of the Accounting Principle Board of establishing reliability as well as consistency in financial reporting and protecting shareholders interests.. see Zeff S. A., "Chronology of Significant Developments in the Establishments of Accounting Principles in the United States, 1926-1972"; Journal of Accounting Research, (Spring 1972), PP. 217-227.
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## Chapter Six

### "The Public"

#### 6.1 Introduction

The primary purpose of this investigation was to obtain and analyse empirical evidence of the impact of tax reformation on the attitudes of an experienced sample of the public in Kuwait. This investigation is divided in general into 3 stages, each of them designed to test a specific area, namely:

- 1> Attitudes toward the imposition of taxes;
- 2> The evaluation of the present tax system;
- 3> Expectations about the future relationship between tax and accounting.

The aim of this research may be very broad, but it is vital in any inquiry not to begin with too restrictive a vision. Hypotheses are indispensable at all stages, and not least at the very beginning of the inquiry. This idea is very well articulated in the following observation;

"A hypothesis implies an antecedent question to which it offers a provisional and, if it is to serve its purpose, a testable answer. The explanation is that the kind of question the Webbs had in mind was one loaded with assumptions drawn from the investigator's personal prejudices or political ideals". (\*)

#### 6.2 Design of The Questionnaire

The essential information was gathered from the sample by means of a questionnaire (Appendix A) in order to cover a large area at minimum cost. Questionnaire were used

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\* Marshall T. H., in Webbs, S. and B., "Methods Of Social Study"; Cambridge University Press, 1975, pp. XVII - XIX.



because of the difficulty in eliciting co-operation from respondents (filling it takes about 10 minutes at the most). The questions are classified according to the type of information they reveal as follows: [Table 6.1]

- 1) Personal Data(e.g., job, educational level, monthly income, etc.).
- 2) Attitudes Toward Taxation, 3) Tax Preference,
- 4) Tax Rate, 5) Present Tax Law Evaluation,
- 6) Tax Administration, 7) Tax & Accounting.

Table 6.1

"The Public Questionnaire Design"

"Questions Classification according to the related information"	
Information Type	Question No.
1> Personal	1,2,3,4,5,6
2> Attitudes toward imposing taxes	7,13,16,17 23
3> Tax Preferences	8,9,10,11,21,22
4> Tax Rate	12
5> Present tax law evaluation	18-A, 19,20
6> Tax Administration	14,15,18-B
7> Tax & Accounting	24,25,26

At the end of the questionnaire a 9 line space was allocated for the participants to make suggestions and offer criticisms. A cover letter accompanied the questionnaire, which explained the researcher's status, the research stage, and its confidentiality.

The questionnaire was first structured in English then

was translated into Arabic, which is the language spoken and written in Kuwait. Before the final typing of this questionnaire, its early drafts were reviewed by 5 Arabic-speaking persons in order to reduce bias as well as to correct for any possible mis-translation.

#### 6.2.1 Sampling

The population of interest in this study were knowledgeable people in tax within the Kuwaiti population. This selected sample was chosen for the following reasons;

1> The inquiry concerns a very specific subject to which not all the public has the capability to contribute. In fact, not all the public were aware of the tax laws of Kuwait, nor do they have the required financial and economical background and knowledge to comment on this area of public finance.

2> Results of the pilot study showed that even among well educated people there is a high percentage of tax ignorance. One respondent stated that;

"Noticeable ignorance in the decree and in taxation generally among the public will weaken the findings of this study, unless the questionnaire is to be distributed among selected participants".

This kind of purposive sampling technique is often used in place of random sampling, which is particularly useful when the number of units in the sample must be limited to a small figure. In purposive sampling, a sample is chosen "which is representative with respect to certain known characteristics of the population. The assumption is

made that if the subjects are, indeed, typical in these respects, they will be typical with respect to the subjects being studied".\*

The prime goal of sampling was to select a sample which will provide significant responses. The more acquainted respondents were with financial matters, the better were they able to understand the questions. Random sampling might be the most common method of obtaining a representative sampling, but other methods such as purposive sampling, are also acceptable and are often used. Although the sample utilised in the present research was bias, but consideration is taken when interpreting results. Thus, Responses should be seen as of people with vested interests towards tax introduction. Accordingly, the sample was chosen as shown in Table 6.2.

A first glance at the sample combination and the associated backgrounds of the participants indicates that almost 80% of them have financial knowledge or past experience in taxation and related areas.

Since the subject of the questionnaire was of a relative sensitivity that might lead some people not to respond, it was decided to consult and work with "key persons" who were friends holding key positions in the respondents' working places. Also, the researcher obtained a certified letter from the University of Kuwait- supporting this research. A follow up plan was worked out

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\* Hansen M. H., Hurwitz W. N., and Madow W. G., "Sample Survey Methods and Theory"; John Wiley & Sons, Inc., 1953, pp. 71-72.

with the key person to collect the responses on the basis of an average 30 hours reply time.

Table 6.2

"The Sample"

Sources	Number Of responses
1> Kuwait Investment Authority	25
2> Ministry Of Finance & Economy:-	
A. Tax Department...	45
B. Budgeting Department...	15
C. Accounting Department..	25
D. Financial Control Dept.	15
E. Legislation & Laws Dept.	10
3> The Audit Bureau...	25
4> Kuwait University..	15
5> Kuwait Stock Exchange...	45
6> Ministry of Industry & Commerce..	35
7> Technological Education Authority	25
8> Ordinary persons at a Supermarket, a Club, and a public library..	20
	Total
	300

The researcher travelled to Kuwait on December 4th, 1987 and stayed there for about three months. This period was spent on administering all the 3 questionnaire of this study, and an average of 25 days was assigned for the distribution, collection, and analysis of each.

### 6.2.2 Data Analysis Models

Basically two statistical methods were employed here to analyse the collected data and to test the proposed hypotheses. These methods were the mean analysis or the arithmetic mean analysis, and the Chi Square  $(X)^2$ . The former technique was used to measure the central tendency which assists in representing an entire set of data descriptively. The mean of this sample  $(X)^1$  was tested in

accordance with the following formula;

$$\bar{y} = \frac{\sum_{i=1}^n i y}{n} \quad \text{----> ( 1 )}$$

Where,

$\bar{y}$  = The observed mean,  
 $y$  = Likert Scale average [ The summated rated of responses scores to yield an individual attitude score]  
 $\Sigma$  = The sum of;  
 $n$  = Number of observations.

The Likert scale is helpful in purporting all questions to the same goal, which was to investigate people's attitudes toward the introduction of taxes. The product of this formula ( $\bar{y}$ ) was used to test for the hypothesis that the public in Kuwait was in favour of imposing taxes. This test was worked out by equating the expected value of the null hypothesis to 2, for the uncertain person in this case should average to 2 in his attitude. Thus, any average above 2 indicated a favourable attitude, and likewise averages below 2 indicated unfavourable attitudes. Moreover, the student t distribution with a .05 level of significance ( $\alpha = .05$ ) was used to perform this test. In this respect, the following formula was utilised;

$$t = \frac{\bar{y} - o^u}{S/\sqrt{n}} \quad \text{----> ( 2 )}$$

Where,

$t$  = The computed t statistics;  
 $\bar{y}$  = The observed mean;  
 $o^u$  = The hypothesised mean ( $H_0 = 2$ )  
 $S$  = The standard deviation;  
 $n$  = Number of observations.

To arrive at a decision a rule was assumed here that was based on the comparison between the computed  $t$  above and the critical  $t_a$  at the given degree of freedom, as follows:

A> For favourable attitudes (proposed low income, financially educated group -the Concerned), the expected mean should be  $> 2$  :

$$\begin{aligned} H_0 : \mu &= 2 \\ H_1 : \mu &> 2 \end{aligned}$$

This  $H_0$  will be rejected if  $t_a > t$

B> For unfavourable attitudes (proposed high & medium income, less concerned people), the expected mean should be  $< 2$  :

$$\begin{aligned} H_0 : \mu &= 2 \\ H_1 : \mu &< 2 \end{aligned}$$

$H_0$  will be rejected if  $t < t_a$

The latter technique ( $\chi^2$ ) was a general method used for testing compatibility based on a measure of agreement between the observed mean and the expected frequencies averages. It was also employed to supplement the mean and regression analysis by constructing contingency tables. This measurement was defined by the following formula;

$$\chi^2 = \sum_{i=1}^K \frac{(O_i - e_i)^2}{e_i} \quad \text{-----> ( 3 )}$$

Here,  $O_i$  = Observed averages (mean),  
 $e_i$  = Expected averages,

For the  $i$  th cell, and  $K$  denotes the number of cells.

Perfect agreement with expectation was revealed if  $\chi^2$  value was equal to 0, whereas its value was greater if the differences from expectations were great. Therefore, increasingly large values of  $\chi^2$  may be thought of as corresponding to increasingly poor experimental agreement.

### 6.3 Preliminary Statistics

In the light of the information gathered through the questionnaire, it seemed that the majority of the sample was in favour of imposing taxes subject to certain conditions. Before analysing this information statistically and descriptively, it is useful to describe the characteristics of the respondents in order better to classify the sample. As table 6.3 shows the personal data of respondents in percentages, the sample can be primarily classified into high and medium income groups, and low income people.

The high income group represented respondents with incomes over KD 2000 to 5000, or 35% of the sample, whereas the low income group represented respondents with a monthly income between KD 300-1000, or 65% of the sample. This information was important in classifying the attitudes toward taxation and the effect of income levels on these attitudes. This classification will be discussed later when the income & attitude association hypothesis is tested.

It was also clear that because the sample was purposely chosen, the educational (financial) backgrounds of respondents were relatively high.

Table 6.3

" Preliminary Statistics of The Public Sample "

[1] Educational Level	Bachelor 66% - Master 12% - Doctoral 7% High school 4% - Others 15%
[2] Monthly Income (KD)	300-500 (14%) - 500-1000 (51%) 1000-2000 (18%) - 3500-5000 (17%)
[3] Monthly Expenses as a % of [2]	10-20 (5%) - 20-35 (7%) - 35-50 (12%) 50-70 (22%) - 70-90 (32%) - 90-100 (22%)
[4] Other Income sources	Yes ( 35% ) - No ( 65% )
[5] Of what type	Rent (40%) - Trade (20%) - Businesses (7%) Foreign Investment (3%) - Shares returns (13%) - Other sources (17%)

Results indicated that the consumption rate of the sample is high in proportion to their earnings. The data revealed that less than 25% of the sample save 50% of their income and more than 75% of them save less than one third of their earnings. In some cases the saving ratios count for less than 11% of the monthly consumption ratio (10 / 90 percent). It is thus worth designing a tax strategy that encourages saving and reduces unproductive consumption. This policy is of a particular importance, especially if one bears in mind that more than 65% of the public earn their living from a single source of revenue. Also, even in cases of more than one source of income, rent - which is a non productive investment- comprised 40% of its total.

#### 6.4 Attitudes Toward Taxation

Generally, the majority of respondents (51%) agreed on



the introduction of taxes in broad terms, whereas 45% of them were against it. Analysis of responses in favour of taxation revealed the strong influence income level has on participants' attitudes. A large portion (47%) of those in favour of taxes were low income people (between KD 300-500), while in contrast replies of most of the high income group were against its imposition (39% of 45%). Though it is early to draw any conclusion here, there was some disagreement on the issue from the viewpoint of financial burden. This disagreement in respondents' perceptions did not end here, but spread to influence the favourability of tax types. For example, almost 90% of those favouring the introduction of taxes preferred selective taxes (142 responses out of the 159 favouring taxes responded with the introduction of a selective taxation). In contrast, more than 60% of high income participants opposed selective taxation (85/141). Table 6.4 shows responses to questions 7 to 12.

By and large, responses to these questions could be arranged in accordance to their percentages of either "positive" or "negative" replies to the given type of taxes as in table 6.5 below.

The sample is likely to be not quite prepared to accept taxation on expenditure as opposed to other sorts of taxes. This is clear from the percentages shown above, which also indicate that they favour selective taxes more than other types. These perceptions may be due to the multiple differences in the participants' income. However,

Table 6.4

"Public General Attitudes Toward Taxes"

* Are you For or Against...? *		
7. Income taxes....?		
Against	For	Undecided
45%	51%	4%
8. Expenditure taxes....?		
Against	For	Undecided
54%	36%	10%
9. Selective taxes....?		
Against	For	Undecided
28%	69%	3%
10. Property taxes....?		
Against	For	Undecided
48%	45%	7%
11. Withholding taxes....?		
Against	For	Undecided
51%	41%	8%
12. What tax rates do you see....? *		
Progressive	Regressive	Proportional
52%	2%	31%
* 15% of the sample were undecided.		

Table 6.5

"The Ranking of Tax Sorts Preference"

	For	%	Against	%
<1>	Selective	69	Expenditure	54
<2>	Income	53	Withholding	51
<3>	Property	45	Property	48
<4>	Withholding	41	Income	46
<5>	Expenditure	36	Selective	28

for the other two types -property and withholding- respondents were undecided about the matter and the decision here was split between approval and opposition. The researcher is inclined to ascribe attitudes toward selective and expenditure taxes to income levels and financial notions allied to the previous discussion, while attitudes toward property and withholding taxes could be a reflection of the unfamiliarity of these concepts.

As far as tax rate preference is concerned, responses to question 12 supported the proposition that income and tax preferences are -to a certain degree- linked to each other, or in other words are dependent on each other. Nevertheless, this proposition was not widely supported by all the sample, since this relationship between income and tax rate preference is not always true. 52% of tax supporters preferred progressive taxation, but of these, only 28% were of low income level. Therefore, the view that low income people tend to accept more progressive tax rate while high income persons prefer the opposite is not always valid.

The above discussion suggests that tax legislators in Kuwait when constructing a tax formula may assess the following:

- 1> An effective strategy to encourage saving and to curtail unproductive consumption;
- 2> A suggestion of adopting a tax scheme in accordance with the table 6.5 order.

In fact, some sort of selective tax will be adopted within the coming tax codes similar to what has been concluded. In an interview with the director of the tax department, he pointed out that;

"The new tax preparation is more likely to be enforced on specific corporations and enterprises than individuals. It is also a considerable possibility that only foreign enterprises will be liable to pay taxes while indigenous companies will be exempted from paying taxes.."

- 3> As to attitudes toward taxation, despite the fact that the majority of pro-tax respondents were of low income level (65%), this does not indicate that the other brackets were against it (the other 35% of the supporters were of high income group).

The succeeding section is an examination of any possible relationship between income brackets and the attitudes toward taxation through a hypothetical testing approach.

## 6.5 Data Analysis

### 6.5.1 Mean Analysis

In order to perform the mean analysis test, the sample had to be classified into the following;

- High income (X)<sup>1</sup>,

- Low income (X)<sup>2</sup>,
- Concerned people - in tax & financial affairs(X)<sup>3</sup>,
- Less concerned people - (X)<sup>4</sup>

The information required to test the null hypothesis is provided in Table 6.6. From the above table and applying formula (2) above, we can arrive at t - the computed t -, as the following;

Table 6.6

"Testing The Public Attitudes"

The Variable (X..)	Expected Mean	Observed Mean * ( $\bar{Y}$ )	# of Observations ( n )	Standard of deviations ( S )
High Income 1 (X)	2	2.61	97	.64
Low Income 2 (X)	2	2.28	129	.71
Concerned 3 P. (X)	2	2.49	113	.63
Less Conce- 4 rned P. (X)	2	2.53	102	.82

\* Obtained through formula (1) above, and a statistical computer programme (Statistical Package for Social Science - SPSS).

1> High income (X)<sup>1</sup>..

$$t = \frac{\bar{y} - o^u}{s / \sqrt{n}}$$

$$t = \frac{2.61 - 2}{.64/\sqrt{97}} = 9.38$$

Comparison of this computed  $t$  with the critical  $t_a$  at a .05 level of significance, will yield a decision to accept or reject the null hypothesis. This critical region is usually expressed as  $Z$  in most statistical text books and found under tables of standard normal distribution areas.\*

If we know that  $Z (.05) = 1.65$ , then it follows:

$$H_0 : \mu_0 = 2$$

$$H_1 : \mu_0 > 2$$

Since  $t > t_a$ , then the null hypothesis is rejected where the mean test of this group is greater than 2 indicating that they are in favour of tax imposition. Similarly,

2> Low income brackets  $(X)^2$ ..

$$t = \frac{2.28 - 2}{.71/\sqrt{129}} = 4.479$$

If  $t_a = 1.63$  (a = .05)

$$H_0 : \mu_0 = 2$$

$$H_1 : \mu_0 < 2$$

The null hypothesis is rejected at a .05 level of significance, and the observed mean is also greater than the expected mean which support the proposition that low income people are also in favour of taxation.

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\* in the present case the text referred to was of Paul Hoel and Raymond Jessen, "Basic Statistics for Business and Economics", John Wiley & Sons, Inc., N.Y., 1971).

3> Concerned people (X)<sup>3</sup>..

$$t = \frac{2.49 - 2}{.63/\sqrt{113}} = 8.26$$

If  $t_a = 1.67$  (a = .05)

Again the null hypothesis is rejected here, and the mean test is also proved valid, indicating that this group is also in favour of tax imposition.

4> Less concerned people (X)<sup>4</sup>..

$$t = \frac{2.53 - 2}{.82/\sqrt{102}} = 6.527$$

If  $t_a = 1.79$  (a = .05)

The null hypothesis is rejected and the mean test indicates a favourable attitude of this group toward taxation.

### 6.5.2 Chi Square Analysis (X)<sup>2</sup>

Applying formula (3) provided above, the  $X^2$  for data of the high and low income groups (Table 6.7) can be computed. The table is the contingency table - frequencies of the two groups tax attitudes and its dependence on the level of income.

Since the computed  $X^2$  (24.981) does not fall within the 5 percent critical value of  $X^2$  at  $df = 2$  (5.99147), then the decision rule here is to reject the hypothesis of possible independence between income level and attitudes, which is a significant result.

Table 6.7

"Respondents Contingency Table of Income and Attitudes Toward Tax Introduction"

Attitude Group	With	Against	Undecided	Total
High Income	74	51	17	142
Low Income	91	61	6	158
Total	165	112	23	300

$$* df = (r-1) (c-1) = (2-1) (3-1) = 2$$

$$X = \frac{2}{91} \frac{(74-91)^2}{61} + \frac{2}{61} \frac{(51-61)^2}{6} + \frac{2}{6} \frac{(17-6)^2}{6} = 24.981$$

Therefore, the two variables (income & attitudes) are dependent on each other, indicating that income affects respondents' attitudes. Moreover, the accepted fact that the low income group tend to select progressive tax rates while high income persons favour the opposite is yet to be verified by future studies (i.e., larger sample, more classified groups, considering other factors like age, job, type of education, etc.).

Additionally, it may be concluded that educational background also has some influence on the respondent's tax rate selection. In this research, only those participants who were tax-oriented (or had vested interests in tax) were identified as concerned people (X)<sup>3</sup>. Nevertheless, it is observed by comparing the standard deviations of all groups



that the variation among the less concerned group (X)<sup>4</sup> is greater than among the rest of the groups (S =0.82). This variability points to the proportional inconsistency in this group's responses.

#### 6.6 Tax Provisions

In response to the inquiry regarding the reasons for favouring taxes (question 13), the following purposes and related percentages were obtained:

The Purposes -----	Percent -----
- Sharing citizenship responsibilities	27%
- Redistributing income & wealth	18%
- To enhance the government budget	27%
- Sustaining other sources of finance	19%
- Resembling social values	9%

In addition, other objectives for preferring taxes were indicated by respondents, such as the use of taxes as an economic control tool, the rationalisation of public expenditure, to direct investment plans toward optimality, and as a religious Zakat system (see chapter 2 - 2.3.5). Suggestions for adopting the Zakat, in particular were emphasised by many respondents, and it was given a higher priority than any sort of taxation. For instance, one respondent said:

"Zakat ought to be enforced at this time and it will totally substitute the need for taxation, if it is truly applied".

Another one stated,

"I accept paying taxes only when there is a need for it, which should be of an Islamic nature in the sense that it

serves the public interests. Thus, to fulfil this task, the government should first start developing more effective means for collecting Zakat which best serve the present needs".

Although a high portion of the respondents believed that any tax scheme should be directed toward generating government funds, 91% of them demanded pre-conditions before the execution of such a scheme. These conditions are to secure a control system on public spending and expenditure, to provide an adequate and fair tax system, and to ensure the independence of the tax authority or the body responsible for implementing the tax strategy. These notions were derived from participants' remarks such as:

"It is impossible to impose taxes now where there is no parliament to supervise the implementation of such legislation";

"Before we think of introducing taxes, we have to appreciate its difficulty. It is always the low income people who suffer from its enforcement, while, because high income brackets are the most influential persons, they evade it with so many means";

"The Kuwaiti citizen will not comply with any sort of taxes, unless he is assured of their best utilisation";

"Any objection to tax imposition is likely to stem from the fear of its unfair application, and harsh economic consequences".

Among those respondents who agreed on the establishment of a tax authority, 72% demanded total independence for this body. This finding suggests that for a tax policy to be successful, a fully independent, self-regulating tax administration seems to be a priority.

## 6.7 Effects of Tax on Business Development

Two questions (16,17) were designed to evaluate the effect of taxes on the business environment in Kuwait at present and in the future. Generally, responses to these questions reflected respondents lack of awareness of the tax policy role in investment decisions. However, as noted earlier, more than half of the respondents were not aware of any influence of the absence of taxes on people's prosperity (54% against, 40% with). In other words, even within the enforcement of a tax system, financial funds will be available to be disposed, regardless of any tax restrictions or regulations.

However these replies were declared within the enforcement of the present tax law, which is of no influence on investment and people's welfare currently.

For example, participants were asked to specify the degree of effects tax has on investment decisions. The majority of respondents viewed the absence of taxes as an encouraging incentives for investors, but they varied in their estimation of its significance. In percentages, 46% of the sample considered it as important "sometimes", and 32%, 9%, 7%, 6% indicated it is important "often", "always", "seldom", and "never" respectively.

## 6.8 Evaluation of Present Tax System

Question 18 (A) was to investigate the sample's evaluation of degree No.3, while part (B) was designed to assess the tax administration. Respondents, in general,

appeared to consider the decree very simple and felt it ought to be replaced by new legislation. More than 60% of the respondents indicated that the law is simple and in some cases they went far in underestimating its existence. Another 32% of the sample indirectly support this view for they answered with "do not know", which indicates two points:

- 1> That the law is not known by a high percentage (32%) of the sample (even though the sample was biased toward tax experienced people). Some comments indicated this problem;

"Even though I know very little about the decree, I do suggest a massive campaign to introduce the public to this important subject, and I prefer this kind of questionnaire to be adopted by the tax administration";

- 2> The legislation itself lacks strength or its enforcement is poor. The director of the tax department himself admitted that;

"Although the decree is somewhat comprehensive and has some positive articles, i.e. the tax rate article, the decree is very primitive in many aspects and has multiple shortcomings".

Similarly, in an interview with Adel Nour (The Auditing Bureau Senior tax inspector and controller), he evaluated the decree thus:

"It is natural to observe many large holes in the decree, for it did not exceed a few pages and was not supplemented by an explanatory deed. This weak fabrication of the decree made it completely ignored by the public as well as by some state departments. Strangely, one of the ministries signed an agreement with a contracting company, that consisted of an exemption article from paying taxes by this taxable company, which clearly neglected the decree's enforcement. This indicates that even among some government agencies, the decree is ignored".

Only 6% of the sample believed that the decree is complicated, and the researcher believes that this small group might have looked at the law from a specific viewpoint or perhaps did not distinguish between the regulation itself and the performance of the tax department.

On the other hand, 40% of the respondents believed that the tax department at the Ministry of Finance has limited experience in taxation and still lacks many necessary skills. Unfortunately, some people were completely unaware of the tax department existence and responsibilities.

* Evaluating the capabilities of the tax department *			
Lacks of Experience	Need more Experience	Qualified Enough	Highly Skilled
12%	40%	14%	--
"Do not know responses were 34%".			

There was a general agreement among the respondents that the tax department is not yet mature and still needs to be developed. The point just discussed was clarified by the tax department's director:

"Kuwait tax administration is only 7 years old in the sense of being an organised, well established government department. Before 1981 it was only a division of the budgeting department with just 2 employees in charge, but now it is an independent department operated by more than 21 well educated accountants in addition to 10 other capable staff".

Nevertheless, the same director admitted that;

"Only 50% of the department's work is completed and efficiently inspected, whereas other important tasks totally fall short in the department, like conducting empirical studies and research projects".

Similarly, Mr. Nour reported twin shortcomings, saying:

"One can say that the tax department satisfactory organisational structure is not accomplished yet and any improving strategies should consider the formulation of a solid accounting base of its inspectors, to perfectly serve at this vital administration".

In support of his view, he further mentioned;

"The 1981 proposed tax plan is an obvious example where the Audit Bureau was invited to participate in such legislation and without extreme exaggeration, I can tell that all the suggestions of the Bureau have been adopted, except a few alterations contributed by the tax department".

It is also worth mentioning that a relatively large number of respondents were concentrating on a specific type of default in the department, that is the naive procedures the department adopts in collecting tax dues. Over 11% of the participants presumed the low tax collection ratio to be a result of the department's mis-conduct. Also, most of them doubted that the tax administration is serious in collecting taxes and in maintaining efficient follow-up procedures.

Results of replies to question 19 support the poor evaluation of the decree. A relatively large percent (30%) of the sample who knew very little about the decree's incentives. The most probable judgement is that the decree lacks adequate incentives for businesses development, and

the incentives provided are worthless or inefficient.

* Evaluating the Decree's tax incentives *		
Encouraging	Moderate	Discouraging
19%	10%	41%
"Do not know" responses were 30%.		

It appears from the above that a massive media is most needed to engage people in tax introduction. This need has been foreseen from some respondents' comments:

"It is thought that the Kuwaitis will reject even the discussion of the subject because of their ignorance about the taxation, therefore the educational process should precede any tax imposition to guarantee its acceptance".

Also, by another respondent;

"I doubt that a large percentage of the population will support any tax regulation in the country, unless it has been notoriously prepared for by dense media".

#### 6.9 Tax Reformation

In response to question 20 "Do you agree on tax reformation in Kuwait ?", 74% of the participants responded positively, whereas only 8% opposed such a proposal and 18% gave no opinion.

* With or Against the reformation of Kuwait tax Laws *		
With	Against	Undecided
74%	8%	18%

Those 74% approving reformation were asked (question 21) to indicate the type of taxes they believed most suitable. Their replies are shown in the following percentages;

1) Capital gains tax	32%
2) Property Tax	21%
3) Income tax	19%
4) Sales tax	16%
5) Withholding tax	12%

The order of percentages supports to some extent the order concluded from the tax preference inquiry (questions 8 to 11). These percentages also reveal a desire that the inequality in income and properties should be lessened by means of certain types of taxes such as the first three selected items. Withholding tax, on the other hand, was not favoured even though it help to reduce such inequality. This result may indicate that respondents were not fully aware of withholding tax. In addition some respondents made other suggestions such as the introduction of a Zakat system, inheritance taxes, and expenditure taxes.

Following this inquiry, respondents were asked to affirm the role of taxes ( if enforced ) on 3 areas as follows;

A. The state budget (total respondents = 75);			
Agree (59%)	Disagree (30%)	Undecided (11%)	
B. Economic rationalisation (total responses = 79);			
Agree (63%)	Disagree (26%)	Undecided (11%)	
C. Redistribution of wealth (total responses = 68);			
Agree (43%)	Disagree (41%)	Undecided (16%)	



It appears that the majority of respondents believed that taxes will play a main role in enhancing the state budget. Many respondents have stressed the importance of rationalising government expenditures. For example:

"Taxes come after expenses rationalisation programmes are implemented, and better public services are provided".

"If something is to be imposed, there should be more constraints on government spending";

"Supporting taxes can be obtained through multiple privatisation programmes of the public authorities as well as government agencies and fairly pricing their service costs";

"First, the government has to tax itself by more effective cuts in worthless spending, then public taxes come";

Also,

"Paying taxes raises the question of the proper allocations of these taxes, and how we make sure that it will be spent in the legal channels".

It is clearly conceivable that unless there are real need and aims for imposing taxes, the legislation will not gain wide acceptance.

On the other hand, respondents were divided equally in determining the role of taxes in redistributing wealth and income. It is interesting to note that some respondents (mostly low income people) believed that any tax introduction will be opposed by the high class and wealthy people, and since they can influence the government's decision, it is possible to employ the policy towards protecting their interests, including maintaining current levels of wealth and earnings.

Additionally, other purposes for tax enforcement were mentioned by the respondents, such as;

- 1> Contributing in the reclassification of some social values (the development of charity establishments);
- 2> Correlating between taxes and the construction of all Islamic activities (the orphanage establishments and health care programmes);
- 3> The reduction of immigrants;
- 4> Reducing illegal trading.

Although these suggestions are possible and have some value, however, the tax role in enhancing the state budget seemed to be the most prevailing object at present.

#### 6.10 Tax & Accounting

In question 24, participants were asked about the importance of taxes in significantly developing the accounting profession. The majority of respondents (90%) replied positively to this question. Moreover, over 40% of the sample believed that the current tax regulation is totally inefficient in advancing the accounting profession in the country. Respondents could have based their opinions upon the poor enforcement of the degree, lack of co-ordination with accounting firms, and the weak status of the accounting profession itself. More than 31% of the respondents indicated no opinion, while less than 30% esteemed that the present codes do contribute in this regard (Table 6.8). Of the last group, 47% of them left the last question (26) unanswered, whereas 29% conceived this influence as proportionally important, 22% stated it is

important, and 2% saw it as not important at all. These percentages indicate that the present regulation is not playing its assumed role in the advancement of the accounting profession, nor it is counted as having one within this context.

The tax department director himself argued for more co-operation from the accounting establishments and firms to enhance local tax application. He also indicated;

"only 75% of the accounting firms are fully co-operative with the department, while the rest (25%) are not, thus we treat them accordingly".

Likewise, Mr. Nour made similar observations:

"There is supposed to be a momentous link between the accounting profession and the tax administration, nevertheless this link is indeed missing within the application of the present tax law".

Table 6.8

"The Impact of Taxation On Accounting"

* Taxation will enhance Kuwait Accounting profession *		
Agree	Disagree	Undecided
90%	5%	5%

* Taxation -at present- is an important element in Kuwait Accounting regulation *		
Agree	Disagree	Undecided
28%	41%	31%

### 6.11 Summary

The statistical tests adopted in this chapter revealed that income and the educational background of the person contribute significantly to the formulation of his attitudes toward taxation. In addition to income, the objects and uses of taxes, and the effective control over government spending significantly affect people attitudes towards tax introduction.

The findings showed also that most respondents support taxation, for it is a way;

- (1) to share public responsibilities;
- (2) to enhance the government budget;

Unfortunately, the weak fabrication of the law has even affected the awareness of people its regulations, a phenomenon that is observed even among concerned and well educated people. The decree's incentives were also poorly appraised by the respondents in terms of promoting investments. Thus, tax reformation seems to be appropriate and could include Sales, income, and capital gains taxes.

Finally, the positive expectations of the correlation between tax and accounting will be further investigated in chapter 8.

*Chapter Seven*  
*"Foreign Investors"*

**7.1 Introduction**

The second questionnaire of this study was designed to ascertain foreign investors' attitudes toward the reform of taxes in Kuwait. This attempt completed part of the empirical investigation related to local taxation and its impact on international investment in the country. Indeed, Kuwait's tax law is derived from international jurisdiction, for its existence arose from the efforts of multinational oil companies to avoid double taxation.

Consequently, this chapter seeks to investigate:

- 1> The impact of taxation on investment decisions ?
- 2> The role of tax incentives in promoting foreign investments in Kuwait;

**7.2 The Questionnaire Design**

The method of inquiry adopted here was a questionnaire (Appendix B) together with a number of interviews. The questionnaire was administered by post during January / March 1988. Nine of the responding firms were interviewed subsequently with a view to obtaining:

- 1) Clarification of expressed views;
- 2) Further information on:
  - A. The effects of tax on firm's decisions;
  - B. The impact of tax on accounting practices.

The questionnaires consisted of 6 sections covering 10 pages, with an introductory cover, and a blank page for additional comment at the end. These sections and contents

as well as its arrangement are shown in Table 7.1 below. Confidentiality of respondents' replies was assured in advance, and they were advised that their further comments would be respected also. Moreover, a certified letter from Kuwait University - College of Commerce - was obtained to support the appeal for full co-operation with the researcher.

**Table 7.1**

**" Foreign Investors' Questionnaire Design"**

Section No.	Title	No. of Questions	Its Sequence
1	General Data	7	1 to 7
2	Tax & Investment	5	8 to 12
3	Kuwait Tax Laws	6	13 to 18
4	Tax Incentives & Incidences	9	19 to 27
5	The Tax Administration	5	28 to 32
6	The Accounting Profession	3	33 to 35

**7.2.1 The Sample**

The sample of respondents was obtained from the trade directories - foreign companies and establishments - as well as from the tax department's files. Given the lack of familiarity of these people with question-based research as well as the sensitive nature of the subject matter, it was decided to distribute part of the questionnaire with the tax department's full assistance (their personal contact) to achieve satisfactory replies.

After several meetings with the department's officers, two groups of foreign firms were listed. Namely, the tax department list (firms that had good relations with the department), and the mail list (firms which had had more than 3 disputes with the tax department). A total of 60 copies of the questionnaire were produced (30 copy among each list).

### 7.3 The Empirical Investigation - Analysis of Responses

Within two weeks of posting the questionnaire, responses started to flow in. Arrangements were also made to visit the tax department every Thursday (beginning from the third week of January) to collect responses received from the first group. The total number of received responses from group (1) was 19 (63% response rate), and responses from group (2) were 11 responses (a response rate of 37%).

#### 7.3.1 General Data

#### 7.3.2 Preliminary Data

Information obtained in regard to the main activities of the respondents, the residence or registration of the firms, their working life in Kuwait, form of organisation, and capital employed (the size of the firms) is summarised in Table 7.2 below.

Given the formal structure of responding firms, it appears that limited liability establishments constitute the majority of foreign firms in Kuwait. Almost 75% of the sample were businesses of this type, which raise the

possibility of promoting individual partnerships and other sorts of businesses through the tax policy.

Table 7.2

** General Data of Foreign Investors in Kuwait **			
-----			
1> Type of investment..			
Engineering (18%)	General Trading (25%)	Construction (39%)	
Industrial (7%)	Chemical Manufacturing (4%)		
Consulting (5%)	Others (2%)		
2> Country of residence or registration of business...			
U.K. (21%)	Japan (17%)	Korea (10%)	USA (17%) Germany (4%)
Italy (6%)	France (5%)	China (9%)	Others (11%)
3. Commencement of Business			
Over 30 years ago	Between 10 & 30 years ago	Between 5 & 10 years ago	less than 5 years ago
23%	44%	18%	12%
* The remaining (3%) were of blank responses.			
4. Form of organisation			
a. Public Ltd. liab. co. [27%]	b. Partnership [ 0 ]		
c. Private Ltd. liab. co. [41%]	d. Public sector body [25%]		
e. Individual proprietorship [ 0 ]	f. Others... [ 0 ]		
** Left replies 7%			
5. Capital employed ( value of total assets KD 000 )			
a. > 100 [7%]	b. 100-501 [14%]	c. 501-2,500 [5.6%]	
d. Over 2,500 [49%]	(blank replies 24.4%)		

A notable feature of the obtained percentages is the size of firms operating in the country. More than 24% of the sample left this question unanswered, while the majority of respondents (49%) stated that the value of



their assets exceeded KD 2.5 million. Although this figure is large enough to reflect the amount of revenue these firms may realise, still a large portion of the sample has refrained from replying to this inquiry, perhaps because of its sensitivity. The amount of tax payable on revenues is sometimes assessed according to the size of the firm, its reputation, and field of operation, especially in cases of disputes with the tax department. Thus, it was to be expected that many respondents would be unwilling to declare their financial situation so openly, particularly in the case of a survey supported by the tax department.

### 7.3.3 Organisational Objectives

Maximising profit was the most popular objective (86%) followed by maximising employee welfare (57%) and maintaining a going concern (43%) respectively. Maximising the value added of the firm and owners' wealth figured as subsidiary objectives (Table 7.3).

Although these objectives were marked as important in the firms' policies directed toward maximising the market share, however, these subsidiary objectives were given priority over the market strategies. Few respondents added items to the list of objectives provided in question 7. The ranking of picked alternatives in question 7 does not correspond to the original ranking of these alternatives in the question. This may indicate that respondents have chosen items from the list which most closely reflect their own goals, rather than picking unarticulated objectives.

Table 7.3

<b>** Foreign Investors Organisational Objectives **</b>		
<b>-----</b>		
<b>Questionnaire List</b>		<b>* Ranking *</b>
<b>-----</b>		<b>-----</b>
a. Maximising profit	86%	[1]
b. Maximising owners' wealth	14%	[5]
c. Maximising market share	3%	[6]
d. Maximising value added	28%	[4]
e. Maximising employee welfare	57%	[2]
f. Maintaining a going concern	43%	[3]
<hr/>		
<b>Respondents Additions</b>		<b>No. of References</b>
<b>-----</b>		<b>-----</b>
g. Diversification		4
h. Product Quality		4
i. Preserving a good reputation		3
j. Consumer satisfaction		2
k. Assisting in the country's development		1
l. Seeking new inventions		1

#### 7.3.4 Tax & Investment

Generally, respondents supported the proposition that taxation is a problem area, making it difficult for them to achieve their designated goals. This view was expressed by 57% of respondents, and rejected by 41% of them. In order to clarify their views, respondents were requested to indicate the impact of tax on their investment plans (Q. 9). The results of this inquiry are given below:

Q. Is taxation a problem area...?		
Yes [57%]	No [41%]	No opinion [2%]

Q. Is Kuwait taxation a significant consideration in deciding to invest or not ?				
Always	Often	Sometimes	Seldom	Never
43%	26%	0%	29%	2%

Nearly 2/3 of the respondents considered local taxes a problem, whereas a small percentage of the sample indicated little or no influence of taxation on their investments. Table 7.4 tabulates the difficulties which confront foreign investors in Kuwait.

Table 7.4

*Difficulties that confront foreign investors in Kuwait*							
	(Low) R a n k i n g (High)						
	1	2	3	4	5	6	7
a. Political uncertainty	14%	13%	5%		2%	29%	
b. Government administrative routine	2%	7%			29%	34%	
c. Import control	30%			4%	11%		
d. Scarcity of various labour skills	27%		12%	13%		27%	14%
e. Currency exchange controls	28%	10%					8%
f. Labour relations	21%	9%		10%	15%		

Among these difficulties, the scarcity of various labour skills and government administrative routines were recognised as the major difficulties in Kuwait. The ranking

of these difficulties is shown below.

* Ranking of difficulties magnitude *					
a.	b.	c.	d.	e.	f.
3%	41%		11%	2%	
- The rest were blank replies.					

Government administrative routines were seen as the most noticeable obstacle (41%) toward achieving the firm's goals. Scarcity of skilled labour was the next most troublesome difficulty faced in Kuwait (11%). It is worth noting, however, that a considerable percentage of the respondents (37%) refrained from answering this question, perhaps due to;

- 1) Environmental constraints (e.g., people who work in industries perceive import controls as more important than labour relations);
- 2) The organisational objectives (priorities);
- 3) Characteristics of the firm (size, involvement, etc.)
- 4) The firm's relationship with government agencies including the tax administration.

Responses to the relationship between these difficulties and taxation suggested the following results (table 7.5);

- 1) Tax problems confronted in Kuwait are generally more important than other problems except for government administrative routines and the scarcity of skilled labour.
- 2) Although Kuwait's taxation is based on very limited regulations, and despite the recent organisation of enforcement, respondents viewed the tax burden as more serious than the political instability of the country. Perhaps because Kuwait is politically perceived stable market.

- 3) Taxation is linked with other difficulties (e.g., government intervention of one sort or another, the tax incentives given only to national firms, the fees and duties on certain foreign imports).

Table 7.5

** Taxation V Difficulties in Kuwait **			
Compared with =====	Taxation is =====		
	More important Problem	Equally Im. Problem	Less Im. Problem
a. Political uncertainty	35%	48%	17%
b. Government administrative routine	31%	22%	47%
c. Import control	52%	31%	9%
d. Scarcity of various labour skills	34%	37%	15%
e. Currency exchange controls	47%	32%	7%
f. Labour relations	54%	28%	3%

However, there was general agreement among most of the participants that local taxation is a major element in their investment plans. A question may be raised here concerning the reasons for such variation in experiences among them. More than 50% of the respondents always or often find Kuwait taxes a significant factor in their plans, while about 30% of them seldom or never do. Subsequent interviews with some of the respondents suggested possible explanations:

1) Tax considerations are sometimes excluded from companies' policies due to the insignificance of taxation in the decision process and not because companies do not encounter the impact of taxation. For example, investment decisions may be based on some variables which can lessen the effects of taxation on the pre-tax profit, or the attainment of a given profitability is not a priority, as revealed by some respondents;

"Certainly taxes would be a consideration, however it is not a main one. It comes along the line".

"We arrange our calculations to perfectly fit the tax situation in Kuwait. When we first came here we had all the tax consequences in mind, but this was not the end of the line. The main inhibition was the fear of low demand on our products".

"Even if you have to pay taxes, it works out well on your accounts because of the provided privileges and the gained goodwill.. Also, despite the importance of a good return on employed capital, that could be arranged concurrent to tax allowances and incentives provided".

2) The other suggestion relates to firms operating in certain fields of high demand, like high technology or manufacturing and chemical industries. Taxation has been taken in such projects appraisal as a stable environmental variable, resulting in a lack of sensitivity to variations in taxation, which also are not normally reported.

3) A third explanation relates to those investors who have their tax matters arranged with greater concerns. They see themselves as having a greater degree of flexibility in

choosing locations for and methods of investments. A manager in general trade company interviewed indicated:

"Generally, tax in a host country - particularly a developing one, so to speak Kuwait- is not a reason for going into a country. But rather it can very well be the reason for not going into it."

Such companies will not be attracted to invest in a foreign country for its favourable tax conditions alone. Nevertheless, taxes may well attract foreign investors to come into a country as opposed to another market.

In Kuwait, however, it appears that most foreign investors are searching for high yields. Consequently, whatever influences their returns would be their concern, including taxation.

### 7.3.5 Evaluation of Kuwait's Tax Laws

#### 7.3.5.1 Present Regulations (Decree No.3 /1955)

Results of the survey show that foreign investors believe the local tax burden to be too high in comparison with regulations in their homelands. Only 15% of the respondents believe that the burden is moderate, while no response suggested that the burden is low (Table 7.6).

Normally, replies to such an inquiry would be overstated especially if coming from the people most concerned. Foreign investors tend to avoid markets where their profit margins are chopped by tax obligations, although they maintain the right of double taxation reliefs. In this sense, the manager of a foreign firm has indicated that;

"..The question of tax burden is of a known answer. Relatively, the comparison

between taxes paid abroad and those paid to a national government is the judgement element. Being a foreign investor, I would prefer tax payments within host countries themselves, rather than between host countries and homeland..."

Table 7.6

** Tax laws & Administration Evaluation **				
-----				
1. Tax burden:-				
Too High	Somewhat High	Moderate	A little Low	Too Low
43%	42%	15%		
2. Complexity:-				
a. Very simple [12%]		b. Simple [78%]		
c. Complicated [6%]		e. very complicated [4%]		
3. Tax declaration :-				
a. Straight forward [13%]		b. Systematic & organised [8%]		
c. confusing & ambiguous [67%]		d. poorly organised [5%]		
- 7% of the respondents gave blank replies.				
4. Tax department:-				
a. lack of experience [19%]		b. without suitable exp. [52%]		
c. qualified enough [16%]		d. highly skilled [5%]		
- 8% of the participants left this part un answered.				
5. Other aspects :-				
- The language problem...				

In general, for foreign investors, tax in the host countries is lower than in the home land. Respondents could have apprehended the situation in Kuwait in comparison with other developing countries regardless of other related factors, including tax rates in the country of residence.<sup>(1)</sup> Due to the presence of an excessively high taxation at home, investors find Kuwait a tax haven.



Moreover, the presence of overseas taxation will have no effect on the parent company's tax bill unless the average of all overseas tax rates paid on profits remitted exceeds the tax rates effective in the home country. In the case of a U.K. multinational, for example, only profits remitted back to the U.K. as dividends from subsidiaries are subjected to U.K. taxation. Against U.K. taxes, allowances are permitted for all underlying taxes paid abroad on the dividends received. Since profits levels in Kuwait are extremely high, the burden of taxes is considerably reduced. Yet some foreign companies find themselves paying higher taxes because of the rules in their homeland (e.g., Relieving Advance Corporation Tax in the U.K.). This view is derived from respondents comments:

"..Overseas taxes are not a main problem in our case for U.K. taxation has always been high. In fact, in most countries we have been trading in, tax rates were not higher than the U.K. rates. Also, where the host country's tax rates exceed the U.K. rates, we manage very well due to the rewarding profit margin"

Another respondent shared this view:

"..Compared with developed countries, developing markets pay you back a satisfying return on assets. The extent to which you can get relief is, however, our worry abroad. But on the top of that, the profit margin is capable of overcoming such worries.."

In addition to tax relief and other allowances, foreign investors - particularly the multinationals- are in a position, within limits of course, to shift profits between countries via transfer prices policies in order to

minimise their taxes globally. Within the same company or group of companies, four types of transaction may be employed to fulfil that purpose; 1) trading in goods and services among different divisions, 2) selling intangibles like patents or R & D, 3) transfer of funds between affiliated entities, 4) the allocation of headquarters' administrative expenses or management fees over different sections of the company. With the increased volume of international activities between countries at present, those transactions have risen sharply. A respondent stated that:

"..Whenever we feel that our tax bracket is high, we seek to maintain our returns in some way or another. Legislatively, we ask for consultancies or order technical services from our international branches or even local subsidiaries, which are in line with the local tax regulations."

Moreover, foreign firms protect their investment by similar methods such as the utilisation of accelerated depreciations. In order to maintain a generous cash flow, these firms use depreciation accounts as cushions to protect the stability of their cash flow against adverse short term fluctuations or against being absorbed by taxes.

"..So as not to be taken by a sudden cash shortage we tend to keep a very adequate cash flow. Even if it comes to pay surcharge or low delay penalties. it is still better for us than looking for external financing at a killing interest rate".

Over all, it is apparent that foreign investors in Kuwait are realising a good return on their investment. However, there is more or less general agreement among them that local taxes constitute a high burden on them.

Results shown in table 7.6 indicate that the majority of respondents (90%) considered tax decree No. 3 for 1955 a simple one, whereas 6% and 4% of the sample considered it complicated and very complicated respectively. Complexity here relates to difficulties in interpreting its codes and in obtaining definite explanations of various articles open to varied interpretation, particularly those related to the determination of taxable income and the accounts for allowances and other reliefs.

Yet, tax declaration procedures were seen "Confusing & Ambiguous" (67%). This large percentage represents respondents who could not prepare their tax declaration either because they were not fully aware of the regulation requirements for tax declaration, or they had a history of previous disputes with the tax department.

Furthermore, Over 70% of the respondents thought that the tax department has neither adequate experience nor the necessary qualifications to administer the country's tax legislations. These results show the little importance attached by the taxables to the tax department in solving their tax problems. Even though these percentages are based on the views of only one of the two concerned parties, however, the conclusions drawn from these views are not promising in terms of the future capacity of the tax administration in the country to deal with changes in the system. One of the interviewees has said;

"..Among the worst failings of the tax department, the slowness in tax

settlement, the indecision among tax authorities, and the harshness of some tax officials are the major ones.."

Another stated:

"..Other difficulties added to the list arose from the lack of trust between the tax department and the taxables, the differences in the cultural standards, language barriers, and the mentality of treating.."

Some of these difficulties are common features of investment in developing countries, but others are of the investors' own making. Also, some of the difficulties were cited by a group of investors whose opinions reflect their particular interests, since they believe the tax administration is eliminating their prospects.

Responses to tax reformation inquiry yielded the following astonishing outcomes.

* Perceptions regarding tax reformation *		
Yes [83%]	No [ ]	Do not know [12%]
- 5% of the answers were blank.		

The overwhelming majority of people who supported the reformation considered the present codes beyond their aspirations. Clear evidence of this is found in the presence of very few respondents (3) who oppose such reformation, who would have opposed reformation had the present regulations been of great benefit to them.

The anticipation of respondents regarding the coming tax package are ranked in percentages as in table 7.7.

Table 7.7

** Tax Sorts Ranking **	
-----	
a. Income Tax	71%
b. Capital gain tax	17%
c. property tax	21%
d. Sales tax	29%
e. Withholding tax	9%

Income taxes (71%) were the category most respondents wished to see included in the new tax package, followed by sales taxes (21%). These results bear out the early ones concluded from the public responses to the first questionnaire (chapter 6). Income taxes referred to here are comprehensive imposts which apply to corporations as well as individuals, either foreign or indigenous. Perhaps this characteristic of the tax gave it more credibility than other suggested options.

It is noticed that a few respondents disregarded the possibility of enforcing taxes in the country, and even though sales taxes were second in popularity among the tax sorts, a few respondents referred to indirect taxes as a constraint. Similarly to the results concluded from the public responses, it seems that foreign investors are not keen to accept some sorts of taxes such as withholding and ad valorem taxes.

The overwhelming majority (86%) of respondents

expected some impact of tax reformation on business development. In particular, respondents were requested to indicate the effect of tax introduction in Kuwait on specific areas. These areas and their obtained responses were (Table 7.8):

Table 7.8

<b>** Anticipated Effects of Tax Reformation **</b>			
-----			
- Will it have effects on Business Development..			
Yes [86%]    No [1%]    Do not know [3%]    (Blank 10%)			
- Will it have effect on...			
	Agree	Undecided	Disagree
a. Governmental planning	57%	16%	27%
b. Economic control of public expenditure	41%	21%	19%
c. Redistribution of wealth	39%	37%	17%

The majority of respondents acknowledge a tax impact on government planning and control over public expenditure. Respondents were, however, divided in their views of the effect of taxation on wealth redistribution in the country. A high portion of them (37%) were "undecided" on this matter, revealing doubts concerning effectiveness of tax to achieve social benefits allied to the redistribution of income and wealth. Perhaps replies to this inquiry were based on the assumption that income taxes (only on foreign firms) are the type of impositions expected, in addition to their limited enforcement on corporations rather than individuals.

### 7.3.5.2 The Following Amendments

These amendments and following orders were issued by the Ministry of Finance & Economy during the last 7 years. Results to the evaluation of these amendments are produced in Table 7.9 below.

Table 7.9

** Effects of the ministerial amendments and issues on foreign investments **						
	INCENTIVE /			DISINCENTIVE		OTHER COMM- ENTS (IF ANY)
	M A J O R	M I N O R	N E U T R A L	M A J O R	M I N O R	
a. Circular No. (17) for 1983, (Tax declaration requirements)	29%	14%	43%		14%	
b. Resolution No. (206) for 1985, (Requisite Books...)	14%	43%	43%			
c. Ministerial order No. (44) Of 1985 (Subcontracting...)	14%	14%	28%	29%	15%	
d. Resolution No. (103) for 1983 (Assets re-exporting...)	13%	50%	37%			
e. Order No. (5) / 1982 (Allowable administrative expenses)	28%			72%		

The first issue examined was circular No. 17 for 1983. Except for a small percentage of the sample (14%), almost all respondents were satisfied with this resolution. Over 40% of them considered this resolution to be an incentive, while 40% of respondents believe the resolution has had no effect on their businesses. Their position could indicate

agreement with the requirements for tax declaration as stated in the resolution. Others were content with those requirements because they prepare such declarations any how for their financial own and planning control in addition to financial reporting purposes.

Resolution No. 206 for 1985 was generally well regarded by respondents. Over 55% of them saw it as an incentive that assisted them in regulating their firms' commercial and accounting structures. Even the 43% of participants who saw it as a neutral element can be taken to imply satisfaction, because the resolution is beneficial in nature.

Also, it is worth mentioning that these two resolutions have positive influence on firms' operations, therefore, they were evaluated as advantageous. On the other hand, ministerial order No. 44 for 1985 and order No. 5 of 1982 were poorly evaluated by respondents since their effects are contrary to the interest of foreign investors in some respects. For instance, order No. 44 was visualised by over 40% of the sample as a disincentive since their operations can be clearly revealed and their tax liability can be determined more easily.

Similarly, responses to the effect of order No. 5/1982 were parallel to responses to order 44/1985 in that more than 70% of the respondents were dissatisfied with this order. This is natural, since the order specified the amount of administrative expenses in respect of headquarters



allowed to be deducted from taxable income. Foreign investors are better off determining the amount by themselves rather than being restricted to certain allowances.

In contrast, replies regarding resolution No. 103 of 1983 were quite favourable as more than 60% of the respondents indicated benefits from this enactment. A further large portion of them indicated that this resolution at least had neutral effects on their business growth, even if it had not motivated them to employ the full capacity and operational life of their assets in their businesses.

Generally, it could be said that the evaluation of the amendments issued by the Ministry is related to a large extent on the influence they have on the amount of income declared for tax purposes. The more the regulations restrict taxables from reducing their taxable income, the more likely it is that they will be contravened by these taxables.

Regarding foreign investors attitudes towards a list of suggestions (question 18), a large number of them agreed on tax introduction in Kuwait, though they differed in the scale of rates that should be applied (Table 7.10).

Analogous to their previous responses, respondents indicated a preference for income tax introduction that is applicable to every corporate and private company operating in Kuwait (over 32% of the sample considered it an advantage in order to claim double taxation reliefs).<sup>(2)</sup> In Contrast, a large percentage of the participants (77%) considered sales taxes a disincentive factor in their investments. Only

23% of them anticipated favourable effects of sales taxes on businesses in their sector.

Table 7.10

** Foreign Investors Perceptions Toward Some Suggestions **						
	INCENTIVE /			DISINCENTIVE		OTHER COMM- ENTS (IF ANY)
	M A J O R	M I N O R	N E U T R A L	M A J O R	M I N O R	
f. Corporate income taxes (national & foreign firms)	30%	16%	33%		21%	
g. Imposing higher progressive tax rates (45%)	16%		34%	30%	20%	
h. foreign transfers charges (12%)	21%			38%	41%	
i. Dividends taxes (other than ordinary shares)		25%	51%	24%		
j. Reduced rates for public companies (i.e. 35%)	17%	33%	50%			
k. New resident tax (annual exemption of KD20,000)	40%	20%	17%		23%	
l. Sales tax introduction	23%			51%	26%	

Similarly their expectations for the rest of the suggestions were as follows:

- a) A neutral effect from taxes on dividends;
- b) Disagreement on foreign transfers charges at a rate of 12%;
- c) Favourable response to reduced tax rates for public companies;
- d) Rejection of the idea of higher progressive taxes of 45%;

e) Agreement with the imposition of resident tax including an annual exemption of KD 20,000.

With the many concurrent controls imposed by the government, there have been various incentives offered by the state to help develop enterprises. A number of questions were put to respondents in order to explore the effectiveness of Kuwait's tax incentives provided in decree No. 3 of 1955 (Table 7.11).

Table 7.11

"Evaluation of Present Tax Incentives"

	CONTRIBUTION			
	M A J O R	RELA- TIVELY IMPOR- TANT	M I N O R	NEGLEGIBLE OR NO CONTRIBUTION
a. Free trade.....	14%	71%		15%
b. Lump sum depreciation & accelerated allowances.			71%	29%
c. Development rebate on fixed assets...	43%	14%	29%	14%
d. Other investment reliefs			50%	50%
e. Cash subsidies....	18%	34%	13%	35%
f. Guaranteed prices & other services....	17		47%	18%

\*\* Incentives Ranking \*\*

a.	b.	c.	d.	e.	f.
-49%-	-----	-31%-	- 4%-	-----	-----

- 16% Blank replies.

It is interesting to note that among those incentives, respondents found tax incentives offered by the government to be less useful than non-tax incentives. Lump sum depreciation and accelerated allowances were considered by over 70% of the sample of minor importance in the promotion of private enterprises, while in comparison cash subsidies made more contribution as more than half of the sample indicated.

The main business incentive valued by the sample was the free trade state in the country followed by development rebate on fixed assets (40%). Other interesting results were the low value of investment reliefs, and the insignificance of guaranteed prices and other services in the growth of foreign investments. These incentives are ranked according to the relative usefulness and listed in two groups, non-tax related incentives and tax-related incentives (Table 7.12).

When asked to evaluate Kuwait tax incentives, over 70% of respondents regarded them discouraging, and only 29% believed that these incentives are moderate (point 4).

** Kuwait tax laws incentives **						
Encouraging				Discouraging		
1	2	3	4	5	6	7
			29%		14%	57%

These percentages correspond with previous valuation of tax related incentives which showed their poor

usefulness. In this respect, one respondent stated:

"..We would take advantage of those tax incentives, but they would not tip the scale.."

Several others perceived the offered tax incentives poorly:

"..Tax incentives are very important to encourage private investments, however, their feeble usefulness in Kuwait is damaging their theoretical value.."

"..Although changes to these incentives (tax incentives) are common in the country, their effects on our business growth are totally minor.."

"..I do not think tax incentives -especially those related to capital allowances - are effective nor essential in developing countries like Kuwait. It is quite likely that we arrange our growth without any significant consideration to them.."

Table 7.12

** The Ranking of Tax Incentives **	
Offered Incentives	No. Of Responses
1> Free Trade.....	34
2> Development Rebate.....	23
3> Cash Subsidies.....	21
4> Guaranteed Prices.....	7
5> Lump Sum Depreciation.....	3
6> Investment Reliefs.....	1

Type of Incentive	% Of Positive Response
A. Non-Tax Related..	
1) Free Trade .....	85%
2) Cash Subsidies.....	52%
3) Guaranteed Prices..	17%
B. Tax Related	
1) Development Rebate on Fixed Assets.....	57%
2) Lump Sum Depreciation..	8%
3) Other Investment Reliefs..	3%

Not surprisingly, a large number of respondents indicated "No benefit is gained from these incentives", while only 14% of respondents indicated such benefit. Of the minority who benefit from these incentives, the maximum amount of savings reported by respondents was below KD 10,000. Tax savings are a sensitive issue to the sample, which is quite clear from the large number of blank replies on this question (almost 2/3 of the sample left this question un-answered).

Do you benefit from local tax incentives	
Yes [14%]	No [86%]

** How much ... (in annual - KD) **		
-----		
a.<10,000 [29%]	b.< 25,000 [ ]	c.< 40,000 [4%]
d.<75,000 [ ]	e.< 130,000 [ ]	f.< 200,000 [ ]
- the remaining % belong to left replies.		

### 7.3.5.3 Kuwait Taxation & Growth of Businesses

Taxation in Kuwait was seen as a constraint on foreign investment growth as judged from responses to (Q. 24) below.

Q.24			
** Did taxes restrict your growth...? **			
Yes [51%]	No [38%]	No opinion [11%]	

Over half of the sample regarded taxation as a factor discouraging them from achieving the planned level of growth in the last five years. Affirmative responses to this inquiry appears to be conforming with earlier results of this questionnaire (questions 8 to 12), which suggest that taxation was a significant factor in foreign

investment decisions. Tax difficulties were ranked as one of the major difficulties faced by foreign investors in the country (question 12), a result that links with the 51% of the respondents who replied in the affirmative to question 24.

Taxation may not be the biggest problem seen by respondents, although it is a common problem for them. Hence, some respondents replied in the negative, while there was a high number of "No opinion" responses on this matter.

More specifically, 22% of the sample denied any effect of tax on their businesses diversification programmes. This shows the divergence of opinions among foreign investors.

* Did taxation influence your diversification programmes ?			
Yes	[39%]	No	[22%]
Do not know	[18%]	(Blank	21%)

On decisions relating to remittances of profits or the distribution of earnings to proprietors and tax impact on it, 56% of the sample confirmed the impact of taxes, whereas 35% of them denied such influence.

** Is Kuwait's taxation a relevant consideration in your distribution of earnings to proprietors ? **			
Yes	[56%]	No	[35%]
Do not know	[9%]		

\*\* If yes, specify....? \*\*

Very Important Consideration	Somewhat important Consideration	Minor Consideration
37%	21%	39%

- 3% were blank responses.

One of the interviewed respondents considered this impact a restriction which hampered his company's management from conforming exactly with the proprietor's desires. Nevertheless, he appreciated the need for such measures which is widely known in international transactions, and even in many other countries similar restrictions are very difficult to cope with. Of those 56% affirmative responses, only 17% of them considered taxation a very important factor in their dividends policies. Through a certain question directed to five interviewed participants, a somewhat clearer picture emerged concerning the impact of taxes on earnings distribution. It appears that even within tax regulations, foreign investors attempted to minimise their tax liabilities globally by using various policies.<sup>(3)</sup> Among them were;

1> Forming overseas subsidiaries to collect earnings outside the host country. In some legislations, like the U.K. tax legislation, taxes are only payable on dividends received in the country from overseas subsidiaries; thus the creation of foreign holding companies to collect overseas earnings is a useful tax planning device. Similarly, many other countries do not tax the retained earnings of foreign subsidiaries until dividends are repatriated. These allowances have encourage foreign investors to accumulate enormous amounts of funds, especially in low-tax countries (tax havens). In turn, this state has raised various controversial issues surrounding



homeland enforcements to overcome the consequences of this practice, and more importantly, to overcome fictitious operations of transfer pricing.<sup>(4)</sup> One interviewee explained:

"..In order to hold funds, an overseas subsidiary can serve as a vehicle for that purpose..".

2> Share in net income can be paid by the subsidiary to the parent company in forms other than dividends, where the effective tax rates on dividends are higher than those on those forms:

"..Choosing from different types of income distribution is an occasional method meant to provide a level of flexibility in distributing dividends. Presumably, because of the high tax rates on cash dividends we refer to such ways.."

"..Consulting our parent company and requesting technical services are our tax havens, whenever we feel that we are obliged to pay more than we should have to".

3> Taking advantage of some double taxation reliefs for the deduction of taxes and dues paid overseas. It is better for businesses to bring incomes from countries with high tax rates into their homeland as is the case with some U.K. multinationals which employ the U.K. unilateral double taxation relief to deduct their underlined foreign income taxes.

"..It is foolish to bring earnings from free or low tax countries into the homeland (U.K.). While, on the other hand it is not wise not to regard the double taxation relief when paying overseas taxes, when it is lower than your homeland..".

#### 7.4 The Tax Administration

This part starts with another sensitive question concerning respondents' annual tax payments in Kuwait

(question 28), Their responses are shown below.

** Average (annual) tax payment (KD) ? **					
-----					
a. < 10,000	[ ]	b. > 10,000	[ ]	c. > 30,000	[28%]
d. < 100,000	[ ]	e. > 200,000	[13%]	f. < 350,000	[ ]
-Most of the respondents left this part un-answered (59%)					
** Do you see that as " your fair tax liability " ? **					
Yes	[14%]	No	[47%]	Undecided	[39%]

Normally, this type of question is avoided by respondents especially in developing countries, thus it is not surprising to obtain blank responses from about 60% of the whole sample to such a question. This question was planned to serve as an introductory one to the following questions, had there been wider response. An average tax liability could have been derived from positive responses to question 28, followed by an investigation of its fairness as declared by the participants.

Respondents were requested to specify if they had been in a dispute with the tax department before. A substantial number of them answered in the affirmative (86%) which increases the depth needed in attacking this issue. Most of the respondents who had had disputes with the tax department claimed to have had more than three such disputes in 1 to 3 years on the average (Table 7.13).

Table 7.13

*Have you been in a dispute with the Tax department..?*			
Yes [86%]	No	[14%]	
** How often..? **			
Once[15%]	Twice[ ]	3 times[16%]	More than 3[69%]
** Within..... **			
3 Months[ ]	6 Months[ ]	9 Months[7%]	1 Year [38%]
2 Years [ ]	3 Years [22%]	5 Years [ ]	10 Years[33%]

Their disputes were mainly due to disagreement on the accounting practices (47%), and on some tax regulations (32%) or the interpretations of the tax codes (21%). Others added further causes such as indecision in the tax authority, the delay in settling tax liabilities, and the lack of mutual trust between the two parties.

** What was the main disagreement about ? **	
a. legal interpretation	[21%]
b. Accounting practices	[47%]
c. Tax regulations	[32%]

"..The worst part of it is settling a tax declaration where you are faced with demands for tax payments while your cash flow level is getting into the red. All that occurs even before we compute our profits..".

"..We are always mis-trusted when it comes to income determination [the gloomy areas]. On the other hand, we often disregard the words of some tax officials as granted. In most cases, we try our best to communicate with higher officials to solve the problem adequately..".

## 7.5 Taxation & The Accounting Profession

Respondents were asked to indicate the probability of accountancy enhancement in the country correlated to the reformation of tax regulations. The result of this inquiry is shown below.

** Will tax enhance the accounting profession **		
Yes [64%]	No [19%]	Do not know [17%]
** Has the absence of taxation influence your accounting practice in Kuwait ? **		
Yes [28%]	No [48%]	Not applicable [24%]

Comparing the present practices of accountancy and the large number of disputes caused by disagreement on accounting practices, one can conclude that tax regulations at present are falling short in appropriately influencing accounting practices. Foreign investors were not effectively governed nor required by tax regulations to follow certain accounting procedures, as indicated by almost half of the sample, despite the fact that over 60% of the sample believed in such a role for taxation.

Some of the weaknesses in the link between taxation and the accounting profession mentioned by respondents were:

- 1) Tax accounting education and consciousness are lacking and unknown by most taxables.
- 2) lack of adequate accounting pronouncements related to this subject.
- 3) Lack of channels of co-operation between tax authorities and accounting firms locally.
- 4) Shortage of professional guidelines relating to tax planning or technical advice on tax.

## 7.6 Summary & Conclusion

Even though the technique adopted and the findings obtained were useful and illuminating, the sensitivity of the subject under examination associated with the unique status of the respondents -the only taxables in the country at present-, totally reliable replies were not achieved. Foreign firms' managers were very cautious in their responses and were not keen to talk freely about their views on the matter. Wider interpretation of the results is needed here to build sound conclusions (i.e., the evaluation of these results in the light of similar results from other comparable countries, or with results of another sample within the same country - the public and professional establishments). This procedure was chosen to prevent any bias in our findings resulting from foreign investors' reluctance to confide.

Furthermore, it has been reported that this sample supports tax reformation on the basis of two tax types; income taxes imposed on national as well as international entities and individuals, and sales taxes. Foreign investor's views, with respect to tax reformation, coincide to a large extent with those concluded from the public sample responses (Income & sales tax).

One of the main conclusions that can be drawn from this survey is that foreign investors are not attracted locally because of the tax incentives offered, for they were very poorly evaluated. Nor do they appear to leave the country for tax reasons. It is mainly the high profit

margin gained which attracted them. Thus they are motivated to defend their gains from any external threats, and taxes are seen as such a threat.

Another noticeable finding is the greater link assumed between the accounting profession and taxation. In fact, most of the disputes between taxables and the tax authority arisen from disagreements about accounting practices, especially those for tax purposes. The association between the two subjects has been derived from income determination procedures, which is also found to be a major cause of disputes.

The significance impact of tax regulations on the accounting profession could be marked in the following;

- 1) Tax enforcement encourages the maintenance of adequate accounting records and leads to greater compliance with the law at the same time.
- 2) Accountants could locate financial information, clients' services and other advice, minimising areas of controversy with the tax authorities.
- 3) Vigorous application of tax codes requires a fair interpretation and clarification of these codes, and accountants are in a good position to serve this function.

However, these functions cannot come about unless the accounting profession is organised, and accountants are furnished with suitable recognition as intermediaries in tax legislation. This part of the study is discussed in the following chapter.

## Notes

- 1) "Company residence is defined in terms of incorporation (USA, Canada, France, The Netherlands, Germany), however in other legislations it is defined in terms of where the real business is carried on, for the purpose of the income tax, and the real business is carried on where central management and control actually resides". De Beers Consolidated Mines Vs. Howe (1906) Appeals court, p. 455-458. [Al-worth S. J., "Taxation and The Financial and Investment Decisions of Multinational Firms"; unpublished D.Phil Thesis, Exeter College, 1984.p. 30.] Quoting Tiley, John & Hayton, David J., "Capital Transfer Tax"; Butterworth, 2nd Ed., 1978, p.789]. Determining the residence of the country implies that a company is taxed on its world-wide income by the country of residence. Unilateral relief (or Double Taxation Agreements) are however, provided against taxes on foreign income. These privileges are mainly planned to lessen the taxing power of the residence country by excluding like earnings or by applying foreign tax credits.
- 2) Basically, the ultimate tax burden on foreign earnings depends on the system of double taxation relief offered in the home country. But it could be one of five forms. These forms are; 1) credit without deferral, 2) credit with deferral, 3) exemption, 4) deduction without deferral, 5) deduction with deferral. The prevailing methods of double taxation at present, however, are the first three forms, whilst the later two methods apply to wealth taxes and withholding taxes on interest income (if no treaty is signed between the two concerned countries).. The third form (an exemption) is occasionally most preferred as illustrated in the attached table. see Al-Worth J. S., op. cit., pp. 23-30. Model Double Taxation Convention on Income and Capital, Article 23, OECD, 1977.
- 3) The importance of these tax policies is derived from the degree of freedom available to the multinational firm for minimising its tax liabilities which is related to the tax policy it pursue. Naturally, this degree of freedom is more flexible in the case of a multinational firm than a firm operating in a single country. "Casual empirical evidence suggests that taxation is amongst the most important factors accounting for financial arrangements peculiar to multinational companies, such as financial subsidiaries residing in tax havens."... Al-Worth J. S., op. cit., p. 115.

- 4) Transfer price levels are generally affected by several factors. These factors as stated by AL-worth J. S., op. cit. [quoting Lessard Donald (1979)]:-
- A. Formal barriers to free international transactions (i.e., exchange controls on funds movement, restrictions on nationality of investors, etc.).
  - B. Informal barriers to international transactions (i.e., information costs, transactions costs, traditional investment pattern..).
  - C. Domestic capital markets imperfections (i.e., mandatory credit allocations, ceiling on interest rates, limited legal protection for minority shareholders..).



\*\* Options of Double Taxation Reliefs \*\*

I T E M	C	A	S	E	S
	[ A ]	[ B ]	[ C ]	[ D ]	
1> Corporate- Source Income.....	100	100	100	100	
2> Income Tax on Subsidiary income -Source (40%)	40	40	40	40	
3> Subsidiary Net Income... ( 1 - 2 )....	60	60	60	60	
4> Parent Taxable income...	100	100	0	100	
5> Parent income tax... ( 60% X <4>)	60	60	0	36 *	
6> Foreign Tax Credit...	..	40	..	..	
7> Total Corporate Taxes... [ ( 2 + 5 ) - 6 ]	100	60	40	76	

**Assumption:**

1) Source-country income corporate tax (40%) & Residence-country corporate tax 60%.

[\*] ((100-40) X 60%)

2) Cases:-

[A] = No double taxation relief.

[B] = Foreign tax credit is permitted in residence country

[C] = Foreign income is exempted from residence country tax

[D] = Tax paid in source country is deductible in residence country.

Additionally, the following assumptions are given for most of them are relevant to most multinationals operating in Kuwait.

1. There are no separate dividends or personal taxes in Kuwait and some homeland countries.
2. All profits are distributed.
3. The multinational firm is either wholly owned or a branch of the parent company.
4. Homeland tax rates are higher than rates in the host country.
5. Home country recognised the host country's tax base.

*Chapter Eight*  
*"Accounting Firms"*

**8.1 Introduction**

This chapter begins by discussing the research approach used in looking at the link between accounting and taxation in Kuwait. It then examines the results of the survey conducted through a questionnaire distributed among the local accounting firms. This survey examined the accountants' work today and investigated the extent to which their work involves taxation. Of course this stage sought to determine their evaluation of the current tax decree and its enforcement, in addition to their anticipations of the future correlation between the two subjects.

**8.2 Research Objectives & Approach**

The principal objectives of the survey were:

- 1> To explore tax influence on the accountants practice;
- 2> To seek perceptions of local accountants toward the effectiveness of tax decree No. 3 and its imposition;
- 3> Investigate the role of accountants in tax reformation.

The initial methods of research adopted here were questionnaires, together with multiple interviews. The first technique was selected because of its popularity as a data gathering mean at little time from respondents, as Miller observed:

" In the competition for their time, respondents increasingly examine the purpose of the study, the sponsorship, the utility of the findings to them, the time required to fill it out, the clarity and readability of the type, and,

perhaps, the quality of the paper". (\*)

A supporting letter from the University of Kuwait addressed to accounting firms was obtained. Names of licensed accountants were also obtained from the Ministry of Commerce & Industry on December 7th, 1987. The list obtained contained 39 accounting firms which are permitted to practice the profession in Kuwait. 25 offices of those firms (64%) were contacted personally on December 22nd, 1987, while the remaining firms were sent a copy of the questionnaire by post (19/12/87). Through personal contact, 14 offers of interviews with accountants represented in the sample were secured. 11 of them were interviewed at an agreed date, whereas 3 of them were unable to spare the time.

The accounting firms' questionnaire (Appendix C) was designed to reveal information concerning two main areas; Kuwait's current tax laws and its association with the local accounting system. Thus the structure of the questionnaire was formulated to fit those areas (table 8.1).

### 8.3 Response Rate

The reasonable response rate decided here was a conjectural minimum of 35% (or at least 14 responses). In general responses to mailed questionnaires are typically low, and in most cases fall to less than 50% of the examined sample.

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\* Miller D. C., " Handbook of Research Design and Measurement"; 3rd. Ed., New York, Mc Kay, 1977, P. 73.

Table 8.1

"The Design of the Accounting Firms' Questionnaire"

Part	Subject	# of Questions	Their Sequence
1	General Data	5	1 - 5
2	Kuwait Tax Laws	7	6 - 12
3	The Tax Administration	6	13 - 18
4	Tax & Accounting Profession in Kuwait	18	19 - 36

" It is quite surprising that results have been presented where response rates have fallen as low as 20%" (\*)

In this study, the response rate (64.1%) was good, above the anticipated (35%), and relatively representative of the sample. Despite the fact that "there is always a response bias towards those who are interested in the subject matter",\*\* the distribution manner of this questionnaire contributed well to the number of replies.

During the period of January the 9th and March the 4th, 25 completed questionnaires were received from respondents (response rate of 64.1%). These 25 received responses included responses from 5 "type A" accounting firms and 11 "type B" accounting firms; the rest did not state their firm's classification type. This classification

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\* Brittain J. M., "Information and Its Users"; Bath University Press, 1970, P. 25.

\*\* Goode, W. J. and Hatt, P. K., " Methods in Social Research"; Mc Graw-Hill, New York, 1952, P. 173.

was based on the firm's affiliation with one of the big international accounting firms (type A), or lack of association with similar firms (type B). In fact, only 24 responses included usable data since one respondent did not complete all questions. Thus, the response rate was actually 61.5%, which was still above the conjectured rate (35%) and could be satisfactorily relied on in setting some results.

#### 8.4 Position of Respondents

Although the questionnaires sent were addressed to the "chief accountant or senior auditor", a variety of occupations were stated by respondents. These positions include the following (Table 8.2);

Table 8.2

"Occupations of Respondents of The 3rd Questionnaire"

Occupation	No. of Response
Chief Accountant	5
Senior Public Accountant	4
First Auditor	4
Financial Controller	3
Managing Director	2
Secretary	2
Auditor	2
Un specified	3
=====	=====
Total	25

These descriptive designations were admittedly unexpected, but rather noteworthy. Public accounting services in Kuwait are not organised in terms of the job description or the management accountant's role (e.g., A book-keeper is widely known as an accountant). However, it is possible

that these positions can be justified for persons performing designated accountancy functions which justify the relevance of their responses.

#### 8.4.1 Forms of Organisation

Typically, the private limited type of accounting firm is the most prevailing (79%), as the results below indicate.

a. Public limited liability co. [ ]	b. Partnership [12%]
c. Private limited liability co. [79%]	e. Public sector-
d. Individual proprietorship [ 9%]	body [ ]

#### 8.4.2 Firms' Objectives

Firms' objectives ranked according to priority as revealed by respondents is given below.

1. Maximising owners' wealth	97%
1. Maximising market share	97%
2. Maximising profit	75%
3. Maintaining a going concern	62%
4. Kuwait economy growth	37%
5. Maximising employee welfare	13%

The prior two objectives determined by respondents referred to the same goal- maximising the value added of the firm, since most firms are privately owned.

### 8.5 Kuwait's Tax Law

#### 8.5.1 Tax Burden

A large percentage of respondents (60%) felt the burden of the effective tax regulations was too high (table 8.3).

These results to some extent correspond with foreign investors replies. It is, thus, convenient to conclude that income tax decree No. 3 of 1955 imposes a high burden on taxables, a view that was also upheld by some of the tax department officers (chapter 6).

Table 8.3

" Evaluation of Present Tax Law "

1. Current tax burden:-				
Too High	Somewhat High	Moderate	A little Low	Too Low
41%	19%	31%	9%	
2. Complexity:-				
a. Very simple [30%]		b. Simple [40%]		
c. Complicated [22%]		e. Very complicated [8%]		
3. Tax declaration procedures :-				
a. Straight forward [28%]		b. Systematic & organised [11%]		
c. confusing & ambiguous [36%]		d. Very dis-organised [25%]		
4. Tax department (From dealings with it) :-				
a. lack of experience [11%]				
b. without suitable experience [66%]				
c. qualified enough [22%]				
d. highly skilled [ ]				
- Blank replies were 1% of the sample.				

### 8.5.2 Complexity

In broader terms, the decree's level of complexity was negatively estimated by respondents (less than 1/3 of them have considered the decree complicated). One participant indicated that;

"the words of the Act should be given their ordinary meaning rather than their ordinary wide meaning".

Another said;

"..the decree's words are not grounded in common sense, despite its very simple pronouncement".

"..Basically, it is quite enough to state that the decree's enactment circumstances are different from the surroundings of its application. No wonder then if it is considered complicated".

"Int. # 6" \*

"..I have read the decree a few times and memorised it.. but in terms of interpreting it, I believe the more you read it the more you arrive at new venues of possible explanations.."

"Int. # 7"

### 8.5.3 Declaration Procedures

With reference to their certainty and clarity, only 39% of the participants perceived these procedures certain and clear enough to comply with. Contrarily, over 60% of them declared these procedures ambiguous and dis-organised. A senior accountant at a local firm (type B) asserted that;

"..With the absence of a detailed procedures manual of tax declaration, the tax officer and public practitioners are two blind birds in a bush. Consequently, this has increase probabilities of guess work..".

"..You want updated guide-lines and faster action from tax officials concerning your tax declaration, however this need is totally ignored here..".

In a more accepted fashion, respondents agreed on the assumption that these procedures are fairly concise and thus susceptible to multiple interpretation.

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\* Refer to list of Interviews for respondents' profile (Appendix D).



#### 8.5.4 Tax Department

Over 75% of the respondents reckoned the department to be without the sufficient experience and none of them saw the department as highly skilled. The capabilities of the tax department are even seriously questioned as stressed by an eminent certified accountant;

- ".. The weakness of the tax department is well revealed in the following;
- 1> Lack of experienced staff and modern equipment and machinery;
  - 2> The poor organisational techniques for coping with the ever-growing work load;
  - 3> Essential tax training programmes are not provided for tax personnel by the department nor by the academic institution in the country;
  - 4> And, the formal status of the department as an independent authority is not achieved, which hampers in many cases their tasks due to certain bureauratic measures and barren government routines".

Similarly, other respondents described the department's disappointing performance thus:

"..If one can describe the work of the [tax] department in few words, he can conceivably argue that their work is a kind of guess work rather than a clarified and planned one... Presumably, the lack of minimum experience -let alone the essential background and knowledge- come at the top of these reasons.."

".. The words of high-positioned directors have been found more valuable and effective than the formal advice of the tax inspector..".

Respondents further mentioned 4 areas of weakness;

- 1) The structure of the decree and the unavailability of an explanatory deed;
- 2) Actual tax enforcement is based on presumed methods;

- 3) The relationship between the tax department and taxables was not legislatively articulated;
- 4) The lack of attention to taxation by the tax department until recently, as noted by Al-Bassam;

"..Our contact with the tax department is over 12 years old, during which no interest in enforcing taxation was existing. It only materialised 5 or 6 years ago...".

"Int. # 6"

Others said;

"..The [tax] department's responsibilities have well exceeded its capabilities, especially if one considers the short life of the department. It has even been charged with the formulation of a tax act, which is entirely a function of the legislators, not the administrators of taxation..".

"Int. # 5"

"..Tax regulations in general were very weak in all aspects including the organisation of the tax department ... This is an ordinary product for a legislation that has been set by a foreign body which care mainly for its interests".

"Int. # 1"

#### 8.5.5 Tax Reformation

A massive majority (94%) of participants supported the proposition of tax reformation in Kuwait (table 8.4). None of them declared opposition to such a proposition. On the other hand, those undecided participants were perhaps in favour of the reformation itself, but were not so certain about the reformation package, which was observed in responses to the following question.

Of the 94% supporting reformation, 33% favoured taxes on capital gains, 26% selected sales taxes, and 40% of them were split equally on income tax and property taxes. The distinction of these percentages indicate that many

respondents were undecided. Except for capital gain tax, all other sorts have close preference rates. However, the importance of the coming tax package to the enhancement of government resources was widely adopted by respondents. One of them suggested that:

"... According to my sources of information, a new tax legislation is being prepared, which we all look for. Yet, there is a long line of priorities that should be considered before setting the tax package, and no doubt that state solvency and development is counted No. 1 in the list".

Table 8.4

** In favour of income taxes **			
With [94%]	Against [0%]	Undecided [6%]	
** Reform Package **			
a. Income Tax		20%	
b. Capital gain tax		33%	
c. property tax		20%	
d. Sales tax		26%	
e. Withholding tax		--	
(6% Blank responses)			

#### 8.5.6 Reformation Effects

With respect to tax reformation effect on business development, 87% of the respondents anticipated positive effect, particularly on the following (table 8.5);

Table 8.5

"Tax Effects on The Government Policy"

	Agree	Undecided	Disagree
a. Governmental Planning..	51%	13%	27%
b. Economic control of Public expenditure.....	34%	29%	31%
c. Redistribution of wealth.	41%	9%	39%

The influence on government planning seems to be most accepted by respondents, while doubts were raised regarding tax effectiveness on the other two areas. Specifically, the rationalisation of government spending and the securing of standard public welfare were suggested as expected effect, as observed by one respondent:

".. For any tax strategy to be valid for Kuwait, it should be primarily attached to government orientation toward expenses rationalisation in addition to other factors. Such as.. the existence of a democratic political states, sustaining the current level of welfare, increased tax literacy among many taxpayers, and the availability of a predominantly money market as well as other economic criteria..".

Since Kuwait largely depends on oil revenues, its economy is more vulnerable to financial crisis than those more diversified economies. Therefore, any imposts on non-oil sectors will be harmful at this stage of development, as these sectors require more support. The argument for this hypothesis could be seen from a senior accountant at "A" type of accounting firm;

"...The economy of Kuwait is rather a

unique one where you find the ample state funds are generated from a single source. This economic characteristic will surely effect the taxation strategies of the government that on many occasions emphasises the growing support and subsidization programmes offered to other sectors of the economy. The solution to this riddle will be noteworthy and excessively damaging if it is not counted for".

"..We need a tax strategy that has some roots is the financial planning of the state.. We do not want destructive quick decisions like what happened in Saudi Arabia just 3 weeks ago when they introduced an income tax legislation and abolished it one week later on.."

"Int. # 10"

On the whole, these results show that respondents in general recognise a positive effect of taxes on government activities or activities which are largely determined by governmental variables. In contrast, less tax impact is seen on private sector activities - or those which are not totally governmental.

#### 8.5.7 Amendments to the Decree No. 3

The tax department has issued in 1983, circular No. 17 that specified required statements for tax declaration. After almost five years of this circular's enforcement, respondents were approached to evaluate the effectiveness of this circular (table 8.6). An overwhelming percentage of them (50%) rated this circular a major incentive on their firm's performance, which is an expected result because of the need for such guideline. It has been reported by a client auditor in a "B" type of accounting firm that:

"...We all have been looking forward to

receive such pronouncement from the tax department which I believe highlighted two essential points;  
 First: the presence of a tax organising authority, an article that has been forgotten for a long time.  
 Second: a first step in providing very necessary guidelines and relevant tax declaration procedures..".

Table 8.6

"Evaluation of Ministerial Amendments"

	INCENTIVE /			DISINCENTIVE		
	M A J O R	M I N O R	N E U T R A L	M A J O R	M I N O R	OTHER COMM- ENTS (IF ANY)
a. Circular No. (17) for 1983, (Tax Declaration Requirements)	56%	44%				
b. Resolution No. (206) for 1985, (Requisite Books & Records...)	89%	11%				
c. Ministerial order no. (44) of 1985 (Subcontracting.....)	70%	10%	10%		10%	
d. Resolution No. (103) for 1983, (Assets Re-exporting.....)	60%	29%			11%	
e. Order No. (5) / 1982, (Allowable Administrative Expenses ..)	24%	12%	9%	9%	19%	

Evaluation of resolution No.(206) for 1985 indicated that almost 90% of the respondents considered this resolution a major incentive to their firms. It has facilitated the auditing function of the firm based on the presence of regular accepted commercial records.

Before promulgation of this resolution, a large number

of taxables did not maintain regular records of their transactions for many reasons, mainly the following:

- 1> Tax evasion purposes;
- 2> Government leniency with regard to this matter;
- 3> Lack of influential accounting discipline (compliance);
- 4> Lack of accounting education and consciousness;
- 5> Lack of tax effective methods of assessments.

This picture was largely echoed in replies to order No. 44/1985 evaluation which was well appreciated by respondents (80%). Only 10% of respondents reported disincentive effects resulting from the conflict with legal and ethical conducts of the profession.

As far as resolution 103/1983 is concerned, respondents declared benefits from it. Few of them (11%) remarked it an unnecessary hindrance to foreign investment development.

Order No. 5/1982, on the other hand, was disputed among respondents regarding its usefulness. They are divided into; neutral respondents (9%), supporters (36%), and opposers (28%). Respondents of the latter group claimed that the application of this order was causing them a dilemma especially when negotiating tax liabilities on behalf of their clients. Some of their comments were;

"...We are not against the order itself, however our main concern and painful mystery has always been with the tax department's interpretation and application of the order..".

"...I won't be exaggerating if I say that this is the most controversial area of clients' tax declarations, not only in this office, but in nearly 80% of accounting firms in the country..".

"...On preparing a client profile of a tax dispute case, the prior check we

follow is to re-audit his income statement. In particular we examine the allocation of his business expenses simulating the head-quarter's or the {annoying administrative expenses}..".

These quotations, in addition to the percentages pertaining to evaluation of this order, reflect the sense that some respondents were linking the effectiveness of the order with its rigid enforcement. Probably those respondents were facing difficulties in complying with this order's requirements. On the whole, participants well apprehended the amendments to the decree and except for some areas of disagreements with the tax department's applications, all the amendments were considered encouraging.

#### 8.5.8 Suggestions

The first postulate examined - corporate tax imposition, was greatly welcomed by respondents (table 8.7). Nearly 80% of the sample considered it an incentive factor for development. Only 12% of them did not accept this proposition because they had some doubts concerning its enforcement on all establishments. Their doubts are derived from their past experiences with income tax enforcement that has been confined to non-Kuwaiti corporations, as stated by respondents;

"..First of all this issue has to be clearly defined in terms of the taxables subject to this act. Afterwards one can look at the issue's fairness..".

"..I understand from this proposition that corporate taxation is to be imposed on all firms and companies 'whether black or white'".



Table 8.7

* Public Accountants Perceptions Toward Some Suggestions *						
	INCENTIVE /			DISINCENTIVE		
	M A J O R	M I N O R	N E U T R A L	M A J O R	M I N O R	OTHER COMM- ENTS (IF ANY)
f. Corporate Income Taxes (on national & foreign firms)	75%	13%			12%	
g. Imposing Higher Progressive Tax Rates (45%) rate limit of 45%.	31%	19%	20%	11%	19%	
h. Foreign Transfers Charges (12%)	11%	33%	22%	33%		
i. Dividends Taxes (other than ordinary shares tax)	50%	12%	25%	13%		
j. Reduced tax rates for public companies (i.e., 35%)	50%	11%	13%	10%	16%	
k. New resident tax (annual exemption of KD 20,000)	29%	14%	14%	43%		
l. Sales tax introduction	33%	31%	18%		16%	

With reference to the suggestion of 45% tax rate, respondents can be classified into; supporting group (50%), neutral respondents (20%), and opposition group (30%). The first group was comparing the high tax rates currently in force and the proposed rates which are widely known in most tax jurisdictions. The opposition group reflected respondents who compare the proposed rates with the tax free state currently enjoyed by all indigenous firms.

Even though the majority were favouring the adoption of foreign transfer charges (over 40%), a large portion of

respondents were reported as rejecting this proposition (30%).

The introduction of dividends taxes were well appreciated by over 60% of the respondents. In contrast, 13% of them has dis-counted it on the ground that this type of tax requires an advanced system of taxation as well as a highly organised tax administration. The economic rationale may not support such taxes at this stage of development, despite its fruits. Other than that, the researcher agrees with those respondents who considered dividend taxes a disincentive factor at present.

Item j. (reduced rates for public companies) was estimated positively by 60% of the sample. Some of the respondents were in doubt of the fairness of this privilege as it discriminates irrationally. Others had doubts regarding its proper application, as has been stated:

"..Public companies here is more or less a flexible feature. Despite that I agree with the idea itself, but who can guarantee its right application...".

Unexpectedly, responses to item k. (resident tax) were equally divided, but rather more definite in opposing it (43% counted it a disincentive element). As regards sales taxes, the majority of respondents (64%) favoured its introduction. Neutral responses (18%) were a small lenient group and more likely counted with the supporting group. For example, one respondent marked the "neutral" cell and stated the following:

"... Sales taxes are very useful and fairly easy to administer. However, if combined with income taxes in Kuwait then

I would hesitate to accept it. It is just too much as a first shot..".

Surprisingly, in spite of the majority of participants who agreed on sales tax (64%), few responses to an earlier question (8) favoured sales tax as a component of the tax package (only 26%). The best explanation of this confusing response is that respondents may have valued sales tax in connection with the other sorts of taxes given in question 8 above. Also, the possibility of false responses can not be ruled out here, which perhaps has affected these results.

### 8.5.9 Abolishing Decree No. 3

As expected, few participants were satisfied with the decree and about 20% of them opposed its revocation. However, the majority of respondents (over 80%) disagreed with further amending the decree and instead support its obliteration by new issued legislation.

#### "Amending Decree No. 3"

Agree						Disagree
1	2	3	4	5	6	7
16%			3%			81%

## 8.6 The Tax Administration

### 8.6.1 Tax Disputes

As shown below, approximately 60% of the respondents have had previous disputes regarding their clients' tax affairs. Of those 60%, more than 40% had 3 or more disputes. The prevailing frequency of disputes exceeded 3 times (an average of 1 dispute every 19 months).

Furthermore, respondents were asked to declare the common causes of their disputes. Their answers are ranked in order of frequency below;

** Tax Disputes **			
Yes	[59%]	No	[29%] (blank 12%)
** Its Frequency **			
Once	Twice	3 times	More than 3
[14%]	[13%]	[15%]	[43%]

\* Disagreement Causes \*

The cause =====	%
1. Accounting practices...	42
2. Tax regulations.....	25
3. Legal interpretations..	24
4. Tax inspector judgement.	7
5. Others.....	2

It is obvious that the accounting practices of accounting firms are the main occasioners of disputes between the firm and the tax department. Each party blames the other for causing this type of conflict, as can be seen from their claims. The tax department planning and following up controller, for instance, claimed that;

"...With greater sorrow, these accounting firms seek to satisfy their clients even at the expense of sound accounting principles and procedures..."

"Int. # 3"

The inspection controller has also defended the department's position;

"..Unfortunately, little is received from these [accounting] firms.. And even very discouraging actions are remarked

concerning some of their practices like offering technical assistance on how to evade taxes for their clients.."

"Int. # 4"

"..Although we maintain good ties with most of the accounting establishments, some firms require continuous follow up to make them comply with tax regulations. However, it is impossible for us to teach them their work on every occasion...".

"Int. # 4"

In contrast, accountants claimed other reasons for disputes:

"..One thing I have noticed over the last 2 or 3 years is the drop in inspectors' knowledge, particularly those related to tax accounting and the new standards of the auditing profession. More and more often you are dealing with people who don't really seem to know what they are talking about..".

"..One of the [tax] department staffs' major defaults, is that they always apply new instructions on retroactive basis.. Sadly even before deep tests of these instructions whether they fit in or not..".

"Int. # 7"

"..If there is one single thing missing in the tax department, it is certainly would be applying the term 'mutual trust & understanding '. Tax declarations are repeatedly audited regardless of being prepared by us..".

"Int. # 6"

"..The [tax] department needs to improve its intelligence sources ! Yes, that is true, but it should improve firstly its understanding of tax accounting...".

In some accounting firms, defence even gave way to strong attack;

"..Among the prior reasons of disputes with the tax authority, corruption I believe form a generally recognised one

among our surroundings. The department should seriously examine this phenomenon and start to eliminate it as early as possible...".

No cases , however, were made under this accusation because of its sensitivity and confidentiality as claimed by the respondent. Moreover, the other causes of disputes had some link with the accounting practices of respondents (legal interpretation of depreciation expense). A chief accountant in a "B" type of firm has mentioned that:

".. Our lawyers do often return to us to inquire about the allocations of depreciation and the accounting explanation of disputes raised on these basis".

Tax regulations in some parts do form areas of disputes as they were reported to be ambiguous and carrying very concise guidelines as delineated in the second section of part 8.5.\*

#### 8.6.2 Tax Administration Reform

Similarly, respondents were required to state their views regarding; 1) Tax administration reformation, 2) Its merger with the audit bureau. Their responses to this inquiry are shown in table 8.8.

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\* Most of the differences arise from the fact that the tax law is ambiguous and lacks clear provisions for allocations of costs and expenses. For instance, the law has no instructions regarding accelerated depreciations or allowances for bad debts and losses on foreign currency holdings.

Table 8.8

<b>** Tax Authority Establishment **</b> YES (20%)      NO (50%) Do Not Know (19%) - 11% Blank - <b>** Its Formal Body **</b> 1> General Tax Bureau 2> Government Authority <b>** Audit Bureau &amp; Tax Department Merger **</b>						
Very Adequate		Adequate		Totally Improper		
1	2	3	4	5	6	7
		3%	6%		5%	84%

It appears from the above percentages that a large portion of the sample (50%) opposes the formation of other tax agencies besides the tax department. Their argument is largely based on the cost-effectiveness of such alternatives which could highly affect the tax collection ratio. A rather humorous respondent has even stated that:

"..I do not think that even the building costs of that authority would be paid back within the coming 5 years as we always find here..".

Others have disregarded this proposition on the basis of shortage of suitable and capable staff, the small number of taxables, and the long period such an option will take to be realised. Some opposed it on the basis that first, tax regulations should be determined and effectively formulated to be applied, then should come the authority responsible for its enforcement.

"..Now it is entirely inadequate to talk

about the coming tax authority. We first have to establish proper tax laws and the associate set of accounting principles and practices compatible with tax applications.."

"Int. # 6"

Respondents who agreed on establishing a tax authority (20%), have named 2 bodies seen as most appropriate to be adopted, namely a general tax bureau, or a government authority.

The only article that respondents have strongly agreed on was that of combining the tax department with the audit bureau is totally improper, and could even hamper the department's presumed tasks. Additionally, such a merger could abolish the independence of both the bureau and the department (80%).

Further, respondents suggested the following to improve the tax administration;

- 1) Conducting internal courses of inspection;
- 2) The employment of modern administrative techniques (e.g., computers, evaluation of performance, etc.);
- 3) Setting up relevant studies and research;
- 4) Supplying the department with qualified accountants;
- 5> Furnishing the department with adequate recognition.

#### 8.7 Tax & The Accounting Profession in Kuwait

More than 70% of the respondents answered positively to the possible effect of tax on their practices. Arguments, however, were raised by respondents reflecting the extent of this influence. A senior auditor has further deliberated;

"..Such relationship between tax and accounting profession is amply known in developed countries where both tax legislations are well articulated and the (accounting) profession is well regulated, organised, and recognised. I



would suppose that similar strong links could be achieved if these two essential elements are achieved..".

"..What is accepted world wide in this respect, is totally unknown in Kuwait. I can certainly say that the role of accounting firms in Kuwait does not exceed the role of a commercial mediator..".

"Int. # 2"

"..Currently I doubt there is a strong link between the two areas in Kuwait.. otherwise we would not have witnessed the crisis of the stock market in 1982..".

"Int. # 10"

#### 8.7.1 Tax Influence on The Profession

Those respondents who anticipated influence of tax enforcement on the profession (71%) were asked to confirm such influence on several areas (table 8.9).

Eventually, tax regulations will contain the requisites of commercial book-keeping including accounting books and records for tax purposes. Although these prerequisite materials may differ in their format or even in size, it is indisputable that these requirements will condition the practices of public accountants. An ample percentage of them (79%) confirmed positive effects on their books and records.

The significance of this influence has been comparatively argued by senior auditor of a type "A" firm;

"..Ambitiously, one would assume that the future of tax formation in Kuwait will certainly define such articles like books of accounts and the formal records for tax declaration. This aspiration is basically based on the comparison between present tax codes -that don't mention any particular method of records keeping-, with the sufficient and supposed system of tax guidelines..".

Analogously, Over 90% of the respondents have denoted positive effects of taxes on their auditing procedures (internal & external).

Table 8.9

** Taxation Influence On Accounting Practices **			
Yes	No	Do not Know	
[71%]	[27%]	[2%]	
** Areas Of effects **			
A. Accounting Books & Records...			
Positive [97%]	Negative [ ]	Do not Know [3%]	
B. Auditing Procedures (internal & External)...			
Positive [91%]	Negative [ ]	Do not Know [9%]	
C. Accounting Principles & Methods in determining income (i.e., Accrual, cash basis, adjusted cash...etc)..			
Positive [71%]	Negative [26%]	Do not Know [3%]	
D. Depreciation methods used...			
Positive [68%]	Negative [6%]	Do not Know [26%]	
E. The evaluation of inventories & stock on hand...			
Positive [71%]	Negative [4%]	Do not Know [25%]	
F. Type of cost presented (Historical- current..etc)..			
Positive [83%]	Negative [15%]	Do not Know [2%]	
G. The future of the financial statements & reporting.. (Nature, quantity, reliability..etc)			
Positive [81%]	Negative [16%]	Do not Know [3%]	

### 8.7.2 Accounting Principles

Even though the majority have predicted new desirable developments on these principles, still there were some doubts among a group of participants (26%) regarding the effectiveness of taxation on accounting standards setting. These doubts were indicated by some respondents:

"..Although I entirely agree that grave

tax influence will be reflected on accounting practices, but yet when talking about accounting principles or auditing standards setting.. I think we are very well amplifying the facts..".

"Int. # 6"

"..I don't see such influence simply because we are discussing the formation of a tax legislation not the accustomed GAAP's. Also, the authority responsible for tax enactment is simply a tax administration simulating the Inland Revenue in U.K. I don't expect it to be both an Inland Revenue and FASB at the same time..".

The tax department's senior expert has also given little regards to the present codes contribution in this sense;

"..A review of the tax legislation suggests that its contribution to accounting principles and practices is less significant. This act does not define the term 'income '. Income tax therefore is, as its name implies, a tax on income, actual or notional irrespective of the standard by which it is measured".

Moreover, the president of KSAA has declared two types of effect taxation will have on employed accounting techniques. First, the disclosure of real taxable income by taxables since they all follow unified set of techniques to arrive at taxable income. Thus public interests will be protected as the probability of tax evasions will be eliminated. Second, abilities available at present are not sufficient to secure the establishment of such generally accepted rules, let alone the enormous amount of time and effort needed for these "tax accounting principles" to be introduced.

Nevertheless, most participants recognise a minimum positive effect of tax introduction on accounting standards

setting, viz-a-viz speeding up the process of accounting regulation and standard setting, and the development of a recognised body of accounting authority.

Similar results to item (C) were received in response to items (D) and (E), presumably because these items represent similar ideas (establishing either general principles of professional practices, or specific methods of treatment like depreciation accounts). The single remark observed here is that a large number of respondents stressed the need for allowing accelerated depreciations to stimulate growth within the private sector.

In response to the possible effect of tax on the cost presented in financial reporting, more than 80% of the respondents have estimated a good deal of improvement in the nature of these costs. Although none of them has specified a particular basis of costing, most of them required it to be generally agreed on, which would have significant influence on financial reporting.

### 8.7.3 Tax & Developing The Profession

** Taxation will enhance the accounting profession **		
Yes [93%]	No [2%]	Not applicable [5%]
** Taxation is a consideration in developing accounting regulations in Kuwait **		
Yes [78%]	No [11%]	Do not know [11%]
** How important is this consideration ? **		
Very Important Consideration	Somewhat important Consideration	Minor Consideration
16%	57%	27%

Over 90% of respondents have confirmed the favourable effect of tax on accounting practice. However, not all of them regarded tax as a significant consideration in advancing accounting regulation locally, as argued by one chief accountant:

"..The [accounting] profession has been unable to realise its goals in full, and I can't say that it will totally do so just because of tax imposition. The structure of tax orders in addition to professional conducts and obligations are not the only cure of the existing weak profession..".

#### 8.8 Tax Implementation Elements

The potential of a flourishing tax regulation in the country as perceived by respondents was specified in 3 major elements: effective professional support, more government enforcement, and education for the public (table 8.10). This actually reflect the 3 parties most concerned in this issue, namely; 1) The government; 2) The public; and 3) Practising accountants.

Respondents' considerations of these groups would naturally include themselves, as equally important to the views lawyers or economists or even politicians. However, without the parties most concerned (the government & the public) a tax jurisdiction can not exist in the first place. Actually, the role of these two concerned is determined by the government which has the upper hand to enforce the tax policy.

Table 8.10

"Tax Implementation Elements"

	IMPORTANCE		
	MAJOR	MINOR	NONE
A. Education for local accountants.	71%	29%	
B. Co-operation with international organisations.		37%	29%
C. More government enforcements.	87%	8%	
D. Massive economical publicity.	11%		
E. Education for the public.	83%	17%	
F. Effective professional support.	92%	5%	
G. Reformation of accounting practice to include taxation procedures.	79%	14%	
H. The adoption of foreign taxation methods.		3%	93%
I. Greater support from the private sector.	69%	17%	

8.8.1 Potential Strategies

In this regard, many strategies may be adopted to assist the public in complying with the new taxation. In response to the researcher's questionnaire, 97% of the participants indicated the need for including tax education in the syllabus of the academic institutions, particularly at the university level. Additionally, over 70% of them have also agreed on adding taxation to the exam requirements of the accounting profession.

Four public accounting firms have largely accepted the

inclusion of taxation in their employment qualifications and requirements (table 8.11). A financial controller of a large accounting firm, has suggested the introduction of refresher courses made for general practitioners:

"..Something on a regular continuous basis, combining revision of general principles with presentation of new developments..".

Table 8.11

<b>** Taxation Inclusion in The Syllabus of :- **</b>			
-----			
A. The academic institutions (The university level)..			
Yes	[97%]	No [ ]	Do not know [ ]
B. The accounting profession's license exam & requirements			
Yes	[74%]	No [7%]	Do not know [14%]
C. Central Audit Bureau enforcement...			
Yes	[58%]	No [16%]	Do not know [13%]
D. The qualification requirements to work for an auditing & accounting consulting bureau...			
Yes	[91%]	No [6%]	Do not know [3%]

It is therefore recommended that the tax department encourage academic institutions to contribute in the introduction of taxation (developing compulsory coaching programmes and conducting pertinent tax studies). Thus, participants were asked to estimate the capability of these institutions (table 8.12).

### 8.8.2 Institutions Capacities

Broadly, respondents believed in the ability of local institutions to contribute significantly in tax formation. Only in cases of providing effective training programmes and guiding policies to practical tax problems, have

respondents indicated low scores. The ranking of these capabilities accordingly were;(table 8.13);

Table 8.12

** Academic Institutions Capabilities **						
A. Providing effective training ...						
Strongly Agree			Undecided		Disagree	
1	2	3	4	5	6	7
49%		2%	7%		9%	33%
B. Providing recommendations and advises on how to develop tax policies, understanding and practice..						
Agree				Disagree		
1	2	3	4	5	6	7
57%	9%	9%			8%	17%
C. Conducting requisite and local tax studies..						
Agree				Disagree		
1	2	3	4	5	6	7
67%	8%	7%	7%	9%		
D. Responding positively to the tax system demands and practical problems..						
Agree				Disagree		
1	2	3	4	5	6	7
23%		8%	21%	7%	9%	32%
E. To support the taxation practice by a competent research programmes..						
Agree				Disagree		
1	2	3	4	5	6	7
79%		3%	4%		2%	12%



F. Furnishing accounting profession with well qualified accountants, particularly in the area of taxation..

Agree						Disagree
1	2	3	4	5	6	7
78%		7%	13%			2%

G. Developing effective auditing procedures, which are appropriate to the new tax system requirements..

Agree						Disagree
1	2	3	4	5	6	7
57%		5%	16%		7%	15%

H. To contribute effectively to the advancement of Kuwait public accounting procedures and practice..

Agree						Disagree
1	2	3	4	5	6	7
59%		2%	9%		6%	24%

Table 8.13

** Ranking of Capabilities **			
	Percent (%)		
	-----		
	Agree	* Dis-Agree	
	=====		
1. Supporting Tax Practices..	79	[9]	12
2. Qualifying Tax Accountants	78	[20]	2
3. Conducting Requisite studies..	67	[22]	9
4. Advancing Accounting Practices..	59	[17]	24
5. Developing Auditing Procedures ..	57	[28]	15
6. Providing Tax Advises .....	57	[26]	17
7. Providing Effective Training ..	49	[20]	33
8. Responding to Tax Demands ...	23	[45]	32
-----			
* Numbers in [ ] represent not totally decided persons			

It is interesting to note that contributions based on theoretical or clerical features were well anticipated by respondents (B,C,E,F,G,H), while they had less confidence in practical assignments that require practical services (A,D). Past experiences would support this notion as most previous studies were of low practical value.

Regarding the accounting profession, the institutions appear to have the recognised status to contribute to its advancement (60%). Apart from the low-valued practical contributions, some doubts concerning the recognised role of the institutions in advancing the profession's regulation procedures have also been raised:

"..I am sure that most local accounting academic staff know little about

taxation.. [accounting] institutions can hardly contribute in tax accounting education.. discussing their possible contributions in the profession development is something too far away..".

"Int. # 9"

## 8.9 Tax Works

The general picture concluded here was that tax-related work is not a significant portion of private practitioners' activities. Most of the participants (78%) had dealt with less than 15 tax cases in their life. A large percentage of them (11%) had never been engaged in a tax matter.

** Number of tax cases accepted in Kuwait **				
A. None [11%]	B. 3 & more [9%]	C. Less than 15 [78%]		
D. More than 20 [2%]	E. More than 35 [ ]			

It should also be borne in mind that questionnaires were addressed to chief accountants or accountants in equivalent positions. Presumably, those accountants would represent the tax expert (or partner) of the firms surveyed. Thus if these questionnaires' reached - as is most likely- accountants with the greatest commitment to tax work, then received results are disappointing. Data provided by interviewees reflect this.

"..Actually our services are determined by clients' requests. If there are many {tax clients}, then we would be stimulated in this direction. But the status in Kuwait is not a flourishing one in this sense, thus we keep our tax commitment to a low minimum..".

It seems reasonable to say that accountants spend less than 1/10 of their time on tax related work. This state is

a result of the low demand for tax services by clients.

### 8.9.1 Tax Problems

Identification of the types of tax problems handled by respondents would seem fruitful, as it would reflect points of disagreements, and methods of solving them. Income tax problems have formed the largest portion of tax commitment (47%), followed by tax planning (27%).

** Tax Problems Sorts **			
A. Income tax	[47%]	B. Capital tax	[9%]
C. Indirect tax	[ ]	D. Tax planning	[27%]

Tax problems in the expression of respondents include;

- 1) Ensuring the correctness of tax declarations and dispatched information ;
- 2) The preparation of clients' accounts for tax purposes;
- 3) Technical services, representing the client in contacts with the tax authority and other agencies, and arranging clients financial affairs with the financial institutions.

Tax planning and relevant advice were notably misunderstood by respondents. For example, a type (B) firm controller, when asked about tax planning, replied;

"..Our clients' tax work is of a routine computational nature. A little bit of this, little bit of that.. and the whole problem would be solved .. What you call this type of services is not so material, as long as the client is paying his dues with a big smile..".

When other respondents were requested to differentiate computational (compliance services) from planning (legal advice), most became slightly apologetic or gave completely irrelevant replies.

The general trend of practice appeared to be built basically on determining taxable income. Experience in specific tax problems is not yet a feature of respondents practice. Despite this, some larger firms have recently adopted a policy of assigning an advocated accountant to tax services only. Three respondents referred to plans to set up a tax division within their firms.

### 8.9.2 Solutions & Sources

The other aspect of the case is the methods and references employed to expound these problems. When asked to specify their methods of solving tax problems, most respondents indicated that they refer to the tax department. Approximately 75% of them reported relying on this alternative, then looking at some other options, as shown in table 8.14.

Table 8.14

** Problem Solving Methods **	
A. Government publications & Statutes	[ 8% ]
B. Consultations with colleagues	[ 9% ]
C. Correspondence with tax department	[ 75% ]
D. In-house information services	[ 8% ]
E. Commercial tax information & pamphlets	[ 0% ]
F. Tax specialists & Books	[ 0% ]

In addition to referral to the tax department, 9% of the respondents indicated that they consults with colleagues in the firm, as reported by a senior auditor;

"..When we get stuck with a problem, we chase round the answer inside the firm until we come up with something reliable..".

No respondent has used commercial tax information or professional advice. The lack of these information sources indeed leaves no choice for public accountants other than referring to government publications. Moreover, several individuals maintained files of valuable tax cases and practical problems. These profiles could be of great benefit if organised and published. However the reply came from one of those individuals;

"..These are our real asset of tax expertise that is worth competing for..".

### 8.9.3 Keeping Up to Date

Only 45% of respondents attempted to bring themselves up-to-date with taxation, while some of them did so from time to time, though not regularly. It is however, noteworthy that a large number of participants were interested in this issue to the extent of proposing a national tax conference to review the tax status of Kuwait.

"..We have been interested in taxation since our firm's existence.. In fact we have, in conjunction with International Price Water House- issued a guide on Kuwait taxation in 1974. Our aspirations will certainly continue in this regard. A national conference dealing with this subject would be most beneficial..".

"Int. # 7"

"..The ever increasing tax affairs in our firm have encouraged us to establish a tax division consisting of 3 accountants and a tax consultant..".

"Int. # 12"

### 8.9.4 Pertinent Publications

As to the sort of publications usually consulted by

respondents, the British Tax Review was the journal most read (table 8.15).

Table 8.15

** Reading Publications **		
Yes	No	Sometimes
[45%]	[22%]	[33%]
** The Publications **		
	No. of respondents	
A. British tax review	[ 3 ]	
B. Taxation Or Taxes	[ 1 ]	
C. Tax cases leaflets	[ 2 ]	
D. quarterly Record	[ - ]	
E. Business tax cases	[ 2 ]	

The Journal of accountancy and accountancy magazine were reported as regular sources of information for 3 of the respondents in their area of taxation. Unfortunately, this shows the scant regard attached to taxation by some public accountants, for these two journals are not greatly concerned with taxation.

#### 8.9.5 Difficulties

More specifically, respondents were requested to declare whether they attempt to maintain a level of updated information on Kuwait's tax development. Confirming the observed growing interest in local taxation, over 90% of the respondents replied in the affirmative.

The major complaint of 74% respondents who indicated some difficulties in keeping updated with Kuwait tax was the scarcity of related information (31%). In addition, respondents also complained of the frequent changes in the

tax codes by the ministry of finance (table 8.16).

One accountant felt that;

"..the trouble observed here was the feeling that the desired information must exist some where, not knowing exactly where to look for it, and drawing a blank from supposed sources..".

Table 8.16

<b>** Information Access Difficulties **</b>	
Yes [26%]	No [74%]
<b>** Reasons for Difficulties **</b>	
A. Lack of clarity in legislations	[ 15% ]
B. Difficulty of access to information	[ 13% ]
C. Frequent changes in tax laws	[ 24% ]
D. Scarcity of related information	[ 31% ]
E. Lack of government co-operation	[ 1% ]

"..It is a problem of accessibility all the time. I know that there should be a relief, but where to look for it.. this is the headache.. And certainly the tax department is not its aspirin...".

#### 8.9.6 Improvements

The importance of this inquiry comes from the revelation that 45% of participants are approached for tax advice or information on a regular basis. Several suggestions were received from respondents pertinent to the improvement in tax information (table 8.17). Suggestions were also made by respondents that the tax department should pass on all new tax issues to accounting firms as well as taxables through a mailing programme.

On the personal level, almost all respondents reported extremely good relationships with the tax administration.



AL-Qadi described them in terms of corporation and providing instructions;

"..they would occasionally give information on an unofficial basis about tax department's internal instructions".

Direct communications with senior tax officials - those with some level of authority- were recommended.

"We all have to refer to senior officials at the ministry in order to discuss our points..".

Table 8.17

<b>** Tax Information Involvement **</b>		
Yes	[45%]	No [41%] Sometimes [14%]
<b>** Information Accessibility improvements **</b>		
1> Updated publications of tax regulations.		
2> Continuous follow up.		
3> Training / Consultations / In-house libraries...		
4> Better communication with the tax department.		

### 8.10 Conclusion

The findings of this survey justify the view that the decree must be replaced by a new enactment rather than simply be amended. A tax package is suggested for this purpose according to the following sequence:

- 1- Capital gain tax;
- 2- Sales tax;
- 3- Income tax;
- 4- Property tax.

To a certain extent, this package coincides with the package previously suggested by the public (chapter 6).

The efficiency of the coming tax system seems to hinge

on the improvement of current accounting practices as well as auditing procedures. This necessitates the development of an organised accounting profession, as follows:

- 1) Recognising a responsible body for accountancy;
- 2) Establishing codes of professional conduct;
- 3) Securing all possible support from all concerned.

For the most part however, both accountants and accounting firms are responsible for smooth operation of the tax machinery. The accounting function in this sense is of great value for:

- 1) Optimal planning and recording of business transactions;
- 2) Measuring taxable incomes and verifying record transactions;
- 3) Proper arranging of tax incentives and related issues;
- 4) Providing requisite tax services.

Finally, there are signs of strong correlation between the accounting profession and tax orientation in the country. Although the latter theme relies on the effectiveness of the first, it is clear that tax is certainly the foreseen agent of accounting development in Kuwait.

## Chapter Nine

### "Comparative Outlook"

#### Introduction

This chapter is to highlight the taxation systems of Kuwait in comparison with those of Arab countries, namely Saudi Arabia, Egypt, and Kingdom of Jordan. The selection of these countries was based on the similarity among these countries in the economic, social, and political frontier.

#### 9.1 Saudi Arabia

##### 9.1.1 Income Tax

Income tax imposed in Saudi Arabia is similar to the Kuwait system of taxation. Saudi Arabia was the first Gulf state to introduce income tax in the region. In fact "it was only in November 1950 that the first income tax law was issued by a royal decree. The imposition of taxes affected both personal income and corporate profits with minimum exemptions in both categories".<sup>(1)</sup> Salaries and wages of foreign persons have been exempt from tax since 1975.

Profits of Saudi-registered entities owned jointly by foreigners and nationals are apportioned. Foreign participants are subject to income tax on the basis of their share in the entity, while the Saudi share is subject to Zakat.<sup>(2)</sup>

##### 9.1.2 Zakat

Zakat is a religious charge payable by all Saudi nationals and companies which are incorporated in a GCC state and carrying on business in the kingdom. Zakat is

payable on capital goods, properties, and profits or incomes. The general rate of Zakat is 2.5% on both income and capital with special provisions for agricultural produce and livestock (Royal Decree 17/2/28/2877 of 1950).<sup>(3)</sup>

### 9.1.3 Other Sorts of Taxes

In addition to income tax and Zakat, the kingdom has some indirect taxes including custom duties on all imported goods payable at 3% to 20% of the CIF value. A royalty is also payable by those allowed to exploit natural resources (special tax regulation is applied to petroleum companies).<sup>(4)</sup> Finally, there is a social security system whereby the employer has to contribute 8 to 10% of the gross salaries and wages paid to his employees and to deduct 5% from the employee each month (Social Security Act).

### 9.1.4 Taxable Income Computation

Generally speaking, income generated in Saudi Arabia is subject to income tax (the concept of income source). Tax rates applied in the kingdom are divided as follows:

#### A. On Individuals:-

	S.R. ----	Rate ---
First	16,000	5%
	16,000-36,000	10%
	36,000-66,000	20%
Over	66,000	30%

#### B. On Companies:-

	S.R. ----	Rate ---
-	100,000	25%
-	Over 1,000,000	45%

### 9.1.5 Depreciation Rates

The straight-line method of depreciation is the prevailing method utilised. The approved depreciation rates are;

	%
- Building...	3
- Generating turbines...	5
- Drilling & welding equipment...	7.5
- Furniture & fixtures...	10
- Construction Equipment...	12.5
- Office equipment...	15
- Compressors...	20
- Automobiles...	25

### 9.1.6 Concluding Remarks

1> The main tax rationale throughout the country's history has been to raise revenue without concern for other objectives. The role of tax in the kingdom economic development, for example, has not yet been comprehended in the tax horizon.<sup>(5)</sup>

2> The tax rate is proportional and reaches only (30%) at an income exceeding S.R. 66,000. That is, high income people are treated in a similar manner to lower income people, even though their ability to pay is higher;

3> Since companies' tax rates are double those on personal income (40% and 20% respectively), evasion channels have been devised by entrepreneurs which have affected the tax proceeds (establishing individual partnerships);

### 9.1.7 Tax & Accounting Mutuality

The first attempt to develop tax accounting was in 1950 when taxpayers were required to maintain proper accounting records.<sup>(6)</sup> Tax regulations have stipulated

that tax returns be certified by a chartered accountant in order to be accepted. The picture, however, was premature in 1950 because it presumed the existence of an effective accounting profession of great competence and high morals. (7)

Some authors even expressed doubts regarding the degree of tax understanding possessed by the accounting firms:

"..Lack of understanding of the Saudi tax system is reflected in published audited financial statements, where Saudi corporations overpaid the Zakat on net profit simply through including dividends, which have been subject to the Zakat before, in the profit and loss account.." (8)

The reciprocal effect of tax and accounting had greater impact on the former rather than the latter. Among the several ingredients that influenced tax provisions in the kingdom were all the known factors except the role of the accounting profession. Taxable income, for example, was mainly influenced by practices and provisions outside the kingdom rather than the contribution of local accounting.

"..Taxable income in Saudi Arabia is mainly determined by the accounting concept of income. This coincidence is attributed to the fact that the income tax law was influenced by tax provisions and practices abroad more than by the accounting profession at home, because the accounting profession at that time was little known, moreover, the number of corporations was few; they could not have had much influence over the development of a concept of taxable income..". (9)

Another example is minister of finance decision No. 340 first permitted deduction for tax purposes of a depreciation allowance up to 10%.

"But later in his decision No. 431, he referred to business practices in countries such as Egypt, Britain, and France, and reached the conclusion that reasonable allowances for

depreciation should be determined by established business practices rather than by predetermined percentages".<sup>(10)</sup>

The influence on this particular area of tax and accounting interaction, was twofold. The history of depreciation shows that accounting thought prevailing at that time had significant influence on the development of tax provisions. While the inclusion of more rigid tax provisions to achieve tax objectivity, reflected accounting principles in the kingdom.<sup>(11)</sup>

Accountants have always attempted to harmonise taxable and accounting income in order to maintain a sound utilisation of accounting principles. This goal has directed Saudi accounting towards conservatism. "However, the degree of conservatism will be greater for non-Saudi companies subject to up to 40% income tax than for Saudi companies subject to 2.5% income Zakat".<sup>(12)</sup>

Similarly, investment tax credits were not granted in the Saudi tax legislation and the adoption of such provision would have further the diversified accounting principles and the associated difficulties. This implies "the question of proper accounting treatment and whether to consider it a tax reduction, asset cost reduction, or some other variation".<sup>(13)</sup>

The success of Saudi Arabia income tax largely depends upon the existence of a competent accounting function. This role has recently been acknowledged by the Saudi Ministry of Finance and national accountants in their co-operation to establish tax accounting standards.

## 9.2 Egypt

### 9.2.1 Tax Acts

The Egyptian tax system is somewhat involved. Direct and indirect taxes in many forms are levied in Egypt. These taxes and the respective laws arranging them are described below (Table 9.1). The current Egyptian tax system contains the following taxes - illustrated in Figure 9.1:

#### A. Direct Taxes...

1> Wealth Tax (on land, real estates, inheritance duties).

2> Income Tax:-

I. Tax on actual individual revenues:-

a. On business incomes:

1) Tax on mobile capital;

2) Tax on commercial & industrial profits.

b. On individual incomes:

1) Payroll tax;

2) Tax on profits of non commercial professions;

3) General income tax.

II. Tax on fund companies' profits (abolished in 1988).

#### B. Indirect Taxes...

1> Customs tariffs; 2> Stamp taxes; 3> Entertainment;

4> Some royalties; 5> Consumption taxes.

### 9.2.2 Tax on Actual Individual Revenues

For the purpose of tax enforcement, taxpayers and taxable income sources are classified into;

1- Egyptian nationals: Income from all sources is taxable.

2- Residents: Income from all sources is taxable.

3- Non-Residents: Only income derived in Egypt is taxed.

#### 9.2.2.1 General Tax

The general tax on income (surtax) is assessed on aggregate net income according to the following scale;

Net Income (L E).	Tax Rate (%)
0 -1200	--
1201-2000	8
8001-9000	25
Over 100,000	80



Table 9.1

## "Tax Legislation in Egypt 1930-1983"

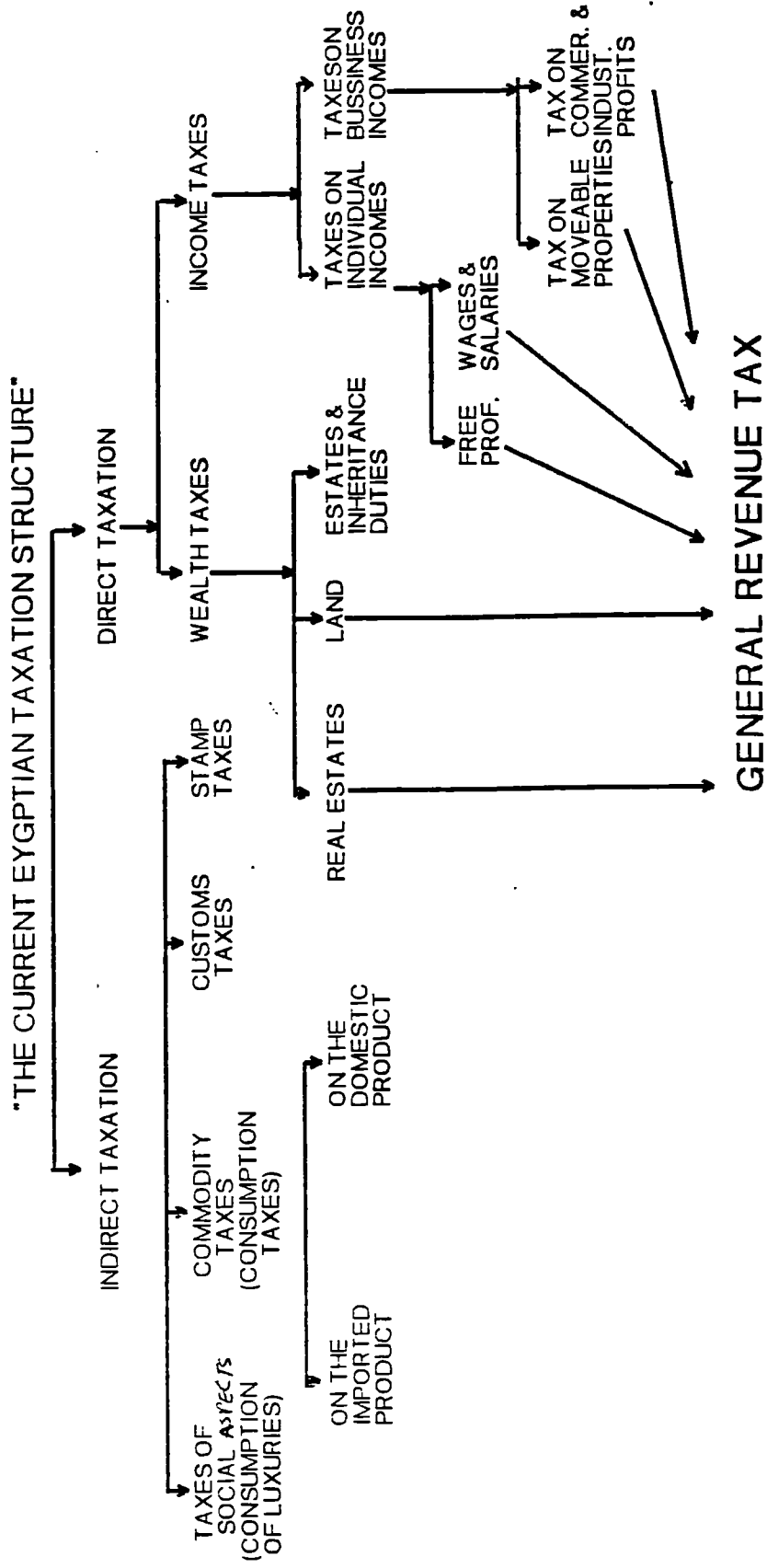
	No	Act	Concerning	Amended
D	1.	14 / 1939	Taxes on non-movable properties, profits, income	
	2.	-- / 1944	Levying estates (Inheritance) duties	
	3.	99 / 1949	Introducing general tax on income	early 1950
I	4.	43 / 1974	Stimulating foreign investments & promoting savings (incentives for industrial development & mining )	32/1977
R	5.	32 / 1977	Arab investments & foreign capital (free zones, up to 8 years exemption)	
E	6.	46 / 1978	Taxation equity (extending the scope of taxable incomes).	Abrogated by law 157/1981
C	7.	157/ 1981	Reforming income tax, abrogating defence and national security tax. This law envisaged the following principles; 1>Social justice (exemption granted to limited incomes - general tax limit of L E 2000); 2>Promotion of saving & investment (agriculture and industry); 3>Rigid tax declarations and book keeping procedures to eliminate tax evasion.	87/1983
T				
T				
A				
X	8.	87 / 1983	Amending law 157/1981 (increase tax on income brackets - higher rates on commercial & industrial profits over L E 13500:40% & over L E 4500: 32% )	

	No	Act	Concerning	Amended
I	1.	2 / 1930	Customs tariff enactment	66/1963
N	2.	44 / 1939	Stamp duty imposition	244/1951
D	3.	244 / 1951	Modifying stamp duty rates of 1939.	111/1980
I	4.	66 / 1963	Few modification to protect domestic industries.	
R				
E	5.	111 / 1980	Further adjustment to law 244/1951 stamp duty rates.	
C				
T	6.	202 / 1980	Presidential decree dividing custom tariffs into; on imports & on exports	
T	7.	133 / 1981	Merging all indirect taxes under "consumption tax"	102/1982
A				
X	8.	102 / 1982	The inclusion of more taxable goods under consumption tax.	

- Compiled From;

- 1- Various ministerial laws, ministry of finance, Egypt.
- 2- National bank of Egypt, economic bulletin, published by the research department, Vol. XXX VII, No.1, 1984, PP. 9-45
- 3- Platt, C. J., "Tax Systems of Africa, Asia and the Middle East", Gower Publishing Co., Hants, 1982.
- 4- Robert E. D., Hayek P. E., and Zaki, F. A., "Foreign Investment in Egypt"; Fund for Multinational Management Education, New York, 1979.

FIGURE 9.1



### 9.2.2.2 Payroll Tax

Income tax on salaries and wages rise gradually with successive net income thresholds as shown in table 9.2.

Table 9.2  
"Payroll Tax Rates in Egypt"

Bracket No.	Net Income. (L E)	Tax Rate (%)
1	2000	--
2	2000-3000	8%
3	3000-4000	9%
4	4000-5000	10%
5-9	+ 1000	+ 1%
10	10000-20000	18%
11	20000-25000	22%
12	25000-30000	24%
13-16	+ 5000	+ 2%
17	50000-60000	35%
18	60000-65000	40%
19	65000-70000	45%
20	70000-75000	50%
21	75000-100000	55%
22	100000-200000	60%
23	200000 & Over	65%

- Source: Income Tax Law No. 57/1981.

### 9.2.2.3 Commercial & Industrial Profits Tax

Private commercial and industrial earnings are charged comprehensively subject to limited exemptions. Tax rates under this provision are;

	Net Income (L E)	%
First	1000	20
Following	1500	23
Following	2000	27
Following	2500	32
Following	3000	35
Following	3500	38
Over the Above		40

Profits of industrial activities are subject to the following;

	Net Income (L E)	%
First	1000	20
Following	1500	23
Following	2000	27
Over the Above		32

#### 9.2.2.4 Tax on Non-Commercial or Industrial Profits

This tax is applied on professions or activities which are not classified under any other tax category. Tax on non-commercial profits rise on a graduated scale with successive net income thresholds as follows:

Net Income (L E)	Tax Rate (%)
First 1000	18
Following 1500	20
Following 2000	25
Amounts over the above	30

#### 9.2.2.5 Tax on Movable Assets

Generally, this tax is imposed on interests from loans, debts, salaries, etc. All these sorts of income are subject to defence, national security, war effort, and municipal tax, which are additional taxes on net income or profits imposed after surtax computation. Their rates are:

	Defence	National Security	War Effort	Municipal
Salaries & Wages...	1.5-6%	1-4%	--	--
Non-Commercial Profits.....	10.5%	8%	2.5%	--
Commercial and Industrial Profit..	10.5%	8%	2.5%	1.7%
Income from movable capital assets.....	10.5%	8%	2.5%	2.55%

### 9.2.3 Concluding Remarks

- 1> Due to the heavy and diversified packages of taxation the country has undergone, tax proceeds have rapidly increased at an annual growth rate of 14% during the last 20 years.<sup>(14)</sup> This financial resource has made a significant contribution to the GDP figures of Egypt (approximately 1/4 of GDP). Indirect taxes have formed more than 70% of total tax proceeds (over 80% in some years).
- 2> The private sector contributes 61% - 93% of total taxes. While large-income taxpayers (free professions and general tax) make only a modest contribution to total direct taxes (2-3%). "This indicator highlights the unbalanced taxation structure and the limited scope of the taxable community".<sup>(15)</sup>
- 3> The Egyptian taxation system does not reflect a clear trend or policy. Even though the financial purpose is always emphasised, some doubts have been raised regarding the realisation of such objective (e.g., the accumulation of ever increasing tax arrears, the ignorance of tax transfer incidences, the leniency of exemptions).<sup>(16)</sup>

### 9.2.4 Tax & Accounting Mutuality

This interaction, in fact, is reflected in more co-ordination between the two fields within the accounting standards formed by the standard setting committee established for this purpose. Among the issued standards, accounting guideline No. 3 was dispatched for depreciation accounts and the relevant tax accounting ought to be applied.<sup>(17)</sup> Moreover, standard No. 4 "foreign exchange

transfer prices" has been issued in response to tremendous pressure from multinational enterprises to lessen the effect of this problem, particularly in relation to tax.

The issue of law No. 133 of 1951 (regulating the accounting and auditing professions), signified the importance of the profession. Auditors have since then begun to examine and legally certify tax declarations.

Law No. 253 of 1953 (amending law No. 14 of 1939) legislated the certification of taxpayers' declarations by a licensed accountant. The auditor's responsibilities were further regulated under article 85 and 85 (A, B, C) of the aforesaid law where comprehensive penalties were constituted to be imposed on dishonest auditors.<sup>(18)</sup>

The executive regulation to tax law 157/1981, has also contributed in establishing accounting rules applied to realisation of net profit for tax purpose.<sup>(19)</sup> These rules were legislated in 6 articles that listed the accounting methods used in certain cases (i.e., real estate purchasing or selling, construction cost of disposed buildings).

Furthermore, Minister of Finance decree No. 168/1982 has further regulated the accounting procedures related to the maintenance of accounting documents and the taxation card associated with each taxable account. The foundation of a tax committee within the accounting body (Egyptian Accountants and Auditors Association), the pronouncement of tax accounting guidelines, are further features of such regulation.

### 9.3 Jordan

#### 9.3.1 Tax Acts

Jordan has imposed income tax since 1933. However, Jordan's first attempts to impose modern taxes were in 1964 (Law No. 25), and in 1985 (Law No. 57). Table 9.3 shows the development of tax laws in Jordan.

#### 9.3.2 Taxable income

##### 9.3.2.1 Personal Taxation

Income taxes are imposed on income earned in the kingdom according to the following tax rates (law 25/1964);

"The Income Tax Rates in the 1964 Law"\*

Chargeable Income	Tax (at lower band)	Marginal Tax Rate %
0-400	--	5
401-800	20	7
801-1200	48	10
1201-1600	88	15
1601-2000	148	20
2001-2400	228	25
2401-2800	328	30
2801-4000	448	35
4001-6000	868	40
6001-8000	1668	45
8001 and over	2568	50

\* Plus 10% Social Service Tax

- Source: Income Tax Law No. 25 / 1964.

All income from different sources is pooled in a single total and subject to a single progressive rate. A 10% surcharge is also added to the income tax as social services tax. Only income derived from sources within the kingdom is subject to tax.



Table 9.3

## "Jordanian Tax Acts - 1925- 1985"

	No	Act	C o n t e n t s
	1.	-- / 1925	Urban land & building tax 1925
D	2.	-- / 1939	Income tax on wages & salaries in the east bank.
	3.	-- / 1941	First income tax in the west bank.
I	4.	26 / 1945	Income tax on profits & incomes in the east bank.
	5.	13 / 1947	Repealing income tax law of 1941.
R	6.	50 / 1951	Income tax for the unified banks.
	7.	60 / 1951	Amending 1925 law (minor charges).
E	8.	11 / 1954	Municipality tax (on land or property at 17%).
C	9.	12 / 1954	1) Abolishing Law 50/1951; 2) Reducing the progression of the tax rates; 3) Excluding Jordanian overseas incomes from taxation.
T	10	30 / 1955	Taxes on rural land & buildings.
	11	15 / 1963	1) Amending law 30/1955; 2) Progressive specific rates (5% on industrial buildings & between 0.7 to JD 1.5 on land).
T			
A	12	42 / 1963	1) Increasing the tax rates on building (8-10%); 2) Decreasing tax rate on land (8-5%)
	13	25 / 1964	1) First modern income tax; 2) Global income concept -all sources 3) 10% surcharge (social service tax)
X			
	14	9 / 1967	New rates (10% on land & 24% on net annual rental value of buildings).
	15	57 / 1985	1) Abrogating law 25/1964; 2) including all sources of income.

I N D I R E C T T A X	No	Act	C o n t e n t s
		1.	1 / 1962
	2.	25 / 1966	Unified additional taxes on imports (surcharge or ad valorem)
	3.	80 / 1966	- Ad valorem supplements
	5.	28 / 1969	- Additional tax on imports
	6.	78 / 1976	- Regulation for imports license fee of 4% of the value
	4.	82 / 1979	- 11% surcharge on imports subject to tariff

- Sources:

- 1- Smadi, M. A., 1982.
- 2- Ministry of finance, annual reports, various issues, Jordan.
- 3- Central Bank of Jordan, monthly statistical bulletin, Vol. 16, No. 7, July 1980.
- 4- Government of Jordan, Income Tax Law No. 25/1964.
- 5- Official Gazette, Nos. 1800 of 17/10/64 and amendments- No. 2833, page 28, January 1st, 1979- No. 2613, p. 571, March 16, 1976.

### 9.3.2.2 Company Taxation

Companies' taxable income is defined as "net profit after deducting the legally accepted operating expenses as defined by the law (articles 9-13)". An amendment in 1979 distinguished between 3 types of company according to the field of activity. Each group of these companies is subjected to a specific flat rate as follows: (20)

Company Type -----	Tax Rate % -----
1. Commercial banks, financial and insurance companies, foreign exchange.	45
2. Public industrial shareholding companies	38.5
3. Other public & private shareholding	40

### 9.3.3 Indirect Taxation

Jordanian indirect taxation embraces various sorts of imposts. The earliest type was (tariff system). Among the additions to the Jordanian tariff system, regulation No. 82 of 1979 imposed 11% additional surcharges on taxable imports.

Over and above these imposts, in accordance with regulation No. 78 of 1976, a 4% license fee was imposed on imports except for exempted items, especially those imported by government departments. (21)

### 9.3.4 Other Tax

In addition to the taxes discussed above, there are:

- 1> University tax of 1% on joint stock companies; (22)
- 2> Tax on the issue of capital share (1/1000%);
- 3> Transfer duties on real estate (10%);
- 4> A social welfare tax of 10%.

### 9.3.5 Deductions

The chargeable income is ascertained after deducting

all disbursements and expenses such as; 1) Paid interests, rents, annual contributions, taxes, etc.; 2) Bad and doubtful debts and donations; 3) Deductions in respect of losses and depreciations. Losses may be carried forward for deduction from taxable income derived during the succeeding 6 years. Depreciation is calculated by the straight-line method at rates determined by the director of the income tax department. The following are some approved rates;

	%
	---
Buildings	2-4
Machines	8-12
Furniture & Fixtures	9
Equipments	12
Mobiles & Lorries	15
Heavy Vehicles	20-25

**9.3.6 Concluding Remarks**

The Jordanian tax policy was set to raise revenue as the first priority, followed by social aspects. Yet, such goals have not been completely realised since government domestic revenues did not grow as fast as government expenditures - domestic revenues were slightly above 40% of total government revenues.<sup>(23)</sup> Political power as well as the tax system's deficiency in arranging direct taxes were the main causes of this situation. Tax administration is also responsible for a large range of trades and professions are not yet covered by the tax system.

As far as the tax rates are concerned, criticisms have been made of the sufficiency of these rates, "The law put a ceiling of 50 per cent on the upper limit of the income tax

schedule. This reveals that the law gave the upper income levels a clear advantage, while in other countries the upper limit of income tax is far more than the 50% level".<sup>(24)</sup>

Another feature is the dominance of indirect taxes over other direct imposts in Jordan. Nearly 48% of domestic revenues came from import duties in 1972, that is over 72% of total indirect taxes. This symbolise the revenue objective of the tax strategy and to a lesser extent the development aspects.<sup>(25)</sup>

#### **9.3.7 Tax & Accounting Mutuality**

The role of the Jordanian accounting system in tax implementation has been very poor. Tax legislation has been almost silent in this respect, except for a few requirements of accounts and maintenance of relevant books.

The Jordanian government has tried to encourage the local accounting profession to contribute towards tax enforcement during the last seven years. In 1975 in particular, the government established significant communication channels with the accounting profession (leading accounting firms and the academics) before the promulgation of income tax law No. 57 of 1985. Indeed such contact has resulted in more responsibilities on the part of accountants (Article 22).

#### **9.4 Regional Tax Systems - A Comparative Outlook**

Before investigating such comparison, it is worth noting that the origin of each country's tax system has had

a great influence on the tax policies of these countries. All Gulf states, Jordan and Iraq were former British colonies that have adopted the English tax structure. Whereas Egypt, Syria, Lebanon and North African states were dominated by the French empire early this century, thus their taxes were imported from France. Differences in tax sources have been reflected in various aspects of taxation in the selected countries. Taxable income, for example is assessed separately on several kinds of earnings Egypt, while it is treated as a whole in Jordan.

#### 9.4.1 Taxables

Basically, all legislations have made foreign establishments and entities of all kinds subject to tax. However, foreign individuals have been treated differently in each country. Kuwait, for example, exempts foreign individuals from paying taxes, Saudi Arabia enforces income taxes on them (rather fluctuated enforcement), while Egypt and Jordan impose income taxes on them where they satisfy certain rules.

National enterprises are, on the other hand, exempted in both Kuwait and Saudi Arabia from paying income taxes, but required to pay Zakat in Saudi Arabia. In Jordan and Egypt, these entities are subject to income tax and counted taxable units, regardless of their organisational forms.

#### 9.4.2 Taxable Income

1) Taxable income under the Egyptian tax system include all sources of revenue generated or gained by the taxable. In contrast, only generated revenues are taxable,

for other sources of revenues are either exempted (Kuwait & Saudi Arabia) or subject to other sorts of tax (Jordan).

2) All tax legislations allow certain expenses to be deducted from taxable income, though there are variations in the extension and percentage of such allowances (e.g., Saudi enforcement is more rigid in terms of allowing depreciation and allocations than Jordan).

3) The Egyptian legislation does not discriminate between ordinary and extraordinary revenues (earnings & capital gains) for tax purposes (general tax).

4) All these legislations do not allow certain expenses (bad debts allocation) even though they represent taxables' conservative approach. This treatment is out of step with accounting principles (the matching concept).

5) The determination of loss carry forward or backward incentive has varied from severe restriction (Saudi Arabia) to very relaxed enforcement (Kuwait).

6) Only the Egyptian legislator has imposed taxes on working capital gains (shares - treasury bills, etc.)

7) The treatment of head office overheads is regulated within certain limitations (Egypt, Jordan), whereas such treatment is not clear yet in Saudi Arabia or Kuwait.

#### **9.4.3 Tax Rates**

Generally all countries have adopted progressive taxation on income. Egypt, however, enforce proportional tax rates on commercial and industrial profits in such a manner as to promote this sector in the country. Kuwait,

Saudi Arabia and Jordan impose progressive tax rates regardless of the revenue source.

#### 9.4.4 Exemptions

Exemptions in all four countries are of a similar nature, except for Egypt which offers more restricted but advanced types of exemptions. Social exemptions, for example, are provided in Jordan to a very limited extent, but Egypt is the only country to offer a wide range of social exemptions (dependents, personal allowance, etc.). However, these exemptions are provided more widely to individuals than to enterprises.

#### 9.4.5 Tax Computation

1) Tax computation procedures are almost analogous in all legislations. The tax department in each country has established its own rules for examining declared tax liabilities, and gives little weight to the view of the external auditor who examines these declarations.

2) Accounting firms views are not recognised in tax disputes. Although such role theoretically exists in all legislations, it is up to the tax authority in each country to determine their role in tax enforcement.

3) Taxables are obliged to maintain honest accounting books under all legislations. However, it is up to tax authority to strictly enforce this requirement, which unfortunately has been poorly exercised by the Gulf states compared with the more organised Egyptian system.



4) Some tax administrations (Egypt & Jordan) have been furnished with the authority to impose additional tax declaration. Other legislations have yet to experience such and other privileges.

5> Tax application is pursued in these countries in one of two ways; 1> Based on tax declarations 2> through arbitrary assessment. Similarly, tax instalments are computed by common methods, but their numbers vary ( Kuwait and Saudi Arabia 4, Egypt 2, Jordan up to 3).

#### 9.4.6 General Evaluation Of Tax Status

1> The variation in tax enforcement in these countries is attributed to the origin of the tax legislation. Also, some tax legislations were partly based on religious grounds like the Zakat system and the income tax on foreign entities' profits. This system is adopted in Saudi Arabia and Libya. However, in general it appears that the tax system in these countries is a direct reflection of their economic growth and cultural progress. The Gulf states, in comparison with Egypt or Jordan, for example, are well off in terms of the public finance prospects, therefore, less need to enforce income tax on individuals is perceived in the Gulf states, while such taxation was enacted same considerable time ago in Egypt and Jordan.

2) The tax systems examined have included both direct and indirect taxation a high proportion being of the latter type. In fact its effect is remarkable in relatively poor countries like Egypt compared with the wealthy Gulf states.

Egyptians on low income are worse off when indirect taxation rises sharply, because their incomes are fixed.

Among the various reasons for the spread of indirect taxes in these countries are:

- a> The excessively low per capita income especially in highly populated areas such as Egypt;
- b> Due to the harshly economic atmosphere, countries such as Egypt and Jordan have established close ties with the international community. This has stimulated more customs and duties on the expanding imports;
- c> The high consumption rates;
- d> The influence of foreign investment concessions;
- e> The imbalance in the social structure of these societies;
- f> The ease of administrating and collecting indirect taxes.

3) The common features of these legislations include;

- a> Tax is objective rather than subjective (imposed on income without regard to the taxpayer's status);
- b> Tax assessment (tax declaration & arbitrary assessment);
- c> Tax rates in most regional countries are progressive;
- e> The main tax objectives are financial in most states.
- f> Tax administrations and correlative technical tools are not sufficient.
- g) Social aspects of taxation are still not encountered. Egypt has started to address some of these aspects (the redistribution of wealth), but it need to be more legislated.
- h) Promotion of foreign investments is not fully realised in the Arabian world (tax incentives).

i) The tax policy is installed to fulfil financial goals. Little is attached to the role of tax in economic growth.

#### Notes

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22. International Bureau of Fiscal Documentation, Taxes and investment in the middle east, loose-leaf supplement No. 38, July 1987, PP. 44-46.
23. Smadi, M. A., "Public Expenditure and Taxation in Jordan: 1954-1979"; Un-published Ph.D. thesis, University of Keele, 1982, PP. 135-137.
24. Smadi M. A., op. cit., P. 150.
25. Ministry of Economy, "Encouragement of Investment" Law No. 53 of 1972, (Aman, Nov., 1972), PP. 244-245.

## *Chapter Ten*

### *"Kuwait's Indirect Tax"*

#### **10.1 Introduction**

Indirect taxes are virtually unknown in Kuwait. Except for import duties of 4% and other charges or administrative fees, no indirect taxes are levied in Kuwait. In this chapter focus is given to the feasibility of introducing indirect taxes in Kuwait.

#### **10.2 Import Duties**

Revenues from import duties have gradually decreased over the past 5 years. In the 1982/83 budget, import duties represented 3.07% of total revenues, a very small proportion. This percentage dropped to 2.5% in 1985/86 budget because of the import recession as well as the impact of the Gulf War.

However, a change began in 1987 when this percentage rose to 3.46% for the first time since the beginning of the decade. As illustrated in table 10.1, the average contribution of import duties in total revenues was about 2.7% during the last 8 years. This percentage is considerably lower than those of developing countries.<sup>(1)</sup> One would even conclude that the general level of tariffs in Kuwait is negligible in comparison with those of many developed countries.

##### **10.2.1 Elasticity of Import Duties**

In view of the current import substitution position, import duties are bound to decline because of the erosion in the customs base. Therefore, the ultimate objective

should be the creation of an income elastic duty system that provides an automatic increase in customs revenue in the long run. One possibility is to measure the elasticity of import duties and use the results in the tax policy.

Table 10.1

" Contribution of Import Duties to Total Revenues "  
1982/83 - 1986/87  
KD,000

Year	Import Duties	% Change	% to Total * Indirect Tax	% to Total Revenues
1982/83	79.851	(21.1)	28.5	3.07
1983/84	67.420	(18.4)	23.4	2.12
1984/85	61.312	(9.9)	23.0	2.23
1985/86	59.481	(3.1)	23.2	2.53
1986/87	66.353	10.35	27.6	3.46

The Average Contribution =  $13.41 / 5 = 2.682\%$

\* This includes: Import duties, Taxes on international trade, Taxes and fees on goods and services, Taxes on property transfer, and government departments service charges.

- Source : Annual Statistical Abstract, Edition XXIV, Ministry of Planning, Kuwait, 1987, p. 270.

### 10.2.2 Assessment of Elasticity

The approach used to calculate elasticity of import duties is presented in this section. Disaggregation is used here to identify the elasticity of import duties to its

base. Other components of indirect taxes are not included in this approach because of their minor contribution to GDP. The results obtained from this measure permit the identification of that part of the revenue growth which is within the control of the authorities, or the import duties elasticity to indirect tax base.<sup>(2)</sup> This constituent may be raised by administrative reforms, and thus in this sense the tax revenue is within the government control. On the other hand, the tax base to GDP elasticity shows the growth of the base to changes in the economy structure.

Due to the simplicity of the tariff structure which does not identify all variables of import duties nor other duties, further disaggregation is adopted here to measure the elasticity of some imports categories. This method was employed in a similar case in Pakistan to gain better understanding of the tax base.<sup>(3)</sup> It was concluded that the excise elasticity was elastic to total national income, but with respect to the commodity base it was generally below unity. In other words, further disaggregation showed that those taxes which appeared to be elastic sources of revenue, were not so with respect to their tax bases.

### 10.2.3 Elasticity Assessment Results

#### A. Indirect Tax:

The definition of indirect taxes here includes import duties and other services charges as shown in table 10.1 above. The formula used here is a double-log and linear form (using Stat-Graph Computer Programme);

$$\text{Log ID} = a + b \text{Log Z}$$

Where, ID = Indirect Tax

Z = GDP at factor cost.

Applying data of the period 1979-1986 obtained from the Accounts Department, Ministry of Finance, the result was:

$$\text{Log ID} = 7.40 + 1.68 \text{Log Z}$$

(5.61)

$$R^2 = 0.63 \quad DW = 1.63 \quad DF = 18$$

Figures in ( ) = t-values

The elasticity coefficient is well above unity at 1.68 and the high  $R^2$  of 0.63 reflects a relatively strong correlation between GDP and indirect taxes. In addition, the low Durbin-Watson statistics (DW) of below 2 indicate no auto-correlation problem exists. Examination of import duties could further explain this elasticity coefficient.

#### B. Import Duties:

Import duties elasticity is first calculated with respect to GDP to their base, then the elasticity of base to GDP. The respective results are given below:

$$\text{Log IP} = a + b \text{Log Z}$$

$$\text{Log IP} = -5.65 + 1.58 \text{Log Z} \quad \text{-----}> \quad [ 1 ]$$

(22.65) Import Duties  
to GDP

$$R^2 = 0.96 \quad DW = 1.85 \quad DF = 18$$

Where, IP = Import Duties, Z = as above, and

$$\text{Log IP} = -1.75 + 0.98 \text{Log TP} \quad \text{-----}> \quad [ 2 ]$$

(29.03) Import Duties  
to Total Imports

$$R^2 = 0.97 \quad DW = 1.66 \quad DF = 18$$

Where, IP = as above, TP = Total Imports, and

$$\text{Log TP} = -1.96 + 1.05 \text{ Log Z} \quad \text{-----} \rightarrow \quad [ 3 ]$$

(7.17)

Total Imports  
to GDP

R = 0.76                  DW = 1.72                  DF = 18

At a 1% level of confidence, the income elasticity of import duties is above unity (the t-statistics value). Again there is a notable association between an increase in GDP and import revenues as indicated by  $R^2 = 0.96$  (formula 1). However, the elasticity of import duties to its base (formula 2) indicates the contrary. This elasticity is below unity (0.98), which could mean that the tax base is not properly taxed, despite the remarkable correlation between them as given by the high  $R^2$ . This low elasticity is attributed to several reasons such as the very low rate of import duties (4%), the large scale of exemptions, and the changing mix of imports due to import substitution.

Simultaneously, the relation of tax base with GDP (the tax base income elasticity) at 1% level of confidence is above unity (1.05) which is a significant indication considering the low percentage of indirect taxes to GDP. Also, a reasonable link between GDP and the tax base may be inferred from the  $R^2$  of 0.76 (formula 3).

Altogether, the above findings suggest that there is a good revenue potential from import duties provided that the tax base is properly taxed. Support for this view is derived from the already high income elasticity of the import duties as well as that of the tax base to income. Therefore, under perfect conditions and assuming ease in administering import duties, the contribution of import



duties to GDP is in the hands of the authorities.

Obviously, without leading to what is known as "lop-sided development of the tax system",\* it would seem vital to establish a policy of co-ordination between import duties and other levies.

Overall, these statistical findings, along with the expanding economic structure of Kuwait may lead to such a relationship between import duties and domestic tax. This perception is supported by the widely-held principle that after a certain stage of economic development, international trade taxes give way to taxes on domestic transactions.<sup>(4)</sup>

### 10.3 Indirect Taxes Most Applicable to Kuwait

Whatever the proposed tax for Kuwait, be it on income, outlay, or wealth, it first has to be scrutinised in terms of its suitability to the needs of the country. No tax is popular, and the fact that a particular tax may suit one country by no means indicates its suitability elsewhere. Therefore, every country should be taken as an independent case. This observation has been well stated by Stout:

"..It is not the tax changes themselves that one should judge but all the circumstances of their introduction " (5)

It is also impossible to form a perfect tax system that would fulfil all the known objectives of taxation. The evaluation of any specific tax with regard to all the principal objectives of taxation is rather vain and sterile.

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\* For a case whereby tax diversification is ignored and easy taxes are continuously tapped, see Hart A. G., "Fiscal Policy in Latin America"; Journal of Political Economy, Vol. 78, July-August 1970, pp. 857-89.

Accordingly, analysis of the applicability of various types of indirect tax to Kuwait should prove useful in:

- 1) Determining the appropriate tax;
- 2) Evaluating the capability of the administration.

This analysis is presented by means of a review of common indirect taxes, and their pros and cons, with special reference to Kuwait.

### 10.3.1 Import Duties

Developing countries, in particular, rely significantly on custom duties. Their many advantages include:<sup>(6)</sup>

- 1) They are easier to administer;
- 2) Their cost / revenue ratio is relatively small;
- 3) Small economies are able to avoid tariff retaliation;
- 4) They restrict the import of consumer goods;
- 5) These duties may positively affect the saving / GNP;
- 6) Cause minimum interference with investment incentives;
- 7) Assist in capital development planning;
- 8) They meet the revenue objective if properly based;
- 9) They serve the equity criteria (differential rates).

On the other hand, import duties have a number of disadvantages (price elasticity of potentially taxable commodities). A conflict may develop between the equity and revenue criteria. For example, goods that may "Justifiably be taxed under the equity criteria may be price elastic. Besides the loss of revenue, higher tariffs on luxuries may instigate development of domestic luxury industries with detrimental effects on economic growth".<sup>(7)</sup>

Also, as far as Kuwait is concerned, import duties are the most convenient tool as their effect on both the economy and on people is minor and gradual. However, considerations should be taken to discriminate between imported goods (e.g., luxuries & essentials).

#### 10.3.1.1 Supplements to Import Duties

These are administrative charges to a substantial percentage of customs and are very often imposed without exemption. These supplements are of relatively low value in terms of the revenue objective. Also, these charges could have damaging effects if they were very high, particularly if combined with lengthy official procedures.

#### 10.3.2 Excise Duties

In order to maintain an equitable indirect tax system, selective excises may be imposed on particular items. By taxing luxuries heavily, for example, or by favourably treating necessities, such an objective may be achieved, although this may create detrimental effects (e.g., on resource allocation, and extra administrative costs).<sup>(8)</sup> However, with a limited number of items, excise tax is administratively feasible and could satisfy the benefit principle, though it may not satisfy the efficiency criteria.

Excises in Kuwait may achieve two objectives:

- 1) Curtailing unproductive consumption, 2) To raise revenue, especially if properly planned, and as noted by Chelliah, confined to commodities that satisfy any of the following:<sup>(9)</sup>
  - a. High income elasticity of demand;
  - b. Low price elasticity of demand;
  - c. Luxuries consumed by the well-to-do;
  - d. Goods absorbing scarce resources;
  - e. Low cross-elasticity products.<sup>(10)</sup>

Overall, caution must be exercised when applying the tax in order to avoid the substitution effects of imports (e.g., the transfer of consumption to cheaper products)

within the economy of Kuwait. In particular, the Kuwaiti tax policy makers should consider the following:

- 1> the range of domestic commodities which may be affected by import substitution, (the smaller the number, the more feasible is the use of excise taxes);
- 2> the administrative capacity to deal with taxables;
- 3> vulnerability of commodities to excise taxes (elasticity);
- 4> the importance of the revenue objective (the rates);
- 5> the nature of production and distribution, especially at the retail level - the smaller is the scale, the better is the use of excise tax.

### 10.3.3 Sales Tax

An alternative but indirect way of taxing personal expenditure is to levy a tax on the purchase or sale of goods and services. Generally, sales taxes, if applied in Kuwait could achieve the following two main objectives:

- 1) they could raise a huge amount of revenue as they possess a high degree of revenue elasticity over time. Sales tax, if properly designed would be more profitable for the government than a number of excises;
- 2) Sales tax when harmonised with general tax rates, may not disturb the allocation of resources;
- 3) Ease and efficiency in the tax administration. However, objections to sales tax are based on the possible effects of this tax on economic neutrality. These effects can be avoided by a uniform tax at the retail level which is administratively not feasible.<sup>(11)</sup>

#### 10.3.3.1 Types of Sales Tax

Sales tax can be imposed on the production or the distribution of commodities either at a single stage (manufacture, wholesale, retail), or multiple stages (e.g., the turnover tax).<sup>(12)</sup> The turnover tax is calculated at each stage of distribution, has the following disadvantages;

- 1) It discriminates against non-integrated firms;
- 2) Thus, leading to frequent evasion;
- 3) Imports favourability over domestic goods;
- 4) Cause distortion the consumer's preferences;

#### 5) Difficulty in freeing of imports of all cumulated tax.<sup>(13)</sup>

In many developing countries, the common type of sales tax applied is the pre-retail tax whereby tax is collected at the point of importation rather than domestic sale, since most taxable goods are imported in finished form. In some of those countries where the trade structure is controlled by individuals or families on non-commercial charter, the manufacturing form of tax is frequently applied.<sup>(14)</sup>

Retail taxes, on the other hand, are divided to universal sale tax, tax applying to larger and smaller retailers, retail and wholesale level tax on the value added technique.<sup>(15)</sup> But in general, these forms of sales tax require a certain degree of organisation within the retail level.

In view of the advantages and disadvantages of these types of sales taxes as well as the nature of Kuwait's commercial sector, one could recommend a single point sale tax at an advanced stage of tax introduction.

#### 10.3.4 Value Added Tax (VAT)

VAT is a broad-based tax which is assessed at each stage of production and distribution on the increment in the value added. It is more capable of reaching private consumption than any other form of consumption tax.<sup>(16)</sup>

VAT has, therefore, consumption as its base. This base is divided into multi-stage taxes with no overspill into exports, capital investment or business costs. Generally, VAT can be characterised as follows:<sup>(17)</sup>

- 1) It is a sales tax;
- 2) It is a general tax;
- 3) It uses a proportional tax rate(s);
- 4) It can be levied at all stages of production;
- 5) It does not discriminate between industrial organisations;
- 6) tax liability is similar to that in retail sales tax;
- 7) Allow exemptions (Zero rating); (18)
- 8) VAT is impartial between domestic production and imports.

VAT is imposed in all countries of the European Economic Community (EEC), but few developing countries have adopted VAT as it requires the existence of a developed general sales tax, and reliable accounting system.<sup>(19)</sup>

As far as Kuwait is concerned, the application of a VAT system is not recommended at the early stages of tax introduction. Kuwait lacks sales tax which is an essential prerequisite for implementing VAT. Moreover, the domestic industrial production of Kuwait is not sufficiently large as to encourage VAT imposition.

#### 10.4 Concluding Remarks

Results of elasticity measures indicated the significance of customs duties to GDP. It is proposed that import duties be increased, and then prior to reformation of the tax system, goods are classified in accordance with their elasticities.

The conditions of Kuwait inhibit the development of retail sales tax or a VAT system. As an available alternative, the government could consider the application of a general sales tax at an advanced stage of tax introduction. This could be used as a supplement to import duties and a minor scale of excises.

### Notes

1. Mazur M., "Economic Growth and Development in Jordan"; *Economia Internazionale*, Vol. 28, 1975, p. 222.
2. Salama Abdin A., "Sources of Finance for Economic Development in the Sudan"; Ph.D. Thesis, University College of North Wales, 1975, pp. 302-303.
3. See Lewis S. R. Jr., "Revenue Implications of Changing Industrial Structure"; *National Tax Journal*, 20 Dec. 1967, pp. 395-411.
4. Salama Abdin A., *op. cit.*, pp. 314-316.
5. Stout David, "Value Added Tax"; in (*Taxation Policy*); William A. Robinson and Bernard Crick, ed., Penguin Books Ltd., Middlesex, England, 1972. P. 193.
6. Smadi M. A., "Public Expenditure and Taxation in Jordan: 1954-1979"; Ph.D. thesis, University of Keele, 1982, pp. 184-186.
7. Salama Abdin A., *op. cit.*, p. 262.
8. *Ibid.*, p. 268.
9. Chelliah R. J., "Taxation of Consumption Expenditure with Special Reference to India"; in Bird R. M. and Oldman O., "Readings on Taxation in Underdeveloped Countries"; The John Hopkins Press, Baltimore, 1967.
10. Salama Abdin A., *op. cit.*, p. 269.
11. *Ibid.*, p. 271.
12. *Ibid.*, pp. 271-273.
13. *Ibid.*, p. 272.
14. Due J. F., "Alternative Forms of Sales Taxation for a Developing Country"; *Journal of Development Studies*, Vol. 8, 1971/72, pp. 263-276.
15. Due J. F., *op. cit.*
16. Salama Abdin A., *op. cit.*, p. 275.
17. Tait Alan, "Value Added Tax"; McGraw-Hill Book Co. Ltd., Berkshire, England, 1972, p. 1-5.
18. Horsen E. G., "Britain and Value Added"; *Lloyd Bank Review*, No. 103, 1972.
19. These requirements and other difficulties of applying VAT are thoroughly discussed in Lent G. E. et al., "The Value Added Tax in Developing Countries"; I.M.F. Staff Papers, Vol. XX, No. 2, July 1973, pp. 318-378.

## Chapter Eleven

### "Kuwait's Tax Reformation"

#### - Introduction

The chapter begins with a discussion of the tax canons most applicable to Kuwait. An in-depth analysis is made of the transitional stages of the tax reformation, including the objectives of each stage, and its 3 procedures. Special attention is devoted to the the tax authority's organisational structure, and the role of accounting in it.

#### 11.1 Tax Reformation Criteria Applicable To Kuwait

Having considered the economic structure and the socio-economic factors associated with taxation in Kuwait, as well as the outcomes of the empirical investigation, it is possible to identify the major principles of the tax strategy desired for the country as follows:

- 1> The elimination of large un-productive surpluses;
- 2> The redirection of those surplus toward productive development efforts;
- 3> The adoption of more social aspects such as;
  - [a] Equal distribution of the burden of taxes (in accordance with each person's tax capacity);
  - [b] Objective redistribution of wealth;
- 4> The assurance of flexibility of the tax system.

This is rather a complex combination of principles difficult to construct into a tax policy. However, this policy would be divided into long-term stages in order properly to accommodate these elements.

A thoughtful examination of the components of this "transitional" tax strategy highlights some imperative correlations. The tax policy is aimed at promoting economic development among all sectors, which must share



equitably in the burdens imposed by this policy. Socially, similar observations would be recognised with regard to the different classes of the population, as made by Chelliah;

"..If the poorer classes are prevented from increasing their incomes, the richer classes are prevented from using their surplus for excess consumption. Sacrifices in consumption are shared alike by all members of the society" (1)

## 11.2 Inferred Objectives Of The Tax Policy

The evaluation of the various merits of tax objectives according to priority is frequently adopted. However, even though these objectives are ranked in order of importance, one of them may sometimes be achieved at the expense of another. "The history of fiscal politics abounds with illustration of this sort".<sup>(2)</sup>

Kuwait's tax policy objectives do not widely differ from the generally-held ones. However, It would be a inappropriate to equate the tax objectives adopted in the USA, with those most suitable for the gulf states. Nor will it be applicable to import tax tools implemented in the U.K., France, or even Egypt and install them as fixed input in Kuwait. VAT, for instance, would be extremely difficult to administer in Kuwait at an early stage where an administration capable of managing VAT system is lacking.

Many authors have supported such argument;

"Naturally the outlines of a tax structure tailored for development will look substantially different in a conventional developing country than in a highly sophisticated economy like ours (the English)." (3)

Furthermore, the policy is to be flexible enough to

accommodate changes in the economy. This need is well recognised by Musgrave:

"..The economic objective of tax policy vary with the stages of economic development, as do the economic criteria by which a good tax structure is to be judged.." (4)

The tax reformation recommended for Kuwait is broken down into 3 transitional stages as shown in Chart 11.1.

### 11.3 The Transitional Stages

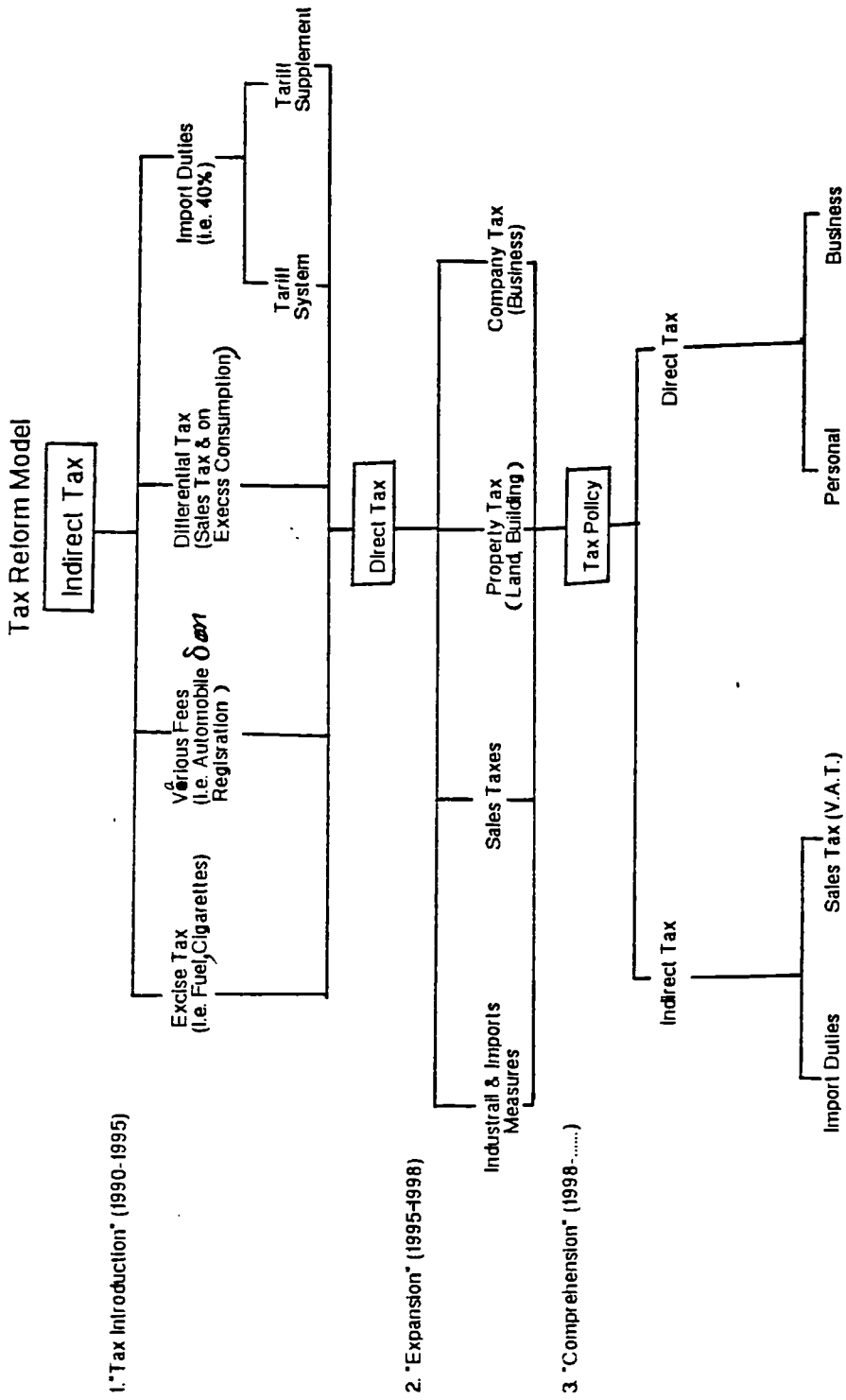
#### 11.3.1 Stage 1 (Tax Introduction)

This early stage of reformation is of paramount importance to the country's tax horizon. The transition from a tax-free state to any system of taxation is certainly sensitive. The probability should be recognised of confrontations with pressure groups (especially merchants) as tax always bears connotations of limitations on people's prosperity. In this respect, all parties should be persuaded of the objectives and tools of the tax system discussed below.

##### 11.3.1.1 Stage 1 Objectives

For the introduction of tax, it is desirable to spell out the tax policy in a widely accepted form which at the same time curtails excess consumption. "Differential Taxation" as it is called, would presumably cause some movement away from luxury consumption, for example, to investment goods and industries, because of the tax imposed on the former and exemptions granted for the latter. By means of import duties and sales tax on certain luxuries or commodities, the un-productive surplus in the economy would

Chart 11.1



be directed towards more productive spending. This would;

- 1> Eliminate the excess purchasing power in the hands of the public, which has inflationary results;
- 2> Form a rich source of government revenues;
- 3> Promote industries which contribute to economic development.

The duration of this stage is estimated to be from 3-5 years, including a preliminary tax-introductory period for all concerned (3-6 months). It is also important that other related functions, (i.e., the accounting and auditing profession and the legal services) should technically accommodate themselves to the new era. By the end of this stage, an evaluation plan must be advanced before transition to the second stage. This process should last for 6 to 12 months at the most.

### 11.3.2 Stage 2 (Tax Expansion)

#### 11.3.2.1 Stage 2 Objectives

Consequently, the second stage continues the objectives of the first stage, and adds a new frontier of tax objectives, such as;

- 1> To make the private sector a source of revenue for the state accounts;
- 2> To achieve equitable redistribution of income and other social considerations (i.e., charities, the Zakat system, co-operative social establishments);
- 3> To broaden the tax base.

Moreover, at this stage it is of vital importance to raise the rate of saving in the economy. The reduction of inequalities of income is not intended here to override the growth of private investment as is frequently seen in developing countries, especially those with low per capita income and considerable budget deficit.<sup>(5)</sup>

This stage, therefore, includes a combination of taxes on business profits on a progressive scale (maximum upper limit of 35-40%), and other sorts of direct taxation (excess property, land, and building). At the end of this stage (about 1998), an evaluation period of 3-6 months is scheduled to rectify any shortcomings of tax enforcement.

### 11.3.3 Stage 3 (Comprehension)

By this point most of the tax objectives would have been achieved within the given criteria of the tax policy. So far, criteria 1, 2, 3 and in part 4, have been met by the tax package. To complete the whole picture, flexibility in the tax system is to be ensured.

#### 11.3.3.1 Stage 3 Objectives

This stage is intended to:

- 1> Stabilise the economy;
- 2> Raise the ratio of saving to national income;
- 3> Promote private and public investment;
- 4> Accentuate the public contribution to government expenditure according to the ability to pay.

It is thought that the addition of these objectives to the above aims, would make the proposed policy successful.

## 11.4 Tax Administration Organisation

Indeed, the establishment of a qualified tax administration is equal in importance to a well formulated tax package. Securing a capable tax management is the next vital task of tax legislators, since the usefulness of tax reforms is only theoretical, unless implementation is carried out by an adequate task force. Therefore, it is the

second priority in the tax reformation to formulate;

- 1> Tax legislation process.
- 2> Tax administration organisation.

#### 11.4.1 Tax Legislation Process

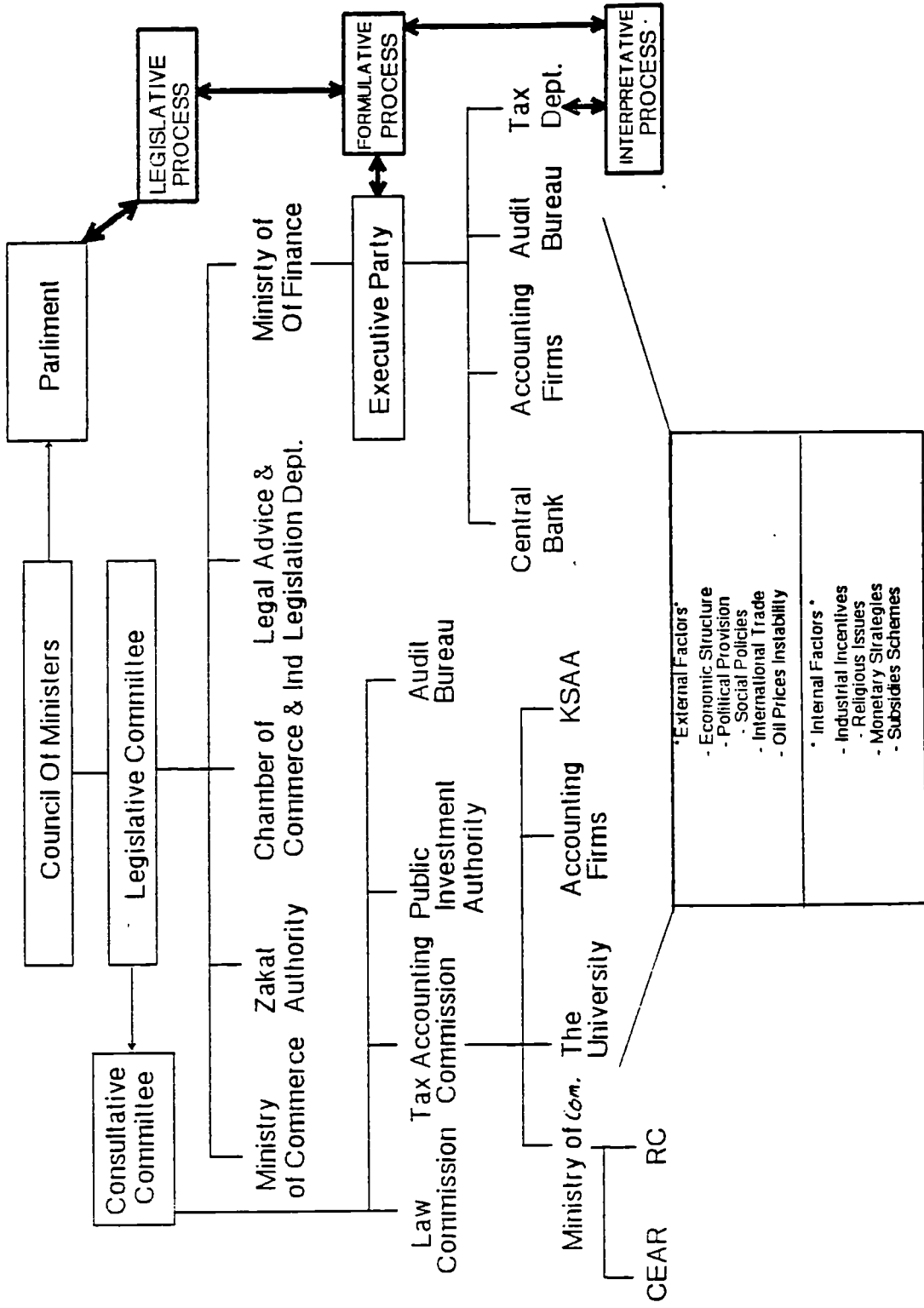
The government is the primary force in the formulation of tax policy. Thus it may be assumed that the proposal of the tax policy would be "government made". This is usually prepared by the government ministry responsible for the country's financial affairs, or as known in many countries by the treasury department.

##### 11.4.1.1 The Formulative Process

The Ministry of Finance is obliged to draw up the tax policy of the country. This process of course is performed over gradual stages of negotiation, study and revision and evaluation of all external and internal factors. Representatives of all parties including the public should be appointed (Chart 11.2).

Minor administrative and procedural details are beyond the scope of this study. However, it may be said that the executive committee formed for tax introduction in Kuwait is to furnish all these and other sort of information relevant to taxation to an assistant secretary to the minister of finance. He is also, as the director of the tax authority - as shall be discussed later- to be assisted by staff and employees of all categories and by external bodies (see the chart). Recommendations from such outside groups have carried significant weight and been frequently and actively

CHART 11.2 "TAX LEGISLATION MODEL"



implemented by government officials in many countries.<sup>(6)</sup>

The executive committee should, for the tax introduction stage co-ordinate with the consultative committee of the council of ministers, established from representatives from most concerned groups -as shown in Chart 11.2.

#### 11.4.1.2 The Legislative Process

Once the proposed tax policy has been presented to parliament, the legislative stage begins with discussions, revisions, and voting upon the tax proposal. Parliament may accept the programme in total, modify it, or scrap it and start anew. Within this legislative process, hearings including public hearings should be held. Two important aspects stand out here;

- 1> The participation of all parties in tax legislation, especially at the hearing procedures;
- 2> Direct consultation to supplement full parliamentary scrutiny of tax proposals.

When an agreement is reached in parliament, the third process begins by the enactment of the proposal.

#### 11.4.1.3 The Interpretative Process

The Ministry of Finance, on receiving the enacted tax draft, must issue regulations which elaborate on the statutory provisions in the code. This process is of great importance since it will clarify the tax law so as to minimise the possibility of future disputes, as one commentator noted:

"Regulations are a significant part of the legislative process, not only because the



statute at times specifically requires regulation, but also because of the need to clarify the law and provide illustrations of its operations". (7)

These codes, the "Executive Regulations", would restate the statute and provide useful examples of its application. The executive committee is the party most capable of performing this task, as it will have monitored the proposal from formulation to enactment, and will therefore be in favourable position to interpret the statute.

In this regard, it is of great importance to ascertain; 1) public participation by all means, especially the media. Public inputs in tax regulation has been frequently employed in the interpretative process, as emphasised by Nolan;

"Frequently, the comments (in public hearings) raise points not previously considered ... Which may make it necessary to add additional rules or to revise significantly the terms of those previously published". (8)

2) The role of the accountants and lawyers.

### 11.5 Tax Authority

Once parliament has enacted legislation giving the tax policy effect, the executive committee will be responsible for implementing the policy as part of its statutory responsibility for the management of taxes. The executive committee should then officially establish a tax administration under the management of the "Tax Authority". The tax authority will be accountable in general terms to the finance minister for its stewardship, but it must be directly administered by an assistant secretary.

The tax authority should be divided into sub-sections according to the sort of taxation manned in each division (Chart 11.3). A suitable cadre of professional economists, statisticians, lawyers, and accountants should be employed.

The use of a well organised filing system and on-line computerised data bases should be established under the registration division.

#### 11.6 Tax Administration Training

In order to maintain a modern and well accommodated tax administration during a period of extensive changes, multiple training programmes will be required. A strategy for improving the capabilities of the staff could be achieved by means of training programmes as follows;

##### 11.6.1 Training Levels

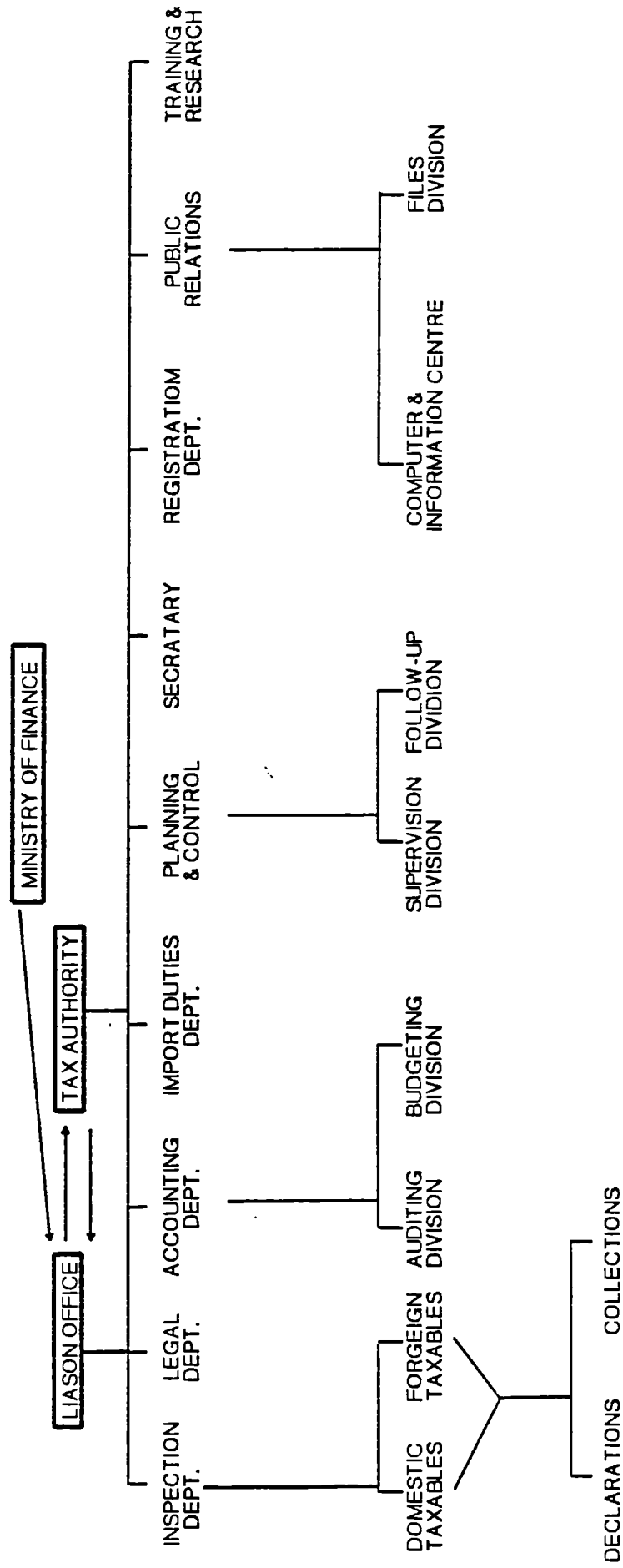
###### 11.6.1.1 The Preliminary Course

This course would provide staff with basic ideas concerning: 1) Book-keeping, 2) The preparation of accounts from incomplete records, 3) The computation of profits and subsequent tax liability, 4) The examination of accounts and tests of credibility, 5) Some legal interpretations and the legislative aspects of the tax act, 6) Preliminary economic taxation.

These subjects should be covered within 9-12 months of starting employment, which could be achieved by scheduling afternoon classes. Tests at the end of the course should be conducted before progressing to the advanced course.

Chart 11.3

"Tax Administration Organisation"



### 11.6.1.2 The Advanced Course

The advanced course would develop the skills of the trainees in a wide range of significant subjects such as:

- 1) Taxpayer's rights and duties;
- 2) Assessments, disputes, investigating fraud and appeals proceedings;
- 3) Tax theory and practice;
- 4) Computerised taxation;
- 5) Tax schedules, allowances, and practical problems.

The duration of this course would be approximately 1 year plus 2-3 months of applications.

### 11.6.1.3 The Complementary Course

Fully-trained officers would be required to pass the first two levels before attending this course. Only those who had succeeded at course 1 and 2 would be official candidates for job promotion and other job incentives. The syllabus of this course would include;

- 1) Studies of the statutory provisions of the tax law;
- 2) Tax influence on the family income;
- 3) Investment promotion and tax incentives;
- 4) Tuition on the examination of accounts.

Examinations devoted to tax enforcement, tax accounting and other subjects should be conducted by the end of this course. The participants could be allowed 2 or 3 attempts to complete this course.

## 11.7 The Role of Accounting

On matters of fiscal policy, there is no body better qualified to comment than the accounting profession. The accounting profession must accept a significant share of the tax administration task, and more co-operation (mutual reliance and trust) between the accountants and tax

inspectors should be established. The importance of this accountancy function has been foreseen by Winjum;

" It is interesting to note the role of the chartered accountant in this system. His role as independent attestor ends with his signing of the audit certificate. If he is also retained by his client to prepare and negotiate the client's tax return, he performs this function under his role as a tax expert, not as an independent accountant. At this stage he becomes an advocate for his client and the fact that he is also an independent verifier of financial information does not add any additional credibility to the tax return. At this stage it is only his expertise in the tax field that is valued and relied on by his client and the tax inspector." (9)

Accounting involvement in tax formation must therefore be given priority by the Ministry of Finance. This would entail the recognition of the accounting profession as a relevant party in tax policy construction (the formulative process and the executive committee). Moreover, the profession must be furnished with some sort of tax enforcement responsibility, e.g., audited tax returns, certified tax declarations, tax representation and other services. Members of the accountancy profession should play their full part in this vital economic sphere and assume a leading constructive role in the design and structure of the tax system. Accountants should, contribute in the following;

- 1) Possible conflicts between tax rules and commercial accounting practice should be resolved, harmonising the two areas.
- 2) Accountants must define the profession's principles, standards, ethics, and conduct.
- 3) They should form a judicial body to resolve differences in practice with especial reference to tax accounting.

If as Michael Chatfield said,

"..The absence of a single source of accounting authority inhibits unity with tax rules, which for administrative purpose, must be as precise and uniform as possible",<sup>(10)</sup>

Then the enforcement of the tax policy by the tax authority only would be inept.

### 11.8 A Supporting Judicial System

Of paramount importance to the enforcement of tax legislation is the establishment of a supporting and well organised judicial system related to resolving tax interpretation problems. The development of such a system even though it seems to be out of the scope of this study, would emphasise the role of the legal profession in tax reformation.

Currently, the judicial system of Kuwait is consisted of 3 main courts; Supreme Court, Court of Appeal, and Court of First Instance. The latter court has two divisions; major claims and minor claims. In addition, there is a government claim division, which is totally devoted to governmental cases. A similar division is also maintained under the major claims court. The appeal system is this judicial organisation is represented by two courts; the appeal division (within the major claims court), and the appeal court which decide on cases referred from the court of first instance.<sup>(11)</sup>

Although the researcher has a limited knowledge of the structure of the legal profession, the following suggestions are made to accompany the wider introduction of tax, which are

generally based on establishing a solid appeal system;

1) at present, there is no division within the judicial system that deals with tax affairs. Perhaps the need for such a division was not seen in the past where tax enforcement in Kuwait was very limited. However, within the proposed tax model, there should be a "tax division" to assess the complicated and expensive tax claims and dispute procedures. This also, necessitate the employment of capable staff with a legal background, and other tax expert. This need made is made more necessitating by the international dimension correlated with tax enforcement, and foreign taxables who may have expert advisers;

2) Taxables should be allowed to appeal against the tax department decision of tax liabilities. This appeal is available only at the first instance court within the present judicial system. If this privilege is guaranteed to the tax authority, then it should be equally allowed for the other party;

3) Establishing a "specialist section" within the tax division to be consulted in matters of disputes of specific subjects (commercial accounting principles, economic appreciation, international trade control, etc.). This division should be supported by consultants and, if needed, external experts.

Overall, there needs to be a further look into the introduction of an adequate judicial system correlated with taxation needs.

## Notes

1. Chelliah, R. J., "Fiscal Policy In Underdeveloped Countries"; George Allen & Unwun Ltd., 1960, P. 67.
2. Fitting the main functions of fiscal policy (allocation, distribution, and stabilisation) remains the consideration of fiscal policy makers, who must co-ordinate them all in an overall pattern of fiscal policy. This co-ordination is basically a derivative function of "What are the adequate objectives of the policy itself". Although, there are ideal requirements for a "Good Tax Structure" - see Musgrave, R. A., and Musgrave, P. B., "Public Finance in Theory and Practice"; McGraw-Hill Book Co., 2nd Ed., 1976, p. 17. - their optimality should be linked with other questions such as : "Optimality for whom, why, and when ?". Actually, seemingly tax policy goal may not be so if adopted too early or too late.
3. Hicks, Ursula K., "Direct Taxation and Economic Growth"; Oxford Economic Papers, Vol. VIII, No.3, Oct. 1956, P. 303.
4. Musgrave, R. A., "Fiscal Systems"; Yale University Press, 1969, P. 125.
5. Asian countries in particular seem to rely on such social objectives as reducing income and wealth inequalities, despite the crucial fact that like goal might be achieved on the account of the private investment growth. This phenomenon occurs even in more caps among the population and most important in the depletion of the private capital, which is the merely solid ground in these countries... See Chelliah R. J., "Fiscal Policy in underdeveloped Countries"; op. cit., Chapter 3.
6. In the United States, for example, the AICPA Federal Tax Division - the ABA Tax Committee, and the American Law Institute (ALI) are three useful sources of such assistance, whose recommendations carry weight with treasury personnel. Similarly, the Institute of Chartered Accountants in England and Wales (ICAEW) plays a noticeable role in the tax reformation in the U.K. See, Reese, Thomas J. "The Politics of Taxation"; (Ph. D. Dissertation, University of California, Berkley, 1976) P.57.
7. Cohen, Edwin S., "The Role of The Treasury Department in The Federal Tax Legislation Process"; national tax journal 32 (September 1979) P. 259.
8. Nolan, John F., quoted in Schmid Paul F., "The Tax Regulations Making Process... Then and Now"; Tax Lawyer 24, (Spring 1971) P. 548.



9. Ross L. N., "Taxation And The Accountant"; The 19th Advanced Accounting Seminar, Victoria University of Wellington, New Zealand, Oct. 2/3 1970.
10. Chatfield, Michael, "A History of Accounting Thought"; (New York, R. E. Krieger, 1974), p. 211.b
11. Judicial organisation law, article 5. see Rakib W., and Abdul-fatah A., "Kuwait Judicial System Principles"; Dar-Al-Kotub, 1984, pp. 107, 111-115 (In Arabic), and Decree No. 40/1980, article(s) 1, 2.

## *Chapter Twelve*

### *C O N C L U S I O N*

#### *12.1 Summary*

In this final section we recapitulate the main findings and methods followed by the thesis. The principal aim of this thesis was to determine the tax system most appropriate for Kuwait and its potential impact of the system on the accounting profession.

The economic background to tax reformation was discussed, and taxation was found to have had a significant influence on the state budget, which is becoming increasingly vulnerable because of the decline in oil revenues.

Examination was made of the structure and future of the tax system in Kuwait, utilising the theory and practice of public finance in developing countries, and a simplified attempt to measure the tax effort and capacity in Kuwait was undertaken. In addition, the potential relationship between tax and accounting and their anticipated interaction was investigated. The Kuwaiti system of taxation was evaluated using various statistical techniques, and special emphasis was given to the practical tax experiences of neighbouring countries. This chapter sets forth the main conclusions which emanated from the analysis, and which were discussed fully in the relevant chapters.

## *12.2 Conclusions*

In general, each taxation system depends on the historical, socio-political and economic environment of the country, but if the system is to be effective it must be tailored carefully to the peculiar needs of that country.

As far as this study is concerned, results of the experienced sample' views, including the statistical and hypothetical testing, are provided in table 12.1. The results show a similarity of opinions.

It appears that there is a dependency relationship among factors affecting peoples' attitudes towards taxation. Income level, for example, was found to be a significant variable determining the tax sorts favoured. The educational background, also has some influence on the respondent's tax preferences. Concerned people (those with financial experience) were identified as preferring indirect sorts of taxes rather than direct tax, whereas less concerned people (ordinary individuals) were more likely to accept direct progressive tax. Further examination of this subject would certainly be useful and should therefore be undertaken by the Ministry of Finance.

Overall, conclusions derived from this study as applicable to tax reformation, tax administration, and the accounting profession are given in the following:

Table 12.1

" Attitudes Towards Tax "

Attitudes	Hypothesis / Decision
1) High Income People (X) <sup>1</sup>	The hypothesis was rejected, indicating that they support tax introduction.
2) Low Income People (X) <sup>2</sup>	The null hypothesis was rejected at a 0.05 level of significance. This group also is in favour of taxation.
3) Concerned People (X) <sup>3</sup>	The mean test of this group is greater than 2 resulting in the rejection of the null hypothesis. This group also supports tax.
4) Less Concerned People (X) <sup>4</sup>	At a 0.05 level of significance, the null hypothesis was rejected. A mean of 6.52 indicates that this group is in favour of tax.
5) Income Level & Attitude	Contingency table of income and attitudes (Chi Square analysis) was estimated at 24.981, which does not fall within the 5% critical value of $X^2$ at the degree of freedom (5.991). The decision, thus, was to reject the hypothesis of possible independence between income level of the respondent and his attitude toward tax.

### 12.2.1 Tax Reformation

(1) The fiscal policy of Kuwait is of great significance to the proper planning of the country. Therefore, care and adequate forethought should be taken before establishing any tax strategy.

(2) Kuwait's fiscal policy should aim at solving problems in the balance of payments and providing sources of income other than oil revenues.

(3) Due to the rise in domestic expenditures, the role of the government in economic activity has grown in the past 10 years. However, the growth rates of government revenues in general, and domestic revenues in particular have not corresponded with the rise in domestic expenditure, which in turn has affected government spending.

(4) The poor implementation of tax legislation in the past has affected public perceptions of tax importance. In this respect a wide range of media contacts with the public is essential before the application of any form of taxes.

(5) The political and social features of Kuwaiti society have contributed to the weak tax orientation.

(6) Little consideration is given to the impact of the decree on peoples' prosperity.

(7) Despite the welfare state and the relatively high per capita income in Kuwait, income disparities among the families in Kuwait are large (particularly between Kuwaiti and non-Kuwaiti families). Remedial policies are necessary.

(8) The abolition of the decree No. 3 of 1955 seems to be a generally accepted proposition as revealed by results to

the questionnaires.

(9) Although there was a notable increase in the tax base and related tax efforts in the late years, the tax system has not significantly contributed towards government revenues, nor has it had any effect on the redistribution of income.

(10) Measurement of the economic surplus and accordingly the maximum base of taxation, as well as tax efforts and tax ratio assessment should be considered.

(11) The findings on revenue instability accentuate the significance of import duties in the state's revenues.

(12) The government should consider the promotion of industrial alternatives within the tax policy (tax incentives).

(13) Some types of taxation, such as property and land tax, are of minor importance to the tax system. First, their influence in the country is very low and could cause some economic distortions, let alone the social and political implications. Second, the costs associated with implementing such sorts of tax is so high that it would exceed the revenues generated. Third, within the present capabilities the likelihood of being able to administer these taxes is very low. However, future plans should consider the adoption of minor charges based on the concept of these taxes (e.g., registration fees of lands or properties, some municipal charges on land and properties accumulation, etc.).

(14) Emphasis should also be given to correlating import duties and supplements with some domestic imposts such as excises (at minimum level).

(15) The insignificance of tax in state revenues is exacerbated by the small size of taxables and the different policies adopted by these taxables to protect their earnings by many legislative means (see chapter 7).

(16) The tax incentives provided at present are of low value to foreign investors.

(17) Tax policies should not be transplanted from one country to another regardless of the stage of development each country enjoys.

(18) The implementation of modern tax in Kuwait and in many developing countries is limited by the level of illiteracy and the deficiency in tax elements such as; the maintenance of proper records, the availability of successful tax administration. In order to overcome such difficulties, methods of gradual tax introduction, the establishment of an adequate tax administration, and appropriate education programmes are strongly recommended herein.

(19) As discussed in chapter eleven, the tax policy should be flexible enough to respond to any inflationary pressures.

(20) The re-planning of the objectives and means of a social insurance programme to support the tax area in the country could also contribute in achieving an optimal fiscal policy. Other charges and government fees could also be used to achieve the tax policy's goals (chapter 10).

(21) The reliance on indirect tax in Kuwait seems to be inevitable for the tax system to be mobilised and for the public to accept taxation in the country.

(22) The curtailment of unproductive consumption as well as

the encouragement of saving should be adopted in the tax policy as prime objective.

(23) On the other hand favourable treatment should be given to capital goods importation (broadened tax incentives).

(24) Greater objectivity would be achieved by increasing the number of academicians in the tax legislation process.

### *12.2.2 Accounting Profession*

The following can fairly describe the present status of the accounting profession:

(1) It is found that public recognition of the accounting profession is low.

(2) Kuwait lacks sound accounting rules, conducts, and ethical rulings.

(3) The absence of accounting for constructing national accounts.

(4) Accounting regulation in Kuwait has generally been initiated by the government. Self-regulation is yet to be observed in Kuwait, though state-regulation is the most appropriate for Kuwait.

(5) The need for a developed accounting profession is increasing to meet the vast and growing economy.

(6) Recently, more attention has been given to the accounting profession by the government, which could be the beginning of the development stage.

(7) The role of accountants in tax enforcement at present is minimal. This is caused in part by the inadequacy of the accounting profession itself, and the weak tax regulation.



(8) The link between the accounting function and taxation is further demonstrated in the numerous disputes between the tax department and taxables on accounting matters.

In order to improve the accounting profession, the profession should consider the following suggestions:

(1) All parties concerned are responsible for the advancement of the accounting profession in the country (government, KSAA, accounting firms, private sector, etc.).

(2) Efforts should be concentrated towards achieving;

- A. National accounting standards;
- B. Formal code of professional ethics;
- C. Organisation of accounting firms and services;
- D. The support of national accountants to participate in the development of their profession;
- E. Encouraging research in the field of accounting;
- F. Improvement of accounting education;
- G. Concentration on practical rather than theoretical issues.
- I. International collaboration and co-operation.

(3) A certain degree of compatibility between macro and micro accounting data should be established.

(4) There is a need for independent action on the part of professional accountants regarding tax accounting.

(5) Appropriate distinction between financial accounting and accounting for tax purposes.

(6) Within the accounting profession, there should be a place for a tax accounting committee responsible for:

- A. Setting accounting rules for tax declaration purposes;
- B. Liaison with other functions of the accounting profession;
- C. Conducting requisite tax studies;
- D. Establishing a discipline for tax representation in disputes negotiations and legislative procedures;
- E. Conducting training programmes for the tax officials.

This committee could be formed by a ministerial order (Ministry of Finance) and could be attached to KSAA or to

another official body under the supervision of the minister of commerce.

### *12.2.3 Tax Administration*

(1) The tax department should be maintained in its current state within the current legislation. However if the suggested tax policies are to be adopted, a new structure of the tax administration should be incorporated as suggested in chapter eleven.

(2) The possibility of enforcing compulsory registration with the tax department of all commercial establishments, should be examined.

(3) The implementation of job description and other administrative techniques should be introduced immediately within the tax department.

(4) Awareness of the tax system is necessary through mass media programmes to overcome tax ignorance.

(5) Whilst limitations in the research data mean that the figures must be treated with caution, it nevertheless seems very likely that scope for improvement in the tax department's performance is minimal within the application of the current tax legislation.

(6) Improvement in tax treatment should therefore be more carefully considered and arrangements should be made to establish channels of communication with the taxables.

(7) In this respect, the tax department could adopt the following:

A. The simplification of tax declaration procedures;

- B. Provision of tax advice on regular and friendly basis;
- C. Establishment of a clear policy on avoidance;
- D. Recognising the importance of mutual trust and co-operation between the department and the accounting firms representing clients on tax matters.

(8) There are some means by which the tax administrative machinery in the country could be improved, among them:

- A. Providing the tax administration with adequate manpower, particularly skilled staff;
- B. Furnishing it with more financial and technical support;
- C. Conducting on-the-job training programmes and mock cases (as discussed in chapter 11);
- D. The use of educational programmes, publicity and publication of tax guides;
- E. Granting the tax administration more authority;
- 6. Continuous evaluation of the tax department performance.

### *12.3 Limitations*

The conclusions and recommendations drawn in this study are limited by several factors. First, the inherent mail questionnaire problem of non-response bias has not been completely overcome. Statistical tests employed indicate that non-response bias may exist. However, the significance of hypothesis testing, the lack of significant differences in the demographics of respondents, and the high response rate reduce the probability of serious non-response bias.

Second, is the lack of an appropriate econometric model to capture tax reforms in a single source of revenue economy within the developing countries block.

Third, the simple framework used in selecting the sample did not include a large segment of the groups concerned. This limitation is specifically applicable to the lower class of the population and the small size of foreign investors.

Fourth, the selective technique employed to determine the public sample may give rise to some unrepresentative views. However, specific nature of the issue under investigation necessitated such procedure.

Fifth, there are very few studies estimating the impact of tax on accounting. Thus, an analytical approach was adopted.

Sixth, the scope of this study was, to some extent, limited to a one side effect. Tax influence on accounting was rather more investigated in this thesis because of the limited size of such work.

#### *12.4 Further Research Topics*

The prime findings of this study can be extended to cover a large number of issues related to tax reformation.

First, the study was limited to those people with tax interest or concern in the exchange of its information. A study, possibly an empirical investigation, of the attitudes of lawyers and politicians would appear to be useful; what do they perceive as tax problems or recommendations ?

Second, tax incidence and burden remains an area of significant importance that deserves further research. Our findings in this regard are tentative.

Third, the impact of the fiscal policy on income and wealth distribution in Kuwait is a topic which requires serious examination.

Fourth, the revenue instability assessment provided in this study was not comprehensive, which leaves another valuable area for research by the Ministry of Finance.

Fifth, the social implications of tax introduction in Kuwait are also of great relevance for the implementation of a successful tax policy.

Sixth, A general equilibrium framework is most suitable for a future work that will enlarge the assumptions of the simultaneous economic consequences of taxes and accounting at the same time. By and large, the influence of accounting on the fiscal policy would, through an empirical study, explain much of this point.

Seventh, research could be done into how to associate taxation with reliable, consistent, and comprehensible accounting system.

Eight, another study could determine the extent to which accountants believe in the contribution of others within their profession in tax presentations; is it accepted or not ? Does it influence them ?.

Ninth, this study suggests the participation of the profession in the tax process. If this expectation is accepted, then further research must answer the question of the available resources and their adequacy to Kuwait. Would this participation be through an independent body ?

Tenth, it is very important to investigate the view of the government about the degree of participation assigned to the profession for the performance of its tasks.

Finally, other matters associated with tax enforcement such as the political costs associated with different tax and accounting policies.

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\ APPENDIX [ A ] /

UNIVERSITY OF HULL

DEPARTMENT OF ACCOUNTANCY & FINANCE

Questionnaire Concerning Taxation Reform in Kuwait

I am an assistant teacher at Kuwait University- department of Accountancy- and currently a doctoral programme researcher at the University of Hull. As part of my research, this questionnaire is designed to evaluate Kuwait's present tax laws and to investigate people's views regarding the introduction of local taxes.

I assure you that the confidentiality of your answers will be respected. Although, no one except the researcher will see the completed questionnaire, the grouped results of this questionnaire will be employed and published in an academic doctoral thesis.

Most questions can be answered with a cross ( X ) in the appropriate box. If you wish to make any additional comments, please use the space below each question or that at the end of the questionnaire. If you have any queries on the administration of the survey, please contact Mr. Wael AL-Rashed ( Tel. 481-6804 or 484-6675 ).

I should be most grateful if you would please return the completed questionnaire as soon as possible. I enclose a stamped addressed envelope.

Thank you very much for helping me in my research project.

1. Occupation :-
 

Student [ ]      Employee [ ]      Teacher [ ]

Merchant [ ]      Free Trader [ ]      Other... [ ]
2. What is your educational level ?
 

a. High school [ ]    b. College [ ]    c. Bachelor degree [ ]

c. Master [ ]    d. Doctoral [ ]    e. Other..... [ ]
3. Your monthly income (KD ) is:
 

a. Under 300    [ ]      b. 300 - 500    [ ]

c. 501 - 1000    [ ]      d. 1000 - 2000 [ ]

e. 2000 - 3500 [ ]      g. 3500 - 5000 [ ]

h. 5000 - 10000 [ ]      i. Over 10000 [ ]
4. What is your family monthly expenses ( as a percentage of your family income ) ?
 

a. 10-20% [ ]    b. 20-35% [ ]    c. 35-50% [ ]

d. 50-70% [ ]    e. 70-90% [ ]    f. 90-100% [ ]
5. Do you have any other income besides your salary ?
 

Yes [ ]                      No [ ]
6. If your answer to question 5 is yes, please specify the nature of the other income ?
 

Rent [ ]      Trade [ ]      Foreign Investment [ ]

Shares returns [ ]      Own Business [ ]      Others.. [ ]
7. Are you in favour of income taxes in Kuwait ?
 

With [ ]              Against [ ]              Undecided [ ]
8. Do you prefer expenditure tax instead of income tax to be introduced in Kuwait (for example value added tax) ?
 

Yes [ ]      No [ ]              No opinion [ ]
9. Or otherwise, do you agree on a selective employment tax instead of a direct taxation ?
 

Agree [ ]              Disagree [ ]              Undecided [ ]



10. If your answer to question 7 is (with), please state of what sort the tax should be ?

Progressive [ ] Regressive [ ] Proportional [ ]

11. Do you agree with a property tax in Kuwait ?

Agree [ ] Disagree [ ] Undecided [ ]

12. Do you agree on a withholding tax in Kuwait ?

Agree [ ] Disagree [ ] Undecided [ ]

13. Overall and if you are in favour of the introduction of taxes in Kuwait, what is your rationale behind that ?

- 1> Sharing citizenship responsibilities [ ]
- 2> Redistributing wealth & income [ ]
- 3> To enhance the government budget [ ]
- 4> To sustain public finance resources [ ]
- 5> Showing social and political values [ ]
- 6> Others..... [ ]

14. Would you agree with the establishment of a tax authority in Kuwait (i.e. Tax Administration) ?

Yes [ ] No [ ] Do not know [ ]

15. If your answer to question 14 is Yes, do you think that it should be independent ?

Yes [ ] No [ ] Do not know [ ]

16. Would it be correct to say that tax free trade in Kuwait is a major elements in people prosperity ?

Yes [ ] No [ ] Do not know [ ]

17. In your experience have you found taxation in Kuwait a significant consideration in deciding to invest ?

Always	Often	Sometimes	Seldom	Never

18. How do you view Kuwait tax laws in terms of:-

1. Complexity:-

- a. Very simple [ ]      b. Simple [ ]
- c. Complicated [ ]      e. very complicated [ ]
- f. Do Not Know [ ]

2. Tax department (in applying tax laws rules) :-

- a. lacks experience [ ]      b. Needs more experience [ ]
- c. qualified enough [ ]      d. highly skilled [ ]
- f. Do Not Know [ ]

3. Other aspects :-

.....  
 .....  
 .....

19. In a grading scale, how do you evaluate Kuwaiti tax laws' existing incentives ?

Encouraging				Discouraging		
1	2	3	4	5	6	7

20. Are you for or against the reform of Kuwait tax Laws ?

For [ ]      Against [ ]      Undecided [ ]

21. If your answer is yes, do you think that the reform should include any of the following :-

(Please tick against your appropriate item)

- a. Income Tax
- b. Capital gain tax
- c. property tax
- d. Sales tax
- e. Withholding tax
- g. Other (specify)
- .....
- .....

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22. Based on the previous question, would you think the tax you suggest will have a positive effect on business development in Kuwait ?

Yes [ ] No [ ] Undecided [ ]

23. Do you expect tax considerations (if applied in Kuwait) to play a significant part in :-

	Agree				Disagree		
a. Governmental Budgeting...	1	2	3	4	5	6	7
b. Economic control.....	1	2	3	4	5	6	7
c. Redistribution of wealth.	1	2	3	4	5	6	7
d. Other (specify)..... .....	1	2	3	4	5	6	7
e.....	1	2	3	4	5	6	7
f.....	1	2	3	4	5	6	7

24. From your experience in Kuwait, will taxation enhance the accounting profession significantly ?

Yes [ ] No [ ] Do not know [ ]

25. Is the present Kuwait taxation a relevant consideration developing the accounting regulations in Kuwait ?

Yes [ ] No [ ] Do not know [ ]

26. If you answered with Yes, please specify if it is:-

Very Important Consideration	Somewhat important Consideration	Minor Consideration

27. Would you be willing, if necessary, to complete another questionnaire or to grant an interview ?

Yes [ ] No [ ]

If yes, at what address may I write to you ?

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NB.:- Please write down all your suggestions with respect to the questionnaire and any sought improvements you consider appropriate.

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THANK YOU FOR COMPLETING THIS QUESTIONNAIRE  
Wael AL-Rashed  
University of Hull, England.

\ APPENDIX [ B ] /  
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UNIVERSITY OF HULL

DEPARTMENT OF ACCOUNTANCY & FINANCE

Questionnaire to Foreign Investors in Kuwait

I am an assistant teacher at Kuwait University- department of Accountancy- and currently a doctoral programme researcher at the University of Hull. As part of my research, this questionnaire is designed to evaluate Kuwait's present tax laws and to investigate views of those concerned regarding the introduction of local taxes.

I assure you that the confidentiality of your answers will be respected. However, although that no one except the researcher will see the completed questionnaire, the grouped results of this questionnaire will be analysed and published in an academic doctoral thesis.

Most questions can be answered with a cross ( X ) in the appropriate box. If you wish to make any additional comments, please use the space below each question or that at the end of the questionnaire. If you have any queries on the administration of the survey, please contact Mr. Wael AL-Rashed ( Tel. 481-6804 or 484-6675 ).

I should be most grateful if you would please return the completed questionnaire as soon as possible. I enclose a stamped addressed envelope.

Thank you very much for helping me in my research project.

PART I --> GENERAL DATA ...

1. Name of Firm.....  
 (if your firm is one of a group of companies, please answer on the basis of the group, if you think this is more useful)

2. What type of investment do you have in Kuwait ?

It is .....

3. Country of residence or registration of business.....  
 .....

4. Commencement of Business

Over 30 years ago	Between 10 & 30 years ago	Between 5 & 10 years ago	less than 5 years ago

5. Form of organisation

- a. Public Ltd. liability co. [ ]
- b. Partnership [ ]
- c. Private Ltd. liability co. [ ]
- d. Public sector body [ ]
- e. Individual proprietorship [ ]
- f. Others..... [ ]

6. Capital employed ( value of total assets KD )

- a. Under 100,000 [ ]
- b. 100,001 - 500,000 [ ]
- c. 500,001 - 2,500,000 [ ]
- d. Over 2,500,000 [ ]

7. It is usual for business firms to have one or more objectives even if these are not formally set out. The following are some of the common objectives of business enterprises. What do you consider are the main objectives up to 3) of your organisation ?

- a. Maximising profit
- b. Maximising owners' wealth
- c. Maximising market share
- d. Maximising value added
- e. Maximising employee welfare
- f. Maintaining a going concern
- g. Other (specify).....  
 .....


PART II --> TAX & INVESTMENT...

8. Would it be correct to say that taxation is or has been a problem area making it difficult for your firm to achieve its objectives ?

Yes [ ] No [ ] No opinion [ ]

9. In your experience have you found taxation in Kuwait a significant consideration in deciding whether or not to invest ?

Always	Often	Sometimes	Seldom	Never

10. Here is a list of difficulties that foreign investors face in developing countries. Have you found these to be relevant in Kuwait ?

(Low) R a n k i n g (High)

	1	2	3	4	5	6	7
a. Political uncertainty							
b. Government administrative routine							
c. Imports control							
d. Scarcity of various labour skills							
e. Currency exchange controls							
f. Labour relations							
Others ( specify )							
g. ....							
h. ....							

11. Which one or two problems out of the list in question 10 would you say have caused you the most difficulty ? (tick up to 3 items)

a.	b.	c.	d.	e.	f.	g.	h.

2. Where would you place difficulties caused by taxation in Kuwait in relation to those in question 9 ?

Compared with  
=====

Taxation is  
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		I M P O T A N C E		
		More Im. Problem	Equally Im. Problem	Less Im. Problem
a.	Political uncertainty			
b.	Government administrative routine			
c.	Imports control			
d.	Scarcity of various labour skills			
e.	Currency exchange controls			
f.	Labour relations			
	Others, if specified in Question 10			
g.	.....			
h.	.....			



PART III --> KUWAIT TAX LAWS...

13. How do you view Kuwait's tax laws compared with those of your homeland in terms of:-

1. Tax burden:-

Too High	Somewhat High	Moderate	A little Low	Too Low

2. Complexity:-

- a. Very simple [ ]      b. Simple [ ]  
 c. Complicated [ ]      e. very complicated [ ]

3. Tax declaration :-

- a. Straight forward [ ]      b. Systematic & organised [ ]  
 c. Confusing & ambiguous [ ]      d. Poorly organised [ ]

4. Tax department:-

- a. Inexperienced [ ]      b. Without suitable experience [ ]  
 c. Qualified enough [ ]      d. Highly skilled [ ]

5. Other aspects :-

.....  
 .....  
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14. Are you in favour of the reform of Kuwait tax Laws ?

- Yes [ ]      No [ ]      Do not know [ ]

15. If your answer is Yes, do you think that the reform should include any of the following :-

- a. Income Tax  
 b. Capital gain tax  
 c. property tax  
 d. Sales tax


e. Withholding tax

g. Other (specify)

.....  
 .....


16. Would you think that such reform will have a positive effect on business development in Kuwait ?

Yes [ ] No [ ] Do not know [ ]

17. Do you expect tax considerations (if applied in Kuwait) to play a significant part in :-

	Agree				Disagree		
	1	2	3	4	5	6	7
a. Governmental planning....							
b. Economic control of public expenditure							
c. Redistribution of wealth..							
d. Other (specify)..... .....							

18. The following are some of the amendments to Kuwait tax act introduced by the Ministry of Finance & Economy. In your opinion, what effect, if any, are these amendments likely to have on your Business growth and performance ?

	INCENTIVE			DISINCENTIVE		
	M	M	N	M	M	OTHER
	A	I	E	A	I	COMM-
	J	N	U	J	N	ENTS
	O	O	T	O	O	(IF
	R	R	R	R	R	ANY)
			AL			
a. Circular No. (17) for 1983, concerning the required statements and certificates for tax declaration.						
b. Resolution No. (206) for 1985, in respect of requisite books and commercial records to be kept by every body corporate which is subject to income tax decree no. 3 for 1955.						



PART IV --> TAX INCENTIVES & INCIDENCES...

19. The following are some incentives offered by the Kuwaiti government for the promotion of private enterprises. Please tick those that you think have made a significant contribution to the growth of firms in your area of business .

				CONTRIBUTION			
		RELA- TIVELY IMPOR- TANT		M I N O R		NEGLIGIBLE OR NO CONTRIBUTION	
a.	Free trade.....						
b.	Lump sum depreciation & accelerated allowances..						
c.	Development rebate on fixed assets...						
d.	Other investment reliefs...						
e.	Cash subsidies....						
f.	Guaranteed prices & other services....						
g.	other (specify).....						
j.	.....						

20. Which one or two of these incentives was (were) most useful for firms in your area of business ?

a.	b.	c.	d.	e.	f.	g.	j.

21. On a grading scale, how do you evaluate Kuwait tax laws incentives ?

Encouraging

Discouraging

1	2	3	4	5	6	7

22. Do you benefit from the local tax incentives at present ?

Yes [ ] No [ ]

23. How much is your annual tax incentives savings (KD) ?

a. < 10,000 [ ] b. < 25,000 [ ] c. < 40,000 [ ]  
d. < 75,000 [ ] e. < 130,000 [ ] f. < 200,000 [ ]

24. If your firm has not grown in the past 5 years, was taxation an important discouraging factor ?

Yes [ ] No [ ] No opinion [ ]

25. Will Kuwait taxation regulations hamper your diversification of business activity ?

Yes [ ] No [ ] Do not know [ ]

26. Is Kuwait taxation a relevant consideration in your distribution of earnings to proprietors ?

Yes [ ] No [ ] Do not know [ ]

27. If you answered with yes, please specify if it is:-

Very Important Consideration	Somewhat important Consideration	Minor Consideration
-----	-----	-----

PART V --> THE TAX ADMINISTRATION...

28. What is your annual tax payment in Kuwait (KD) ?

- a. < 10,000 [ ]    b. > 10,000 [ ]    c. > 30,000 [ ]
- d. < 100,000 [ ]    e. > 200,000 [ ]    f. < 350,000 [ ]

29. Do you see that as " your fair tax liability " ?

- Yes [ ]            No [ ]            Undecided [ ]

30. Have you been in a dispute before with the Tax department (Ministry of Finance) regarding your tax declaration ?

- Yes [ ]            No [ ]

31. If your answer is Yes, please state how often ?

- Once [ ]    Twice [ ]    3 times [ ]    More than 3 [ ]

Within..

- 3 Months [ ]    6 Months [ ]    9 Months [ ]    1 Year [ ]
- 2 Years [ ]    3 Years [ ]    5 Years [ ]    10 Years [ ]

32. What was the main disagreement about ?

- a. legal interpretation [ ]    b. Accounting practices [ ]
- c. Tax regulations [ ]    d. Others.. (specify)
- .....
- .....
- .....
- .....

PART VI --> THE ACCOUNTING PROFESSION...

-----

33. From your experience in Kuwait, will taxation enhance the accounting profession significantly ?

Yes [ ]                      No [ ]                      Do not know [ ]

34. Has the absence of taxation influenced your accounting practice in Kuwait ?

Yes [ ]                      No [ ]                      Not applicable [ ]

35. If your answer to question 34 is Yes, Please state in what manner it did ?

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.....  
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36. Would you be willing, if necessary,  
to complete another questionnaire  
or to grant an interview ?

Yes    [    ]                      No    [    ]

If yes, at what address may I write  
to you ?

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NB:- Please write down all your suggestions with respect to  
the questionnaire and any sought improvements you  
consider appropriate.

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**THANK YOU FOR COMPLETING THIS QUESTIONNAIRE**

Wael AL-Rashed  
University of Hull, England.



\ APPENDIX [ C ] /  
-----/

UNIVERSITY OF HULL

DEPARTMENT OF ACCOUNTANCY & FINANCE

Questionnaire to Accounting Establishments,  
and professional Firms in Kuwait

I am an assistant teacher at Kuwait University- department of Accountancy- and currently a doctoral programme researcher at the University of Hull. As part of my research, this questionnaire is designed to evaluate Kuwait's present tax laws and to investigate professional views regarding the introduction of local taxes.

I assure you that the confidentiality of your answers will be respected. However, although no one except the researcher will see the completed questionnaire, the aggregated results of this questionnaire will be analysed and published in an academic doctoral thesis.

Most questions can be answered with a cross ( X ) in the appropriate box. If you wish to make any additional comments, please use the space below each question or that at the end of the questionnaire. If you have any queries on the administration of the survey, please contact Mr. Wael AL-Rashed ( Tel. 481-6804 or 484-6675 ).

I should be most grateful if you would please return the completed questionnaire as soon as possible. I enclose a stamped addressed envelope.

Thank you very much for helping me in my research project.

PART I --> GENERAL DATA ...

1. Name.....

2. Name of Firm.....

(if your firm is one of a group of companies, please answer on the basis of the group, if you think this is more useful)

3. Occupation .....

4. Form of organisation

- a. Public Ltd. liability co. [ ]
- b. Partnership [ ]
- c. Private Ltd. liability co. [ ]
- e. Public sector-body [ ]
- d. Individual proprietorship [ ]
- f. Others (specify).....

5. It is usual for business firms to have one or more objectives even if these are not formally set out. The following are some of the common objectives of business enterprises. What do you consider are the main objectives (up to 3) of your organisation ?

- a. Maximising profit
- b. Maximising owners' wealth
- c. Maximising market share
- d. Kuwait economy growth
- e. Maximising employee welfare
- f. Maintaining a going concern
- g. Other (specify).....


PART II --> KUWAIT TAX LAWS...

6. How do you view Kuwait tax laws in terms of:-

1. Current tax burden:-

Too High	Somewhat High	Moderate	A little Low	Too Low

2. Complexity:-

- a. Very simple [ ]      b. Simple [ ]
- c. Complicated [ ]      e. Very complicated [ ]

3. Tax declaration procedures :-

- a. Straight forward [ ]      b. Systematic & organised [ ]
- c. Confusing & ambiguous [ ]      d. Very dis-organised [ ]

4. Tax department (through out dealing with it) :-

- a. Inexperienced [ ]      b. Without suitable experience [ ]
- c. Qualified enough [ ]      d. Highly skilled [ ]

5. Other aspects :-

- 1>.....
- 2>.....
- 3>.....

7. Are you in favour of income taxes in Kuwait ?

- With [ ]      Against [ ]      Undecided [ ]

8. If your answer is Yes, do you think that the reform should include the introduction of any of the following :-

- a. Income Tax
  - b. Capital gain tax
  - c. property tax
  - d. Sales tax
  - e. Withholding tax
- |  |
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g. Other (specify)  
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9. Would you think that such reformation will have a positive effect on business development in Kuwait ?

Yes [ ] No [ ] Do not know [ ]

10. Do you expect tax considerations (if applied in Kuwait) to play a significant part (scaling wise) in :-

	Agree					Disagree	
	1	2	3	4	5	6	7
a. Governmental Planning..							
b. Economic control of Public expenditure.....							
c. Redistribution of wealth.							
d. Other (specify)..... .....							

11. The following are some of the amendments to Kuwait tax act introduced by the Ministry of Finance & Economy. In your opinion, what effect, if any, are these amendments likely to have on your Business growth and performance ?

	INCENTIVE /			DISINCENTIVE		
	M	M	N	M	M	OTHER
	A	I	E	A	I	COMM-
	J	N	U	J	N	ENTS
	O	O	T	O	O	(IF
	R	R	R	R	R	ANY)
			AL			
a. Circular No. (17) for 1983, concerning the required statements and certificates for tax declaration.						
b. Resolution No. (206) for 1985, in respect of requisite books and commercial records to be kept by every body corporate which is subject to income tax decree no. 3 for 1955.						
c. Ministerial order no. (44) for 1985, in respect of establishm-						

ents, authorities and companies informing about subcontractors and contractors.

d. Resolution No. (103) for 1983, in connection with foreign companies re-exporting of their plants, machinery and equipment

e. Order No. (5) / 1982, in connection with the amount allowable as the administrative expenses of foreign companies head offices or their branches operating in Kuwait.

Other suggestions include:-

f. Anew issue of tax a form liable to every corporate and private company operating in Kuwait.

g. A higher progressive tax rate to be imposed as anew tax package (upper rate limit of 45%).

h. All foreign transfers will be charged at a rate of 12% or an equivalent rate to interest rates, with regard to tax treaties between Kuwait and other countries.

i. Dividends declared on shares other than ordinary shares will not be exempt from dividend tax

j. Public companies will be liable to income tax at a reduced rate of 35% on taxable income.

k. New resident tax laws with an annual tax exemption on local earnings of KD 20,000.

l. An introduction of sales tax in Kuwait.

12. Do you agree with further amendments to the 1955 tax law instead of establishing a new tax system in Kuwait ?

Agree [ ] Do Not Agree [ ] No Opinion [ ]

PART III --> THE TAX ADMINISTRATION...

13. Have you been in a dispute before with the Tax department (Ministry of Finance) regarding your tax declaration ?

Yes [ ] No [ ]

14. If you answered Yes, please state how often ?

Once [ ] Twice [ ] 3 times [ ] More than 3 [ ]

Within..

3 Months [ ] 6 Months [ ] 9 Months [ ] 1 Year [ ]

2 Years [ ] 3 Years [ ] 5 Years [ ] 10 Years [ ]

15. What was the main disagreement about ?

a. legal interpretation [ ] b. Accounting practices [ ]

c. Tax regulations [ ] d. Others.. (specify)  
 .....  
 .....

16. Do you consent with the formation of other tax authorities, agencies and consultations (besides the tax department) ?

YES ( ) NO ( ) Do Not Know ( )

17. If your answer is Yes, please indicate what formal body that you see most appropriate ?

- 1> .....
- 2> .....
- 3> .....

18. In your opinion, would it be appropriate to combine the taxation authority with the Auditing Bureau in Kuwait ?

Very Adequate		Adequate		Totally Improper		
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----

PART V --> TAX & ACCOUNTING PROFESSION IN KUWAIT...

19. Will taxation influence (by any how) your accounting practice if applied in Kuwait ?

Yes [ ] No [ ] Do not Know [ ]

20. If your answer to question 19 is yes, Please specify from the given items, what effect it will have on:-

A. Accounting Books & Records...

Positive [ ] Negative [ ] Do not Know [ ]

B. Auditing Procedures (internal & External)...

Positive [ ] Negative [ ] Do not Know [ ]

C. Accounting Principles & Methods in determining income (i.e., Accrual, cash basis, adjusted cash, etc.)..

Positive [ ] Negative [ ] Do not Know [ ]

D. Depreciation methods used...

Positive [ ] Negative [ ] Do not Know [ ]

E. The evaluation of inventories & stock on hand...

Positive [ ] Negative [ ] Do not Know [ ]

F. Type of cost presented (Historical- current, etc.)..

Positive [ ] Negative [ ] Do not Know [ ]

G. The future of the financial statements & reporting.. (Nature, quantity, reliability, etc.)

Positive [ ] Negative [ ] Do not Know [ ]

H. other aspects.....  
.....  
.....  
.....  
.....

21. From your experience, will taxation enhance the present accounting profession significantly ?

Yes [ ] No [ ] Not applicable [ ]

22. Is Kuwait taxation a relevant consideration in developing the accounting regulations in Kuwait ?

Yes [ ] No [ ] Do not know [ ]

23. If you answered with yes, please specify if it is:-

Very Important Consideration	Somewhat important Consideration	Minor Consideration

24. From the given items, please specify what are the most important factors (maximum 3) which will enable tax regulation to be understood in Kuwait ?

	I M P O R T A N C E		
	MAJOR	MINOR	NONE
A. Education for local accountants.			
B. Co-operation with international organisations.			
C. More government enforcements.			
D. Massive economical publicity.			
E. Education for the public.			
F. Effective professional support.			
G. Accounting practice Reformation to include taxation procedures.			
H. The adoption of foreign taxation methods.			
I. Greater support from the private sector.			
G. Others..... ..... .....			

25. Do you agree with the inclusion of tax education & application in the syllabus of :-

A. The academic institutions (The university level)..

Yes [ ] No [ ] Do not know [ ]



B. The accounting profession license exam & requirements..

Yes [ ] No [ ] Do not know [ ]

C. Central Audit Bureau enforcement...

Yes [ ] No [ ] Do not know [ ]

D. The qualifications requirements to work for an auditing & accounting consulting bureau...

Yes [ ] No [ ] Do not know [ ]

E. Others.....  
 .....  
 .....  
 .....

26. In your view, do the academic institutions have the ability to contribute to the establishment of an adequate tax system in terms of:-

A. Providing effective training for firms and personnel...

Strongly Agree			Undecided		Disagree	
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----
-----	-----	-----	-----	-----	-----	-----

B. Providing recommendations and advises on how to develop tax policies, understanding and practice...

Agree					Disagree	
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----
-----	-----	-----	-----	-----	-----	-----

C. Conducting requisite local tax studies...

Agree					Disagree	
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----
-----	-----	-----	-----	-----	-----	-----

D. Responding positively to the tax system demands and practical problems..

Agree					Disagree	
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----
-----	-----	-----	-----	-----	-----	-----

E. To support the taxation practice by a competent research programmes..

Agree						Disagree
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----

F. To furnish the accounting profession with well qualified accountants, particularly in the area of taxation...

Agree						Disagree
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----

G. Developing effective auditing procedures, which are appropriate to the new tax system requirements...

Agree						Disagree
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----

H. To effectively contribute to the advancement of Kuwait public accounting procedures and practice..

Agree						Disagree
1	2	3	4	5	6	7
-----	-----	-----	-----	-----	-----	-----

27. How many times have you dealt with tax problems in Kuwait ?

- A. None [ ]      B. 3 & more [ ]      C. Less than 15 [ ]  
 D. More than 20 [ ]      E. More than 35 [ ]

28. Of what sort were the most of these tax problems ?

- A. Income tax [ ]      B. Capital tax [ ]  
 C. Indirect tax [ ]      D. Tax planning [ ]  
 E. Others (Specify).....

29. How do you set about solving these problems ?

- A. Government publications & Statutes [ ]
- B. Consultations with colleagues [ ]
- C. Correspondence with tax department [ ]
- D. In-house information services [ ]
- E. Commercial tax information & pamphlets [ ]
- F. Tax specialists & Books [ ]
- G. Others..... [ ]

30. Do you ever read articles or publications on taxation in government publications or specialist magazines ?

Yes [ ] No [ ] Sometimes [ ]

31. If you please, indicate if you regularly read any of the following publications (or others):-

- A. British tax review [ ]
- B. Taxation Or Taxes [ ]
- C. Tax cases leaflets [ ]
- D. quarterly Record [ ]
- E. Business tax cases [ ]
- F. Others..... [ ]  
..... [ ]  
..... [ ]  
..... [ ]  
..... [ ]

32. Do you try to keep in touch with new development in Kuwait taxation as they occur ?

Yes [ ] No [ ]

33. If you answered with yes, do you find this difficult ?

Yes [ ] No [ ]

34. If you do find difficulty, Can you state the reason(s) ?

- A. Lack of clarity in legislations [    ]
- B. Difficulty of access to information [    ]
- C. Frequent changes in tax laws [    ]
- D. Scarcity of related information [    ]
- E. Lack of government co-operation [    ]
- F. Others..... [    ]  
..... [    ]  
..... [    ]  
..... [    ]  
..... [    ]

35. Are there any ways in which you are directly involved in providing tax information for use by other ?

Yes [    ]      No [    ]      Sometimes [    ]

36. What improvements do you see in the kinds of tax information available to you ?

- 1>.....
- 2>.....
- 3>.....
- 4>.....
- 5>.....

37. Would you be willing, if necessary, to complete another questionnaire or to grant an interview ?

Yes [ ]   No [ ]

If yes, at what address may I write to you ?

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NB.: Please write down all your suggestions with respect to the questionnaire and any sought improvements you consider appropriate.

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THANK YOU FOR COMPLETING THIS QUESTIONNAIRE

Wael AL-Rashed  
University of Hull, England.

\ APPENDIX [ D ] /  
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*"The Interviews"*

A list of selected interviews conducted by the researcher during the period, December 1987 - March 1988, are provided in this appendix. All these interviews were carried out in Kuwait.

- 1> Name :- Khalid AL-Subaihi.  
Job :- Director of the tax department.  
Date :- 11/1/1988      Duration :- 55 Minutes.
- 2> Name :- Adel Nour.  
Job :- The Audit Bureau Senior Tax Inspector.  
Date :- 5/1/1988      Duration :- 135 Minutes.
- 3> Name :- Sami AL-Saqobai.  
Job :- The Tax Department Planning & Following up  
Controller.  
Date :- 19/1/1988      Duration :- 60 Minutes.
- 4> Name :- Jasim AL-Sharah.  
Job :- The Tax Department Inspection Controller.  
Date :- 17/1/1988      Duration :- 65 Minutes.
- 5> Name :- Mohammad Awad.  
Job :- Senior Expert at the Tax Department.  
Date :- 19/1/1988      Duration :- 105 Minutes.
- 6> Name :- Dr. Sadiq AL-Bassam.  
Job :- - Faculty Member /Accounting Department/  
Kuwait University.  
- President of KSAA.  
- Certified Public Accountant.  
Date :- 23/1/1988      Duration :- 133 Minutes.
- 7> Name :- Akram AL-Qadi.  
Job :- Senior Auditor - Talal Abou-Khazala Accounting  
Firm.  
Date :- 25/1/1988      Duration :- 70 Minutes.

- 8> Name :- Dr. Ahmad AL-Muzaini.  
Job :- - Faculty Member / Law Department / Public  
Authority of Technological Education.  
- Local Author of Taxation texts.  
Date :- 23/2/1988 Duration :- 65 Minutes.
- 9> Name :- Dr. Osama Fathi.  
Job :- - Faculty Member / Accounting Department /  
Public Authority of Technological Education.  
- Local Author of Taxation Articles.  
Date :- 8/2/1988 Duration :- 55 Minutes.
- 10> Name :- Dr. Abas AL-Mejren.  
Job :- - Faculty Member / Economics Department /  
Kuwait University.  
- Local Author of Taxation Articles.  
Date :- 9/2/1988 Duration :- 85 Minutes.
- 11> Name :- Dr. Abdul-Hafeed Abdul-Allah.  
Job :- - Faculty Member / Law Department / Kuwait  
University.  
- Local Author of Taxation Articles.  
Date :- 7/2/1988 Duration :- 67 Minutes.
- 12> Name :- Adnan M. Saleh.  
Job :- - Superintendent - out stations & Accounting  
sections - Kuwait Airways.  
Date :- 21/2/1988 Duration :- 75 Minutes.