



MERGERS AND ACQUISITIONS

Oman

Taxation of Cross-Border
Mergers and Acquisitions

2010 Edition

TAX

Oman

Introduction

Mergers and acquisitions (M&A) are becoming much more common in Oman. There have been a number of acquisitions in the recent years, particularly in the infrastructure sector.

Since Oman became a member of the World Trade Organization (WTO) in November 2000, the government has been liberalizing the commercial and investment laws to attract foreign investment. It is now possible for foreign companies to hold majority ownership up to 70 percent in Omani companies. Even 100 percent ownership is now allowed with the approval of the Council of Ministers. Furthermore, following the introduction of a new Income Tax Law which became effective on 1 January, 2010, all companies, irrespective of their nationality will pay taxes at a uniform rate of 12 percent. Previously, foreign companies paid taxes at higher rates. This development is expected to give a further boost to M&A.

Recent Developments

Oman has promulgated a new income tax law which became effective from 1 January 2010. The major amendments brought in by the new tax law are as follows.

Uniform Tax Rates for All Companies

As mentioned above, a uniform tax rate of 12 percent of taxable income in excess of OMR 30,000 is applicable henceforth.

Introduction of a Service PE Rule

The definition of a permanent establishment (PE) has been amended such that foreign companies providing any consultancy services in Oman will not create a PE if their presence in Oman is less than 90 days in any tax year.

Capital Gains

Capital gains have been specifically included under the scope of income chargeable to tax. Consequently, any capital gains arising on the sale of business, including restructuring, could be subject to tax in Oman.

Taxability of Global Income and Deduction of Tax Paid in Foreign Jurisdictions

Tax shall be charged on any income irrespective of whether it is realized or arose in or outside Oman. However, if a company has paid income tax outside Oman on income earned or realized outside Oman, it may deduct the tax paid outside Oman from the tax payable on its taxable income in Oman. Hence the principle of taxation has shifted from territorially-based system, to a global taxation system.

Taxability of Foreign Dividends

Only distributions of profit by an Omani company are exempt from tax. Therefore, dividends received from foreign companies are now taxable in Oman.

Change in Method of Computing Depreciation

The method of computing depreciation on capital assets (except buildings, ships, and aircraft) has changed from straight-line method to the written-down method.

Asset Purchase or Share Purchase

An acquisition in Oman may take place in the form of purchase of the business and assets of a company, or the purchase of its shares. In a purchase of assets, the tax authorities seek to determine whether the transfer of assets has taken place at the market value and at arm's length. Any capital gains arising in the hands of the transferor are subject to tax. Profits on sales or transfers of shares of a company registered on the Muscat Securities Market (MSM) are exempt from tax in Oman, but profits on the sale of other securities are subject to tax.

On the other hand, in a business acquisition, goodwill on an acquisition of assets (but not shares) is allowed as a deduction under tax law. Some of the tax considerations relevant to each method are discussed later in the chapter. The relative advantages are summarized at the end of the chapter.

Purchase of Assets

The main advantage of a purchase of assets is that the purchaser can selectively acquire assets of the business without necessarily inheriting the history and liabilities of the acquired company. The tax issues that arise in

the case of a purchase of assets are discussed later in the chapter.

Purchase Price

A purchase of assets will usually result in an increase in the base cost of those assets for both capital gains tax and capital allowance purposes. In addition, historical tax liabilities generally remain with the company and are not transferred with the assets.

Goodwill

Goodwill, representing the excess of the purchase price over the fair value of assets acquired, is allowed as a deduction over a period considered reasonable by the tax authorities.

Depreciation

Depreciation of capital assets charged in the accounts is ignored for tax purposes. Oman tax legislation enables the cost of capital assets (except land) to be written off against taxable profits at a specified rate by means of depreciation. Depreciation is available with respect to tangible capital assets (plant and machinery, vehicles, furniture, computers, and buildings) and certain intangible assets (for example, intellectual property rights and computer software).

The Income Tax Law of Oman has changed the method of computation of depreciation of capital assets with effect from 1 January 2009. Apart from buildings, aircraft and ships, which continue to be depreciated on the straight-line method, all other capital assets must be depreciated by the written-down method, and for these assets the pooling of assets concept has been introduced.

The annual tax rate for depreciation for permanent buildings is 4 percent, whereas for temporary buildings/structures the rate is 15 percent. Depreciation for quays, jetties, pipelines, and railways is 10 percent. Hospital and educational institute buildings can be depreciated at 100 percent a year. For heavy machinery, vehicles, furniture, computers and software, and intellectual property rights the depreciation rate is 15 percent. For digging equipments such as rigs the rate is 10 percent. The depreciation rate all other equipment not included in the above categories is 15 percent.

Tax Attributes

Tax losses are not transferred on an asset acquisition. They remain with the transferor company or are extinguished. However, in the case of a share

acquisition, the transferee company would assume the tax losses, if any, of the transferor company.

Capital gains arising from a sale of assets would be taxable in the hands of the vendor.

Value-Added Tax (VAT)

Currently there is no VAT in Oman.

Transfer Taxes

Currently, there are no stamp duties or similar taxes in Oman.

Purchase of Shares

The tax issues that arise in the case of a purchase of shares are discussed later in the chapter:

Tax Indemnities and Warranties

In a share acquisition, the purchaser is taking over the target company together with all related liabilities, including contingent liabilities. The purchaser will, therefore, normally require more extensive indemnities and warranties than in the case of an asset acquisition.

Where significant sums are at stake, it is customary for the purchaser to initiate a due diligence exercise, which would normally incorporate a review of the target's tax affairs.

Tax Losses

Losses can only be carried forward in the hands of the entity which incurred the losses. The major advantage in the case of a purchase of shares is that the acquired entity's losses can continue to be used to set-off against future taxable profits. Losses can be carried forward for a period of five years from the year in which they are incurred.

Crystallization of Tax Charges

In the case of an acquisition through purchase of shares, the purchaser can claim the tax losses of the transferor. However, if the acquisition is a purchase of assets, the benefit of setting off the transferor's tax losses is not available to the purchaser. The tax losses can only be claimed by transferor, otherwise they lapse.

Pre-Sale Dividend

In certain circumstances, sellers may prefer to realize part of the value of their investments as income by means of pre-sale dividends. This would reduce the proceeds of sale and thus, indirectly, lower the tax burden on the gain on sale.

Transfer Taxes

There is no stamp duty in Oman.

Tax Clearances

Any change in the ownership of a company has to be reported to the tax authorities of Oman. A company is required to file a revised business declaration form, specifying the changes in the ownership, with the tax authorities.

Choice of Acquisition Vehicle

The main decision to be made by a company contemplating an acquisition of an existing business in Oman is whether to opt for the acquisition of shares or the acquisition of assets.

This section sets out the matters to be considered in such a choice from the perspectives of both the acquirer and the vendor.

Local Holding Company

An Omani holding company structure may not be appropriate for Oman, because the taxation system does not provide for group relief.

Foreign Parent Company

A foreign parent company can purchase the shares of the local target, because a mere purchase of shares in a local company will not result in the creation of a PE for the foreign company. Therefore, any capital gains arising at the time of exit will not be subject to tax in Oman. Further, there are no withholding taxes (WHT) levied in Oman on payment of dividends.

Non-Resident Intermediate Holding Company

Same tax implications as in the case of foreign parent company.

Local Branch

Establishment of an Oman branch is possible only when a foreign company is awarded a contract by the Government in Oman and the branch can only be registered for the period of contract. Hence, a branch structure may not be the most appropriate form for M&A activities in Oman.

Joint Ventures

Joint ventures – partnerships with local companies – could be considered. However, it is advisable to form a company with the joint venture partners as owners.

Choice of Acquisition Funding

In the case of a merger or acquisition involving the purchase of assets structured through a local entity established in Oman, the Commercial Companies Law and the Foreign Capital Investment Law govern the minimum equity funding required as discussed below. Thin-capitalization rules are expected to be introduced through executive regulation to the new tax law. KPMG in Oman understands that the thin-capitalization rules are likely to be applicable only to transactions between related parties. Therefore, if funding is obtained by the acquirer from unrelated parties for the transaction, it should not be subject to future thin-capitalization rules in Oman. If the acquisition is structured as a branch in Oman, any interest cost incurred by the head office attributable to the acquisition is not likely to be allowed as a deduction to the branch, because it would be construed as a cost of the head office, not of the branch.

In the case of a purchase of shares, however, no deduction would be allowed to the acquirer, because investment income (dividends/share of profits) is, in most cases, exempt from tax in Oman.

Debt

If the acquisition is financed through debt, the major advantage would be deductibility of interest. The acquirer can arrange debt from banks and from Omani shareholders. Care should be taken to ensure that the imminent introduction of thin-capitalization rules (as discussed earlier in the chapter) is taken into account. Please also note that fair value adjustments on hedging of interest liabilities of debt are not allowable deductions. If attributable to the local operation they would be allowed only on the actual settlement of the payment.

Deductibility of Interest

Annual payment of interest on debt as shown in the financial statements is allowed by the tax authorities. Fair value adjustments (mark-to-market) as required by international accounting standards (IAS) on hedging are not allowable deductions.

Withholding Tax on Debt and Methods to Reduce or Eliminate

There is no WHT in Oman on interest payments

Checklist for Debt Funding

- Consider the impact of thin-capitalization rules which will be introduced shortly in Oman.

- If loans are taken out from related parties to fund the acquisition, ensure that the rates are comparable to rates that can be obtained from third parties to avoid adjustments by the tax authorities;

Equity

An acquisition can also be funded with equity. Oman has no capital duty or any other duty or tax on issuance of share capital.

The following points should be noted when funding with equity:

- When a new joint stock company (new company) is formed to acquire the target, there is a lock-in period of two financial years before promoters can withdraw their money from the new company.
- If the target is loss-making, dividends can only be issued after setting off all carried forward losses.
- There is no tax on distributions of dividends. Dividends declared by an Omani company are exempt from tax in Oman.
- In the case of a public company the promoters can have a minimum 30 percent and a maximum 60 percent of the capital.

Hybrids

These are not common in Oman.

Discounted Securities

These are not common in Oman.

Deferred Settlement

If the buyer defers the payment due to the target and earns interest on deferred settlement, the interest expenses incurred by the target may not be allowed as a deduction.

Other Considerations

When acquiring an entity operating in Oman the following legislation should be taken into account.

Commercial Companies Law

The Commercial Companies Law of Oman provides that mergers and acquisitions could take place in one of the following ways:

- dissolution of one or more companies and the transfer of their assets and liabilities to an existing company; or
- dissolution of two or more companies and establishment of a new company to which the

assets and liabilities of the dissolved companies are transferred.

The key steps involved in a merger or acquisition transaction include the following:

- The company taken over should pass a resolution relating to its dissolution and merger with the other company.
- The merger/acquisition should be announced in two daily newspapers for two consecutive days, and should be registered in the Commercial Register of the Minister of Commerce and Industry (MOCI).
- The take-over resolution cannot take effect until after expiry of three months from the date of the registration of the merger/ acquisition in the Commercial Register. The MOCI may, by a decision published in two daily newspapers for two consecutive days, reduce this period if it is in the public interest.
- The creditors of the company taken over have a right, during this period, to object to the merger, in which case the take-over resolution becomes ineffective (if their objection cannot be resolved).
- All rights and liabilities of the company taken over are considered as transferred to the incorporating company after the take-over resolution becomes effective.

Foreign Capital Investment Law

M&A transactions involving foreign investment must also comply with the Foreign Capital Investment Law of 1994, as amended from time to time. Under this law, any foreign national or entity wishing to engage in any commercial, industrial, or tourism business in the Sultanate, or acquire an interest in the capital of an Omani company, must obtain a license from the Ministry of Commerce and Industry. The license is granted on certain conditions, including the requirement for the business to be carried on through an Omani company with a capital of not less than OMR 150,000 (USD 390,000). Foreign companies may also operate in Oman as branches, by virtue of a special contract or agreement with the Government or in the case of projects declared by the cabinet as necessary for the country. A branch registration is valid only for the duration of the project.

Foreign participation in the capital of an Omani entity is permitted up to 70 percent without specific approval and can exceed 70 percent in certain circumstances

with the approval of the Council of Ministers following the recommendation of the MOCI. Such approval would be considered only for projects deemed critical to the development of the national economy. In such exceptional cases, capital of the company must not be less than OMR 500,000 (USD 1,300,000).

When the acquisition involves the take-over of a locally incorporated company by another locally incorporated company, care must be taken to ensure that the foreign investment limit of 70 percent is not exceeded in the acquiring company unless approval of the Council of Ministers is obtained. When a new company is created into which one or more companies are to be merged, the provisions of the Foreign Capital Investment Law relating to share capital and foreign shareholding would have to be complied with.

In the case of a takeover of the Oman branch of a foreign company, the acquiring company should satisfy itself that the branch registration continues to be an appropriate form for operating in Oman. The change in ownership would need to be reported to the MOCI.

Oman's foreign capital investment law specifically provides for:

- the right of foreign investors to repatriate capital and profit;
- the protection of foreign investments by stipulating that foreign investment projects may not be confiscated or expropriated unless it is in the public interest, in which case an equitable compensation is required to be paid; and
- referring any disputes between foreign investment projects and third parties to a local or international arbitration tribunal as may be agreed.

Income Tax Law

Clearance from the Omani tax authorities is not required prior to a merger or acquisition but the Omani tax authorities need to be informed of the merger/acquisition with a request to close the tax file of the merging entity. Further, the company whose ownership has changed, on account of merger/acquisition, is required to file a revised business declaration form with the tax authorities. Please note that as per the new tax law, the tax rate for all the companies, irrespective of their shareholding patterns, is 12 percent of the taxable profit in excess of OMR 30,000.

Labor Law and Omanization

The government has set Omanization (employment of Omani nationals) targets for certain sectors, which need to be adhered to by the merged entity.

Other Approvals/Consents

- Apart from complying with the Commercial Companies Law and the Foreign Capital Investment Law, in the case of public companies and regulated industries like banking and insurance, approval of the regulating agency is also required.
- For all mergers and acquisitions, consideration would need to be given to informing and, where applicable, obtaining the consent of key customers (particularly in the case of government contracts) and suppliers.

Foreign Exchange Controls

There are no exchange controls in Oman. Capital and income may be repatriated abroad without restriction.

Double Tax Treaties

Oman has signed comprehensive double tax avoidance treaties with 26 countries:

- Algeria
- Brunei
- Canada
- China
- France
- India
- Italy
- Korea
- Lebanon
- Mauritius
- Netherlands
- Pakistan
- Seychelles
- Singapore
- South Africa
- Sudan
- Syria

- Thailand
- Tunisia
- United Kingdom
- Uzbekistan
- Yemen

Acquirers should take into account treaty benefits available when structuring their mergers or acquisitions.

Other Matters

Under the Omani tax law, losses incurred on assets such as stocks or debtors, are allowed as a deduction in the year when the write-offs take place, rather than the year in which provisions for such losses are established. In the case of mergers and acquisitions, any write-offs after the acquisition against provisions established prior to the acquisition are not allowed as a deduction, on the basis that the acquirer did not pay for such assets. This is despite the fact that such provisions may not previously have been allowed as a deduction in the hands of the acquired company.

Concerns of the Seller

The seller would be concerned about the imposition of capital gains tax, which could be levied on the capital gains arising on the transfer of assets or shares (especially if the shares are non MSM-listed), and would, therefore, seek to reduce, or minimize the capital gains tax liability.

Group Relief/Consolidation

There is no concept of group relief applicable in Oman.

Transfer Pricing

Transactions between related parties are scrutinized in great detail by the tax authorities. They expect such transactions to be at arm's length. Whilst, currently, there are no specific rules on transfer pricing in the tax law, it is widely expected that certain rules such as thin-capitalization rules will be introduced through the executive regulations. Currently, the preferred approach of the tax authorities to pricing is the cost-plus approach.

Foreign Investments of a Local Target Company

Under the new tax law of Oman, a company is liable to tax on its global income and would be eligible to claim tax deductions for the tax paid in foreign jurisdiction on that income. Since the foreign tax can only be claimed to the extent of company's tax liability in Oman, due consideration should be given to the foreign investments of the target which are located in low tax or tax-free regime countries.

Comparison of Asset and Share Purchase

The advantages and disadvantages of purchasing assets and purchasing shares are summarized below.

Advantages of Asset Purchases

- The acquirer would be entitled to depreciation on the fair value of assets purchased.

Disadvantages of Asset Purchases

- Pre-acquisition losses cannot be carried forward and used by the acquiring company.
- The company selling the assets will be liable to tax on any capital gains arising from sale of the business assets (including goodwill).
- Provisions established by the acquired company on the assets transferred are not allowed as a deduction in the hands of the acquirer when these provisions are written off or reversed.

Advantages of Share Purchases

- Pre-acquisition losses can be carried forward.
- Provisions established by the acquired company are allowed as a deduction when these provisions are written off or reversed.

Disadvantages of Share Purchases

- Goodwill paid on acquisitions of shares is not allowed as a deduction.
- Capital gains realized by the seller on the shares transferred (other than those registered in Muscat Securities Market) are likely to be taxed.

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