

Newsletter

Vol 1, 2017

Audit / Tax / Advisory



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Message from the Managing Partner



Davis Kallukaran
Managing Partner

Dear friends,

The month of February has seen some firm decisions by the Sultanate government to enhance the revenue stream. Tax laws have been totally revamped. The fiscal measures aim to bring down the budget deficit by increasing the tax rates and widening the tax net. It also aims at cutting down certain exemptions given to the tax payers. The government feels that the businesses in the Sultanate have come out of their shell and can now support by itself. The basic exemption of RO 30,000/ hitherto enjoyed by the tax payers have also been withdrawn. A detailed version of the amendments is given in the following pages.

Business in the GCC have very minimal understanding on the impact of a VAT regime. The recent surveys show that most of the businesses have not yet incorporated VAT in their business plans. The signing of GCC VAT agreement by Saudi Arabia and Bahrain last week has made the VAT legislation a reality. The GCC value added tax regime is to adopt the best practices from the European model. As of date about 114 countries plus the EU have adopted the vat regime with the tax rates varying from 25% in Denmark to 10% in Lebanon and Egypt. The business community across the GCC is concerned on how the VAT will impact their businesses, Systems and processes.

Vat is a tax on final consumption. It will be a new fiscal instrument for revenue stability during periods of fluctuating oil prices and can offset revenue losses from depleting oil reserves.

Vat is proposed to be introduced in the Sultanate, effective January 2018. businesses in Oman have to specifically understand how VAT will impact their current business

processes, systems, and operations. This will also have financial implications on the supply chain. Further, VAT will affect virtually all functions of business, especially IT, HR, procurement, sales, marketing and finance. A proper training and integration with all levels of the operational structure is required.

Finally, the introduction of VAT adds challenges and uncertainties to businesses in Oman. They have to develop an efficient and cost effective VAT framework to comply with the challenges and upcoming regulations.

Challenges in introduction of Vat

Getting the right people, appropriate training, setting the system modification are key challenges in the implementation of VAT. Further the increase in the cost of inventory and Ecommerce could also pose big challenge. Most of all Businesses should consider the VAT implications in any contracts going beyond January 1, 2018 to protect their interest.

Amendments to tax law - Highlights

Tax registration:

Existing Law	Amended as	Effective from
Within 3 months (90 days) of incorporation or commencement of activity whichever is earlier	Within 2 months (60 days) of incorporation or commencement of activity whichever is earlier	Immediate effect from 27 February, 2017
To notify changes to CR within 2 months (60 days) of modification	To notify changes to CR within 1 month (30 days) of modification	

Income tax rates:

Existing Law	Amended as	Effective from
Up to RO 30,000 – No taxes	15% on the taxable income, without any statutory deduction	Tax year 2017
Above RO 30,000 – 12% of the taxable income		

Withholding taxes:

Existing Law	Amended as	Effective from
1. Royalties 2. Consideration for research and development 3. Consideration for the use or right to use computer software 4. Management fees	All the items 1 to 4 and also includes 5. Dividend on shares 6. Interest 7. Fees for Provision of services	Immediate effect from 27 February, 2017

Tax Exemptions:

Existing Law	Amended as	Effective from
Tax exemptions were allowed maximum of 10 years to: 1. Industry (manufacturing) 2. Mining 3. Exports of locally manufactured or processed goods 4. Operation of hotels and tourist villages 5. Agricultural and animal produce, including processing such produce 6. Fishing and fish processing, farming and breeding 7. Education 8. Medical care	Tax exemption is now available only to Industry (manufacturing) and the maximum period is 5 years. No more tax exemption eligible for any other activities.	Immediate effect from 27 February, 2017

Penalties:

Particulars	Existing Law	Amended as
If returns are not filed within the due dates	Maximum of RO 1,000	Maximum of RO 2,000
If returns are not filed as per the tax laws and executive regulations	Not specified	Maximum of RO 3,000
Difference between the Income assessed and the Income declared in the return	Minimum not specified Maximum 25% of the difference	Minimum – 1% of the difference Maximum – 25% of the difference
Non submission of assessment replies and as requested	Maximum of RO 2,500	Maximum of RO 5,000

Punishments:

Particulars	Existing Law	Amended as
An intentional non-submission of returns by the Principal officer	Imprisonment of one month or maximum fine of RO 2,000 or both	Imprisonment of one to six months or fine of RO 500 to RO 20,000 or both
The above offence is repeated within 2 years	Imprisonment of one year or maximum fine of RO 2,000 or both	Imprisonment of three to twelve months with fine of RO 2,000 to RO 30,000
An Intentional actions by the principal officer like Non submission of documents, information, accounts, records, statements as per the Law Not preserving the books of accounts as per the Law Destruction, concealment of records and documents requested as per Law	Imprisonment of one month or maximum fine of RO 2,000 or both	Imprisonment of six months to three years or fine of RO 5,000 to RO 50,000 or both.

Tax assessments:

Particulars	Existing Law	Amended as
Tax assessments	To be completed within 5 years	To be completed within 3 years
Tax objection	To be completed within 10 months	To be completed within 8 months
Estimated assessment in case of non-submission of returns/fraud	Time limit for completion of estimated assessment 10 years	Time limit for completion of estimated assessment 5 years

VAT in GCC

Insight: GCC Macroeconomics

For the VAT in the GCC, the “VAT agreement” under consideration sets a single tax rate of 5 percent and harmonizes its main features, but leaves significant discretion for member countries to set their respective tax base. It leaves to countries the liberty to decide the tax treatment of six sectors, namely: education, health, financial services, real estate, domestic transportation and oil and gas.

The Agreement also allows member countries to zero-rate certain domestic food items from a common list of about 100 items drawn up using customs Harmonized System (HS) codes.

VAT Concepts: Mechanics

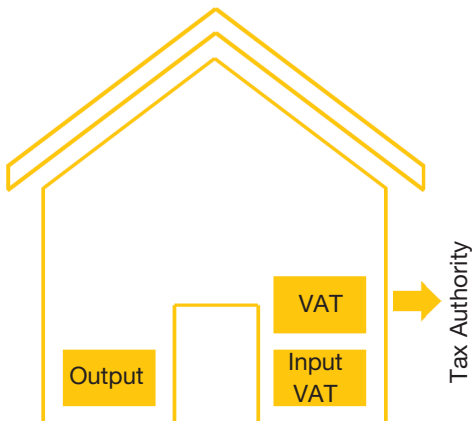
VAT is structured to be paid by end consumers and is a tax applicable on spending on goods and services (“Consumption Tax”).

How VAT works can be illustrated as follows:

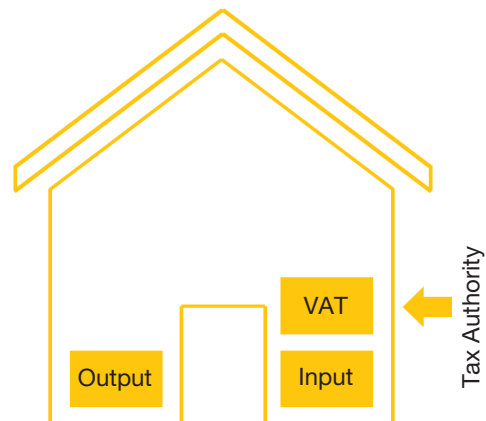
It is expected that no accumulation occurs for the businesses, because the total tax remitted to the revenue equals the statutory rate applied to the final consumer price. ($5\% \times 4,000 = 200$).

Tax rate—5% All companies are VAT registered business	Price	Tax on Sales (Output VAT)	Credit (Input VAT)	Payable Tax
Producer 1	1,000	50		50
Producer 2 (Producer 2 purchased from producer 1)	2,000	100	50	50
Wholesaler (Wholesaler purchased from producer 2)	3,000	150	100	50
Retailer (Retailer purchased from Wholesaler)	4,000	200	150	50
Total		500	300	200

VAT is 'self-enforcing', in a way that other indirect taxes are not. It is paid at each production stage in order to claim credit for its inputs against the VAT received on its outputs. A business would need to show, if required, that the VAT had been paid by its suppliers. VAT is an Indirect tax for the business as the businesses act as the tax collectors. This means that:



- When the Output VAT is higher than the Input VAT, there will be VAT payable to the tax authority.



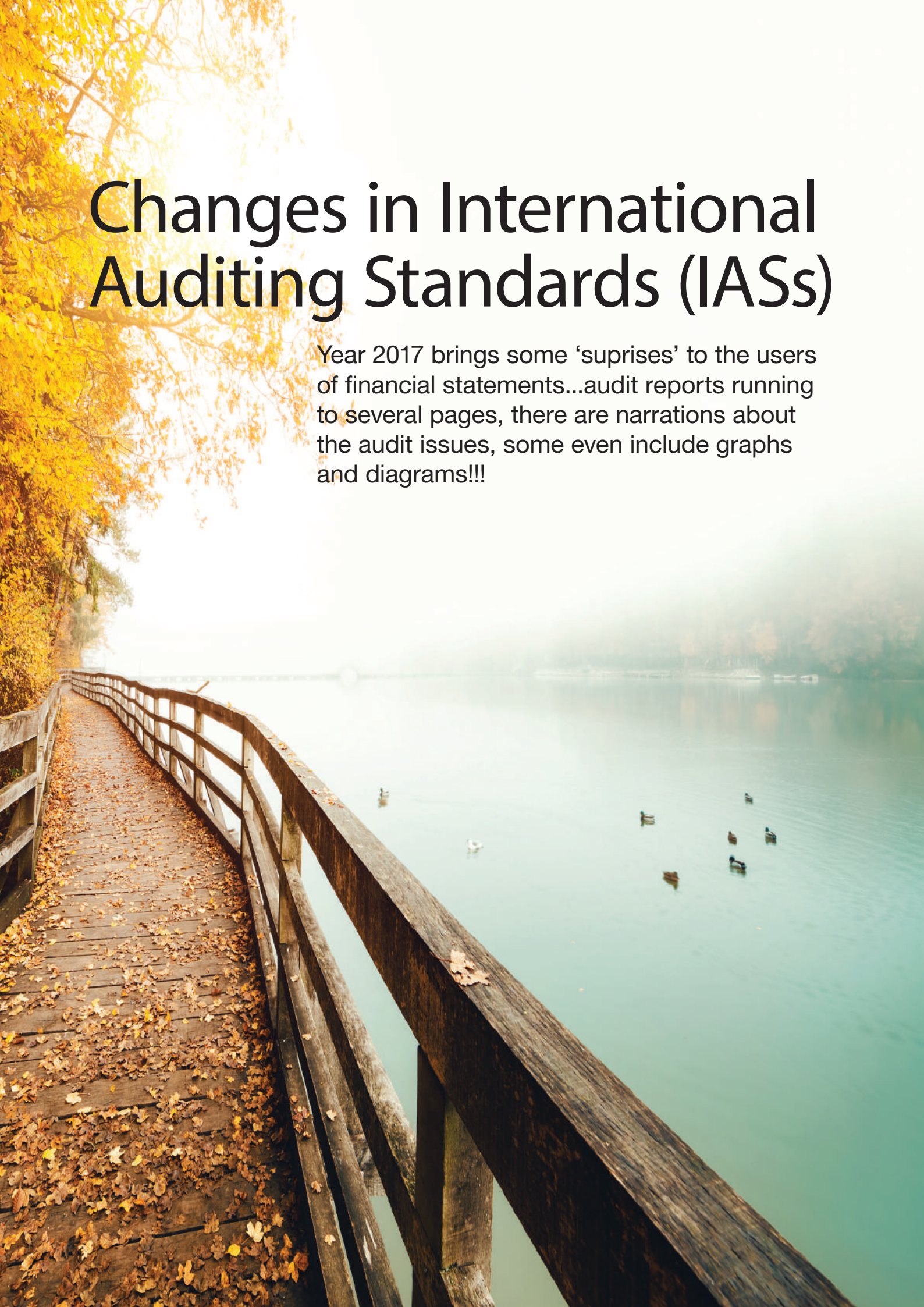
- When the Output VAT is lower than the Input VAT, there will be VAT refundable/receivable from the tax authority.



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Changes in International Auditing Standards (IASs)

Year 2017 brings some 'surprises' to the users of financial statements...audit reports running to several pages, there are narrations about the audit issues, some even include graphs and diagrams!!!



Yes it is true, there were several changes in International IAS's effective for the audits for the periods ending on or after 15 December 2016, which includes:

- Changes in independent auditor's report format and contents (ISA 700 (revised) : Forming an opinion and Reporting on Financial statements)
- Key Audit Matters (KAMs') to be included in independent audit reports (ISA 701 (new) : Communicating Key Audit Matters in the Independent Auditor's report) Reporting on Financial statements)
- Changes regarding qualifications, adverse opinion , disclaimer of opinion, other matters and emphasis of matter paragraphs (ISA 705 (revised): Modifications to the Opinion in the Independent Auditor's Report and ISA 706 (revised) Emphasis of matter paragraphs and other matters paragraphs in the independent auditor's report)
- Revisions were there in some other related standards also (ISA 570, ISA 260 and ISA 720)

Independent Auditor's Report

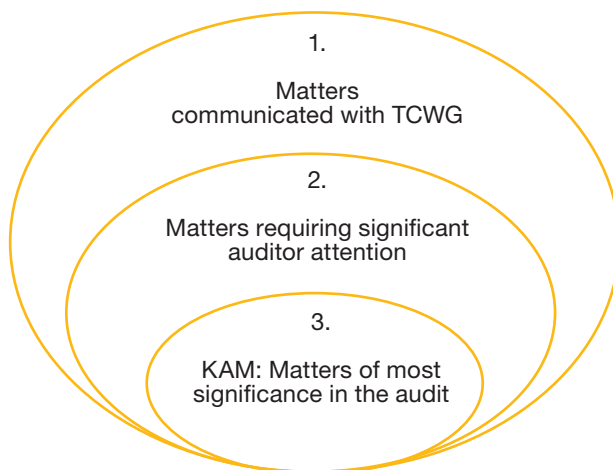
Audit report had undergone major changes in the format and contents, highlights are:

- In fact the format of the report was changed upside down. Earlier report was ending auditor's opinion whereas the revised report is starting with auditor's opinion.
- Enhanced description of auditor responsibilities and key features of the audit
- Responsibilities of those charged with governance redefined
- Statement about the independence and other ethical responsibilities included
- Naming of the engagement partner is required (for list company audits)
- Enhanced reporting on going concern
- Key audit matters

Key audit Matters (KAMs) – applicable for listed companies

- KAMs are those matters that in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period.
- KAMs should be selected from matters communicated with management or those charged with governance.
- KAMs need to be included unless the law or regulation precludes or in extremely rare circumstances when there is adverse consequences.
- KAM is prohibited for a disclaimer of opinion, but required for a qualified or adverse opinion.
- Auditor should disclose why matter is considered as KAM, how it was addressed in audit process and how the same is concluded along with auditor's observations.
- KAM can be areas of higher assessed risk of material misstatement, significant judgement, effect on significant events or transactions.

Decision making framework for KAM



Crowe Horwath International took the initiatives to summarize the KAMs reported in countries where the similar reporting already followed. Most common issues reported in UK are:

- Impairment of goodwill (43%)
- Accounting for revenue (42%)
- Other assets impairment (29%)
- Taxation (43%)

Some other issues usually included as KAM are:

- Allowance for impairment loss of inventory
- Property plant and equipment
- Purchase price allocation etc.



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IFRS 16 - Leases

Leasing is an important financial solution for companies. It enables them to use property, plant and equipment without needing to incur large initial capital investments or purchases. As per the current IAS 17, leases are either classified as off balance sheet operating leases or as finance leases. The new standard will recognise all leases on the balance sheet. Off balance sheet lease financing numbers are substantial. Listed companies using IFRS or US GAAP disclose almost US\$3 trillion of off balance sheet lease commitments. Some industry sectors will be more affected than others.

Companies will require to apply the new standard from 1 January 2019. Lessees should initially recognise a right-of-use asset and lease liability based on the discounted payments required under the lease. Initial direct costs and restoration costs are also included in the right-of-use asset.

Lessor accounting does not change and lessors continue to reflect the underlying asset subject to the lease arrangement on the balance sheet.

This technical change in the accounting then impacts key ratios which investors and debt providers often use to assess business strength and performance, including Gearing (which will look worse as liabilities increase), Return On Capital Employed (which will look worse as the asset base increases) and Earnings Before Interest Tax Depreciation and Amortisation (which will improve as the rental expense is replaced by an interest and depreciation charge). Entities should ensure they spend time explaining to their investors and other stakeholders the impact of the new accounting standard.



The key question, then, is how this will change business behaviour, particularly when negotiating to take on, or extend, a property lease. As entities seek to minimise the impact they could look to reduce lease terms or include additional break clauses and it may even impact an entities decision as to whether to lease or buy.

These requirements may result in lessors either demanding higher rents in exchange for shorter term leases or alternatively offering improved lease incentives in order to encourage lessees to sign longer term leases. It is too early to tell how this will impact the market but understanding the changing accounting requirements will help both lessors and lessees when negotiating over how to structure leases.

The change to lease accounting does not affect a company's economic position or commitments to pay cash, which are typically already considered by lenders. Accordingly, the IASB is of the view that any changes to the cost of borrowing following the implementation of IFRS 16 will result from improved decision-making, which will in turn be the result of improved transparency about a company's financial leverage.



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Know your Tax obligations

Business in Oman is subject to corporate income taxes on the surpluses generated and the tax system can be one of the most baffling areas of business life. The tax practice in Oman assumes significant importance due to the rapid changing practice in the tax administration and compliance in strictly implementing the provisions in the tax laws especially in tax assessment procedures and income tax filing requirements.

Return filing requirements

There is no extension of time granted for filing the income tax returns beyond the due date, summons is being issued for non-filing of returns and penalties are levied for non-compliance of summons hearing. Therefore, it is important to comply with tax filing obligations which require the tax payer by furnishing two returns of income each year in the forms prescribed for this purpose and within the due dates and with the correct declaration.

The Provisional Return of Income (PRI) are to be filed within 3 months from the end of the accounting period along with the advance tax payment either on actual (if audit finalized) or on estimate (if audit

not finalized). The tax department expects there shall not be a huge variation between the estimated and the final declaration, and the estimation shall be on a reasonable basis.

The Final Return of Income (FRI) is to be filed within 6 months from the end of the accounting period along with the balance payment of taxes and along with the audited financial statements accompanied with the schedules and appendices required as per tax laws of Oman.

Tax assessments

During assessment the income tax authorities are consistent in asking for detailed and extensive documentation in support of the replies to their assessment queries, the disallowances in certain areas

have become routine and regular especially bad debts, related party transactions.

The strict approach to the assessment nowadays does not assure that the assessments will be based on previously agreed assessments. The significantly increasing depth and extent of the assessment procedures brings important obligation on the part of the tax payer to maintain appropriate books of accounts, supporting documents, proofs, data and records in order to promptly respond to the Secretariat General's request for smooth completion of assessment by the tax authorities.

Fines and Penalties

It is also an important alert that if the taxpayer fails to declare correct income in the return of income for any tax year, the Secretary General may impose fine not exceeding 25% of the difference between the amount of tax on the basis of the correct taxable income and the amount of tax as per the return submitted.



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M&A considerations for 2017: Don't let tax derail the deal

Laurence Field, Senior Tax and Corporate Business Partner at Crowe Clark Whitehill, reflects on the M&A tax landscape that evolved through 2016 before looking ahead to assess what businesses need to know if they are looking to get a transaction over the line in 2017. Whether it is specific regulatory requirements that need to be observed, or a culture change in the treatment of tax as part of deal-making, he explains that while tax considerations will never make a deal, they certainly can break a deal.



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Making an acquisition? Why tax is important

Tax strategies need to be reviewed to ensure they are still fit for purpose. Historically much tax due diligence has been backwards-looking: addressing the question of whether the right returns have been filed, at the right time, with the right amounts being paid. However, with the ongoing changes to taxes, tax due diligence needs to be increasingly forward-looking and the question arises over the extent to which existing strategies remain fit for purpose.

What will the impact of already announced changes be? Will there be additional tax charges as governments both home and abroad implement policies based on their plans to maximise the tax take? With an increasing number of governmental 'hands' itching to get a share of tax revenues, dealmakers that operate across borders, in particular, will need to review their structures to ensure they are fit for purpose.

Taxable presence in M&A

The Organisation for Economic Co-operation & Development (OECD) has been working on proposals to try and ensure that profits are taxed in the country where they are earned. Current practice can result in a mismatch between where profits are earned and where the economic activities in earning those profits are allocated. Companies will need to review and understand the way in which they operate overseas to determine if they could have a different tax profile.

Why does this matter?

Tax is a key cost for a business. It has the ability to complicate or even kill a deal. Backwards-looking tax due diligence, while providing some comfort about the past, does little to help establish the tax profile for the future. With the tax authorities announcing new changes on a regular basis, working through the forecast impact on future cashflows should be an important part of the tax due diligence process. Our experience is that tax will rarely make a deal, but it can certainly derail one.

Almost two-thirds of financial professionals identified “overpaying for deals” as the biggest risk facing buyers in 2016 (according to Navigating the Risks of the Contemporary M&A Market, a ‘strategic buyer’ survey conducted by the **Financial Executives Research Foundation (FERF) and Crowe Horwath International (CHI)**). The risk of overpaying on a deal can be mitigated somewhat by prudent pre-acquisition transaction planning. Ensuring your structuring stays clear of tax traps will therefore continue to be a priority for dealmakers in 2017. In light of the direction of travel in the regulatory environment, which is unequivocally towards greater transparency and reporting requirements being placed on taxpayers, this is more important than ever because structures are being scrutinised by authorities that have access to increasingly detailed levels of financial information under new disclosure standards.

With “identifying potential tax risks” and “the need for a tax efficient structure” is listed by FERG/CHI as low-down concerns for company boards when it comes to categorising valuation risks. Overlooking future tax risks could be as costly as failing to identify historic ones. Corporate residency, for tax purposes, is a potential post-closing tax issue to contend with, but this hinges on whether the acquirer is seeking to move headquarters (as in the case of inversion).

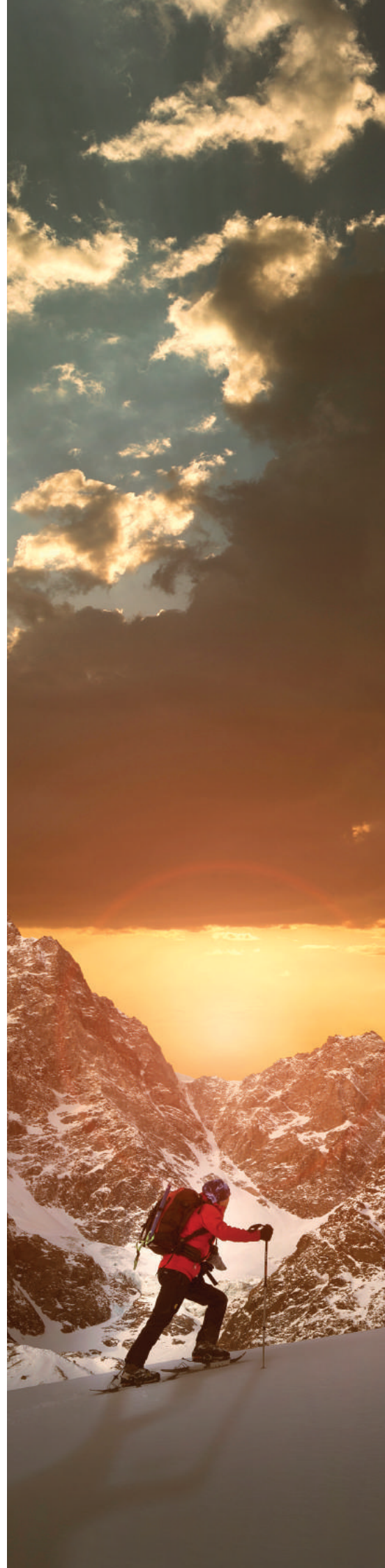
The bigger picture

The international picture must also be considered, given the volume of cross-border deals as a proportion of total deal activity. The rules governing corporate use of debt and equity and legislative reform to bring greater parity to the tax treatment of each source of funding will also impact deal activity in the year ahead.

Business fluidity to aid smooth deal flows

Tax should be considered as a routine business cost and appropriate due diligence and planning should therefore go into tax considerations ahead of targeting any deal work. The importance of business interactions across various departments is an essential part of mitigating these potentially costly tax surprises.

The HR, finance, tax, legal and IT departments all need to be engaged and interconnected to understand tax issues. As we embark upon a new year of deal making, challenges are aplenty. But, on the tax side, many of these challenges are perfectly manageable and with proper planning should not prevent a deal from going through. CFOs and finance professionals must focus on risk assessments not only about the past but also the future. While some risks are environmental, many are well within the control of the acquirer to vet pre-deal and subsequently mitigate post-deal.



New impairment model under IFRS 9

Introduction

Every business that reports under IFRS has financial instruments. Reporting under IFRSs will be impacted by the new standard on financial instruments, IFRS 9 that has an effective date of 1 January 2018.

The major impact of IFRS 9 arises from its new impairment model. IFRS 9 provides more visibility for credit risk management as compared to its IAS 39. Under IFRS 9 a single set of impairment requirements applies to all financial instruments in the scope of IFRS 9 that are not accounted for at Fair Value through Profit or Loss (FVPL). Hence, financial assets that are debt instruments measured at amortized cost or at fair value through other comprehensive income will be under the scope of impairment that include financial assets such as debt securities, loans and advances, trade receivables etc.

Impairment model of IFRS 9

IFRS 9 has replaced the incurred loss model of IAS 39 (the standard that it is replacing) with expected credit loss (ECL) model; and introduces ECLs over the entire life of financial instruments from the date of initial recognition (i.e. from day one).

Financial instruments carrying a low credit risk at the reporting date after their initial recognition shall be considered for 12-month ECLs (Stage 1) and a loss allowance would be measured, while still these financial assets would remain 'performing' or 'standard' or 'active' or 'good' financial assets.

Under IFRS 9 it will be vital to carefully monitor for deterioration

of credit quality (i.e. any significant increase in credit risk) over lifetime of financial instruments (Stage 2) as it changes from Stage 1 to Stage 2, while such financial assets are sometimes referred to as 'under-performing' financial assets.

While credit-impaired financial instruments include financial assets that have objective evidence of impairment at the reporting date which are also labelled as 'non-performing' or 'bad' financial assets and shall be considered for Stage 3 impairment loss recognition.

A simplified approach is available for trade receivables, contract assets (under IFRS 15) and lease receivables (under IAS 17) to directly consider for lifetime ECLs (Stage 2) while contract assets and lease receivables with significant

financing component may choose to recognize ECLs from Stage 1.

The ECL model of impairment is forward-looking, for example it is possible to consider anticipated risk and provision for higher losses in the future. In practice, this depends a lot on the availability and relevance of forward-looking (macro-economic) data. The requirements address the change in specific credit risk profile of a debt instrument.

Implementation of IFRS 9 will not only affect the calculation of ECL allowances but also increase the volatility of profit or loss due to anticipated impairments.

IFRS 9 implementation challenges

It is therefore important for key management personnel to understand and manage the business-wide impact of these changes on product design and pricing strategies, departments' operational efficiency, capital and ultimately to shareholders value. For financial institutions on the other side, the changes are expected to result in demand for enhancement of capital.

Although, the impairment approach is sound and robust at a conceptual level, in reality, there are multiple

implementation challenges especially for the financial institutions that will have to be addressed such as:

- Significant deterioration and link to more than 30 days past due rebuttable presumption
- 90 days past due rebuttable presumption of default
- Reflecting macro-economic forecast factors into quantitative estimates of ECL
- Estimating an IFRS 9 based probability of default (particularly for financial institutions)
- Development of practical expedient for low credit risk financial assets (and portfolios)
- Application to modified debt instruments and credit-impaired financial assets
- Complexity in data and its availability for reporting and disclosures

Adopting the ECL model of impairment will significantly increase transparency (such as through enhanced credit risk disclosures) and benefit users of financial statement and stakeholders, besides bringing long-term benefits on the credit risk management.



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New comers



Ishita Vijay Mithani

A young, talented ACCA (Association of Chartered Certified Accountants) Affiliate She is well versed in professional auditing and accounting standards such as the ISAs, IASs and IFRS.

A motivated individual brought up in Oman, providing us a fresh insight into the latest developments and promising value addition to the firm. She holds a BSc(Hons) in Applied Accounting from Oxford Brookes University, U.K. Awarded by Majan College, Muscat for consistently showing Excellent Academic Performance in ACCA.



Jaikishan Thanki

A qualified chartered accountant from The Institute of Chartered Accountants of India and a Graduate in Bachelors of Commerce (Mumbai).

Completed articleship with G.K. Choksi & Co. for 3 years in Mumbai gaining experience in audit, compliance and taxation matters.

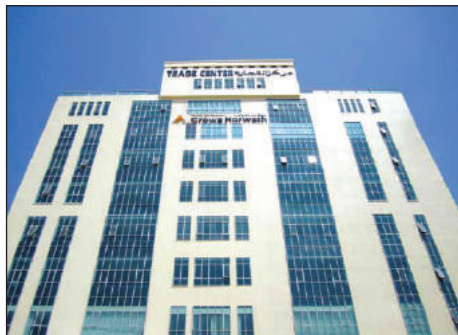
Vast experience in the audits of various trading companies, diamond manufacturing units, trusts, share brokers and inspection of members of stock exchanges.

About Crowe Horwath International

Crowe Horwath International is ranked among the top 10 global accounting networks with more than 209 independent accounting and advisory services firms in over 130 countries around the world. Crowe Horwath International's member firms are committed to impeccable quality service, highly integrated service delivery processes and a common set of core values that guide decisions daily. Each firm is well-established as a leader in its national business community and is staffed by nationals, thereby providing a knowledge of local laws and customs which is important to clients undertaking new ventures or expanding into other countries. Crowe Horwath International member firms are known for their personal service to privately and publicly held businesses in all sectors and have built an international reputation in the areas of audit, tax and advisory services.

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- Forensic Accounting
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- Accounting Services
- Company Incorporation
- ISO Consulting
- Strategy Consulting
- Policies & Procedures
- Market Research
- Feasibility Studies
- HR Consulting
- Corporate Training
- Corporate Advisory

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