Iraq issues new Instructions governing taxation of contracts between Iraqi and foreign contracting parties

Executive summary

The new Instructions No. 1 of 2014 (the New Instructions), relating to the tax accounting of contracts entered between Iraqi and foreign contracting parties, were published in the Iraq Official Gazette.

The New Instructions, which are effective from 1 January 2015, amend the previous Instructions No.2 of 2008 (the 2008 Instructions) and significantly broaden the scope of Iraqi taxing provisions. Companies contracting in Iraq should carefully consider the application of these New Instructions and how their Iraq tax position might be affected.

Detailed discussion

Doing business in Iraq vs. doing business with Iraq

The 2008 Instructions defined a number of criteria or factors that distinguish between “doing business in Iraq” (a taxable activity) and “doing business with Iraq” (a non-taxable activity). If any one of the factors relating to a taxable activity is applicable, a company would be deemed to be “doing business in Iraq” and, therefore, taxable in Iraq. Conversely, if all factors did not apply it would mean that a company is “doing business with Iraq” and, therefore, not taxable in Iraq. The factors giving rise to taxable activity can be summarized as follows:

- The place of signing the contract by the party performing work under the contract (vendor or service provider) is in Iraq
- The place of performance of work is in Iraq
- The place of delivery of goods or services is in Iraq
- The place of receipt of payment for the work is in Iraq
The New Instructions amend the language of the above factors determinant of “doing business in Iraq” as follows:

- The vendor or service provider has a branch or an office in Iraq and the contract is signed by the branch/office representative, any of the branch/office’s employees, or any other person who is resident in Iraq and is authorized to sign the contract.

- The contract’s legal formalities and requirements are completed in Iraq in the name of the vendor or service provider (e.g., customs clearance, payment of customs duties, opening of letter of credit, and any related procedures taking place in Iraq, irrespective of whether the vendor or service provider has a branch, an office or an agent in Iraq).

- Payments under the contract, to the vendor or service provider, are received fully or partially in Iraq, regardless of the currency used to make the payments.

Or

- The vendor or service provider receives payment in barter.

The application of the above amended factors has not yet been tested in practice; therefore, it is not yet clear how the New Instructions will be applied by the General Commission of Taxes (GCT) to distinguish between “doing business in Iraq” and “doing business with Iraq.” Needless to say, a great deal of uncertainty exists with respect to the application and interpretation of the factors of “doing business in Iraq,” whether in their old or new form, and taxpayers should be aware of the risk that the GCT might change its current interpretation of the factors at any time and without prior notice.

**Withholding on payment of final instalment**

Another important change introduced in the New Instructions is with respect to the withholding of the entire amount of the final instalment under a taxable contract, as required under the 2008 Instructions. Under the 2008 Instructions, the contractor was not allowed to release the final instalment in a series of payments to a sub-contractor or service provider until the sub-contractor or service provider submitted a tax clearance certificate to the contractor. If the sub-contractor or service provider was unable to produce a tax clearance certificate within 180 days, the contractor would be obligated to remit the entire amount of the final instalment to the GCT to be deposited in the account of its sub-contractor or service provider to serve as an advance tax payment against its Corporate Income Tax (CIT) liability.

Under the New Instructions, in cases where the sub-contractor or service provider is unable to produce a tax clearance certificate, the contractor may now withhold and remit to the GCT 10% of the amount of the final instalment and release the remaining 90% to the sub-contractor or service provider.

The remaining amendments introduced by the New Instructions mainly relate to procedural issues; for example, the Information Form that should be submitted to the GCT when registering the contracts for withholding tax purposes.

Companies operating in Iraq should review their contractual arrangements and withholding tax compliance within the context of the New Instructions.
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