COALITION PROVISIONAL AUTHORITY ORDER NUMBER 49

TAX STRATEGY OF 2004

Pursuant to my authority as Administrator of the Coalition Provisional Authority (CPA), and under the laws and usages of war, and consistent with relevant U.N. Security Council resolutions, including Resolutions 1483 and 1511(2003),

Noting the suspension by CPA Order Number 37 of all income tax for assessed income resources detailed in Article 2 of Income Tax Law Number 113 of 1982 and the real property rent tax of Law Number 162 of 1959 as amended, and all other taxes not specifically identified in Order 37 as continuing in force from April 16, 2003, to the end of calendar year 2003 and the reinstatement of these taxes on April 1, 2004, including the reinstatement of the income tax at the lower maximum rate of 15 percent,

Noting the desire of the Governing Council to subject both private and public sector employees to tax in order to ensure that the tax burden is shared by all sectors of Iraqi society,

Recognizing that these revenues are for the benefit of the Iraqi people, and

Determined to create conditions suited to the economic reconstruction of Iraq, including an efficient and modern income tax system,

I hereby promulgate the following:

Section 1
Purpose

The purpose of this Order is to revise the tax rates and tax exemptions of Income Tax Law Number 113 of 1982, and the Real Estate Rent Tax Law Number 162 of 1959, to provide certain additional exemptions from tax, to suspend certain taxes, and to provide rules for applying unused losses against income from the same source earned in future years ("carrying forward losses") in light of the suspension of income taxes for financial year 2003 and for the first three months of financial year 2004.

Section 2
Increase in Allowances

1) Item (1) of Article 12 of Income Tax Law Number 113 of 1982 is amended to read as follows:

   "(1) A resident person shall be granted the following allowances per each year of assessment on the basis of his or her status in the year in which the income has arisen:

a) ID 2,500,000 for the taxpayer himself (or herself, if she is unmarried (other than a widow or divorcee) or if her income is not added to her husband's income), and ID 2,000,000 for his wife, or wives, if she is a housewife and has no income or if her income is added to his income.

b) ID 200,000 for each of his children irrespective of their number.

c) ID 3,200,000 for the widow or divorcee herself and ID 200,000 for every child lawfully maintained by her, regardless of the number."

2) Item (5) of Article 12 of Income Tax Law Number 113 of 1982 is amended to read as follows:

"(5) The taxpayer shall be granted an additional allowance of ID 300,000 if his age is more than 63 years of age, in addition to allowances granted to him in other sections of this Article."

3) The allowances as set forth in paragraphs (1) and (2) of this section shall be reduced by one-fourth during financial year 2004.

Section 3
Reduction in Income Tax Rates

1) Item (1) of Article 13 of Income Tax Law Number 113 of 1982 is amended to read as follows:

"(1) Tax shall be imposed on the taxpayer in respect of each year of assessment at the following rates:

(A) Income of resident individual after granting the allowance(s) provided for in Article 12 as modified by this Order:

At the rate of 3% on amounts up to ID 250,000.

At the rate of 5% on amounts over ID 250,000 and up to ID 500,000.

At the rate of 10% on amounts over ID 500,000 and up to ID 1,000,000.

. At the rate of 15% on amounts over ID 1,000,000.

(B) Income of non-resident individual (other than the income provided for in Article 19 of this Law).

At the rate of 3% on amounts up to ID 250,000.

At the rate of 5% on amounts over ID 250,000 and up to ID 500,000.
At the rate of 10% on amounts over ID 500,000 and up to ID 1,000,000.

At the rate of 15% on amounts over ID 1,000,000.

(C) Income of limited liability companies, at a fixed rate of 15%.

(D) Income of private joint-stock companies, at a fixed rate of 15%.

(E) Income of mixed joint-stock companies, at a fixed rate of 15%."

(F) The amounts delineating the tax brackets as set forth in paragraphs (A) and (B) shall be reduced by one-fourth for financial year 2004.

2) Item (2) of Article 13 of Income Tax Law Number 113 of 1982 is amended to read as follows:

   "(2) Iraqi nonresident individuals shall be subject to tax at the rates for Iraqi residents set forth in Section 3(1) of this Order on their income from Iraqi sources."

3) Foreign companies that are registered in Iraq or otherwise have a permanent establishment in Iraq will be subject to tax at a fixed rate of 15% on their income in Iraq.

Section 4
Exemptions

1) The CPA, Coalition Forces, forces of countries acting in coordination with Coalition Forces, and departments and agencies of Coalition Forces' governments, are not liable for any tax or similar charge within the territory of Iraq.

2) Governments and international organizations are not liable for any tax or similar charge within the territory of Iraq.

3) Foreign (non-Iraqi) employees and foreign (non-Iraqi) contractors and subcontractors of the CPA, Coalition Forces, forces of countries acting in coordination with Coalition Forces, and departments and agencies of Coalition Forces' governments, that are providing technical, financial, logistical, administrative or other assistance to Iraq, and foreign employees of such contractors and subcontractors, shall not be liable to pay any tax on income or similar charge within the territory of Iraq on income from foreign

sources or on income from or paid on behalf of the CPA, Coalition Forces, forces of countries acting in coordination with Coalition Forces, or departments or agencies of the governments of Coalition Forces.

4) Foreign (non-Iraqi) employees and foreign (non-Iraqi) contractors and subcontractors of foreign (non-Iraqi) governments, international organizations, and non-governmental organizations registered pursuant to CPA Order Number 45, that are providing technical, financial, logistical, administrative or other assistance to Iraq, and foreign employees of such contractors and subcontractors, shall not be liable to pay any tax on income or similar charge within the territory of Iraq on income from foreign sources or on income from or paid on behalf of such governments, international organizations, and non-governmental organizations.

5) In addition to the foregoing, the following persons shall be exempt from payment of income tax:

   a) members of foreign diplomatic missions to Iraq, as well as members of their households, if they are not citizens of Iraq;

   b) members of consular offices, as well as members of their households, if they are not citizens of Iraq;

   c) honorary consuls of foreign countries, but only for income received from the country that has appointed them honorary consul.

6) In accordance with administrative guidance to be issued by the Ministry of Finance, non-governmental organizations registered pursuant to CPA Order Number 45 and non-profit organizations that are not required to register as non-governmental organizations that are not engaged in political activities are not liable for tax on income or similar charge within the territory of Iraq.

Section 5
Losses

Article 11 of Income Tax Number 113 of 1982 is amended by adding new Items (3), (4) and (5) to read as follows:

"(3) Income from financial year 2003 and for the first three months of financial year 2004 shall not be taken into consideration in determining the income against which losses from preceding financial years may be deducted under this article.

(4) Financial year 2003 shall not be taken into account in determining the 5 consecutive years to which losses may be carried under this article.

(5) Losses incurred in financial year 2003 and in the first three months of financial year 2004 may not be carried forward under this article.”

Section 6
Reduction in Real Estate Rental Rates

The Law of the Real Estate Tax Number 162 for the year 1959 and its modifications (“the Law of Real Estate Tax”) is amended as follows:

(1) Item (1) of Article 2 of the Law of Real Estate Taxis amended to read as follows:

“(1) A tax is assessed and collected that is 10% of the annual revenue from all real estate including the subject’s living share from the real estate (other than income from sales of real estate).”

(2) Item (2) of Article 2 of the Law is deleted and Item (3) of the Law of Real Estate Tax is renumbered to Item (2).

(3) Item 1 of Article Twenty-One of the Law of Real Estate Tax is amended to read as follows:

“The tax is to be collected in two equal parts; the first is due the first of January of the financial year and the second is due the first of July of the financial year. For financial year 2004, the tax will be paid in one part and is due on 1 July 2004. The subject has the right to pay this tax at the location of his residence, his work location or in the governorate where the majority of his real estate is located. All revenue shall be combined. A memo setting forth the calculation and form should be submitted with the payment.”

(4) Item 2 of Article Twenty-One of the Law of Real Estate Tax is deleted.

(5) Item 1(b) of Article Twenty-Two of the Law of Real Estate Tax is deleted and item 1(c) is renumbered item 1(b).

(6) Article Twenty-three of the Law of Real Estate Tax is amended to read as follows:

“The tax is collected according to the Law of Governmental Secured Debt Collection and is considered a secured debt on the subject real estate.”

Section 7
Suspension of 25% Levy on Company Profits

1) Law No. 101 of 1964 Regulating the Disposal of Company Profits is hereby suspended.

2) Law No. 9 of 1998 Amending Law No. 101 of 1964 is hereby suspended.

Section 8
Suspension of Certain Taxes Until March 31, 2004

The following taxes are suspended from January 1, 2004, until March 31, 2004:

1) All income tax for assessed income resources detailed in Article 2 of Income Tax Law Number 113 of 1982, as amended; and

2) Real Property rent tax in accordance with Law Number 162 of 1959, as amended.

3) Other taxes not specifically identified, but that were suspended by CPA Order Number 37 (Tax Strategy for 2003).

4) The following specified taxes are not suspended and shall continue in force:

   a) Excellent and first class hotel and restaurant tax in accordance with Resolution Number 36 of 1997;

   b) Tax upon the transfer of real property in accordance with Resolution Number 120 of 2002;

   c) Car sale fee in accordance with Resolution Number 80 of 1998 and previous relevant laws in force;

   d) Petrol excise duties including, but not limited to, those provided for in Law Number 9 of 1939, Resolution Number 82 of 1996 and the Order Number 66 of 1999 issued by the Economic Affairs Committee.

5) The persons and entities listed in Order 37, paragraph 3(2), shall continue to be exempt from the taxes specified in paragraph 8(4), above after March 31, 2004.

Section 9
Depreciation

The System of Depreciation and Elimination for Private, Mixed and Cooperative Sectors Regulation No. 9 of 1994 is modified as follows:

1) Item (3) of Article 3 is modified by adding the following sentence at the end thereof:

   "No part of book value shall be considered to have been cancelled during financial year 2003 and for the first three months of financial year 2004."

2) New Item (5) is added to Article 3 to read as follows:

   "(5) A taxpayer that used the decreased installment method listed in Item 1(b) of Article 6 during financial year 2002 will compute the depreciation deduction for financial year 2004 by reconfiguring the opening balance of each asset account as of April 1, 2004. The opening balance of each asset account as of April 1, 2004, is equal to the balance of the asset account at the end of 2002, increased by the cost of assets purchased in the asset account and decreased by the fair market value of assets sold from the asset account in financial year 2003 and during the first three months of financial year 2004."

Section 10
2002 Taxes

1) The suspension of income taxes for financial year 2003 by CPA Order Number 37 does not affect income taxes for financial year 2002 and previous years, which remain payable by taxpayers and collectible by the Tax Commission.

2) In case of late payment of taxes owed for financial year 2002, a taxpayer may file a written request with the Tax Commission requesting waiver of interest and penalties. The Tax Commission may, in its discretion, upon making a good faith determination that there was reasonable cause for the late payment, waive such interest and/or penalties.

Section 11
Government and State-Owned Enterprise Employees

1. To ensure that the tax burden is shared by all sectors of Iraqi society, salaries, wages and allowances received by employees of the Government Offices, public and mixed sectors are subject to tax, beginning April 1, 2004. Accordingly:

   a) The phrase in paragraph (5) of Article 2 of the Income Tax Law No. 113 of 1982 "other than those working for government offices, socialist and mixed sector companies" is deleted.

   b) Paragraph (5) of Article 7 of the Income Tax Law No. 113 of 1982 is deleted.

2. To ensure that the Ministry of Finance has sufficient capability to accurately and comprehensively assess and collect taxes on both public and private sector employees in a transparent manner:

   a) For financial year 2004, employees of the government offices, public and mixed sectors shall be entitled to an allowance of ID 5,300,000 for themselves, spouse, and children collectively under Item (1) of Article 12 of the Income Tax Law No. 113 of 1982. If an employee of the public sector has more than 4 children, he or she shall be entitled to an additional exemption of ID 200,000 per child.

   b) The allowances as set forth in paragraph (2)(a) of this section shall be reduced by one-fourth during financial year 2004.

   c) Beginning January 1, 2005, employees of the Government Offices, public and mixed sectors shall be entitled to the same allowances as employees of the private sector, as set forth in Section 2 of this Order.

Section 12
Foreign Tax Credit

Article 5 of the Income Tax Law No. 113 of 1982 is revised by adding new paragraph (4) to read as follows:

> “(4) Income tax paid to a foreign country on income earned in that country may be credited against tax paid to Iraq. The amount of the credit may not exceed the amount of tax assessed in Iraq on the income earned in the foreign country at the rate in effect in Iraq. If taxes paid to a foreign country exceed the amount of this limitation then the excess taxes may be carried forward to credit in 5 consecutive years subject to the limitation in those years. The taxes paid in the carried forward year will be credited first. If, during a taxation period, income is earned in more than one country, the credit allowed by this paragraph will be applied on an individual basis to the income earned in each foreign country. To be credited, the amount of foreign tax paid to the foreign country must be confirmed by either a copy of the tax paid receipt or a confirmation of the amount of tax paid from the tax collection agency of the foreign country.”

Section 13
Implementation

The Minister of Finance, in consultation with the CPA Office of Management and Budget, may issue Administrative Instructions to implement this Order.

Section 14

Applicability

The provisions of this Order shall apply beginning with financial year 2004, which commences January 1, 2004.

Section 15
Entry into Force

This Order shall enter into force on the date of signature.

2/20/04

L. Paul Bremer, Administrator
Coalition Provisional Authority

EXPLANATORY NOTE
CPA ORDER NUMBER 49, TAX STRATEGY OF 2004

I. INTRODUCTION

This note explains how CPA Order Number 49 resumes income taxes that were suspended for the 2003 financial year by CPA Order Number 37 (Tax Strategy for 2003). Taxes suspended in that Order included the corporate and personal income taxes that were imposed on employees in the private sector, the self-employed, professionals and small enterprises. Under CPA Order Number 49 corporate and personal income taxes will be reintroduced on April 1, 2004, at significantly reduced rates of no more than 15 percent as compared to the maximum rate of 40 percent under the previous income tax system. In addition, the existing allowances have been substantially increased.

As a result of these changes, the income tax burden on the average Iraqi family will be eliminated or substantially reduced. For example, beginning in 2005, the first full calendar year in which the tax will be in effect, a one-earner family with four children will not pay tax on the first ID 5,300,000 of income compared to ID 1,400,000 under existing law. If that family's income is ID 9,000,000, the tax will be reduced from ID 2,715,000 to ID 475,000, a savings of ID 2,240,000. Annex I describes the impact of the new tax rate structure in 2005 for families and single taxpayers. Similar reductions in tax will occur in 2004 for the nine months the income tax is in effect.

Reducing the income tax rates, increasing the allowances, and retaining the rules in effect under existing law are important steps in supporting current reconstruction and stabilization efforts in Iraq. At the same time, the Ministry of Finance is committed to modernizing the current tax system to improve compliance and reduce the administrative burden on taxpayers. Resuming the existing income tax system, therefore, is an interim measure pending the completion of the tax reform process and restoration of the tax administration capabilities of the Tax Commission.

II. INDIVIDUAL INCOME TAX

1. Increased Allowances

To lower the tax burden on individuals, the allowances for individuals described in Article 12 of Income Tax Number 113 of 1982 are increased by CPA Order Number 49. The full increase of exemptions will not occur until 2005, the first full year to which the order applies. Beginning in 2005, for each taxpayer, the allowance will increase from ID 600,000 to ID 2,500,000, with the allowance for a nonworking wife increasing from ID 400,000 to ID 2,000,000. The allowance for each child will double from ID 100,000 to ID 200,000, while the allowance for a widow will increase from ID 1,000,000 to ID 3,200,000. These exemptions will be decreased by one-fourth for the year starting April 1, 2004, to reflect the fact that the income tax will not be reinstated for the first quarter of 2004.

2. Top Rate Lowered to 15 Percent

The personal income tax imposed on employees of private sector companies and collected through withholding by their employers will recommence on April 1, 2004, with a maximum rate of 15 percent as shown in the table below.

Rate	Annual Income (after allowances)
3%	Up to ID 250,000
5%	Over ID 250,000 and up to ID 500,000
10%	Over ID 500,000 and up to 1,000,000
15%	Over ID 1,000,000

The amount delineating the tax bracket amounts will be decreased by one-fourth for the year starting April 1, 2004, to reflect the fact that the income tax will not be reinstated for the first quarter of 2004.

Many workers will be exempt from the tax because of the increased allowances provided for in CPA Order Number 49. For those workers subject to the tax, the lower rates of 3-15 percent, compared to the former top rates of 40 percent for Iraqi residents and 45 percent for non-residents (Article 13 of Income Tax Law No.113), will reward work, encourage savings and investment by workers, and increase compliance with tax laws.

3. Compliance Measures

The wage withholding system will be improved in 2004 to better assist employers to meet their obligations under the law. The Tax Commission will create a new comprehensive taxpayer identification number system that will facilitate tracking of and improved control over tax payments. The Tax Commission will issue a new guide for employers that contains withholding tables reflecting the new rate structure. In addition, the Tax Commission will simplify information returns and payment forms. These new processes and forms will be distributed to employers well in advance of the deadline for remitting the tax on wages earned in 2004.

4. Public and Mixed Sector Employees

Beginning April 1st, public and mixed sector employees will have to share the tax burden along with the rest of Iraqi society. This is necessary to ensure that sufficient tax revenues can be collected while not overburdening any segment of society with high tax rates. To ensure that the tax on public and mixed sector employees is collected accurately and transparently, tax collection systems for those employees need to be developed. This will take time. Therefore, to ensure that the tax is accurately and transparently collected in 2004, higher allowances will apply to public and mixed sector workers. These higher allowances will effectively exempt many public and mixed sector workers from taxation, and with fewer such workers to tax initially, the capacity of the tax collection system can be properly developed over time. Beginning January 1, 2005, however, public, mixed, and private sector workers will be subject to taxation at the same rates.

Example:

> Financial year 2004. Assume a public sector employee with a wife and two children is paid wages of ID 430,000 by the public sector employer during each month of financial year 2004. The employee will not be subject to tax in financial year 2004 since the monthly allowance allowed the employee during financial year 2004 is ID 441,667 (i.e., one-ninth of the presumed annual allowance of ID 3,975,000. The presumed annual allowance for financial year 2004 is ID 3, 975,000 or ID 5,300,000 reduced by one-quarter to take into account that the income tax is reinstituted on April 1, 2004).

Financial year 2005. Beginning on January 1, 2005, the employee is paid ID 450,000 per month. Under the order, the employee for financial year 2005 is entitled to a total allowance of ID 4,900,000 (i.e., personal allowance of ID 2,500,000, a spousal allowance of ID 2,000,000 and an allowance of ID 200,000 for each child) or a monthly allowance of ID 408,334.. Accordingly, the employee will be subject to tax on ID 41,666 of wages. The taxpayer's public sector employer will be required to withhold tax from that amount.

III. CORPORATE INCOME TAX

1. Lower 15 Percent Tax Rate

The tax rate for income earned by corporations from April 1, 2004 will be a flat 15 percent. As provided for in the current Income Tax Law Number 113 of 1982, the rate will be levied on the income of private sector companies, including income of foreign companies operating in Iraq. This lower rate, compared to the prior rate of up to 40 percent, will encourage reinvestment of company profits. This in turn will encourage increased capital investment and job creation in Iraq by private sector firms. The lower flat rate also will lead to increased revenue collection as companies respond to Iraq's transition to a free market-based economy.

2. Transition Rules

CPA Order Number 49 includes two transition rules to clarify the application of certain tax provisions to compute net income properly beginning on April 1, 2004.

a. Treatment of Losses under Article 11 of Income Tax Law Number 113 of 1982.

Under Article 11 of Income Tax Law Number 113, taxpayers can apply losses in excess of income against income earned from the same source in future years ("carry-forward" the unused loss) for up to five years. CPA Order Number 49 includes three modifications to Article 11 of Law Number113. First, CPA Order Number 49 provides that income from financial year 2003 and the first three months of financial year 2004 shall not be considered in determining the income against which losses may be deducted. Second, CPA Order Number 49 provides that any unused losses as of 31 December 2002 may be carried forward for an additional year. Third, CPA Order Number 49 provides that losses incurred in financial year 2003 and in the first three months of financial year 2004 may not be carried forward under Article 11.

Examples:

- Modification 1: In 2002, Company A incurred a loss of 10 million dinars. In 2003, Company A had profits of 8 million dinars. Because the income tax was suspended for 2003, the carry-forward loss of 10 million dinars cannot be used to offset the profits of 8 million dinars. Instead, the 10 million dinar loss is carried forward for up to five years beginning with the financial year beginning on April 1, 2004.

- Modification 2: In 2003, Company B incurred a loss of 5 million dinars. Because the income tax was suspended for 2003, the 5 million dinar loss cannot be carried forward and is extinguished for tax purposes.

- Modification 3: Company C in 2000 had a net operating loss of 10 million dinars. Under prior law, the loss could be used to offset profits earned in 2001-2005. In 2001 and 2002, the company had profits of 2 and 4 million dinars, respectively, and it offset these profits with the 10 million dinar loss. At the end of 2002, its net operating loss was 4 million dinars. Under the transition rule announced in CPA Order Number 49, the 4 million dinar loss can be used to offset cumulative profits earned up to that amount in 2004, 2005 and 2006.

b. Depreciation Deductions. Under Article 8 of Income Tax Law Number 113 of 1982 and the "System of Depreciation and Elimination for Private, Mixed and Cooperative Sectors Number. 9 of 1994," taxpayers are entitled to take deductions for depreciation of buildings and other tangible assets and for amortization of intangible assets. CPA Order Number 49 modifies Regulation Number 9 on depreciation rules regarding computation of depreciation deductions in 2004. The Order contains 3 modifications to Regulation Number 9. First, no part of book value shall be considered to have been cancelled during financial year 2003 and the first three months of 2004. Second, if the taxpayer used the straight line method of depreciation in 2002, the depreciation deduction in 2004 is computed by extending the useful life of depreciable property by one year and three months. With respect to depreciable property purchased in 2003, the useful life of such property will commence in 2004.

If the taxpayer used the declining balance method of depreciation in 2002, the depreciation deduction for 2004 is computed by reconfiguring the opening balance of each group as of April 1, 2004. The opening balance of each group for 2004 is equal to the balance of the group at the end of 2002 increased by the cost of property purchased in the group and decreased by the fair market value of property sold from the group in 2003 and the first three months of 2004.

Examples:

- Straight-line: Company A purchased depreciable property with a useful life of five years for 1.2 million dinars in 2000. It took depreciation deductions using the straight line method of depreciation of 240,000 dinars each year, 20,000 per month, from 2000-2002. To compute depreciation deductions beginning April 1, 2004 the useful life of the property is extended by one year and three months to March 31, 2006. As a result, Company A can claim a depreciation deduction for such property in 2004 of 180,000, another depreciation deduction of 240,000 in 2005, and 60,000 in 2006.

- Straight-line: Company B purchased depreciable property with a useful life of 10 years for 4 million dinars in 2003. Company B can depreciate the property over 10 years beginning on April 1, 2004.

- Declining Balance: Company C uses the declining balance method of depreciation. At the end of 2002, the balance of Group 3 property was 10 million dinars. No purchases or sales were made in 2003 or during the first three months of 2004. Company C can claim a depreciation deduction beginning April 1, 2004 for Group 3 property equal to 15 percent (the yearly full rate is 20% for this group of property) of 10 million or 1.5 million dinars for Group 3 property.

- Declining Balance: Company D uses the declining balance method of depreciation. In 2003, it purchased Group 2 property for 5 million dinars. At the end of 2002, the balance of Group 2 property was 15 million dinars. Assuming no purchases or sales of property in Group 2 in 2003 and the first three months of 2004, Company D can claim a depreciation deduction in 2004 for Group 2 property equal to 15% of 20 million dinars (the yearly rate for Group 2 property is 20%) or 3 million dinars.

3. Revision of Company Tax Return

In order to ease the compliance burden on companies and improve tax collection, the Tax Commission will redesign the company tax return, simplifying the computation of tax liability. The new form will clearly explain how each element of the return should be computed and will require more detail on the income and deductions of the company so that its tax liability may be more easily determined. At the same time, the new form will eliminate the requirement to furnish significant commercial information unrelated to the tax liability computation. The new form will reconcile financial statement information with the tax return and will facilitate the transcription of the information to a computerized tax database. A draft form will be prepared by mid-2004 and will be made available for public comment.

4. Compliance Measures

In tandem with the changes outlined above, the Ministry of Finance will introduce in 2004 several measures to boost compliance and ease the administrative burden on taxpayers and the Tax Commission. One of the most significant initiatives will be the introduction of taxpayer identification numbers for the largest companies. This in turn will enable the Tax Commission to track payments made by each company to ensure greater accountability and control. The Tax Commission will phase-in computerization of the existing interim tax system during 2004 to facilitate processing of tax returns and payments. In addition, the Tax Commission will launch a comprehensive tax training program for tax officials, along with a program to educate companies and their accountants on the revised company tax return.

IV. FOREIGN TAX CREDIT

The Order modifies Article 5 of the Income Tax Law Number 113 of 1982 to provide for a foreign tax credit for taxes paid to foreign countries. Because the foreign tax credit is intended to alleviate double taxation, and not to reduce Iraqi tax liabilities on profits earned within Iraq, the foreign tax credit is limited to Iraqi tax liability on income earned in the foreign country. For example, an Iraqi company (or individual) with ID 20,000,000 of income earned in Jordan that faces an Iraqi tax rate of 15 percent has a foreign tax credit limit of ID 3,000,000 (15 percent of ID 20,000,000). If the company (or individual) pays Jordanian income taxes of less than ID 3,000,000, then the company (or individual) would be entitled to claim a foreign tax credit for all of its Jordanian income taxes paid. If, however, the company (or individual) firm pays ID 4,000,000 of Jordanian taxes, then it would be permitted to claim no more than ID 3,000,000 of foreign tax credits. The excess Jordanian taxes in the amount of

ID 1,000,000 may be carried forward to the next 5 years and claimed as a credit subject to the limitation in those 5 years. The foreign taxes paid in the carried forward year will be credited first.

The order provides that the limitation on the amount of foreign taxes that will be creditable is to be determined separately for each country to which the company (or individual) paid tax. In addition, the Order provides that the foreign tax will not be creditable unless the taxpayer substantiates the amount of tax paid by either supplying a copy of the payment receipt or a statement from the tax authority of the foreign country verifying the amount of tax paid.

V. REAL ESTATE RENTS TAX

In order to simplify the administration of the real estate rents tax (Real Estate Tax Law Number 162 of 1959), the Order provides that rents from real estate will be taxed at a flat rate of 10% of the combined rental income from all real estate rented by the taxpayer. This replaces the two-tier system of current law.

VI. CONCLUSION

This note summarizes measures necessary to resume income taxation in Iraq in 2004 and improve compliance on an interim basis. The tax system must be reformed to support a market economy. Towards that end, the Ministry of Finance will comprehensively assess the tax system to identify means of (i) eliminating distortions that interfere with market activity; (ii) improving fairness by removing exemptions; and (iii) simplifying rules to improve compliance and ease administrative burdens on individual and corporate taxpayers. The Tax Commission will also be modernized by: (i) adopting a functional structure; (ii) computerizing processes and systems; and (iii) improving the training of tax officials. A formal consultation process with the taxpaying public will ensure that these reforms will serve the needs of the Iraqi people.

Annex I

Impact of New Tax Rate Structure in 2005

One-earner Family with 4 Children

Annual Income	Current Tax	New Tax	Change in Tax
I.D.	I.D.	I.D.	I.D.
1,000,000	0	0	0
1,500,000	10,000	0	-10,000
2,000,000	95,000	0	-95,000
3,000,000	355,000	0	-355,000
5,000,000	1,115,000	0	-1,115,000
6,000,000	1,515,000	40,000	-1,475,000
9,000,000	2,715,000	475,000	-2,240,000

One-earner Family with 2 Children

Annual Income	Current Tax	New Tax	Change in Tax
I.D.	I.D.	I.D.	I.D.
1,000,000	0	0	0
1,500,000	35,000	0	-35,000
2,000,000	135,000	0	-135,000
3,000,000	415,000	0	-415,000
5,000,000	1,195,000	3,000	-1,192,000
6,000,000	1,595,000	85,000	1,510,000
9,000,000	2,795,000	535,000	2,260,000

Single Taxpayer with no Dependents

Annual Income	Current Tax	New Tax	Change in Tax
I.D.	I.D.	I.D.	I.D.
600,000	0	0	0
700,000	10,000	0	-10,000
750,000	15,000	0	-15,000
800,000	20,000	0	-20,000
1,000,000	55,000	0	-55,000
1,500,000	155,000	0	-155,000
2,000,000	295,000	0	-295,000
3,000,000	635,000	20,000	-615,000
5,000,000	1,435,000	295,000	-1,140,000