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cutting through complexity

Saudi Tax & Zakat Update Newsletter 2012

Saudi Arabia's Double Tax Treaty Network Continues to Expand

Ireland and Malta ink Double Tax Treaties with Saudi, Luxembourg in final stages

The trend of entering into double tax treaties with key trading partners continues with Saudi Arabia signing double tax avoidance agreements with Ireland and Malta. A unique feature of these treaties is that they provide for an exemption from the 5% withholding tax on interest, similar to the treaty with the UK. A treaty with Luxembourg, which we assume will be similar to the UK, Ireland and Malta treaties is in the final stages of being negotiated.

Saudi tax treaties are varied in the relief that they provide, with some treaties providing reduced rates of withholding tax on royalties and licensing fees while others provide limited relief from capital gains tax.

In light of the latest developments, companies will need to consider specific treaties with a view to maximizing the relief and benefit that is made available through the treaties. Some of the key countries which have entered into a double tax treaty with Saudi Arabia are detailed here.

Country	Status of Tax Treaty
Austria	Effective since January 2008
Azerbaijan	Signed August 8, 2011
Bangladesh	Effective since January 2012
Belarus	Effective since January 2011
China	Effective since January 2007
France	Effective since January 2009
Greece	Effective since January 2011
India	Effective since January 2007
Italy	Effective since January 2010
Ireland	Signed in December 2011
Japan	Effective since January 2012
Kazakhstan	Signed June 2011
Korea (Republic of)	Effective since January 2008
Malaysia	Effective since January 2008
Malta	Signed in January 2012

Country	Status of Tax Treaty
Netherlands	Effective since January 2011
Pakistan	Effective since January 2007
Poland	Signed February 22, 2011
Romania	Signed April 26, 2011
Russia	Effective since January 2011
Singapore	Entered into force on July 1, 2011
South Africa	Effective since January 2009
Spain	Effective since January 2009
Syria	Signed 2009, not yet effective
Turkey	Effective since January 2010
Tunisia	Signed 2010, not yet effective
United Kingdom	Effective since January 2010
Uzbekistan	Effective since January 2011
Vietnam	Effective since 1 January 2012

Saudi Tax & Zakat Update Newsletter 2012

From a tax perspective, the varied nature of the relief provided by the treaties presents a challenge to tax practitioners and taxpayers as they get to grip with the terms of each treaty as well as DZIT's interpretation of those terms.

The recent practice of the DZIT requires taxpayers to pay now the domestic rate of withholding tax and claim later a refund or credit, even though a treaty provides a reduced rate.

This has been challenged by taxpayers and an option of obtaining advance rulings in order to apply tax treaty rates is being considered.

It is hoped that the DZIT would apply the spirit and intent of a double tax treaty allowing for a more competitive and internationally accepted taxation regime in the Kingdom.

Domestic Double Tax and its implication for Saudi Companies

Guidelines for Avoiding Domestic Double Tax

An amendment to the Saudi tax law was issued which clarifies the situation where tax and zakat could be imposed twice on the same net profit reported in the tax declarations of two Saudi resident companies, one being an Investment Holding Company and the other a Subsidiary. The amendment reads as follows:

"Income derived by a resident company in the Kingdom from its operations and the operations of its branches will be excluded from taxation if the following conditions are met:

- The same income was subject to Saudi tax;
- Shareholding percentage in the investee company cannot be less than 10%; and
- The shares in the investee company are held for at least one year.

With respect to income realized from investments and operations outside the Kingdom, such income will be taxed in Saudi Arabia unless an in force double tax treaty between Saudi Arabia and the country of the Investee states otherwise."

Some practical issues with regard to the above amendment still need further clarification and have been highlighted below:

Considerations for Domestic Double Tax

- Practical application on this change needs to be considered?
- Effective date not yet determined and retroactive application should apply or not?
- Date from which the one year shareholding may be determined?
- Acquisitions and changes in shareholding during the year.
- No double tax or Double Zakat envisaged? What happens in year one?
- No Holding company regime in Saudi Arabia, however, in certain cases and with prior approval of DZIT, consolidated Zakat filings may be possible and only where subsidiaries are wholly owned.
- Status of credit of foreign tax against zakat.

Saudi Tax & Zakat Update Newsletter 2012

DZIT's Increasing Compliance Focus

Custom lists

The DZIT has recently been requesting import value lists from the Customs Authority in order to confirm the value of goods imported and declared by taxpayers in their annual declarations during the financial period.

If the value of foreign purchases in the company's declaration is higher than the amount stated in the Customs Authority's list, the DZIT's approach is to disallow the excess amount as a non-deductible expense.

However, if the amount stated in Customs Authority list is higher, then DZIT considers the difference as undeclared revenue and has computed 'deemed profit' on the difference.

In view of this approach, companies need to accurately declare the value of foreign purchases and where possible, request a copy of the Customs Authority list in order to ensure the accuracy of their annual Zakat / Tax declarations. Based on experience, the key challenges facing taxpayers when attempting to reconcile the differences arise mainly due to:

- Foreign exchange rate differences
- Valuation of imports for customs duty purposes
- Timing of transactions eg. Hijri vs Gregorian dates
- Goods in transit or returned
- Goods re-exported
- Goods imported in the name of another entity / contractor for a project

The Customs Authority have also been closely monitoring companies importing into Saudi Arabia to ensure that the license and commercial registration allow for products/goods to be imported and the imported items are in accordance with the license and commercial registration. Companies with share capital of less SR 10 million have been requested to obtain special approval from the Customs Authority in Riyadh.

Arabic Financial Statements

The DZIT has confirmed that audited Arabic financial statements are required for submission with the Zakat returns of 100% Saudi or GCC owned entities; the DZIT has also extended this requirement to mixed companies (foreign and Saudi / GCC shareholding).

In order to avoid a penalty for late filing provided under the tax law, it is recommended that the Arabic financials are prepared and signed well in advance of the filing deadline.

Schedule Details

The DZIT requires details supporting all expenses be provided by the Zakat / Tax payers, for example, beneficiaries name, commercial registration, DZIT number and addresses. Notwithstanding the above, prior to allowing any costs, the DZIT have been requesting a detailed analysis together with copies of the supporting documents to determine whether or not these are allowable expenses.

Saudi Tax & Zakat Update Newsletter 2012

Latest DZIT Interpretation and Practice Notes

Foreign employees salary transfers in Saudi

In response to a recent query, Saudi-based employees of foreign companies have been given the option to transfer full or part of their salary to their home country bank account.

This process takes place by the Saudi branch transferring part of the employee's salary to a local Saudi bank and then sending a request to its head office (the related party) to transfer the remaining amount of the employee's salary to his / her home country bank account. After that a debit note is issued by the head office to the branch, the branch then records it in its books and settles the amount on a quarterly basis.

According to the DZIT withholding tax is not applicable on the related party settled debit notes because it is considered as compensation for the employee's salary provided that the amount is compatible with the employee's specified employment contract with the Saudi branch.

However, withholding tax is applied at 15% in the case of a profit margin charged by the related party because the profit margin is in return for the services performed by the related party to the branch.

Place of Management

The tax law provides that a company will be considered as resident in Saudi Arabia during the tax year if the company is incorporated in accordance with the Saudi Companies Regulations or place of central control and management is in Saudi Arabia.

The DZIT has specified that the following conditions would indicate that a company's place of central control or management is in Saudi Arabia:

- Occurrence of board meetings in Saudi in which major decisions and policies related to the management of the company are made; or
- Senior decisions about managing the company functions, for instance the CEO decisions and his deputies are made in the kingdom; or
- Most of the company businesses income is in the Kingdom.

Needless to say, evidence will need to be provided to DZIT to prove that the company's central control and management is located in Saudi Arabia and therefore be considered as resident for Saudi tax purposes. This may be an important analysis for purposes of determining the tax versus Zakat status of 100% GCC companies doing business in Saudi Arabia.

New IT System and Compliance

As a result of the introduction of the new IT system in the DZIT over the last 2 years, taxpayers have been experiencing delays in issuance of Zaka certificates, acknowledgements and assessments.

We understand that due to problems in uploading tax and Zakat return information in the system and closer scrutiny at the time of submission, including extremely close review of all scheduled items is expected to cause further delays in processing of returns and issuance of Zakat certificates.

Contract Reporting

The Saudi tax law requires that all contracts in value exceeding SR 100,000 for services, supply and contractors should be reported to the DZIT. While there is currently no penalty for non-compliance, there have been instances where the DZIT has held the local contracting party liable for taxes not paid by the other party as a result of this requirement not being met.

Contract or Toll Manufacturing

The DZIT has clarified that contract manufacturing or tolling arrangements may result in a non-resident company creating a Permanent Establishment in Saudi Arabia if any of the following conditions are present.

- Resident (Saudi) company is manufacturing on behalf of non-resident; or
- Resident company purchases raw materials from suppliers specified by non-resident; or
- Finished products are sent to any party that non-resident specifies both inside and outside Saudi Arabia.

Furthermore, the resident company's deemed to be an agent of the non-resident if it holds goods on behalf of non-resident and contracts with customers on behalf of non-resident.

The non-resident company will therefore be required to register for tax and pay tax on revenue earned not with standing the legality of 'trading' in Saudi Arabia.

Capital Gains Tax within Entities of a Group

The Saudi tax law provides for a 20% capital gains tax on any gains on sale of shares by a non-resident in a Saudi company. Such sale transaction should be reported and tax paid within 60 days of 'date of sale transaction'. In response to a query raised in connection with the capital gains tax in case of group re-organization or internal restructuring, the DZIT indicated that as long as there is a change of legal ownership in a Saudi company, then a capital gains reporting and tax filing obligation arises.

However, if a change involving transfer between entities within the same group is undertaken for commercial and business purposes, a strong argument can be made that no capital profits on share sale / transfers are intended and accordingly capital gains tax should not be payable since no Saudi source income has been realized.

Where a sale is made to a third party or there is a change in terms of which the Saudi company's Tax / Zakat profile changes (e.g. GCC companies sell to foreign non-GCC shareholders) then in such cases Saudi source income may be attributed on a "deemed capital gain".

Informing the DZIT of the change (within 60 days) is required and supporting documentation showing the date of change / sale is required.

Date of Sale for Capital Gains Tax purposes

The Saudi tax law doe not define what an effective date of sale for purposes of capital gains tax in Saudi. There has been various interpretation and the practice of the DZIT has been inconsistent.

We are aware of instances when the Date of signature of the sale agreement, Date of approval and change in SAGIA license, Date of issuance of updated commercial registration and Date of approval from Ministry of Justice have been considered as potential effective sale date. The date on which consideration is passed between buyer and seller has also been suggested as a possible date of sale.

Due to the uncertainty and potential adverse tax implications arising from delay in reporting and filing of a capital gains tax return, taxpayers are advised to ensure that proper documentation and evidence to support the intention of the parties as to the intended 'date of economic and legal transfer' is available to avoid any tax risk in future.

It is also important to note that the DZIT have been requesting the following documents, together with the capital gains tax return:

- Share Purchase Agreement.
- Amended Commercial Registration.
- Amended SAGIA license.
- Management Accounts / Audited financial statements at the date of sale.
- Evidence / documents to support change of ownership / shareholders etc.
- Proof of cost base.
- Evidence to support payment of sales price.

Approach to Withholding Tax on Related Party Payments

Withholding Tax rate on payments made by a branch to its head office or by a company to a related party for services, reimbursements etc. have always been subject to 15% withholding tax rate. Also, dividends, rent, insurance and interest payments made to related parties have been subject to 5% Withholding Tax.

However, a recent appeal decision at the Higher Appeal Committee (HAC) in Riyadh has ruled that 5% Withholding Tax is applicable on the payment of technical & consulting services fee to a non-resident related party instead of 15%.

We understand that in another case, the Preliminary Appeal Committee (PAC) has ruled that Withholding tax should apply on payments made to non-resident related parties on the basis of actual payment and not at the time of accrual of a liability or expense.

The taxpayer or the DZIT may file an appeal against the PAC's decision before the HAC or in the case of a HAC decision to the Board of Grievance within 60 days of the appeal decision. Accordingly, taxpayers are advised to note that the above decisions are not yet final and to carefully examine their current agreements with related parties to determine whether their agreements are up to date with the current rates or possible case for lower rates may be made based on specific circumstances.

Important Development with regard to Loans for Zakat Purposes

The DZIT practice has been in many cases in the past to add all credit balances that remain with a company for 12 months or more to its Zakat base including balances due to related parties, accounts payable, accrued expenses and advances from customers.

Furthermore, the approach adopted by the DZIT has been that any amount reflected as a loan or lease receivable or similar would not be deducted from the Zakat base of the entity to which such amounts are due.

The above approach adopted by the DZIT have been as a result of the Preliminary and Higher Appeal Committees constantly supporting the DZIT interpretation of a Fatwa whereby any debt payable; whether long or short term and used to finance assets or used for working capital if one lunar year elapses on it, are added to the zakat base, while debts receivable are not considered as deductible for zakat purposes.

However, a recent decision from the Board of Grievances did not accept the DZIT's interpretation of the fatwa and concluded that only the owner of the money should pay Zakat since Zakat should not be computed twice on the same funds during the same year.

Furthermore, in another Board of Grievance decision, it has been ruled in favour of a taxpayer, whereby they have accepted the deduction of long term receivables / investments from the tax base of a taxpayer involved in finance leasing thereby avoiding double Zakat and allowing for assets in the form of 'receivables' as a deduction for Zakat purpose.

The above decisions and approaches by the Board of Grievances to loans and receivables for Zakat purposes have a significant impact and potential Zakat optimization opportunities may be considered in light of these important decisions.

GCC Shareholders in a Saudi Company

DZIT Requirements for GCC Companies

The DZIT regulations state that in the case of GCC "mixed companies" (having GCC and foreign equity participations) the foreign shareholder is subject to tax on his share of profits while the GCC shareholder is assessed to zakat.

In order to obtain the above treatment, GCC companies will be required to provide the DZIT with the supporting documents including an official copy of the registration documents of the company duly attested by the Saudi consulate in that GCC country confirming the ratio of shareholding and nationality of the shareholders in the company and any amendments thereto as well as a copy of the articles of associations duly attested by the Saudi consulate in that GCC country.

The DZIT has also indicated that the above concession does not apply to GCC banks which continue to be subject to tax. This approach is also applied to branches of GCC companies in Saudi Arabia and GCC nationals who operate via an establishment in Saudi Arabia. However, this matter is currently under dispute and being challenged with the regulators.

Saudi Tax & Zakat Update Newsletter 2012

Discussions Between Saudi & Kuwait Tax Authorities

Taxability of Partitioned Neutral Zone income between Saudi and Kuwait

Companies carrying on a trade or business in the islands of Kubr, Qaru and Umm Al Maradim and the offshore area of the Partitioned Neutral Zone (PNZ) under the control and administration of Saudi Arabia are subject to tax in Kuwait on 50% of the taxable profit.

As the offshore area in the Neutral Zone has now been formally divided between Saudi Arabia and Kuwait, the Saudi tax authorities now consider that contracts for the work to be performed in PNZ should only be subject to tax in Saudi Arabia. Accordingly, the contracts awarded by the contract owners only refer to payment of tax in Saudi Arabia and require tax clearance certificate only from Saudi tax authorities.

However the Kuwaiti tax authority does not concur with the above position and continues to insist that the operations in the PNZ are still subject to tax in Kuwait as per Kuwaiti Law.

Tax and Zakat Compliance - Important Reminders

Filing Date and limit on number of returns to be accepted by DZIT

Filing of Annual Tax / Zakat declaration for entities with a financial year ended 31 December 2011 are reminded that the final date for submissions is Sunday, 29 April 2012. (120 days after year end).

However, taxpayers should try and ensure that Tax / Zakat returns are filed as soon as possible and by no later than Wednesday 25 April, 2012, to avoid last minute rush delays and also to avoid any fines or penalties. Under the current tax law no extensions are granted.

Furthermore, the DZIT has also imposed limits on the number of Tax / Zakat returns it will physically receive each day from tax advisors and accountants. It has been indicated that a limit of 10 Tax / Zakat returns per firm per DZIT office would be accepted. Furthermore, the DZIT has indicated that they will not accept Zakat only returns after 13 April 2012. However, since 13 April 2012 is a Friday and weekend in Saudi, therefore we understand that April 11, 2012 would be last day for receipt of Zakat returns. This may have a major impact on the timing of submission of returns and clients are advised to plan accordingly.

Penalties and Fines for Delay

In cases where the tax declaration together with the payment for tax is not done within 120 days of the end of the taxpayer's financial year, a delay penalty equal to the higher of 1% of gross receipts but not to exceed SR 20,000 and an amount calculated based on the table here.

Currently there are no penalties in force on late payment of Zakat, however a delay in filing the Zakat return could result in delays in issuance of the required Zakat certificate.

Saudi Tax & Zakat Update Newsletter 2012

Tax Return Attestation

Taxpayers whose revenue for the year exceeds One Million Saudi Riyals are required to ensure that their tax declaration is certified as correct by a Certified Public Accountant licensed to practice in Saudi Arabia.

Failure to comply with this requirement, will lead the DZIT to impose a late filing penalty on the grounds that the tax declaration is not filed according to the manner prescribed by the DZIT. The certification should state that:

- The tax declaration information is extracted from and in conformity with the taxpayer's books and records; and
- The tax declaration is in compliance with the provisions of the Saudi Arabian Income Tax Law.

Delay after due date (Number of days)	Penalty (Percentage of unpaid tax)
1 to 30 days	5 %
31 to 90 days	10 %
91 to 365 days	20 %
Over 365 days	25 %

Arabic Books & Records

According to the Saudi tax law, all taxpayers are required to maintain commercial books and accounting records locally in Arabic language to support their Tax / Zakat declarations.

It has been the recent practice of the DZIT not to accept the tax return, or finalize the assessments or even issue a tax certificate where the taxpayer did not have books and records maintained in Arabic language in Saudi Arabia.

Furthermore, the DZIT was reluctant to receive any responses to their queries if the response includes extract from the ledger or journal vouchers in a language other than Arabic.

GOSI Certification

In order to claim salary as deduction for tax purposes, the DZIT requires a certificate from GOSI in support of the salary claimed in the Tax / Zakat declaration and a certificate from the auditors of the company confirming the part of salary which is not subject to tax. If the salary confirmed by GOSI certificate is less than the amount charged in the tax declaration, the DZIT may require from the taxpayer to provide the reconciliation between two amounts.

In case of failure to provide the required reconciliation, the DZIT may disallow the difference.

Withholding Tax

Taxpayers should continue to be aware of provisions of the Saudi income tax law which requires withholding tax on payments for services from an in-Kingdom source to non-resident parties. The rates of withholding tax range from 5% to 20% depending on the nature of service / payment.

Strict Compliance Regime

The DZIT has been requesting the following documents to be attached to the annual Tax / Zakat returns before acceptance, and we expect this practice to continue.

- Audited financial statements (in case of mixed and Zakat only entities).
- Stamp and signature on all schedules and attachments submitted with the Tax / Zakat returns, even where not applicable.
- Annual withholding tax return, even if not applicable.
- Annual GOSI certificates showing the amount of salaries and wages paid to Saudi and non-Saudi employees and not number of employees.
- In some instances, certificate from "Passport Office" for employee details, in cases where commercial operations are yet to commence or no revenue is reported.
- Separate cheques for each type of payment i.e. One for Zakat, One for Corporate Tax and One for Withholding tax.
- Online payments now possible and accuracy of the details captured is critical. Taxpayers to submit copies of receipts or bank transfer to support any tax or Zakat paid during the year together with the tax returns.
- Copies of latest Articles of Association and updated Commercial Registration certificate.
- Local and Foreign purchases need to be clearly mentioned on the Tax / Zakat return.

Saudi Tax & Zakat Update Newsletter 2012

Monthly Withholding Tax Filing

Taxes withheld under the tax law should be paid to the DZIT, on or before the 10th day of the month following the month in which the payment was made. The tax law provides for the imposition of delay fine at the rate of 1% of unpaid tax for each 30 days delay from the due date.

Filing of Annual Withholding Tax Statement

Under the current tax law, each person who is obliged to withhold the tax is required to file, the prescribed annual statement for withholding tax, within 120 days from the end of his financial year together with his annual Tax / Zakat declaration.

The annual withholding tax form is required to be submitted with the annual Tax / Zakat return even in cases where no withholding tax was paid, in which case a nil annual withholding tax return is required.

Advance Tax

Taxpayers are reminded that an advance payment on account of corporate income tax for the year is payable in three instalments i.e. by the end of the sixth, ninth and twelfth months of its financial year. Each instalment of advance payment of tax is calculated in accordance with the following formula:

25% × (A - B)

Where: (A) is equal to the taxpayer's liability as per the tax return for the preceding year; and (B) is equal to tax suffered by the taxpayer at source (i.e. withholding tax) in the preceding year.

A taxpayer is not required to make advance payments if the amount of each payment calculated above would be less than SR 500,000 (i.e. corporate taxes payable in preceding year are less than SR 2, 000,000)

KPMG in the News

KPMG Annual Tax Seminar

ARAB NEWS - Published 5th March 2012

KPMG Al- Fozan and Al-Sadhan held their 2012 Saudi Arabia Tax and Zakat update seminar in Riyadh, Jeddah and Al Khobar recently.

The main objective of the seminar was to update clients and investors on the latest developments with regard to application of Tax and Zakat regulations in Saudi Arabia during the last year.

The seminar which was facilitated by Ebrahim Baeshen, partner and Suleman Mulla, tax director based in Jeddah, highlighted issues such as, the Department of Zakat and Income Tax (DZIT)'s approach to deductible items for Tax and Zakat purposes, impact of the expanding network of Saudi Arabia's double tax agreements on business decisions and an interesting section on structuring of investments and importance of tax due diligences.

Important decisions made by the tax authorities on issues such as deductibility of loans for zakat purposes, lease receivables and critical aspects on the correct rate of withholding tax on payments to non-residents was also discussed.

The seminar also highlighted challenges faced by clients with regard to compliance matters such as mandatory submission of Arabic audited financial statements, GOSI certificates and detailed supporting information required to accompany Tax and Zakat returns.

The impact of the new IT system and impact of the strict review process being implemented at the DZIT was also shared with attendees.

The seminar concluded with an interactive session during which the presenters responded to some complex questions raised by the delegates, who covered a broad spectrum of sectors across KPMG's growing client base.

Abdullah Hamad Al Fozan, chairman of KPMG said: "The tax seminar is one of the most important seminars held annually by KPMG. We are always keen to provide a clear vision that guides clients and investors in the Kingdom of Saudi Arabia to make correct investment decisions."

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