KPMG

# Saudi Tax and Zakat

2008 / 2009

## Taxation and the concept of Zakat 2009

The past year has seen significant developments in the area of tax and zakat in Saudi Arabia. Some of these are directly aligned with attracting foreign investment. Such developments are encouraging and bode well for the Kingdom as it drives economic diversification in order to be less reliant on oil revenues.
While significant progress has been made on this front, and as investors look to Saudi Arabia for continued investment opportunities in a global downturn, a word of caution – the tax regime in Saudi Arabia is complex and fraught with pitfalls. And unlike 2008 when oil prices reached record highs, 2009 has seen subdued oil prices with the result that pressure will mount for tax revenues to help fuel the Kingdom's ambitious infrastructure plans.

### 1. CORPORATE TAX IN SAUDI ARABIA

According to Saudi tax law (effective from July 30, 2004) resident capital companies (on non-Saudi/GCC shareholders' share) and non-residents who have business activities in the Kingdom through a permanent establishment, are subject to corporate income tax in Saudi Arabia at a rate of 20%. A company will be considered a resident company if it is formed under the Saudi Companies Regulations, or if its central control and management is situated within the Kingdom.

***A. INCOME SUBJECT TO TAX:***

Income subject to tax is gross income and includes income, profits, gains of any type and any form of payment arising from carrying out activity. Gross income includes capital gains and incidental income but excludes certain exempt income.

***B. DEDUCTIBLE EXPENSES:***

Generally, all ordinary and necessary expenses of earning income subject to tax paid or accrued by the taxpayer during the taxable year are deductible in determining the tax base.
Deductible expenses are broadly as follows:
a) All expenses that are necessary and normal to the business, paid or accrued

are allowed deductions provided they meet the following criteria:

- Actual expenses supported by verifiable documentation or other evidence.

- Related to earning taxable income.

- Related to the subject tax year.

- Of non-capital nature.

b) Loan charges (interest) incurred during the tax year or the resultant of the following formula, whichever is less. The taxpayer's total income from loan charges (interest income), plus 50% of (A-B). "A" = income subject to tax other than income from loan charges (interest income). "B" = expenses allowed under the law other than loan charge expenses (interest expense).

c) Other deductible expenses include:

- Bad debts provided they meet certain conditions.

- Cost of repairs or improvements of fixed assets are deductible on condition that the deductible expense for each year may not exceed 4% of the remaining value of the related asset group at year-end. Amounts in excess should be added to the remaining value of the asset group and depreciated.

- A deduction is allowed for research and development costs connected with income subject to tax.

- Value of goods or services delivered to the taxpayer by related parties to the extent that it is in excess of an arm's length value.

***C. NON-DEDUCTIBLE EXPENSES:***
Certain types of expenses are, however, not deductible such as expenses of a capital nature and certain specific expenses not deductible under the provisions of the law. The following are expenses that are not allowed as a deduction in accordance with the tax law:

- Expenses not connected with the earning of income subject to tax.

- Payments or benefits to a shareholder, a partner or their relatives which constitute employment income or which do not represent an arm's length payment for property or services.

- Entertainment expenses.

- Income tax paid in the Kingdom or to another state.

- Fines and penalties paid or payable to any party in the Kingdom (not including those paid for breach of contractual obligation).

- Payments made to head office by branches for royalties, commission,

interest and indirect allocated general and administrative expenses.

- Deductions for provisions and reserves (other than provisions for doubtful debts in banks).

***D. CARRY FORWARD OF PREVIOUS YEARS' LOSSES:***
Previous years' approved tax losses can be carried forward until they are recovered in full. The maximum loss which may be utilised each year is limited to 25% of net income for the year, and any balance is carried forward.

***E. TAX DEPRECIATION:***
Depreciation is calculated for each group of fixed assets by applying the prescribed depreciation rate to the remaining value of each group at the fiscal year-end. The value for each group at the end of the year is calculated by:

- Adding the remaining value of the group at the end of the preceding taxable year less previous depreciation deductions (the remaining value of each group at the end of the preceding taxable year is defined to be the total value of each group at the end of the preceding taxable year net of depreciation of the preceding taxable year).
- Adding 50% of the cost of assets that were purchased in the current year.
- Adding 50% of the cost of assets purchased in the preceding taxable year.
- Deducting 50% of the consideration received from the disposal of assets during the taxable year.
- Deducting 50% of the consideration received from the disposal of assets during the preceding taxable year.

***F. TAX DECLARATION:***
The due date for filing the tax declaration and payment of tax is within 120 days of the fiscal year-end. Taxpayers are required to file an annual tax declaration. If a taxpayer's income exceeds SR1m ($267,000), the tax declaration must be certified as correct by a chartered accountant who is licensed to practice in the Kingdom.

***G. FINES:*** The fine for non-registration with the Department of Zakat and Income Tax (DZIT) varies from SR1,000 ($267) to SR10,000 ($2,670). The fine for non-submission of tax declarations by the applicable due date is the higher of:

a) 1% of gross receipts but not to exceed SR20,000 ($5,340);
b) 5% of the underpaid tax if the delay is up to 30 days from the due date;

c) 10% of the underpaid tax if the delay is more than 30 days and not more than 90 days from the due date;

d) 20% of the underpaid tax if the delay is more than 90 days and not more than 365 days from the due date; or

e) 25% of the underpaid tax if the delay is more than 365 days from the due date.

Delay fine (in addition to fine for non-submission of tax return) is 1% of the unpaid tax for each 30 day delay, and fraud and evasion fine totals 25% of the difference in tax resulting from misrepresentation or fraud.

***H. ADVANCE PAYMENT:*** An advance payment on account of tax for the year is payable in three installments, i.e. by the end of the sixth, ninth and 12th months. Each installment of advance payment of tax is calculated in accordance with the following formula: 25% X (A-B), where A is equal to the taxpayer's liability as per the tax declaration for the preceding year and B


*Depreciation rates*

| Category/group | Depreciation rate |
|---|---|
| 1. Fixed buildings | 5% |
| 2. Industrial & agricultural movable buildings | 10% |
| 3. Factories, machines & equipment, computer application programmes, passenger cars & cargo vehicles | 25% |
| 4. Expenditures for geological surveying, drilling, exploration & other preliminary work to exploit & develop natural resources & their fields | 20% |
| 5. All other tangible or intangible assets not included; impervious categories, such as furniture, planes, ships, trains & goodwill | 10% |

is equal to tax suffered by the taxpayer at source (i.e. withholding tax) in the preceding year.

The taxpayer is not required to make advance payments if the calculated amount of each payment is less than SR500,000 ($133,500).

### *I. RECOVERY BY TAXPAYER OF OVERPAID AMOUNTS:*

The taxpayer is entitled to recover overpaid amounts plus a compensation of 1% for each 30 days delay in receiving the refund commencing 30 days after submission of a claim by the taxpayer.

### *J. ACCOUNTING BOOKS AND RECORDS:*

Taxpayers must maintain books and accounting records in Arabic. Taxpayers must prepare financial statements to be audited by a licensed auditing firm.

## 2. WITHHOLDING TAX IN SAUDI ARABIA

The Saudi Arabian tax law provides for actual withholding tax at different rates on payments made to non-resident parties by a resident or a permanent establishment of a non-resident from a source of income in the Kingdom of Saudi Arabia. Accordingly, any payment for services provided by a non-resident enterprise that is from a source in the Kingdom is subject to withholding tax. Services are defined to mean anything done for consideration other than the purchase and sale of goods and other property.

### *A. WITHHOLDING TAX RATES:*

In accordance with the provisions of the tax law and by-law, the amount of withholding tax is calculated at the following rates:

*Withholding tax rates*

| | |
|---|---|
| Management fees | 20% |
| Royalties | 15% |
| Payments against services to the head office or to a related party | 15% |
| Rent, consultancy or technical services, air tickets or airfreight or sea freight, international telecommunication services, dividends, interest on loans, insurance or re-insurance installments | 5% |
| Any other payments | 15% |

***B. WITHHOLDING TAX OBLIGATIONS:***

A person withholding tax under the new law is required to:

- Register with and pay to the DZIT the amount withheld during the first 10 days of the month following the month of payment to the recipient.

- Provide the non-resident or the taxpayer with a certificate, stating the amount of the payment and the amount of tax withheld.

- At the end of the tax year, provide to the DZIT the name, address, and where appropriate, the taxpayer's registration number(s), if available, of the person(s) receiving the payment, along with any additional information the DZIT may require.

- Maintain the records that are required to ascertain his withholding obligations according to the by-law.

***C. WITHHOLDING TAX PROCEDURES:***

The DZIT has special forms for the purpose of reporting withholding tax. A form for withholding tax on a monthly basis is considered a self-declaration of the withholding tax during the month. A person obliged to withhold tax is required to provide the form to the DZIT during the first 10 days of the month following the month in which the payment was made to the beneficiary. Each person obliged to withhold tax is required to file the form for withholding tax on annual basis and provide it to the DZIT within 120 days from the end of the financial year. This form will be a consolidation of all the monthly withholding tax forms filed by the person for the last 12 months i.e. the financial year.

## 3. TAX TREATIES

Saudi Arabia has double tax treaties

currently in force with Austria, China, France, India, Pakistan, South Africa, South Korea and Spain. Several other treaties have also been concluded with Italy, Malaysia, Russia, Belarus and Syria, but await ratification. This is impressive, considering that five years or so ago, the only treaty Saudi Arabia had was with France. The French-Saudi treaty, which was originally subject to a five-year term, was renewed in 2009 for a further five years. The UK-Saudi treaty and Turkey-Saudi will come into effect on January 1, 2010. Currently, a treaty with Egypt is under negotiation. The expansion of Saudi Arabia's tax treaty network (especially over the past year or so) is indicative of the Kingdom's desire to increase bilateral trade with its major trading partners. Saudi Arabia has air transport treaties with Belgium, Canada, China, India, Indonesia, Japan, Jordan, the Netherlands, Pakistan, the Philippines, Singapore, Sweden, Switzerland, the US and the UK. These treaties dictate that income and profits derived by an air transport enterprise of one contracting state from the exercise of air transport in international traffic, including income derived from training schemes, management and other services rendered by an air transport enterprise, shall be exempted from tax in the other contracting state.

## 4. CONCEPT OF ZAKAT IN SAUDI ARABIA

Zakat is an obligatory payment required from Muslims according to the sharia (religious law) and forms one of the five pillars of Islam. In most Muslim countries the payment of zakat has been left to the individual, whereas in Saudi Arabia the collection of zakat is governed by regulations. The guide on zakat in Saudi Arabia is based on the provisions of Royal Decrees, Ministerial Resolutions and Department of Zakat and Income Tax (DZIT) circulars that are in force from time to time.

In Saudi Arabia zakat is assessed on Saudi and GCC nationals and on companies that are wholly owned by those individuals or their equity interest in companies.

There are certain rules that apply to the method of calculating the zakat liability. In general, zakat is levied at a fixed rate of 2.5% on the higher of adjusted taxable profits or the zakat base as illustrated below.

The following items are added to arrive at the zakat base:

- Contributed capital at the beginning of the year. Additions to capital made

during the year (as long as these are not used to fund fixed assets) are excluded but will be included in the following year.

- The credit account of owner(s) at the beginning of the year.

- Retained earnings (net of appropriations or reserves) at the beginning of the year.

- All appropriations (or reserves) from retained earning.

- Net adjusted profits for the year before any distribution including profits earned on foreign investment.

- Long-term loans.

- Short-term loans used for financing of fixed assets.

The following items are deducted from the above and are therefore not part of the basis for zakat:

- The net book value (tax) of fixed assets (i.e. cost less accumulated depreciation).

- Organisation and pre-operating costs, net of amortisation.

- Operating losses for the year.

- Accumulated losses carried forward from previous years.

- Long-term investments in Saudi companies. Deduction of investments in foreign companies are only allowed if certain requirements are satisfied.

- Dividends paid from the previous year's profits.

- A number of items are not allowed as a deduction from the zakat base including inventory, investments in bonds/sukuks, cash, etc.

## 5. OTHER TAXES

Saudi Arabia does not have employees tax, value-added tax, general sales tax or stamp duties. However, there are customs duties, social security and levy on the transfer of land. Social security payments on salaries are as follows:

| Category of Employee | Annuity branch (Pension annuity) | | Occupational Hazards | Total |
|---|---|---|---|---|
| | Employer | Employee | Employer | |
| Saudi nationals | 9% | 9% | 2% | 20% |
| Non-Saudi nationals | – | – | 2% | 2% |

## 6. FISCAL INCENTIVES IN ECONOMIC CITIES

Recently the Saudi Arabian General Investment Authority (SAGIA) has provided detailed information regarding application procedures and requirements for investment in various economic cities being planned in the Kingdom. SAGIA has indicated that it hopes to provide a best-in-class regulatory environment that offers attractive investment regulations and incentives, unmatched regulatory performance, efficiency and sustainable competitiveness to investors.
Some proposed fiscal incentives applicable to the economic cities include the following:

***(A) TAXES:***

In order to increase foreign direct investment and raise the employment and skill level of Saudis, it is proposed that investors meeting certain basic conditions in Jazan Economic City and Prince Abdulaziz bin Mosaed Economic City (Hail) may be eligible for tax credits and exemptions for projects in the following form:

- 50% tax credit on Saudi employees' payroll.

- 50% tax credit on Saudi employees' training costs; with respect to industrial activities.

- A one-time credit of 15% of the investor's industrial investment capital carried forward for up to 10 years.

***(B) RE-EXPORT ZONES:***

Each economic city would contain a bonded re-export zone that will comprise an industrial zone, logistics hub and a port area.

Within this district all imported raw material used for manufacturing products that are intended for re-export will be exempt from import fees. In

addition, investors will be eligible for customs fees exemptions on machinery, equipment, tools and spare parts, which are imported for the manufacture of industrial products.

***(C) TAX INCENTIVES FOR UNDEVELOPED PROVINCES:***

Following the issuance of Circular No. 359, dated 26/11/1429, by the Council of Ministers, the Saudi government has confirmed provision of a 10-year tax incentive for investments in the following underdeveloped provinces in Saudi Arabia:

- Hail • Northern Border • Jizan • Najran • Abha • Al Jouf

In terms of the incentive rules, an investor will be granted tax credit against the annual tax payable in respect of the following costs incurred for Saudi employees, which will be calculated as follows:

- 50% of the annual cost incurred on training of Saudie employees.

- 50% of the annual salaries paid to Saudi employees, if there is any balance of tax payable after applying the above.

In addition, a tax credit equal to 15% of the capital is provided to qualifying industrial projects. The project must meet the following conditions in order for the tax incentives to apply:

- Capital invested in the project should not be less than SR1m ($267,000).

- Number of Saudi employees should not be less than five.

- The Saudis should be employed as technical or senior administrative staff.

- Employment contracts signed with the Saudi employees or trainees should not be less than one year.-

- Saudi employees and trainees should be residents at the project location.

- Training provider, whether local or international, must be approved by the relevant authorities.

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