IMPORTANT DISCLAIMER: No person, entity or corporation should act or rely upon any matter or information as contained or implied within this publication without first obtaining advice from an appropriately qualified professional person or firm of advisors, and that such advice specifically relates to their particular circumstances. This publication should not be regarded as offering a complete explanation of the taxation matters that are contained within this publication.

This publication has been sold or distributed on the express terms and understanding that the publishers and the authors are not responsible for the results of any actions which are undertaken on the basis of the information which is contained within this publication, nor for any error in, or omission from, this publication.

The publishers and the authors expressly disclaim all and any liability and responsibility to any person, entity or corporation who acts or fails to act as a consequence of any reliance upon the whole or any part of the contents of this publication.

PKF International Limited is an association of legally independent member firms.
A. TAXES PAYABLE

COMPANY TAX: The following are chargeable to income tax:

- Saudi-Arabian resident companies
- non-resident companies who do business in the Kingdom through a permanent establishment
- non-resident companies with income subject to tax from sources within the Kingdom.

A company is considered to be a resident company if it meets either of the following two conditions:

1. it is formed under the Kingdom of Saudi Arabian Companies Regulations
2. its place of central control and management is situated within the Kingdom of Saudi Arabia.

A permanent establishment of a non-resident in the Kingdom, unless otherwise provided by the Income Tax Regulation, arises where a non-resident has a permanent place through which it carries out business, in full or in part, including business carried out through an agent.

The applicable income tax rate is 20%, with the exception of tax rates for the gas and oil industries.

The income tax rates applicable to companies engaged in natural gas investment activities is 30%. (Such companies are subject to a higher tax rate from 30% to 85% based upon the cumulative rate of return.)

The income tax rate applicable to companies engaged in the production of oil and other hydrocarbons is 85%.

Income tax can be paid in instalments throughout the tax fiscal year and is payable within 120 days of the fiscal year end.

Previous years’ approved tax losses may be carried forward until fully recovered (using up to 25% of a year’s taxable profit to offset approved losses).

Heavy penalties, levies and the seizure of taxpayer’s property may be imposed for the non-payment of tax and/or for tax evasion.

CAPITAL GAINS TAX: Capital gains on transferable securities are exempt from tax if the securities are acquired on or after 30 July 2004 and the transfer is effected in accordance with the provisions of the Saudi stock market regulations.

Capital gains or losses on non-depreciable assets are taxable or deductible under the standard rules as the case may be.

Capital gains and losses on depreciable assets are not taken into consideration in determining the tax base. The effect of such gains or losses on the tax base is (partly) reflected by the depreciation method provided for in the Decree and regulations.

BRANCH PROFIT TAX: Non-resident companies are taxed in Saudi Arabia in so far as they carry on an activity through a permanent establishment (PE) or derive an income in Saudi Arabia. Income derived through a PE is subject to tax under standard rules, while other income is subject to a final withholding tax.

The following are considered to constitute a permanent establishment:

- construction sites and assembly facilities
- installations and sites used for surveying for natural resources, drilling equipment, and ships used for surveying for natural resource
- a fixed base where a non-resident natural person carries out business
- a branch of a non-resident entity which is licensed to carry on business in the Kingdom.

A place is not considered a permanent establishment of a non-resident in the Kingdom if it is used in the Kingdom only to do the following:
store, display, or deliver goods or products belonging to the non-resident

hold a stock of goods or products belonging to the non-resident only for the purposes of processing by another person

purchasing goods or products only for the collection of information for the non-resident

performance of any other activities that are preparatory or auxiliary in nature to the interests of the non-resident

drawing up contracts for signature with regard to credits (loans), delivery of goods, or provision of technical services

execution of any combination of the activities indicated in subparagraphs 1 to 5 above.

As far as capital gains are concerned, non-residents are taxed in the same way as residents.

SALES TAX/VALUE ADDED TAX (VAT): There is no VAT or other similar sales (or consumption) tax in Saudi Arabia.

FRINGE BENEFITS TAX: There is no tax on employment income in Saudi Arabia.

LOCAL DUTIES: There are no local duties payable in Saudi Arabia.

REAL ESTATE TAX: There is no real estate tax in Saudi Arabia. Zakat (religious tax) may be payable on real estate if held for speculative purposes.

OTHER TAXES: Zakat is payable by individual Saudis and other GCC nationals. Zakat is calculated at the rate of 2.5% and is chargeable on the total of the taxpayer’s capital resources and income that are not invested in fixed assets. These include the company’s capital, net profits, retained earnings and reserves not created for specific liabilities. Only resources (including income) which have been held for at least 12 months are subject to zakat.

B. DETERMINATION OF TAXABLE INCOME

Income is from a source in the Kingdom of Saudi Arabia if it is:

• derived from an activity which occurs in Saudi Arabia

• derived from immovable property located in Saudi Arabia, including gains from the disposal of an interest in such immovable property and from the disposal of shares or partnership interests in a company, the property of which consists, directly or indirectly, principally of interests in such property

• derived from the disposal of shares or a partnership interest in a resident company

• derived from the rental of movable property used in Saudi Arabia

• derived from the sale or license of industrial or intellectual property in Saudi Arabia

• shares’ profits, management fee, or director’s fee paid by a resident entity

• payments for services made by a resident entity to its head office or to an affiliated company

• payments made by a resident for services performed in whole or in part in Saudi Arabia

• attributable to a permanent establishment of a non-resident located in Saudi Arabia.

Tax rates apply to net profits, which are defined as the difference between:

• the gross income, i.e. the sum of all profits, earnings or compensations (regardless of their nature or mode of payment) received in relation to the business activity, including capital gains on fixed assets and occasional profits but excluding exempt income; and

• deductible expenses.

The regulations specify that proceeds from the following are part of gross income: buying and selling, financial and commercial transactions, activities pertaining to the dealing in or development of oil or other mineral resources, and transactions concerning movable or immovable property. In addition, commissions, profits on shares and securities and, in general,
proceeds from any business transaction the object of which is profit or from any source of wealth are included in gross income.

Exempt income includes capital gains related to the alienation of negotiable securities on the stock market (subject to conditions) and capital gains on the sale of properties which are not part of business assets.

**DEDUCTIBLE EXPENSES:** All costs and expenses paid or incurred during the tax year to earn taxable income such as salaries and wages, travel expenses which are connected with the business or enterprise, and rent on properties used in the business, are deductible from the tax base.

As a general rule, however, expenses are only deductible if they satisfy the following conditions:

- they are actual/real
- they are related to taxable income (which means that costs related to exempt income will not be deductible)
- they are related to the tax year during which they were incurred
- they do not increase the value of fixed assets.

The regulations provide for a certain number of other expenses which may be deducted from the tax base. Specifically, the regulations provide for the deduction of:

- employers’ contributions paid for the employees to retirement funds (as defined by the applicable regulations) and to (appropriate) savings funds. The deduction is limited to a maximum of 25% of the employee’s income
- research and development (R&D) expenses incurred in Saudi Arabia during the tax year. The deduction does not apply to the cost of land and other fixed assets acquired for the purposes of R&D activities. These assets remain depreciable under the standard rules
- costs of repair, maintenance and improvement of (depreciable) fixed assets. These costs are deductible from the tax base in the year in which they are incurred. The deduction is limited to 4% of the residual value of the group of assets concerned at the end of the tax year. Any excess over this amount is added to the residual value and depreciated accordingly.

**NON-DEDUCTIBLE EXPENSES:** The following are not deductible:

- salaries, wages and the like paid to an entrepreneur, partner or shareholder or to their dependents or relatives, except in the case of stock companies
- any amount paid in excess of the actual value of a transaction made with one of the persons mentioned above
- leisure expenses such as costs of parties, sports events, travelling expenses, etc.
- income tax and related penalties whether due in Saudi Arabia or elsewhere
- penalties and fines due to the infringement of applicable regulations
- bribes
- commissions paid to insurance agents in excess of 3% of the premiums collected by the insurance company in Saudi Arabia
- payments made by Saudi branches to headquarters that are wholly owned by foreign companies for:
  - (a) royalties
  - (b) interest or other financial costs
  - (c) general administrative costs determined by apportionment on a lump-sum basis (see indirect expenses below)
- amounts paid in excess of normal market prices for transactions made between associated enterprises.

**DEPRECIATION:** All fixed assets, whether tangible or intangible (except land) are depreciable using the straight-line method of depreciation only. Depreciation is normally calculated on a full-year (12 months) basis. However, where a depreciable asset is brought into the taxpayer’s business part way through a fiscal year, the amount of depreciation must reflect the date on which the asset was first put into use. Normally, a monthly pro-rata basis is acceptable.
Depreciation allowances are calculated for groups of assets (and not individually for each asset) at the following rates:

- buildings – 5%
- movable industrial and agricultural facilities – 10%
- machinery, factories and equipment, including computer programmes and means of transport – 25%
- costs of geological studies, exploring and drilling expenses and costs of preparatory operations for the exploitation and development of natural resources – 20%
- all other fixed assets, whether tangible or intangible, not covered by the above (including ships, aircraft, trains, furniture, etc) – 10%.

Goodwill may not normally be depreciated whilst the business is run as a going concern. Where goodwill has been purchased for value, it may be treated as a depreciable asset if an individual ruling to that effect is obtained from the Department of Zakat and Income Tax (DZIT).

**STOCK/INVENTORY:** The cost of inventory is calculated using the absorption cost method. Taxpayers using cash-based accounting may use the direct (or prime) cost method.

Closing stock is valued at the book value or the market value whichever is lower. Book value is determined by using the weighted average method. However, the taxpayer may use another method, after obtaining written permission from the DZIT. He may not change this method without the prior approval of the DZIT.

**DIVIDENDS:** Saudi Arabia resident companies are taxable on dividends receivable whether or not those dividends are received from other Saudi Arabian companies or from overseas.

**INTEREST DEDUCTIONS:** Interest expenses are deductible up to the following limit (except for banks):

\[(\text{income from loans} + 50\% \times \text{other income}) - \text{deductible expenses (other than interest)}\]

**LOSSES:** Operational losses of a business may be carried forward indefinitely. However, the annual deduction is limited to 25% of the profits as shown in the annual return. Losses related to exempt activities may not be deducted or carried forward.

**FOREIGN SOURCED INCOME:** Resident companies are taxed on their worldwide income, i.e. including income from transactions carried on, or branches situated, abroad. This means that all forms of overseas income are subject to tax under standard rules.

**INCENTIVES:** There are no incentive rules in Saudi Arabia.

**C. FOREIGN TAX RELIEF**

No relief for foreign taxes is granted under Saudi tax regulations.

**D. CORPORATE GROUPS**

There is no group tax regime in Saudi Arabia.

**E. RELATED PARTY TRANSACTIONS**

The DZIT may reallocate revenues and expenses relating to transactions made between related parties or parties under the same control in order to reflect the returns that would have resulted if the parties were independent and unrelated. Companies are deemed to be under common control if the same person or related persons control, directly or indirectly, 50% or more of the voting rights or value of the company.

**F. WITHHOLDING TAX**

Distributed income (including dividends) paid to non-residents is subject to a 5% withholding tax. However, the withholding tax does not apply to distributions made by companies operating in the oil and the gas sectors. The regulations define distributed income as any distribution made by a resident company to a non-resident shareholder. Distributed income is also deemed to include profits transferred by a PE to a related entity.

Income from loans paid to a non-resident is subject to a 5% withholding tax.

Royalties paid to non-residents are subject to a final 15% withholding tax.

**STOCK/INVENTORY:** The cost of inventory is calculated using the absorption cost method. Taxpayers using cash-based accounting may use the direct (or prime) cost method.

Closing stock is valued at the book value or the market value whichever is lower. Book value is determined by using the weighted average method. However, the taxpayer may use another method, after obtaining written permission from the DZIT. He may not change this method without the prior approval of the DZIT.

**DIVIDENDS:** Saudi Arabia resident companies are taxable on dividends receivable whether or not those dividends are received from other Saudi Arabian companies or from overseas.

**INTEREST DEDUCTIONS:** Interest expenses are deductible up to the following limit (except for banks):

\[(\text{income from loans} + 50\% \times \text{other income}) - \text{deductible expenses (other than interest)}\]

**LOSSES:** Operational losses of a business may be carried forward indefinitely. However, the annual deduction is limited to 25% of the profits as shown in the annual return. Losses related to exempt activities may not be deducted or carried forward.

**FOREIGN SOURCED INCOME:** Resident companies are taxed on their worldwide income, i.e. including income from transactions carried on, or branches situated, abroad. This means that all forms of overseas income are subject to tax under standard rules.

**INCENTIVES:** There are no incentive rules in Saudi Arabia.

**C. FOREIGN TAX RELIEF**

No relief for foreign taxes is granted under Saudi tax regulations.

**D. CORPORATE GROUPS**

There is no group tax regime in Saudi Arabia.

**E. RELATED PARTY TRANSACTIONS**

The DZIT may reallocate revenues and expenses relating to transactions made between related parties or parties under the same control in order to reflect the returns that would have resulted if the parties were independent and unrelated. Companies are deemed to be under common control if the same person or related persons control, directly or indirectly, 50% or more of the voting rights or value of the company.

**F. WITHHOLDING TAX**

Distributed income (including dividends) paid to non-residents is subject to a 5% withholding tax. However, the withholding tax does not apply to distributions made by companies operating in the oil and the gas sectors. The regulations define distributed income as any distribution made by a resident company to a non-resident shareholder. Distributed income is also deemed to include profits transferred by a PE to a related entity.

Income from loans paid to a non-resident is subject to a 5% withholding tax.

Royalties paid to non-residents are subject to a final 15% withholding tax.
Other withholding taxes are as follows:

- management fees – 20%
- payments made to head office or an associated entity against services – 15%
- rent, technical and consultancy services, payments made for air tickets, air freight or marine freight, international telecommunication, dividend, loans fees (interest) and insurance or reinsurance premiums – 5%
- any other payments – 15%.

G. EXCHANGE CONTROL

There is no exchange control in operation in Saudi Arabia.

H. PERSONAL TAX

The following persons are subject to taxation:

- a resident Saudi individual who does business in the Kingdom
- a non-resident who does business in the Kingdom through a permanent establishment
- a non-resident with income subject to tax from sources within the Kingdom.

A natural person is resident in the Kingdom for a tax year if he meets either of the following two conditions:

1. he or she has a permanent place of abode in the Kingdom and physically resides in the Kingdom for a period in aggregate not less than 30 days during the taxable year; or
2. he or she physically resides in the Kingdom for a period of not less than 183 days in the taxable year.

For the purpose of this paragraph, presence in the Kingdom for part of a day is considered presence for the whole day. Presence in case of transit between two points outside the Kingdom is not included.

Only business income earned by individuals is taxable. There is no tax on employment income. Business and professional income is taxed in the same way and under the same rules as corporate profits. Individuals not carrying on a business or professional activity are not taxed on interest and dividend income.

Individuals carrying on a business or professional activity are taxed at the same rate (i.e. 20%) and under the same rules as corporate entities. Income tax can be paid by instalments throughout the tax fiscal year. Income tax is payable within 120 days of fiscal year end.

SOCIAL SECURITY CONTRIBUTIONS:

With effect from 26 March 2001, employees pay a contribution of 9% for insurance relating to old age, disability and death.

Certain employees such as civil servants, artisans, farmers, seamen, domestic servants, etc are excluded from the insurance scheme. Note, however, that the three latter categories of persons may be covered by the scheme on the basis of a ministerial decision. Furthermore, persons carrying on independent business activities such as professionals, tradesmen, artisans, etc and employer’s family members employed in a family-run enterprise where no other workers are employed may request to be covered by the scheme.

I. TREATY AND NON-TREATY WITHHOLDING TAX RATES

<table>
<thead>
<tr>
<th>Dividends (%)</th>
<th>Interest (%)</th>
<th>Royalties (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-treaty countries:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporations</td>
<td>0/5</td>
<td>5</td>
</tr>
<tr>
<td>Treaty countries:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>0/5</td>
<td>10</td>
</tr>
<tr>
<td>France</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>India</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Pakistan</td>
<td>5/10</td>
<td>10</td>
</tr>
</tbody>
</table>