

Saudi Arabia:

# Proposed New Tax Law & Proposed New Zakat and Tax Procedures Law

November 2023



## In brief

A strong and unprecedented step down the way of reforming and developing the tax system and landscape has been launched by Zakat, Tax and Customs Authority "ZATCA" on Wednesday, October 25, 2023.

ZATCA has introduced a proposed almost brand new comprehensive Tax Law and Zakat & Tax Procedures Law for public consultation through Istitlaa Portal for 60 days until Monday, December 25, 2023.

The objective of the project is to develop and update the current tax law to be in line with the international best practices, considering the best practices in the pioneering G20 countries as well as the other pioneering countries.

Also, the proposed new income tax law has been introduced to be consistent with Kingdom's vision and goals of encouraging foreign investment as well as domestic economic growth, in addition to supporting tax compliance and transparency and being compatible with the direction of international cooperation organizations in order reflect the Kingdom's pioneering role in the international tax cooperation.

## In detail

The proposed new tax law may be summarized as follows:

### The proposed new tax law in a nutshell

In line with ZATCA's approach of being up to date and competent with the comparative tax regulations, ZATCA has taken the initiative to propose a new tax law according to the international best practices, the proposed new tax law includes the following key updates, among others:

- Changing the tax treatment of the partnerships.
- Transparent tax treatment of the investment funds in line with their Zakat treatment.
- Stating alternative methods of tax computation for the Micro-Enterprise (i.e., infinitesimal) taxpayers.
- Stating special provisions regarding the following:
  - Transferring the residency to and out of the Kingdom as per articles 30 and 31.
  - Re-investment reserve.
  - Tax treatment of the merger and demerger transactions.
  - Cases of non-coincident tax treatment of financial instruments between different jurisdictions.
  - Tax treatment of the taxes paid outside the Kingdom.

### Overview of the proposed new tax law

The proposed new tax law includes five main sections as follows:

- **Section 1:** General provisions.
- **Section 2:** Taxation of Legal Persons.
  - **Chapter 1:** Persons subject to tax.
  - **Chapter 2:** Taxable Income.
  - **Chapter 3:** Tax base.
  - **Chapter 4:** Special provisions.
  - **Chapter 5:** Computation of the due tax.
- **Section 3:** Taxation on the income of the non-Saudi natural persons.
- **Section 4:** Withholding tax.
- **Section 5:** Other provisions.

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ZATCA take an unprecedented step towards developing the tax environment and enhance the transparency in dealing with zakat and taxpayers on its way to achieve the objectives of the Kingdom's Vision 2030.

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## What's New?!

The Proposed New Tax Law and Zakat and Tax Procedures Law have provided new developments to the tax regime, below is a summary of the key updates:

- Introducing new definitions in the tax law, including but not limited to ( Preferential Tax Regime, Corresponding Adjustments, Hybrid Instruments...etc.)
- Unifying the WHT rate for services to be a flat 10% rate.
- Although this was always the case, the proposed new tax law clearly states that there is no tax on the natural person's income from employment.
- Reducing the statute of limitation period to 3 years instead of 5 years.
- Imposing delay penalty on delays in paying due Zakat for the first time.
- Imposing additional penalty to the delay penalty in case of amendments made by ZATCA.
- Increasing the tax and Zakat evasion penalty to ranging from 100% to 300% of the due Zakat or Tax.

## In depth

Below is a summary of a thorough look at the proposed new tax law:

- Definitions have been reintroduced to include new definitions and also to provide more elaboration and clarifications, including the following, among others:
  - Endowments, investment funds and any other form of partnerships are explicitly considered legal persons for the purpose of the new law.
  - The definition of the partnership has been broadened to include any other form of partnerships - other than those forms according to the Companies code - this is also included in the definition of the partnership as per the proposed new law.
  - Jurisdiction is defined as the territory in which a judicial or governmental body practices its authority.
  - The definition of the activity has been broadened to explicitly include any ongoing activity or **series of activities** carried out to generate profit.
  - Royalty definition has been further clarified to not include only the use or right of use, but also to include the **exploitation** of the intellectual rights.
  - **Islamic Financial instruments** definition has been newly introduced as "Any contracts, arrangements, or financial rights promoted as compliant with Shari'ah Law by issuing party".
  - **Controlled Transactions** definition has also been newly introduced as "Any transaction between the categories of persons specified in Article (7) of the Law, **including nominal transactions** and the exchange of any valuable consideration, **to the extent that such transactions have a statutory impact**".
  - **Group** definition has been newly introduced as well, it is defined as "Two or more Related Persons required to prepare consolidated financial statements by virtue of the relevant accounting standards, or will be required to prepare consolidated financial statements in case one of them is a listed company in a financial market".
  - The definition of **Preferential Tax Law** has been introduced for the first time in the income tax law as follows:"Any provision, applicable in other jurisdictions, that grant tax treatment or benefits exceeding those granted in the Kingdom, whether granted under the tax or non-tax regulations applicable in the jurisdiction, whether temporary or permanent, granted throughout the jurisdiction or in specific parts thereof, or available to all or some Taxpayers in accordance with Article (10) of the Law" . In this regard, it's worth noting that ZATCA's board in coordination with the Ministry of Foreign Affairs, will determine the list of the Jurisdictions and territories deemed to apply Preferential Tax Regimes, as this list will be reviewed at least once a year and when necessary.



- **Services** has been reproduced in the definitions' article as follows: **“Any act, other than the supply of goods, that is performed, with or without consideration”**.
- A broader definition of **Payments** has been newly introduced as follows: **“Any in-kind or cash consideration paid or payable, including settlements, offsets and book adjustments that are due and payable”**.
- A more precise definition of **Adjusted Net Profit** has been introduced as follows: “The net accounting profit for the Tax Year, less non-taxable income, plus expenses incurred for loan charges, depreciation, **donations** and gifts”.
- In addition to the above, the following new key definitions have been introduced in the proposed new law:
  - Arm's length principle.
  - Corresponding adjustment.
  - Interest.
  - Book value.
  - Fair value.
  - Net operating loss.
  - Income from debt claims.
  - Hybrid instrument.
- Any terminology that has no specific definition in the proposed new law shall be interpreted according to the following references in the following order:
  - a) The by-law.
  - b) Zakat and Tax Procedural Law.
  - c) Other tax and Zakat laws in force in the kingdom.
  - d) Other regulations in force in the Kingdom, provided that such definition or interpretation does not contradict the provisions of this Law.
  - e) International agreements.
  - f) Accounting standards adopted in the Kingdom, provided that such definition or interpretation does not contradict the provisions of this Law.
- **Taxable Persons** article clearly state that either opening bank accounts and / or investing in the stocks of the listed companies in the Saudi stock market does not qualify the person to be a taxable person.
- **Source of Income** article states that in case the non-resident taxpayer who has a Permanent Establishment “PE” in KSA carries out an activity in KSA of the same nature of the PE's activity, the profit derived from such activity should be attributable to PE **UNLESS** the non-resident taxpayer could prove that there is a sufficient economic, commercial or legal justification for not conducting such activity through his PE in KSA.
- **Source of Income** article also states that income is considered derived from a source in the Kingdom if it is derived from the sale or licensing **the use , exploitation or right to use or exploit** manufacturing or intellectual property in the Kingdom.
- Furthermore, **Source of Income** article clearly states that income derived from providing services totally or partially in KSA is considered derived from a source in Saudi. The article has clarified this further by stating that this includes **services performed remotely through technical or electronic means** that facilitate the performance of the activity or deriving the income.



- **Permanent Establishment (PE)** article has further clarified the PE definition by considering the following (among others) trigger a PE for the non-resident:
  - A place of management
  - Offices
  - Premises used as a sale outlet
  - A non-resident person is considered to have a PE in the Kingdom if such person performs services in the Kingdom if those services continue for a period or periods exceeding a total of **thirty (30)** days within any twelve (12) months period, this in case the non-resident performs the service:
    - Himself, or
    - Through his employees,
    - Affiliates,
    - **Contractors,**
    - **Or persons engaged for this purpose.**
- **PE** article also provides more emphasis on the cases according to which a PE is created for the non-resident, this includes the following:
  - A non-resident person shall not be considered to have a Permanent Establishment in the Kingdom merely because it carries on Activity in the Kingdom through a broker, general commission agent or any other agent of an independent status, provided that such person is acting in the ordinary course of its business.  
**Notwithstanding, if the business of such agent is conducted wholly or mostly on behalf of the Non-resident Person or more who is connected and commercial or financial conditions are made or imposed that differ from those generally agreed to by two independent persons, the agent is not considered an independent agent for the purpose of this paragraph.**
- Article (8) of the proposed new law provides a broadened definition and provisions regarding the **Effective Control and Persons Under Common Control**.
- **Exempt Income** article provides valuable insights regarding the exemption of the capital gains resulting from the restructuring transactions, this is as mentioned in **Article 12-Para1.(e)** which states the following: “ Income derived by a non-resident capital company from direct or indirect disposal of shares or stocks or units or any kind of Partnership in a Resident Company, **in case such disposal is made to a Resident capital company in the Kingdom from the same Group**”.
- **Deductible Expenses** article clearly state that “Real Estate transaction tax paid by the Taxpayer, which is a result of the sale of real estate that us an asset of the Taxpayer” is a deductible expense for tax purposes.
- Also non-recoverable input VAT according to the VAT Law is treated as a deductible expense for tax purposes.
- The new proposed law set the rule of **having a limit for the expenses paid in cash** to be allowed as a deductible expense for tax purposes, noting the allowed limit should be determined according to the by-law.
- **Capital Gain** is calculated as the difference between the higher of sale or fair value and the book value of the asset.
- **Depreciation** to be calculated according to the straight line method instead of double declining method as currently applicable. Depreciation rates to be determined according to the by-law.
- For the first time, the Income Tax Law provides Special Provisions for **Merger and Demerger** transactions as per Article 32, this includes but not limited to stating that Gains or Losses resulting from Merger and Demerger transactions do not constitute part of the taxable income, subject to certain conditions.
- The new law grants ZATCA's Board or the Competent Authority the right to issue a decision whereby special Tax provisions or treatments shall apply to specific Activities or specific locations in the Kingdom.



- **Tax Credit** for the foreign tax paid abroad against the due corporate income tax on the same taxable income in KSA can be provided subject to certain conditions according to the provisions of Article (40).
- **Tax Incentives For Green Investments** are introduced for the first time according to the provisions of Article (42) subject to the conditions set as per the by-law.
- **Taxable Income of Non-Saudi Resident Natural Person** is clarified according to the provisions of Article (44), which also explicitly states that income from employment (i.e., Employer and Employee relationship) is not a taxable income for the Non-Saudi Resident Natural Person, subject to the provisions stated per the by-law.
- **Withholding Tax “WHT”** Article (55) states the following among others:
  - Payments for **Services are subject to 10% withholding tax**. The article does not differentiate between the nature or type of the services, which makes all services subject to a flat withholding tax rate.
  - Capital increase through the retained earnings or profits is considered as a dividend distribution for the sake of the withholding tax.
  - The following payments are subject to **20% withholding tax** in case the beneficial owner is a Resident Person or Permanent Establishment situated in a jurisdiction where a preferential tax regime is applicable:
    - Debt claims between related companies, including bonds and Sukuk.
    - Dividends.
    - Rent.
    - Services.
    - Royalty.
  - For the sake of the WHT article, profits of non-resident generated through a permanent establishment in the Kingdom shall be deemed distributed within (120) days from the taxable year end.
    - WHT article provides a list of the payments that are not subject to WHT, which provides clarity regarding some items that used to be frequently disputed, this includes the following, among others:
      - Compensation for work performed, such as salaries, benefits, bonuses, and similar forms of remuneration paid by the employer to a natural person who works for the employer or is contractually engaged with the employer in a way similar to the relationship between an employer and employee, or works for the employer under their direction or supervision. Additionally, bonuses received by board members or directors or those in a similar capacity shall be deemed as remuneration for the sake of this article.
  - **Withholding Tax** has additional provisions in the proposed new law as per Article (51), which states the following, among others:
    - The tax shall be withheld on **the due date** of the Taxable Payments made by the withholding party **if payments are made between Related Parties**. This means that WHT on related parties' transactions is due based on the payment accrual date instead of the actual payment date as the case for non-related parties.
    - In case the tax has not been withheld, the paid amount to the non-resident beneficiary will be treated as the net amount after WHT. This means that the amount subject to withholding will be the actual paid amount in addition to the due WHT that has not been deducted, accordingly, this will increase the amount of the due WHT.

- The new law states that a Non-resident who derives income from a source in the Kingdom through disposal of assets is required to file a **Tax Return on Capital Gain**. This is a new compliance requirement compared to the current practice, according to which a notification is filed in these situations with no specific format. The application of this provision, among others, is determined according to the provisions of the Zakat and Tax Procedures Law.

### **Key provisions from the proposed Zakat and Tax Procedures Law**

The Law has provided several provisions regarding the Zakat and Tax Procedures, this includes the following key provisions among others:

- ZATCA has the right to issue an assessment on a deemed basis in case of not filing the return within the statutory period, nevertheless, ZATCA should not issue an assessment on a deemed basis before 60 days from the statutory date of filing the return, this is with an exception for the cases determined by the by-law.
- No Assessment may be carried out by ZATCA for a Zakat or Tax period **after three (3) years** from the end of the **calendar year** in which the statutory period for the submission of the return expired. This **could be extended to ten (10) years** in case of not filing the return in the legally prescribed period, committing an act of Tax evasion, or if the taxpayer agreed thereon in writing.
- Non-payment (totally or partially) of the Due **Zakat** or Tax within the legally prescribed period and unlawful refund of **Zakat** or Tax shall be punishable by the following fines:
  - A fine equivalent to **two percent (2%) of the value of Zakat or Tax unpaid or unlawfully refunded** for every month **or part thereof** which Zakat or Tax was not paid, **not exceeding (50%) of the unpaid Zakat or Tax**. The fine is calculated from the day following the expiration of the period specified by the Regulations for the payment of Due Zakat or Tax according to the **Zakat** or **Tax** Return or **Import Declaration** or from the day following the date on which the amount was refunded.
  - An additional fine equivalent to one percent (1%) of the value of unpaid Zakat or Tax for every month or part thereof, in the event that the Due Zakat or Tax is amended by ZATCA after 30 days following the date of the amendment notification.
- The penalty for committing any act of evasion or participating in it shall be a **fine ranging from (100%) to (300%)** of the due Zakat or Tax.

## Transfer Pricing

- Emphasizing the importance of Transfer Pricing in the Income Tax Law, the proposed income tax law now, for the first time, includes a specific article for Transfer Pricing (Article 9 of the draft income tax law) which aligns the law with the existing TP Bylaw. The draft tax law also includes a specific article (Article 8 of draft income tax law) that aligns the definition of effective control to the existing TP Bylaw.
- Article 9 of the draft Income Tax Law of the draft law focuses on the application of the arm's length principle in relation to related party transactions and aligns the provisions of corresponding adjustment between the TP Bylaws and the Income Tax Law.
- Article 10 of the draft Income Tax Law proposes to introduce anti avoidance procedures, specifically identifying related party transactions with preferential tax regimes, and applies special tax treatment to the transfer pricing rules on these transactions. Tax Regimes other than the Kingdom that meets any of the following criteria would fall under Preferential Tax Regimes:
  - The legally applicable income tax is less than 15%. This includes taxes federally and regionally imposed and other taxes or fees so long as they are imposed on the income.
  - There is no information exchange agreement concluded between the relevant Jurisdiction and the Kingdom.
  - Tax benefits are given by the relevant Jurisdiction to Nonresidents without being required to carry out actual economic activities in such Jurisdiction.

Hence, entities operating in the Kingdom and having cross-border related party transactions would need to identify whether their related parties operate in such Preferential Tax Regimes and conduct a risk assessment once the rules are formalized.

- Given the proposed modifications to the WHT rates (refer page 6 of this news alert), it is advisable for entities operating in the Kingdom having transactions with related parties (such as services, royalties and loans) to reassess their Transfer Pricing policies to ensure efficient structures.
- As per the PE article enumerated on page 5 of this news alert, if a foreign related party is doing business in KSA, the operations could be deemed as a dependent agent PE if the terms and pricing under such an arrangement are not done at arm's length. Thus in such a scenario, TP analysis is critical.
- Article 24 of the draft Zakat and Tax Law procedure proposes a penalty for failure to file an information disclosure statement that ranges from SAR 5,000 to SAR 50,000. The provisions which impose the new penalty regime do not preclude the proposed penalties from being applicable to transfer pricing non-compliance, including failure to file disclosure, documentation and general Transfer Pricing compliance obligations.



# The takeaway

As a new tax law is proposed, a through read and detailed analysis has to be carried out to assess the potential tax and compliance implications on the overall business environment. Therefore, Tax and Zakat payers are highly recommended to cooperate with ZATCA and provide their feedback regarding the proposed amendments through the Istitla portal:

(<https://istitlaa.ncc.gov.sa/ar/Finance/GAZT/Pages/default.aspx>) in order to support ZATCA in its positive endeavors to develop the tax environment in Saudi in line with the Kingdom's Vision 2030.

For further discussion about this and how this can impact your business, feel free to reach out to us for support

[www.pwc.com/me](http://www.pwc.com/me)

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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# Thank you

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