

## UAE-KSA double tax treaty is now in force

### Are you prepared?

#### Introduction

On 23 May 2018, the United Arab Emirates (UAE) and the Kingdom of Saudi Arabia (KSA) signed an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital Double Tax Treaty (DTT).

This agreement represents the first DTT among Gulf Cooperation Council (GCC) Members. The DTT entered into force on 1 April 2019 and it generally applies from 1 January 2020. The DTT might offer potential reduction or an exemption from the KSA domestic withholding tax (WHT) with respect to payments made from KSA to UAE.

#### Applicability of the DTT

The DTT applies to:

- Any person who, under the laws of that state, is liable to tax therein and includes that state and any political subdivision or local authority thereof;
- Taxes on income, capital and Zakat (applicable in KSA only).

#### Potential benefits under the DTT

	WHT rates under KSA domestic tax law		WHT rates under the DTT
Dividend	5%	>	5%
Interest	5%	>	0%
Royalty	15%	>	10%
Management fees	20%	>	0%*
Fees for technical services	5% / 15%**	>	0%*

\* Potentially exempt if the income is considered as "business profits" under article 7 of the DTT or as "other income" under article 22 of the DTT and provided that no Permanent Establishment (PE) has been triggered in KSA.

\*\*The WHT rates on fees for technical services vary depending on the nature of the technical service as well as whether the service provider is a related or non-related party (i.e. 15% applies on related party service providers).

#### Examples of application of the DTT

Below are practical examples of beneficial treatments under the DTT<sup>1</sup>:

UAE holding company (UAE HoldCo) grants a loan to a related party, KSA operating company (KSA OpCo); under the DTT, interest payments from KSA OpCo to UAE HoldCo should not be subject to WHT in KSA, as opposed to WHT at 5% as per the KSA domestic law.

UAE HoldCo owns intellectual property (IP) rights and grants the right to use the IP to KSA OpCo. Under the DTT, royalty payments made by KSA OpCo to UAE HoldCo should be subject to 10% WHT, instead of 15% (as per the KSA domestic law).

UAE HoldCo recharges costs to KSA OpCo for management/ technical services. This income may potentially fall under the business profits (article 7 of the DTT) or may be considered as other income (article 22 of the DTT) and, as such, no WHT should be applicable on the management/ technical service fees paid by KSA OpCo to UAE HoldCo, provided that UAE HoldCo has no PE in KSA.

UAE HoldCo, through its employees, provides consultancy services to KSA OpCo for a period of five months during one year. Under Article 5 of the DTT, the presence of UAE HoldCo employees in KSA for only five months should not create a PE. Therefore, UAE HoldCo should not be subject to corporate income tax in KSA and the service fees paid by KSA OpCo to UAE HoldCo should not be subject to WHT in KSA.

The DTT includes a "specific exemption" provision for income from investments made by persons such as central banks, government authorities and public financial institutions wholly owned by the other state or its local government (Article 27).

<sup>1</sup>These examples are provided for illustration purposes only. The practical application of the DTT benefits may vary depending on the facts and circumstances.

## Bear in mind

01

To ensure application of the DTT, the recipient of the income/capital shall also demonstrate business purpose and **Economic Substance (ES)** in the country of residency. In this regard, it is worth noting that the UAE has recently introduced the ES rules.

02

The DTT adopts the **Principle Purpose Test**, which aims to deny treaty benefits when, considering all the relevant facts and circumstances, it is reasonable to conclude that obtaining such benefits was one of the principal purposes for entering into that particular transaction or arrangement (Article 29).

03

The DTT restricts excessive **payments of interest or royalties** to related parties and provides tax authorities with rights to conduct Transfer Pricing (TP) adjustments for non-arm's length transactions/arrangements.

04

The **interpretation** of the DTT is an ongoing process, its applicability and interpretation by the relevant authorities may change and develop over time.

## We are here to help

Our team has vast experience in supporting clients with the application of treaty benefits. In particular, we can provide assistance to:

- Analyze the applicability of the UAE-KSA DTT (as well as other DTTs) to real scenarios to ensure the applicability of more favorable tax treatments and facilitate cash repatriation from foreign countries;
- Assess whether anti-abuse rules might deny the application of beneficial tax treatment to the real situation;
- Help with the interpretation of DTTs and provide insights on its applicability and interpretation by the relevant authorities;
- Review business operating structures in line with current and new legislations;
- Evaluate alternative structures for current or future investments to ensure compliance with the legislation and to benefit of the most favorable tax treatment;
- Obtain tax relief under any DTTs;
- Obtain and filing supporting documentation such as tax residency certificate, form Q7B and form Q7C; and
- Analyze the UAE Economic Substance rules impact, including entity classification, risk mitigation, compliance review and reporting support.

## Contacts

Our tax experts listed below would be happy to arrange for a one on one discussion to further elaborate on the approach, address your compliance needs and questions and explore how we can assist.

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