Income Tax

هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Guideline

on Exempt Income from Income Tax

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Note: The English version is for guidance purposes only. In case of any discrepancy between the Arabic and English versions, the Arabic version shall prevail

The Zakat, Tax and Customs Authority has issued this Guideline to clarify certain treatments related to the implementation of the statutory provisions in force on the date of its issuance. The content of this Guideline shall not be deemed an amendment to any of the laws and regulations in force in the Kingdom of Saudi Arabia.

The Authority affirms that it shall apply the explanatory treatments set out in this Guideline, where applicable, considering the relevant statutory provisions. If any clarification or content contained in this Guideline is amended in relation to an unchanged statutory provision, the updated explanatory treatment shall apply to transactions carried out after the date of publication of the updated version of the Guideline on the Authority's official website.

Amendment log

#	Edition No.	Amendment Date	Section/ Item	Amendment Type	Amendment Description	Remarks
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1. Introduction

The Zakat, Tax and Customs Authority has prepared this Guideline with the aim of providing clarifications regarding the nature of income exempt from Income Tax, in accordance with the provisions of the Income Tax Law and its Implementing Regulations, collectively referred to hereinafter as the Governing Provisions of Income Tax, in the Kingdom of Saudi Arabia.

This Guideline is based on the Governing Provisions of Income Tax and the Authority's interpretation thereof and its adopted policy. It aims to reduce ambiguity and confusion that may be encountered by any person subject to tax when seeking to identify income that may be subject to tax and income that is exempt from tax, where applicable.

The Authority is keen to cooperate with all persons; however, this does not preclude the occurrence of differences in viewpoints between the Authority and such persons. This Guideline does not affect the Authority's right to conduct audits, issue assessments, and impose penalties on persons whom the Authority considers to have violated the Governing Provisions of Income Tax.

For further information on the application of the Governing Provisions of Income Tax to a specific case, you may contact the Authority through the designated channels to request the issuance of a non-binding Interpretive Decision. The Authority shall endeavor to provide the required information regarding the application of the Governing Provisions of Income Tax to the relevant case.

2. General Provisions Related to Income Tax in the Kingdom

2.1 Income Tax

Income Tax is a direct tax imposed pursuant to the provisions of the Income Tax Law issued by Royal Decree No. (M/1) dated 15th Muharram 1425H/7th March 2004G and its amendments, on the shares of non-Saudi partners in capital companies, on non-Saudi residents who conduct a commercial activity within the Kingdom, and on non-residents who derive income from a source in the Kingdom. It also applies to persons engaged in the investment of natural gas and those engaged in the production of oil and hydrocarbons, as clarified in Section 2.2 of this Guideline.

2.2 Persons Subject to Income Tax in the Kingdom

Pursuant to Article 2 of the Law, the following persons are subject to tax:

1. **A resident capital company**, with respect to the shares owned directly or indirectly by non-Saudi persons, as well as the shares owned directly or indirectly by persons engaged in the production of oil and hydrocarbons.
   This excludes shares owned directly or indirectly by persons engaged in the production of oil and hydrocarbons in capital companies listed on the Saudi financial market, as well as shares owned directly or indirectly by such companies in capital companies. Capital companies include joint stock companies, limited liability companies, and partnerships limited by shares, and investment funds are deemed capital companies for the purposes of the Income Tax Law. Shares in such companies are subject to tax if they are owned directly or indirectly by non-Saudi persons, as well as shares owned by Saudis or non-Saudis in capital companies operating in the field of oil and hydrocarbon production, with one exception: where such company is listed on the Saudi financial market (Tadawul).

2. **A non-Saudi resident natural person** who carries out an activity in the Kingdom.
   Any resident natural person who does not hold Saudi citizenship and who derives income from a source in the Kingdom, and who carries out, in the same period, a commercial, professional, vocational, or any other activity with the intent of generating profit, shall be subject to Income Tax in accordance with the provisions of the Law.

3. **A non-resident person who carries out an activity in the Kingdom through a Permanent Establishment**.
   Any person, whether Saudi or non-Saudi, in accordance with Article 1 of the Regulations, and whether natural or legal, who is not resident in the Kingdom and who carries out a commercial activity therein through a Permanent Establishment (as further clarified in Section 2.4 of this Guideline), or who has derived income from a source in the Kingdom, shall be subject to tax.

4. **A non-resident person who derives taxable income from sources in the Kingdom without having a Permanent Establishment therein**.
   Any person shall be subject to tax if they derive specific income from a source in the Kingdom, even if they are not resident therein and do not have a Permanent Establishment in the Kingdom.

5. **A person engaged in the investment of natural gas**.

6. **A person engaged in the production of oil and hydrocarbons**.

2.3 Concept of Residency under the Income Tax Law

The concept of residency, in accordance with the provisions governing Income Tax, varies depending on the legal nature of the person to whom the provision applies. With regard to natural persons, a natural person shall be considered a Resident in the Kingdom during the relevant tax year if either of the following conditions is met:

7. The person has a permanent residence in the Kingdom, whether owned, leased, or provided by another party, provided that the person is also present in the Kingdom for a total period of not less than 30 days during the tax year, whether consecutive or non-consecutive.
8. The person resides in the Kingdom for a period of not less than 183 days during the relevant tax year, whether consecutive or non-consecutive, even if the person does not have a permanent residence.

"Permanent residence" refers to a dwelling owned by a natural person, or leased under rental contracts during the tax year for a total period of not less than one year, or a residence provided to a natural person by any other party during the tax year for a period of not less than one year. The nationality of the person shall not be taken into account in determining the place of residence. A person, whether natural or legal, shall be considered non-resident in the Kingdom if the residency conditions specified in the provisions governing Income Tax are not met.

For this purpose, residency for part of a day shall be counted as residency for a full day. Transit stays, regardless of their duration, shall not be counted as residency if they constitute mere passage between two points outside the Kingdom.

With regard to legal entities, a company shall be considered a Resident in the Kingdom during the relevant tax year if either of the following conditions is met:

9. It is established in accordance with the Saudi Companies Law, such that it is incorporated, registered, its Articles of Association are documented, and its activities are conducted in accordance with its provisions.
10. Its Place of Effective Management is located in the Kingdom, even if it is incorporated outside the Kingdom. The Place of Effective Management means the place where senior policies are primarily formulated and where key administrative and commercial decisions necessary for conducting the company's business are made. The Place of Effective Management shall be deemed to be in the Kingdom where at least 2 of the following 3 conditions are met[1]:

    a. Regular meetings of the Board of Directors are held in the Kingdom, during which key decisions related to the management and operation of the company are made.

    b. Senior executive decisions, such as decisions of the Chief Executive Officer and their deputies, are taken in the Kingdom.

    c. The majority of the company's activities generate the majority of its revenues therein.

If a capital company, as defined in the preceding paragraph, becomes resident in the Kingdom, it shall be subject to all statutory provisions and requirements applicable to all resident capital companies and shall be required to file its annual income tax returns for income earned from its operations and the operations of its branches inside and outside the Kingdom.

2.4 Permanent Establishment in accordance with the Income Tax Law

As a general rule, a Permanent Establishment in accordance with the Income Tax Law, of a non-resident in the Kingdom, consists of a fixed place of business through which the non-resident carries out its activity, wholly or partially. This includes activities carried out by a non-resident through an agent.

(1) These conditions serve to clarify the concept of the Place of Effective Management, noting that it is a broad concept pursuant to Minister of Finance Decision No. (2194) dated 12th Rajab 1432H/14th June 2011G.

The Law enumerates a number of places that constitute a Permanent Establishment, including[2]:

1. Construction sites, assembly facilities, and supervisory activities related thereto.
2. Installations and sites used in surveying natural resources, drilling equipment, vessels used in surveying natural resources, and supervisory activities related thereto.
3. A fixed base through which a non-resident natural person carries out their activity.
4. A branch of a non-resident company licensed to conduct business in the Kingdom.

The term "agent" referred to above means a dependent agent who has any of the following powers:

- To negotiate on behalf of the non-resident.
- To conclude contracts on behalf of the non-resident.
- To maintain a stock of goods in the Kingdom owned by the non-resident and regularly use it to fulfill customer orders on behalf of the non-resident.

In addition, the place where a non-resident carries out insurance and/or reinsurance activities through an agent shall be considered a Permanent Establishment of the non-resident, even if the agent is not authorized to negotiate or conclude contracts on behalf of the non-resident.

The Law also exempts certain places from the concept of a Permanent Establishment, such that a place shall not be considered a Permanent Establishment of a non-resident in the Kingdom if it is used solely for the following purposes:

1. Storage, display, or delivery of goods or products belonging to the non-resident.
2. Maintenance of a stock of goods or products belonging to the non-resident for the purpose of processing by another person.

(2) This enumeration, and the counting of places that do not fall within the scope of a Permanent Establishment, is set out in Article 4 of the Law.

3. Purchasing goods or products, or collecting information, for the non-resident only.
4. Carrying out other activities of a preparatory or auxiliary nature for the benefit of the non-resident.
5. Preparing contracts for signature relating to loans, supply of goods, or technical services.
6. Carrying out any combination of the activities referred to above.

The Law further provides that a non-resident partner in a resident partnership shall be deemed to own a Permanent Establishment in the Kingdom in the form of an interest in the partnership.

3. Exempt Income from Income Tax in the Kingdom

Under the Income Tax Law in the Kingdom, the income subject to tax is determined in accordance with the provisions of Article 8, Paragraph 1 of the Law. Tax exemption is one of the most significant advantages available to the taxpayer under the Income Tax Law in the Kingdom, in accordance with the exemptions set out in Article 10 of the Law and Article 7 of the Regulations. These exemptions are intended to encourage investment and trading in the Saudi financial market. Accordingly, income shall be exempt from Income Tax if it falls under any of the following categories:

1. Capital Gains Realized from the Disposal of Securities

Capital gains mean gains realized as a result of the disposal of certain assets of the establishment, including assets or securities, or the disposal of ownership interests by the partners. However, the exemption under the Law applies only to capital gains realized from the disposal of securities traded on the financial market in the Kingdom, whether through sale, trading, or similar transactions, and is subject to a number of conditions. Capital gains shall be exempt provided that all of the following conditions are met:

a. The gains are realized from the disposal of securities that are:

- Traded on the Saudi financial market; or
- Traded on a foreign financial market, provided that such securities are also traded on the Saudi financial market.

b. The investments disposed of were not held prior to the effective date of the Income Tax Law and its Implementing Regulations[3], which entered into force on 13th Jumada Al-Akhirah 1425H/30th July 2004G[4].

This exemption applies provided that the disposal is carried out in accordance with the Capital Market Law and its Implementing Regulations, where the security is traded in the Kingdom, or in a foreign financial market where the security is also traded on the Saudi financial market.

2. Gains Resulting from the Disposal of Properties Other Than Business Assets

Any gain realized from the disposal of any property owned by the taxpayer shall be exempt from Income Tax, provided that such property does not constitute part of the business assets used in carrying out the taxpayer's activity. Where the disposed properties form part of the business assets that are, by their nature, essential for carrying out the taxpayer's main activity, such gains shall not be exempt from tax.

3. Cash or In-Kind Distributions Due from Investments of a Resident Capital Company in Other Companies

Companies may, upon realizing profits, distribute such profits to their shareholders pursuant to a resolution of the Board of Directors. Such distribution whether cash or in kind shall be exempt from Income Tax under the Law if they arise from the investment of a resident capital company[5] in other companies, whether resident or non-resident.

(3) The effective date of the Law and its Implementing Regulations has been determined in accordance with Article 74 of the Regulations.
(4) The Implementing Regulations added an additional condition for the applicability of the exemption, namely the date of the investment's inception, in accordance with Article 7 of the Regulations.
(5) The concept of residency is clarified in Section 2.3 of this Guideline.

For this exemption to apply, the following 2 conditions must be met:

a. The ownership interest of the resident capital company (the exempt taxpayer) in the capital of the investee company must not be less than 10%.

b. The minimum ownership percentage referred to above must have been held for a period of not less than 1 year.

Cash distributions, as well as in-kind distributions (such as stock or free share distributions, for example), arising from investments of a resident capital company in other resident or non-resident companies shall be exempt from tax, provided that the following conditions are met:

a. The resident capital company's investment in the share capital of the investee company is 10% or more during the years for which the distribution is made.

b. The ownership of these investments, at a minimum of 10%, is maintained for one year or more during the year in which the distribution is made.

4. Practical Examples

Below are illustrative practical examples of income exempt from Income Tax in accordance with Article 10 of the Law:

Example 1

An individual (Teaglis), a Spanish national interested in trading in the Saudi financial market, sold shares that he had subscribed to in 2009 in Al-Tamayuz Company, a Saudi company listed on the Saudi securities market, to another investor in accordance with the Capital Market Law. He realized capital gains amounting to SAR 30,000. Accordingly, he is entitled to receive the full amount without being subject to Income Tax, as such gains are exempt pursuant to the Law.

Example 2

Target Company, an Australian company with a Permanent Establishment in the Kingdom whose main activity is trading in electrical appliances, disposed of a private vehicle used by the company's General Manager. The vehicle had previously been purchased through a personal loan from the company, with ownership retained by the company. The company realized gains amounting to SAR 30,000. If the company included this amount in its revenues, it may deduct it from the taxable income reported in its tax return, considering them exempt income on the basis that the disposal related to properties not included among the business assets.

Example 3

Al-Khubara Company, a resident capital company in the Kingdom, acquired a 15% ownership interest in the first quarter of 2019 in Suits Company, a resident company. In the second quarter of 2021, Suits Company distributed profits in the form of cash dividends to its shareholders, of which Al-Khubara Company's share amounted to SAR 15,000. If the company included this amount in its revenues, it may deduct it from the taxable income reported in its tax return, considering it exempt income pursuant to the Law, as the conditions set out in Paragraph (c) of Article 10 of the Law were met.



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