



الهيئة العامة للزكاة والدخل
General Authority of Zakat & Tax

Income tax on capital gains from restructuring events

Circular Number [2005003] issued on 31 May 2020

TAX CIRCULAR



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Subject matter of this Circular

- It is not uncommon for the management or owners of a business to reorganize the legal structure of the legal entity or group of entities for financing, operational or other reasons. A reorganization or restructuring event may involve the transfer of ownership in shares or assets from one entity to another. In such an event, the transfers of property or shares often realize a gain on the value of the capital asset transferred as part of the restructuring.

Through this Circular, GAZT addresses taxation of capital gains arising from restructuring events in the Kingdom of Saudi Arabia ("the Kingdom" or "KSA"), and seeks to provide clarification as to the following points:

- 1 Taxation of capital gains arising out of the disposal of shares or assets by a resident
- 2 Taxation of capital gains arising out of the disposal of shares by a non-resident.
- 3 Taxation of capital gains arising out of the indirect disposal of shares by a non-resident.



1. Taxation of Capital Gains Arising Out of the Disposal of Shares or Assets by a Resident Taxpayer

1.1 Disposal of Shares And Assets: A resident taxpayer is subject to tax on all gains from its activities, including capital gains¹. This includes gains arising from:

- The disposal of an immovable property or disposal of a share in such immovable property
- The disposal of shares, stocks or partnership in a resident Saudi company
- The disposal of operating assets. However, gains resulting from non-operating assets (i.e. assets other than those used in the activity) are exempt from tax on capital gains².

Capital gains realized from the disposal of shares traded on the Saudi stock market as well as on a stock market outside the Kingdom are exempt from tax, subject to the restrictions below³.



- For the disposal of shares traded on the Saudi stock exchange, the disposal must be done in compliance with the Capital Market Law in the Kingdom.
- For the disposal of shares traded on a foreign stock exchange, for the exemption to apply the shares must also be traded on the Saudi Stock Exchange.
- In all cases, the shares disposed of were not part of an investment existing before July 30, 2004 (the date of enforcement of the Income Tax Law).

Capital gains realized by a non-Saudi shareholder from the sale of founders shares and the sale of shares through a privately negotiated transaction⁴ pursuant to the Capital Market Authority law and implementing regulations are eligible for the exemption if the investment in the shares -the disposal of which resulted in the capital gain- was not undertaken prior to July 30, 2004.



1.1.1 The Article 10 Exemption: Stock Dividend and Stock Splits

In some cases, persons have long-term holdings in shares in a publicly listed company and such shareholding increases over the years through stock dividend or stock splits. Where a shareholder makes an initial acquisition of shares prior to July 30, 2004 but their shareholding increases due to receiving stock dividend after July 30, 2004, the income derived from the portion of the shares acquired prior to July 30, 2004 is not eligible for Article 10 relief from tax on capital gains. However, income derived from the portion of the shares received after July 30, 2004 as dividend (stock dividend) is eligible for the Article 10 exemption provided all other conditions are satisfied.

In the case of split shares, the date on which the share is split does not affect the date of its acquisition for purposes of determining eligibility for an exemption under Article 10. Thus, if shares are acquired prior to July 30, 2004 and such shares are split after July 30, 2004, capital gains on the disposal of such shares will not be eligible for an Article 10 exemption.



1.2 Gains Arising from a Merger

Generally, the absorption of one company into another through a merger will not always constitute a disposal for purposes of capital gains. There is not any explicit merger provision in the Income Tax Law. However, the standard provisions of the Income Tax Law refer to a 'disposal' of shares and assets, but a merger will not necessarily always amount to a disposal for purposes of tax on capital gains.

In some mergers, the target entity's obligations and rights survive and continue after the merger. In such cases, the restructuring event may more precisely be described as a consolidation of the target with another entity (for purposes of this circular, we will refer to the post-merger or consolidation entity as "the Surviving Entity"). Generally, in order for there to be a taxable event, there must be taxable income generated or a gain realized from the shares transferred from the target to the acquiror.



However, where there is an exchange of shares of the target entity for shares in the Surviving Entity, it is likely that the rights and liabilities associated with the shareholding itself continue on after the merger in spite of the change to the shares themselves. However, where no actual income is generated as a result of the merger, no tax consequences arise from the exchange of shares. In such a case, capital gains will be due upon any subsequent disposal of the shares by the original shareholders of the target entity of their shares in the Surviving Entity post-merger.

Alternatively, some mergers may involve the disposal of assets and shares. In such cases, the disposal underlying the merger will be deemed a taxable event triggering capital gains tax, unless the internal corporate restructuring facility for transfers between group companies applies.

1.3 Internal Corporate Restructuring

In certain cases, intragroup transfers of shares, financial securities, tangible and intangible assets between does not trigger capital gains tax provided the following conditions are met⁵:



- The Companies are wholly owned directly or indirectly within group;
- The companies transfer occurs between companies residing in the Kingdom; and
- Transferred assets are owned within group for two years from the date of transfer.

Where the conditions are satisfied, any gains resulting from a transfer which is conducted for internal reorganization purposes only, should not be subject to capital gains tax. For purposes of this provision, a group is regarded as any group of juridical persons (legal entities) deemed to be Related Persons as defined in the Transfer Pricing By-Laws⁶.

In instances where the group is a multinational group, restructuring could occur within entities that reside outside KSA. Where the restructuring occurs amongst group entities residing outside KSA and there is no change in the ownership of the KSA members of the group, capital gains tax is not triggered in KSA. However, where a restructuring results in the change of the direct owners of a KSA resident entity as it appears in the resident company's CR, articles of association and/or its foreign investment license, capital gains tax is triggered and becomes due upon the transfer of ownership of the shares. This is true regardless of



whether or not the ultimate owners of the resident entity remain the same. Capital gains on indirect disposal is discussed further in sub-paragraph 1.5.1.

1.4 Capital Gains Arising on the Disposal of Shares by a Non-Resident

A non-resident who directly derives income or capital gains from a source in the Kingdom is subject to tax in accordance with the standard rules⁷. However in practice, this tax is currently reported and collected via the Saudi resident company of which the non-resident is a shareholder or owner.

Non-residents are taxed in the same way as residents in respect of capital gains. Tax due on capital gains by a non-resident should be paid by the KSA capital company on behalf of the non-resident shareholder. The KSA capital company must report the gains derived by its non-resident shareholder as part of its taxable income. A non-resident should also report any capital gains associated with the activity of a permanent establishment in the Kingdom. A Gulf Cooperation Council ("GCC") State company which is not a resident of the Kingdom is treated as a "foreign" entity for capital gains tax purposes. Therefore, capital gains realized by a Gulf company (a non-Saudi resident) from disposal of its share or part of it in a Saudi resident capital company are subject to tax in the Kingdom.



1.5 Capital Gains Arising on the Indirect Disposal of Shares by a Non-Resident

- 1.5.1 Indirect disposal of shares: Generally, the provisions of the Income Tax Law are applied on resident capital companies in respect of the shares which are directly or indirectly owned by non-Saudis and non-GCC citizens. In this respect, indirect ownership is defined as ownership up to the second level. The disposal by a non-resident shareholder of their shares in another non-resident company that holds shares in a Saudi-resident entity is commonly referred to as **an indirect disposal**. An indirect disposal may result in a capital gain the value of which is wholly or partly related to the Saudi-resident entity. The Income Tax law contains no specific provisions detailing capital gains tax on the indirect disposal of shares. However, GAZT considers that such indirect disposal would not trigger capital gains tax if the indirect disposal does not impact the direct ownership of the resident entity (that is, if the disposal of shares does not result in amendments of the commercial registration, foreign investment license and/or Articles of Association of the Saudi-resident entity)

¹Refer to Article 8, Taxable Income, Income Tax Law

²Refer to Article 10(b), Tax-Exempt Income, Income Tax Law

³Refer to Article 10(b), Tax-Exempt Income, Income Tax Law and Article 7, Exempt Income, Executive Regulations

Glossary of Defined Terms Used In the Regulations and Rules Of The Capital Market Authority, issued by the Board of the Capital Market Authority Pursuant to its Resolution Number 4-11-2004 Dated 20/8/1425H Corresponding to 4/10/2004G.

⁴Refer to Article 9(m), Gains or Losses Resulting from Disposal of Assets, Income Tax Law

⁵By-laws issued pursuant to the Ministerial Board Resolution No. [6-1-19] dated 25/05/1440H corresponding to 31/01/2019. Also see, definition of "Group", Transfer Pricing Guideline, second ed.

⁷Refer to Article 1(2)(b), Executive Regulations