هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Circular

Taxation of Permanent Establishments in the context of Double Taxation Agreements

Publication Number 2303001 issued on May 17-2023

The Zakat, Tax and Customs Authority ("ZATCA", "Authority") has issued this Circular for the purpose of clarifying certain tax treatments concerning the implementation of the statutory provisions in force as of the Circular's issue date. The content of this Circular shall not be considered as an amendment to any of the provisions of the Laws and Regulations applicable in the Kingdom.

Furthermore, the Authority would like to highlight that the clarifications and indicative tax treatments prescribed in this Circular, where applicable, shall be implemented by the Authority in light of the relevant statutory texts. Where any clarification, interpretation or content provided in this Guide is modified - in relation to unchanged statutory text - the updated indicative tax treatment shall then be applicable prospectively, in respect of transactions made after the publication date of the updated version of the Circular on the Authority's website.

1. Introduction

1.1. This circular serves to provide information and guidance regarding the Permanent Establishment ("PE") relating to the performance of services determination and tax implications in the Kingdom of Saudi Arabia ("KSA" or "the Kingdom") according to the Double Taxation Agreements ("DTA") signed with foreign jurisdictions.

1.2. For the purposes of this circular, the tax treatment is based on the provisions of DTAs. References to the KSA Law are however made to clarify the domestic treatment in case a PE is deemed to be triggered. The term Law refers together to the Income Tax Law issued by Royal Decree No. (M/1) dated 15/1/1425H, and its related amendments as well as its regulations issued by Ministerial Decision No. (1535) dated 11/6/1425H and its related amendments.

1.3. PE has the meaning given under Article 5 ("PE") of the DTAs, and the main use of the concept of a PE in the DTAs is to determine the right of a contracting state to tax the profits of an enterprise resident of the other contracting state, in which it should not be taxable unless it has a PE through which it conducts business. The income derived from this activity should only be taxed to the extent that it is "attributable" to the PE.

1.4. Whilst the Circular provides guidance on the determination of the existence of a PE based on DTAs provisions, it does not aim to clarify the mechanism for attributing income that is taxable in the relevant contracting state[1].

1. For more details in that respect, we invite you to refer to the Circular Number 2104001 issued by ZATCA in April 2021 on the Force of Attraction rule in the context of PE.

2. Situational Context

2.1. In the context of cross border transactions where a non-resident is performing activities in KSA or for the benefit of a KSA customer, it is important to determine whether such activities constitute a PE for the non-resident which will be taxable in KSA.

2.2. The concept of PE is found in Article 5 of the United Nations Model Convention ("UN MTC") and the Organization for Economic Co-operation and Development Model Tax Convention ("OECD MTC"). Although there may be differences between both models, the concept remains the same. The DTAs signed by the Kingdom are following the main concept of both models, with some being largely inspired by the OECD MTC and other incorporating provisions from both the OECD and the UN MTCs.

2.3. The Article 5 of DTAs recognizes several types of PE, such as the Fixed Place of Business, the Agency PE, the project PE (construction sites), the Service PE.

2.3.1. The Fixed Place of Business is identified in paragraph 1 of both models where the term permanent establishment means "a fixed place of business through which the business of an enterprise is wholly or partly carried on". Both UN and OECD MTCs use the same wording, and this paragraph highlights the importance of satisfying certain conditions in order to have a PE in a contracting state, which are as follows:

- Having a "place of business", which covers premises, facilities or installations used for carrying on the business of the enterprise. It also covers cases where there are no premises available for carrying on the business, but simply a certain amount of space at its disposal.
- Having a "fixed" place, which has a degree of permanency at a certain geographical location.
- Carrying out the business activities on a regular basis.
- The place has to be at the disposal of the enterprise.

2.3.2. The Agency PE concept is defined in paragraphs 5 and 6 of the same article, in which a PE is deemed to exist when an agent, acting on behalf of a foreign enterprise, habitually exercises authority to conclude contracts or habitually plays the principal role leading to the conclusion of contracts, unless the agent is an independent agent (legally and economically independent from its principal) acting in the ordinary course of its business. And these contracts need to be:

- In the name of the enterprise, or
- For the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
- For the provision of services by that enterprise

2.3.3. The concept of the project PE is mentioned in Article 5, paragraph 3 of the OECD MTC, and in Paragraph 3 (a) of the UN MTC with some differences, the paragraph states that a building site or construction or installation project (the UN MTC added assembly and supervisory activities) constitutes a permanent establishment only if it lasts more than twelve months (the UN MTC reduces the minimum duration to six months). In special cases this six - month period could be reduced in negotiations between contracting states.

2.3.4. The Service PE concept, which was introduced more recently in paragraph 3 (b) of Article 5 to the UN MTC, is found in 54[2] DTAs out of the 57 DTAs that KSA has signed. The paragraph deals with the furnishing of services, including consultancy services, the performance of which does not, of itself, create a PE under the OECD MTC. The principal objective for the introduction of this paragraph under the UN MTC was to ensure that such services, which in many cases generate large profits, are taxable within the contracting state.

2. Countries which have a DTA with KSA and have paragraph 3(b) under Article 5 are: Albania, Algeria, Austria, Azerbaijan, Bangladesh, Belarus, Bulgaria, China, Cyprus, Czech Republic, Egypt, Gabon, Georgia, Greece, Hong Kong, Hungary, India, Ireland, Italy, Japan, Jordan, Kazakhstan, Korea, Kosovo, Kyrgyzstan, Latvia, Luxemburg, Macedonia, Malaysia, Malta, Mexico, Morocco, Netherlands, Pakistan, Poland, Portugal, Romania, Russia, Singapore, South Africa, Sweden, Switzerland, Syria, Tajikistan, Tunisia, Turkmenistan, Turkey, Ukraine, United Arab Emirates, United Kingdom, Uzbekistan, Venezuela, and Vietnam.

2.4. This Circular focuses on the concept of Service PE and does not encompass the other types of PEs. The Circular aims at providing clarity on the interpretation of Article 5. 3 (b) in DTAs with different contracting states. Specifically, it addresses:

2.4.1. The activities and business model that do or do not result in the creation of a PE under this Article.

2.4.2. The taxation mechanism applicable in KSA where in instances a PE is deemed to exist.

3. Key concepts relating to the existence of a Service PE.

3.1. Instances where a Service PE is created

3.1.1. Technical interpretation

3.1.1.1. In accordance with Article 5.3 (b), a Service PE would be deemed to exist when a non-resident enterprise provides services to a customer in KSA.

3.1.1.2. The exact provision under Article 5. 3 (b) may vary between DTAs, however in most of the DTAs signed with KSA, the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise is deemed to constitute a PE to the extent that the activities are conducted (for the same or a connected project) within a contracting state for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.

3.1.1.3. The paragraph highlights three main tests to determine whether a Service PE is deemed to exist:

- "Furnishing of services", which means that the enterprise must be providing services through its employees;

- "Within, which means that the employees must be physically present on the ground in KSA;
- "More than 183 days in any 12-month period", which means that being physically present in the country for a certain period of time to perform the services is primordial to determine whether or not the non-resident entity is deemed to create a PE in KSA.

Please note that most of KSA's DTAs that have Article 5.3 (b), the threshold stipulated in the DTA is more than 182 days/ 183 days/ 6 months in any 12-month period, according to the respective DTA

3.1.1.4. Under the DTAs, only the profits directly attributable to the PE may be taxed in KSA provided that the relevant DTA does not contain a provision extending the scope of taxation under the Force of Attraction concept[3]. Profits directly attributable to the PE encompasses the income derived from the sole activity of the PE in KSA.

3.1.2. Tax treatment in the Kingdom

3.1.2.1. If a PE is created in KSA, the non-resident is deemed to be subject to tax according to the DTAs and under the terms of the Law.

3.1.2.2. In accordance with the Law, the PE shall be subject to income tax on a net basis measured by the gross income and reduced by the expenses attributable to the PE, provided that they are incurred for the purposes of conducting business through the PE.

3.1.3. Examples of application

3.1.3.1. Practical examples are set out below to illustrate the determination of a Service PE.

3. For more details in that respect, we invite you to refer to the Circular Number 2104001 issued by ZATCA in April 2021 on the Force of Attraction rule in the context of PE.

Example 1:

An employee of a Dutch consulting company resident in the Netherlands is providing financial services to a KSA resident company. The employee is required to travel to KSA and perform such services in the premises of the KSA resident company for an extensive period - more than 200 days in a fiscal year. As such, the employee is interacting with the finance department during his time in KSA and the employee along with the finance team are holding meetings with the CEO and CFO in the office to address all the business needs.

Based on the DTA between the Netherlands and KSA, the Dutch company is deemed to have a PE in KSA, under Article 5 paragraph 3b, due to the physical presence of the employee for a period exceeding the DTA threshold. The income derived from the service activity is directly attributable to the PE and therefore brought within the scope of income tax in KSA. According to the provisions of the DTA, the income of the Dutch company that is not attributable to the PE is not subject to income tax in KSA.

Example 2:

A British resident training company is providing training services regarding business development, finance, marketing, and sales to a KSA resident related company. The services are provided under a contract that is valid for one year. The employees of the British company providing such services are required to facilitate the trainings online as well as physically in KSA. The physical training sessions are held at the premises of the KSA resident customer. The employees of the British company supplying the services are required to travel and stay an average of 17 days every month (c. 204 days in total) in KSA to prepare for and conduct the trainings. The British company is charging back the costs incurred by its employees to the KSA Company.

Based on the DTA between the United Kingdom and KSA, the British company is deemed to have a PE in KSA on the basis that the duration of the physical presence of its employees for the purpose of rendering the services exceeds the threshold set under the DTA. The income derived from conducting such services shall be directly attributable to the PE and therefore brought within the scope of income tax in KSA. According to the provisions of the DTA, the income of the British company that is not attributable to the PE is not subject to income tax in KSA.

3.2. Instance where a Service PE not created?

3.2.1. Technical interpretation

3.2.1.1. In accordance with Article 7 ("Business Profits") of the DTAs, the profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a PE situated therein.

3.2.1.2. As such, where a Service PE is not triggered, the profits of the non-resident enterprise should be taxable only in the residence state based on its domestic law.

3.2.1.3. The Article 7 of DTAs applies to all types of income from conducting business that are not covered by other articles of the DTAs with KSA. Those types of income generally include service fees, which do not trigger a PE and are not included in the other articles as stated above.

3.2.2. Tax treatment in the Kingdom

3.2.2.1. In instances where a PE is not established, the income generated by the non-resident in respect of activities performed for the benefit of a KSA resident would not fall within the scope of income tax in KSA. In certain cases, it may fall within the scope of withholding tax ("WHT")[4]. In such cases, WHT will be imposed on the gross payment and not on the net profit (as with income tax).

4. For more details with respect to the application of WHT in the Kingdom, we invite you to refer to the WHT Guideline issued by ZATCA on 6 July 2021 "Guideline to the application of the withholding tax provisions of the Income Tax Law" and the "Compiled Resolutions and Circulars regarding withholding tax" issued by ZATCA on 18 February 2021.

3.2.2.2. For example, a special treatment for technical services, outside of Article 7 on Business Profits, is applicable in some DTAs with KSA where payments for technical services are classified as royalty payments under Article 12 ("Royalty").

3.2.2.3. A limited number of DTAs treat technical services under Article 12 ("Royalty"); those DTAs are concluded with Egypt, Ethiopia, Gabon, Georgia, Malaysia, Morocco, and Vietnam. In such cases, the income generated from the provision of technical services should be treated under the Royalty Article. WHT should therefore be applied on the gross amount paid to the non-resident enterprise. In such a case, the DTAs usually offer a reduced rate than the one applicable under the domestic law.

3.2.3. Examples of application

3.2.3.1. Practical examples are set out to illustrate instances where a Service PE is not deemed to exist.

Example 3:

A Vietnamese resident company has signed a contract with a KSA company to provide technical services. The employees of the Vietnamese resident company are based and residing in Vietnam, where they attend several online meetings to provide the employees residing in KSA with these services. The service contract is valid for a period of 12 months and does not require the employees to be present in KSA to conduct such services.

Based on the DTA between Vietnam and KSA, the services of a technical nature do not trigger a PE in KSA as based on Article 5 paragraph 3 (b), as it is required to have the employees performing such services on the ground in KSA. Since the employees are rendering such services remotely, the Vietnamese company is not deemed to have a PE in KSA. In such a case, the income generated from the technical services are included in the definition of royalties under the DTA and should be subject to a WHT on a gross basis as specified in the DTA - to the extent that the income classify as income from a source in KSA subject to WHT.

Example 4:

An Egyptian resident management consultancy company in Egypt is providing consultancy services to a KSA resident company for a period of 8 months. Under the service contract, the employees of the Egyptian company are required to work from the premises of the KSA resident company for a period of 4 months, during which they will hold meetings with the management to collect data and information in order to prepare and deliver their final reports.

Based on the DTA between Egypt and KSA, the provision of paragraph 3 (b) of Article 5, related to the furnishing of services, in order to create a PE. It is required to have the employees performing such services on the ground in KSA for a period or periods aggregating more than six months. Since the employees are rendering such services in KSA for only 4 months, the Egyptian company is not deemed to have a PE in KSA. In such a case, the income derived from conducting such services is not subject to income tax in KSA.

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