



MERGERS AND ACQUISITIONS

Saudi Arabia

Taxation of Cross-Border
Mergers and Acquisitions

2010 Edition

TAX

Saudi Arabia

Introduction

Saudi Arabia's economic reforms have allowed the economy to grow rapidly in recent years. Saudi Arabia has implemented various programs to improve the business environment, provide comprehensive service to investors, and foster investment opportunities in key sectors of the economy. This has attracted foreign investment into the country and encouraged mergers and acquisitions (M&A).

Although the Saudi Arabian tax regulations do not address taxation of cross-border M&A directly, the Saudi Companies Act has an impact on such transactions and the Saudi Capital Market Authority has issued Mergers and Acquisitions Regulations, which set the rules and provide some guidance relating to Saudi-listed companies,

Recent Developments

Saudi Arabia has established a bond market for debt securities in Saudi Arabia.

Asset Purchase or Share Purchase

Saudi Arabia's foreign investment regulations permit foreign ownership of capital and shares in a Saudi company, provided a foreign capital investment license is obtained.

The Saudi Companies Act provides for mergers in which:

- The companies involved are liquidated and their assets and liabilities are contributed to a newly incorporated company. The shareholders of the liquidated companies receive shares in the new company in exchange for their shares in the liquidated companies.
- One or more companies are absorbed by an existing company. The shareholders of the absorbed companies receive new shares in the absorbing company.

Acquisitions can also take place by buying shares in a company subject to foreign investment regulations.

Purchase of Assets

Purchase Price

The cost base of an asset purchased, produced, manufactured, or constructed by the taxpayer is the amount paid or incurred by the taxpayer in-cash or in-kind in respect of the acquisition of the asset.

Goodwill

Goodwill paid on acquisition of shares in a company would be considered to be a cost of investment, and a deduction would be allowed for this on disposal. The purchaser may pay for the goodwill of a business as a going concern. The goodwill is tax-deductible and can be amortized over a maximum period of 20 years for accounting purposes and at a rate of 10 percent for tax purposes.

Depreciation

No gain or loss is taken into account on disposal of an asset that is depreciable under the Saudi tax law. The result of disposal of such assets is dealt with under the depreciation method stipulated by the law.

Tax Attributes

Tax in Saudi Arabia consists primarily of corporate income tax, withholding tax, and Zakat. In the case of local companies, corporate income tax is assessed on the share of the profit of the foreign partner in the local company. Generally, the maximum corporate income tax rate is 20 percent.

Zakat is a religious levy on Saudi and Gulf Cooperation Council (GCC) nationals and companies that are wholly-owned by Saudi or GCC nationals. The Zakat rate is 2.5 percent of the higher of the Saudi/GCC share of Zakat base, or the Saudi/GCC share of profit.

Although there are no specific rules in the corporate income tax and Zakat regulations that address M&A, it should be noted that any capital gains arising as a result of a sale or transfer of assets (including the entire business) would be treated as normal business income and taxed at the normal corporate income tax rates.

Value-Added Tax (VAT)

No transfer tax, value-added tax (VAT), or any other indirect tax is imposed on M&A transactions.

Transfer Taxes

There is no stamp duty on the acquisition of shares or assets.

Purchase of Shares

In a purchase of shares the purchase price will be the cost base for the purposes of determining the capital gains tax payable on a subsequent sale.

Tax Losses

Losses can be carried forward without any time limit in the hands of the entity that has incurred the loss. However, the allowable deductible accumulated losses in any taxable year should not exceed 25 percent of the profit made in that year. The balance of accumulated losses would have to be carried forward to the following year, to be offset against any taxable income made in that year.

An acquisition of shares in a company, therefore, would not result in the acquired company losing the potential benefit of carrying forward losses.

However, where there is change of 50 percent or more in the underlying ownership or control of a company, no deduction for losses carried forward is allowed for the non-Saudi shareholder in the taxable years following the change.

Pre-Sale Dividend

In certain circumstance, the seller may prefer to realize part of the value of his/her investment as income by means of a pre-sale dividend. Such a dividend may be subject to 5-percent withholding tax (WHT), but would reduce the proceeds of the sale and consequently the gain on sale, which may be subject to 20 percent capital gains tax.

Transfer Taxes

Saudi Arabia does not impose stamp duty tax.

Choice of Acquisition Vehicle

The following information is relevant when considering a merger or acquisition in Saudi Arabia.

In Saudi Arabia, foreign investors are not permitted to operate or acquire businesses without first obtaining an investment license from the Saudi General Investment Authority (SAGIA). Foreign investors with a license from

SAGIA may directly acquire a Saudi operating company. However, the Saudi Arabian foreign investment regulations impose some restrictions on available areas of investment, which is known as the negative list. The following forms of business entity can be used in Saudi Arabia:

- Companies with variable capital
- Co-operative companies
- Corporations
- General partnerships
- Joint ventures
- Limited liability companies
- Limited partnerships
- Partnerships limited by shares

Foreigners generally conduct business through either a limited liability company or a branch.

Local Holding Company

According to the draft new Saudi Companies regulations, a joint stock company or a limited liability company may be a holding company whose main purpose is to participate in joint stock companies or limited liability companies that are associated with it with a percentage shareholding enabling it to dominate and control them and provide support and assistance to them. Its name shall be coupled in addition to the company type with the word holding.

Foreign Parent Company

An investor may operate in Saudi Arabia by setting up a limited liability company (LLC). The LLC is required to have at least two shareholders, who could be legal or natural persons. Under the current Foreign Capital Investment Law in Saudi Arabia, an LLC can be established with 100-percent foreign ownership, with a required minimum invested capital of SAR 500,000, a license from SAGIA, and a Commercial Registration Certificate from the Ministry of Commerce (MOC). In addition the LLC must transfer 10 percent of the net profit each year to a statutory reserve until this amount is equal to 50 percent of the capital of the LLC. The entity will also be required to withhold tax on dividends as well as other payments to the non-resident foreign partner, depending on the nature of payment.

In addition, the entity would be subject to corporate tax of 20 percent on its taxable profits. Actual expenses

incurred specifically and necessarily for generating gross income are allowed as deductible expenses, as long as supporting documentation is available to support such deductions in Saudi Arabia.

A company can merge with another company of the same or of a different kind. A co-operative company cannot, however, merge with a company of a different kind.

Non-Resident Intermediate Holding Company

If the foreign country taxes capital gains and dividends received from overseas, an intermediate holding company resident in another territory may be used to defer this tax and perhaps take advantage of a more favorable tax treaty with Saudi Arabia.

Local Branch

A foreign investor may also operate in Saudi through a branch. A branch requires a minimum invested capital of SAR 500,000, a license from SAGIA, and a Commercial Registration Certificate from the MOC.

A branch has no legal reserve requirements. However, it is required to withhold tax from remittances and profits transferred to the head office. Actual expenses incurred specifically and necessarily for generating gross income are allowed as deductible expenses, as long as supporting documentation is available to support such deductions.

Joint Ventures

Foreign investors may establish an LLC or Joint stock company with a Saudi partner. The corporate tax will be assessed on the foreign shareholder's share of the entity's taxable income.

Choice of Acquisition Funding

The investment may be financed on either the local or foreign market. No limitations apply to local financing.

It is possible to finance an acquisition through a share capital contribution and/or with debt. There are no specific rules under the corporate income tax law with respect to thin-capitalization. There are minimum capital requirements, however, under the companies law.

There are WHT implications on payment of interest or dividends to non-resident shareholders in a Saudi company. Interest expenses are also subject to certain limitations under the Saudi tax law.

Debt

Companies may finance their operations through bank loans or they may issue capital market debt

instruments, but there are some restrictions on issuing debt securities.

Deductibility of Interest

Under the current Saudi tax law, the claim of interest expense has been restricted to the interest expense incurred during the tax year, or the result of the following formula, whichever is lower:

The taxpayer's total income from loan charges (interest), plus 50 percent of (a) minus (b) where:

- "a" = income subject to tax other than income from loan charges
- "b" = expenses allowed under the law other than loan charge expenses

Withholding Tax on Debt and Methods to Reduce or Eliminate

According to the Saudi Tax law, WHT at a rate of 5 percent is payable on the gross amount of actual interest paid or settled to a non-resident lender.

Under Saudi Tax law, interest is defined as any amount paid for the use of money. This includes income realized from loan transactions of any type, whether secured by guarantees or not, or by giving rights to participate in the profits of the borrower or not. It also includes income realized from government and non-government bonds.

Equity

According to the Saudi Companies law, LLCs must fully pay their capital and retain it in a local bank account until the company's regulatory requirements are met.

Unlike LLCs, joint stock companies may raise capital by issuing shares. The shares must be nominal shares and may not be issued at a value higher than their nominal value, unless such a premium is stated in the company's article of association and agreed by the shareholders. The share premium is then added to the company's statutory reserve.

Other Considerations

Concerns of the Seller

The tax position of the seller can be expected to have a significant influence on any transaction. In certain circumstances, the seller may prefer to realize part of the value of his/her investment as income by means of a pre-sale dividend. The rationale here is that the dividend may be subject to 5 percent WHT, but reduces the proceeds of the sale, and thus the gain on the sale, which may be subject 20-percent capital gains tax.

Company Law and Accounting

All business entities are required to maintain a journal, general ledger, and inventory book in Saudi Arabia in Arabic. In addition, all original supporting documentation for all entries recorded in the accounting books must be maintained locally to enable the government authorities to request and review them at any time. According to the Saudi Accounting Regulations and in practice, all books and records must usually be retained for a period of at least ten years.

Audit of Financial Statements

An LCC/ branch will be required to prepare and have the financial statements audited by a locally licensed accountant. Financial statements should confirm with the standards laid down by the Saudi Organization for Certified Public Accountants (SOCPA).

Group Relief/Consolidation

Saudi Tax law does not provide for any group reliefs. Each entity within a group is regarded a separate legal entity and is thus required to pay its tax liability independently.

Transfer Pricing

Saudi Arabia has no specific transfer pricing rules. However, the tax law provides for certain measures against tax avoidance. In determining the tax liability, the Department of Zakat and Income Tax (DZIT) in Saudi Arabia has the right to:

- disregard a transaction that has no tax effect;
- reclassify according to its reality a transaction whose form does not reflect its substance;
- raise an arbitrary assessment on a taxpayer according to the relevant facts and circumstances if a taxpayer fails to make timely filing of its declaration, or does not maintain accurate accounts and records, or fails to maintain accounts and records in the required form and manner;
- allocate income or deductions between related persons or persons under common control as necessary to reflect the income that would have resulted from a transaction between independent persons (arm's-length principle); and
- adjust tax assessable profits if an individual taxpayer attempts to split income (as defined in the law) with another taxpayer to reduce the tax liability.

Dual Residency

The concept of dual residency is not relevant in Saudi Law. However, for Saudi tax purposes, a company is a resident company if it meets any of the following conditions:

- it is formed under the Companies Regulations; and
- Its place of central control and management is situated within the Kingdom.

Foreign Investments of a Local Target Company

Based on the ministerial decision dated 28/4/1428H corresponding to 16/5/2007G, the Saudi tax authority adopted the following important rules relating to the treatment of investments for Zakat purposes in Saudi Arabia:

First: holding companies and their wholly owned subsidiaries should submit consolidated financial statements that include the holding company and its subsidiaries, whether such subsidiaries are registered inside or outside the Kingdom, and the Zakat assessment will be on a consolidated basis as one unit and one Zakat base.

Second: investments in entities outside the Kingdom – joint ventures – will be deducted from the Zakat payer base on the condition that the Zakat-payer submit financial statements audited by a certified public accountant authorized in the investee country for the purpose of calculating the Zakat due on such investments and payment of such Zakat to the department, or the submission of proof of Zakat payment in the country of the investee; and thereafter deduct such investments from the Zakat base of the Saudi investing company to avoid duplication of Zakat in these companies. If the Zakat-payer fails to comply with any of the above requirements, such investments will not be deducted from his/her Zakat base.

Third: any investment – local or abroad – in forward transactions or in Sukuk representing a debt irrespective of the issuer's location and the period of the investment are not to be deducted from the Zakat base.

Comparison of Asset and Share Purchases

Advantages of Asset Purchases

- The purchase price (or a proportion) can be depreciated or amortized for tax purposes (including goodwill).
- It is possible to acquire only part of a business.
- For GCC shareholders, the value of fixed assets may be deducted from the company's Zakat base.

Disadvantages of Asset Purchases

- The possible need arises to renegotiate supply, employment and technology agreements, etc.
- A higher capital outlay is usually involved (unless debts of the business are also assumed).
- Any capital gains arising as a result of a sale or transfer of assets (including the entire business)

would be treated as normal business income and taxed at the normal corporate income tax rates.

- Capital gains on disposals of certain assets (including shares in an unlisted Saudi company) are determined according to the sale value and cost price at the time of the transaction. Certain specific rules apply to asset sale transactions.

Advantages of Share Purchases

A capital gain realized on a sale of securities traded on the Kingdom's stock market is exempt income if it is performed in accordance with the regulations of the stock market in the Kingdom and securities disposed of did not exist before the effective date of 31 July 2004.

Disadvantages of Share Purchases

Capital gains accruing to a foreigner from the sale of shares in a local company are subject to tax at a rate of 20 percent.

Withholding Tax Rate Chart

Double tax treaties signed and in effect by Saudi Arabia include France, India, China, Pakistan, South Africa, Austria, Korea, the United Kingdom (1 January 2010), and Spain. Treaties signed but not yet effective include Belarus, Bangladesh, Syria, the Netherlands, Russia, Italy, Greece, Uzbekistan, and Turkey. Treaties which KPMG in Saudi Arabia understands are in very advanced stages of negotiation include those with Japan, Cuba, and Germany.

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Austria	5 ¹	5 ¹	5	10
China	5 ¹	5 ¹	10	10
France	2 ²	2 ²	2 ²	3 ³
India	5	5	10	10
Italy	5	10	10	10
Korea	5	10	5	5/10 ⁵
Malaysia	5	5	10	10
Netherlands	5	10	5	7
Pakistan	10	5	10	10
South Africa	10	5	5	10
Spain	5	0	5	8
United Kingdom	5/15 ⁴	5/15 ⁴	5	8/5 ⁵

Notes

1. Dividends paid to governments, local authorities and state owned entities (etc.) are exempt.
2. Taxable only in France (as the state of residence).
3. Taxable in Saudi Arabia (as the source state), but no treaty rate is specified. Therefore the domestic rate (15 percent) applies.
4. The 15-percent rate applies to "qualifying dividends" paid by property investment vehicles.
5. Royalties for the use or the right to use industrial, commercial, or scientific equipment are subject to a 5-percent withholding tax. Other royalties are subject to the 8-percent rate.

KPMG in Saudi Arabia

Muhammed Saloojee
KPMG Al Fozan & Al Sadhan
KPMG Towers Salahudeen Street
P.O. Box 92876
Riyadh
116633
Saudi Arabia

Tel. +966 (1) 874 8570
e-Mail: msaloojee@kpmg.com

Suleman Mulla
KPMG Al Fozan & Al Sadhan
7th Floor AlDainy Plaza,
Madinah Road
P.O. Box 55078
Jeddah
21534
Saudi Arabia

Tel. +966 (2) 658 1616 Ext. 219
Fax +966 (2) 605 0597
e-Mail: smulla@kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2010 KPMG Al Fozan & Bannaga, a Saudi Arabia partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (KPMG International), a Swiss entity. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International Cooperative ("KPMG International"), a Swiss entity.