The Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE) signed a long awaited Double Tax Treaty (DTT) on 23 May 2018, the first of its kind signed between two Gulf countries. The text of the DTT was published in the official KSA Gazette on 5 March 2019. The ratification process is now complete and the DTT will be applied as of 1 January 2020.

The DTT is largely based on the 2014 Organization for Economic Co-operation and Development (OECD) Model Tax Convention (updated in 2017). Both the UAE and KSA are members of the BEPS inclusive framework and have signed the Multilateral Instrument (MLI) agreement.

This alert discusses several key provisions of the DTT and our perspective on its impact.

**Residency**

The DTT adopts the standard language of the OECD Model Tax Convention to define ‘resident’ (i.e. one who ought to benefit from the DTT). As an additional access mechanism, the DTT expressly provides for certain tax exempt entities to qualify as ‘resident’ and benefit from the DTT, such as:

- state owned sovereign funds
- entities that are exempt because of religious, educational, charity, scientific or other similar reasons
- pension funds

Both the UAE and KSA offer tax incentives such as free trade zones (FTZs) and special economic zones (SEZs). While there is no explicit mention of these regimes under the ‘resident’ principle, entities set up in these regimes would traditionally obtain a tax residency certificate and claim the beneficial provisions of the applicable tax treaty (subject to the fulfilment of prescribed conditions).

It remains to be seen if, in practice or by express provisions, DTT benefits will be granted to entities in FTZs and SEZs. However, Article 29 of the DTT clarifies that access to the DTT will be denied if obtaining the benefits was one of the principal purposes of an arrangement or transaction (the Principal Purpose Test).

For dual resident individuals, the DTT provides typical ‘tie-breaker rules’ to determine residency for DTT purposes. For entities, the place of effective management is where the organization would be considered ‘resident’.
As a general governance mechanism, the DTT stipulates that ‘competent tax authorities’ should coordinate and mutually agree on the requirements and conditions subject to which tax benefits under the DTT will be granted.

Withholding tax
The DTT prescribes withholding tax rates for payments of dividends, interest and royalties. The DTT does not prescribe specific guidance on the provision of services (i.e. management or technical).
Due consideration to be provided in case of provision of cross-border services, in order to identify whether such activities result in a permanent establishment read-with Article 7 of the DTT (business profits).

<table>
<thead>
<tr>
<th>Payment</th>
<th>Domestic rate UAE</th>
<th>Domestic rate KSA</th>
<th>DTT rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>N/A</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Interest</td>
<td>N/A</td>
<td>5%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Capital gains
The UAE does not currently impose capital gains tax. The provisions of Article 13 are therefore predominantly relevant for UAE investors with investments in KSA.
The DTT allocates taxation rights to KSA only in the following cases:
— the sale of immovable property located in KSA
— the sale of shares in unlisted KSA entities
The sale of shares in listed KSA entities is exempt from capital gains tax imposed domestically by KSA (subject to the fulfilment of prescribed conditions). This exemption is also indirectly provided for under the DTT.

Permanent establishment
The permanent establishment (PE) sections of the DTT are somewhat similar to the United Nations (UN) model, making provisions for elements such as building sites, construction or installation projects for more than six months (versus 12 under the OECD model).
Provisions include:
the Service PE, which encompasses services through employees or other personnel engaged for such services if their presence is for (a) period(s) of more than 183 days within any 12 month period

— the Agency PE, which comprises cases where a PE is created if a dependent agent maintains a stock of goods from which it regularly delivers merchandise on behalf of the enterprise

The PE provision also includes additional restrictions based on the MLI. Entities may no longer evade identification as a PE by fragmenting their activities over multiple locations. To assess whether a PE exists, the overall levels of activity will need to be analyzed. The commercial role of the agent must also be considered when determining PE status. If the activity of the agent leads to the conclusion of contracts (without major changes), their role is not considered ‘preparatory and auxiliary’ and may result in an agency PE for their principal.

These provisions (based on the principles of OECD / UN model conventions) read with an understanding of BEPS Action Plans, should enable the determination of a PE and the certainty of tax impact.

**Business profits**

Article 7 follows the most recent OECD developments. In addition, it incorporates a limited force of attraction rule in PE scenarios. If a person conducts business in another country through a PE, any similar business conducted by the individual elsewhere could potentially be attributed to the said PE. The potential implications of this Article would require due deliberation.

**Elimination of double taxation**

Should a person be subject to double taxation which is not in line with the DTT, the resident country should grant this person a tax credit. It is worth noting that, typically, any tax treaty tends to cover Zakat under its scope. However, Article 24 of the DTT clearly stipulates that the DTT provisions cannot be used to reduce any KSA Zakat obligations. The applicability of DTT is restrictive in this regard.

**DTT administration**

Both countries have agreed to implement a Mutual Agreement Procedure and an Exchange of Information mechanism. Both provisions will allow the countries to collaborate on any matter currently not covered by the DTT and/or exchange relevant information.

**Summary**

The DTT is aligned to international standards, factoring in emerging OECD principles pertaining to the abuse of PE and DTT frameworks.

The DTT has some unique features—particularly with respect to ‘resident’ and PE clauses, the tax credit mechanism, and the force of attraction— that will require close attention.

Withholding tax relief on royalty and interest payments from KSA, along with MAP, may result in additional cross-border business.