# KSA signs Multilateral Instrument, a game changer in International Taxation

## Introduction

On 18 September 2018, the Kingdom of Saudi Arabia ('KSA') became one of the 84 countries to have signed the Multilateral Convention (the Convention/the Multilateral Instrument/MLI) to implement Tax Treaty-related measures to prevent Base Erosion and Profit Shifting ('BEPS').

The convention is an outcome of the initiatives taken by the Organization for Economic Co-operation and Development ('OECD') to tackle BEPS, i.e. aggressive international tax planning with the intention of shifting profits to low-tax or no-tax jurisdictions.

The Multilateral Instrument will modify Tax Treaties between two or more parties to the convention, without any need to re-negotiate their bilateral Tax Treaties.

## KSA's provisional list of expected reservations and notifications

Saudi Arabia has released its provisional list of expected reservations and notifications that will be confirmed pursuant to ratification of the same.

Thus, KSA has made reservations so as to not apply the following Articles to its Covered Tax Agreements ('CTA' or Tax Treaties):

- Article 3 (Transparent Entities)
- Article 4 (Dual Resident Entities)
- Article 8 (Dividend Transfer Transactions)
- Article 10 (Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions)
- Article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents)
- Article 17 (Corresponding Adjustment)

The notification provides a list of Tax Treaties that KSA wishes to be covered by each Article of the Convention. For example, KSA has listed 53 Tax Treaties to be covered by Article 2 (Interpretation of Terms) of the MLI.

## Key features of the notification

Pursuant to the adoption of the MLI, the provisions that are expected to be applicable to the covered Tax Treaties include the following:

**a) Article 5 — Application of methods for elimination of Double Taxation**

Article 5 provides three alternative ways for elimination of double taxation of income (in two jurisdictions). KSA has decided on Option C, which provides for the use of a foreign tax credit regime. However, the amount of foreign tax credit shall not exceed the amount of tax liability arising on foreign-sourced income under the domestic tax law provisions.

**b) Article 6 — Purpose of a Covered Tax Agreement**

KSA has adopted the preamble provisions of the MLI that will lay down the purpose of a CTA. The preamble text reads as follows:

"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)".

KSA has listed Tax Treaties that do not contain the above preamble language and refers to a desire to develop an economic relationship and enhance cooperation in tax matters.

**c) Article 7 — Prevention of Treaty Abuse**

In the MLI, Article 7 provides three approaches for the prevention of treaty abuse:

- Principle Purpose Test (‘PPT’)
- Simplified Limitation of Benefits (‘LOB’) provisions
- Detailed LOB provisions

By not making any reservation, KSA has decided to adhere to the minimum standard by applying the default option of PPT. Thus, Treaty benefits can be denied if it is reasonable to conclude that obtaining tax benefits (either directly or indirectly) is one of the principal purposes of the arrangement, unless granting the benefit would be in accordance with the purpose of the provisions of Tax Treaties. The said provisions will supplement the existing general anti-avoidance rules in KSA tax laws.

**d) Article 9 — Capital Gains from Alienation of Shares or of Interests in Entities Deriving their Value Principally from Immovable Property**

Article 9(4) of the MLI states that gains derived from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in the country of the source of gains.

Thus, the said provision aids the anti-abuse rule with regards to taxation of capital gains on the sale of shares of company, deriving their substantial value from immovable properties. This is in line with Article 5(2) of the Saudi Arabian tax law.

**e) Article 12 — Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies**

Commissionaire arrangements refer to principal-commission agent relationship established to artificially avoid Permanent Establishment ('PE'). Article 12 refers to PE created through persons acting on behalf of an enterprise, who habitually conclude contracts or **habitually play a principle role, leading to conclusion of contract** that are routinely concluded without any material modification by the enterprise. The contracts referred to are in the name of the enterprise or for the transfer of the ownership or right to use property owned by that enterprise or for the provision of services by that enterprise.

Traditionally, independent agents are an exclusion to such arrangements. However, the MLI widens its scope to include persons closely related to an enterprise who will not be considered as independent agents.

**f) Article 13 —Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions**

Article 13 provides three alternatives as regards provisions for specific activity exemptions. KSA has decided to choose Option A, which means that in addition to specific activities listed under exclusions under the PE Article in Tax Treaties, it will additionally be necessary to prove that these activities, including overall activity, will be preparatory and auxiliary in nature.

**g) Article 14 — Definition of a person closely related to an enterprise**

KSA has decided to adopt this Article without any reservation. A person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or **both are under the control of the same persons or enterprises**.

A person shall be considered to be closely related to an enterprise if one possesses **directly or indirectly more than 50 per cent of the beneficial interest** (or, in the case of a company, more than 50 percent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company).

**h) Article 16 — Mutual Agreement Procedure ('MAP')**

KSA has decided to adopt provisions of the MLI relating to MAP. MAP allows taxpayers to approach competent authorities in their respective countries to resolve tax disputes relating to provisions of Tax Treaties within a specified time-frame.

## Conclusion

This is a turning point in KSA in the entire progression of international tax laws and bilateral tax treaties. As foreign MNCs investing in KSA rely on Tax Treaties, the impact of the MLI on various structures requires a detailed analysis. While the MLI is yet to be ratified, it will be prudent to review the existing structures at this stage, which may be impacted by the provisions of the MLI.

## How can we help:

- Reviewing the investment structures of MNCs in KSA
- Reviewing existing business arrangements (including toll manufacturing and commissionaire arrangements) and highlighting risks, if any, and making recommendations regarding the way forward
- Assessing the possibility of approaching Competent Authorities for protracted tax litigation based on our experience in KSA
- Reviewing Related Party transactions with non-residents and providing recommendations from a Transfer Pricing perspective

Kind Regards,

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