

## Tax Provisions on Economic Activity

### -Under the Saudi tax systems-

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#### *Abstract*

*The study aimed to identify the nature of taxes under the Saudi income tax system and its importance to stand on the provisions of the value-added tax on economic activity under the electronic billing regulation. Only, unlike the tax laws in most countries, he did not address the case of a Saudi who performs his job duties abroad and gets his income from the Saudi treasury. Paying zakat.*

#### **Introduction**

Taxes of all kinds and forms are the main resource that most countries rely on to cover their public expenditures, where the state's proceeds from taxes are used to achieve its economic, social and financial goals. In addition, its role in bringing about economic and social stability and balance for all segments of society, considering when imposing them the ability of the taxpayers to perform them according to the principle of justice among all those subject to them. This is what expressed in Article (20) of the Basic Law of Governance at KSA in defining the principles of tax imposition by the government, which states... "Taxes and fees are imposed only when needed, and on the basis of fairness, and they may not be imposed, modified, or Cancellation or exemption from it, except in accordance with the law" .

The Saudi government imposed several types of taxes, and began to implement them in different stages, after approving the system that legislates them. The income tax system was approved, according to the system issued by Royal Decree No. (M / 1) on (15/1/1425AH) and the subsequent amendments, with the aim of imposing a tax on the individual personal income, and on the income or profit resulting from capital investments. The Kingdom issued the value-added tax system on (4/28/1441AH) to impose the tax on the import and supply of goods and services. The application of this system came to impose value-added tax, after the Kingdom's ratification of the unified agreement for value-added tax for the Gulf Cooperation Council.

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#### Problem Statement:

Under the multiplicity of economic activities carried out by both legal and natural persons, and the diversity of these activities, especially with the emergence and spread of what is known as “digital economic activities”, an additional burden has been imposed on the tax regulator in determining the nature of taxable economic activities. In addition to defining the conditions for applying the tax, how to determine its base, the rules for its collection, the conditions for exemption from it, and the penalty for violating its provisions.

Hence, the study problem comes in identifying the tax policy followed by the Saudi regulator on economic activities in the Kingdom, by examining the tax provisions approved by the Saudi tax systems on these activities.

#### The Study Significant:

The study significant appears from two aspects, scientific and practical side as follow:

##### First: the scientific significant:

1. The significant of the study subject, which deals with the concept of tax and its importance to the state, where the tax is considered as one of the most important sovereign resources on which many countries rely in financing their budgets, and spending them on economic projects that achieve social justice for all citizens.
2. Standing on the cognitive perspective of some topics and concepts related to taxation, which not adequately addressed in previous studies (according to the researcher's knowledge), such as the provisions of tax on digital economy activities, and the provisions of electronic tax invoicing.
3. The study significant emerges from the cognitive side by identifying the provisions of the tax imposed on economic activities in KSA, and identifying legislative gaps according to the Saudi system in this field.
4. Compensating for the lack of studies that dealt with this subject, especially in the Saudi system. Therefore, this study considered as one of the rare studies (according to the researcher's knowledge) that dealt with the subject according to the Saudi system, and thus the scientific value of this study is evident.

##### First: the practical significant:

1. It is hoped that this study will be a reference for people to learn about their regular status of being subject to the provisions of income tax and value-added tax.

II. Develop solutions, proposals and recommendations necessary to address the study problem.

III. It is hoped that the study results will be able to achieve the desired objectives of the current study.

The Study Objectives:

The study seeks to achieve the following objectives:

- a. Identifying the concept of taxes, and their importance.
- b. Standing on the historical context of the tax regulation emergence in KSA.
- c. Addressing the provisions of the tax on economic activity under the Saudi income tax system.
- d. Dealing with the provisions of the tax on economic activity under the Saudi income tax system.
- e. Determine the extent to which income tax provisions apply to digital economic activity.
- f. Dealing with the provisions of the tax on economic activity under the value-added tax system and the unified value-added tax agreement for the Gulf Cooperation Council.
- g. Standing on the provisions of the value-added tax on economic activity under the electronic billing regulation.

## **The first Topic**

What are Taxes, and their importance

The first content: definition of tax in the KSA

According to the Saudi income tax system, although the Saudi regulator did not define income tax clearly and explicitly, it defined the activity that is subject to income tax as "Commercial activity in any form, professional, craft, or any other similar activity intended to make a profit and includes the use of movable and immovable money" . According to the same system, the tax is imposed on the individuals' personal income, and on the income or profit realized from capital investments . The Saudi regulator also distinguished between those subject to income tax, according to their legal personalities, between a natural person and a legal person, as well as according to their nationalities, between Saudis and non-Saudis. In addition, the Saudi regulator distinguished between a resident and a non-resident, according to the text of Article (2) of the income tax system.

According to the value-added tax, it is a form of indirect tax imposed on the increase in the value of goods and services and on all stages of manufacturing and distribution of goods and services . In another definition, it is a general tax imposed on products and services, and one of its results is ensuring fairness in imposing fees at the level of the consumer and the importer, throughout the production and distribution stage, regardless of the nature of the means used for this purpose .

According to the general guideline for value-added tax issued by the Saudi Zakat, Tax and Customs Authority, value-added tax is also a tax on consumption that is paid and collected at every stage of the supply chain, from the manufacturer's purchase of raw materials to the retailer's sale of the final product to consumer.

As for the Saudi value-added tax system, despite the fact that the Saudi regulator did not define the value-added tax clearly and explicitly, he referred to its concept in the context of Article (2) of the system. However, Article (2) of the system showed that the value-added tax is imposed on the import and supply of goods and services, and at a basic rate of 15% of the export or import value .

## **The Second Topic**

### **Legal Provisions of the Tax on Economic Activity in KSA**

The Kingdom of Saudi Arabia has been diligence to develop appropriate financial legislation to impose and collect taxes, in order to help achieve the country's economic, political, social and development goals. The Saudi government imposed several types of taxes on economic activities operating in its territory, and began applying them in different stages, after approving the system that legislates them.

The first content: the provisions of income tax on economic activity and its applicability to digital economic activity:

Income tax is one of the most important direct taxes for which income is used as a source. Given the importance of these taxes in the national economy, tax legislation has given special attention to them, as a result of their financial, economic and social effects on the individual, society and the state in general. Income tax may take different forms according to the tax legislation of each country and the purpose and target groups. There are those who take the specific tax system on salaries, wages and commercial profits. In addition, there are those who adopt the unified tax system on the income of natural persons. In KSA, the tax regulator adopted the tax system on the income of resident natural persons (non-Saudis), in the event that they are

residents in the Kingdom and carries out activity in it, or if they are partners in a resident company.

Through this content, the study highlighting the provisions of income tax on economic activity in the KSA, and their applicability to digital economic activity, by dividing it into two sections as follows:

The first section: the provisions of the tax on economic activity under the Saudi income tax system:

In the income tax system, the Saudi tax regulator relied on the criterion of territoriality of income as a basis for exercising tax sovereignty over these activities . The Saudi tax regulator considered that the income generated inside the Kingdom is the basis for imposing the tax for companies that do not have branches outside the Kingdom. As for companies that have branches abroad, they are differentiated as follows :

☐ Companies that have independent branches abroad are subject to tax entering head office inside the Kingdom, and are not subject to income tax generated by branches located abroad.

☐ Companies that have non-independent branches abroad are subject to income tax generated from the head office.

In accordance with the principle of territoriality, Zakat, Tax and Customs Authority in the Kingdom (formerly the Authority of Zakat and Income) has worked since (1407AH) to exclude revenues from deposit and lending operations carried out by banks and foreign lending and financing institutions, if they had no branches, offices or a resident representative in the Kingdom. However, this was done on the basis that these operations are not considered as practicing the activity inside the Kingdom, so the revenue generated from them is not subject to income tax for the bank or the foreign lender .

According to the Saudi income tax system for the year (1425AH), the tax is imposed on the individuals' personal income, and on the income or profit realized from capital investments . The Saudi regulator also distinguished between those subject to income tax, according to their legal personalities, between a natural person and a legal person, as well as according to their nationalities, between Saudis and non-Saudis. In addition, the Saudi regulator distinguished between a resident and a non-resident, according to the text of Article (2) of the income tax system. Accordingly, the following are subject to the income tax system in the KSA:

First: The resident natural person (non-Saudi) who exercises activity in the Kingdom:

According to Article (3) of the Saudi Income Law, a natural person is considered a resident of the KSA, if he fulfills one of the following two conditions:

If he has a permanent home in the Kingdom , and that he resides in the Kingdom for a total period of not less than thirty days a year. Accordingly, it becomes clear that the Saudi regulator chose to specify the duration of residence in days, and linked it to the condition of permanent residence, to confirm the intention to settle.

Residing in the Kingdom for a period of not less than (183) days in a year, where residence in the Kingdom for part of a day is considered a full day. The residence of a person in the Kingdom while he is in transit between two points outside it is not considered (transit) . Nationality is not taken into account in applying the provision of this article .

From above, we find that the Saudi regulator has restricted income taxpayers to non-Saudi residents only. Contrary to tax laws in most countries, it did not address the case of a Saudi who performs his job duties abroad and gets his income from the Saudi treasury. This is due to the exemption of Saudis in general from income tax, and the reason for this - according to the researcher's opinion - is that this category is subject to the obligation of zakat. Therefore, and in the interest of the Saudi regulator not to burden the Saudi citizens financially, in the event that an income tax was imposed on them in addition to the zakat obligation, they were exempted from the provisions of the income tax.

Second: resident capital companies for the shares of non-Saudi partners:

According to the provisions of Article (2) of the income tax system for (1425 AH), resident capital companies are among the categories of economic activities that the Saudi regulator has approved as being subject to income tax.

Moreover, money companies are defined as companies based on financial consideration, and the personality of the partner has no importance in these companies, as it is based on the accumulation of capital to achieve the purpose of the company. This type of company is represented in the shareholding company, which is a company consisting of partners who are united only by financial consideration, and its capital is divided into shares of equal value, each part of which is called a share. The partners are not responsible for the debts of the company except to the extent of the shares they subscribed to, in addition to the limited liability company (LLC) . According to the Saudi corporate law, capital companies are divided into two main types: joint stock companies and LLC. The company is considered resident in the Kingdom if any of the following two conditions are met:

a) To be an establishment (company) in accordance with the Saudi Companies Law:

According to Article (2) of the Saudi Companies Law of (2015AD), the company (establishment) is defined as “a contract whereby two or more persons commit themselves to contribute to a project that aims for profit by providing a share of money, work, or both together to share the profit or loss that arises from this project” . Considering the company as a contract, where this contract requires being subject to the general rules in contracts, and thus recognizing the freedom of the contracting parties to organize and determine the rights and obligations that arise from it .

b) That the Kingdom be the headquarters of its main administration:

It is the place where senior policies are drawn up, key decisions are taken for the company, and board meetings are held on a regular basis. On the other hand, that most of the company’s business, from which most of its revenues are generated, is in the Kingdom .

Therefore, resident capital companies, according to the conditions of establishing the company in the Kingdom, are one of the categories subject to the Saudi income tax system, for the shares of non-Saudi partners in it. According to the provisions of Article (43) of the income tax system, the tax is levied on the shares of the general partners in the partnership limited by shares, as in the partnership of persons, and then the shares of the general partners are deducted to determine the tax base of the company. The provisions contained in this system for partnerships apply to the shares of general partners in companies limited by shares . However, If there is a change in the ownership or control of the capital company, so that the percentage of the change reaches (50%) or more, the share of the non-Saudi in the losses incurred before the change may not be deducted in accordance with Article (21) of this Law in the tax years following the change .

Third: The permanent establishment for a non-resident who exercises activity in the Kingdom:

According to Article (2) of the Saudi Income Tax Law of (1425 AH), a non-resident person who exercises activity in the Kingdom through a permanent establishment is one of the persons subject to income tax in the Kingdom.

A permanent establishment for a non-resident in the Kingdom is every permanent place through which a non-resident carries out an activity, and is included in that activity that a non-resident performs through his agent. Article (4) of the aforementioned Income Tax Law enumerated the cases of permanent establishment as :

1. Construction places, assembly facilities, and carrying out the supervision work related thereto.
2. Installations, places, and ships used in surveying natural resources, and carrying out the supervision works.
3. A fixed base from which a non-resident natural person exercises his activity.
4. branch of a non-resident company authorized to conduct business in the Kingdom.

The activity in which a non-resident carries out the insurance and/or reinsurance activity through an agent is considered a permanent establishment for the non-resident, even if the agent is not authorized to negotiate and complete contracts on his behalf .

In the same context, Article (4) of the system excluded some cases or purposes in which the place used in the Kingdom is not considered a permanent establishment for a non-resident, and these purposes are :

- a. Storing, displaying, or supplying goods or products belonging to a non-resident.
- b. Maintaining a stock of goods or products belonging to a non-resident in order to processing by another person.
- c. Purchasing goods or products in order to collecting information only for non-residents.
- d. Performing other activities of a preparatory or auxiliary nature for the benefit of non-residents.
- e. Preparing contracts for signature related to loans, supply of goods or technical services.

The Saudi regulator considered that the income is generated from a source in the Kingdom in many cases. Among these cases is if the income is attributed to a permanent a non-resident establishment located in the Kingdom, including income from sales in the Kingdom from goods of the same or similar kind to goods sold by a non-resident through a permanent establishment. Moreover, the income arising from the provision of services or the performance of another activity in the Kingdom of the same nature as the activity performed by the non-resident through the permanent establishment, or an activity similar to it .

However, the Saudi regulator set the tax rate on the tax base of a non-resident person because of an activity he carries out in the Kingdom through a permanent establishment at (20%) .



Fourth: Every Saudi or non-Saudi natural or legal person working in the field of natural gas investment:

Work in the field of natural gas investment means all the activities of natural gas exploration, production, collection, purification, treatment, fractionation of its liquids, production and assembly of its condensate, and transportation . The activity of distributing gas and its products, through licensed local distribution networks according to the gas supply and pricing system is one of the aspects of investment in natural gas. In addition, the licensed activity of storing gas and its products is considered a self-contained activity according to the gas supply and pricing system, and is one of the aspects of investment in natural gas .

The Saudi regulator has set the tax rate on the tax base of the taxpayer who works in the field of natural gas investment at (20%) .

The second section: The extent to which income tax provisions apply to digital economic activity:

According to a non-resident person, Article (2) of the Saudi Income Tax Law of (1425 AH) specified the spatial scope of the tax on the profits of non-residents . In addition, article (1) of the executive regulations of the Saudi income tax system of (1425AH) provides for a breakdown of the persons subject to income tax, as previously referred . This confirmed by Article (7) of the Agreement on the Avoidance of Double Taxation, and the Prevention of Evasion from Taxes Imposed on Income and Capital between the Council of Arab Economic Unity.

It is noted here that the concept of a permanent establishment in this sense, and as stated in Article (4) of the Saudi income tax system, reduces the chances of the state imposing full tax sovereignty over the activities of the digital economy, and this is due to several reasons, which are :

First: What was stated in Article (4) of the income tax system would narrow the concept of a permanent establishment, by stipulating that it is necessary to have a permanent place to practice the activity in order for the concept of a permanent establishment to exist. This contradicts the special nature of the activities of the digital economy, which allows the project to deal with consumers in the host country without the need for it to have a permanent place to conduct the activity. In addition, the electronic trade can take place in full on the territory of the host country, without taking place in the form of physical goods in reality.

Second: The Saudi income tax system, according to paragraph (c) of Article (4), excluded from the concept of a permanent establishment a non-resident who is subject to income tax. If it is for the purposes of

storing, displaying and supplying goods, commodities and products belonging to a non-resident, or if it is for the purposes of performing activities of a preparatory or auxiliary nature for the benefit of a non-resident. This would reduce the chances of tax sovereignty over the activities of the digital economy, which depend mainly on the existence of a place inside the Kingdom to store goods and products that are imported from agents outside the Kingdom in order to selling them later after they are displayed and marketed through websites.

Third: Not subjecting the activities of non-resident legal persons to tax, which are the most common types of companies that deal with digital economic activities, which is an unjustified discrimination for this type of company. However, the profits achieved by resident legal persons on the shares of non-Saudi persons are subject to tax. This would lead to the weak of the tax base and then weak tax collections for economic activities in general and digital economic activities in particular.

According to above, the concept of a permanent establishment, as stated in Article (4) of the Saudi Income Tax Law of (1425 AH), limits the ability of Saudi tax legislation to confront the phenomenon of tax avoidance for digital economy activities in the field of income tax. This requires - according to the researcher's point of view - from the Saudi regulator to reconsider the text of this article to achieve the required effectiveness in including the activities of the digital economy with the provisions of the income tax, and in a manner consistent with the spread of such activities in the Kingdom. Moreover, the dependence of a large segment of citizens on goods and services that are obtained through websites.

The second content: Provisions of the tax on economic activity under the value-added tax system and electronic billing regulations:

Through this requirement, the study will highlighting the provisions of the tax on economic activity under the value-added tax system and the electronic billing regulations, by dividing it into two sections as follows:

The first section: the provisions of the tax on economic activity under the value-added tax system and the unified agreement of the Gulf Cooperation Council:

The KSA has ratified the unified agreement for value-added tax for the Gulf Cooperation Council (GCC) . This agreement and the imposition of value-added tax included in it came in line with the objectives of the economic agreement between the GCC, and the development of similar legislation and legal bases in the economic, financial and tax fields. Whatever it is, this contributes to strengthening the economy of the GCC states, and is a continuation of the measures and steps taken to consolidate economic unity among the GCC .

Moreover, based on the provisions contained in the unified agreement for value added tax, the Kingdom has issued the value added tax system (VAT) , as well as the executive regulations for the VAT system.

According to the Saudi VAT system, the VAT is imposed on economic activities related to the import and supply of goods and services at a basic rate of (15%) of the supply or import value, unless there is a provision providing for tax exemption or the imposition of a zero rate . From the above text, it is clear that the nature of the economic activities subject to the VAT according to the Saudi system is the import and supply activities in particular.

As for the persons subject to value-added tax, they are the persons who engage in economic activity related to supplies, whether they are natural or legal persons. Provided that this economic activity is independent in order to generating income and that the conditions for compulsory registration for VAT purposes in the Kingdom are met .

In accordance with the provisions of Article (3) of the VAT Law and Article (4) of its Implementing Regulations, registration with the Zakat, Tax and Customs Authority is mandatory for all persons whose annual supplies exceed a certain registration limit, as specified in the Unified Agreement for VAT. The mandatory registration limit according to the agreement is (375,000 SR) or its equivalent . That is, if the taxable supplies of a person during (12 months) exceed the amount of (375000 SR), (the mandatory registration limit), then he must register with the competent authority in order to calculating and collecting value-added tax for his economic activity.

The second section: Section Two: Provisions of value-added tax on economic activity under the electronic billing regulation:

In order to the commitment of those subject to VAT to submit their returns accurately and on time, and thus reduce cases of tax evasion with regard to VAT, the General Authority for Zakat, Tax and Customs has worked to implement electronic invoicing on a mandatory basis, as of (December 4, 2021AD), for all taxpayers subject to VAT .

The government agency responsible for applying electronic invoicing, which is the General Authority for Zakat, Tax and Customs, aims to increase the percentage of compliance with tax returns . This is done by enhancing transparency in commercial transactions, limiting the volume of hidden economy transactions, and combating commercial concealment.

However, because the tax declaration is usually done mainly by traditional methods, the taxpayer may not submit the declaration by the legal date specified for that, or provide data and information that do not reflect the true reality of his activity, commercial dealings or

income, which represents a form of tax evasion. Accordingly, applying the electronic billing system and linking all taxpayers to it electronically, would create electronic invoices and approve them instantly, and enable tax administrations to follow up the implementation of all commercial transactions for all companies registered in this system . Therefore, standing on the tax base of the taxpayer without the need to submit traditional declarations through tax declaration forms that may be tainted by inaccuracy and misleading, which gives tax returns accuracy and great efficiency. Accordingly, Article (3) of the regulations obligates the persons subject to this regulation , to issue electronic invoices for all their transactions for which tax invoices must be issued” .

### **Conclusion:**

In order to the prominent role played by imposing and collecting taxes on the national economy, and its contribution to achieving the desired economic development, the KSA has sought to put in place special provisions to regulate all types of taxes. The Kingdom also sought to establish the limits of the relationship between the taxpayer, whether they are natural or legal persons on the one hand, and the state on the other hand, by defining the persons subject to it, and the economic activities and incomes that apply to them. In addition to specifying the conditions for its entry into force, the tax rate, the method of determining its base, the rules for its collection, the conditions for exemption from it, and the penalty for violating its provisions.

Therefore, the current study came in an attempt to cover the aspects related to the provisions of the tax imposed on economic activities in the KSA, according to what was stated in the income tax system, the VAT system, and related systems and regulations, the most prominent of which is the electronic billing regulation. The study reached many results, and in light of them a set of recommendations were presented, as follows:

First, Results:

1. The study showed that taxes are considered one of the most important financial tools and policies that the state resorts to, in order to achieve the financial goals it aspires to, whether they are economic, social or developmental. Moreover, taxes are also a major source of support for the state's general budget.
2. The study showed that the Saudi regulator restricted income taxpayers to non-Saudi residents only. Unlike the tax laws in most countries, he did not address the case of a Saudi who performs his job duties abroad and receives his income from the Saudi treasury. This is

due to the exemption of Saudis in general from income tax, in the interest of the Saudi regulator not to overburden Saudi citizens financially, because of their obligation to pay zakat.

3. The study showed that the concept of a permanent establishment, within the meaning of Article (4) of the Saudi income tax system, reduces the chances of the state imposing full tax sovereignty over the activities of the digital economy.

4. The study showed that the Saudi regulator determined the scope of the VAT on economic activities according to the VAT system according to two criteria: The personal criterion in view of the taxable person, and the criterion of the nature of the economic activity or transaction. Every economic activity that represents taxable supplies, receipt of goods and services by a non-resident and non-taxable person, in addition to the import of goods by any person is subject to VAT.

5. The study showed that the approval of the Saudi regulator of the electronic billing regulation and the development of the necessary rules and procedures for its optimal application, is an affirmation by the regulator of the importance of the role of electronic billing in automating all procedures related to VAT on economic activities in the Kingdom. Therefore, enabling the Zakat, Tax and Customs Authority to follow up on those subject to this tax, and to ensure their compliance with the provisions of VAT.

#### Second: Recommendations:

a) The recommendation of the Saudi regulator to reconsider the text of Article (4) of the income tax system to achieve the required effectiveness in including the activities of the digital economy with the provisions of income tax, and in line with the spread of such activities in the Kingdom. In addition, the dependence of a large segment of citizens on goods and services that are obtained through websites.

b) Recommendation to those subject to VAT to the provisions of Article (3) of the VAT system, by taking the initiative to register with the Zakat, Tax and Customs Authority in order to calculating and collecting VAT for his economic activity.

c) Recommending to those subject to VAT to abide by the provisions of the electronic invoicing regulations and to issue authentic electronic invoices that show the reality of their commercial dealings in terms of imports and supplies.

d) Recommendation of the Saudi regulator to conduct comprehensive and periodic reviews of tax systems in the Kingdom. In addition amending the tax systems in line with all the changes and developments that the Kingdom is witnessing in the field of economic

activities, which require their organization and follow-up in order to achieving effectiveness in tax collection.

e) Given the limitations of previous studies in this field, students and researchers recommend conducting more studies to find out the provisions of the tax on economic activities according to the Saudi tax systems, with a focus on the role of electronic invoicing in the effectiveness of tax control on economic activities.

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