

Client Alert

December 2018

End of service gratuity in the UAE and KSA - Limiting your liability when your employee leaves

End of Service Gratuity (EOSG) rules have been long established in the United Arab Emirates (UAE) and the Kingdom of Saudi Arabia (KSA) and seem, at least on the face of it, straightforward.

On termination of employment, employees in the UAE and the KSA are entitled to receive an EOSG provided that certain qualifying conditions are fulfilled. However, the lack of clarity in certain provisions of the UAE law and the KSA law means that employers still regularly underestimate the complexity of calculating the EOSG and establishing when and how much EOSG is payable.

This confusion results in different practices, not just within the market, but even within a company. Not only does it increase a company's exposure to claims by departing employees, but some employers end up overpaying those employees.

Below is a summary of the key questions that clients ask us in connection with EOSG in the UAE and the KSA, and our recommendations.

FAQs

1. Who is eligible for EOSG?

UAE

Employees who have one or more years of continuous service save for the following circumstances:

- participation in a pension scheme or savings fund which meet the qualifying conditions allowing the employer to "contract out" of EOSG;
- dismissal under Article 120 of the UAE Labour Law (Article 120 sets out an exhaustive list of different types of misconduct);
- resignation without notice (other than in circumstances which allow the employee to do so as provided for in the UAE Labour Law); or



- resignation from a fixed term employment contract where the employee has less than five years of service.

KSA

EOSG is granted to employees who:

- resign, provided they have been in employment for two years or more; or
- are terminated other than for "cause" pursuant to Article 80 of the Saudi Labour Law.

What employers need to do

Ensure the eligibility requirements are met so that you do not inadvertently pay EOSG to an employee who is not entitled to it.

2. How is EOSG calculated?

UAE

EOSG accrues at the rate of:

- 21 days' salary for each of the first five years of service; and
- 30 days' salary for each year thereafter.

The calculation is pro-rated for any part of the year worked and the total EOSG payment may not exceed the equivalent of two years' salary.

KSA

EOSG accrues at the rate of:

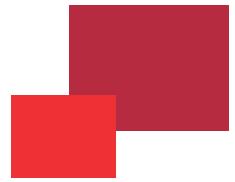
- half a month's (i.e. 15 days) wage for each of the first five years of service; and
- one month's (i.e. 30 days) wage for each year thereafter.

The calculation is pro-rated for any part of the year worked.

EOSG is uncapped.

What employers need to do

Ensure that you are using the correct methodology to calculate EOSG.



3. How is salary calculated for EOSG purposes?

UAE

EOSG is based on the employee's last wage (exclusive of allowances and increments) prior to termination of employment. In other words, EOSG is calculated on basic salary.

The Labour Courts have held on a number of occasions that commission payments should be included in the calculation of an employee's basic salary for EOSG purposes. In practice, commission payments tend to be averaged out over an agreed period – typically 6 -12 months.

In some cases, bonus awards should also be taken into account. This will depend on the terms of the bonus scheme in place.

KSA

EOSG is based on the employee's last wage prior to termination of employment.

"Wage" is broadly defined to include basic salary together with the value of every cash or in-kind allowance or benefit payable to the employee on a regular basis pursuant to the employee's contract or as an "acquired right". This can include housing allowances, air travel tickets, regular bonus payments (provided such are not excluded from the employment contract) and in some cases, transportation allowances.

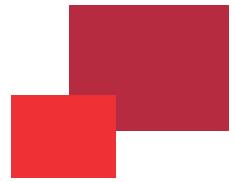
The only elements of the "wage" that it is permissible to exclude by contract from the EOSG calculation are commission payments "and similar elements of the wage that by their nature are subject to increase and decrease".

What employers need to do

UAE Employers: Seek advice as to whether bonus awards should be included in the EOSG calculation.

Saudi Employers: Ensure that your employment contracts exclude commissions/bonuses from the EOSG calculation.

Check that the correct allowances are taken into account when calculating the wage for EOSG purposes.



4. Is EOSG payable where an employee resigns?

UAE

Yes - albeit it is calculated on a different basis as follows:

- EOSG is reduced by two thirds for employees who have between one and three years of service (i.e. seven days' pay per year of service); and
- EOSG is reduced by one third for employees who have between three and five years of service (i.e. 14 days' pay per year of service).

Where an employee who has completed five years of service resigns, he/she is entitled to the full EOSG.

KSA

Yes - albeit it is calculated on a different basis as follows:

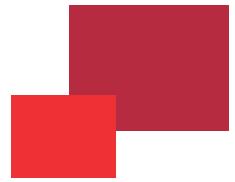
- There is no entitlement to EOSG if the employee has less than two years of service;
- Employees who have completed between two and five years of service are entitled to one third of the normal EOSG payment; and
- Employees who have completed between five and ten years of service are entitled to two thirds of the normal EOSG payment.
- Where an employee who has completed 10 years of service resigns, he/she is entitled to the full EOSG.

There are three exceptions to the above rule. Employees who resign will be entitled to the full EOSG in the event:

- the employee abandons the work because of a force majeure that is beyond his/her control;
- a female employee resigns within six months of her marriage or three months of giving birth; or
- the employee resigns due to misconduct on the part by the employer.

What employers need to do

Ensure that you apply the reduced calculation where an employee resigns.



5. Does employment with a related employer count towards continuous service for EOSG purposes?

UAE

Only UAE service with the current employer should be recognised unless the employment documentation indicates otherwise. Therefore, employment documentation should be drafted carefully where the employee has previous service with a related employer (even if he/she worked in a different jurisdiction) to avoid the employee claiming that he/she has a contractual right to an increased EOSG.

KSA

Save for employment transfers in the context of a corporate transaction within Saudi Arabia, only Saudi service with the current employer should be recognised unless the employment documentation indicates otherwise. Therefore, employment documentation should be drafted carefully where the employee has previous service with a related employer (even if he/she worked in a different jurisdiction) to avoid the employee claiming that he/she has a contractual right to an increased EOSG.

What employers need to do

Seek advice when drafting employment contracts and related documentation in respect of employees who have previous service with a related employer.

6. Is it possible to "contract out" of EOSG?

UAE

EOSG is a mandatory employment right. However, the Labour Law allows an employer to offer a retirement or saving scheme to employees in place of its obligation to pay EOSG. In order to replace the EOSG benefit, the saving or retirement scheme must meet certain conditions.

KSA

The Saudi Labour Law does not provide that the EOSG obligation can be replaced by providing employees with access to a suitable saving or retirement scheme. Under Islamic law (*Shari'ah*), an employee cannot waive his/her right to EOSG before it has accrued, i.e. at the end of his/her employment. However, some flexibility is possible for non-Saudi nationals and in some situations, it may be possible to provide for contractual set off of the EOSG against contributions into a retirement scheme (or paid-out early in



cash). Effective documentation is important to capture any payments into a retirement scheme (or early cash pay-out) to ensure they are deemed credit toward and are eventually deducted from the employee's EOSG on termination.

What employers need to do

UAE and KSA Employers:

Seek advice to ensure that appropriate provisions are included in the employment contracts and pension scheme documentation to protect you, as far as possible, from paying out employer contributions and EOSG.

7. Are nationals eligible for EOSG?

UAE

UAE nationals must be registered with the General Pension and Social Security Authority (GPSSA) and the employer must make pension contributions to the GPSSA on the employee's behalf.

UAE nationals who are registered with the GPSSA and receive pension contributions are not entitled to an EOSG payment, unless they earn over a certain monthly threshold (in which case it can be argued that the EOSG payment is calculated on the difference between the actual salary and the threshold).

KSA

Yes. This is the case even though a Saudi national and his/her employer each contribute a certain percentage of the employee's wage to the General Organisation for Social Insurance (GOSI) towards the Saudi employee's pension, unemployment insurance and medical coverage and disability benefits.

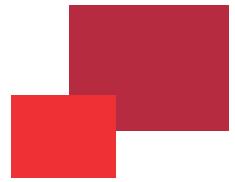
What employers need to do

UAE and KSA Employers: Be aware of your obligations towards nationals vis-a-vis EOSG.

8. Are GCC nationals eligible for EOSG?

UAE

GCC nationals must be registered with the GPSSA and the employer must make pension contributions to the GPSSA on the employee's behalf. Broadly speaking, a GCC national will not be entitled to receive both employer pension contributions and EOSG.



KSA

Yes. This is the case even though GCC nationals receive employer pension and social security contributions that are made by their Saudi employer.

What employers need to do

UAE Employers: Seek advice as to whether your GCC national employees are entitled to EOSG.

For further information, please do not hesitate to contact one of the lawyers below.

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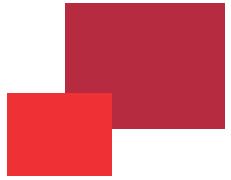
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