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Transfer Pricing Alert

20 February 2019

Saudi Arabia

Transfer Pricing Bylaws finalised

1. Introduction

1.1. On 15 February 2019, the General Authority of Zakat and Tax ('GAZT') of the Kingdom of Saudi Arabia ('KSA') issued the final Transfer Pricing bylaws pursuant to the Board Resolution No. [6-1-19] dated 25/05/1440H corresponding to 31/01/2019 ('TP bylaws') along with a set of 52 Frequently Asked Questions ('FAQs')[1].

1.2. The draft bylaws were issued on 10 December 2018 for public consultation (comments were invited till 9 January 2019). Our alert, which covers the key aspects and our detailed analyses of the draft bylaws can be accessed here. We also took this opportunity to submit feedback and seek clarifications from the GAZT on some key provisions in the draft bylaws. Our representation to the GAZT can be accessed here.

1.3. We are pleased to note that many issues regarding applicability and compliances have been positively addressed by the GAZT in the form of clarifications in the FAQs/ amendments in the final bylaws and further clarity on procedural and other aspects is expected in the Guidelines.

1.4. This alert discusses the key changes and clarifications in the final TP bylaws and the FAQs issued, and provides a summary of requirements for businesses in KSA.

2. Highlights of the changes and clarifications

S.No.	Highlights	Article/ FAQ ref	Para ref to our alert
1.	TP is not a new concept in KSA. TP bylaws provide more guidance in application of TP principles and will apply to controlled transactions carried out during the year ending 31 December 2018 and onwards.	FAQ 1 FAQ 8	3.1

[1] *It has been clarified that the FAQs are only meant to provide additional clarification/ guidance and the tax legislation, TP Bylaws, the Guidelines and/or a formal opinion by GAZT shall supersede the FAQs.*

S.No.	Highlights	Article/ FAQ ref	Para ref to our alert
2.	TP bylaws will: • **Apply to** KSA income tax payers (including mixed ownership companies); • **Not apply to** Zakat-only paying entities (except for CbC provisions); and • **Apply to** transactions between two KSA resident entities also.	 FAQ 3 FAQ 4 FAQ 7	 3.2 3.2 3.2
3.	Disclosure Form of Controlled Transactions ('DFCT') must be submitted along with income tax return for all related party transactions (regardless of value) along with a certification from a licensed auditor regarding consistent application of the TP policy.	Article 14(C)	4
4.	DFCT to report controlled transactions at arm's length value which have been used to compute income tax base and accordingly, sufficient transfer pricing documentation needs to be in place by date of filing of DFCT (even for entities which are exempted from maintaining Local File/ Master File).	FAQ 27	4
5.	CbC notification will form part of the DFCT.	FAQ 34	4
6.	Master files and local files can be required by the GAZT after at least 30 days from request (earlier 7 days for local file), with a further 60-day extension provided for the 2018 related files that may be requested during 2019[2].	FAQ 8	4
7.	**Frequency of updating TP documentation:** • Local File – Comparability analysis may be performed tri-annually provided that there is no change in the conditions and circumstances of the taxpayer and its controlled transactions. • Master File – Needs to be updated only if there is a change in the group structure/ other information presented therein.	 FAQ 21 FAQ 39	 4 4
8.	**Key Dates:** 30 April 2019 – **File the DFCT (which includes CbC notification as well)** along with the income tax return, submit **licensed auditor certificate** and **have sufficient TP documentation** in place to support transfer prices 29 July 2019 – **Master File/ Local File can be required to be submitted** (wherever applicable) any time after this date (includes 60 days additional time given for 2019 filings)[2] 31 December 2019 – **File CbC report** with GAZT for 2018 reporting year (wherever applicable)	Articles 14B, 14C, 16B, 17B, 18D, 18F and FAQ 8, 34	4
9.	Language - TP documentation is "encouraged" to be maintained in Arabic and maintaining the same in any other language does not absolve the taxpayer from any legal obligation for documents to be submitted in Arabic.	FAQ 6	5.4
10.	Penalties for non-compliance will be levied as provided in the Income tax law	FAQ 52	5.8

A summary of the compliance requirements under the bylaws and a brief analysis of the key changes in the final bylaws vis-à-vis the draft bylaws is provided in the subsequent sections.

[2] *The request may be made by the GAZT at any time after 120 days from year end i.e. after filing DFCT. Accordingly, at least 30 days will be available post the request and a further 60-day extension has been given for the filings to be made in 2019.*

3. Applicability of TP bylaws

3.1 Effective date

While many taxpayers were anticipating deferment of the date of applicability of the TP bylaws, it has been clarified that the same shall be effective from the date of publication in the official gazette and will be applicable to controlled transactions carried out during the fiscal year ended 31 December 2018 and onwards.

It has been clarified that Transfer Pricing is not a new concept to KSA's income tax regime with Articles 63 and 64 of the Income tax law already addressing transactions between related persons. It has been further clarified that the TP bylaws have been issued to address TP matters in a more detailed and regulated manner. Hence, there is a possibility that these TP bylaws form the guiding principles for audits by the GAZT for the years even prior to 2018.

3.2 Applicability of TP bylaws

The TP bylaws are applicable to a person engaged in a **Controlled Transaction** and provide that such person shall conduct such transaction under terms that are similar to comparable transactions between independent persons i.e. at arm's length. Controlled transactions mean any transaction involving **Related Persons** or **Persons Under Common Control**. The TP bylaws contain elaborate definitions on scope of such persons and our observations on changes in the underlying definitions are provided in paras 5.1 and 5.2 subsequently.

Following table throws light on applicability of TP bylaws on certain categories of taxpayers and transactions:

S.No.	Nature of taxpayer/ transaction	Article/ FAQ ref	Whether TP bylaws applicable	Our comments
1.	KSA income tax payers	Article 2 FAQ 3	Yes	Article 2 of the TP bylaws provides that the bylaws shall be applicable to every Taxable Person pursuant to the Law which has been defined in Article 1 as "The Income Tax Law issued by Royal Decree No. (M/1) dated 15/1/1425H and the amendments thereon" and FAQ 3 further clarifies that the bylaws are applicable to all taxpayers under the KSA Income tax law (including mixed ownership companies to the extent of profits attributable to non-GCC shareholders).
2.	Zakat payers	Article 2 FAQ 4	No (except for CbC provisions)	Persons which pay only Zakat have been kept outside the purview of TP bylaws except for CbC related provisions. However, it is to be noted that transactions undertaken by income tax payers with related zakat payers would still be covered by the TP bylaws. Additionally, Zakat regulations provide for disallowance of payments made to related parties for materials/ services, in excess of prices used by independent parties as deduction in computation of adjusted net income. The FAQ 4 further specifies that TP bylaws would generally not apply to persons which pay only Zakat. Clarification on whether the TP bylaws could be used by Zakat payers to defend their transfer prices in transactions with related parties would have been helpful.

S.No.	Nature of taxpayer/ transaction	Article/ FAQ ref	Whether TP bylaws applicable	Our comments
3.	Transactions between KSA residents	FAQ 7	Yes	FAQ 7 clarifies that the TP bylaws will be applicable to controlled transactions between domestic taxpayers as well i.e. to transactions between related persons which are KSA residents.
4.	Transactions with natural persons	FAQ 23	Yes	FAQ 23 clarifies that the TP bylaws will be applicable to controlled transactions with natural persons.

3.3 Compliances required

For the persons which are required to comply with the provisions of the TP bylaws, following compliances are required to be undertaken:

A) Filing of Disclosure Form of Controlled Transactions ('DFCT');

B) Maintaining of Master File and Local File [exemption granted to natural persons and small sized enterprises i.e. juridical persons with controlled transactions of total arm's length value not exceeding SAR 6 mn (approx. Eur 1.4 mn) in a 12-month period[3]; and

C) Filing Country-by-Country ('CbC') Report/ CbC Notification (which is a part of the DFCT).

More details on the same are covered in the following section.

4. Snapshot of TP compliance requirements

The following table provides an overview of the compliance requirements, due dates and key provisions/ clarifications based on the final TP bylaws and FAQs.

Particulars	Applicable to	Due Date	Clarifications in the final bylaws/ FAQs
DFCT - Specified information regarding controlled transactions	All taxable persons required to file annual income tax return which includes companies with partial non-GCC shareholding in their structure	120 days from the end of fiscal year (First due date: 30 April 2019)	• DFCT is an electronic form that will be part of the annual income tax declaration. • Language will be same as that of income tax return (i.e. Arabic). • A DFCT is required to be supplemented by an affidavit from a licensed auditor declaring that TP policy is consistently applied by the taxpayer in KSA. As per the bylaws, it appears that the auditor does not need to certify arm's length nature of transactions but only needs to certify that TP policies are consistently applied. More clarity on this along with the contents of the certificate is awaited. • There is no 'transaction value-based' exemption from filing DFCT/ obtaining affidavit from auditor.

[3] *The exemptions regarding maintenance of Master File and Local File would not be available if:*

a) *Controlled transactions are carried out with persons which are deemed to be residents of or established in a special economic zone in KSA or legally granted any exemption or relief from tax/ zakat/ both in KSA;*

b) *The GAZT believes that any of the circumstances for tax-avoidance as detailed in Article 63 exists; or*

c) *A corresponding adjustment has been sought by the taxpayer.*

Particulars	Applicable to	Due Date	Clarifications in the final bylaws/ FAQs
			• It has been clarified in the FAQs that the transaction value reported in the DFCT should be the arm's length price that is used in the calculation of the tax base. • FAQs contain guidance on granular aspects of reporting, for instance, in respect of reporting multiple transactions with the same person, business restructuring, shareholding details, non-maintenance of Master File/ Local File etc. • The CbC notification will also form a part of the DFCT. • Sufficient TP documentation must be prepared at the time of submission of the DFCT. 'Sufficient documentation' has not been defined under the bylaws/ FAQs and clarity regarding the same would be welcome. In our view, a functional, assets and risks analysis and an economic analysis to substantiate arm's length nature of controlled transactions that are reported in the DFCT would be necessary by the date of filing the DFCT.
Master File ('MF') - Information on global business operations and TP policies Local File ('LF') - Information regarding taxpayer, TP analysis for controlled transactions, industry analysis and financial information	Taxable persons **except**: a) Natural persons b) Small size enterprises	Confirmation of maintenance to be given in DFCT[4] To be submitted on request by GAZT (at least 30 days to be given and additional 60 days given for 2018) For 2018, these documents can be requisitioned by the GAZT as early as 29 July 2019.	• The 6 mn threshold to assess whether MF/ LF are to be maintained are to be reviewed annually. • Though exempted from preparation of detailed MF/ LF, 'Small size enterprises' should have sufficient TP documentation in place to support arm's length nature of their controlled transactions and also to establish that **arm's length value** of such transactions does not exceed SAR 6 mn in a 12-month period. • MF not required to be prepared annually if there is no change in group structure/ other relevant information required to be presented in the MF. • The FAQs clarify that taxpayers are required to perform comparability analyses on a **triannual basis if there is no change in conditions and circumstances of the taxpayers and their controlled transactions**. • Time limit for request of LF by the GAZT extended to 30 days instead of 7 days as per the draft bylaws. • Local file to include business strategy and business restructurings or transfer of intangible property in the current reporting year and the preceding year.
CbC Report	CbC report is to be filed by a KSA resident income tax/ zakat payer being an Ultimate Parent Entity ('UPE')/ Surrogate Parent Entity ('SPE')/ Constituent entity[5] that is member of an MNE group[6]	12 months after end of reporting year (First due date: 31 December 2019)	• Along with income tax payers, Zakat payers are also included within the purview of CbC regulations. • CbC reporting will be required in cases where a valid Qualifying Competent Authority Agreement ('QCAA') is not in place (even though an International Agreement may have been signed). Considering that KSA is not yet a signatory to the CbC MCAA and has not activated CbC exchange relationships, constituent entities may be required to file CbC even in cases where UPE/ SPE is filing the same overseas if such QCAAs are not in place by the due date of filing of the CbC report. Clarity on transitional measures until QCAAs are in place is awaited.

[4] *In case exemption from maintenance of Master File and Local File is available the DFCT should mention "Not Applicable" against the relevant fields*
[5] *Report is to be filed only where no CbC report is filed outside KSA or KSA does not have an underlying information exchange mechanism in place with the country in which such report is filed; In other cases, a CbC notification would need to be filed.*
[6] *Having consolidated group revenue exceeding SAR 3.2 billion (approx. Eur 750 mn) in the preceding financial year*

Particulars	Applicable to	Due Date	Clarifications in the final bylaws/ FAQs
			• Forms and information requirements pertaining to CbC report will be set out in the Guidelines. • The threshold of 3.2 bn SAR is to be based on consolidated group revenue for the preceding year instead of the current reporting year. • The FAQs clarify that an online portal will be made available to taxpayers for filing their CbC Reports which will require a one-time registration (details to be made available in due course). • The FAQs also clarify that the information in the CbC Report, on its own, does not constitute conclusive evidence that transfer prices are or are not appropriate for initiating a transfer pricing assessment.
CbC notification regarding identity and residence of the CbC reporting entity	Notification is to be submitted by a KSA income tax payer of an MNE group	120 days from end of reporting year (First due date**:** 30 April 2019)	• All taxable persons including UPE and SPE (in KSA) to notify the details regarding the CbC reporting entity. • The notification will form part of the DFCT.

Some of the other important changes and clarifications are summarised in the following section.

5. Summary of other important changes/ clarifications

5.1 Definition of related persons – 'Effective control' criteria

Related persons under the bylaws include persons exercising 'effective control' and the bylaws have provided for certain conditions and thresholds for determining whether such control exists. The amended definitions will prevent related party categorisation in cases where persons enter into genuine commercial transactions with unrelated parties and provide more clarity on computing ratio for threshold in other cases. The following aspects have been amended/ clarified further in the final TP bylaws:

- **Control through grant of loans** - Determination of related persons in this context would **exclude** cases where funds are borrowed from '***Financial Institutions***' (which have been defined in the bylaws). Also, for meeting the 'control' condition, the total outstanding balance of loans from persons (other than Financial Institutions) should be 50% or more of the ***long term & short-term debt and capital excluding retained earnings of the person at the year-end***.
- **Control through furnishing guarantees** - On similar lines, guarantees from **Financial Institutions** have been **excluded** from the definition. Also, for meeting the 'control' condition, guarantees should cover 25% or more of borrowings of the person ***at the year-end***.
- **Control through business dependence** - The revised definition comprises those cases where at least 50% of the ***absolute aggregated value*** of a Person's business activities are dependent on a person ***at the year-end***. Though, the current bylaws/ FAQs do not

provide clarity on what ‘absolute aggregated value’ would mean, the same could be understood to mean the aggregate of income and expenses of a person i.e. being representative of the entire business activities. More clarity on this aspect would be useful.

5.2 Definition of related persons – Determining whether two juridical persons are related

Article 1(25)(c) provides that two or more juridical persons would be considered as related if they meet one of the following criteria:

(i) They are persons under common control;

(ii) They are controlled/ effectively controlled by the same person; or

(iii) The Persons who control/ effectively control them are ‘Related’.

We understand that the above cases extend only to categorisation of two or more ‘sister concerns’ as ‘Related’ and do not seem to extend to a case which determines relationship between a parent entity and its subsidiary.

It is interesting to note that apart from the three cases mentioned above, the draft bylaws mentioned the following additional case which does not appear in the final version of the bylaws:

“when a juridical person participates directly or indirectly in the management, control or capital of the other, or otherwise has Effective Control of the other.”

The omission of the above provision which determines the relationship between a parent entity and its subsidiary, seems to be inadvertent in the final bylaws.

However, a parent entity and its subsidiary may still be considered as falling within the definition of related persons as they are controlled by the same person (as the UPE/ natural person who controls the parent entity directly/ indirectly will also exercise indirect control over the subsidiary through the parent entity[7]).

5.3 Clarifications in respect of the application of TP methods

The FAQs clarify the following in respect of the application of TP methods:

- **Use of appropriate PLI while using Transactional Net Margin Method (‘TNMM’)**
  For application of TNMM, it is necessary to identify a Profit Level Indicator (‘PLI’) that can act as an appropriate base to compare net profit margin of controlled transactions with uncontrolled comparables. The FAQs also contain a brief description of PLIs and their use.

- **Example where ‘Other Method’ could be used**
  The Other Method might include valuation reports to support tangible/ intangible transactions undertaken by the taxpayer.

[7] *Assuming that the parent entitycontrols/ has effective control over the subsidiary.*

- **Manner of selection of a tested party**
  A tested party is an entity in the transaction to which a TP method can be applied in the most reliable manner and for which the most reliable comparable can be found. It will most often be the one that has the less complex functional analysis profile.

5.4 Language of TP documentation

The FAQs provide that the GAZT encourages the submission and maintenance of documentation in the official language to the extent it is reasonably possible. Accordingly, it can be inferred that taxpayers may maintain documentation in a language other than Arabic. However, please note that maintaining documentation in any other language does not absolve the taxpayers from any legal obligation for documents to be submitted in Arabic.

5.5 Use of local comparables vs foreign comparables

Article 13C of the bylaws and FAQ 18 stress that local comparables are preferred over foreign comparables. Practically, availability of relevant local Saudi Arabian comparables for performing a transfer pricing analysis may be a challenge, given that limited information is available in the public domain in a manner which allows for performing such analysis. It remains to be seen whether, to overcome these practical challenges, the GAZT would allow a taxpayer to rely on foreign comparables especially in cases where benchmarking using foreign comparables would provide a more appropriate result, for instance, in cases where the foreign related person in a transaction is selected as the tested party (being the least complex entity in the transaction).

5.6 Implications on Permanent Establishments ('PEs')

As mentioned in Article 3 of the bylaws, the tax base of a PE in KSA shall be determined according to the arm's length principle. It has further been laid down that subject to the relevant international taxation agreement, expenses that may be deducted from the tax base of a PE shall be determined in accordance with the relevant income tax law provisions. In this regard, clarity would be required on whether a PE (or any other entity) which opts to file the income tax return on a deemed profit basis i.e. where taxable profit is determined as a percentage (approved by the GAZT) of the gross revenue, will also need to comply with the transfer pricing bylaws. In our opinion, given that the GAZT has pre-approved the manner of computing profits subject to tax, a transfer pricing analysis exercise in such cases it is possible to argue that TP analysis should not be relevant, but clarification on this point in the Guidelines would be helpful.

5.7 Guidelines

Though the FAQs clarify many aspects of the TP bylaws, the Guidelines referred to in the bylaws providing further information and details are still awaited. The Guidelines would be issued upon approval by the Governor of the GAZT and, based on the TP bylaws and the FAQs, would include the following:

- Information regarding the selection of an appropriate TP method;

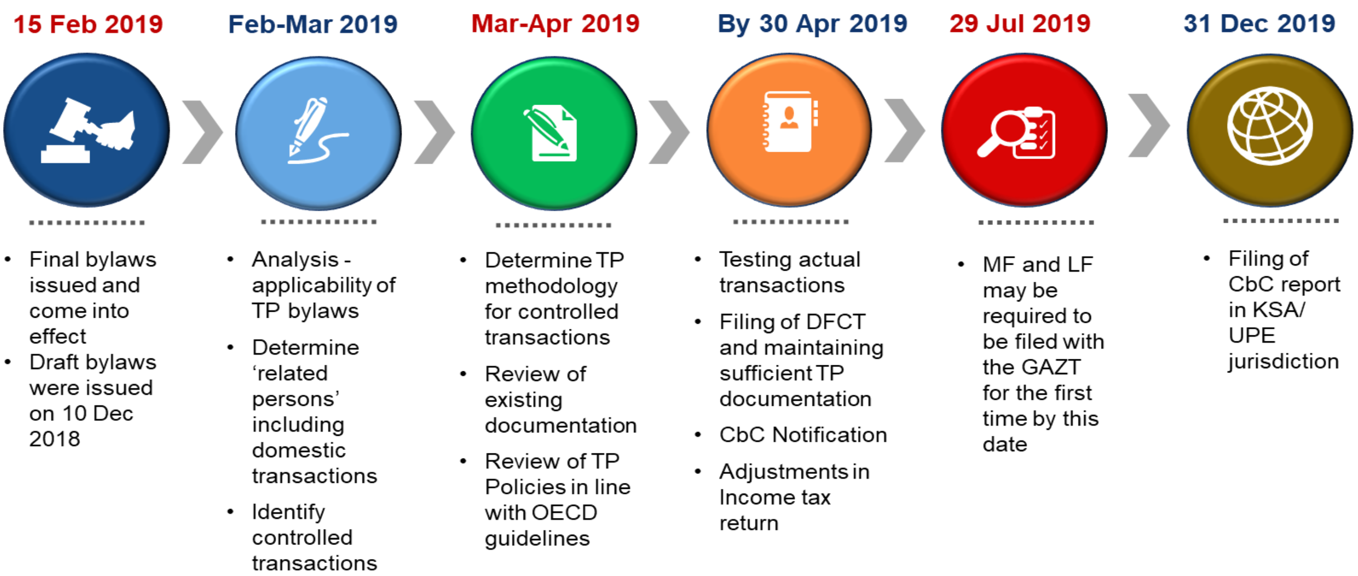
- Statistical measure of the arm's length range and selection of a point within the Arm's Length Range for making adjustments;
- Rules and limitations pertaining to the use of information and comparability factors regarding comparable transactions;
- Administrative procedures concerning the submission of the DFCT;
- Forms of the CbC reports and the information required to be provided therein; and
- Rules regarding Audit Procedures.

5.8 Fines and Penalties

Specific provisions for the levy of penalties for non-compliance of TP documentation requirements or non-submission of such information are not outlined under the TP By-laws. However, the FAQs clarify that failure to comply would trigger penalties and fines as per the Income Tax laws.

6. What next for KSA headquartered businesses/ MNEs having presence in KSA

One of the key aspects of managing transfer pricing risks would be to undertake a holistic review of TP arrangements/ documents as on date. Given the limited timeframe for compliances, some of the key considerations/ action points for taxpayers in the KSA with indicative timelines for completion are shown below:



7. Contact us

While this Alert summarises the key aspects of the TP bylaws and the FAQs, if you would like our assistance in understanding the specific implications of the transfer pricing laws to your business, planning ahead from a litigation risk mitigation perspective and undertaking requisite compliances, please feel free to get in touch with us at nilesh.ashar@dhruvaadvisors.com or vartika.jain@dhruvaadvisors.com.

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