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Transfer Pricing and ESR interplay for RHQ





A decade ago, the decision to establish a regional headquarters was largely driven by geography, connectivity, and market access.



Today, the conversation has evolved. As multinational enterprises increasingly choose Saudi Arabia as the base for their regional leadership teams, a new question has emerged in boardrooms across the world: **What makes a Regional Headquarters truly successful?**



The answer is no longer limited to office space, headcount, or regional oversight responsibilities. In today's business and tax environment, success is measured by something much deeper, the ability of an RHQ to demonstrate that it genuinely creates value.



Saudi Arabia's Regional Headquarters (RHQ) Program has become one of the most significant initiatives under Vision 2030, attracting multinational enterprises seeking to position themselves closer to one of the world's most dynamic economies. The Kingdom's vision extends beyond attracting companies; it aims to attract decision-makers, innovators, and regional leaders who will shape business strategies from within Saudi Arabia.



Beyond Compliance: The Story Behind ESR and Transfer Pricing

As businesses establish and expand their RHQs, they are entering an environment where regulators increasingly expect substance over form. The focus is no longer on where an entity is registered, but on where decisions are made, risks are managed, and value is created. This shift has placed Economic Substance Requirements (ESR) and Transfer Pricing (TP) at the center of every successful RHQ strategy.

Lets consider one example:

Consider two regional headquarters operating in Saudi Arabia. Both entities occupy modern offices in Riyadh. Both oversee operations across the Middle East. Both charge management fees to affiliated companies across the region.






On paper, they appear very similar, yet when regulators examine how these organizations actually operate, a very different picture may emerge.

One RHQ has senior executives based in Saudi Arabia who actively shape regional strategy, approve investments, oversee commercial performance, and manage key business risks. The leadership team regularly meets in the Kingdom, makes strategic decisions locally, and drives regional growth initiatives. The other RHQ primarily performs administrative coordination, while most significant decisions continue to be made elsewhere.

Although both entities may generate similar revenues, their ability to justify those profits can be fundamentally different. This is where the interplay between Economic Substance Requirements and Transfer Pricing becomes critical.



Transfer pricing determines how profits should be allocated among entities within a multinational group but economic substance determines whether an entity has earned the right to receive those profits in the first place.

In simple terms, transfer pricing answers the question:



“ **How much profit should the RHQ earn?** ”

while



“ Economic substance answers the more important question: **Why should the RHQ allocate the expenses and earn a profit on these expenses at all?** ”

From Structures to Substance: A Global Shift



The global tax landscape has undergone a profound transformation over the past decade. Historically, multinational groups could often rely on contractual arrangements to allocate profits and responsibilities across jurisdictions. Today, tax authorities are increasingly focused on economic reality rather than legal form.



Therefore, the era where tax outcomes were driven primarily by legal form is rapidly giving way to a more substance-driven approach. Today, economic substance, commercial intent, and real operational conduct play a decisive role in determining tax consequences in tax audits and tax disputes adjudication. For businesses and compliance functions, aligning structure, documentation, and business reality is no longer just best practice it is essential for sustainable tax compliance and effective tax dispute management/resolution.

The OECD's Base Erosion and Profit Shifting (BEPS) initiatives accelerated this transformation by introducing a fundamental principle:

Profits should follow value creation.

This principle has reshaped how RHQs are evaluated. Tax authorities now look beyond intercompany agreements and ask practical questions:



Where are strategic decisions made?




Who controls key business risks?



Which employees create value?



Where does management actually operate?

An aerial view of a modern city skyline at sunset, featuring several prominent skyscrapers and a dense urban landscape.

For RHQs in Saudi Arabia, these questions are no longer theoretical. They form the basis of how profits, incentives, and compliance positions are assessed.



Furthermore, the introduction of the OECD's Pillar Two global minimum tax framework reinforces the importance of maintaining commercially sustainable operating models. Multinational groups must now consider how their substance profile, transfer pricing policies, and global tax position interact across multiple jurisdictions.



The message from regulators is becoming increasingly clear:

Profits should follow people, decisions, and value creation.

The Business Impact: More Than a Tax Consideration

Regulators increasingly expect RHQs to demonstrate active involvement in managing regional operations. They expect to see senior executives based in the Kingdom, management meetings taking place locally, and strategic decisions being documented and implemented from Saudi Arabia.





From a transfer pricing perspective, RHQs are required to ensure that all transactions with related parties comply with the arm's-length principle. This includes maintaining appropriate documentation that demonstrates the nature of services provided, the benefits received by affiliated entities, and the methodology used to determine intercompany charges. Documentation should also support the commercial rationale for the transactions and establish that the pricing reflects economic reality.



In addition, organizations are increasingly expected to maintain evidence of governance and decision-making activities. Board minutes, management committee records, business plans, strategic reports, and documentation of regional oversight activities can all serve as important evidence supporting both economic substance and transfer pricing positions.



RHQs should be able to demonstrate not only that services were performed, but also that affiliated entities derived a genuine commercial benefit from those services. The ability to connect activities performed in Saudi Arabia with measurable business outcomes across the region is becoming a key differentiator in supporting transfer pricing positions.



For RHQs, this means that earning management fees or regional service income is no longer determined solely by intercompany agreements. Instead, tax authorities seek evidence that the RHQ genuinely performs the activities for which it is compensated. An RHQ that claims to provide strategic oversight must demonstrate that strategic decisions are being made in Saudi Arabia. Similarly, an RHQ that earns remuneration for managing regional risks must be able to show that it possesses the capability and authority to assess, monitor, and control those risks.





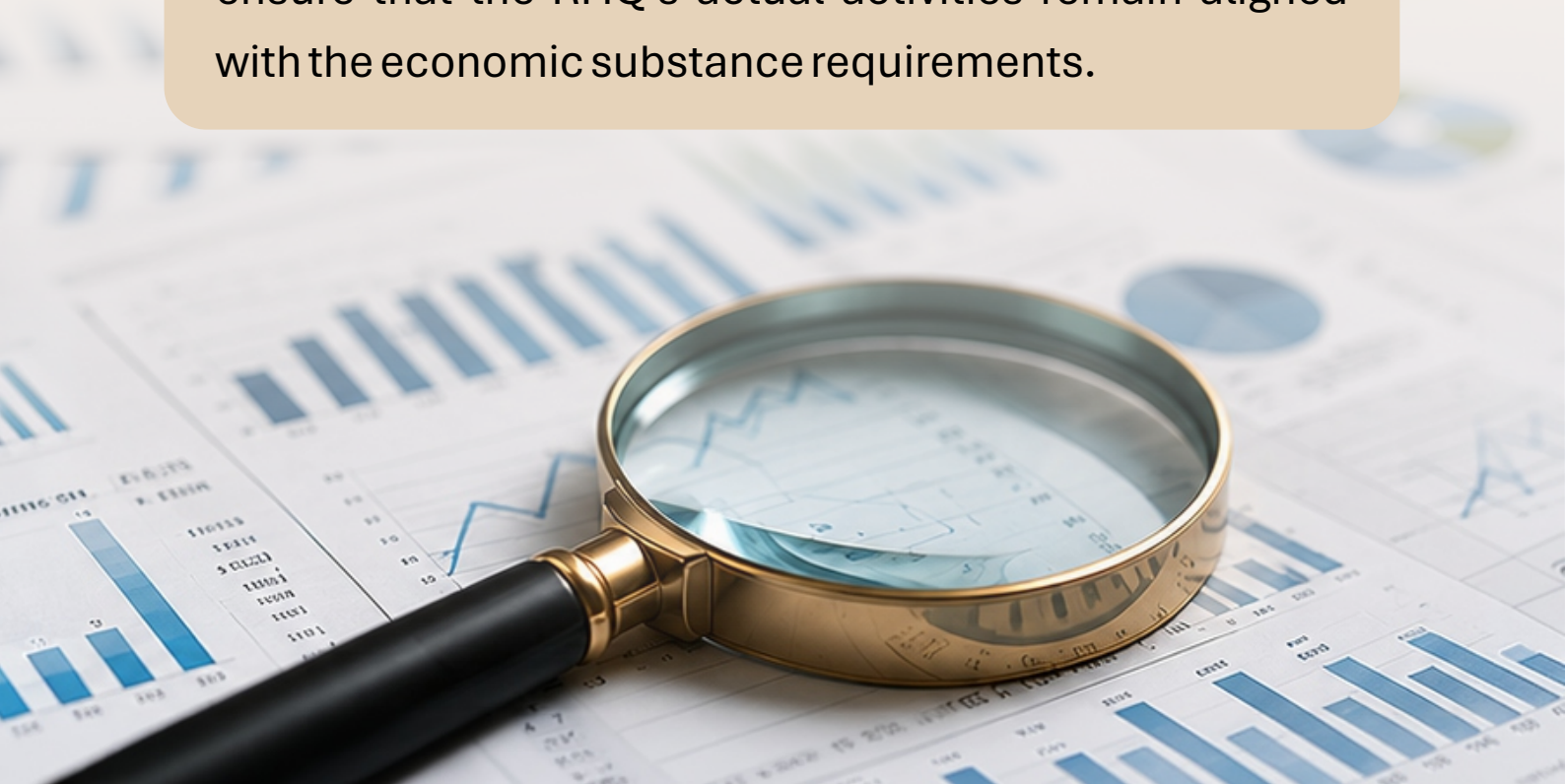
Compliances for RHQ in Saudi Arabia – **A Practical Perspective**

ZATCA has issues guidelines for RHQ and under these guidelines, an RHQ is required to submit an annual declaration, in a form to be prescribed by ZATCA, confirming that it has satisfied the prescribed Economic Substance Requirements. While the reporting form and detailed filing procedures are yet to be notified, businesses should not view this as a compliance obligation that can be addressed at a later stage. Rather, it signals the authorities intention to periodically assess whether an RHQ is genuinely operating as a regional decision-making centre and not merely existing to avail regulatory or tax incentives.



From a practical standpoint, this means multinational groups should begin preparing well in advance by maintaining robust documentation evidencing the RHQ's regional management functions, strategic decision-making, qualified employees, governance framework, operational expenditure, and other substance indicators. The annual declaration is expected to move beyond a simple compliance form and serve as a mechanism for ZATCA to verify that the RHQ continues to meet the eligibility conditions throughout its lifecycle.

Consequently, businesses should establish internal governance processes, maintain contemporaneous records, and periodically review their operating model to ensure that the RHQ's actual activities remain aligned with the economic substance requirements.



Conclusion

As regulatory expectations continue to evolve, the distinction between Economic Substance Requirements and Transfer Pricing is becoming increasingly blurred. One validates the presence of value creation, while the other determines how that value should be rewarded. Together, they provide a complete picture of an RHQ's role within a multinational group.

The organizations that will thrive under the RHQ regime are not necessarily those with the most sophisticated structures, but those with the most authentic ones. They will be the businesses that place decision-makers where decisions are made, align profits with value creation, and ensure that their operational reality matches their strategic narrative.

In the years ahead, regulators may continue to scrutinize structures, policies, and documentation. However, the fundamental question will remain remarkably simple:

Does the RHQ genuinely create value for the region it serves?

For organizations that can confidently answer "yes" with the people, processes, governance, and evidence to support it economic substance and transfer pricing become more than compliance requirements.

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