



# KSA introduces Transfer Pricing Regulations



## Introduction

The General Authority of Zakat and Tax (GAZT) in the Kingdom of Saudi Arabia (KSA) has recently issued draft Transfer Pricing Bylaws (TP Bylaws), inviting comments from the public. The deadline for submitting feedback is 3 Jumada Al Awwal 1440 (9 January 2019).

While TP Bylaws shall be effective from the date of publication in the official gazette, the provisions shall apply to all 'Controlled Transactions' to which a taxpayer was party to during the fiscal year ending 31 December 2018. Further, the requirement to maintain TP documentation shall be effective from 31 December 2018.

## Key highlights of the draft TP Bylaws

### 1. Detailed provisions in TP Bylaws and impact on taxpayers

The TP By-Laws provide a wide range of 'Controlled Transactions' (between related persons or persons under common control — the various terms have been defined).

The TP Bylaws shall also apply to transactions between resident entities. However, it appears that entities that are subject to Zakat shall only be insulated from TP Bylaws. It will be interesting to see the impact of TP adjustments on mixed companies and the corresponding impact on the calculation of the Zakat-base

### 2. Related Persons (Related parties)

The term 'Related Persons' has been defined in a very broad manner. In addition to the definition contained in the tax law, the following shall be considered as 'Related Persons' (or related parties) for the purposes of TP Bylaws.

- If one entity has the ability to control business decisions of another entity or entities;
- If two or more entities are under common control or are controlled by the same group of persons;

It is important to note that, unlike the tax law provisions, the TP Bylaws do not link the definition of control with direct or indirect ownership of voting rights. The definition is based on substance rather than the legal form of (ownership-based) control. Accordingly, it is possible that two or more entities may be considered 'Related Persons' even with no common ownership.

### **3. Low threshold**

The requirement to maintain a Master File and Local File is not necessary for the following:

- (a) Natural persons;
- (b) Small size enterprises (entities with arm's length value of 'Controlled Transactions' not exceeding SAR 6 million (USD 1.6 million) in a 12-month period; and
- (c) Entities that either do not enter into 'Controlled Transactions' or are party to such transactions but the aggregate arm's length value, which does not exceed SAR 6 million (USD 1.6 million) during any 12-month period

### **4. Transfer pricing methods**

The TP Bylaws have approved the following five TP methods:

- (a) Comparable Uncontrolled Price Method
- (b) Resale Price Method
- (c) Cost Plus method
- (c) Transactional Net Margin Method
- (c) Transactional Profit Split Method

A taxpayer may adopt transfer pricing methods other than the approved methods, provided the taxpayer is able to demonstrate with supporting documents that none of abovementioned methods provide a reliable measure of an arm's-length result and that the suggested method satisfies the provisions of 'Transfer Pricing Methods.'

### **5. TP Disclosure Form to be filed with annual income tax declaration**

Taxpayers shall be required to submit specified disclosure forms in respect of 'Controlled Transactions,' along with their annual income tax declaration (within 120 days following the end of their fiscal year). Moreover, the disclosures would include details for all 'Controlled Transactions' that are undertaken either without consideration or for some non-monetary consideration, such as barter arrangements

### **6. TP documentation and timelines**

The mandatory TP documentation requirements broadly appear to be consistent with the requirements under the OECD BEPS Action 13. It is pertinent to note the following time limits:

### TP documentation

When requested, taxpayers would be required to submit TP documentation to the GAZT within 30 days of such a request.

### Master and local file

Taxable Persons shall be required to maintain and make available the following on request from the GAZT:

- (a) Master file containing information on the global business operations and Transfer Pricing policies of the Multinational Enterprise Group to which the Taxable Person belongs; and
- (b) Local file containing detailed information on all Controlled Transactions of the Taxable Person

When requested by the GAZT, the local file or any part thereof shall be submitted within seven days from the date of the request or any other time limit indicated by the GAZT in the request. As this requirement is only for taxpayers, it appears that entities that are subject to Zakat only would not be subject to these documentation requirements.

### Country-by-Country Report (CbCR)

Country-by-country report (CbCR) and the notification need to be submitted by persons who are members of the Multinational Enterprise (MNE) Group with the consolidated group revenue exceeding SAR 3.2 billion (approximately US\$ 852 million or EUR 750 million).

Taxable persons shall submit the notification to the Authority **within 120 days** following the end of the fiscal year. Further, the CbCR shall be filed **within 12 months** after the last day of the fiscal year of the MNE Group.

## 7. Corresponding adjustments

The scope of the corresponding effect of TP adjustments made by tax authorities in other jurisdictions has been restricted to treaty-partner jurisdictions only. Moreover, a claim for corresponding adjustments would be subject to time limitation provisions set out in the tax law (five years).

## 8. TP adjustments by GAZT

It seems that while making any TP adjustments to the tax base of taxable persons, GAZT officers would need to disclose the comparable benchmark to the taxpayer concerned.

## 9. Additional guidelines

The GAZT will issue additional guidelines for selection of suitable methods (possibly identifying relevant databases for benchmarks) to be used and other matters relating to TP.

## 10. Advanced Pricing Agreements (APAs)

The draft regulations do not suggest that the GAZT would be entering into APAs with taxpayers. The TP Bylaws make reference to acceptable Arm's Length Range, the rules, conditions and limitations for which shall be set out in the guidelines to be issued by GAZT.

## 10. Penalty for non-compliance

Specific provisions for levy of penalties for non-compliance of TP documentation requirements or non-submission of such information are not outlined in the draft TP Bylaws. However, failure to file the declaration within the due date or for not using the prescribed forms triggers penalties as per Income Tax laws and Bylaws.

## Conclusion

As a member state of G20, Saudi Arabia had already endorsed the BEPS Action Plan. In September, KSA signed the Multilateral Convention to implement Tax Treaty-related measures to prevent Base Erosion and Profit Shifting. Thus, developing regulations for implementing the CbyC initiative as part of the BEPS Action Plan were expected.

The GAZT is becoming more cognizant of the importance of tax collection, particularly as the Saudi Arabian government is seeking to diversify its revenue base and move away from being an oil-only based economy.

The issuance of draft TP Bylaws demonstrates GAZT's commitment to bring transformation in the taxation system of the country.

In view of the above, review of transactions with related parties, which could be impacted by the draft TP Bylaws, is the need of the hour.

## What can companies expect?

It appears that GAZT will scrutinize transfer pricing policies, business activities, supply chain arrangements, inter-company transactions, etc. of companies in more detail. Therefore, documentation and appropriate benchmarking of inter-group transactions to comply with the TP Bylaws is important for managing related tax risks. Thus, entities that are subject to tax and mix entities may have the maximum impact, whereas companies subject to Zakat may have a reduced impact.

Also, by extending the scope of regulations to transactions between resident entities, the GAZT is seeking to ensure that there are no tax or Zakat leakages.

## How can we help?

Our qualified teams with a strong background and knowledge in transfer pricing and corporate tax combined with familiarity with related local and regional legal frameworks, can help you understand the GAZT's requirements and expectations. Furthermore, as part of KPMG's global network, our experts have good understanding of issues that generally arise with the introduction of Transfer Pricing regulations. We seek to localize our international experience for the benefit of our clients.

We can help you in

- Reviewing the existing business structures and arrangements of entities in KSA from a TP perspective and identifying cases where two (or more) entities may be considered related parties
- Reviewing business arrangements, transactions with related parties, embedded arrangements, identifying risks (if any) in the existing TP arrangements of the group and making recommendations for the way forward
- Providing suggestions on selection and adoption of approved TP methods that are more suited to specific business arrangements
- Reviewing business arrangements, transactions with related parties, embedded arrangements, identifying risks (if any) in the existing TP arrangements of the group and making recommendations for the way forward
- Assistance in development of TP documentation that can provide robust defense in case of a revenue challenge
- Conducting trainings and apprising senior management of various provisions that could impact the business along with documentation and compliance requirements

Considering that tax litigation in most countries (in terms of volume) has moved largely toward transfer pricing adjustments, the introduction of TP Bylaws is a very significant development in the Kingdom. Our global experience suggests that the introduction of TP Bylaws would result in increased tax litigation.

Based on our experience relating to the introduction of VAT in January 2018, we expect a formal issuance of the TP Bylaws to be followed up by the GAZT with inquiries, notices and specific audits. It is, therefore, recommended that entities look into their business arrangements from a transfer pricing perspective and start preparing the related documentation.

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