

KSA introduces Transfer Pricing Regulations



Introduction

In December 2018, the General Authority of Zakat and Tax (GAZT) in the Kingdom of Saudi Arabia (KSA) had issued a draft of Transfer Pricing Bylaws (TP Bylaws) for public consultation. Along with others, KPMG had also submitted its comments and recommendations on the draft TP Bylaws.

On 15 February 2019, the GAZT formally released the final TP Bylaws. Along with the TP Bylaws, the GAZT also issued a set of Frequently Asked Questions (FAQs) and answers to those questions. As mentioned in the FAQs document, the answers to FAQs do not represent GAZT's interpretation of the TP Bylaws and that the laws and regulations (including TP Bylaws) should prevail in case of a contradiction.

To know more about transfer pricing please click on the link [here](#).

Key highlights of the TP Bylaws

1

Effective date and submission of TP Disclosure Forms

(a) Effective date

The draft version of TP Bylaws clearly stated that the provisions relating to maintaining TP documentation would come into force and have effect as of 31 December 2018 and that controlled transactions undertaken during the year ending (now ended) 31 December 2018 would be subject to the TP Bylaws. The final version, however, sets out the date of publication as the effective date of the bylaws. There is no specific mention of any reporting in respect of the year ended 31 December 2018.

The answer to FAQ No. 8 clarifies that TP documentation requirements are applicable to reporting year ending on 31 December 2018 and all subsequent reporting years. The answer further clarifies that the GAZT also retain a right to seek documentation in respect of transactions undertaken during the years prior to 2018. However, in all cases, the taxpayers would be allowed at least 30 days for submitting the requisite information and documentation.

In light of the above, it seems that the Disclosure Form for Controlled Transactions (DFCT) may be required to be filed along with tax returns for the year ended 31 December 2018. This is on the basis that the filing requirement (a procedural matter) arises after the issuance of the TP Bylaws. The GAZT retain a right to seek additional information in support of a tax return. Accordingly, they may require a taxpayer to provide TP documentation (including Master File or Local File or any part thereof) in respect of the financial year ended 31 December 2018. The answer to FAQ 8 clarifies that the GAZT would provide an additional 60-day grace period for submitting TP documentation, if sought, for the year ended 31 December 2018.

For controlled transactions undertaken during the years prior to 2018, the GAZT may also require any information or documentation.

(b) Disclosure Form for Controlled Transactions

The matter relating to the effective date of the TP Bylaws is important because the DFCT requires detailed information to be submitted, including:

- Details of all 'Controlled Transactions' undertaken for or without monetary consideration (such as barter arrangements).

- A list of all shareholders. For listed entities, information of all shareholders, directly owning more than 5% shares would need to be disclosed.
- Where there has been an internal reallocation of functions, assets and risks within a group, the same needs to be reported as part of the DFCT for the reporting year relevant to the change.

The DFCT shall form part of annual tax declaration and be submitted electronically (in Arabic only) by every person engaged in controlled transactions, irrespective of their value.

Along with DFCT, taxpayers would also be required to produce an auditor's certificate confirming that an MNE's TP policy has been consistently applied by and in relation to the taxpayer.

2

Related Persons (Related parties) and Effective Control

(a) 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.

There is an apparent mismatch between the definition of the term 'Related Parties', as contained in the Income Tax Law and that in the TP Bylaws. Article 25 of the TP Bylaws provides that the provisions of the Income Tax Law (and Income Tax Regulations) are to be construed and interpreted in a manner consistent with TP bylaws. Under the generally accepted rules of interpretation, all laws and regulations need to be interpreted in a cohesive manner and avoiding any vacuum. However, in case of an unavoidable conflict, the superior legislation prevails over the subservient legislation.

In light of the above, one would expect that the provisions of the Income Tax Law (being issued under a Royal Decree) shall prevail over TP Bylaws (being issued by the GAZT). The mismatch could therefore result in a tax litigation. We are seeking specific confirmation from the GAZT and will be issuing another Tax Alert upon receipt of their confirmation / clarification.

(b) Effective Control

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.

The riding clause of definition of 'effective control' now contains the words "without limitation" before setting out specific cases of effective control. This suggests that the scope of effective control has been broadened and the specific instances set out in clauses (a) to (k) are now only illustrative. Thus, taxpayers not falling within specific-instance clauses [(a) to (k)] may still fall within the scope of the definition of effective control.

Exceptions

A specific exception has been provided whereby Financial Institutions are not to be considered related parties with their borrowers solely on the basis of their (funded or unfunded) credit arrangements with the borrowers. The term 'Financial Institution' has been defined to cover only those entities that are regulated by one or more central government agencies responsible for licensing and supervising it in jurisdictions in which it operates. This was one of the specific recommendations made by KPMG.

3

Applicability on taxpayers and Zakat-payers and the scope of transactions

The following points are important:

- The TP Bylaws are applicable on all Taxable Persons, as defined in the Income Tax Law. This includes entities that are jointly owned by GCC and foreign (non-GCC) shareholders (mixed entities).
- Permanent establishments and branches of foreign companies are also subject to TP Bylaws. However, it is not very clear how arm's-length principle will be applied on those permanent establishments that are paying tax on a deemed-profit basis, where the rate of deemed-profit has already been agreed with the GAZT. As the TP Bylaws require TP documentation for all cases where an entity maintains accounting records for any reason (including for management reporting purposes), it seems that all permanent establishments (including those paying tax on a deemed-profit basis) are required to maintain (and submit, if required) TP documentation.

- Transactions between domestic related parties are also covered within the scope of TP Bylaws.
- Companies that are owned 100% by GCC nationals, and are subject only to Zakat, are not subject to TP documentation requirements relating to Master File, Local File and DFCT. Such entities are subject to requirements relating to the filing of Country-by-Country Report (CbCR), provided they meet the threshold requirement for global gross revenues (being in excess of SAR 3.2 billion). However, the Zakat regulations also require transactions between related parties to be undertaken on an arm's-length basis. Moreover, overseas subsidiaries or affiliate entities of Saudi Zakat-paying entities would likely be subject to foreign TP requirements. A TP adjustment arising in a foreign jurisdiction may result in Zakat leakage in Saudi Arabia, as the application of corresponding adjustments set out in the TP Bylaws is only for taxpayers. Given the implications, and the fact that the GAZT reserve the right to direct any person to prepare and maintain documentation related to controlled transactions, Zakat-payers are recommended to ensure that their controlled transactions are on an arm's-length basis, duly supported by relevant documentation and analysis.

TP documentation and timelines

The mandatory TP documentation requirements are broadly in line with the requirements under the OECD BEPS Action 13.

(a) TP documentation and provision thereof to the GAZT

The GAZT may seek a taxpayer to provide a copy of their Master File or Local File or any part thereof at any time by issuing a notice of not less than 30 days. As mentioned above, only in respect of financial year ended 2018, taxpayers will be given an additional extension of 60 days for providing Master File or Local File or any part thereof.

(b) Master File

The Master File should contain information on the global business operations and Transfer Pricing policies of the Multinational Enterprise Group to which the taxable person belongs. In respect of any 'intangibles', the Master File should provide for identity of legal and de-facto owners of intangibles.

(c) Local File

The Local File should contain detailed information on all Controlled Transactions of the taxable person and should also contain information in respect of any business restructurings (transfers of risks, functions, tangible or intangible assets impacting directly or indirectly the taxpayer in Saudi Arabia) in the current year on in the preceding year.

(d) Comparability analysis

The GAZT expect taxpayers to perform comparability analysis on a 'triannual' basis (every 4 months). It appears that the intention is 'triennial' i.e. once every three years and not triannual. We are seeking clarification from GAZT in this regard and that will be part of our next Tax Alert.

(e) Language for record keeping

The GAZT are encouraging the submission and maintenance of TP documentation in Arabic. However, certain contents of TP documentation in a foreign language (English) might also be accepted by the GAZT.

Summary

The above documentation requirements are only for taxpayers. Therefore, entities that are subject to Zakat only would not be subject to these documentation requirements.

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

- Natural persons;
- 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).

(f) Country-by-Country Report (CbCR)

The CbCR should be electronically filed on a web portal (to be developed by the GAZT) that would require a one-time registration for MNEs. The requirement relating to notification for CbCR has not changed and remains at 120 days after the year-end, while the filing deadline also stands at 12 months after the year end.

The CbCR requirement applies on taxpayers as well as Zakat-payer entities.

The CbCR and the notification need to be submitted by members of an Multinational Enterprise (MNE) Group with consolidated group revenue exceeding SAR 3.2 billion as per consolidated financial statements of the MNE Group.

Where CbCR is being filed in another country that has signed the Multilateral Instrument (MLI) and the Qualifying Competent Authority Agreements (QCAA), the filing of the notification to the GAZT should suffice. However, if the foreign country systematically fails to provide a copy of CbCR to the GAZT, then the local constituent entity is required to provide a copy of the CbCR submitted in the foreign jurisdiction.

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Corresponding adjustments

The scope of the corresponding effect of TP adjustments made by tax authorities in other jurisdictions has been broadened to all countries that have signed International Agreements. This is another welcome amendment to the draft Bylaws and is in line with the recommendations made by KPMG.

A claim for corresponding adjustments would be subject to time limitation provisions set out in the tax law (five years).

6

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.

7

Transfer pricing methods

The five TP methods (as below) set out in the draft TP Bylaws remain unchanged:

- (a) Comparable Uncontrolled Price Method
- (b) Resale Price Method
- (c) Cost Plus method
- (d) Transactional Net Margin Method
- (e) 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'.

8

Penalties

No specific penalties for non-compliance of TP documentation requirements or non-submission of such information have been set out in the TP Bylaws. However, penalties normally applicable under the Income Tax Law would also apply on TP defaults. For example, penalty on delay or failure in filing a declaration by the due date or for not using the prescribed forms.

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 (such as, information to be disclosed in the CbCR, etc.).

10

Advanced Pricing Agreements (APAs)

The TP Bylaws 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.

What should businesses expect?

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 CbCR initiative as part of the BEPS Action Plan were expected.

The GAZT are becoming more cognizant of the importance of tax collection, particularly as the Kingdom is seeking to diversify its revenue base and is moving away from being an oil-only based economy. The issuance of formal TP Bylaws demonstrates GAZT's commitment to bring transformation in the taxation system of the country.

It appears that GAZT will be scrutinizing 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 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 limited 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.

Tax litigation in most countries (in terms of volume) has moved largely toward transfer pricing adjustments. This is an area where tax authorities around the world are putting more focus, especially after the BEPS Action Plan. This assertion is substantiated by the fact that the number of countries with formal TP laws has doubled since 2015. In this backdrop, 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 that the issuance of the TP Bylaws will 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.

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 your existing business structures and arrangements from a KSA 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.

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