Global Transfer Pricing Landscape

Kingdom of Saudi Arabia

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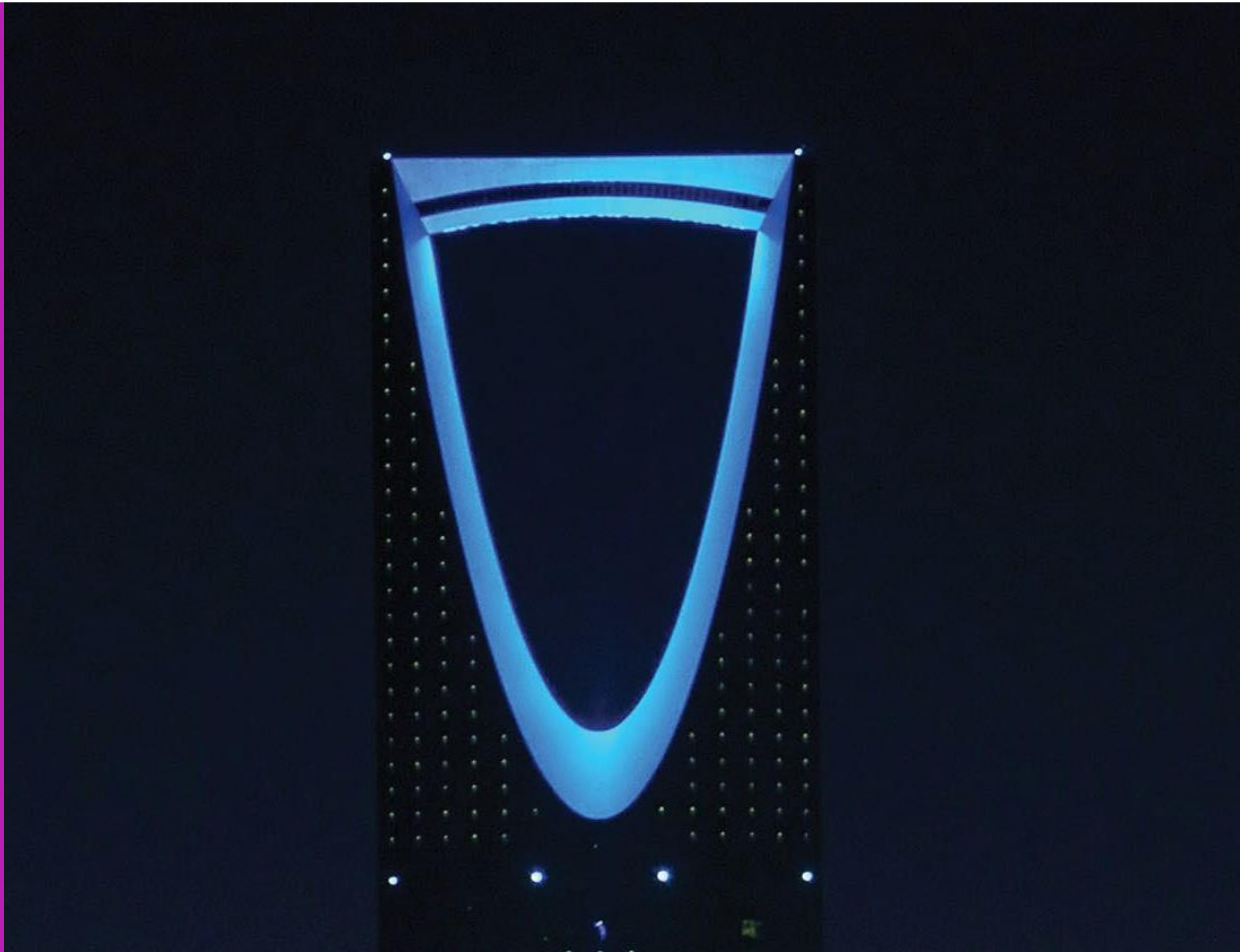

Highlights

February 2019

Introduced a set of comprehensive Transfer Pricing regulations in a separate Bylaw.

March 2019

Released guidelines to aid taxpayers in compliance with the Bylaws.

May 2020

Issued an updated guidance note providing clarifications to taxpayers on rules of interpretation as well as cosmetic changes introduced in the document.

Introduction

In KSA, detailed provisions on transfer pricing were introduced by the Transfer Pricing Bylaws (TP Bylaws) issued by the General Authority of Zakat and Tax (GAZT – tax authority) pursuant to Board Resolution No. [6-1-19] dated 25/05/1440H corresponding to 31 January 2019. These generally follow the OECD guidelines to keep the KSA provisions in line with the global practices.

The transfer pricing provisions apply to every taxable person (only judicial person including Permanent Establishments (PEs)), which provides that the price of any controlled transaction should be similar to comparable transactions between independent persons regarding the arm's length principle.

The Bylaws shall apply to controlled transactions to which taxable persons (only judicial persons) are a party to during the fiscal year ending 31 December 2018. A 100% Zakat payer is exempted from TP Bylaws unless a judicial person is required to file Country-by-Country Report (CbCR).

Related Persons

Two persons can be said to be related via a control-in-ownership or effective control.

Control via Ownership: A non-resident or resident person that owned/owns, directly or indirectly, 50% or more in another person or is owned by commons persons.

Effective Control: This would be the ability of a person to control the business decisions of another person.

The levels of effective control are categorized as follows:

- Governance: Influence through a management agreement, trust arrangement, or the control on the board of directors.
- Funding: Control over decision-making from an economic point of view through debt or equity capitalization.
- Business: The business is heavily dependent upon transactions with other persons for sale, purchase, etc.

An illustrative definition of effective control has been provided in the TP Bylaws as follows:

- Ability to perform functions of management;
- Ability to act as a trustee under a trust arrangement;
- Ability to control, appoint, or remove 50% or more of the board of directors of other person;
- Right to receive 50% or more share in profits;
- Provided loans, the value of which exceeds 50% or more of the total debts of the borrower;
- Issued guarantees covering 25% or more of total borrowings of other person;
- 50% or more of the value of business activities depends on transactions with other person;

- Participation in management or having ownership of 50% or more in other person.

Fulfillment of any of the above-illustrated parameters shall establish a related person relationship. However, the updated guidelines provide the taxpayer with an option to counter this relationship if he is able to substantiate that no effective control exists.

Controlled Transactions

The regulations cover international transactions as well as domestic transactions, which include business arrangements in goods, services, loans, and intangibles. Further, it shall also include any notional transactions, or consideration exchanged between a person and its PE.

Arm's Length Price and Methods

The arm's length remuneration of a controlled transaction shall be determined by applying any of the five approved methods (no order of preference). These methods form the most reliable measure of an arm's length result:

i. Comparable uncontrolled price method;

ii. Resale price method;

iii. Cost plus method;

iv. Transactional net margin method; and

v. Transactional profit split method.

Other methods can be applied provided that the taxable person is able to demonstrate that none of the above methods provide a reliable measure of an arm's length result.

Benchmarking Approach

Tested Party: This is usually the least complex party to the transaction, which allows for easier comparison of the margin as opposed to a more complex party.

Database: No specific database is prescribed in the TP Bylaws, and the Authority will not automatically reject the use of any particular database provided that the information derived from that database is accessible.

Multiple Years: In order to normalize the data of potentially comparable persons, searches should include three consecutive years of data.

Selection of Comparables: The updated guidelines state that the selection of comparable uncontrolled transactions must be obtained within a similar industry and in a geographical market comparable to Saudi Arabia. However, the Authority may accept the use of foreign comparable transactions by a taxable person in the event of unavailability or absence of such domestic comparable transactions.

Moreover, the second edition of Saudi Arabia's transfer pricing guidelines clarify that the companies owned by a natural person may be included in the comparability analysis as a comparable, assuming that the natural person will not materially impact the profitability of the company.

Arm's Length Range: Taxpayers can use the interquartile range (25th to 75th percentile). Generally, any point within this interquartile range should be considered in line with the arm's length principle. However, unless properly substantiated, the Authority expects that the median point is used when determining the transfer pricing policy if the prices are outside the interquartile range.

The arm's length range should be updated every three years. If there are any changes to the functional analysis, the benchmarking approach should be updated.

Revised transfer pricing guidelines have clarified that there shall not be any materiality thresholds for the applicability of the arm's length principle on controlled transactions entered into by related persons. Hence, irrespective of the extent of transfer pricing documentation applicable, the controlled transaction should be at arm's length.

Transfer Pricing Documentation

Documentation Approach

The transfer pricing documentation requirements have been aligned with the OECD BEPS project, in which three-tier documentation, viz. CbCR, Master File, and Local File were introduced. The general documentations are also prescribed by the Bylaws.

The Local File

Local File is applicable when the value of controlled transactions during any 12 months period is SAR 6 million or above.

Local File provides detailed information on a controlled transaction with the taxable person. The taxpayer is required to maintain the Local File information a all times and submit the following details to the Authority within 30 days of the request:

- Taxpayer's information such as management structure, organization's information, business description, strategy, and restructuring, if any;
- Description of intragroup controlled transaction, related person's information, relevant agreements, and benchmarking approach as discussed above;
- Industry analysis of business segment and financial information such as financial statements, relevant schedule of working, etc.

However, the Local File is required to be prepared at the time of filing of returns only.

Further, natural persons and small enterprises are not required to maintain the Local File documentation.

The Master File

Master File provides an overview of the MNE's global business, the transfer pricing policy, and the economic activities/functions of the related persons.

Master File is applicable when the value of controlled transactions during any 12 months period is SAR6 million or above.

The following information should be included in the Master File and provided to the Authority within 30 days of the request:

- Group's legal and beneficial ownership structure, including geographical locations;
- Description of the group's business such as important drivers, supply chain, service arrangement, markets, functional analysis, and restructurings, if any;
- Information on group's intangibles such as strategy, DEMPE analysis, important intangibles and their arrangement, pricing policies, and transfers, if any;
- Financial activities of the group such as funding decisions, central financing entities and activities, pricing policies, etc.
- Group's financials and tax position, including annual consolidated financial statement of the group, financial and internal reporting, and list of advance pricing agreements entered, if any;
- Further, natural persons and small enterprises are not required to maintain the Master File documentation.

Country-by-Country Report (CbCR)

CbCR is applicable when the consolidated group revenue of an MNE group during the year immediately preceding the current reporting year, as reflected in its consolidated financial statement, exceeds SAR 3.2 billion (approximately EUR 750 million).

The report includes tax jurisdiction-wide information relating to the MNE's global activities. A CbCR must contain the following details:

- Information relating to the aggregate value of revenue (both from controlled and uncontrolled transactions), profit (or loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets other than cash or cash equivalents in respect of each country in which the MNE group of the taxable person operates; and
- An identification of each constituent entity of the MNE group indicating the country of tax residence was different from the country of tax residence, the country under the laws of which the constituent entity is organized, and the nature of the main business activity or activities of such member entity.

The said report is required to be submitted within 12 months from the end of the reporting year of the said MNE group.

Every Saudi Arabian taxpayer who is part of an MNE group with a consolidated group revenue exceeding the threshold of SAR 3.2 billion must register at the GAZT automatic exchange of information portal and file an Article 3 notification to the GAZT along with its income tax return.

The GAZT added useful and comprehensive step-by-step practical guidance for the registration and submission in its CbCR portal in the second edition of transfer pricing guidelines.

As per the revised guidelines, the constituent entities operating in KSA shall be exempted from filing the CbCR in KSA if the ultimate parent entity is not required to file the CbCR in its local jurisdiction on account of the threshold limits not being met. However, such constituent entity shall have to notify the GAZT and provide necessary information to depict that while the laws of KSA require CbCR to be filed, the same has not been filed only on the ground that the group has not met the threshold of that local jurisdiction via a CbCR notification.

Controlled Transaction Disclosure Form (CTDF)

A transfer pricing disclosure form is required to be filed by all the taxpayers entering into controlled transactions along with income tax return, which requires disclosure of the related party transactions, business restructuring, profit and loss declaration, maintenance of Master File and Local File, shareholding details, etc.

Furthermore, the said disclosure form is to be supplemented by a Chartered Accountant certificate, declaring that the transfer pricing policy of the MNE group is consistently applied in relation to the taxpayer in Saudi Arabia.

Based on the current tax laws, there is a 120-day period after the last day of the financial year to submit the tax return, whereas, for partnerships, the same applies with a reduced 60-day period to submit the tax return.

Penalties for Non-compliance

In both cases, the disclosure form should be submitted 120-days after the last day of the financial year, irrespective of any exceptions to the deadline for filing the tax return.

Audit Procedures

There are no specific transfer pricing penalties notified yet. However, penalties may be levied by the tax authority in line with the Income Tax Act for non-compliance.

The Authority shall follow the audit rules and procedures established under the Income Tax Law, as the specific audit rules for TP Bylaws have not yet been notified.

Corresponding Adjustment

Where a taxable person has entered into a controlled transaction with a non-resident person located in another jurisdiction that is a party to an International Agreement with KSA, and the tax authority of such other country has made or proposed an adjustment in the tax base of controlled transaction based on the arm's length principle, the KSA tax authority shall examine its consistency and make an appropriate adjustment to the tax base of the KSA taxpayer with the view to eliminate economic double taxation. The taxpayer is required to submit an application to this effect, substantiating its claim for adjustment.

Specifc Guidelines

Safe Harbour and Advance Pricing Arrangement

There are no Safe Harbour and APA rules notified by the tax authority in KSA. However, taxpayers can apply for advance rulings in specific matters.

The guidelines provide special guidance for various transfer pricing issues as detailed below:

Financial Transactions

Examples have been provided for arm's length approach for loan transactions, guarantee, cash transactions, risk assurance, etc. Arm's length nature must be established considering both lender and borrower perspective, credit ratings, transaction functionality, risk allocations, benefits derived from transaction to each party, market conditions for comparable transactions, etc.

Intangibles

The guidance includes a specific framework on the identification of the intangible and economically significant risk associated with development, enhancement, maintenance, protection, and exploitation (DEMPE) of intangibles.

It defines 'De facto owner of intangibles' to regard a person as an economic owner of intangibles if he is in control of DEMPE functions, making significant decisions, and managing and bearing respective risks. It is possible that the legal owner and de facto owner are not the same persons.

Business Restructuring

The business restructuring has an impact on the profit potential of a person. The 'profit potential' means 'expected future profits.' To determine whether compensation is applicable, a comparison of pre-business restructuring and post-business restructuring functions performed, risk assumed, and assets used is important.

Valuations

The guidance note specifies the use of valuation techniques to determine arm's length pricing of a controlled transaction.

Summary of Transfer Pricing Requirements

Effective from

Fiscal Year ending December 2018

Compliance Requirements

- Transfer pricing disclosure form and CbCR notification to be filed along-with corporate income tax return.
- Maintain three-tier documentation – Local File, Master File, and CbCR as per TP Bylaws.

Penalties

Penalties levied in lines with income tax law.

Method and Preference for Comparable

- Five approved methods without hierarchy. Other methods can be used in cases where approved methods are not applied.
- Local comparable preferred. Foreign comparables can be accepted if domestic data not available

Safe Harbour and APA

Not available as of now

BEPS/CbCR applicability

Applicable

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