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Global Tax Alert

News from Transfer Pricing

Saudi Arabia's Tax Authority releases final transfer pricing bylaws and FAQs

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Executive summary

Saudi Arabia's General Authority of Zakat and Tax (GAZT) issued, on 15 February 2019, the final Transfer Pricing (TP) Bylaws (TP bylaws), which have been available since 10 December 2018 in draft for public consultation. The final TP bylaws include several amendments compared to the draft TP bylaws. In conjunction with the release of the final TP bylaws, the GAZT also published a Frequently Asked Questions (FAQs) document, which serves as a reference guide for the purposes of interpretation and practical implementation of the TP bylaws.

This Alert summarizes the key amendments in the final TP bylaws as compared to the draft version.¹

Highlights

With respect to the new TP compliance requirements introduced in the TP bylaws, there are several significant amendments to the earlier draft version:

- ▶ **Reporting period:** In terms of accounting period that is covered by the TP bylaws, the GAZT has removed the reference to the fiscal year ended 31 December 2018 as being the first year the provisions of the TP bylaws would apply, however, the FAQs document confirms that the TP documentation requirements are applicable for fiscal years ended

31 December 2018 onwards. This should not prejudice the GAZT's rights under the Saudi Income Tax Law to request information related to preceding fiscal years if required.

- ▶ **Zakat payers are required to file a country-by-country (CbC) report:** With respect to CbC reporting (CbCR), the applicability of the legislation has been extended to also cover persons subject to Zakat.
- ▶ **Disclosure form:** Together with the Disclosure Form of Controlled Transactions (disclosure form), taxpayers will be required to submit an affidavit from a licensed auditor through which the auditor certifies that the TP policy of the multinational enterprise (MNE) is consistently applied by, and in relation to, such taxpayers.
- ▶ **Master file and local file:** The deadline for providing the local file to the GAZT has been amended from 7 days to 30 days from the date of request, so it is now aligned with the timeline for providing the master file. As per the GAZT website and the FAQs, however, during 2019 only, taxpayers will be granted an extension of 60 days to provide the master file and local file.
- ▶ **CbCR:** The concept of a surrogate parent entity has now been included into provisions regarding the CbC report. The final TP bylaws also clarify that the consolidated group's revenue threshold used to determine the applicability of CbCR requirements should be based on the immediately preceding fiscal year.
- ▶ **Language of TP documentation:** The FAQs state that the GAZT encourages submission in Arabic to the extent it is reasonably possible, while also indirectly acknowledging that the GAZT may accept the documentation in languages other than Arabic.
- ▶ **Effective control:** The final TP bylaws also include revision and clarification with respect to the definition and examples of effective control. Specifically, certain terms in the TP bylaws have been defined, including "financial institutions," "international agreements," "systemic failure," and "taxable person."
- ▶ **TP Guidelines:** The bylaws and the FAQs also refer to the TP guidelines in several places. Such guidelines have not been issued yet, however, when issued will provide greater insight into the TP laws. The final TP bylaws state that TP guidelines may be issued upon approval by the Governor of the GAZT.
- ▶ **The TP bylaws and the FAQs** are available on the [GAZT website](#).

Detailed discussion

On 10 December 2018, the GAZT published draft TP bylaws for public consultation. The draft TP bylaws follow international standards, including establishing the arm's-length principle and documentation standards as set out in the *Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines*.²

The draft TP bylaws indicated new compliance requirements for fiscal years ended on or after 31 December 2018, including a Disclosure Form of Controlled Transactions, and TP documentation and CbCR requirements that are broadly aligned with the OECD's Base Erosion and Profit Shifting (BEPS) Action 13 Final Report.

On 15 February 2019, the GAZT published the final version of the TP bylaws. The final TP bylaws include additional amendments and further explanation on a few provisions in the draft TP bylaws. Additionally, in conjunction with the release of the final TP bylaws, the GAZT also published an FAQs document, which serves as a reference guide for the purposes of interpretation and practical implementation of the TP bylaws.

The key amendments included in the final TP bylaws are set out below.

Scope of application

While the draft TP bylaws, Article 2 states that the TP provisions apply to all taxable persons under the Income Tax Law, the final TP bylaws have extended the coverage of the applicability of TP bylaws to include persons subject to Zakat who are not subject to corporate Income Tax Law in Saudi Arabia. Nevertheless, this coverage extension is only applicable for CbCR requirements as explained in Article 18 of the TP bylaws and not the compliance or documentation requirements. In short, the bylaws do not apply to entities subject only to Zakat, except if they are subject to CbCR. The TP bylaws and the FAQs document also confirm that there is no exemption for domestic controlled transactions, i.e., controlled transactions within Saudi Arabia.

Related persons definition

As previously included in the draft TP bylaws, the TP bylaws retain the expanded definition of "related persons" for TP purposes, which introduces into Saudi tax law the concept of effective control which can be indicated by several conditions. This means that taxpayers may be considered

having a relationship for TP purposes that is akin to a related party relationship, regardless of any common ownership of share capital among them, if they are presumed to be able to control the business decisions of the other entity.

The following list includes examples of conditions that may be considered to indicate the existence of effective control (as amended):

- ▶ Management services or trustee arrangements
 - ▶ Ability to control the composition of 50% of the board of directors of the other party
 - ▶ The legal or *de facto* right to receive 50% or more of the profits of the other party
 - ▶ Provision of loans with outstanding balance representing 50% or more of the long-term and short-term debt and capital excluding retained earnings as of the year-end balance of the reporting year (except loans from financial institutions)
 - ▶ Provision of guarantees to cover 25% or more of the value of other party's total borrowings as of the year-end balance of the reporting year (except guarantees written by (financial institutions)
- (for the above two clauses, the exemption of loan from financial institutions is a new addition)
- ▶ Significant business dependency with other party whereby 50% or more of the absolute aggregated value of the business activities as of the year-end balance of the reporting year depends on transactions with such other party
 - ▶ Direct or indirect ownership of 50% or more, or management participation in the other party
 - ▶ Principal or supplier relationships under an exclusive agency or distributorship arrangement
 - ▶ Exclusive rights to use intangible property granted by the nonresident party
 - ▶ Having the ability to control the business decisions of the other party

The final TP bylaws have also introduced certain new definitions of terms for the purposes of interpretation of the provisions on the TP bylaws, e.g., "financial Institution," "international agreement," and "systemic failure."

Disclosure form

As previously introduced in the draft TP bylaws, all income taxpayers in Saudi Arabia will be required to submit to the GAZT together with their annual income tax declaration

a disclosure form containing information related to their controlled transactions. Saudi Arabian taxpayers that have related party transactions will have to submit the first disclosure form within 120 days of the end of financial year 2018.

The FAQs also provides the following clarifications with respect to the disclosure form:

- ▶ The disclosure form should include the transactions with related persons who are natural person (i.e., individuals)
- ▶ The language of the disclosure form will be similar to the language of the tax declaration as the disclosure form is part of the tax declaration
- ▶ No aggregation or netting is allowed when reporting the transactions in the disclosure form
- ▶ The arm's-length value of transactions should be reported
- ▶ With respect to "non-monetary charge/free of charge," the FAQs document defines these transactions as transactions for which consideration would have been paid had the transaction been conducted with a third party and, therefore, transactions without consideration between related persons are presumed to be not at arm's length as it is expected that such a transaction would be for consideration if it were between independent parties
- ▶ With respect to shareholding information, shareholding details including the names, jurisdictions and ownership percentages of individual shareholders are required for these fields (for listed companies only shareholders which hold 5% or more shares need to be disclosed in the form)
- ▶ CbCR notification is an integral part of the disclosure form

Affidavit

The final TP bylaws also require the taxpayer to submit an affidavit from a licensed auditor together with the disclosure form. Through such affidavit the licensed auditor certifies that the TP policy of the MNE is consistently applied by, and in relation to, such taxpayers. Neither the TP bylaws nor the FAQs elaborate further on the exact format or language of such an affidavit, nor do they define the term "transfer pricing policy." It is expected that the GAZT will issue further clarification in this regard.

TP documentation

The TP bylaws require Saudi Arabian entities and branches of foreign companies that are subject to the Corporate Income Tax Law in Saudi Arabia to maintain a TP master file and local file. The thresholds for maintaining TP master file and

local file documentation are connected to the aggregate annual arm's-length value of the controlled transactions. If the annual value is below SAR6m in a given fiscal year, that entity will be exempted.

In terms of timing, the GAZT has removed the reference to the fiscal year ended 31 December 2018 as being the first year the provisions of the TP bylaws would apply, however, the FAQs document confirms that the TP documentation requirement is applicable for fiscal year ended 31 December 2018 onwards. This should not prejudice the GAZT's rights under the Saudi Income Tax Law to request information related to preceding fiscal years if required.

The deadline for providing the local file to the GAZT has been amended from 7 days to 30 days from the date of request, so is now aligned with the timeline for providing the master file. As per the GAZT website and the FAQs, however, during 2019 only, taxpayers will be granted an extension of 60 days to provide the master file and local file. As requests for TP documentation would only come after the filing of the tax return, this means that tax payers will have a minimum 210 days from the end of the fiscal year ended 31 December 2018 to prepare and submit the documentation to the GAZT in 2019.

CbC reporting

The TP bylaws introduce a CbCR obligation in line with Saudi Arabia's commitment to the BEPS Action 13 minimum standard. Saudi Arabian taxpayers that are members of an MNE group with consolidated group revenue exceeding SAR3.2b will be subject to CbCR requirements in Saudi Arabia, and will be required to notify the GAZT regarding the submission of the CbCR within 120 days of the end of the reporting year. As discussed above, the CbCR requirements are also applicable for the persons subject to pure zakat in Saudi Arabia as per the final TP bylaws.

The concept of a surrogate parent entity has also now been included in the provisions regarding CbCR in the final TP bylaws (article 18 of the TP bylaws). The final TP bylaws also clarify that the consolidated group's revenue threshold used to determine the applicability of CbCR requirements should be based on the immediately preceding fiscal year.

With respect to the procedures for the submission of the CbCR in Saudi Arabia, based on the FAQs document, a portal will be made available to taxpayers who are part of an MNE group for filing their CbC reports. A one-time registration will be needed on the portal, the details of which will be made available in due course.

Language of the TP documentation

Although the TP bylaws do not specify the language in which the TP documentation should be submitted, the TP FAQs (q. #6) encourage that the submission and maintenance of documentation is in the official language of Saudi Arabia to the extent reasonably possible. For the submission of local documentation, it will be at the GAZT's discretion to specify the language of the document to be submitted. Ultimately, it will remain at the GAZT's discretion to request an Arabic translation of TP documentation, if the documentation is submitted in any language other than Arabic.

Other significant provisions

The various other provisions of the final TP bylaws and FAQs, such as the embodiment of the arm's-length principle, determination of an arm's-length range, and the description of acceptable TP methods, are in line with the draft TP bylaws and are broadly based on OECD standards. The FAQs also explain that for the failure of complying with the TP requirements in Saudi Arabia, all penalties and fines under the Income Tax Law will apply.

Though small enterprises are exempt from TP provisions and documentation requirements, Article 19 allows the GAZT to ask for documentation related to controlled transactions within 30 days if the enterprise transacts with tax/zakat exempt entities or special economic zones, gives reason to the GAZT to believe that it is undertaking tax avoidance, applies for a corresponding adjustment or falls under the GAZT's commitment of fulfilling any international obligation.

In fact, considering that the "arm's-length principle" is part of the final zakat bylaw of 2017 and the draft zakat law of 2018, zakat payers must also ensure related-party transactions are conducted in accordance with this principle.

The final TP bylaws also states that TP guidelines may be issued upon approval by the Governor of the GAZT.

Implications

The most important new requirement of the final TP bylaws compared to the draft bylaws is the affidavit that is to be issued by the licensed auditor regarding the consistent application of the TP policies of the MNE to the Saudi taxpayer. Taxpayers should reach out to their auditors to discuss the auditor's readiness to engage with taxpayers on this issue. Correspondingly, taxpayers should prepare and maintain the "transfer pricing policy" for the perusal of their auditors for them to be enabled to prepare the affidavit.

The issuance of the final TP bylaws as well as the FAQs document confirm the commitment of the GAZT to implement new TP compliance requirements which are applicable for the taxpayers in Saudi Arabia starting for the fiscal year ended 31 December 2018. The final TP bylaws also extend the scope and applicability of the TP bylaws to entities subject only to zakat, specifically with respect to the CbCR filing requirements.

It is important for taxpayers in Saudi Arabia to ensure that they are in position to meet the new compliance requirements, in particular, the preparation of the disclosure form, as well as the TP documentation covering controlled transactions entered into during the fiscal year ended 31 December 2018.

Endnotes

1. For background, see EY Global Tax Alert, [Saudi Arabia's tax authority releases draft transfer pricing bylaws](#), dated 11 December 2018.
2. OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Paris, [<https://doi.org/10.1787/tpg-2017-en>].

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