

Transfer Pricing Bylaws in KSA

What does the recent public consultation document mean for Zakat paying businesses?

August 2022



Introduction

The Zakat, Tax and Customs Authority (ZATCA) issued a public consultation document (PCD) proposing that some amendments be made to the current Transfer Pricing (TP) Bylaws in the Kingdom of Saudi Arabia (KSA) on 4 July 2022. The deadline for members of the public and relevant stakeholders to submit their comments on the PCD was 30 July 2022. It is expected that the final Bylaws will be released next and will be applicable for the accounting periods ending 31 December 2022. However, at this stage, whilst this is our expectation, the proposed amendments do not specify the effective date of its application.

Currently, the TP Bylaws have a very limited application to 100% Zakat paying entities, such that they are confined only to compliance with the Country-by-Country Reporting (CbCR) requirements for entities if they meet a consolidated revenue threshold. Most of the other provisions in the TP Bylaws are applicable to only Corporate Income Tax (CIT) payers, whether they are 100% foreign owned or partially Gulf Cooperation Council (GCC) owned and hence partially subject to CIT. However, through a significant amendment proposed in the TP Bylaws, the ZATCA seeks to bring Zakat paying entities (hereinafter also referred to Zakat payers) within the scope of the TP Bylaws.

In this publication we cover the proposed significant amendments impacting 100% Zakat payers in KSA, and highlight the various amended Articles of the TP Bylaws. This publication also highlights how Zakat payers may be impacted by these amendments, illustrating these impacts through certain example scenarios and structures.

Key amendments proposed in the KSA TP Bylaws

Below outlines the key areas in the PCD which affects Zakat payers.

1. Definition of related party

The related party definition within the existing TP Bylaws covering effective control has been expanded to Zakat payers.

2. References to Zakat regulations

The amendments to the TP Bylaws make references to Articles 21, 22 and 23 of the Zakat regulations of 2019. These Articles seem to suggest that ZATCA may apply provisions of the TP Bylaws to Zakat payers prior to its effective date as the Zakat regulations of 2019 contain provisions on arm’s length dealings with related parties.

3. Disclosure Form

The regulations suggest that Zakat payers will be required to file a Disclosure Form (DF) together with the Zakat declaration due 120 days after the financial year-end. The following additional items will be included in the TP DF:

- Assets, total funds, advance payments, debts, and other components of the Zakat base.
- The total allowed deduction from the Zakat Base as indicated in the declaration submitted for that Zakat/Tax year.
- The taxpayer’s statement covering related party transactions without consideration or non-monetary transactions.

4. TP documentation

The TP documentation (i.e., Master File (MF) and Local File (LF)) threshold remains the same for both Zakat and taxpayers (i.e., a cumulative intra-group transactions value threshold of SAR 6 million). Both domestic and international transactions conducted by Zakat payers fall within the scope of the TP Bylaws.

Further, there are a few other amendments in various clauses of the TP Bylaws that have been proposed by ZATCA to include Zakat payers. These amendments are ancillary in nature and have been proposed to be included in the TP Bylaws to ensure consistency. A comparison of the TP compliance requirements to be undertaken by Zakat payers before the proposed amendments and after the proposed amendments become effective are summarized in the table below:

Transfer Pricing Compliance requirement	Before the proposed amendments		After the proposed amendments	
	Prepare and Maintain	Submit	Prepare andmaintain	Submit
Master File*	✗	NA	✓	On request
Local File*	✗	NA	✓	On request
Disclosure Form	✗	NA	✓	✓
CbCR**	✓	✓	✓	✓
CbCR Notification***	✓	✓	✓	✓

*If the aggregate value of related party transactions exceeds SAR 6 million for the financial year.
**If the consolidated group revenue exceeds SAR 3.2 billion for a KSA headquartered group in the period prior to the reporting period.
*** In case the multinational group files CbCR in some other jurisdiction, then the taxpayer being a constituent entity of the group must file a CbCR notification on the ZATCA portal.

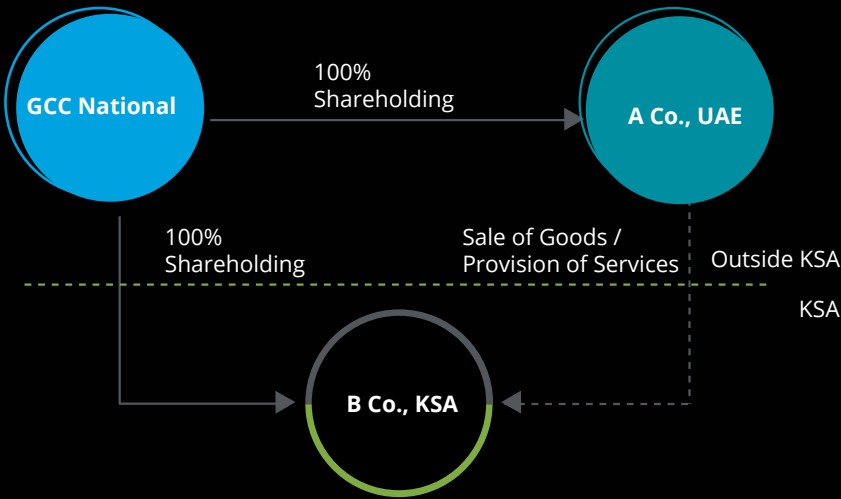
5. Other Amendments

There are some clarification amendments proposed in other various Articles of the Bylaws to ensure their implementation to Zakat paying entities.

Possible impact on various structures/transactions due to proposed applicability of the TP Bylaws on Zakat payers:

Below we outline a few illustrative scenarios relating to certain structures and transactions, what the TP implications are prior to the PCD and what the implications will be after the implementation of the proposals:

Scenario 1 – Outbound Transactions of a GCC owned KSA company transacting with an affiliate in a zero/low tax jurisdiction



Facts and background

- A Co. (based in UAE) and B Co. (based in KSA) are wholly owned subsidiaries of a GCC National.
- B. Co. being wholly owned by a GCC National is a 100% Zakat paying entity.
- A Co. sells certain goods and renders certain services to B Co.

TP implications before applicability of proposed amendments

- ✓ B Co., KSA being 100% owned by a GCC national is not liable to CIT and consequently, the provisions of the TP Bylaws are not applicable.

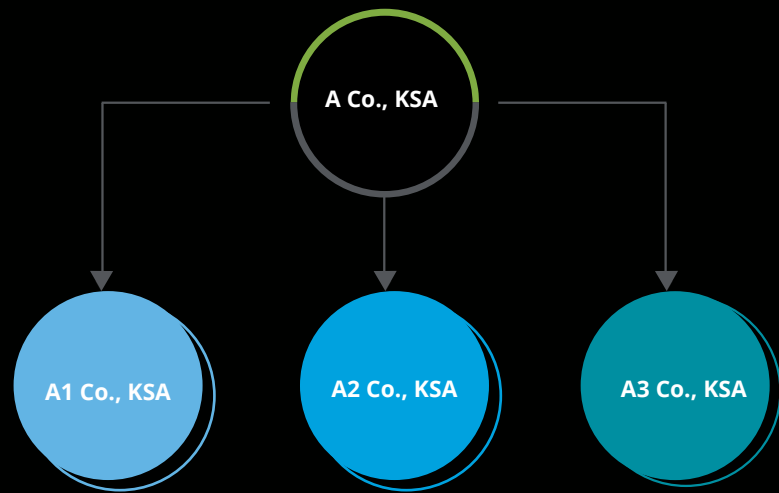
TP implications after applicability of proposed amendments

- ✓ The provisions of the TP Bylaws will be applicable to B Co., KSA and it will be required to maintain a robust TP policy and will have to adhere to TP compliance requirements such as filing a DF.

Impact on B Co., KSA

- ✓ B Co. may need to additionally undertake the following TP compliance requirements in KSA subject to a threshold of SAR 6 million with respect to an aggregate value of related party transactions:
 - Prepare and maintain a contemporaneous a TP LF and
 - Prepare and maintain a MF.

Scenario 2 – Group operating within KSA



Facts and background

- A1 Co., KSA, A2 Co., KSA and A3 Co., KSA are wholly owned by A Co., KSA
- A Co., KSA is owned by a GCC National
- All the companies of the group within KSA transact with each other.

TP implications before applicability of proposed amendments

✓ A Co., KSA or any of its subsidiaries (A1Co, KSA, A2 Co. KSA or A3 Co., KSA) being 100% owned by a GCC national are not liable to CIT and consequently, the provisions of the TP Bylaws were not applicable to any of the entities.

TP implications after applicability of proposed amendments

✓ The entire group would now come within the ambit of TP Regulations (KSA TP Bylaws and all the group companies will be required to maintain a robust TP policy and adhere to TP compliance requirements in KSA.

✓ It is important to note that the PCD does not clarify the application of the TP Bylaws in domestic situations. We await further clarification on whether each entity of the group will be required to file a DF or any one entity can file the DR for all the entities (similar to the concept of consolidating the Zakat return).

Impact on the Group

✓ Subject to further clarification post initial consultation, and in addition to filing a DF, all the entities (or any one entity) of the group may have to additionally undertake the following TP compliance requirements in KSA subject to meeting the threshold of SAR 6 million with respect to the aggregate value of related party transactions:

- Prepare and maintain a contemporaneous TP LF and
- Prepare and maintain a MF.

Scenario 3 – TP adjustment for Zakat groups



Facts and background

- GCC national owns two groups (“Group A”) and (“Group B”) in KSA that have ownership in multiple entities inside and outside KSA.
- One of the Group A entities provides interest free loans to another entity that is part of Group B.
- Both Groups file separate Zakat returns on a consolidated basis.
- During a TP audit, the tax authority performed a TP adjustment by applying an arm’s length interest rate on the loan provided by Group A’s entity to Group B’s entity.

TP implications before applicability of proposed amendments

- ✓ At present, since the TP Bylaws are not applicable to Zakat payers, the TP documentation would not usually be expected nor requested by the tax authority from either Group A or Group B to support the arm’s length nature of transactions.

TP implications after applicability of proposed amendments

- ✓ Post the proposed amendments, TP will be applicable to the Zakat paying entities and all transactions will need to be conducted in accordance with the arm’s length principle.
- ✓ If a Zakat payer is not able to support the arm’s length nature of an intra-group transaction through a TP analysis and supporting documentation, the tax authority may apply a TP adjustment to the Zakat base of Group A and/or Group B.

Impact on the Zakat payers (Group A and Group B)

- ✓ Group A will be required to pay Zakat on the adjusted profit resulting from a TP adjustment (i.e., interest income at an arm’s length interest rate). However, Group B may not necessarily be able to get relief automatically from the corresponding adjustment.
- ✓ In view of above, both Group A and Group B will need to ensure that all transactions are conducted in accordance with the arm’s length principle since the inception of the transaction and at the time of filing the Zakat return.

Scenario 4 – Recharacterization of loan into equity



Facts and background

- A Zakat paying entity (“Entity B”) has received a significant loan from its related party (“Entity A”) to finance its working capital needs.
- Entity B has limited fixed assets and therefore limited deductions are available under Article 4 (3) (c) of the Zakat Regulations.
- Entity A and Entity B file a separate Zakat return.
- During a TP audit, the tax authority recharacterized the loan into equity as the terms of the loan were not in accordance with the arm’s length principle.

TP implications before applicability of proposed amendments

- ✓ At present, since the TP Bylaws are not applicable to Zakat payers, TP documentation would not usually be expected nor be requested by the tax authority from either Zakat payers to demonstrate the arm’s length nature of loan.
- ✓ To calculate Zakat, Entity B would include the Loan amount provided by Entity A in its Zakat base only to the extent that deductions are available under Article 4 (3) (c) of the Zakat regulations.
- ✓ Since Entity B has limited fixed assets, the loan amount should not be taken into consideration for the purpose of calculating the Zakat base.

TP implications after applicability of proposed amendments

- ✓ TP will be applicable to the Zakat payers and they will be required to demonstrate the arm’s length nature of the transactions. The tax authority will scrutinize the terms of the loan by analyzing various factors including but not
- ✓ limited to the following:
 - The presence or absence of a fixed repayment date
 - The obligation to pay interest
 - The right to enforce the payment of principal and interest
 - The status of the funder in comparison to regular corporate creditors
 - The existence of financial covenants and security
 - The ability of the recipient of the funds to obtain loans from unrelated lending institutions.

Impact on the Zakat payers (Group A and Group B)

- ✓ In case the tax authority recharacterizes the loan into equity, the restriction of Article 4 (3) (c) for adding the loan amount to the Zakat base will no longer be applicable.
- ✓ Funding received by Entity B from Entity A will be considered as equity and will be included in the Zakat base of Entity B for the purpose of calculating the Zakat liability.
- ✓ Entity A will not necessarily be able to get relief automatically from a corresponding adjustment. Therefore, all intra group transactions will be conducted in accordance with arm’s length principle since the inception of the transaction and at the time of filing the Zakat return.



Key points for clarification:

Additional considerations for Zakat payers

In addition to what has been covered above and based on further details yet to be released, additional questions Zakat payers need to consider are as follows:

- 1. Whether the TP rules will be applied retrospectively to Zakat payer in future TP audits?
- 2. Whether the DF is required to be filed for each entity even though the Zakat return might be filed on a consolidated basis?
- 3. Whether the additional information in the DF will be applicable to both taxpayers and Zakat payers or only to Zakat payers?
- 4. Whether the statement certifying the maintenance of TP documentation as per (Chapter Eight) of the Bylaws, will be required from the management of the company or the licensed auditor?
- 5. In cases of corresponding adjustments to an entity filing a Zakat return on a consolidated basis, what will be the basis of an adjustment by ZATCA considering the impact is eliminated at a group level?
- 6. Similarly, if ZATCA requires entities to file individual returns and there is a corresponding adjustment to one entity, given that there is no domestic provision for relief in Article 20 and Article 21 of the TP Bylaws, what measures should be taken to mitigate any additional exposure?

Deloitte can help

Given the above important issues covered in this publication, Deloitte can support Zakat paying businesses to prepare for the upcoming changes to the TP Bylaws by:

- 1. Setting a TP policy framework to understand possible implications of the proposed amendments to Zakat payers.
- 2. Undertaking a sanity check and customized policy framework to ensure effective compliance with the existing laws and the proposed amendments.
- 3. Assessing TP implications resulting from the proposed amendments impacting both inbound and outbound operations.
- 4. Providing transaction specific advice, including benchmarking analyses, a review of agreements and an overall review of specific intra-group transactions. For example, leasing of assets, intra-group financing activities, intra-group service charges and charges associated with the use of intangible assets.
- 5. Helping Zakat payers meet the TP compliance obligations when the amendments come into force.

Contacts

For further information, please get in touch with one of our experts listed below.



Mohamed Serokh
ME Transfer Pricing
Leader
mserokh@deloitte.com



Farhan Farouk
KSA Business Tax
Leader
ffarouk@deloitte.com



Danial Khalid
Senior Director
Transfer Pricing
dkhalid@deloitte.com



Joy Mukherjee
Director
Transfer Pricing
jmukherjee2@deloitte.com



Gohar Ali Naqvi
Director
Transfer Pricing
gnaqvi@deloitte.com



Yunus Afsar
Senior Manager
Transfer Pricing
yuafsar@deloitte.com

This publication has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication.

Deloitte & Touche (M.E.) LLP (“DME”) is the affiliate for the territories of the Middle East and Cyprus of Deloitte NSE LLP (“NSE”), a UK limited liability partnership and member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”).

Deloitte refers to one or more of DTTL, its global network of member firms, and their related entities. DTTL (also referred to as “Deloitte Global”) and each of its member firms are legally separate and independent entities. DTTL, NSE and DME do not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories, serves four out of five Fortune Global 500® companies. Learn how Deloitte’s approximately 300,000 people make an impact that matters at www.deloitte.com.

DME would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. DME accepts no duty of care or liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

DME is a leading professional services firm established in the Middle East region with uninterrupted presence since 1926. DME’s presence in the Middle East region is established through its affiliated independent legal entities, which are licensed to operate and to provide services under the applicable laws and regulations of the relevant country. DME’s affiliates and related entities cannot oblige each other and/or DME, and when providing services, each affiliate and related entity engages directly and independently with its own clients and shall only be liable for its own acts or omissions and not those of any other affiliate.

DME provides audit and assurance, consulting, financial advisory, risk advisory and tax, services through 27 offices in 15 countries with more than 5,000 partners, directors and staff.