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Introduction

Although the Kingdom of Saudi Arabia (KSA) tax law does not have detailed transfer pricing regulations, it does explicitly state that transactions between related parties should be conducted based upon the arm's-length principle. This provision in the law allows the Department of Zakat and Income Tax (DZIT) to re-allocate revenues and expenses in transactions between related parties so as to reflect the returns that would have resulted if the parties were independent or unrelated. Taxpayers are also required to maintain documentation (in Arabic) to support the 'precise determination of tax payable by it'. Finally, the DZIT may use its discretion to examine a taxpayer's records and to request underlying documentation. As such, the DZIT can scrutinise related-party transactions, re-allocate/adjust revenues and expenses, disregard transactions, and/or reclassify a transaction whose form does not reflect its substance.

Statutory rules

Transfer pricing legislation

The KSA tax law contains no detailed transfer pricing rules or guidelines. However, transactions between related parties and the arm's-length principle are explicitly addressed in the law. More specifically, Article 63(c) provides that the DZIT may re-allocate revenues and expenses in transactions between related parties to reflect the returns that would have resulted if the parties were independent or unrelated. Furthermore, Article 64 defines related parties and Article 58 requires taxpayers to maintain documentation (in Arabic) to support the 'precise determination of tax payable by it'. Moreover, Article 61 provides the DZIT with the authority to examine a taxpayer's records. Taken together, these articles provide DZIT with the authority to request underlying documentation and to make income adjustments based on the arm's length principle whereby the DZIT's arm's- length test may differ significantly from Organisation for Economic Co-operation and Development (OECD) standards. Payments for goods or services delivered to the taxpayer by related parties to the extent that it is in excess of an arm's length value is considered non-deductible from a KSA perspective.

Related parties

As per Article 64: Related Persons and Persons under Common Control of the KSA tax law, companies and organisations are considered to be under common control if they are 50% or more controlled by the same related person(s). Control is defined as ownership of rights to income or capital, voting rights or value, or other beneficial interest either directly or indirectly through one or more subsidiaries of any type of companies.

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Transfer pricing methods
The KSA tax law does not explicitly define specific transfer pricing methods, nor does KSA currently have transfer pricing guidelines.

Other regulations
Tax rates
The corporate tax rate in KSA is 20% of the net adjusted profits. Zakat, an Islamic assessment, is charged on the company's Zakat base at 2.5%. The Zakat base represents the net worth of the entity as calculated for Zakat purposes, including net adjusted profits. Only non-Gulf-Cooperation-Council (GCC) investors are liable for paying corporate tax in KSA. In most cases, KSA citizen investors (and citizens of the GCC countries) are liable for Zakat. Where a company is owned by KSA and non-KSA interests, the portion of taxable income attributable to the non-KSA interest is subject to corporate tax, and the KSA share goes into the basis on which Zakat is assessed.

For tax purposes, a recent change was effected in October 2010 with the intention of mitigating double taxation on foreign investor income realised from investments in other resident companies. According to this change in law, such income is to be excluded for tax purposes, subject to the following conditions:

- Such income is subject to tax in KSA.
- The percentage of ownership in the company invested in is not less than 10%.
- The period of ownership of shares is not less than one year.

With respect to the income realised by a resident capital company from its investments and operations outside KSA, it will be subject to tax in KSA (unless an effective double-tax treaty between KSA and the country invested in stipulates different provisions). However, for Zakat purposes, the concept of consolidation is acceptable and relief could be obtained for subsidiaries wholly owned by KSA companies that are subject to Zakat.

Moreover, an entity operating in KSA that has undertaken more than one project under the same commercial registration is required to consolidate the results of such projects into the financial statements of that entity and subject them to taxation as a single operation.

Non-deductible expenses
A number of expenses are non-deductible for tax and Zakat purposes. Some of the most relevant non-deductible expenses should be:

- net interest expenses exceeding 50% of the taxpayer's earnings before interest and tax (EBIT)
- provisions (such as bad-debt provisions and end-of-service benefits)
- contributions to pension funds, saving funds or social insurance outside KSA, and
- entertainment expenses.

Withholding taxes
Payments made from a KSA resident or permanent establishment (PE) to a non-resident for services performed are subject to withholding taxes. The withholding tax rates can range from 5% to 20% based on the type of service and whether the beneficiary is a related party. Moreover, withholding tax should be paid within the

first ten days of the month following the month during which the payment was made. The domestic rate for withholding tax is 5% on dividends, 15% on royalties and 5% on interest.

Branch income
Taxable income from a branch of a non-KSA-based corporation is taxed at 20%. Certain charges levied on a KSA branch by the head office are non-deductible for KSA purposes. Such non-deductible items may include:

- Royalties or commissions.
- Loan charges (interest expense) or any other financial fees.
- Indirect administrative and general expenses allocated on an estimated basis.

Thin capitalisation
No special legislation governs thin capitalisation for tax purposes. A KSA company may deduct interest payments to affiliates, provided that the amount of debt and rate of interest are at arm's length and that the interest deductibility formula is met. A KSA company may be financed with minimum capital, and there is no limit to the amount of debt that may be used.

Based on Saudi interest capping rules the taxpayer's net interest expense in excess of 50% of taxable earnings before interest and tax (taxable EBIT) should be added back to the tax base. However, this rule applies to interest expense irrespective of the recipient's qualification as related or unrelated party.

Legal cases
No specific transfer pricing cases have been brought in KSA courts. However, summarised below are a few insights, based upon experiences with the DZIT:

- Offshore supplies from related parties may require a certificate from the supplier's auditor that the purchase price for the goods equals international market prices, although it should be possible to reconcile book values of offshore supplies with the corresponding customs documentation.
- Head office (management) charges must be certified by the head office auditors as being direct expenses only, not including a profit margin, or they are likely to be partly or completely treated as non-deductible.
- Payments to related parties in excess of market values might be treated as constructive dividends and thus may attract 5% withholding tax if the recipient's parent company is not resident in KSA.
- The DZIT is entitled to rewards if it identifies additional tax liabilities. Hence, high-value major transactions might experience increased scrutiny during tax audits.

Burden of proof
Given the absence of transfer pricing guidelines with specific transfer pricing provisions (including delineation of specified transfer pricing methods), there are no specific rules regarding burden of proof. However, taxpayers are expected to produce sufficient transfer pricing documentation (and other supporting documents, including intercompany agreements, schedules and invoices) to support its declared transactions on the tax return.

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Tax audit procedures

Saudi tax authorities are allowed to conduct tax audits at any time during the office hours of taxpayers. The authorities are not required to give the taxpayer prior notice of their visits. In practice, though, the audit team often notifies the advisors of taxpayers with particularly big operations and agrees the date, time and location for the kick-off meeting.

In case the taxpayer under review cannot provide sufficient documents to support its filing position, the DZIT is entitled to estimate the appropriate tax base and/or impose penalties. The law stipulates minimum estimates which vary depending on the industry of the taxpayer. Although the law encourages tax inspectors to use all available information and to apply realistic estimates many Saudi tax inspectors have a tendency to apply quite generous 'risk premium'.

According to Saudi law tax auditors are entitled to bonus payments in case they manage to increase tax revenues for the public treasury.

Returns

Tax filings are based on each taxpayer's fiscal year. Returns are due to be filed with the DZIT and tax due must be paid within 120 days after the taxpayer's year end. The system is one of self-assessment. Advance tax payments are required to be made for a current tax year under the following conditions:

- The taxpayer has earned income during the year.
- An advance payment of 25% of the amount resulting from the taxpayer's tax liability based on the previous year return minus the withheld tax.
- The computed payment is at least SAR 500,000.
- Three equal advance payments of tax on the last day of the sixth, ninth and twelfth months of the tax year.
- Late payment of an advance payment is subject to a delay penalty of 1% of the amount due for every 30 days of delay.

Appeals

Appeals against assessments issued by the DZIT are heard by the Preliminary Appeal Committee. Appeals against a decision by the Preliminary Appeal Committee are heard by the High Appeal Committee. A 60-day time limit applies for making appeals against tax assessments for financial years after 2004, as noted in the following table:

Appeal committee	Law
Appeal statutory date	Within 60 days from the date the final assessment is received
Committee ruling	Final unless appealed to the High Appeal Committee
Formation of the committee	Resolution from the Ministry of Finance

A time bar of five years generally applies to tax reassessments/audits by the DZIT unless the DZIT views the taxpayer's approach as tax evasion, in which case a ten-year time bar would apply.

Applicable tax penalties

Item	Law
Non-registration	From SAR 1,000 to SAR 10,000
Failure to file the tax return	From 5% to 25% of the unpaid tax
Delay payment	1% of the unpaid tax for each 30 days of delay
Evasion	25% of the unpaid tax

Use and availability of comparable information

Given the absence of transfer pricing guidelines, KSA has no specific rules regarding comparable information.

Tax treaty network

KSA has signed double-tax treaties with more than 30 countries, most of which are in force in 2010 and 2011, while the others are still being finalised or awaiting the ratification process. In addition, and to encourage foreign capital investments, there are plans for negotiations of double-tax treaties with several additional countries.

More specifically, KSA has entered into tax treaties with several countries, including Austria, China, France, India, Italy, Malaysia, Pakistan, South Africa, South Korea, Turkey and the United Kingdom. A number of other treaties are not yet in force (i.e. Poland, Singapore and Vietnam), and negotiations with a number of other countries are in progress. With that said, double-tax treaties have not often been effectively tested in KSA. However, they generally follow the OECD model treaty and may provide certain relief, including withholding tax on service fees, dividends, royalties and interest.