

# KSA publishes final Transfer Pricing By-Laws

February 2019

## In brief

On 15 February 2019, the General Authority of Zakat and Tax (“GAZT”) in the Kingdom of Saudi Arabia (“KSA”) published the [Transfer Pricing By-Laws](#) (“the By-Laws”) in final form, as well as an accompanying [FAQs document](#) (“the FAQs”).

These follow hot on the heels of the draft transfer pricing By-Laws (“the draft By-Laws”) which were published on 10 December 2018, and include clarification of deadlines for the various compliance requirements as well as a major new requirement for the transfer pricing (“TP”) policy of an entity to be certified by a licensed auditor.

This news alert provides guidance on the changes and clarifications made to the By-Laws from the draft version as well as insight into the new requirements, and ultimately what this means for affected businesses. A link to our previous news alert on the draft By-Laws can be found [here](#).

## In detail

### The publications

#### *The By-Laws*

The GAZT has fully reviewed feedback received on the draft By-Laws, and seemingly used this feedback in issuing the final By-Laws.

It has passed a resolution to approve the By-Laws, which will be effective from their date of publication in the official gazette.

It has also been clarified in the FAQs in question 8 that the By-Laws will apply to the reporting year ended 31 December 2018 and all subsequent reporting years.

#### *The FAQs*

Alongside the By-Laws, the GAZT has published the FAQs, which provide further clarity on the application of the By-Laws.

#### *The Guidelines*

As with the draft By-Laws, the By-Laws and the FAQs refer to the GAZT’s own Guidelines in many places. Whilst none have yet been published, we expect that these Guidelines will be issued in due course to provide further

practical guidance to help businesses comply with the procedural aspects of the By-Laws.

### **Main changes to the By-Laws, clarifications and new requirements**

#### *Persons subject to the By-Laws*

Consistent with the draft By-Laws, Article 2 confirms that notwithstanding any provision to the contrary, the By-Laws shall apply to all taxable persons under the Law.

The “Law” means the Income Tax Law issued by Royal Decree No. (M/1) dated 15/1/1425H and its amendments. This is the Corporate Income Tax Law in the KSA.

The first point to note is that the By-Laws will therefore apply to entities which are subject to tax only, and to mixed ownership entities that are subject to both Zakat and tax, and this is stated in the FAQs (question 3).

Generally, therefore, the By-Laws do not apply to entities that are subject to Zakat only.

However, Article 2 now includes additional wording to confirm that whilst the By-Laws generally apply to taxpayers (and mixed ownership entities subject to Zakat and tax), it does not prevent the Country-by-Country Reporting (“CbCR”) requirements as

prescribed in Article 18 from applying to Zakat payers.

So Zakat payers should note that they, alongside tax payers and mixed ownership entities, are also now expected to comply with the CbCR requirements if they meet the relevant threshold (see below). This is confirmed by question 4 of the FAQs.

To accommodate this extension to Zakat payers, the definition of “taxable person” in the By-Laws has been expanded, and now states that the term includes persons required to comply with the By-Laws (or any part thereof) even when they are not subject to tax (i.e. Zakat payers in the case of the CbCR requirements).

#### *Scope of the By-Laws - domestic transactions*

Question 7 of the FAQs states that unless expressly exempt in the By-Laws, all related party transactions, regardless of the place of residence, nationality or domicile of the persons are within the scope of the By-Laws.

Our understanding is therefore that alongside cross-border controlled transactions, domestic controlled transactions are also within the scope of the By-Laws.

#### *Scope of the By-Laws - retrospective application*

Question 8 of the FAQs state that whilst the By-laws apply to reporting years ended 31 December 2018 onwards, under the Income Tax Law the GAZT has the right to request information, documents, or perform an audit for years prior to the effective date of the By-Laws.

Indeed, question 1 of the FAQs confirms that transfer pricing is not a new concept in the KSA's income tax regime, with Articles 63 and 64 of the Law having addressed related party transactions long before the introduction of these By-Laws.

#### *Non-arm's length pricing*

In circumstances where the terms, conditions or remuneration of a controlled transaction are not consistent with the ALP, the draft By-Laws in Article 4 previously enabled the GAZT to reallocate and recategorise revenue and expenses arising out of a controlled transaction to reflect the arm's length result.

Article 4 has been amended, and the GAZT is now able to reallocate or disregard the result of a controlled transaction, where the terms, conditions or remuneration of the transactions are not consistent with the ALP.

#### *Documentation requirements*

##### **Disclosure Form of Controlled Transactions (“CTDF”)**

Article 14 of the By-Laws remains broadly consistent with the draft version, with the information required to be disclosed and the deadline for submission (being 120 days after end of the fiscal year) remaining the same, except for one major additional requirement.

The By-Laws state that “together with the Disclosure Form...the Tax Payer must submit an affidavit from a licensed auditor through which the auditor certifies that the Transfer Pricing policy of the MNE is consistently applied by and in relation to the Tax Payer”.

We note that “transfer pricing policy” is not defined in the By-Laws. Further, as the auditor is expected to certify whether the TP policy is “consistently applied”, it is yet to be determined exactly what the scope of this certification will entail.

This is a major new requirement relative to the information in the draft By-Laws and is an important one because it places a unique and significant responsibility on auditors and on all businesses (see below for CTDF threshold information) to ensure that the transfer pricing policy is consistently applied.

Article 4, Paragraph A, of the By-Laws requires the taxpayer to make adjustments to their tax base to reflect arm's length pricing of controlled transactions, and report those adjustments in their annual tax declarations. This is nothing new, and was also reflected in the draft By-Laws.

However, undertaking the analysis to determine the arm's length price for actual and notional transactions; making adjustments to the tax base using this analysis; reporting those adjustments in the annual tax declaration if necessary; completing the CTDF including disclosure of the most appropriate TP method applied and whether TP documentation has been maintained; and

having an auditor certify that the policy has been applied consistently – and all by the annual tax declaration and CTDF submission deadline – may be a significant challenge.

For taxpayers with a 31 December 2018 year-end, the CTDF needs to be submitted to the GAZT by 30 April 2019, and so the certification requirement may potentially be challenging for many taxpayers in such a short time frame.

The FAQ's provide the following information in respect of the CTDF:

- it will be an electronic form that is part of the annual income tax declaration;
- all controlled transactions must be reported including those with natural persons;
- it should be prepared in a language similar to the tax declaration, which may cause additional work in translation for taxpayers;
- no minimum threshold, being applicable to all taxpayers with controlled transactions irrespective of value;
- transactions reported can be aggregated, if all with the same related person, of the same type, and of the same nature. However, netting off of transactions is not allowed;
- the transaction values reported should be the arm's length values used in calculating the tax base; and
- the CbC notification is an integral part of the CTDF (see below).

We await the release of the CTDF proforma, and submission information from the GAZT in its Guidelines.

#### Master file and Local File

The GAZT has removed the requirement from Article 15 (General Obligations) for sufficient documentation to be readily accessible and available at the time of submission of the CTDF.

Instead, the requirement in Article 15 is just that sufficient documentation containing

information and economic analyses to evidence the arm's length nature of the transactions should be readily available and accessible upon request.

The Master file will need to be provided to the GAZT within a maximum of 30 days from request (or the length of time given in the request if longer), and Article 16 remains unchanged in this respect.

Article 17 now extends the time limit for the Local file to be provided from within 7 days to within 30 days upon request by the GAZT (or the length of time given in the request if longer). This is a positive and welcome change.

In addition, the GAZT has stated on its website, and described further in the FAQs, that it will provide an extension of 60 days to the requirements to submit the Master file and Local file on request for 2019 only.

It states that the GAZT may request the Master file and/or the Local file any time following the 120 days after the end of the reporting year.

The extension of 60 days to provide the Master file and/or Local file would be in addition to the minimum 30 days upon request.

So, taking the example of a reporting year ended 31 December 2018, the first requirements to provide documentation to the GAZT could be from 29 July 2019<sup>1</sup> (i.e. 120 days after the end of the reporting year + 30 days minimum to respond to a request + 60 days extension).

**However, notwithstanding the change to Article 15 above, or the extensions granted during 2019, our recommendation would be that the documentation (and underlying analyses) are still fundamentally in place by the time of the filing of the CTDF for the reasons of auditor certification and reporting of adjustments in the annual tax declaration as outlined above.**

For the Master file, Article 16 includes a new requirement to disclose the identity of the legal and de facto owner of intangibles, in addition to the previous requirement to list intangibles of the Group.

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<sup>1</sup> 29 July 2019 is calculated as being 210 days from and including 1 Jan 2019

For the Local file, Article 17 now specifies that information on the business strategy of the taxpayer and information on business restructurings and intangible asset transfers should be included for the year covered by the Local file, and the preceding year.

Finally, the FAQs state in question 6 that the GAZT encourages documentation to be maintained and submitted in the official language (i.e. Arabic). Our understanding is therefore that the Master file and Local file could be maintained and submitted in English or any other language.

However, a footnote confirms that acceptance of documentation by the GAZT in any other language than Arabic will not relieve a taxpayer of any legal obligations, if any (e.g. under the Income Tax Law), to comply with language requirements.

In practice, it remains to be seen what the outcome will be if taxpayers submit and maintain documentation in English or in any other language.

#### Country-by-Country Reporting (CbCR)

The CbCR provisions in Article 18, including deadlines and thresholds, are broadly consistent with those in the draft By-Laws, other than as explained below.

As mentioned earlier, the CbCR requirements now include Zakat payers as well as taxpayers.

The provisions of Article 18 specifically refer to Zakat payers in the context of a Constituent Entity that is not the Ultimate Parent Entity ("UPE") or Surrogate Parent Entity ("SPE"). However our understanding is that even a UPE or SPE that is a Zakat payer will need to comply with the CbCR requirements if it meets the SAR 3.2bn consolidated group revenue threshold.

The application of the threshold has now been clarified, with businesses required to assess whether it has been breached in respect of the year preceding the current reporting year (i.e. in line with OECD requirements).

The details of the information to be included in the Country-by-Country ("CbC") report have been removed from Article 18, which now states that the form of the report and the information to be included will be specified in the Guidelines. The FAQs confirm in question 46 however that an online portal will be made

available for businesses to submit their reports.

Finally, the requirements for a CbCR notification are now confirmed to apply to constituent entities, UPEs and SPEs, whereas they were previously drafted to apply only to constituent entities. Further, question 44 of the FAQs states that the notification will be made as part of the annual tax / Zakat declaration.

#### Documentation - deadlines and thresholds

**CTDF** – to submit within 120 days following the end of the fiscal year. No minimum threshold, applicable to **all taxpayers** with controlled transactions irrespective of value.

**[New] Certification of CTDF by licensed auditor** - required by the CTDF submission deadline, as above. No minimum threshold, applicable to **all taxpayers** with controlled transactions irrespective of value.

**Master file and Local file** - GAZT may request from 120 days after the fiscal year end. For requests made in 2019, the deadline to provide the report is within 90 days of request. The requirements apply to individual companies with transactions with arm's length value of more than SAR 6m on an annual basis. No requirement to prepare in any year in which the threshold is not met.

**CbCR notification** – to submit within 120 days of the year-end to which the CbC report relates, as part of the annual tax declaration / CTDF.

**CbC report** – to file within 12 months of the year-end to which the report relates. The first report should be prepared for the group's fiscal year ending 31 December 2018 onwards. Applies to groups with consolidated group revenue exceeding SAR 3.2bn in the preceding year (c. €750m).

#### Penalty provisions

Whilst the By-Laws do not include specific provisions relating to penalties for non-compliance, question 52 of the FAQs state that all penalties and fines under the Income Tax Law are applicable to all income tax matters.

Our understanding is therefore that the penalty provisions in the Law will extend to

non-compliance with the transfer pricing requirements as set out in the By-Laws.

### Other points to note

#### Further considerations for Zakat payers

In line with the draft By-Laws, Article 19 of the By-Laws maintains that the GAZT may at its discretion direct any person to prepare and maintain documentation (i.e. the master file and local files) related to controlled transactions and to request such documentation within 30 days in certain circumstances. The documentation requirement could therefore extend to Zakat payers.

Further, the provisions of both the current 2017 and draft 2018, Zakat By-Laws require intra-group transactions to be conducted in accordance with the arm's length principle ("ALP").

So, whilst Zakat payers are not directly required to comply with the Master file and Local file documentation requirements of the By-Laws, it is recommended that they ensure pricing for intra-group transactions meets the ALP and maintain appropriate documentation to evidence this.

#### Additional changes made to the By-Laws

- Updates to the definition of effective control in Article 1.

Financial Institutions are excluded from having effective control where they provide 50% or more loans / 25% or more of guarantees to cover a person's total borrowings.

The circumstance surrounding the provision of 50% or more of loans has been updated to "50% or more of long term and short term debt and capital excluding retained earnings as of the year-end balance of the reporting year".

The circumstance for the issue of guarantees covering 25% or more of total borrowings is now confirmed to be measured by reference to the year-end balance of the reporting year.

The circumstance for the control over 50% or more of a person's business activities, is now confirmed to be measured by reference to the absolute aggregated value

of a person's business activities as of the year-end balance of the reporting year.

- Updates to the definition of "Related Persons" in Article 1, specifically in respect of two juridical persons being related.

The definition no longer includes wording to assess whether one juridical person is related to another juridical person by participating directly or indirectly in the management, control, or capital of that other juridical person, or otherwise having effective control.

Our understanding is that this has not altered the scope of "related persons", which for companies still depends on whether they are "persons under common control" or whether there is "effective control".

- Updates to the definitions in Article 1 of Surrogate Parent Entity (to accommodate the changes to the CbCR requirements in Article 18 above), and Transfer Pricing (where loan transactions are now specifically included in the scope of the By-Laws).
- The addition of new definitions to Article 1 for Financial Institution, International Agreement, and Systemic Failure (with respect to the failure or effective suspension of automatic exchange of CbCR information).
- The removal of the provisions previously contained in Article 26 regarding the effective date of the By-Laws, and the right of the GAZT to request information on controlled transactions retrospectively.

#### Other points to note in the FAQs

The FAQs state that:

- taxpayers are required to perform comparability analyses every 3 years if there is no change in circumstances and conditions of the taxpayer or the controlled transactions (question 21).

However, given the requirements under the CTDF and further guidance regarding the frequency of updates to the Master file in the FAQs at question 39, our understanding is that the GAZT expects

taxpayers to take responsibility to ensure that all information in their TP documentation is kept up to date to reflect the controlled transactions and associated business circumstances.

On that basis, and given the annual requirement to submit the CTDF, it will be important for tax payers to determine whether their TP documentation and associated TP analysis can simply be rolled over from one year to the next, whilst obtaining the necessary certification on the controlled transactions from the auditor, or whether a major update of the documentation and associated analyses will be required. This will be an important

annual consideration.

- Small enterprises (i.e. with annual transactions with a total arm's length value not exceeding SAR 6m) need to maintain and submit upon request sufficient and adequate documentation that evidences the arm's length nature of transactions (question 41).

Our understanding is that small enterprises will be subject to the CTDF and auditor certification requirements, as well as the requirement to provide documentation (in whatever form this is maintained) to the GAZT within a minimum of 30 days upon request.

### ***The takeaway***

The publication of the By-Laws is a major tax development in the KSA and the wider region, and likely to affect almost all multinationals operating in the KSA.

There is now a significant additional requirement for all taxpayers with controlled transactions irrespective of value - i.e. the auditor certification regarding the consistent application of TP policy. There is no extension for this requirement or the filing of the CTDF, and taxpayers will therefore need to act with urgency to undertake the necessary analyses, and prepare substantially complete documentation to meet this deadline. This effort will be required despite the 60 day extension to provide the Master file and Local file upon request.

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## **Let's talk**

For a deeper discussion of how this issue might affect your business, please contact:

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