Kingdom of Saudi Arabia (KSA)

Transfer Pricing Updates

February 2024

Introduction

As we step into 2024, this alert provides an overview of the recent transfer pricing updates which may be relevant for taxpayers in Kingdom of Saudi Arabia (KSA) starting 2024.

The First one is the applicability of transfer pricing provisions to Zakat payers from 1 January 2024 and the second one focuses on the specific incentives provided for companies having their regional headquarters in KSA with a focus on what relevant parameters should one have in mind for such RHQ companies from a transfer pricing side.

A. TP for Zakat Payers

The Zakat, Tax and Customs Authority, "ZATCA" has issued a guideline on treatment of Zakat Transactions with related parties for Taxpayers maintaining statutory accounts. This guideline comes in pursuance to ZATCA's amendment of the Transfer Pricing Provisions, in April 2023, widening its ambit to cover Zakat payers effective from Financial Year commencing on or after January 1, 2024.

The objective of this guideline is to reduce the disputes and disagreements between the Zakat Taxpayers and ZATCA regarding Zakat treatment of the transactions. With this intent, ZATCA has analysed and categorized the key related party transactions and has detailed the treatment of such transaction for computing the Zakat base.

1. Related Parties for Zakat Transactions

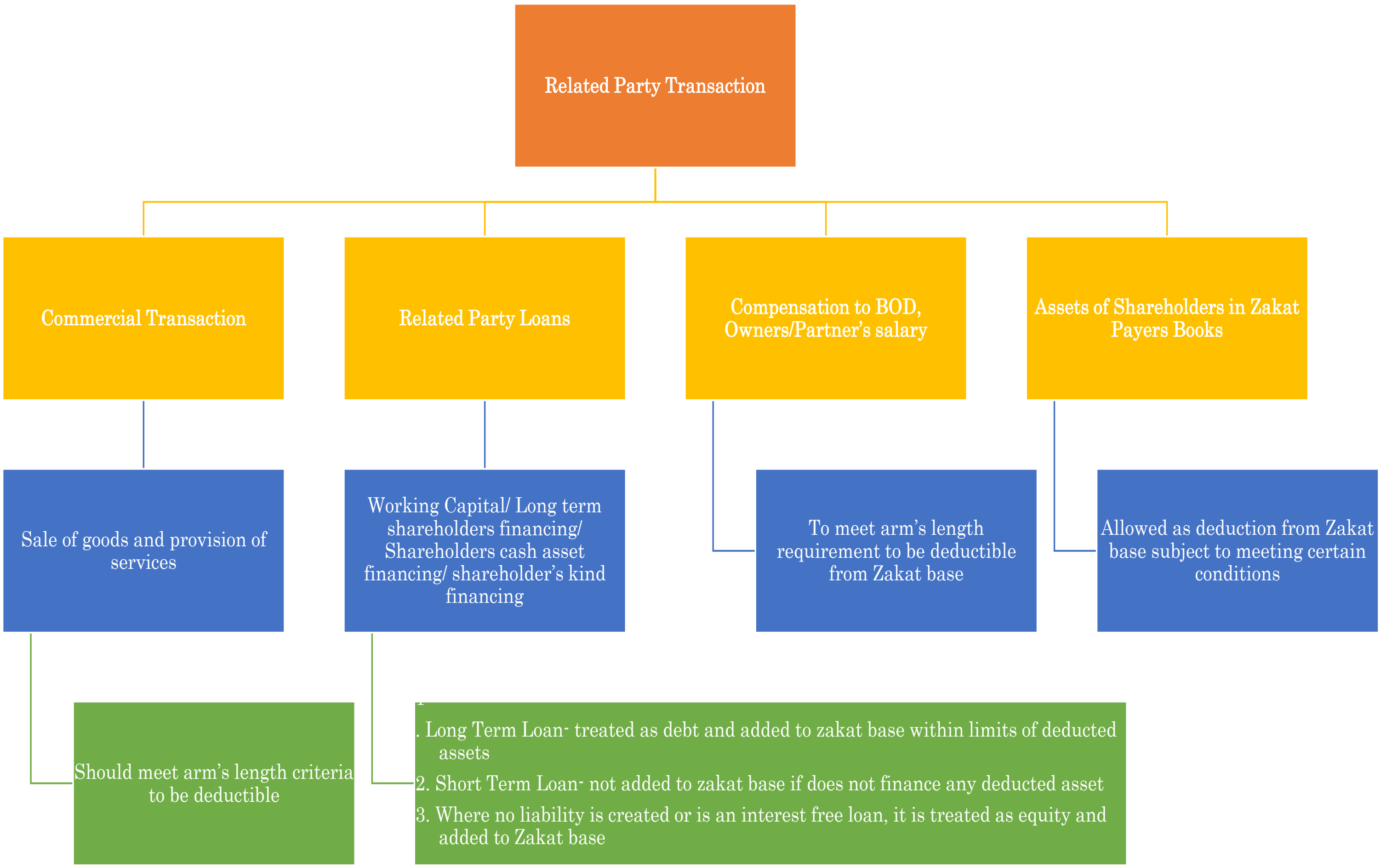
- Related parties (RP) for the purposes of Zakat Transactions is defined to include natural or legal person who are related as per
    - Accounting standards; or
    - Transaction Pricing Instructions and their subsequent amendments

2. RP Transactions and Treatment

- The guideline classifies the zakat transactions between related parties into three types namely:-
    - Commercial Transaction
    - Indirect Financing
    - Direct Financing
- Zakat Treatment of Related Party Transactions
    - **Commercial Transactions**
        - Refers to sale of goods and provision of services
        - Transaction value should meet arm's length criteria for computation of zakat base else necessary adjustments need to be made
    - **Indirect Financing**
        - Refers to transactions where costs or expenses are borne by related parties on behalf of taxpayer.
        - These do not affect the income statement of the Taxpayers and hence no adjustment required.
        - However where this is treated as a liability in the financial statements, then it shall be considered as debt for Zakat treatment.
    - **Direct Financing**
        - Usually takes the form of
            - Working Capital
            - Long term shareholder's financing
            - Shareholders cash asset financing
            - Shareholder's in kind financing
        - Related Party loans which are long term are normally treated as debt and added to the Zakat Base within the limits of the deducted assets.
        - Loans which are short term and are used to finance deducted assets are added to Zakat base unlike those that do not finance deducted assets are not added to zakat base.
        - If the essence of the financing transaction is free of debt, then it shall be treated as equity and added to the internal source of funds.
        - Owners/ Shareholders loans to individual establishments and one person companies treated as equity irrespective of their treatment in the financial statements and added to Zakat base without capping limits.
        - Thus any financing arrangement with related parties, where the nature and terms of arrangement does not comply with the arm' length principle, can be re-characterised and treated accordingly.
    - **Compensation paid to Members of the Board of Directors and Partner's salary**
        - Compensation to members of the Board of Directors are allowed as deduction while determining the tax base.
        - The Salaries and allowances to Partner/ Owner is fully deductible only if there is a legal employment contract, registration with general organisation for social insurance(GOSI) is complete and the provision of wage protection system applies.

  - Further the transaction pricing guidelines now require these rewards and compensation to be at arm's length to be fully deductible.
  - The ZATCA can at any time request for additional information to verify that the salaries and allowances provided to Owners/ Partners are rational and meet arm's length.
- **Assets recorded in Zakat Payers Financial Statements but Registered in the name of the Partner/ Owner**
  - Allowed as deduction not exceeding their source of funding added to zakat base provided such asset is:-
    - Used in company's activity
    - It constitutes in-kind share in the capital
    - There is an obstacle preventing transfer of ownership of asset to the company
- **Other Points for consideration**
  - Related Parties debit and credit arising from different financial and commercial transactions not allowed to be offset, unless done as per accounting standards.

The below chart summarizes the related party transactions and its treatment



Way forward

The Transaction Pricing guidelines brings indirectly all Zakat related party transactions within the ambit of Transfer Pricing. Hence it becomes imperative for Zakat Taxpayers to assess existing and proposed related party transactions to ensure that they adhere to the arm's length principle along with satisfying the required compliance of local file and Masterfile subject to the thresholds.

B. Regional Headquarters

The Ministry of Investment of Saudi Arabia (MISA), in coordination with Ministry of Finance and ZATCA announced on December 05, 2023, a 30 year tax incentive package for "The Regional Headquarters Program", as a further stimuli for multinational companies to establish their RHQ in Saudi Arabia.

The Qualified RHQ's will be subject to:-

- Zero percent (0%) Corporate tax and withholding taxes for a period of 30 years
- 10 year exemption from Saudization requirements which demand a specific percentage of Saudi nationals in a company's workforce
- Issue of unlimited number of visas for RHQ employees.
- Ajeer program (to work and apply for jobs) for dependents of RHQ employees
- Exemption from professional accreditation requirements in KSA, if the RHQ employees are duly accredited in their country.

The Saudi Ministry of Finance has issued conditions that limit Saudi Government Agencies to undertake business with MNC's that do not have RHQ in Saudi Arabia and has placed further regulations curtailing allotment of government projects except in exceptional circumstance to such MNC's.

The guidance has issued the list of mandatory activities that are to be carried out by a RHQ and also optional activities that can be carried out by RHQ, which are highlighted in the below table[1].

Mandatory RHQ Activities	Optional RHQ Activities
Provision of strategic direction and management functions like for e.g.:- • Formulating and monitoring regional strategy • Coordinating strategic alignment • Business planning, business development and budgeting	• Sales and marketing • HR and Personnel Management • Accounting and auditing • Legal • IP rights management • R&D • Souring of raw materials and spares

[1] The table is only indicative and does not provide the exhaustive list of services

Impact on TP

MISA has clarified that RHQs will be subject to transfer pricing regulations however no specific Transfer Pricing guidelines has been issued to address the applicability of TP provisions to RHQs. Accordingly the prevailing Transfer Pricing Regulations would need to be applied for RHQ transactions as well.

Considering that the program comes into effect from 01 January 2024, and RHQs are subject to TP Regulations, it becomes imperative to ensure that the RHQ earns an arm's length markup for the services that it renders. Further given that RHQ are required to perform strategic direction and management functions, clear delineation of transactions between shareholders activity and management functions becomes essential and warrants robust documentation including appropriate legal agreements, cost pool workings, demonstrating the "Need Benefit Test", rationale for adoption of allocation keys for apportionment of common cost in case of management services. Where the RHQ engages in other optional activities, then they need to earn an appropriate arm's length return for their services commensurate to their functional and risk profile, including consideration of control over risk.

About us

VSTN Consultancy Private Ltd is a boutique Transfer pricing firm with extensive expertise in the field of international taxation and transfer pricing.

Our offering spans the end-to-end Transfer Pricing value chain, including design of intercompany policy and drafting of Interco agreement, ensuring effective implementation of the Transfer Pricing policy, year-end documentation and certification, BEPS related compliances (including advisory, Masterfile, Country by Country report), Global Documentation, safe harbour filing, audit defense before all forums and dispute prevention mechanisms such as Advance Pricing agreement.

We are structured as an inverse pyramid where leadership get involved in all client matters, enabling clients to receive the highest quality of service.

Being a specialized firm, we offer advice that is independent of an audit practice, and deliver it with an uncompromising integrity.

Our expert team bring in cumulative experience of over five decades in the transfer pricing space with Big4s spanning clients, industries and have cutting edge knowledge and capabilities in handling complex TP engagements.