



cutting through complexity

Global Transfer Pricing Review

Saudi Arabia

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TAX



Saudi Arabia

KPMG observation

While Saudi Arabia does not have complex transfer pricing rules, transactions between related parties must be concluded on terms as if the parties were independent. As a result, KPMG in Saudi Arabia is seeing the Department of Zakat and Income Tax (DZIT) scrutinizing cross-border transactions between related parties and challenging such transactions where arm's length principles are not satisfied.

Even though there is a need to maintain arm's length pricing under Saudi tax law, there are no detailed transfer pricing rules in Saudi Arabia to reach an acceptable arm's length price for a particular transaction. In the absence of such detailed rules, the Saudi tax authorities generally accept a price if they are satisfied that it represents the fair market value (FMV) of the subject services or goods.

The lack of specific transfer pricing rules does provide wide powers to the Saudi tax authorities to accept or reject any particular pricing mechanism. Hence, it is always better to provide as much objective support as possible for arm's length pricing between related parties to be able to defend any potential challenge from the Saudi tax authorities.

KPMG in Saudi Arabia notes that transfer pricing is one of the top priorities for the DZIT. The DZIT is currently in the process of developing detailed guidelines on transfer pricing. A recent Ministerial Resolution (No. 1776 dated 19 March 2014 — Article 10, Para 11) states:

- in respect of transactions with related parties, the DZIT will issue rules for determining the "fair value" or "arm's length value" of those transactions in accordance with agreed international standards
- however, the DZIT has not made any formal announcement on a timeline for implementation of formal transfer pricing guidelines/rules. KPMG's current understanding, based on informal discussions, is that the projected timeline for the introduction of formal transfer pricing guidelines/rules is late 2015.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable	Not applicable
Legal requirements		●
Protection from penalties	●	
Reduce risk of adjustment	●	
Shifts burden of proof		●

Basic information

Tax authority name

Department of Zakat and Income Tax (DZIT).

Citation for transfer pricing rules

No specific transfer pricing rules have been issued by the Saudi tax authority, however, the principle of arm's length transactions has been embedded within Saudi tax law.

We note that transfer pricing is one of the top priorities for the DZIT in Saudi Arabia. The DZIT is currently in the process of developing detailed guidelines on transfer pricing. A recent Ministerial Resolution (No. 1776 dated 19 March 2014 — Article 10, Para 11) states:

"In respect of transactions with related parties, the DZIT will issue rules for determining the "fair value" or "arms' length value" of those transactions in accordance with agreed international standards."

However, the DZIT has not made any formal announcement on a timeline for implementation of formal transfer pricing guidelines/rules. Based on informal discussions, our current understanding is that the projected timeline for the introduction of formal transfer pricing guidelines/rules is late 2015.

Effective date of transfer pricing rules

Not applicable.

What is the relationship threshold for transfer pricing rules to apply between parties?

50 percent or more directly or indirectly related; beneficial ownership may also be taken into account by the DZIT.

What is the statute of limitations on assessment of transfer pricing adjustments?

There is no specific statute of limitations set out in Saudi tax law, however, there is a general statute of limitations which shall apply in case the Saudi tax authority is making adjustments to taxable income from the perspective of the arm's length standard. The specific limitation is five years, and 10 years in cases where the tax return was not filed, or if filed, was found to be incomplete or incorrect with intent to evade tax. In practice the DZIT does not follow this and has been known to extend beyond 10 years.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

No.

What types of transfer pricing information must be disclosed?

Not applicable.

What are the consequences of failure to submit disclosures?

Not applicable.

Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

No.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for all transactions. Notwithstanding the lack of formal transfer pricing guidelines, we recommend companies prepare transfer pricing documentation (following OECD Guidelines) especially, where related party transactions are significant. This will assist in mitigating the risk where the DZIT applies the anti-avoidance provisions in the tax law.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

No. While the DZIT is not required to follow OECD Guidelines currently, we recommend that any transfer pricing study undertaken be completed in accordance with the OECD Guidelines.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 30 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

Generally where the DZIT requests information they expect a response within 30 days. However, in practice this varies considerably and is usually longer as the DZIT may grant an extension.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

If an adjustment is proposed by the Saudi tax authority because of a dispute regarding an arm's length price and an addition is made to taxable income because of this, such adjustment will become part of a larger tax assessment by the Saudi tax authority. However, such assessment orders can be challenged by the taxpayer like an assessment order addressing any other issues. A taxpayer can appeal against such an order in the Preliminary Appeal Committee (First Appellate Authority), and if not satisfied, in the Higher Appeal Committee (Second Appellate Authority), and finally the Board of Grievance will be the last Appellate Authority.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Penalties are applicable under general provisions of Saudi tax law. Penalties resulting from misrepresentation is 25 percent of the tax sought to be evaded. Additionally, there is also a delay fine on unpaid or underpaid tax amounting to one percent for each 30 days.

To what extent are transfer pricing penalties enforced?

No specific transfer pricing penalties but general penalties under the tax law may apply.

What defenses are available with respect to penalties?

Not applicable.

What trends are being observed currently?

From a practical perspective, taxpayers are already required to produce documentation to support related party transactions. The DZIT has the power to request documentation to support related party transactions (Article 61). Failure to produce documentation can lead to the disallowance of expenses (Article 58). based on our experience, the DZIT in Saudi Arabia is increasingly requesting documentation to support related party transactions and comparing the price paid to third party prices. In some cases, the DZIT has adjusted transfer prices between related parties but there is a lack of applied transfer pricing methodology to support these transfer price adjustments.

For goods supplied by related parties, Saudi companies are being requested to submit custom clearance documents. In some cases a certificate from the sellers' auditors has been requested confirming that the supply of goods was made at international market prices, prevailing at the date of dispatch. The DZIT has also raised questions around substance, beneficial ownership, and the nature of the services provided.

Special considerations

Are secret comparables used by tax authorities?

Not applicable.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

While there are no local comparables in any benchmarking set used by the DZIT in Saudi Arabia, the DZIT has a right to raise an arbitrary assessment in the case of any transaction between related parties or parties under common control, to allocate income or deductions between these parties as is necessary to reflect the income that would have resulted from a transaction between independent persons.

Furthermore, the tax law provides for the DZIT to adjust the tax base of an individual taxpayer and other person to

prevent any reduction in tax payable as a result of income splitting (assumed to apply to corporate taxpayers as well). For purposes of the above, income splitting means:

- the transfer of income, directly or indirectly, from one person to an associate; and
- the transfer of property (including money), directly or indirectly, from one person to an associate with the result that the associate realizes income from that property, where the reason or one of the reasons for the transfer is to lower the total tax payable upon the income of the transferor or the transferee.

In determining whether the taxpayer is seeking to split income, the DZIT may consider the value given by the transferee.

Do tax authorities have requirements or preferences regarding databases for comparables?

Not applicable.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Not applicable.

Does the tax authority have other preferences in benchmarking? If so, please describe.

Not applicable.

What level of interaction do tax authorities have with customs authorities?

The Saudi tax authority (DZIT) interacts quite extensively with customs authorities, and many taxpayers have received notices in the past for the gap in their purchases/imports or sales/exports etc. as reported to/recorded by the two respective authorities.

In practice, the DZIT often compares the value of the goods as per the invoice/contracts, the auditors' certificate, the amount declared for customs duty, the value as reflected in the financial statements, etc.

In the case where the cost of 'Imported Goods' reflected in the income statement would not match with the value of goods declared for customs duty purposes, the DZIT may disallow deduction of the difference and

accordingly raise the assessment of the corporate tax liability and penalty for the period of default.

It is therefore important to ensure consistency between the value of the goods as disclosed in the contract/invoice, auditor's certificate, customs clearances, financial statements, etc.

Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes. A branch is not allowed to take a deduction for a head office cost allocation.

Are management fees subject to withholding?

Yes.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

No.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

No.

Other unique attributes?

Not applicable.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Saudi Arabia has expanded its double tax treaty network in recent past and around 30 tax treaties are now in effect.

All of the Saudi Arabian treaties (except France) follow the Organisation for Economic Co-operation and Development/United Nations model and include the 'Associated Enterprises' article. However, the practical application of this provision is yet to be challenged by the DZIT in Saudi Arabia.

If extensive, is the competent authority effective in obtaining double tax relief?

This is yet to be ascertained in terms of the existing tax treaty network in Saudi Arabia.

When may a taxpayer submit an adjustment to competent authority?

Not applicable.

May a taxpayer go to competent authority before paying tax?

Not applicable.

Advance pricing agreements

What APA options are available, if any?

None.

Is there a filing fee for APAs?

Not applicable.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Not applicable.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

Not applicable.

KPMG in Saudi Arabia

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