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AN OUTLOOK ON THE IMPLEMENTATION OF TRANSFER PRICING LEGISLATION IN THE KINGDOM OF SAUDI ARABIA

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The tax landscape is noticeably developing across Middle Eastern countries as traditional sources of state revenues are declining. Sovereign nations in the region are also being subject to mounting global pressure by organisations like the OECD to implement mechanisms for preventing base erosion and profit shifting. The Kingdom of Saudi Arabia recently introduced transfer pricing legislation after an initial draft was circulated to the public for feedback. This paper explores the Transfer Pricing Bylaws issued by the local revenue authority and the increased burden that businesses operating in the region will have to bear given the current cultural norms and business practices.

I. INTRODUCTION

Traditional sources of state revenues are declining, causing some Middle Eastern countries to re-examine revenue streams. Oil, the most heavily relied on natural resource, has dropped in price to unprecedented levels.¹ In response, the Kingdom of Saudi Arabia ('KSA') set up a development plan to diversify its economy.² One of the ways that the KSA plans on doing so is through tax collection,³ which was evidenced with the adoption of a 5% Value-Added Tax ('VAT') on goods and services in 2017 and a subsequent increase to 15% in July 2020.⁴ In line with all revenue-raising efforts, the tax landscape is noticeably developing across the Middle East.

On the 18th of September 2018, the KSA joined the Inclusive Framework ('IF') on Base Erosion and Profit Shifting ('BEPS') which brought together countries from around the globe to implement the BEPS Action Plan.⁵ Countries which are part of the IF have agreed to move towards embedding Action 5: Countering harmful tax practices, Action 6: Preventing treaty abuse, Action

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¹ 'Saudi Arabia Signals End of Tax-Free Living as Oil Revenues Slump', *The Guardian* (online, 31 January 2017) <<http://www.theguardian.com/world/2017/jan/31/saudi-arabia-tax-approved-oil-revenues-slump>>.

² Mohamed Abdel-Rahman, 'Economic diversification in the Kingdom of Saudi Arabia' (Conference Paper, ESCWA Meeting on "Diversification in the Arab World", Beirut, 2003).

³ See Suparna Dutt D'Cunha, 'UAE And Saudi Arabia End Tax-Free Living, Roll Out 5% VAT as Oil Revenue Slump', *Forbes* (online, 1 January 2018) <<http://www.forbes.com/sites/suparnadutt/2018/01/01/uac-and-saudi-arabia-end-tax-free-living-roll-out-5-vat-as-oil-revenue-slump/>>.

⁴ 'Saudi Ministry of Finance: Additional Measures to Confront the Financial and Economic Impact of the Coronavirus Pandemic' *Saudi Press Agency* (online, 11 May 2020) <<http://www.spa.gov.sa/viewfullstory.php?lang=en&newsid=2084883>>.

⁵ 'Members of the Inclusive Framework on BEPS' *OECD* (PDF Document, February 2019) <<http://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>>; *OECD*, 'Action Plan on Base Erosion and Profit Shifting', *OECD Publishing* (PDF Document, 19 July 2013) 14 <<http://www.oecd.org/ctp/BEPSActionPlan.pdf>>.

13: Re-examining transfer pricing documentation and Action 14: Making dispute resolution mechanisms more effective.⁶

BEPS Action 13 contains the guidelines for ‘Transfer Pricing Documentation and Country-by-Country Reporting’.⁷ The implementation of the Action Plan has global significance as it improves the nation’s business and investment reputation and accomplishes the goal of both, increasing its revenue sources and opening the economy to foreign investors.

Specifically, the adoption of comprehensive transfer pricing legislation is a step in the right direction toward eliminating business uncertainty and setting an example for the rest of the Middle East and North Africa (‘MENA’) region. To date, little attention has been paid to the possible regional domino effect awaiting the implementation of the KSA’s transfer pricing legislation. Equally, in the context of an absolute monarchy, the way the new laws will protect taxpayers from tax-collection have yet to be tested. Since challenging the status quo is often disruptive, this article explores the *Transfer Pricing Bylaws* (‘Bylaws’) issued by the local revenue authority: the General Authority of Zakat and Tax (‘GAZT’), and the increased burden businesses operating in the region will have to bear given the current cultural norms and business practices.

II. PREVIOUS TRANSFER PRICING PRACTICES IN THE KINGDOM

Although the KSA government did not have transfer pricing specific legislation, the *Saudi Arabian Income Tax Law* (‘SAITL’) previously addressed related concepts.⁸ The laws set out in the SAITL do not hold much specificity but encompass the main concepts. Article 63 gave the tax authority the power to modify transactions, subsequently adjusting tax liabilities in the jurisdiction.⁹ This readjustment could be done when the tax authority was convinced that the form of a transaction does not reflect its substance.¹⁰

Article 64 pertained to ‘Related Persons’ and ‘Persons under Common Control,’ and subsection 64(c) established that companies are deemed related where control is fifty per cent or more. Control was further defined by outlining the different corporate vehicles.¹¹ Article 58 pertained to the documentation language to be kept in Arabic.¹² Relevantly, subsection 61(a) required the taxpayer to provide these records when requested by the tax authority, leading to the conclusion that the law is drafted to be reactive, and that compliance is only expected when a request is made.¹³

The Articles summarised above provided the basic steps related to the arm’s length principle. However, important details were absent as there was no specific method stated for identifying what does or does not constitute an arm’s length price and how to benchmark or compare it to other comparables. Businesses looking to transact in the Kingdom were faced with an evident lack of certainty.

⁶ ‘About the Inclusive Framework on BEPS’ *Organisation for Economic Co-operation and Development*, OECD (Web Page) <<http://www.oecd.org/tax/beps/about/>>.

⁷ OECD, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report* (OECD Publishing, 2015).

⁸ *Income Tax Law 2004* (Saudi Arabia).

⁹ Ibid art 63(1).

¹⁰ Ibid art 63(2).

¹¹ Ibid art 64.

¹² Ibid art 58.

¹³ Ibid art 61(a).

III. ANALYSIS OF THE NEW TRANSFER PRICING BYLAWS

As a non-OECD ('Organisation for Economic Co-operation and Development') country,¹⁴ the KSA government has re-examined the transfer pricing principles embedded within their laws and has issued new legislation on the subject. The nation's tax authority published a draft on the 10th of December 2018 to obtain the opinion of stakeholders before the finalisation,¹⁵ with the final legislation issued on the 15th of February 2019. This is a significant step towards international tax norms since previously the KSA only prescribed minor anti-avoidance rules relating to the arm's length principle.¹⁶ Equally, the implementation is a significant step for the region which only has two other countries that have introduced similar legislation: Egypt and Qatar.¹⁷ Other neighbouring countries, like Oman, mirror the KSA's previous laws recognising basic anti-avoidance rules such as the arm's length principle without any specific regulations.¹⁸

The Saudi Arabian transfer pricing documentation has the potential to streamline and eliminate uncertainty for taxpayers as it complies with the *OECD Model Tax Convention* ('*Model Convention*').¹⁹ For example, it is immediately clear from the Articles that the legislation incorporates the three-tiered approach to transfer pricing set out by the OECD in Action 13,²⁰ as the requirements for a Local File, Master File and Country-by-Country Reporting ('CbCr') have been introduced.²¹ Ironically, some uncertainty is also introduced by adhering to the *Model Convention*. The *Bylaws* make mention of an OECD concept known as the Place of Effective Management ('POEM') with no definition to fall back on.²² The lack of a definition is not an issue unique to the KSA's legislation. The definition of the POEM is also unavailable under Article 4 of the *Model Convention*, where a reading of the relevant commentary is required to understand the concept.²³

¹⁴ 'OECD work with G20 Countries', *G20 - Organisation for Economic Co-operation and Development*, OECD (Web Page) <<http://www.oecd.org/g20/>>.

¹⁵ 'Saudi Arabia publishes draft Transfer Pricing By-Laws' *PwC Middle East Insights* (PDF Document, December 2018) <<http://www.pwc.com/m1/en/tax/documents/2018/saudi-arabia-publishes-draft-transfer-pricing-by-law.pdf>>; 'GAZT issues final transfer pricing regulations' *Deloitte Tax@Hand* (Web Page, 19 February 2019) <<http://www.taxathand.com/article/11111/Saudi-Arabia/2019/GAZT-issues-final-transfer-pricing-regulations>>.

¹⁶ See *Income Tax Law 2004* (n 8) art 58–64.

¹⁷ Mark Schofield and Maged EzzEldeen, 'Egypt updates Transfer Pricing Guidelines', *PwC Middle East* (PDF Document, October 2018) <<http://www.pwc.com/m1/en/services/tax/me-tax-legal-news/2018/egypt-updates-transfer-pricing-guidelines-october-2018.html>>; *Income Tax Law* (Qatar) art 51 issued by circular No 24 of 2018.

¹⁸ *Income Tax Law* (Oman) arts 126–128 issued by Royal Decree 28/2009.

¹⁹ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing, 2017) <<http://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-201745419.htm>>

²⁰ Ibid 233.

²¹ *Transfer Pricing Bylaws* (Saudi Arabia) arts 16–18 Final Legislation, published 15 February 2019 <http://gazit.gov.sa/ar/RulesRegulations/Taxes/Documents/Transfer_Pricing_Bylaws_EN.pdf>.

²² Ibid art 16(4)(b).

²³ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing, 2017) 285 [24]; see also John F Avery Jones, 'Place of Effective Management as a Residence Tie-Breaker' (2005) 59(1) *Bulletin for International Fiscal Documentation* 20.

IV. EXTENDED SCOPE OF THE *BYLAWS*

There appeared to be an unintentional issue of scope when the initial draft of the *Bylaws* was released, where a traditional non-taxpayer could fall under the definition of a taxpayer.²⁴ In the KSA, a person is either subject to income tax or Zakat. Zakat obligations are a form of Islamic assessment levied on Gulf-Cooperation-Council (“GCC”) individuals instead of income tax.²⁵ The assessment is made depending on their citizenship and residency status.²⁶ Only Non-GCC investors must pay corporate taxes in the Kingdom,²⁷ and the nation’s tax authority states that ‘Zakat is only levied on Natural Saudi persons who are residing in the Kingdom of Saudi Arabia (KSA) and GCC countries’ nationals of the same status.’²⁸

Between the release of the draft legislation and the final copy, Article Two of the *Bylaws* has been substantially modified. The scope has been extended to cover Zakat payers. The *Bylaws* state that the scope of the legislation covers ‘every Taxable Person’.²⁹ ‘Taxable Person’ is partly defined within the *Bylaws* as, ‘Person subject to tax as per the Law.’³⁰ The definition of “Law” refers back to the definition in the *SATTL* and by default excludes Zakat payers.³¹ However, exceptions have been made throughout the final document, compared to the earlier draft. The most noticeable exception is found under the CbCr regulations, where under Article 18(B)(1), CbCr expressly applies to persons subject to Zakat.³²

The definition of ‘Taxable Persons’ that was added in the final draft, deems people who are Zakat payers to be included within the scope if the legislation intends to implicate them indirectly; ‘Whenever a Person who is not a Person Subject to tax is required to comply with the *Bylaws* or any part thereof, the term Taxable Person is be deemed to include such Person.’³³

Another example of the wider scope is found under Article 19(B), where the authority may ‘direct any Person to prepare and maintain documentation related to Controlled Transactions ... where Controlled Transactions are carried out with Persons who are legally granted any exemption or relief from tax or zakat obligations, or both’.³⁴ The wording related to these sections makes it clear that the authority has the power to demand persons initially expected to be exempt from this legislation to comply with the demands. This is something businesses need to consider as the draft *Bylaws* might have given Zakat payers a false sense of security.

²⁴ *Draft Transfer Pricing Bylaws* (Saudi Arabia) art 2 Published 10 December 2018.

²⁵ ‘International Tax - Saudi Arabia Highlights 2019’, *Deloitte* (PDF Document, 5 February 2019) <<http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-saudiarahiahighlights-2019.pdf>> 1.

²⁶ *Ibid*.

²⁷ ‘Saudi Arabia, Kingdom of *International Transfer Pricing – PwC* (PDF Document, 5 October 2013) <<http://www.pwc.com/gx/en/international-transfer-pricing/assets/kingdom-of-saudi-arabia.pdf>> 722 [2].

²⁸ ‘Frequently Asked Questions’ General Authority of Zakat and Tax (Web Page) <<http://gazt.gov.sa/en/HelpCenter/FAQs/Pages/default.aspx>>.

²⁹ *Transfer Pricing Bylaws* (n 21) art 2.

³⁰ *Ibid* art 1(A)(31).

³¹ *Income Tax Law 2004* (n 8) art 2.

³² *Transfer Pricing Bylaws* (n 21) art 18(B)(1).

³³ *Ibid* art 1(A)(31).

³⁴ *Ibid* art 19.

The specific inclusion could be interpreted in two ways: firstly, to compel some Zakat payers to hand over documentation, or secondly, to ensure that there is no revenue leakage by requesting additional documents from a Zakat payer to assist authorities with more information on a taxpayer's transactions. Only practice will reveal how the inclusion will be used.

V. COMPLICATIONS ARISING FROM LOCAL OWNERSHIP SCENARIOS

Under Article 1(A)(2), 'Arm's length' is defined. The definition is in line with international norms 'where conditions are made or imposed between two or more Related Persons in their commercial or financial relations...' ³⁵ The legislation mentions on multiple occasions that control and relatedness are contingent on 50% or more control or ownership. ³⁶ Looking at the definition of 'Related Persons,' under Article 1(A)(25), the scenarios under subsection (b) describe relationships of 50% or more of the voting rights, income or capital of the Capital Company or Partnership as related persons. ³⁷

Given the cultural differences and business practices that the region is accustomed to, control is not always parallel to legal ownership. ³⁸ The prevalence of this situation can create complications where businesses are identified under those definitions. It is common practice for local persons to silently partner with businesses by being a majority shareholder on paper for a fee. ³⁹ Since local partners are not limited to sponsoring only one business this could lead to transactions not always appearing to be of arm's length even if they genuinely are. It is also worth noting that, in the KSA, the local sponsor would likely be a Zakat payer, and prima facie, would not be subject to most of the *Bylaws* compliance requirements.

Foreign ownership laws for corporate vehicles across the MENA region are generally restrictive. ⁴⁰ For this reason, it is not uncommon for companies to have a minority stake in subsidiaries. Therefore, further analysis will be required to determine what the substance of the relevant transaction is, as opposed to the form. The practical application of the rules will be tested.

Looking at neighbouring countries and trade partners: Oman's restrictions prevent foreigners from owning more than 65% of a business, and the United Arab Emirates ("UAE") and Qatar both have a 51% local ownership requirement unless the company is located in a specific economic zone. ⁴¹ Depending on the industry, the KSA's domestic laws historically favoured local shareholdings by

³⁵ Ibid art 1(A)(2).

³⁶ Ibid arts 21, 23.

³⁷ Ibid art 1(A)(25).

³⁸ 'Preparing for Transfer Pricing Legislation in the Middle East' *Deloitte* (PDF Document, 15 April 2019) <http://www2.deloitte.com/content/dam/Deloitte/xs/Documents/tax/me_tax-transfer-pricing-whitepaper_v1.pdf> 6.

³⁹ Charles Salem Hallab and Tahan A Thraya, 'The Improving Case for Joint Ventures in the Middle East: A Look at Two Key Jurisdictions—the Kingdom of Saudi Arabia and the United Arab Emirates' *Mayer Brown* (Webinar PDF, 27 July 2017) <<http://www.mayerbrown.com/the-improving-case-for-joint-ventures-in-the-middle-east-a-look-at-two-key-jurisdiction-the-kingdom-of-saudi-arabia-and-the-united-arab-emirates/>> 8.

⁴⁰ Ibid.

⁴¹ 'Rules Regulations' *The Public Authority for Investment Promotion and Export Development* (Web Page) <<http://ithraa.om/Invest-in-Oman/Rules-Regulations>>; *Federal Law No. 2 of 2015* (United Arab Emirates) art 10; 'Commerce Law - Foreign Ownership', *Hukoomi - Your Official Gateway to Information and Services in Qatar* (Web Page) <<http://portal.www.gov.qa/wps/portal/topics/Business+and+Finance/Commerce+Law>>.

instilling a 25% local ownership requirement either through a person or a company wholly owned by a Saudi Arabian citizen.⁴² However, with the liberalisation of its market, restrictions are loosening for foreign company owners.⁴³ The lack of majority taxpayer ownership at first glance appears to put a majority of businesses outside the scope of the transfer pricing legislation. From a practical perspective, it might prove difficult and burdensome for the GAZT to distinguish what satisfies the definition of control given the different ownership structures.

Due to the foreign ownership restrictions mentioned above, large numbers of multinational companies entering the market use joint ventures to do so and 'In most Middle Eastern countries, MNEs (multinational enterprises) offer the full array of entry choices ranging from simple export to fully owned affiliates. The most prevalent entry modes are franchising and joint ventures. Entering through wholly-owned subsidiaries is very limited.'⁴⁴ Under Article 1(A)(12) of the *Bylaws*, effective control is defined to cast an extensive net. Two examples of the situations that meet the effective control definition which is prevalent in joint venture structures is: 1) Where the party has the ability to 'conclude an agreement to provide management services to the company' or 2) if a person 'issued guarantees to cover 25% or more of the value of the Person's total borrowings'.⁴⁵ Companies might need to reconsider how they set up their operations and observe the criteria put forward by the definition of control. Otherwise, they would be required to comply with the legislation even if the economic reality is of genuine arm's length.

According to a survey conducted by Deloitte, '68% of respondents confirm that intra-group loans/guarantees are in place, despite the MENA region being cash rich.'⁴⁶ In addition to direct loans and guarantees between related parties, banks are also known to finance local subsidiary companies at various rates with guarantees from parent businesses.⁴⁷ This is particularly important given the control definition mentioned previously and will, therefore, need to be priced at arm's length.⁴⁸ In a joint survey, the World Bank found that 'Guarantee schemes have proved particularly popular and are in operation in ten MENA countries.'⁴⁹ The prevalence of such guarantees will also require due consideration from neighbouring countries adopting transfer pricing legislation.⁵⁰

⁴² 'Kingdom of Saudi Arabia to Permit 100% Foreign Ownership of Engineering Entities' *PwC Middle East* (Web Page, Aug 15, 2017) <<http://www.pwc.com/m1/en/services/tax/me-tax-legal-news/2017/ksa-to-permit-100-percent-foreign-ownership-of-engineering-entities.html>>.

⁴³ Ibid.

⁴⁴ Kamel Mellahi, Mehmet Demirbag and Liesl Riddle, 'Multinationals in the Middle East: Challenges and opportunities' (2010) 46(4) *Journal of World Business* 406, 408.

⁴⁵ *Transfer Pricing Bylaws* (n 21) arts 1(A)(12)(a), 1(A)(12)(f).

⁴⁶ 'Preparing for Transfer Pricing Legislation in the Middle East' *Deloitte* (PDF Document, 2019) <http://www2.deloitte.com/content/dam/Deloitte/xs/Documents/tax/me_tax-transfer-pricing-whitepaper_v1.pdf>.

⁴⁷ 'KSA Transfer Pricing Draft Regulations Summary of initial views' *Deloitte* (PDF Document, 11 December 2018) <<http://www2.deloitte.com/content/dam/Deloitte/xs/Documents/tax/ksa-transferpricing-regulations%20.pdf>>.

⁴⁸ *Transfer Pricing Bylaws* (n 21) art 1(A)(12)(f).

⁴⁹ Roberto Rocha, Subika Farazi, Rania Khouri and Douglas Pearce, 'The Status of Bank Lending to SMEs in the Middle East and North Africa Region: Results of a Joint Survey of the Union of Arab Bank and the World Bank' (The World Bank, 2011) 5.

⁵⁰ Ibid.

VI. ACCEPTED METHODS OF DETERMINING AN ARM'S LENGTH TRANSACTION

Generally, the method used for determining an arm's length transaction is vital since the financial result of a tax loss is not a criterion for rejecting comparables. The acceptance of the use of methods by the competent authority is equally fundamental. There are different reasons as to why or how a company might price their product and 'it is the facts and circumstances surrounding the company in question that should determine its status as a comparable, not its financial result'.⁵¹ Foreign companies entering new markets such as the Middle East will need to consider the different pricing strategies used when conducting business.

Article 7 of the *Bylaws* is comprised of the approved methods. The *Bylaws* approve the Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus Method, Transactional Net Margin Method, and Transactional Profit Split Method, all of which are in line with the OECD recommendations.⁵² The next two Articles, Eight and Nine, explicitly state that there is no need to apply more than one method, and the use of a non-approved method can be used if demonstrated to be more appropriate.⁵³ Companies and advisors find the leniency to be a welcomed concession,⁵⁴ since the acceptance of foreign comparables should make it easier on companies preparing transfer pricing documentation for the first time. There will undoubtedly be some delays before useful databases of comparables are established in the region and to date, there has not been any documentation or resources that describe the availability of any such databases.

The approach that the GAZT takes appears, *prima facie*, favourable to the taxpayers. Interestingly, on the 21st of June 2018, the OECD revised their guidance on the application of the Transactional Profit Split Method. The OECD advised that the method should be applied only when it is deemed to be most appropriate.⁵⁵ The abovementioned report put forward significant methods of determining appropriateness followed by examples which allow wider scope for application.⁵⁶ The revised guidance allows competent authorities to effectively reduce or circumscribe the use of loss-makers from a comparables set, resulting in the GAZT's ability to split a taxpayer's profit across jurisdictions and take in more revenue. It would be interesting to see the approach that the GAZT takes after the publishing of this report: either by way of an update to the legislation or with changes to their acceptance of methods when determining arm's length transactions.

⁵¹ Peter Han, 'Comparability: OECD Invitation to Comment on a Series of Draft Issues Notes' *KPMG LLP* (PDF Document, 30 November 2006) <<http://www.oecd.org/tax/transfer-pricing/37859442.pdf>>.

⁵² *Transfer Pricing Bylaws* (n 21) art 7; OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017* (OECD Publishing, Paris, 2017) 101.

⁵³ *Transfer Pricing Bylaws* (n 21) arts 8, 9.

⁵⁴ Josh White, 'Saudi Businesses Prepare the Ground for New TP Rules', *TP Week* (Web Page, 13 December 2018) <<http://www.tpweek.com/articles/saudi-businesses-prepare-the-ground-for-new-tp-rules/arhphvhn>>.

⁵⁵ OECD, *Revised Guidance on the Application of the Transactional Profit Split Method: Inclusive Framework on BEPS: Action 10*, OECD/G20 Base Erosion and Profit Shifting Project (Report, 21 June 2018) <<http://www.oecd.org/tax/beps/revised-guidance-on-the-application-of-the-transactional-profit-split-method-beps-action-10.pdf>>.

⁵⁶ *Ibid.*

VII. THREE-TIERED DOCUMENTATION

As initially foreshadowed with the draft regulations, there is a de minimis amount on the documentation requirements. ‘Small Enterprises’ which are defined as having controlled transactions of less than six million Saudi Riyals (AU \$2,500,000) a year do not need to maintain the Local File or Master File documentation.⁵⁷ Additionally, Article 18 covers the CbCr rules required to be filed by companies making over 3.2 billion Saudi Riyals (AU \$1.2 billion) a year.⁵⁸ The CbCr de minimis is in line with other countries which have implemented the *Model Convention* such as Australia.⁵⁹

Businesses operating in the region will need to monitor their activities to see if they trigger any of the thresholds. Taxpayers who find themselves within the scope of the CbCr requirements will have to hand over documentation, along with the Local File and Master File, within a month of its request.⁶⁰ Between the publication of the draft legislation and the final document, several Articles relating to the compliance timelines have been modified and extended. The initial draft gave taxpayers seven days to produce a local file upon request. However, after recognising the added compliance burden, the previously small timeframe has been increased from seven to thirty days in the final *Bylaws*.⁶¹ The timeline modification makes it evident that the GAZT is holding open lines of communication with stakeholders and that feedback related to the draft is being taken seriously. This suggests that the tax authorities are not trying to disrupt or cause undue pressure on taxpayers.

VIII. WHAT CAN COMPANIES EXPECT FROM THE GENERAL AUTHORITY OF ZAKAT & TAX?

Transfer pricing legislation is one of many determinants that potential taxpayers examine before investing in a country. The approach the GAZT takes early on is critical, as businesses would be reluctant to invest where the tax authority is portrayed to be heavy-handed. Such a perception could cause further detriment to a nation with a current outflow of Foreign Direct Investments (‘FDI’).⁶²

The implementation of new compliance requirements such as the Disclosure Form, Master File, Local File and CbCr detailed above sends a clear message that the GAZT is serious about taking a stance against the abuse of inter-company transactions and will scrutinise companies for non-compliance. Although their enforcement appears strict, the GAZT advocates for transparency on both sides of the relationship. Article 13 makes it clear that both the taxpayer and the tax authority are unable to rely on information ‘that is not, or could not be made available’ to the other party, otherwise known as a secret comparable.⁶³ Further, the taxpayer is allowed to utilise comparable data from a foreign jurisdiction if local data is not available.⁶⁴ Understandably, local comparables would be hard to come by, given the region's recent advance into transfer pricing data recording

⁵⁷ *Transfer Pricing Bylaws* (n 21) art 19.

⁵⁸ *Ibid* art 18.

⁵⁹ *Income Tax Assessment Act 1997* (Cth) s 815-E.

⁶⁰ *Transfer Pricing Bylaws* (n 21) art 19(B).

⁶¹ *Draft Transfer pricing Bylaws* (n 24) art 17(B).

⁶² United Nations Conference on Trade and Development, *World Investment Report 2018* (United Nations Publication, 2018) 189.

⁶³ *Transfer Pricing Bylaws* (n 21) art 13.

⁶⁴ *Ibid* art 13(B).

and the lack of available domestic databases.⁶⁵ The tax authority's drafting appears to be consistent with the OECD's recommendation for taxpayers not to be overburdened, nor to have requests made which carry a 'disproportionately high cost'.⁶⁶

Tax authorities generally have limited resources, like all other organisations, and it can be assumed that the GAZT is no different. The authority would operate using a risk-based approach to audits,⁶⁷ focusing on cases that they perceive to be more aggressive or complex than others.⁶⁸ Doing so may be easier now with the automated analysis of data, but there has not been any news or announcements that they have adopted such an approach. It is not clear how the authority plans on filtering all the new documents they are to receive. However, it is important to note that the KSA is no stranger to digital advancements. The country's sovereign wealth fund, also known as The Public Investment Fund, invests heavily in cross-border data-driven digital businesses.⁶⁹ Given the Kingdom's appetite for technology and high-tech solutions, it would not be a stretch for the GAZT to leverage systems and artificial intelligence to process files and apply a triage method to focus their attention on specific cases.⁷⁰

In the region, 'Companies are accustomed to decentralised models, but this may be the time to centralise transfer pricing policy and devote more resources to compliance and preventative measures against disputes and audits.'⁷¹ One of the ways taxpayers can mitigate or prevent disputes and audits is through the use of an Advance Pricing Agreement ('APA'). Taxpayers are traditionally risk-averse, and APAs can serve as a way to attain certainty in this new transfer pricing environment.⁷² However, there is no mention of APAs within the final legislation, and taxpayers will need to look for updates on the GAZT website for any developments. Non-Zakat paying

⁶⁵ The Platform for Collaboration on Tax (PCT), *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* (Toolkit, September 2017) 37.

⁶⁶ OECD, 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017' (OECD Publishing, 2017) 239.

⁶⁷ See Munawer Sultan Khwaja, Rajul Awasthi and Jan Loeprick 'Risk-Based Tax Audits: Approaches and Country Experiences (English)', *The World Bank* (PDF Document, 1 January 2011) <<http://documents.worldbank.org/curated/en/490491468159916971/pdf/627010PUB0Risk000public00BOX361489B.pdf>>.

⁶⁸ Ibid.

⁶⁹ Andrew Torchia, Stephen Kalin and Marwa Rashad, 'Saudi's PIF Invested in 50-60 firms via SoftBank fund: Director' *Reuters* (online, 23 October 2018) <<http://www.reuters.com/article/us-saudi-investment-pif/saudis-pif-invested-in-50-60-firms-via-softbank-fund-director-idUSKCN1MX12X>>; 'Ride-hailing company Careem secures \$200 million in funds from Saudi and Japanese investors' *CNBC* (Web Page, 18 October 2018) <<http://www.cnn.com/2018/10/18/careem-secures-200-million-in-funds-from-saudi-and-japanese-investors.html>>; Eric Newcomer, 'The Inside Story of How Uber Got Into Business With the Saudi Arabian Government' *Bloomberg* (Web Page, 3 November 2018) <<http://www.bloomberg.com/news/articles/2018-11-03/the-inside-story-of-how-uber-got-into-business-with-the-saudi-arabian-government>>.

⁷⁰ PricewaterhouseCoopers International Limited, 'US\$320 billion by 2030? The Potential Impact of AI in the Middle East' *PwC Middle East Publications* (PDF Document, 2018) <<http://www.pwc.com/m1/en/publications/documents/economic-potential-ai-middle-east.pdf>>.

⁷¹ White (n 54).

⁷² See Michelle Markham, *Advance Pricing Agreements: Past, Present and Future* (Kluwer Law International, 2012) ch 4.

international companies which are heavily involved in the use of intangibles could have the most to gain by sitting across the table from GAZT and negotiating an APA.⁷³

IX. NEW CHALLENGES

Introducing new taxes is not standard practice in this part of the world ; ‘... (VAT) implementation has been a considerable challenge for most businesses in the UAE and KSA ... VAT represents the most comprehensive and transformative regulatory requirement that business(es) has (have) had to take on.’⁷⁴ The implementation of VAT has required significant resource allocation by businesses, which is mainly due to the lack of adaptable business systems and accompanying framework: ‘Most local businesses do not have VAT capabilities already built into their IT systems, while international businesses have had to introduce unique local VAT rules and codes into their ... systems.’⁷⁵

Similar to the KSA, neighbouring states which traditionally have less oil are also attempting to eliminate reliance on their natural resources for revenue.⁷⁶ The VAT roll-out in the region is a perfect example of the phenomenon, as the UAE followed the KSA in issuing the same legislative effective date after receiving the International Monetary Fund recommendation to do so.⁷⁷ Bahrain also followed suit and implemented VAT on the 1st of January 2019.⁷⁸ The mimetic approach taken by neighbouring states demonstrates the KSA’s influence on the GCC and arguably the rest of the Middle East.

With the new *Bylaws* in place, businesses operating in the MENA region will have new and recurring compliance burdens. However, if a country has a sense of familiarity with previous compliance requirements such as VAT, adapting to new legislation is not expected to be overly onerous.⁷⁹ A comparison can be made with the implementation of VAT in the UAE, where businesses were sprung with entirely new challenges. ‘VAT was new to all these countries, and required much greater effort to adjust within a very limited timeframe...’⁸⁰ Since the KSA has already dealt with

⁷³ See generally Michelle Markham, ‘Tax in a Changing World: The Transfer Pricing of Intangible Assets’ (2005) 40 *Tax Notes International* 897.

⁷⁴ David Stevens, ‘VAT: What are the Regulatory Challenges for Businesses in UAE, Saudi?’, *Gulf Business* (online, 25 March 2018) <<http://gulfbusiness.com/vat-regulatory-challenges-businesses-uac-saudi/>>.

⁷⁵ Ibid.

⁷⁶ See ‘Value Added Tax (VAT)’ *The United Arab Emirates’ Government Portal* (Web Page, 7 January 2019) <<http://government.ae/en/information-and-services/finance-and-investment/taxation/valueaddedtaxvat>>.

⁷⁷ Shiraz Khan, ‘A Comparison of the VAT Regimes in Saudi Arabia and the UAE’, *Lexology/ Al Tamimi & Company* (Web Page, 29 September 2017); see generally ‘The Economic Outlook and Policy Challenges in the GCC Countries’, *International Monetary Fund* (PDF Document, 14 December 2017) <<http://www.imf.org/~media/Files/Publications/PP/2017/pp121417gcc-outlook-and-policy-challenges.ashx>>;

⁷⁸ مرسوم بقانون رقم (٤٨) لسنة ٢٠١٨ بإصدار قانون ضريبة القيمة المضافة [Law Decree no. (48) for the year 2018 Issuing Value Added Tax] (Bahrain) <<http://www.legalaffairs.gov.bh/Media/LegalPDF/L4818.pdf>>; see also ‘Bahrain to implement VAT effective 1 January 2019’, *Deloitte* (Web Page, 11 October 2018) <<http://www2.deloitte.com/sa/en/pages/tax/articles/vat-gcc-bahrain-implement-vat-effective-1-January-2019.html>>.

⁷⁹ White (n 54).

⁸⁰ Reggie Mezu cited in Shiv Mahalingham, ‘Transfer Pricing has Landed in the MENA Region’, *TP Week* (Web Page, 25 October 2018) <<http://www.tpweek.com/articles/transfer-pricing-has-landed-in-the-mena-region/arfvjsae>>.

implementing VAT and businesses were previously aware of the arm's length concept, compliance is expected without substantial disruption.

Although it is too early for plug and play software compliance solutions to be available in the market, the gap will no doubt be filled rapidly given the expected trend of adoption. Software and accounting companies are likely to identify opportunities and make such products readily available. Until then, companies need to be proactive in their approach and potentially attend industry seminars on the topic.⁸¹

Overall, the legislation aims to make it easier for businesses to confidently comply regardless of the new set of yearly documents that need to be prepared. 'All of these [obligations] require further careful consideration and preparation by companies, and will impose an additional recurrent compliance burden than is currently the case'.⁸² Taxpayers need to calculate how they are affected, the risks involved within their structure of operation, and how fast they can scale to compliance.

X. CONCLUSION

The *Bylaws* represent an essential step towards complying with international anti-avoidance frameworks. Two reasons make the actions taken by the GAZT monumental towards the eradication of tax-based profit shifting. First, their laws evolved from a few Articles in the *SAITL* to comprehensive and detailed legislation that is heavily influenced by the *Model Convention*. Secondly, the implementation of transfer pricing specific legislation will likely have a strong chain reaction to neighbouring countries, particularly countries in the GCC.

When considering the implications of the international community, the legislation arguably falls short of accomplishing all goals. Given the different assessment levels, foreign revenue authorities will be unlikely to fully benefit from the *Bylaws* implementation when Zakat payers transact abroad unless the foreign jurisdiction is enforcing their own transfer pricing legislation.

The GAZT appears open to suggestions and comments as was demonstrated with the modifications made to the *Bylaws* after consulting with local businesses and stakeholders.⁸³ There appear to be real efforts to attain certainty and set a favourable environment for attracting foreign investments into the country. Further amendments made to the *Bylaws* will not come as a surprise if certain practices are seen to be too burdensome over time. Conversely, if prescribed, the scope could be increased to cover Zakat payers as well.

⁸¹ 'KPMG Holds Seminars on Zakat Regulations, Transfer Pricing Bylaws' *Saudi Gazette* (online, 26 March 2019) <<http://saudigazette.com.sa/article/562080/BUSINESS/KPMG-holds-seminars-on-zakat-regulations-transfer-pricing-bylaws>>.

⁸² White (n 54).

⁸³ 'Draft Zakat Regulations Released for Public Comment' *Deloitte Tax@Hand* (Web Page, 06 January 2019) <<http://www.taxathand.com/article/10871/Saudi-Arabia/2019/Draft-zakat-regulations-released-for-public-comment>>.