

# Saudi Arabia: New Transfer Pricing Guidelines for Zakat payers

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## In brief

On 26 November 2023, the Zakat, Tax and Customs Authority (“ZATCA”) issued detailed guidelines on the Zakat treatment of related party transactions applicable to Zakat payers maintaining statutory accounts (“the Guidelines”).

The much awaited Guidelines provide Zakat payers with important clarifications and practical examples on what may be considered as “related party transactions” and the applicable Zakat treatment in light of the application of the Transfer Pricing Bylaws to such transactions.

This initiative follows the ZATCA’s announcement on 7 April 2023, where the Board of Directors of ZATCA announced the approval of the proposed amendments to the Transfer Pricing Bylaws, extending the applicability of the Transfer Pricing (“TP”) provisions to Zakat payers effective for Financial years (FYs) starting on or after 1 January 2024.

## In detail

### Overview of the Guidelines

The Guidelines provide details, as well as illustrative examples, regarding the Zakat treatment of the following eight types of related party transactions:

1. **Commercial transactions:** Include related party transactions pertaining to selling goods or providing services or both, involving Zakat Payer(s). It also extends to situations involving reimbursement of costs and financing transactions leading to the creation of a liability.
2. **Financing working capital:** Includes transactions pertaining to working capital financing by related parties leading to the creation of current liabilities
3. **Shareholders loans:** Includes transactions pertaining to short-term or long-term loans from shareholders for the purpose of using them in operational or investment activities.
4. **Shareholder’s equity:** Includes transactions pertaining to financing by shareholders in cash or in kind as equity, as recognised in the statement of equity.
5. **Asset financing:** Includes transactions where assets are provided by shareholders, which is recognised as part of fixed assets
6. **Board of directors remunerations:** Includes lump sum or other forms of compensations for board members
7. **Shareholders salaries:** Includes salaries, allowances, and other benefits allocated to the shareholders
8. **Assets owned by the shareholders:** Includes fixed assets registered in the names of the shareholders being used by the Zakat Payer(s) and recognised in their financial statements.

### Applying transfer pricing principles for Zakat Payers

The Guidelines clarify how the application of the Transfer Pricing ByLaws will impact the Zakat treatment for these eight transactional groups. In general, the Zakat treatment will depend on the commercial nature of these transactions and the appropriate application of the arm’s length principle. To illustrate this point, two examples from the Guidelines are summarised as follows:

#### Case 1: Commercial Transactions

The Guidelines provides an example for commercial transactions involving the supply of goods from one related party to another. In the example, the supply of goods is priced significantly higher than the arm’s length amount by reference to the price of comparable goods set by independent suppliers. As such, under this example, the Zakat results of the related party purchaser are adjusted to deny the expense over and above the arm’s length price.



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## Case 2: Financing Transactions

The Zakat treatment of financing transactions will depend on the commercial nature of the pricing, and specific terms and conditions of the financing arrangement. Where a loan by a related person (including shareholder loans) is not priced at arm's length or does not carry commercial terms in a proper intercompany agreement, such as a fixed maturity date, the impact may require an adjustment to achieve arm's length pricing or a change in the overall characterisation of the loan. The Guidelines provide an example in this regard where a loan that does not have commercial terms is characterised as equity for Zakat purposes rather than a liability.

For all related party transactions, the Guidelines refer to the existing Transfer Pricing Bylaws and the Transfer Pricing Guidelines for the Transfer Pricing methodologies to be applied with respect to the related party transactions.

### Phasing in of Transfer Pricing Compliance

The updated Transfer Pricing Bylaws, issued on 7 April 2023, introduced compliance requirements such as the submission of a Controlled Transaction Disclosure Form and Transfer Pricing Affidavit with their Zakat returns. Zakat Payers will also need to prepare a Transfer Pricing Local File and Master File subject to the following exemptions:

- **Phase 1** covers the first three years up to 2027 and will exempt Zakat payers with aggregated related party transactions less than SAR 100mn from the Master File / Local File requirement
- **Phase 2** covers the period on and after 2027 and will only exempt Zakat payers with aggregated related party transactions equal to or less than SAR 48mn

### Way forward

The upcoming compliance requirements taking effect from 01 January 2024 will have a significant impact on Zakat payers. These Guidelines provide important clarifications on the Zakat treatment of transactions that potentially would fall under the scope of the Transfer Pricing Bylaws.

Zakat payers must review their related party transactions and assess their preparedness for the compliance with the new requirements. This includes review of the pricing mechanism for the existing arrangements and putting in place a transfer pricing policy covering all in-scope related party transactions as well as a compliance roadmap to ensure preparedness for future compliance requirements.

Finally, it is important to have the relevant processes, controls and legal agreements in place to ensure the appropriate implementation of the transfer pricing policy, correct Zakat treatment, and adequate adherence to the compliance requirements.

A transfer pricing "health check" is a good first step on a Zakat payers transfer pricing journey.

# The takeaway

In light of the upcoming Transfer Pricing compliances applicable to Zakat payers starting 01 January 2024, the ZATCA has issued this Guideline to provide clarifications on the related party transactions and their Zakat treatment.

It is important to identify these transactions, where they occur and ensure that they are conducted in line with the Arm's length Principle as per the provisions of the KSA Transfer Pricing Bylaws and KSA Transfer Pricing Guidelines.

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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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