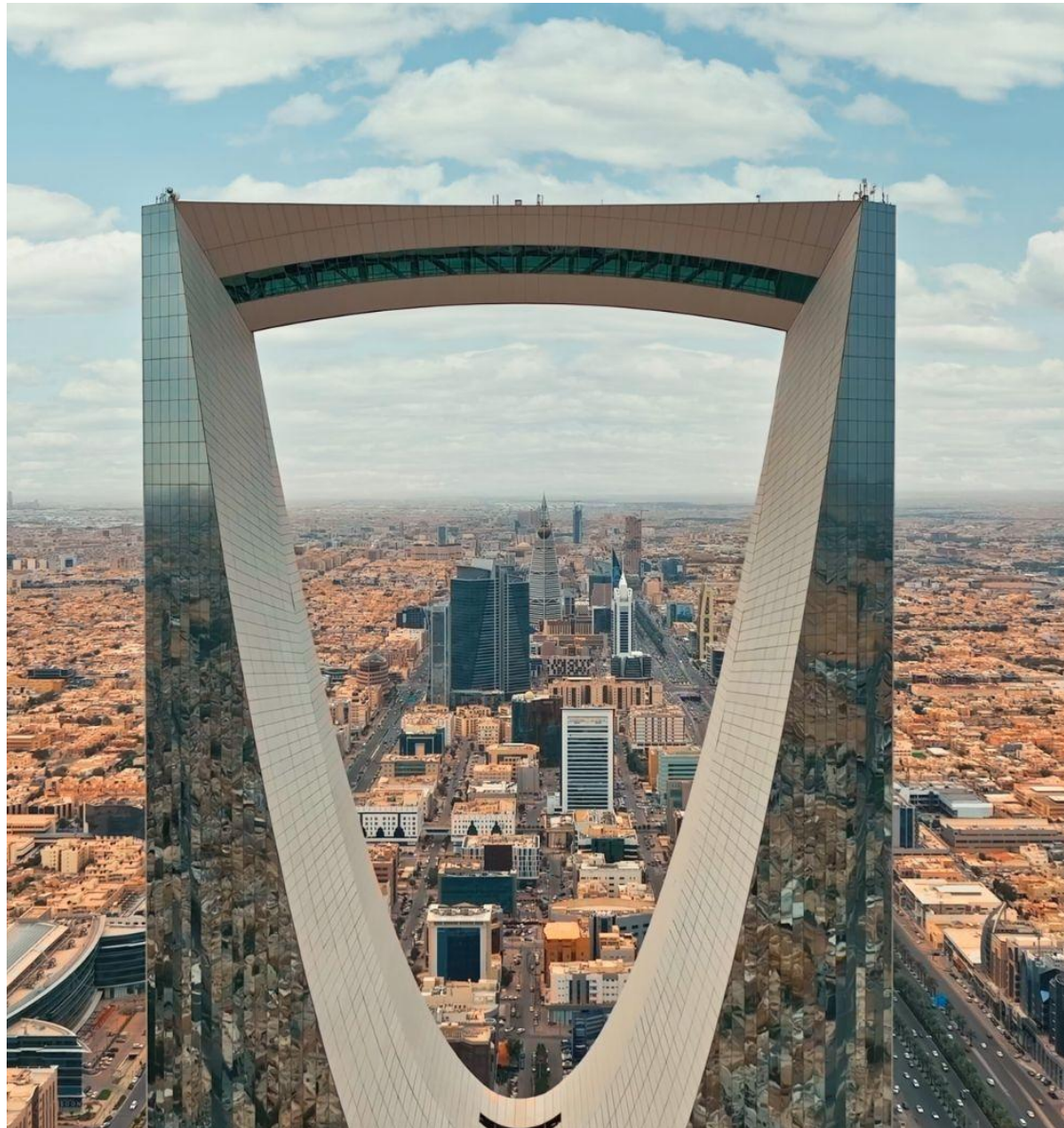


# Saudi Arabia: Regional Headquarters Program and Transfer Pricing

January 2024





## In brief

Effective January 1, 2024, inbound multi-national companies (MNCs) intending to do business in the Kingdom of Saudi Arabia (KSA), with the KSA government, are required to establish their Regional Headquarter (RHQ) in the KSA. Qualifying RHQs will benefit from a tax incentive program offering a zero percent corporate tax and withholding tax rate for 30 years applied on the RHQ activities, as well as other benefits such as a 10 year exemption from Saudization requirements.

To qualify for this regime, the RHQ is required to employ certain executive / senior-level individuals, and to perform strategic management activities on behalf of its related party branches and affiliates in the region. These services performed by the RHQ constitute related party transactions and will, therefore, need to be conducted on an arm's length basis. Given the tax incentives available to RHQs, tax authorities in the jurisdictions transacting with the RHQ will likely place a higher degree of scrutiny on the transfer pricing arrangement due to the potential opportunity for tax arbitrage. Further, failure to engage in dealings at arm's length could jeopardize the RHQ's status and license which could, in turn, disrupt the MNC's ability to conduct business in the KSA.

Considering these aspects of the regulations, the transfer pricing policy and documentation for the RHQ should be robust and comprehensive, and aligned with the regulatory requirements set out by the Ministry of Investment of Saudi Arabia (MISA).

## In detail

### Transfer pricing for RHQs

MISA has announced on its [website](#), that RHQs will be subject to Transfer Pricing regulations. However, there have been no special transfer pricing rules or guidance released that deal specifically with RHQs. As such, MNCs must reference existing transfer pricing regulations in KSA contained within the Transfer Pricing ByLaws and the associated Guidelines issued by the Zakat, Tax, and Customs Authority (ZATCA). Some of the key considerations for conducting a transfer pricing analysis for RHQs are below.

### Qualifying activities and the functional analysis

The first step when conducting a transfer pricing analysis is to perform a functional analysis, the purpose of which is to evaluate the functions, assets, and risks of the related parties. The personnel and functions of an RHQ are restricted to mandatory activities around strategic direction and management functions as well as optional activities such as sales and marketing (further details can be found [here](#)). As such, the functional and transfer pricing analyses for the RHQ should align with the requirements and restrictions. The legal agreement and local file documentation for the RHQ should also be carefully worded to ensure compliance with the RHQ requirements.

Challenges may arise whereby certain individuals employed by the RHQ also conduct client facing / commercial activities. In such cases, these individuals will need to ensure their activities are limited to those that are "qualifying activities" for the RHQ which can potentially be managed via dual contracts. Further, the activities undertaken should be carefully captured in the functional profile, legal agreements, and transfer pricing documentation of the RHQ.


### Selecting the transfer pricing method

The transfer pricing regulations allow for several methods to price intercompany transactions depending on which method will produce the most reliable measure of an arm's length price. In the case of the RHQ, it may be appropriate to apply the Transactional Net Margin Method (TNMM) and compensate the RHQ at cost, plus a margin. However, depending on the facts and circumstances, other methods may be more appropriate. For example, the Comparable Uncontrolled Price (CUP) method may be appropriate where reliable data is available to price the RHQs services on a rates and hours basis. Further, in case the Profit Split Method (PSM) method is being considered, it must be assessed whether the RHQs activities are conducted in an integrated manner with the group, and are considered to be non-routine activities generating key value or cost savings for the business.



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Regardless of the method selected, the best method analysis will need to carefully consider the RHQ restrictions to align with the regulations around the required personnel and qualifying activities.

### Remunerating the RHQ at arm's length

Once the best method is selected, this method will be applied to determine the arm's length pricing of the arrangement. In applying the best / most appropriate method for an RHQ, some key considerations are as follows:

- **Selection of comparables** - In the case the TNMM is applied, given the expected strategic nature of some of the RHQ activities, it is likely a mark-up will need to be determined by reference to third party comparables. It is thus imperative that the comparables selected align with the functional profile of the RHQ and allowable activities. In addition, the benchmarking analysis to calculate the arm's length mark up will need to apply KSA specific criteria and search filters which differ from the OECD Guidelines.
- **OECD Safe Harbor:** The Organization for Economic Cooperation and Development ("OECD"), in its [TP Guidelines](#), proposes a safe harbor mark-up of five percent on the cost for "low value adding intercompany services". However, the KSA TP Bylaws have not adopted the OECD's low value adding service principal ("LVAS") into its by-laws, and the list of activities for an RHQ is wider than the scope of OECD's LVAS activities. Thus, absent any further guidance, we would expect that this safe harbor may not be applicable for RHQs, particularly for the mandatory activities.
- **Profit or Revenue Split:** In light of the mandatory strategic functions of the RHQ, the profit or revenue split method may be considered and potentially applied. However, given that the MISA guidance states that RHQs should not perform commercial operations that generate revenue from customers, compensating an RHQ with a share of the profits or revenues may pose certain questions around whether the RHQ is directly engaged in revenue generating activities as is often the case in the entities involved in a profit / revenue split. As such, if the PSM is the best / most appropriate method, such concerns should be carefully considered and addressed.

### Transfer pricing documentation

We expect that transfer pricing filings and documentation will be required for RHQs similar to other companies in the KSA. Thus, the intercompany legal agreements and transfer pricing documentation for the RHQ should be robust and comprehensive, and aligned with the regulatory requirements set out by the Ministry of Investment of Saudi Arabia (MISA) with careful attention to the above areas of consideration.

### Way forward

To fulfill the regulatory requirements and avail themselves of the significant tax and business incentives offered under the RHQ program, MNCs will need to carefully consider the transfer pricing policy for their RHQ entity and ensure it is aligned with the regulatory requirements and restrictions for RHQs. Given the sensitive areas noted in this article, a transfer pricing analysis should be performed in conjunction with relevant legal and regulatory teams leading the RHQ set up.

Finally, it is critical for MNCs to put in place robust and carefully worded intercompany legal agreements and transfer pricing documentation covering the related party transactions with the RHQ, both from a KSA, and foreign related party standpoint.

# The takeaway

In light of the RHQ program that has come into effect starting 01 January 2024 in KSA, and the fact that TP regulations will be applicable to RHQs, MNCs seeking to benefit from the program must ensure compliance with the TP Bylaws in a manner that is consistent with the legal framework of an RHQ.

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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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# Thank you

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