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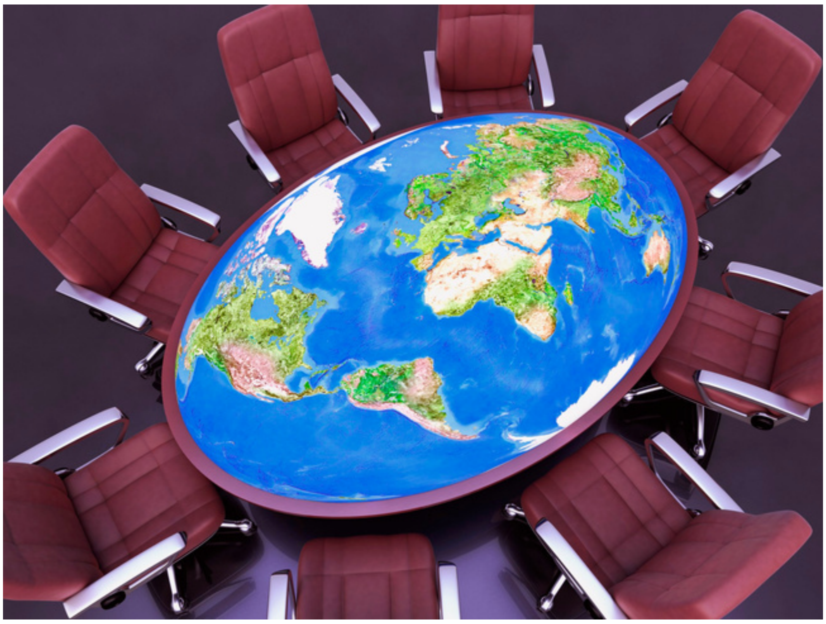
The Transfer Pricing bedrock:

RELATED PARTIES, CONNECTED PERSONS A GCC[1] OVERVIEW



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PREAMBLE

In the context of taxation, the terms "connected persons" and "related parties", are often used to describe relationships between individuals and entities that may have an impact on tax liabilities and tax reporting requirements.

Whilst there may be some variations in the definitions of related parties and connected persons across jurisdictions, the purpose remains similar, i.e. assessing the degree of legal and/or factual interdependence between the parties concerned to determine the applicability of specific tax requirements.

Generally, transfer pricing (TP) rules seek to determine whether the pricing, terms and conditions governing a transaction between related parties and connected persons are similar to those between unrelated parties. Hence, an accurate delineation of the related parties and connected persons is the bedrock of any TP analysis.

It is the first and most crucial step for tax practitioners prior to commencing any tax or TP analysis.

In this research paper, we discuss the key notions of related parties and connected persons. We also delve into these key concepts from the Organisation for Economic Co-operation and Development (OECD) standpoint as well as selected Middle Eastern domestic tax legislation[2].
We finally cover some of the practical challenges faced by GCC businesses in respect of identifying their related parties and connected persons.

OECD OVERVIEW:
The root concept of "associated enterprises"

The OECD Transfer Pricing Guidelines[3] ("OECD TPG") refer to "associated enterprises" as it comes to defining the scope of the TP regulations. For this purpose, the OECD TPG define associated enterprises by reference to Article 9 of the OECD Model Tax Convention ("MTC"). As such, two enterprises are considered to be associated if one of the enterprises meets the conditions of Article 9, sub-paragraphs 1.a) or 1.b) of the OECD MTC with respect to the corresponding enterprise[4]. Consequently, controlled transactions that are in scope of the OECD TPG, are transactions taking place between associated enterprises.

Article 9 of the MTC applies to parent companies and their subsidiaries and has as an objective to ensure a fair allocation of capital and profit between associated enterprises. For this purpose, Article 9 of the MTC requires all three elements of participation to be fulfilled in order for two enterprises to be characterized as associated, i.e., participation in (i) capital, (ii) management and (iii) control.

A mere factual approach to these criteria is not sufficient for the application of Article 9 of the MTC. Instead, a substance-based approach, is preferred and recommended. Taxpayers should be able to demonstrate, based on elements of facts, that the participation, in any of its required forms has as a consequence, the ability to influence and control the counterpart.

The definition of associated enterprises serves as a guidance for taxpayers and tax authorities to determine cases for application of Article 9 of the OECD MTC, particularly paragraph 2, dealing with corresponding adjustments.

On the other hand, local tax and TP legislations have a wider objective and refer to notions of related parties and connected persons bringing in more nuances to the meaning of control and ownership as explained in the following chapters.

LOCAL TAX LEGISLATION OVERVIEW: Related parties and connected persons

Related Parties

The notion of related parties is often used in domestic TP legislations; however, it cannot be found in the OECD TPG nor in the United Nations Manual for Transfer Pricing[5] (UN MTP), where the notion of associated enterprises is used instead.
The term "Related parties" usually refers to natural persons (individuals), juridical persons (companies) or other form of entities that have a close economic and/or legal relationship. This relationship is often based on ownership, control or significant influence over the other party. The local control and/or ownership prerequisites for the characterization of related parties differ from one jurisdiction to another and are further determined in the local tax legislation and related guidance.
For this purpose, local tax legislations may pre-set (or not) the shareholding and control thresholds for the qualification of related parties.

In this regard, it is internationally common to set the legal ownership threshold for related parties at 50% or more, based on the idea that a shareholding majority leads to an ability to exert control and influence over another party.
Such an approach is mostly inspired from international accounting standards,

In addition to the legal control prerequisites, local tax legislations may further recognize cases of factual control, which in turn requires a substance, fact-based assessment. It is not very common to have set criteria within local tax legislations as it comes to the definition of factual control. Taxpayers and tax authorities rather rely on recognized best practices and other factual criteria such as detailed organizational charts, reporting lines and role descriptions, commercial and/or contractual arrangements, financial and/or non-financial evidence of economic interdependence, etc.

Connected Persons

The term "connected persons" is not very common in local tax legislations. The concept of connected persons generally extends beyond that of related parties to cover specific natural persons (individuals).
The concept of connected persons refers to individuals or entities that have a close relationship with each other. This relationship is often defined based on specific criteria outlined in tax laws or regulations. In this regard, tax laws generally refer to relations of “kinship”.
"kinship" generally refers to the familial relationship between individuals. The specific definition of kinship can vary depending on the tax laws and regulations of a particular jurisdiction. Typically, it includes relationships such as:

1. Spouse: Refers to a legally married partner
2. Parent: Refers to a biological or adoptive parent of a child
3. Child: Refers to a biological or legally adopted child of a parent
4. Sibling: Refers to brothers or sisters who share at least one common parent
5. Grandparent/Grandchild: Refers to the relationship between grandparents and grandchildren.

Additionally, some tax laws may include other relatives within the scope of kinship, such as stepchildren, stepparents, in-laws, or even extended family members like aunts, uncles, or cousins.

The specific tax benefits or provisions that are tied to kinship can vary widely between jurisdictions. For example, tax laws may provide deductions or credits for supporting dependents, offer preferential tax rates for married couples, or provide exemptions for certain transfers of property between family members.

A GCC PERSPECTIVE

Tax and TP matters have long been on the agenda of tax authorities in advanced tax jurisdictions. Detailed guidelines, case law and doctrine, are available to taxpayers to help guide their tax analyses and interpretations. In the GCC area, international tax and TP terms and concepts are fairly new. Whilst certain GCC domestic tax legislations offer detailed and useful definitions of selected tax concepts, taxpayers still have to undertake a diligent analysis of their legal and organizational structures in order to determine the applicability of such concepts to their organizations.

The chapters below provide a summary of the related parties and connected persons definitions based on the local tax legislation in selected GCC jurisdictions where TP regulations have been adopted, i.e. The Kingdom of Saudi Arabia, Qatar and the United Arab Emirates.

The Kingdom of Saudi Arabia (KSA)

The Saudi Arabia Transfer Pricing Bylaws[6] (KSA TP By-laws) refer to the notions of related persons or persons under common control with quite an extensive list of criteria to be regularly and closely monitored by qualifying taxpayers.
The notion of person is defined in Article 1 (22) and covers both natural and juridical persons (recognized by law or fact to have legal personality), including permanent establishments.
The definition of a related person is provided under Article 1 (25) of the KSA TP Bylaws, making a distinction between the cases of (i) two natural persons, (ii) a natural person with a juridical person and (iii) two juridical persons.

Table 1 hereafter illustrates the various scenarios for qualifying related parties for TP purposes in KSA.

Table 1: Related Parties criteria in KSA

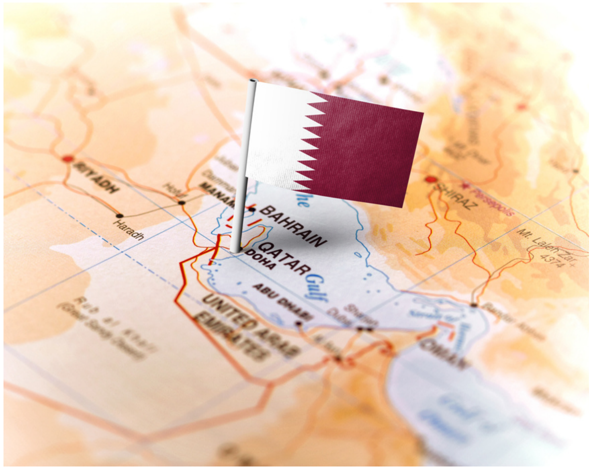
Scenario	Related Party Criteria
Two natural persons	(i) relatives through marriage or (ii) relatives to the fourth degree; or (iii) partners in a partnership
Natural person and juridical person	(i) if the natural person is a partner in a partnership and, either alone or together with a related person(s), directly, indirectly (or both) controls fifty percent (50%) or more of the voting rights, income, or capital of the partnership (ii) if the person or a related person thereto is a shareholder in a capital company and he, either alone or together with a related person(s), directly, indirectly (or both) controls fifty percent (50%) or more of the voting rights, income or capital of the company (iii) as for agencies administering property held in a trust, fund or any such similar arrangement, if the individual benefits or is capable of benefiting from them, either alone or with a related person(s) (iv) if the person alone or jointly with a related person thereto directly or indirectly participates or is able to participate in the management, control or capital of a juridical person
Two juridical persons	(i) they are under common control (ii) when the person who controls or has the capacity to control the business decisions of a juridical person has, alone or together with a related person, effective control over the other juridical person (iii) when the person who has effective control over a juridical person and the person who has effective control of the other juridical person are related persons.

Herein, the notion of "effective control" takes all its importance. As per the extensive scenarios listing, effective control not only covers legal control but also factual control including cases where one party has the ability to conclude an agreement on behalf of the other party or to act as a trustee, etc.

Based on the above, one can conclude that the KSA TP Bylaws are likely to capture numerous scenarios of related persons or persons under common control having regard to the extensive definitions of "person", "related persons" and "effective control" for TP purposes.

Hence, it is key for businesses to monitor their legal and (particularly) commercial relationships as these evolve, as well as perform a related parties assessment analysis on a regular, contemporaneous basis.

Qatar



The Qatar tax landscape is characterized by the co-existence of two tax regimes, i.e. the Qatar State Tax regime and the Qatar Financial Center Tax regime. As both tax regimes host different legislations, it is important to analyse the related party concept under both tax regimes and highlight the differences accordingly.

In terms of the Qatar State tax regime, in accordance with the provisions of Article 52 of the Executive Regulations (ERs) of the Qatar Income Tax Law (QITL) and the Frequently Asked Questions (section 2, Q1)[7], the Qatari regulations refer to the term “associated enterprises”.

Where the ERs use an explicit reference to the international accounting standards for the definition of associated enterprises, the FAQs in turn clarify that an entity is deemed to be associated to another entity, resident abroad, in the following cases (i) the reporting entity holds, at the end of the financial year (FY), directly or indirectly, more than half (50%) of the capital or voting rights of the other entity; or (ii) more than half (50%) of the reporting entity’s capital or of its voting rights is held, at the end of the FY, directly or indirectly, by the other entity.
Based on the above, it appears that the definition of associated enterprises for Qatar State tax purposes is fairly aligned with the international accounting standards and is rather based on legal control versus factual control.

In parallel to the above, the Qatari Financial Centre (QFC) Tax regime rather offers a more complex and extensive definition and refers to “associated persons” for purposes of TP[8]. In this context, the term “person” includes[9], in addition to a natural person, a body of persons corporate or unincorporate, as well as any partnership. Accordingly, the term “associated persons” covers the following situations[10]:

- One person controls the other, either directly or indirectly;
- Both persons are controlled by the same person or persons.

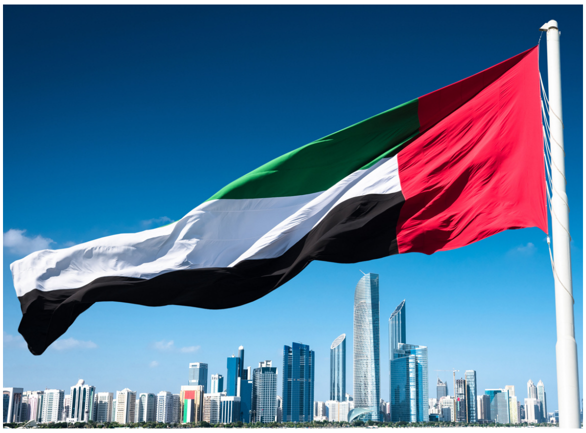
The notion of "control" is clarified[11] further and is summarized in Table 2 hereafter.

Table 2: Control criteria in Qatar

Scenario	Control Criteria[12]
Natural person and juridical person	A person controls the company if: (i) they have the power, through the holding of shares or voting rights in that company, or (ii) by virtue of any powers conferred by the Articles of Association or any other document regulating that company, to secure that the affairs of the company are conducted in accordance with their wishes.
Two natural persons (connected persons)[13]	• One of them is an individual and the other is his spouse, a relative of his or of his spouse, or the spouse of such a relative; • The first person is in partnership with the second person or is the spouse or relative of the second person; or • One of them is the trustee of a settlement and the other is either a settlor of that settlement or a person connected with the settlor.
A partnership	If a partner has the right to a share of more than half of the assets or income of the partnership.

In light of the findings above, it appears that the QFC regulations are likely to capture more associated persons in a TP context as compared to the ERs for Qatari State taxpayers. It will be key for businesses to know about the nuances and differences between the relevant Qatar tax regimes, i.e. Qatar State Tax regime, QFC regime, assess and plan their intercompany transactional structures accordingly.

The United Arab Emirates (UAE)



On 9 December 2022, the UAE released the Federal Decree-Law No. 47 of 2022 (UAE Decree-Law).
Article 35 of the UAE Decree-Law defines related parties as a natural or juridical person that directly / indirectly has a relationship with another natural or juridical person through kinship (in the case of natural persons), ownership or control.

For purposes of the above, kinship is established in situations where two or more individuals are related by affiliation, up to the fourth degree.

In turn, control and ownership materialize when a person (natural or juridical) has the ability to influence the other person either in their own right, by agreement or by factual influence, including situations where one person has the ability to:

1. Exercise 50% or more of the voting rights of another person
2. Determine the composition of 50% or more of the Board of Directors of the other person
3. Receive 50% of more of the profits of another person
4. Determine or exercise significant influence over the conduct of the business and affairs of another person[15].

Conceptually, the notion of control as per the UAE Decree-Law is aligned with the OECD / UN definitions and further refers to both legal (50% threshold) and factual control. Factual control, or the ability to determine or exercise significant influence over the conduct of the business of another person is not strictly defined in the UAE-Decree law as such. Taxpayers will have to rely on comparable international best practices and adopt a pragmatic, objective reasoning to determine whether there is factual control between the parties concerned.
It is further important to note that the definition of related parties in the UAE Decree-Law covers permanent establishments, branches and partners in the same unincorporated partnerships which may also be considered as related parties in the UAE.

Similarly, related party definitions include a trustee, founder, settlor or beneficiary of a trust or foundation and its related parties. This inclusion was intended to ensure that where the trustee, founder, settlor or beneficiary is a taxable person, transactions with the trust or foundation and its related parties, including for example other trustees or beneficiaries, are all conducted on an arm's length basis[16]. This is particularly relevant for family businesses and wealthy natural persons in the UAE operating through trusts or foundations. It will be critical to assess the tax qualification of the trust or foundation as such, as well as analyse the related party qualifications between the trust or foundation and their related parties. The case can get even more complex when the same individual owns or controls several trusts, foundations, etc, at the same time.

Of particular importance, the UAE Decree-Law in its Article 36 sets limitations on payments to connected persons. For this purpose, connected persons are defined more widely than related parties (per Article 35 of the UAE Decree-Law). As such, a connected person includes an owner of the taxable person, a director or officer of the taxable person, or a related party of either of the latter persons. For the specific case of unincorporated partnerships, it is further specified that any other partner in that unincorporated partnership is a connected person of that taxable person, as is any person who is a related party of said partner[17].

The purpose of the clause above is to prevent taxable persons from reducing their corporate tax liability by allocating excessive payments to natural persons who have a close connection to the taxable person, particularly where any income derived by such natural persons in their personal capacity would not be subject to corporate tax in the UAE. As such, Article 36 states that payments to connected persons shall be tax deductible in case (i) their value corresponds to the market value of the underlying services provided and (ii) they are incurred wholly and exclusively for the taxpayer's business. The UAE Decree Law does not further specify the methodology to be used for purposes of determining the market value of such payments to connected persons. However, it is reasonable to assume that TP methodologies may be used to arrive at a fair market value in this case. Practical challenges may not be excluded given the difficulty to identify publicly available information related to, e,g, senior executive compensation, etc.

As an exception to the rule above, the tax deductibility limitations would not apply to taxable persons whose shares are traded on a recognized stock exchange or that are subject to regulatory oversight by a competent authority in the UAE.

PRACTICAL CHALLENGES

The varying and rather technical definitions of related parties and connected persons in domestic tax legislations may cause practical challenges for taxpayers as well as tax authorities for purposes of assessing related party transactions in a TP context.

For multinational enterprises operating in various jurisdictions, the difficulty becomes even bigger, as they need to analyse the definition of related parties and connected persons in the various jurisdictions where they operate and assert the consequences of the diverging notions in relation thereof. This leads to an overly complicated compliance burden with businesses having to report and analyse different controlled transactions in different jurisdictions, for the same intercompany dealing(s).

Another difficulty may arise in respect of conducting a central benchmarking analysis for a transaction involving related parties in different jurisdictions. Where the related parties criteria diverge in the jurisdictions concerned, the benchmarking search strategy and results would need to be adjusted to ensure that the resulting set of comparables complies with the applicable control criteria in each jurisdiction, Pragmatic solutions exist and may be considered by businesses to avoid an overly burdensome compliance process in such cases.

Finally, other OECD BEPS[18] reporting requirements may put an extra burden on businesses having to comply with other tax reporting requirements referring to closely similar terms to the related parties, such as the concept of "closely related parties" under the BEPS Action 7 report as well as the "constituent entities" concept under BEPS Action 13 (Country by Country Reporting). This all adds to the complexity of the TP reporting and compliance process and puts an extra burden on in-house tax resources.

CONCLUSON

The tax sovereignty principle gives each jurisdiction the right to establish its own set of local laws and regulations. However, in a cross-border context, difficulties may arise where a group operates in two (or more) distinct jurisdictions holding different tax definitions and interpretations, such as for the notions of related parties or connected persons.

As jurisdictions endeavour to align their interpretation of associated enterprises under Article 9 of the OECD MTC with the purpose of avoiding double taxation, local tax regulations still hold diverging objectives and provide for diverging tax terms and definitions. Consequently, it is of crucial importance to conduct a thorough analysis of the internal tax legislation of each jurisdiction concerned as it comes to identifying related parties and connected persons.

In the Middle East, the economic environment is characterized by a significant presence of family conglomerates, involving a complex mix of both natural and juridical persons that are closely related by several intercompany transactions. Historically, payments taking place within the same conglomerate were not subject to tax scrutiny. However, with the evolving tax landscape in the Middle East, family businesses will need to conduct a thorough analysis of their related parties, connected persons and intercompany transactions in order to avoid compliance penalties as well as double taxation.

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. [8] QFC Tax regulations, V6 December 2020 and QFCA Tax Manual Extract (Transfer Pricing)
. [9] Article 140 of the QFC Tax regulations V6 December 2020
. [10] Article 56 of the QFC Tax regulations V6 December 2020
. [11] Article 57 of the QFC Tax regulations V6 December 2020
. [12] Furthermore, a person who exercises control over the affairs of a company or partnership, or who is able to exercise or is entitled to acquire direct or indirect control over the company or partnership shall be taken to have control of that company or partnership. The legislation deems a person („the potential controller") to have indirect control of a company or partnership if he would be taken to be directly controlling the company or partnership if the rights and powers attributed to the potential controller included the rights and powers of persons connected with the potential controller
. [13] Article 57(4) of the QFC Tax regulations V6 December 2020
. [14] The fourth degree of kinship includes great-great grandparents, great-great-grandchildren, nieces and nephews
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. [18] BEPS refers to Base Erosion and Profit Shifting

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