



# Transfer Pricing Documentation

BRIEF ON SRO 1191(I)/2017 DATED NOVEMBER 16, 2017



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## **BACKGROUND**

Transfer Pricing is not a new subject in Pakistan. Provisions in taxation law, dealing with determination of arm's length result of transaction between associates existed in erstwhile Income Tax Act, 1922, in the form of section 42. The same was continued under section 79 of the now repealed Income Tax Ordinance, 1979. Presently, section 108 of the Income Tax Ordinance, 2001 (the Ordinance), deals with determination of arm's length result of transaction between associates. These provisions are supplemented by Chapter VI of the Income Tax Rules, 2002 explaining in detail the methods prescribed for determining arm's length result of transaction between associates.

Through the Finance Act (FA), 2016 section 108 of the Ordinance was amended to provide maintenance of certain details and documents for purpose of substantiating the taxpayer's claim that the prices for transactions with associates are on arm's length basis.

On September 12, 2016, Pakistan signed Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MC) under the aegis of OECD (Organisation of Economic Cooperation and Development). Pursuant to Article 6 of the Convention, two Multilateral Competent Authority Agreements were to be signed: One relates to automatic exchange of tax related information, which was signed on June 7, 2017, whereas the other, the Multilateral Competent Authorities Agreement is related to exchange of Country-by-Country reports ("CbC MCAA"), which was signed on June 21, 2017.

As the cornerstone of the OECD's Base Erosion and Profit Shifting (BEPS) project, Country-by-Country Reporting (CbCR) requires multinational enterprises to report detailed financial and tax information relating to the global allocation of their income and taxes, among other indicators of economic activity. The purpose of the CbC MCAA is to set forth rules and procedures necessary for the competent authorities of jurisdictions opting to automatically exchange CbC Reports filed by the MNE (Multinational Enterprises) Group in the jurisdiction of its tax residence, with the tax authorities of all jurisdictions in which the MNE Group operates.



## **Latest Development**

Secondary legislation relating to CbC MCAA has now been notified by SRO 1191(I)/2017 dated November 16, 2017, introducing Chapter VIA in Income Tax rules, 2002. These rules contain Transfer Pricing Documentation (TPD) requirements, which are summarized in this flyer. The link to access the said SRO on FBR's website is:

<http://download1.fbr.gov.pk/SROs/2017111616115342861191-2017.pdf>

The CbC MCAA can be accessed using the link:

<http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/cbc-mcaa.pdf>

The List of CbC MCAA Signatories can be accessed using the Link:

<http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/CbC-MCAA-Signatories.pdf>

## **TRANSFER PRICING AUDIT**

Through FA, 2017, section 230E has been introduced for establishing Directorate-General of Transfer Pricing. Such Directorate comprise of a Director-General and as many Directors, Additional Directors, Deputy Directors, Assistant Directors and such other officers as the FBR may, by notification in the official Gazette, appoint.

The functions of the Directorate General of Transfer Pricing shall be to conduct transfer pricing audit. It is clarified that transfer pricing audit refers to the audit for determination of transfer price at arm's length in transactions between associates and is independent of audit under section 177, 214C or 214D which is audit of the income tax affairs of the taxpayer.

The FBR is expected to notify the criteria for selection of the taxpayer for transfer pricing audit and may further specify functions, jurisdiction and powers of the Directorate-General of Transfer Pricing.

## **TRANSFER PRICING DOCUMENTATION**

The documentation requirements as contained in the SRO 1191 are largely consistent with the transfer pricing guidelines of the OECD. The three-tiered approach prescribed in the OECD Transfer Pricing Guidelines is implemented, whereby the following reports / documents are required to be filed / maintained, as the case may:

Prescribed Documentation	Timelines	
	Tax Year 2017	On-wards
(1) Country by Country Report (CbCR);	March 31, 2018	Within 12 months after the end of the reporting fiscal year of MNE group.
(2) Master File; and	The Master File and Local File can be requested by the Commissioner Inland Revenue [CIR] at any time after the due date of filing of income tax return and shall be furnished within 30 days of such request, with an extended period of further 45 days if allowed by the CIR (further extendable under exceptional circumstances).	
(3) Local File		

## **COUNTRY BY COUNTRY REPORTING**

### *Who is required to file?*

Every entity (branch / company ) in Pakistan which is part of Multinational Entity Group (**MNE**) whose consolidated group revenue is Euro 750 million or more during a fiscal year.

### *Responsibility to furnish CbCR*

- (a) An Ultimate Parent Company (UPC) or Surrogate (substitute) Parent Company (SPC) of an MNE group resident in Pakistan, is required to furnish CbCR to FBR within the prescribed deadline);
- (b) A constituent entity of MNE group in Pakistan, not being UPC or SPC, if any of the following applies:
  - (i) the UPC or SPC is not obligated to file CbCR in its country of residence;

- (ii) the UPC or SPC is required to file CbCR in its country of residence, but there is no Competent Authority Agreement (CAA) in place for automatic exchange of CbCR between Pakistan and the Country of residence of UPC or SPC i.e. that Country is not a signatory to CbC MCAA; or
- (iii) both (i) and (ii) above are not applicable however there has been a systematic failure due to which such information is not exchanged.

### *CbCR Contents*

The CbCR should contain the following information for each country wherein the constituent entities of the MNE Group operates:

- a) Revenues from related and unrelated parties;
- b) Profit / Loss before income tax;
- c) Income tax paid;
- d) Income tax accrued;
- e) Stated capital;
- f) Accumulated earnings;
- g) Number of employees;
- h) Tangible assets other than cash; and
- i) Main business activities.

The format of CbCR is prescribed in SRO 1191(I)/2017.

### *Responsibility of constituent entities*

Whether or not CbCR is required to be filed, a constituent entity resident in Pakistan, which is not the UPC or SPC, shall furnish to the FBR details of its UPC or SPC of the MNE group and the country in which such entity is resident.

The information as mentioned above, is required to be furnished to FBR on or before the due date of filing of tax return. However, for the tax year 2017, the above information is required to be provided to the FBR by February 15, 2018.



## **MASTER FILE**

Every taxpayer, being a constituent entity of an MNE group having turnover of more than Rs. 100 million, is required to keep, maintain and make available the Master File to the FBR.

### **Master File contents**

The Master File must inter alia include the following information about the MNE group;

- (a) Legal and ownership structure of MNE and country / jurisdiction of each entity;
- (b) Nature of business activities of MNE;
- (c) Information of intangible assets;
- (d) Inter-company financial activities.

The contents of Master File in detail are provided in Rule 27L, [introduced through SRO 1191(I)/2017 dated November 16, 2017].

## **LOCAL FILE**

Every taxpayer entity in Pakistan which has undertaken transactions exceeding the monetary limit of Rs. 50 million with related parties is required to keep, maintain and make available the Local File.

### **Local File contents**

The Local File must include the following information;

- (a) Legal and ownership structure, management structure and organization chart with other related information of local entity;
- (b) Nature of business activities of local entity;

- (c) Key competitors;
- (d) Details in respect of each category of related party transaction including:
  - Description of the transaction
  - The amount of receipts/ payments
  - Identification of and relationship with the related party
  - List and copies of inter-company agreements
  - Comparability and functional analysis
  - Transfer pricing methods selected and applied
- (e) Financial information (viz. audited financial statements, transfer pricing methodology used and related other information.

The contents of Local File in detail are provided in Rule 27N, [introduced through SRO 1191(I)/2017 dated November 16, 2017].

## **PENALTIES**

Failure to furnish the documents shall be subject to penal consequences under the Income Tax Ordinance.

<b>Offence</b>	<b>Penalty</b>
Failure to keep and maintain documentation required under Section 108 of the Ordinance or Income Tax Rules, 2002 (Rules).	1% of the value of transaction, the record of which is required to be maintained under Section 108 and Rules.
Failure to maintain records required under Section 108.	Rs. 10,000 or 5% of the amount of tax on income whichever is higher.
Failure to furnish the information required under Section 108.	Rs. 25,000 for the first default and Rs. 50,000 for each subsequent default.

***KEY QUESTIONS TO CONSIDER***

- Are all stakeholders playing their part to minimize the risk of your transfer pricing being challenged by tax authorities?
- Is your transfer pricing strategy integrated with your business strategy?
- Are your transfer pricing outcomes aligned with economic value creation?
- Do you have clearly defined roles and responsibilities so that transfer pricing is operating seamlessly across your business?
- What controls are in place to ensure the impact of business change is taken account of in your transfer pricing?
- How quickly and efficiently can senior management defend a tax authority challenge? Are your legal agreements and transfer pricing documentation complete and in one place?
- Do you have a robust audit trail to prove to tax authorities that your transfer pricing calculations have been performed in accordance with your policy?
- Do your annual consolidated revenues exceed Euro 750 million and do you have international presence in OECD countries that are currently implementing CbCR requirements?
- Are you part of MNE group having turnover of more than Rs 100 Million, requiring to keep, maintain and make available the Master File to FBR?
- Whether your undertaken transactions with related parties exceed Rs. 50 million, requiring you to prepare Local File and make available to FBR?
- Have you ensured that data shared with tax authorities reconciles with external data sources?

## ***LET'S DISCUSS***

This update should not be considered as professional opinion / advice on any matter as this note summarises the key matters and requirements of CbC-MCAA for the guidance of the stakeholders in general. This update can also be accessed on our web-site [www.pwc.com/pk](http://www.pwc.com/pk).

If you have any query or need any clarification, please free to contact our Transfer Pricing team comprising the following:

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