

# Transfer Pricing Country Summary Pakistan

July 2018

## Legislation

### **Existence of Transfer Pricing Laws/Guidelines**

There is a general anti-avoidance rule in the Pakistani tax law that applies to transfer pricing (TP). In addition, the arm's length standard was firstly introduced in Section 108, Chapter V, part IV of the Income Tax Ordinance (ITO) 2001. The ITO, amended in 2017, provide powers to the Pakistan's Federal Board of Revenue (FBR) distribute, apportion or allocate income, deductions or tax credits between the persons as is necessary to reflect the income that the persons would have realized in an arm's length transaction.

Furthermore, the Section 108 determines the methods and steps to establish the arm's length standard. This section resembles with the Article 9 of the OECD Model Tax Convention.

As of January 2006, a joint-force, formed by the Securities and Exchange Commission of Pakistan (SECP) and the Central Board of Revenue (CBR) has concluded that transfer pricing extends across the corporate sector and is not limited to any class of companies. It has, therefore, recommended that the application of the International Accounting Standard (IAS) 24 should extend to all companies registered under the Companies Ordinance of 1984, other than small companies. Companies shall present the Board of Directors and the Audit Committee of the company all the transactions with related parties, rule that applies to transactions undertaken at a non-arm's length price.

### **Definition of Related Party**

The Section 85 of the ITO describes the conditions under which two or more parties are considered to be associated in the following circumstances:

- The relationship between the two parties is such that one may reasonably be expected to act in accordance with the intentions of the other, or both persons may reasonably be expected to act in accordance with the intentions of a third person;
- A member of an association of persons and the association, a trust and any person who benefits or may benefit under the trust, direct and indirect shareholders control 50% or more (i) voting power, (ii) rights to dividends or (iii) rights to capital;
- An individual and a relative of the individual;
- Members of an association of persons (AOP);
- A member of an association of persons and the association, where the member, either alone or together with an associate or associates under another application of this section, controls fifty per cent or more of the rights to income or capital of the association;
- A trust and any person who benefits or may benefit under the trust;
- A shareholder in a company and the company, where the shareholder, either alone or together with an associate or associates under another application of this section, controls either directly or through one or more interposed persons.

## Record Keeping

The relevant documentation should be maintained for six years, from the date of the filling the tax return, according to the ITO (General Statute of Limitations).

## Transfer Pricing Scrutiny

In 2007, the FBR created a special transfer pricing task force to focus on the banking sector, petroleum and gas exploration companies, the pharmaceutical sector and non-resident companies. The objective of the task force, which comprises representatives from the government and private sectors, is to make recommendations for improving revenue collection from non-resident companies, particularly those engaging in e-commerce, e-communication, electronics/computer software, contract sharing, and the determination of beneficial ownership and attribution concepts of investment income. Arising from this may be the revision of the definition of royalty and fee for technical services.

In December 2014, the FBR formed a transfer pricing unit to establish a regime meant to provide technical backstopping to field offices and build their capacity, to develop a resource base including database of comparables, to propose improvements in law and policy, basically a regime where transfer pricing adjustments are given a greater importance.

Earlier, there was no specific audit requirement. The FBR commissioner, during the course of regular audit proceedings, has the powers to ask for the TP related transactions.

Now, Finance Act, 2017 has established the "Directorate-General for Transfer Pricing" to conduct transfer pricing audit by insertion of section 230E. For the purpose, transfer pricing audit is meant as audit for determination of transfer price at arm's length in transactions between associates, independent of audit of income tax affairs under sections 177, 214C or 214D of the Ordinance. The Finance Act, 2017 also proposes that the Board may specify the criteria for selection of the taxpayer for transfer pricing audit and also specify the functions, jurisdiction and powers of the Directorate.

## Transfer Pricing Penalties

The FA 2017 introduced penalties in relation to transfer pricing provisions contained in section 108 of the Ordinance, as follows:

Offense	Penalty
<ul style="list-style-type: none"> <li>Failure to maintain records required under the Ordinance or the rules made there under</li> <li>Failure to furnish the information required or to comply with any other term of the notice served under section 176</li> </ul>	<ul style="list-style-type: none"> <li>1% of the value of transactions, the record of which is required to be maintained.</li> <li>25,000 Rupees for the first default and 50,000 Rupees for each subsequent default</li> </ul>

<ul style="list-style-type: none"> <li>• Failure to furnish information or country-by-country report within the due date</li> <li>• Failure to keep and maintain document and information required under section 108 or the rules</li> </ul>	<ul style="list-style-type: none"> <li>• 2,000 Rupees for each day of default subject to a minimum penalty of 25,000 Rupees</li> <li>• 10,000 Rupees or 5% of the amount of tax on income, whichever is higher</li> </ul>
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### Advance Pricing Agreement (APA)

Pakistan does not have an advance pricing arrangement regime. Advance rulings may be sought, but generally apply when a non-resident has a question of law or fact regarding a tax liability.

## Documentation and Disclosure Requirements

### Tax Return Disclosures

Taxpayers are expected to disclose related party transactions in their financial statements in accordance with the International Financial Reporting Standards (IFRS). Taxpayers must report transactions above 50 million Rupees with non-resident in their tax returns.

Transactions include:

- Tangible property
  - Finished Goods
  - Stock in Trade or Raw Material
  - Property of Capital Nature
  - Others

### Documentation requirements

Previously to the Finance Act 2016 (FA 2016), the Law in Pakistan had not provided with any specific documents to be filed with tax return related to TP. However, FA 2016 introduced the general documentation requirements which taxpayers shall maintain when entering into transactions with associated parties.

In November 2017, the notification Statutory Regulatory Order (SRO) 421(I)/ 2017 stated the TP documentation, which taxpayers are required to maintain. Every Pakistani multinational enterprise (MNE) which is member of a group is required to prepare a Country-by-Country Reporting, Master File and Local File, once the following thresholds are met:

- CbCR for MNEs with consolidated revenues of more than 750 million Euros;
- Master file for MNE group turnover of more than 100 million Rupees;

- Local file for related party transactions of more than 50 million Rupees.

### **Main requirements**

#### a) CbCR

The layout of the CbCR is prescribed in the notification SRO 1191(I)/2017, and it mainly follows the orientation set forth in Action 13 of the BEPS project. If the constituent entity resident in Pakistan is not the ultimate parent company (UPE), such entity shall furnish to the FBR the details of its UPE or the surrogate parent entity of the MNE and the country or territory of which the said entities are resident, on or before the date the constituent entity is required to file the tax return under section 118 of the ITO.

#### b) Local file

The Local file set forth in Rule 27M, shall include: (a) local entity structure including its management structure of the local entity, a local organization chart and a description of the individuals to whom local management reports and the country or countries in which such individuals maintain their principal offices; (b) a detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity; (c) key competitors; (d) information for each category of controlled transactions in which the taxpayer is involved; and (e) financial information.

#### c) Master file

The Master file regulated in Rule 27K, must include standardized information relevant for all MNE's, as follows: (a) chart illustrating the MNE's legal and ownership structure and geographical location of operating entities; (b) general written description of the MNE's business; (c) information of intangibles; (d) inter-company financial activities; and (e) annual consolidated financial statement for the fiscal year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.

### **Language for Documentation**

The FBR accepts any transfer pricing documentation drafted in the Urdu or English language. Any documents not originally drafted in Urdu or English may, by notice in writing from the FBR, need to be translated into such at the expense of the taxpayer.

### **Small and Medium Sized Enterprises (SMEs)**

There are no special transfer pricing rules for small and medium sized enterprises deviating from the general regime of transfer pricing.

## Deadline to Prepare and Submit Documentation

There is no statutory deadline for preparation of TP documentation. In general, TP documentation shall be available when submitting the income tax return, and the Master file and Local file should be available to the FBR within 30 days from the date of the request, provided that 45-day extension may generally be obtained from the FBR.

Regarding the CbCR, the due date for preparing and submitting, whether the Constituent entity is the ultimate parent company or not, is on or before 31 March 2018 for the tax year of 2017, and for the following years, the information is required to be filed not later than twelve months after the last day of the reporting fiscal year of the MNE Group.

## Statute Of Limitations

The general statute of limitations should not exceed more than six years from the date of the filling the return, according to the Income Tax Ordinance, 2001. This is in case there is no fraud suspected. If there is suspicion of fraud, then there is no time limitation.

## Transfer Pricing Methods

The FBR outlines the following methods should be applied for the purpose of determining the arm's length result:

- The comparable uncontrolled price method (CUP);
- The resale price method (RPM);
- The cost-plus method (CPM); or
- The profit split method (PSM).

The profit split method should be applied if any of the other methods specified (CUP method, the resale price method, the cost-plus method) cannot be reliably applied.

Between (1), (2) and (3), there shall be made a choice which provides the most reliable results, as this is considered to be the transaction-based methods.

It is pertinent to note that in view of the Pakistan Tax Authorities having consistently ignored the internationally accepted criteria and procedures in application of Comparable Uncontrolled Pricing Method, Pakistan and Germany through a Memorandum of the Meeting of the Competent Authorities

held on 6-7 July 2004 in Berlin, Germany agreed at paragraph 5 of the Memorandum that “the most preferable method (for determining arm’s length price) is the resale price method.”

Where the four stated methods do not provide a reliable measure of an arm’s length price, the FBR may use any other method. The transactional Net Margin Method (TNMM) has not been specifically provided for, but the FBR can accept the adoption of this method, if he finds that other methods, under the facts and circumstances, are not appropriate. The FBR may also refer to international standards, case law and guidelines when determining an arm’s length price.

## Comparables

Although there is no specific reference in the regulations about local comparables, the FBR preference has been for local comparables. Where local comparables’ information is not available, it is recommended that documentation be provided evidencing that a local search was attempted.

**Note:** This document is for informative purposes only.

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