Egypt – New Transfer Pricing Guidelines

Egyptian and GCC Enterprises need to act now to reduce the risk of ETA audit and penalties. Submission of local documentation is 2 months after the tax return.

New Transfer Pricing Documentation Requirements

The Egyptian Tax Authority (ETA) issued the Egyptian Transfer Pricing Guidelines (ETPG) in October 2018 as a guide to the application of Article (30) of the Income Tax Law No.91 of 2005 (ITL 2005). Article (30) of the ITL 2005 entitles ETA to determine the taxable profit in accordance with the arm's length price.

The ETPG requires companies to provide 3 levels of transfer pricing documentation to the ETA (Master File, Local File and Country by Country Report) as part of their tax compliance obligations. This will minimise the risk of audit by ETA and the likelihood of having transfer prices adjusted by the ETA. The ETPG and transfer pricing documentation requirements are in line with the transfer pricing documentation requirements published as part of the OECD's Base Erosion and Profit Shifting (BEPS) project.

Who will be effected?

<u>An Egyptian parented Group of Associated Enterprises (EGAE).</u>

The Parent entity is that which, directly or indirectly, owns a sufficient interest in one or more entities of the GAE such that it is required to prepare Consolidated Financial Statements under domestic accounting standards.

<u>A Group of Associated Enterprises (GAE) with a business activity in Egypt.</u>

This would include non-Egyptian enterprises with an associated enterprise in Egypt as well as two or more associated enterprises in Egypt itself. Therefore Egyptian enterprises, GCC enterprises with associates in Egypt and other non-Egyptian enterprises with associates in Egypt will all be effected by the ETPG.

What transfer pricing documentation is required?

The ETPG require enterprises to evidence that transactions with associated enterprises are at 'arm's length' prices. This evidence and the details of how it was arrived at and the amount of tax paid needs to be set out in a three-tiered transfer pricing documentation approach:

Master File:- Containing information that is relevant to all the GAE members;

Local File:- Specific information on the controlled transactions of the local taxpayer in Egypt; and

Country-by-Country Report (CbCR):- Information regarding the global allocation of income and taxes paid by each member of the GAE.

Who should prepare the transfer pricing documentation?

The Local File transfer pricing documentation will ordinarily be prepared by the local Egyptian enterprise.

The Master File transfer pricing documentation will ordinarily be prepared by the Parent of the GAE. If this is an Egyptian parented GAE then this will be prepared by them in Egypt and sent to the foreign enterprise for their tax compliance purposes. The Master File if prepared by the foreign parent will be provided by them to the Egyptian enterprise and submitted to ETA.

The CbCR will be prepared by the Parent of the GAAE. If the parent is foreign it will be transmitted automatically to the ETA by the foreign tax authority, if the parent is Egyptian then the CbCR will be transmitted by the ETA to the foreign tax authority automatically.

Egypt – New Transfer Pricing Guidelines

When does the transfer pricing documentation need to be filed with ETA?

Taxpayers are required to submit their transfer pricing documentation to ETA on an annual basis.

The Local File has to be submitted to ETA's transfer pricing department two months following the Egyptian enterprise's date of filing its tax return.

The Master File has to be submitted to the ETA's transfer pricing department after it has been prepared in accordance with the GAE's ultimate parent's tax return filing date.

The Country by Country Report should, in general be submitted to the tax authority in the jurisdiction of the GAE's ultimate parent within one year following the close of the relevant financial year that it covers. For the purposes of the ETPG and Egyptian parented GAEs, the first CbCR should be prepared for the GAE's fiscal year ending 31st December 2018 and filed within 12 months.

How often does the transfer pricing documentation have to be updated?

Taxpayers should prepare their transfer pricing documentation annually to support their transfer pricing positon, and update it to reflect any changes. It is recommended taxpayers review their transfer pricing documentation to assess whether it remains valid and accurate.

It is recommended that taxpayers prepare a new comparables benchmark search every three years, and ensure the current one is still relevant by reviewing it annually.

Although transfer pricing documentation may be prepared and maintained in a language other than Arabic, ETA may require the taxpayer to submit an official translation at their own expense.

Burden of Proof

If the taxpayer has complied with the requirements of the ITL the burden of proof is initially with the ETA to determine that controlled transactions are not at arm's length.

It the taxpayer does not submit documentation on time to evidence how transfer pricing has been implemented and that it is at arm's length, ETA is more likely to assign it a high tax risk rate, and hence be audited by ETA. In such cases, ETA is entitled to determine the arm's length transfer price, and adjust the transfer pricing established by the taxpayer.

Penalties

The Law stipulates penalty percentages determined in accordance to the amount of the disputed annual tax base. These penalty provisions are applicable to transfer pricing adjustments resulting from an audit.

Please contact The Cragus Group for further advice and assistance on preparing your transfer pricing documentation:

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Egypt – New Transfer Pricing Guidelines

What information needs to be included in each transfer pricing document?

The actual information that should be included in each of the above three tiers of transfer pricing documentation is not proscribed since the appropriate documentation depends on each taxpayer's specific circumstances. The ETPG set out the factors that should be considered by taxpayers in determining the appropriate level of documentation at each tier dependent on their particular circumstances. Furthermore, the ETPG provide guidance as to the documents that would be expected to represent sufficient evidence of the credibility of their transfer pricing policies.

Master File

1. The organisational structure of the GAE as a whole (e.g. ownership linkages with the GAE, changes in the main shareholdings over the year if any, the location of each member, the legal structure of each entity etc);

2. An outline of the business activities undertaken by the GAE, including a description of the supply chain, key service agreements, key geographic markets, brief functional analysis on the principle contributions to value creation, details if the five largest products/services offerings and any important business restructuring transactions;

3. The GAE controlled financial activities, including a description of how the group is financed and the relevant financing agreements, identification of GAE members with central financing function and their location, details of the place of effective management along with a description of the relevant transfer pricing financing policies;

4. The GAE intangibles, including a description of the overall strategy for the development, ownership and exploitation of intangibles, list of important intangibles and their ownership, details of principal research and development facilities and management location, relevant agreements and transfer pricing policies, and any important transfers of interests in intangibles among the members of the GAE: and

5. The GAE's financial and tax positions, including the annual consolidated financial statements of the GAE, and a list and brief description of any existing APAs or other tax rulings relating to the allocation of income amongst the GAE members.

Local File

Step 1: Identifying the controlled transactions and understanding the nature of such transactions of the Egyptian taxpayer.

1. Documents related to the nature of the industry/market in which the taxpayer operates. Including details on:

- The taxpayer's business including its business lines, and activities;
- The nature of the taxpayer's industry dynamics and the analysis of the economic factors influencing both the taxpayer's business and the industry; and

- The market in which the taxpayer operates in terms of its location, size, competition, etc.

2. Documents relating to the taxpayer's business policies and strategies, including details on:

- The taxpayer's business model
- The taxpayers transfer pricing policy
- The organisational and management structure of the taxpayer
- The business strategies adopted by the taxpayer, especially those strategies which are likely to influence the pricing of controlled transactions, such as pricing strategies, market penetration/expansion strategies, or any business restructurings etc.
- Details from any studies conducted prior to the strategy implementation including the aim of the strategy, its duration, its related costs and the expected profit.

3. Documents related to the controlled transactions under review:

- Documents identifying the object (property and/or service) of the transaction under review;
- Business relationships between the transaction parties (selling/purchasing goods, providing services, using intangibles, etc.);
- Documents describing the controlled transactions in terms of its range, type, timing and frequency, the parties to the transaction, the amount of controlled payments and receipts for each transaction broken down by tax jurisdiction etc.;
- Contracts/agreements showing the contractual terms of the transaction; and
- A preliminary functional analysis of the functions performed, assets used and risks assumed by the taxpayer and by the associated enterprise involved in the controlled transaction under review.

4. Documents relating to the comparables including:

- A list of any known comparable enterprises having transactions similar to the controlled transactions;
- Documents identifying the screening criteria for selecting comparables;
- A preliminary functional analysis of the functions performed, assets used and risks assumed by the selected comparable enterprise in the selected comparable uncontrolled transaction.

Step 2: Selecting the most appropriate transfer pricing method(s)

1. Documents identifying the pricing method(s) used:

- Description of the process used to select the pricing method and the reasons that method in particular was selected for pricing the controlled transactions under review;
- If a profit based transfer pricing method has been used, taxpayers should submit documents outlining the reasons for considering the three traditional methods as being less appropriate in these circumstances and the reason why this profit method was regarded as providing a better solution.

2. Documents showing the analysis conducted to evaluate the reliability of the data used.

Egypt – New Transfer Pricing Guidelines

Step 3: Applying the selected pricing method.

1. Documents that are generally produced regardless of the pricing method used;

- Detailed comparability study conducted by the taxpayer including the characteristics of the property or service, the functions performed, the assets used, risks assumed, the contractual terms, market circumstances, business strategies adopted etc.
- Details of the results of the search for comparables in the local market, the region or globally depending on where the most appropriate comparables can be found.
- The search strategy used to identify the most appropriate comparables
- Material differences between the controlled and the selected comparable uncontrolled transactions, how these were quantified and necessary adjustments made.
- Details of all the calculations made with the financials when applying the selected method(s).
- Copy of existing unilateral, bilateral/multilateral APAs and other tax rulings relevant to the taxpayer's controlled transactions covered in the local file.

2. Documents related to the pricing method applied;

These will be different depending on the pricing method applied since different methods require different types of data and analysis.

- CUP Method – Documents accurately describing the characteristics of the property/service of the uncontrolled comparable and the controlled transaction together with the effect of any differences.

- RPM – The functional analysis of both the taxpayer and the independent comparable enterprise. Documents showing the functional comparability, how gross margins are earned in both transactions, and statement showing how differences in accounting practices have been reconciled.

- CPM – The functional analysis of both the taxpayer and the independent comparable enterprise. Documents showing - the functional comparability; how the cost base of the controlled transaction under review was calculated including how indirect costs were allocated; and the comparisons drawn between mark-ups of gross profits earned in both transactions.

- PSM – Documents showing whether the level of applying this method is on a transactional basis or aggregate basis and why; the functional comparability; the combined profit that was calculated; the contribution or residual analysis; reconciliation of accounting practices; and the basis of projecting profits.

- TNMM – Documents showing details of the benchmarking analysis undertaken; the steps followed; the qualitative and quantitative analysis used to arrive at the final set of comparables; the profitability ratios used and the reasons for using these ratios in particular; how the range of outcomes was evaluated and how the taxpayer selected the most reliable arm's length net profit margin, etc.

Egypt – New Transfer Pricing Guidelines

Step 4: Determining the arm's length amount and introducing a review process to reflect any changes:

1. Documents that are expected to be prepared throughout this step may outline the following details:

- The established arm's length price;
- The actions undertaken to monitor changes that may affect he price e.g. circumstances of the taxpayer and the comparable enterprises, changes in the validity of data used in prior steps;
- The evaluation of the impact of such changes on the validity of the arm's length amount;
- The adjustments made to account for such impact(s), in order to obtain a reliable arm's length amount to be used in the near future.

2. General documents recommended to be prepared;

- The amount of sales and operating results from the last few years (three years is ideal) preceding the transaction under review;
- Annual reports and financial statements of the taxpayer. Segmented financial statements;
- Profitability analysis with respect to the controlled transactions. Including analysis of the profitability of the taxpayers with respect to each controlled transaction on a stand-alone basis against the arm's length range of comparables identified.

Country-by-Country Reporting

1. Country-by-Country Reporting requires aggregate jurisdiction-wide information regarding the GAE's global allocation of income, taxes paid, and certain indicators of the location of key economic activity.

2. GAE's are also required to report other quantitative data in respect of their jurisdictional business operations such as number of employees, stated capital, retained earnings, tangible assets and each entity within a jurisdiction.

3. Foreign parented GAE's who have revenues of over Euro750m will file a CbCR with their local tax authority. ETA will receive, in most cases automatically, a copy of that foreign parented GAE's CbCR when it has been filed. The information and structure of the foreign parented GAE's CbCR will be that agreed by the foreign tax authority but will be based on the OECD template.

4. Egyptian parented GAE's with turnover above EGP 3billion will need to file a CbCR with the ETA using the OECD template.