Daily Tax Report: International

INSIGHT: Transfer Pricing Case Law Developments and their Application to the MENA Region

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Sept. 9, 2020, 8:01 AM

Shiv Mahalingham, of the Cragus Group, discusses the Apple and Cameco cases, and their importance for multinational enterprises facing transfer pricing audits in the Middle East and North Africa region.

Over the 2020 summer months there have been two important international case law developments relating to transfer pricing. The economic precedents established in these transfer pricing cases in North America and in Europe will be considered and applied by tax inspectors in the MENA region and as such it is important for multinational enterprises (MNEs) operating in the region to be aware of the key issues that may arise as a result of these cases. This is especially true for regimes including Algeria, Egypt, Kingdom of Saudi Arabia (KSA), Morocco, Qatar and Tunisia who have adopted many of the OECD transfer pricing principles being discussed in these cases (see previous article).

The two cases covered in this article are:

1. European Commission v. Ireland and Apple, General Court Ruling, July 2020;
2. Canada v. Cameco Corp, Federal Court Ruling, June 2020.

This article sets out a summary of each of the above cases and how the precedents apply to the MENA region. Note that the 2020 rulings set out below (both in favor of the taxpayer) are in relation to transfer pricing cases which have been on appeal since the initial judgments were conveyed.

Apple

Apple entered into unilateral agreements with the Irish tax authority over a number of tax years to agree the level of taxable profits in Ireland. In August 2016, the European Commission (EC) held that these agreements were in contravention of the EC state aid rules. The premise of the EU state aid rules is that a company which receives government support gains an advantage over its competitors. Therefore, the state aid rules generally prohibit such "aid" unless it is justified by reasons of general economic development.

Ireland and Apple appealed against this decision and in July 2020, the General Court of the EU ruled in favor of Ireland and Apple in finding that the tax agreements in this case did not constitute state aid. The following points were noted in the judgment in particular:

1. the agreements were not based on the discretion of the Irish tax authorities;
2. the EC had failed to demonstrate that the level of taxable profits in the agreements was not reflective of the activities and functions actually performed in Ireland and the strategic decisions taken and implemented outside of Ireland.

It is important to appreciate that the link between lower taxable profits and state aid was acknowledged in the above ruling. Therefore, it is critical that any tax rulings are supported by economic analysis justifying the level of taxable profits. This would be sensible practice within the EU and in non-EU jurisdictions.

The ruling of the General Court is an important development in the arena of transfer pricing certainty as the initial EC ruling in 2016 dissuaded many MNEs from seeking tax rulings within the EU if these were going to create a state aid challenge.

Importance to MENA

Whilst there are no state aid rules in the MENA region, unilateral (i.e. conducted with one taxing authority) tax rulings and advance pricing agreements (APAs) are available in the region to help provide certainty for MNEs. Unilateral transfer pricing APAs and tax rulings are available in Algeria, Egypt, KSA, Morocco and Tunisia.

The above case confirms that a tax ruling supported by robust economic analysis will continue to be an important tool for MNEs. In fact, a transfer pricing policy that includes unilateral discussions/rulings with tax authorities can demonstrate a strong level of transparency and corporate governance for MNEs.

Cameco

Cameco established a subsidiary in Switzerland with the rights to purchase uranium (from related and unrelated parties) and on sell this uranium to third party customers (outside of Canada). Cameco Canada sold certain rights and inventory to Cameco Switzerland and the profits (heightened by an uplift in the price of uranium) were subject to taxation at a lower rate in Switzerland than they would have been in Canada.

The Canadian Revenue Authority argued that this was a sham transaction purely to avoid taxation; however, in 2018 the Canadian Tax Court ruled in favor of Cameco, highlighting that the transactions undertaken were consistent with transfer pricing principles (sections 1.36 and 1.37 of the OECD Transfer Pricing Guidelines were discussed in particular and the difficulty in recharacterizing a transaction if it is supported by strong economic analysis and commercial substance) and were merely the legal foundation of the implementation of a tax plan.

In June 2020, the Federal Court of Appeal upheld the Tax Court ruling in favor of Cameco. Cameco had strong economic substance in place in Switzerland that supported the level of taxable profits in Switzerland.

Importance to MENA

The Cameco case is an important "post-BEPS" transfer pricing case that demonstrates that MNEs operating in the region are able to benefit from the centralization of economic substance in lower tax locations (e.g. the United Arab Emirates or Bahrain). Transfer pricing policy design should therefore take this into account.

Planning Points

The common theme for international transfer pricing cases is always to have ensured that transfer pricing policy has been designed and documented commensurate with the appropriate level of economic substance. However, there are also the following lessons that can be taken from these cases:

1. unilateral tax rulings relating to transfer pricing will continue to be an effective means of obtaining certainty;
2. transfer pricing policy design relating to low tax regimes should reflect OECD principles.

The above cases also demonstrate that tax planning supported by robust economic analysis will continue in the post-BEPS environment.

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Topics

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Companies

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