

Daily Tax Report: International

Transfer Pricing in the Middle East in 2021

By Shiv Mahalingham

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Shiv Mahalingham of The Cragus Group provides a summary of important transfer pricing documentation requirements in the Middle East region for 2021 and adds his on-the-ground experience of developments.

Transfer pricing regulations and guidance in the Middle East were released, updated, and even reversed in certain circumstances throughout 2020; it has been difficult to keep track of these changes. This article is intended to serve as a helpful depository of the transfer pricing local file documentation requirements for multinational enterprises (MNEs) operating in the region (now that most MNEs will have completed their country-by-country reporting (CbCR) obligations in December 2020).

The article focuses on the Kingdom of Egypt (Egypt), the Kingdom of Saudi Arabia (KSA) and the State of Qatar (Qatar), as these are the territories in the region with formal transfer pricing documentation requirements. I have added my on-the-ground experience with the regimes also and CbCR is not included here (to be covered in an article later in the year).

Egypt

What are the key dates and deadlines to be aware of? Are submissions required to the local tax authority?

1. A summary transfer pricing form is included as part of the tax return each year.
2. A master file must be prepared and submitted to the Egyptian Tax Authority (ETA) each year—the MNE's master file will be sufficient for these purposes and may only need to be updated every three years.
3. A local file must be submitted to the ETA each year (separate files are required per taxable entity).

Transfer pricing documentation (as set out above this will be one master file for the MNE and a separate local file for each taxable entity) must be submitted to the ETA within 60 days of the submission date for tax returns (the master file can be submitted later in the year if required to coincide with the MNE group's transfer pricing compliance cycle and when the master file will be available).

This submission date will be June 30, 2021 for most MNEs with a calendar financial year end and April 30 tax return deadline.

What are the key departures from the OECD Transfer Pricing Guidelines?

The Egypt Transfer Pricing Regulations reference the Organization for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines, and these will be important in interpreting any areas that the Egypt Transfer Pricing Regulations and Guidance do not address.

The Egypt Transfer Pricing Regulations adopt the OECD three-tiered approach to documentation (master file–local file–CbCR) and there is a strong amount of consistency between the Egypt Transfer Pricing Regulations and Guidance and the OECD Transfer Pricing Guidelines.

The key departures are as follows:

1. searches for comparables should in the first instance be limited to the local Egyptian market and then if local comparables cannot be identified the scope may be expanded to regional and then global comparables;
2. the Egypt Transfer Pricing Guidance sets out a sixth factor of comparability alongside the OECD five factors:

Egypt	OECD
Characteristics of the property transferred or services provided	Characteristics of the property transferred or services provided
Functional analysis	Functional analysis
Contractual terms	Contractual terms
Economic circumstances	Economic circumstances
Business strategies	Business strategies
<i>Government policies</i>	

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Is there a requirement for local comparables?

As set out above, the preference is for local Egyptian comparables in the first instance.

Is documentation required each year?

It is recommended that the master file is updated every three years (unless there are material changes) and the local file is updated/refreshed each year.

What is the preferred language of documentation?

Arabic is recommended as the preferred language of submission for documentation but in practice both Arabic and English are accepted. The ETA can order MNEs to pay for an Arabic translation on request.

How common are transfer pricing audits since the inception of the transfer pricing regulations?

Egypt, in the past, followed a more traditional approach to transfer pricing audits in which queries were initiated by research/reviews into accounts, tax returns and other documents. However, the October 2018 update to the Guidance confirmed that the local file must be submitted to the ETA two months after the tax return filing as set out above. I would anticipate transfer pricing audits to increase in volume later in 2021 after these documents are received and reviewed by the ETA.

What are the penalties for non-compliance?

A penalty of 1% of related party transactions may be levied for failure to complete the transfer pricing disclosures in the corporate income tax return.

Additional penalties of \$3,000 may apply for failure to submit documentation (this amount can be increased for repeated failures, to a maximum of 3% of the value of the related party transaction).

Adjustments, interest and corporate income tax penalties may be applied to transfer pricing adjustments if transactions cannot be supported at arm's length.

Is there an exemption for smaller local entities?

There is a de minimis limit for related party transactions below 8 million Egyptian pounds or \$500,000.

KSA

What are the key dates and deadlines to be aware of? Are submissions required to the local tax authority?

1. transfer pricing disclosure form and affidavit (submitted to General Authority of Zakat and Tax (GAZT) 120 days after year end);
2. local file and master file (must be in place 120 days after year end—April 2021 for most MNEs with a calendar financial year end).

Aside from the disclosure form, transfer pricing documentation is only to be submitted to GAZT on request.

What are the key departures from the OECD Transfer Pricing Guidelines?

The OECD Transfer Pricing Guidelines are not referenced in the KSA Transfer Pricing Bylaws but are referenced in the KSA Transfer Pricing Guidance. The OECD Transfer Pricing Guidelines will be important in interpreting any areas that the KSA regulations and Guidance do not address.

The KSA Transfer Pricing regulations adopt the OECD three-tiered approach to documentation (master file–local file–CbCR) and there is a strong amount of consistency between the KSA Transfer Pricing Regulations and Guidance and the OECD Transfer Pricing Guidelines.

The key departures are as follows:

1. the extensive definition of control which requires a consideration of (i) financial and (ii) trading influence on one person over another in addition to traditional management/governance/share ownership control relationships;
2. it is specified in the KSA Transfer Pricing Guidance that loss-making companies must not be included in a search for potential comparables;
3. the OECD Transfer Pricing Guidelines require prices to be within the arm's length range; however, there is a local requirement in the KSA to target the median of comparable results (or have very strong arguments supporting why there is a different position in the inter-quartile range being adopted);
4. the KSA Transfer Pricing Guidance sets out a sixth factor of comparability alongside the OECD five factors:

KSA	OECD
Characteristics of the property transferred or services provided	Characteristics of the property transferred or services provided
Functional analysis	Functional analysis
Contractual terms	Contractual terms
Economic circumstances	Economic circumstances
Business strategies	Business strategies
<i>Analysis of risks</i>	

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Is there a requirement for local comparables?

The geographic market is listed as an important consideration in the KSA Transfer Pricing Guidance; however, in practice, GAZT will accept regional and global comparables where the economic facts and circumstances support this.

Is documentation required each year?

It is recommended that the master file is updated every three years (unless there are material changes) and the local file is updated/refreshed each year.

What is the preferred language of documentation?

Arabic is recommended in the KSA Transfer Pricing Bylaws as the preferred language of submission for documentation but in practice both Arabic and English are accepted.

How common are transfer pricing audits since the inception of the transfer pricing regulations?

The KSA is the largest economy in the Middle East (circa \$800 billion gross domestic product) and has the most mature transfer pricing regime in terms of audit intensity, despite the regulations only having been introduced in January 2019 (Income Tax Law—Issued by Royal Decree (M/1) dated 15/1/1425H, Bylaws January 2019, Guidance March 2019, Guidance May 2020). Article 62 of the KSA Income Tax Law will be observed for transfer pricing audits.

In practice, GAZT have been challenging KSA entities that have losses or lean margins displayed in the tax returns and disclosure forms (see below). There have been a handful of cases where larger MNEs with recognizable brands have been challenged despite healthy profit margins in KSA. There is often a parallel discussion relating to withholding taxation on intra-group transactions.

GAZT request five items at the outset of a transfer pricing enquiry:

1. transfer pricing policy;
2. master file;
3. local file;
4. comparability analysis;
5. intra-group agreements;

due within 30 days of request (extensions are granted in appropriate circumstances).

What are the penalties for non-compliance?

There are no specific transfer pricing penalties in the KSA Transfer Pricing Bylaws and Guidance for any non-compliance with the requirements. However, in practice, GAZT will impose strict penalties under the KSA Income Tax Law for any required adjustments and underpaid taxation.

Is there an exemption for smaller local entities?

There is an exemption from transfer pricing documentation requirements in KSA for taxpayers where the arm's length value of intra-group transactions is less than 6 million Saudi Arabian riyal (\$1.6 million) in a 12-month period (note the wording here—it will be important to include the "deemed" value of intra-group transactions).

Qatar

What are the key dates and deadlines to be aware of? Are submissions required to the local tax authority?

1. Transfer pricing questionnaire/disclosure form (submitted to the general tax authority (GTA) 120 days after year end) is required for all MNEs with turnover/assets exceeding 10 million Qatari riyal (\$2.7 million).
2. Advanced approval is required from the GTA if the taxpayer is not applying the comparable uncontrolled price (CUP) method for intragroup transactions involving Qatar.
3. A master file must be in place at the time of tax return submission—the MNE group's master file will be sufficient for these purposes and may only need to be updated every three years.
4. A local file must be in place at the time of tax return submission.
5. MNEs with turnover/assets greater than 50 million Qatari riyal will need to submit the transfer pricing documentation to the GTA within a further two months of the tax return submission date—this will be June 30 for most MNEs with a calendar financial year end.

What are the key departures from the OECD Transfer Pricing Guidelines?

The Qatar Transfer Pricing Regulations reference the OECD Transfer Pricing Guidelines, and these will be important in interpreting any areas that the Qatar Regulations (and future guidance) do not address.

The OECD Transfer Pricing methods will be permitted (see below with respect to approval from the GTA for not using the CUP method).

The Qatar Transfer Pricing Regulations adopt the OECD three-tiered approach to documentation and there is a strong amount of consistency between the Qatar Transfer Pricing Regulations and Guidance and the OECD Transfer Pricing Guidelines.

A statutory safe harbor exists for intra-group loans—interest deductions will be restricted based on debt of three times the shareholders' equity and it will be necessary to evidence that the loan provides economic benefits.

Is there a requirement for local comparables?

Not specified and the recommendation is to apply OECD Transfer Pricing principles.

Is documentation required each year?

It is recommended that the master file is updated every three years (unless there are material changes) and the local file is updated/refreshed each year.

What is the preferred language of documentation?

Arabic is recommended as the preferred language of submission for documentation but in practice both Arabic and English are accepted.

How common are transfer pricing audits since the inception of the transfer pricing regulations?

The first annual cycle of transfer pricing compliance will begin after submission of the April 2021 tax returns and transfer pricing questionnaires. It is expected that audits will commence thereafter.

What are the penalties for non-compliance?

While the GTA has not specified any transfer pricing penalties for failure to comply with the new regulations, the tax authorities retain the right to impose a penalty up to the maximum amount of 500,000 Qatari riyal for noncompliance under general tax audit provisions.

Is there an exemption for smaller local entities?

MNE Groups with turnover/assets below 50 million Qatari riyal will not need to submit transfer pricing documentation to the GTA. There is also a de minimis requirement of turnover/assets below 10 million for submission of the annual transfer pricing questionnaire with the tax returns.

In Summary

MNEs not only have to prepare local transfer pricing documentation but also to submit this documentation to the relevant tax authorities in many instances in the region. There is also a transfer pricing summary requirement at the time of tax return filing.

I would recommend that this initial tax return requirement is applied by MNE groups as the first stage in their own risk assessment as this will determine the level of resources to be deployed on transfer pricing documentation.

I would like to wish a happy, healthy, prosperous (and transfer pricing audit free) 2021 to all.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

Shiv Mahalingham is a Tax Partner—Global Transfer Pricing at The Cragus Group, Dubai.

Topics

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