



Transfer Pricing
Country Summary

Pakistan

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1. Introduction

Pakistan is not an OECD member yet. The OECD's model rules on TP documentation have been included in Pakistani income tax law, including the three-tiered approach to TP documentation in 2016 through the Finance Act. The government authorised new legislation to efficiently implement CbCR and impose formal TP documentation standards in Pakistan. The FBR finalised the draft regulations announced in June 2017 to provide specifics on the CbCR and TP documentation requirements on 16 November 2017.

2. Laws & Regulations

a) References to OECD/EU/Local Rules

In the Pakistani tax law, a general anti-avoidance rule 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 Pakistan's Federal Board of Revenue (FBR) to apportion, distribute, or allocate income, deductions or tax credits between the persons as is necessary to reflect the income that would have been realised in an arm's length transaction.

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

As of January 2006, a joint force formed by the SECP (Securities and Exchange Commission of Pakistan) and the CBR (Central Board of Revenue) 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 company's Audit Committee all the transactions with related parties. The rule applies to transactions undertaken at a non-arm's length price.

b) Definition of Related Party

Section 85 of the ITO describes the conditions under which two or more parties are deemed related in the following circumstances:

- The two parties' connection is such that one may fairly expect the other to act in line with their intentions, or both can reasonably be expected to act in accordance with the intentions of a third party;
- A member of an association of entities/persons and the association, any person and trust who benefits or able to benefit under the trust, direct and indirect shareholders control 50% or more (i) voting power, (ii) rights to dividends or (iii) rights to capital;
- A relative of the individual and individual himself;
- Members of an association of persons (AOP);
- A person who is a member of an association of persons and who controls fifty percent or more of the association's rights to income or capital, either alone or with an associate(s) under another application of this section;
- A trust, and also everybody who benefits from or may profit from 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.

c) Nature of Transfer Pricing Documentation

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 PKR with non-resident in their tax returns. Transactions include:

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

d) Tax Havens & Blacklists

Pakistan does not have a Tax Haven list available.

e) Advance Pricing Agreement (APA)

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

f) Audit Practice

In 2007, the FBR created a special transfer pricing task force to focus on banking, petroleum and gas exploration, pharmaceutical, 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 revising 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 a database of comparables, to propose improvements in law and policy, basically a regime where transfer pricing adjustments are given greater importance.

Now, Finance Act 2017 has established the "Directorate-General for Transfer Pricing" to conduct Transfer Pricing audit by insertion of section 230E. For that purpose, transfer pricing audit is meant to determine 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 specify the criteria for selecting the taxpayer for transfer pricing audit and specify the functions, jurisdiction, and powers of the Directorate.

3. Transfer Pricing Documentation

a) Level of Documentation

Previously to the Finance Act 2016 (FA 2016), the Law in Pakistan had not provided any specific documents to be submitted with tax returns 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 a 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:

The layout of the CbCR is prescribed in the notification SRO 1191(I)/2017, and it mainly follows the orientation outlined 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, until the date the constituent entity is required to file the tax return under section 118 of the ITO.

- The master file for MNE group turnover of more than 100 million PKR:

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

- Local file for related party transactions of more than 50 million PKR:

The Local file outlined in Rule 27M shall include: (a) local entity structure including its management structure of the local entity, a local organisation 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 the controlled transactions in which the taxpayer is involved; and (e) financial information.

b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity, including an indication of 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.

d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines in paragraph 1.51.

e) Choice of Transfer Pricing Method

The FBR outlines the following methods that should be applied for 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 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 method.

In light of the Pakistan Tax Authorities' consistent disregard for internationally accepted criteria and procedures for Comparable Uncontrolled Pricing Method to be applied, Pakistan and Germany agreed in a Memorandum of the Meeting of the Competent Authorities held on the 6-7 July 2004 in Berlin 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.

f) Economic Analysis – Benchmark Study

Although there are no specific references 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.

g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalises the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept.

h) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

| | Prepare or File? | Format | Deadline | Notification Deadline* | Threshold* (Yes/No) | Local Language (Yes/No)*(If "No", it can be filed in English) |
|--|------------------|----------------|--|------------------------|---------------------|---|
| Corporate Income Tax | File | Local format | December 31 st or September 30 th , depending on the FY-end. | No | No | No |
| Master File | Prepare | Local format | Within 30 days upon request | No | Yes | No |
| Local File | Prepare | Local format | Within 30 days upon request | No | Yes | No |
| CbCR | File | Special Format | December, 31 st . | Yes | Yes | No |
| Annual Accounts | Prepare | IFRS | December 31 st or September 30 th , depending on the FY-end. | No | No | No |
| Segmented P&L | Prepare | Excel/Other | Ready upon filing CIT/TP documents. | No | No | No |
| * Pakistan has signed the MCAA agreement for the filing of CBCR on 21 June 2017. | | | | | | |

There is no statutory deadline for the 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 a 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 each year. The CbC Reporting itself is required to be filed no later than twelve months after the last day of the reporting fiscal year of the MNE Group.

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

i) Mandatory Language

The FBR accepts any transfer pricing documentation drafted in Urdu or English. 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 taxpayer's expense.

j) Notification Requirement

Until the day the constituent entity is obliged to file a return under section 118 of the ITO, the information should be supplied to the FBR depending on whether the constituent entity is an ultimate or surrogate parent entity. Therefore, the notification must be made on 31 March of each year at the latest.

k) 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).

l) Penalties and Interest Charges

Where any person fails to furnish the CbCR information required under section 108 of the ITO, such person shall pay a penalty of PKR 25,000 for the first default and PKR 50,000 for each subsequent default.

In the case of not filing CbCR, Master File and Local File, the taxpayer is subject to a minimum penalty of PKR 25,000 and PKR 2,000 for each day of default.

In the case of non-timely filing of CbCR, Master File and Local File, the taxpayer is subject to PKR 25,000 for the first default and PKR 50,000 for each subsequent default.

In the case of incomplete or incorrect filing of CbCR, Master File and Local File, the taxpayer is subject to pay the penalty of 1% of the value of transactions for which a record is required to be kept under section 108 of the Income Tax Rules, 2002.

Specifically for Master File and Local File, the taxpayer is subject to penalties for not having the Master File available PKR 10,000 or 5% of the tax on income, whichever is higher.