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TRANSFER PRICING -
AMENDMENTS IN INCOME TAX RULES, 2002 TO CATER THE ORGANISATION FOR ECNOMIC CO-OPERATION AND DEVELOPMENT ("OECD") REQUIREMENTS AND ITS IMPACTS

Dear Reader

We are pleased to transmit our comments on recently issued SRO 144(I)/2018 dated February 09, 2018. It is our endeavor to provide update to our valuable readers, tax and accountancy professionals, students of accountancy profession, media and general public.

We appreciate your worthy comments on this document.

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President

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TRANSFER PRICING - AMENDMENTS IN INCOME TAX RULES, 2002 TO CATER OECD REQUIREMENTS AND ITS IMPACTS

1. PREFACE

Globalisation, over the years, has reshaped the world trade. It has resulted in movement of technology, people and capital without barriers. With economies moving towards greater integration, business houses too shifted to greater integration. Globalisation has resulted in a shift from-country-specific operating models to global business modelswith the entire value chain spread across various countries.Consequently, the world has witnessed a large increase innumber of Multinational Enterprises ("MNEs") operating worldwidegrowing their global footprint by establishing aweb of subsidiaries, joint ventures, Permanent establishments etc.

The initial financial challenge of globalisation was of double taxation.While execution of bilateral trade and tax treaties to avoid double taxation betweennations provided a solution to the said problem, therehas been a growing concern internationally amongst Governments about erosion ofthe tax base of their countries. This is possible by way of claimingexcessive deductions, avoiding taxable presence in a country,etc. which results in non-taxation or low taxation of income,i.e., "base erosion", and artificial allocation of income awayfrom jurisdiction where real activity occurs i.e. "profitshifting"

A. BASE EROSION AND PROFIT SHIFTING ("BEPS")

Base erosion and profit shifting refer to tax planning strategies used by MNEs that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.

BEPS concerns strategies which aim to move profits to where they are taxed at lower rates and expenses to where they are relieved at higher rates. The result is a tendency to associate more profit with legal constructs and intangible rights and obligations, and reduce the share of profits associated with substantive operations involving the interaction of people with one another. "While these corporate tax planning strategies may be technically legal and rely on carefully planned interactions of a variety of tax rules and principles, the overall effect of this type of tax planning is to erode the corporate tax base of many countries in a manner that is not intended by domestic policy.

B. BEPS PROJECT

BEPS practices are not a new phenomenon in the backdrop of constant globalization. Capital movement between countries followed the globalization. This necessitated the presence of bilateral double tax avoidance treaties between countries. These treaties were designed with the primary objective of avoiding double taxation of income and allocating taxing rights between treaty partners. The allocation of rights generally skewed in favour of the capital exporting country vis-à-vis a capital importing country. This meant that developing countries conceded allocation rights in favour of developed countries in orderto attract capital. The skewed allocation of taxing rights coupled with inadequate expanse of treaty network gave rise to gap in international tax framework leading to tax avoidance.

The 2012 G20 Los Cabos summit referred to "the need to prevent base erosion and profit shifting" in their final declaration and tasked the OECD to develop an Action Plan. The G20 Leaders endorsed the BEPS Action Plan at the 2013 G-20 St. Petersburg summit.[6] The BEPS Package, consisting of reports on following 15 actions designed to be implemented domestically and through tax treaty provisions, was agreed at the 2015 G20 Antalya summit.

- Action 1: Addressing the Tax Challenges of the Digital Economy
- Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements
- Action 3: Designing Effective Controlled Foreign Company Rules
- Action 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
- Action 5: Countering Harmful Tax Practices More Effectively, taking into account Transparency and Substance
- Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
- Action 7: Preventing the Artificial Avoidance of Permanent Establish ment Status
- Actions 8–10: Aligning Transfer Pricing Outcomes with Value Creation
- Action 11: Measuring and Monitoring BEPS
- Action 12: Mandatory Disclosure Rules
- Action 13: Transfer Pricing Documentation and Country-by-Country Reporting
- Action 14: Making Dispute Resolution Mechanisms More Effective
- Action 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties[7]

C. ACTION 13 - TRANSFER PRICING (“TP”) DOCUMENTATION AND COUNTRY BY COUNTRY (“CBC”) REPORTING - BACKGROUND

Presently, chapter V of the OECD guidelines provides guidance on TP documentation. Action 13 aims to streamline the existing guidance by providing detailedrecommendations on TP documentations and CBC reporting. Action 13 prescribes theminimum reporting standards which should be considered by the countriesimplementing OECD’s recommendations in the final report for revising their existing TP documentation norms.

Action 13 was an attempt to address the above limitations of chapter V of OECD guidelines and to answer the call of G-20 nations' for development of a standardised reporting template for effective risk assessments. OECD was also directed to strike a balance between the need for enhanced transparency and the compliance costs borne by businesses while developing revised documentation guidelines. Accordingly, OECD, at the behest of G20 countries, through its subsidiary body, Working Party 6, drafted Action 13. Action 13 lays down detailed guidelines for TP documentation and also provides a standardised reporting format called "Country-by-country Report". Given below is an overview of the important developments which ultimately resulted in the roll-out of final report on Action 13

July 2013	OECD released a report laying outa15-point Action Plan to tackle variousBEPS related issues. The said reportidentifiedtransparency as a key element inthe global fight against BEPS.
Jan 2014	Draft report setting out revised guidance on TPdocumentation and CbC reporting was released. It attempted toidentify key issues for public comments. Further, italso provided a draft of the CbCR template
March 2014	OECD published the commentsreceived on discussion draft on TPdocumentation and CbC reporting
May 2014	Public consultation was heldby OECD on the draft report at the OECD Conference Centre inParis, France
September 2014	Based on the comments received, OECD deliveredguidance on TP documentation and CbC reportingwith the consensus of 44 countries (all OECD members, OECD accession countries, G 20 countries)
February 2015	OECD released guidanceon the implementation ofTPdocumentation and CbCreporting, primarily dealingwith the implementation ofCbC reporting requirement
June 2015	OECD released the implementation package for CbC reporting, recognising that developing countries may require support for the effective implementation of CbC reporting
October 2015	Final report on TP documentation and CbC reporting was released by OECD along with final reports on other action plans. The final report combined the earlier draft guidance on TP documentation and CbC reporting; implementation guidance on TP documentation and CbC reporting;and implementation package for CbC reporting

D. GLOBAL LEGISLATIONS FOR TRANSFER PRICING

Countries with Transfer Pricing legislation ordinarily follow the Transfer Pricing Guidelines of Organization for Economic Cooperation Development (“OECD”) for Multi National Entity (“MNE”) groups and tax administrations which provide guidance on the application of the ALP. OECD has also recommended country-by-country reporting to address Base Erosion and Profit Shifting (“BEPS”).

Sixty-eight (68) countries have welcomed the transfer pricing rules and have signed the Competent Authority Agreement on Exchange of Country-by-Country reports. Competent authority agreement means an agreement between authorized representatives of those foreign jurisdiction that are parties to an international agreement with Pakistan.The rules of nearly all countries allows related parties to set prices in any manner, but also permits the tax authorities to adjust those prices where the prices charged are at non-arm’s length principle.Following is the list of 68 Signatories along with their signing dates:

S. No.	SIGNATORIES	SIGNING DATES
01.	Argentina	30-06-2016
02.	Australia	27-01-2016
03.	Austria	27-01-2016
04.	Belgium	27-01-2016
05.	Belize	20-06-2017
06.	Bermuda	15-04-2016
07.	Brazil	21-10-2016
08.	Bulgaria	17-11-2017
09.	Canada	11-05-2016
10.	Cayman Islands	21-06-2017
11.	Chile	27-01-2016
12.	Costa Rica	27-01-2016
13.	Colombia	21-06-2017
14.	Croatia	06-07-2017
15.	Curaçao	30-06-2016
16.	Cyprus	01-11-2016
17.	Czech Republic	27-01-2016
18.	Denmark	27-01-2016
19.	Estonia	27-01-2016

20.	Finland	27-01-2016
21.	France	27-01-2016
22.	Gabon	26-01-2017
23.	Georgia	30-06-2016
24.	Germany	27-01-2016
25.	Greece	27-01-2016
26.	Guernsey	21-10-2016
27.	Haiti	22-06-2017
28.	Hungary	01-12-2016
29.	Iceland	12-05-2016
30.	India	12-05-2016
31.	Indonesia	26-01-2017
32.	Ireland	27-01-2016
33.	Isle of Man	21-10-2016
34.	Israel	12-05-2016
35.	Italy	27-01-2016
36.	Japan	27-01-2016
37.	Jersey	21-10-2016
38.	Korea	30-06-2016
39.	Latvia	21-10-2016
40.	Liechtenstein	27-01-2016
41.	Lithuania	25-10-2016
42.	Luxembourg	27-01-2016
43.	Malaysia	27-01-2016
44.	Malta	26-01-2017
45.	Mauritius	26-01-2017
46.	Mexico	27-01-2016
47.	Monaco	02-11-2017
48.	Netherlands	27-01-2016
49.	New Zealand	12-05-2016
50.	Nigeria	27-01-2016
51.	Norway	27-01-2016
52.	Pakistan	21-06-2017
53.	People's Republic of China	12-05-2016
54.	Poland	27-01-2016
55.	Portugal	27-01-2016
56.	Qatar	19-12-2017
57.	Russian Federation	26-01-2017
58.	Senegal	04-02-2016

59.	Singapore	21-06-2017
60.	Slovak Republic	27-01-2016
61.	Slovenia	27-01-2016
62.	South Africa	27-01-2016
63.	Spain	27-01-2016
64.	Sweden	27-01-2016
65.	Switzerland	27-01-2016
66.	Turks and Caicos Islands	21-06-2017
67.	United Kingdom	27-01-2016
68.	Uruguay	30-06-2016

E. TP DOCUMENTATION OBJECTIVES

(i) TAXPAYER'S ASSESSMENT OF ITS COMPLIANCE WITH ARM'S LENTH PRINCIPLE ("ALP"):

In the absence of any local TP documentation requirements, there is a risk that taxpayers tend to report higher numbers in their corporate tax returns without any reasonable basis. TP documentation requirements tend to obligate the taxpayer with the need to adopt a TP method after an in-depth FAR (Functions, Assets and Risk) analysis. It also helps achieving a self-compliance system as the taxpayer is more likely to take reasonable steps to ensure compliance with the ALP at the time of return filing to avoid penalties.

(ii) TP RISK ASSESSMENT:

Risk assessment represents the initial point of any audit cycle. As mostly countries have limited resources at their disposal for conducting TP audits, it is practically impossible for them to carry out detailed scrutiny of each and every transaction entered by taxpayers. Therefore, to utilise the resources judiciously for effectivescrutiny, it is important that the tax authorities are able to identify highrisk TP areaswhich warrant further analysis during thecourse of audits.

To conduct such assessment of high risk areas, availability of reliable, relevant and correct information to tax authorities is an important pre-requisite. Maintenance of strong documentation by the taxpayer will ensure that reliable and correct factual data is available on records, which can be relied upon by the tax administration for making effective risk assessments at early stages of audit cycle.

(iii) TP AUDIT:

TP audits are generally complex as they tend to be fact-based and may involve analysis of complex transactions/issues. For effective completion of audits, tax authorities may require documents pertaining to the transactions of taxpayers. Since majority of the information required is in possession of the taxpayer, tax authorities are primarily dependent on the taxpayer for the same to perform effective audits.

Accordingly, such documentation, if properly maintained, can help in satisfying the information needs of tax authorities significantly and can potentially curb the necessityof any unusual and special information requests during the course of audit.

The TP documentation maintained by the taxpayer in relation to its intra-group transactions is of utmostimportance, particularly, for the tax authorities of thetaxpayer's country. The importance of TP documentationis clearly evident from the fact that over the years, variouscountries across the globe have introduced their ownlocal legislation relating to TP, which in turn includesdocumentation requirements. Furthermore, the growingrealisation among nations about the importance oftransparency between tax authorities and taxpayer toestablish effective and robust tax machinery as well as totackle growing BEPS related issues has in-turn resulted inenhanced focus on documentation needs.

F. TRANSFER PRICING RULES AND CBCR REPORTING IN PAKISTAN

Rules 20 to 27 of Income Tax Rules, 2002 govern transfer pricing assessment/monitoring in Pakistan between Associates. These rules provide that transactions should be on ALP.

ALP may be applied by Commissioner using following four methods:

1. Comparable Uncontrolled Price Method
2. Resale Price Method
3. Cost Plus Method
4. Profit Split Method

Moreover, Rules 27A to 27O provides Documentation and CbCR requirements between Associates [as required to be maintained under section 108 of Income Tax Ordinance, 2001 ("ITO")]. These rules require every taxpayer who has entered into a transaction with its associates to maintain documents, information, files and CbCR and any other information and documents pertaining to transaction with its associates.

The purpose of this legislation appears to maintain the transparency and to testify as to whether Companies are paying the right amount tax with the authorities or not.

G. AMENDMENTS IN RULES 27A TO 27O

In these rules, certain terms have been used, some of which are defined as under:

(i) COMPETENT AUTHORITY AGREEMENT

Competent authority agreement means an agreement:

- That is between authorized representatives of those foreign jurisdictions that are parties to an international agreement with Pakistan; and

- That provides legal authority for the automatic exchange of country-by-country Reports between the party Jurisdictions

(ii) CONSTITUENT ENTITY

Constituent Entitymeans;

(i) Any separate entity of an MNE group that is included in the consolidated financial statements of the MNE group for financial reporting purposes or would be so included if equity interest in such business unit of an MNE group were to be traded on a stock exchange;

(ii) Any such entity that is excluded from the MNE group's consolidated financial statements solely on size or materiality grounds; and

(iii) Any permanent establishment of any separate entity of the MNE group included in sub-clauses (i) or (ii), provided the entity prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes.

(iii) MNE GROUP

MNE group means any group that –`

(i) includes two or more entities the tax residence for which is in different jurisdictions or includes an entity that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction; and

(ii) has a total consolidated group revenue equivalent to seven hundred and fifty million euros or more, or an equivalent amount in Pakistan Rupees, during the fiscal year immediately preceding the reporting fiscal year as reflected in its consolidated financial statements for such preceding fiscal year;

(iv) SURROGATE PARENT ENTITY

Surrogate parent entity means any constituent entity of the MNE group that has been designated by such MNE group, in place of the ultimate parent entity, to file the country-by-country reports in the country or territory in which the said constituent entity is resident, on behalf of such MNE group;

(v) ULTIMATE PARENT ENTITY

Ultimate parent entity means a constituent entity of an MNE group that meets the following criteria, namely:

(i) it owns directly or indirectly a sufficient interest in one or more constituent entities of such MNE group such that it is required to prepare consolidated financial statements under any law for the time being in force or the accounting standards of the country or territory of which the entity is resident or it would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange in the country or territory of which the entity is resident; and

(ii) there is no other constituent entity of such MNE group that owns directly or indirectly an interest described in sub-clause (i) in the first mentioned constituent entity.

By virtue of SRO 144(I)/2018 dated February 09, 2018, following amendments in Chapter VIA of the Income Tax Rules, 2002 were introduced as under.

i. Rule 27A

- In Sub-rule (2) of rule 27A, the FBR has extended the scope of furnishing infor mation to FBR also. Prior to this amendment, the documents, informa tion, files and reports were required to be furnished to the Commissioner only. Now the same may be submitted to either the FBR or the Commissioner as the case may be.
- In clause (c) of sub-rule (4), an Explanation has been added in sub-clause (iii) of clause (c)to clarify that "constitute entity resident in Pakistan" shall also include permanent establishment of a non-resident.
- In clause (e) of sub-rule (4), the scope of the term "Entity" has been extended by including an association of person ("AOP") to the definition of Entity.
- A new term, "related party", has also been added by inserting a new clause (j). "Related party" has been defined in clause (j) as an Associate and meaning of the term associate has been referred from section 85 of the Income Tax Ordinance, 2001, which provides that two persons shall be associates where the relationship between the two is such that one may reasonably be expected to act in accordance with intentions of other or both persons may reasonably be expected to act in accordance with intentions of a third person. (Please see section 85 of ITO for specific definition)

ii. Rule 27C

This Rule requires every constituent entity whether ultimate parent or the surrogate parent entity resident in Pakistan to provide the Federal Board of Revenue the information on or before the date the constituent entity is required to file return under ITO for every fiscal year. For tax year 2017 the FBR requires the information to be provided on or before 28thFebruary, 2018 which was earlier 15th day of February.

a new para has also been inserted extending the requirements of surrogate parent company to furnish details of its ultimate parent entity of the Multinational Enterprises Group and the details of the country or the territory of which the said entity is resident.

iii. Rule 27D

Sub-rule (1) of this rule requires every ultimate or the surrogate parent entity to file CbCR to the board within 12 months of fiscal year end of the MNE group. Sub-rule (2) requires FBR to transmit and exchange country by country reports to the jurisdiction that are parties to the competent authority agreement. This sub rule provides legal authority for automatic exchange of country by country reports between the said jurisdictions.

The requirements of this rule shall be for reporting fiscal years pertaining to tax year 2017 and onwards. It has been clarified vide SRO that any provision of the rules will not apply to transactions before 1st day of January, 2016.

iv. Rule 27E

This rule requires the Constituent Entity to file a CbCR to the FBR with respect to the reporting fiscal year of an MNE group of which it is constituent entity on or before twelve months after the last day of the reporting fiscal year of the MNE group, if

a) The ultimate parent entity of the MNE Group is not obliged to file a country by country report in the territory of which the ultimate parent entity is resident;
b) The country or territory in which the ultimate parent entity is resident has an international agreement to which Pakistan is a party but does not have a competent authority agreement to exchange country by country report; or
c) There has been a systematic failure of the country or territory of which the ultimate parent entity is a resident and the said failure has been intimated by the Board to such constituent entity.

Provided that where there are more than one constituent entities of the same MNE group and one or more of the above stated conditions apply, the MNE group may designate one of such constituent entities to provide the country by country report to the Board within 12 months of fiscal year end of the MNE group.

Vide aforementioned SRO, a new proviso has been inserted which precludes this rule to apply on a constituent entity IF the ultimate or surrogate parent entity of the constituent entity is not required to file country-by-country report in its jurisdiction of residence for the sole reason that, as per jurisdiction rules of ultimate or surrogate parent entity, the total consolidated group revenue, in near equivalent amount in domestic currency, is less than 750 million Euros.

v. Rule 27G

As per sub-rule (1) of this rule the time limitation in which the country-by-country report is to be filed is on or before 12 months and for tax year 2017 this rule requires country-by-country report to be filed by not later than 15 months after the last day of reporting fiscal year of MNE group, which was earlier to be filed by 31st day of March, 2018.

Hence, the fixed date to file country-by-country report for tax year 2017 has been withdrawn.

Furthermore, vide the above stated SRO, new proviso has been introduced in the instant rule which specifies the time when the country-by-country report is to be filed, transmitted and exchanged. The Country-by-country report is to be filed within 12 months after the last day of fiscal year end of the MNE group. A new proviso has been inserted which provides that in case notification of a systematic failure is received by the constituent entity, the said period of 12 months shall further be extended by 45 days from the date of receipt of notification.

Moreover, the insertion of new proviso in sub-rule (2) allows the country-by-country report to be exchanged and transmitted within 18 months. The time line earlier was 30th day of June2018.

The SRO has further added two new Rules, 27P and 27Q respectively.

vi. Rule 27P

This new rule empowers the FBR to allow extension in time to persons to file any document, information, file or report with the Board. The extension ha to be sought through filing an application with the Board, and the Board will pass an order in writing thereto. The power is exclusively of discretionary nature as the new rule is silent on the point for how long a person may be allowed extension. The extension will be granted for the time as the Board deems appropriate.

vii. 27Q

This new rule defines the mode of how the documents, reports, information and details are required to be furnished to the Board. The documents, reports, information and other required details have to be provided to the board electronically via electronic mail on its designated email address, that is, cbcr@fbr.gov.pk . The mode of furnishing the document is subject to changes from time to time.

H. DOCUMENTATION REQUIREMENTS AS PER ACTION 13 AND IN PAKISTAN

Documents that are required to be filed by both action 13 and rules 27A to 27O under Income Tax Rules, 2002 of Pakistan are as under;

a) Master File;
b) Local File; and
c) Country-by-Country reports

(i) MASTER FILE

Every constituent entity having a turnover of more than Rs. 100 million is required to keep and maintain a Master File. A master file shall contain standardized information relevant for all MNE group members and must include:

- Legal and ownership structure of MNE and geographical location of operating entities;
- General written description of the MNEs business;
- Information of Intangibles;
- Intercompany financial activities; and
- Annual consolidated financial state ment for the fiscal year, if any

(i) MASTER FILE

Every constituent entity having a turnover of more than Rs. 100 million is required to keep and maintain a Master File. A master file shall contain standardized information relevant for all MNE group members and must include:

(ii) COUNTRY-BY-COUNTRY REPORTS

Country by Country report with respect to an MNE group, as per FBR guidelines, consists of two tables i.e. Table 1 and Table 2:

i. Table 1 – Over view of allocation of Income, taxes and business activities by tax jurisdiction.

With respect to each Jurisdiction in which the MNE group operates, following information is required:

- The aggregate information relating to the amount of total revenue (includes revenue of unrelated party and related party);
- Profit or loss before income tax;
- Income tax paid on cash basis;
- Income tax accrued of current year;
- Sated capital;
- Accumulated earnings;
- Number of employees; and
- Tangible assets other than cash or cash equivalents

ii. Table 2 - Llist of all constituent entities of the MNE group reflecting the following:

- Tax jurisdiction;
- Constituent Entities resident in the tax jurisdiction;
- Tax jurisdiction of organization if different from tax Jurisdiction of residence; and
- Main business activities.

I. COMPARISON BETWEEN OECD GUIDELINES AND RULES IMPLEMENTED IN PAKISTAN

Refer coming pages

SR. NO.	OECD GUIDELINES	RULES IN PAKISTAN
01	The term "fiscal year" means an annual accounting period with respect to which the ultimate parent entity of the MNE group prepares its financial statement	The term Fiscal Year has been defined as; i. A tax year where the ultimate or surrogate parent entity is resident of Pakistan; and ii. In case the ultimate or surrogate parent entity is not resident in Pakistan, an annual accounting period of ultimate parent entity of the MNE Group.
02	Here the word "jurisdiction" has been used.	Here the word "Country or Territory" has been used. The term jurisdiction and country or territory bears the same meaning.
03	The term "Qualifying Competent Authority Agreement" has been used	The term Competent Authority Agreement has been used. Both the terms bear the same meanings.
04	"Constituent Entity" has been defined as i. any separate business unit of an MNE Group that is included in the Consolidated Financial Statements of the MNE Group for financial reporting purposes or would be so included if equity interests in such business unit were traded on a public securities exchange; ii. any such business unit that is excluded from the MNE Group's Consolidated Financial Statements solely on size or materiality grounds; and iii. any permanent establishment of any separate business unit of the MNE Group that is included in (i) or (ii) above provided the business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes.	"Constituent Entity" has the same definition as defined in OECD guidelines, only an explanation has been added in the rules which is as under: ***The expression 'constituent entity resident in Pakistan' wherever appearing in this chapter shall include permanent establishment in Pakistan of a non-resident person.***

05	The term "International Agreement" means the Multilateral Convention for Mutual Administrative Assistance in Tax Matters, any bilateral or multilateral tax treaty, or any tax information exchange agreement that by provides legal authority for the exchange of tax information between jurisdictions, including automatic exchange of such information.	The term "international Agreement" means an agreement referred to in sub-section (1) of section 107 of ITO and includes the Multilateral Convention for Mutual Administrative Assistance in Tax Matters, any bilateral or multilateral tax convention or any Tax Information Exchange Agreement to which Pakistan is a Party and that by its terms provides legal authority for the exchange of tax information between jurisdictions, including automatic exchange of such information.
06	The term "Reporting Entity" means the Constituent Entity that is required to file a CbC report in its tax residence jurisdiction on behalf of the MNE Group. It may be the Ultimate Parent Entity, the Surrogate Parent Entity, or any entity that is required to file a CbC report.	The term 'reporting entity' means the constituent entity including the parent entity or the surrogate parent entity or any constituent entity under rule 27D, that is required to file a country-by-country report in its jurisdiction of tax residence on behalf of the MNE group.
07	The term "MNE Group" means any Group that includes two or more enterprises with their tax residence in different jurisdiction, or that includes an enterprise that is tax resident in one jurisdiction and has a permanent establishment taxed in another jurisdiction.	"MNE group" means any group that- includes two or more entities with their tax residence in different jurisdictions or includes an entity that is tax resident in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction; and has a total consolidated group revenue equivalent to 750 million euros or more, or an equivalent amount in Pakistan Rupees, during the fiscal year.
08	The term "Systemic Failure" means, that the jurisdiction has a Qualifying Competent Authority Agreement with a particular country, but has suspended automatic exchange or otherwise persistently failed to automatically provide to such country CbC reports in its possession of MNE Groups that have Constituent Entities in such country.	"systemic failure" means that country or territory has a competent authority agreement with Pakistan, for automatic exchange of country-by-country reports, but has suspended automatic exchange, or has continuously failed to automatically provide to Pakistan country-by-country reports in its possession of MNE groups that have entities in Pakistan;

J. IMPACT ON TP DOCUMENTATION AND CBC REPORTING ON PAKISTAN

CbCR, is likely to be impactful, for both FBRand the MNEs based in Pakistan. It will have long term impacts on the taxpayer. We have attempted to gauge the possible implications of CbC reporting on Pakistan as under:

1. ADDITIONAL COMPLIANCE REQUIREMENT

By the implementation of documentation and reporting requirements, the taxpayers will be burdened with additional tasks of preparing “Master file” and “CbC Reports” in addition to thealready existing local documentation requirements under ITO and Income Tax Rules, 2002. For thebusiness houses affected by the documentation and reporting requirements, it would be an addedburden to gather data for the entire group,to develop competencies for compiling such vast financialand non-financial data, and to report the same in therequired template.

Another factor that requires consideration is that in some cases, the CbC Report is required to be filed by the taxpayer, even though the Parent Entity or the SurrogateEntity might be filing the same in their owncountry. Such a requirement may result in an exponentialincrease in the number of taxpayers who will be filing CbC Reports in Pakistan. Such enhanced documentation requirements will evidentlyattract significant costs and administrative challenges forthe MNEs.

Moreover, in case the country of resident of neither a parent nor a surrogate entity has signed the competent authority agreement, it would be virtually impossible for the constituent entity residing in Pakistan to file the Master File as the constituent entity might not have the requisite information itself being small in size as compared to MNE group to which it belongs.

2. RISK BASED APPROACH

Pakistan has moved towards a risk–based approach for TP assessment purposes. The main objective behind development of CbCR template was to provide an overview of MNE group’s global allocation ofincome, economic activities, and taxes in one standard ised format. Such standard ised report will help in conducting effective risk assessments. Once CbC report submissions begin, it is likely that the preliminary screeningfor risk assessment will become more severe and vigorous asthe FBR’s access to critical taxpayer data would enhance. Furthermore, tax authorities would be in a better position to identify any mismatch in value creation and allocation of income.

Such effective assessment will help in identifying the highrisk TP areas and other BEPS related issues. It may alsohelp in shifting away the focus from widely litigated, redundant TP issues. While such an approach will makethe tax administrations more effective and capable of comprehensive analysis, it may also bring some breather forthe taxpayers suffering from unending TP litigations.

3. MISUSE OF CBCR DATA BY FBR

OECD in Action 13 has made it clear that CbCR data is not to be used as a substitute for a detailed TP analysis of individual transactions. It has encouraged that ALP be determined on the basis of a comprehensive functional analysis and comparability analysis. It has further described that the information in the CbCR does not constitute conclusive evidence on itsown about the fact that whether transfer prices are appropriate or not. Therefore, it suggests that the same should not be used by tax administrations to propose TP adjustments based on a global arithmetic apportionment of income.

However, with access to details pertaining to MNE groupsuch as income, asset base, employee strength, kind of business activities carried on, etc., taxpayer may be faced with another imminent challenge of tax administration proposing to allocate group profits among various jurisdictions and proposing to apply profit split method to analyse the arm's length nature of the controlled transactions, in ignorance of OECD's recommendations.

From the taxpayer's perspective, it is imperative that taxauthorities refrain from such prima-facie analysis. Else taxpayers are likely to be burdened with the challenge to tackle new and aggressive assessment strategies as the CbCR data might be treated as definite information for the purpose of amendment of assessment under sections 122(5) and 122(5A) of ITO.

4. CONFIDENTIALITY THREAT

An important pre-requisite for effective implementation and use of CbCR is adequate automatic exchange arrangements for exchanging CbCR filed in one jurisdiction with other jurisdictions where CEs of the MNE group are tax residents.

Furthermore, to ensure that tax administrations are willing to do such an exchange, it is important that countries have robust data confidentiality systems in placeto safeguard taxpayer's information. Accordingly, in the Pakistani scenario, before Pakistani administration proceeds with execution of such exchange arrangements with other countries, it is required that Pakistan government revisits its data safety norms to ensure that it is aligned with the internationally recognised standards. Thispractice will help ensure that other countries are willing to enter into information exchange treaties with Pakistan.

K. FUTURE COURSE

1. CREATING AWARENESS AND EDUCATING EMPLOYEES

Currently, awareness about BEPS and CbCR is considerably low among the masses. The situation is equally grim for the employees working in the industry who would be designated with the responsibility to assist companies in complying with the CbC reporting requirements. Therefore, Pakistan business groups are faced with an urgent need to develop a knowledge base on CbCR and share the same within their group. The introduction

The introduction of CbC reporting is likely to result in a set of initial challenges such as interpretation issues, sourcing of information from various countries, and organising the same into atemplate. However, some of these issues can be tackled by taking some preliminary damage control steps such as training the relevant personnel and developing a knowledge-base on CbCR.

2. ASSESSING INFORMATION NEEDS

Post creating awareness about the reporting requirements, business groups should consider completing the CbCR template as a trial run to identify:

- The information required by the Template;
- Available information in hand; and
- Information required to be sourced from group companies.

Such a trial run will help in identifying the gaps that exist between the information needed and information available. In addition, it will help in identifying the challenges faced in filling the templates, the areas which run a risk of misinterpretation and the kind of resources that will be required to meet the new compliance requirements.

3. ASSESSING AND MINIMIZING EXPOSURE

Once the draft template is ready, the information presented should be analysed to identify prima-facie exposures i.e., mismatch between the reported figures relating to revenue, profits, taxes, headcount and asset base employed. Such inconsistencies between between numbers reportedcan attract unwanted attention, may be misinterpreted as apossible BEPS risk area and can result in intensive audit proceedings.

4. PROPER SUBSTANTIATION OF TP TRANSACTION

It is important to ensure that tax allocations are substantiated by appropriate justification and supporting documentation, especially in areas that might attract attention from tax authorities as a result of the CbC disclosures. As part of the need for more robust substantiation, a new approach to bench mark the intercompany transactions is expected. Such change may involve shift in focus from transaction-level justifications tomacro-grouplevel justifications. Since this will be a new departure, businesses will need to develop the benchmarking capabilities to carry out such evaluations and provide the supporting documentation.

5. CATERING MISMATCHES

The new CbC reporting requirement is likely to result in business houses giving some consideration to restructuring of their value chains. This may involve reconsidering the group structure as well as need for multiple entities, and revisiting the TP arrangements to reduce the risk of intensive audits and consequent tax demands. With the increasing focus on realignment of taxation withsubstance, it is likely that MNEs will give adequate thought to aggressive tax planning strategies including use of intergroup transactions to shift income to low tax or no-tax jurisdictions.

CONCLUSION

The CbC reporting is likely to transform TP analysisfrom a transactional level analysis into a macro orgroup-level analysis. MNEs might feel burdened withthe reporting requirements, especially in the initialyears. The preparation of CbCR is seen as a time consuming and expensive exercise. Furthermore, the new documentation requirements are beyond justreporting obligations, but demand an in-depth scrutiny of the figures reported to identify possible mismatch. While tax administrations may be benefitted from the flow of new information, they may find the task of exchanging and analysing the said information to be challenging.

While many countries have already implemented CbC reporting requirement, others are expected tointroduce the required changes in near future. Further, more and more countries are expected tosign treaties for effective exchange of information. Simultaneously, OECD will develop mechanisms to monitor jurisdictions' compliance with their commitments to adopt recommendations of Action 13 and to monitor the effectiveness of the filing and dissemination mechanisms. The outcomes of this exercise will be taken into consideration by OECD in its 2020 review.

DISCLAIMER

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