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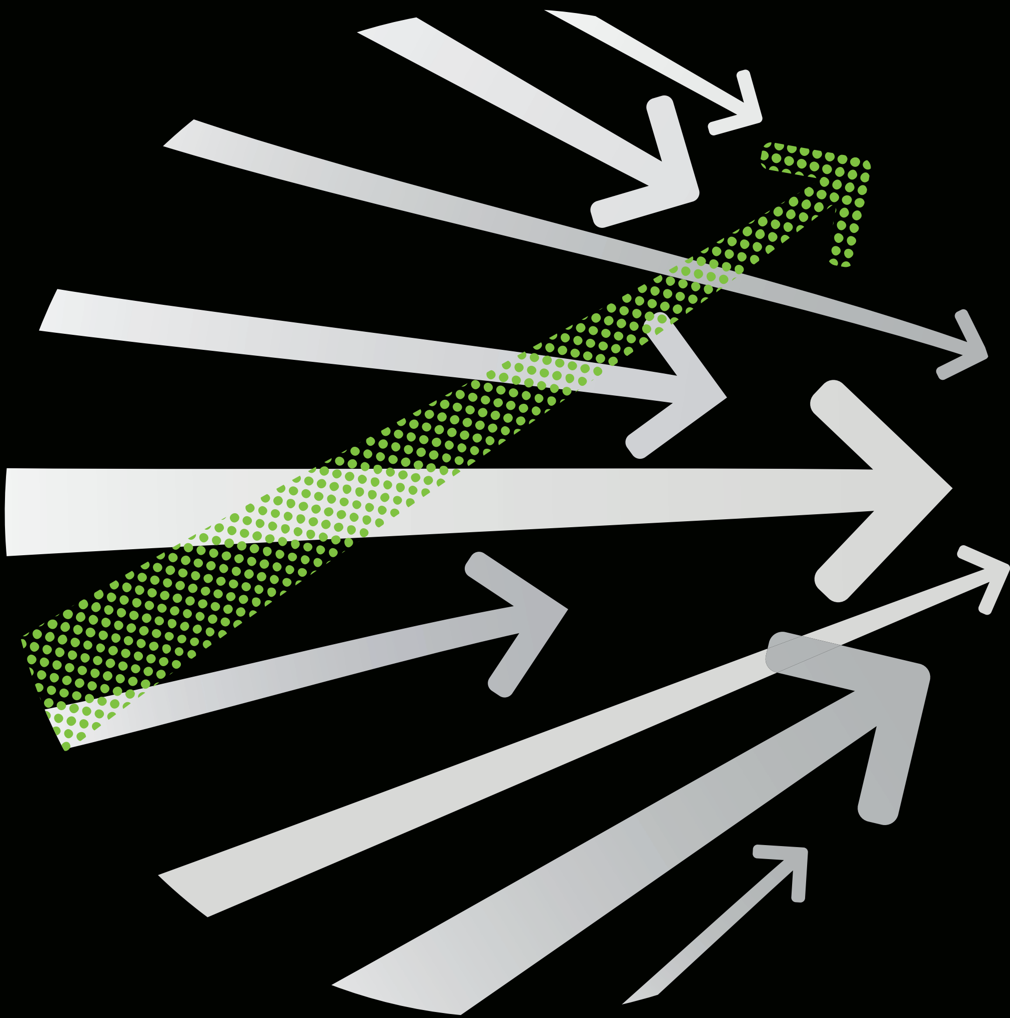


Preparing for Transfer Pricing legislation in the Middle East

Whitepaper series | Volume 1

In the Middle East since 1926

Transfer Pricing is one of the most critical issues facing international businesses. New regulations in the Middle East make this an important time to address this issue.

A significant number of jurisdictions in the Middle East have adopted or are soon to adopt transfer pricing (TP) regulations: Oman, Qatar[1], Bahrain and the United Arab Emirates (UAE) have all signed the Base Erosion through Profit Shifting (BEPS) Inclusive Framework (IF) committing to implementing the four minimum standards[2], which include action 13 (transfer pricing documentation and Country by Country Reporting). Other IF Signatories for the Middle East include Egypt[3], Saudi Arabia[4] (KSA) and Tunisia with Kuwait[5] signing the Multilateral Convention[6] (MC) and Lebanon expressing intent to sign also. Additional jurisdictions may decide to follow suit in the coming months and in summary: Transfer pricing has landed in the Middle East. It is important to understand what this means for businesses operating in the region.

This first volume in a series of Deloitte Middle East Transfer Pricing whitepapers sets out:

1. The results of an October 2018 transfer pricing survey for businesses operating in the region, and
2. Some helpful guidelines for businesses operating in the region that will assist in evaluating risks and opportunities.

One of the key takeaways from this whitepaper should be the significant opportunities that exist for businesses investing in the Middle East and North Africa (MENA) to design an efficient transfer pricing structure that facilitates and compounds this investment.

Oct - Dec 2017

Oman and Qatar join the OECD Inclusive Framework on BEPS.

Qatar signs the OECD's Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of Country-by-Country (CbC) reports.

Dec 2017 - Mar 2018

Bahrain and UAE added to the EU "Black List" of Tax havens.

Subsequently, Bahrain and UAE commit to undertaking certain tax reforms and are removed from the black list.

May 2018

Bahrain and UAE join the OECD inclusive framework on BEPS.

As of this date, the total number of participating jurisdictions are 116.

June 2018

UAE signs the MCAA.

This represents a significant step forward in the implementation of CbC reporting in the region.

September 2018

Qatar publishes new Country-by-Country Reporting (CbCR) requirements.

The decision applies to financial years starting on or after 1 January 2017. The first reporting deadline is 31 December 2018.

Oct - Dec 2018

Saudi Arabia's transfer pricing formal regulations anticipated by Q2018 4.

Transfer Pricing survey – The journey to TP in the Middle East

Deloitte undertook a Transfer Pricing survey in October 2018 to assess growing transfer pricing trends in the MENA region. Over 30 Chief Financial Officers (CFOs)/Heads of Tax responded to this survey and the results are set out below.

Key themes arising from the survey results include, but are not limited to, the following:

As a vital early step, businesses need to asses their capability to manage new transfer pricing regulations through a targeted policy for compliance and cash tax optimization.

65%

of respondents are concerned (or highly concerned) about transfer pricing compliance.

25%

have actually changed the group Transfer Pricing policy/structure in response to recent legislative developments in the region.

This may be an indication that businesses have already given some thought to transfer pricing risks in light of so many MENA jurisdictions signing up to the BEPS minimum standards.

82%

of respondents agree (or strongly agree) that transfer pricing structures are under greater scrutiny in the region.

14%

have witnessed a Transfer Pricing audit in the region to date (compared to 25% who have witnessed a Transfer Pricing audit outside of the region).

We would expect the percentages witnessing audits to increase as tax authorities from the region increase their own experience in transfer pricing over the coming years.

46%

respondents prepare Transfer Pricing documentation in-house.

50%

confirm that the C-Suite and Board of Directors have changed their views on tax planning since the adoption of regulations in the region.

This is consistent with our experience in meetings/discussions with executives who recognize that transfer pricing is a key business risk.

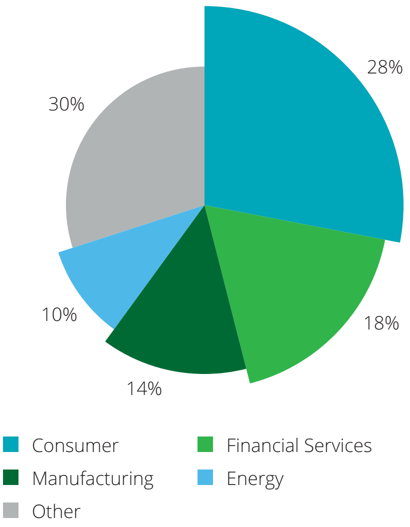
54%

of respondents are concerned about increased media, political and activist group interest in corporate taxation.

One may have expected this percentage to be higher for the region but transfer pricing is still a new concept to many stakeholders.

Full results

1. In what industry does your group operate?



The largest industry subset of survey respondents was Consumer (28%) followed by Financial Services (18%), Manufacturing (14%) and Energy (10%). Other industry groups represented include Technology and Real Estate.

2. Where is your group headquartered?

25%

of survey respondents were headquartered in the UAE.

21%

from KSA.

And the balance from other MENA territories (and some global inbound groups). The high percentage from KSA is indicative of the transfer pricing regulations that are anticipated to be released in the next month in this location.

3. Is your organization concerned about the increased media, political and activist group interest in corporate taxation and transfer pricing?

54%

of respondents agreed (or strongly agreed) that their organization was concerned about this issue.

14%

disagreeing.

It is likely that the respondents who neither disagreed nor agreed with this statement may witness an increase in concern in the coming months as more regulations are introduced and stakeholders like the media report on transfer pricing issues.

4. Is the C-suite and/or board of Directors of your organization actively engaged in establishing or improving your organization?

82%

of respondents agreed (or strongly agreed) that the Board is actively engaged in organizational improvements.

18%

were neutral or disagreed with this statement.

Structural improvements and change to the organization (such as expansion into new products and markets) will have a significant impact on the transfer pricing profile of a business.

5. Did the C-suite and/or Board of Directors in your organization change their views on tax planning in the Middle East since the adoption of transfer pricing regulations in the region?

46%

of respondents agreed (or strongly agreed) that the Board of Directors has indeed changed views on tax planning due to the adoption of transfer pricing regulations.

This is an important consideration as businesses are cognizant of the reputational and governance risks of non-compliance and from adopting aggressive tax planning policies. A measured and robust policy should always be the preferred course.

6. Do you believe that tax structures implemented today are under greater scrutiny in the ME by tax administrations?

82%

of respondents agreed that tax structures are under greater scrutiny in the ME.

However, many of the challenges we are seeing at present relate to withholding taxation and/or deemed profit attributions to permanent establishments. Transfer pricing audits will become more frequent as Tax administrations become more familiar with their own adopted regulations over the months and years.

7. Did your organization implement significant change to its structure as a result of the recent changes relating to transfer pricing in the region?

The respondents were split down the middle with this question with 50% disagreeing (or strongly disagreeing) that the organization has implemented significant change. We would recommend against drastic changes that do not align with commercial objectives and caution businesses to take a more balanced approach to structured that manages risks and looks for opportunities.

8. Are Tax Authorities becoming increasingly aggressive in tax examinations?

61%

of respondents agreed (or strongly agreed) that Tax Authorities in the region are becoming increasingly aggressive in tax examinations and it is important for businesses to prepare for challenges and ensure that there is support in place for intra-group transactions.

9. Have you encountered a transfer pricing enquiry from a Tax Authority in the region?

14%

of respondents have encountered a transfer pricing enquiry; the low number is understandable as transfer pricing regulations are in their infancy and the time lag between adoption of new regulations and the surfacing of transfer pricing audits may be 18-24 months depending on the jurisdictions in question.

10. Have you encountered a transfer pricing audit from a Tax authority outside of the region?

25%

have encountered a transfer pricing enquiry from a Tax Authority outside of the region. However, the number is still relatively low indicating that MENA based groups may have a grace period before they must deal with the frequency and intensity of transfer pricing audits that other businesses face in Europe, The Americas and Asia-Pacific.

11. If yes, did the enquiry result in an adjustment?

43%

of businesses that were audited ended up with a transfer pricing adjustment with 57% being able to fend off that enquiry with no adjustment. This is an encouraging statistic to show that in the majority of cases, Tax administrations will give due regard to the fact base and accept a well-designed and documented transfer pricing policy.

12. Does your business develop intellectual property (brands, patents, etc.) in the region?

36%

of respondents confirmed that the business develops intellectual property in the region; transfer pricing of intangible assets such as intellectual property is a complex area and it is important for groups to ensure that they are maximizing the opportunities to leverage and charge for valuable intangible assets developed in MENA.

13. Does your company make intra-group loans to subsidiaries in other locations and/or guarantee loans to subsidiaries?

68%

of respondents confirm that intra-group loans/guarantees are in place, despite the MENA region being cash rich.

As for intangible assets, the transfer pricing of financial transactions is covered by a separate body of case law and international guidance and there are a number of complexities to manage (and opportunities to explore).

14. Do you prepare transfer pricing documentation in-house?

46%

of respondents confirmed that they prepare transfer pricing documentation in-house and this is consistent with international experience where businesses have been upskilling on transfer pricing to control the risk and compliance process. We are aware of a number of MENA based groups who have hired in-house transfer pricing specialists in recent months and we expect this trend to continue.

15. How concerned is the company about managing transfer pricing compliance?

61%

of respondents are concerned (or highly concerned) about managing transfer pricing compliance; the balance are either (i) ahead of the curve and have already adopted a robust policy or (ii) have note had cause to date to be concerned.

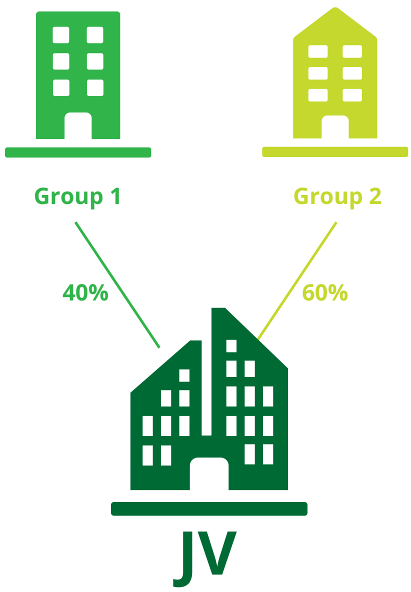
Guidelines for businesses operating in the Middle East

The following guidelines set out some useful steps businesses can take to asses risks and opportunities.

Guideline number 1: Do not assume that the transfer pricing regulations will apply as there may be exemptions/exceptions.

- Domestic transactions are most often exempt from transfer pricing requirements due to tax neutrality and can be carved out of transfer pricing risk reviews and documentation. However, there are tax regimes (e.g. KSA Zakat, Special Economic Zones, Abu Dhabi tax holidays for oil & gas, Qatar QFC regime) which convey different effective tax rates for companies operating in the same domestic location that are involved in different activities or located in different sub-regions (this is an important consideration for transfer pricing – both a risk and an opportunity);
- Note that it is common in the MENA region for a subsidiary to have less than 50% share ownership due to foreign ownership restrictions. Prima facie this may appear to be out of the scope for transfer pricing; however, the subsidiary may still be controlled/managed and this would put it within the transfer pricing definition of "associated" or "related";
- Joint Ventures (JVs) are common also in the region due to restrictions on foreign ownership, and transfer pricing regulations may apply in situations where the parties do not view themselves as associated/related. In addition, it is important to ensure from a transfer pricing perspective that the stake issued to the parties is economically aligned with their respective contributions – experience has shown that there are often departures from this in practice in MENA due to cultural factors/preferences and control not always being in alignment with ownership. However, many JVs can be structured from a commercial perspective so that they do not trigger transfer pricing regulations in the relevant jurisdictions. The OECD guidelines are helpful in extracting cash and resolving disputes between JV parties with respect to economic rewards based on activity at arm's length. As a final comment: if indeed the JV is a minority holding, "intra-JV" prices may be potential third party comparable uncontrolled prices that will assist in supporting intra-group prices at arm's length;

Joint Venture example



Transfer pricing can apply to JVs for control or even 30%-40% holdings, depending on the jurisdiction, despite the fact that JV parties may consider themselves and conduct themselves to be at arm's length.

- With respect to Country-by-Country Reporting[7] (CBCR), the OECD guidelines confirm that there should be no general exemption for investment funds, non-corporate entities or non-public corporate entities. A CBCR "Group" is in fact defined as a collection of enterprises related through ownership or control such that it is either required to prepare consolidated financial statements (or would be if equity interests were traded on a public securities exchange). A detailed review of group holdings, control and minority investments may identify certain divisions that do not need to be reported as part of the CBCR regulations as they are not consolidated under generally accepted accounting principles. It should be noted that certain jurisdictions include an Anti-Avoidance clause to prohibit certain activities taken in an effort to avoid CBC reporting. The clause states that "If a person enters into any arrangements and the main purpose, or one of the main purposes, of the person in entering into the arrangements is to avoid any obligation under these Regulations, these Regulation are to have effect as if the arrangements had not been entered into." Paragraph 55 of the final Action 13 report, lays out the intent that there are no exemptions from filing CBC reports apart from the specific exemptions outlined. Further to the final report, there have been a series of updates to the implementation guidance and included in this guidance are specific sections dedicated to helping determine an MNE group for CBC reporting and which parts of the group would fall into the constituent entity definitions. We have found in the past that considering the accounting treatment of an entity in the consolidated reporting for a group can help us to determine the total population of entities that should likely be in the report based on the guidance provided;
- Certain jurisdictions (e.g. Iran, Iraq, Jordan, Libya, Palestine Territories) have not introduced transfer pricing regulations nor have they expressed any desire to. We do not see any challenges from these jurisdictions in relation to transfer pricing or arm's length pricing, and so there is no need to expend resources relating to local transfer pricing in these jurisdictions (businesses headquartered in these jurisdictions may of course have operations in other jurisdictions in which transfer pricing regulations are present). In fact, jurisdictions with no transfer pricing regulations may present a planning opportunity, given the light touch that will be taken by local tax authorities in relation to intra-group transactions.

Guideline number 2: You may have (a little) more time than you think to get up to speed with the transfer pricing regulations.

Assuming that transfer pricing does apply to business operations in the Middle East then there is still time to get your house in order. By way of example, we expect regulations to be released in KSA in November/December 2018 (Deloitte has been involved in scripting guidance and manuals relevant to the KSA regulations). The TP rules are likely to be applicable to December 2018 tax return filings, which will be due by the end of April 2019 (in KSA, audited financial statements should be filed concurrently with the tax return). In the past, KSA Tax Inspectors from the General Authority of Zakat and Tax (GAZT) may not have enquired into transactions for 18-24 months. However, given the history and sequence of events following the implementation of VAT in KSA, it can be inferred that GAZT will be active on transfer pricing enquiries within 12 months of the regulations being issued with targeted reviews and specific issues audits.

Timeline between introduction of regulations and tax audits

Guideline number 3: Businesses can view the introduction of new transfer pricing regulations as an opportunity as opposed to a compliance burden.
For decades, multinational businesses have been attempting to centralize substance in low tax locations including Switzerland, Luxembourg, Singapore and even more 'exotic' locations. The OECD BEPS[8] project changed the fabric of tax planning in the modern environment and underpinned the importance of economic substance and robust support for principal/hub structures. However, the detailed guidance emerging from the OECD's lengthy consultation with business has provided us with a useful guide for planning in terms of marrying substance with appropriate and relevant arm's length pricing. There are a number of jurisdictions in the Middle East (for example Dubai or Bahrain) that possess not only low/zero tax rates but also provide access to a skilled international workforce making them a popular choice for a regional hub. A recent United Nations Conference on Trade and Development (UNCTAD) report on World Investment for 2017/2018[9] confirmed that more than 25% of the world's 500 largest companies have the UAE as the regional base of their operations in MENA. In addition, the UAE is ranked 30th (globally) in terms of the quantum of Foreign Direct Investment (FDI) inflows (rising five positions from 2016/2017 and continuing to move up this prestigious list). The UAE has also moved above Luxembourg and is closing in on the UK when the comparison is honed down to global financial centers attracting FDI (there is still some work to be done to catch Switzerland and Singapore, but those jurisdictions have had a head start on the UAE):

World Investment Report 2018 total FDI inflows – Financial centers

A separate Global Power City Index[10] released in October 2018 placed Dubai as a City at position 29 in the World (ahead of Geneva, Paris and Boston) , and a World Bank 2018/2019 "Ease of Doing Business" study witnessed the UAE climb 10 places from the previous year to rank 11th out of 190 business hubs. The World Bank study confirmed that "The UAE has become a global hub for innovation, entrepreneurship and investment." Given the significant investment flows, businesses that are operating in the region are likely to have already built up significant economic substance in the UAE, and we are partnering with business to unlock the following opportunities for planning and cash flow savings:

Head office charges
Operating locations should pay arm's length intra-group charges to Middle East regional hubs or business headquarters in return for the head office services provided, which may include finance, legal, HR and IT. Note that depending upon the precise structures and the services provided at 'Branch' level, VAT may apply in the Gulf Cooperation Council (GCC) territories to such charges, and there are also withholding tax considerations to factor in. This may also be complicated by whether services from the Branch are made within the GCC, or to an external recipient, and whether those services are made in relation to goods in KSA, the GCC or external to the GCC at the time that the supplies are made. It is important to minimize tax leakage by having a firm fact base in place that sets out the services being provided and to ensure that these are segregated out and labeled correctly in agreements/invoices.

Intellectual property
Middle East regional hubs or business headquarters create significant intellectual property in the form of brands, customer relationships and data that should be charged for at arm's length when utilized in other locations. Among the Deloitte 2018 Transfer Pricing survey respondents, 36% confirmed that their businesses create valuable intellectual property in the region.

Guarantee fees
Whilst external debt is not common in this cash rich region[11], it is common for Middle East Parented businesses guarantee third party (e.g. Bank) debt loaned to subsidiaries. This is a potentially valuable intra-group service that can be priced at arm's length.

In addition to the above, global tax changes such as US Federal taxation reform[12] is creating additional opportunities for businesses operating in the Middle East. Depending on the circumstances, the effective corporation tax rate in the US may be below the statutory rates in the Middle East, which range from 15%-25%. The introduction of transfer pricing regulations in these territories provides a timely opportunity to ensure that there is sufficient economic support for intra-group charges that will create a cash flow benefit for US multinationals.

Guideline number 4: Technology Part I - Let technology be your friend in navigating through the complexities brought by new transfer pricing regulations

The Deloitte CbCR Solution
The CbC Report will require businesses to provide Tax Authorities with visibility over their global operations. Businesses will be expected to recognize key CbCR risk areas and possibly provide explanations for their effective tax rates, should these be queried by Tax Authorities.

The CbC Report contains aggregated information on a jurisdictional basis of a multinational entity's revenues, profits, taxes, stated capital, accumulated earnings, employees and assets. The CbC Report will also provide Tax Authorities with location and business activities of the multinational entity's operations.

Disclosure of financial information is a sensitive area for businesses operating in the region, and it is important for groups to have complete oversight over this information that will be logged with Tax Authorities and shared with other Tax Authorities in the jurisdictions in which the business operates.

Deloitte has developed a cutting-edge tool, Deloitte's CbC Digital Exchange (CDX), which helps collect and analyze the data needed under CbC reporting requirements. The use of CDX has helped streamline the CbCR data gathering and review process for many businesses and the simple, intuitive user interface offers:

- A flexible upload process to allow approved users to contribute data by geography, business unit, or other segment into a central repository.
- An aggregated view of the data in the required CbCR format.
- Simulation functionality with the ability to run top-down and bottom-up scenarios.
- The ability to sort and filter results.

The Deloitte documentation solution
The preparation of transfer pricing documentation can be a lengthy and costly process. Therefore, in response to client needs, Deloitte developed a technology solution (Digital DoX) that reduces the compliance burden on businesses and provides them with greater control over the documentation process.TP Digital DoX is a web-based solution available on the myInsight platform. It facilitates and streamlines the efficient preparation of TP

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documentation reports, while allowing for close collaboration across Deloitte as well as a business' internal project teams.

Factual and financial information is gathered via user-friendly online questionnaires, the responses to which are mapped into an automatically generated TP master file, local file or stand-alone reports following a modular approach.

TP Digital DoX will offer you time and resource savings by:

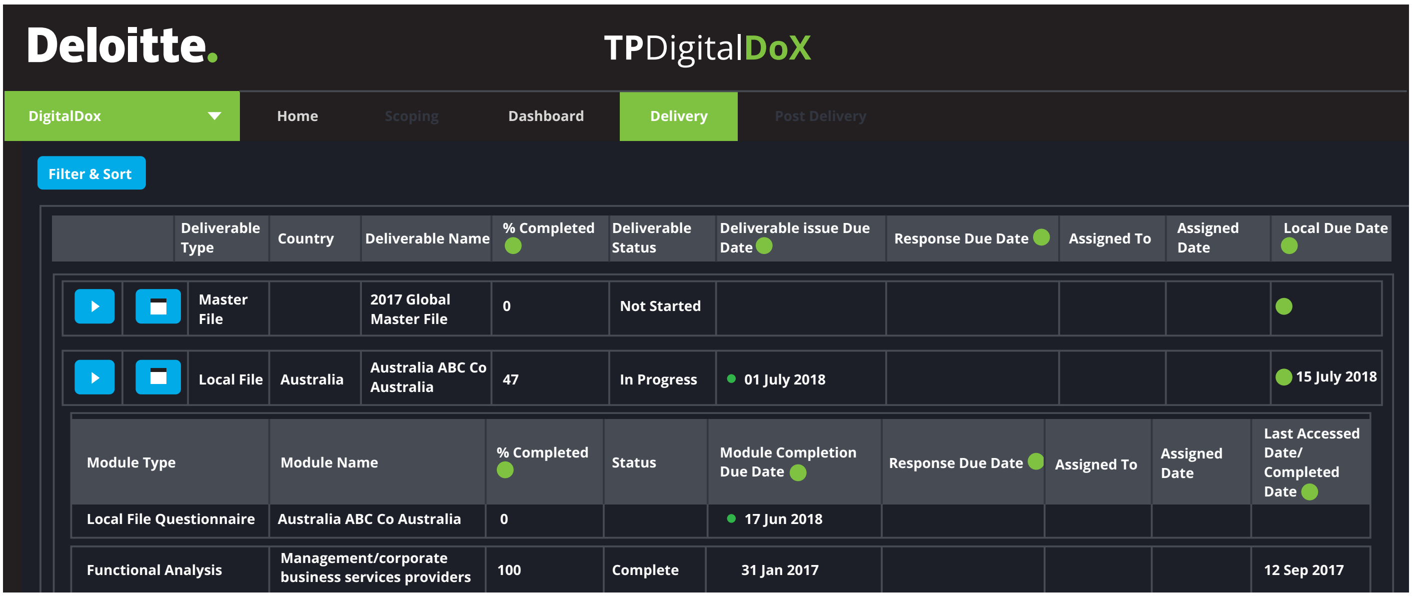
- Streamlining information gathering and report compiling to support the entire lifecycle of a TP documentation engagement
- Facilitating an integrated, online process to generate local and OECD/BEPS-compliant transfer pricing documentation reports
- Enhancing project efficiencies and helping to manage human error
- Providing a single global platform used by the entire Deloitte TP practice across the world, which facilitates increased collaboration with Deloitte and your global project teams
- Being flexible, customizable and scalable, enabling you to meet specific project requirements amidst expanding business needs

Key features include:

- A web-based, user-friendly solution
- Automatic simultaneous multiple report generation
- Central project management by way of an integrated dashboard
- A modular approach to TP documentation, giving you the ability to review at the modular level with the functionality to track changes and comment on a specific item or overall at the section level
- Significant pre-built logic based on Deloitte's latest global experience
- A highly secure platform ensuring you maximum data protection and information security

Guideline number 5: Technology Part II - Embed Transfer Pricing within ERP systems

Transfer pricing information will be required from business ERP systems (the "quality out equals quality in" adage is an accurate one) in terms of cost base segregation and revenue/profit allocations. If the source financial information is not accurate then the businesses will be at risk of a challenge in relation to how transfer pricing methodologies are implemented in practice.



Transfer pricing is implementable with individual ERP platforms, a combination of ERP platforms or other data source systems. Through this system-based service offering, businesses can benefit by automating and accelerating existing time- and resource-consuming transfer pricing monitoring and data analysis processes, thereby, enabling limited internal resources to focus on more value-added tasks. Deloitte TP Insite Smart helps to turn data into knowledge and actionable insights, including the following:

- Gaining transactional-level insight into intercompany transactions
- Monitoring transfer pricing policy implementation across transactions and entities on a regular basis
- Enabling root-cause analyses of deviations from transfer pricing policies/targets and determining corrective actions
- Assessing tax impacts of TP adjustments and underlying indirect tax implications
- Facilitating what-if scenario analyses
- Enhancing visibility and control over TP audits and year-end adjustments

Guideline number 6: Don't reinvent the wheel

Cross-border intra-group transactions will relate to (at least) two jurisdictions; it may be the case that your business already has transfer pricing analysis and support that can be leveraged in the Middle East when looking to comply with new regulations. Whilst there are some departures in terms of thin capitalization safe harbors and deemed profit margins, regulations being introduced in the Middle East are closely aligned with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017[13], and therefore a coordinated approach may help to reduce selling, general and administrative (SG&A[14]) costs (in the form of unnecessary spend on advisers' fees).

Transfer Pricing relates to intra group transaction between associated entities; such transactions often create tax arbitrage within a multi national businesses and must be priced at arm's length.

Guideline number 7: Training for in-house tax teams

It is important for businesses to upskill on transfer pricing through training and bringing in personnel with the appropriate experience.

Deloitte Middle East holds regular workshops themed by industry (e.g. Financial Services, Oil&Gas, Tech/Telecoms), where you can discuss transfer pricing with peers and leading Deloitte experts in the field. In addition, Deloitte provides one day workshops for clients to cover transfer pricing specifics to include general principles, acceptable methodologies, cost base allocations, "smart compliance" technology options, common boardroom discussions around transfer pricing and other key transfer pricing issues. In short, we partner with our clients to guide them through all aspects of the transfer pricing process.

Conclusion

82% of respondents in the Deloitte 2018 Middle East Transfer Pricing survey agree that transfer pricing structures are under greater scrutiny in the MENA region.

A raft of new transfer pricing regulations will be implemented in MENA over the next few years; however, this can be viewed as an opportunity for businesses to design an efficient intra-group pricing framework for the region to align with investment strategy and stay on top of risks by deploying technology solutions that accord with existing business systems.

Endnotes

1. Transfer pricing and thin capitalization rules apply in the Qatar QFC regime
2. Members of the IF have committed to implement four minimum standards of the BEPS package, which in excess of Action 13 are Actions 5, 6 and 14, which relate to harmful tax practices, treaty abuses and dispute resolution respectively.
3. Transfer pricing and thin capitalization rules apply in Egypt (including a 4:1 debt: equity statutory safe harbor to permit/restrict interest deductions).
4. Transfer pricing regulations are anticipated in November/December 2018 and there exists an earnings-based restriction for thin capitalization purposes.
5. Whilst formal transfer pricing regulations have yet to be introduced, Kuwait does have the arm's length concept in local law including deemed profit margins for types of transaction.
6. Signing the MC (to implement tax treaty related measures to prevent Base Erosion through Profit Shifting) signals a commitment to be in line with wider international tax developments.
7. OECD/G20 initiative to increase transparency of tax payable worldwide
8. Base Erosion through Profit Shifting
9. worldinvestmentreport.unctad.org/
10. Mori Memorial Foundation Institute for Urban Strategies, ranking economic strength, research and development, cultural interaction and accessibility among other criteria
11. Although we are seeing more calls for external funding than in previous years
12. Recent tax changes in the U.S. to bring the statutory current tax rate down and provide greater tax incentives for businesses
13. read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page1
14. Selling, General and Administrative costs

Contacts

Deloitte has a growing team of Transfer Pricing specialists, covering the entire GCC region; details of our senior contacts are set out below.

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