

Egyptian Transfer Pricing Guidelines

A guide to the application of Article (30) of the Income Tax Law No. 91 of 2005



وزارة المالية

مصلحة الضرائب المصرية
Egyptian Tax Authority

الضرائب...مصلحتك أولاً



Acknowledgment

The Egyptian Tax Authority (ETA) would like to thank all those who contributed to the issuance of the "Egyptian Transfer Pricing Guidelines".

ETA also mourns the passing of our late colleague Ms. Amal Abdelrazeq - a team member who participated in the first version of the Guidelines. We are deeply indebted and immensely grateful to her. May her soul rest in peace.

For their strenuous efforts and unfailing support that have been vital in delivering these Guidelines, ETA is also sincerely grateful to:

- Technical Assistant to Vice Minister of Finance for Tax Policy, Yasmine Hammad.
- ETA Senior Translator, Nahed Algazaz.

A very special gratitude goes out to Mr. Amr ElMonayer - the former Vice-Minister of Finance for Tax Policy - who led the team working on these Guidelines. His knowledge and insight were indispensable to the team; ETA honors his outstanding leadership in the pursuit of these Guidelines.

ETA is also indebted to the international organizations, particularly the experts of the Organization of Economic Co-operation and Development (OECD) for their worldwide professional experience and their valuable input, on the implementation of transfer pricing.

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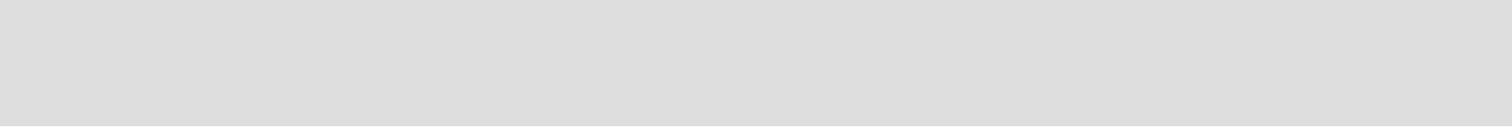
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Introduction*

This circular sets out the views of the Egyptian Tax Authority (ETA) on the application of transfer pricing rules according to Article (30) of Income Tax Law No. 91 of 2005 (referred to in these guidelines as the "Law") and the amended Articles (38), (39) and (40) of the Executive Regulations thereof. This circular is an update of the "Egyptian Transfer Pricing Guidelines" issued in 2010, and shall be updated regularly in accordance with the legislative requirements and practical application.

These Guidelines aim to be a practical guide rather than prescriptive rules. They provide taxpayers with guidance on the application of the arm's length principle in pricing their controlled transactions and discuss the documentation that taxpayers are required to develop in order to demonstrate to ETA their compliance with such a principle.

Although Egypt is not a member country of the Organisation for Economic Co-operation and Development (OECD), the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* - issued in July, 2017 (referred to in these Guidelines as the "OECD Transfer Pricing Guidelines") are acknowledged as an important guide followed by the OECD Member countries and many non-member countries, and accordingly have become a globally accepted transfer pricing standard. Therefore, ETA used the OECD Transfer Pricing Guidelines as a basic reference in preparing this circular, and hence the OECD Transfer Pricing Guidelines should be consulted for a more detailed discussion of the principles contained in this circular.

* These guidelines are introduced in both English and Arabic. It should be emphasized that the English text is not an authentic translation of the Arabic. In case of difference in meaning, the Arabic original shall overrule.

* Examples and cases included in these guidelines are hypothetical and the numerical amounts, prices, mark-ups, margins, adjustments, etc, have no factual basis and should not be taken as benchmarks.

* For simplicity purposes, many of the real world complexities were not considered in these examples and case studies.



Overview of Guidelines

Scope of Guidelines
Approach to Egypt's Guidelines
Overview of Base Erosion and Profit Shifting Project
Future Work
Law Provisions
Definitions

Scope of Guidelines

These Guidelines shall be used for the purposes of the application of Article (30) of the Law. They therefore apply to transactions between associated enterprises resident in Egypt, as well as to transactions between enterprises resident in Egypt and their non-resident associated enterprises.

Approach to Egypt's Transfer Pricing Guidelines

Transfer pricing is not an exact science. It is a matter of judgment and finding an answer. Therefore, a key objective for taxpayers in transfer pricing should be to present comprehensive evidence to ETA to demonstrate that its transfer prices are set at arm's length.

Accordingly, ETA acknowledges that these Guidelines cannot provide an exhaustive discussion of transfer pricing issues, and that they only provide guidance on the factors to be considered in conducting transfer pricing analysis and determining the arm's length price.

It should be emphasized that taxpayers who provide sufficient documentation proving that they made appropriate efforts to establish transfer prices that comply with the arm's length principle are likely to be assigned by ETA a low tax risk rating. On the contrary, where the documentation provided to ETA indicates that taxpayers did not give adequate consideration to their transfer pricing practices, those taxpayers will be assigned a high tax risk rating taking into consideration that taxpayers with a high perceived risk are more likely to be audited by ETA than those perceived to have a low risk.

Therefore, taxpayers are required to prepare and maintain adequate documentation demonstrating their compliance with the arm's length principle.

ETA believes that the transfer pricing rules will be administered most efficiently, if taxpayers and ETA cooperate in resolving transfer pricing issues. Taxpayers are, therefore, encouraged to discuss any concerns about their transfer pricing practices with ETA.

In addition, if a taxpayer believes that its business activities and the associated transfer pricing issues are unique or complex, the taxpayer is encouraged to conclude an advance pricing agreement (APA) with ETA to avoid future tax disputes, subject to ETA's approval.⁽¹⁾

Overview of Base Erosion and Profit Shifting Project

International tax issues are a high priority issue on the political agenda globally, due to the significant increase in the integration of national economies and markets, which has placed strain on the international tax rules currently being enacted. Loopholes and weaknesses in the international tax rules create opportunities for **base erosion and profit shifting (BEPS)**, thereby requiring major actions to be taken by policy makers promptly to restore confidence in the international tax system, and ensure that the required measures are effectively inaugurated so that profits are taxed where economic activities take place.

In response to this, the OECD adopted a 15-point Action Plan to address BEPS in September of 2013. The Action Plan identified 15 actions along three key pillars, as follows: introducing **coherence** in the domestic rules that affect cross-border activities, reinforcing **substance** requirements, and enhancing **transparency**.

Action 13, titled "Transfer Pricing Documentation and Country-by-Country Reporting", of the 15-point Action Plan was aimed at introducing updated guidance on the documentation requirements previously endorsed by the OECD Transfer Pricing Guidelines, to further the BEPS project's three key pillars. Therefore, updated guidance on transfer pricing documentation, including a template for **Country-by-Country Reporting (CbCR)** has been issued, to enhance transparency while taking into consideration compliance costs.

¹ See Part Two of these Guidelines, for a practical guide to the application of Article (30) of the Law in respect of APAs.

However, globalization and trade movements require the implementation of the Action Plans to go beyond the OECD countries thereby creating global solutions that are targeted towards combatting BEPS. To that effect, the OECD established an inclusive framework in 2016 for monitoring the implementation of the BEPS project's recommendations, with all non-OECD interested countries having the opportunity to participate on an equal footing. The inclusive framework member countries have agreed four minimum standards for implementation of the BEPS project. These are Actions 5, 6, 13, and 14.⁽²⁾

The Inclusive Framework member countries have further developed a monitoring process and put in place review mechanisms to ensure effective implementation. At present, more than 115 countries, including Egypt, have become members of the Inclusive framework. The updated guidance on documentation requirements included in these Guidelines endorses the key principles contained in the OECD Transfer Pricing Guidelines.⁽³⁾

Future Work

"Transfer Pricing for Tax Purposes" has been introduced in Egypt since 2005, followed by the issuance of the first version of the Egyptian Transfer Pricing Guidelines in 2010, which has given taxpayers adequate time to understand the principles underlying such a topic in order to be able to put these principles into practice. Thus, with the issuance of these updated Guidelines, ETA expects taxpayers to be fully prepared to appropriately apply the principles contained herein in practice, and to be fully compliant with Article (30) of the Law, and its executive regulations Articles (38), (39), and (40).

The first part of these guidelines provides taxpayers with practical guidance and explanation of the main concepts and issues that arise in the area of transfer pricing. Consequently, this part provides taxpayers with guidance on the arm's length principle, comparability analysis, transfer pricing methods and documentation requirements. Whereas, the second part of the guidelines addresses the principles and application of Advance Pricing Agreements (APAs) in detail.

Other issues as relevant to the topic of transfer pricing, such as the application of the arm's length principle to transactions involving intangible property, controlled services and Cost Contribution Arrangements (CCAs) will be addressed in separate Guidelines to provide the in-depth practical guidance required by taxpayers for an appropriate application of the principles.

Moreover, ETA plans to issue separate guidelines regarding the tax treatment of Permanent Establishments (PE) including the attribution of profits between the head office and PE. Other future work will include issuing industry specific Guidelines to address key transfer pricing issues for certain industries and provide a practical guide to the appropriate application of transfer pricing principles thereof.

Law Provisions

Income tax law No. 91 of 2005 and the Executive Regulations thereof (as per the amendment of May 22, 2018) stipulate the following provisions on transfer pricing:

The Law

Article (30)

In case associated enterprises have set conditions for their commercial and/or financial transactions other than conditions set with independent enterprises, where such conditions lead either to reduce the tax base or shift the tax burden from a taxable enterprise to an exempt or non-taxable enterprise, ETA has the right to determine the taxable profit on the basis of the arm's length price.

ETA Commissioner may conclude agreements with such associated enterprises to follow one or more methods in determining the arm's length price in their transactions.

The Executive Regulations of this law shall specify methods of determining the arm's length price.

²Action 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 13 "Transfer Pricing Documentation and Country-by-Country Reporting", and Action 14 "Making Dispute Resolution Mechanisms More Effective".

³ See Chapter V "Documentation" of the OECD Transfer Pricing Guidelines, and the corresponding appendices.

The Executive Regulations⁽⁴⁾

Article (38)

ETA has the right to verify the application of the arm's length principle by associated enterprises in their controlled commercial or financial transactions, particularly with regard to the exchange of goods and services, allocation of shared expenses, royalties, interests or other commercial or financial transactions carried out between the associated enterprises.⁽⁵⁾

Article (39)

"As specified in Article (30) of the Law, the arm's length price shall be determined according to one of the following methods:

1. Comparable Uncontrolled Price (CUP) Method.
2. Cost Plus Method (CPM).
3. Resale Price Method (RPM).
4. Profit Split Method (PSM).
5. Transactional Net Margin Method (TNMM)."

⁴Articles (38), (39) and (40) of the Executive Regulations of Tax Law No. 912005/ are amended by virtue of the Minister of Finance's Decree No. 2212018/. The old articles state the following:

Article (38):

"ETA has the right to verify the associated enterprises' application of the arm's length principle in their transactions with regard to the exchange of goods, services, raw materials, capital equipment, allocation of shared expenses, royalties, interests and other commercial and/or financial inter-transactions carried out."

Article (39):

"The arm's length price is specified, as stipulated in Article (30) of the law, according to one of the following methods:

1. Comparable Uncontrolled Price Method (CUP)

According to this method, the price of goods or services, transferred between associated enterprises, shall be determined on the basis of the price of same goods and services transferred between an associated enterprise and independent enterprises. The comparison depends on other similar goods and services taking into account the following factors:

- a. Legal conditions to which each party to the contract is committed;
- b. Market circumstances; and
- c. Special circumstances of the transaction in question.

2. Cost Plus Method (CPM)

According to this method, the price of goods or services, transferred between associated enterprises, shall be determined on the basis of the total cost of the goods and services plus a certain percentage as a gross markup in favor of the supplier or the service provider, such a markup shall be determined either on the basis of the cost plus markup earned by the taxpayer in their comparable uncontrolled transactions carried out with independent enterprises or on the basis of the markup earned by another independent enterprise in comparable uncontrolled transactions.

3. Resale Price Method (RPM)

According to this method, the price of goods or services, transferred between associated enterprises, shall be determined on the basis of the resale price of the goods and services sold to an independent third party after deducting a percentage representing a reasonable gross margin to the reseller of such goods or services.

The gross margin shall be determined on the basis of the gross margin earned by same reseller in comparable uncontrolled transactions with independent parties.

The gross margin may also be determined on the basis of the gross margin earned by an independent enterprise in a comparable transaction."

Article (40):

"The Comparable Uncontrolled Price (CUP) method has the first priority in the determination of the arm's length price. In case the required data are not available to apply such method, either of the two methods prescribed in the preceding Article shall be applied. In case of inability of taxpayers to apply any of the three methods mentioned in the preceding Article, any other method described by the Organisation of Economic Co-operation and Development (OECD) or any other method appropriate for the taxpayer may be followed.

In all cases, there may be an advance agreement between ETA and the taxpayer with respect to the method to be followed by the taxpayer to determine the arm's length price for transactions between associated enterprises".

⁵For the purpose of these Guidelines, the term "exchange of goods and services" encompasses, but is not limited to, the purchase and sale of tangible goods (including raw materials as well as semi-finished and finished goods), capital equipment, provision and receipt of services, and any other commercial transactions.

In addition, the term "financial transactions" encompasses, but is not limited to, transfer of shares, provision of loans and/or financial guarantees, and such other financial transactions.

Article (40)

“To determine the arm's length price, the taxpayer may apply any of the methods specified in the preceding article in accordance with the nature of the financial or commercial transaction as well as the transaction conditions. In case none of these methods is applicable, the taxpayer may follow any other applicable method provided that sufficient documents and records that support the appropriateness of the chosen method are maintained.

Furthermore, taxpayers may conclude an Advance Pricing Agreement with ETA on the method to be followed to determine the arm's length price of their transactions with associated enterprises.

The Minister shall issue guidelines on the application of Article (30) of the Law that includes how to apply the transfer pricing methods to determine the arm's length price, considerations for applying each method, as well as documents and records that should be maintained. ETA shall consider these guidelines as its basic reference for verifying the application of the arm's length principle, unless otherwise required under certain cases which will be carried out based on taxpayer's request and upon the approval of ETA's Commissioner.⁽⁶⁾

Definitions

Definitions mentioned in the Law

Arm's Length Price

The price upon which two or more independent enterprises deal, determined according to market forces and transaction conditions.

Associated Enterprise

Any person related to a taxpayer in a way that affects the determination of the tax base including:

1. Husband, wife, descendants, and ascendants;
2. A corporation and the person who directly or indirectly holds therein at least 50% of the number or value of shares, or voting rights;
3. Partnerships, active partners, and silent partners;
4. Any two or more enterprises in each of which another person holds at least 50% of the number or value of shares, or voting rights.

Definitions and Abbreviations for the purposes of these Guidelines

APA

Advance Pricing Agreement

BEPS

Base Erosion and Profit Shifting

CbCR

Country-by-Country Reporting

Controlled transactions

Transactions conducted between associated enterprises

CPM

Cost plus method

⁶See Part Two of these Guidelines, for a practical guide to the application of Article (30) of the Law in respect of APAs.

CUP method

Comparable uncontrolled price method

EGP

Egyptian Pound

Egyptian Parented GAE

A parent entity that is resident in Egypt for tax purposes (See definition of Parent entity below).

ETA

The Egyptian Tax Authority

Executive Regulations

The Executive Regulations of law No. 91 of 2005

Group of Associated Enterprises (GAE)⁽⁷⁾

Two or more associated enterprises with business activities in the same country or in two or more countries

Independent enterprises

Two enterprises are independent enterprises with respect to each other if they are not associated.

Law

Income Tax Law No. 91 of 2005

OECD

Organisation for Economic Cooperation and Development

OECD Transfer Pricing Guidelines

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

Parent entity

The entity which directly or indirectly owns a sufficient interest in one or more entities of the GAE such that it is required to prepare Consolidated Financial Statements under the domestic Accounting Standards.

PSM

Profit split method

RPM

Resale price method

TNMM

Transactional net margin method

Uncontrolled transaction

Transactions conducted between enterprises that are independent with respect to each other dealing at arm's length.

⁷ For the purpose of these Guidelines, the term "GAE" is similar to the term "Group" as defined in Annex IV to Chapter V of the OECD Transfer Pricing Guidelines.



Part One

Principles and Implementation



Chapter One

The Arm's Length Principle

- 1.1 Scope of Chapter
- 1.2 Introduction
- 1.3 Factors influencing controlled transactions
- 1.4 What is the arm's length principle?
 - 1.4.1 Reasons for adopting the arm's length principle

1.1 Scope of Chapter

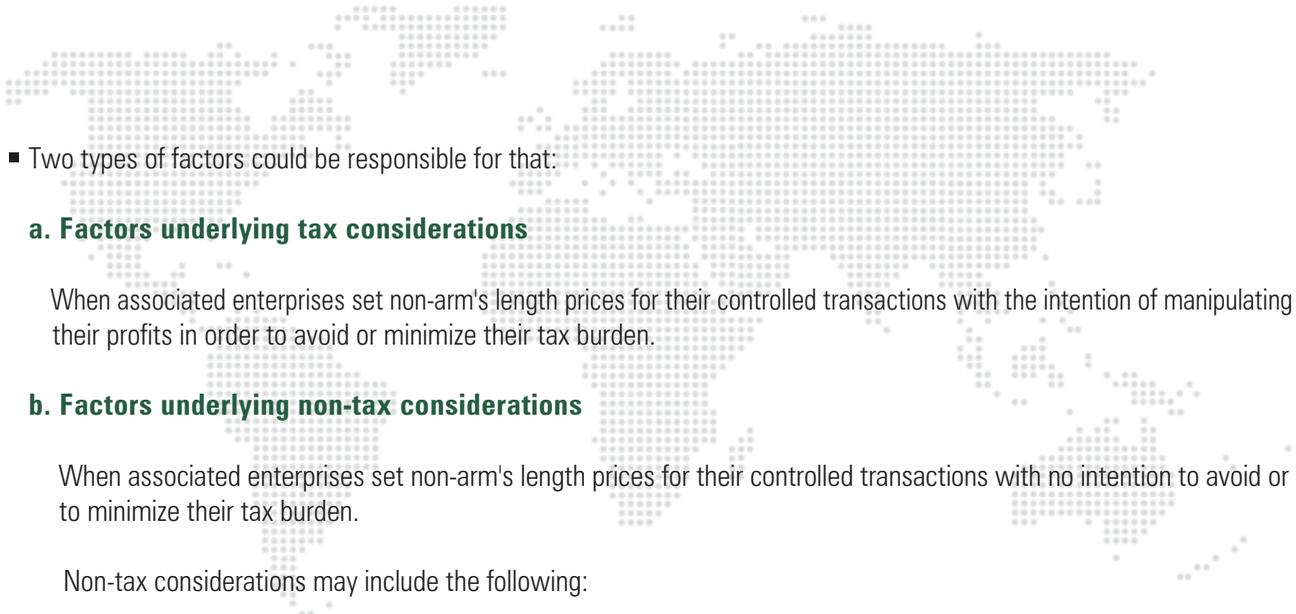
This chapter provides a discussion on the concept and definition of the arm's length principle.

1.2 Introduction

- The main goal of any enterprise is to maximize its profit. Similarly, a group of associated enterprises (GAE) is basically concerned with maximizing the total profit achieved by the group as a whole, regardless of each group member's contribution to this profit. Avoiding or minimizing the income tax due is a technique adopted by some enterprises in order to achieve such a goal.
- Therefore, there is a risk that controlled financial and commercial transactions, which take place between the members of a GAE, may be conducted at non-arm's length conditions in an attempt to shift the tax burden from one group member to another and/or from one country to another.
- **Accordingly, the key purpose of these guidelines is to ensure that any controlled financial or commercial transactions in which a person resident in Egypt for tax purposes engages are conducted at arm's length prices and that the relevant tax base reflects the economic contribution of the relevant associated enterprise.**
- As a result, the use of the arm's length principle seeks to eliminate the effect of any ownership relationship between associated enterprises through its adopted transfer pricing practices. As such, in any controlled transaction, each group member is expected to earn income that is commensurate with the functions it performs in relation to the transaction taking into account assets used and risks assumed.

1.3 Factors influencing controlled transactions

- In the open market, the prices of goods and services are ordinarily determined by market forces. Thus, when independent enterprises deal with each other, market forces determine the conditions of their commercial and financial relations (e.g. the price of goods transferred or services provided and the conditions of such a transfer or provision). By contrast, when associated enterprises deal with each other, external market forces may not directly affect their commercial and financial relations in the same way due to the existence of other factors.
- This is the reason why the definition of associated enterprises in Article 1 of the Law emphasizes the fact that the associated person is related to a taxpayer in a way that affects the determination of the tax base. This may be either in situations where such transactions occur between persons where one person participates directly or indirectly in the management, control or capital of an enterprise, or in situations where the same persons participate directly or indirectly in the management, control or capital of two or more enterprises. Article 1 of the Law further provides examples of situations, which are automatically presumed to be transactions between associated persons. Such situations may however also include other fact patterns and in determining whether the transactions take place between associated persons, the participation in the management, control or capital will be taken into consideration as well as other facts and circumstances that could lead to outcomes that the transactions are not carried out in accordance with arm's length principle.

- 
- Two types of factors could be responsible for that:

a. Factors underlying tax considerations

When associated enterprises set non-arm's length prices for their controlled transactions with the intention of manipulating their profits in order to avoid or minimize their tax burden.

b. Factors underlying non-tax considerations

When associated enterprises set non-arm's length prices for their controlled transactions with no intention to avoid or to minimize their tax burden.

Non-tax considerations may include the following:

- Difficulty of determining an arm's length price in the absence of market forces;
- Commercial strategy adopted by associated enterprises (e.g. in the case of introducing a product into a new market, the enterprise may temporarily charge a price lower than the normal market price in order to create a market for that product);
- Restrictions imposed by some countries on profit repatriation or capital transfer;
- Customs valuations and anti-dumping duties; and
- Fluctuations in foreign exchange rates.

Although all of the above-mentioned factors are based on non-tax considerations, they may affect transfer prices and the amount of profits attributable to associated enterprises within a GAE.

1.4 What is the arm's length principle?

Arm's length according to the Law

According to Article (1) of the Law:

"The arm's length price is the price upon which two or more independent enterprises deal, and it is determined according to market forces and transaction conditions."

Arm's length according to the OECD Transfer Pricing Guidelines

The international standard that the OECD member countries have agreed should be used for determining transfer prices for tax purposes is set forth in Article 9 of the OECD Model Tax Convention as follows:

"Where conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

- **In other words, the arm's length principle sets the conditions for commercial and financial relations between independent enterprises as the benchmark against which the conditions of commercial and financial relations between associated enterprises are to be evaluated; given that the product, the transaction and the surrounding circumstances are comparable in both cases.**
- Thus, a comparability analysis should be conducted by associated enterprises to ensure that the conditions of their commercial and financial relations are set according to the arm's length principle.

(Chapter Three of Part One of these Guidelines includes a detailed explanation of the comparability analysis).

1.4.1 Reasons for adopting the arm's length principle

Egypt has adopted the arm's length principle for two main reasons:

- 1) The arm's length principle is considered the most reliable way to determine properly the amount of tax base attributable to an Egyptian enterprise's operations in controlled transactions; and
- 2) Applying the arm's length principle minimizes the potential for double taxation as it represents the international norm.

Example (1) - for illustrative purposes only

- Franco is a multinational parent company resident in France.
- The company owns 55% of the outstanding common stock of its Egyptian subsidiary "Egypco", and 51% of the outstanding common stock of its Greek subsidiary "Greeco".
- Egypco manufactures product (x) and sells the finished product to Greeco.
- Egypco produces the product at an average cost of EGP 30.00 per unit.
- Greeco sells the finished product for EGP 50.00 per unit.

➡ According to the Law, Egypco and Greeco are associated enterprises.

Assume the following case scenarios:

- **First case scenario:**
Egypco sells the product to Greeco for EGP 30 per unit.
- **Second case scenario:**
Egypco sells the product to Greeco for EGP 50 per unit.
- **Third case scenario:**
Egypco sells the product to Greeco for EGP 40 per unit.

An analysis of how the income and expenses per unit are allocated between the two subsidiaries follows:

Table (1.1): Analysis of the Allocation of Income and Expenses between Eypco and Greco

Numbers in EGP

Scenario #	Egypt's Subsidiary Eypco			Greece's Subsidiary Greco			Combined Gross Profit
	Manufacturing Costs	Selling Price	Gross Profit	Costs of Goods Solds	Selling Price	Gross Profit	
1	30	30	0	30	50	20	20
2	30	50	20	50	50	0	20
3	30	40	10	40	50	10	20

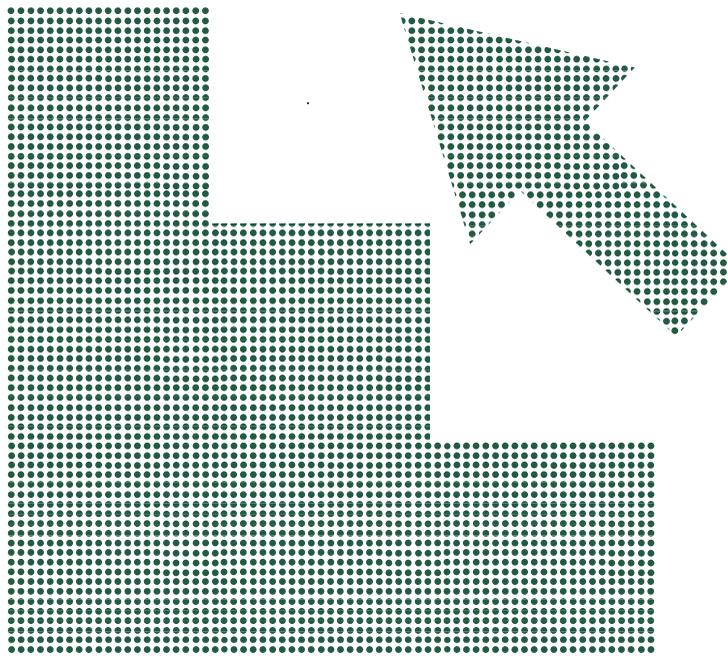
- Based on this analysis, it is obvious that under each scenario the combined profit is EGP 20 per unit. This means that none of the transfer price changes in any of the scenarios has affected the overall profitability of the GAE. However, such changes have dramatically affected the allocation of profits between the two subsidiaries.
 - In the first case scenario, 100% of the combined profit is received by Greco, and Eypco received none of the profit, resulting in zero income tax liability due on Egypt's operations.
 - In the second case scenario, 100% of the combined profit is received by Eypco (EGP 20), whereas Greco has not received any of the profits. This means that the total profits realized in this case is attributed to Egypt's operations and is to be taxed in Egypt.
 - In the third case scenario, 50% of the combined profit is received by Eypco. Hence, (EGP 10) is to be taxed in Egypt as it represents the income attributable to Egypt's operations.

▪ **Based on the previous analysis, applying the arm's length principle is the basic step to be followed, in order to determine whether the amount of income attributable to Egypt's operations is correct and consistent with the Egyptian subsidiary's relative economic contribution to the controlled transaction. This, in turn, ensures that the Egyptian Treasury receives the appropriate share of taxes.**

At this point, the following question is to be raised:

How should a taxpayer practically apply the arm's length principle in pricing its controlled transactions?

(The answer to this question is provided in the next four chapters of Part One).



Chapter Two

Practical Application of the Arm's Length Principle

2.1 Scope of Chapter

2.2 Introduction

2.3 The four-step approach

2.3.1 Step 1: Identifying the controlled transactions and understanding the nature of such transactions

2.3.2 Step 2: Selecting the most appropriate pricing method(s)

2.3.3 Step 3: Applying the selected pricing method(s)

2.3.4 Step 4: Determining the arm's length amount and introducing a review process to reflect any future changes

Summary of Chapter 2

2.1 Scope of Chapter

This chapter provides taxpayers with guidance on how to practically apply the arm's length principle in pricing their controlled transactions.

2.2 Introduction

- The previous chapter introduced a detailed explanation of the definition of the arm's length principle, the importance of applying such a principle by associated enterprises, and the consequences of violating it at tax jurisdiction level.
- Thus, ETA realizes the importance of providing taxpayers with guidance on how to apply the arm's length principle.
- This chapter provides a four-step approach through which taxpayers are advised to develop the reasoning and documentation needed to support the evaluation of their transfer prices.
- **In light of the OECD's updated guidance on transfer pricing documentation and the introduction of CbCR, which are also endorsed by these updated Guidelines, these Guidelines provide practical guidance on how taxpayers should tailor the preparation of their transfer pricing documentation to be in-line with the OECD's updated documentation requirements while maintaining the Egyptian four-step approach to transfer pricing documentation.**

2.3 The four-step approach

Taxpayers are advised to follow the four-step process described below, in order to price their controlled transactions according to the arm's length principle:

- 2.3.1 Identifying any controlled transactions and understanding the nature of such transactions;
- 2.3.2 Selecting the most appropriate pricing method(s);
- 2.3.3 Applying the selected pricing method(s);
- 2.3.4 Determining the arm's length amount and introducing a review process to reflect any future changes.

The following is a further elaboration on each of the four steps:

2.3.1 Step 1: Identifying the controlled transactions and understanding the nature of such transactions

The first step that should be taken by taxpayers is to identify their transactions with associated enterprises and understand the nature of these transactions by identifying and analyzing the following elements:

- a. **Scope of the controlled transaction**, which represents the range of activities covered by such a transaction, along with the characteristics of these activities;
- b. **Type of the controlled transaction**, which represents the components of that transaction; such as tangible and intangible property, services, interests, insurance, loans (both interest bearing and interest free);
- c. **Timing** represented by the date and frequency of the transactions;

- d. **Expected costs and benefits** of the transaction to the taxpayer and the associated enterprises;
- e. **Contractual terms of the transaction taking** into consideration that if there is any difference between the contractual terms and the actual conduct of the parties to the transaction, the nature of the transaction is to be analyzed based on the actual conduct;
- f. **Parties to the transaction** and the nature of their relationship to the taxpayer;
- g. **Organizational structure** of the taxpayer and that of the GAE as a whole;
- h. **Business objectives**, policies, plans and strategies adopted by the taxpayer along with its financial performance;
- i. **Nature of the industry and the market** within which the taxpayer carries out their business. For instance, the location, size, stability, competition, economic power of suppliers and customers, flexibility to enter and exit the market, taxpayers' market share, government policies, exchange rates, etc.

In addition, a preliminary functional analysis should be conducted by the taxpayer in order to identify:

- a. **Functions performed** by each of the parties to the controlled transaction, as well as the economic significance of each of these functions;
- b. **Risks assumed** by each of the parties; and
- c. **Assets used** by each of the parties.

Conducting the functional analysis will allow the taxpayer to:

- a. Determine its **economic contribution** within the GAE;
 - b. Identify the most **economically significant functions** carried out, and how performing such functions should be reflected in the price or profit;
 - c. Measure the availability of potential **comparable uncontrolled transactions** conducted either by the taxpayer itself or by independent enterprises.
- It should be noted that the functional analysis conducted in this step is not a comprehensive one. At this stage, conducting the analysis merely determines the selection of the tested party and most appropriate transfer pricing method. A more detailed analysis will be conducted in the third step of this process.

(Functional analysis is discussed in detail as part of the comparability analysis in chapter three of Part One of these Guidelines).

2.3.2 Step 2: Selecting the most appropriate Pricing Method(s)

- Throughout this step, the taxpayer should select one or more transfer pricing method in order to establish arm's length prices for its controlled transactions. The selection of a transfer pricing method always aims at **“finding the most appropriatemethod”** for a particular case. For this purpose, the selection process should take account:
 - Respective strengths and weaknesses of the recognised method(s);
 - The appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis;
 - The availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods; and
 - The degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them.

- Since different transfer pricing methods require that different basic data must be obtained for their successful application, taxpayers should be aware that evaluating the amount and the reliability of data available on the comparable uncontrolled transactions is a critical issue at this stage. The identification of potential comparables has to be made with the objective of finding reasonably reliable data recognizing that they will not always be perfect. For instance, uncontrolled transactions may be scarce in certain markets and industries. A pragmatic solution may need to be found, on a case by case basis, such as broadening the search and using information on uncontrolled transactions taking place in the same industry and a comparable geographical market, but performed by third parties that may have different business strategies, business models or other slightly different economic circumstances; information on uncontrolled transactions taking place in the same industry but in other geographical markets; or information on uncontrolled transactions taking place in the same geographical market but in other industries. The choice among these various options will depend on the facts and circumstances of the case, particularly on the significance of the expected effects of comparability defects on the reliability of the analysis.
- Thus, for the purpose of selecting an appropriate pricing method, taxpayers should not only use the information obtained throughout the previous step but also collect the data needed in selecting such a method.

(Transfer Pricing Methods are explained in chapter four of Part One of these Guidelines).

2.3.3 Step 3: Applying the selected pricing method(s)

- Taxpayers should extend the functional analysis conducted in the first step to a detailed comparability analysis. Thus, at this stage, broader comparisons are expected to be drawn, and more factors determining the comparability of the selected comparable uncontrolled transaction and the controlled transaction under review are to be considered in such an analysis.

(Comparability Analysis is explained in chapter three of Part One of these guidelines).

- As a result, any material differences between the controlled transaction and the selected comparable uncontrolled transaction should be identified through this step, and hence any required adjustments that need to be made. This, in turn, is likely to result in a reasonably reliable pricing outcome.
- In order to improve the degree of reliability of the pricing outcome, taxpayers should use, where appropriate, group or aggregate data, apply more than one method, if use of a single method is not conclusive, extend the analysis over a number of years, etc.

2.3.4 Step 4: Determining the arm's length amount and introducing a review process to reflect any future changes

- Since the business environment is very dynamic, taxpayers should not use the method applied in the previous step on a permanent basis without regularly monitoring the validity of both the method and the data used in the above shown pricing steps.
- Thus, taxpayers should monitor the changes occurring (if any) regularly and evaluate the impact of such changes on their transactions and on the selected comparable transactions used in the previous steps.
- Where such changes have a material impact on the reliability of data or the validity of the method applied, taxpayers should make any necessary adjustments.
- **Additionally, taxpayers should prepare and maintain documents that outline all the actions described above “for at least five years”, in accordance with Article (91) of the Law.**

Summary of Chapter 2

Taxpayers are advised to adopt the following four-step approach in pricing their controlled transactions:

1. Step 1: Identifying the controlled transactions and understanding the nature of such transactions

Through analyzing different elements related to these transactions (e.g. the scope, parties, type, timing, contractual terms, organizational structure, market conditions) and conducting a functional analysis.

2. Step 2: Selecting the most appropriate pricing method(s)

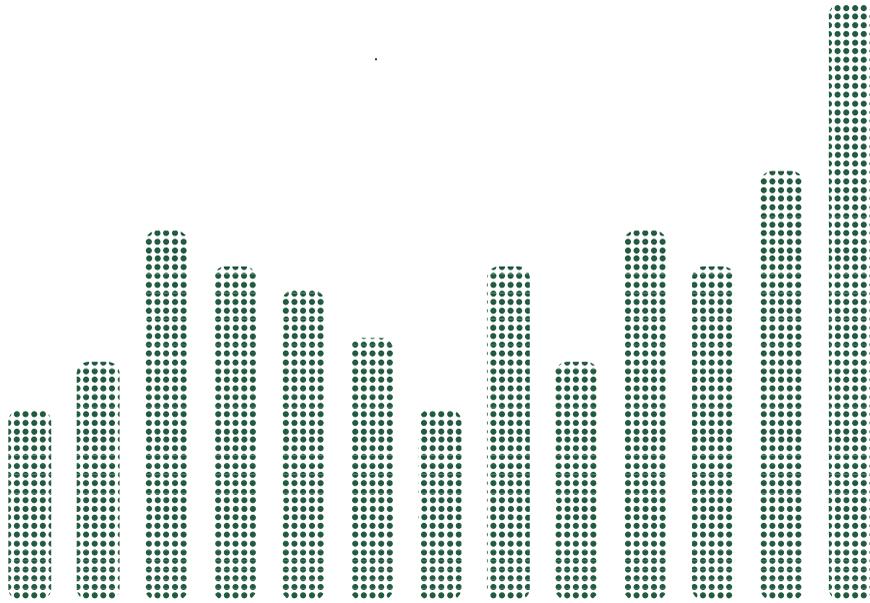
Taking into account the fact that different transfer pricing methods require different basic data to be created or obtained for their successful application, taxpayers should evaluate the amount and the reliability of data available on the comparable uncontrolled transactions throughout this step, in order to select the most appropriate pricing method.

3. Step 3: Applying the selected pricing method(s)

This step includes conducting a more detailed comparability analysis.

4. Step 4: Determining the arm's length amount and introducing a review process to reflect any future changes

This step includes monitoring the changes and evaluating the impact of such changes on both the controlled transactions and the selected comparable uncontrolled transactions. Where such changes have a material impact on the reliability of data or the validity of the method applied, taxpayers should make any necessary adjustments.



Chapter Three

Comparability Analysis

- 3.1 Scope of Chapter
- 3.2 Introduction
- 3.3 Comparability Analysis according to the OECD Transfer Pricing Guidelines
 - 3.3.1 Definition
 - 3.3.2 Importance of Comparability Analysis
 - 3.3.3 Factors determining comparability
 - 3.3.3.1 Characteristics of property or services
 - 3.3.3.2 Functional Analysis
 - 3.3.3.3 Contractual Terms
 - 3.3.3.4 Economic Circumstances
 - 3.3.3.5 Business Strategies
 - 3.3.3.6 Government Policies

Summary of Chapter 3

3.1 Scope of Chapter

This chapter provides a detailed discussion of the comparability analysis along with an explanation of each of the factors determining comparability.

3.2 Introduction

- The role of the comparability analysis has been highlighted throughout **Chapter Two** as a fundamental tool used in applying the arm's length principle to controlled transactions.
- The **first and the third steps** of the **four-step** approach presented in **Chapter Two** requires taxpayers to conduct a comparability analysis as one of the critical measures through which they can appropriately select comparable uncontrolled transactions and thus be capable of establishing reliable arm's length prices for their controlled transactions.
- Therefore, the main aim of this chapter is to provide taxpayers with more practical details on the significance of the comparability analysis, how and which factors to be considered to conduct such an analysis.

3.3 Comparability Analysis according to the OECD Transfer Pricing Guidelines

3.3.1 Definition

The OECD Transfer Pricing Guidelines define the comparability analysis as follows:

"A comparability analysis is a comparison of a controlled transaction with an uncontrolled transaction or transactions. Controlled and uncontrolled transactions are comparable if none of the differences between the transactions could materially affect the factor being examined in the methodology (e.g. price or profit margin), or if reasonably accurate adjustments can be made to eliminate the material effects of any such differences".

3.3.2 Importance of Comparability Analysis

- The principle of comparability is fundamental in the determination of arm's length transfer prices. This is due to the fact that the price or profit of an uncontrolled transaction is used as a benchmark against which the price or profit of a controlled transaction is to be evaluated. Thus, the reliability of the comparison conducted between controlled and uncontrolled transactions depends heavily on the degree of similarity between controlled and uncontrolled transactions particularly in regards to the characteristics of the property or services transferred and the functions performed in each of the transactions taking account of the assets used and risks assumed.

3.3.3 Factors determining comparability

- The OECD Transfer Pricing Guidelines describe the following factors as the major factors determining comparability:
 - 3.3.3.1 Characteristics of property or services;
 - 3.3.3.2 Functional Analysis;
 - 3.3.3.3 Contractual Terms;
 - 3.3.3.4 Economic Circumstances;
 - 3.3.3.5 Business Strategies; and
 - 3.3.3.6 Government Policies

3.3.3.1 Characteristics of property or services

- In the open market, different characteristics of goods or services are usually reflected in their values.
- For example, a product with better quality and more features would ordinarily be sold at a higher price.
- Thus, in order to determine the comparability of two transactions, taxpayers should conduct comparisons between the features of property or services transferred in both controlled transaction and uncontrolled transactions.
- **In general, similarity in the characteristics of the property or services transferred will matter most when comparing prices of controlled and uncontrolled transactions, and less when comparing profit margins of such transactions.**
- According to the OECD Transfer Pricing Guidelines, the most important characteristics to be examined in analyzing this factor include, but are not limited to, the following:
 - a. In the case of transfers of tangible property:
 - Physical features of the property;
 - Property quality and reliability; and
 - Property availability and volume of supply.
 - b. In the case of provision of services:
 - The nature and extent of the services.
 - c. In the case of intangible property:
 - Form of transaction (e.g. licensing or sale);
 - Type of intangible (patent, trademark, or know-how);
 - Duration and degree of protection; and
 - Anticipated benefits from the use of the property.

3.3.3.2 Functional Analysis

Functional analysis represents one of the most important factors in determining the comparability of transactions and enterprises as illustrated by the following example:

Example (2) - for illustrative purposes only

- Egypco is a multinational parent manufacturing company resident in Egypt.
- Egypco owns and uses itself all patents and trademarks. It manufactures product X and sells the finished product as follows:
 - Egypco sells 50% of the production volume of product X with warranty to Jorco; which is Egypco's subsidiary in Jordan. **(A controlled transaction)**
 - The other 50% of the production volume of product X is sold **without warranty** to Jordist, which is an independent distribution company in Jordan. **(An uncontrolled transaction)**
- Then, both Jordist and Jorco sell product X to different independent retailers in Jordan, with a warranty in all cases.

- While Egypco provides Jorco with marketing brochures of product X free of cost, Jordist prepares its own brochures and pays for the related costs. Assume for the purposes of this example that marketing is an economically significant function.
- In an attempt to set an arm's length price for its controlled transaction with Jorco, Egypco decided to select its uncontrolled transaction with Jordist as a comparable uncontrolled transaction (internal comparable) especially as the same product (Product X) is transferred in both transactions.
- The question that arises in this case is:

Is the above mentioned uncontrolled transaction between Egypco and Jordist comparable to the controlled transaction between Egypco and Jorco?

- The following table, which identifies the main functions performed, assets used, and risks assumed by each of the parties to the transactions will assist in answering this question:

a. Functions performed by the parties in each of the transactions

Table (3.1): Analysis of the Functions Performed by the parties to each of the transactions

Functions performed	Controlled transaction	Uncontrolled transaction
Manufacturing	Egypco	Egypco
Marketing	Egypco	Jordist
Selling & distribution	Jorco	Jordist

Table (3.1) highlights the differences in the functions performed between the controlled and uncontrolled transactions. In the controlled transaction, Egypco performs the marketing function while in the uncontrolled transaction Jordist performs this function. In other words, Egypco performs economically more significant functions in the controlled transaction as compared to the uncontrolled transaction.

There are no differences in regard to the manufacturing, and selling & distribution functions between the controlled and uncontrolled transactions.

b. Assets used by the parties in each of the transactions

Table (3.2): Analysis of the Assets Used by the Parties to each of the Transactions

Assets used	Controlled transaction	Uncontrolled transaction
Plant and equipment	Egypco	Egypco
Patent and trademarks	Egypco	Egypco

Table (3.2) shows that there are no differences in regard to the assets used between the controlled and uncontrolled transactions.

c. Risks assumed by parties in each of the transactions

Table (3.3): Analysis of the Risks Assumed by the Parties to each of the Transactions

Risks assumed	Controlled transaction	Uncontrolled transaction
Manufacturing	Egypco	Egypco
Marketing	Egypco	Jordist
Warranty	Egypco	Jordist

Table (3.3) highlights the differences in the risks assumed between the controlled and uncontrolled transactions. In the controlled transaction, Egypco assumes the marketing and warranty risks while in the uncontrolled transaction, Jordist assumes those risks. In other words, Egypco assumes more significant risks in the controlled transaction as compared to the uncontrolled transaction.

(There is no difference in regard to the attribution of the manufacturing risk between the controlled and uncontrolled transactions).

- According to economic theory, there is a direct relationship between the economic significance of the functions performed, risks assumed, and assets employed by an enterprise in a particular transaction and the return such an enterprise expects to earn on that transaction.
- Therefore, Egypco should expect to earn a higher return on its controlled transaction than the return it expects to earn on its uncontrolled transaction (and therefore charge a higher price for the product to Jorco)
- **This means that transferring products with similar characteristics, or even the same products, in two different transactions is not a sufficient factor on its own for considering the two transactions as being comparable.**
- Where there are differences in the characteristics of the property or services; the functions performed, the assets used and risks assumed; or in the contractual terms; economic circumstances or business strategies, appropriate comparability adjustments need to be made, particularly if more appropriate comparables cannot be found. In the example above there are economically significant differences in the functions performed and risks assumed between the controlled and the uncontrolled transactions. It may be possible to determine the remuneration for the additional functions performed and risks assumed by Egypco in the controlled transaction and thus calculate appropriate comparability adjustments in a reliable manner. Even if there remain some differences between controlled and uncontrolled transactions after making appropriate comparability adjustments, a judgement needs to be made as to whether the uncontrolled transactions constitute reasonably reliable comparables bearing in mind that perfect comparables are scarce.

- Thus, another comparability factor to be considered in determining the comparability of transactions and enterprises is the **“Functional Analysis”**.

Definition of Functional Analysis

According to the OECD Transfer Pricing Guidelines

“Functional analysis is an analysis of the functions performed (taking into account assets used and risks assumed) by associated enterprises in controlled transactions and by independent enterprises in comparable uncontrolled transactions.”

- Based on this definition, it is obvious that the functional analysis is a highly significant comparability tool that focuses on three main aspects in any transaction:

- a. Functions or activities performed by each party to a transaction and the economic significance of such functions;
- b. Assets (both tangible and intangible) employed by each party to that transaction; and
- c. Risks borne by each party to that transaction.

a. Functions performed

- Conducting the functional analysis enables an associated enterprise to:
 1. Identify the economic significance of the functions it performs in a transaction taking into account assets used and risks assumed, as well as the relative importance of such functions in relation to the overall operation of the GAE. This, in turn, enables the enterprise to determine how it should be compensated for such functions; and
 2. Judge the validity of the uncontrolled transaction to be used as a comparable against which a controlled transaction could be benchmarked, so that the enterprise can set an arm's length price for that controlled transaction.
 - **An enterprise, which carries out a larger number of functions in a particular transaction, will not necessarily receive a greater share of the profit earned on that transaction. This is due to the fact that, the other party to that transaction may be performing the more economically significant functions, and/ or making unique and valuable contributions and hence should be rewarded the greater part of profit earned. Accordingly, it is the economic significance of the functions performed that matters, rather than the number or the scope of functions.**
 - For example, if a parent company provides its subsidiary with the manufacturing know-how and valuable patents, while the subsidiary carries out the basic manufacturing activities only, then the parent company should typically expect the largest part of profit earned as it performs the most significant value adding functions by contributing such unique and valuable intangible assets.
- ➡ This leads us to the most critical part of the functional analysis, which is identifying the economically significant value adding activities (the main functions performed, assets used and risks assumed) and how these activities affect the arm's length price or profit margin of a particular controlled transaction. This may be done through what is called "indicators of economic significance".

Indicators of Economic Significance

- Taxpayers may use a number of indicators, in order to determine whether the functions performed in a particular transaction are considered to be of high economic significance. These indicators are expected to reveal whether or not the functions performed are:
 1. Representing a significant portion of operating costs;
 2. Subject to a distinctive set of cost drivers (e.g. human resources skills, technology, product/process design, quality management, etc.);
 3. Performed by competitors in different ways; or
 4. Important in differentiating one competitor from another.

Importance of specific classification of the functions performed

- While conducting the functional analysis, taxpayers should bear in mind:
 - Although the functions performed by any enterprise are classified into broad categories such as:
 1. Design;
 2. Manufacturing;
 3. Assembling;
 4. Research and Development;
 5. Servicing;

6. Purchasing;
7. Distribution;
8. Marketing;
9. Advertising;
10. Transportation;
11. Financing; and
12. Management.

- Such a classification may be of limited use in conducting the functional analysis. This is due to the fact that many activities within these broad categories may be performed by associated enterprises. Therefore, taxpayers should take into consideration a more specific classification of the functions performed in order to guarantee selecting highly comparable transactions.
 - For example, manufacturing activity may include developing products; developing know-how; manufacturing raw materials and finished goods; developing quality control standards, etc. Similarly, the marketing activity includes developing promotional and training materials; training personnel; developing marketing plans; planning TV commercials and trade shows, etc.
 - Thus, if a member of a GAE is responsible for developing the marketing plans while another member of the GAE is responsible for developing the promotional brochures, then, although both of the GAE members conduct marketing functions, each of the members is expected to be rewarded differently. This is due to the difference in the nature of each of the functions they perform as well as the difference in the economic significance of each of these functions.
 - Another example is where an associated enterprise takes on responsibility for developing the know-how in a particular controlled transaction and selects an uncontrolled transaction as a comparable in which the independent enterprise is responsible for manufacturing the finished goods. Although each of these functions is classified as a part of the broad manufacturing category, the uncontrolled transaction would not be expected to produce a reliable comparable uncontrolled price for the controlled transaction. This is due to the substantial difference in the nature and the economic significance of both functions performed in the two transactions. Such a difference can materially affect the reliability of the pricing outcome unless reasonably reliable comparability adjustments can be made.
- **At this point, it should be noted that analyzing the functions performed by each of the parties to a transaction entails determining which assets are contributed by each party and how risks are allocated between those parties.**

b. Assets used

- While identifying and analyzing the functions performed in a particular transaction, taxpayers should also identify the assets employed, or to be employed, in that transaction. This analysis should consider:
 1. Type of assets used such as plant, property and equipment, the use of valuable intangibles, etc.
 2. Nature of assets used such as age, market value, location, property right protections available, etc.
- If intangible assets are contributed to a particular transaction, the taxpayer should identify the nature of such assets along with the effect of using them on the value chain. This, in turn, will assist the taxpayer in determining the expected amount of profit attributed to the usage of that intangible.
- Such an analysis of the assets used (both tangibles and intangibles) also assists taxpayers in understanding the role of such assets in the profit making process, and hence enables them to select appropriate comparable uncontrolled transactions in which either similar assets are employed or accurate adjustments could be made to account for material differences (if any).

c. Risks assumed

- **"The higher the risk, the higher the expected return"**. This is well-known economic theory which should be considered by taxpayers in conducting their functional analyses.
- This rule implies that, in the open market, if two independent enterprises assume different levels of risk in a particular transaction, the one which assumes a higher risk should expect to earn a greater portion of the profit earned on that transaction even though the actual profit may be lower.

Example (3) - for illustrative purposes only

- Recalling Example (2), in which Egypco sells product X to Jordist with no warranty and sells the same product to Jorco with warranty. In such a case, Jordist assumes a higher risk (the warranty risk) than Jorco does, and hence would be entitled to a higher expected return that is commensurate with such risk.

- Thus, in order to select a proper comparable uncontrolled transaction against which a controlled transaction is to be benchmarked, a taxpayer should analyze the significant risks assumed in both the controlled and the uncontrolled transactions as well as make reasonably reliable comparability adjustments to account for material differences (if any). If there are material differences in the risks assumed in the two transactions where appropriate adjustments for such differences cannot be made, such transactions are not comparable.
- The following is a sample of the types of risks which might be assumed by an enterprise in a particular transaction and may be considered in conducting a functional analysis depending on the type of transaction. It should be noted that this list is not exhaustive.
 - 1) Market risks such as input cost and output price fluctuations;
 - 2) Inventory risks;
 - 3) Risks of the success or failure of investment in research and development;
 - 4) Financial risks such as those caused by currency exchange rate and interest rate variability;
 - 5) Credit risks; etc.

Risks allocation and the economic substance consideration

- While analyzing the risks assumed in a particular transaction, taxpayers should ensure that the purported allocation of such risks is consistent with the economic substance of that transaction.
- For example, if a cross-border transaction takes place between two members of a GAE, and the contractual terms of that transaction provide that the purchaser is the party that assumes the exchange rate risk while the actual conduct between the two members indicates that the purchaser does not actually assume such a risk, instead, the seller does. In such a case, if the seller, as a taxpayer, selects a comparable uncontrolled transaction based on the contractual terms, the selected comparable uncontrolled transaction is likely to be misleading as the seller in such a transaction might not assume the exchange rate risk. This means that an inappropriate transfer pricing outcome is likely to result.
- Additionally, ETA may wish to challenge the purported allocation of exchange rate risk, and hence adjust the transfer price accordingly.
- Subsequently, while conducting the functional analysis for a particular transaction, taxpayers are required to determine whether the purported risks are consistent with the economic substance of that transaction, and if so, to what extent each party to that transaction bears such risks in practice.

- **ETA would expect to find the functional analysis as an essential part of the taxpayer's transfer pricing documentation.**
- In this respect, ETA will apply the new OECD guidance on allocation of risks under the BEPS project, including the six-step process for identifying and analyzing risks in a controlled transaction, as follows.⁽⁸⁾
 - a. Step one:** Identification of economically significant risks with specificity;
 - b. Step two:** Determination of contractual assumption of the specific, economically significant risks assumed by the associated enterprises;
 - c. Step three:** Functional analysis to determine the capacity (ex: risk/control mitigation, financial capacity) in which the associated enterprises that are parties to the controlled transaction operate in respect to the assumption and management of the specific, economically significant risks;
 - d. Step four:** Interpreting the above steps to determine whether the contractual assumption of the economically significant risks is consistent with the conduct of the associated enterprises;
 - e. Step five:** Re-allocation of risks where inconsistencies are identified, i.e. when the associated enterprise assuming the risks under steps one to four does not control/have the financial capacity to assume the risk; and
 - f. Step six:** Pricing of the controlled transaction taking into account the risk allocation (financial and other consequences of risk assumption) and appropriately compensating risk management functions.

3.3.3.3 Contractual Terms

- Considering the "contractual terms" as one of the factors determining comparability reflects their critical influence on the price/ margin of a transaction.
- This influence is derived from the role the contractual terms play in defining, explicitly or implicitly, how the responsibilities, risks, and benefits are to be divided between the parties in a particular transaction.
- Contractual terms include but are not limited to:
 - a. Sales or purchase volume;
 - b. Contract duration;
 - c. Delivery terms;
 - d. Credit and payment terms;
 - e. Terms governing the provision of warranties;
 - f. Terms governing the rights to updates, or modifications;
 - g. Where a transaction has been formalised by the parties through written contractual agreements those agreements provide the starting point for delineating the transaction.
 - h. Terms governing collateral transactions or ongoing business relationships between the buyer and the seller, including arrangements for the provision of ancillary or subsidiary services;
 - i. Terms allocating the different risks, such as the exchange rate risk, inventory risk, etc.
- Thus, contractual terms should be analyzed and included as part of the functional and comparability analyses discussed above.
- While analyzing the contractual terms of a particular transaction, taxpayers should take the following into consideration:

⁸See the OECD Transfer Pricing Guidelines.

- a. The terms of a transaction could be found in written forms other than a contract, such as correspondence between the transaction parties. In such cases, certain alternative documents that reflect the actual transaction conduct should be considered such as sales and purchase volumes, and corresponding prices at the time when the transaction occurred.
- b. In some cases, the terms of the transaction do not take a written form. In such a case, the contractual relationships of the transacting parties must be deduced from:
 - The way the transacting parties actually conduct the transaction, and
 - The economic principles that normally control the contractual relationships between independent enterprises.
- c. In transactions between independent enterprises, the divergence of interests between the parties ensures that:
 - Contractual terms are concluded that reflect the interests of both of the parties;
 - The parties will ordinarily seek to hold each other to the terms of the contract; and
 - Contractual terms will be generally ignored or modified only if it is in the interests of both parties.

However, the same divergence of interests may not exist in the case of associated enterprises or any such divergences may be managed in ways facilitated by the control relationship and not solely or mainly through contractual agreements. It is, therefore, particularly important in considering the commercial or financial relations between associated enterprises to examine whether the arrangements reflected in the actual conduct of the parties substantially conform to the terms of any written contract, or whether the associated enterprises' actual conduct indicates that the contractual terms have not been followed, do not reflect a complete picture of the transactions, have been incorrectly characterized or labelled by the enterprises, or are a sham.

- d. Where conduct is not fully consistent with economically significant contractual terms, further analysis is required to identify the actual conduct of the transaction. Where there are material differences between contractual terms and the conduct of the associated enterprises in their relations with one another, the functions they actually perform, the assets they actually use, and the risks they actually assume, considered in the context of the contractual terms, should ultimately determine the factual substance and accurately delineate the actual transaction.
- Thus, contractual terms and actual conduct by the parties affect the comparability of the controlled and uncontrolled transactions, and hence are to be considered by taxpayers in selecting reliable benchmark comparable uncontrolled transactions.

3.3.3.4 Economic Circumstances

- Taxpayers should be aware of the effect that market/economic circumstances have on the comparability of two transactions.
- Different economic circumstances in different markets may drive arm's length prices to vary from one market to another, even for transactions involving the same property or services.
- Thus, in selecting a comparable uncontrolled transaction, an associated enterprise should ensure that:
 - a. The market in which the associated enterprise operates is comparable to the market in which the selected comparable independent enterprise operates; and
 - b. Market differences do not have a significant effect on price; otherwise, appropriate adjustments should be made.

- The following economic factors are recommended by the OECD Transfer Pricing Guidelines to be considered in measuring market comparability:
 - a. Geographic location;
 - b. Size of the markets;
 - c. Extent of competition in the markets and the relative competitive positions of the buyers and sellers;
 - d. Availability of substitute goods and services;
 - e. Levels of supply and demand in the market as a whole and in particular regions, if relevant;
 - f. Consumer purchasing power;
 - g. Nature and extent of government regulation of the market;
 - h. Costs of production, including the costs of land, labor, and capital;
 - i. Transport costs;
 - j. Level of the market (e.g. retail or wholesale);
 - k. Date and time of transactions;
 - l. Business, economic and product cycles; etc.

3.3.3.5 Business Strategies

- In the business environment, each enterprise strives not only to survive but also to expand and grow. As a result, different enterprises adopt different business strategies in order to achieve their goals.
- Thus, business strategies take into consideration different factors affecting business conduct in any enterprise, such as:
 - a. Innovation and new product development;
 - b. Degree of diversification;
 - c. Risk aversion;
 - d. Market penetration and market share;
 - e. Distribution channels selection;
 - f. Pricing;
 - g. Assessment of political changes;
 - h. Input of existing and planned labor laws; and
 - i. Other factors bearing upon the daily conduct of business.
- Accordingly, it is clear that business strategies could have a material effect on the comparability of transactions and enterprises.
- Therefore, while selecting comparable uncontrolled transactions for transfer pricing purposes, taxpayers should consider business strategies as one of the factors determining comparability.
- Taxpayers are advised to identify whether the business strategy was devised by the GAE as a whole, or separately by one member of the group. Moreover, they should identify the role of each of the GAE members in implementing such a business strategy.
- It should be realized that an independent enterprise would not adopt a business strategy that is expected to reduce its profitability for the benefit of another enterprise unless it is appropriately remunerated for it.
- This issue can be illustrated through the discussion of the "market penetration" strategy.

Market penetration

- Where a taxpayer adopts a market penetration strategy in order to enter a new market or increase its market share, such a taxpayer is likely to incur more costs (e.g. due to start-up costs or increased marketing costs) and may temporarily charge lower prices than the prices of the comparable products in the same market.
- Thus, the amount of profit achieved in such cases, during the market penetration phase, tends to be lower than the profit levels achieved by other taxpayers operating in the same market. In this case, the taxpayer sacrifices current profit on anticipation of higher profits on the long-term.
- However, deciding whether the reasonably expected remuneration following this strategy is consistent with the arm's length principle is a critical issue for both the taxpayer and ETA.
- Thus, when taxpayers adopt a business strategy in which they temporarily sacrifice their current profits for higher future profits (a market penetration strategy or any other similar strategy), they are advised to consider whether an independent enterprise under similar conditions would have been willing to sacrifice its current profits for higher future profits for a similar period under similar economic circumstances and competitive conditions.
- Taxpayers should be aware of the fact that, when evaluating a taxpayer's claim of following a business strategy that temporarily decreased profits in return for higher long-term profits, ETA will subject such a claim to particular scrutiny.

■ A sample of the factors that should be considered in this regard includes:

a. *The conduct of all the parties is to be examined to determine whether it is consistent with the professed business strategy.*

- For example, if a manufacturer, for the purpose of a market penetration strategy, charges its associated distributor a lower price, the cost savings to the distributor may be reflected in the price charged to the distributor's customers or in greater market penetration expenses incurred by the distributor.
- Additionally, a market penetration or market share expansion strategy would usually be reflected in intensive marketing and advertising efforts.

b. *The nature of the relationship between the parties to the controlled transaction is to be examined, in order to determine whether such a relationship is consistent with the taxpayer bearing the costs of the business strategy.*

- For example, an independent enterprise acting solely as a sales agent with little or no responsibility for long-term market development would generally not bear the costs of a market penetration strategy.

c. *ETA may also consider whether there is a plausible expectation that the business strategy will produce a return sufficient to justify its costs within a period of time that would be acceptable in an arm's length arrangement.*

- Taxpayers should be aware of the fact that even if a business strategy such as market penetration was unsuccessful, the failure itself would not cause ETA to disregard such a strategy for transfer pricing purposes.
- However, if, at the time of the transaction, the expected outcome was not plausible or if the claimed business strategy is unsuccessful but still followed by the taxpayer beyond what an independent enterprise would accept, in such a case, ETA may consider that the conditions do not accord with the arm's length principle.

3.3.3.6 Government policies

- In some countries, governments may practice some interventions such as price controls; interest rate controls; controls over payments for services or management fees; controls over the payment of royalties; subsidies to particular sectors; exchange control or anti-dumping duties.
- Thus, when a taxpayer is involved in a transaction conducted by or with associated enterprises residents in such countries, a taxpayer might claim that an arm's length price must be adjusted to account for such government interventions.
- According to the OECD Transfer Pricing Guidelines, these government interventions should be treated as conditions of the market in these countries and in the ordinary course they should be taken into account in evaluating the taxpayer's transfer price in that market.
- For example, a country with price controls must take into account that those price controls will affect the profits that can be realized by enterprises selling goods subject to those controls.
- The problem which might arise in this regard is the difficulty of finding a comparable independent enterprise that is subject to similar government interventions.
- Thus, in such a situation, taxpayers are advised to exert each effort to exercise their judgment on what independent enterprises might have done in similar circumstances.

Summary of Chapter 3

This chapter addressed the following key points:

- The comparability analysis is fundamental to the determination of arm's length transfer prices. This is due to the fact that the prices identified or profits earned by independent enterprises in comparable uncontrolled transactions are used to benchmark the prices charged or profits earned by the members of a GAE in controlled transactions.
- It is worth noting that the availability of comparable products or functions between any two transactions is fundamental for a reliable comparability analysis.
- Factors determining comparability:
 - a. **Characteristics of Property or Services:** Specifications of product can significantly affect the comparability of the transactions.
 - b. **Functions Performed:** The functional analysis is an essential tool used by taxpayers in identifying the functions performed, assets used and risks assumed in controlled and uncontrolled transactions.
 - c. **Contractual Terms:** Define how the responsibilities, risks and benefits are divided between the parties to a particular transaction.
 - d. **Economic Circumstances:** Different economic circumstances in different markets may drive arm's length prices to vary from one market to another, even for transactions involving the same property or services.
 - e. **Business Strategies:** Business strategies should be considered in determining comparability for transfer pricing purposes. They take into consideration different factors affecting business conduct in any enterprise, such as market penetration schemes, innovation and new product development, etc.
 - f. **Government Policies:** Comparables might need to be adjusted to account for government interventions. These interventions might include price controls; interest rate controls; subsidies to particular sectors; exchange rate policy, etc.



Chapter Four Pricing Methods

- 4.1 Scope of Chapter
- 4.2 Introduction
- 4.3 Transfer Pricing Methods as defined by the law and the OECD Transfer Pricing Guidelines
 - 4.3.1 The Law
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- Use of Alternative Methods
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Summary of Chapter 4

4.1 Scope of Chapter

This chapter describes and discusses the acceptable pricing methods that taxpayers should use in establishing arm's length transfer prices for their controlled transactions as well as the principles underlying each of these methods.

4.2 Introduction

Recalling that the second and the third steps of the four-step approach were all about guiding taxpayers to select and apply the appropriate pricing method to set arm's length prices for their controlled transactions, this Chapter discusses the acceptable transfer pricing methods under the Law. By the end of this chapter, taxpayers should be aware of highly significant issues, such as the pricing methods available, the characteristics of each method, the factors for determining the most appropriate transfer pricing method to be applied, and which methods are highly recommended to be used in particular cases.

4.3 Transfer Pricing Methods as defined by the law and the OECD Transfer Pricing Guidelines

4.3.1 The Law

- Article no. (30) of the Law stipulates that the pricing methods that are to be used in establishing arm's length prices for the financial and commercial relations between associated enterprises are stated in the Executive Regulations of this Law.
- The amended Articles no. (39) and (40) of the Executive Regulations identify the pricing methods that are to be used, as well as the approach that should be followed by taxpayers when selecting and applying the most appropriate transfer pricing method to determine the arm's length price of a controlled transaction.
- Moreover, the amended Article no. (40) stipulates that where none of the transfer pricing methods endorsed by Article no. (39) could be used, taxpayers could use any other method the taxpayer considers more appropriate to the facts and circumstances of the case to assure that the prices and conditions of controlled transactions are determined in accordance with the arm's length principle as required by Article 30 of the Law.
- Such other methods should however not be used in substitution for the methods specified under Article no. (39), i.e. OECD recognized methods, where the latter are more appropriate to the facts and circumstances of the case. In cases where other methods are used, their selection should be supported by an explanation of why the OECD recognised methods were regarded as less appropriate in the circumstances of the case and the reasons why the selected method was regarded as providing a better solution.

4.3.2 The OECD Transfer Pricing Guidelines

- According to the OECD Transfer Pricing Guidelines, pricing methods are classified into two broad categories:

a) Traditional Transaction Methods:

This category includes:

- (1) CUP method;
- (2) RPM; and
- (3) CPM.

b) Transactional Profit Methods:

This category includes:

- (1) PSM; and
- (2) TNMM

- According to the OECD Transfer Pricing Guidelines:

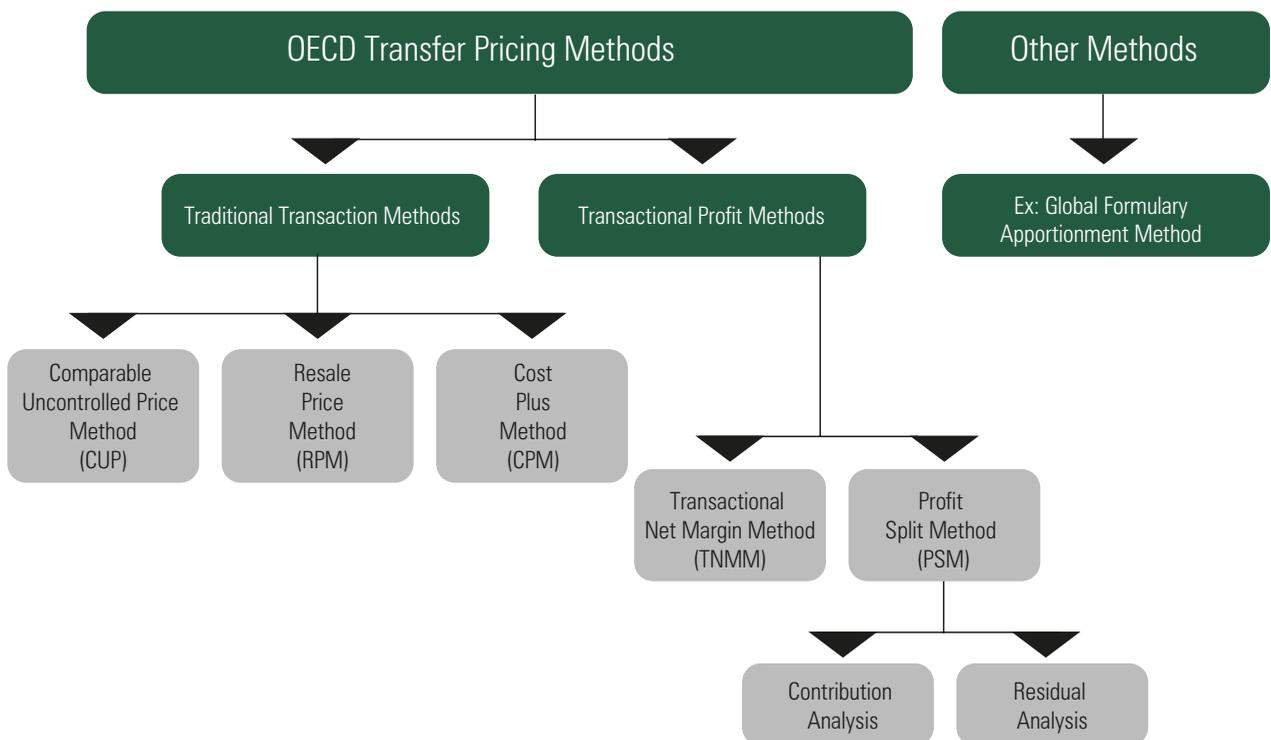
“ The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case.

Where a Traditional Transaction Method and a Transactional Profit Method can be applied in an equally reliable manner, the Traditional Transaction Method is preferable to the Transactional Profit Method; and

Where the Comparable Uncontrolled Price Method (CUP) and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred.”

- The following chart depicts the pricing methods provided by the OECD Transfer Pricing Guidelines:

Figure (I): Transfer Pricing Methods



4.4 Traditional Transaction Methods

Overview

- The most direct way to establish whether the conditions made or imposed between associated enterprises are arm's length is to compare the prices charged for property or services transferred in controlled transactions undertaken between those enterprises with the prices charged in comparable uncontrolled transactions undertaken between independent enterprises.
- This approach is the most direct because any difference in the price of a controlled transaction from the price in a comparable uncontrolled transaction can normally be traced directly to the condition of commercial and financial relations made between the associated enterprises.
- Thus, the arm's length price can be established by directly substituting the price in the comparable uncontrolled transaction for the price of the controlled transaction.
- However, in practice, there will not always be comparable transactions available to allow reliance on this direct approach; therefore, it may be necessary to use other less direct approaches, such as comparing gross margins between controlled and uncontrolled transactions to establish whether the conditions between associated enterprises are arm's length.
- These approaches, direct and indirect, are reflected in the three traditional transaction methods described below.
- The key difference between these three traditional transaction methods in practice is that, while taking all comparability factors into consideration, the CUP method primarily focuses on the comparability of the property or services being transferred, while the RPM and CPM primarily focus on the comparability of the functions being performed taking into account the assets used and risks assumed.
- In other words, the CUP method is concerned with the price of the comparable property or services transferred in comparable circumstances, whereas the RPM and CPM are concerned with the gross profit margins earned in return for the functions performed taking into consideration the assets used and the risks assumed.

➔ In a perfect world, all three methods would separately result in the determination of the same arm's length price. However, in real world the imperfections in comparables or the use of more than one method will lead to a range of arm's length prices.

4.4.1 Comparable Uncontrolled Price Method (CUP)

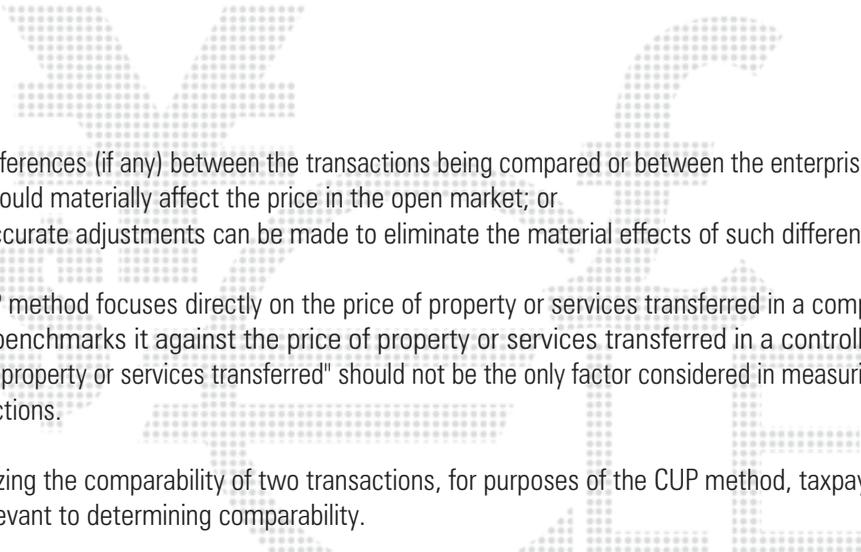
- The OECD Transfer Pricing Guidelines defines the CUP method as follows:

"A transfer pricing method that compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances."

Issues to be considered for the application of the CUP method

Where the CUP method is used to establish arm's length prices for controlled transactions, taxpayers should be aware of the following issues:

- An uncontrolled transaction is comparable to a controlled transaction for purposes of the CUP method if one of the following two conditions is met:

- 
- a. None of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market; or
 - b. Reasonably accurate adjustments can be made to eliminate the material effects of such differences.
- Although the CUP method focuses directly on the price of property or services transferred in a comparable uncontrolled transaction and benchmarks it against the price of property or services transferred in a controlled transaction, the "characteristics of property or services transferred" should not be the only factor considered in measuring the comparability of the two transactions.
 - Thus, while analyzing the comparability of two transactions, for purposes of the CUP method, taxpayers should consider all the factors relevant to determining comparability.

(Factors determining comparability are discussed in Chapter Three of Part One of these Guidelines).

- Under the CUP method, it may be appropriate to select either an internal or an external comparable.
 - a. **Internal Comparable:** where the price of a controlled transaction is determined by the price of the items transferred between one party to the controlled transaction and an independent enterprise in a comparable uncontrolled transaction.
 - b. **External Comparable:** where the price of a controlled transaction is determined by the price of the items transferred between two independent enterprises none of which is party to the controlled transaction, in a comparable uncontrolled transaction.
- While using the CUP method, taxpayers should bear in mind that minor differences in the characteristics of the property transferred in the controlled and uncontrolled transactions could materially affect the price, even though the nature of the business activities undertaken may be sufficiently similar to generate the same overall profit margin.
- Taxpayers should not select the price at which they incidentally sell a particular product to an independent enterprise as a benchmark against which the transfer price of the same product in a controlled transaction is to be evaluated. The only exception is where sales of this product between the the associated enterprises are also incidental.
- Recalling that the CUP method is the most direct and reliable way to apply the arm's length principle, taxpayers should make every effort to adjust the available data, when possible, to achieve comparability and thus be used appropriately in a CUP method.

When is this method recommended to be used?

- The CUP method is the most appropriate method to be used for commodities, raw materials, agricultural products, chemical base products, and financial products.

- The OECD Transfer Pricing Guidelines endorsed new guidance on the Actions 8-10 topic “Aligning Transfer Pricing Outcomes with Value Creation”, particularly, in respect of the use of the CUP method in pricing controlled commodity transactions.⁽⁹⁾

On the basis of the new guidance, the arm’s length price for commodity transactions may be determined using the price of similar uncontrolled commodity transactions, or using comparable uncontrolled arrangements represented by a “quoted price”.

- The reference to “commodities” shall be understood to encompass physical products for which a “quoted price” is used as a reference by independent parties in the industry to set prices in uncontrolled transactions. The term “quoted price” refers to the price of the commodity in the relevant period obtained in an international or domestic commodity exchange market. In this context, a quoted price also includes prices obtained from recognised and transparent price reporting or statistical agencies, or from governmental price-setting agencies, where such indexes are used as a reference by unrelated parties to determine prices in transactions between them.
- A key factor in determining the reliability of using the quoted price for determining the arm’s length price of a controlled commodity transaction is the extent to which the quoted price is commonly used in the ordinary course of business in the industry to agree prices for uncontrolled comparable transactions. Other comparability factors and economically relevant characteristics (including physical features, quality, contractual terms such as timing and terms of delivery, insurance... etc.) should also be considered. Where conditions are found to be different in a manner that materially affect the price of the controlled commodity transaction, reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the controlled and uncontrolled commodity transactions are comparable.
- Finally, the pricing date (i.e. the specific time or date selected by the parties to determine the price for commodity transactions) agreed between the associated enterprises is another key factor which needs to be considered when applying the CUP method to price a controlled commodity transaction. The taxpayer should provide reliable evidence of the pricing date agreed by the associated enterprises in the controlled commodity transaction at the time the transaction was entered into. This may include proposals and acceptances, contracts, or other documents setting out the terms of the arrangements, and should prove that this is consistent with the actual conduct of the parties.
- If ETA determines that the taxpayer has utilized different pricing date that enabled the adoption of the most advantageous quoted prices in the taxpayer’s contracts, or if the pricing date specified in the written agreement between the associated enterprises is inconsistent with the factual pattern of the case, ETA may deem a different pricing date consistent with those other facts of the case and what independent enterprises would have agreed in comparable circumstances.

When are other traditional methods to be used?

- When taxpayers realize that the application of the CUP method is not expected to generate the most reliable measure of an arm's length price for a controlled transaction, taxpayers are advised to consider the use of any other method stipulated under Article (39) of the Executive Regulations.
- Such a situation may arise where:
 - a. The quality of the data available on the uncontrolled transactions is not sufficient enough to use the CUP method;
 - b. It is hard to find an uncontrolled transaction that is sufficiently similar to a controlled transaction in a way that the differences between the two transactions have no material effect on price; or
 - c. It is difficult to determine reasonably accurate adjustments to eliminate the effect of the differences between the controlled and uncontrolled transactions on price.

⁹ See the OECD Transfer Pricing Guidelines.

4.4.2 Resale Price Method

- The OECD Transfer Pricing Guidelines define the **RPM** as follows:

"A transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. custom duties), as an arm's length price of the original transfer of property between the associated enterprises"

- In addition, the OECD Transfer Pricing Guidelines define the "**resale price margin**" as follows:

"A margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit."

- Where an associated enterprise uses the RPM in establishing an arm's length price for one of its controlled transactions, the enterprise should select a comparable uncontrolled transaction in which the resale price margin earned by the reseller could be used as a benchmark to determine a proper resale price margin of the reseller in that controlled transaction, and hence uses such a resale price margin in setting an arm's length price for its controlled transaction.
- As a rule, the RPM begins with the resale price to independent enterprises, of a product purchased from an associated enterprise reduced by a comparable gross margin. This comparable gross margin is determined by reference to either:
 - a. Internal Comparable Transaction:** Where the resale price margin of the reseller in the controlled transaction is determined by the resale price margin realized for these items between one party to the controlled transaction and an independent enterprise in a comparable uncontrolled transaction; or
 - b. External Comparable Transaction:** Where the resale price margin of the reseller in the controlled transaction is determined by the resale price margin realized between two independent enterprises none of which is party to the controlled transaction in a comparable uncontrolled transaction.

The RPM looks at the resale price margin of one of the associated enterprises involved in the controlled transaction. The associated enterprise examined is referred to as the **tested party**. Typically, the RPM is applied to the least complex of the associated enterprises (i.e. the reseller) involved in the controlled transaction. Thus, the tested party usually does not own valuable intangible property.

Issues to be considered for the application of the RPM

Taxpayers that use the RPM in establishing arm's length prices for their controlled transactions should be aware of the following issues:

1. Less product comparability is required under the RPM than under the CUP method

- While product differences have a substantial influence on products prices, such differences may have less influence on the gross profit earned in a transaction, given the RPM depends on the resale price margin, which represents gross profit for specific functions performed, assets used and risks assumed in a particular transaction, rather than an explicit product/service.

2. The comparability of functions performed, assets used and risks assumed must be analyzed

- As a general rule, the gross margin in a controlled transaction is comparable to the gross margin in a comparable uncontrolled transaction when there are no differences between the transactions that could materially affect the factor being examined in the methodology (e.g. price or margin), or if reasonably accurate adjustments can be made to eliminate the material effects of any such differences.

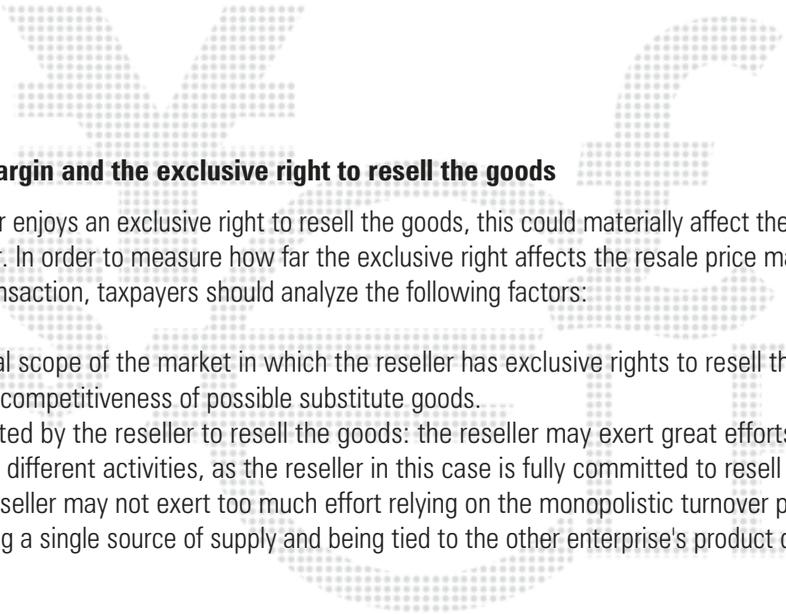
- The nature of the functions performed, assets used and risks assumed in any transaction can substantially affect the amount of gross margin earned in that transaction. Accordingly, taxpayers are advised, for the purposes of using the RPM, to evaluate the comparability of the functions performed, assets used and risks assumed, in both the controlled transaction and the selected comparable uncontrolled transaction. If any material differences are noted, taxpayers should exert every effort to make the necessary adjustments to account for such differences.
- Moreover, the direct relationship between the resale price margin and the level of activity performed by the reseller must be considered. Thus, where an enterprise uses the RPM to set arm's length prices for its controlled transactions, it should be aware of the nature of the relationship between the level of activity performed by the reseller and the amount of the resale price margin earned by this reseller.
- Where the tasks of the reseller are confined to transferring the goods to a third party, then such a reseller performs a limited level of commercial activity and would be expected to earn a relatively small resale price margin. On the other hand, when the reseller carries on other activities in addition to the resale activity (e.g. marketing, advertising, etc.) and bears the risks associated with these activities, then this reseller would expect to receive a higher resale price margin.
- Therefore, for purposes of applying the RPM, taxpayers should proceed with the following steps:
 - a. Select an uncontrolled transaction in which the activities performed, risks assumed and assets used by the reseller are similar to those of the reseller in the controlled transaction; and
 - b. Make any necessary adjustments to account for material differences (if any) in the level of activity carried out by the reseller in the comparable uncontrolled transaction.
- Finally, although the RPM focuses more on the functions performed in the controlled and comparable uncontrolled transactions than on the characteristics of the property or services, the functional analysis should not be the only factor considered in measuring the comparability of the two transactions. Thus, when analyzing the comparability of two transactions, for the purposes of the RPM, taxpayers should consider all comparability factors to determine comparability, to the extent relevant.

3. The lower the value added by the reseller to the product, the easier the application of the RPM

- It is easier to use the RPM where the reseller does not add substantially to the value of the product through further processing (e.g. transforming semi-finished goods into finished ones) or contribute to the creation / maintenance of intangible property associated with the product (e.g. trademarks or trade names, etc.).
- Such activities transform the identity of the products transferred and make it more difficult for an associated enterprise to evaluate the contribution of the original products transferred to the value of the final product.

4. The shorter the time period between the purchase date and the resale date, the more accurate the result is likely to be

- A resale price margin is more accurate when the resale is realized within a short time of the reseller's purchase of the goods. With passage of time, many changes are likely to occur such as market changes; economic changes; exchange rate fluctuations; changes in the level of costs, etc.
- Therefore, while selecting a comparable uncontrolled transaction for the purpose of applying the RPM, an associated enterprise is advised to select a transaction in which the resale price margin was realized by the reseller shortly after the purchase date.



5. Resale price margin and the exclusive right to resell the goods

- Where the reseller enjoys an exclusive right to resell the goods, this could materially affect the resale price margin earned by such a reseller. In order to measure how far the exclusive right affects the resale price margin earned by the reseller in a particular transaction, taxpayers should analyze the following factors:
 1. Geographical scope of the market in which the reseller has exclusive rights to resell the goods and the existence and relative competitiveness of possible substitute goods.
 2. Efforts exerted by the reseller to resell the goods: the reseller may exert great efforts to sell the goods through carrying out different activities, as the reseller in this case is fully committed to resell those goods. On the other hand, the reseller may not exert too much effort relying on the monopolistic turnover provided in such a situation.
 3. Risk of having a single source of supply and being tied to the other enterprise's product development cycles, supply delays, etc.
- The outcome of such an analysis is to be considered by taxpayers in selecting the comparable uncontrolled transaction(s), and in the adjustments made to account for the material differences for purposes of using the RPM.

6. Resale price margin and accounting practices

- Different enterprises may report their financial results using different accounting practices. As a result, the way of calculating the resale price margin may differ from one enterprise to another. Therefore, where an associated enterprise applies the RPM, it should analyze how the reseller in both the controlled transaction and the comparable uncontrolled transaction calculates the resale price margin earned.
- This entails identifying the types of costs in each of the transactions in order to calculate the resale price margin. For example, while a cost item is accounted for as an operating expense item in the controlled transaction and the same cost item is accounted for as an item of the cost of sales in the uncontrolled transaction, this means that the comparable resale price margin will reflect a higher level of gross profit because of the difference in the accounting practices adopted by each of the resellers in this case.
- Thus, in such situations, if the associated enterprise used the comparable resale price margin without making the appropriate adjustments, it is likely to miscalculate the profit attributable to its controlled transaction and hence misprice it. Therefore, taxpayers are strongly urged to make the necessary adjustments to eliminate the effect of any material accounting practices differences, in order to guarantee a reliable pricing outcome.

When is this method recommended to be used?

The RPM is often the most appropriate method where it is applied to distribution operations.

4.4.3 Cost Plus Method

- The OECD Transfer Pricing Guidelines define the "CPM" as follows:

"A transfer pricing method using the costs incurred by the supplier of property (or services) in a controlled transaction. An appropriate cost plus mark-up is added to this cost, to make an appropriate profit in light of the functions performed (taking into account assets used and risks assumed) and the market conditions. What is arrived at after adding the cost plus mark-up to the above costs may be regarded as an arm's length price of the original controlled transaction".

- Additionally, the OECD Transfer Pricing Guidelines define the "Cost Plus Mark-Up" as follows:

"A mark-up that is measured by reference to margins computed after the direct and indirect costs incurred by a supplier of property or services in a transaction".

- Where an associated enterprise uses the CPM in establishing an arm's length price for one of its controlled transactions, such an enterprise should select one or more comparable uncontrolled transactions in which the gross mark-up earned could be used as a benchmark to determine a proper mark-up to be added in that controlled transaction, and hence uses such a mark-up in setting an arm's length price for its controlled transaction.
- As a rule, the CPM begins with the costs incurred by a supplier of a product or service provided to an associated enterprise, and a comparable gross mark-up is then added to those costs. This comparable gross mark-up is determined by reference to either:
 - a. **Internal Comparable Transaction:** Where the cost plus mark-up of the supplier in the controlled transaction is determined by the cost plus mark-up realized for these items between one party to the controlled transaction and an independent enterprise in a comparable uncontrolled transaction; or
 - b. **External Comparable Transaction:** Where the cost plus mark-up of the supplier in the controlled transaction is determined by the cost plus mark-up realized between two independent enterprises none of which is party to the controlled transaction in a comparable uncontrolled transaction.

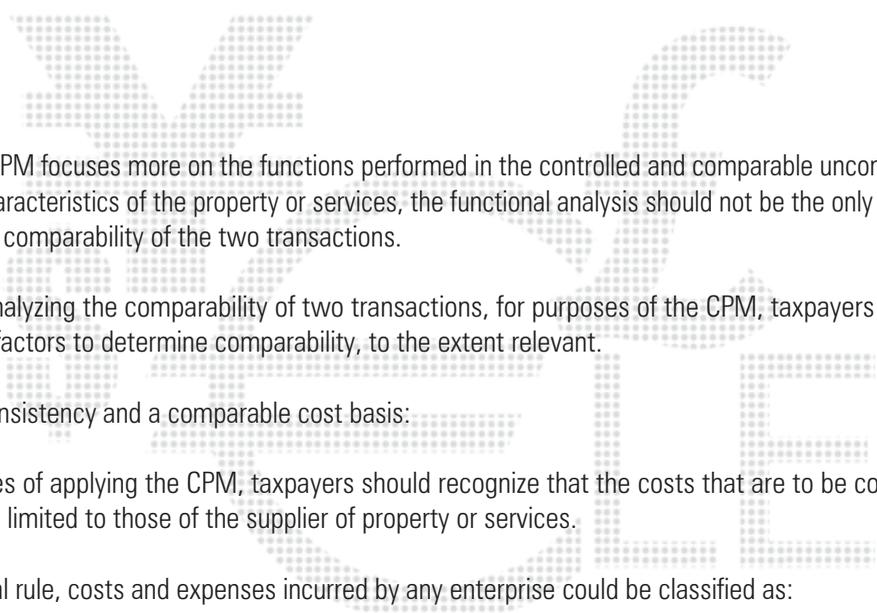
The CPM looks at the cost plus mark-up of one of the associated enterprises involved in the controlled transaction. The associated enterprise examined is referred to as the **tested party**. Typically, the CPM is applied to the least complex of the associated enterprises (i.e. the supplier) involved in the controlled transaction. Thus, the tested party usually does not own valuable intangible property.

Issues to be considered for the application of the CPM

Taxpayers who use the CPM in establishing arm's length prices for their controlled transactions should consider the following issues:

1. While selecting a comparable uncontrolled transaction for purposes of applying the CPM, an associated enterprise should select an uncontrolled transaction that has no material differences to the controlled transaction, or where reasonably accurate adjustments can be made to eliminate such differences. In other words, the uncontrolled mark-ups, to determine an arm's length mark-up for the controlled transaction, must be those realized by enterprises performing similar functions and preferably selling similar goods to independent parties.
2. Differences between the controlled transaction and the selected comparable uncontrolled transaction that can materially affect the gross mark-up should be accounted for. Taxpayers are expected to exert every effort to make any necessary adjustments to eliminate the effect of such differences, taking into account that the reliability of the CPM outcome is highly influenced by the accuracy of such adjustments.
3. As with the RPM, less product comparability and fewer adjustments may be necessary to account for product differences under the CPM than under the CUP method.
4. Under the CPM, taxpayers should deeply analyze comparability factors which are expected to significantly affect the cost plus mark-up of a particular transaction.
5. Taxpayers are advised to give more weight to the comparability of the functions performed, risks assumed and assets employed by suppliers in the controlled and the selected comparable uncontrolled transactions, as this is a highly critical factor affecting the cost plus mark-up in any transaction, and thus will affect the reliability of the CPM outcome.

(Factors determining comparability are discussed in Chapter Three of Part One of these guidelines).

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6. Although the CPM focuses more on the functions performed in the controlled and comparable uncontrolled transactions than on the characteristics of the property or services, the functional analysis should not be the only factor considered in measuring the comparability of the two transactions.
 7. Thus, when analyzing the comparability of two transactions, for purposes of the CPM, taxpayers should consider all comparability factors to determine comparability, to the extent relevant.
 8. Accounting consistency and a comparable cost basis:
 - For purposes of applying the CPM, taxpayers should recognize that the costs that are to be considered under this method are limited to those of the supplier of property or services.
 - As a general rule, costs and expenses incurred by any enterprise could be classified as:
 - a. **Direct Costs:** costs that are used in producing a product or service such as the cost of raw materials;
 - b. **Indirect Costs:** costs that are common to several products or services such as the cost of repair department that services equipment used to produce different products; and
 - c. **Operating Expenses:** the operating expenses of the enterprise as whole such as supervisory, general, and administrative expenses.
 - The CPM uses margins, which are calculated after taking into consideration both direct and indirect costs, without considering the operating expenses.
 - Since different accounting practices may be followed in different countries and such differences in the accounting practices make it difficult to draw any precise lines between the three cost categories described above, an associated enterprise using the CPM should ensure that the accounting practices followed in both the controlled transaction and the selected comparable uncontrolled transaction are consistent. If this is not the case, such an associated enterprise may need to make appropriate adjustments for accounting practices differences in both the controlled transaction and the selected comparable uncontrolled transaction.
 - An example of the problems which may arise under the CPM as a result of accounting practices inconsistency is where the supplier in the controlled transaction treats a particular cost item as an indirect cost (i.e. this cost item is accounted for as part of the cost of sales), while the supplier in the selected comparable uncontrolled transaction treats the same cost item as an operating expense (i.e. this cost item is not subtracted at the gross profit level). In such a case, and assuming that the aforementioned accounting practices difference is the only difference between the two transactions, the gross profit in the comparable uncontrolled transaction may be higher than the gross profit in the controlled transaction.
 - Unless the associated enterprise makes the necessary adjustment to account for such a difference by including this cost item as an indirect cost of the selected comparable uncontrolled transaction, the gross mark-up of the controlled transaction may be miscalculated, and hence an unreliable price of the controlled transaction will result.

▪ **Thus, taxpayers should:**

- a. **Follow the Egyptian Accounting Standards in determining the cost basis of their controlled transactions as in any other transaction. When applying the CPM, cost items such as depreciation should be calculated in accordance with the financial reporting standards (Not in accordance with the standards stated by the Law for purposes of calculating the taxable amount); and**
- b. **Ensure that the accounting practices followed in the selected comparable uncontrolled transaction is consistent with those followed in the controlled transaction; otherwise, taxpayers should make appropriate adjustments to account for accounting differences in both the controlled transaction and the selected comparable uncontrolled transaction, in order to obtain a reliable result.**

9. Allocation of Costs:

- While applying the CPM, some associated enterprises may try to allocate more costs to the purchaser in a controlled transaction in favor of the supplier, as this will result in a lower level of costs incurred by the supplier and hence the cost plus mark-up will be calculated on a lower cost base. This occurs ordinarily in allocating the overheads.
- Therefore, in any particular controlled transaction, taxpayers should allocate to the supplier an appropriate share of overheads and other costs incurred by the purchaser for the benefit of the supplier. Otherwise, an inaccurate pricing outcome may result.
- The basis of overhead allocation is another issue to be considered in this respect. Taxpayers are expected to select an apportioning basis appropriate for each particular case. The selected basis should be used consistently. Where different types of indirect costs are being allocated, different allocation bases may be used for each type. Examples of allocation bases are the turnover, number or cost of employees, etc.

When is this method recommended to be used?

This method may be most useful where semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction entails provision of services.

Use of Alternative Methods

- As mentioned earlier, where a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method; and where the Comparable Uncontrolled Price Method (CUP) and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred. Moreover, if the CUP Method cannot be reliably applied, it is advisable to support the use of alternative transfer pricing methods by sufficient explanation detailing why the CUP method was regarded as less appropriate in the circumstances of the case, and why the selected other method was regarded as providing a better solution.
- Traditional transaction methods are preferable to other methods because they are the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are arm's length. However, the complexities of real life business situations may put practical difficulties in the way of reliably applying these traditional transaction methods. In these situations, where there is no data available or the available data is not of sufficient quality to achieve comparability for purposes of the application of traditional transaction methods, taxpayers may have to consider transactional profit methods.

4.5 Transactional Profit Methods

Overview

- Profit arising from a controlled transaction can be a relevant indicator of whether the transaction was affected by conditions that differ from those that would have been made by independent enterprises in otherwise comparable circumstances.
- Thus, transactional profit methods examine the profits that arise from particular controlled transactions.
- The OECD Transfer Pricing Guidelines endorses the use of two transactional profit methods:
 1. The PSM; and
 2. The TNMM.
- The key difference between the PSM and the TNMM is that the PSM is applied to all parties involved in the controlled transaction, whereas the TNMM is applied to only one party as will be explained later on in this chapter.

4.5.1 Profit Split Method (PSM)

- Where transactions are so interrelated that they cannot be evaluated on a separate basis, or where both parties make a unique and valuable contribution to the controlled transaction, taxpayers could use the PSM.
- The PSM seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction(s). References to “profits” should be taken as applying equally to losses.
- Accordingly, there are two steps for the application of the PSM:
 - a. The first step is to determine the total profit earned by the GAE from a controlled transaction. The profit means the total integrated profits related to a controlled transaction, not the total profits of the group as a whole. The profit to be split is generally the operating profit, before the deduction of interest and taxes.
 - b. The second step is to split the profit between the parties based on the relative value of their contributions to the controlled transactions, considering the functions performed, the assets used, and the risks assumed by each member of the GAE, in relation to what independent parties would have received.
- The total profit could be allocated using one of the following approaches:
 - a. **Contribution Analysis Approach:** where the total operating profit from a controlled transaction of the GAE is divided between the associated enterprises based upon the relative value of the functions performed by each of the associated enterprises participating in the controlled transaction, supplemented as much as possible by external market data that indicate how independent enterprises would have divided profits in similar circumstances.
 - b. **Residual Profit Split approach:** where the GAE operating profit of the controlled transactions is divided between the associated enterprises. This process is carried out in two stages:
 - i. Each of the parties to the controlled transaction is assigned a return to the basic functions that it performs (e.g. manufacturing or distribution). Ordinarily, this basic return is to be determined by reference to the market returns achieved for similar types of transactions by independent enterprises.

- ii. The residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the circumstances that might indicate how this residual would have been divided between independent enterprises. Indicators of the parties' contributions of intangible property could be particularly useful in this context.
- c. The OECD Transfer Pricing Guidelines do note, however, that these approaches are not necessarily exhaustive or mutually exclusive. The taxpayer may use alternative ways to split profit, provided that the taxpayer provides reasonable evidence that the selected approach leads to a reliable arm's length result.

4.5.2 Transactional Net Margin Method (TNMM)

- There are two steps for the application of the TNMM :
 - a. Comparing the net profit margin realized by the taxpayer, or its associated enterprise in a controlled transaction, with the net profit margin realized by the same taxpayer/associated enterprise or by an independent enterprise in a comparable uncontrolled transaction; and
 - b. Examining the net profit margin relative to an appropriate base such as costs, sales or assets.
- The TNMM therefore looks at the profits of one of the associated enterprises involved in the controlled transaction. The associated enterprise examined is referred to as the **tested party**.
- The TNMM operates in a manner similar to the CPM and RPM. Therefore, it requires a level of comparability similar to, or even less than, that needed for the application of the CPM and RPM. A careful evaluation of the functional differences is also required.
- While CPM and RPM compare gross profit margins, TNMM compares net profit margins. Thus, where the relevant information exists at the gross margin level and where this information is reasonably reliable, taxpayers should apply the CPM or RPM.
- Since the TNMM uses net margins to determine arm's length prices, the TNMM is a less direct method than the RPM and CPM. It should be noted that many factors may affect net profit margins but may have nothing to do with transfer pricing.
- Typically, the TNMM is applied to the least complex of the associated enterprises involved in the controlled transaction. Thus, the **tested party** usually does not own valuable intangible property.
- ETA recommends that taxpayers adopt the following three steps in their search for external comparable transactions under the TNMM:
 - a. **Step 1:** Select entities with similar industry classifications to the tested party, taking into consideration that closer comparability of products and functions produces more reliable results.
 - b. **Step 2:** Screen all the detailed information, financial and textual, available on the entities selected in Step 1 in order to determine if the information indicates that they could be considered to have comparable transactions. Although entities are reported in a similar industry code, the available information may reveal that the selected entities' transactions are not comparable to those of the tested party.

c. Step 3: Where material differences, between the associated enterprise's situation and that of comparable entities' transactions selected in Step 1 and not screened out by the testing in Step 2, exist and can be determined, appropriate adjustments should be made where possible and any entities for which necessary adjustments cannot reasonably be made should be eliminated.

- This method has the added benefit that generally more comparable data are available and fewer adjustments are required to account for differences in functions and risks between the controlled and uncontrolled transactions.

- Several profit level indicators/profitability ratios are allowed under the TNMM, typically based on operating profit, which provides a measure of a company's profitability that is used to compare the **tested party** with the comparable companies identified.⁽¹⁰⁾ As mentioned earlier, a profit level indicator may express profitability in relation to an appropriate base such as: (i) sales, (ii) costs or expenses, or (iii) assets.
- Therefore, when applying the TNMM, the net profitability of the controlled transaction is compared to the net profitability of the uncontrolled transaction(s), using a profit level indicator, such as:⁽¹¹⁾
 - a. **Return on Assets (ROA):** Ratio of operating profit to operating assets.
 - b. **Return on Capital Employed (ROCE):** Ratio of operating profit to capital employed.⁽¹²⁾
 - c. **Operating Margin (OM):** Ratio of operating profit to operating revenue/sales.
 - d. **Return on Total Costs (ROTC):** Ratio of operating profit to total operating costs.

- Taxpayers should apply the TNMM on a transactional basis and not on a company-wide basis, since the TNMM's applicability becomes less reliable when applied to the aggregate activities, particularly if the taxpayer is engaged in various different transactions or functions. The method should be used to analyze only the profits of the associated enterprise that are attributable to simpler controlled transactions or functions. However, it may be possible to apply TNMM on an aggregate basis when the aggregate activities/transactions are sufficiently interlinked, as for example when similar sales functions are conducted for products in similar product lines.
- Moreover, taxpayers may opt to apply the TNMM, or any other method, on a company-wide basis to corroborate the results obtained from the separate analyses performed on a transactional basis. However, a company-wide analysis by itself would not be sufficient for a comprehensive transfer pricing analysis.

When is this method recommended to be used?

- TNMM may be appropriate for use in situations where data limitations on uncontrolled transactions make it more reliable than traditional methods. Moreover, TNMM may be more reliable if the data available on gross margin level are less reliable due to accounting differences (i.e. differences in the treatment of certain costs as cost of goods sold or operating expenses) between the tested party and the comparable companies for which reliable adjustments cannot be made. In any case, all comparability factors should be taken into consideration when selecting a TNMM, and the process for such analysis for the purpose of selecting and applying a TNMM should not be less reliable than for other methods.

¹⁰ Operating profit is the income of a company net of direct and indirect expenses, but before deduction for interest and taxes, calculated as sales minus cost of goods sold minus operating expenses. Only profits resulting from operating activities are relevant for transfer pricing purposes.

¹¹ This is not an exhaustive list of profit level indicators which can be used when applying the TNMM.

¹² Capital employed is typically computed as the total assets minus cash and investments.

- TNMM is typically applied when one of the associated enterprises to the controlled transaction makes a unique and valuable contribution (e.g. contributes unique and valuable intangibles) for which an arm's length return cannot be easily determined. In that case, the TNMM would be applied to the routine associated enterprise performing routine functions that do not involve a unique and valuable contribution.
- The TNMM is usually applied to broad comparable functions rather than discrete controlled transactions. Returns to these functions are typically measured by a profit level indicator/profitability ratio that is unlikely to be affected by factors unrelated to arm's length pricing.

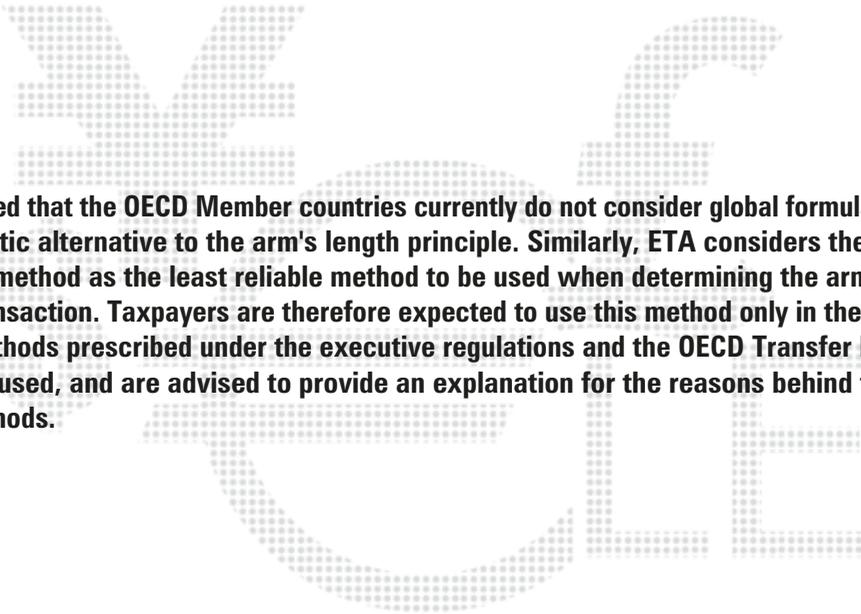
- **In case none of the methods stipulated under Article no. (39) of the Executive regulations (i.e. CUP method, RPM, CPM, PSM, and TNMM) can be reliably applied, taxpayers should maintain and be prepared to provide sufficient documentation to ETA explaining why the methods stipulated under Article no. (39) cannot be reliably applied before using any other method that taxpayers deem most appropriate to the circumstances of the case. A comparability analysis must be performed in any case to select and apply the most appropriate transfer pricing method.**

4.6 Other Methods

- There may be situations where a taxpayer considers the possibility to use any of the transfer pricing methods recognized under Article no. (39) of the Executive regulations and is unable to establish an appropriate degree of comparability based on the facts and circumstances. In such situations, the taxpayer may have to consider using a method, other than the recommended methods, that will satisfy the arm's length principle (i.e. yield a result consistent with that which would be achieved by independent parties engaging in comparable uncontrolled transactions under comparable circumstances).
- "Global Formulary Apportionment Method" has sometimes been suggested as an alternative to the arm's length principle as a means of determining the proper level of profits across national taxing jurisdictions.

4.6.1 Global Formulary Apportionment Method

- A global formulary apportionment method would allocate the global profits of a GAE on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined formula.
- There are three essential steps to applying a global formulary apportionment method:
 1. Determining the unit to be taxed (i.e. which of the subsidiaries of a GAE should comprise the global taxable entity);
 2. Determining the global profits accurately; and
 3. Establishing the formula to be used to allocate the global profits of the unit. This formula is most likely based on some combination of costs, assets, payroll, and sales.
- It is important to distinguish the PSM from the Global Formulary Apportionment (GFA). The latter allocates the total profits of the **group** between parties on the basis of an arbitrary pre-determined formula, perhaps based on weighting of relative labor costs, relative capital employed, and/or other relative factors. By contrast, the PSM seeks to allocate the integrated profits of a **transaction** on the basis of the actual relative contributions of the parties to the profit in light of what comparable independent enterprises would have sought to achieve in comparable circumstances. Thus it seeks to establish a more objective measure of each of the parties' profit.



- **It should be noted that the OECD Member countries currently do not consider global formulary apportionment method a realistic alternative to the arm's length principle. Similarly, ETA considers the global formulary apportionment method as the least reliable method to be used when determining the arm's length price of a controlled transaction. Taxpayers are therefore expected to use this method only in the case where none of the other methods prescribed under the executive regulations and the OECD Transfer Pricing Guidelines can be reliably used, and are advised to provide an explanation for the reasons behind the inapplicability of all other methods.**

Summary of Chapter 4:

Several important principles have been outlined in this chapter:

- There are five acceptable transfer pricing methods. The direct focus of the CUP method is on product similarities. The other four methods focus instead on rewards to economic functions performed, assets employed and risks assumed. The other four comparability factors (i.e. contractual terms, economic circumstances, business strategies and government policies) should, however, also be considered when performing the comparability analysis.
- The following table provides a summary of the main characteristics of each transfer pricing method and the key differences between them.

Criteria				
Method	Attribute	Product Comparability	Functional Comparability	Comparable Party / Product
CUP	Price	Very high level of comparability required	Very high level of comparability required	Property/ Service
RPM	Gross margin	Medium level of comparability required	High level of comparability required	Distributor/ Reseller
CPM	Gross mark-up	Medium level of comparability required	High level of comparability required	Supplier, ex: Contract manufacturer/ Toll manufacturer/ Low risk assembler/ Service provider
PSM	Operating margin	Medium level of comparability required	High level of comparability required	Manufacturer/ Service provider / Distributor
TNMM	Operating margin	Medium level of comparability required	High level of comparability required	Manufacturer/ Service provider / Distributor

- There may be situations where the taxpayer may have to consider using a method, other than the recommended methods under Article no. (39) to satisfy the arm's length principle. Global Formulary Apportionment Method has sometimes been suggested as an alternative to the arm's length principle as a means of determining the proper level of profits across national taxing jurisdictions.
- Taxpayers should be able to demonstrate the arm's length character of their transfer pricing practices, which may also be supported by analyses under more than one acceptable transfer pricing method.
- In general, the transfer pricing policy should involve the following:
 - Identifying comparable uncontrolled transactions which will serve to benchmark the conditions in the controlled transactions.
 - Identifying the material differences (if any) that might affect comparability, especially those affecting the characteristics of property or services and the functional analysis, between the controlled and the uncontrolled transactions.
 - Making the necessary comparability adjustments to eliminate the effect of such differences, and hence obtain a reasonably reliable pricing outcome that is consistent with the arm's length principle.



Chapter Five

Documentation and Other Practical Considerations

- 5.1 Scope of Chapter
- 5.2 Introduction
- 5.3 Documentation according to Law and the Executive Regulations thereof
- 5.4 Documentation Guidelines
- 5.5 A Three-Tiered Transfer Pricing Documentation
- 5.6 The four-step approach and the supporting documents
- 5.7 Documents recommended to be produced throughout each of the Four Steps

Master file

- 5.7.1 Step 1: Identifying the controlled transactions and understanding the nature of such transactions
 - 5.7.1.1 Documents related to the GAE as a whole

Local file

- 5.7.1 Step 1: Identifying the controlled transactions and understanding the nature of such transactions (cont'd)
 - 5.7.1.2 Documents related to the nature of the industry/market in which the taxpayer operates
 - 5.7.1.3 Documents related to the taxpayer's business policies and strategies
 - 5.7.1.4 Documents related to the controlled transactions under review
 - 5.7.1.5 Documents related to the comparables
- 5.7.2 Step 2: Selecting the most appropriate transfer pricing method(s)
 - 5.7.2.1 Documents identifying the pricing method(s) used
 - 5.7.2.2 Documents presenting the analysis conducted to evaluate the reliability of data used
- 5.7.3 Step 3: Applying the selected pricing method
 - 5.7.3.1 Documents that are generally produced regardless of the pricing method used
 - 5.7.3.2 Documents related to the pricing method applied
- 5.7.4 Step 4: Determining the arm's length amount and introducing a review process to reflect any future changes

- 5.8 Country-by-Country Reporting
- 5.9 Other Practical Considerations

5.1 Scope of Chapter

This chapter provides guidance on the information and documentation that taxpayers are required to develop and maintain in order to prove to ETA that the prices established for their controlled transactions are arm's length.

5.2 Introduction

- The previous chapters of these Guidelines provided taxpayers with guidance on how to establish arm's length prices for their controlled transactions. However, a final step is to be taken by taxpayers in order to prove to ETA the reliability of their transfer pricing policy and hence minimize the audit risk as well as the likelihood of having their transfer prices adjusted by ETA. **That is Documentation.**
- This chapter contains updated requirements for transfer pricing documentation, intended to enhance transparency, in-line with the OECD Transfer Pricing Guidelines, hence, the development of a three-tiered approach to transfer pricing documentation (hereinafter referred to as the three-tiered transfer pricing documentation) including (i) **master file**, (ii) **local file**, and (iii) **CbCR**.
- More specifically, the three-tiered transfer pricing documentation consists of (i) a **"master file"** containing information that is relevant to all the GAE members; (ii) a **"local file"** that specifically covers and analyzes the controlled transactions of the local taxpayer; and (iii) a **"Country-by-Country Report"** containing certain useful information regarding the global allocation of income and taxes paid by the GAE along with other indicators of the location of economic activity within the GAE.⁽¹³⁾
- Together, these three documents will necessitate that taxpayers articulate appropriate and consistent transfer pricing positions and provide tax administrations with useful and targeted information to assess transfer pricing risks, and determine the appropriate cases where audit resources can most effectively be deployed. These new documentation requirements are to be implemented for fiscal years ending December 31, 2018.⁽¹⁴⁾

- The introduction of the three-tiered transfer pricing documentation provides for a more practical approach to preparing the information and documents required while maintaining the Egyptian four-step approach, in-line with the OECD Guidelines issued in 2017.

5.3 Documentation according to the Law and the Executive Regulations thereof

- **Article (90) of the Law states that:**

"ETA may make adjustments to the tax assessment based on data stated in the tax return as well as the supporting documents thereof. ETA may also make the tax assessment on a deemed profit basis in light of the data available in case the taxpayer neither files the tax return nor submits the data and documents supporting the tax return thereof. In case documents available are evident that the tax return and the factual information are not compatible, ETA must notify the taxpayer of such incompatibility, conduct a tax audit as well as correct and/or adjust the tax return and determine the taxable income."

- **Article (96) of the Law establishes the obligation of taxpayers to provide data and documents requested by ETA in writing. Taxpayers not obliged to provide such data and documents shall be subject to penalties stipulated in Article (135) of same Law**

"Taxpayers shall provide data and copies of books, documents and instruments including lists of customers and suppliers requested by ETA in writing within fifteen (15) days from the date of request, unless the taxpayer submits sufficient evidence of difficulties experienced in preparing and providing the required data within the specified period. ETA Commissioner, or the person so authorized, may appropriately extend the above-mentioned period in case the taxpayer provides sufficient evidence of difficulties experienced in providing such data and copies of documents".

¹³ See Chapter V "Documentation" of the OECD Transfer Pricing Guidelines, and the corresponding appendices.

¹⁴ The fiscal year relates to the consolidated reporting period for financial statement purposes, and not to taxable years or to the financial reporting periods of the subsidiaries.

- **Article (30) of the Law stipulates that ETA is entitled to determine the taxable profit in accordance with the arm's length price".**

- **Based on the above mentioned Articles, the following issues should be emphasized:**

- Taxpayers are required by the law to maintain records and documents supporting the amount of taxable income stated in their income tax returns. The profit derived from the controlled transactions is to be considered in calculating the amount of taxable income, and hence the tax due. This means that taxpayers are required by the law to prepare and maintain records and documents outlining the basis on which the prices of such transactions were established.
- ETA is authorized by the Law to adjust the taxable profit on the basis of the arm's length price; consequently, calculate the correct tax liability if it was evidenced that the conditions set between associated enterprises for their commercial or financial relations are not arm's length.
- Thus, taxpayers are required to prepare and maintain records and documents evidencing that their controlled transactions were priced according to the arm's length principle. Such documents are expected to include an explanation of how the controlled transactions prices were established, through outlining different issues such as the processes followed, the analyses conducted, the methods used, the comparables selected, etc.
- Therefore, adequate documentation represents a key tool that should be used by taxpayers to demonstrate to the ETA the reliability of their transfer pricing outcomes.

- Such a discussion raises two important questions:

- **The first question is:**

What are the records and documents that taxpayers are advised to prepare and maintain, in order to demonstrate their compliance with the arm's length principle?

- **The second question is:**

How does ETA evaluate the adequacy of documentation provided by taxpayers in this regard?

The answers are developed throughout the following documentation guidelines:

5.4 Documentation Guidelines

- First of all, taxpayers should be aware that there is no comprehensive predefined set of documentation requirements that meet the circumstances of all taxpayers, because appropriate documentation depends on each taxpayer's specific case and circumstances.
- **These documentation guidelines demonstrate the factors that should be considered by taxpayers in determining an appropriate level of documentation for their specific circumstances, and hence enable them to better identify the documents to be prepared in order to present a persuasive argument for their transfer pricing policies and relevant practices**
- Moreover, these guidelines provide taxpayers with a sample of the documents that would be expected to represent sufficient evidence of the credibility of their transfer pricing policies.

5.5 A Three-tiered transfer pricing documentation

- The OECD's updated guidance on transfer pricing documentation requires GAEs to prepare a **three-tiered transfer pricing documentation** thereby providing tax administrations, in a **"master file"**, with high-level information on their global business operations and transfer pricing policies that is to be made available to all relevant tax administrations.
- Second, a detailed transactional transfer pricing documentation is required to be prepared, in a **"local file"**, specific to each country, identifying the relevant controlled transactions, the amounts involved, and the analysis of the transfer pricing determinations performed.
- Third, large GAEs (subject to a specific threshold) are required to file a **CbCR** on annual basis, for each tax jurisdiction in which they do business where the amount of revenue, profit before income tax, income tax paid and accrued, and other measures of economic activity should be provided.
- The following provides a more detailed description of the requirements under each set of documents.

Master file

- The master file should provide an overview of the GAE group business, including information on the nature of its global business operations, its transfer pricing policies, and its global allocation of income and economic activity.
- This information is meant to provide a high-level overview to give the relevant global economic, legal, and financial context on the GAE's transfer pricing practices. Such information should be included in a master file if its exclusion would impact the reliability of the transfer pricing outcomes.

Local file

- The purpose of the local file is to provide detailed information relating to the controlled transactions of a local taxpayer, and should include supplementary information to that which is included in the master file.
- Such information should include a detailed functional analysis, financial information regarding those specific transactions, the selection and application of the most appropriate transfer pricing method and a comparability analysis.
- Local files should be prepared on an entity-by-entity basis, and not on a group-basis (i.e. for two or more related taxpayers resident in Egypt for tax purposes).

Country-by-Country Report

- The CbCR requires **jurisdiction-wide information** regarding the GAE's global allocation of income, taxes paid, and the location of key economic activity where the GAE group operates. As part of this CbCR, GAEs are also required to report their number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction.
- Finally, GAEs should identify each entity within the group doing business in a particular tax jurisdiction, and provide an indication of the business activities each entity engages in. It also requires a listing of all **Constituent Entities** for which financial information is reported, as well as their main business activities.⁽¹⁵⁾
- For Egyptian tax and transfer pricing purposes, a CbCR will be required for Egyptian Parented GAEs if the GAE for which a taxpayer resident in Egypt is the parent company achieved an annual consolidated group revenue of equal to or exceeding **EGP 3 billion**. In such a case, a CbCR will be required only if the Egyptian Parented GAE has a foreign subsidiary/subsidiaries.

¹⁵See Annex III to Chapter V "Documentation" of the OECD Transfer Pricing Guidelines for a model template of the Country-by-Country Report.

- Whereas, for taxpayers resident in Egypt which are subsidiaries of foreign parented GAEs, a **CbCR** should be filed in the jurisdiction of tax residence of the **ultimate parent entity** ⁽¹⁶⁾ subject to the OECD threshold (i.e. if the annual consolidated group revenue is equal to or exceeding **Euro 750 million**).
- As such, only Egyptian parented GAEs, i.e. Egyptian parent companies, will be required to file a CbCR with ETA.
- **CbCRs** will be shared between the relevant tax administrations through **automatic exchange of information**, pursuant to government-to-government mechanisms.

5.6 The four-step approach and the supporting documents

- For purposes of preparing adequate documentation, taxpayers are advised to develop their transfer pricing documentation, throughout the four-step process outlined in chapter two of Part One of these Guidelines. In this regard, ETA recommends that taxpayers document the actions undertaken throughout each of the four steps.
- This will ensure that all the data collected, comparisons drawn and analyses conducted throughout the process of applying the arm's length principle will be supported by detailed documents.
- The below four-step approach documentation guidance lays out a summary of the relevant set of supporting documents required to be provided under each of the **master file**, and the **local file**.
- **It should be emphasized that the documents sample listed below should not be considered as a minimum compliance requirement. Similarly, it is not intended to set forth an exhaustive list of the transfer pricing documents that ETA may request.**

5.7 Documents recommended to be produced under the Master file and Local file throughout each of the Four Steps

Master file

5.7.1 Step 1: Identifying the controlled transactions and understanding the nature of such transactions

5.7.1.1 Documents related to the GAE as a whole including details on:

- The **organizational structure** of the GAE as a whole (e.g. ownership linkages within the GAE, changes in the main shareholdings, the location of each member, etc.);
- The outline of the **business activities** undertaken by the GAE, including a description of the supply chain, key service agreements, key geographic markets, brief functional analysis on the principle contributions to value creation, details of the five largest products/services offerings and important business restructuring transactions;
- The GAE controlled **financial activities**, including a description of how the group is financed and the relevant financing agreements, identification of GAE members with a central financing function and their location, details of the place of effective management along with a description of the relevant transfer pricing financing policies;
- The GAE **intangibles**, including a description of the overall strategy for the development, ownership and exploitation of intangibles, list of important intangibles and their ownership, details of principal research and development facilities and management location, relevant important agreements and transfer pricing policies, and any important transfers of interests in intangibles among the members of the GAE; and

¹⁶ See Model Legislation included in Annex IV to Chapter V "Documentation" of the OECD Transfer Pricing Guidelines for the definitions of "Ultimate Parent Entity", and "Constituent Entity."

- The GAE's **financial and tax positions**, including the annual consolidated financial statements of the GAE, and a list and brief description of any existing APAs or other tax rulings relating to the allocation of income amongst the GAE members.

Local file

5.7.1 Step 1: Identifying the controlled transactions and understanding the nature of such transactions (Cont'd)

5.7.1.2 Documents related to the nature of the industry/ market in which the taxpayer operates, including details on:

- The taxpayer's business including its business lines, and activities;
- The nature of the taxpayer's industry dynamics and the analysis of the economic factors influencing both the taxpayer's business and the industry; and
- The market in which the taxpayer operates in terms of its location, size, competition, etc.

5.7.1.3 Documents related to the taxpayer's business policies and strategies, including details on:

- The taxpayer's business model;
- The taxpayer's transfer pricing policy;
- The organizational and management structure of the taxpayer; and
- The business strategies adopted by the taxpayer, especially those strategies which are likely to influence the pricing of controlled transactions, such as pricing strategies, market penetration/ expansion strategies, or any business restructurings etc.
- In this regard, it should be noted that details on the studies conducted prior to the strategy implementation should be provided. Such details should emphasize the aim of the strategy, its duration, its related costs and the profits expected to be earned in return of such costs, etc.

5.7.1.4 Documents related to the controlled transactions under review:

- Documents identifying the object (the property and/ or services) of the transaction under review;
- Business relationships between the transaction parties (selling/purchasing goods, providing services, using intangibles, etc.);
- Documents describing the controlled transactions in terms of its range, type, timing and frequency, the parties to the transaction, the amount of controlled payments and receipts for each transaction broken down by tax jurisdiction etc.;
- Contracts/ agreements showing the contractual terms of the transaction; and
- A preliminary functional analysis of the functions performed, assets used and risks assumed by the taxpayer and by the associated enterprise involved in the controlled transaction under review.

5.7.1.5 Documents related to the comparables including:

- A list of any known comparable enterprises having transactions similar to the controlled transactions;
- Documents identifying the screening criteria for selecting the comparables;
- A preliminary functional analysis of the functions performed, assets used and risks assumed by the selected comparable enterprise in the selected comparable uncontrolled transaction.

5.7.2 Step 2: Selecting the most appropriate transfer pricing method(s)

5.7.2.1 Documents identifying the pricing method(s) used

- Describing the processes followed to select such a method, and explaining the reasons for selecting that method in pricing the controlled transaction under review.
- In the case of using a profit based transfer pricing method, taxpayers are advised to submit documents outlining the reasons for considering the three traditional transaction methods as less appropriate in the circumstances of the case and the reason why the selected other method was regarded as providing a better solution.

5.7.2.2 Documents presenting the analysis conducted to evaluate the reliability of data used

5.7.3 Step 3: Applying the selected pricing method

5.7.3.1 Documents that are generally produced regardless of the pricing method used

This category may outline the following details:

- The detailed comparability study conducted by the taxpayer. Such a study includes an analysis outlining the comparisons drawn between the controlled transaction under review and the selected comparable uncontrolled transaction(s) with regard to different factors including the characteristics of the property or service transferred, the functions performed and the economic significance of each, the assets used, the risks assumed, the contractual terms, market circumstances, business strategies adopted, etc.
- In this respect, the OECD Transfer Pricing Guidelines state that: "The geographic market is another economic circumstance that can affect comparability. The identification of the relevant market is a factual question. For a number of industries, large regional markets encompassing more than one country may prove to be reasonably homogeneous, while for others, differences among domestic markets (or even within domestic markets) are very significant."
- Thus, it may be the case that uncontrolled transactions from markets other than that of the taxpayer constitute reliable comparables, or may be used as the best available comparables in the absence of local market comparables.
- **It is therefore recommended that the taxpayer first considers the search for comparables in the local market. When this data is not available, the taxpayer is advised to expand the geographic location in which the search is being performed gradually to initially consider comparables operating within the same geographic region. When this data is not available, the taxpayer may then search for comparables globally, or within those regional markets in which the taxpayer industry's operating conditions are deemed to be comparable.**

- **Hence, if the tested party for which comparables are being searched is an Egyptian entity, it is recommended that Egyptian comparables are first searched for. When data on Egyptian comparables is not available, regional (i.e. Middle Eastern and African) comparables may be searched for instead. When Middle Eastern and African comparables cannot be located, global comparables may then be searched for.⁽¹⁷⁾**
- Yet, in the search for the most reliable available comparables, potential differences in geographic markets and locations need to be weighed against the other economically relevant characteristics. In any case, the details of the strategy adopted to arrive at the comparable transaction(s)/companies should be clearly disclosed in the local file.
- The material differences between the controlled and the selected comparable uncontrolled transactions, how such differences were quantified and how the necessary adjustments were made accordingly, in order to account for such differences.
- Documents showing all the financial calculations made in applying the selected method(s) and determining the arm's length value.
- A copy of existing unilateral, bilateral/multilateral APAs, and other tax rulings to which the taxpayer is not a party and which are relevant to the taxpayer's controlled transactions covered in the local file.

5.7.3.2 Documents related to the pricing method applied

- Such documents differ from one case to another based on the pricing method applied in each case. This is due to the fact that different methods require different types of data and analyses, which is consequently reflected in the documentation developed throughout this step. In any case, a description of any important assumptions made in applying the transfer pricing method should be provided.
- The following represents a sample of these documents:

a. CUP method

- Documents that accurately describe the comparisons drawn between the characteristics of property or services transferred in the controlled and the comparable uncontrolled transactions, along with any differences. Such comparisons may extend to describe how such differences affect the specifications, effectiveness and quality of such property, and what impact these differences have on the price.

b. RPM

- The functional analysis of both the taxpayer and the comparable independent enterprises with respect to the controlled and the comparable uncontrolled transactions, along with documents emphasizing their functional comparability;
- Documents showing the comparisons drawn between gross profit margins earned in both transactions; and
- Statement presenting reconciliation of differences between the accounting practices followed by the taxpayer and those followed by the selected comparable independent enterprises.

c. CPM

- The functional analysis of both the taxpayer and the comparable independent enterprises with respect to the controlled and the comparable uncontrolled transactions, along with documents emphasizing their functional comparability;
- Documents outlining how the cost base for the controlled transaction under review was calculated, through highlighting the costs included in the cost base, the basis of allocating indirect costs included in the cost base, etc;
- Documents showing the comparisons drawn between mark-ups of gross profits earned in both transactions; and

¹⁷ ETA utilizes a specialised financial database for transfer pricing audit purposes, in order to verify/determine the arm's length price of taxpayers' controlled transactions, subject to the audit.

- In the case of using marginal costing, documents providing the reasoning for using it and how effective it is in determining the arm's length gross profit mark-up in such a case.

d. PSM

- Documents showing whether the level of applying this method is transactional basis or aggregate basis and providing the reason for that; and
- Documents showing the functional comparability, the combined profit that was calculated, the contribution or residual analysis, reconciliation of accounting practices differences, the basis of projecting profits (if the combined profit used is projected).

e. TNMM

- Documents showing the details of the benchmarking analysis undertaken, and the series of steps followed, including qualitative and quantitative analyses, to arrive at the final set of comparables; and
- Documents showing the profitability ratios used and the reasons for using these ratios in particular, how the resulted range of outcomes was evaluated and how the taxpayer selected the most reliable arm's length net profit margin, etc.

5.7.4 Step 4: Determining the arm's length amount and introducing a review process to reflect any future changes

- Documents that are expected to be prepared throughout this step may outline the following details:
 - a. The established arm's length price;
 - b. The actions undertaken to monitor the changes in the circumstances of both the taxpayer and the comparable enterprises, as well as the changes in the validity of data used in the previous steps;
 - c. The evaluation of the impact of such changes (if any) on the validity of the arm's length amount; and
 - d. The adjustments made to account for such an impact, in order to obtain a reliable arm's length amount to be used in the near future.

General documents recommended to be prepared

- a. The amount of sales and operating results from the last few years (three years is ideal) preceding the transaction under review;
- b. Annual reports and financial statements of the taxpayer. The taxpayer should also provide financial statements on a transactional basis, i.e., segmented financial statements; and
- c. Profitability analysis with respect to the controlled transactions. The profitability analysis should entail analyzing the profitability of the taxpayer with respect to each controlled transaction on a stand-alone basis against the arm's length range of the comparables identified. It should also show how the financial data used in applying the transfer pricing method ties with the annual audited financial statements.

5.8 Country-by-Country Reporting

- As mentioned earlier, the **CbCR** requires aggregate jurisdiction-wide information regarding the GAE's global allocation of income, taxes paid, and certain indicators of the location of key economic activity where the GAE group operates. GAEs are also required to report other quantitative data in respect of their jurisdictional business operations such as their number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction, along with an identification of each entity within the group doing business in a particular tax jurisdiction.

- Annex III to Chapter V “Documentation” of the OECD Transfer Pricing Guidelines provides a model template of the CbCR. Taxpayers who meet the **CbCR** threshold in any year, are required to prepare a **CbCR** for that given year using the said model template.^{(18),(19)} As mentioned earlier, a **CbCR** will be required for Egyptian parented GAEs if the GAE for which a taxpayer resident in Egypt is the parent company achieved annual consolidated group revenue of equal to or exceeding **EGP 3 billion**. Whereas, taxpayers resident in Egypt which are subsidiaries of foreign parented GAEs will be subject to the OECD threshold (i.e. annual consolidated group revenue of equal to or exceeding **Euro 750 million**).
- The **CbCR** will be primarily used by ETA for performing high-level transfer pricing risk assessment, and evaluating other tax and BEPS related risks, as relevant. As such, a **CbCR** does not provide comprehensive evidence that transfer prices are or are not arm’s length, and the information contained in there cannot be used as a substitute for the detailed transactional transfer pricing analysis as required under the master file and local file.

5.9 Other practical considerations

As a general rule, all the rules stated by the Law with respect to record-keeping and documentation are also applicable to transfer pricing documentation. However, the following issues are to be considered:

Submission of records and documents to ETA

- Taxpayers are required to submit their transfer pricing documentation to ETA on an annual basis. In particular, the master file and the local file should be submitted by the taxpayer directly to ETA’s transfer pricing department. Since the master file relates to the GAE as a whole, it should be prepared in accordance to the GAE’s ultimate parent’s tax return filing date, and hence should be made available to ETA by the taxpayer in due course.
- The local file is required to be submitted to ETA’s transfer pricing department two months following the date of filing the tax return.
- The **CbCR** should in general be submitted within one year following the close of the relevant financial year that it covers. The **CbCR** should be filed in the jurisdiction of tax residence of the ultimate parent entity and will be shared between the relevant tax administrations through automatic exchange of information, pursuant to government-to-government mechanisms. For the purpose of these Guidelines, the first **CbCR** should be prepared for the subject GAE’s fiscal year ending December 31, 2018, and should therefore be filed within twelve months after the close of the GAE’s 2018 fiscal year.
- It should be emphasized that the adequacy (including both the amount and quality) of transfer pricing documentation is determined by the completeness, accuracy and timeliness of such documentation. Thus, to ensure preparing adequate documentation, taxpayers are advised to prepare contemporaneous documentation (i.e. to prepare and maintain their transfer pricing records and documents at the time the transaction occurs).
- In addition, the introduction of the three-tiered transfer pricing documentation will enable taxpayers to prepare well organized and articulate transfer pricing documentation which will give ETA assurance that taxpayers have analyzed their transfer pricing positions reported on their tax returns, have accurately considered the available data on comparable transactions, and have maintained consistent transfer pricing positions.

¹⁸ See Annex III to Chapter V “Documentation” of the OECD Transfer Pricing Guidelines for a model template of the Country-by-Country Report.

¹⁹ Further practical guidance will be issued in due course, in respect of the CbCR filing requirements (i.e. format, instructions, electronic filing..etc.).

Frequency of documentation updates

- Taxpayers should prepare their transfer pricing documentation annually to support their transfer pricing position, or update their existing transfer pricing documentation to reflect any changes in the business affecting their controlled transactions. As such, it is recommended that taxpayers annually review their transfer pricing documentation to assess whether the functional and economic analyses remain valid and accurate.
- To simplify compliance burdens on taxpayers, it is recommended that taxpayers prepare a new benchmarking search every three years, rather than annually. However, the results of the benchmarking search should be updated annually, by reviewing the comparable companies/transaction(s) in order to assess whether they are still comparable and update their financial information annually to reliably apply the arm's length principle.

The original documents are to be submitted

- Taxpayers should be aware that, in the case of tax audit, ETA will not accept any copies of the documents required and that the original transfer pricing documents are to be submitted.

Maintaining records and documents in languages other than Arabic

- In the case of preparing and maintaining transfer pricing documents in languages other than Arabic, ETA may require the taxpayer, at its own expense, to submit an official translation of the required documents.

Statute of Limitation and the recommended period of retaining records and documents

- According to Article (91) of the Law, taxpayers are obliged to keep records and documents for five years starting from the legal deadline for filing the tax return of the tax period. Although the same statute of limitation period applies to transfer pricing documents, in some cases, it is in the taxpayer's best interest to retain transfer pricing documents beyond that period, particularly when such documents support the reliability of transfer prices established for a subsequent year as in the case of long-term contracts.

Burden of proof

- Article (129) of the Law places the burden of proof initially on ETA, provided that the taxpayer complied with the requirements of the Law. However, under Articles (90) and (130) of the Law, the burden of proof can be shifted to the taxpayer when the taxpayer does not file the due tax return or does not submit the data and documents supporting the tax return.
- Thus, as a consequence of either the failure to produce documents that show how transfer pricing has been implemented, or the submission of inadequate or incorrect documents, the taxpayer is more likely to be assigned a high tax risk rate, and hence be audited by ETA. Furthermore, in such a case, ETA will be entitled to determine the arm's length transfer price and to adjust the transfer price established by the taxpayer accordingly.
- Therefore, to discharge the burden of proof, taxpayers are advised to prepare and maintain records and documents that outline the process undertaken to develop an appropriate transfer pricing outcome, and evidence the arm's length character of their transfer pricing practices.

Transfer pricing adjustments and associated penalties

- The Law stipulates penalty percentages determined in accordance to the amount of the disputed annual tax base. The same penalty provisions are applicable in the case of transfer pricing adjustments resulting from an audit.

Summary of Chapter 5:

- A taxpayer's main purpose in preparing and maintaining documentation should be to demonstrate to ETA that its transfer prices are consistent with the arm's length principle.
- There is no explicit set of documentation to be prepared and maintained by all taxpayers, because appropriate documentation depends on each taxpayer's specific case and circumstances.
- Taxpayers are required to prepare their transfer pricing documentation in accordance to the new three-tiered documentation, including **master file**, **local file**, and **CbCR** (subject to a threshold requirement). In doing so, taxpayers are advised to develop their transfer pricing master file and local file throughout the four-step process outlined in chapter two of Part One of these Guidelines.
- Taxpayers are required to prepare their three-tiered documentation on an annual basis, and update their transfer pricing analyses annually, as deemed necessary.
- The burden of proof is placed initially on ETA. However, if the taxpayer fails to provide ETA with the documents outlining how its transfer prices were established, the burden of proof will be shifted to the taxpayer.



Annex

Illustrative Examples

Annex: Illustrative Examples

This annex includes a number of examples illustrating the main concepts, characteristics and assumptions underlying the traditional transaction pricing methods as well as the TNMM discussed in chapter four of Part One of these Guidelines. By providing such examples, ETA aims at providing taxpayers with guidance on how to apply such methods in real life situations.

Example

- Referring back to Example (1) provided in chapter one of Part One of these Guidelines:
 - Franco is a multinational parent company resident in France and owns %55 of the outstanding common stock of its Egyptian subsidiary; Egypco, and %51 of the outstanding common stock of its Greek subsidiary; Greeco.
 - Egypco manufactures product (x) and sells the finished product to Greeco
- ETA selected Egypco for audit and conducted the following analysis, in order to decide whether product (x) is transferred from Egypco to Greeco at arm's length.
- The income statements of the two subsidiaries are as follows:

Egypco's income statement (Manufacturer):

Sales to Greeco (1000 units sold at a transfer price of EGP 100/ unit)	EGP 100,000 (controlled transaction)
<u>Less</u>	
Manufacturing costs	EGP 75,000

Gross profit	EGP 25,000
<u>Less</u>	
Operating expenses	EGP 15,000

Net profit	EGP 10,000

Greeco's income statement (Distributor):

Sales to third parties	EGP 160,000
<u>Less</u>	
Purchases from Egypco	EGP 100,000 (controlled transaction)

Gross profit	EGP 60,000
<u>Less</u>	
Operating expenses	EGP 40,000

Net profit	EGP 20,000

▪ **Assume the following case scenarios**

• **The First Case Scenario:**

The **CUP method** is selected in this case, and ETA selected, as a benchmark, a comparable uncontrolled transaction in which a comparable independent enterprise sold comparable products in comparable circumstances at a price of EGP 108.75 per unit.

• **The Second Case Scenario:**

The **RPM** is selected in this case, and ETA selected, as a benchmark, a comparable uncontrolled transaction in which a comparable independent distributor performing comparable, functions using comparable assets, and bearing comparable risks earned a gross margin of 32%.

• **The Third Case Scenario:**

The **CPM** is selected in this case and ETA selected, as a benchmark, a comparable uncontrolled transaction in which a comparable independent manufacturer performing comparable functions, using comparable assets, and assuming comparable risks earned a mark-up of 45%.

▪ **The analysis**

• **The First Case Scenario:**

Under the CUP method, provided that all other facts and circumstances being comparable, ETA will:

1. Focus directly on the price at which the unit of manufactured product was transferred between Egypco and Greco.
In this case, the transfer price / unit = EGP 100.00
2. Compare the aforementioned transfer price to the price charged in the selected comparable uncontrolled transaction.
In this case, the selected comparable uncontrolled price/ unit = EGP 108.75
3. Judge whether the transfer price adopted between Egypco and Greco is consistent with the selected comparable uncontrolled price.

Comparing the two prices, ETA concluded that the transfer price established for the controlled transaction between Egypco and Greco (EGP 100/ unit) is not arm's length, since it is not consistent with the one established for the selected comparable uncontrolled transaction (EGP 108.75/ unit). Thus, ETA adjusted the transfer price of the products sold to Greco, which accordingly resulted in adjusting the taxable profit and the tax liability due.

The following represents the adjusted income statement of Egypco:

Egypco's adjusted income statement:

Sales to Greeco (1000 units sold at EGP 108.75 / unit)	EGP 108,750 (after transfer pricing adjustment)
<u>Less</u> Manufacturing costs	EGP 75,000 -----
Gross profit	EGP 33,750
<u>Less</u> Operating expenses	EGP 15,000 -----
Net profit	EGP 18,750 -----

The adjustments resulted in a 87.5% raise in Egypco's taxable profit [(18,750 -10,000)/ 10,000]].

• **The Second Case Scenario:**

Under the RPM, provided that all other facts and circumstances being comparable, ETA will:

1. Focus on the gross margin earned by Greeco (the distributor). In this case, the gross margin earned by Greeco

$$(60,000/160,000) = 37.5\%$$

2. Compare the gross margin earned by Greeco to the gross margin earned by the selected comparable independent distributor. In this case, the comparable gross margin earned by the selected comparable independent distributor = 32%

3. Judge whether the gross margin obtained by Greeco (37.5%) is consistent with the gross margin earned by the selected comparable distributor (32%).

Comparing the two gross margins, ETA concluded that the gross margin adopted by Greeco (37.5%) is not consistent with the one earned by the selected comparable distributor in comparable transactions (32%). This indicates that the transfer price adopted in the controlled transaction between Egypco and Greeco is not arm's length.

Thus, ETA will make the following adjustments, in order to determine the arm's length price for the controlled transaction between Egypco and Greeco:

The adjusted arm's length gross margin = 32%.

$$\begin{aligned} &\text{The arm's length transfer price} \\ &= \text{Sales to third parties} - (\text{adjusted arm's length gross margin} * \text{Sales to third parties}) \\ &= \text{EGP } 160,000 - (32\% * \text{EGP } 160,000) \\ &= \text{EGP } 160,000 - (\text{EGP } 51,200) = \text{EGP } 108,800 \end{aligned}$$

The following represents the adjusted income statement of Egypco:

Egypco's adjusted income statement:

Sales to Greeco (1000 units sold at EGP 108.80 / unit)	EGP 108,800 (after transfer pricing adjustment)
Less:	
Manufacturing costs	EGP 75,000
Gross profit	EGP 33,800
Less:	
Operating expenses	EGP 15,000
Net profit	EGP 18,800

The adjustments resulted in an 88% raise in Egypco's taxable profit $[(18,800 - 10,000) / 10,000]$.

• The Third Case Scenario:

Under the CPM, provided that all other facts and circumstances being comparable, ETA will:

1. Focus on the gross mark-up earned by Egypco (the manufacturer). In this case, the gross mark-up earned by Egypco = $(100,000 - 75,000) / 75,000 = 33\%$.
2. Compare the mark-up earned by Egypco to the mark-up earned by the selected comparable independent manufacturer in the selected comparable uncontrolled transaction. In this case, the comparable mark-up earned by the selected comparable independent manufacture = 45%.
3. Judge whether the mark-up added by Egypco in its controlled transaction with Greeco is consistent with the mark-up earned by the selected comparable manufacturer in the selected comparable uncontrolled transaction.

Comparing the two mark-ups, ETA concluded that the mark-up adopted in the controlled transaction between Egypco and Greeco (33 %) is not consistent with the one earned by the selected comparable manufacturer in comparable transactions (45%). This indicates that the transfer price adopted in the controlled transaction between Egypco and Greeco is not arm's length.

Thus, ETA will make the following adjustments, in order to determine the arm's length price for the controlled transaction between Egypco and Greeco:

The adjusted gross profit mark-up = $75,000 * 45\% = \text{EGP } 33,750$
 The arm's length transfer price = $33,750 + 75,000 = \text{EGP } 108,750$

The following represents the adjusted income statement of Egypco:

Egypco's adjusted income statement:

Sales to Greeco (1000 units sold at EGP 108.75 / unit)	EGP 108,750 (after transfer pricing adjustment)
Less manufacturing costs	EGP 75,000
Gross profit	EGP 33,750
Less Operating expenses	EGP 15,000
Net profit	EGP 18,750

In this case, the adjustments resulted in a 87.5% raise in Egypco's taxable profit $[(18,750 - 10,000) / 10,000]$.

Based on the previous analysis, it is obvious that the application of each of the traditional transfer pricing methods resulted in the same transfer price for the controlled transaction between Egypco and Greeco.

Conclusion:

In a perfect world, all three methods would separately result in the determination of the same arm's length price for a particular transaction. However, taxpayers should realize that, in real world situations, the imperfections in comparables or the use of more than one method will lead to an arm's length range.

Example on the CUP Method

- Egypco is the Egyptian subsidiary of the parent company; Japco, that is located in Japan.
- In order to distribute product X in Egypt, Japco sells this product to two enterprises: its subsidiary Egypco, and Egytal, which is an independent Egyptian enterprise.
- Japco sells product X to Egypco on CIF basis. While Egytal takes possession of product X at Japco's factory price (on F.O.B basis).
- ETA selected Egypco for audit and conducted the following analysis, in order to decide whether product X is transferred from Japco to Egypco at arm's length price.
 - In March, 2016, Japco sold 7,000 units of product X to Egypco at EGP 100.00 per unit (including EGP 5 freight/ unit, EGP 4 insurance / unit and EGP 5 customs duties/ unit), while sold the same amount of units of product X during the same time period to Egytal at EGP 75.00 per unit.
 - After conducting a comparability analysis, ETA selected the uncontrolled transaction between Japco and Egytal as a comparable, against which the controlled transaction between Japco and Egypco is to be benchmarked.
 - In order to account for the comparability differences between the above mentioned controlled and uncontrolled transactions, ETA made the following comparability adjustments to the data of Egytal:

Unit price of product X sold to Egytal		EGP 75.00
Add:		
Adjustment for Freight/ unit	EGP 5.00	
Adjustment for Insurance/ unit	EGP 4.00	
Adjustment for customs duties/ unit	EGP 5.00	
	
Total adjustments/ unit		EGP 14.00
	
Adjusted comparable uncontrolled price /unit of X		EGP 89.00
	

All other facts and circumstances being comparable, comparing the transfer price at which the unit of X was transferred from Japco to Egytco (EGP 100.00) to the comparable uncontrolled price at which the unit of X was transferred from Japco to Egytal (EGP 89.00), ETA concluded that the transfer price adopted in the controlled transaction between the two associated enterprises is not arm's length and that it is overstated, which resulted in understating Egytco's taxable profit. Thus, ETA adjusted the transfer price / unit of X in Egytco's accounts to the arm's length transfer price of EGP 89.00/unit (EGP 75.00/unit + EGP 14.00/ unit) instead of 100.00/ unit. The result is EGP 77,000 increase in Egytco's taxable profit.

It should be emphasized that, for simplification purposes, this calculation assumes that customs duties, insurance and freight are so called "pass-through" costs that do not imply additional functions and/or risks to be assumed by Egytal. Otherwise an appropriate profit element would also have to be taken into account when making the comparability adjustment.

Example on the RPM

- Egytco is the Egyptian subsidiary of Japco, which is a multinational parent company resident in Japan.
- Japco produces two similar models of digital cameras: model A & model B.
- Both digital camera models are similar in terms of properties, construction, production processes and functions.
- In order to distribute its production of digital cameras in Egypt, Japco follows the following strategy:
 - Japco sells model A digital cameras to Egytco (a controlled transaction), which, in turn, sells them to independent retailers in Egypt.
 - On the other hand, Japco sells model B digital Cameras to Egydigital, an independent Egyptian enterprise (an uncontrolled transaction). Egydigital, then, sells model B digital Cameras to independent retailers in Egypt.
- The key functional differences between the above-described controlled and uncontrolled transactions are as follows:
 - While Japco trains Egydigital's sales force and develops training material for them free of cost, Egytco develops its own training material, trains its own sales force and bears the related costs.
 - While Japco bears the warranty risk in its uncontrolled transaction with Egydigital, Egytco bears the warranty risk in its controlled transaction with Japco.

- 
- Both markets of models A & B digital cameras are similar in Egypt.
 - For purposes of this example, it is assumed that all other facts and circumstances are comparable.
 - While auditing Egypco's tax return for the financial year 2016, ETA found the following intra-group transactions and financial data:
 - On January 15th, 2016, Egypco purchased 5,000 model A digital cameras from Japco for EGP 1,000/ camera.
 - During February 2016, Egypco sold the 5,000 model A digital cameras to a number of independent retailers in Egypt for EGP 1,100/ camera.
 - Egypco developed its own training material and trained its own sales force on model A digital camera for EGP 13,750.
 - The warranty costs are L.E. 30,250.
 - ETA conducted the following analysis in order to decide whether model A digital cameras are transferred from Japco to Egypco at arm's length price:
 - 1) ETA selected the transaction between Japco and Egydigital as a comparable uncontrolled transaction.
 - 2) The gross profit margin earned by Egydigital from the resale of model B digital cameras to independent retailers was found to be 13%.
 - 3) Additionally, ETA conducted a functional analysis, in order to identify and adjust the significant differences between the controlled and the selected comparable uncontrolled transactions.
 - 4) Based on the functional analysis, ETA concluded that Egypco performs more marketing functions (developing training material and training its own sales force) than those performed by Egydigital, and hence the functions performed by Egypco are not comparable to those performed by Egydigital.
 - 5) Moreover, ETA concluded that Egypco bears higher risks (the warranty risk) than those borne by Egydigital, and thus, the risks assumed by Egypco are not comparable to those assumed by Egydigital.
 - 6) Since the differences in the functions performed and risks assumed are significant and can materially affect the relevant gross profit margin earned by both enterprises, ETA made the necessary adjustments to eliminate the effect of such differences on gross profit.

Egypco's Income Statement

Sales to third parties (5,000 cameras X EGP 1,100)	EGP 5,500,000
(-) Purchases from Japco (5,000 cameras X EGP 1,000)	EGP 5,000,000
Gross Profit	EGP 500,000

Comparability Adjustments

Since the functional analysis reflected a number of differences between the controlled and the selected comparable uncontrolled transactions, which can materially affect the gross margin, ETA made the following comparability adjustments to account for such differences and to reach the correct gross margin.

Egypco's net sales of model A digital camera to independent retailers in Egypt	EGP 5,500,000
Arm's length resale price margin based on Egydigital's comparable gross margin (5,500,000 X 13.00%)	EGP 715,000
Add: Adjustments for functional and risk differences:	
Training costs	13,750
Warranty costs	30,250
Total adjustments	EGP 44,000
Adjusted gross profit	EGP 759,000

Adjusted transfer price of model A digital cameras from Japco to Egypco

Adjusted transfer price of model A digital cameras from Japco to Egypco
= Egypco's net sales of model A digital Cameras – Adjusted gross profit
= EGP 5,500,000 – EGP 759,000 = EGP 4,741,000
Adjusted transfer price per camera = EGP 4,741,000/ 5,000 cameras
= EGP 948.2/camera

Egypco's Adjusted Income Statement

Sales to third parties (5,000 cameras X EGP 1,100)	EGP 5,500,000
(-) Purchases from Japco (5,000 cameras X EGP 948.2)	EGP 4,741,000
Gross Profit	EGP 759,000

Based on the abovementioned adjustments, Egypco's gross profit increased by **51.8%** [(EGP 759,000 – EGP 500,000) / EGP 500,000], which will materially increase Egypco's taxable profit and the tax due accordingly.

Example on the CPM

- Egypco is a multinational manufacturing company resident in Egypt.
- Egypco manufactures leather purses and sells its production to Bahrainco, which is Egypco's foreign subsidiary in Bahrain.
- Egytal is an independent Egyptian manufacturing enterprise, which also manufactures leather purses and sells its production to independent distributors in Bahrain.
- Then, Bahrainco and the independent distributors sell the leather purses to independent retailers in Bahrain.
- After conducting a detailed comparability analysis, Egypco selected Egytal along with its aforementioned uncontrolled transactions as a comparable, in order to establish an arm's length price for its controlled transaction with Bahrainco. Many factors were considered in conducting this analysis such as:
 - **Product comparability and functional analysis:**
The product manufactured by Egypco is similar to the product manufactured by Egytal in terms of properties, production processes and functions. Additionally, both Egypco and Egytal play the same role in the controlled transaction and the selected comparable uncontrolled transactions, respectively. In other words, Egypco and Egytal are comparable in terms of the functions performed, assets used, and risks assumed by each of them in the controlled and the selected comparable uncontrolled transactions, respectively.
 - **Market Comparability:** The markets of both products are also similar and both Bahrainco and the independent distributors are wholesalers.
 - **Other Factors:** are also similar such as the time stage, the transaction volume, the contractual terms, etc.
- For purposes of this example, it is assumed that all other facts and circumstances are comparable.

- According to data available on the selected comparable, Egytal earns 10% gross profit mark-up on its manufacturing costs relating to its sales to the independent distributors in Bahrain.
- Thus, Egypco used 10% mark-up in pricing its controlled transactions.
- While auditing Egypco's tax return for the financial year 2016, ETA found the following intra-group transactions:
 - On July 12th, 2019, Egypco produced 1,000 units of leather purses at EGP 200/ unit.
 - During August, 2016, Egypco sold the 1,000 units of leather purses to Bahrainco for EGP 220/ unit.
- While examining the transaction under review in order to evaluate the reliability of its price, ETA found a material difference between the accounting practices applied by Egypco and those applied by Egytal.
- This difference is related to the way each of the companies calculates its cost base. While Egypco accounts for supervisory, general, and administrative costs as operating expenses, and thus these costs are not reflected in the costs of production in the transaction under review, Egytal accounts for supervisory, general, and administrative costs as part of the manufacturing costs.
- Such a difference can materially affect the comparability of the mark-up earned by Egytal, and hence leads Egypco to underestimate the value of the mark-up that should be added to the costs of production in its controlled transaction, resulting in pricing such a transaction at a value that is lower than the arm's length price.
- Therefore, Egytal's gross profit mark-up should have been adjusted to account for the difference in the accounting practices rather than using it directly in pricing its controlled transaction.
- According to the data available on the selected comparable uncontrolled transaction, Egytal produces the unit of leather purse at EGP 210 per unit (7% of this value represents supervisory, general, and administrative costs) and sells its production to independent distributors in Bahrain for EGP 231 per unit.
- Hence, ETA decided to make the following adjustments to express the cost base in each of the transactions in equivalent terms, in order to judge the reliability of the price adopted by Egypco in the transaction under review.

Egypco's Income Statement		Egytal's Income Statement	
Sales to Bahrainco (1,000 units X EGP 220)	220,000	Sales to independent distributors (1,000 units X EGP 231)	231,000
(-) cost of sales (1,000 units X EGP 200)	200,000	(-) cost of sales (1,000 units X EGP 210)	210,000
Gross Profit	20,000	Gross Profit	21,000
Gross profit mark-up	20,000 / 200,000 = 10%	Gross profit mark-up	21,000 / 210,000 = 10%

Comparability adjustments

Based on the available data, and after auditing the documents submitted by Egypco to justify that the price established for its above mentioned controlled transaction is arm's length, ETA concluded the following:

- 1) Although Egypco selected an uncontrolled transaction that is highly comparable to its controlled transaction and that ETA is persuaded that there is no problem with the selected comparable, the price established for the above-mentioned controlled transaction is not arm's length.
- 2) By reviewing the pricing steps followed by Egypco in establishing an arm's length price for the controlled transaction under review, it is obvious that Egypco used the CP mark-up earned by Egytal directly without adjusting it for the differences in the accounting practices, which resulted in a significant difference in the cost base, and hence in the value of the mark-up.
- 3) Thus, ETA made further adjustments to account for such differences and reach the correct gross profit mark-up.

Adjusting the cost of production in the selected comparable uncontrolled transaction:

Cost of production including SGA costs	EGP 210,000
(-)supervisory, general, and administrative costs 7% X EGP 210,000)	EGP 14,700

Adjusted cost of production	EGP 195,300
	=====

Thus, the gross profit mark-up earned by Egytal is to be adjusted accordingly as follows:

Sales to independent distributors in Bahrain	EGP 231,000
(-) Adjusted cost of production	EGP 195,300

Gross Profit	EGP 35,700
	=====

Gross profit mark-up = 35,700 / 195,300 = **18.3%**

Thus, the gross profit mark-up that should be used by Egypco in pricing its controlled transaction is 18.3%

Establishing an arm's length price for Egypco's controlled transaction

Sales to Bahrainco = cost of sales * (100% + The adjusted comparable gross mark-up)
 = EGP 200,000 * 118.3%
 = EGP **236,600**

Egypco's adjusted Income Statement

Sales to Bahrainco (1,000 units * EGP 236.6)
 (-) cost of sales (1,000 units EGP 200)
 Gross Profit

EGP **236,600**
 EGP 200,000

 EGP **36,600**

Based on the above adjustments Egyptco's gross profit increased by **83%** [(EGP 36,600-EGP 20,000)/ EGP 20,000], which will materially increase Egypco's taxable profit and the tax due accordingly.

Example on the TNMM

- EgyptTech is a multinational wholesale distribution company resident in Egypt. EgyptTech is a subsidiary of JapanTech, the parent company of the Tech TVs multinational Group, resident in Japan.
- JapanTech manufactures TV sets for worldwide distribution, and sells its production locally in Japan, as well as to its subsidiary distribution companies including EgyptTech, under the Tech brandname (developed and owned by JapanTech).
- JapanTech only sells its production to associated enterprises (i.e. members of the Tech TVs Group) for worldwide distribution, and does not sell any of its produced TV sets to uncontrolled distributors.
- Similar TV sets are produced by uncontrolled manufacturers, and sold to uncontrolled distributors, but not under the Tech tradename.
- EgyptTech is under audit for the taxable year 2015. Based on the facts and circumstances, ETA performed an analysis for each of the transfer pricing methods stipulated under the Law and determined that the TNMM will provide the most reliable measure of an arm's length result.
- EgyptTech was selected as the tested party as it engages in activities that are less complex compared to those undertaken by JapanTech, and does not own or contribute valuable intangible assets, whereas JapanTech owns and develops the Tech tradename.
- ETA used its specialist benchmarking database to perform a comparability analysis, from which to determine whether the intra-group pricing of TV sets sold from JapanTech to EgyptTech has been set in accordance with the arm's length price.
- Based on the comparability analysis performed by ETA, there was data for independent wholesale distribution companies with functional profiles similar to that of EgyptTech. These potential comparables were further reviewed qualitatively to select companies in the same industry segment that perform similar functions and bear similar risks as EgyptTech.
- The operating profit margin (i.e. ratio of operating profit to sales) was used as the profit level indicator for the purposes of comparison, and this ratio was relatively stable where at least three years are included in the average.
- Based on the analysis performed by ETA, a final set of 10 companies was identified as comparable to EgyptTech. The three-year average operating profit margin was calculated for each of the 10 companies, which was determined to be as follows:

Company	Operating Profit Margin			
	2013	2014	2015	Three-year average
A	2.4%	3.0%	2.8%	2.7%
B	2.5%	3.0%	2.8%	2.8%
C	3.0%	3.2%	3.5%	3.2%
D	3.7%	3.5%	3.5%	3.6%
E	4.0%	4.4%	4.5%	4.3%
F	4.8%	5.0%	5.5%	5.1%
G	5.3%	5.5%	5.0%	5.3%
H	6.1%	7.0%	6.5%	6.5%
I	7.0%	6.5%	8.0%	7.2%
J	12.0%	10.5%	10.0%	10.8%
			Minimum	2.7%
			Lower quartile	3.3%
			Median	4.7%
			Upper quartile	6.2%
			Maximum	10.8%

- The three-year average operating profit margin earned by the comparable independent distributors ranged from a minimum of 2.7% to a maximum of 10.8%, with a median of 4.7%, and the interquartile range was 3.3% to 6.2%.
- Given that the TNMM relies on broad comparability factors, the data available on the comparable independent distributors may not be sufficiently complete to conclude that all likely differences (particularly immaterial differences) have been identified.
- In other words, while every effort has been made to exclude those companies that have a lesser degree of comparability to EgyptTech, the set of comparable independent companies arrived at provides a range of operating profit margins for which some comparability defects may remain that cannot be identified/quantified, and are therefore not adjusted. In such a case, statistical tools should be used to narrow the range thereby excluding potential outliers to enhance the reliability of the analysis.
- As such, ETA used the arm's length range of the comparable independent distributors to assess whether the transfer price EgyptTech used to purchase TV sets from its parent company JapanTech was considered arm's length.

Scenario One

- During 2015, **JapanTech** sold 1,000 units of TV sets to **EgyptTech** for EGP 6,240/ unit.
- The financial performance of **EgyptTech** in 2015 was as follows:

	2015
Sales (to independent distributors)	8,000,000
Cost of goods sold (purchases from JapanTech – 1,000 units*6,240)	6,240,000
Gross profit	1,760,000
Operating expenses	1,400,000
Operating profit	360,000
Operating profit margin (ratio of operating profit to sales)	4.5%

- **EgyptTech** achieved an operating profit margin of 4.5% for the taxable year 2015, which falls within the arm's length range of the comparable independent distributors.
- Therefore, ETA concluded that **EgyptTech** has appropriately considered the arm's length principle in its transfer pricing practices, and that the pricing of its controlled transaction with JapanTech was consistent with the arm's length range of comparable transactions.

Scenario Two

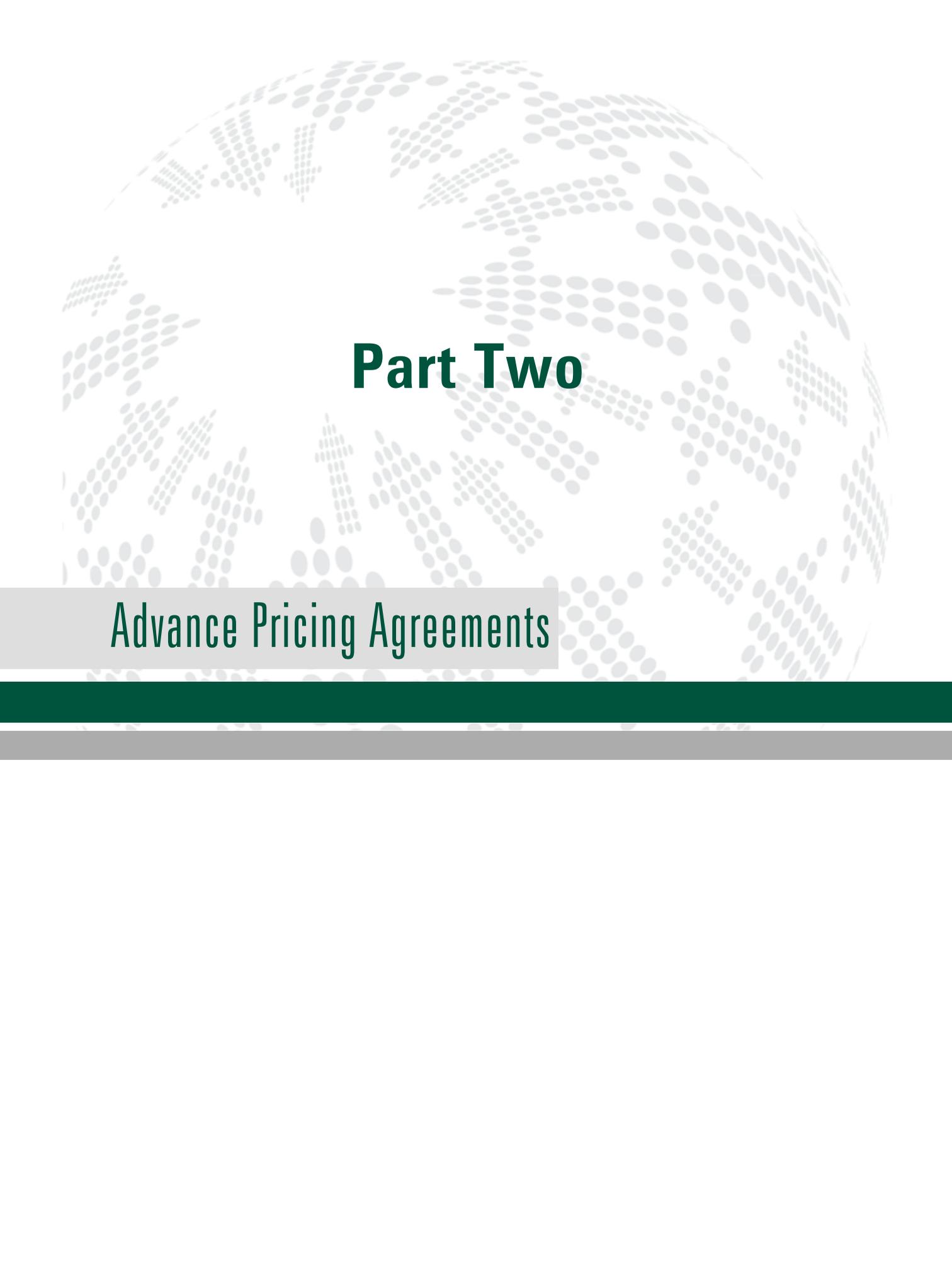
- During 2015, **JapanTech** sold 1,000 units of TV sets to **EgyptTech** for EGP 6,400/ unit.
- The financial performance of **EgyptTech** in 2015 was as follows:

	2015
Sales (to independent distributors)	8,000,000
Cost of goods sold (purchases from JapanTech – 1,000 units*6,400)	6,400,000
Gross profit	1,600,000
Operating expenses	1,400,000
Operating profit	200,000
Operating profit margin (ratio of operating profit to sales)	2.5%

- EgyptTech achieved an operating profit margin of 2.5% for the taxable year 2015, which falls below the arm's length range. Therefore, ETA decided to make an adjustment to EgyptTech's transfer price (i.e. purchase price of TV sets from JapanTech), to bring its operating profit margin up to the median of the arm's length range, thereby arriving at the appropriate operating profit and accordingly taxable profit.
- Hence, EgyptTech's adjusted financial results for the taxable year 2015 are as follows:

	2015
Sales (to independent distributors)	8,000,000
Cost of goods sold (purchases from JapanTech 1,000 units*6,224)	6,224,000
Gross profit	1,776,000
Operating expenses	1,400,000
Operating profit	376,000
Operating profit margin (ratio of operating profit to sales)	4.7%

- Based on the above adjustment to EgyptTech's transfer price (i.e. purchase price from JapanTech), EgyptTech's operating profit increased by 88% [(EGP 376,000-EGP 200,000)/ EGP 200,000], which will materially increase EgyptTech's taxable profit and the tax due accordingly.



Part Two

Advance Pricing Agreements



Overview of APAs

Introduction
OECD Transfer Pricing Guidelines
Future Work
Abbreviations for the purpose of these Guidelines

Introduction

It has been the experience of many tax administrations in different countries that resolving transfer pricing disputes through the normal audit procedure has always been complex, and proved to be a lengthy and costly process for both; tax administrations and taxpayers. The difficulties surrounding this process led to the evolvement of the Advance Pricing Agreement (APA) concept as an alternate to resolving transfer pricing issues.

ETA has therefore introduced an APA program to help taxpayers determine, in advance, the appropriate arm's length price for their intra-group transactions with associated enterprises in accordance with the provisions of Article (30) of the Law, and its Executive Regulations amended Articles (38), (39), and (40).

Hence, if a taxpayer believes that its business activities and the associated transfer pricing issues are unique or complex in nature, the taxpayer is encouraged to conclude an APA with ETA to avoid future tax disputes.

It should be noted that concluding an APA with ETA is subject to ETA's approval on the APA request submitted by the taxpayer.

This Part of the Transfer Pricing Guidelines sets out the views of ETA on APAs in light of the provisions of the Law, and describes the mechanisms, procedures, and implementation of the APA program in Egypt.

These Guidelines are intended to provide practical guidance to taxpayers wishing to enter into APAs with ETA on how they may apply for an APA and the manner in which their APA application will be processed. The Guidelines also serve as a reference for other countries' tax administrations and taxpayers to understand Egypt's APA program.

OECD Transfer Pricing Guidelines

The OECD Transfer Pricing Guidelines stipulate the following on APAs:

"An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations. APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues. They may be most useful when traditional mechanisms fail or are difficult to apply."

ETA used the OECD Transfer Pricing Guidelines as a basic reference in preparing this circular, and hence the OECD Transfer Pricing Guidelines should be consulted for a more detailed discussion of the principles contained in this circular.

Future Work

The APA program is a new concept in Egypt, thus, ETA realizes that taxpayers need adequate time to understand the principles underlying such a program to put these principle into practice. Therefore, ETA has decided to only introduce unilateral APAs into the Egyptian APA program at this point.

These Guidelines thus provide a description of the main concepts, mechanisms and procedures of concluding a unilateral APA with ETA. A description of other APA types, including BAPAs and MAPAs, is provided in Chapter five of this part.

However, for the purpose of these Guidelines, the conclusion of BAPAs and MAPAs will not be enacted by ETA until further official notice.

Abbreviations for the purposes of these Guidelines⁽²⁰⁾

APA

Advance pricing agreement

APA report

APA annual compliance report

BAPA

Bilateral advance pricing agreement

MAPA

Multilateral advance pricing agreement

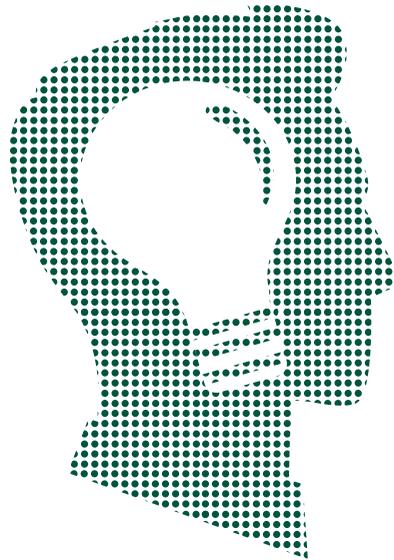
PE

Permanent Establishment

TPM

Transfer pricing methodology

²⁰ See "Definitions" section included in the "Overview of Guidelines" under Part One of these Guidelines for other definitions used in Part Two.



Chapter One

Understanding APAs

- 1.1. Overview
- 1.2. Types of APAs
- 1.3. Benefits of APAs
- 1.4. Scope of APAs
 - 1.4.1. Nature of transactions covered, and duration
 - 1.4.2. Taxpayers eligible to apply

Summary of Chapter 1

1.1. Overview

- An APA is a procedural arrangement between a taxpayer and a tax administration that determines the TPM which should be used to establish the arm's length transfer price(s) of certain prospective controlled transaction(s) between a taxpayer and its associated enterprises.
- The APA program is designed to enable taxpayers and ETA to agree on the proper treatment of the transfer pricing of potential controlled transaction(s) in which the taxpayer will engage for a specific period (typically more than one year) under certain terms and conditions. Therefore, the APA program is intended to provide a cooperative process to resolve potential transfer pricing disputes in advance. An APA is a legal enforceable agreement that is binding on ETA and the applicant taxpayers.
- All APA requests should be submitted to and administered through the transfer pricing department within ETA.

1.2. Types of APAs

- There are three types of APAs, namely **unilateral, bilateral (BAPA), and multilateral (MAPA)**.
- A unilateral APA is an agreement that solely involves a taxpayer and a tax administration, i.e. a taxpayer and ETA only, on an appropriate transfer pricing methodology (TPM) for the transaction(s) at issue; whereas, a BAPA or MAPA is an agreement concluded on a bilateral or multilateral basis, respectively, involving more than one taxpayer and the relevant tax administrations of two or more governments. Therefore, a BAPA or MAPA is an agreement entered into between a taxpayer resident in Egypt and ETA, along with the relevant associated enterprise(s) and foreign tax administration(s), in accordance with the provisions of the mutual agreement process contained in Article 25 of the OECD Model Tax Convention.

1.3. Benefits of APAs

- An APA is a legally binding agreement, and serves as an effective tool to enhance collaboration between the taxpayer and ETA. A taxpayer thus stands to benefit from an APA, as follows:
 - a. Provides certainty with regard to transfer pricing issues and the appropriate TPM to apply in pricing the controlled transaction(s) covered by the APA, which provides an accurate prediction of the tax treatment of domestic and international controlled transaction(s).
 - b. Provides taxpayers with objective information to better predict costs and expenses including tax liabilities, thus assuring taxpayers of the relevant rights and obligations.
 - c. Reduces costly and time-consuming examination of transfer pricing issues where there is a regular tax/transfer pricing audit rather than an APA, and lowers the potential for protracted and expensive litigation.
 - d. Reduces record keeping burden, since the taxpayer is aware in advance of the required documentation to be created and maintained to demonstrate compliance with the agreed upon TPM.

1.4. Scope of APAs

The OECD Transfer Pricing Guidelines stipulate that:

“Tax administrations may find APAs particularly useful in profit allocation or income attribution issues arising in the context of global securities and commodity trading operations, and also in handling multilateral cost contribution arrangements. The concept of APAs also may be useful in resolving issues raised under Article 7 of the OECD Model Tax Convention relating to cost allocation problems, permanent establishments, and branch operations.”

In this context, an APA's scope may cover all of the transfer pricing issues of a taxpayer, or may be limited to cover a specific controlled transaction(s) and affiliate(s).

- The scope of an APA typically covers the following:
 - a. Taxpayer and the domestic/foreign associated enterprise(s);
 - b. Controlled transaction(s) covered by the APA;
 - c. TPM to be applied including arm's length outcomes from applying the agreed TPM;
 - d. Duration of the APA;
 - e. Critical assumptions; and
 - f. Other agreed terms and conditions, as relevant.⁽²¹⁾
- Except in exceptional circumstances (i.e. where it is appropriate based on the particular facts and circumstances of the case), an APA will typically not specify the actual taxable profits or income to be taxed. Rather, an APA will specify an appropriate set of criteria (e.g. TPM, comparables, comparability factors and appropriate adjustments thereto, critical assumptions as to future events) for the determination of conditions consistent with the arm's length principle for those controlled transactions over a fixed period of time.

1.4.1. Nature of transactions covered, and duration

- APAs are not restricted to specific types of controlled transactions or industries. Thus, APAs are not limited to, but may potentially cover controlled transactions involving the following:
 - a. Purchase, sale, transfer and use of tangible assets;
 - b. Transfer or license/use of intangible assets;
 - c. Financial transactions; and
 - d. Service transactions, including cost contribution arrangements.
- An APA typically applies to prospective years and transactions, the actual term of an APA would depend on the industry, products and transactions involved. In practice, APA duration will vary depending on the facts and circumstances of the particular case. The exact duration will be determined in accordance to the terms and conditions of the enforceable APA between ETA and the taxpayer.

1.4.2. Taxpayers eligible to apply

- The option to apply for an APA is open to all taxpayers, who are subject to the provisions of the Law. These Guidelines are also applicable to PEs. More specifically, transactions between parts of the same business enterprise operating in different countries (e.g. between a head office and a PE or between two separate PEs) are also eligible for an APA, subject to the provisions of the relevant double tax treaty.

■ However, an APA program cannot accommodate all taxpayers' requests, and in fact, cannot be used by all taxpayers. Therefore, APAs should be used prudently by taxpayers to assist in resolving unique or complex transfer pricing issues, as the procedure may be costly and time-consuming.

²¹ See Chapter 3 – APA Filing: Processing a Unilateral APA request, of Part Two of these Guidelines for a detailed description of the APA scope.

Summary of Chapter One

- There are three types of APAs, namely unilateral, BAPA, and MAPA.
- A unilateral APA is an arrangement between a taxpayer and a tax administration that determines the TPM which should be used to establish the arm's length transfer price(s) of a taxpayer's prospective controlled transaction(s) with its associated enterprises.
- The APA program is intended to provide a cooperative process to resolve potential transfer pricing disputes in advance.
- Benefits of APAs include:
 - a. Providing certainty with regard to the application of an appropriate TPM in pricing the controlled transaction(s) covered by the APA;
 - b. Assuring taxpayers of the relevant rights and obligations;
 - c. Reducing costly and time-consuming examination of transfer pricing issues during audits; and
 - d. Reducing record keeping burden.
- APAs apply to prospective years and transactions, and the actual term of an APA would depend on the industry, products and transactions involved.
- Any taxpayer operating in Egypt, who is subject to the provisions of the Law, is eligible to apply for an APA, including PEs. However, APAs should be used prudently by taxpayers to assist in resolving key transfer pricing issues.



Chapter Two

Process of applying for a Unilateral APA

2.1 APA Process

2.1.1. Pre-filing meeting

2.1.1.1 Critical assumptions

2.1.1.2 Covered period

2.1.2. Submission of formal application

Summary of Chapter 2

2.1 APA Process

- The process of applying for and concluding a unilateral APA would generally range between three to six months.⁽²²⁾ A taxpayer who applies for a unilateral APA is subject to the following APA application and administration process:
 - a. Pre-filing meeting;
 - b. Submission of application using a prescribed form;
 - c. Review of APA documentation package;
 - d. Evaluation and necessary negotiation;
 - e. Signing of the APA; and
 - f. APA compliance, i.e. submission of APA annual compliance report throughout the term of the APA.

2.1.1. Pre-filing meeting

- A taxpayer wishing to conclude a unilateral APA with ETA is required to make a written request to ETA for a pre-filing meeting, at least six months prior to the first day of the proposed covered period. The taxpayer should submit an information package along with the written request, covering the below listed pre-filing meeting topics, using Form 1 - APA: Unilateral APA - Application for Pre-filing Meeting.⁽²³⁾
- ETA will respond to taxpayer with a confirmation of the pre-filing meeting date. The purpose of the pre-filing meeting is to determine the suitability of an application for APA, which can be done over more than one session, in order for ETA to obtain the required information for a preliminary assessment to make an informed decision on whether the taxpayer can proceed with an APA application.

The following topics will be discussed in the pre-filing meeting:

- a. The period to be covered by the APA;
- b. Associated enterprise(s) involved and intra-group transaction(s) to be covered (including nature and scope) under the arrangement;
- c. Overview of the taxpayer's business operations in prior and future years;
- d. High level description of functional and risk profiles of the taxpayer and associated enterprise(s) involved in the APA application;
- e. The proposed TPM, and high level description of the relevant critical assumptions;
- f. The extent of information and documentation required; and
- g. Any other situations requiring explanation, or relevant issues.

■ **For ease of reference, the APA information package should include:**

- a. The global organization structure of the Group under which the taxpayer operates, and the industry in which it operates;
- b. Associated enterprise(s) relevant to the controlled transaction(s), and the transactions' flows;
- c. Overview of the taxpayer's business operations, and high level description of functional and risk profiles of the taxpayer and the relevant associated enterprise.
- d. The transfer pricing and corporate income tax audit history (if any), and related domestic or foreign tax audit issues;
- e. The reasons for requesting an APA;
- f. Relevant transfer pricing policies, accounting systems and practices;
- g. The proposed TPM under the APA and the underlying rationale;
- h. The key representatives of the taxpayer who will be involved throughout the APA process; and
- i. Any documents relating to similar previous application or APA by other tax administrations.

²² This is an indicative timeframe and may vary depending on the case at hand.

²³ See Appendix One for Form 1 - APA – Unilateral APA - Application for Pre-filing Meeting. Form 1 - APA can be downloaded from ETA's website or collected from the transfer pricing department at the following address: 9th Plot, Block 10 ,43th District, Nasr City, Cairo, Egypt.

- If the two parties form consensus, ETA will formally notify the taxpayer in writing, within two weeks from the date of the meeting in which they reached consensus, to submit a formal APA application.
- Given that each APA is unique with a different set of facts and circumstances, the acceptance of a transfer pricing case for an APA with ETA is subject to an evaluation process, and is to be determined on a case-by-case basis. However, ETA will **prioritize** transfer pricing cases for an APA when:
 - a. The controlled transactions or transfer pricing issues are considered to be unusually complex;
 - b. The application of the TPM may give rise to questions of reliability and accuracy;
 - c. The application of the TPM presents an innovative application, and employs uncommon techniques;
 - d. The applicant taxpayer operates in a specialized industry, or proposes to engage in transactions with associated enterprises located in a specific country/region (ex: low tax-rate jurisdictions / tax havens) that qualifies the APA for a prioritized attention; or
 - e. The applicant taxpayer's controlled transactions have been audited and will continue in the future on the same basis, in order to avoid transfer pricing disputes that may arise in future years by concluding an APA on the same basis that has been agreed for the audited years.

2.1.1.1 Critical assumptions

- Critical assumptions are the assumptions relating to the:
 - a. Operational and economic conditions that in the event of their occurrence, may significantly affect the controlled transaction(s) under consideration, and the ability of the selected TPM to reliably reflect the arm's length price of the transaction(s); and
 - b. Changes in governmental laws and regulations, business activities and market conditions that may have a material effect on the transaction(s) covered by an APA.
- Examples of critical assumptions include; but are not limited to:
 - a. Changes to the relevant domestic tax law and treaty provisions;
 - b. Assumptions relating to tariffs, duties, import restrictions, value-added tax and other relevant regulations;
 - c. Assumptions relating to exchange rates, interest rates, credit ratings and such other relevant factors; and
 - d. Assumptions relating to the nature of the functional and risk profiles of the enterprises involved in the controlled transaction(s) covered by the APA.
- Critical assumptions are very different and specific to each APA case, and should therefore be addressed and highly tailored to the facts and circumstances of each APA case.
- For example, if the reliability of the proposed TPM is sensitive to exchange rate fluctuations, it may be necessary to take into account the degree to which movements in the exchange rates will not impair the reliability of the TPM application. The degree to which any movement in the exchange rate will not have an impact on the reliability of the TPM may also be built into the terms and conditions of the APA, along with the threshold which if trespassed, the TPM should be revisited, or which forms a breach of a critical assumption hence requiring the APA to be re-negotiated.

Moreover, the OECD Transfer Pricing Guidelines state the following example in respect of the significance of critical assumptions to an APA:

“The reliability of any prediction used in an APA depends both on the nature of the prediction and the critical assumptions on which the prediction is based. For example, it would not be reasonable to assert that the arm’s length short-term borrowing rate for a certain corporation on intragroup borrowings will remain at six percent during the entire coming three years. It would be more plausible to predict that the rate will be LIBOR plus a fixed percentage.⁽²⁴⁾ The prediction would become even more reliable if an appropriate critical assumption were added regarding the company’s credit rating (e.g. the addition to LIBOR will change if the credit rating changes).”

- As such, critical assumptions are required to be established and described within the context of an APA in detail, including how the occurrence of such critical assumptions would impact the reliability and applicability of the TPM. An APA may be subject to revision or cancellation if the taxpayer failed to meet a critical assumption during the term of the APA.
- **In the event of cancellation, ETA is entitled to perform a transfer pricing audit on the taxpayer’s transfer pricing practices including those controlled transactions that were previously covered by the cancelled APA, in accordance with the typical audit procedures, which may subject the taxpayer to transfer pricing adjustments.**⁽²⁵⁾

2.1.1.2 Covered period

- The taxpayer should propose an initial term for the APA, taking into consideration the industry in which the company operates and the nature of the controlled transaction(s) to be covered by the APA. The term of an APA would vary depending on the specific facts and circumstances of each APA case.
- The APA may be renewed for further period after the expiration of the APA term.

(APA renewal is discussed in Chapter four of Part Two of these guidelines).

2.1.2. Submission of formal application

- An application for a Unilateral APA, to which the relevant documents should be attached, must be submitted using Form 2 - APA within two months after receiving the formal notification from ETA pursuant to the pre-filing meeting.⁽²⁶⁾
- The relevant documents for the APA application should ideally be submitted in both, English and Arabic languages. However, the taxpayer may initially submit the documents in English, and ETA will inform the taxpayer if an Arabic translation is required.

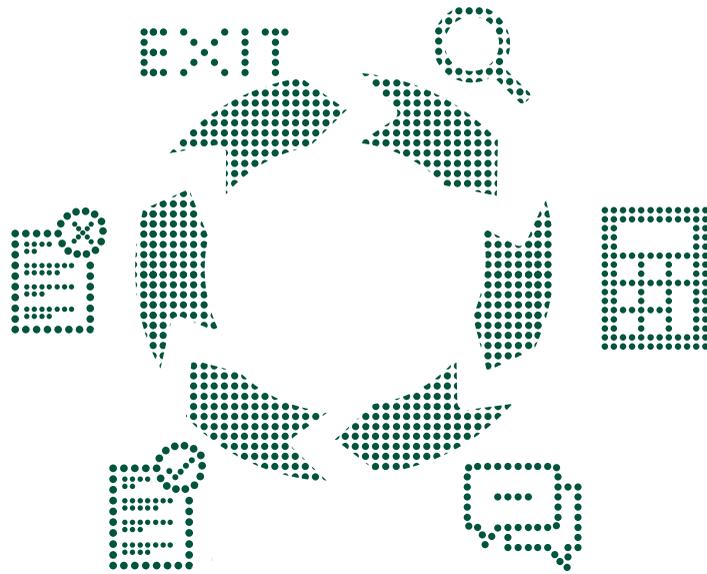
²⁴ The London Interbank Offered Rate (LIBOR) is an average of estimated interest rates by each of the top banks in London that they would be charged were they to borrow from other banks at that time.

²⁵ See Sections 4.5 and 4.6 for the Revision and Cancellation of an APA, respectively.

²⁶ See Appendix Two for Form 2 – APA: Unilateral APA Application. Form 2 - APA can be downloaded from ETA’s website or collected from the transfer pricing department at the following address: 9th Plot, Block 10 ,43th District, Nasr City, Cairo, Egypt.

Summary of Chapter Two

- Applying for and concluding a unilateral APA would generally range between three to six months, subject to the following process:
 - a. Pre-filing meeting;
 - b. Submission of APA application;
 - c. Review of APA documentation package;
 - d. Evaluation and negotiation;
 - e. Signing of the APA; and
 - f. APA compliance.
- A taxpayer wishing to conclude a unilateral APA with ETA is required to make a written request to ETA for a pre-filing meeting, at least six months prior to the first day of the proposed covered period, and submit an information package along with the written request.
- If the two parties form consensus, ETA will formally notify the taxpayer, in writing, within two weeks from the date of the meeting in which they reached consensus to submit a formal APA application.
- Critical assumptions are very different and specific to each APA case, and should therefore be addressed and highly tailored to the facts and circumstances of each case. They are required to be established within the context of an APA in detail.
- The term of an APA would vary depending on the specific facts and circumstances of each APA case.
- An application for a Unilateral APA must be submitted using Form 2 - APA within two months after receiving the formal notification from ETA pursuant to the pre-filing meeting.



Chapter Three

APA Filing: Processing a Unilateral APA Request

- 3.1. Processing a Unilateral APA request
 - 3.1.1 Review of APA documents submitted by taxpayer
 - 3.1.2 Evaluation of the APA documentation package
 - 3.1.3 Negotiation of the APA submission
 - 3.1.4 Completion of processing the APA request
 - 3.1.5 Declining an application
 - 3.1.6 Withdrawal of request

Summary of Chapter 3

3.1. Processing a Unilateral APA request

3.1.1 Review of APA documents submitted by taxpayer

- If the taxpayer receives a formal notification from ETA to proceed with the APA request, the taxpayer will be required to submit a formal APA application, along with the APA documentation package. The taxpayer is responsible for ensuring that all the required information and documents have been included within the APA documentation proposals made within the APA submission.⁽²⁷⁾
- ETA will confirm its commitment to accept an APA request for review by sending an official acceptance letter to the applicant taxpayer within 30 days after receiving the APA application and APA documentation package. The acceptance letter will set out the relevant terms and conditions under which ETA will review and evaluate the taxpayer's APA documentation package. It is essential that the taxpayer identify all authorized representatives in the APA application, including their contact details for any notifications issued by ETA.
- Given that the APA process is unique to each taxpayer's case, the different APA cases will require different submissions that may vary in terms of information included, economic and legal analyses, etc.

- In general, the **APA documentation package** should particularly include the following:
 - a. Names, addresses and tax file references of the taxpayer and the associated enterprise(s) as relevant to the proposed APA (both in Egypt and overseas);
 - b. Detailed description of the proposed controlled transaction(s) to be covered by the APA, including transaction flows through the value chain;
 - c. Years to be covered by the APA;
 - d. Details of the taxpayer and the associated enterprise(s) (as relevant to the covered controlled transactions) including ownership structure, organization chart and operational aspects of the business;
 - e. Information concerning the taxpayer as well as the Group such as the nature of the business, industry environment and worldwide organizational structure;
 - f. Functional analysis of each entity relevant to the controlled transaction(s) proposed to be covered by the APA, with a clear characterization of each entity;
 - g. A description of the main functions performed, risks assumed, and assets employed by entities in the group, which contribute significantly to defining and creating value or where key intangibles are owned/developed;
 - h. Details and analysis of the proposed TPM together with its rationale, i.e. identification of assumptions made in selecting the proposed TPM that are critical to the reliability of its application under the arms' length principle. The taxpayer should explain why the proposed TPM is appropriate for application;
 - i. Taxpayer's projected financial data for the period covered by the APA;
 - j. An economic analysis, covering the financial years covered by the APA including the full comparability study conducted and the application of the arm's length principle.

²⁷ See Appendix Two for Form 2 – APA: Unilateral APA Application. Form 2 - APA can be downloaded from ETA's website or collected from the transfer pricing department at the following address: 9th Plot, Block 10 ,43th District, Nasr City, Cairo, Egypt.

- k. The relevant intra-group agreements according to which the controlled transaction(s) are organised;
- l. Description of the critical assumptions under which the proposed TPM and analysis will apply, and the events that should be considered in respect to the specified assumptions, or critical changes that may occur in the business operations which are likely to impact the transactions; and
- m. Any other necessary/relevant information such as documents illustrating prior similar application or APA between an associated enterprise and another tax administration (unilateral APA, BAPA, or MAPA).

- ETA will review the **APA documentation package** to assess the appropriateness of the case for a formal unilateral APA.
- It should be noted that, in the course of reviewing the APA documentation package, the proposed TPM and its applicability will be subject to further review and discussion. Consequently, the application of the proposed TPM may be revised, or an alternative TPM may be incorporated into the final APA. Consequently, ETA is entitled to propose alternative methodologies, limit or extend the proposed scope of the APA, or decline the application altogether.
- Also, in the course of reviewing the APA documentation package, ETA may determine that it needs to conduct site visits to gain a better understanding of the business and the industry, to clarify issues and to gather more information.

3.1.2 Evaluation of the APA documentation package

- ETA will address APAs in the order in which it receives the APA submissions from taxpayers.
- Upon receipt and review of the formal APA documentation package and other required documents, ETA will evaluate the documents and form a position within a period of three months of the receiving date. If the evaluation phase is required to be extended due to special factors, ETA will formally notify the taxpayer.
- In the context of the evaluation process, ETA will examine and assess the appropriateness and completion of the information and analyses submitted by the taxpayer within the APA documentation package. Therefore, ETA may further request additional information from the taxpayer during the evaluation process for clarification purposes. ETA may also require the taxpayer to perform additional accounting or economic analyses upon review of the documents submitted. ETA and the taxpayer will mutually agree on reasonable cut-off dates for receiving final information.
- Moreover, ETA reserves the right to add additional controlled transaction(s) to the taxpayer's APA request when the transactions are so interrelated that they must be analyzed together.
- Any additional information requested by ETA in respect of the APA application and documentation package should be made available within a reasonable timeframe, as will be mutually agreed, from the date of the request. Otherwise, ETA may consider that the applicant taxpayer is not serious and may therefore terminate the process.
- At the end of the review, analysis, and evaluation stage of the APA process, ETA will discuss its general position and findings with the taxpayer, through the negotiation process outlined in the following section.

3.1.3 Negotiation of the APA submission

- ETA's transfer pricing department will arrange negotiations and discussions with the taxpayer following the review and evaluation process of the APA documentation package.
- Once ETA concludes its analysis pursuant to the review and evaluation process, the taxpayer will be informed in writing of ETA's position to commence the negotiation process.

- If there are differences between the taxpayer and ETA's positions, the taxpayer must respond in writing prior to the commencement of negotiation meetings regarding the TPM or other terms of the proposed APA. After receiving the taxpayer's response, if there are still differences between the taxpayer and ETA's positions, ETA will make itself available within 15 days to discuss the issues in an effort to reach agreement.
- If both parties form consensus, ETA's Transfer Pricing Department will prepare the draft APA along with an evaluation report and the relevant documents, and will submit them to the Tax Commissioner for approval.
- If approved by the Tax Commissionaire, a **draft APA** will be prepared, outlining the following:
 - a. Information of associated enterprise(s) such as names and addresses;
 - b. Controlled transaction(s) and the years covered by the APA;
 - c. The selected comparable transactions, TPM and calculation methods, and financial projections relating to the controlled transaction(s);
 - d. Critical assumptions;
 - e. Obligations of the taxpayer including annual reporting, record keeping, and notifying the ETA of changes to the critical assumptions, etc.;
 - f. Legal force of the arrangement, and confidentiality of documents and information;
 - g. Provisions on mutual responsibilities; and
 - h. Effective date.
- Where a taxpayer has entered into an APA with ETA, no adjustments will be made under Article 30 of the Law to the specified controlled transaction(s), provided the terms and conditions of the APA are satisfied. However, negotiating and concluding an APA does not restrict ETA to conduct transfer pricing audits and make adjustments on the taxpayer's controlled transaction(s) for years not covered by the APA.

3.1.4 Completion of processing the APA request

- The duration taken to formalize a position is dependent upon the cooperation of the applicant taxpayer, the complexity of the case and the completeness and quality of the information provided. An APA can only be concluded once the terms and conditions have been confirmed and agreed upon by all parties involved. The authorized representatives of both ETA's transfer pricing department and the applicant taxpayer will officially sign the unilateral APA.
- In this respect, the OECD Transfer Pricing Guidelines state that:

At the conclusion of an APA process, the tax administrations should provide confirmation to the associated enterprises in their jurisdiction that no transfer pricing adjustment will be made as long as the taxpayer follows the terms of the arrangements. There should also be a provision in an APA (perhaps by reference to a range) that provides for possible revision or cancellation of the arrangement for future years when business operations change significantly, or when uncontrolled economic circumstances (e.g. significant changes in currency exchange rates) critically affect the reliability of the methodology in a manner that independent enterprises would consider significant for purposes of their transfer pricing."

- The APA process does not however restrict ETA from notifying a treaty partner in accordance with the relevant treaty that ETA has concluded a unilateral APA.

3.1.5 Declining an application

- In the course of reviewing an application, ETA may take a position to decline the application if it is found to be inappropriate, particularly under any of the following circumstances:

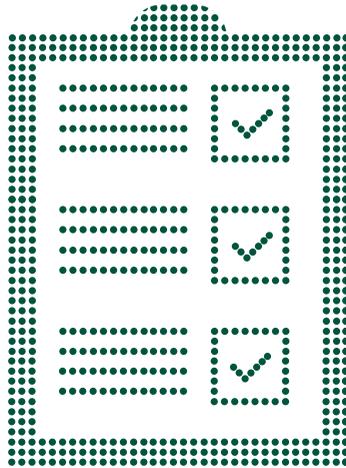
- a. If the applicant taxpayer failed to comply with the provisions of the Law and its executive regulations, the Egyptian Transfer Pricing Guidelines, or proposed to apply the TPM in a manner that does not adhere to the arm's length principle as contained in the Law.
 - b. Where the proposed covered controlled transaction(s) involve a tax avoidance arrangement;
 - c. Where it is considered to be an inefficient use of ETA's resources to pursue an APA due to the limited nature and value of the proposed transaction(s), or in the case where the arm's length principle can reliably be applied without material uncertainty;
 - d. Where the proposed controlled transaction(s) on which the APA is sought are subject to an appeal, for which a final resolution has not been reached;
 - e. The covered transaction(s) are based on a hypothetical situation or not seriously considered, such as applying for an APA on a nonexistent transaction; or
 - f. Where the applicant taxpayer demonstrates lack of cooperation in providing complete and reliable information, as requested during the APA process.
- If an application is declined by ETA, the taxpayer will be formally informed, in writing, of the reasons for ETA's decision. The taxpayer has the opportunity to respond and make further representations within 30 days after which the subsequent decision of ETA will be considered final.

3.1.6 Withdrawal of request

- The taxpayer may withdraw the application at any time. Withdrawal of the application must be made in writing to ETA. However, it is highly discouraged to withdraw from the process at a late stage without a valid reason because of the foreseeable waste of ETA's resources that will be caused by such action. The occurrence of such case will also reduce the taxpayer's chance to conclude an APA with ETA in the future, as the taxpayer will be considered as not serious.
- If the taxpayer is later selected for a regular tax/transfer pricing audit, the taxpayer should provide up-to-date documents/analyses as will be required during the audit process.
- Moreover, the fact that the taxpayer has withdrawn from the APA process will not have an impact on ETA's decision to select that taxpayer to be audited for tax/transfer pricing purposes.
- If the taxpayer withdraws an APA request, neither the taxpayer nor ETA will have any obligations to each other. Any previous undertakings relating to the APA request will be of no further force and effect. Confidentiality and protection of information submitted to ETA will apply in any case.

Summary of Chapter Three

- If ETA notifies a taxpayer that it wishes to proceed with an APA request, post a pre-filing meeting's assessment, the taxpayer is required to submit a formal APA application, along with an APA documentation package.
- ETA will confirm its commitment to accept an APA request for review by sending an official acceptance letter to the applicant taxpayer. It is therefore essential that the taxpayer identify all authorized representatives in the APA application, for any notifications issued by ETA.
- The **APA documentation package** should include all the pre-requisite documents and analyses required for reviewing and processing the APA request by ETA.
- Upon receipt and review of the formal **APA documentation package**, ETA will evaluate the documents and form a position within a period of three months.
- At the end of the review, analysis, and evaluation stage of the APA process, ETA will discuss its position with the taxpayer, through the negotiation process.
- If both parties form consensus, ETA's Transfer Pricing Department will prepare the draft APA along with an evaluation report and the relevant documents, and will submit them to the Tax Commissioner for approval.
- The authorized representatives of both; ETA's transfer pricing department and the applicant taxpayer will officially sign the unilateral APA, after the APA terms and conditions have been agreed and approved by all parties.
- The taxpayer may withdraw the APA application at any time, which must be made in writing to ETA. However, it is highly discouraged to withdraw from the process at a late stage without a valid reason.



Chapter Four

Post APA Filing: APA Compliance and Other Key Considerations

- 4.1. Filing of APA annual compliance report
- 4.2. APA annual compliance reports
- 4.3. APA audits
- 4.4. Adjustments
- 4.5. Revision of APA
- 4.6. Cancellation or Termination of APA
- 4.7. Renewal of APA
- 4.8. Other practical considerations
 - 4.8.1 Confidentiality and disclosure of APA
 - 4.8.2 Power to request further information
 - 4.8.3 Role of taxpayer

Summary of Chapter 4

4.1. Filing of APA annual compliance report

- After an APA has been concluded with ETA, the taxpayer will be required to file an APA annual compliance report (APA report), on an annual basis, according to the terms of the APA for each assessment year covered by the APA. The purpose of this report is to describe the taxpayer's actual operations for the period and demonstrate compliance with the terms and conditions of the APA.
- An APA report should address all items covered by the APA, and any other relevant issues in respect of revising or cancelling the APA. APAs are different, and each APA case is unique with respect to the transfer pricing issues it covers. Therefore, the specifics of each APA will set out the particular requirements of its APA report, such as the content and scope.
- **The APA report is required to be filed with ETA's transfer pricing department within 60 days from the date of filing the tax return. If the taxpayer does not file an APA report as required, ETA may cancel the APA altogether.**
- ETA will review the APA report to ensure that the terms and conditions of the APA have been complied with, and to evaluate the application of the agreed upon TPM and the resulting intra-group pricing thereof, along with the information and explanations provided in the APA report.
- In the course of reviewing the APA report, ETA will also look into any items requiring a specific response, such as a request to revise the APA. ETA will contact the taxpayer if any clarifications or information is required further to the submitted APA report. The outcome of the review process of the APA report will provide for actions required to be taken, if any, in respect of the reported results such as the need to propose adjustments, revise, or cancel the APA.

4.2. APA annual compliance report

■ **The APA report should include the following:**

- a. The audited financial statements for the relevant financial year/tax period of the taxpayer;
- b. A detailed description and analysis of the covered transaction(s) by the taxpayer in their financial statements for the relevant financial year;
- c. A description of any changes in the financial or tax accounting methods or principles employed, if any, for the relevant financial year with regard to the covered transaction(s) that differ from the methods upon which the APA has been concluded. This should include a description of how such changes have had an impact on the arm's length pricing of the transaction(s).
- d. A description of any failure, if any, and the reasons for such failure to meet a critical assumption. If this is inapplicable, a statement on the continuing relevance/validity of the critical assumptions has to be furnished;
- e. Information, analyses and computations necessary to support the application of the TPM for the covered transactions and the results which comply with the TPM for that year of assessment; and
- f. An analysis of any compensating adjustments⁽²⁸⁾ (described hereunder) required under the APA with the relevant tax computations.

- **If the taxpayer fails to create and submit the complete information and analyses in respect of the APA report as required, ETA is entitled to cancel the APA, which may consequently subject the taxpayer to the regular tax/transfer pricing compliance audit.**

²⁸ Compensating adjustment is an adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer's opinion, an arm's length price for controlled transaction, even though this price differs from the amount actually charged between the associated enterprises. This adjustment would be made before the tax return is filed.

4.3. APA audits

- A taxpayer who has concluded an APA with ETA, must maintain all books and records (including accounting records and other relevant records), required for ETA to be able to ascertain compliance with the APA or in other words audit the APA.
- The APA audit process will not involve evaluating or proposing changes to the terms and conditions of the APA, or the agreed TPM and will only be limited to monitoring the compliance of the taxpayer's transfer pricing practices with the terms stipulated within the APA. This includes assessing whether the material representations made in the APA request, the related submissions, the APA reports accurately describe the taxpayer's operations and transfer pricing practices, whether critical assumptions remain valid, and whether the taxpayer has applied the TPM in accordance with the terms of the APA.
- A regular tax/transfer pricing compliance audit may still be conducted on the taxpayer for transaction(s) that are not covered under the APA. In the event that the APA is cancelled (See Section 4.6), a full regular tax/transfer pricing compliance audit may be conducted.

4.4. Adjustments

- An APA may contain a provision that allows the taxpayer to make a compensating adjustment. A compensating adjustment would bring the taxpayer's actual results of the covered controlled transaction(s) into agreement with the amounts or results determined by the application of the TPM as set out in the APA, in the event of deviation.
- **A compensating adjustment** should be made throughout the relevant financial year/tax period to ensure that the final actual results arrived at post applying a compensating adjustment conform as closely as possible to arm's length prices if the TPM had been applied as set out in the APA. These interim compensating adjustments should minimize the amount of the compensating adjustment that may be required at or after year-end.
- **A subsequent compensating adjustment** may then arise after the taxpayer files its tax return and the APA report for a particular year. More specifically, if it is determined by ETA from the APA report's review process that:
 - a. The taxpayer was not fully compliant with the terms and conditions of the APA during a specific financial year;
 - b. The actual operating results of the taxpayer did not fall within the agreed arm's length range of prices for which no compensating adjustments have been made by the taxpayer; or
 - c. A compensating adjustment has been made that does not fully adjust the transfer prices to the agreed arm's length range of prices,

ETA will propose an adjustment to bring the actual operating results to the agreed arm's length price in accordance with the APA. The applicable penalties under the Law will also apply. Such an adjustment will not affect the continuity of the APA in the subsequent years.

- The taxpayer's taxable income for a specific financial year/tax period will include all compensating adjustments computed for the purpose of the APA and will be used as such for all Egyptian income tax purposes.
- In principle, the taxpayer should make the compensating adjustment in their tax return when it is determined by the taxpayer that the result of the covered transaction is not in agreement with the APA, prior to the APA report filing. The required compensating adjustments shall be paid with the payment of the corporate income tax due from the taxpayer in respect to the taxation year to which the compensating adjustment relates.

4.5. Revision of APA

- During the term of the APA, if there are significant/critical changes that affect the implementation of the APA, the taxpayer should report these changes to ETA in writing promptly, with a detailed explanation regarding the impact of these changes on the implementation of the APA. Such reporting should set out the reasons for the proposed revision to the APA and include supporting documentation.
- Based on ETA's review of the taxpayer's operations, ETA will discuss with the taxpayer and either revise the provisions and relevant conditions of the arrangement or terminate the arrangement, depending on the impact of the changes on the implementation of the APA.
- Examples when an APA may be revised include:
 - a. Changes in laws, including changes to a double tax treaty provisions, that modifies the income tax treatment of issues covered by the APA; or
 - b. Material changes in circumstances, for example, when a taxpayer's business activities have been changed implying a functional profile change from being a full-fledged distributor to a limited risk distributor, or when drastic changes in the economic environment occur that affects business activities.
- If the taxpayer and ETA agree to revise an APA, a new effective date will be set for the revised APA and stated therein. If no agreement to revise the APA is reached, the APA will be cancelled.

4.6. Cancellation or Termination of APA

- An APA may be cancelled in the occurrence of any of the following events:
 - a. Failure to comply with the terms and conditions of the APA by the taxpayer;
 - b. Failure to meet a critical assumption as agreed under the APA;
 - c. Failure to provide information, documentation and APA report by the taxpayer as required by these APA Guidelines, and all other relevant provisions;
 - d. If a dispute arises between ETA and the taxpayer in respect of the tax treatment of the transfer pricing arrangements covered by the APA during the term of the APA, to which a resolution cannot be reached. In that case, an APA Steering Committee will be involved for consultation. If the outcome of such consultation is not acceptable to the taxpayer, the APA shall be cancelled; or
 - e. If it is determined that the taxpayer made any misrepresentation, fraud, omission or a statement that is false or misleading as a violation of the Law which is subject to the provisions of Article 133 of the Law.
- If ETA cancels an APA, ETA will inform the taxpayer in writing specifying the reasons for the cancellation and the effective date of the cancellation (typically the first day of the financial year/tax period within which the event that led to the cancellation of the APA occurred).
- The APA will be of no force or obligation with respect to the taxpayer and ETA as of the effective date of cancellation/termination. Once an APA has been terminated, the transactions which have previously been covered by the APA will be normally subject to the provisions the Law, and any relevant double tax treaties. For example, if there is a misrepresentation in the APA application, all the years of the APA may be revoked.

4.7. Renewal of APA

- The process to renew an APA is similar to the process followed to apply for the initial APA request, for which a renewal is sought. As such, appropriate supporting documentation, including updated documents, analyses and other relevant information should be submitted in order for ETA to process a renewal request.
- To renew an ongoing APA, the taxpayer is first required to file a renewal request, within a reasonable timeframe, usually not less than three months before the ongoing APA expires.⁽²⁹⁾ Upon receiving the application for renewal, ETA will inform the taxpayer if it wishes to proceed with the renewal request for the taxpayer to submit the required documents.
- The taxpayer should submit the renewal APA documentation package for ETA to consider the specific facts and circumstances associated with the request, the scope and complexity of the transfer pricing issues contained in the renewal submission, including the degree to which facts, critical assumptions, or underlying circumstances of the previous APA have changed.
- ETA may renew an APA under similar terms and conditions, as per the ongoing APA if:
 - a. Both the taxpayer and ETA are satisfied with the TPM application as stipulated within the ongoing APA;
 - b. No material changes have taken place in respect of the circumstances and critical assumptions underlying the APA, i.e. critical assumptions remain valid; and
 - c. The taxpayer has fully complied with the terms and conditions of the ongoing APA.
- If the taxpayer proposes to amend the ongoing APA for the renewal purposes, the proposed amendments together with updated analyses, and supporting documentation should accompany the request to renew the APA. This is particularly relevant when:
 - a. Material changes have occurred in the facts, circumstances, or critical assumptions underlying the ongoing APA; or
 - b. If it has been determined that upon application, the ongoing APA did not adequately consider subsequent economic, technical, product, or industry developments.
- ETA will evaluate the taxpayer's renewal request, taking into account the amendments required due to the changed facts and circumstances.
- The renewal process will focus on updating the critical assumptions and facts set out in the initial APA and amending the related analyses as required. ETA will subsequently review and evaluate the renewal APA documentation package and negotiate with the taxpayer to draft the new APA and complete the renewal process.

4.8. Other practical considerations

4.8.1 Confidentiality and disclosure of APA

- During the APA process, ETA will abide by the secrecy of information clauses as stipulated under the Law, Article 101, and will ensure the confidentiality of trade secrets and other information and documentation submitted in the course of the APA process.

²⁹ See Appendix Three for Form 3 – APA: Unilateral APA Renewal Application. Form 3 - APA can be downloaded from ETA's website or collected from the transfer pricing department at the following address: 9th Plot, Block 10 ,43th District, Nasr City, Cairo, Egypt.

- In the event that a taxpayer withdraws from the APA process, or if the APA application is rejected by ETA after consideration of information, ETA will similarly apply the relevant secrecy of information and confidentiality requirements, as with the case of a successfully completed APA.

4.8.2 Power to request further information

- During the APA application process, ETA may at any time request, in writing, from the taxpayer to provide further information and documents with respect to the application submitted, as deemed necessary for evaluation and negotiation purposes. ETA reserves the right to discontinue an APA process where a taxpayer demonstrates lack of cooperation in providing complete and reliable information, as requested.

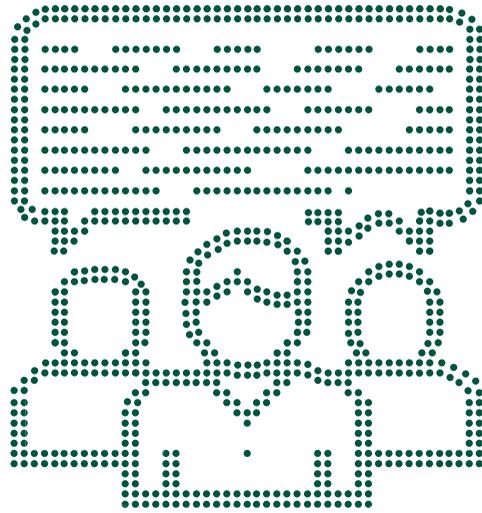
4.8.3 Role of taxpayer

- Throughout the course of the APA process, the cooperation of the applicant taxpayer with ETA is essential in respect of a successful APA submission and negotiation. To that end, the taxpayer is expected to provide ETA with all the prerequisite information and documents in a timely manner, ensuring the completeness and appropriateness of such documents for a smooth APA process.
- The taxpayer is also expected to make every effort to demonstrate clearly its business model and transfer pricing practices to ETA for a better understanding of the APA's underlying facts.

- Therefore, the quality and completeness of the analyses performed including industry, functional and economic/comparability analyses, as well as the completeness of the data relating to the taxpayer's business model, industry, markets, and countries covered by APA are the cornerstone to a successful APA process.

Summary of Chapter Four

- The taxpayer is required to file an APA report, on an annual basis for each assessment year covered by the APA, to describe the actual operations for the period and demonstrate compliance with the terms of the APA.
- The APA report should be filed with the transfer pricing department within 60 days from the date of filing the tax return.
- ETA will review the APA report to ensure that the terms and conditions of the APA have been complied with, and to evaluate the application of the agreed upon TPM.
- A taxpayer who has concluded an APA with ETA, must maintain all books and records, required for ETA to audit the APA. The APA audit process will be limited to monitoring the compliance of the taxpayer's transfer pricing practices with the terms stipulated within the APA.
- A regular tax/transfer pricing compliance audit may still be conducted on the taxpayer for transaction(s) that are not covered under the APA.
- The taxpayer may make a compensating adjustment to bring the actual results of the covered controlled transaction (s) into agreement with the results determined by the application of the TPM as set out in the APA, in the event of deviation.
- A subsequent compensating adjustment may then be proposed by ETA after the taxpayer files its tax return and the APA report for a particular year, if any deviation still exists. The taxpayer's taxable income for a specific tax period will include all compensating adjustments computed for the purpose of the APA.
- The APA may be cancelled under certain conditions (such as failure to comply with APA terms, file an APA report, or if misrepresentation has been made by the taxpayer), in the event of which, ETA will inform the taxpayer in writing.
- An ongoing APA may be renewed, in which case, the taxpayer is required to file a renewal request no later than three months before the ongoing APA expires. ETA will then inform the taxpayer if it wishes to proceed with the renewal request for the taxpayer to submit the required documents.
- During the APA process, ETA will abide by the secrecy of information clauses as stipulated under the Law, Article 101, and will ensure the confidentiality of sensitive information and documentation submitted in the course of the APA process.
- The cooperation of the applicant taxpayer with ETA is essential in respect of a successful APA submission and negotiation. The taxpayer is therefore expected to provide ETA with all the prerequisite information and documents in a timely manner, ensuring the completeness and appropriateness of such documents.



Chapter Five

Understanding BAPAs and MAPAs

- 5.1. Overview
- 5.2. Benefits of BAPA/MAPA
- 5.3. Other considerations
- 5.4. Future work

Summary of Chapter 5

5.1. Overview

- Many countries prefer BAPAs or MAPAs to unilateral APAs due to concerns over double taxation issues, and that a bilateral (or multilateral) approach is more likely to ensure that the outcome of the arrangements will reduce the risk of double taxation, will be reasonable and fair to all tax administrations and taxpayers involved, and will provide greater certainty to the taxpayers concerned.
- BAPAs and MAPAs involving the competent authority of a treaty partner should be conducted within the scope of the mutual agreement procedure under Article 25 of the OECD Model Tax Convention, which provides that:
 - a. Competent authorities shall attempt to resolve by mutual agreement any difficulties or uncertainties arising as a result of the interpretation or application of the Convention; and
 - b. Competent authorities may consult together for the elimination of double taxation in cases not covered explicitly by the Convention.
- In addition, the exchange of information provision contained in Article 26 may also facilitate administering and concluding BAPAs and MAPAs, as it encourages competent authorities to cooperate in the form of exchange of information.

5.2. Benefits of BAPAs/MAPAs

- In addition to the general benefits associated with concluding an APA as set out under Section 1.3 - "Benefits of APAs", entering into a BAPA or MAPA provides the involved tax administrations and taxpayers with the following benefits:
 - a. Facilitates collaboration and exchange of information amongst the involved competent tax administrations of different countries, thereby ensuring a fair and consistent application of the arm's length principle; and
 - b. Enables taxpayers to avoid potential double taxation issues and transfer pricing adjustments (the corresponding adjustments³⁰) which may result thereof) in two or more tax jurisdictions, ensuring that profits are appropriately allocated and taxed.

5.3. Other considerations

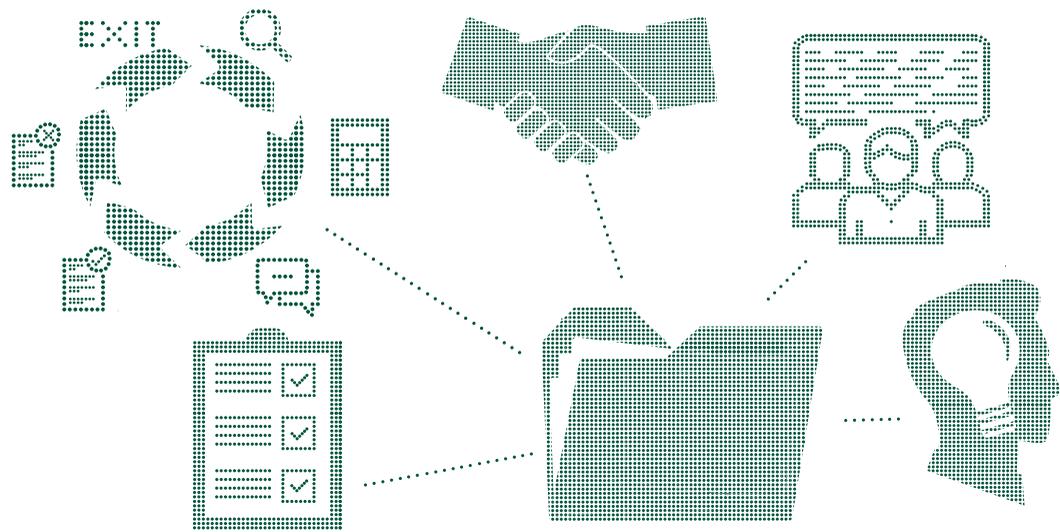
- In the case of a MAPA request however, the underlying facts, circumstances, and the relevant markets may differ in each of the participating countries. Therefore, the same TPM and the same APA terms and conditions may not be suitable to apply similarly in all respects for all participating countries. A MAPA will apply only to those transactions, and for those participants and time-periods, specified in the APA.
- As such, the final TPM agreed by the involved tax administration(s) in a BAPA or MAPA may differ from the initial TPM proposed by the taxpayer in the original APA submission. The taxpayer may reject this agreement or withdraw the APA request in such case, if the taxpayer is not in agreement with the TPM selected by the relevant competent authorities.

As mentioned earlier, the APA program is a new concept in Egypt, thus, ETA has decided to only introduce unilateral APAs into the Egyptian APA program at this point.

³⁰ Corresponding adjustment is an adjustment to the tax liability of the associated enterprise in a second tax jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction, so that the allocation of profits by the two jurisdictions is consistent.

Summary of Chapter Five

- Recently, many countries have expressed their preference for concluding BAPAs or MAPAs to unilateral APAs due to concerns over double taxation issues.
- BAPAs and MAPAs involving the competent authority of a treaty partner should be conducted within the scope of the mutual agreement procedure under Article 25 of the OECD Model Tax Convention.
- Benefits of BAPAs and MAPAs include:
 - a. Facilitating collaboration amongst the involved competent tax administrations, thereby ensuring a fair and consistent application of the arm's length principle; and
 - b. Enabling taxpayers to avoid potential double taxation issues and transfer pricing adjustments, hence ensuring that profits are appropriately allocated and taxed.



Appendices

Appendix One: Form 1 - APA

Appendix Two: Form 2 - APA

Appendix Three: Form 3 - APA

Appendix Four: Unilateral APA Process Timeline

Appendix One: Form 1 - APA



**Form 1 - APA
Unilateral APA - Application for Pre-filing Meeting**

Please fill out this form and sign the declaration to conduct a pre-filing meeting with ETA

Applicant (Taxpayer) details

Legal name of the Applicant
(Taxpayer)

Tax file identification

Address of the Applicant

Details of the Applicant's authorized representative

Name

Position

Contact details (phone number
and email address)

Email addresses and phone
numbers of other persons with
whom correspondence should be
made

Background

The global legal structure of the Applicant's group.

High-level description of the industry in which the Applicant, and the Group operate.

Details of the controlled transaction(s) proposed to be covered by the APA, including nature, scope and associated enterprise(s).

Country (Countries) in which the relevant associated enterprise(s) are located.

Business model and high-level overview of the Applicant and the wider Group's business operations

High-level description of the functional, asset and risk profiles of the Applicant and the relevant associated enterprise(s) with respect to the controlled transaction(s) proposed to be covered by the APA.

Controlled transactions

TPM used for the controlled transaction(s) proposed to be covered by the APA, in the last three years (if applicable).

Proposed TPM including profit level indicator (if applicable) to be used and high-level description of the critical assumptions associated with the application of TPM.

Group transfer pricing policies as relevant to the controlled transaction(s)

Number of years proposed to be covered by the APA.

Other information

History of corporate income tax and transfer pricing audits (including transfer pricing adjustments), assessments and appeals with ETA, or the relevant foreign tax administration(s), with regard to the controlled transaction(s) proposed to be covered by the APA.

Any other relevant information necessary for the purpose of the pre-filing meeting (ex: similar previous APAs by other tax administrations).

Declaration

I declare that all the information furnished in this form is correct and truly stated.

Signature**date****Notes**

1. The application for a pre-filing meeting should be filed with the transfer pricing department at the following address:
9th Plot, Block 10 ,43th District, Nasr City, Cairo, Egypt.
2. Separate attachments can be enclosed with this application, if the space provided is found to be insufficient.
3. All relevant documents/analyses should be enclosed with this application form at the time of submission.

Appendix Two: Form 2 - APA



**Form 2 - APA
Unilateral APA Application**

Please fill out this form and sign the declaration to apply for a Unilateral APA

Applicant (Taxpayer) details

Legal name of the Applicant
(Taxpayer)

Tax file identification

Address of the Applicant

Details of the Applicant's authorized representative

Name

Position

Contact details (phone number
and email address)

Email addresses and phone
numbers of other persons with
whom correspondence should be
made

Unilateral APA Application Checklist

Background

Checklist	Please insert <input type="checkbox"/> if the information is attached to this form, or <input type="checkbox"/> if the information is not available	Comment (if applicable)
The global legal structure of the Applicant's Group, organizational arrangement and operational set-up.		
Names of the associated enterprise(s) with whom the controlled transaction(s) proposed to be covered by the APA are to be conducted, and the country(ies) in which they are located.		
Functional currency for each associated enterprise, and the currency used for the controlled transaction(s) proposed to be covered by the APA.		
Details of the controlled transaction(s) proposed to be covered by the APA, including nature, scope and transaction flow.		
Business model and detailed description of the Applicant and the Group's business operations currently (including products and services), and in the last 3 years.		

Industry and Market Analysis

Checklist	Please insert <input checked="" type="checkbox"/> if the information is attached to this form, or <input type="checkbox"/> if the information is not available	Comment (if applicable)
Detailed analysis of the industry in which the Group, the Applicant and the associated enterprise(s) operate.		

Functional Analysis

Checklist	Please insert <input checked="" type="checkbox"/> if the information is attached to this form, or <input type="checkbox"/> if the information is not available	Comment (if applicable)
Detailed description of the functional, asset and risk profiles of the Applicant and the relevant associated enterprise(s) with respect to the controlled transaction(s) proposed to be covered by the APA.		
Business strategies – current and future, and business plans/direction for the period proposed to be covered by the APA, for the Applicant, and the wider Group.		
Copies of all relevant intra-group agreements (Please enclose copies).		
Financial information including: a) Financial statements of the Applicant and associated enterprise(s) for the past three years; and b) Segmented financial statements (by product line/division..etc) of the Applicant and associated enterprise(s) for the past three years (Please enclose copies).		

Controlled transactions and TPM

Checklist	Please insert <input type="checkbox"/> if the information is attached to this form, or <input type="checkbox"/> if the information is not available	Comment (if applicable)
Relevant legal considerations and requirements (Egyptian and relevant foreign laws), and double tax treaty between Egypt and the foreign country(ies), if applicable		
TPM used for the controlled transaction(s) proposed to be covered by the APA, in the last three years (if applicable), including policies and practices applied.		
Proposed TPM including profit level indicator (if applicable) to be used and the critical assumptions associated with the application of TPM. Please provide all details including detailed analyses (comparability analysis, details of comparable transactions...etc) and explanations required to establish the appropriateness of the proposed TPM.		
Analysis of each TPM included in the Transfer Pricing Guidelines, applied or rejected, for each covered controlled transaction(s).		
Group transfer pricing policies as relevant to the controlled transaction(s).		
Number of years proposed to be covered by the APA, and the date from which the APA is sought to be applicable.		
Accounting and costing system, policies and practices including any significant financial and tax accounting differences that may affect the TPM application		

Other information

Checklist	Please insert <input type="checkbox"/> if the information is attached to this form, or <input checked="" type="checkbox"/> if the information is not available	Comment (if applicable)
History of corporate income tax and transfer pricing audits (including transfer pricing adjustments), assessments and appeals with the ETA, or the relevant foreign tax administration(s), where relevant, with regard to the controlled transaction(s) proposed to be covered by the APA.		
Any other relevant information necessary for the purpose of the pre-filing meeting (ex: similar previous APAs by other tax administrations).		
Proposed terms and conditions, and critical assumptions for the APA		

Declaration

I declare that all the information furnished in this form is correct and truly stated.

Signature

date

Notes

- Unilateral APA application should be filed with the transfer pricing department at the following address: 9th Plot, Block 10 ,43th District, Nasr City, Cairo, Egypt.
- Separate attachments can be enclosed with this application, if the space provided is found to be insufficient.
- All relevant documents/analyses/agreements should be enclosed with this application form at the time of submission.

Appendix Three: Form 3 - APA



Form 3 - APA Unilateral APA Renewal Application

Egyptian Tax Authority:

The APA signed on (date-month-year) between our company and ETA will expire on (date-month-year). After expiration, the facts and circumstances in relation to the controlled transactions in the future years (from <year> to <year>) will be similar to those under the existing APA, without material changes. Therefore, we submit this application for a renewal of the APA.

Taxpayer name:

Taxpayer Identification Number:

Date:

Attachments:

1. The existing APA.
2. The annual compliance reports in relevant years regarding implementation of the APA.
3. Supporting documents to prove that the facts and the relevant setting under the existing APA have not materially changed.
4. Projections for future tax years to be covered by the renewal.

Appendix Four - Unilateral APA Process Timeline

