

## How to Treat in Transfer Pricing Requirement?

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### Introduction

XYZ (Pvt) Ltd is a fully owned subsidiary of the PQR Holdings PLC. Its main business operation is providing telecommunication services and solution. XYZ (Pvt) Ltd has faced to a credit shortage issue as it provide services on credit basis.

XYZ (Pvt) Ltd had two alternatives to funding cash requirement to its telecommunication projects, alternatives are by taking Bank loan with average market rate or funding through its parent company with reduced or no interest.

XYZ (Pvt) Ltd with influence of PQR Holdings PLC will accepting second alterative which obtain tax saving in group perspective. In this scenario XYZ (Pvt) Ltd will be able to continue its business operations and subsequent settlement of loan will be taken place with zero or reduced interest.

### Discussion of the Issue

Implication of above scenario is given below,

- XYZ (Pvt) Ltd will be funded by PQR Holdings PLC
- Nil interest ( Other income ) income of PQR Holdings PLC from funded loan to XYZ (Pvt) Ltd
- XYZ (Pvt) Ltd do not pay any interest on loan received from parent company while the parent company may paying an interest to its outside liabilities which reduce companies operation profit

### Further elaboration

As per the above scenario it will be affecting in favor of parent company taxable income. Under Normal circumstance tax rates are follows.

	<b>Rate</b>
Tax on business income	<b>12%</b>
Tax on other income	<b>35%</b>

Due to zero interest loan, Parent company's tax on other income will be relatively low than the Company provide same loan to outside entity. Ultimately this will be affected to the government tax income.

	If given to XYZ Pvt Ltd	If given to outsider company
Loan amount	100,000.00	100,000.00

Interest income	0.00	10,000.00 (100,000.00*10%)
Tax on interest	0.00	3,500.00 (10,000*35%)

Due to this type of transactions between companies the Commissioner of Inland Revenue has published a gazette dated 25th March 2015 which requires the tax payer to

- ✓ Submit details of transactions with associated undertakings to the department of Inland Revenue as a part of the return under section 107 of the Inland Revenue act.
- ✓ Specify the pricing method used to determine the arm's length price, which would mean the taxpayers must possess transfer pricing documentation as required by the regulations prior to filing the return.
- ✓ An approved accountant (Auditor) to certify that all transactions are carried out on an arm's length basis and that the necessary documentation has been checked by the auditor.

*(This certificate is In addition to the certificate to be submitted by the director's report in the published annual accounts that all transactions between associated undertakings are carried out on an arm's length basis)*

**(Reference: Government Notifications No. 1823/5- Monday August 12, 2013 and Government Notifications- No 1907/26 – Wednesday, March 25, 2015)**

## **Conclusion and Recommendation**

This will be affected to government tax income since the companies may try to manipulate the tax payment. After analyzing the above scenario it was recommended the tax payer to provide details of the following transactions with associated undertakings along with the Returns filed for the year of assessment as per the extra ordinary gazette no. 1907/26 dated 25 March 2015

- Trading of raw materials and finished goods
- Assembling, processing, manufacturing of goods or articles
- Purchase or sale of any other moveable or immovable property or lease of such property
- Purchase, sale or use of intangible property such as royalty, know-how, patents, copyrights, licenses etc.
- Services such as financial, administrative, technical, commercial services etc.
- Loans and advances
- Mutual agreement or arrangement for the allocation or apportionment of costs
- Other

As per regulation 12 of the gazette notification every undertaking that enter in to a transaction with an associated undertaking shall keep and maintain information and documents