Jordan: Jordan introduces formal transfer pricing requirements

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Insights
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In brief

On June 7, 2021, the Hashemite Kingdom of Jordan ("Jordan") published the Regulation No. 40 for the year 2021 in its Official Gazette ("the regulation"). The regulation introduces formal transfer pricing ("TP") requirements in accordance with the provisions of the Article 77/A of the Income Tax Law No. 34 of 2014 ("the Income Tax Law") and comes into force 30 days after the date of publication in the Official Gazette.

The regulation requires transactions between related parties to be dealt with on an 'arm's length basis', i.e. on similar terms and conditions that could have been agreed upon, if the persons involved in the transactions were independent. In addition, taxpayers are required to comply with annual TP documentation requirements as follows:

- TP disclosure form – To be submitted by the time the tax return is due. The form is expected to include certain information on related party transactions including the nature of transactions, the TP method, etc.

- TP Master file and Local File – To be maintained with the TP disclosure form and submitted upon request by the Income and Sales Tax Department ("department"). An exemption is provided for natural persons and small establishments with arm's length value of related party transactions not exceeding 500,000 Jordanian Dinars ("JOD")

- Country by Country Report ("CbCR") and notifications – CbCR notification to be submitted by the time the tax return is due and CbCR to be submitted within 12 months from the year end. Requirements applicable to both Jordan headquartered and non-Jordan headquartered multinational Groups with consolidated revenue more than JOD 600 million (approx. EUR 695 million / USD 845 million)

This issuance of formal TP requirements by Jordan demonstrates its commitment as an inclusive framework member to implement the recommended actions as per the Organization of Economic Cooperation and Development ("OECD")'s Base Erosion and Profit Shifting ("BEPS") Project.

This news alert provides detailed guidance and insights into these new TP requirements, and ultimately what this means for affected taxpayers.

In detail

Background

The OECD embarked upon a 15 point BEPS Action Plan in 2013, providing recommendations to increase coherence, reinforce the requirement for economic substance, and enhance transparency within the international tax system. The final action points were published by the OECD in 2015, including Action 13, titled "Transfer Pricing Documentation and Country-by-Country Reporting", which formalized a three-tiered approach to TP documentation.

In 2016, the OECD established an "Inclusive Framework" for monitoring the implementation of the BEPS project recommendations, enabling non-OECD countries the opportunity to participate on an equal footing. Jordan joined this inclusive framework in 2019, committing to implement the recommended BEPS actions starting with the four minimum standards, including Action 13. Publication of the formal TP regulation demonstrates Jordan's commitment to implement the recommended actions as per the BEPS project.

Until the publication of this regulation, Jordan did not have any specific TP rules. However, the existing law included a general 'arm's length principle', which required the terms and conditions of any transaction, agreement or arrangement between the related parties to be similar to the terms and conditions that could have been agreed as if the parties of the transaction were independent. In case of any differences, the department could adjust the income and the tax for the related parties to reflect pricing between independent parties in accordance with international standards. Hence, the regulation also formalizes the existing general 'arm's length principle' in the law by providing specific TP guidance and documentation requirements.

Applicability and key provisions

Effective date

The regulation was published in the Official Gazette on June 7, 2021 and comes into force 30 days after the date of publication in the Official Gazette.

Scope

The regulations apply to any person undertaking related party transactions.

Where,

Person means -

A natural or a legal person, including a group of persons established by contractual arrangement and permanent establishments

Related party means -

A natural person (and related persons) is related to a legal person through control of 50% or more over voting rights, income, or capital; or are able to participate in the management, control or capital of that legal person.

Two or more legal persons are related if a legal person (and related persons) controls 50% or more over voting rights, income, or capital or able to participate in the management, control or capital of the other legal person; or the legal persons are under common control; or if one or more legal persons have “effective control” over one or more other legal persons.

In this regard, effective control is defined as the ability of any person or group of persons to exercise effective influence on the decisions and actions of another person in any of the following cases:

- the ability to conclude agreements to provide, or effectively performing, management functions
- the ability to control the composition of 50% or more of the board of directors
- the ability to receive 50% or more of the profits
- provision of loans that constitute 50% or more of the total loans and capital, except undistributed profits
- issuing guarantees covering 33% or more of the total value of other persons’ loans
- where 50% or more of a person’s business activities depend on transactions with the other person
- if this person or group of persons is related to the person who owns 50% or more of a legal person or participated in its management
- if the person or group of related persons are commercial agents or suppliers to the other person

Transaction means –

Any transaction, agreement or arrangement involving exchange of goods, services, loans, financing and disposal of movable and immovable assets, including:

- Purchases or sale of goods
- Purchases or sale of property and other assets
- Providing or receiving services
- Agency works
- Leasing transactions
- Funding related to research and development
- Licensing and franchising agreements
- Financing, including loans and owners’ contributions, in cash or in kind

Applicability and key provisions (contd…)

Arm’s length principle

The regulation requires transactions between related parties to be dealt on an ‘arm’s length basis’, i.e. on similar terms and conditions that could have been agreed upon, if the persons involved in the transactions were independent. If the terms or conditions of transactions between related persons are not aligned with the arm’s length principle, the taxable person must adjust the income in the tax return. If the taxable person fails to do so, the department can direct such person to adjust the income or disregard the related party transactions.

Comparability analysis

Based on the regulation, the transactions between independent persons can be compared with related party transactions to determine the arm’s length price if:

- No fundamental differences exist between the transactions; or
- An appropriate adjustment is made for any differences.

In this regard, the following comparability factors need to be considered:

- The nature of the transactions
- Contractual terms of transactions
- The economic circumstances in which the transactions are conducted
- Business strategies followed by the parties
- Analysis of functions, assets and risks related to the transactions

Non-local comparable transactions can also be acceptable, if local comparable transactions are not available and the taxpayer is able to consider the impact of differences in economic, geographical or any other factors.

TP methods

The following are the approved TP methods under the regulations:

- Comparable Uncontrolled Price Method (CUP).
- Resale Price Method (RPM).
- Cost Plus Method (CPM).
- Transactional Net Margin Method (TNMM)
- Profit Split Method (PSM).

None of the methods above have any preference in application. Further, the taxpayer may also apply any other method after proving that none of the methods referred above can be reliably applied.

Corresponding adjustment

A taxpayer can make an application to the department to make a corresponding adjustment to the taxpayers income, in case any adjustment is made to the income of any non-resident related person in relation to the transaction entered into with the taxpayer. The application can be made in case the jurisdiction of the non-resident has an appropriate tax agreement with Jordan. The department will review the application on the basis of arm’s length principle and may either allow or reject the corresponding adjustment accordingly.

Aggregation of transactions

If the taxpayer undertakes two or more related party transactions under similar facts and circumstances, and the transactions are closely interlinked and cannot be analyzed separately, then it is permissible to aggregate the transactions for the purpose of comparability analysis and application of TP method.

Applicability and key provisions (contd…)

Documentation requirements

TP disclosure form

Article 9 of the regulation introduces the mandatory submission of disclosure form of the related party transactions. The following information needs to be disclosed in the form:

- Information related to transactions, including the names of related persons and the jurisdiction;
- Any business restructuring undertaken within the Group or by the taxpayer;
- Information about the actual and the beneficial owners;
- Total revenues, total expenditures and the value of the net profit or loss mentioned in the tax return;
- Information on the type and nature of the relationship between the related persons;
- The nature of transactions;
- The TP method;
- Details of any free of charge transactions or transactions with non-cash consideration; and,
- A declaration if the required TP documents are maintained (i.e. the master file and the local file).

Deadline - Aligned to the tax return submission date (i.e. within four months from the end of the year).

Master file and Local file

The taxpayer is obligated to maintain a local file that includes basic and detailed information on all its related party transactions. The taxpayer is also obligated to maintain a master file that includes basic and detailed information on Group level business and TP policies. The detailed content of these documents will be prescribed in the specific instructions which are yet to be issued.

Natural persons and small establishments are excluded from the requirement to maintain Master file and Local file. Small establishments are persons with aggregate arm's length value of related party transactions not exceeding JOD 500,000 during a period of 12 consecutive months. However, department may require such persons to prepare and submit required documents within a specified time (not less than 30 days) in certain cases.

Deadline - A declaration is required in the disclosure form if these documents are maintained. However, the documents are required to be submitted only upon request from the department.

CbCR and CbCR notification

The CbCR requirements extend to Jordan tax resident entities part of a Multinational Group with consolidated revenues exceeding JOD 600 million (approx. EUR 695 million / USD 845 million).

Only the Jordan resident Ultimate Parent Entities ("UPE") of the Group are primarily required to submit the CbCR. However, under the secondary filing requirement, Jordan resident entities of Groups headquartered outside Jordan may also be required to submit the CbCR in certain cases.

Deadline - CbCR to be submitted within 12 months from the end of the reporting year. CbCR notification is required to be filed by the time tax return is due by all the covered entities indicating the identity of the UPE.

Penalties

Any person who violates the provisions of this regulation shall be punished with the penalties stipulated in the Income Tax Law. Based on the Income Tax Law, the penalty for late tax filings ranges from JOD 100 to JOD 1,000. In addition, there are other penalties related to understatement of income and non-payment of tax, which may be applicable in case of any TP adjustment by the department.

PwC observations

Year of applicability

The regulations come into force rather immediately i.e. after 30 days of being published in the Official Gazette on June 7, 2021. No specific first year of applicability is mentioned. In view of this, unless any year of applicability is mentioned in the accompanying instructions likely to be issued subsequently, the taxpayers should immediately evaluate their risks related to the open tax years and revisit their TP policies on a going forward basis in light of the requirements as per the regulation.

Additional instructions

Additional instructions are expected to be issued related to the implementation of the regulation including (i) the form, content and administrative procedures related to master file and local file, CbCR and notifications, disclosure form; (ii) application of arm's length range; (iii) application of prescribed TP methods; (iv) concept of surrogate filing entity related to CbCR; etc.

Alignment with OECD TP guidelines

The regulation is broadly aligned to the OECD TP guidance in principle. However, there is no specific reference to the OECD TP guidance in regulation, but only a general reference to the 'international standards'. Any differences with the OECD TP guidelines can be ascertained better at a later stage, once the additional instructions to implement the regulation are published.

The takeaway

The publication of the regulation is a major tax development in Jordan, and likely to affect a large number of multinationals operating in Jordan.

The regulation reflects a positive approach to TP by Jordan, consistent with OECD principles and in our view represents a fair and transparent step toward the implementation of TP rules. There are some areas where further clarification is needed, which will likely be clarified through additional instructions to be published.

For taxpayers in Jordan, the regulation introduces additional documentation requirements which include TP disclosure form, Local file, Master file, CbCR and CbCR notifications. Taxpayers are suggested to proactively evaluate the applicability of these requirements. Given the wide application of the rules under the regulation, taxpayers are also recommended to take a detailed look at their business operations and current TP policies to identify any TP risks for the open tax years and on a forward looking basis.

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Let's Talk

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